



Gradient Alliance

Monthly Bulletin: January 2016

In Economic news:



- Budget deficit reaches 7.2% in 2015 on high "contractual payments".
- 2016 budget revisions continue, VAT/NBT latest casualty.
- Sri Lanka looks to IMF to shore up reserves..
- Sri Lanka joins China led AIIB.
- USD 5-6bn FDI targeted; 2015 inflows fall to USD 700-800m.
- Private sector credit continues to grow in November.
- Sri Lanka slightly improves to 83rd in the Corruption Index.
- Inflation rises 4.2% YoY in December. CCPI at 0.9% in January.
- Rupee in January at 142.06/146.1 vs. USD (down 0.01% MoM).
- Stock market closes at 6,340.10 in January (-8.0% MoM).

In Business news:

- Tourist arrivals at a record 1.7m in 2015, up 17.8%; Fox News includes Sri Lanka as "one of the top under the radar destinations".
- Vehicle regs. up 54.4% YoY in 2015, reaches an all-time high 660,200 regs.
- Tea production in 2015 at a three year low.
- Trade deficit in November 2015 contracts to USD 629,9m (-13.2% YoY).
- LMD-Nielsen business sentiment index rise to 152 (+5 pts MoM).

In Consumer news:

- Nielsen consumer confidence index falls to 75 (-9 pts MoM).
- Bread prices up.
- Rs.100 on per kg of canned fish reimposed.



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In Economic news:

Budget deficit reaches 7.2% in 2015. According to Mr. Ravi Karunanyake, Minister of Finance, Sri Lanka's budget deficit in 2015 was 7.2% of Gross Domestic Product (GDP), higher than targeted 6.0%, due to "unexpected payments for contractors".

6.0% target was established as recently as November 29th, 2015,



revised from 4.4% of GDP. The deficit exceeds International Monetary Fund (IMF)'s forecast of 5.5%-6.0%.

Mr. Karunanayke attributed the increased deficit to heavy spending

Budget revisions continue as new VAT/NBT proposals temporarily shelved.

In yet another U turn, making a mockery of the budget preparation process, the govt. deferred implementing two of its major revenue proposals, citing need to extend relief to people and the private sector.

The net effect of changes to Value Added Tax (VAT) and Nation Building Tax (NBT) was to generate almost Rs.65bn in new revenue.

NBT threshold was to come line with VAT (Rs.3m per quarter) and the rate doubled to 4%. Moreover, previously excluded sectors, telecommunication, supply of electricity and lubricants was to be charged NBT.

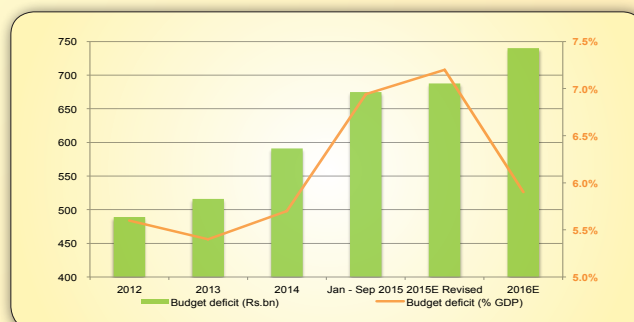
Further, service sector would have been liable to pay VAT at 12.5% while manufacturers and import traders charged 8% and wholesalers and retailers exempt from VAT.

The Ministry of Finance said above amendments should not be implemented until the relevant legislative enactments are passed by Parliament. But it also noted that

on contractual payments for infrastructure projects started by the previous government, which according to him "was put in the last year's budget".

However populist policies of the current regime of higher state sector salaries and allowance, reduced utility tariffs, reduced fuel charges, lower import taxes on select items have also contributed to such dire state of affairs.

For 2016, Sri Lanka aims to reduce the budget deficit to 5.9% of GDP. The IMF warned Sri Lanka not to have loose monetary and fiscal policies and urged structural reforms to safeguard economic



Source: Ministry of Finance and Gradient Alliance Analysis

• "Considering the cost of living impact, restriction on the exempt supplies applicable on wholesale and retail trade (deemed VAT) is removed with effect from 01.01.2016

• Vehicle importers who have imported motor vehicles for personal use on LCs opened before Budget 2016 are permitted to be cleared from Customs by paying the duties under the rate that prevailed at 20.11.2015, without paying any demurrages."

Most welcome the reversal as the hike in NBT was to have made companies directly pass it on to the end consumer.





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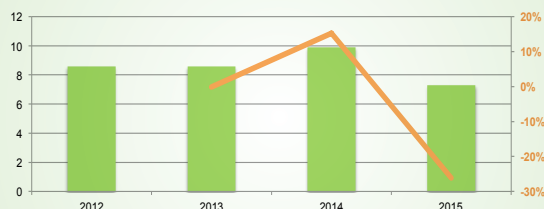
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In Economic news:

Sri Lanka looks to IMF to shore up reserves, as unidentified investor pumps in USD 1.0bn. The Central Bank of Sri Lanka (CBSL) was said to be in discussions with the IMF to procure USD 1.0bn under a Stand by Arrangement.

Such funds will boost the country's international reserves which currently stands at about USD 7.3bn. This is likely to come under further pressure should foreigners continue to pull out of government securities, exports persist to decline and foreign remittances slowdown.

International Reserves of Sri Lanka (USD bn.)



Source: Central Bank of Sri Lanka

Foreigners have been reducing holdings in Sri Lanka's treasuries and equity investments citing better opportunities elsewhere and volatile domestic conditions.

The situation is likely to worsen in the second of the half of 2016 as Sri Lanka has to service at least USD 4.0bn of debt which will be compounded should political turmoil in the Middle east impact foreign remittances.

Speaking on the matter, Mr. Sarath Amunugama, Minister of Special Assignment,

- "Unfortunately, our economy depends on global economic situation. There is a huge gap between the inflow and outflow of capital as a result of the prices of our traditional exports of tea, rubber and coconut have been low in the last couple of years.

- In contrast, prices of many of our import goods have been on the rise except oil and petroleum products. Sri Lanka's economy would have been in an extremely precarious situation if oil prices also remained high.



- The relief package given to the public in two stages last year, slashing prices of several commodities including fuel and gas prices, use of Concessionary Vehicle Import Permits have contributed to deplete the State revenue in a big way.



In a scenario of smacking transparency right across it's face, Mr. Ravi Karunanyake, Minister of Finance stated that USD 1.0bn is to be deposited in Sri Lanka to defend the currency, from an individual whom he declined to identify.

All Mr. Karunanyake revealed was that the investor is Belgian and is

working with a Sri Lankan partner, transferring the money in from banks in Brussels and Luxembourg.

He further noted "Instead of going for bonds and other borrowing, we are permitting it to take place. This is better than negative returns in Europe". The deposits are to receive 2% and is said to be part of Ministry's plans to raise about USD 3 to 4bn.

Separately Mr. Arjuna Mahendran, Governor, CBSL confirmed foreign inflows of USD 1.0bn from Saudi Arabia in February 2016.



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In Economic news:



International economic bigwigs advise Sri Lanka at a forum. The George Soros Foundation organised an economic forum in Sri Lanka under the theme 'Steering Sri Lanka towards Sustainable and Inclusive Development'.

The well attend event saw presentations from Mr. Ranil Wickramasinghe, Prime Minister, Sri Lanka, Mr. George Soros Founder Chairman of Open Society, and Mr. Joseph Stiglitz.

Basing the discussion on a preliminary study on Sri Lanka carried out by the Harvard University, it identified (1) Macroeconomic and fiscal stability, (2) Structural transformation and competitiveness, (3) Urbanisation and development and (4) Regional development and social inclusion as risk and opportunities for Sri Lanka.

According to Mr. George Soros "I am very pleased to be attending this conference because I am very impressed by what this Government has achieved in a very short period of time.

It has moved towards a more open society and this is the cause my

Foundation supports. I am pleased to be of assistance to the extent that we can be and I have people here looking at inv. opportunities."

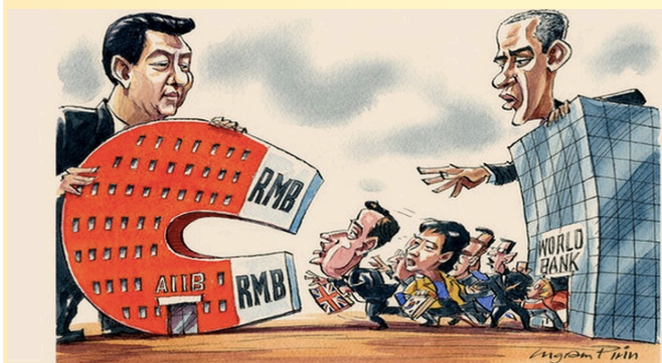
According to renowned economist Joseph Stiglitz, the government could raise tax revenue by taxing environmental pollution, inelastic goods, land, consumption and road congestion. He noted;

- Carbon taxes help to address the problem of emitters of greenhouse gases not facing the full social cost of their actions.
- Taxing inelastic goods, was another way to raise tax revenue that leads to less distortions.
- Land taxation which requires having a national land registry.
- Taxation on consumption of luxury goods can help in situations of balance of payments problems.
- Road and congestion taxes, coupled with modern technology, could allow tracking vehicles and taxing the externality of congestion.

Sri Lanka to join AIIB. The cabinet of Sri Lanka approved the country's admission to obtain formal membership of the Asian Infrastructure Investment Bank (AIIB).

The government is to subscribe to about USD 268m, a quota raised based on Sri Lanka's GDP. According to a cabinet paper "Cabinet has approved the drafting of a Bill to enable Sri Lanka to obtain the formal membership of AIIB through ratification of the member agreement.

Approval was also given to join Group G led by Indonesia to form a constituency of AIIB. Commencing 2Q16, the AIIB is to lend about USD 10-15bn a year for the first five to six years.

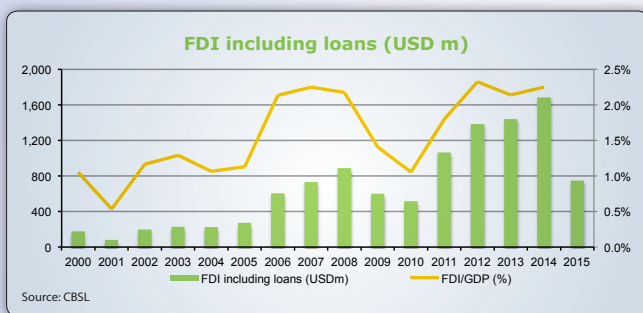




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In Economic news:



Sri Lankan targets USD 5.0-6.0bn of FDIs as 2015 inflows fall. According to Mr. Malik Samarawickrama, Minister of Development Strategies and International Trade

- “We are targeting USD 5-6bn in FDI in the next three years and I am quite optimistic that we will get there.

- It will no doubt be a challenge with the prevailing global climate but we are very positive because now Sri Lanka is well placed to attract this kind of investment as people are also looking for new places.

Britain to increase trade focus on Sri Lanka. According to Mr. Hugo Swire, Minister of State for Asia at the Foreign and Commonwealth Office, Britain is banking on Sri Lanka with British companies competing for about GBP 1.0bn in a range of industries and sending a multi-sectoral trade mission next month.



He attributed political changes in Sri Lanka to have opened up the space for more aggressive investment opportunities to foster economic growth in both countries paving away the way for stronger engagement. He further noted

- We have a program to attract investments country wise and will have road shows in Mumbai, Tokyo, Beijing and even Europe and the United States and so on.

- So within the course of this year we hope to cover 5-6 major countries and at the same time I have been invited to China. They will come up with a program to set up industries – particularly in the Southern and Western regions. They want to have economic zones and bring in the investors themselves.”

He also noted that FDIs in 2015 was about USD 700–800m, lowest since 2010.



- “The Government of Sri Lanka has sent a very clear message to the international community across the world that it is open for business from all corners of the globe.

- Attracting Foreign Direct Investment is I know a top priority for the Government as it seeks to strengthen the Sri Lankan economy and put Sri Lanka in a stronger position to deal with the global challenges both our countries face.

- The elimination of corruption improves business confidence, not only for the existing business community, but it also helps make Sri Lanka a destination of choice for new Foreign Direct Investment.”

UK is among the top 10 investors and is Sri Lanka's third largest market.



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In Economic news:

Trade deficit in November 2015 contracts to USD 629.9m (-13.2% YoY). Exports in November declined for the ninth consecutive month falling 7.4% YoY to USD 835.2m with imports decreasing 11.0% YoY to USD 1.47bn.



The resulting trade deficit was partially funded by USD 574.5m (-7.2% YoY) of worker remittances.

- Agriculture exports (~22% of exports) declined for the ninth straight month, down 13.8% YoY to USD 199.4m.

Tea exports fell (USD 108.5m, -21.1% YoY) on lower demand from Russia and Middle East and declining world prices. Average export price of tea was USD 4.1 per kg unchanged from October but down from USD 4.75 per kg in November 2014.

Sea food exports were USD 13.4m (-33.3% YoY), continuing to be impacted by the EU ban on fish exports from Sri Lanka.

- Industrial exports (~77% of exports) were USD 633.2m, down 9.3% YoY. Apparel exports were USD 410.2m, down 2.5% YoY and rubber products decreased to USD 56.0m (-19.5% YoY).

Chemical products exports also fell, USD 17.8m (-40.5% YoY). However gem exports rose significantly, 110.5% YoY, USD 20.0m.

- Consumer goods imports (~18% of imports) were USD 391.0m, up 7.1% YoY, driven by vehicle imports of USD 117.6m (+25.0%



YoY). However, food and beverage imports were only USD 127.6m (-13.7% YoY).

- Intermediate goods imports (~59% of imports) were USD 690.7m, down 24.1% YoY. Textile and textile article imports declined (USD 167.7m, -22.3% YoY) and fuel imports reduced to USD 193.7m (-28.3% YoY). Average crude oil import price declined to USD 45.46 per barrel (vs. USD 76.82 in November 2014).

- Investment goods imports were USD 382.6m, up 3.1% YoY. Imports of machinery and equipment were USD 195.1m, +8.4% YoY, building materials, USD 135.7m +35.5% YoY and transport equipment were USD 54.1m, -41.3% YoY.





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In Economic news:



Human Development Report 2015
Work for Human Development
WEB VERSION



TI noted "in places like Guatemala, Sri Lanka and Ghana, citizen activists in groups and on their own worked hard to drive out the corrupt, sending a strong message that should encourage others to take decisive action in 2016".

Sri Lanka 83rd in the Corruption Perceptions Index and 73rd in the Human Development Index. Sri Lanka improved to two places to 83rd in Transparency International's (TI) 2015 Corruption Perceptions Index. The index ranks perceived level of public sector corruption.

Despite a rise in ranking country score declined to 37 from 38 indicating perception of corruption in the public sector has worsened.

Sri Lanka lies third in South Asia behind Bhutan and India but ahead of Nepal, Pakistan, Bangladesh and Afghanistan.

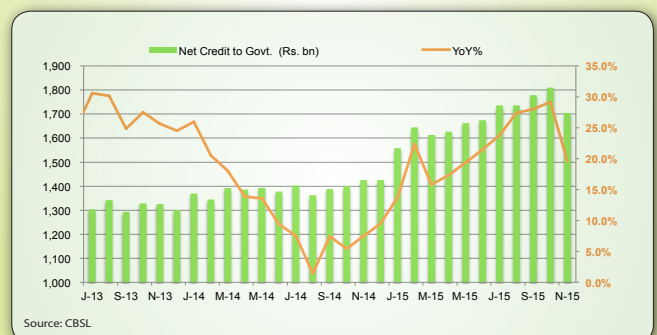
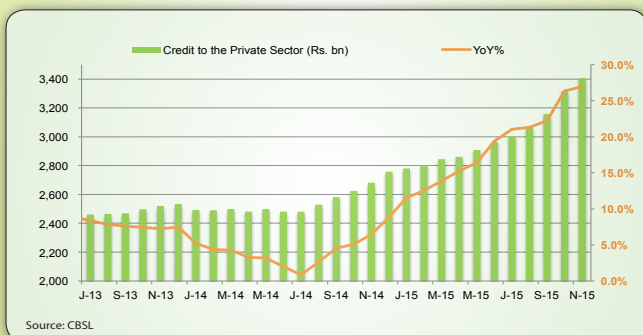
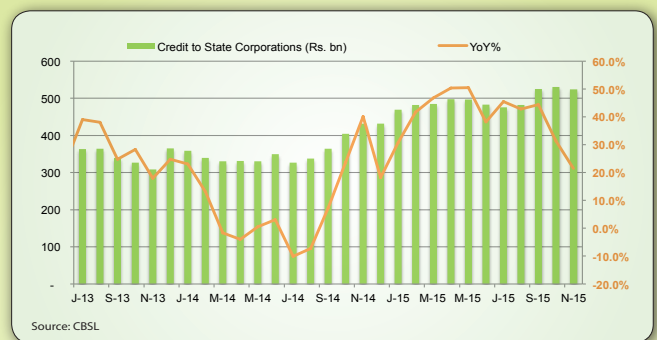
Sri Lanka remained at 73rd in the Human Development Index for 2014. Despite doing well in areas of gender equality including health, education and command over economic resources Sri Lanka failed to improve its ranking.

It noted, life expectancy increased from 74.3 in 2013 vs. 74.9 in 2014. Expected years of schooling rose from 13.6 to 13.7. Sri Lanka's score of

Private sector credit continues to grow. Credit to private businesses and personal customers grew 27.0% YoY to Rs.3,405.6bn in November 2015.

CBSL increased the Statutory Reserve Ratio applicable on all rupee deposits of banks by 1.5% to 7.5% to curb excessive credit creation and resultant demand pressures on inflation; market interest rates are slated to rise after a time lag.

Following this excess, liquidity, which averaged Rs.90bn was to have declined to Rs.42bn. CBSL maintained the Standing Deposit Facility Rate and the Standing Lending Facility Rate at 6.00% and 7.50%. Credit to state corporations increased 21.4% YoY to Rs.524.0bn.



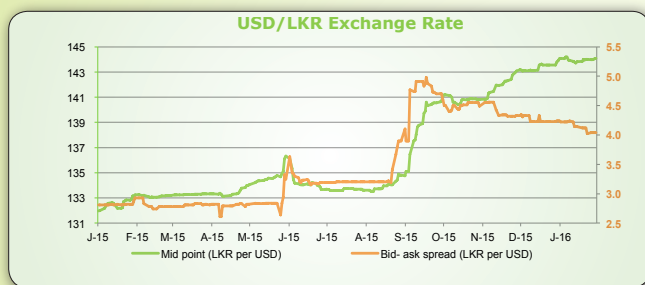


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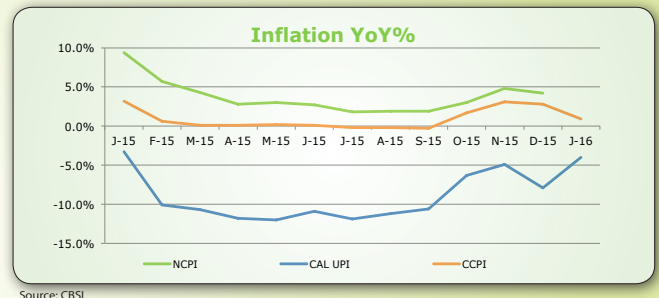
In Economic news:

Rupee in January 2015 at 142.06/146.1 vs. USD (Rupee weaker 0.01% MoM).



Inflation rises at 4.2% YoY in December. Segments of the National Consumer Price Index (NCPI) (1) value of food items increased 0.9% MoM and (2) value of non-food items rose 0.1% MoM.

Separately, Colombo Consumer Price Index rose just 0.9% YoY in January 2016. The NCPI is compiled using prices collected from all the nine provinces with base year of 2013. NCPI was created as the Colombo Consumer Price Index only covers the urban areas of the Colombo District.



Stock market closes at 6,340.1, down 8.0% MoM.

Baring stores & supplies (+1.0% MoM) all other sectors recorded negative growth during the month. Worst performing sectors in the month were information technology (-19.8% MoM), oil palms (-13.0% MoM) and investment trusts (-11.4% MoM).

• CBSL took over Entrust Securities, a primary dealer in government securities as it failed to submit a viable restructuring plan. National Savings Bank was appointed as the management agent.

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In Business news:



America traffic was 84,943 (+16.9% YoY).

- Middle East arrivals increased 13.6% YoY to 101,066.

In tourism news:

- The Tourism Ministry says the aim is to attract 2.2m visitors in 2016, up 22% YoY.

Under its' key strategic objectives, it intends to increase the average daily tourist expenditure to USD 200, to generate a revenue of USD 2.75bn.

- Countering criticism that Sri Lanka tourism lacked

Tourist arrivals up 17.8% YoY in 2015. Tourist arrivals in 2015 reached an all time of 1,798,380, up 17.8% YoY, just shy of the revised 1.8m target. According to Sri Lanka Tourism Development Authority, during the year;

- Indian arrivals were 316,247 (+30.3% YoY).
- Western Europe: U.K: 161,845 (+12.3% YoY), Germany: 115,868 (+12.3% YoY) and France: 86,126 (+9.2% YoY).
- East Asia arrivals: China and Hong Kong 214,783 (+67.6% YoY).
- Russian arrivals decreased 11.3% YoY to 61,846 while North

a cohesive marketing and promotional plan, Sri Lanka Tourism announced a strategic marketing plan.

The 2016 plan involves "the private and public sector stakeholders addressing long standing needs of the industry and the future expectations of the country as a tourism destination".

The USD 80m marketing campaign is to focus on country's main product offerings and includes participation at 46 travel fairs and 20 road shows.

- Fox News included Sri Lanka as one of the top under-the radar destination for 2016. It notes "This tropical Island in the Indian Ocean offers sweeping landscapes of lush green countryside, towering waterfalls and golden sand beaches.

Sri Lanka has several national parks and eight UNESCO World Heritage Sites, including the Temple of the Tooth, which is said to hold Buddha's tooth relic. It's also known for its tea plantations.

We want to get there before everyone else discovers it and it changes."

Others in the top ten-list, Colombia, Japan, Switzerland, Greenland, Ohio, China, Georgia, Montenegro and Nicaragua.





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In Business news:

Vehicle registrations up 54.4% YoY in 2015.

• According to JB Securities total vehicle registrations were a historic high, 660,200 in 2015, up 54.4% YoY. In 2015,

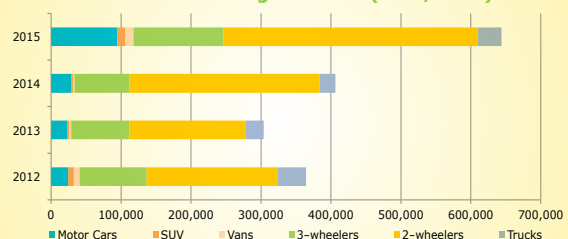


- Motorcar registrations were 94,723 (+226.1% YoY) while SUV and vans rose to 9,910 (+4.9% YoY) and 11,556 (+398.7% YoY)
- 3 wheeler registrations were a staggering 128,897 (+64.0% YoY).
- Motorcycle registrations were 362,955 (+33.8% YoY).
- Total truck registrations were 37,224 (+41.7% YoY) with mini trucks accounting for about half of all truck registrations (17,227), followed by lite trucks (7,305) and pickups (5,031).

According to Mr. Murtaza Jafferjee, CEO, JB Securities;

- "In 2015, Sri Lanka set a record as the number one destination for used car exports from Japan in terms of value. Malaysia being the next highest is almost 40% lower.
- Sri Lanka imported 48,402 used Japanese cars, at an avg. value of 1.75m yen. Malaysia imported 19,409 cars totalling 50bn yen, New Zealand (NZ) with 102,487 cars totalling 47.28bn yen.
- Even though the largest volume of cars were exported to NZ, those cars are of low value since they are old, while cars imported to Sri Lanka are hardly used, with 5,000-10,000 km of usage.
- Despite increases of tariffs on hybrids in the budget, tariffs and additional costs imposed on hybrids are 55% lower than that of a similar petrol vehicle, Sri Lankans will continue to demand used Japanese vehicles as the local agents do not offer the entire product range available in Japan."

Motor Vehicle Registrations (New/Used)



Source: JB Securities

Common floor rates on telcos. Telecommunications Regulatory Commission (TRC) will introduce common floor rates for call charges from February 1, 2016, at Rs.1.50 per minute, while those between networks it will be Rs.1.80.

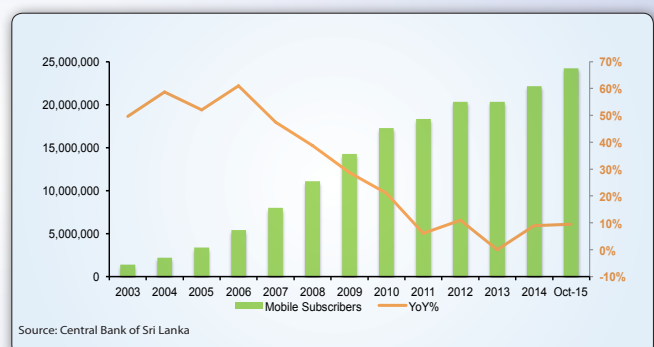
TRC says this will ensure small telecom operators remain competitive, noting

"Operators had requested to review the floor rate, especially the small operators having a lower market share. When this type of tariff is there, they can compete with big operators."

Sri Lanka mobile penetration is over 100% and is considered overcrowded with service providers Dialog Axiata and Mobitel accounting for around two-thirds of the phone market. This is followed by Airtel, Etisalat and Hutchison.

On a separate note, Fitch Ratings revised its' outlook on the country's telcos to 'Stable' from 'Negative' as a result of the scrapping of recurring taxes imposed on them from the Interim

Budget in 2015, which could have diluted the industry Earnings Before Interest Tax Depreciation and Amortization margin by 6-7%.



Source: Central Bank of Sri Lanka



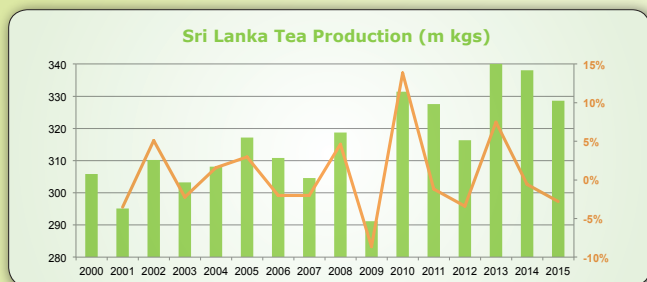
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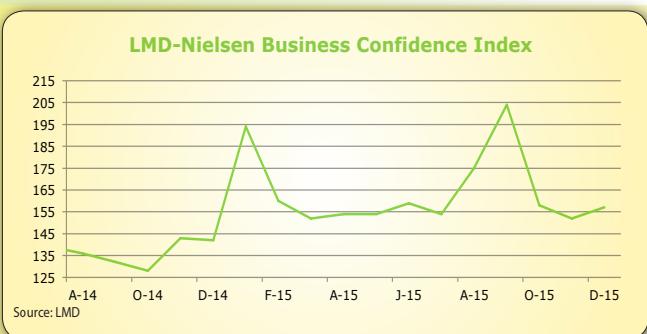
Tea production in 2015 at a three-year low.

Tea production in 2015 declined to 328.9m kgs, down 2.8% YoY affected by adverse weather conditions and trade union action curtailing smooth production.



Source: Sri Lanka Tea Board

According to Asia Siyaka Commodities, Sri Lanka would need exceptional growing conditions and a revival in the market at least through a depreciation of the rupee, if the 2016 annual production figure of over 330m kgs is to be met. It noted



Source: LMD

LMD-Nielsen business confidence index rise to 157 in December (+5 bps MoM). As per Mr. Shaheen Cader, Managing Director, Nielsen, "an underlying positive growth trend – after disallowing for the peaks and troughs due to recent elections.

Despite concerns about high taxation... the business sector is more optimistic about the Sri Lankan economy, post the budget. The depreciation of the Sri Lankan Rupee has not dampened the BCI. Businesses may have accepted the devaluation as a necessity for economic growth, and to correct the ballooning



• A key factor would be the dry conditions projected for 1Q 2016 and this could play a significant part in 2Q as well.

• Reduced fertiliser subsidy and banning of cost-effective weedicide would place both estate and smallholders under pressure, considering the added restriction of lower prices.

• Continuing uncertainty over wage negotiations could also trigger disruption of work in estates, any negotiated wage increase would further pressurize the plantation companies.

Balance of Payments deficit."

THE ECONOMY - More than half the survey sample (versus only 36%, in November) is of the view that the economy will improve in the coming 12 months. A further 34% deem that prevailing economic conditions will persist, while 15% were negative.

BIZ PROSPECTS - With respect to sales volumes, at least six-in-10 businesspeople state that conditions will improve in 2016, while 28% anticipate the status quo to be maintained and just over a tenth expect to be worse off.

INVESTMENT - There's a split verdict on the country's investment climate – 41% of those surveyed state that prevailing conditions are healthy, 31% say they are 'fair' and marginally below that number offer no more than a thumbs down.

"I cannot see an improvement in the investment climate, after the announcement of the new budget," a member of the business community laments.

Another states: "The Govt. is trying to attract more foreign investors, rather than helping local businesses first."



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In Consumer news:

Bread prices up. The price of a 450g loaf of bread was increased by Rs.1.0 to Rs.55 the All Ceylon Bakery Owners' Association Chairman N.K. Jayewardene stated. This was following the increase of NBT by the budget, which was subsequently temporarily shelved.



Rs.100 tax on per kg of canned fish reimposed. This tax which was reduced during elections last year, is now deemed necessary to promote local producers.

Sri Lanka imports about 20,000 MT of canned fish annually with annual consumption amounting to Rs.10bn. Govt will offer permits to local companies to import mackerel to be canned, which would also be exempt from new taxes.

On a separate note, the Sri Lankan cabinet approved relocating the Manning Market from Colombo Fort to Peliyagoda at a cost of Rs.4.0bn.

Nielsen consumer confidence declines to 75 in December (-9 bps).

Consumers seem to have reacted negatively to the devaluation of the rupee and higher taxation on vehicles, resulting in a substantial increase in pessimism in relation to purchasing power in the next 12 months.

Thus, the Nielsen Consumer Confidence Index (CCI) dropped sharply, to 75, in December - this also represents a 12-month low for the index.

In terms of job prospects in the next 12 months, just over a third of respondents expect a positive outcome, while the majority (66%) hold a pessimistic view.

More than three-quarters of those polled say the state of their personal finances will be unsatisfactory in the 12 months ahead, which is in line with the prior month's outcome.

As for being able to purchase essential items, only 16 percent (versus 23%, in November) say that conditions will be 'good' or better in the 12 months ahead.

Q: What do you think the job prospects for Sri Lankans will be in the next 12 months?

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Excellent	8	2	3	2	5	8	3	6	3	4	4	1
Good	41	42	27	33	22	19	21	54	51	33	31	33
Not so good	45	47	52	53	52	49	60	31	41	46	49	48
Bad	6	9	18	12	21	24	16	9	5	17	16	18
Base	100	100	100	100	100	100	100	100	100	100	100	100

Q: What do you think your state of personal finances will be in the next 12 months?

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Excellent	5	2	1	3	5	3	1	2	0	2	3	0
Good	28	41	23	31	25	18	28	38	29	27	20	24
Not so good	48	43	58	50	58	66	53	44	62	50	59	47
Bad	19	14	18	16	12	13	18	16	9	21	18	29
Base	100	100	100	100	100	100	100	100	100	100	100	100

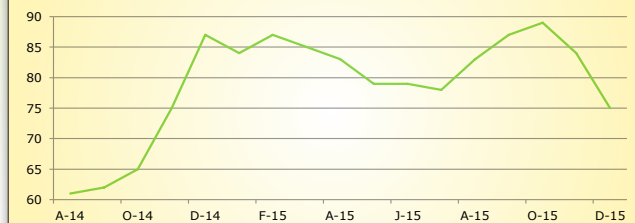
Q: How do you think the next 12 months will be for people to buy the things they need?

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Excellent	5	4	1	3	4	5	3	4	3	5	4	1
Good	29	45	25	30	30	29	35	41	42	41	19	15
Not so good	49	43	61	56	49	52	43	46	46	44	64	50
Bad	17	8	13	11	17	14	19	9	9	10	13	34
Base	100	100	100	100	100	100	100	100	100	100	100	100



As for being able to purchase essential items, only 16 percent (versus 23%, in November) say that conditions will be 'good' or better in the 12 months ahead...

Nielsen Consumer Confidence Index



Source: LMD

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