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WEEKLY BRIEF

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INTRODUCTION

The key international story that ran the week was the entrant of DeepSeek to the generative AI market that not only had a shock effect on interested groups but saw Nvidia lose $600 billion in market value. The highest single day loss for any company on Wall Street.

The controversy that was sparked by the low-cost alternative for generative AI, was almost equally followed by the series of decisions being made by the Trump administration to effectively neutralise the liberal economic thinking that has been prescribed to countries such as China.

This week we explore the stories that made it to the news and the ones that were left out to give you insights about the key factors that shape the world around you.

DOMESTIC

1) Sri Lanka's Story, Stepping into February 2025

Despite the Central Bank's claims of "deflation" as a positive economic indicator, the reality is far more concerning. The 4% deflation recorded in January 2025—the fifth consecutive month of negative inflation—signals a weak economy, not a recovering one. While falling prices might seem beneficial, in reality, they indicate weak consumer demand, stagnant wages, and struggling businesses that are unable to raise prices due to lack of spending power. This economic stagnation contradicts the liberal narrative of stability and growth.

At the same time, Sri Lanka's merchandise trade deficit has widened, highlighting the country's increasing reliance on imports. Export earnings in 2024 grew by 7.2% year-on-year, reaching $12.77 billion—driven by petroleum products, textiles, tea, and coconut-based goods. However, import expenditure surged by a much higher 12.1%, reaching $18.84 billion. The widening gap means Sri Lanka is draining more foreign reserves, increasing its dependency on external borrowing, and failing to develop a competitive domestic manufacturing base. Worse still, high-value exports like gems and machinery saw substantial declines, exposing structural weaknesses in the economy.

Tourism, while a bright spot, remains insufficient to offset trade imbalances. With 2 million arrivals generating $3.17 billion in 2024, the sector provided much-needed foreign exchange. However, this revenue remains vulnerable to external shocks—whether geopolitical tensions, global recessions, or natural disasters—and is not a substitute for a strong industrial base.
The biggest warning sign is the deterioration in Sri Lanka's terms of trade—the ratio of export prices to import prices—which declined further to 85.5 index points in 2024.

While the volume of exports grew by 12.9%, the unit value of those exports fell by 5%. This means Sri Lanka is forced to sell more just to maintain earnings. Similarly, the import volume index rose by 17.9%, while import prices declined by 4.9%, indicating that increased import expenditure is driven purely by volume rather than value-added consumption. This is an unsustainable cycle, where Sri Lanka is working harder but earning less for its exports while spending more on imports.

Even Sri Lanka's growing reliance on imports tells a troubling story. Key import increases in 2024 included machinery, textiles, chemicals, and consumer goods, showing that local industries remain too weak to meet domestic demand. The one seemingly positive figure—declining fuel imports—was not due to efficiency gains but rather weak industrial demand, further proving the lack of real economic activity.

Sri Lanka's economic trajectory under orthodox economic policies is unsustainable. The government celebrates export growth without acknowledging that the monetary policy mix and other regulatory barriers are hindering the country's trade prospects. It should not be of surprise that exports are being outpaced by rising imports as the current policy regime privileges importers over exporters. The government highlights declining inflation without recognizing that it reflects economic weakness rather than stability. And it relies on tourism as a lifeline while ignoring the vulnerabilities of a service-based economy.

Sri Lanka's Gross Official Reserves (GOR) stood at $6.1 billion at the close of 2024, up from $4.4 billion a year earlier. This increase was largely driven by substantial net purchases of foreign currency by the Central Bank and inflows from international financial institutions. However, GOR fell from $6.5 billion in November 2024 to $6.1 billion by December 2024, primarily due to government payments for external commercial debt restructuring. The reserves include the renewed three-year swap facility with the People's Bank of China (PBOC). As of December 2024, GOR, including the PBOC swap, provided import coverage for 2.6 months with usable reserves.

Despite the 10.7% appreciation of the Sri Lankan rupee in 2024, the currency depreciated by 1.7% against the US dollar in January 2025. Additionally, the rupee weakened against other major currencies during this period. Reflecting the rupee's nominal appreciation in 2024, Sri Lanka's real effective exchange rate (REER) also saw an increase. The REER index, which measures the country's competitiveness against a basket of 24 currencies, rose from 70.2 at the end of 2023 to 76.7 at the end of 2024, signaling a decline in Sri Lanka's external competitiveness.

Without a shift toward domestic production, industrialization, value-added exports, and intelligent trade policies, Sri Lanka will remain a market for foreign goods rather than a self-sustaining economy. The global trend toward protectionism should serve as a wake-up call—Sri Lanka must act now to secure its economic future before it is too late.

INTERNATIONAL

1) DeepSeek Shocker, not so shocking!

Speaking exclusively to the editorial team at Humano Version Former Sri Lankan Ambassador to China Dr. Palitha Kohona stated that monitoring the growth of China over his tenure, rendered it completely un-shocking that DeepSeek came up with a challenger Generative AI Model, to that of western tech innovators such as OpenAI. He also mentions that more is in store.

Let's look at its history!

Founded in May 2023 by hedge fund and AI expert Liang Wenfeng, DeepSeek operates independently with exclusive funding from High-Flyer, a quantitative hedge fund also established by Wenfeng. This unique financial model allows DeepSeek to prioritize long-term AI innovation without the constraints of external investors, reinforcing China's position as a leader in cutting-edge technology.

DeepSeek made its debut in the AI space with the launch of DeepSeek Coder in November 2023, an open-source model designed for coding tasks. This was followed by the release of DeepSeek LLM, a powerful 67-billion-parameter model competing with global AI leaders. In May 2024, DeepSeek-V2 sent shockwaves through the Chinese AI market with its impressive performance and highly competitive pricing. Its affordability disrupted the industry, forcing major domestic tech giants such as ByteDance, Tencent, Baidu, and Alibaba to lower their AI model prices to stay competitive—demonstrating China's ability to drive innovation and efficiency in the sector.

DeepSeek's success is largely attributed to its advanced approach to cost reduction and accessibility. By leveraging reinforcement learning and state-of-the-art architectures like Mixture of Experts (MoE), the company has significantly lowered the computational costs of AI training.

DeepSeek-V3, for example, was developed at a fraction of the cost of similar models from Western companies like Meta, with a reported $5.5 million investment covering a portion of its total training expenses. This efficiency extends to its API services, where DeepSeek-R1 is priced at just $0.55 per million input tokens and $2.19 per million output tokens—drastically undercutting OpenAI's $15 and $60, respectively. Additionally, DeepSeek's commitment to open-source development enhances accessibility by eliminating licensing fees and fostering a collaborative ecosystem for AI research and deployment. This approach not only reduces financial barriers but also strengthens China's role in democratizing advanced AI technology, making it more widely available for businesses, developers, and researchers worldwide.

DeepSeek's emergence signals a shift toward open-source AI, disrupting traditional hierarchies in the tech industry. By showcasing advanced efficiency and fostering a cooperative development model, it proves that open-source innovation can drive technological breakthroughs. This evolving landscape challenges the long-standing dominance of American firms, positioning open-source AI as a viable and strategic force shaping the future of global AI research and development.

2) Tarrif-ying Trump

As global trade conflicts intensify, Sri Lanka watches with concern as the United States and the European Union head toward a potential tariff war. The EU has strongly opposed Washington's plans to impose tariffs on European goods, warning of firm retaliation. This comes after the US administration extended sweeping tariffs on Canada, Mexico, and China, a decision that has already sparked economic concerns worldwide.

With the proposed 25% tariffs on Canada and Mexico and 10% on China set to take effect in February 2025, economic projections indicate significant global repercussions. Estimates suggest these measures will shrink US economic output by 0.4% and increase taxes by $1.2 trillion between 2025 and 2034. American households are expected to bear an additional $830 in tax burdens in 2025 alone, with tariffs on Canada and Mexico contributing $958 billion to this total.

These policies build on earlier tariff hikes, including the nearly $80 billion in taxes imposed by the Trump administration on $380 billion worth of imports in 2018 and 2019, followed by additional levies under the Biden administration. The continuation of these protectionist measures is estimated to lower US GDP by 0.2% in the long run, reduce capital stock by 0.1%, and eliminate approximately 142,000 full-time jobs.

For Sri Lanka, these trade battles present both risks and opportunities. As a nation reliant on global markets, disruptions in major economies can impact supply chains, alter commodity prices, and shift investment patterns. Higher tariffs in the US and EU could slow overall trade growth, affecting demand for exports from emerging economies, including Sri Lanka. At the same time, as Western nations reconfigure their supply chains, Sri Lanka has a chance to position itself as an attractive trade partner, offering stability and competitive manufacturing capabilities.

The broader concern remains the uncertainty these trade conflicts create in global commerce. Protectionist policies have historically driven up consumer prices, reduced output, and stifled economic growth—trends that are evident in the US, where tariffs have directly raised costs for businesses and households. With economic tensions escalating, Sri Lanka must closely monitor developments and strengthen trade ties with diversified partners to navigate the shifting global landscape effectively.

3) Modi's Union Budget

India's coalition government, led by Prime Minister Narendra Modi, has presented its first full-year budget since losing its parliamentary majority. Finance Minister Nirmala Sitharaman introduced policies aimed at reviving economic momentum, addressing inflation, and boosting middle-class spending in the region's third-largest economy.

Following years of rapid expansion exceeding 8%, India now faces its slowest growth in four years, with high food prices and stagnant wages dampening consumer demand and corporate earnings.

India's Union Budget: Key Takeaways

>Tax Relief: Income tax exemption raised to ₹1.2M ($13,841), with revised tax slabs to boost urban consumption. However, direct tax impact is limited as only 1.6% of Indians pay income tax.

>Infrastructure Push: Capital expenditure target increased to ₹11.2T ($129.18B) despite lower-than-expected spending. Interest-free loans for states to boost infrastructure.

>Energy & Insurance: Nuclear energy target set at 100GW by 2047, with ₹200B ($2.3B) allocated. FDI cap in insurance raised from 74% to 100%.

>Industry & Regulation: ₹1.5T ($17.31B) support for small-scale industries. Regulatory reforms planned to ease business compliance. Subsidies and tax cuts to boost local manufacturing.

>Fiscal Management: Fiscal deficit target at 4.4% by 2026 (from 4.8%). GDP growth expected to slow to 6.3-6.8%. Reserve Bank of India may ease interest rates amid slowing growth and inflation.

Observing these changes it is clear that Prime Minister Modi's coalition government is looking at advancing its industrial base by loosening the leash on the middle class. Confronted with an urban economic slowdown, the weakest growth in four years, and global challenges—including U.S. tariff threats and geopolitical tensions—Finance Minister Nirmala Sitharaman alongside her Prime Minister faced significant pressure. A feat that they have face head on.

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