

# MID YEAR FISCAL POSITION REPORT

- 2006 -

Ministry of Finance and Planning



**MID – YEAR**  
**FISCAL POSITION REPORT**

**2006**

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Issued under section 10 of the Fiscal Management (Responsibility)  
Act No. 03 of 2003

Mahinda Rajapaksa  
**President and Minister of Finance & Planning**

## **Mid Year Fiscal Position Report**

**Issued by the Hon. Minister of Finance**

**Under Section 10 of the Fiscal Management (Responsibility) Act No.03 of 2003**

In terms of Section 10 of the Fiscal Management (Responsibility) Act No. 03 of 2003 the Minister of Finance & Planning is required to present the a Mid-year Fiscal position report to the public by the last day of June of the year and thereafter laid before the parliament.

The purpose of this report is to provide updated information on the Government's fiscal performance against the Fiscal Strategy of the Government.

The report contains the performance of Government revenue, expenditure, cash flow operations and borrowings during the first four months of 2006. The report also provides updated information, depending on the availability of information, relating to macro economic performance, price development, employment, foreign aid, Government debt, Balance of Payments, money and credit development.

## **Fiscal Developments and Economic Performance January - June 2006**

### **AN OVERVIEW**

#### **Budget Deficit is Managed**

1. Fiscal developments during the first four months of 2006 indicated a 19 percent growth in Government revenue due to the buoyant performance in both direct and indirect taxes which increased by 21 percent. An accelerated growth in Government expenditure by 24 percent influenced by higher capital expenditure, higher salaries, increased cost of the fertilizer subsidy, enhanced advances for paddy purchases and settlement of arrears of procurement is also observed in comparison with the corresponding period of last year.
2. During the first four months of the year, 25 percent of the total provision of capital expenditure has been utilized, compared with 27 percent in the same period in 2005. Current expenditure accounted for 33 percent of the total allocation in 2006, compared with 34 percent in the first four months in 2005. Revenue generated during the period accounted for 28 percent of estimated revenue in comparison with 29 percent of the corresponding period of 2005.
3. Reflecting higher recurrent expenditure, revenue account resulted in a deficit of Rs. 35.8 billion during the first four months of 2006 in comparison with Rs. 30 billion during the corresponding period of 2005. The overall deficit increased to Rs. 88.8 billion compared to Rs. 67.9 billion due to increased public investments. Budget deficit including Post-Tsunami expenditure in relation to GDP during the first four months was 3.2 percent in comparison with 2.9 percent during the corresponding period of last year. The deficit excluding Post Tsunami reconstruction expenditure remained at 2.9 percent.
4. In the context of increased demand for resources, the treasury operations gave priority to providing required resources to development programs and other essential expenditure while minimizing funding of non- priority expenditure programmes, to make budgetary operations complementary with monetary policy operations of the Central Bank.

#### **High Growth Momentum Continues**

5. As revealed by the Department of Census and Statistics, the renewed growth momentum of the economy seen in 2005 continued, registering a real GDP

growth rate of 7.1 percent with a significant reduction in the unemployment rate to 7.2 per cent in the first quarter of 2006. According to the Central Bank of Sri Lanka, the first quarter GDP grew by 8.1 percent. The current indications from both data sources are that economic activities have remained buoyant and the first half GDP growth would be in excess of 7 percent.

### **Inflationary Pressure Builds-up**

6. The inflation rate, as measured by the Colombo Consumer Price index, which has been declining since early 2005 edged upwards after April 2006 and registered an average of 10.1 percent in June 2006. The year on year inflation showed a 17.7 percent sharp rise in the Index. The key price trigger was the price of food items such as bread, milk, tea, most varieties of fish and vegetables. The upward price pressure remained high owing to the impact of the high oil price, rising consumer demand with increasing incomes and increased construction and other investment activity. Domestic fuel prices of petrol and kerosene at the end of May was higher by Rs. 13 per liter while diesel was higher by Rs.11 per liter compared to the corresponding period of last year. Consequential adjustments in transport fares have also been made during this period by approximately 15-20 percent.

### **Impact of High Oil Price is too Strong**

7. The excessively high oil price is also a major challenge, exerting pressure on the balance of payments and financial position of Ceylon Petroleum Corporation (CPC) and Ceylon Electricity Board (CEB), two state enterprises which heavily depend on imports. In this context, the interest and exchange rates indicated some volatility with a depreciation of the exchange rate and an upward movement in the interest rates, towards the end of the first half of the year.

### **Government Enters into Several New Agreements**

8. The Government entered into several new aid agreements with the donors amounting to US\$ 637 million during January- June 2006. These included US\$ 540 million of loans and US\$ 97 million of grants. New foreign aid agreements amounting to US \$ 135 million for the post Tsunami recovery programmes were signed during the first half of 2006 and with the new agreements signed in 2006, total foreign resources available for Tsunami related rehabilitation and reconstruction programs amounted to US\$ 1,765 million by mid 2006

## **Balance of Payments Records a Surplus**

9. While imports have grown at a faster rate than exports due to increased cost of petroleum products and higher imports of intermediate and investment goods, the balance of payments generated an overall surplus of US\$ 151 million during the first quarter of 2006. This was mainly supported by increased worker remittances and a surplus in the services account including income from higher tourist arrivals. These developments have continued further, and it is likely that the overall balance of payments would show a surplus of around US\$ 216 million in the first half of 2006.

## **Demand Pressure Under Close Surveillance**

10. Both fiscal and monetary policy actions were taken to reduce demand pressures and adjust domestic prices in line with higher international oil prices. From the fiscal side, efforts continued under the Fiscal Management Reform Program to strengthen revenue performance by way of improving revenue administration and enhancing the capacity of the revenue collecting agencies. Further, steps were taken for timely implementation of the tax proposals announced in the Budget. Actions taken so far in the form of customs tariff adjustments and increase in domestic prices of petroleum products are expected to ease the pressure on the budget. The Central Bank also raised its policy interest rates in May by 25 basis points to curtail private sector credit growth, which is expanding by about 22 percent.
11. The expenditure programs need to be cautiously managed with a view to minimize undue expansionary pressures in the coming months so that fiscal deficit, excluding post-tsunami rehabilitation and reconstruction expenditures, is contained below 8 percent of GDP in 2006 so that the prevailing growth momentum would be sustainable while reducing inflationary pressures in the economy.

## **BUDGET OUT-TURN JANUARY-APRIL 2006**

12. Revenue / GDP ratio improved to 4.9 percent of GDP largely due to higher growth in tax revenue. Current expenditure also grew in relation to GDP due to pressure from operational expenditure and subsidies. Hence revenue account was in a deficit at 1.3 percent of GDP. The most important feature was the improvement in public investments to 2.1 percent of GDP from 1.7 percent during the corresponding first four months of 2005. Due to the ownership

change in the treasury bills holdings in favour of the banking system, financing from the banking system increased to 0.7 percent of GDP.

**Table I: Summary of the Budget - April**

	<i>Rs. Mn.</i>	
	2005	2006
Revenue	112,087	133,859
Tax	97,893	118,086
Non-Tax	14,194	15,773
Expenditure	179,954	222,617
Current	142,050	169,651
Public Investment	39,705	56,205
Other	-1,801	-3,239
Revenue Account	-29,963	-35,792
Overall Deficit	-67,867	-88,758
Financing	67,867	88,758
Grant	5,150	6,480
Foreign Loans	10,639	13,807
Domestic Financing	52,078	68,471
Non-Bank	45,753	50,089
Bank	6,325	18,382
Revenue / GDP (%)	4.7	4.9
Current Expenditure / GDP (%)	6.0	6.2
Public Investment / GDP (%)	1.7	2.1
Revenue Deficit / GDP (%)	1.3	1.3
Overall Budget Deficit / GDP (%)	2.9	3.2

*Source: Department of Fiscal Policy*

#### **GOVERNMENT REVENUE**

#### **Taxation Policy Changes Aimed at Higher Revenue**

- With a view to sustaining a higher revenue effort, the Government took several policy measures in relation to taxation. Most of the policy changes announced in the 2006 Budget were made statutory during the first quarter of the year. Revenue from taxation grew by 21 percent as compared to the period ending the first four months of 2005. As a ratio of GDP it increased to 4.9 percent.

However, the growth in revenue was not enough and fell short by about Rs. 6 billion to meet cash flow requirements.

- Increase in income tax for companies with a taxable income in excess of Rs. 5 million, and for business of gaming and auto lotteries and personal income taxes came into effect from April 2006. Several incentives for professionals including the exemption of foreign currency earnings from income tax was incorporated into tax laws. Reduced taxation for co-operatives and SMEs is also in force from April 2006 to promote SME sector development.
- The maximum tax payable under Economic Service Charge (ESC) by any entity was raised to Rs 60 million while the threshold for liable turnover was brought down to Rs 40 million. Relief was granted to distributors and small factory owners, by reducing the ESC rate. The ESC was made applicable for BOI enterprises and tax holiday/ exempt entities as well.
- Revised Excise taxes on cigarettes and liquor in the 2006 Budget and strengthening the enforcement mechanism had a positive impact on revenue collection. The license fee applicable for liquor sales outlets was doubled. Items manufactured in Sri Lanka with a specified minimum value addition were exempt from Excise Duty to encourage local manufacturing, while motor bicycles were exempt from duty to encourage purchase of such items at affordable prices. Higher Excise Duty rates on motor vehicles were maintained for revenue consolidation as well as to moderate such imports in the context of prevailing oil prices. Excise tax of Rs. 2.50/lit on petrol and Rs. 1.00/lit on diesel is maintained in support of the road maintenance fund which is set up under the Trust Ordinance to provide a regular flow of funds for road maintenance.
- The mark-up applicable to VAT base at the point of import was raised to 7 point while VAT liability on essential commodities was confined to the point of import at 5 percent. VAT rate was reduced on locally manufactured soft drinks while exemptions were offered for computers and accessories, timber logs and high protein agro food manufactured using grain cultivated in Sri Lanka. Items under the 5 percent rate band are not eligible for refund while items in the 20 percent band are entitled to claim only a 15 percent refund. The VAT refund system was streamlined and a special account was opened to cater to refunds to avoid delays in payments. 10 percent of the VAT collected at the point of import is credited directly to this account. A bank guarantee has been required for VAT refunds within a stipulated period, to prevent fraudulent actions.



- Customs duty was exempt or reduced for packaging and printing material, three wheeler tyres and musical instruments to expand relevant areas, while specific duties were introduced to address valuation complexities and under valuation issues. A specific duty of Rs. 12.50 per kilo of wheat flour and 6 percent on wheat grain were imposed to protect domestic paddy farmers. The duty free allowance for cigarettes was withdrawn to curtail such imports.
- The Port and Aviation Levy (PAL) was raised to 2.5 percent while exempting imports for re-export.
- Stamp duty was introduced for limited instruments and documents, other than on Letters of Credit and those, which are subject to Debit tax, PAL and share market transactions.
- Social Responsibility Levy was increased to 1 percent to support the National Action Plan for Children.
- Betting and Gaming Levy was raised for live and non-live telecast gaming centers while legislations would be introduced to relocate gaming centers in designated areas.
- The Cess on non-essential imports as well as the Cess on export of tea and rubber was revised upwards in order to provide increased resources to related local industries.
- Measures to improve taxpayer compliance and other tax administrative reforms have been introduced to increase Government revenue.

**Box 1: Tax Administrative Reforms**

- The time bar for lodging returns was reduced to 6 months, for making an assessment to 18 months, 3 years if a return has not been lodged to compel both the tax administration and taxpayers to discharge their obligations expeditiously.
- An appeal is deemed to have acknowledged within 30 days from the date the appeal was received, even if a letter of acknowledgement has not been issued (also applicable to VAT law), to protect tax payer rights.
- A 10% discount is permitted to tax payers who pay taxes in advance while a penalty is imposed on late payments.
- A concession of 25 percent of all duties on the importation of classified vehicles is allowed for tax payers whose paid income tax is not less than Rs 250, 000 per year and if such position has been maintained over a five year period, as a reward to compliant tax payers.
- Return of a person who opens a tax file voluntarily with an income of less than Rs. 1 million is accepted, without insisting on a statement of accounts.
- Returns of person who voluntarily enters the tax system first time or has progressively increased his tax payments year to year is accepted without further assessment, to promote best practices in taxation.
- Corporate structure of the Inland Revenue Department is reconstituted to strengthen the senior management to improve tax administration, audit and surveillance, policy analysis, use of technology and human resources development.

### **Income Taxes Record a Steady Growth**

- Total revenue from corporate profit tax, personal income tax, tax on interest income and ESC at Rs. 17,414 million recorded a healthy increase of 38 percent

in the first four months of 2006 compared to an increase of revenue during the corresponding period of the last year. The impact of removal of exemptions, deductions and loopholes in tax laws, timely enactment of legislation and the commitment made by tax administration enabled this buoyant performance. A full impact of taxation policy and administrative changes are expected from the second quarter of the year.

- During the period under review 7,061 new income tax files were opened. Major sources of tax revenue came from manufacturing, transport, banking, and trading sectors as well as withholding tax on employment income. Arrears collection of past overdues amounted to about Rs. 600 million.

### **Excise Taxation Remained Buoyant**

- Revenue from Excise taxes on liquor, cigarettes, petroleum products, motor vehicle and certain other selected consumer durables increased by 31 percent in Jan-April 2006 to Rs. 27 billion. This rise is mainly attributable to an increase in hard liquor production by 21 percent, 11 percent growth in sales volumes of long cigarettes, increase in motor vehicle imports and improved enforcement.
- A higher volume growth in production of liquor, effective measures to curtail illicit liquor, and revision of excise duty in November 2005, contributed to increase excise revenue from liquor by Rs 4,973 million in 2005 to Rs.6,608 million during the first four months of 2006 – an increase of 32 percent.
- Under the influence of the combined impact of high taxes and 11 percent increase in the sales volume, revenue from excise duty on cigarettes increased to Rs 10,175 million - 34 percent growth over the corresponding period in 2005. Countervailing measures at Customs to curtail smuggling and the removal of the duty free allowance for cigarettes at the Airport, have contributed to sustain demand for cigarettes liable for excise taxation.
- Due to the recovery of demand for motor vehicles and the increase in the value of motor vehicle imports, excise duty revenue increased by 31 percent. High excise duty on motor vehicles is maintained to arrest the growing demand, particularly in the context of rising oil prices.
- Excise duty on Petrol and Diesel generated Rs 3,862 million and this amount is now earmarked for road maintenance. The fund is managed by a Trust to ensure a steady flow of funds for road maintenance.

**Table II: Revenue Performance; January - April**

	(Rs.Mn).		
	2005	2006	Growth (%)
<b>1. Tax Revenue</b>	<b>97,893</b>	<b>118,086</b>	<b>20.6</b>
Income Tax	12,632	17,414	37.9
Value Added Tax	44,183	47,454	7.4
Excise Tax	20,952	27,471	31.1
Ports Development Levy	3,012	6,042	100.6
Import Duties	13,322	15,859	19.0
Others	3,792	3,846	1.4
<b>2. Non Tax Revenue</b>	<b>14,194</b>	<b>15,773</b>	<b>11.1</b>
Interest / Rent	2,572	5,298	106.0
Profit and Dividends	1,199	1,781	48.5
Sales and Charges	3,137	6,582	109.8
Social Security Contributions	1,932	1,683	-12.9
Other	5,354	429	-92.0
<b>TOTAL</b>	<b>112,087</b>	<b>133,859</b>	<b>19.4</b>

Source: Department. of Fiscal Policy

### Moderate Growth in VAT Revenue

- VAT revenue up to April 2006 amounted to Rs. 47.5 billion and recorded a 7.4 percent increase. However, more recent data up to May indicate further improved performance as shown in Table III. VAT revenue totaled Rs. 60.6 billion reflecting 13 percent growth in VAT on domestic activities and 8 percent increase in import based VAT. Refunds on VAT including the clearance of long standing arrears of about Rs.1,200 million amounted to Rs. 6,138 million. Revenue from VAT increased owing to the higher margin imposed on the computation of the tax base at the point of import, rate increase in the financial sector, coupled with the improved performance in the banking sector, revival of the tourism sector after the Tsunami, buoyant growth in other services sectors, imposition of a 6 percent duty on wheat grain and higher international prices of certain commodity prices.

**Table III: Collections of Value Added Tax Jan - May 2006**

	(Rs.Mn)	
Tax Base	2005	2006
Domestic	30,208	34,246

Imports	30,217	32,537
<b>Gross Revenue</b>	<b>60,425</b>	<b>66,783</b>
Refunds	4,580	6,168
<b>Net Revenue</b>	<b>55,845</b>	<b>60,615</b>

*Source: Department of Fiscal Policy*

### **External Trade Based Taxes Sustained Buoyant Performance**

- Import duty collection at Rs. 16 billion as of April 2006 registered a 19 percent growth over the corresponding period in 2005. The imposition of a 6 percent tax on wheat grain, specific duties on selected items which are vulnerable to under-valuation and increased value of imports including motor vehicles generated higher import duty revenue. The growth should be viewed in the background that the increase in non-fuel imports in 2006 has been predominantly in the investment and capital goods category carrying lower duty rates.
- Improved customs surveillance contributed towards better performance. Customs revenue collected from raid and detections of smuggling, amounted to Rs 424 million.
- Revenue from Port and Aviation Levy (PAL) generated Rs. 6 billion, mainly due to the increase in the rate from 1.5 to 2.5 percent and high turnover of imports. This improvement in PAL collection has taken place despite the exemption granted for imports that are used for export. A 100 percent growth in revenue was witnessed during the first four months of the year compared to the corresponding period of the previous year.

### **Non- Tax Revenue Shows Stability**

- Non- tax revenue excluding the Central Bank profit transfers at Rs 15.8 billion has performed at targeted levels. Sub categories like interest income; profit and dividend from public enterprises have also increased during the period under review. There was no profit transfer from the Central Bank during the first four months of 2006 in comparison with Rs. 5,000 million during the corresponding period of last year. The overall non-tax revenue at Rs.15,773 million recorded an 11 percent increase.

## **BOX II: -FISCAL MEASURES**

### **Import Tariff**

- 31.01.2006 - RPO No. 01/2006-Revision of duty rates on rice and wheat flour
- Wheat flour duty increased from 15% to 15% or Rs.12.50 per Kg
  - Rice duty increased from Rs.9/- per Kg to Rs.20/- per Kg
- 28.02.2006 -RPO No. 02/2006-Implimentation of 2006 Budget Proposals
- Wheat grain duty increased from 2.5% to 6%
  - Customs duty on Construction machinery exempt

### **VAT**

- 01.01.2006 - Value Added Tax (Amendment)Act No 8 of 2006
- VAT reduction for locally produced medicated soft drinks
  - VAT exemption for
    - Manufacture of high protein and energy food products
  - Reduction of the period specified for the issue of refunds to exporters
  - Extension of deferment facility available to direct exporters
- 01.01.2006

### **Other Tax Measures**

- 01.04.2006 -Finance Act No11 of 2006
- Concessionary motor vehicle levy for holders of Sri Lanka Nation Building Bonds (SLNBB) and for good tax payers –Gazette no 1446/16 of 23.05.2006
- 01.01.2006 -PAL on imports for export removed while PAL on other imports increased to 2.5% from 1.5%
- SRL increased from 0.25% to 1%
- 01.04.2006 - A consolidated Inland Revenue Act No 10 of 2006
- 01.04.2006 - Economic Service Charge Act No 13 of 2006
- Gazette No 1447/10 of 30.05.2006
- 01.04.2006 -Stamp Duty (Special Provisions) Act No 12 of 2006
- Re-introduction of Stamp Duty
    - Gazette No 1439/1 of 03.04.2006
    - Gazette No 1439/2 of 03.04.2006
    - Gazette No 1439/3 of 03.04.2006
    - Gazette No 1441/17 of 20.04.2006
    - Gazette No 1441/18 of 20.04.2006
- 01.04.2006 -Betting and Gaming Levy (Amendment) Act No 14 of 2006

### **Other Measures**

- Banking (Amendment) Act No 15 of 2006
- Enhanced agricultural sector credit by commercial banks
- Monetary Law (Amendment) Act No 9 of 2006
- Fixing the minimum percentage of loans to be extended to any specified sector of the economy

### **Tariff rates**

- 01.02.2006 -Increase the fixed charge in electricity bills
- 24.04.2006 -Bus fare increased by 16%

### **Fuel prices**

- 15.04.2006 - Fuel prices increased by Rs.8/-
- Petrol –From Rs 80 to Rs 88
  - Diesel - From Rs 50 to Rs 58
  - Kerosene- From Rs 30.50 to Rs 38.50
- 11.06.2006 -Fuel prices increased
- Petrol –From Rs 88 to Rs93
  - Diesel - From Rs 58 to Rs 61
  - Kerosene- From Rs 38.50 to Rs 43.50

## **Policy Thrust to Rationalize Public Expenditure Continues**

- While channeling increased expenditure towards pro-poor, pro-growth development initiatives and strengthening public services with significant emphasis on infrastructure development, Government took several policy initiatives particularly in areas such as cadre management, loans and advances to public servants, fertilizer & fuel subsidies, rural development and debt management to ensure the effectiveness of Government spending programmes and also to curtail excessive growth in recurrent expenditures.
- Circular instructions were issued to all Ministries, Departments, Agencies and Enterprises to obtain prior approval on recruitment in order to ensure that such appointments are made within the approved cadre and budgetary provisions. This is to encourage all spending agencies to closely monitor its cadre and employment cost in order to consolidate expenditure on personnel employment.
- Public servants' housing/property loans have been implemented through banks with the Government providing an interest subsidy. This will enable speedy processing of loan applications, while reducing pressure on advance accounts operated by line ministries and agencies complementing Government budgetary operations.
- Fertilizer subsidy has been targeted to small holding agriculture. The paddy sector which is largely a small holding activity and vulnerable to vagaries of weather and market fluctuations is provided with a Rs. 350 per 50 kg bag subsidy on all varieties of fertilizer. This is also extended to vegetable and other food crop cultivators in paddy lands. Smallholder plantation agriculture (less than 5 acres holding) is given a subsidy of Rs. 750 per 50 kg. Urea bag. This is to reduce the upfront cost of smallholder farming to enable them to improve their margins from agricultural production.
- In the context of rising oil prices, administered prices on petrol, diesel and kerosene were raised during April and May in order to contain the cost of subsidy on fuel. Annual adjustments to bus fares were also made in line with these changes.

**Table IV: Domestic Petroleum Price Adjustment**

Item	Domestic Prices			Formula Prices
	Jan. 06	Apr. 06	Jun-06	May-06
Petrol	80.00	88.00	93.00	104.10
Diesel	50.00	58.00	61.00	73.19
Kerosene	3050	38.50	43.50	68.64
Fuel Oil 180 cSt	30.30	38.30	43.30	48.97
Fuel Oil 380 cSt	26.00	36.00	41.00	44.35

*Source: Department of Fiscal Policy*

- New rural development initiatives are targeted to the poorest 119 divisional secretary areas in order to ensure that increased resources are channeled to poorer areas in the country and to make them manageable within available resources.
- Government borrowing programme is managed through the use of least cost borrowing instruments as well as through the selection of an appropriate mix between domestic and foreign debt instruments in order to contain the cost of interest on public debt.
- Foreign Aid utilization is improved through improvements in the procurement process and expeditious reimbursement of funds.
- A Cabinet Sub-Committee has been set up to formulate proposals on defunct state enterprises to ensure that best economic value is realized and the burden on the National Budget is reduced.



## **Overall Public Expenditure Records a High Growth**

- As announced in the Budget 2006, the Government introduced a new fertilizer subsidy scheme, a cost of living allowance for public servants and pensioners, increased provisions for pro-poor development programmes and enhanced capital expenditure to accelerate infrastructure development. Several of these initiatives came into effect from the beginning of the year, reflecting a 19 percent increase in recurrent expenditure and a 39 percent increase in capital expenditure during the first 4 months of 2006. The growth in expenditure is also influenced by enhanced releases for the paddy purchasing programme and the clearance of spillover payments from the previous year, particularly on fertilizer and food programmes.

## **Salaries and Pension Costs Remained High**

- Expenditure on salaries to public servants increased to Rs. 54,961 million - an increase of 20 percent over the corresponding period of the previous year. Increased salary expenditure is due to the implementation of new salary proposals which included a Rs. 1,000 monthly cost-of-living allowance and the full impact of the recruitment of about 42,000 graduates into the permanent cadre of the public service and the recruitment of nurses and employees to clerical and technical categories in the public services. Out of the total cost of salaries and wages, Rs. 20,670 million was on account of employees in Provincial Councils.
- Total pension payments increased to Rs. 18,333 million recording a 25 percent increase underscoring the increase in pension payments as well as the number of pensioners eligible for pensions. Pensioners are also given monthly cost-of-living allowances of the Rs.500. One-off impact was also seen in the increase of pensions due to correction of anomalies. During the first four months 4,392 people retired from the public service.

## **Upward Pressure on Interest Rates Reflects in Debt Servicing**

- Interest payments on foreign and domestic debt amounted to Rs. 48,385 million registering a 14 percent increase mainly due to an increase in the domestic interest rate on Government securities in response to the upward adjustment in policy rate by the Central Bank of Sri Lanka. Re-profiling the public debt portfolio, a better debt management mechanism and alternative financing arrangements are being studied to contain interest expenditure on public debt.

## Repaid Growth in Public Investment Expenditure

- With a commitment to accelerate development programmes including the Post Tsunami reconstruction and North and East development activities and the new emphasis on rural infrastructure development, the capital expenditure was increased by 39 percent to Rs. 51,966 million. Absorbing an increased aid disbursement of around US\$ 355 Million (approximately Rs. 36 billion) the capital expenditure on infrastructure accelerated rapidly during this period. These projects include roads, water supply schemes, health facilities, school buildings, irrigation and rural infrastructure.

**Table V: Performance of Government Expenditure - Jan-April**

	Rs.Mn.	
	2005	2006
<b>Total Current</b>	142,050	169,651
Salaries and Wages	45,700	54,961
Interest	42,584	48,385
Welfare and Samurdhi	9,377	11,635
Fertilizer Subsidy	1,570	5,708
Pension Payments	14,582	18,333
Other Expenditure	28,237	30,629
<b>Capital Expenditure</b>	37,904	51,966
Large Infrastructure	16,326	20,216
Provincial Councils	1,313	2,703
Small Infra.& Other	20,265	29,047
<b>Total</b>	<b>179,954</b>	<b>221,617</b>

*Source: National Budget Department*

## Strengthening the Rural Economy through Pro-Poor Growth Strategies

- Pro-poor expenditure programmes consisting of Samurdhi assistance, welfare payments and the fertilizer subsidy totaled to Rs. 17,343 million as compared to Rs. 10,947 million during the corresponding months of the pervious year.

- “Gama Naguma”, a community based integrated rural development initiative to empower the poor has been targeted in 119 poorest divisional secretariat divisions as phase I of the programme. The programme was launched in February 2006 in the following villages and is now being expanded to identified poorest divisional secretariate areas island wide.

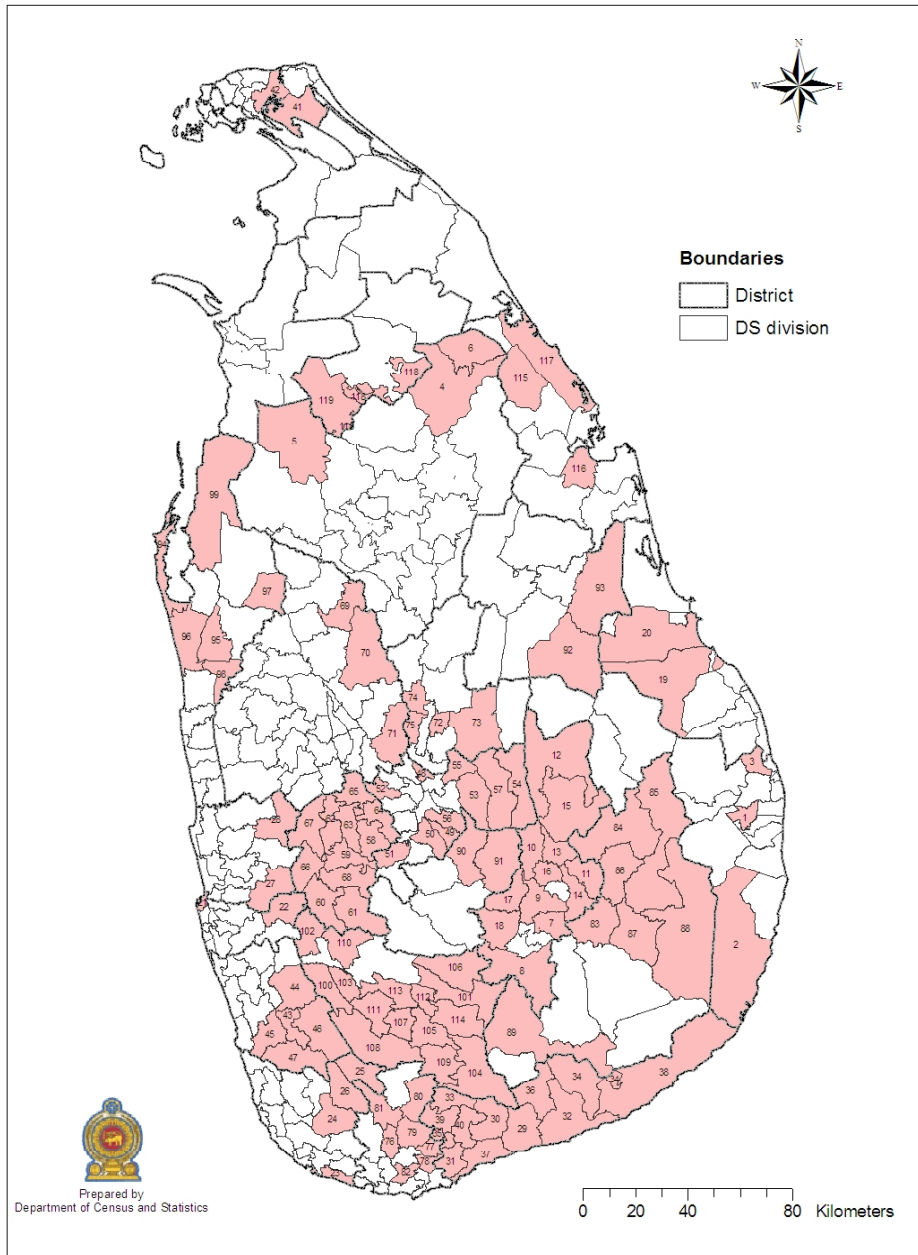
**Table VI: Villages under Gama Naguma Programme**

District	AGA division	Village
Hambantota	Siyabalanduwa	Jayaminigama Hatakotasa
	Suriyawewa	Bedigamtota
Badulla	Rideemaliyadda	Etabewala
		Kanugollagama
Puttalam	Kalpitiya	Kombuwattan
Rathnapura	Elapatha	Kadawanatta, Hennyaya
Kandy	Minipe	Minipe
Kegalle	Aranayake	Wattegedaragama
Matale	Ambanganga Korale	Sirangahawatta
Nuwaraeliya	Hanguranketha	Happawara
Anuradhapura	Padeviya	Bisokotuwa
		Eke Kanuwa

*Source: National Budget Department*

- The expenditure on "Maga Naguma", and "Dahasak Maha Wev" - the two island wide rural infrastructure development programmes amounted to Rs. 512 million as at end May 2006. Expenditure under "Rajarata Navodaya", "Pubudamu Wellassa" and other specific regional development initiatives reached the final phase of implementation and the total expenditure amounted to Rs. 225 million.
- Programmes such as “Jana Pubuduwa”, “Gami Diriya”, and "Gami Pubuduwa”, designed to restore community infrastructure, livelihood development and micro enterprise development among "Samurdhi" beneficiaries were strengthened incurring a cost of Rs. 429 million. Rs. 411 millions has been used for the Industrial Village Development Initiatives to empower rural industrial activities.

**DS divisions (119) Selected for Rural Development Programmes**



- A 50 percent increase in the Samurdhi monthly allowance has been implemented in 113 AGA divisions and another 106 divisions will be covered under the 2<sup>nd</sup> phase. Rs. 2,000 million has been released up to end May 2006 for this programme. Death Assistance Scheme and Childbirth allowance under the Samurdhi Programme were doubled as proposed in the Budget 2006, from December 2005.

### **New Programmes on Mothers and Children**

- Under the school meal programme for children in less advantaged areas, mid day meals have been provided for 291,827 children covering 6,238 schools.
- 581 children have received “Senehasa” bank accounts, the scheme designed to assist children who have lost parents consequent to the Tsunami or the conflict in the North and East.
- A programme to provide a nutritional food basket to the value of Rs 500 per month was launched and 5,800 expectant mothers in 10 divisional secretariat areas benefited under a pilot projects, costing Rs. 58 million.

**Table VII: Pilot Projects - ‘ A Food Basket for Expectant Mothers’ Programme**

<b>District</b>	<b>Divisional Secretariat Area</b>
Hambantota	Suriyawewa
Badulla	Katuwana
	Redimaliyadda
	Meegahakiula
Puttalam	Kalpitiya
	Mundalama
Nuwala Eliya	Ambagamuwa

*Source: National Budget Department*

## Enhanced Assistance for Agriculture

- The fertilizer subsidy was targeted to smallholder agriculture to assist low income-farmers. Accordingly, all varieties of fertilizer were provided at Rs.350 per 50kg bag, for paddy agriculture.

**Table VIII: Fertilizer Subsidy – Paddy Sector**

Fertilizer	Market rate Per 50kg bag (Rs.)	Subsidies Price per 50 kg bag (Rs.)	Subsidy per 50 kg bag (Rs.)
Urea	1,950	350	1,600
MOG	1,575	350	1,225
TSP	1,100	350	750

*Source: Department of National Budget*

- The fertilizer subsidy has been extended to tea, rubber and coconut small holders (cultivating less than 5 acres). This subsidy was also extended to farmers who grow other crops such as big onion, red onion, chilies and maize. Large-scale farmers are not given the fertilizer subsidy. The cost of fertilizer subsidy up to April 2006 has reached Rs. 5,708 million compared with Rs. 1,570 million in 2005. Other expenditures channeled to agriculture by way of interest subsidy for agricultural credit, restructuring credit for paddy mills and for the provision of agricultural seeds stood at Rs. 30 million as at April 2006.
- Efforts to help paddy agriculture through the increased fertilizer subsidy and high producer prices for paddy farmers continued particularly in the context of favorable environment for cultivation as well as the bumper "Maha" harvest. The advances provided for the purchase of paddy through Government Agents (GAs) up to end of June 2006 was Rs, 2,622 million. Such advances were Rs. 1,073 million during the corresponding period of the previous year. The recovery of these advances have been commenced. Total recoveries from advances granted in 2005 is Rs. 408 million.
- High tariff is maintained on imported wheat flour and grain to re-orient consumption towards rice and rice flour. Government has also decided to restrict advertisements promoting imported Milk Powder in order to encourage local milk production.

**Table IX: Advances for the Paddy Purchase Scheme**

**(Rs. Mn)**

District/Institution	Jan- April 2005	Jan- April 2006
Pollonnaruwa	340	830
Anuradhapura	163	515
Ampara	210	495
Badulla	25	40
Trincomalee	30	90
Kurunegala	75	136
Puttalam	15	32.5
Hambantota	25	115
Monaragala	15	38
Bataloa	20	40
Kandy	10	45
Matara	-	13
Ratnapura	10	17
Manner	25	20
Vauniya	30	25
Mulletive	25	25
Kilinochchi	40	50
Matale	15	27.5
Department of Agrarian Dept.	-	75
Total	1,073	2,629

*Source: National Budget Department & Department of Treasury Operation*

- Taxation on agricultural income was exempt in 2005 to encourage investment and this was further extended to agricultural processing in 2006 giving an impetus to the value addition in this sector. Imposition of Value Added Tax on items such as packetted tea has been removed to boost such export production and promote brand themes.
- The 15 percent tax on income from export of agricultural products were also removed.

#### **Welfare Expenditure to Protect the Poorer Segment of the Society**

- The expenditure on welfare assistance provided in support of the poorer segments of the society, displaced persons, differently-abled soldiers and vulnerable groups, reached Rs 4,879 for the period January-April 2006.

### **Human Resource Development Expenditure Preserved**

- Total expenditure on health, skills development and education stood at Rs 37 billion up to April 2006 as compared to Rs. 31.7 billion in the corresponding period of the previous year. Capital expenditure increased to Rs. 6.5 billion as compared to Rs. 5 billion during the corresponding period of the previous year. During the first four months, several new additional infrastructure facilities connected to hospital complexes and school buildings have been undertaken. 65 rural schools have been provided with solar power computer centres. 200 computer learning centres have been established.
- Various programmes targeting children to provide free text books, school season tickets, uniforms, and nutritional meals cost Rs. 329 million up to April 2006.

### **Expenditure on Public Enterprises**

- A number of public enterprises continue to depend on Treasury assistance. The expenditure provided to Ceylon Transport Board amounted to Rs. 1,934 million. Transfers to other enterprises totaled Rs. 971 million during the first four months of 2006.
- most of these transfers are on account of operational losses of these enterprises and to meet frequent cash deficits. A Cabinet Sub-Committee has been appointed to formulate strategies to transform defunct entities and economically unviable operations to generate internal revenue sources and to reduce their burden on the National Budget.

### **Post Tsunami Reconstruction Activities**

- Housing reconstruction programme has completed 50,631 permanent houses by the end of May 2006. A further 38,947 permanent houses are currently under construction. The total number of permanent houses required is estimated at 120,000 units, in view of the revised buffer zone.
- Since the donor driven construction programme has not made satisfactory progress, arrangements have been made to shift house construction under the owner driven programme. This has necessitated additional funding of around US\$ 50 million. In order to accelerate housing construction under the Tsunami programme the district secretaries have been given the flexibility to take decisions at district level.



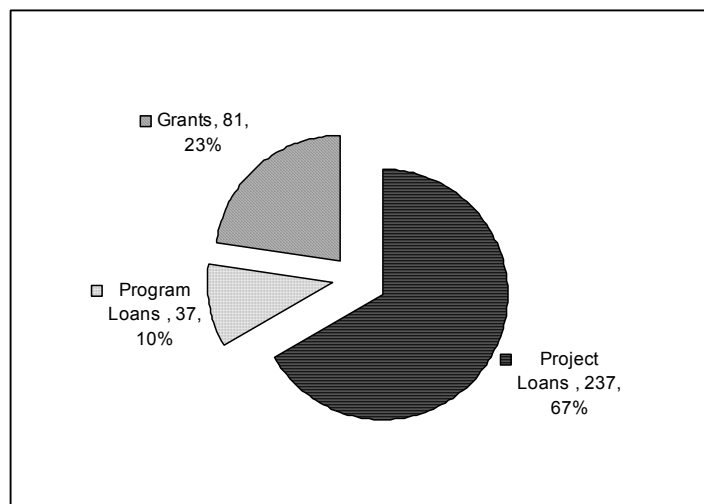
- In the education and health sectors physical reconstruction of schools, health centres and other related infrastructure has reached near 50 percent progress. In the health sector 109 projects are in designing and planning stage while 69 projects are in work in progress stages. 24 health projects have been completed. Under the school reconstruction programme, 78 schools are in the designing and planning stage while 86 school are in work in progress status. 130 water related projects have been planned and 96 projects are at various stages of implementation.
- Almost all road projects are expected to be awarded to contractors during July - September 2006. 5 major bridges are under construction and other 20 bridges are in design stage. The reconstruction and rehabilitation of 1,173 Km of National highway and 25 major bridges are planned under Post Tsunami Reconstruction Strategy. The work in relation to all these projects are in progress.
- Arrangements have been finalized to commence work in respect of the 300 MW coal power plant at Puttalam and fishery harbour facilities in the Kalutara, Galle, Hambantota and Ampara Districts. Administrative complex and an International Conventional Centre at Hambantota, a 150 bed hospital at Matara (Godagama) and modern hospital at Galle under the Post Tsunami Assistance package.
- During the first four months nearly Rs. 4 billion has been spent on account of Tsunami related work.

## **FOREIGN ASSISTANCE**

### **The Use of Foreign Aid**

The total aid disbursement by end May 2006 amounted to US \$ 355 million. These disbursements were made in the form of project loans, program loans and grants. Of the total disbursement, project loans accounted for US \$ 237 million, program loans accounted for US \$ 37million and grants accounted for US \$ 81 million. Disbursements relating to Post-Tsunami reconstruction activities stood at US\$ 77 million.

**Figure 1 – Composition of Disbursements – US \$ mn.**

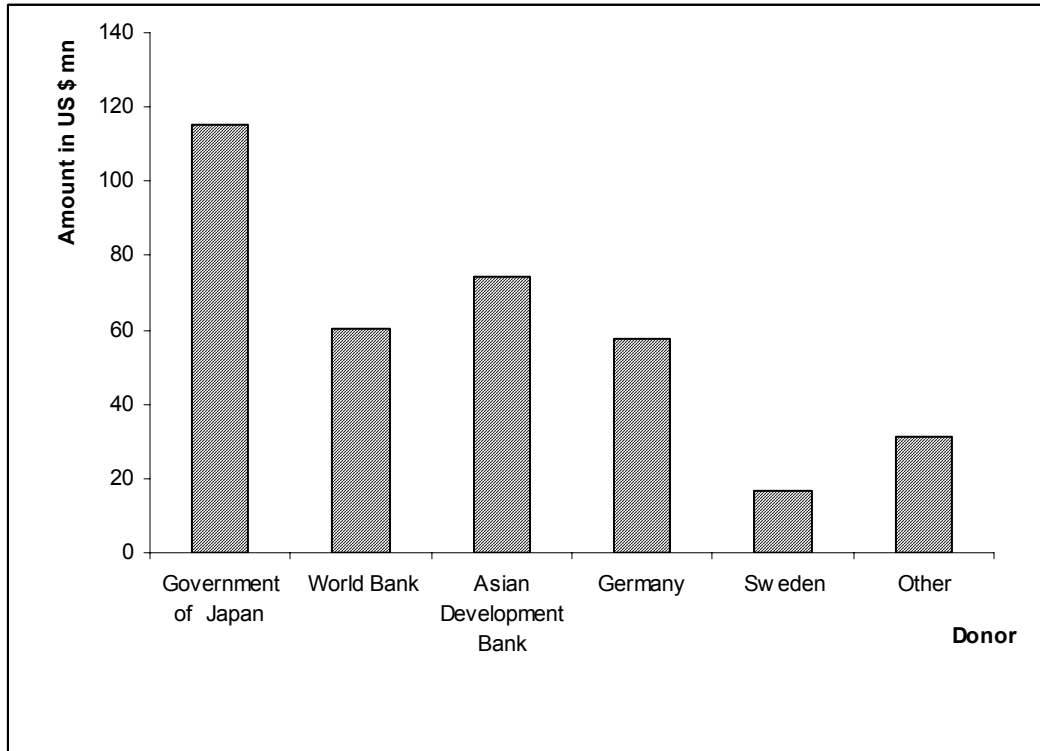


**Table X: - Aid Disbursements -(January - May 2006)**

<b>Donor</b>	<b>Amount US\$ mn</b>
Government of Japan	115.5
World Bank	60.4
Asian Development Bank	74.1
Germany	57.4
Sweden	16.6
Other	31
<b>Total</b>	<b>355</b>

*Sources: Department of External Resources*

Figure 2- Disbursements by Donors



The Government of Japan, World Bank and ADB contributed 65% of the total disbursements. The Government of Japan disbursed US\$ 115mn for the large projects such as Southern Expressway project, Bandaranaike International Air Port project, Kaluganga Water Supply project, Small Scale Infrastructure Rehabilitation & Upgrading and the Tsunami Affected Area Recovery and Take Off project and from the Small and Medium Entrepreneurship Development project. Disbursements made by the ADB comprised of US\$ 20 mn from the Rural Finance Sector Development Programme and another US\$ 20 mn from the road sector projects and the balance from the other social infrastructure projects. A considerable amount of funds has been disbursed by the World Bank, especially from the Post- Tsunami Reconstruction of Houses and Roads project (around US\$ 22 mn), Renewable Energy for Rural Economic Development project (US\$ 12 mn) and the Community Development and the Livelihood Improvement project (US\$ 11 mn).

In addition, under Technical Assistance Cooperation, Government has received around 300 scholarships which include long-term and short-term training courses in the areas of IT development, agriculture, environment, irrigation human resource development and Management. The total value of the 300 scholarships is around US\$ 30 mn. Based on the demand in Government agencies more than 67 volunteers have been dispatched from Japan, Korea, UN and Australia etc., during the period.

### New Aid Agreements

The total aid commitments made (agreement, signed ) by donors to Sri Lanka, during the period from January to June 2006 amounted to US \$ 637 million. These commitments were made in the form of project loans and grants. Of the total commitments, project loans and grants accounted for US \$ 540 million and US \$ 97 million respectively and US\$ 200 mn was for the Post-Tsunami reconstruction activities.

**Table XI: Agreements Signed**

Se. No	Sector	Donor	Project Name	Amount in US\$ mn	
				Loan	Grant
1	<b>Construction of Roads &amp; Bridges</b>	JBIC	Pro-Poor Eastern Province Infrastructure Development(T)	38.0	
2		USA	Provide cost of goods and services for a feasibility study on Post Tsunami Road Equipment Requirements Project (T)		0.4
3		World Bank	Road Sector assistance	98.8	
4		EIB	Post -Tsunami Line of Credit (T)	85.2	
5		Germany	DFCC V - Credit Line to SME in North & East	6.1	
6		USA	Promoting livelihood of the Tsunami affected people		0.2
7	<b>water</b>	Denmark	Town South of Kandy Water Supply Project	54.0	
8		World Bank	National water Mgt Improvement project		0.5
9	<b>Port Development</b>	JBIC	Galle Port Development	125.0	
10	<b>Housing &amp; Township Development</b>	CIDA	Environmental Assesment of the permanent housing project		0.3

**Table XI: Agreements Signed**

11		Korea	Construction of Hambantota Administrative Complex	20.0	
12	<b>Education</b>	ADB	Technical Education Development	20.0	
13		ADB	Education Sector Development		0.7
14		World Bank	Education Sector Development		59.3
15		Sweden	Establishment of E learning Centre		2.0
16	<b>Tourism</b>	JBIC	Tourism Resources Improvement	23.0	
17	<b>Others</b>	Pakistan	US\$ 20 mn Pakistan Line of Credit	20.0	
18		China	Agreement on Economic & Technical Cooperation		2.5
19		China	Assistance for South Asian Games		0.2
20		World Bank	Tsunami Emergency Recovery Project		24.9
21		USA	Tsunami Recovery & Reconstruction		2.0
22		UNDP	Urban Governance Project		0.6
23		UNDP	Strengthening Plan Implementation Capacity		0.8
24		ADB	Independent External monitoring of resettlement Activities		0.6
25	<b>Others</b>	ADB	Strengthening Local Government Infrastructure		0.5
26		ADB	Capacity Building of the Environment & Social Division		0.8
27		ADB	Micro Insurance Sector Development		0.8
28		ADB	Local Infrastructure Improvement	50.0	
	<b>Total</b>			<b>540</b>	<b>97</b>

The World Bank and the Government of Japan both committed US\$ 135 mn for the road sector projects. While the World Bank provided assistance for Road Sector Development, the commitment of Japan for the road sector will be utilized for the rehabilitation of part of the main highway in the Eastern Province affected by the Tsunami disaster. In addition, Japan has committed US\$ 124 mn and US\$ 22 mn for Galle Port Development and for Tourism Resources Improvement respectively. The Galle Port Development project will facilitate the Southern region development plan presently being implemented by the Government. The Asian Development Bank has contributed to develop Technical Education and the strengthening of the Local Government Infrastructure during this period. In addition, ADB intends to sign an agreement for US \$ 150 mn for the National Highway project by July 2006.

### **Aid Commitments**

The Committed Undisbursed Balance (CUB) of foreign aid for Government's development programme including Post-Tsunami reconstruction activities as at end April 2006 was US \$ 4.3 billion as shown below in Table XII .

**Table XII - Details of Committed Undisbursed Balance by Sectors**

<b>Sector</b>	<b>CUB US\$ mn</b>
Agriculture, Irrigation ,Land, Plantation & Fisheries	279.21
Environment & Forestry	122.04
Roads ,Bridges , Ground Transport , Ports & Airport Aviation	743.64
Power & Energy	504.49
Rural Development	171.38
Water Supply & Sanitation	385.58
Health, Education & Vocational Training	376.26
Housing & Urban Development	63.90
IT, Science & Technology, Institutional Development	100.24
Financial Management	97.14
Trade,Tourism, Industrial Development & Private Sector Development	235.05
Tsunami Rehabilitation	960.39
Rehabilitation	158.98
Other	122.80
<b>Total</b>	<b>4321.14*</b>

*Source: Department of External Resources*

These funds will be used for projects identified by the Government and implemented during a period ranging from 2-5 years. The expected utilization of donor funds for the year 2006 is US \$ 1.2 billion. A sum of US\$ 354 mn has been disbursed as of end May 2006 based on reported figures of the respective development partners. The total CUB includes a sum of US \$ 849 mn for North and East Development.

**Table XIII: - Committed Undisbursed Balance – North & East**

<b>Sector</b>	<b>CUB US\$ mn</b>
Agriculture & Fisheries	71.93
Housing	117.92
Water Supply	63.73
Community Development	126.28
Roads & Bridges & other Infrastructure Development	233.18
SME Development	15.00
Health , Nutrition & Education	183.42
Power & Energy	28.47
Other	9.19
<b>Total</b>	<b>849.08</b>

*Source: Department of External Resources*

### **External Debt**

As at 30<sup>th</sup> April 2006, total debt service payment was US\$ 163 mn which includes principal repayments of US\$ 115 mn. The estimated total debt repayment for the year 2006 is about US \$ 545 million which includes US \$ 162 million as interest payments and US \$ 382 million as principal payment. The Government debt stock as of 30<sup>th</sup> April 2006 is about US \$ 9,559 million as compared to US\$ 9,278 million as of end 2005.

## GOVERNMENT TREASURY OPERATIONS

### Cash Operations

The net cash flow from operating activities, by the end of June 2006 amounted to Rs. 36.5 billion, as there has been a shortfall in the cash inflow in the form of revenue and a slight increase in the cash outflow from operating activities. The Government's cash operations, after investment activities, during the first half (Jan - Jun) of 2006 indicated a net cash deficit of Rs. 77.5 billion, compared with Rs. 58.5 billion during the corresponding period of 2005. Cash outflow from investment activities increased by Rs. 7 billion over the original cash flow estimates. However, as repayments on debt was below estimates, gross borrowings were raised to meet the cash deficit of Rs. 77.5 billion.

The overall closing balance which corresponds to working overdraft balance with the banks declined from Rs. 11 billion at the beginning of the year to Rs. 10 billion at the end of June 2006.

**Table XIV: Statement on Government Cash Flow Operations  
2005 and 2006 - First Six Months**

Item	Actual Jan - June 2005	2006 Jan-June (Rs Mn)	
		Original Estimate	Actual Cash Flow
Total cash inflows from Revenue	156,622	213,656	203,993
Total cash outflow from operating activities	(186,828)	(238,145)	(240,503)
Net cash flow from operating Activities	(30,206)	(24,489)	(36,510)
Cash Flow from Investing Activities	(28,342)	(33,571)	(41,032)
Net Cash Surplus ( Deficit )	(58,548)	(58,060)	(77,542)
Opening Cash Balance	(5,211)	(10,989)	(10,989)
Gross Borrowings *	179,801	216,622	226,135
Debt Repayment	(123,078)	(144,368)	(142,797)
Net Borrowings	56,723	72,254	83,338
Adjustment Account Balance (TEB, RFA, Deposits etc)	1,693	6,640	(3,513)
<b>Closing Balance</b>	<b>(5,443)</b>	<b>(11,985)</b>	<b>(10,136)</b>

\* Excluding Foreign Aided Project Finance

Source: Department of Treasury Operations



## **Government Debt Managed Within Approved Limits**

The Government debt operations indicated a total domestic gross borrowing of Rs. 226 billion from January to June 2006, including the US\$ 300 million raised in the domestic market as Sri Lanka Development Bonds. The repayments of domestic debt including foreign currency denominated domestic debt amounted to Rs. 99.9 billion thus limiting net domestic borrowings to Rs 125 billion. Foreign loan repayments amounted to Rs 42.8 billion. The Government's foreign borrowing during this period amounted to Rs. 33 billion of which 88 percent came in as project loans. The total gross borrowing consisting of foreign and domestic during the first six months of the year amounted to Rs. 258 billion indicating that the Government had utilized 47 percent of the approved annual borrowing limit for the current year. This borrowing level is well within and consistent with the approved limit for 2006.

The outstanding public debt stock as at end May 2006 grew by 9.2 percent, which is lower than the expected growth in nominal GDP, implying a further reduction of debt/GDP ratio to about 90 per cent, compared with 94 per cent as of end 2005.

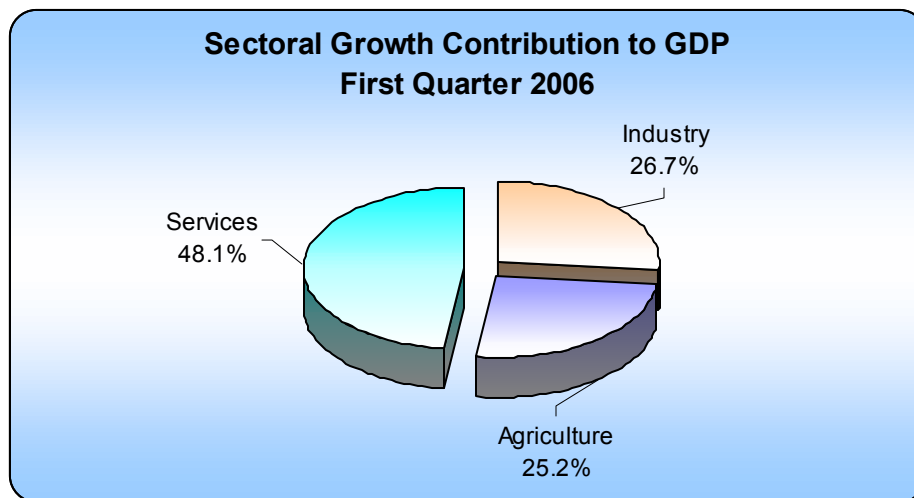
## **THE ECONOMY**

### **The Economy Displays a Strong Growth**

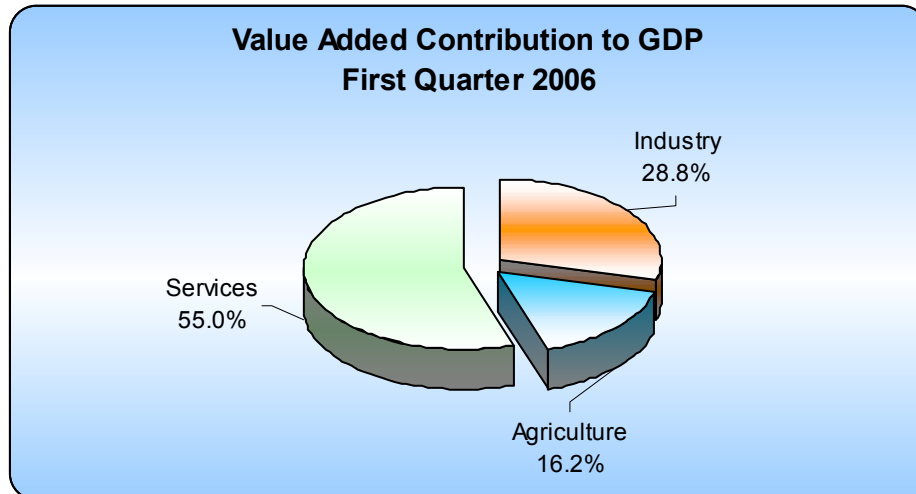
- The economy after a speedy recovery from the Tsunami shock and registering 6.2 percent growth in 2005, recorded an impressive 7 percent growth during the first quarter of 2006 reflecting resilience of the country's economy to external shocks.
- The recent high growth momentum has been mainly due to the increased investment activity including the post tsunami development work and improved domestic supply in response to growing domestic demand supported by a significant growth in private sector credit.
- The growth was broad based. Continued expansion in agriculture, mainly improved performance in tea, rubber, paddy and food crops and rapid recovery in the fisheries sector, contributed towards a quarterly 11 percent growth in agriculture during the first quarter.

- Tea production increased by 6 percent against the 1.2 percent growth in the same period of 2005 and Rubber and Coconut production grew by 17.3 percent and 10.1 percent respectively, indicating a rapid recovery from the negative growth rate recorded in the relevant period of 2005. The value addition in the fisheries sector has grown by 25 percent. A significant increase could be seen with the low base resulted from the Tsunami setback during the relevant period of 2005.
- In the industry sub sector, manufacturing activities consisting of factory industries, export processing industries, and small industries showed moderate growth rates of around 5 percent, while electricity, gas and water generated 11 percent growth in value addition. Construction industry reflecting the post Tsunami reconstruction work as well as increased investments in roads, urban development, education and health. Infrastructure recorded a 7 percent growth.

**Figure 3: Sectoral Contribution to GDP**



*Source: Department Census & Statistics*



*Source: Department Census & Statistics*

- The value addition in the service sector which accounted for 55 percent of GDP increased by 6.2 percent in comparison with 5.5 percent growth, growth in trade consisting of domestic as well as external trade accelerated to 6 percent, while hotel services recovered from the previous year setback to record a modest growth of 2 percent. Contribution to GDP from transport and communication accelerated from the previous years rate of 6.9 percent to 7.8 percent during the first quarter of this year mainly due to rapid improvement in cargo services and sustaining 9 percent growth in telecommunication services which expanded by 22.9 percent a year ago. Financial services, responding to high economic activities, domestic credit growth, and continued expressions in trade and industry grew by 7 percent. Private services as well as Government services too expanded in terms of their constitution to GDP.

### **Employment**

- Total employed population increased from 2,383,241 (2.4mn) in 2005 to 2,447,279 (2.5 mn) at the end of first quarter 2006 reflecting increased employment opportunities in Agriculture activities. Consequently, unemployment population declined to 546,236 or 7.2 percent of the labour force. Unemployment rate at the age group of 20-24 has declined from 24.6 percent to 22.4 percent while the unemployment rate of those who have G.C.E. (A/L) and higher qualification has declined from 13.8 percent to 12.1 percent. It is noteworthy that while male unemployment rate remained around 5.5 percent, female unemployment rate has declined to 10.1 from 11.9 percent.

## Inflationary Pressure is High

- Rate of change in the process reflected in the Colombo Consumer Price Index (CCPI) showed a gradual decline from 12.8 percent in mid 2005 to 9.2 percent in April 2006 and an upward movement thereafter, recording 9.4 percent in May and 10.1 percent in June 2006. Year on year basis inflation increased to 17.7 percent by June 2006.

*Table XV: Inflation - Annual Average*

Mon h	CCPI		SLCPI	
	2005	2006	2005	2006
January	8.8	11.1	9.5	9.4
February	10.0	10.3	11.0	8.3
March	11.1	9.6	12.3	7.3
April	11.9	9.2	13.2	6.5
May	12.4	9.4	13.9	6.2
June	12.6	10.1	14.4	
July	12.7		14.5	
August	12.8		14.3	
September	12.7		13.5	
October	12.5		12.7	
November	12.1		11.8	
December	11.6		10.6	

*Source: Central Bank of Sri Lanka*

CCPI: Colombo Consumer Price Index,,  
SLCPI: Sri Lanka Consumer Price Index

- Price of food and fuel and light exhibited the highest index point change. Increase in fish and vegetable prices coupled with increase in oil prices as well as high demand for goods reflecting rising income as well as an expansion in construction and other investment activities have contributed towards the rising inflationary pressure in the economy.
- In this context, both fiscal and monetary policy measures have been put in to place to contain the demand pressures in the economy. Central Bank policy rates were adjusted upwards for the first time in 2006 by 25 basis points. Upward adjustments in the tariff on wheat grain and flour will have a favorable impact on Government revenue. The recorded increase in domestic fuel prices is expected to reduce budgetary pressure on money and credit, though it has an one-off impact on domestic inflation.

## **External Sector Developments**

- External trade continued to expand, reflected in both exports and imports. Exports have increased by 4 percent growth during the first 4 months of 2006, with a remarkable 12.3 percent growth in agricultural exports and a moderate growth of 3.7 percent in industrial exports. Imports during this period grew by 17.5 percent.
- The cost of petroleum imports continued to be a heavy burden on the balance of payments. Petroleum products imports absorb 26 per cent of the export earnings costing US \$ 1,656 million in 2005. This year during the first four months, US \$ 662 million has been spent on petroleum products and the total oil bill is likely to be in the region of US \$ 2 billion by the end of the year.
- Reflecting these developments, the cumulative trade deficit by April reached US\$ 1,056 million against the US\$ 675 million in the corresponding period of 2005. Fuel import bill which has risen by 45 percent to US\$ 639 million compared with the first four months of 2005, contributed to this increase in the trade deficit.
- The service sector exports in the balance of payments performed well mainly due to the improvement in tourism and Port related services. Tourist arrivals increased by 25 percent to 209,440 arrivals during the first four months of 2006 compared to the same period in 2005. Mobilization of private remittances increased by 27 percent in the first four months of 2006 to US\$ dollars 815 million compared to the same period of 2005.
- The balance of Payments (BOP) had generated a surplus of US\$ 158 million by end May 2006, mainly benefiting from the high private remittances, improvements in tourism and growth in exports, despite the growing oil losses.

## **Foreign Assets**

- The gross official foreign reserve increased to US\$ 2,826 million by end June despite intervention in the market to stabilize exchange rate volatility. Total foreign reserves of the country was US\$ 4,532 million by end April 2006. The official foreign reserves were sufficient for about 3.4 months of imports as of end June. Gross official reserves as of end 2005 amounted to US\$ 2,735 million.

**Table XVI: Performance of External Trade - Jan - April**

	20 5 (US\$ Mn.)	006 (U \$ Mn.)
<b>Exports</b>	<b>1,943.72</b>	<b>2,020.61</b>
Agriculture	341.77	383.74
Tea	240.87	267.23
Other	100.92	116.49
Industrial	1502.91	1,572.99
Food, Beverages and Tobacco	77.25	129.7
Textiles and Garments	887.8	899.12
Rubber products	110.78	114.66
Diamond and Jewellery	94.28	98
Mineral	50.34	50.99
Unclassified	48.7	12.87
<b>Imports</b>	<b>2618.57</b>	<b>3,077.29</b>
Consumer goods	529.01	551.96
Food & Drink	261.96	264.44
Other Consumer Goods	267.05	287.52
Motor Cars & Cycles	56.09	79.77
Intermediate goods	1529.8	1,789.56
Petroleum	442.25	639.11
Fertilizer	47.92	68.93
Chemicals	79.41	77.35
Textiles & Clothing	450.19	437.62
Diamonds	70.77	70.44
Other Intermediate Goods	439.24	496.04
Investment goods	545.16	696.61
Machinery & Equipment	248.68	353.89
Transport Equipment	83.33	113.01
Building Materials	157.32	175.04
Other Investment Goods	55.83	54.68
Unclassified	14.62	39.15
<b>Trade Balance</b>	<b>-674.85</b>	<b>-1,056.68</b>

*Source: Central Bank of Sri Lanka*

### Financial Sector Developments

- A salient feature of the financial sector during this period has been the steady growth of monetary aggregates and relative stability of financial markets reflected in small volatility in interest rates with a marginal upward movement in recent months. Deposit mobilization increased by 20 percent in the first four months.

- Narrow money (M1) growth on a point-to-point basis was 14.7 percent in April in comparison with 12.5 percent in March, while the growth in broad money (M2b) was 19.9 percent.
- Net credit to the Government (NCG) by the banking system increased by Rs. 5.0 billion in April as a result of the increase in holdings of Treasury Bonds, while NCG from the Central Bank declined with a decline in holdings of Treasury Bills. Credit to public corporations increased by Rs. 2.8 billion as a result of increased borrowings by Ceylon Petroleum Corporation while credit to the private sector from commercial banks recorded a growth of 23.6 percent in April 2006. In rupee terms private sector credit increased by Rs. 7.0 billion from March to April 2006. The expansion in credit consists of loans granted for commercial, consumption, housing and industrial purposes.

