



## Pathfinder Economic Flash

### El Nino Looms: Are We Ready?

There is an emerging consensus that this is likely to be an El Nino year. Experts have indicated that there is a 58% probability that it will begin to take effect in 3Q 2014; there is an 80% chance of it materializing in the last quarter of this year.

El Nino causes very disruptive weather effects with severe flooding in some areas and drought in others. The last episode resulted in the food crisis of 2006/7 when there was a severe spike in global prices. This time around the effects are expected to be more severe.

For Sri Lanka, the import prices of wheat, sugar and milk powder (due to an increase in the cost of feed) are likely to be adversely affected. There could also be direct weather effects, particularly for agriculture and power generation. Consequently, there could be repercussions for both inflation and the balance of payments.

It is important that the government and businesses are pro-active in considering timely mitigation measures

*El Niño is a band of warm ocean water temperatures that periodically develops off the Pacific coast of South America.*

*El Niño, accompanies high air surface pressure in the western Pacific, while the cold phase, La Niña, accompanies low air surface pressure in the western Pacific. Mechanisms that cause the oscillation remain under study.*

*Developing countries dependent upon agriculture and fishing, particularly those*

As mentioned above, agriculture, irrigation/water supply and power generation are the sectors which are most likely to be affected.

#### **Possible Effects on Agriculture, Food, Nutrition and Proposed Actions**

With 31% of the population involved in agriculture, clearly this sector requires particular attention. There is a high probability that the drought conditions, which have been prevailing in the country, will be intensified as the effects of El Nino gathers strength. The

Agriculture Department needs to raise the awareness of farmers regarding ways and means of mitigating these negative impacts. This is likely to be challenging as farmers tend to be tradition- bound and follow customary methods of farming. Seeds of early maturing and less water intensive crops need to be provided, particularly in areas of the country that experience

‘water stress’. For instance, farmers can be encouraged to grow cash crop cereals, such as soya and green gram, during the next Maha Season. Consideration should also be given to ways and means of maximizing production of various crops in the Yala Season before the full effects of El Nino kick-in as the year progresses. In the longer term, the agricultural research system should be geared to pursue vigorously the improvement of productivity. Improved seed varieties and better agronomic practices can have significant benefits.

Livestock production can also be affected. Drought and the increased prices of imported feed could depress both milk and meat production.

Attention should also be paid to the implications for the food and nutrition levels of the people, particularly in vulnerable areas of the country. Priority should be given to ensuring the protection of infants as well as pregnant and lactating women.

It is noteworthy that Sharad Phawar, the Indian Agriculture Minister until recently, had already indicated that India was ready with a contingency plan to respond to El Nino effects. Fears that India will be adversely affected have been heightened by the failure of the South West Monsoon to hit the Kerala coast by 31<sup>st</sup> May. This is the first time in six years (i.e. since the last El Nino year) that this has happened. The contingency plans are ready, in particular, for 500 districts which are considered especially vulnerable.

### **Need for Water Conservation**

Timely action should also be taken to initiate **water conservation** efforts and regulate the release of water for different purposes: agriculture, households and power generation. A concerted effort should be made to promote rain/drainage water harvesting; and invest in minor tanks. Difficult decisions will need to be made regarding the use of water for different purposes; all of which are important for the lives of the people. Clear and early planning are, therefore, of the essence.

### **Mitigating the Impact on Power Generation**

The increase in the unit cost of **power generation** will be another negative effect of the El Nino phenomenon. The contribution of hydropower fell to 22% percent in 1Q 2014 from over 50% in 2013. Despite the recent rainfall, the likelihood is that there will have to be a very heavy dependence on thermal generation in the ensuing months. While the increased capacity of coal-based generation from the Norochcholai plant will have a mitigating effect, there will still be challenging political decisions to be made regarding electricity pricing and/or increasing the subsidy. The latter option would adversely affect the operational viability of the CEB and eventually the balance sheets of either the government or the state banks. These effects can be mitigated to some extent through a carefully planned forward purchasing program for oil imports.

Severe drought also increases the risk of forest fires. It heightens the flammability of vegetation and creates conditions for the spread of fires and an increase in the intensity of burning.

The adverse El Nino effects on agriculture and power generation will have significant implications for the balance of payments and the budget.

In addition, the production of export crops, including tea, rubber, coconut and ‘other export crops,’ are likely to experience an adverse impact. At the same time, there is likely to be an increased recourse to imported oil. These impacts place a high priority on building up a cushion of external reserves to contain the negative impact on domestic absorption (i.e. on consumption and investment), as a means of protecting living standards and the growth rate. The external risks are likely to be compounded by the Federal Reserve’s anticipated exit from its QE program later in the year, when the effects of El Nino are expected to gather momentum. It is encouraging, therefore, that the country’s current reserves stand at a comfortable level.

There are also likely to be additional pressures on the budget from various drought-related expenditures and downward pressure on revenue as a result of the dislocation of economic activity. This places a high premium on fiscal discipline to ensure that these can be accommodated within the government’s medium- term fiscal consolidation program.

### **Working Towards Mitigating Impacts of El Nino**

There is considerable experience from around the world regarding ways and means of mitigating the effects of El Nino. Very early action is necessary for all the relevant Government Departments to draw on a combination of local knowledge, and foreign experience in countries which experience similar El Nino effects, to draw up contingency plans to address the various risks. There is no time to be lost. Minister Champika Ranawaka has asked whether we are ready. No time should be lost in responding to his call to action. In the short-run, Sri Lanka should be ready to minimize the adverse effects of the El Nino phenomenon expected to hit later this year. In the longer-term, local capacity should be built at several levels to increase resilience and mitigate the effects of drought. Strengthened insurance programs can play an important role in this respect for the crucial agricultural sector.

*This is the Forty-Eighth Economic Flash published by the Pathfinder Foundation.  
Readers’ comments are welcome at [www.pathfinderfoundation.org](http://www.pathfinderfoundation.org)*

