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CENTRAL BANK OF SRI LANKA

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# Press Release

Issued By Economic Research Department

Date 31.10.2020

## The Central Bank publishes “Recent Economic Developments: Highlights of 2020 and Prospects for 2021”

Today, the Central Bank of Sri Lanka released its report on “Recent Economic Developments: Highlights of 2020 and Prospects for 2021”. The Report can be downloaded from the website of the Central Bank of Sri Lanka in all three languages.<sup>1</sup>

In addition to the regular update on economic developments, the Report also presents an update to the medium term macroeconomic projections published by the Central Bank in April 2020, taking into account the information available up to mid-October 2020. The publication of the Report this year comes at a crucial juncture as the economy continues to navigate through multipronged socio-economic challenges and uncertainties caused by the COVID-19 pandemic.

According to the Report, the Sri Lankan economy, which experienced below potential growth in recent years, encountered renewed challenges amidst the outbreak of COVID-19. Reflecting the combined effects of the spread of COVID-19 locally and the introduction of lockdown measures, the slowdown in global economic activity, and the

<sup>1</sup> Weblink to the English Version: <https://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/recent-economic-developments/recent-economic-developments-2020>

adverse weather conditions in the country, the economy contracted by 1.6 per cent in the first quarter of 2020, year-on-year, as per the provisional estimates of the Department of Census and Statistics (DCS). GDP estimates for the second quarter have not yet been released by the DCS citing difficulties in capturing the true nature of disruptions and new activities as well as novel ways of working that emerged this year with the onset of the pandemic. Nevertheless, high frequency data point towards a strong recovery in many areas of economic activity in more recent months prior to the resurgence of COVID-19 infections and resultant containment measures in October 2020.

The recovery of activity was facilitated by the concerted efforts of the Government and the Central Bank. Relief measures and large scale policy stimuli were introduced to help businesses and individuals affected by the pandemic. The Central Bank initiated a series of monetary easing measures, including multiple reductions of the policy rates and the Statutory Reserve Ratio (SRR), thereby injecting ample liquidity into the market and lowering borrowing costs significantly, given the unprecedented circumstances caused by the pandemic. The adverse effects of the pandemic also prompted the introduction of concessional credit schemes to fulfil the needs of small and medium scale enterprises (SMEs), alongside debt moratoria for businesses and individuals affected by the pandemic. Responding to these measures, credit to the private sector showed a significant improvement in August and September 2020, reversing the slowdown observed in previous months. The Central Bank also provided required funds to the Government by purchasing Treasury bills at primary auctions. Increased credit flows to the public sector mainly contributed to the acceleration of broad money growth during the nine months ending September 2020. Meanwhile, the financial system withstood the adverse impact stemming from domestic and global economic slowdown, while supporting the revival of the economy.

In the meantime, the external sector, which was severely affected at the initial stages of the pandemic, marked a notable rebound with an improvement in the trade balance, a revival of workers' remittances, a stable exchange rate, and a reasonable level of official reserves. The external sector stability was supported by the restrictions placed on non-essential imports and selected outflows as well as low global petroleum prices. Proactive measures taken by the Government and the Central Bank and the unexpected rebound in workers' remittances since June 2020 helped partly cushion the impact of the significant

decline in earnings from tourism due to persistent global travel restrictions. The financial account of the balance of payments (BOP) experienced subdued performance as the pandemic affected cross border financial flows. However, gross official reserves remained at adequate levels, benefiting from inflows to the Government and the Central Bank, including the net purchases of foreign exchange from the domestic foreign exchange market.

Amidst adverse speculation and Sovereign rating downgrades, the Government met all its debt service obligations including the settlement of the International Sovereign Bond (ISB) that matured in early October 2020. Meanwhile, the performance of the fiscal sector was significantly affected by the decline of government revenue amidst the economic fallout, while the large amount of outstanding bills brought forward from the previous year weighed on the expenditure management efforts of the Government. The Government's plans to reduce the budget deficit over the medium term remain critical in ensuring macroeconomic stability and the sustainability of public debt in the period ahead.

Meanwhile, subdued demand conditions and well anchored inflation expectations helped maintain inflation broadly within the target range of 4-6 per cent thus far during 2020, although a transitory acceleration was observed due to the rise in food prices. Inflation is expected to be maintained in this range over the medium term with appropriate policy measures, within the flexible inflation targeting framework of the Central Bank.

Economic growth is expected to rebound in 2021, and maintain the upward trajectory over the medium term, supported by pro-growth policies of the Government. Policies to boost domestic production are also expected to ease the pressure on the external sector of the economy on a sustained basis. Nevertheless, the success of containing COVID-19 locally and globally remains critical in determining the pace and the magnitude of domestic economic recovery and revival in the period ahead.