

INTRODUCTION

During 2020 Sri Lanka faced an emergency health situation due to the COVID-19 global pandemic, which in turn significantly impacted the country's economy. Subsequent lockdowns and curfews across the country posed serious challenges to economic activity and the financial system. The Central Bank of Sri Lanka (CBSL) launched immediate policy and relief measures to assist the Government of Sri Lanka to respond to this global health emergency, including implementing relief schemes for businesses and individuals affected by the pandemic. These were brought into effect through a set of monetary policy, financial sector policy and external sector measures. These measures have helped cushion the impact of COVID-19 on businesses and ease the burden on the people during this unprecedented global health emergency and subsequent economic downturn.

MONETARY POLICY MEASURES

The CBSL reduced the policy interest rates on several occasions during 2020.

POLICY INTEREST RATES WERE REDUCED BY 250 BASIS POINTS

The reductions in policy interest rates [Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR)] were intended to encourage borrowing by firms and households in support of raising the levels of production and consumption in the economy. The policy interest rate reductions helped lower the market lending rates notably, thereby reducing the burden on businesses and individuals.

Inflation was low in 2020 and the CBSL expects inflation to remain within the desirable levels.

The CBSL lowered the Statutory Reserve Requirement (SRR) on all rupee liabilities of Licensed Commercial Banks.

STATUTORY RESERVE RATIO (SRR) WAS REDUCED BY 300 BASIS POINTS

By reducing the SRR, the CBSL enhanced the amount of cash available in the banking sector for lending to businesses and individuals. The additional liquidity in the domestic money market enabled the financial system to expedite the allocation of credit to the different sectors of the economy, while reducing the cost of funds of Commercial Banks. On the demand side, this will have an impact on the wealth and cashflows of businesses and individuals, and affect their decisions on whether to consume now or save for later. On the supply side, since businesses normally finance most of the working capital and short term liquidity requirements through bank loans, lower interest rates will affect their activities through the reduction in cost of funds.

The CBSL reduced the Bank Rate

The Bank Rate is the interest rate at which the CBSL lends funds to Commercial Banks for emergency purposes. This rate, which was set at 15%, has been reduced to 8.5% and is now linked to the Standing Lending Facility Rate with a margin.

FINANCIAL SECTOR POLICIES

While it was important to address the public health issues due to the spread of the virus, a prolonged crisis would adversely affect corporate balance sheets and cause structural damage to the long-term health of the economy. Instead of temporary slow-downs in business activities, some enterprises may shut down permanently if they cannot sustain operations due to accumulating financial losses. These businesses would not rebound

quickly when the economy re-opens, which may have implications for financial system stability. Such a scenario would create a longer-term supply constraint that would be a drag on any economic resurgence once the spread of COVID-19 is under control. Therefore, CBSL supported the economic activities of SMEs through this transitional period while simultaneously addressing the public health issue related to the virus. Enhancing the resilience of the economy through these challenging times can be a significant determinant on the success of an eventual economic resurgence in Sri Lanka, where vital sectors are able to quickly return to robust productivity.

CBSL introduced various extraordinary regulatory measures to be implemented by Commercial Banks to support businesses and individuals affected by COVID-19 outbreak and informed licensed banks to avail such relaxations in the interest of their customers and economy.

4% INTEREST FOR LOANS



The CBSL, in consultation with the Government of Sri Lanka, introduced the Saubagya Covid-19 Renaissance Facility in three phases to provide working capital loans at 4% per annum interest rate to businesses, including the self-employed and individuals, adversely affected by the COVID-19 outbreak, through Licensed Banks, thereby supporting the revival of economic activity in the country.

CBSL also introduced a wide range of concessions including a debt moratorium (capital and interest) and a working capital loan facility for COVID-19 hit businesses and individuals.

Small and Medium Enterprises (SMEs) engaged in business sectors such as manufacturing, services, agriculture (including processing), construction, and other sectors such as Tourism, direct and indirect export-related businesses including apparel, IT, tea, spices, plantation were considered for the debt moratorium.

SAUBAGYA LOAN SCHEME FUND ALLOCATION INCREASED TO RS. 150 BN



Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) were also instructed to provide a debt moratorium for eligible businesses (including tourism, export related businesses and SMEs), and self-employment businesses and individuals on

various types of performing and non-performing credit facilities. Several other concessions were also provided such as delaying recovery actions, suspending recovery/legal actions against non-performing borrowers, waiving off penal interest rates, and options for loan reschedulements. With a view to support the small businesses and individuals who are financially affected due to the second wave of COVID-19, LFCs and SLCs were directed to extend the debt moratorium by another six months until 31.03.2021.

CBSL continuously monitored the impact of the outbreak on the economic sectors and introduced extensions to the above concessions on need basis to affected sectors such as the tourism sector. Further, considering the impact of the subsequent exigencies of the COVID-19 outbreak, commercial banks were instructed to extend the debt moratorium granted to COVID-19 affected businesses and individuals for a further period of six months, i.e., up to 31 March 2021.

The CBSL also introduced a mechanism through which commercial banks borrow funds at 1% from CBSL to be channeled to contractors and suppliers of the Government through the commercial banks at 4%, up to the value of their outstanding dues from the Government.

The dues from the Government served as collateral against which the contractors and suppliers could borrow funds to pursue their business activities.

CBSL introduced maximum interest rate caps applicable for credit cards, pre-arranged temporary overdrafts, pawning advances, penal interest rates on all loans and advances. Further, enhanced interest rates on rupee accommodations for exporters were reduced in line with the reduced market interest rates.

HOUSING DREAMS MADE MORE ACCESSIBLE



The CBSL imposed a ceiling on interest rates on mortgage backed housing loans for salaried workers. This measure is expected to provide affordable housing facilities to middle income households.

This way, the CBSL helped cushion the impact of any cash flow mismatches that could arise due to the sudden loss of income streams.

The CBSL announced its intention to introduce priority lending targets for micro, small and medium enterprises

to promote economic sectors with higher growth and earning potential. This would enable the streaming of funds into investments for sectors that fall outside those that traditionally attract bulk of the capital.



CBSL collaborated with the LankaClear and LCBs to keep Sri Lanka's payment infrastructure at the globally competitive level and raised awareness of digital payment mechanisms. In order to enhance the awareness of the general public of the numerous state-of-the-art digital payment methods that are available in Sri Lanka, the promotional campaign of "2020- Year of Digital Transactions" was launched by CBSL prior to the lockdown. To enhance security of transactions carried out through mobile applications, CBSL revised guidelines on the minimum compliance standards for payment related mobile applications; covering new developments in payment related mobile applications. With the view to promote LANKAQR for retail payments, CBSL conducted

programmes to launch the LANKAQR in Matale and Colombo and instructed local Commercial Banks and operators of mobile phone-based e-money systems to join LANKAQR as issuers and/or acquirers.

Further, CBSL facilitated high value payments to government institutions by enhancing the maximum value limit of Common Electronic Fund Transfer Switch (CEFTS) transactions carried out through LankaPay Online Payment Platform. CBSL also reduced the transaction fees of LankaSettle System and extended the cut-off time for accepting customer transactions. Having reviewed the Liability Manager (LM) limits given in the Payment and Settlement Systems Circular, the CBSL decided to revise the LM limits for LankaPay Common Electronic Fund Transfer Switch (CEFTS) to facilitate effective payment and settlement services to the customers. Further, in order to reduce the cost of online customer payments, the maximum fee per transaction of CEFTS transactions carried out through online payment channels was reduced with effect from 01.01.2021.

CUSTOMER FEE OF LANKASETTLER (RTGS) TRANSACTIONS REDUCED TO RS. 400 PER TRANSACTION

The CBSL also ensured the uninterrupted supply of currency for payments and settlement activities.

While promoting digital payment and settlement

mechanisms, CBSL acknowledged that this transformation cannot happen overnight and ensured that there was adequate currency in circulation for meeting all cash transactions by the public.

EXTERNAL SECTOR POLICIES

The CBSL continued its efforts to maintain external sector stability by limiting foreign exchange outflows and enhancing inflows amidst the pandemic, while maintaining gross official reserves at adequate levels.

MEASURES TO MAINTAIN STABILITY OF EXCHANGE RATE AND ADEQUATE INTERNATIONAL RESERVES

Along with the Government, the CBSL imposed import restrictions on selected goods, to promote domestic production and prevent leakages of foreign exchange for financing imports of non-essential and luxury goods.

In the domestic foreign exchange market, the CBSL intervened in order to avoid any undue fluctuations in the exchange rates. In addition, Sell-Buy Forex SWAP facilities were introduced to fulfil the liquidity requirement in the domestic foreign exchange market. The CBSL, also suspended customer forward contracts

of foreign exchange to temporarily curtail the excess volatility in the forward rates. By purchasing US dollars from the domestic foreign exchange market, as and when market conditions were conducive, the CBSL managed to maintain international reserves while meeting country's balance of payment requirements.

In addition, the CBSL secured a repo facility for USD 1,000 million from Federal Reserve Bank New York, and operationalised the USD 400 million bilateral currency swap agreement entered between the CBSL and Reserve Bank of India.

FOREIGN EXCHANGE MANAGEMENT POLICIES

CBSL limited the issue of foreign currency notes as travel allowance to resident Sri Lankans travelling abroad to a maximum of US dollars 5,000 from US dollars 10,000 to ease the pressure on the exchange rate from the demand side.

CBSL imposed temporary restrictions on the outward remittances of capital transactions to minimise foreign currency outflows,

SPECIAL DEPOSIT ACCOUNT CREATED

CBSL facilitated the creation of a Special Deposit Account, offering more favorable terms to attract more foreign exchange to the country.

CBSL also permitted the recovery of loans granted to Sri Lankans employed abroad in Sri Lanka Rupees, as a last resort where necessary when recovery of such loans in foreign currency is remote.

CBSL directed Commercial Banks and the National Savings Bank to suspend facilitation of the importation of all types of motor vehicles, other than those excluded specifically under the Banking Act Directions, under Letters of Credit; non-essential goods specified in the

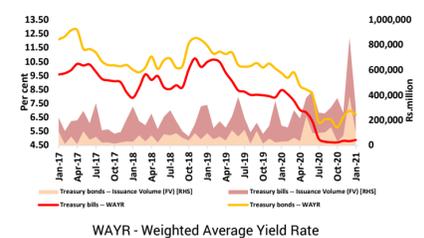
Directions under Letters of Credit, Documents Against Acceptance and Advance Payment; and to suspend the purchase of Sri Lanka International Sovereign Bonds. This was done with a view to easing the pressure on the exchange rate and the stress on financial markets due to the impact of the COVID-19 pandemic.

CBSL issued operating Instructions to Commercial Banks on the new USD/LKR Buy-Sell currency SWAPs for tenors beyond one year and up to two years period under the Scheme named "Inward Investments SWAPs" to hedge the foreign exchange risk pertaining to foreign currency inflows that are channeled through the Inward Investments Accounts of non-residents. These operating instructions were intended to encourage the fresh foreign inflows to the country.

DEBT MANAGEMENT POLICIES

CBSL mobilised funds from the domestic money and capital market by the CBSL on behalf of the Government to meet its essential expenditures. The CBSL ensured that the Government had adequate funds to assist those affected by the pandemic, by facilitating the purchase of Treasury bills at the primary auctions by subscribing to shortfalls. This funding enabled the Government to provide social security payments for a large share of the population as well as make payments in relation to essential health and other public services. CBSL also continued to provide provisional advances to the Government to smooth out cash flow operations of the Government.

Treasury bills, Treasury bonds WAYR and Issuance Volume



In 2020, CBSL raised nearly Rs. 4 Trillion in treasury bonds and bills at historically low interest rates, which enables budgetary savings of Rs. 280 billion.

CBSL fulfilled the country's debt servicing requirements despite the immense challenges put forth by the crisis, and helped maintain Sri Lanka's impeccable record for timely debt servicing.

SUCCESSFULLY SETTLED 1 BN WORTH OF MATURING ISBS ON BEHALF OF GOVERNMENT

CBSL also issued Guidelines for recording of secondary market transaction data and sending securities settlement instructions to the Scripless Securities Settlement System (SSSS) to facilitate the collection of more information pertaining to transactions in the SSSS, to reinforce the prevailing transaction recording requirements, and to capture more attributes of transactions carried out in the secondary market for government securities such as the settlement value, price and interest rate of the transactions.

IMPROVED TRANSPARENCY OF SECONDARY MARKET TRANSACTIONS

CBSL also reinforced the current transaction recording requirements and improved the transaction recording practices in the secondary market to enhance transparency.