

# We Must Strive Even Further!



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The Sri Lankan economy grew at 7.6 percent during the first quarter of 2014. Inflation was at an all time low, interest rates have reduced while per capita incomes have been gradually increasing. "This was not achieved overnight, but through well thought-out, forward-looking strategies where the country's development agenda was set, not just for the next five years but for generations to come," says Ajith Nivard Cabraal, Governor of the Central Bank. He also spoke of the stability of the Sri Lankan economy as well as the financial and monetary sector, where he stressed the need for people to recognise the achievements of the country. "No person can deny that there is development, then why not be practical and honest and acknowledge it?" states the Governor, who believes that the country can do much more, and that we must strive even further!

By Udeshi Amarasinghe

Photography Mahesh Bandara and Indika De Silva

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**Economic indicators continue to improve in Sri Lanka despite unfavourable global economic conditions. Can you elaborate on these**

## **achievements?**

Over the last few years, we have ensured that every single macro fundamental in the country moves in the direction that it should. As a result, those that need to go up have gone up, and those that need to come down have come down. That has made it possible for us to confidently say that Sri Lanka is now on a sustainable growth trajectory. This was achieved through a disciplined approach that we have gradually introduced into the economy. The private sector venturing out more boldly as a result of the end of the conflict is another important factor that has contributed to the economic growth. Overall, we have been able to develop a virtuous cycle within the economy, where when certain economic elements had improved, those in turn, had pushed other economic elements to perform better. Those factors have helped a great deal, while the improvements in infrastructure, the increased confidence levels, and the fact that foreign investors have been bullish about Sri Lanka, have also helped. This has allowed us to overcome the external challenges as a result of the global economy not faring too well. Fortunately, in the past several months, there has been a turnaround in the global economy, which has given our economy a further boost. Therefore, going forward we will be able to comfortably usher a new era where there would be sustainable development.

**Over The Last Few Years We Have Ensured That Every Single Macro Fundamental In The Country Has Been Moving In The Direction That It Should... This Has Made It Possible For Us To Confidently Say That Sri Lanka Is On A Sustainable Growth Trajectory.**

**Inflation reached the lowest rate recorded since 2012 to 3.2 percent in May 2014, can you explain to us as to how this was achieved?**

Our current level of low inflation was achieved as a result of three basic initiatives. The first was that the government, the Central Bank and the private sector helped to improve the supply side, where the supply of goods and services has been consistent, with productivity levels improving. The second was that we at the Central Bank kept a close tab on demand, by strictly controlling the monetary expansion and keeping it within the required levels. The third was that the fiscal deficit was carefully managed by the government. These three factors together helped us to maintain inflation in mid-single digit levels, which has been a great boon to business. This result has also shown the country and the world that Sri Lanka can have sustained price and economic stability, and this new

platform will help us in the future to attract investments from outside. Further, because there is now stability in our exchange rate and prices, people find it easier to do business since no one can do business in a stable manner when prices are fluctuating rapidly.

**We are seeing interest rates decreasing considerably; will we see a further reduction?**

We have been careful to ensure that interest rates do not drop too much or too fast, mainly because there is a section of the population that has been used to incomes, which were based on fairly high interest rates. However, what many people do not realise is that even though interest rates were high at the time when inflation was high, their incomes were substantially eroded. At that time, the value of the currency also went down sharply and consistently due to the heavy depreciation of the Rupee.

Today, all that has changed. The value of the currency is not diminishing, and although on nominal terms, the amount of interest that depositors may receive may appear to be less, it is much higher than inflation, which shows that people are enjoying a real interest from their deposits. That is of course a good outcome. At the same time however, in the short term, people sometimes carry a perception that their incomes have shrunk due to the interest rates declining, and it is natural that a period of time will have to elapse before this feeling is changed. That is why we think it is not too prudent to allow the interest rates to drop too much, and therefore, we try to maintain a reasonable balance in the interest rates.

Economics is all about balancing different competing fundamentals. In that sense, we always keep a careful eye on all changes to ensure that there are no major disturbances caused to the various stakeholders in our economy, at a pace they find difficult to adjust.

**Together With Foreign Remittances, Tourism Receipts And Other Investment Inflows, The Amount Of Foreign Exchange That Has Flowed Into The Country Has Been Quite Adequate To Ensure That The Sri Lankan Rupee Remains At Stable Levels.**

**What can you tell us about the movement of the Sri Lankan rupee, since**

### **imports are falling and credit growth is slowing?**

Although credit growth has been rather low, over the past year or so, it is mainly because of our own policy of slowing it down a little. Nevertheless, the total funds that have been applied for investment purposes have not diminished. Today, there are many sources from which investments could flow into businesses. The fact that Sri Lanka's growth rate has been as high as 7.6 percent in the first quarter is a good indicator that there has been no sluggishness in the growth of the economy. That growth has been recorded even in the midst of the agriculture sector not performing too well due to adverse weather conditions.

At the same time, a salutary feature of recent times has been that imports have not increased unduly, although the increase in exports has been quite substantial. Accordingly, together with foreign remittances, tourism receipts and other investment inflows, the amount of foreign exchange that has flowed into the country has been quite adequate to ensure that the Sri Lankan rupee remains at stable levels. In fact, the Sri Lanka Rupee has now become one of the most stable currencies in the world.

### **The Central Bank eased policy rates throughout last year, but this year the Central Bank has left policy rates unchanged. Why is this?**

The current policy rates are at levels where it allows all stakeholders to continue with their businesses and economic activities without a hindrance. Therefore, we think that our policy rates are at an appropriate level and we also do not see the risk of any major reduction in growth or any sharp increase in inflation. As a result, we do not need to make any changes at this time.

### **During the last couple of months there was a general feeling that the economy was not moving. Why is that?**

Contrary to such "general feeling" that you refer to, the actual indicators show that the economy has been moving quite rapidly. In fact, the Sri Lankan economy has moved by 7.6 percent, quarter to quarter, and that is a substantial growth. Except for a couple of countries, there is no other country in the world that had a first quarter growth of 7.6 percent in 2014. Therefore, we are growing at one of the fastest paces in the world! The contention that the economy is moving slowly is fallacy that some analysts and politicians are attempting to show.

**The Central Bank has been able to earn positive returns through effective international reserve management. Can you elaborate on this?**

In today's context, we have had to make certain tough calls to ensure positive reserve management returns, because the US Federal Reserve has brought down their short term interest rates to almost zero, and the European Central Bank now has a negative interest rate, in order to stimulate their struggling economies. It is therefore a very challenging international arena for reserve management. But, even in those challenging circumstances, our reserve management teams have done well, and they have provided us with some satisfactory returns. We have an excellent team who has received training from all over the world, and they have been exposed to the most advanced levels of investment techniques. That is why they have been able to earn positive returns for the country.

**The lending rates in the market have still not adjusted in line with the decline in the deposit rates and corporates have resorted to alternative sources of financing. Can you explain to us the reasons behind this?**

If flour prices go up, the bread prices will be increased immediately. But, if the flour prices come down, bread prices will not be reduced so quickly. In the field of banking also, this happens. When inflation comes down, and interest rates reduce, you would find that banks are not so eager to reduce the interest rates as much as they should. They would, of course, promptly reduce the deposit rates, but the reduction in the lending rates come a lot slower. We have highlighted this situation on a couple of occasions, and in fact, in the last monetary policy statement, we gave a clear message that we would wish to see lending rates coming down quickly, because there is now reasonable space for a further reduction. Hopefully, that reduction will take place soon. If that does not take place, then we have to resort to other instruments and tools to persuade the banks to reduce rates, so that there is a fair economic environment.

**Our Economy Is Expected To Grow Fast, And In That Growth Model, We See The Need For Strong Financial Institutions In The Future. To Achieve That Objective, There Will Need To Be A Consistent Organic Growth Of The Banks And NBFIs, As Well As Greater Synergies Created As A Result Of Mergers Between Institutions.**

We think the banks will now take heed of our message, and reduce their lending rates, particularly the long term lending rates, so that people who are doing

business will be able to approach their business decisions with less risk, lower interest rates and greater confidence.

**The consolidation of the financial sector is seen as a move in the right direction, can you elaborate on the thinking behind this?**

We are of the view that Sri Lanka's banks and non-bank financial institutions (NBFIs), need to be stronger, more stable and bigger, in order to be able to serve their customers better, particularly in the context of Sri Lanka becoming a 100 billion US dollar economy in the next few years. As we have repeatedly said, our economy is expected to grow fast, and in that growth model, we see the need for strong financial institutions in the future. To achieve that objective, there will need to be a consistent organic growth of the banks and NBFIs, as well as greater synergies created as a result of mergers between institutions, which would help the sector to become stronger and more stable. That was the idea behind encouraging the finance companies to be acquired by banks, or to merge with one another. The banks too were expected to seek ways and means by which they could merge with each other, or develop relationships with other financial institutions. That was the rationale behind the consolidation plan, and we believe that will make Sri Lanka's financial system one of the most stable systems in the world.

Many outside independent and knowledgeable observers and experts have stated that they find this initiative of great interest, particularly because many other countries went through such a consolidation process, only when they were in trouble. Countries have usually done this when their economies were in turmoil or if their banking sector faced collapse. Unlike them, Sri Lanka is implementing this initiative at a time when the economy is stable and when it can make those adjustments without too much difficulty or stress. In that sense, Sri Lanka will be a role model for the future, and many multilateral institutions have offered their support as well as their finances towards making this initiative a success.

**Can you compare how we were in 2005, and today, and what we can expect in the future?**

In 2005, we were in serious turmoil. Our country was plagued with terrorism; macro fundamentals were in tatters; debt levels were soaring; inflation was unacceptably high; growth was sluggish. There was nothing positive that we could go out and talk about. Now, everything has changed. Peace has dawned; there is optimism; our macro fundamentals have moved in the right direction; our

debt is under control; infrastructure has improved beyond belief. These changes constitute a dynamic and continuous process, and there are regular and constant improvements. All this makes our country a very interesting destination for investment. Over the next two decades, the landscape of the entire country will change further. Already we see that happening in Colombo. The way our people will think and work will also change in time to come.

There have also been enormous changes that have taken place in our country, which have not been acknowledged or recognised sufficiently, so far. Take the Northern Province. If anyone goes there, they will not be able to even imagine that there was a conflict, just five years ago. In the same way, there has been massive improvement in all corners of our island. If we are practical and honest, we will readily acknowledge these improvements. However, we have to understand that we still have a long way to go, and that will be the challenge for the future.

**There is a question as to whether this amount of development is necessary at this time. What are your thoughts on this?**

Every country needs good infrastructure and continuous improvement in all spheres of activity. If you want to compete globally, attract tourism and investment, the road network has to be developed; there has to be good transportation; the people have to be well educated and smart. All these are very important. In my view we still have not reached the required level and there is more to be done. In this context, I find it strange that some people are still questioning about the need for continuous development. I have also heard some rumblings in this regard and so, let me deal with some of the reactions I have heard.

In the use of the number of hotel rooms, sometimes there is a concern that there is an over-supply of rooms. According to our current projections, we need to cater to 2.5 million tourists by 2016. But, we need to understand that the industry does not come to an end in 2016, and hence we have to project for 2020 and beyond. Projects cannot happen overnight. To build a hotel, it takes more than three years. There is a certain gestation period. Take another example, the old Colombo Port is 700 years old, and it was only in the last 2 years, that it was working at full capacity. 700 years ago, if someone had said that we do not need such a large port, and did not build it, then we would not have had a Colombo Port today.

Further, is the Galle Road adequate for our traffic today? No. But, when I was a child, only a few cars used to ply on the Galle Road. Fortunately however, at the time it was built, it was done with the long term in mind. Today, we are benefiting from that. Actually today, we are even saying that the Galle Road is not enough. Even the roads and infrastructure that we are building today may not be sufficient in 40 or 50 years. That is why we have to take a pragmatic and long-term call on these matters.

At the same time, if we are to create jobs on a consistent basis, we have to have sound infrastructure, IT and a well-educated and trained younger generation. We have to strive to create a higher standard of living for our people. We must get out of the mindset of being a small country that is poor, where people must suffer. We have to get over the mind-set that was instilled in our minds by the colonial powers that they were superior, and we are inferior. I think they still try to do that at times! Let us remember that we are a proud nation and develop a new and stronger attitude.

**In 2005, President Rajapaksa Promised That He Will Make Sri Lanka A New Sri Lanka. He Has Already Done That And More. We Have To Acknowledge That. The Next Ten Years Will Unfold A Huge Opportunity To Build On That Foundation.**

Sometimes I find that the same people who are saying that there is too much rapid development now, go abroad and then say that those countries are very nice. But, strangely, they do not seem to want the people of our own country to enjoy the same benefits!

If we continue on this development journey we will be able to make Sri Lanka a much better place in the next few years. In 2005, President Rajapaksa promised that he will make Sri Lanka a new Sri Lanka. He has already done that and more. We have to acknowledge that. The next ten years will unfold a huge opportunity to build on that foundation.

**As Sri Lanka moves towards becoming a developed country, can you elaborate as to the structures that would be put in place to ensure monetary and financial stability?**

We have taken many measures to ensure that Sri Lanka has a stable economy that the systems are strong and the banking sector is stable. All these factors will



ensure that Sri Lanka will move forward with a greater level of confidence. At the same time, we have taken many measures to improve the productivity as well as the opportunities within our economy. We are developing the five new hubs; maritime, aviation, knowledge, energy and commercial, while tourism is growing fast. All additional activities are also doing reasonably well, and are well supported with better quality infrastructure. All that has been done to create a greater level of economic activity in the country. This new momentum will help us to move towards a USD 4,000 per capita income soon, and in fact, according to our current assessments, we will reach the USD 4,000 per capita income level by 2015. We are now also making plans for 2020, by which time we are hoping that we can move our economy to a per capita income of over USD 7,000. If we were to move with clarity like what we are doing now, there is no reason why we should not become an advanced economy by around 2040. Our current estimates show that by about 2040, we could very well be an advanced economy, which will be a massive change, since we will then be recognised as one of the world's higher income nations. That is what we should all work diligently towards, and unfold that exciting future for our country.

**We Are Now Also Making Plans For 2020, By Which Time We Are Hoping That We Can Move Our Economy To A Per Capita Income Of Over USD 7,000. If We Were To Move With Clarity Like What We Are Doing Now, There Is No Reason Why We Should Not Become An Advanced Economy By Around 2040.**

When we were kids, we could not, even in our wildest dreams, imagine that Sri Lanka will ever become an advanced economy. However, the younger generation of today can look forward to our country reaching an advanced economy stage in just over 25 years. We now have the confidence to predict that we will be an advanced country, and take steps to make that happen.

**The thinking is well beyond five years?**

Of course. That is the way a stable country has to operate. At the time I was appointed as the Governor of the Central Bank in 2006, the government used to issue treasury bonds with a term of about three years only. But today, the government issues treasury bonds for 30 years! That is because there are people who consider Sri Lankan treasury bonds as safe and stable long term investments, instead of a short term risk. They are confident about the country, and are also confident that Sri Lanka will continue to be a stable country. Their approach and

perception has changed because the government has demonstrated that it has the vision and the inclination to take decisions for the long term.

When we built the port in Hambantota or expanded the Colombo Port, those were not projects for two to three years, as some opposition politicians and some so-called good governance activists think. Those were projects for the well-being of generations to come. That is how infrastructure has to be built, and that is the way a country is positioned for the long term. The US Inter-state highways were built in 1954, but not many vehicles used those highways in the early days. Yet, they built it because that was the best time to build, while the land was relatively cheap. If they were to build those same highways now, it would be almost impossible to do so, because the land has become so prohibitively expensive. This type of development has to be done during the early stages of development of a country. That is what Sri Lanka is doing today. Previous governments neglected this vital need by giving all kinds of excuses, and that is probably why some people are asking whether we are doing the right thing, because it may seem astonishing to them to see this vast amount of development activities.

I tell you, we are doing the right thing, because if we do not build this country now, we will never be able to build. We all know that certain roads in Colombo cannot be expanded because the surrounding areas are already built up. That is what happens, when you leave it for too late. The current development is based on the long term vision that the government of President Rajapaksa has. This government has that vision and as we have demonstrated many times, we are prepared to take bold and well calculated decisions because we have a far sighted, bold and courageous leadership. We should continue developing on those lines, and if we continue to do that, Sri Lanka will be in a much better place and all Sri Lankans will be proud to show off the country as we will have a national pride. Even today, when a foreigner visits our country they marvel at the development, hospitality and the cleanliness of Sri Lanka. We must take pride in that. We must strive even further.

Let me also say that the international response to our country has been strong in terms of foreigners visiting Sri Lanka by way of tourism, or making investments. Except for a few individuals in a few countries who are reluctant to do so, because of a section of the diaspora that is inimical to Sri Lanka, all the other countries are extremely bullish about Sri Lanka. Even so, in this background, certain top investors of those countries that are sometimes showing signs of adversity to Sri

Lanka are very bullish about our economy and our country.

This new attitude reflects the new brand of Sri Lanka. This new brand has been very helpful to bring Sri Lanka to a new level of growth, because earlier the Sri Lanka brand was that of a country that was in conflict, without good macro fundamentals. But today, the situation has completely changed. In fact, Lonely Planet and New York Times have recently said that Sri Lanka is one of their top destinations. Investors are also making massive FDIs, which is easily six or seven times, what they used to invest previously. Such sentiments were echoed recently by the famous author, Ruchir Sharma who termed Sri Lanka as one of the new “breakout nations”.

These are all important indicators that our country has improved tremendously and, consequently we are now finally able to project ourselves to the world with pride. Last year, Sri Lanka hosted the Commonwealth Heads of Government Meeting. It was not a very easy meeting to host, but it went smoothly without a single blemish. That also confirmed that we have very capable people, and that is what we have to highlight.

**The Recent Work That Has Been Done, And The Growth We Have Achieved Have Been Exemplary, And Out Of All The Countries In The World That Have Had Conflicts In The Past, Sri Lanka Has Displayed The Most Extraordinary Achievements, In A Comparatively, Short Period Of Time.**

**Any final thoughts?**

We now have the opportunity to further improve the productivity levels and the work ethic of our country. Over the past several years, it has improved dramatically and that has been a very important facet of our country’s overall development. However, going forward, we must put in more work, and thereby ensure that Sri Lanka will continue its re-branding exercise. We must also show to the world, that we are a reconciled nation, and a country where we have left the agonies of the past behind. That will be a challenge that we will have to continuously work on. The recent work that has been done, and the growth we have achieved have been exemplary, and out of all the countries in the world that have had conflicts in the past, Sri Lanka has displayed the most extraordinary achievements, in a comparatively, short period of time. Even in the midst of such

remarkable achievements, it is very unfortunate that some countries take it upon themselves to try to “lecture” to us. I think, instead of trying to impose their so-called values on us, they need to solve their own problems which need their immediate attention. I also think it is about time that they realise we are a mature nation with a 2,500 year history, and that we are quite capable of sorting out our own issues at a pace that the people of this country are comfortable with.



