Spotlight: Econ Op-eds in Summary

Week ended 02nd December '20

In Summary

The underneath contains summaries of the articles given above, including key extracts from these articles.

1. Growth prospects diminishing despite Central Bank's easy money policy
By: Professor Sirimevan Colombage

- Although a low interest rate environment can be positive for businesses, it hasn't resulted in a lot of benefit for private individuals as shown by low credit growth. Instead, it has mostly gone towards cheap borrowings for the government to repay domestic debt.

- However, this will not do much to alleviate the growth dilemma faced by the country this year. Targeted monetary action might actually be worse, since the sectors identified could be discretionary and politically motivated. Additionally, artificial capital controls could repress the financial sector's performance as well.

- Since current growth challenges began before the pandemic, Sri Lanka will need to develop its lagging growth drivers, including education, research, and technology use. This will enable the country to instil a faster recovery than predicted, and perform similarly to the knowledge-based economies of South East Asia.

The Central Bank will maintain its Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) at their current levels of 4.50% and 5.50%, respectively. The Central Bank also intends to introduce maximum interest rates on mortgage-backed housing loans for salaried workers and lending targets for selected sectors of the economy in the near future.

Paving the way to financial repression

While the Central Bank readily adopted monetary easing measures, the effectiveness of such measures in boosting economic growth is doubtful, as explained in my previous column in Daily FT (http://www.ft.lk/columns/Budget-2021-in-the-context-of-the-COVID-19-pandemic/4-709287).

To be fair, the Central Bank alone is not responsible for the impending growth slowdown, since various non-monetary factors such as human resource skills, knowledge inputs, technology infusion, competitiveness, efficiency, research and development (R&D), politics and institutions have a greater bearing on GDP growth. Given Sri Lanka's poor track record with regard to these growth drivers, the Central Bank does not have much space to play around with its monetary policy tools to foster economic growth.

Nevertheless, it is disturbing to note the Central Bank's intention, as declared in its latest monetary policy review, to reintroduce some obsolete direct credit controls for the sake of economic recovery amidst the COVID-19 crisis. Such controls were well-tested and found to be failed prior to economic liberalisation in 1977. Hence, the Central Bank abandoned those controls since then, and moved towards market-oriented monetary tools gearing to launch the flexible inflation-targeting (FIT) monetary policy framework about two years ago.

Reintroduction of direct credit controls is tantamount to a reversal of such market-oriented policy reforms, and such measures are likely to pave the way to financial repression.

Empirically, a major shortcoming of directed credit allocations targeting selected economic sectors, as envisaged in the monetary policy review, is that those sectors are chosen by the authorities at their discretion, mostly driven by political considerations rather than by economic realities. Hence, such directives tend to create market distortions and resource misallocations resulting in deterioration of efficiency and productivity pushing the economy further downward.

The interest rate ceilings to be imposed by the Central Bank for mortgage-backed housing loans too appear to be unjustifiable, as it is not clear how such concessions would contribute to tackle the current economic crisis, apart from helping to resolve housing problems of some employees who are already enjoying regular incomes in the organised sector. By contrast, thousands of workers in the unorganised sector are reported to have no means for survival due to the loss of their jobs and income-generating activities in the pandemic.

Monetary easing measures

The relief measures provided by the Central Bank to the affected households and businesses since the outbreak of the pandemic have been quite extensive. It has implemented a series of monetary easing measures including sequential reductions of the policy interest rates and Statutory Reserve Ratio – SRR (Figure 1). Such measures helped to inject substantial liquidity into the market and to reduce borrowing costs significantly.

Concessional credit schemes were also introduced to facilitate the activities of Small and Medium-scale Enterprises (SMEs), alongside debt moratoria granted for businesses and individuals distressed by the pandemic.

Private sector's response insignificant

In spite of the Central Bank's monetary easing, the year-on-year growth of bank credit to the private sector remained stagnant below 5%, whereas credit to the government rose by as much as 56% and credit to public corporations by 27% by the end of October 2020.

The Government seems to take the advantage of the low interest rate environment, as it can borrow at lower cost in the domestic market to finance its expanding budget deficit. The yield on 364-day Treasury Bills is down to around 5% at present, compared with 8% a year ago.

Negative GDP growth

The Sri Lankan economy experienced negative GDP growth rate of 1.6 % (year on year basis) in the first quarter of 2020 largely reflecting the combined effects of local economic disruptions caused by the lockdowns, curfews and travel bans compounded by the subdued global demand in the face of the pandemic.

According to the official forecasts, GDP growth rate in 2020 would decline to around -2.0%, compared with 2.3% growth in 2019. However, the IMF forecasts that the economy would contract by 4.6% this year, which is significantly higher than the contraction of 0.5 percent predicted in April.

Growth constraints beyond the pandemic

The economy was on a downward path even prior to the outbreak of the pandemic. The average quarterly GDP growth rate was only 3.8% during 2015-2019. Hence, the present growth slowdown cannot be totally attributed to the pandemic.

The low growth trajectory in the past reflects Sri Lanka's failure to develop the necessary pre-conditions to boost growth in line with the evolving growth paradigms. Knowledge, innovation, technology and entrepreneurship have become the key drivers of economic growth in the modern world, in addition to the inputs of labour, land and capital which were prominent in the conventional growth models.

The countries that have been able to progress towards the status of 'knowledge economy' accelerated GDP growth fast, as evident from the success stories of East Asian countries. Such an economy is characterised by high value-added products containing advanced knowledge inputs. Sri Lanka has a long way to achieve the knowledge economy status, and as a result, her growth potential will continue to remain low in years to come, irrespective of the monetary easing policy stance.

Reintroduction of outdated monetary policy tools will only create financial repression further damaging the situation.

For the full article – Refer Daily FT

2. Future of our economy and nation will be what we make of it: Hans
By: Dr. Hans Wijesuriya

- The post-COVID recovery needs to be based on the effective execution of a public-private shared vision for economic revival. This should be driven by three principles. Namely, the protection of life and livelihood, achieving a V shaped economic recovery and the need for bold and innovative measures.

- In taking action towards these goals, fiscal consolidation, maintenance of macro-stability and increasing sector competitiveness in a context where global trade is being reconfigured in favour of domestic production should be some of the priorities for the government. It is important for the private and public sectors to work together towards these.

- These factors become especially important in a world of changing technology. This would create the enabling environment to allow businesses to take advantage of the lower interest rate environment and budget 2021 incentives to drive the engine of growth towards achieving this shared vision for economic revival.

Post-COVID economic revival – public-private shared vision

The year 2020 and the COVID-19 pandemic have inflicted on our nation and the world at large – economic, social and life impacts of unprecedented proportion. Sri Lanka in particular was on the cusp of recovery from the Black Swan event of Easter 2019 only to be faced with the COVID-19 crisis.

The Chamber has espoused the view that an accelerated post-COVID recovery will be predicated on the effective execution of a Public-Private shared vision for economic revival and social sustenance. A vision based on three founding principles.

First, people centricity: Primacy for the protection of life and livelihoods whereby Sri Lanka's employment, human development and socio-economic indicators are secured as an immediate priority.

Second, the ambition of a 'V-shaped' – take-off.

Third, the need and appetite for exceptional, bold and innovative measures which include exceptional stimuli, restraint and calibration to enable the regeneration of growth.

Private sector an equal partner in economic revival

It is our view that the private sector is an equal partner in securing an accelerated economic recovery.

Sri Lanka's private sector has been quick to transform, commencing with employment preservation via adjustment of production and service portfolios alongside the retraining and redeployment of human capital. Equal focus was directed at re-engineering supply and value chains with primacy for domestic supply eco-systems and the sustenance of SMEs.

The private sector has demonstrated that leading the resurgence as opposed to hoping for brighter externalities can deliver transformative results.

Post-COVID outcomes – emboldening results

We congratulate the Government on the management of the economy through these exceptional times – in particular the structured approach underlying the country's economic revival framework. Specifically, the calibration of export and import trajectories has enabled stability with respect to macro indicators such as the trade deficit, balance of payments, currency and reserves ratios.

A sharp export recovery to levels on par with the previous year stands testimony to the resilience of Sri Lanka's export sectors, and the effectiveness of the revival strategies adopted by the government and the private sector. It is emboldening to see the recovery of both traditional and non-traditional exports and the diversification of the export basket which augurs well for the period ahead.

External-internal inter-play: Challenging terrain for vertical take-off

On the global front assumptions and expectations continue to be disrupted. Responses of governments, markets and trading blocks to the multiple waves of the pandemic, challenge us with a volatile external environment.

In Sri Lanka's context, the runway for take-off is by no description a straight line nor smooth in terrain. **B**alancing between growth and debt among others, will require precise navigation.

Equally, the synchronisation of key policy levers across fiscal, monetary, investment, industrial and social development spheres will be pivotal in securing stability while achieving accelerated growth. From among the recovery levers, FDI and Export growth will be pivotal and have been duly prioritised in the Budget 2021.

Doubling down on internal development levers

While the dynamics of external economic levers remain uncertain, building our own certainty by leveraging internal resources is a fundamental tenet of accelerated economic revival. The centre of gravity therefore shifts towards the competitiveness of domestic industries.

The reconfiguration of global trade and the re-emergence of local commerce will no doubt create opportunity for nations and companies to punch above their weight through the leverage of skills, technologies and enabling policy environments.

Shifting the centre of gravity in the direction of domestic production and resourcing, will recalibrate outflows to be more in synchronisation with inflows,

External sectors – Reshaped for the new normal

Equal emphasis needs to be applied to the external sectors in preparation for the progressive relaxation of travel and trade restrictions. A topic addressed at this year's summit will be the resurgence of tourism within the context of the new normal with specific focus on the resurgence of livelihoods across the tourism value chain. The transition of the remarkable recovery trajectory of the export eco-system to a sustainable long run growth gradient remains of overarching importance, in order for our economy to reach the cruising altitudes of 7% growth within the next five years.

Export growth will be predicated on the flow through of domestic production outcomes to the competitiveness of the nations' external facing manufacturing and services sectors. The protection and refreshing of the inward remittance flow through the diversification of knowledge service exports will also be pivotal in bolstering the growth curve.

Economic revival and middle income escape – two-pronged challenge

Our economic growth before and through the COVID crisis ranks among the lowest in the SAARC region, indicative in absolute and relative terms of the confines of the middle income trap, a condition prevalent over the past several years.

We therefore have on one hand the challenge of achieving vertical take-off from the the COVID-19 downturn while on the other, having to navigate an escape from the middle income trap.

Achieving both these objectives while operating within a very tight fiscal space and perfecting the balancing act between growth and debt is a multi-faceted challenge that the private sector and public sector needs to embrace together.

Focus on balanced sectoral growth

Sectoral growth will be dependent on the establishment of fundamental enablers such as energy, digitisation and SME facilitation.

High return on deploying policy levers

We believe that the judicious application of the policy levers available to Government will deliver disproportionate returns. Efficient and timely execution of mega projects would also move the needle. Productivity and efficiency, will be pivotal in converting Policy in to execution and ultimately in the delivery of growth.

Policy and reform agendas are required with respect to trade, labour, public sector and SOEs, capital markets and targeted welfare among others.

Empowering take-off – The role of Government

The battle against COVID has demonstrated the systemised capacity of the Government and public sector. This capacity and potential spans process, systems and people. The expectation of Government would be to convert this systemised capacity and potential in to the delivery of a step change in economic value creation.

A parallel call on Government would be for a high degree of commitment towards the strengthening of fiscal and monetary disciplines, maintenance of macro stability and the elevation of sector competitiveness alongside a progressive approach to global market access.

Staying the course of fiscal consolidation will be pivotal in maintaining positive sentiments of Global Rating agencies as well as in motivating foreign direct investments which together will bolster the sources and cost of capital require to drive growth.

Winning in an era of exponential change

Three mega trends in particular will have a defining influencing on this future.

The First Megatrend – the 4th Industrial Revolution is centred on the democratisation and exponential broadening of the affordability and availability of technologies such as Cloud, Artificial Intelligence, Robotics, 5th Generation Networks and the Internet of Things.

Technology applied correctly has the power to bridge asymmetries in opportunity, eliminate disparities in the access to basic human. These technological advancements will also provide the opportunity for smaller nations to catch up with the legacy dominions and likewise for single country businesses to reach out and be globally competitive.

Technology advancement with respect to connectivity, digitisation and automation will enable the second megatrend – the power of eco-systems and pervasive globalisation

For the full article – Refer Daily FT