

# MTI Business Outlook 2023

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# MTI’s Business Review of 2022 & Outlook for 2023

For the 12th consecutive year, MTI Consulting (via their Corporate Finance practice), in partnership with Daily FT, Daily Mirror, and Sunday Times, has concluded the MTI CEO Business Outlook Study, collectively outlining the Sri Lankan business community’s perception for the state of business in 2023.

Supplemented by MTI’s experience as a thought leadership-oriented organization, the annual survey collated and analyzed the perceptions of over 100 Sri Lankan business leaders about their business’ past and expected performance, their predictions regarding the state of the local and global economy in 2023, and the main challenges that they believe Sri Lanka and Sri Lankan companies will face in 2023.

The results of the survey including its supplementary analysis, will assist organizations in streamlining their strategic decision-making for 2023, effectively enabling them to gear their operations in accordance with the economic sentiments of their peers – especially in the face of unprecedented challenges and uncertainty that prevailed in 2022.

## In 2022, Businesses continue to perform below expectations.

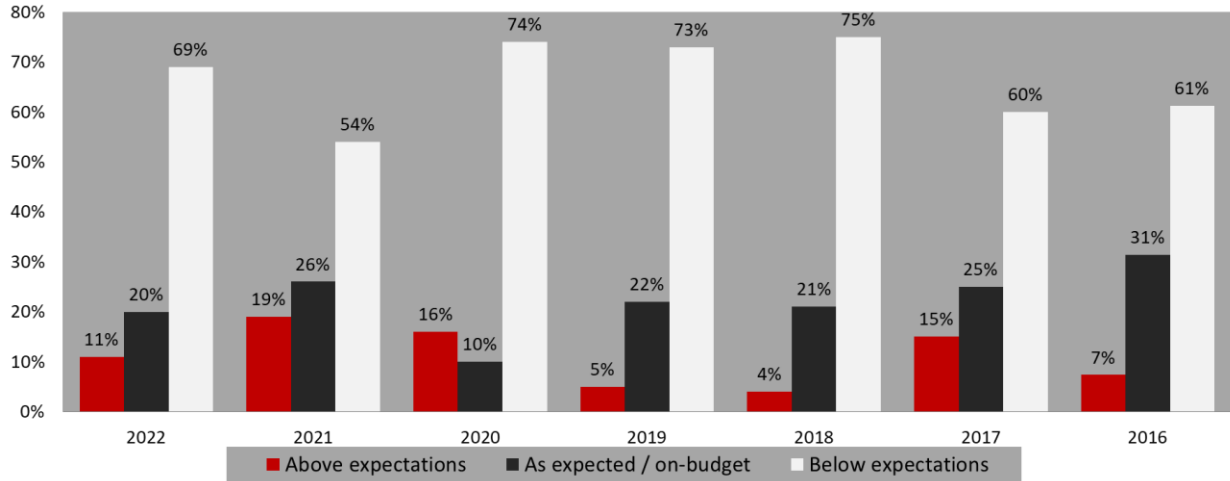


Figure 1 - How did your business perform in the previous year?

69% of the surveyed Chief Executives indicated that their businesses performed below expectations in 2022. This indicates an increase in this sentiment since 2021 – a change that can be due to the economic crisis Sri Lanka is still emerging from.

However, it is notable that 11% of the surveyed CEOs have seen their businesses perform above expectations – an indication that, despite the local economic crisis, some businesses have performed well.

## Macroeconomic Performance

To supplement the CEO perceptions in 2022, MTI has analyzed the key macroeconomic indicators of Sri Lanka.

### Real sector performance in 2022

Indicator (at constant prices)	Period	2021 (LKR Mn)	2022 (LKR Mn)	Change (%)
GDP	Jan – Jun	6,558,775	6,245,215	-4.8%
Agriculture	Jan – Jun	473,867	437,937	-7.6%
Industry	Jan – Jun	1,975,268	1,835,491	-7.1%
Services	Jan – Jun	3,580,336	3,559,173	-0.6%

With the major economic crisis Sri Lanka faced in 2022, the lingering effects of the COVID-19 pandemic and other global challenges, Sri Lanka's usable resources took a nosedive. There has also been very high inflation, sharp rupee depreciation, and major economic contractions.

GDP decreased by 4.8% for the first 6 months of 2022 compared to the 9.3% growth in 2021. This is largely due to the contractions in the Agriculture and Industries sectors.

The Agriculture sector declined by 7.6% mainly because of the lack of inputs, such as chemical fertilizers. The Industries sector declined by 7.1% due to the disruptions in the supply chain while the Service sector faced only a minor contraction of 0.6% due the slight improvement in the Tourism sector.

## External Sector Performance in 2022

Indicator	Period	2021 (US\$ million)	2022 (US\$ million)	Change (%)
Exports	Jan-Sep	8,938.5	9,981.1	11.7%
Imports	Jan-Sep	14,937.5	14,085.2	(5.7%)
Trade Balance	Jan-Sep	-5,999	-4,104	(31.6)
Tourism Earnings	Jan-Sep	98.8	946.4	857.9%
Workers' Remittances	Jan-Sep	4,577	2,574	(43.8)
Official Reserve Assets:	Jan-Sep	2,704	1,779	(34.2)
Foreign Currency Reserves	Jan-Sep	2,129	1,683	(20.9)

External sector showed mixed performance during the first 3 quarters of 2022. This is because of the improvement in trade deficit combined with the reduction in inflows, disturbances in the foreign and local foreign exchange markets and, global economic uncertainties.

Trade deficit reduced to USD 4,104 million in the first nine months of 2022, compared to USD 5,999 million in the same period of 2021. This is a result of earnings from exports increasing and import expenditure decreasing.

Earnings from exports increased to USD 9,981.1 million compared to USD 8,938.5 million in the same period of 2021. This is mainly due Industrial exports which grew by 15.9% due to textiles and garment exports, which contributed to 57.2% of the total industrial export earnings.

Agricultural export earnings declined by 2.4% to USD 1,939.8 million as a result of a decline in earnings from tea, spices, vegetables and unmanufactured tobacco. Total Import Expenditure declined by 5.7% due to import restrictions on non-urgent imports in August 2022.

Earnings from tourism rose to USD 946.4 million for the period of January to September in 2022 compared to USD 98.8 million for the same period in 2021 as a result of increased tourist arrivals (526,232 persons) with the recovery from COVID-19.

## Fiscal Sector Performance in 2022

Indicator	Period	2021 (LKR billion)	2022 (LKR billion)	Change (%)
Budget Deficit	Jan – Aug	-1,328	-1,244	6.32%
Total Govt. Revenue	Jan – Aug	1,051	1,448	37.8%
Tax Revenue	Jan – Aug	952	1,283	34.8%
Non-Tax Revenue	Jan – Aug	99	165	66.7%
Total Govt. Expenditure	Jan – Aug	2,380	2,695	13.2%
Government Debt	As at June 30 <sup>th</sup>	16,565	24,264	46.5%

Unlike the previous years, overall budget deficit in 2022 was contained to Rs. 1,244.4 billion during the first nine months compared to Rs. 1,328.2 billion in the same period of 2021. This can be attributed to the efforts taken by the government to increase the revenue.

Total government revenue increased significantly by 37.9% to Rs. 1,448.5 billion in the first nine months of 2022, compared to Rs. 1,050.8 billion in the same period of 2021. This is mostly because of the increase in tax revenue by 34.8% to Rs. 1,283.4 billion in the first nine months of 2022.

Non-tax revenue, which contributes to 11.4 % of total revenue, increased by 66.8% to Rs. 165.1 billion in the first nine months of 2022. This was mainly due to the revision of fees and charges and the improved revenue collection from rent, profits and dividends from SOEs, and interest income.

By the end of June 2022, Government Debt increased to Rs. 24,264.4 billion. Compared to the same period of 2021 this was an increase by 46.5%. This caused the government to announce a debt standstill for the repayments of foreign debt obligations. The government also sought assistance from the International Monetary Fund (IMF) through an Extended Fund Facility (EFF).

The external sector was stabilised through aggressive policy measures to contain imports, and inflation slowed down in October.

## Monetary Sector Performance in 2022

Indicator	Period	2021	2022	Change (%)
Policy Interest Rates				
Standing Deposit Facility Rate	As at 30 <sup>th</sup> December	5.0%	14.5%	190%
Standing Lending Facility Rate	As at 30 <sup>th</sup> December	6.0%	15.5%	158.33%
Statutory Reserve Requirement (SRR)	As at 30 <sup>th</sup> December	4.0%	4.0%	0%
Average Weighted Prime Lending Rate (AWPR) – of Commercial Banks	As at 30 <sup>th</sup> December	8.61%	27.24%	216.38%
Domestic Credit (LKR billion)	As at 31 <sup>st</sup> August	13,463.8	16,304.1	17.4%
Credit to the Private Sector (LKR billion)	As at 31 <sup>st</sup> August	6,795.5	7,614.2	12%
Reserve Money (LKR billion)	As at 31 <sup>st</sup> August	1,089.3	1,386.2	27.3%

Because of steep escalation of headline inflation and inflation expected to persist in the period ahead, the standing deposit facility rate and the standing lending facility rate was increased drastically by the Monetary Board, from 5% to 14.5% and 6% to 15.5% respectively. Whilst the statutory reserve requirement was held constant at 4.0%.

The Average Weighted Prime Lending Rate was at a very high rate of 27.24% compared to the rate of 8.61% in 2021. In Overall, the Domestic Credit increased by 17.4%, as was the trend in the previous years.

## How have the major industries performed?

- **Banking** - With the tightening of the monetary policy, growth in loans and advances decelerated from 14.5% in 2021 to 6.8% to 2022. Investments also rose by 5.8% during the first 8 months of 2022, from Rs 873.4 billion to Rs 5.8 trillion. Total assets of the banking sector expanded from Rs 2.4 trillion to Rs 19.2 trillion, a record 14.1% growth, which was mainly caused the growth of the deposit base, which grew by Rs. 1.9 trillion.
- **Tea** - The tea sector faced a small decline in the export performance, with a net export value of US\$ 1,258.8 Million in 2022 compared to a US\$ 1,324.37 million in 2021 with export earnings from tea, which made up 11% of merchandise exports, slightly decreasing by 0.76 % y-o-y to US\$ 108.7 million in October 2022. This was mainly due to the lower Export of bulk tea (-1.22%). Total tea production for the period of January to October 2022 was 211.39 million kilograms and cumulative exports for the period of January to November 2022 totaled 230.89 million kilograms.
- **Tourism** - Sri-Lanka's economic situation led way to negative travel advisories imposed by certain countries and through social media. Due to the current foreign exchange crisis and price hikes coupled with scarcity of essential items such as gas and petrol, tourist arrivals fell in May 2022. However, Sri Lanka took measures to increase tourism by resuming direct flights within Russia's largest charter airline causing the tourist arrivals to climb to 42,026 persons in October 2022, with 91,961 foreign tourist's arrivals on a year-to year basis. Earnings of tourism rose to USD 946.4 million during the first nine months of 2022, from USD 98.8 million in the same period in 2021.
- **Construction** - The industry sector faced a negative growth of 7.1% due to the construction industry contracting by 8.9% in 2022. This is because of the halting of construction projects such as the construction of the BIA terminal, due to the ongoing debt treatment policy. Sri-Lanka hopes to seek foreign financing as a loan, from the government of Kuwait for construction and equipping faculty of medicine at the university of Moratuwa.
- **Apparel** - Apparel & Textile exports increased by 14.04 % to US\$ 5,004.58 Mn during the period of January to October 2022 compared to the same period of 2021 with total number of exports in the apparel industry totaling to 487.40 US\$ million. However, exports of Apparel & Textiles decreased by 13.19 % y-o-y to US\$ 441.89 Mn in October 2022. The decrease was driven by both Apparel and Textiles.

## Stock Market Performance in 2022

LKR Billion	Period	2021	2022	Change (%)
Turnover	As at 31 <sup>st</sup> December	1,173	687	-41.43%
Gain (Loss) in Mkt Cap	As at 31 <sup>st</sup> December	2,529	-41	-101.62%
Market Cap	As at 31 <sup>st</sup> December	5,489	3,847	-29.91%
ASPI	As at 31 <sup>st</sup> December	12,226	8,490	-30.56%
S&P SL20	As at 31 <sup>st</sup> December	4,233	2,636	-37.73%
Total net foreign inflow (to the CSE)	As at 31 <sup>st</sup> December	-52.6	30.6	158.17%

2022 was a mixture of shocks and short recovery because of the many unexpected occurrences that impacted the economy, and during these back-to-back crises in the country, the stock market fell to as low as 7,000 points with short recovery in between.

Turnover as of 30th December in 2022 was LKR 687 billion which is a 41% decrement compared to 31st December in 2021. Sri Lankan stocks lost 30.5 % overall in 2022 as the economic crisis and the political instability due to years of policy mismanagement took the toll.

Having the market traded for 230 days in 2022, the market in the last one and half months has somewhat gained after the announcement of the Central Bank that the inflation has started to ease after shooting over percent.

From January to December in 2022, the market experienced a loss in the Capitalization in contrast to the same period in 2021. When comparing the same periods in 2022 and 2021, Market Capitalization showed a decline of 101.6 %.

The highest Market Capitalizations were recorded by Expolanka, LOLC and JKH at the last trade on 30th December 2022. ASPI and S&P SL20 both showed a decrement of 30.6 % and 37.7 % respectively. ASPI landed at 8,490 points and S&P SL20 landed at 2,636 points.

As of 30th December 2022, total net foreign inflow had increased by 158.2 % compared to 31st Dec 2021. By 31st December 2022, net inflow was recorded at LKR 30.6 billion.



# World in 2022

## Global Economy and Trade | 2022

During 2022, the World Economy experienced certain instabilities such as high inflation, tightening financial conditions, Russia's invasion in Ukraine and Covid-19 pandemic. Driven by those, there were GDP contractions in several regions.

World Real GDP was projected to be around 3% in 2022, by the World Bank and IMF, which was projected as an economic slowdown compared to the 6% in 2021.

Emerging market and developing economies were expected to have a growth rate of 3.7 % while advanced economies expected a growth rate of 2.4%.

The United States GDP growth was forecasted to be only 1.6%. The decline in disposable income and higher interest rates constrained consumer spending.

China is expected to have a downgraded economic growth rate of 3.2% as there were limitations to the economic activities in China caused by lockdowns due to Covid-19 and property market crisis.

# World in 2023

IMF has predicted that the global growth will be 2.7% in 2023, while Emerging and Developing Economies are expected to remain at 3.7%, like in 2022. Advanced Economies are expecting a declining growth of 1.1 % with downgrades concentrated in the US and European economies.

China is expected to have a growth rate of 4.4% in 2023. However, China is a major trading partner of the Association of Southeast Asian Nations (ASEAN) region. According to the IMF, ASEAN 5 economies' projected growth is downgraded. One of the expectations underpinning this downgrade is slower growth in major trading partners.

As per the IMF, world trade volume (Goods and Services) is forecasted to grow by 2.5% in 2023. However, the World Bank expects it to grow by 1.6% which is well below the historical average of 4.6% for the period of 2000 to 2022. This will be triggered by the global output growth decline, supply chain constraints and the dollar's appreciation in 2022.

According to the World Bank, oil price is projected as USD 88/bbl in 2023. This is a decline of 4.0% compared to the 2022 projections. This is subject to slower global growth and weakening oil demand, particularly in Europe in 2023. It is expected that Russian oil exports will fall due to the European Union (EU) sanctions on crude oil.

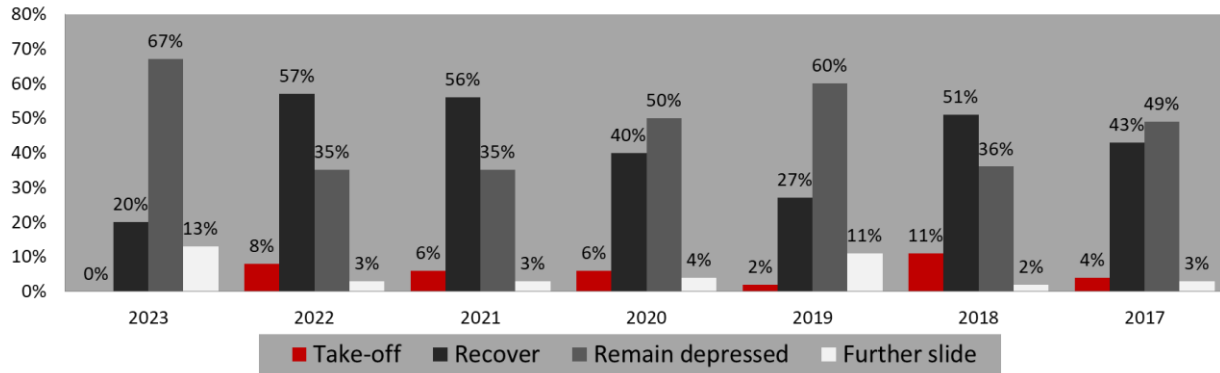


Figure 2 - In 2023, the Global Economy will?

20% of the surveyed CEOs expecting the global economy to recover in 2023 while 80% of the surveyed CEOs are of the view that the global economy will continue to see a depression state or worsen in 2023, in light of the Ukraine-Russia conflict and increasing global inflation pressures.

## In 2023, Sri Lankan Economy is likely to encounter major challenges

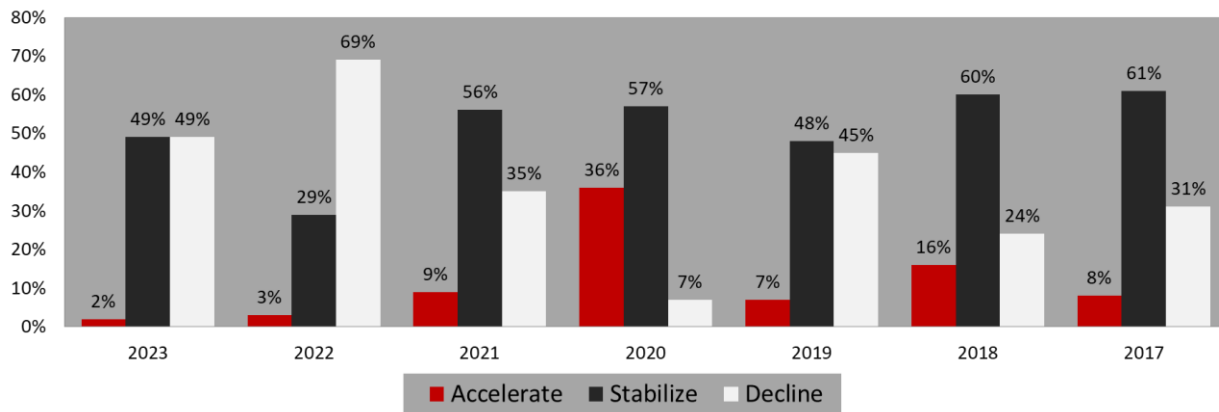


Figure 3 - In 2023, the Sri Lankan economy will?

49% of the CEOs surveyed were of the opinion that the local economy will decline in 2023, which is a notable drop in comparison to the 69% from last year. An equal percentage is hopeful that the economy will stabilize, which is also a significant increase compared to the 29% from the survey responses last year.

However, only 2% of the CEOs were of the opinion that the economy will accelerate, which is even lower than the responses from last year – a declining trend that has been continuing in the most recent years.

# Sri Lanka in 2023

Sri Lanka is still emerging from the economic crisis and has faced the depletion of foreign reserves, shortages of fuel, gas, pharmaceuticals, raw materials, high inflation, and unsustainable debt levels. Issues with the shortage of foreign exchange leading to a shortage of raw materials, increase of prices of inputs and continuation of electricity cuts, are expected to continue. These will negatively affect production, leading to the risk of losing jobs and income.

Demand for Sri Lankan exports as well as tourist arrivals in Sri Lanka are expected to be affected by the recession predicted for most countries in 2023 and the slowdown in the key economies of the United States (US), Euro Area, and China. As a result, pressures of the current economic crisis are expected to continue in 2023.

Trade deficit is also expected to further narrow as a result of increased exports for relieving the challenges faced in production and the decrease in demand for imported items because of high prices, limited financing, and import restrictions.

## Political, Legal & Governance – Main Challenges in Sri Lanka in 2023

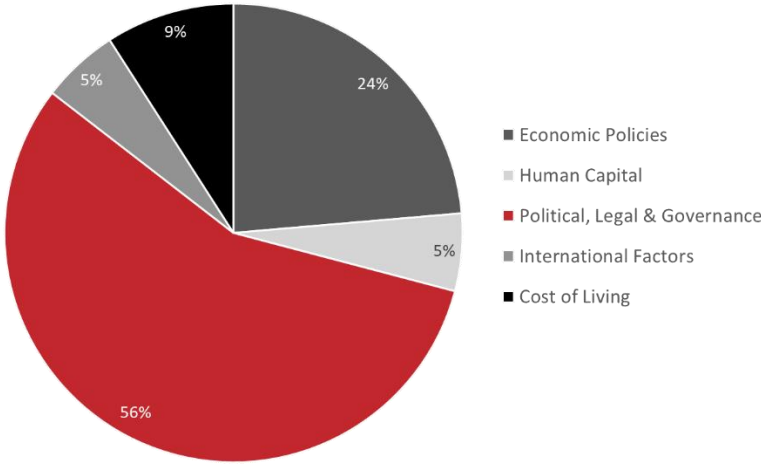


Figure 4 - In 2023, the No. 1 challenge to the Sri Lankan Economy will be?

56% of the surveyed CEOs have identified Political, Legal & Governance issues as the number one challenge to the Sri Lankan Economy this year, followed by Economic Policies (24%). The concerns over these two challenges show that Political, Legal & Governance has become a bigger concern compared to Economic Policies, in contrast to the previous years' survey, which leads to the assumption that CEOs have not witnessed major improvements in areas related to these issues.

Other challenges cited by a minority of CEOs include Cost of Living (9%), Human Capital (5%), and International factors (5%).

# Political Stability is the main concern

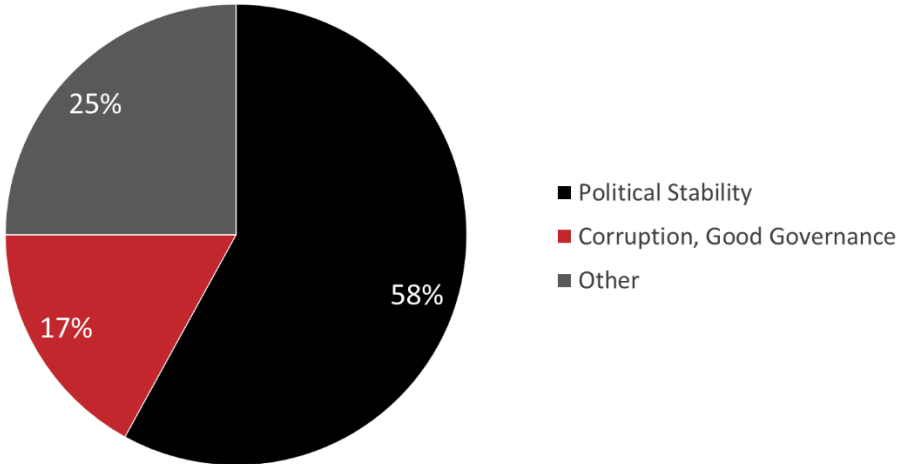


Figure 5 – Analysis of responses citing Economic Policy concerns.

Further analysis of Political, Legal & Governance issues reveals that notably 58% of the surveyed CEOs expressed alarms over Political Stability in the country which is slightly lower than that of last year (63%). There has been a considerable increase in concerns over Corruption & Good Governance for 2023 (17%) compared to that of last year, which was 6%.

Some of the key issues that were highlighted as part of Political Stability was worries of securing IMF support successfully and loss of confidence in the leadership and government of Sri Lanka.

# Slow Business Outlook for 2023

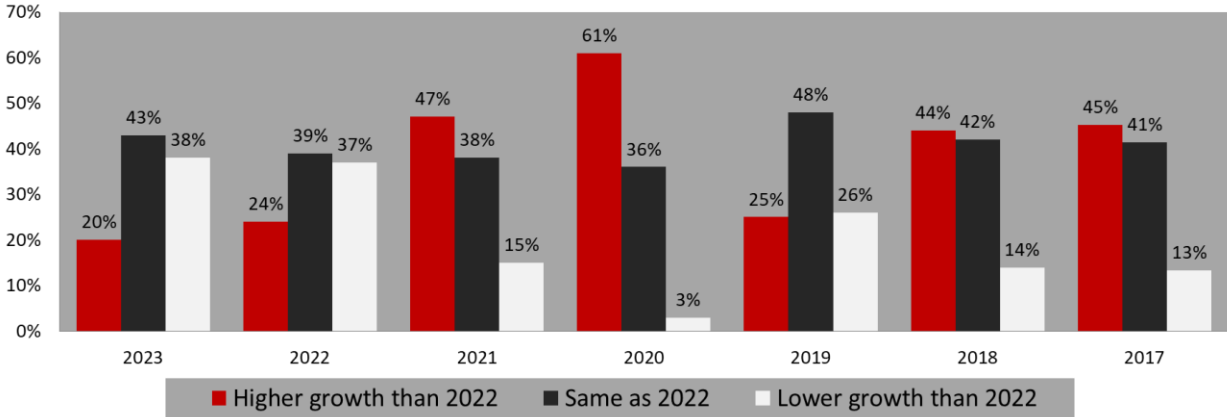


Figure 6 - In 2023, your business will experience?

Despite the rough economic conditions, 20% of the CEOs are optimistic of higher growth than 2023. This is a slight drop in CEO confidence when compared to the 24% in the previous year.

Moreover, 43% of the CEOs anticipate that their business will achieve same level of growth this year compared to that of 2022 followed by 38% of respondents expecting lower growth than 2022.

Overall, a bleak outlook is apparent in terms of business performance with expectations of local and global economic recovery.

## External Challenges Dominate

According to the surveyed chief executives, 53% are certain, that challenges they will face in 2023 will be factors that are external to their businesses while 47% believe they will take the form of controllable (internal) factors – unlike last year, where 85% of the surveyed CEOs believed that the challenges to the business would be external.

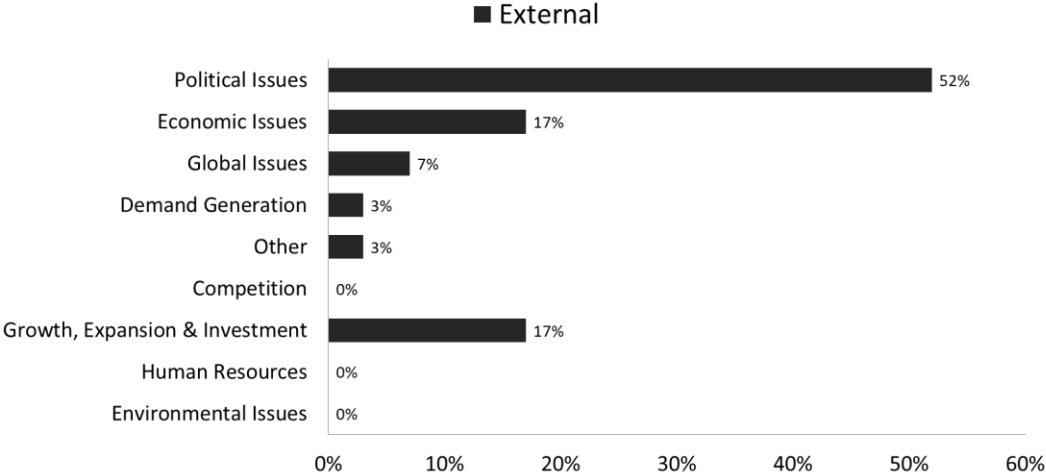


Figure 7 - External Challenges: Breakdown

The key external challenge that concerns CEOs this year is Political issues (52%). Some of the main political issues that were frequently highlighted included regulatory concerns with regards to imports, policy inconsistencies, and interest rates.

17% of CEOs cited Economic issues and Growth, Expansion, and Investment as the 2nd biggest external challenge where issues surrounding inflation, exchange rate, taxation, and interest rates were stressed.

This was followed by Global Issues and Demand Generation which are believed to be the top external challenges by 7% and 3% of the respondents, respectively, with underlying themes being global economic conditions and expenditure on budgets.

Competition (0%), Human Resources (0%), and Environmental Issues (0%) were the least cited external challenges.

# Internal Challenges

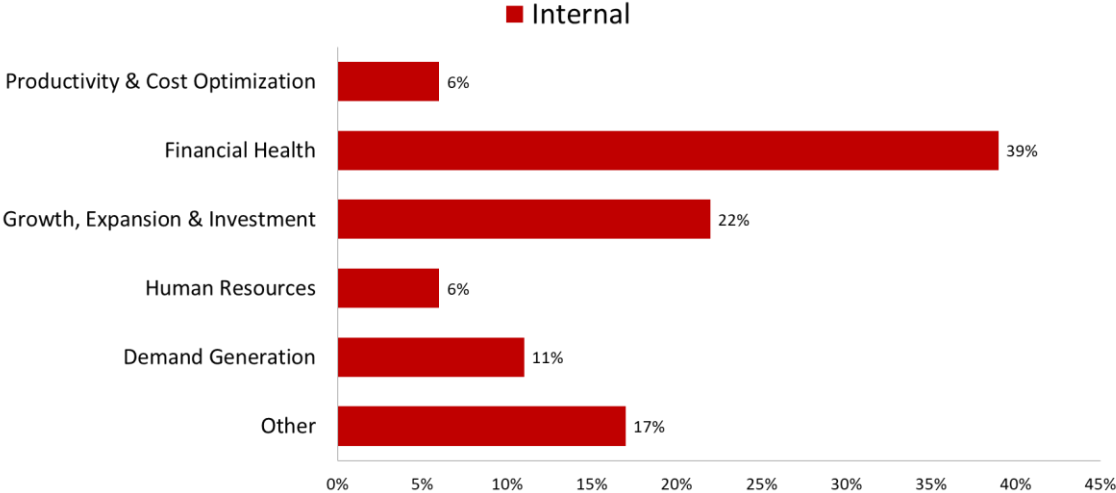


Figure 8 - Internal Challenges: Breakdown

39% of CEOs have identified Financial Health as the key internal challenge for the year, expressing concerns over maintaining the profitability during this rough economic crisis.

Ensuring Growth, Expansion & Investment was cited as the 2nd biggest internal challenge with 22% of the CEOs expressing concerns over imports and global economic outlook.

Furthermore, Demand Generation was pointed out by 11% of the CEOs respectively with a smaller percentage highlighting concerns over Human Resources and Productivity & Cost Optimization.

## Conclusion

With Sri Lanka still facing the lingering effects of the COVID-19 pandemic and expecting to encounter more challenges with regard to the economic crisis, the expectation for the business environment to perform below expectations is continuing – identical to previous years. Issues with the shortage of foreign exchange leading to a shortage of raw materials, increase of prices of inputs, and continuation of electricity cuts, are expected to continue. These will negatively affect production, leading to the risk of losing jobs and income.

CEOs attribute the Political Instability to be the main factor that could have an impact on their business’s performance and external challenges were perceived to be the biggest obstacle for CEOs in operating their businesses in 2023.

Further, the global economy is also expected to continue facing challenges such as the Russian invasion of Ukraine, high cost of living, increasing inflation pressures and the economic slowdown in China. Therefore, it is essential that CEOs take the initiative to work with the Government of Sri Lanka to make positive progress.

Demand for Sri Lankan exports as well as tourist arrivals in Sri Lanka are expected to be affected by the recession predicted for most countries in 2023 so measures have to be taken to value added exports and maintain the recent pickup in tourist arrivals.

Sri Lanka plans to promote Sri Lankan tourism in major cities in India in 2023. These actions as well as improving facilities for tourists and taking measures to ensure their safety during their stay in Sri Lanka will go a long way in boosting Sri Lankan tourism.

## **MTI Corporate Finance**

MTI Corporate Finance is the corporate finance arm of MTI Consulting, a boutique strategy consultancy with a network of associates across Asia, Africa and the Middle East. MTI Corporate Finance provides a comprehensive range of services, including due diligence, feasibility studies, funding new businesses or capitalization of existing ones – from IPOs to private placement facilitation, M&A facilitation, and advisory on governance, compliances and risk management.