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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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The Central Bank publishes "Recent Economic Developments: Highlights of 2021 and Prospects for 2022"

The Central Bank of Sri Lanka today published "Recent Economic Developments: Highlights of 2021 and Prospects for 2022" online. The publication can be downloaded via the Central Bank Website in Sinhala, Tamil and English languages.[1]

An overview of the performance of the Sri Lankan economy in 2021, as reflected in "Recent Economic Developments", the box articles in chapter 1 and the infographic published therein are given below:

The Sri Lankan economy rebounded strongly from the COVID-19 pandemic induced contraction in 2020. The real economy grew by 8.0%, y-o-y, in the first half of 2021, registering a broadbased recovery of the major sectors of the economy. This recovery was underpinned by the extraordinary policy stimuli provided by the Government and the Central Bank across a wide spectrum of businesses and individuals, phasing out of the selective mobility restrictions in tandem with the nationwide vaccination programme, and normalising global activity.

The Government continued the fiscal stimulus measures announced in late 2019 by way of the low tax regime, among other direct financial support. The large scale debt moratoria provided to businesses and individuals were further extended during 2021, thereby smoothing the effects of cashflow disruptions faced by stakeholders amidst multiple waves of the pandemic. Due to the unprecedented monetary policy support provided by the Central Bank during 2020 and the maintenance of the same through January to mid August 2021, market interest rates declined to historically low levels, thereby facilitating credit to businesses and individuals, and supplementing investment needed to revive the economy.

The low interest rate environment benefitted fiscal operations amidst restricted access to global financial markets. Further, the Central Bank provided a large amount of funds to the Government by way of purchasing Treasury bills in bridging the widened financing gap in the midst of the pandemic. However, the Central Bank implemented monetary tightening measures in mid August 2021 by raising policy interest rates and the SRR (effective September 2021) in order to preempt the buildup of excessive inflationary pressures over the medium term, while also addressing imbalances in the external sector.

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[1] Weblink to the English Version: https://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/recent-economic-developments/recent-economic-developments-2021

Merchandise exports reached pre-pandemic levels, while import expenditure also rose, reflecting the normalisation of activity as well as the escalation of prices of all key commodities in the global market. Amidst limited foreign exchange inflows under pandemic conditions, speculative activity exerted further pressure on the domestic foreign exchange market, warranting intervention by the Central Bank to impose a mandatory conversion requirement on export proceeds, provide exchange rate guidance, and ultimately provide liquidity support for essential imports. Meanwhile, the performance of trade in services remained dwarfed by the prolonged setback in the tourism industry, which is expected to rebound fast as global travel activity resumes and vaccination against COVID-19 gathers pace. Workers' remittances, which remained resilient amidst the pandemic, moderated in recent months, mainly reflecting the resumption of cross border travel, modest departures for foreign employment, and the search for exchange gains outside the banking system.

Heightened near term vulnerabilities in the external sector and pressures observed in the financial system owing to the moderation of foreign inflows are being addressed by the Government and the Central Bank through coordinated efforts. Concerted measures are being taken to promote foreign exchange earnings of the country, in terms of merchandise and services exports and workers' remittances. The external current account balance is expected to improve over the medium term, supported by these efforts. FDI to large scale projects, and monetisation of non strategic assets, among others, are expected to attract sizeable non debt creating foreign inflows to the Government in the period ahead, thereby facilitating foreign currency debt servicing, along with several bridging finance facilities that are under discussion. Gross official reserves are expected to be enhanced to adequate levels in the period ahead, despite near term volatilities. The exchange rate continues to remain competitive as reflected by the real effective exchange rate indices.

The Government honoured all its foreign currency liabilities, in spite of speculation by various parties, including international sovereign rating agencies, about Sri Lanka's ability to meet foreign debt service obligations. Meanwhile, the expansion of the Government budget deficit amidst the pandemic is expected to be curtailed along with the normalisation of activity and planned expenditure rationalisation measures by the Government over the medium term.

Headline inflation, in the meantime, exceeded the upper bound of the target range of 4-6%, mainly due to continued high food prices, upward revisions to several administratively determined prices, and relaxation of price controls on selected imported commodities in tandem with the rising global commodity prices. Core inflation also recorded an uptick recently, indicating the strengthening of demand conditions of the economy. While headline inflation could remain above the targeted levels in the near term, the Central Bank remains committed to maintaining headline inflation at the target range over the medium term under the flexible inflation targeting framework with appropriate preemptive measures as and when required, while ensuring the support needed for the economy to reach its potential growth trajectory.

Amidst measures to stabilise the economy from the effects of the pandemic, efforts of the Government towards creating an export oriented production economy and diversifying economic activities with the support of domestic and foreign investors are expected to help sustain the growth momentum of the Sri Lankan economy over the medium term and enhance its resilience.

Economic Effect of Lockdowns

Unlike previous episodes of epidemics, such as SARS, H1N1 or Ebola, the rapid evolution of the COVID-19 outbreak into a pandemic within a short period required countries across the globe to introduce lockdowns and other types of mobility restrictions in an unprecedented manner. The effect of such restrictions is reflected in the global economic contraction of 3.1% in 2020 as per the estimates of the IMF.

In Sri Lanka also, the socio-economic effects of the pandemic and the associated lockdowns and mobility restrictions have been substantial. The first wave of the pandemic during March-May 2020 was addressed by a strict nationwide lockdown, which was relaxed in a phased manner thereafter. The nationwide lockdown resulted in the Sri Lankan economy contracting by 16.4%, y-o-y, during the second quarter of 2020. The second wave during October-November 2020 was addressed by selective lockdowns and mobility restrictions, which reduced the economic fallout to some extent. Yet, the recovery process was disrupted, and the economy recorded a growth of only 1.3%, y-o-y, in the fourth quarter. Accordingly, these resulted in Sri Lanka recording its highest economic contraction of 3.6% in 2020, in contrast to the initial expectation of a real GDP growth rate of around 5%. The third wave of the pandemic since April 2021 has been, by far, its largest wave. Mobility restrictions during the third wave were also selective.

While lockdowns and mobility restrictions were necessary to prevent the spread of the pandemic, their impact in terms of macroeconomic performance was severe. According to projections made by the Central Bank in April 2019, Sri Lanka's nominal GDP was expected at Rs. 17.39 tn in 2020 and Rs. 19.17 tn in 2021. However, with the pandemic, the economy recorded a nominal GDP of only Rs. 14.97 tn in 2020 and is likely to record a nominal GDP of about Rs. 16.5 tn in 2021. This indicates a staggering annual loss of GDP in nominal terms of about Rs. 2.5 tn.

While the COVID-19 pandemic has not spared any key economic sector, it must be mentioned that key foreign exchange earning sectors pertaining to trade and tourism related activities have been hard-hit by the pandemic. In turn, this has been reflected in the decline in the foreign exchange flows to the country, thereby negatively weighing on the stability of the exchange rate and having negative spillover effects on investor confidence. On the fiscal front, the slowdown in economic activity contributed to the reduction in government revenue amidst rising expenditure, thereby exerting significant pressures on the fiscal sector and warranting additional borrowing.

The impact of the lockdowns and mobility restrictions may also be assessed from a labour market perspective. According to the Labour Force Survey Quarterly report for the fourth quarter of 2020 published by the DCS, out of the 8.03 mn of the employed population, own account workers and contributing family workers and those employed in the private sector accounted for 82% of total employment. Further, according to the Labour Force Survey Annual Report for 2019, informal sector employment accounted for 57.4% of total employed. This highlights that even among those engaged in employment, the majority are vulnerable in the wake of such disruptions. Furthermore, Sri Lanka has recorded unemployment rates above 5% since the onset of the pandemic, compared to the average unemployment rate of 4.4% since the end of the conflict. In this regard, such loss of livelihoods results in increased vulnerability and increased poverty, especially in relation to those who are just above the poverty line and those who are outside the ambit of social safety nets.

The recovery observed during the first half of 2021 has been on the back of the extraordinary support provided by the Central Bank to all stakeholders of the economy, via various channels since the onset of the pandemic in March 2020. This includes support to the private sector, the banking sector and the Government. The financial sector has also extended broadbased support to borrowers, including businesses and individuals, to smoothen the negative effects of COVID-19 related disruptions. The Central Bank also took steps to protect affected businesses and individuals from undue penalties and forced acquisitions. However, such stimulus cannot be continued indefinitely without adverse macroeconomic repercussions and financial system stability concerns. At the same time, going forward, it is necessary in future credit evaluation to recognise the pandemic effects on relationships between financial institutions and their clientele.

The above highlights that the COVID-19 pandemic and the lockdowns that it entail create a vicious cycle that can have a scarring impact on businesses and households in the near term and thereby the overall growth trajectory and potential of the Sri Lankan economy in the medium term. Going forward, it is imperative that the Government continues to proactively and holistically strike a balance between minimising the human toll of the pandemic while also minimising the economic toll of these circumstances on the Sri Lankan economy which had already been struggling to recover from a long period of sub-par growth. The cornerstone of maintaining this balance is the ongoing COVID-19 vaccination drive spearheaded by the Government. The much-acclaimed progress that has been observed especially since July 2021 is expected to minimise any disruptions stemming from COVID-19 in the period ahead. However, the public's close adherence to prescribed health guidelines will also be vital to the recovery of the economy. Only then can a virtuous cycle of macroeconomic stability, improved economic growth and enhanced resilience be established to pave way for the creation of an inclusive and sustainable growth trajectory for the Sri Lankan economy.

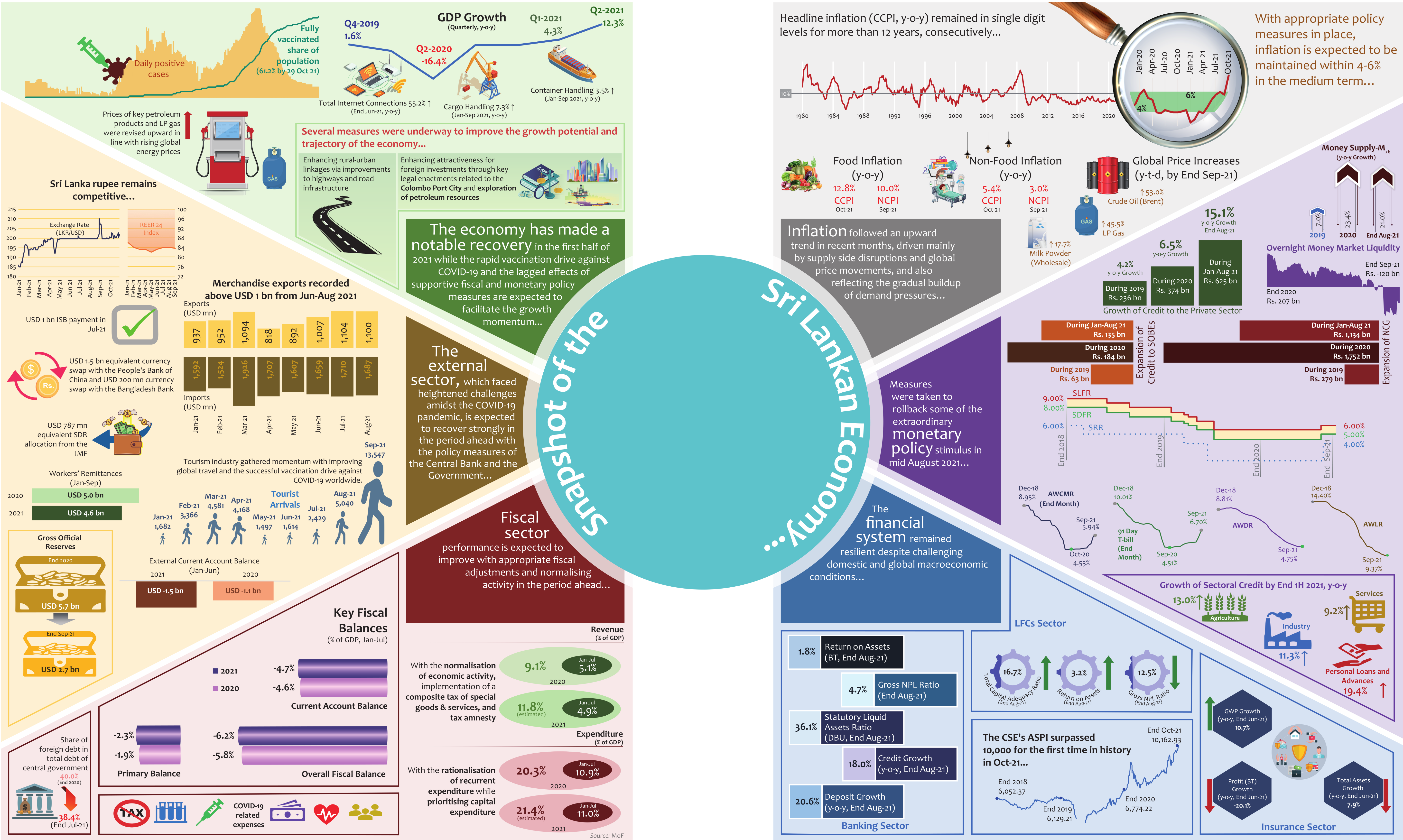
Monetary Expansion during the COVID-19 Pandemic

The outbreak of the COVID-19 pandemic and its unprecedented impact on economies and financial markets forced central banks around the world to adopt extraordinary monetary policy measures, including unconventional policies at an unparalleled scale, to mitigate its impact on their economies and financial markets and prevent those economies from precipitating into a pandemic-driven crisis. The Sri Lankan case was no different. The spread of COVID-19 in Sri Lanka led to a nationwide lockdown during March-May 2020 sending tremors across all segments of the economy, followed by partial lockdowns and mobility restrictions with the resurgence of the pandemic in multiple waves thereafter, thus affecting the lives and livelihoods of millions. Restrictions on mobility, the closure of factories, and the halting of domestic production were set to amplify uncertainty and trigger a massive shock on domestic demand. A swift and substantial policy intervention was required to minimise the impact of the shock on the markets and the economy.

Accordingly, the Central Bank of Sri Lanka adopted a series of policy easing measures at the onset of the pandemic. With a view to reducing the cost of borrowing, the Central Bank reduced its key policy interest rates, while reducing specific lending rates through the imposition of caps as well as the introduction of special low interest rate loan schemes. Further, the reduction of the SRR, provision of required financing to the Government through the purchase of Treasury bills, and the implementation of concessional credit schemes such as the Saubagya COVID-19 Renaissance Facility infused liquidity to the domestic financial market, thereby easing strains in the financial markets, while also encouraging lending to the needy sectors of the economy. The Central Bank provided further relief to distressed businesses and individuals affected by the pandemic by implementing several debt moratoria schemes, while also supporting financial institutions through regulatory forbearance. In addition, the Central Bank continued to fulfill the currency requirements to facilitate transactions in the domestic economy and the increased precautionary demand for currency amidst pandemic-related uncertainties.

Reinforced by these stability-focused and growth-supportive measures implemented by the Central Bank, the domestic economy managed to avert a major economic catastrophe, made gradual headway, and recorded a noteworthy recovery in economic activity and sentiments. Moreover, a notable increase in the provision of low cost credit to the needy and more productive sectors of the economy was also observed, thereby further enhancing its growth prospects. The World Economic Outlook of the IMF also suggested that if not for the swift policy support globally, the severity of the global economic downturn could have been at least three times as large, which signifies the importance of policy stimuli and the possible economic loss if not for such policy support.

With economic activity around the globe gradually reaching normalcy supported by policy stimuli and the successful rollout of the COVID-19 vaccination programmes, central banks around the globe have signalled the need to tighten monetary policy, with some already having taken measures to rollback the support extended since the onset of the pandemic. In the same vein, the Central Bank of Sri Lanka, having observed the gradual normalisation of domestic economic activity and the resultant buildup of demand driven inflationary pressures in the future, allowed monetary conditions to tighten since mid 2021 and signalled the end to its easing monetary policy stance in mid August 2021 by raising its key policy rates, while raising the SRR with effect from 01 September 2021. Furthermore, the maximum yield rates for acceptance at primary auctions of government securities were also removed mid September 2021 onwards, allowing yields on government securities to adjust and be market-determined, while also limiting the need for the Central Bank's purchases of Treasury bills at the primary market auctions. In addition, the Central Bank has continued to conduct overnight and term repurchase (repo) auctions amidst deficit liquidity levels in the domestic money market with a view to maintaining the prevailing tight monetary conditions. Lastly, having identified the need to rollback the notable levels of financing extended to the Government during the pandemic, the Central Bank would work towards gradually unwinding such monetary stimulus as enunciated in '*The Six-Month Road Map for Ensuring Macroeconomic and Financial System Stability*', with a view to preserving macroeconomic and financial system stability without affecting the ongoing recovery of the domestic economy.


Snapshot of the Sri Lankan Economy...
Daily positive cases
Fully vaccinated share of population (61.2% by 29 Oct 21)
GDP Growth (Quarterly, y-o-y)
Q4-2019 1.6%
Q2-2020 -16.4%
Q1-2021 4.3%
Q2-2021 12.3%
Total Internet Connections 55.2% ↑ (End Jun-21, y-o-y)
Cargo Handling 7.3% ↑ (Jan-Sep 2021, y-o-y)
Container Handling 3.5% ↑ (Jan-Sep 2021, y-o-y)
Several measures were underway to improve the growth potential and trajectory of the economy...
Enhancing rural-urban linkages via improvements to highways and road infrastructure
Enhancing attractiveness for foreign investments through key legal enactments related to the Colombo Port City and exploration of petroleum resources
Prices of key petroleum products and LP gas were revised upward in line with rising global energy prices
The economy has made a notable recovery in the first half of 2021 while the rapid vaccination drive against COVID-19 and the lagged effects of supportive fiscal and monetary policy measures are expected to facilitate the growth momentum...
Sri Lanka rupee remains competitive...
Exchange Rate (LKR/USD)
REER 24 Index
Merchandise exports recorded above USD 1 bn from Jun-Aug 2021
Exports (USD mn)
937 952 1,094 818 892 1,007 1,104 1,100
1,592 1,524 1,926 1,707 1,607 1,659 1,710 1,687
Imports (USD mn)
Jan-21 Feb-21 Mar-21 Apr-21 May-21 Jun-21 Jul-21 Aug-21
USD 1 bn ISB payment in Jul-21
USD 1.5 bn equivalent currency swap with the People's Bank of China and USD 200 mn currency swap with the Bangladesh Bank
USD 787 mn equivalent SDR allocation from the IMF
The external sector, which faced heightened challenges amidst the COVID-19 pandemic, is expected to recover strongly in the period ahead with the policy measures of the Central Bank and the Government...
Tourism industry gathered momentum with improving global travel and the successful vaccination drive against COVID-19 worldwide.
Tourist Arrivals
Jan-21 1,682; Feb-21 3,366; Mar-21 4,581; Apr-21 4,168; May-21 1,497; Jun-21 1,614; Jul-21 2,429; Aug-21 5,040; Sep-21 13,547
Workers' Remittances (Jan-Sep)
2020 USD 5.0 bn
2021 USD 4.6 bn
Gross Official Reserves
End 2020 USD 5.7 bn
End Sep-21 USD 2.7 bn
External Current Account Balance (Jan-Jun)
2021 USD -1.5 bn
2020 USD -1.1 bn
Fiscal sector performance is expected to improve with appropriate fiscal adjustments and normalising activity in the period ahead...
Key Fiscal Balances (% of GDP, Jan-Jul)
2021 / 2020
Current Account Balance -4.7% / -4.6%
Primary Balance -2.3% / -1.9%
Overall Fiscal Balance -6.2% / -5.8%
Share of foreign debt in total debt of central government 40.0% (End 2020) 38.4% (End Jul-21)
TAX
COVID-19 related expenses
Revenue (% of GDP)
With the normalisation of economic activity, implementation of a composite tax of special goods & services, and tax amnesty
2020: 9.1%, Jan-Jul 5.1%
2021: 11.8% (estimated), Jan-Jul 4.9%
Expenditure (% of GDP)
With the rationalisation of recurrent expenditure while prioritising capital expenditure
2020: 20.3%, Jan-Jul 10.9%
2021: 21.4% (estimated), Jan-Jul 11.0%
Source: MoF
Headline inflation (CCPI, y-o-y) remained in single digit levels for more than 12 years, consecutively...
With appropriate policy measures in place, inflation is expected to be maintained within 4-6% in the medium term...
Food Inflation (y-o-y) 12.8% CCPI Oct-21; 10.0% NCPI Sep-21
Non-Food Inflation (y-o-y) 5.4% CCPI Oct-21; 3.0% NCPI Sep-21
Global Price Increases (y-t-d, by End Sep-21)
↑ 53.0% Crude Oil (Brent)
↑ 45.5% LP Gas
↑ 17.7% Milk Powder (Wholesale)
Inflation followed an upward trend in recent months, driven mainly by supply side disruptions and global price movements, and also reflecting the gradual buildup of demand pressures...
Money Supply-M2b (y-o-y Growth)
2019 7.0%; 2020 23.4%; End Aug-21 21.0%
Overnight Money Market Liquidity
End 2020 Rs. 207 bn; End Sep-21 Rs. -120 bn
Growth of Credit to the Private Sector
During 2019 Rs. 236 bn (4.2% y-o-y Growth)
During 2020 Rs. 374 bn (6.5% y-o-y Growth)
During Jan-Aug 21 Rs. 625 bn (15.1% y-o-y Growth End Aug-21)
Expansion of Credit to SOBEs
During Jan-Aug 21 Rs. 135 bn
During 2020 Rs. 184 bn
During 2019 Rs. 63 bn
Expansion of NCG
During Jan-Aug 21 Rs. 1,134 bn
During 2020 Rs. 1,752 bn
During 2019 Rs. 279 bn
Measures were taken to rollback some of the extraordinary monetary policy stimulus in mid August 2021...
SLFR 9.00% → 6.00%
SDFR 8.00% → 5.00%
SRR 6.00% → 4.00%
AWCMR (End Month) Dec-18 8.95%, Oct-20 4.53%, Sep-21 5.94%
91 Day T-bill (End Month) Dec-18 10.01%, Sep-20 4.51%, Sep-21 6.70%
AWDR Dec-18 8.81%, Sep-21 4.75%
AWLR Dec-18 14.40%, Sep-21 9.37%
The financial system remained resilient despite challenging domestic and global macroeconomic conditions...
Growth of Sectoral Credit by End 1H 2021, y-o-y
Agriculture 13.0%↑
Industry 11.3%↑
Services 9.2%↑
Personal Loans and Advances 19.4%↑
Banking Sector
1.8% Return on Assets (BT, End Aug-21)
4.7% Gross NPL Ratio (End Aug-21)
36.1% Statutory Liquid Assets Ratio (DBU, End Aug-21)
18.0% Credit Growth (y-o-y, End Aug-21)
20.6% Deposit Growth (y-o-y, End Aug-21)
LFCs Sector
16.7% Total Capital Adequacy Ratio (End Aug-21)
3.2% Return on Assets (End Aug-21)
12.5% Gross NPL Ratio (End Aug-21)
The CSE's ASPI surpassed 10,000 for the first time in history in Oct-21...
End 2018 6,052.37; End 2019 6,129.21; End 2020 6,774.22; End Oct-21 10,162.93
Insurance Sector
GWP Growth (y-o-y, End Jun-21) 10.7%
Profit (BT) Growth (y-o-y, End Jun-21) -20.1%
Total Assets Growth (y-o-y, End Jun-21) 7.9%