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Statement by the Hon. **SARATH AMUNUGAMA**,
Governor of the Bank and the Fund for **SRI LANKA**

**Statement by Hon. Dr. Sarath Amunugama,
Governor of the Bank and the Fund for Sri Lanka**

Mr. Chairman, Fellow Governors, Ladies and Gentlemen

At the last Annual Meeting, we expressed our concern about too slow global recovery, particularly in advanced economies. Unfortunately, after one year there is more uncertainty and recovery is slower than expected in advanced countries in addition to growing turbulence in the euro area and the US. Sovereign debt crises are emerging in the euro area and its contagion effects could spill over to other regions as well. Sovereign risks have already spilled over to banks in the euro area and as a result some have lost access to private funding markets. This has raised risks of severe credit contraction with further negative consequences on recovery. The political impasse over fiscal consolidation in the US has increased the uncertainty of the pace of recovery, investor and consumer confidence without any positive signs such as reducing high level of unemployment and improvements in housing markets and household debt overhang. We are more concerned about the emerging crises than in the past as there is hardly any space for fiscal policy in advanced countries to support recovery in view of looming debt vulnerabilities. Monetary policy has limited space with interest rates already at historical low levels in advanced countries and quantitative easing has failed to deliver desired results. In this environment, emerging market countries have a very limited role in rebalancing acts – shifting from public to private demand and from external to domestic demand – unless advanced countries resort to coherent policy actions to reduce sovereign risks and prevent contagion while strengthening the resilience of their financial systems.

Mr Chairman, let me now turn to my country, Sri Lanka. Sri Lanka continues to reap peace dividends after ending the three decade long war against terrorism. The economy grew by 8 per cent in 2010 which is the first full financial year after conclusion of the war. There is strong evidence of continuation of the growth momentum in 2011 and beyond as the first half of 2011 also grew by 8 per cent. International investor confidence on Sri Lanka has been improving steadily. International rating agencies upgraded Sri Lanka's sovereign ratings and revised outlook in a positive direction in the second consecutive year. Despite some turbulence in international capital markets due to concerns on sovereign debt vulnerabilities in advanced countries, the Sri Lankan government was able to raise capital from international capital markets at historically low rates, reflecting renowned investor confidence on Sri Lanka due to improving macroeconomic fundamentals and political stability. Relatively high fiscal deficits and double digit inflation were the main macroeconomic issues resulting in high levels of public debt, high interest rates and unstable currency was experienced by Sri Lanka in the past particularly during the period of the conflict. Prudent monetary and credible fiscal policies that were implemented by my government have helped bring down inflation to a manageable level and maintain single digit inflation since 2009. The fiscal consolidation process has steadily brought down fiscal deficits from 10 per cent of GDP in 2010 to below 7 per cent in 2011. Our medium term macroeconomic programme targets further fiscal consolidation aiming at bringing down debt to GDP ratio below 60% by 2016 as compared to above 100 per cent of GDP in 2004. Improved macroeconomic management has helped stabilize both the interest rate and exchange rate which are conducive for higher investments. The healthy external sector

performance was reflected in a less volatile exchange rate, while post conflict productivity gains helped maintain competitiveness. The private sector is responding positively to emerging economic opportunities arising from permanent peace and greater integration of the Northern and Eastern provinces with the main stream economy of the country. Private sector credit is currently expanding at around 30 per cent reflecting renewed investor confidence compared to negative growth experienced in the recent past. Such a rapid credit growth is not likely to create excessive demand in the near future as the country now has enhanced capacity to absorb excess demand supported by major infrastructure development programmes commenced under the leadership of His Excellency the President Mahinda Rajapaksa. Completion of major infrastructure projects such as ports, airports, major road and railway networks integrating the lagging regions, building new power plants providing electricity to reach 100% coverage supplement the role of the private sector for enhanced investments in new opportunities such as tourism, internal and external trade, port and airport related services, banking services, BPO and educational services. These are key elements of positioning Sri Lanka as a maritime, aviation, energy, knowledge and commercial hub in the region as envisaged in the vision of my government.

Mr Chairman, let me now explain briefly the progress we have made in the post war resettlement, reconstruction, rehabilitation and reconciliation process. During the last phase of the war, our armed forces rescued 290,000 civilians used by the terrorists as a human shield. More than 95% of these internally displaced people have been resettled by now and the remainder will be resettled once the demining process is completed. In addition, 11,644 ex-LTTE combatants surrendered or were arrested at the end of the conflict. Of these

detainees around 6500 have already been rehabilitated. My government is implementing a comprehensive infrastructure development programme specially targeting the Eastern and Northern provinces where infrastructure facilities were lagging due to the war. In the process of political reconciliation, the government has already conducted local government elections in both conflict affected provinces and provincial elections in the Eastern province.

Provincial elections for the Northern province will be held in the near future in order to establish an elected provincial administration. In the meantime, the government has commenced a dialogue with Tamil political parties with a view to forming long-term constitutional, legal and democratic reforms for sustainable peace. In the process of reconciliation, the Lessons Learnt and Reconciliation Commission (LLRC) commenced its work in August 2010 and is making a good progress. Some interim measures recommend by the LLRC have already been implemented and the full report is expected within next 6 months. For example, some of the remedial measures include the reduction of high security zones, release of a large number of ex-combatants, resolution of land disputes, disarming paramilitary groups. In addition the government has lifted emergency regulations which were in effect during almost entirely during the last three decades.

We continue to benefit substantially from assistance extended by multilateral and bilateral development partners and renewed confidence placed by international investment community in Sri Lanka. We look forward to strengthening these partnerships further.

Thank you.