

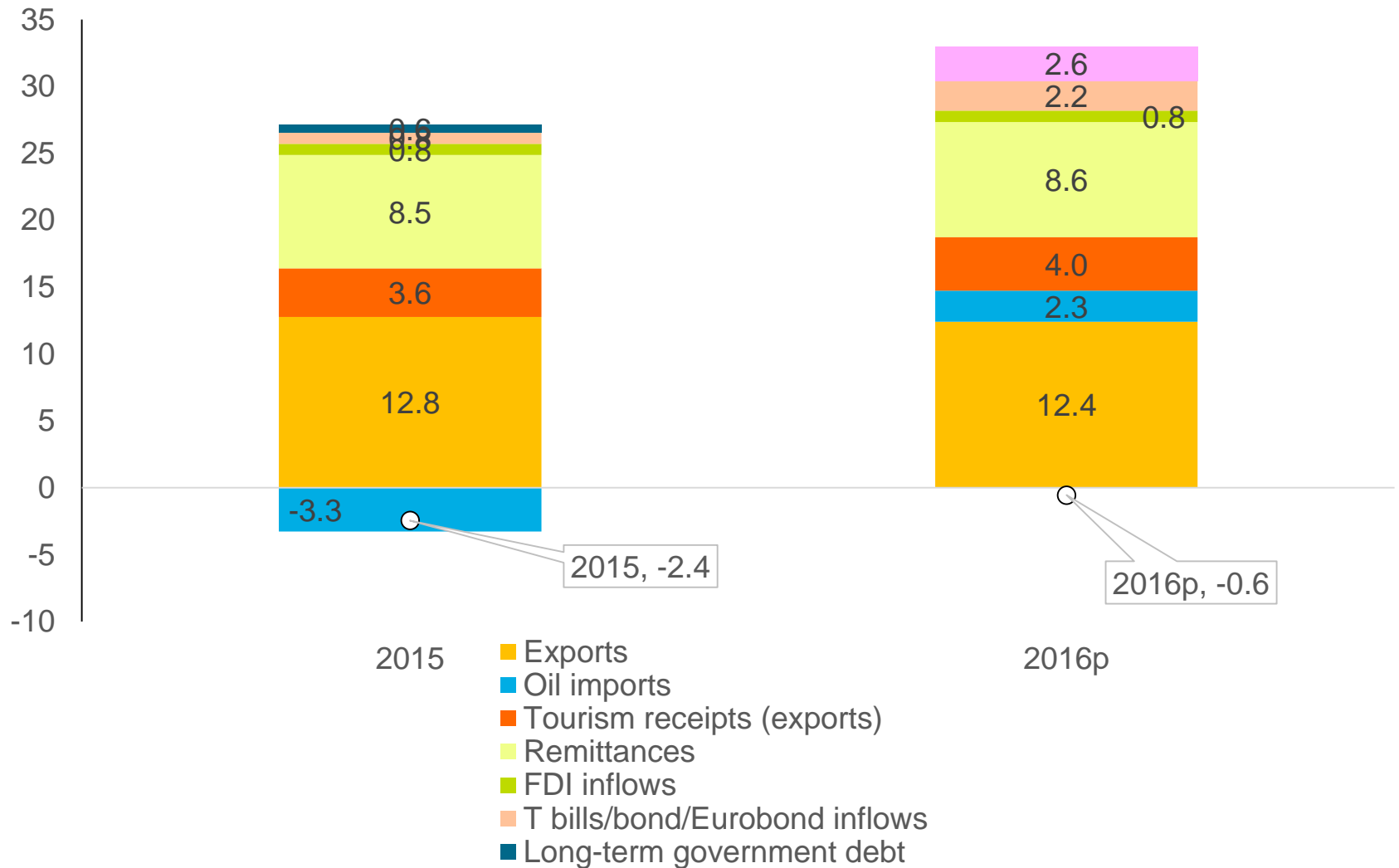
# Outlook & State of Play in Key Economies

LBR LBO Debrief, November 29,  
2016

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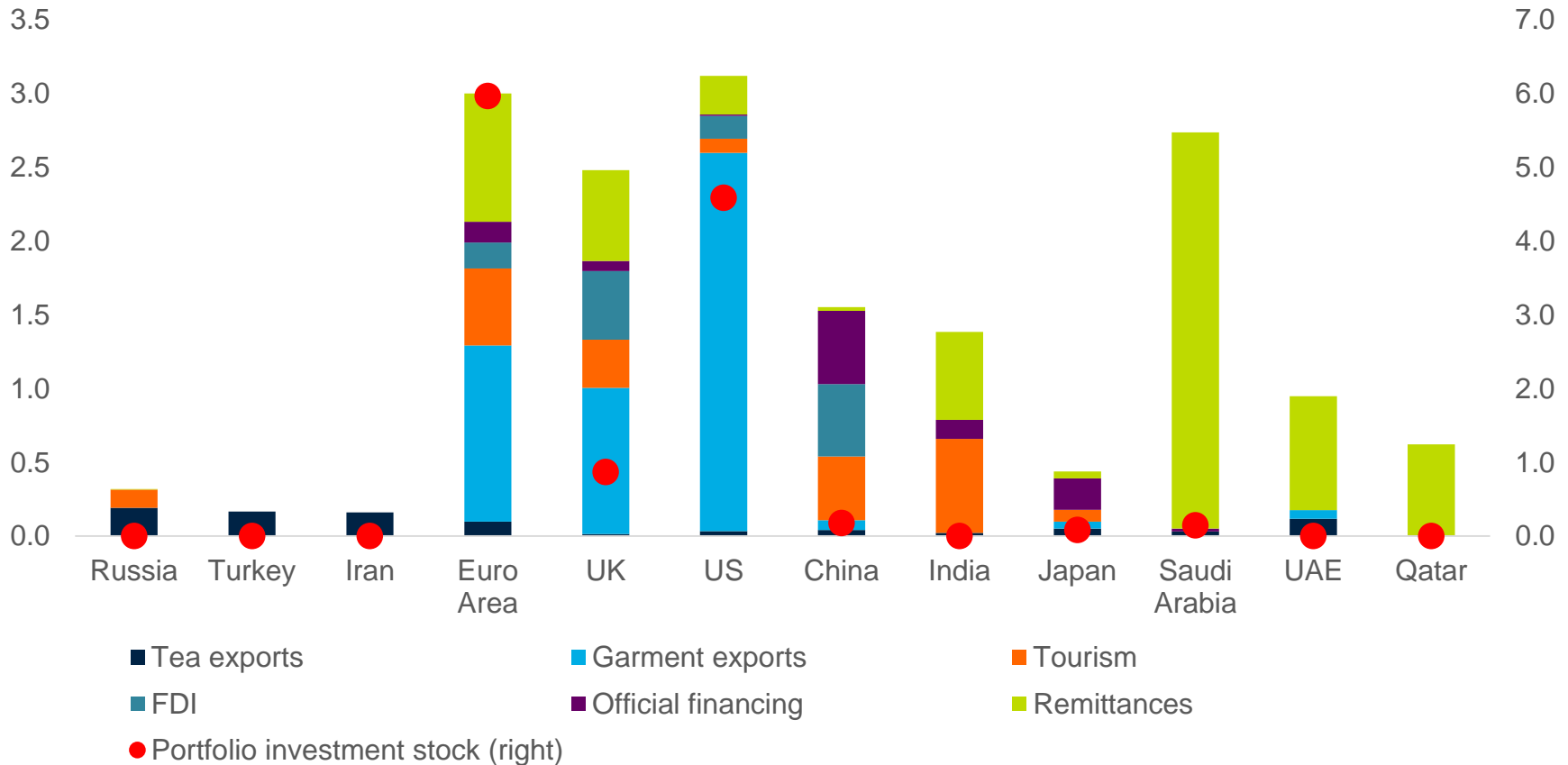
# Sri Lanka depends on exports, remittances, debt inflows



Source: Central Bank of Sri Lanka, WB projections

# Key economies for Sri Lanka

Sources of FX by type and country, % of GDP 2015

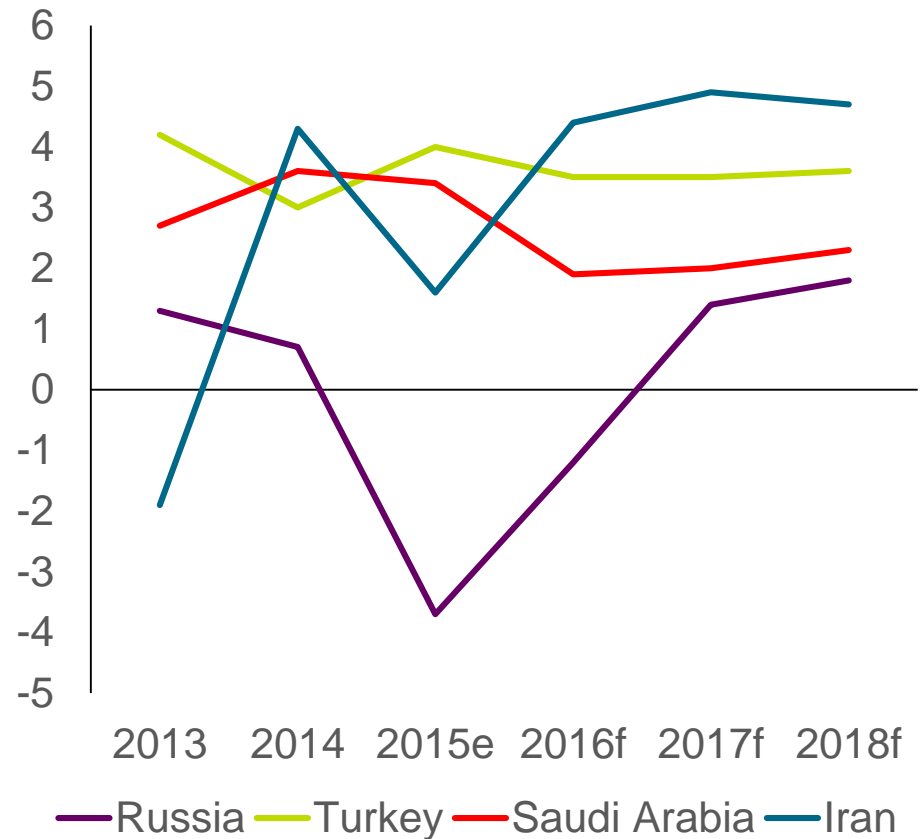
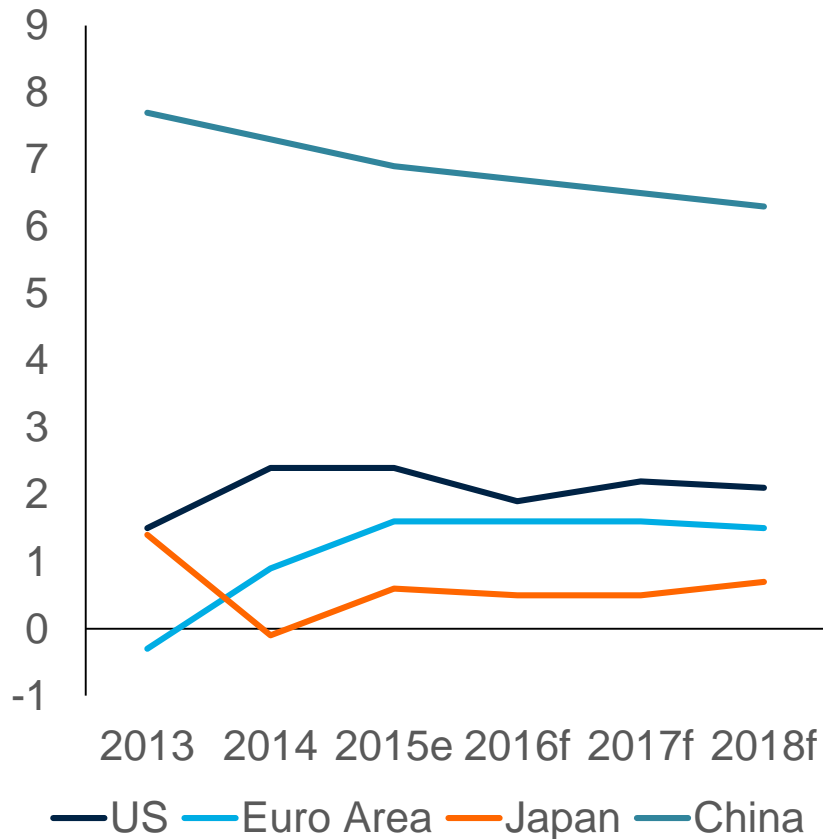


Source: CBSL (exports of garments and tea, tourism: gross tourism receipts proportionally distributed by arrivals, official financing), BOI (FDI flows), World Bank (remittance flows), IMF CPIS (portfolio investment stock)

# Main messages

- Advanced economies continue to be afflicted by weak growth and very low inflation, amid rising uncertainty about future policy direction.
- Growth projected to recover somewhat in 2017-19, although EU referendum outcome in UK and election results in US add policy uncertainty weighing on growth
- Ongoing transition in China from investment to consumption, recession in Russia bottoming out
- Commodity prices gradually recovering, but staying well below 2011-14 highs
- Commodity prices and structural changes in host countries continue to weigh on remittances

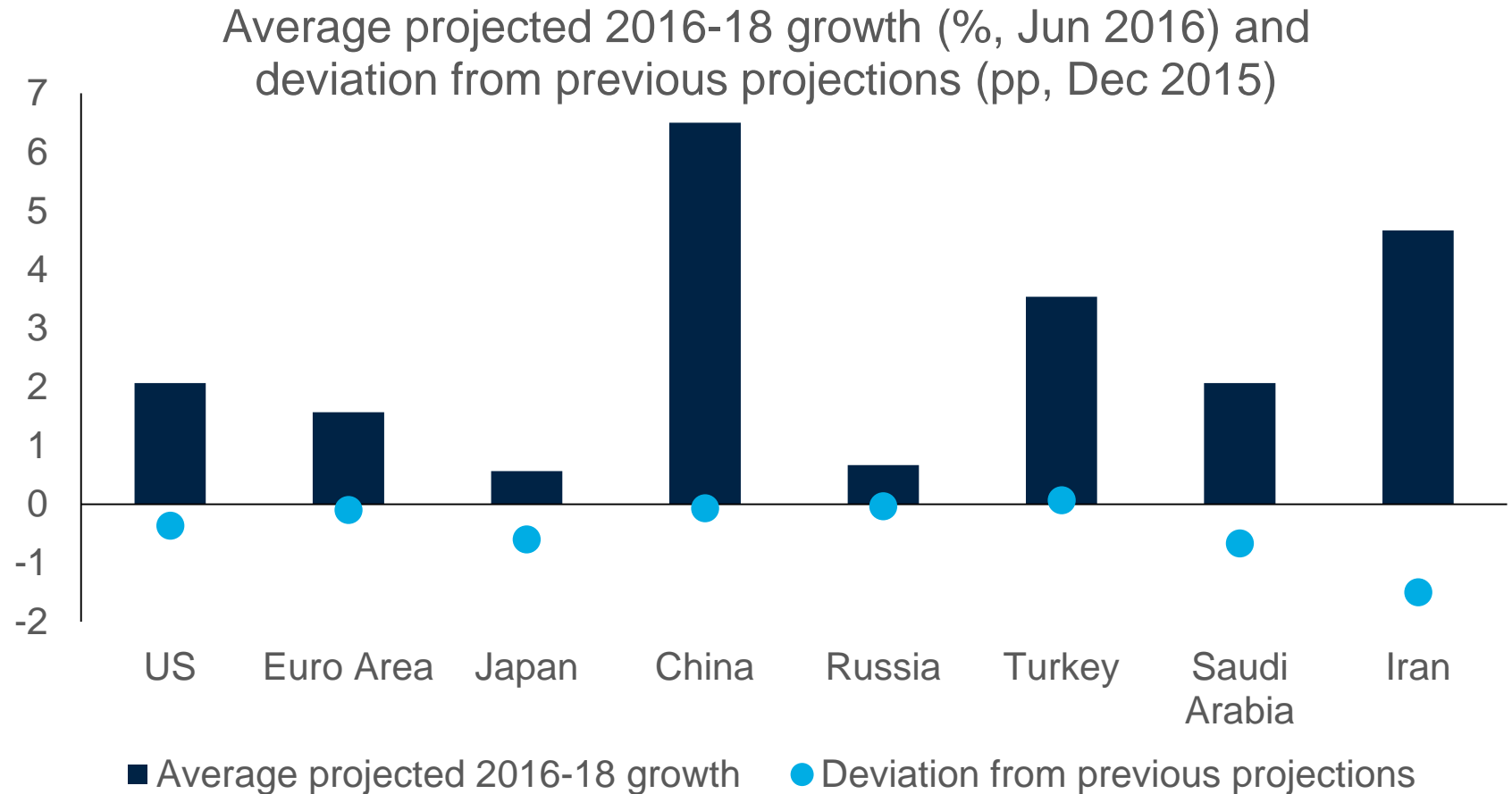
# Growth continues to disappoint in major economies



June 2016 projections. Since then, downward adjustments in almost countries

Source: World Bank Global Economic Prospects, June 2016

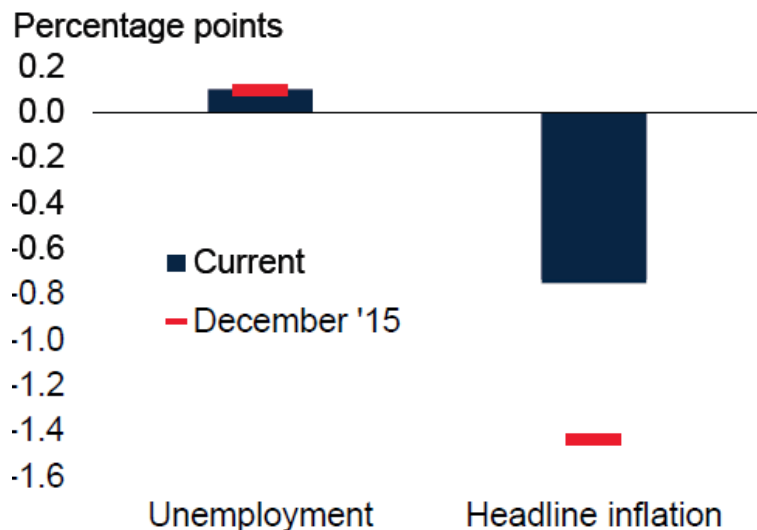
# Growth continues to disappoint in major economies



# United States

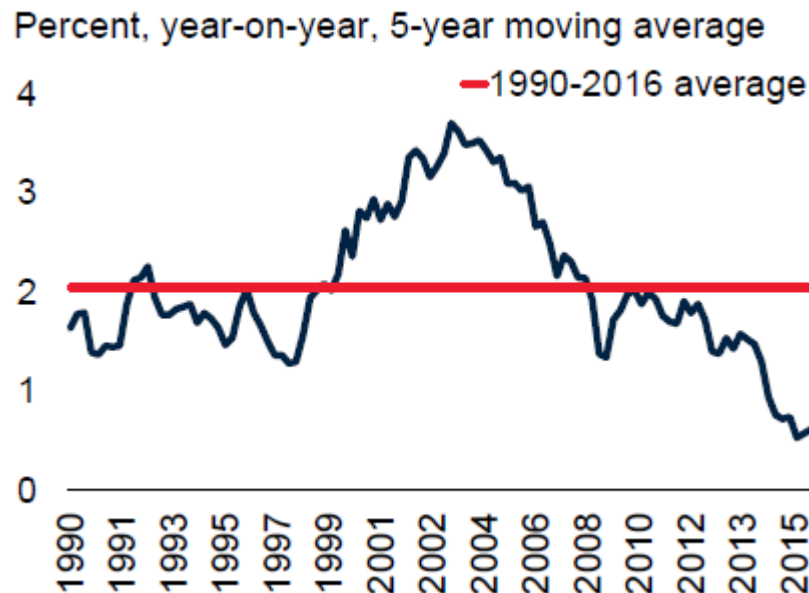
- Growth slowdown projected for 2016, due to weak exports and investment
- Baseline forecasts do not incorporate the effects of policy proposals by the incoming administration, as their scope and ultimate form is still uncertain
- Key monetary policy indicators getting closer to targets and risk of rate increase soon
- However, structurally declining labor productivity constrains potential output growth

## Distance to long-run unemployment and inflation target



Source: WB GEP

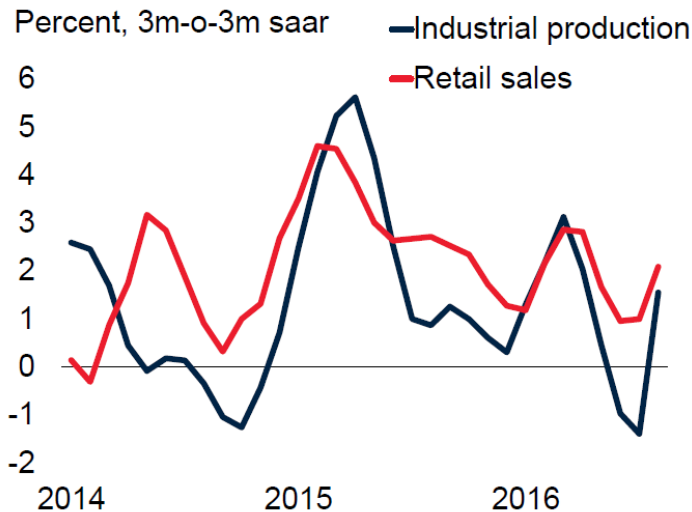
## Labor productivity growth



# Euro Area

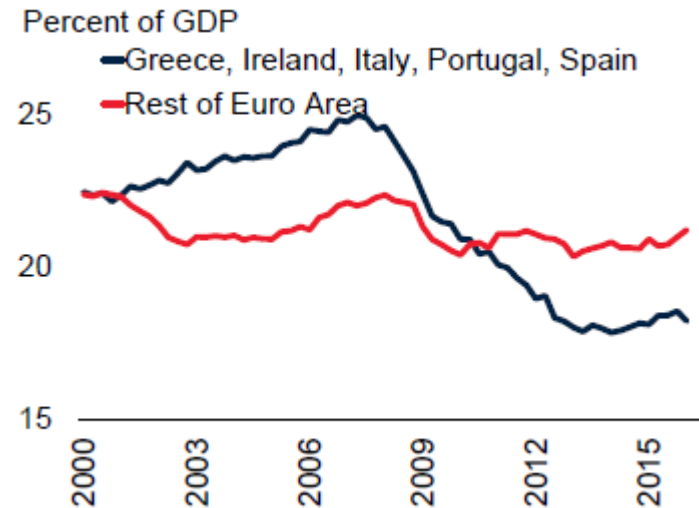
- Euro Area growth projected to slow down in 2016 due to weak domestic demand and exports
- Despite Brexit vote, confidence has been resilient with pick up of activity
- Investment rates holding up in core Euro Area countries
- However, inflation still well below ECB target

## Activity



Source: WB Global Monthly October 2016

## Investment rate in selected countries



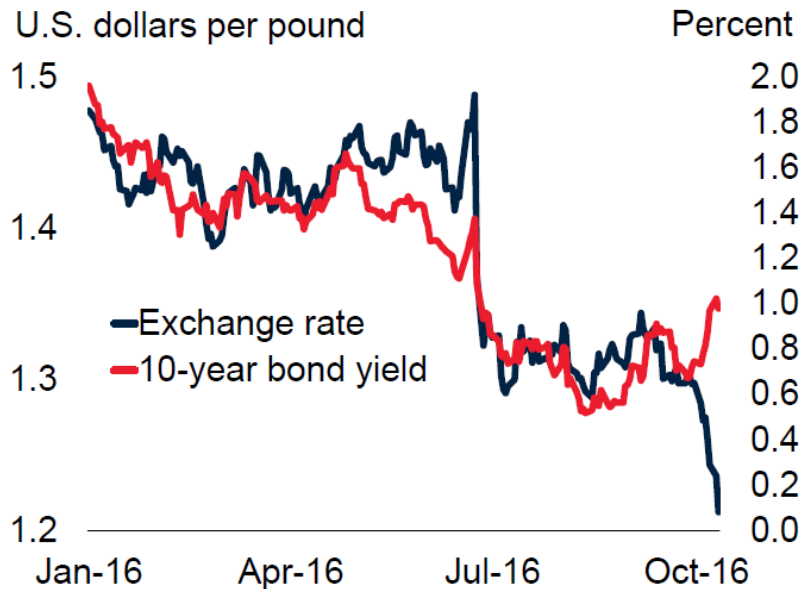
Note: long-term unemployment is share of unemployed looking for work for more than a year



# United Kingdom

- Vote to leave EU (Brexit vote) followed by large depreciation and rising yields
- So far limited cross-border financial market spill-overs
- However, uncertainty about future relationship between UK and EU long lasting, leading possibly to reduced investment in UK and EU

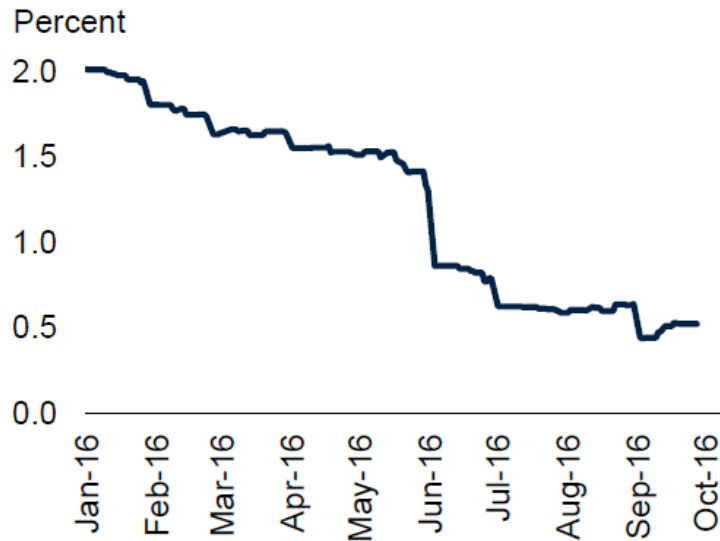
## Exchange rate and 10-year government bond yields



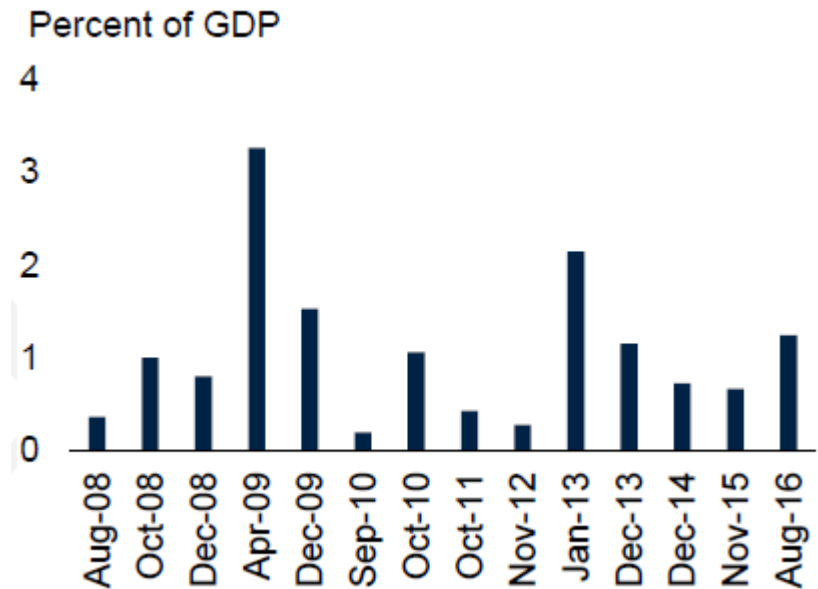
# Japan

- Ongoing softness on activity with Tankan survey of business conditions remaining around 50 in September
- Headline inflation negative and core inflation zero in August
- With 18 percent appreciation in trade-weighted exchange rate, inflation expectations for 2017 lowered again
- Shift to keeping long-term close to zero and public expenditure measures to support growth

## Inflation expectations for Japan in 2017      Discretionary fiscal measures



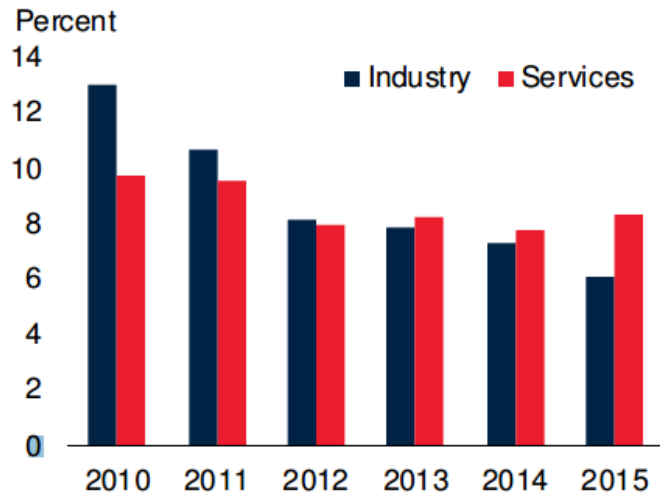
Source: WB Global Monthly October 2016



# China

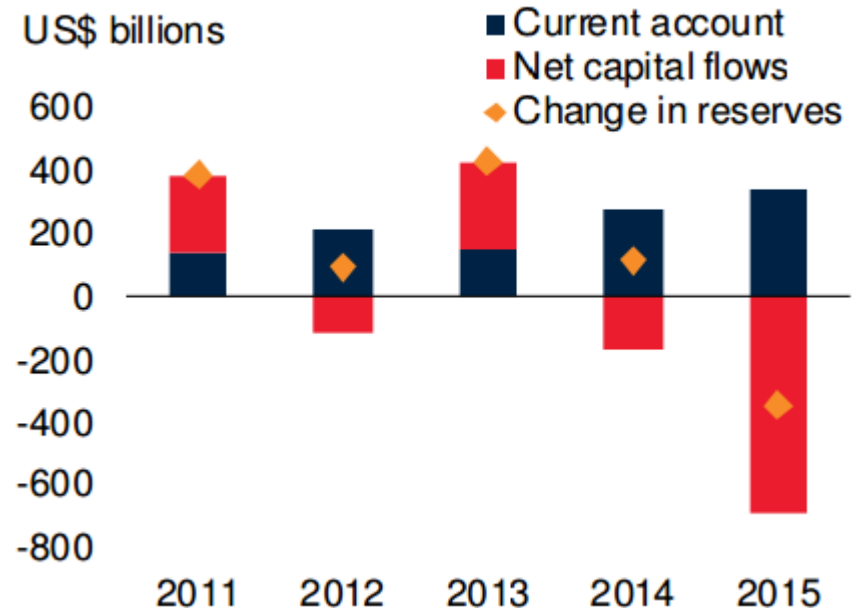
- Ongoing economic rebalancing with growth concentrated in services, while industrial production stabilized at moderate levels
- Strong consumption growth with investment growth moderating
- Sizeable capital outflows putting downward pressure on the currency

## Growth in services and industry, %



Source: Haver Analytics, World Bank

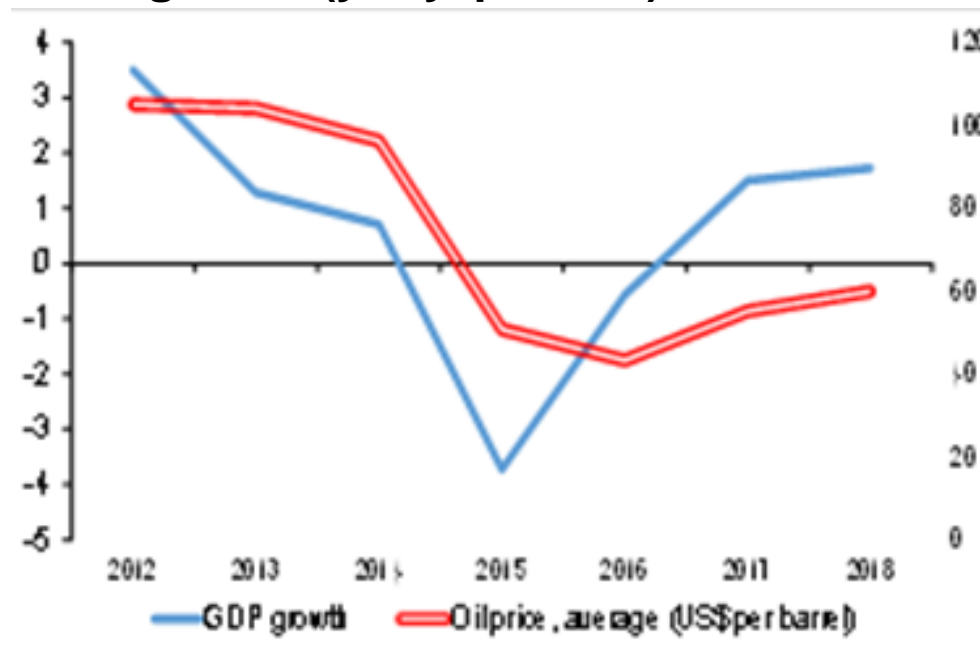
## Balance of payments



# Russia

- Recession continues, although pace of GDP decline has slowed down. For 2016, WB projects growth of the Russian economy at -0.6 percent, compared to -3.7 percent of GDP last year.
- Headline economic and financial trends and indicators are now picking up: inflation reduced, banking sector now largely stabilized and BoP stable, unemployment is near minimum level
- Economy expected to start inching towards growth of 1.5 percent in 2017 and 1.7 percent in 2018, driven by consumption.

## GDP growth (y-o-y, percent)

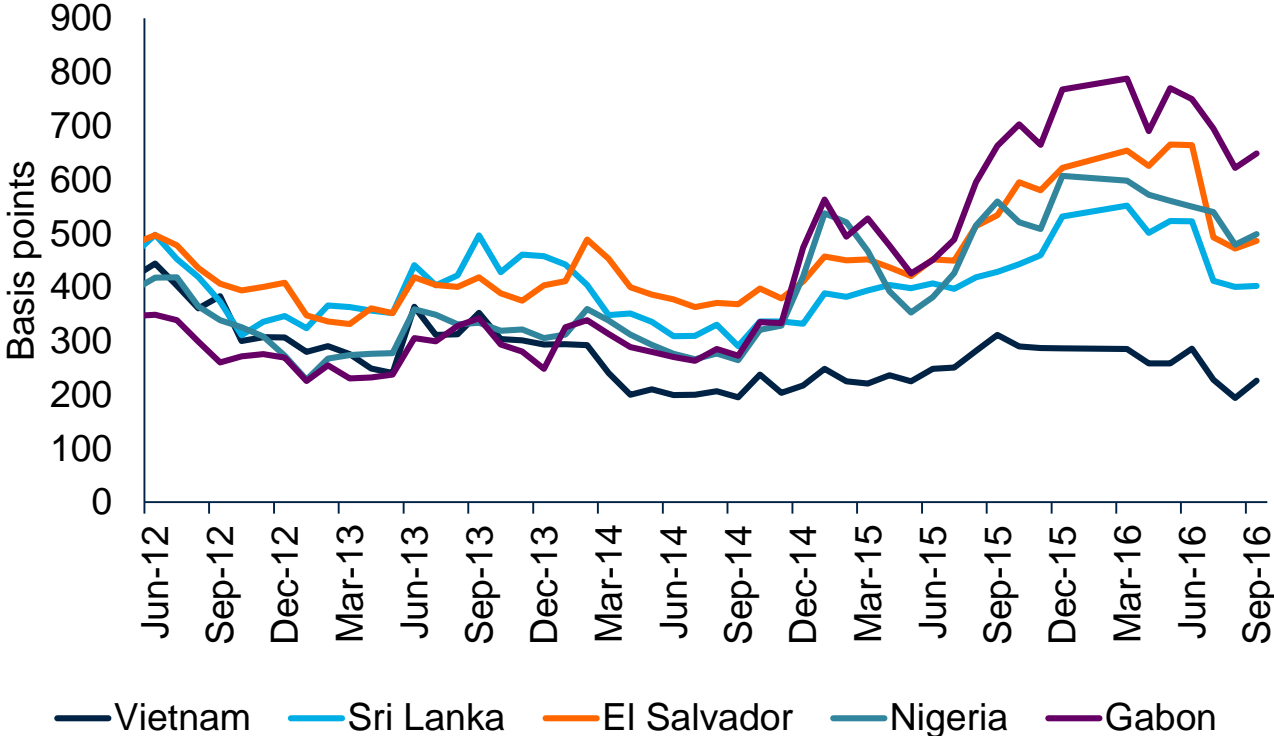


Source: World Bank

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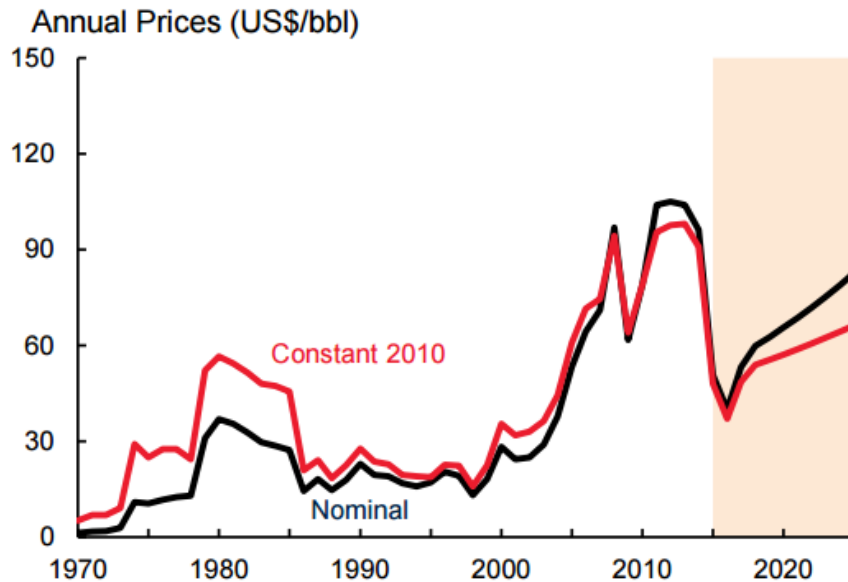
# Tightening financial conditions

Emerging market bond spreads



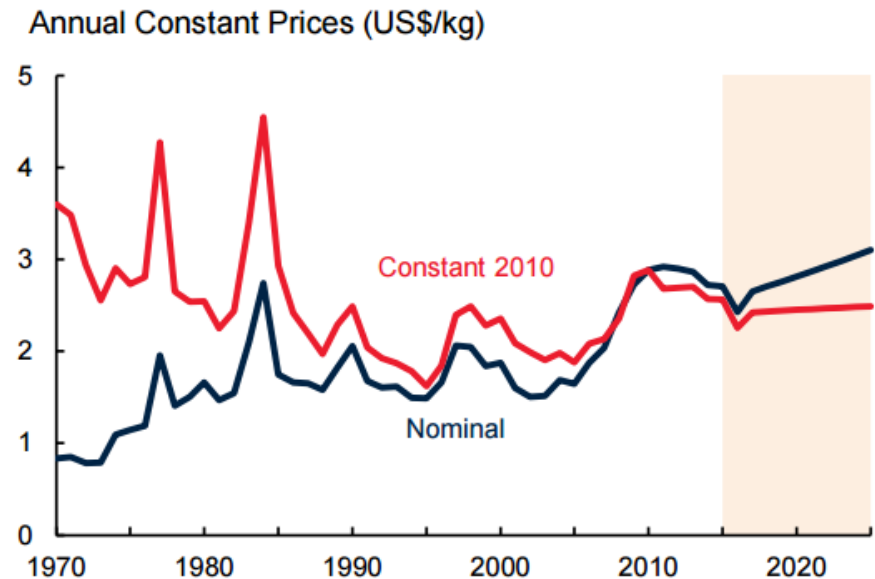
# Commodity prices

- **Oil** expected to average \$43/bbl in 2016 (15% below 2015), average \$55/bbl in 2017
- Consumption is expected to begin to exceed production in 2017, particularly in the second half of the year, and help reduce the large inventories, assuming OPEC success in limiting global production, and that U.S. production will flatten out next year.
- **Global tea prices** expected to decline 4 percent in 2016 and gain 2 percent in 2017 due to the market's expected tightness next season.



Source: World Bank.

Note: 2016-25 are forecasts.

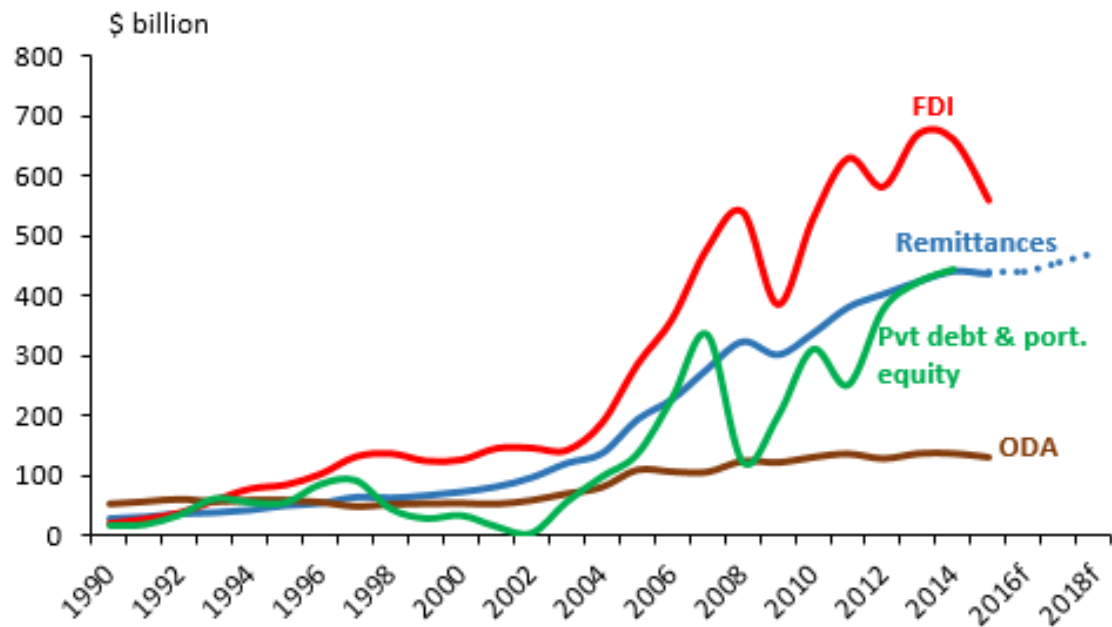


Source: World Bank.

Note: 2016-25 are forecasts.

# Remittance trends

- With tepid global growth, remittance flows to low and middle income countries (LMICs) seem to have entered “new normal” of slow growth
- Remittance flows to LMICs are projected to reach \$442 billion in 2016, an increase of 0.8 percent over 2015
- Remittances from GCC countries continued to decline due to lower oil prices and labor market ‘nationalization’ policies in Saudi Arabia
- Remittances to South Asia are expected to decline by 2.3 percent in 2016, following a 1.6 percent decline in 2015; however flows to Sri Lanka projected to increase modestly



# Bottom line for Sri Lanka

- Challenging external macroeconomic environment
- Major existing export markets not projected to grow fast ->
  - **Need to address anti-export bias, open new markets (FTAs, GSP+) and products to structurally increase exports**
- Tourism still projected to grow fast and low commodity prices will help keep the trade deficit narrow; risk of slowdown in remittances
- Tightening global financial conditions and the interest rate hikes in the US could lead to renewed capital outflows and pressure on the exchange rate could lead to more expensive external debt ->
  - **Stay on revenue-led fiscal consolidation path by strengthening tax base, making tax system fairer, simpler and more efficient and revisiting expenditure priorities**
  - **Reduce external financing needs by dealing pro-actively with Eurobonds maturities from 2019; deepen domestic market**
- Direct impact of a slowdown in China is limited, but there may be an indirect impact through public sector and SOE lending to Sri Lanka and inward FDI ->
  - **Need to remove obstacles to FDI attraction (legal, trade, tax, etc) and develop realistic FDI vision and promotion strategy**
- Geopolitical risks: impact of elections in US and Europe and Brexit referendum unknown so far



# Fiscal reforms can contribute to increased export competitiveness and fairness

- Widen tax base (too few persons and firms registered for tax)
- Stronger on personal income tax base will tax system more progressive
- Reducing VAT exemptions will make tax system simpler, strengthen tax base and reduce untargeted subsidies to non-poor
- Targeted incentives encouraging investment, job creation and exports rather than tax holidays
- Stronger fiscal position conducive to macroeconomic stability and low inflation
- Increased fiscal space for human and physical capital investment and social protection
- More customer-friendly tax administration (RAMIS, ombudsman, etc) will improve investment climate

# Summary of main messages

- Advanced economies continue to be afflicted by weak growth and very low inflation, amid rising uncertainty about future policy direction.
- Commodity prices gradually recovering, but staying well below 2011-14 highs
- Commodity prices and structural changes in host countries continue to weigh on remittances
- Challenging environment for Sri Lanka, but structural reforms can be consistent with improved competitiveness and fairness

# Stay in touch with the World Bank

- Global Economic Prospects June 2016:  
<http://www.worldbank.org/en/publication/global-economic-prospects>  
**(January 2017 coming soon)**
- Commodities outlook October 2016:  
<http://www.worldbank.org/en/research/commodity-markets>
- Remittances outlook September 2016 outlook:  
<http://blogs.worldbank.org/peoplemove/trends-remittances-2016-new-normal-slow-growth>
- Sri Lanka Development Update Fall 2016 with outlook:  
<http://documents.worldbank.org/curated/en/622841476967944601/Sri-Lanka-development-update>


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World Bank Sri Lanka:

 <http://www.worldbank.org/en/country/srilanka>

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