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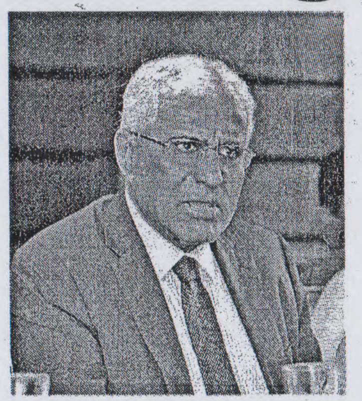
Central Bank cuts economic growth to 3%

- Expects growth to accelerate in 4Q
- Private sector credit contracted by Rs 2.6 bn in May
- Governor stresses on structural reforms to achieve desired growth

By Nishel Fernando



Central Bank Governor Dr. Indrajit Coomaraswamy. Pic by Kushan Pathirajah

The Central Bank (CB) yesterday cut the economic growth to 3 percent for the year from the earlier projected 4 percent, as the Easter Sunday attacks adversely impacted the economic activities.

"After the Easter Sunday bombings, we revised the growth to 3 percent from the original 4 percent projection early this year. I have seen some projections which have been much more gloomier as below 3 percent, and I think it's overdone," CB Governor Dr. Indrajit Coomaraswamy said.

He acknowledged that the GDP growth in the second quarter will be disappointing. However, he noted that the growth would accelerate in the fourth quarter growing from a low base.

"In the first quarter there was a 3.7 percent GDP growth, certainly the second quarter is going to be disappointing. However, for fourth quarter, there are very favourable benefits. In the fourth quarter of last year, the growth was 1.8 percent, and that will provide a base effect which will become favourable this time around," he elaborated.

The Governor also pointed out that the tourism sector, which was impacted by the Easter Sunday attacks mostly, is recovering faster than expected.

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According to CB data, the tourism earnings declined by 13.4 percent YoY to US$1.9 billion from January-June.

He emphasised that restoring sentiment and confidence will be crucial for full recovery from the economic impacts of Easter Sunday attacks.

"The macroeconomic fundamentals are in good shape, we just have to get the positive sentiment and good confidence restored," he said.

Further, he stressed on the implementation of structural reforms to reach desired economic growth.

Speaking on the impact of current drought experienced by some parts of the island, Dr. Coomaraswamy said that it was too early to assess the impact while noting that it is likely to lead to an increase in oil imports as hydropower generation has already come down.

In May, the private sector credit contracted by Rs. 2.6 billion in absolute terms resulting in a cumulative decline of Rs. 19.6 billion during the first five months of the year. The private sector credit growth decelerated to 9.2 percent YoY by end of May from 15.9 percent YoY at the end of 2018.

The Governor noted that settlements of arrears worth of Rs. 100 billion was a contributing factor for the contraction in private credit during first 3-4 months of the year.

He stressed that the CB would continue to exert pressure on banks to cut market lending rates to reflect the policy rate cut in May and the imposed deposit rate caps.

Speaking on the possibility of imposing lending rate caps on banks, Dr. Coomaraswamy said the CB observed sufficient movement in lending rates to be patient.

The CB also expressed concerns over rising NPL ratios in the banking sector, which have risen to 4.8% at the end of June. "We need to be more cautious and monitor carefully," Dr. Coomaraswamy stressed.

He called the NPL ratio of banking sector in the "amber light stage" and not reached the alarming levels.

The NPL rates for non-banking financial institutes have risen to 7.6 percent from 5.8 percent at the end of March.

The CB also expressed concerns on fiscal slippage due to impacts of Easter Sunday attacks, compression of imports and low level of economic activities, while noting that it was key when deciding against further relaxation of monetary policy. During the first four months of the year, the country's fiscal deficit already widened by Rs.112.8 billion YoY to Rs.363.4 billion, driven by a significant decline in revenue from the import-based taxes and excise duties.

On a positive note, Dr. Coomaraswamy highlighted that the country has achieved a current account surplus in the first quarter of this year, after a decade.

Despite the low growth environment, he insisted that the current account surplus was a considerable achievement.

In the first four months of the year, the trade deficit narrowed by US$ 1.5 billion to US$ 2.5 billion from US$3.98 billion compared to corresponding period in 2018.