POST-TSUNAMI RECONSTRUCTION AND THE MACROECONOMIC ASSESSMENT

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Although the GDP growth for 2005 has been projected to slowdown to around 5.5 per cent due to impact of tsunami, faster implementation of reconstruction plans could reach GDP growth towards 6 per cent. Inflation is expected to be somewhat high during the reconstruction phase due to excess demand for goods and services related to reconstruction, high oil prices and other demand pressures. Appropriate monetary policy measures will be taken to contain inflationary expectations.

Reconstruction process will have a significant impact on the balance of payments. Import expenditure will increase substantially widening the trade deficit. Earnings from tourism are expected to decline in 2005 reducing the surplus in the service account. The expected higher grants to the current transfers account would partly offset the impact of worsening trade and service accounts on the current account balance. The resulting widened current account deficit creates a significant financing gap in the BOP. The debt relief has helped reduce the gap to around US dollar 500 million for 2005. However, the gap is expected to be higher in 2006 and beyond without the continued debt relief and also faster progress in the reconstruction phase during 2006. These gaps are expected to be financed fully through donor assistance. As per information from the External Resources Department, donors have already pledged around US dollars 1.0 billion including reallocation of funds from other projects. However, any delay in the mobilization of funds will have adverse implications on external reserves as reconstruction process will have to proceed without delays. If the expected donor assistance is mobilized fully according to the expectations, the BOP will record surpluses and country's reserve position would be strengthened as a part of inflows for reconstruction would be spent domestically.

It has been estimated that the tsunami related expenditure will increase the budget deficit by 2 per cent of GDP to 9.6 per cent of GDP in 2005 and by a higher margin in 2006. The additional financing requirement is expected to be financed largely through outright grants and highly concessional loans so that the impact of higher external financing on public debt could be minimised. The level of public debt has already risen to 107 per cent of GDP at end 2004. The delays in the mobilisation of donor assistance at concessional terms would compel the government to increase domestic borrowings or raise external financing on commercial terms and conditions as these expenditure cannot be postponed. High domestic borrowings will crowd out resources available for the private sector for investment and create further inflationary pressures.