Future Outlook

According to IMF, global growth will receive a boost from lower oil prices, attributed primarily to higher supply. This boost is projected to be more than offset by negative factors, including investment weakness as adjustment to diminished expectations about medium-term growth continues in many advanced and emerging market economies.

Global growth in 2015-16 is projected at 3.5% and 3.7%, downward revisions of 0.3% relative to the October 2014 World Economic Outlook update. The revisions reflect a reassessment of prospects in China, Russia, the Euro area and Japan as well as weaker activity in some major oil exporters because of the sharp drop in oil prices.

The United States is the only major economy for which growth projections have been raised. The main upside risk is a greater boost from lower oil prices, although there is uncertainty about the persistence of the oil supply shock. Downside risks relate to shifts in sentiment and volatility in global financial markets, especially in emerging market economies, where lower oil prices have introduced external and balance sheet vulnerabilities in oil exporters. Stagnation and low inflation are still concerns in the Euro area and in Japan.

Sri Lankan Economy

While 2015 has the potential to bring renewed hope and positive change to the Sri Lankan economy, it will also be fraught with macroeconomic challenges that must be addressed by correct economic policies. The new Government will have to implement appropriate economic and monetary policies aimed at propelling growth if the country is to sustain its middle income status.

The Sri Lankan economy has been growing at an average annual rate of 7.5% over the past three years. Continuing this momentum, GDP is expected to expand by about 7.5%-8% in 2015 – a healthy increase compared to other emerging and developing economies in Asia, which will likely see a growth of 6.4%.

The short-term outlook appears positive across the board. Sri Lanka is well positioned to take advantage of the global economic recovery and the strong growth unfolding in advanced economies. With continued robust export performance, Sri Lanka is expected to narrow its current account deficit further and accumulate additional international reserves.

Performance in Sri Lanka's agriculture sector is predicted to rebound strongly in 2015. Factory-based industries are also expected to gather momentum, thanks to more favourable external and domestic economic conditions.

The rate of inflation should remain at low levels throughout 2015, thanks in large part to the downward trend in fuel prices internationally, which may spark further reductions in domestic pricing. The expected private-sector credit growth, the projected increase in US interest rates and downward pressure on the US $/LKR exchange rate together are likely to trigger a rise in interest rates in 2015. Private-sector credit growth is expected to improve from January 2015 onwards as a result of measures taken in the previous year, aided by the likely revival of the export sector as principal markets recover.

The salary increment proposed for public sector employees in the Government's 2015 Budget should increase their disposable income. As a result, the demand for products and services is expected to rise, boosting business activity. This in turn should increase demand for credit over the coming year, especially in a scenario characterised by moderate interest rates and inflation.

Sri Lankan Banking Industry

In 2015, the Sri Lankan banking industry should see a reversal of the negative forces that have impeded progress over the past three years. Improved credit growth reflecting the expansion of GDP, along with a healthier net interest margin supported by an enhanced CASA mix, should also help spark renewed growth in the banking sector.

Expected GDP growth of more than 7% will boost commercial lending, particularly in the SME and construction segments. The appetite for credit is also expected to grow in the import/export, value-added apparel and tourism sectors. An increased demand, supported by low interest rates, should fuel broader growth in consumer credit. Growing confidence in the Nation's commitment to good governance and the rule of law will help to create a more open and free business environment, triggering greater demand for credit to be deployed in both consumption and investment.

Rounding out this hopeful outlook, many financial analysts believe that margins in the banking sector have stopped their descent and will now begin to recover. The problems associated with weakened asset quality should be overcome with the return of more favourable economic conditions. By further diversifying their loan books while sustaining a measured and appropriate tolerance for risk, banks will be able to lower their exposures. Of course, the one proviso qualifying these positive trends is that all banks must comply with unfolding Basel III rules setting out stricter, higher-equity Tier I capital requirements, and their implementation could hurt returns across the Sri Lankan banking industry in the near term.

Interim Budget 2015 - Proposals that Affect the Banks and Financial Companies

Salient features of the new Sri Lankan Government's revised Budget proposals for 2015 are as follows:

- Super Gains Tax on any company or individual who has earned profits over Rs. 2,000 Mn. in the tax year 2013/14, will be liable to pay 25% of their profit as a one off tax.
- Senior Citizens' Deposits to receive a higher interest rate of 15% per annum for their savings up to a maximum level of Rs. 1 Mn. and higher interest rate of about 5% on NRFC accounts.
- Imposing a cap of 8% over and above the normal lending rate on Credit Cards.
- 50% waiver of advances granted to farmers for a maximum loan capital of Rs. 100,000/- by commercial banks and presently overdue.
- Interest payments and penalties on pawned jewellery to a value not exceeding Rs. 200,000/- held at state banks will be waived off.

Regulatory/Policy Measures to be Introduced in Future

Adopt Basel III framework in line with the international timeline	Enhance the Quantity and Quality of Capital through • Implementation of Capital Conservation Buffer for Systemically Important Banks. • Implementation of Leverage Ratio. Strengthen Liquidity Risk Management • Implementation of Liquidity Coverage Ratio on a staggered basis
Deposit Insurance Cover and Liquidity Support	• The Deposit Insurance Cover will be increased to Rs. 300,000/- and Liquidity Support Scheme for companies with urgent liquidity needs.
Resolution Plans	• Implementation of resolution plans to resolve any stress situation.
Information Security	• Implementation of Baseline Security Standard for Information Security Management based on ISO 27000.
Setting up Business Revival Units	• Establishing separate units in banks to facilitate revival of businesses.
New Accounting Standards issued but not yet effective	• SLFRS 9 - 'Financial Instruments': replaces the existing guidance in LKAS 39 on 'Financial Instruments Recognition and Measurement'.