

Operating Environment

Global growth in 2018 is projected to have hit 3%, the result of trade and manufacturing activity slowing down due to trade tensions between major economies. The impact on investor confidence has led to declines in global equity prices and increased borrowing costs for Emerging Markets and Developing Economies (EMDEs). Fiscal stimulus in the United States and slowing net export activity in the Euro area contributed to advanced economies experiencing a reduction in growth rate from previous years to 2.2%. The strengthening US Dollar, fluctuating energy prices, and weakening commodity prices contributed to increased capital outflows and currency pressures for EMDEs. This led to EMDE growth falling below projections to an estimated 4.2%.

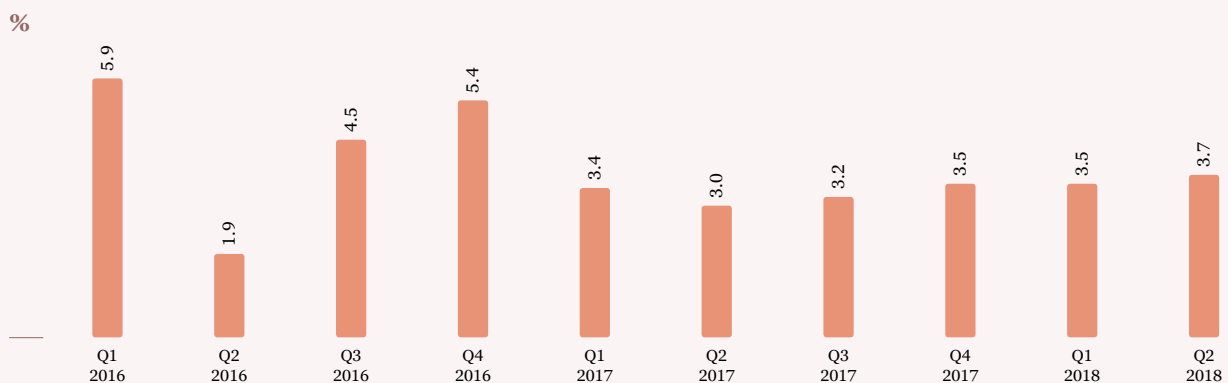
Although South Asia is still the fastest growing region in the world, with an estimated 6.9% economic growth in 2018, Sri Lanka faced challenges that led to the economy falling short of projections. The recovery experienced in the agriculture and services sector was stymied by political instability towards the end of the year, resulting in an estimated growth of 3.9%. The country fell short of the IMF forecast of 4.2% and had one of the lowest growth rates in a region that experienced GDP growth rates around 7%. The three major credit rating agencies downgraded Sri Lanka and the Sri Lankan Rupee depreciated to historic lows during 2018. Sri Lanka remains susceptible to external vulnerabilities due to sizable external debt and current account deficits. The Central Bank of Sri Lanka (CBSL) will focus on debt service payments, which are reported to be around USD 4.2 Bn in 2019. However, 2019 also holds promise for Sri Lanka. A rise by 11 places to 100 of 190 on the World Bank's Ease of Doing Business Index could

potentially help to boost foreign investor confidence. Tourism and hospitality could also see a boost as a result of the country being named the number one destination to visit in 2019 by Lonely Planet.

Despite the challenging conditions faced in the domestic market, Sri Lanka's financial sector was bolstered by the favourable asset growth of the banking sector. Alongside improvements in liquidity and capital levels, financial outreach also strengthened during the year despite non-financial sectors experiencing weaker performance. The Central Bank of Sri Lanka (CBSL) continued to tighten monetary policy, issuing directions on BASEL III liquidity standards and leverage ratios, amongst other measures. Directions on financial derivative transactions of licensed banks were also issued to strengthen risk management. Banks were issued guidelines on the adoption of Sri Lanka Financial Reporting Standard 9 as part of the CBSL's initiative to adopt and implement international best practices.

Going into 2019, there will be an increased focus on digital payment mechanisms. The CBSL has focused on strengthening the country's payment and settlement infrastructure in its efforts to develop a national payment and settlement system that can adapted to the country's growing payment needs. The introduction of a national standard for QR code-based payments, "LANKAQR", in 2018, the establishment of an inter-industry working committee to prepare framework for a Blockchain-based Know Your Customer (KYC) solution, and continuing work on a National Card Scheme are the strongest initiatives yet by the CBSL to promote digital payment mechanisms in the country.

GDP growth of Sri Lanka



Source: Central Bank of Sri Lanka