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WBG Governor's Statement No. 14

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Statement by the Hon. **MAHINDA RAJAPAKSA**,
Governor of the Bank for **SRI LANKA**

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Governor of the Bank for Sri Lanka

Mr. Chairman,

The year 2020 has been unprecedented. COVID-19 has rapidly spread wreaking havoc in economies all over the world. The health pandemic has ground to a halt the global economy and necessitated the adoption of extreme measures within national borders to contain the crisis. The Sri Lankan economy has also been hard hit by the COVID-19 pandemic. We have taken firm action, including aggressive contact tracing, quarantining and lockdown measures, to deal with the crisis. When compared to many countries in the world, Sri Lanka has fared remarkably well in managing the COVID-19 outbreak. While the death rate and the number of infected persons has remained low and community transmission averted to a great extent, isolated outbreaks are being proactively handled to curb any rapid spread of the virus. While, stringent domestic containment measures and negative spillovers from the global economic shutdown have severely affected economic activity, recent indicators show signs of a recovery.

World Economy

The global economy continues to be in recession as the pandemic spreads with second waves of infection in many countries. While the economic outlook remains uncertain, somewhat improved developments in the second and third quarters point to a less dire contraction for global growth in 2020 than earlier predicted. Governments the world over have taken unparalleled measures to support their economies through macroeconomic policies. While central banks have resorted to accommodative monetary policy and liquidity injections to jumpstart economic activity, massive fiscal responses have catered to the health needs of the pandemic while protecting the vulnerable in terms of both households and firms. In the absence of a durable solution to the crisis, fiscal policy will have to lead from the front to not only to provide the necessary support but also to facilitate the envisaged recovery. Countries will witness differentiated outcomes in growth affected by factors such as the size of the tourism sector, effectiveness of measures to contain the pandemic and gaps in response capacity. Medium term growth will be lower for all countries when compared to the pre-COVID situation.

In my own country, in August 2020, the General Elections were conducted in a free and fair manner adhering to strict health guidelines on COVID-19. The General Elections resulted in a new government being elected to office with almost a two third majority which has had a positive impact on business confidence in the country. Mr. Chairman, it is in this background, that I will briefly highlight the economic developments in Sri Lanka.

Sri Lankan Economy

While the country imposed strict lockdown measures during the latter part of March 2020, such measures were carefully crafted to mitigate the impediments to the smooth functioning of the economy and the society. The government swiftly channeled resources to augment the capacities in the health sector to meet the challenges of the COVID-19

virus and also provided support to the vulnerable in society including through cash transfers to households. The government and the Central Bank coordinated to help revive economic activity, with the Central Bank introducing relief measures for businesses and individuals affected by the pandemic by funding working capital concessional loan schemes and imposed maximum interest rates on credit cards, pawning advances and pre-arranged overdraft facilities. This facilitated the recovery of activities by mid May 2020 whereby exports have picked up considerably in the months following to date.

The accommodative monetary policy stance adopted by the Central Bank in 2020 to weather the adverse effects of the COVID-19 pandemic also supported the economic recovery. Against the backdrop of well anchored inflation expectations and absence of demand driven pressures on inflation, the Central Bank reduced its policy rates by 250 bps during the year to 4.50 percent and 5.50 percent for the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) respectively, to support domestic economic activity. The Central Bank also lowered the Statutory Reserve Ratio (SRR) applicable on rupee deposit liabilities of commercial banks by 300 bps to 2 percent during the year to inject much needed liquidity to the domestic money market and enhance credit flows to the economy.

Exports and imports were adversely affected by disruptions to supply and demand chains and interruptions to production processes as a result of strict containment measures taken early on during the year to reduce the spread of COVID-19, while in the services account, the imposition of travel restrictions globally and the closure of the Bandaranaike International Airport (BIA) severely impacted the country's tourism industry with earnings from tourism nonexistent from end March onwards with the cessation of tourist arrivals. The resultant impact on the country's external sector culminated in the government and the Central Bank implementing policy measures, including restrictions on non-essential imports and outward remittances in respect of capital transactions, to curtail outflows of foreign currency with a view to improving the stability of the external sector.

However, with the gradual relaxation of domestic containment measures and the return to near normalcy working conditions, earnings from merchandise exports recovered to pre-COVID levels of USD 1 billion by July 2020. The lower commodity prices following the COVID-19 outbreak and the restrictions imposed by the government on motor vehicles and non-essential imports to ease pressure on the exchange rate, largely contributed to the decline in imports. Consequently, the trade deficit for the period January – July 2020 notably narrowed in comparison to the corresponding period of the previous year. Worker's remittances declined marginally during the first half of 2020 in comparison to the corresponding period of the previous year, although such inflows witnessed a higher than expected growth in July and August 2020.

In the financial account, foreign investments in the government securities market as well as the Colombo Stock Exchange (CSE) reflected a net outflow up to September 2020, although some inflows to the government securities market have been witnessed recently. The Sri Lankan Rupee, which sharply depreciated against the US dollar during the height of the crisis in April this year, has since appreciated enabling the Central Bank to purchase foreign exchange from the market to enhance reserves. Gross official reserves, which include the SAARCFINANCE swap facility of USD 400 million, stood at US dollars 7.4 billion at end August 2020, but declined after the successful repayment of the matured International Sovereign Bond of US dollars 1 billion at the beginning of October 2020.

In November 2020 the government will announce the budget for 2021 which will also spell out its medium term economic plans including a consistent tax policy and a public investment programme aimed at stimulating growth.

Developments with the International Monetary Fund and World Bank

We appreciate the efforts made by the IMF recently to provide emergency lending to member countries seeking urgent financial assistance to cope with the pandemic. Our request for Rapid Financing facility (RFI) was made concurrently with the cancellation of the Extended Fund Facility (EFF), with the new government desirous of implementing a reform program that is in line with our policy priorities.

Mr. Chairman, the COVID-19 pandemic has challenged Sri Lanka's macroeconomic stability. I must reiterate that Sri Lanka remains committed to managing its debt structure going forward. In this regard, we will focus initially on managing the foreign currency exposures and reducing the debt stock. Our medium-term fiscal strategy, to be announced in the 2021 Budget, will be based on a fiscal consolidation path that relies on growth and improved efficacy in spending. This would enable us to lower the budget deficit and reduce the current debt levels to a more sustainable position in the medium term. We also remain committed to meeting all future debt obligations as reflected in our recent sovereign bond repayment of USD 1 billion.

Mr. Chairman, protecting lives and livelihoods remains a priority. The health pandemic we face requires immediate redress in the short term prior to achieving debt sustainability over the longer term. Therefore, the Fund needs to show flexibility in its response to the COVID-19 crisis for middle income countries with high debt levels. As these are exceptional circumstances which demand exceptional measures, the IMF must find a way to address this issue if all member countries are to benefit from emergency financing schemes.

Mr. Chairman, the partnership between Sri Lanka and the World Bank was established after the country became a member of the International Bank for Reconstruction and Development in 1950. Since then the country obtained World Bank's financing for projects as prescribed in the country's public investment program with the objective of promoting competitiveness, inclusiveness and resilience for nearly seven decades.

Mr. Chairman, Sri Lanka wishes to thank the World Bank Group for the financial assistance extended to respond to our health emergency needs and the economic and social fallout arising from the COVID 19 outbreak. Accordingly, WBG provided support for three programmes; USD 128.6 million for the COVID-19 Emergency Response and Health Systems Preparedness Project; USD 88.96 million as Additional Financing for the COVID -19 Emergency Response and Health Systems Preparedness Project; and activation of USD 56 million Contingent Emergency Response Components (CERCs) from World Bank Funded Investment Projects.

The World Bank also supported Sri Lanka by postponing the Accelerated Repayment of IDA Credits under two Acceleration Clauses by another one year.

The government has initiated the contribution to the capital increase of the IBRD in 2020, endorsing the World Bank Group's support for the development challenges of a growing number of middle-income countries, as well as delivery on the global public goods agenda.

Thank you.