



Electricity tariff hike drives up inflation

Headline inflation accelerated to 7.3 percent in May from 6.4 percent in April largely due to the electricity tariff hike.

Inflation, as measured by the Colombo Consumers' Price Index (CCPI) (2006/07=100) computed by the Department of Census and Statistics increased to 7.3 per cent on a year-on-year (YoY) basis in May 2013 from 6.4 per cent in the previous month, the Central Bank said.

The inflation rate on an annual average basis remained unchanged at 8.8 per cent in May 2013 as recorded in the previous two months.

Core inflation, excluding food and fuel prices, on a YoY basis decreased to 5.7 per cent in May 2013 from 6.1 per cent in the previous month while it increased marginally on an annual average basis to 6.6 per cent in May 2013 from 6.5 per cent in April 2013.

The CCPI increased by 2.3 per cent in May 2013 over the previous month, with the Index increasing in absolute terms to 173.9 from 170.0 in April 2013.

"The contribution to the monthly increase in the Index came mainly from price increases in the Non-Food category by 3.7 per cent. Within the Non-Food category, prices increased in the sub-cate-

some support to growth toward the end of this year, but a further significant easing with the aim of quickly rekindling high growth would jeopardize inflation reduction efforts," the IMF said in a staff report released last month.

The IMF has commended the government's move to adjust electricity and fuel prices, but said vulnerable groups in the country needed adequate compensation.

"These companies' (CEB, CPC) large losses are unsustainable. At the same time, electricity prices are high by regional standards. A comprehensive approach is required, including better management, lowering electricity generation costs, raising efficiency, and moving toward cost-recovery pricing, followed by adoption of an automatic price adjustment mechanism. Staff also emphasized the need for targeted social protection measures to mitigate the impact of higher prices on the poor," the IMF said.

Economists and opposition lawmakers have also argued that the government has revised tariffs without implementing crucial reforms at the Ceylon Electricity Board, placing the entire burden from the correction on users.

"There were two ways in doing this: One was to adjust electricity prices and

gories of Housing, Water, Electricity, Gas and Other Fuels (by 9.9 per cent); Recreation and Culture (by 2.7 per cent); Miscellaneous Goods and Services (by 0.4 per cent); Education (by 0.2 per cent); Clothing and Footwear (by 0.1 per cent); and Furnishing, Household Equipment and Routine Household Maintenance (by 0.1 per cent)," the Central Bank said.

"The increase in the sub category of Housing, Water, Electricity, Gas and Other Fuels was totally due to the impact of the upward revision in the electricity charges with effect from 20th April 2013.

"Meanwhile, the prices in the sub-categories of Health; Transport; and Communication were unchanged during the month. Further, the prices in the Food and Non Alcoholic Beverages sub-category also recorded an increase of 0.6 per cent in May.

"The price of most varieties of vegetables, fresh fish, chicken, red onions, limes and milk powder increased during the month. However, a decrease in the prices of some varieties of fruits, eggs, big onions and sugar was reported," the Central Bank said.

The Central Bank last month said inflationary pressures would ease during the coming months. It eased monetary policy rates by 50bps since November last year so as to boost economic growth.

The International Monetary Fund has cautioned the Central Bank against easing monetary policy because inflation risk was elevated.

"Monetary policy should remain on hold until firm evidence emerges that inflation pressures will decline. Staff supports the authorities' goal of reducing inflation to mid-single digits, important for strengthening policy credibility and macroeconomic stability. However, elevated inflation, rising wage demands, and prospective energy-price increases tilt inflation risks to the upside. The recent easing of monetary policy should provide

two, reform the CEB where supply side problems such as generation, transmission and distributional losses were contained. Ideally it should have been a combination of both," Institute of Policy Studies Executive Director Dr. Saman Kelegama told a forum in April.

Over the years the Ceylon Electricity Board has sustained massive losses, reaching almost 1 percent of GDP in 2012. Losses at the CEB grew 217 percent to Rs. 61.2 billion in 2012 from Rs. 19.3 billion a year earlier. CEB's short-term borrowings from banks, other outstanding liabilities to the Ceylon Petroleum Corporation and to Independent Power Producers (IPPs) amounted to Rs. 137 billion while long-term outstanding liabilities stood at Rs. 296 billion as at end 2012.

Containing losses at both the CEB and CPC (where losses fell 5 percent to Rs. 89.7 billion in 2012 from Rs. 94.5 billion a year earlier) were seen as crucial steps in tackling long standing structural imbalances in the economy.

Standard Chartered Bank believes the Central Bank would not ease monetary policy rates further after the surprise 25bps cut last month.

"We believe the CBSL will keep the repo rate at 7.00% until at least Q1-2014, in line with our original call for 50bps of rate cuts by year-end. The IMF called for policy rates to remain on hold, as building economic stability on low inflation is paramount; it had previously cautioned the central bank, stating that inflation is not rising at an 'unduly worrying rate' and controlling the cost of living should remain the priority. In our view, this rate cut is aggressive but it sends a clear signal that growth concerns override inflation risks, while also reducing the likelihood of further rate cuts in 2013," Standard Chartered Bank said in its 'Economic Alert: Sri Lanka - CBSL to pause after aggressive rate cut' released last month.

