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## ECONOMIC, PRICE AND FINANCIAL SYSTEM STABILITY, OUTLOOK AND POLICIES

### 1.1 Overview

**T**he complex challenges encountered by the Sri Lankan economy in 2020 were efficaciously addressed through extraordinary policy interventions by the Government and the Central Bank. These interventions were essential to mitigate the socioeconomic impact of the spillovers of the COVID-19 pandemic and the resultant scarring of households and enterprises. Such interventions were also required to uphold the confidence in the economy, thereby averting acute stresses on macroeconomic and financial system stability.

Alongside the global economic downturn induced by the pandemic, the Sri Lankan economy contracted by 3.6 per cent in real terms in 2020, recording the deepest recession since independence. Mobility restrictions and other containment measures imposed locally and internationally, with a view to preventing the spread of COVID-19, hampered real economic activity across all sectors. The sharp contraction observed in Industry activities during the year was driven by the significant slowdown in construction and manufacturing activities. Services activities also registered a notable contraction due to the pandemic driven deceleration in transportation, other personal services, and accommodation, food and beverage services. The Agriculture sector, too, registered a contraction during the year as the impact of the pandemic outweighed the positive effects of timely policy support and favourable weather conditions. Investment expenditure contracted in 2020, reflecting subdued investor sentiments, while consumption expenditure displayed a marginal growth. The contraction of investment expenditure exceeded the reduction in national savings, resulting in a decline in the savings-investment differential in 2020. Meanwhile, the unemployment rate rose above 5 per cent for the first time since 2009, with a decline in the labour force participation rate, in the wake of uncertainties surrounding the pandemic. Reflecting the combined effect of the contraction in Gross Domestic Product (GDP) at current market prices and the depreciation of the Sri Lankan rupee against the US dollar, GDP per capita declined to US dollars 3,682 in 2020 from US dollars 3,852 in the previous year. The pandemic also caused a decline in the overall size of the economy to US dollars 80.7 billion in 2020 from

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US dollars 84.0 billion in 2019. In spite of the overall contraction, the economy began to show strong signs of recovery during the second half of 2020, responding to the pro-growth policy initiatives across the fiscal and monetary policy fronts.

Supported by timely policy measures undertaken by the Government and the Central Bank, the external sector battled strong headwinds in 2020. The slump in merchandise exports due to the mobility restrictions and lockdown measures was swiftly overcome, demonstrating the resilience of Sri Lankan exporters. Accordingly, export earnings rebounded within a relatively short span of time to reach pre-pandemic levels. Measures to curtail non-essential imports, together with the significantly low global petroleum prices, helped reduce the import expenditure in 2020, resulting in a notable improvement in the trade deficit. The tourism sector was severely affected by global travel restrictions. Foreign inflows, in terms of trade in services relating to the Information Technology and Business Process Outsourcing (IT/BPO) sector, recorded a significant improvement, supported by the surge in novel work arrangements amidst the pandemic. Workers' remittances recorded a notable recovery during 2020, despite the decline witnessed at the onset of the pandemic. With these developments and policy induced adjustments, the external current account deficit improved to 1.3 per cent of GDP in 2020 from 2.2 per cent of GDP in 2019. Meanwhile, inflows to the financial account moderated amidst heightened global uncertainties and the cautious approach adopted by investors towards foreign direct investment (FDI) and portfolio investment. Despite pressures experienced during March-April 2020, and in late 2020, significant volatilities in the exchange rate were prevented with timely measures, and the depreciation of the Sri Lankan rupee against the US dollar was contained at 2.6 per cent in 2020. Overall, the Central Bank absorbed foreign exchange from the domestic foreign exchange market on a net basis during 2020, and gross official reserves were recorded at US dollars 5.7 billion at end 2020, which provided an import cover of 4.2 months.

Fiscal policy was reoriented towards supporting an ailing economy at the turn of the year. However, fiscal operations were faced with significant challenges during 2020 amidst the pandemic, which resulted in lower-than-expected revenue mobilisation and high recurrent expenditure. Capital expenditure was curtailed due to limited fiscal space as well as the impact of the pandemic on economic activity. Reflecting the increased pressure on fiscal operations, the overall fiscal outcome was weaker than initially expected, with a widened deficit in the current account balance and the primary balance, and the overall budget balance being recorded at 11.1 per cent of GDP in 2020. Pressures on the fiscal sector were aggravated by constrained access to foreign financing in 2020 amidst unfavourable global financial market conditions and downgrades of Sri Lanka's rating by sovereign rating agencies. Financing of the budget deficit was met from domestic sources in 2020, reflecting the limited access to mobilising funds from foreign sources and the Government's explicit financing strategy, aimed at reducing the foreign exposure over the medium term. Reflecting the expanded budget deficit and resultant large financing requirements as well as the contraction of GDP, the outstanding central government debt rose to 101.0 per cent of GDP at end 2020, from 86.8 per cent of GDP at end 2019. Nevertheless, the relative share of outstanding foreign debt to total central government debt declined notably to 40.0 per cent at end 2020, from 47.6 per cent at end

2019. Amidst adverse speculation, the Government continued to maintain its impeccable debt service record. Despite the limited fiscal space, the Government continued to provide relief to the businesses and individuals facing severe hardships stemming from the pandemic, with financial support from the Central Bank and the banking sector.

Meanwhile, subdued inflationary pressures and well-anchored inflation expectations provided the necessary space for the Central Bank to significantly relax its monetary policy stance during 2020. These measures were focused on lowering costs of funds for businesses and individuals, ensuring adequate liquidity in the money market, and facilitating the smooth functioning of the financial system under the challenging circumstances caused by the pandemic. The Central Bank implemented extremely accommodative monetary policy measures during 2020, through the reduction of the key policy interest rates to historic lows with a downward adjustment of 250 basis points in total, and the lowering of the Statutory Reserve Ratio (SRR) applicable on rupee deposit liabilities of licensed commercial banks (LCBs) by a total of 300 basis points and the Bank Rate by 650 basis points. In addition, the Central Bank introduced several concessionary loan schemes aimed at providing working capital for businesses affected by the pandemic. Moreover, the Central Bank used direct measures as well as moral suasion to accelerate the reduction in lending rates pertaining to selected financial products. Accordingly, credit extended to the private sector began to rebound in the second half of 2020. Meanwhile, the Central Bank and the banking sector provided necessary financing to the Government to carry out fiscal operations in an undeterred manner amidst the pandemic. Consequently, net credit to the government from the banking system increased substantially during 2020, alongside the expansion of credit to other sectors, thereby resulting in a notable expansion of broad money supply. Meanwhile, the Central Bank ensured the maintenance of financial system stability by introducing several measures aimed at safeguarding the interests of financial institutions as well as those of depositors, while enabling the financial sector to provide the extraordinary support required by the economy due to the pandemic.

While addressing near term vulnerabilities stemming from the pandemic remains an immediate priority, resolving the persistent structural impediments that hinder the country's long term growth prospects is essential in the period ahead. The novel economic policy framework of the Government is expected to address impediments to growth and promote domestic production, especially through the agriculture sector and earmarked manufacturing and export industries, while enhancing non debt creating foreign exchange inflows. The challenges brought about by the pandemic reinforced the need for a novel approach to achieve sustained growth, development and long term stability of the economy. In support of this framework, the Government is expected to continue its pro-growth fiscal policy stance and actively implement productivity enhancing reforms, while remaining committed to ensuring fiscal consolidation over the medium term. In the meantime, the Central Bank will remain committed to maintaining economic, price and financial system stability, and thereby facilitating the pursuit of the economy to attain its high growth potential over the medium term.

Table 1.1  
Macroeconomic Performance (2016-2020)

Indicator	Unit	2016	2017	2018	2019 (a)	2020 (b)
<b>Real Sector (c)</b>						
Real GDP Growth	%	4.5	3.6	3.3 (a)	2.3 (b)	-3.6
GDP at Current Market Price	Rs. bn	11,996	13,328	14,291 (a)	15,013 (b)	14,973
Per Capita GDP (d)	US\$	3,886	4,077	4,057 (a)	3,852 (b)	3,682
<b>External Sector</b>						
Trade Balance (c)	% of GDP	-10.8	-11.0	-11.8 (a)	-9.5	-7.4
Current Account Balance (c)	% of GDP	-2.1	-2.6	-3.2	-2.2	-1.3
Overall Balance	US\$ mn	-500	2,068	-1,103	377	-2,328
External Official Reserves	US\$ mn	6,019	7,959	6,919	7,642	5,664
<b>Fiscal Sector (c)(e)</b>						
Current Account Balance	% of GDP	-0.6	-0.7	-1.2	-3.6 (f)	-7.9
Primary Balance	% of GDP	-0.2	0.02	0.6	-3.6 (f)	-4.6
Overall Fiscal Balance	% of GDP	-5.3	-5.5	-5.3	-9.6 (f)	-11.1
Central Government Debt (g)	% of GDP	79.0	77.9	84.2	86.8	101.0
<b>Monetary Sector and Inflation</b>						
Broad Money Growth ( $M_{2b}$ ) (h)	%	18.4	16.7	13.0	7.0	23.4
Private Sector Credit Growth (in $M_{2b}$ ) (h)	%	21.6	14.7	15.9	4.2	6.5
Annual Average Inflation (i)	%	4.0	6.6	4.3	4.3	4.6

(a) Revised

(b) Provisional

(c) Based on the GDP estimates (base year 2010) of the Department of Census and Statistics

(d) Estimates are updated with the latest population figures.

(e) Based on the revised GDP estimates for 2018 and 2019 released on 16 March 2021 by the Department of Census and Statistics

(f) According to the Ministry of Finance, the fiscal sector statistics of 2019 have been restated as announced in the Budget Speech for 2020.

(g) Includes Treasury bonds of Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013 (matured on 01 June 2018) and Rs. 78,441 million issued to the Ceylon Petroleum Corporation (CPC) in January 2012 (of which Rs. 21,778 million matured on 01 January 2017 and the current outstanding is Rs. 56,662 million)

(h) Year-on-year growth based on end year values

(i) Based on CCPI (2013=100)

Sources: Department of Census and Statistics  
Ministry of Finance  
Central Bank of Sri Lanka

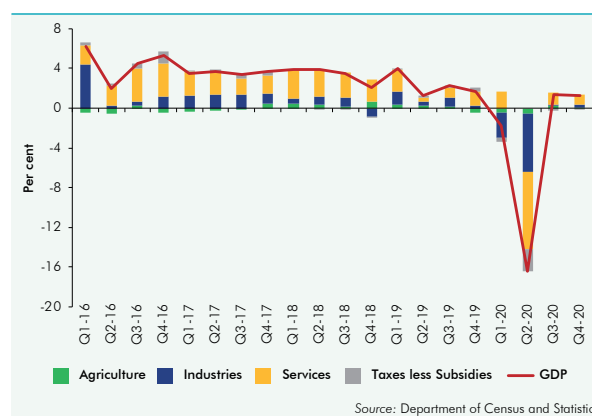
## 1.2 Macroeconomic Developments in 2020<sup>1</sup>

### Real Sector Developments and Inflation

The Sri Lankan economy contracted in 2020, reflecting the effects of the COVID-19 pandemic. As per the provisional national accounts estimates of the Department of Census and Statistics (DCS), the Sri Lankan economy contracted by 3.6 per cent in 2020, compared to the 2.3 per cent growth recorded in the preceding year. This overall contraction in 2020 was driven by the year-on-year contraction of 16.4 per cent experienced during the second quarter of the year, due to the nationwide lockdown measures imposed to contain the COVID-19 outbreak. Nevertheless, the economy rebounded during the second half of the year, registering a real growth of 1.3 per cent,

year-on-year, in spite of the disruptions caused during October-November with the second wave of the pandemic. All sectors of the economy contracted during 2020 (agriculture, forestry and fishing by 2.4 per cent, industry by 6.9 per cent, and services by 1.5 per cent), compared to the previous year. Of the agricultural sector, the subsectors of marine fishing and marine aquaculture, and forestry and logging

Figure 1.1  
Activity-wise Contribution to GDP Growth



Source: Department of Census and Statistics

<sup>1</sup> The Department of Census and Statistics is expected to publish rebased national accounts estimates in mid-2021. With 2015 as the new base year, this rebasing will require reinterpretation of associated ratios and analyses from 2015.

Table 1.2  
Gross National Income by Industrial Origin at Constant (2010) Prices (a)(b)

Economic Activity	Rs. million		As a percentage of GDP (%)		Growth (%)		Contribution to Growth (%)	
	2019 (c)	2020	2019 (c)	2020	2019 (c)	2020	2019 (c)	2020
<b>Agriculture, Forestry &amp; Fishing</b>	<b>686,412</b>	<b>669,802</b>	<b>6.9</b>	<b>7.0</b>	<b>1.0</b>	<b>-2.4</b>	<b>0.1</b>	<b>-0.2</b>
Agriculture and Forestry	573,026	575,280	5.8	6.0	2.1	0.4	0.1	0.0
Fishing	113,386	94,522	1.1	1.0	-4.3	-16.6	-0.1	-0.2
<b>Industries</b>	<b>2,608,211</b>	<b>2,427,844</b>	<b>26.4</b>	<b>25.5</b>	<b>2.6</b>	<b>-6.9</b>	<b>0.7</b>	<b>-1.8</b>
Mining and Quarrying	231,893	202,873	2.3	2.1	2.8	-12.5	0.1	-0.3
Manufacturing	1,540,969	1,481,305	15.6	15.5	1.8	-3.9	0.3	-0.6
Electricity, Gas, Water and Waste Treatment	151,978	150,702	1.5	1.6	4.9	-0.8	0.1	-0.0
Construction	683,371	592,963	6.9	6.2	4.0	-13.2	0.3	-0.9
<b>Services</b>	<b>5,678,485</b>	<b>5,595,469</b>	<b>57.5</b>	<b>58.7</b>	<b>2.2</b>	<b>-1.5</b>	<b>1.3</b>	<b>-0.8</b>
Wholesale and Retail Trade, Transportation and Storage, and Accommodation and Food Service Activities	2,273,094	2,159,819	23.0	22.7	1.7	-5.0	0.4	-1.1
Information and Communication	73,378	83,444	0.7	0.9	15.7	13.7	0.1	0.1
Financial, Insurance and Real Estate Activities including Ownership of Dwellings	1,398,938	1,469,191	14.2	15.4	2.4	5.0	0.3	0.7
Professional Services and Other Personal Service Activities	1,128,115	1,061,637	11.4	11.1	2.2	-5.9	0.2	-0.7
Public Administration, Defence, Education, Human Health and Social Work Activities	804,959	821,377	8.1	8.6	2.3	2.0	0.2	0.2
<b>Gross Value Added at Basic Price</b>	<b>8,973,108</b>	<b>8,693,114</b>	<b>90.8</b>	<b>91.2</b>	<b>2.2</b>	<b>-3.1</b>	<b>2.0</b>	<b>-2.8</b>
Taxes less Subsidies on products	910,242	837,491	9.2	8.8	2.4	-8.0	0.2	-0.7
<b>Gross Domestic Product at Market Price</b>	<b>9,883,350</b>	<b>9,530,606</b>	<b>100.0</b>	<b>100.0</b>	<b>2.3</b>	<b>-3.6</b>	<b>2.3</b>	<b>-3.6</b>
Net Primary Income from Rest of the World	-281,083	-405,185			-6.3	-44.2		
<b>Gross National Income at Market Price</b>	<b>9,602,267</b>	<b>9,125,421</b>			<b>2.1</b>	<b>-5.0</b>		

(a) Based on the GDP estimates (base year 2010) of the Department of Census and Statistics

Source: Department of Census and Statistics

(b) Provisional

(c) Revised

activities contracted notably due to the disruptions caused by the pandemic, while growing of oleaginous fruits also contracted owing to lagged effects of dry weather conditions that prevailed in 2019. On the other hand, the subsectors of growing of vegetables, rice, fruits and cereals other than rice, recorded a healthy performance during 2020, supported by the Government's policy initiatives to promote domestic agricultural production. Within the industrial sector, subdued performance in construction, manufacturing of textiles, apparel, leather and leather related products, and mining and quarrying subsectors primarily contributed to the contraction of industrial activities during 2020, although manufacturing of food, beverages and tobacco products recorded a growth during the year. Of the services sector, financial services and auxiliary financial services, telecommunication, and wholesale and retail trade activities grew during 2020, thereby lessening the impact of the contraction of subsectors of transportation of goods and passengers, including warehousing, other personal services, and accommodation, food and beverage service activities, which were affected

by mobility restrictions, social distancing measures and border closures during 2020. The taxes less subsidies component of the GDP contracted by 8.0 per cent in 2020, reflecting the impact of low tax revenue and increased production subsidies during the year.

**In nominal terms, the Sri Lankan economy contracted by 0.3 per cent in 2020, compared to the expansion of 5.1 per cent in the previous year.**

This, along with the depreciation of the Sri Lankan rupee, caused the overall size of the economy to contract to US dollars 80.7 billion in 2020 from US dollars 84.0 billion in the previous year, and per capita GDP to decline to US dollars 3,682 in 2020 from US dollars 3,852 in 2019. On the expenditure front, final consumption expenditure recorded a moderate growth of 2.1 per cent in 2020 at current prices, in comparison to a growth of 7.4 per cent in 2019. Particularly, the growth of household consumption expenditure moderated to 1.0 per cent in 2020 from 7.3 per cent growth in the preceding year. Government consumption expenditure, on the other

Table 1.3  
Aggregate Demand and Savings-Investment Gap at Current Market Prices (a)(b)

Item	Rs. billion		Growth (%)		As a percentage of GDP (%)	
	2019 (c)	2020	2019 (c)	2020	2019 (c)	2020
<b>1. Domestic Demand</b>	<b>15,932.4</b>	<b>15,924.7</b>	<b>3.8</b>	<b>0.0</b>	<b>106.1</b>	<b>106.4</b>
1.1 Consumption	11,902.2	12,146.2	7.4	2.1	79.3	81.1
Private	10,485.2	10,589.7	7.3	1.0	69.8	70.7
Public	1,417.0	1,556.5	8.1	9.8	9.4	10.4
1.2 Investment (Gross Capital Formation)	4,030.2	3,778.5	-5.5	-6.2	26.8	25.2
<b>2. Net External Demand</b>	<b>-919.4</b>	<b>-951.7</b>	<b>13.4</b>	<b>-3.5</b>	<b>-6.1</b>	<b>-6.4</b>
Exports of Goods and Services	3,472.3	2,483.1	5.5	-28.5	23.1	16.6
Imports of Goods and Services	4,391.7	3,434.8	0.9	-21.8	29.3	22.9
<b>3. Total Demand (GDP) (1+2)</b>	<b>15,013.0</b>	<b>14,973.0</b>	<b>5.1</b>	<b>-0.3</b>	<b>100.0</b>	<b>100.0</b>
<b>4. Domestic Savings (3-1.1)</b>	<b>3,110.8</b>	<b>2,826.8</b>	<b>-2.9</b>	<b>-9.1</b>	<b>20.7</b>	<b>18.9</b>
Private	3,644.5	4,007.2	8.0	10.0	24.3	26.8
Public	-533.7	-1,180.4	-214.4	-121.2	-3.6	-7.9
<b>5. Net Primary Income from Rest of the World (d)</b>	<b>-432.2</b>	<b>-405.2</b>	<b>-10.9</b>	<b>6.3</b>	<b>-2.9</b>	<b>-2.7</b>
<b>6. Net Current Transfers from Rest of the World (d)</b>	<b>1,030.7</b>	<b>1,154.4</b>	<b>3.1</b>	<b>12.0</b>	<b>6.9</b>	<b>7.7</b>
<b>7. National Savings (4+5+6)</b>	<b>3,709.2</b>	<b>3,576.0</b>	<b>-2.7</b>	<b>-3.6</b>	<b>24.7</b>	<b>23.9</b>
<b>8. Savings-Investment Gap</b>						
Domestic Savings-Investment (4-1.2)	-919.4	-951.7			-6.1	-6.4
National Savings-Investment (7-1.2)	-321.0	-202.5			-2.1	-1.4
<b>9. External Current Account Balance (2+5+6) (d)</b>	<b>-321.0</b>	<b>-202.5</b>			<b>-2.1</b>	<b>-1.4</b>

(a) Based on the GDP estimates (base year 2010) of the Department of Census and Statistics

(b) Provisional

(c) Revised

(d) Any difference with the BOP estimates is due to the time lag in compilation.

Sources: Department of Census and Statistics  
Central Bank of Sri Lanka

hand, grew by 9.8 per cent, in nominal terms during 2020, compared to the growth of 8.1 per cent in 2019. Consequently, the share of consumption expenditure in GDP at current prices increased from 79.3 per cent in 2019 to 81.1 per cent in 2020. Meanwhile, gross capital formation, which registered a contraction of 5.5 per cent in 2019, shrank further by 6.2 per cent in 2020 at current prices. The share of gross capital formation in nominal GDP declined from 26.8 per cent in 2019 to 25.2 per cent in 2020. Net external demand for goods and services contracted by 3.5 per cent at current prices in 2020, compared to the growth of 13.4 per cent in 2019, reflecting the combined effect of the slowdown in global demand, border closures that severely affected tourism, as well as the imposition of import restrictions, aimed at easing pressures in the external sector. Although private savings increased, dissavings of the Government caused domestic savings as a percentage of nominal GDP to decline to 18.9 per cent in 2020 from 20.7 per cent in 2019. The domestic savings-investment gap as a percentage of GDP widened from -6.1 per cent in 2019 to -6.4 per

cent in 2020, reflecting the decline in domestic savings exceeding the decline in gross capital formation in 2020. However, improvements in net primary income and net current transfers from the rest of the world limited the decline in national savings to 23.9 per cent of GDP in 2020 from 24.7 per cent in 2019. Deeper contraction in domestic investment caused the national savings-investment gap to improve from -2.1 per cent of the GDP in 2019 to -1.4 per cent of GDP in 2020.

Figure 1.2  
Savings, Investment and the Savings-Investment Gap  
(as a percentage of GDP)

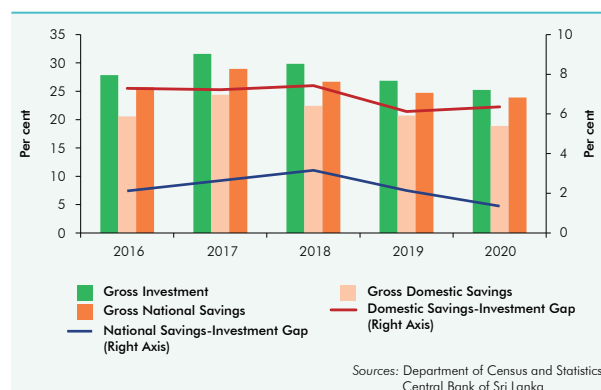
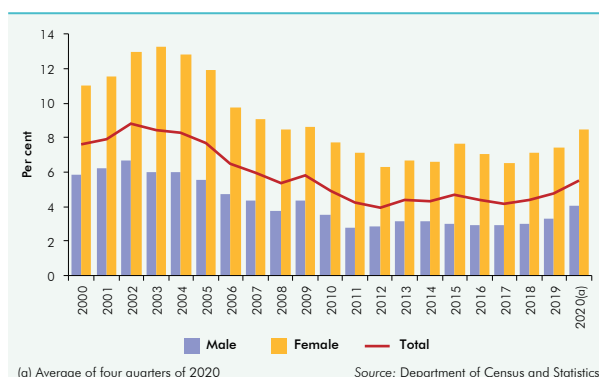


Figure 1.3  
Unemployment Rate



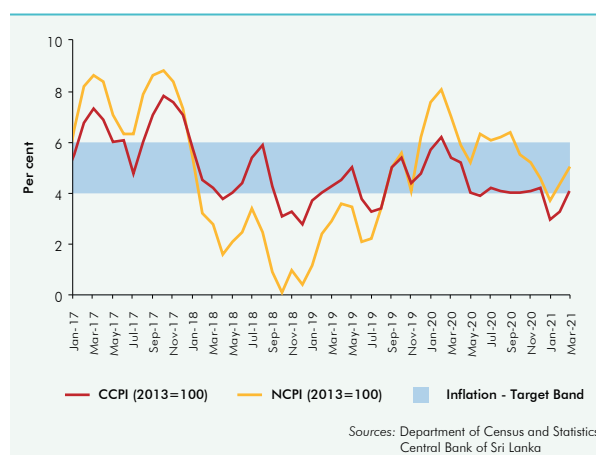
**Effects of the pandemic were observed in the unemployment rate as well as the labour force participation rate (LFPR).** Accordingly, the unemployment rate increased to 5.5 per cent in 2020 from 4.8 per cent in the previous year. Unemployment rates amongst males and females increased from 3.3 per cent and 7.4 per cent in 2019, respectively, to 4.0 per cent and 8.4 per cent, respectively, in 2020. Meanwhile, with the mobility restrictions imposed to curtail the spread of the COVID-19 outbreak, LFPR declined to 50.6 per cent in 2020 from 52.3 per cent recorded in the preceding year. LFPR of both males and females declined from 73.0 per cent and 34.5 per cent, respectively, in 2019 to 71.9 per cent and 32.1 per cent, respectively, in 2020. Agriculture, industry and services sectors accounted for 27.1 per cent, 26.9 per cent and 46.0 per cent of the total employment, respectively.

**Headline inflation remained broadly within the desired range of 4-6 per cent during 2020, while core inflation remained low throughout the year.** Subdued demand conditions, well-anchored inflation expectations,<sup>2</sup> and downward revisions to administered prices helped maintain inflation at the targeted level, despite upward pressures from food inflation, particularly due to elevated prices of certain essential food items and

2 Based on the Inflation Expectations Survey conducted by the Central Bank, which covers corporate and household sectors

supply disruptions due to the pandemic. Headline inflation, as measured by the Colombo Consumer Price Index (CCPI, 2013=100), hovered around the upper bound of the desired range during early 2020 and accelerated to 6.2 per cent, year-on-year, by February 2020. However, with the moderation of food and non-food inflation, year-on-year headline inflation decelerated and was recorded at 4.2 per cent by end 2020, compared to 4.8 per cent recorded in December 2019. Headline inflation, based on the National Consumer Price Index (NCPI, 2013=100), which attaches a relatively high weight to food items, broadly followed the trend in CCPI based headline inflation. NCPI based year-on-year headline inflation decelerated gradually from a peak of 8.1 per cent in February 2020 to 4.6 per cent by end 2020, compared to 6.2 per cent recorded in December 2019. Further, deceleration in both food and non-food inflation and the statistical effect of the high base that was recorded in the same period in 2020 caused CCPI based year-on-year headline inflation to decline below the lower bound of the inflation target during the first two months in 2021, before returning to the targeted range and recording 4.1 per cent by March 2021. Following the movements of CCPI based headline inflation, NCPI based year-on-year headline inflation reached

Figure 1.4  
Headline Inflation (Year-on-Year)



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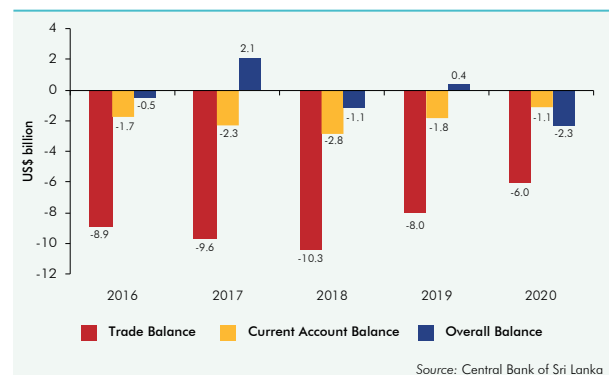
5.1 per cent by March 2021. Meanwhile, core inflation, which excludes the subcategories of volatile food, energy, and transport from headline inflation, and reflects the underlying inflationary trends by removing seasonal price fluctuations and the effects of key administratively determined prices, remained subdued throughout 2020, as per the CCPI and the NCPI. Accordingly, year-on-year core inflation based on the CCPI and the NCPI decelerated to 3.5 per cent and 4.7 per cent, respectively, by end 2020, compared to 4.8 per cent and 5.2 per cent, recorded at the end of 2019, respectively. Further, CCPI based year-on-year core inflation was recorded at 3.1 per cent by March 2021, while NCPI based year-on-year core inflation was recorded at 4.3 per cent by March 2021.

## External Sector Developments

**Sri Lanka's external sector exhibited resilience amidst unprecedented uncertainties during the COVID-19 pandemic, supported by the measures taken by the Government and the Central Bank.** Merchandise exports, which declined significantly during the second quarter of 2020, recovered faster than expected, reaching pre-pandemic levels by the end of the year. Merchandise imports declined significantly in 2020, mainly reflecting the impact of policy measures to restrict non-essential imports and relatively low international petroleum prices during the year. Accordingly, the trade deficit declined by US dollars 1,989 million to US dollars 6,008 million in 2020, compared to the previous year. The surplus in the services account also declined considerably in 2020, compared to 2019, mainly reflecting the impact of the pandemic on earnings from tourism. However, the computer services sector continued to record a healthy growth with uninterrupted functioning of information technology

and business process outsourcing (IT/BPO) related services during 2020. Overall, the surplus in the services account declined to US dollars 819 million in 2020, in comparison to US dollars 2,849 million in 2019. The deficit in the primary income account declined to US dollars 2,101 million in 2020, compared to the deficit of US dollars 2,462 million in 2019, mainly due to the reduction in dividend payments and reinvested earnings of Direct Investment Enterprises (DIEs), and the reduction in interest payments on foreign investment in government securities. Workers' remittances, which recorded a setback at the onset of the pandemic, recovered steadily in the second half of the year, registering a healthy growth, thereby strengthening the surplus in the secondary income account to US dollars 6,207 million in 2020, compared to US dollars 5,766 million in 2019. With these developments, the deficit in the external current account narrowed to US dollars 1,083 million in 2020 (1.3 per cent of GDP), from US dollars 1,843 million in 2019 (2.2 per cent of GDP). Inflows to the financial account remained modest in 2020. Major inflows to the financial account during the year included the foreign currency term financing facility of US dollars 500 million from China Development Bank and US dollars 400 million from the Reserve Bank

Figure 1.5  
Balance of Payments



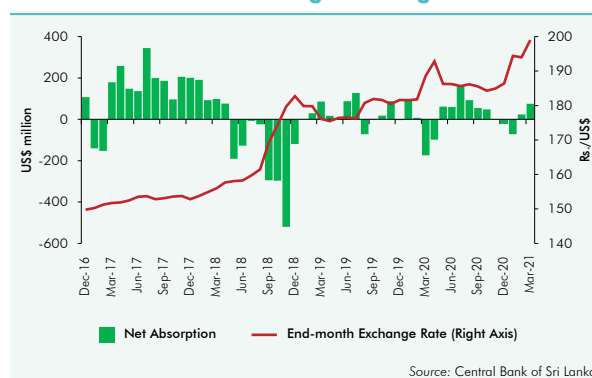


of India in July 2020 under the Framework on Currency Swap Arrangement for the South Asian Association for Regional Cooperation (SAARC) countries. Inflows on account of foreign direct investment (FDI), including foreign loans to DfIs, remained low at US dollars 670 million in 2020, in comparison to US dollars 1,189 million in 2019.

**Despite the challenges in mobilising external financing, Sri Lanka continued to maintain its unblemished record of debt servicing.** Sri Lanka successfully settled the International Sovereign Bond (ISB) of US dollars 1 billion that matured in October 2020. The outstanding external debt of the country, which is a key concern of sovereign rating agencies, declined to US dollars 49.2 billion at end 2020 from US dollars 54.8 billion at end 2019, mainly due to the significant decline in market prices of Sri Lanka's outstanding ISBs, maturing of the ISB in October 2020, the increase in the resident holdings of Sri Lanka's outstanding ISBs, and the decline in the non resident holding of rupee denominated government securities during the year.

**The exchange rate remained relatively stable during 2020, despite intermittent volatilities at the beginning of the pandemic and again towards the end of the year.** The re-emergence of exchange rate volatility since late 2020 was mainly driven by speculative market behaviour due to sovereign rating downgrades and low levels of liquidity in the domestic foreign exchange market. The Real Effective Exchange Rate (REER) indices remained well below the base year level (2017=100), indicating external competitiveness. Gross official reserves declined to US dollars 5.7 billion by end 2020, in comparison to US dollars 7.6 billion recorded at end 2019, amidst foreign debt service payments and limited foreign exchange inflows. Overall, the

Figure 1.6  
Exchange Rate and Central Bank Intervention  
in the Domestic Foreign Exchange Market

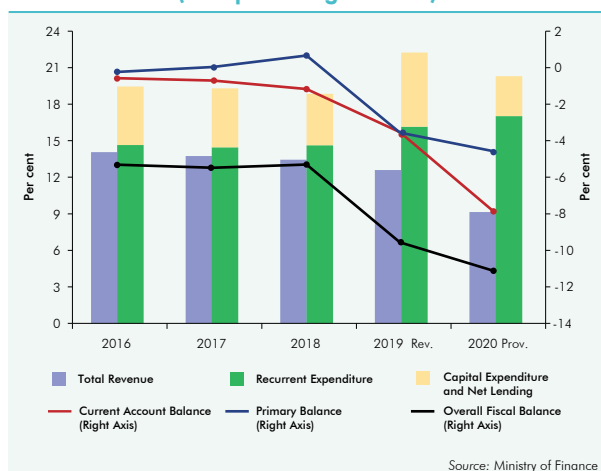


Central Bank was able to absorb foreign exchange from the domestic foreign exchange market, on a net basis, during 2020. The Central Bank continued to absorb foreign exchange from the domestic foreign exchange market, in early 2021, supported by the measures introduced to sell a share of conversions of workers' remittances and export proceeds to the Central Bank by licensed banks.

## Fiscal Sector Developments

**At the turn of the year, the Government took a firm decision to conduct fiscal policy with the intention of stimulating the stagnant economy, but the fiscal outcome was severely affected by the pandemic.** Amidst numerous challenges, the Government continued to support businesses and individuals affected by the pandemic to ensure a fast recovery of economic activity and return of the economy to a high growth path. Fiscal operations in 2020 were carried out under Votes-on-Account (VoAs) and the authorisation of His Excellency the President under the provisions of the Constitution, as the submission of an annual budget for approval by the Parliament was delayed until November 2020. Government revenue moderated in 2020, mainly due to weakened revenue streams owing to the contraction of economic activity as well as the fiscal stimulus measures implemented via tax

Figure 1.7  
Summary of Fiscal Sector Performance  
(as a percentage of GDP)

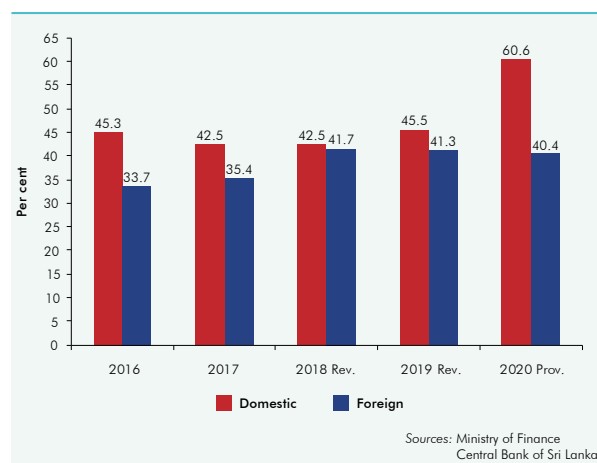


revisions since late 2019. Government revenue as a percentage of GDP declined to 9.1 per cent from 12.6 per cent in 2019, reflecting the sharp decline in tax revenue collection. On the expenditure front, the Ministry of Finance made an adjustment to fiscal statistics by shifting the expenditure incurred on payment of arrears amounting to Rs. 422.6 billion from 2020 to 2019. Accordingly, total expenditure and net lending were recorded at 20.3 per cent of GDP in 2020, compared to 22.2 per cent in 2019. However, recurrent expenditure rose to 17.0 per cent of GDP in 2020 from 16.1 per cent of GDP in 2019, mainly on account of an increase in salaries and wages, subsidies and transfers, and interest payments. Outweighing the impact of the rise in recurrent expenditure, capital expenditure contracted notably to 3.3 per cent of GDP in 2020, compared to 6.1 per cent of GDP in 2019.

**The effects of the pandemic caused the key fiscal balances to deteriorate notably in 2020.** The overall budget deficit, as a percentage of GDP, increased to 11.1 per cent in 2020 from 9.6 per cent in 2019. The current account deficit, which reflects dissavings of the Government, increased to

7.9 per cent of GDP in 2020 from 3.6 per cent of GDP in 2019. Meanwhile, the primary balance, which excludes interest payments from the overall budget deficit and reflects the discretionary component of fiscal policy, recorded a deficit of 4.6 per cent of GDP in 2020, compared to the deficit of 3.6 per cent of GDP in 2019. The outstanding central government debt increased to 101.0 per cent of GDP (Rs. 15,117.2 billion) by end 2020, compared to 86.8 per cent of GDP (Rs. 13,031.5 billion) at end 2019, reflecting the combined impact of the increase in the outstanding debt stock as well as the contraction of GDP during the year. The relative share of foreign debt in total debt declined to 40.0 per cent by end 2020 from 47.6 per cent at end 2019, as the Government financed the budget deficit through domestic sources during 2020, reflecting the expressed preference of the Government for domestic financing over foreign financing as well as the limited access to foreign financing amidst unfavourable global market conditions. Despite adverse speculation of rating agencies, the Government settled all its debt servicing obligations in 2020, including the settlement of the ISB of US dollars 1 billion in October 2020.

Figure 1.8  
Central Government Debt  
(as a percentage of GDP)



## Monetary Sector Developments

The Central Bank continued to relax the monetary policy stance during 2020 with a view to supporting the economy to recover from the effects of the COVID-19 pandemic and to regain the growth momentum, given the subdued inflation conditions. The key policy interest rates, i.e., the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR), were reduced by a total of 250 basis points on five occasions to their historically lowest levels of 4.50 per cent and 5.50 per cent, respectively, during 2020. The SRR applicable on rupee deposit liabilities of LCBs was reduced on two occasions by a total of 3 percentage points to 2.00 per cent during 2020, thereby increasing liquidity in the domestic money market amidst heightened uncertainty emanating from cashflow disruptions and urgent funding requirements of financial institutions. Meanwhile, in order to signal the availability of emergency funding for the financial sector at an affordable cost, the Central Bank reduced the Bank Rate by a total of 650 basis points to 8.50 per cent during 2020, while allowing it to be determined automatically with a margin of 300 basis points above the SLFR. Further, the Central Bank implemented regulatory

measures to reduce excessive interest rates charged on certain financial products, including credit cards and pawning, thereby quickening the monetary policy transmission process and helping marginal borrowers. A maximum interest rate of 7.00 per cent per annum was imposed on mortgage-backed housing loans for a tenure of at least five years for salaried employees in both public and private sectors. Reflecting the impact of these policy, operational and regulatory measures, aggregate market lending rates declined to historic lows, with new lending rates declining to single digits levels, on average. Market deposit rates also decreased substantially, causing some deposit products to generate negative real returns, despite low levels of inflation. Meanwhile, the Central Bank implemented concessional loan schemes under the Saubagya COVID-19 Renaissance Facility, enabling licensed banks to grant working capital loans at a concessional rate of 4.00 per cent to businesses affected by the pandemic. Considering the cashflow difficulties of the Government amidst the pandemic, the Central Bank extended financial support to the Government, mainly by purchasing Treasury bills from the primary market. This contributed towards increasing surplus market liquidity, while also facilitating a notable reduction in yields on government securities during 2020, amidst the

Figure 1.9  
Standing Rate Corridor and Selected Market Interest Rates

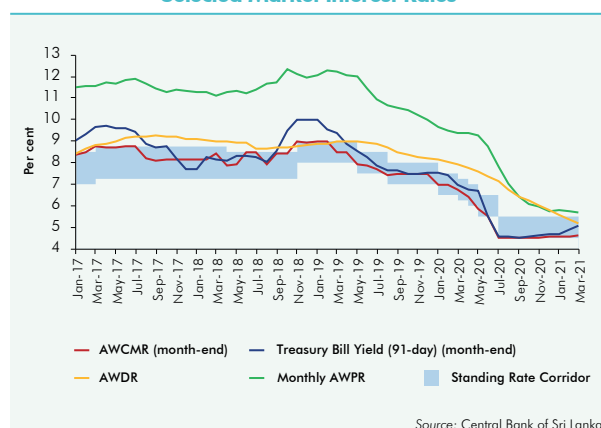


Figure 1.10  
Credit Granted by Commercial Banks to the Private Sector

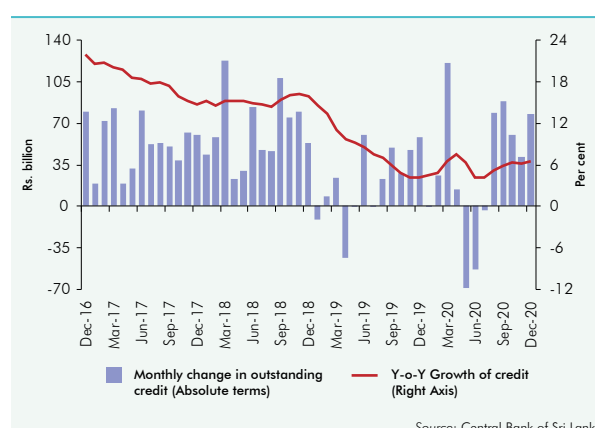
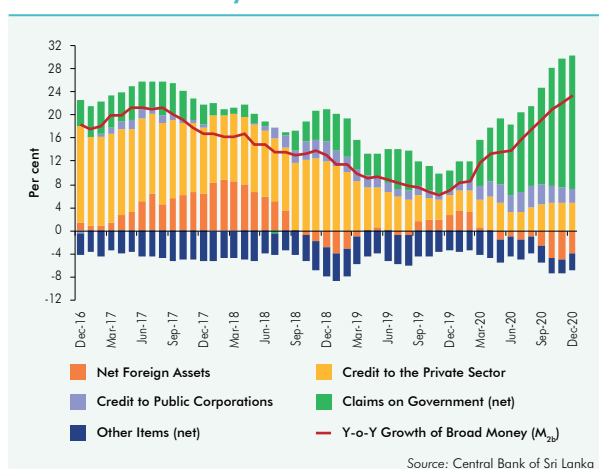


Figure 1.11  
Broad Money Growth and Contribution



accommodative monetary policy stance. With improving market sentiments and the reduction in lending rates, a gradual recovery in credit to the private sector by LCBs was observed towards late 2020. Credit to the private sector increased by Rs. 374.1 billion during 2020, recording a growth of 6.5 per cent, year-on-year, by end 2020. In April 2021, the Central Bank also introduced targets for banks on lending to micro, small and medium scale enterprises (MSMEs) in priority sectors. Meanwhile, credit to the public sector increased substantially during the year, primarily reflecting the notable increase in net credit to the government, resulting in a rapid expansion of broad money supply. The Central Bank conducted monetary policy under its flexible inflation targeting (FIT) framework, which allowed anchoring of inflation expectations on the one hand, and supporting the revival of the economy on the other, given the prevailing negative output gap and the restrictions on non-essential imports and other foreign exchange outflows.

## Financial Sector Developments

**The stability of Sri Lanka's financial system was preserved amidst uncertainties and challenges posed by the COVID-19 pandemic.** The banking sector exhibited moderate growth

despite risks emerging from the challenging economic environment due to the effects of the pandemic. The deterioration in credit quality and the moderation of foreign exchange inflows due to the pandemic remained the major macroprudential concerns on banking sector operations. Meanwhile, the sluggish performance of the Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) sector was reflected through the decline in the asset base, credit and deposits, and profitability, and the increase in non performing loans (NPLs) during the year, mainly due to the pandemic related impediments and the deterioration in public confidence. The Central Bank provided a number of regulatory forbearances with a view to managing the adverse impact of the above outcomes on the banking sector and the LFCs and SLCs sector, while implementing extraordinary policy measures to provide relief to businesses and individuals affected by the pandemic. Other institutional sectors in the financial system, such as insurance and provident funds, recorded a mixed performance. The Central Bank ensured the availability of liquidity in the money market, particularly considering the need to support the financial system, thereby facilitating economic activities amidst the pandemic. Subdued foreign exchange inflows due to the pandemic exerted pressure on the exchange rate, which was managed mainly through restrictions on foreign exchange outflows. The Colombo Stock Exchange (CSE) recovered from the significant decline recorded at the onset of the pandemic, to record a notable improvement since mid-July 2020, supported by the improved appetite of domestic investors for equity investment, despite net outflows of foreign investment from the CSE in 2020.

## 1.3 Global Economic Environment and Outlook

In 2020, the global economy recorded its worst recession in decades. According to the World Economic Outlook (WEO) of the International Monetary Fund (IMF), released in April 2021, the global economy contracted by 3.3 per cent in 2020, compared to a growth of 2.8 per cent in 2019. During 2020, advanced economies were estimated to have contracted by 4.7 per cent, while a contraction of 2.2 per cent was estimated in relation to emerging market and developing economies. Meanwhile, in China, where the COVID-19 pandemic originated, the economy recorded a growth of 2.3 per cent in 2020. Unparalleled policy support on several fronts, including health, fiscal, monetary and social, facilitated an upturn in most economies towards the second half of 2020.

**Extensive policy support at national and multilateral levels and the successful rollout of the COVID-19 vaccination programme have raised optimism about the expeditious recovery of global economic activity, despite uncertainties.** Projections for global growth for the next few years have been revised upward by the IMF to 6.0 per cent in 2021 and 4.4 per cent in 2022, reflecting a stronger-than-expected recovery from the pandemic. However, the global economic recovery is expected to vary across and within regions, attributed to variations in the magnitude of disruptions, the size and effectiveness of policies, pre-pandemic fiscal and socioeconomic conditions, and coverage of vaccine rollout. Advanced economies are expected to recover faster than most emerging market economies, due to increased access to vaccines and large policy space available to maintain accommodative macroeconomic policies for an extended period. Accordingly, advanced economies are projected to grow by 5.1 per cent and 3.6 per cent, in 2021

Table 1.4  
Global Economic Developments and Outlook (a)

Item	2019 (b)	2020 (c)	2021 (Proj)	2022 (Proj)
<b>World Output</b>	<b>2.8</b>	<b>-3.3</b>	<b>6.0</b>	<b>4.4</b>
Advanced Economies	1.6	-4.7	5.1	3.6
United States	2.2	-3.5	6.4	3.5
Euro Area	1.3	-6.6	4.4	3.8
United Kingdom	1.4	-9.9	5.3	5.1
Japan	0.3	-4.8	3.3	2.5
Emerging Market and Developing Economies	3.6	-2.2	6.7	5.0
Emerging and Developing Asia	5.3	-1.0	8.6	6.0
China	5.8	2.3	8.4	5.6
India	4.0	-8.0	12.5	6.9
<b>World Trade Volume (Goods and Services)</b>	<b>0.9</b>	<b>-8.5</b>	<b>8.4</b>	<b>6.5</b>
<b>Price Movements</b>				
Consumer Prices				
Advanced Economies	1.4	0.7	1.6	1.7
Emerging Market and Developing Economies	5.1	5.1	4.9	4.4
Commodity Prices (US\$)				
Oil	-10.2	-32.7	41.7	-6.3
Non Fuel	0.8	6.7	16.1	-1.9
<b>Six-month London Interbank Offered Rate (LIBOR) on US\$ Deposits (per cent)</b>	<b>2.3</b>	<b>0.7</b>	<b>0.3</b>	<b>0.4</b>

(a) Annual percentage change unless otherwise indicated  
(b) Revised  
(c) Provisional

Source: World Economic Outlook (April 2021), IMF

and 2022, respectively. The United States is projected to grow by 6.4 per cent in 2021 and by 3.5 per cent in 2022, compared to the contraction of 3.5 per cent in 2020, supported by large fiscal support and continued monetary accommodation. Growth in the euro area is projected to pick up from a contraction of 6.6 per cent in 2020 to 4.4 per cent in 2021 and 3.8 per cent in 2022. In the United Kingdom, economic activity is expected to record a growth of 5.3 per cent in 2021. Emerging market and developing economies are projected to record a strong growth of 6.7 per cent in 2021. However, the expected recovery of these economies is subject to regional differences in the severity of the pandemic, idiosyncratic features of their economies and health systems, exposure to specific shocks, such as those on commodity exports or tourism, and policy space available to aggressively respond to the pandemic. Emerging and Developing Asia, which contracted by 1.0 per cent in 2020, is expected to grow by

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8.6 per cent in 2021, driven by expected high growth of China and India. The Chinese economy is expected to grow by 8.4 per cent in 2021, while the growth projection for India is 12.5 per cent. Meanwhile, global oil prices are expected to increase in 2021 due to demand-supply mismatches, with risks to the projection being on the upside. Global inflation is expected to be subdued in the near term, reflecting the staggered revival of aggregate demand and subdued wage growth. Notably, in most advanced and emerging market economies, inflation expectations appear to be well-anchored, supported by the improved monetary frameworks.

**Global growth projections entail significant risks due to the uncertainties associated with the pandemic, despite being tilted to the upside over the medium term.** Major upside risks include expedited vaccine production and rollout, strong fiscal support and well-coordinated fiscal and other economic policies along with strong international cooperation. Major downside risks include the possibility of resurgence of the pandemic, tighter financial conditions, substantial and persistent damage to supply potential, intensified social unrest, natural disasters, and geopolitical, trade and technology risks.

## 1.4 Medium Term Macroeconomic Outlook

**The Sri Lankan economy is expected to rebound strongly in 2021 and sustain the high growth momentum over the medium term, buoyed by growth oriented policy support.** The impact of the pro-growth policy agenda of the Government and the accommodative monetary policy stance of the Central Bank are expected to contribute to the growth of the economy in 2021, supported by the effect of the low base. The local and international vaccination drive and the return of

most economic activities to normalcy are expected to help the economy to achieve a high growth rate in 2021. The spillover effects from the expected recovery of the global economy would positively impact external demand, inflows of workers' remittances, portfolio investment, and FDIs. The Government's efforts towards strengthening the production economy will support domestic agrarian production, agro- and natural resource-based industries and other emerging industries and services, and improve overall productivity of the economy as well. Measures to foster self sufficiency in key agrarian products, with necessary protection against dumping and other malpractices, would encourage domestic producers to make long term investment in large scale farming and production facilities. While the export-oriented manufacturing sectors are expected to be strengthened with the establishment of dedicated industrial zones, the opening up of the Colombo Port City for foreign and domestic investment would bolster the country's services sector, in particular. Further, the task forces established for the purpose of strengthening export earnings, with the participation of public and private stakeholders, are expected to support earmarked export sectors. Further, the benefits of the fiscal stimuli provided in the form of substantial tax reliefs and subsidies are expected to materialise in the near term, through the improvement of profitability of firms and the enhancement of investment capacity. The notable reduction of interest rates, and the resultant low cost of borrowing would help pave the way for high growth with the active participation of the private sector in the period ahead. The high growth momentum is expected to persist over the medium term, supported by expeditious measures aimed at expanding the production possibility frontier and resolving structural impediments in the economy, including the rigid doing business environment, and also by maintaining policy

Table 1.5  
Medium Term Macroeconomic Framework (a)

Indicator	Unit	2019 (b)	2020 (c)	Projections				
				2021	2022	2023	2024	2025
<b>Real Sector (d)</b>								
Real GDP Growth	%	2.3(c)	-3.6	6.0	5.2	5.8	6.5	7.0
GDP at Current Market Price	Rs. tn	15.0(c)	15.0	16.6	18.4	20.7	23.2	26.1
Per Capita GDP	US\$	3,852(c)(e)	3,682	3,873	4,092	4,420	4,784	5,178
Total Investment	% of GDP	26.8(c)(f)	25.2	27.5	28.0	28.5	29.0	29.5
Domestic Savings	% of GDP	20.7(c)(f)	18.9	23.1	24.6	26.2	27.4	28.5
National Savings	% of GDP	24.7(c)(f)	23.9	27.3	28.2	29.0	29.8	30.5
<b>External Sector</b>								
Trade Gap (d)	% of GDP	-9.5	-7.4	-6.2	-5.5	-4.6	-3.7	-3.5
Exports	US\$ bn	11.9	10.0	12.5	14.0	15.5	17.0	18.9
Imports	US\$ bn	19.9	16.1	17.8	19.0	20.0	21.0	23.0
Current Account Balance (d)	% of GDP	-2.2	-1.3	-0.2	0.2	0.5	0.8	1.0
External Official Reserves	Months of Imports	4.6	4.2	3.2	3.7	4.3	4.7	5.0
<b>Fiscal Sector (d)(g)</b>								
Total Revenue and Grants	% of GDP	12.6(h)(i)	9.2	11.8	13.0	13.5	14.3	15.1
Expenditure and Net Lending	% of GDP	22.2(h)(i)	20.3	21.2	20.4	19.1	19.0	19.2
Current Account Balance	% of GDP	-3.6(h)(i)	-7.9	-3.1	-1.3	0.0	1.2	2.3
Primary Balance	% of GDP	-3.6(h)(i)	-4.6	-4.2	-2.3	-0.6	0.2	0.9
Overall Fiscal Balance	% of GDP	-9.6(h)(i)	-11.1	-9.4	-7.5	-5.6	-4.7	-4.0
Central Government Debt	% of GDP	86.8(h)	101.0	98.0	95.0	91.0	86.0	80.0
<b>Monetary Sector and Inflation</b>								
Broad Money Growth ( $M_{2b}$ ) (i)	%	7.0	23.4	21.0	12.5	12.5	12.5	12.5
Private Sector Credit Growth (in $M_{2b}$ ) (i)	%	4.2	6.5	12.2	11.6	11.7	12.0	12.0
Annual Average Inflation (k)	%	4.3	4.6	4.3	5.8	6.0	5.5	5.0

(a) Based on information available at the time of going to press

(b) Revised

(c) Provisional

(d) Based on the GDP estimates (base year 2010) of the Department of Census and Statistics

(e) Estimates are updated with the latest population figures.

(f) Total investment, domestic savings and national savings as a percentage of GDP in 2019 were revised by the Department of Census and Statistics from 27.4%, 21.3% and 25.3%, respectively.

(g) Fiscal sector projections are based on the inputs from the Ministry of Finance.

(h) Based on the revised GDP estimates for 2019 released on 16 March 2021 by the Department of Census and Statistics

(i) According to the Ministry of Finance, the fiscal sector statistics of 2019 have been restated as announced in the Budget Speech for 2020.

(j) Year-on-year growth based on end year values

(k) Based on CCPI (2013=100)

Sources: Department of Census and Statistics  
Ministry of Finance  
Central Bank of Sri Lanka

consistency and macroeconomic stability, and envisaged improvements in the external sector through the expected revival of exports of goods and services and financial flows.

**While cautious management of external sector pressures in the near term is crucial in maintaining macroeconomic stability, the implementation of policies to strengthen non debt creating foreign exchange inflows is expected to improve the resilience of the sector in the medium term.** Earnings from exports are expected to strengthen in the period ahead with the envisaged recovery in global demand and the policy drive to improve the tradable sector. To

manage the near term pressures in the external sector, close management of expenditure on imports is expected in 2021, although higher petroleum prices and the recovery of domestic economic activity are likely to increase expenditure on imports somewhat during the year. Expenditure on imports is expected to increase over the medium term with the envisaged expansion of domestic demand and exports, although the expected improvements in the domestic supply of consumer and intermediate goods may dampen the demand for such imports. The envisaged improvement in earnings from exports is expected to result in a contraction of the trade deficit in the medium term. The surplus

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in the services account is expected to improve, underpinned by the recovery of the tourism industry with the reopening of the borders to international tourists and the expected relaxation of travel restrictions globally. Further, the rebound of activities in transport services and the expected high growth in the IT/BPO services subsector is expected to support trade in services over the medium term. The growth momentum of workers' remittances is expected to continue, supported by the prospective rebound of global activity, and the measures implemented by the Government to encourage foreign employment of skilled workers, alongside the incentive framework for migrant workers that is being put in place. With the expected improvements in the merchandise and services exports and workers' remittances, the external current account is expected to improve in 2021 to record a marginal deficit, strictly conditional on the continuation of close management of expenditure on non-essential imports and the recovery of global tourism flows in the second half of the year. The external current account is expected to improve to record surpluses over the medium term, backed by the measures that are being introduced by the Government to promote merchandise and services exports, alongside strengthened institutional support. It is also expected that the planned increased reliance on renewable energy sources for power generation and improvements in public transportation systems will also contribute to the management of the total energy import bill in the future. The expected improvement in investor sentiment would help attract financial flows, including FDI inflows, portfolio investments to the CSE and the government securities market, as the effects of the pandemic dissipate over the period ahead. Major inflows of foreign investment are expected to the Colombo Port City and the Industrial Zone projects, among others. The

improvement in the current account balance and enhanced non debt financial flows are expected to strengthen the gross official reserves over the medium term, while easing pressure on the domestic foreign exchange market. The near term need to meet large foreign currency debt service payments of the Government is expected to be fulfilled with the support of bilateral and multilateral sources of financing, while ongoing improvements in the external debt profile and efforts to enhance non debt creating foreign exchange inflows are expected to ensure the sustainability of Sri Lanka's external debt in the period ahead.

**In line with the Government's policy agenda, the fiscal sector is expected to improve over the medium term, underpinned by the envisaged revival of economic activity.** The business friendly tax regime, which was put in place from end 2019, is expected to continue over the medium term, thereby facilitating a gradual increase of government revenue as businesses and other economic activities continue to expand. The expected rebound of government revenue would also be facilitated by revenue administration reforms to strengthen the tax net. Government expenditure, as a percentage of GDP, is expected to moderate, facilitated by the rationalisation of recurrent expenditure and improved efficiency of capital expenditure in the period ahead. The fiscal burden stemming from underperforming State Owned Business Enterprises (SOBEs) is expected to be reduced with productivity improvements and enhanced managerial efficiency. Although the need for fiscal support for economic activities to recover from the effects of the COVID-19 pandemic would keep the budget deficit elevated in the near term, it is expected to decline to 4.0 per cent of GDP over the medium term with the envisaged improvements on the government revenue and expenditure fronts. Meanwhile, the reliance of deficit



financing on foreign sources would be minimised in line with the expressed preference of the Government to reduce exposure to foreign liabilities. Measures have already been taken to streamline foreign funded public investment projects, while encouraging public-private partnerships, thereby lessening the debt burden of the Government. Consequently, the outstanding debt of the Central Government is expected to gradually reduce from the current elevated levels to around 80 per cent of GDP by the year 2025. In line with the change in the deficit financing strategy, foreign currency debt servicing of the Government is also expected to decline over the medium term. Commitment to improving the fiscal sector performance over the medium term is expected, in order to ensure sustained macroeconomic stability and to prevent disruptions to the envisaged high growth path.

**With proactive policies to rollback any excessive policy stimulus when aggregate demand conditions normalise, inflation is anticipated to be maintained within the targeted range over the medium term.** Inflation is projected to hover around lower single digit levels during most of 2021, reflecting the slack in economic activity. The impact of accommodative monetary policy and fiscal stimulus measures, which were targeted at reviving the economy affected by the pandemic, is expected to induce a gradual buildup of aggregate demand and demand driven pressures on inflation. The rebound of global energy prices and rising global food prices could cause direct and second-round inflationary pressures across the globe. In the meantime, benefiting from continued commitment and policies of the Government targeted at revitalising the economy through enhanced production and measures to control the cost of living, muted supply driven inflationary pressures are foreseen over the medium term.

However, possible weather related disturbances are likely to result in transitory volatilities in food prices, which must be addressed by strengthening supply chain management. Adherence to the envisaged fiscal consolidation path by the Government as well as appropriate monetary policy adjustments made in a forward-looking manner as economic conditions normalise, will help stabilise inflation and anchor inflation expectations in the 4-6 per cent range over the medium term within the FIT framework.

**The envisaged low inflation environment will help the maintenance of the low interest rate structure, facilitating credit flows to the private sector at reasonable cost and thereby supporting the expected high economic growth, while providing a reasonable real return to savers.** The growth of credit to the private sector is projected to accelerate, supported by the prevailing historically low market lending rates, the revival of economic activity buttressed by fiscal and monetary stimuli and the focused efforts to support the MSME sector. The envisaged expansion of credit to the private sector together with the likely increase in credit to the public sector from the banking system is expected to cause the growth of broad money supply to remain elevated in 2021, and moderate thereafter over the medium term aided by the gradual rollback of policy stimulus as economic growth accelerates. Such moderation of fiscal and monetary expansion will not impede the envisaged growth path, as economic growth in the medium term is expected to be driven by productivity improvements and the removal of structural impediments and bottlenecks to growth. The Central Bank will continue to closely monitor the monetary and macroeconomic developments and undertake proactive policy interventions to arrest any undue surge in aggregate demand

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generated through excessive monetary expansion, while reacting to slippages in terms of foreign exchange outflows and fiscal outcomes. In the meantime, the Central Bank will also continue to take steps to channel credit to priority sectors of the economy, particularly segments that display high potential for domestic growth and export earnings. The expansion of credit at reasonable cost to such segments, which would mostly contain MSMEs, would support the development of an entrepreneurship culture within Sri Lanka, and promote inclusive and sustained growth. While the prevailing low interest rate structure presents tremendous opportunities for new and existing business ventures, it also poses significant challenges for economically vulnerable groups that rely on incomes from interest-bearing deposits. The increased focus towards the introduction of safe and alternative financial products that yield reasonably high returns would benefit savers who are adversely affected by the low interest rates. In this context, the financial sector as a whole, is expected to play a proactive role in effective financial intermediation, by developing innovative products to fulfil the needs of the borrowers as well as savers.

## 1.5 Issues and Policies

**Improvements in the Sri Lankan economy over the medium term are expected to be driven by the implementation of the Government's novel economic policy framework based on *Vistas of Prosperity and Splendour*, which aims at addressing longstanding macroeconomic imbalances and ensuring equitable, shared and sustained economic growth.** While the monetary and financial measures by themselves cannot ensure economic revival and regaining of the growth momentum, wide-ranging economic

reforms undertaken by the Government are essential for the country's continued progress. For several decades, the Sri Lankan economy has grappled with numerous structural impediments to growth and macroeconomic stability. Despite the widespread recognition among policymakers and analysts about the need for reform, the needed reforms have been postponed repeatedly. This is reflected in the country's incessant twin deficit burden from the fiscal and external sectors. On the one hand, export earnings have stagnated over the years without much improvement in the production base in the tradable sector, diversification of products and markets, integration into global and regional value chains and on exploiting the untapped potential of services exports. On the other hand, import expenditure has continued to escalate due to the dependence of industrial exports on imported raw materials and thereby the inelastic nature of demand for such products, the increasing demand for imported goods from the growing middle class and the increasing demand for petroleum for power generation and transport activities. While workers' remittance flows have cushioned the external current account deficit, the low level of FDI flows has led to the excessive reliance on external borrowings to bridge the gap between savings and investment. On the fiscal front, the economy has been grappling with high and rigid expenditure and persistently low revenue mobilisation largely due to the lack of any sizeable expansion in the tax base and weak tax administration. The resultant expansion in the fiscal deficit has led to the rapid accumulation of debt to disconcerting levels. The COVID-19 pandemic has exacerbated these incessant economic concerns. However, the pandemic has also offered an opportunity to reset the economy's focus and to address these longstanding structural weaknesses and establish a production based, productivity driven economy. In this context, the Government's

policy focus on building a strong domestic production economy that is export oriented and capable of effectively catering to the growing domestic demand, is a welcome transformation. The Central Bank's maintenance of a low interest environment will also enable domestic ventures to benefit from the Government's pro-growth policies focused on expanding the productive potential of the economy. Improved domestic production can help increase household incomes, paving way for an expansion in the tax base and revenue collection in the period ahead, thereby supporting the planned fiscal consolidation path over the medium term. A key initiative that is underway is the effort to improve the production capacity of the economy and to strengthen non debt creating foreign exchange flows to sectors with export potential, with the active participation of the public and private sector stakeholders in the relevant sectors. National level recognition of these deep-rooted structural problems and the initiatives taken thus far to address them are appreciable. Timely implementation of suitable and coherent policies to redress these issues is vital for the economy to rapidly progress on the envisaged high growth trajectory in a sustainable manner.

**Sluggish improvement in productivity remains a major challenge for sustained economic growth of Sri Lanka.** The country demands more planned and determined efforts to remove bottlenecks in increasing productivity in order to achieve sustained high growth. Productivity improvements in the traditional agriculture sector remain a priority in ensuring equitable growth and development. Substantially low levels of productivity have adverse effects on incomes of farmers and other workers in the agriculture sector. Increasing economies of scale, promoting modern technology based agriculture, adopting smart farming technologies for efficient usage of

resources, such as Good Agricultural Practices (GAP) and Geographic Information Systems (GIS), and efficiently connecting farmers with supply chains are among the major aspects that could enhance the productivity of the agriculture sector. Further, utilisation of nanotechnology for soil improvement and crop disease diagnosis, promoting hydroponics methods, selecting hybridised and high yielding crops, improved post harvesting treatment techniques for packaging, storage and distribution would also help improve productivity in the agriculture sector. Productivity improvements in the industry sector also remain sluggish compared to regional peers. Major factors that hinder productivity improvements in the industry sector include high energy and labour intensity, barriers for small and medium scale enterprises (SMEs) to establish and develop, obstacles in attracting FDIs and inadequate investment in research and development (R&D). Improving technical competencies of the labour force, establishing industrial zones and introducing agglomeration economic policies, and enhancing innovative capacities are among the major factors that could allow the industrial sector to achieve high efficiency levels and benefit from improved productivity. In the services sector, process and product innovation and adoption of new technologies remain vital for productivity improvements. Adoption of the latest technology and better management practices would help resolve productivity related issues that result in the underutilisation of existing resources. In addition, adoption of new technology, particularly in the backdrop of the Fourth Industrial Revolution (4IR), use of data and decisive technologies, such as Machine Learning, Artificial Neural Networks (ANN) and Internet of Things (IoT), would essentially enhance the productivity of all sectors of the economy. Knowledge workforce is an important lever that Sri Lanka could use to increase

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productivity. Knowledge workers boost capabilities of industries to fully utilise the available resources and allow adoption of new technologies, while improving the innovative capacity of the economy and raising the quality of jobs. Thus, policy reforms are necessary to promote industry related vocational training, and re-skilling of labour. This would also include reforms for improving the quality of teaching, and enhancing the scope of education, thereby facilitating productivity improvements, both in the public sector and the private sector, in the period ahead. In the meantime, traditional job creation and seniority based promotion policies at public institutions need a strategic breakaway with increased attention paid to employee skills development and technological enhancement.

**Prioritised export promotion is essential, alongside taking measures to implement long overdue structural reforms to address legacy issues and revive the export sector.**

Although Sri Lanka recorded its historically highest export earnings in 2019 prior to the pandemic hit performance in 2020, such earnings are meagre when compared to those recorded by similar-sized economies in the region. Steering the export sector through the impact of the pandemic and fostering competitiveness in the new global environment are essential, while catching up with peers. In this regard, in the short term, prioritising export promotion in selected sectors, i.e., potential winning industries of the country, will drive the overall export performance, while enhancing domestic production. Concentrating on earmarked subsectors rather than the whole export sector could yield speedy results. Such results are imperative, given the pressing and urgent requirement of improving export earnings to support the external sector. In this regard, the focused sectors identified in the National Export Strategy and by the Presidential Task Force of Economic Revival and Poverty Alleviation could be

a starting point. Such potential winning industries include pharmaceuticals, rubber products, coconut related products, spices, electronics and electrical components, ship and boat building, food and beverages, cosmetics, toys, machinery and mechanical appliances and ceramic products, among others. Additionally, appropriate revisions to the import tariff regime and other taxes, such as corporate tax, could be used to boost selected economic sectors and also to discourage undesirable sectors with marginal domestic value addition. Further, coordinated efforts on branding not only for the country but also for targeted export products are imperative. In the medium term, it is vital to develop policies to diversify exports, in terms of both products and markets. Exploring new export opportunities to upgrade Sri Lanka's export base towards high value added technologically intensive exports remains important. Lack of export oriented FDI flows is also an impediment to the growth of the export sector. Consistent economic policies, stable macroeconomic conditions, a competitive exchange rate, low and stable interest rates, improving doing business conditions, and appropriate management of foreign relations are necessary to enhance investor confidence in the export sector, to attract FDI flows to export oriented winning industries, and to resolve the numerous legacy issues that straddle performance of the export sector.

**Enhancing services exports through exploiting their untapped potential in a productive manner remains a key strategy for improving Sri Lanka's external current account outcome.**

Vulnerability of earnings from tourism to unexpected domestic and global disruptions has highlighted the need to diversify services exports to other services with high potential, while continuing to harness the full potential of the tourism sector. IT/BPO, transport services, financial services and other professional services are key services export sectors that

Sri Lanka can and must focus on beyond tourism, in order to enhance foreign exchange earnings on a sustainable basis. The IT/BPO sector possesses enormous undiscovered potential to become a global industry, benefiting from the ongoing global digitalisation, with its commercial attractiveness, and access to skilled labour coupled with improving Information and Communication Technology (ICT) related infrastructure. IT/BPO/ICT sectors performed well during the pandemic, all over the world. However, in Sri Lanka, earnings of this sector remained relatively low compared to regional peers with similar capabilities, primarily due to the lack of promotion and branding of Sri Lanka as a digital nation. Building such an image would help promote FDIs and attract leading global IT firms to set up regional headquarters in Sri Lanka, which would substantially enhance foreign exchange inflows to the country. The unfavourable ease of doing business rankings affect FDIs and other start-up investments in this sector as well. Furthermore, the unavailability of international payment gateways for inward foreign exchange flows affects SMEs in this sector. In addition to bringing in foreign exchange to the country, this sector would provide job opportunities, especially for the younger workforce and females in the country, offering higher earning potential and flexible working conditions. Although the country possesses a talented, young workforce, it is insufficient to meet the required demand from the industry. Sri Lanka could be actively promoted as a working hub for highly paid IT professionals and digital nomads, competing with other popular hubs in the region. Meanwhile, the strategic location of Sri Lanka in the Indian Ocean provides the country with a massive opportunity to emerge as a maritime and logistics hub in Asia. The addition of the East Container Terminal along with the expeditious development of the West Container Terminal would improve the volumes of container, transshipment and cargo handling, thereby increasing earnings

from port services. Improving the export of financial services is also a feasible option for Sri Lanka. Development of the Colombo Port City as a financial hub is expected to bolster financial services exports, thereby increasing export earnings.

**Innovative strategies to entice both international and domestic tourists are necessary to keep the tourism sector functioning in the new normal that has been created by the pandemic.** Sri Lanka opened its borders for international tourists in January 2021, after being closed for 10 months, using the innovative concept of “bio-bubbles”, where the health and safety of both international tourists and the local communities are ensured through strict social distancing, while also avoiding quarantine requirements for tourists. While the pandemic persists, bio-bubbles can be expanded to include more authorised accommodation providers and tourist sites, while inviting tourists of many different countries to visit Sri Lanka. Further, regional bio-bubbles can be negotiated with countries like the Maldives, which has opened up for tourism, while creating travel corridors with other countries. At the same time, increasing opportunities for those who have been vaccinated against COVID-19 to travel without testing and quarantining can also be explored. Meanwhile, there is further space to develop local tourism in Sri Lanka to help the tourism sector, especially the informal sector, as it is mostly the formal sector that can operate under bio-bubbles. Additionally, the promotion of local tourism could also reduce the number of Sri Lankans from travelling abroad for leisure, thereby helping to minimise foreign currency outflows. In this regard, tourism related authorities should work with the private sector to improve domestic tourism further, through measures such as scheduled tour packages for weekends, customised tours for different age groups, educational tours, and retreats and tours for different income groups. Further, there

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is also a need to create more user friendly and localised information portals on local attractions and information on arranged tours for locals. At the same time, connectivity can be enhanced by providing transportation to tourist sites from city centres. Moreover, the country needs to make use of the opportunity created in the pandemic period to address issues that have kept some tourists away in the past, such as concerns on personal safety, lack of facilities at tourist sites, having to buy costly tickets at individual tourist attractions, noise pollution, and overcrowding. Further, reducing the informality in the sector and introducing insurance schemes and social safety mechanisms for those who are engaged in the sector are imperative to build the resilience of the sector to face unexpected challenges, locally or internationally, especially if the sector is to expand further over the medium term. Additionally, mechanisms to recover due taxes from unregulated accommodation providers and other service providers, including websites that provide a platform for tourism services to be marketed for a fee, must be developed and strictly executed. Immediate attention for the timely implementation of such measures would help the tourism sector to develop in the face of the new normal, while building resilience of the sector to sustain as a major foreign exchange earner of the country.

**The Colombo Port City, the first of its kind in South Asia, is expected to bring numerous socioeconomic benefits to the country, conditional on the country's ability to attract strategic investments by offering an investor friendly atmosphere expeditiously.** The Colombo Port City is being developed with a modern business atmosphere that can compete with other popular investment hubs, such as Dubai, Singapore and Hong Kong, to attract investors, entrepreneurs, innovators, companies, and financial institutions through a well structured and competitive legal, tax and regulatory,

and dispute resolution mechanism. Despite there being many financial service centres in the world, the Colombo Port City has the proximity advantage to major cities in South Asia and East Asia. Expected foreign investment flows to the Colombo Port City would be critical to finance the balance of payments (BOP) of the country over the medium term. Further, this project is expected to support the national economy, through the generation of employment opportunities, while contributing to economic growth and government revenue. Additionally, as Colombo is popular for its favourable living conditions compared to other cities in South Asia and with the pool of skilled workforce, it is expected that the Colombo Port City project will create high quality employment opportunities, which would also reduce the issue of brain drain faced by the country. In the meantime, there is a dire need to maintain policy consistency, improve doing business conditions and expedite approval and the implementation processes to facilitate FDIs as planned with the establishment of the Colombo Port City Commission, which would enable Sri Lanka to successfully compete with other financial hubs in the world.

**The country's continued failure to attract sizeable FDIs highlights the structural, institutional and policy impediments that need to be addressed urgently, while maintaining a consistent policy framework with a long term view.** Unlike other capital flows, FDIs embody many desirable features, such as the transfer of technology, providing a boost to foreign exchange earnings and the development of human capital through technical and managerial know-how. Further, FDIs facilitate integrating with regional and global value chains, infrastructure development and technology innovation, while creating employment opportunities and enabling access to new markets. FDIs are generally a long term source of funds to an economy, compared to other financial flows,

such as portfolio investments and debt flows. Many countries that have attracted substantial levels of FDIs over the past decade have been able to maintain foreign borrowings at manageable levels, thereby maintaining their external debt at sustainable levels. Attracting a high level of FDIs, mainly to tradable sectors and infrastructure, would be the way forward for Sri Lanka to improve external debt sustainability. Developing the Colombo Port City, promoting the Colombo and Hambantota ports as commodity trading hubs and establishing modern investment zones for local and foreign private investors, are expected to attract considerable foreign investments to the country in the period ahead. In this context, while the expected FDIs to these identified projects must be expedited, continuous dialogue with potential investors to attract investments beyond these zones should also be prioritised. To sustain a healthy momentum of FDIs over the medium term, implementing structural and policy reforms to address the issues that hindered the receipt of FDIs over the past several decades must be pursued as a national priority. Sri Lanka's doing business ranking remains low, regardless of the measures taken to improve the rankings. Therefore, concerted efforts are necessary to expedite improving the doing business environment and remove unnecessary bureaucratic delays in investment approval and implementation processes. There are several areas Sri Lanka should improve in order to attract high levels of FDIs in the future, including the establishment of a coherent investment policy, enhancing efficiency seeking FDIs as well as market seeking investment, establishment of investment legislation on par with international best practices, labour and land market reforms, developing a monitoring and evaluation framework, improving investment promotion activities, effective management and development of economic zones, establishing an effective

mechanism to address investor grievances, and systematic evaluation of the effectiveness of investment incentives. There should also be a transparent mechanism for investors to stay updated about the possible areas of investment and the relevant legal frameworks applicable for such investment.

**Improving the external current account balance and the fiscal balance is necessary to continue reversing the expansion in external debt, in order to ensure macroeconomic stability and prevent disruptions to long term economic growth.** For many decades, Sri Lanka has been experiencing twin deficits, namely, deficits in the government budget and deficits in the external current account, emanating from imbalances in the country's fiscal and external sectors. High budget deficits have been propelled by rigid government expenditure and relatively low growth in government revenue. External current account deficits have been magnified by large trade deficits. This has worsened in recent years with merchandise imports being twice as much as merchandise exports, in value. Maintaining a reasonable trade deficit is considered usual for a small emerging market economy like Sri Lanka, although a gradually worsening trade deficit is detrimental to any economy. The current account deficit is reflected in the savings-investment gap, which has necessitated the country to seek foreign capital to finance investment activities. The real issue is not twin deficits per se, but how a country is financing such deficits. For example, many economies with twin deficits manage to finance such deficits through non debt creating means. However, in Sri Lanka, these deficits have been mostly financed through external borrowings, thereby leading to a vicious cycle. The vulnerability of Sri Lanka's external sector was amplified further in 2020 by the impact of the COVID-19 pandemic,

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which has resulted in much needed foreign flows drying up, including income from tourism, while limiting access to the international capital market. As already recognised by the Government, improving the domestic production economy and attracting more non debt creating flows remain vital for Sri Lanka to break this vicious cycle. Initiatives have already been taken by the Government to this end, but in the short run, several additional measures, such as the continuation of restrictions, to suppress the expenditure on non-essential imports and other foreign exchange outflows, may be needed. Focused facilitation effort to improve the doing business environment is necessary to attract FDIs, prioritising the export oriented manufacturing sector. Meanwhile, efforts are necessary to improve domestic savings through the introduction of innovative financial products in the context of the low interest rate environment, while minimising dissavings by the Government.

**Major fiscal challenges that need to be addressed by the Government include the persistently low revenue, rigid recurrent expenditure, rising gross financing needs and the resultant elevated debt level, as well as the need to improve the financial performance of SOBEs.** Tax revenue mobilisation has been impeded by various tax exemptions/holidays, tax evasion and weak tax administration for decades. Certain tax reforms introduced by the Government are aimed at addressing these issues, despite the near term setback due to the COVID-19 pandemic. The adverse near term impact on tax revenue collection due to the fiscal stimulus measures is expected to be offset by the envisaged rebound of economic activity in the period ahead. It is imperative to enhance government revenue by improving the tax base and simplifying documentation requirements in the tax system, while strengthening the capacity for risk based revenue administration to improve tax

compliance, within a simple, efficient, and equitable tax system as envisaged by the Government. Meanwhile, the rising share of non discretionary fiscal expenses, such as interest payments, salaries and wages, and pension payments, continues to add pressure on fiscal operations, thereby challenging the expenditure rationalisation plans of the Government. Relatively large government expenditure, given the low revenue mobilisation and tightening financial conditions, has resulted in high budget deficits, necessitating effective management of government expenditure to avoid significant stresses in the period ahead with increasing borrowing requirements, coupled with large debt service payments of the Government falling due in the near to medium term. This underscores the need for deficit financing through non expansionary sources in the period ahead. Past efforts towards fiscal consolidation by phasing out the relatively high fiscal deficit and government debt have fallen short of expectations. Against this backdrop, the Government needs to strike a fair balance between firming up fiscal consolidation and continuing the facilitation of the envisaged economic recovery and growth in the period ahead.

**Policy adjustments in the period ahead must give due consideration to the fact that the COVID-19 pandemic has had a disproportionate impact on underprivileged segments of the population and has aggravated inequalities, not only related to income, but also in relation to other aspects that affect socioeconomic wellbeing in the short run and productivity in the long run.** As observed across the world and in Sri Lanka, COVID-19 has not had a uniform impact on everyone. The most vulnerable segments have been low wage workers in low income households whose nature of employment neither allows for 'work from home' options nor provides any paid leave. In terms of income inequalities, Sri Lanka has seen



little change over the past several decades, despite the substantial decline in poverty. Between the household survey rounds of 1953 and 2016, there has been little change in the share of household income received by the poorest 20 per cent. When considering the Household Income and Expenditure Survey (HIES) rounds from 1980/81 till 2016, the Gini coefficient has stagnated in the range of 0.43-0.48. Considering the loss of livelihoods and incomes from employment during the pandemic, income inequalities are likely to have worsened, despite the several relief measures that were granted by the Government, which may have helped maintain the living standards of recipients to some extent under trying conditions. In recent years, there have also been several concerns highlighted about the targeting and thereby efficacy of the Government's poverty alleviation efforts considering the significant fiscal expenditure that it entails. The ongoing development of a social registry information system to store information related to welfare programmes is expected to address the prevailing ambiguous exit and entry procedures and to streamline the provision of these benefits. The COVID-19 pandemic also highlighted inequalities in terms of access to education. While the rapid transition of educational activities to digital platforms is appreciable, concerns have been raised about the effectiveness of such initiatives, especially among children from low income families and those living in remote areas. Although mobile penetration is high in Sri Lanka, computer literacy stands at 32.0 per cent, and only 22.2 per cent of households owned a desktop or laptop computer, as per the Computer Literacy Survey for the first half of 2020, highlighting that there are issues in terms of access to online education. As the economy is gradually returning to normalcy, such inequalities related to income and education are likely to create future inequalities relating to opportunity and social mobility over the medium to long run. In turn, the persistent effects of such inequalities

can have implications on generations, leading to perpetuating inequality that will negatively affect economic growth and socioeconomic wellbeing. While the timeline of the pandemic remains uncertain, other structural changes arising from similar unforeseen events or even known ones, such as digitalisation, unless properly planned, can aggravate existing inequalities in the future. Despite universal access to education and health, which are essential redistributive policies, there is a need to assess the quality, quantity and relevance of these services in the context of the changing nature of the economy. This will be pivotal to the success of these services in breaking the cycle of inequality. While the Government continues to focus on the implementation of redistributive policies, innovative mechanisms ought to be introduced to improve the inclusivity, equity and resilience of communities, without increasing the fiscal burden. As a significant share of the labour force is engaged in the informal sector, they remain outside the ambit of any pension or superannuation scheme. Considering the vulnerability of this segment of the labour force, introduction of a nationwide contributory pension scheme is essential to serve as a safety mechanism, especially in view of the rapidly ageing population. The lack of such a retirement scheme for informal sector workers as well as inadequate insurance coverage may lead to increased reliance of vulnerable workers on the public safety net mechanism in the future. Furthermore, allowing public participation in welfare initiatives led by the Government can help improve the coverage, and potentially the quality of provisioning of essential goods and services.

**Increasing food self sufficiency in Sri Lanka is crucial to address food security issues and to ease external sector pressures, while boosting economic growth through increased agricultural production.** Although Sri Lanka is generally self sufficient in certain food categories,

## BOX 1

## Sri Lanka's Food Security in the Context of the COVID-19 Pandemic

**Food Security**

Amongst the myriad economic and social concerns that intensified during the COVID-19 pandemic, issues related to food security have garnered greater attention from policymakers, academics and the general public, locally as well as globally. According to the Food and Agriculture Organisation (FAO) of the United Nations, food security is the condition that exists when all people, at all times, have physical, social and economic access to sufficient, safe and nutritious food that meet their food preferences and dietary needs to live an active and healthy life. This definition covers four major dimensions of food security: availability, access, utilisation, and stability. Therefore, the concept of food security is broader than basic food production and ensuring availability of an adequate food supply. It encompasses numerous factors related to major dimensions of food security such as food production, distribution and storage, spatial availability of food, nutritional adequacy, economic and social accessibility, preferences, non-food aspects such as clean water, sanitation and other healthcare services, which improve food utilisation by individuals, as well as constancy of adequate food availability even during sudden shocks such as pandemics, wars or any seasonal, cyclical or other unexpected events. Food insecurity results in hunger in the short-run, but persistent food insecurity causes malnutrition issues, such as the prevalence of underweight, stunting, wasting and micronutrient deficiencies, and even death in acute cases. Unhealthy food choices compelled by food insecurity, carbohydrate rich diets for example, can lead to obesity and non-communicable diseases like diabetes and hypertension. Generally, children are mostly affected by chronic food insecurity, resulting in lower educational outcomes that will limit their economic opportunities in adulthood. Hence, ensuring food security is crucial for reducing hunger and poverty in Sri Lanka in line with the Sustainable Development Goals (SDGs), thereby improving the general wellbeing of the population and productivity of the labour force, and reducing persistent health and malnutrition issues. Although Sri Lanka has made significant progress towards ensuring food security of the population in the past few decades, the onset of the COVID-19 pandemic has heightened food insecurity at national and household levels.

**Impact of the COVID-19 Pandemic on the Status of Food Security**

As per the FAO, 8.9 per cent of the world population, i.e., approximately 690 million people, were estimated to be undernourished prior to the pandemic. A preliminary estimation by the FAO indicates that the COVID-19 pandemic may add between 83 million to 132 million people to the total undernourished population in the world. Based on data prior to the

pandemic, Sri Lanka was ranked 66<sup>th</sup> among 113 countries in the Global Food Security Index (GFSI) -2019, which considers the dimensions of food availability, affordability, quality, and safety of foods. Meanwhile, child malnutrition has been a longstanding issue in Sri Lanka. According to the Demographic and Health Survey (DHS)-2016 conducted by the Department of Census and Statistics (DCS), stunting, wasting and underweight among children aged 5 years or below were 17.3 per cent, 15.1 per cent and 20.5 per cent, respectively. With unprecedented preventive measures, such as lockdowns and mobility restrictions taken globally and locally, economic activities of the country were disrupted, impacting supply chains and livelihoods of people, and thereby food security, despite the measures taken to ensure uninterrupted food production and distribution during the pandemic period. The experiences during the COVID-19 pandemic emphasise the importance of ensuring food security of the public during such unprecedented economic shocks, and the possibility of the aggravation of existing food insecurity issues in the country if such issues are not addressed appropriately.

**Groups at Risk of Food Insecurity during the COVID-19 Pandemic**

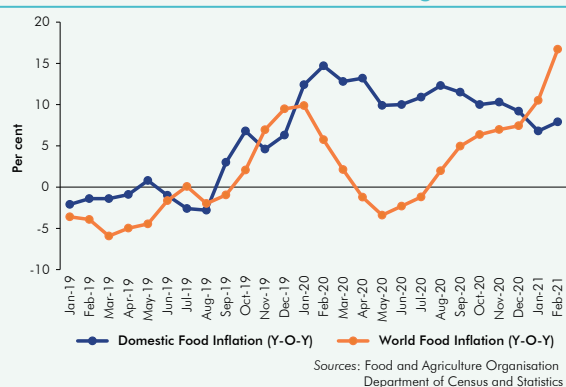
During the COVID-19 pandemic, risks to food security disproportionately aggravated for vulnerable groups of the population that were already facing food insecurity prior to its onset. The most vulnerable groups during the pandemic were individuals who have limited or irregular income, who have limited emergency reserves of food and savings, people with poor health, such as those with malnutrition issues and chronic diseases, those who are living in remote areas with less access to a variety of supplies and markets, certain groups of urban population who are entirely dependent on markets for their food needs, people who have limited social networks, people with limited or no transportation facilities, and other vulnerable groups, such as the elderly, homeless or displaced people and vulnerable children. Meanwhile, employment, either full or part-time, has been dampened by the pandemic-induced worker layoffs and the reduction in working hours in most affected sectors such as tourism, food and beverages, caregiving, and transport, thereby increasing the economic vulnerability of individuals engaged in these sectors.

**Impact of the COVID-19 Pandemic on Food Systems**

Effects of the COVID-19 pandemic transmit to food systems through both demand and supply sides. Although crop cultivation activities were not restricted in Sri Lanka, mobility restrictions resulted in a shortage

of manpower for labour-intensive crop cultivation and other food supply chain activities during the lockdown period. Accordingly, intermediary processes of food manufacturing, including processing, packaging, storage, and distribution, were impacted with labour shortages arising from the islandwide mobility restrictions imposed during the period from March to end April 2020, in particular. Meanwhile, post-harvest losses in perishable products increased notably during the lockdown due to disruptions to food distribution channels and closure of markets. Such supply side disruptions drove up food prices, adversely impacting vulnerable groups with less purchasing power, which prompted the Government to interfere through various measures to mitigate the situation. Nevertheless, as depicted in Figure B 1.1, food price inflation in Sri Lanka remained at elevated levels throughout 2020, making food less affordable for low income households and threatening their food security. Further, the disruption to international food trade due to the pandemic was a major concern for food security in many countries. In the wake of the pandemic, several countries restricted food exports to ensure stable domestic supplies. Such restrictions challenged the food security of net food importing countries during the pandemic, depending on the level of importance of imported food items in a country's food consumption pattern.

Figure B 1.1  
Global and Domestic Food Inflation during the Pandemic



On the demand side, loss of livelihoods of individuals due to the pandemic-induced economic downturn in the Sri Lankan economy could have limited individuals' access to a healthy diet, particularly among the poor. With the emergence of the pandemic, demand for essential food items increased significantly due to panic buying and hoarding of food, thereby limiting access to essential food items for vulnerable groups of the population. Further, people's opinion on the channels of disease spread also played a major role in determining demand for food during the pandemic, resulting in demand for meat products and fish, which are the major sources of protein, declining in 2020, especially during the second wave of the pandemic.

## Policies Adopted to Ensure Food Security amidst the COVID-19 Pandemic

The Sri Lankan Government, with the support of several stakeholders of the economy, implemented numerous measures to address immediate supply and demand side issues related to the pandemic. Accordingly, the Government expanded the social protection programmes to protect people living in lockdown or isolated areas, vulnerable groups, and those who were employed in the most affected sectors in the economy by offering cash and in-kind grants. In addition, the Government continued its nutritional support programmes that target children, and pregnant and lactating mothers during the lockdown period by home delivery of foods. Meanwhile, the World Food Programme also attempted to minimise the disruptions to the school meal programme due to the closure of schools by providing take-home rations to homes of primary school children during July-August 2020. However, prolonged school closures remained a challenge for the continuation of the school meal programme. From a supply side perspective, it was imperative to facilitate emergency financing needs of all stakeholders in the food supply chain, with targeted measures such as the provision of concessional loans, debt moratoria, and business continuity loans, thereby supporting them to withstand the effects of the pandemic. Aligning with this goal, the Central Bank of Sri Lanka eased its monetary policy stance substantially by bringing interest rates to historically low levels in the market. Further, several concessional financing facilities were introduced, including interest subsidy schemes, refinance facilities as well as credit guarantee schemes, as a coordinated effort of both fiscal and monetary policy pillars to support businesses and individuals affected by the pandemic. However, alleviating liquidity constraints of producers and consumers may not be sufficient to ensure food security during a pandemic when intermediaries have greater market power. In such a situation, government procurement and public distribution, as well as stronger monitoring and regulation of markets are necessary to ensure better functioning of the food system and to avoid high food price inflation. Further, the Government's policy agenda to encourage domestic agriculture, which re-introduced and promoted the concept of small family farming and urban farming, was supportive in fulfilling basic food needs of the population to a certain extent during the pandemic. The Government continued the fertiliser subsidy programme to support food production and offered fertiliser free of charge for paddy cultivation. In addition, health authorities took several measures to ensure strict adherence to health and safety regulations by the participants of food supply chain to prevent disease spread through food systems and ensure continuous functioning of food supply chains.

## Way Forward

Although COVID-19 was an unprecedented event, it has underscored the significance of building resilience of the country's food systems and households to cope

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with such shocks and ensure food security of the population. Hence, food security issues of the country need to be addressed with a holistic policy approach with near to long-term strategies to ensure food security to withstand possible future shocks. While improving productivity levels in the agriculture sector, policy focus should also be on providing necessary inputs and water on time, improving marketing and distribution channels, especially through new technological avenues such as digital platforms and home delivery systems targeting needy groups, which will support food accessibility even during extreme events. Further, food production databases and public sector distribution channels should also be strengthened with institutional support from local government authorities in addition to national authorities to prevent consumer exploitation and malpractices by the private sector during a pandemic. Moreover, facilitating regional as well as cross country food trading is crucial to avoid risks to food security since Sri Lanka is import dependent on several major food commodities in the food balance sheet. Promotion of domestic production of these food items remains to be a necessary condition to ensure long-term food security in the country, while managing the short-term challenges when implementing conducive policies towards this end. Moreover, improving warehousing and storage facilities, including cold storage, enhancing packaging and transportation services are important in the medium to long-term to reduce post-harvest losses, prevent food

shortages and maintain food inflation at subdued levels. Meanwhile, wild animals such as elephants, monkeys, peacocks and wild boars create significant crop losses, which in turn threaten domestic food security, requiring a holistic and integrated approach to resolve human-wildlife conflict in an equitable and sustainable manner. Meanwhile, enabling income generation opportunities for economically vulnerable groups will enhance their resilience to cope with unanticipated shocks in the future. In addition, policies must be targeted at educating the public, particularly in relation to nutrition and food safety, to promote healthy eating habits and healthy eating choices amongst individuals. It is expected that these aspects will be taken into consideration when finalising the proposed National Agriculture Policy of the Government.

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such as meat and eggs, it relies on imports for major food categories, such as cereals, pulses, milk and milk products, sugar, starchy crops, and certain fruits and vegetables. Further, Sri Lanka is compelled to import the country's staple food, rice, during the years of drought. Accordingly, food and beverages imports account for around 8 per cent of the total imports of the country. Amidst the external sector imbalances that worsened during the pandemic, increasing domestic food production has become essential to narrow the country's trade deficit. Further, the slow growth in the agriculture sector in recent years has dampened the overall economic growth, resulting in lower incomes for households who are engaged in agricultural activities. Meanwhile, logistical and supply side disruptions that emerged with the pandemic, domestically as well as globally, have impacted the food availability and food choices while escalating food prices in

the market. Consequently, food security at the household level has been threatened, especially for the poorest and most vulnerable segments of the economy. Thus, there is renewed interest in increasing food self sufficiency of the country, particularly in relation to food products that can be produced domestically. With the drive towards increasing food self sufficiency, the Government has committed to providing free fertiliser for paddy production and fertiliser subsidies for several other major crops, while safeguarding local agricultural producers by discouraging imports of certain agricultural products. These are welcome moves towards encouraging domestic production and raising income levels of farmers. Going forward, however, it may be necessary to focus on promoting food self sufficiency by augmenting agriculture sector productivity, since over-reliance by farmers on subsidies will pose a heavy burden on the Government budget. Further,

a heavily subsidised and protected agriculture sector will lead to inefficient resource allocation in the economy in the medium to long term, and may even threaten household food security due to inaccessibility of low cost and a wide range of food products. Therefore, institutional support needs to be provided to the farming community to upscale production, and enhance technology usage and productivity in agriculture activities. In addition, developing markets for agricultural products, reducing post harvest losses, enhancing warehousing and storage facilities and strengthening forward linkages in the value chain, especially by promoting food industries, are essential to encourage domestic agricultural production and thereby increasing food self sufficiency. Such policies will also ensure better price realisation by farmers, which will enhance their household income and re-investment capacities. In addition, land market reforms are also needed to support the productive use of land and address the land fragmentation issue, thereby promoting technology and machinery usage in agricultural activities. Such reforms will also support farmers in accessing credit through the formal financial sector for investments in agricultural production activities.

**The COVID-19 pandemic highlighted the fragilities and vulnerabilities in Sri Lanka's labour force, emphasising the need for urgent labour market reforms to pave way for the creation of a resilient and dynamic labour force that can contribute to the country's transition to a high income economy.** There was a notable disconnect between quarterly GDP and labour market indicators during the year, highlighting the presence of possible shortcomings in labour force surveys and measurements, which is not unique to Sri Lanka and has been observed worldwide during the pandemic. The lack of suitable high frequency

indicators in Sri Lanka, in addition to limited quarterly data, renders it difficult to carry out any real time analysis of labour force trends during such volatile periods. Although the economy is steadily returning to normalcy, concepts of 'physical distancing' and the stringent health regulations that are to be adhered to will have some lingering effects on the economy. In such situations, the most vulnerable people are low wage workers in low income households, i.e., broadly informal sector workers and lower occupational categories among formal sector workers. Based on the Annual Labour Force Survey for 2019, it was estimated that over 57 per cent of those who were employed were engaged in the informal sector and of this, almost 61 per cent were engaged in the non agricultural sector. A more detailed analysis across occupational categories shows that the most vulnerable occupations of services and sales workers, workers in the agricultural sector, craft workers, plant and machine operators, and those engaged in elementary occupations comprise around 88 per cent of informal sector employment and 50 per cent of total employment. The unskilled nature of workers in these sectors makes them vulnerable not only during disruptions such as COVID-19 but also in the wake of digitalisation and automation in the future. In this regard, the Government's initiatives to provide permanent employment opportunities to those with low levels of educational attainment and those hailing from low income households is commendable from a social perspective, as it provides an opportunity for such households to free themselves from the vicious cycle of poverty. Despite the gradual transformation of the economy and the simultaneous presence of 'Generation X' and 'Generation Y' or 'Millennial' workers in the labour force, it is surprising that there has been no evident shift in employment patterns from the public to the private sector. This could be a reconfirmation of the presence of a wedge between 'good jobs' and 'bad jobs', stemming from

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the unconditionally permanent nature of public sector employment alongside pension benefits and wages not being linked to performance. Further, the lack of any performance driven criteria can weigh negatively on the productivity of the growing public sector, which could also have given rise to underemployment and ‘hidden unemployment’. A concerted effort is also required to upskill the labour force, across all education levels, while aligning them with the sectoral priorities of the country. Discussions with various industries reveal a broadbased shortage of skilled and semi-skilled workers across all key sectors. This is to be weighed against the persistently high levels of youth unemployment, a large share of which comprises those with an educational attainment of G.C.E. Advanced Level (A/L) and above. There is an urgent need for the education sector to work with key public and private industry stakeholders to identify the labour needs of the economy and focus on upskilling and reskilling efforts. These should also include the development of future proof digital skills through a process of continued work based learning. Further, for Sri Lanka’s labour force to be able to make a productive contribution to the economy’s progress while reducing their vulnerabilities and assuring them of dignified employment, a concerted effort needs to be made in consultation with all stakeholders to address longstanding issues, such as low levels of female labour force participation and high levels of informal employment in the economy, while addressing the changing nature of employment with the increasing numbers of ‘gig workers’. As stated earlier, another required crucial reform in the labour market is the introduction of a nationwide contributory pension scheme, which could enhance labour market flexibility while reducing future fiscal burdens on social welfare. On the whole, labour market reforms have to be undertaken with a multi-sectoral approach that encompasses not only the

qualitative aspects of the labour force but also legislative aspects that affect the flexibility of the labour market, and in turn, the productive capacity of the economy.

**There is widespread recognition that MSMEs are vital for the generation of inclusive and sustainable growth, highlighting the need to devise unique policy interventions to uplift this segment.** MSMEs play a key role in terms of employment generation and smoothing out of regional disparities. With the growing recognition of the need for a domestic production economy, there is a need to recognise the dearth of support for MSMEs, which are the backbone of a sustainable production economy. One of the key hindrances faced by the sector is access to finance. On the one hand, MSMEs struggle with issues such as lack of collateral, poor project management and financial planning, poor understanding of risks, and overall lack of understanding about financing opportunities available to them and to get support from financial institutions. On the other hand, despite the prevalence of several government backed schemes for MSME funding, the financial sector remains apprehensive about lending to these enterprises. This is partially attributable to the general dearth of expertise or knowledge in development finance, which is essential for project evaluation and feasibility assessment and is rather different from conventional lending practices. Accordingly, the formal financial sector is required to consider the unique needs and constraints faced by MSMEs and develop innovative banking products and services specially focusing on this sector. Although various credit guarantee schemes have had some success in Sri Lanka, the establishment of a well designed and well managed Credit Guarantee Institution can play a pivotal role in bridging this financing gap, as observed in countries such as Chile and Malaysia. The

establishment of a National Development Banking Corporation as proposed by the Government is also timely. In addition to enhancing the 'availability' of credit to MSMEs, there is also a need to focus on improving their 'bankability' to improve access to formal channels of finance and thereby ensuring that they are profitable, productive, and sustainable over the medium to long run. One other means of addressing the issue of 'bankability' of MSMEs is through technical awareness programmes conducted by numerous public institutions and other organisations that work with MSMEs. Such programmes should focus on financial discipline, financial reporting, and organisational and business management. Improved access to finance and financial literacy by MSMEs can have a positive cyclical impact on their performance and progress, which in turn will enable them to adopt newer technologies, increase productivity, improve quality, and enhance their profitability and sustainability. The recently launched National Financial Inclusion Strategy (NFIS) and also the efforts to develop domestic value chains are expected to strengthen the contribution of MSMEs towards inclusive and sustained growth and development.

**The financial sector of Sri Lanka needs to evolve fast to cater to the emerging needs of the economy in the prevailing low inflation, low interest rate environment.** On the one hand, a low interest rate structure poses significant challenges for economically vulnerable groups, particularly senior citizens, due to low returns on their deposits. On the other hand, lending rates must remain low to encourage investment spending. However, financial institutions often find it challenging to fund emerging demand for large scale investment and business ventures due to the lack of balance sheet strength. Meanwhile, the absence of financial institutions specialising in financing large scale development projects

has also restricted the funding avenues for large scale investors. These drawbacks and challenges highlight the importance and the need for financial sector development in Sri Lanka, particularly in the context where the Government is attempting to promote domestically funded investment in large scale projects. To address concerns with respect to low deposit rates, financial institutions should focus on introducing alternative, novel, safe, and attractive financial products, particularly for savers who are adversely affected by low returns. Rising cost to the Government in continuing the additional interest offered for deposits of senior citizens also highlights the importance of introducing alternative financial products. Moreover, measures should be taken to enhance financial literacy and public awareness on the merits of usually unsought and under-advertised financial products, such as life insurance, annuities, unit trusts, repurchase agreements, and equity. Further, the public should be made increasingly aware of value added services, such as wealth management and other financial advisory services, offered by financial institutions at present. Such alternatives would provide the community of savers, including the elderly, with a range of financial products and services that would yield better returns. With respect to enhancing the lending capacities of financial institutions in the context of envisaged high economic growth and the low interest rate environment, the possibilities of financial sector consolidation should be actively pursued. Such consolidation would enhance the resilience of the domestic financial sector, while also addressing the existing weaknesses in the sector through the creation of a large capital base, enhancing its potential to finance large scale transactions and attract foreign investment, widening the range of financial services, and thereby improving the efficiency and profitability of the overall financial sector in the economy. Most importantly, stronger balance sheets of financial

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institutions would enable improved credit flows to needy and productive sectors, while increasing capacity to service the growing financing needs of the economy.

**As the country's interest rate structure is expected to remain in single digit levels, the general public needs to be more vigilant of offers and opportunities promoted by various unscrupulous parties.** With interest rates on savings reducing to significantly low levels, some social groups, who have been adversely affected by low returns on savings, are attracted to risky alternatives that are said to yield better returns. The resurgence of illegal deposit mobilising entities generally gathers pace in a low interest rate environment. Such entities attempt to lure unsuspecting depositors by promising extremely attractive returns despite frequent warnings by the Central Bank on risks involved. Moreover, pyramid schemes, which are prohibited in Sri Lanka, tend to operate in the form of multi level marketing (MLM) or network marketing opportunities that promise extraordinary returns for referrals. As investment in such programmes entails a high degree of risk, the public needs to be vigilant of such prohibited schemes and illegal entities. The public should take all necessary precautions, and conduct due diligence on alternative investment opportunities, while refraining from investing in prohibited schemes. The public could also direct their queries and concerns to the Financial Consumer Relations Department of the Central Bank and seek assistance to avoid the pitfall of being scammed by illegal, *'too good to be true'* financial schemes.

**Although the usage of digital payment methods accelerated with the unexpected circumstances created by the pandemic, fast evolving technology demands preparedness of stakeholders in the financial sector and**

**improved financial literacy among the general public to make use of the technology.** The pandemic created opportunities for the financial sector to attract more people towards digital payment systems. Digitalising payment systems provides various financial as well as non financial benefits to the customer, the merchant and the financial institution. Although the initial capital investment in the payment digitalisation process is relatively high, transaction and administration costs are notably low along with increased speed and improved transparency, compared to cash or paper based transactions. As mobile phone penetration has increased notably over the past few years, promoting digital payments would aid in improving financial inclusion in the country by a broad based attraction of the public to the formal financial system, thereby enhancing prospects of inclusive growth. With rapid technological developments globally, new methods of payments evolve via social media platforms, open banking models, etc. In this regard, the adoption of blockchain technology into the banking system and the introduction of virtual currencies into the monetary system have been deliberated extensively. The outbreak of the COVID-19 pandemic provided the opportunity to progress on this front. Although Sri Lanka has recorded a notable progress in digitalising payment systems with the introduction of mobile payments apps, Quick Response (QR) code related transactions, Point of Sale (POS) transactions as well as e-commerce, a majority of retail transactions takes place through cash or paper based methods in the economy. Against this backdrop, the financial sector needs to further capitalise on Sri Lanka's wider penetration of mobile phones in order to attract the masses towards digital payment systems. While the younger generation adapts fast to innovative payment methods, a larger share of the population remains outside these systems due to factors such as lack of self-confidence and safety concerns.



Hence, further measures are needed to popularise the usage of digital payments in the country in order to reap maximum benefits of technological developments to enhance efficiency in the financial system and increase financial inclusion.

**Environmental issues in Sri Lanka increasingly exert considerable macroeconomic implications, underscoring the importance of a sustainable development policy framework.**

Environmental issues that have repeatedly surfaced over the past several years, such as climate change, depletion of forest cover, land degradation, solid waste disposal including non-degradable and e-waste, threats to wildlife, coastal erosion, air pollution, and pollution of water bodies, generally receive less attention, as environmental conservation and economic growth are often seen as conflicting objectives. However, recurrent natural disasters and climate change have increased the vulnerability of the Sri Lankan economy in the recent past, affecting domestic production and economic activity, BOP as well as energy security. The Global Climate Risk Index (GCRI) that estimates countries' vulnerability to extreme weather events in terms of direct consequences, i.e., deaths and economic losses, has ranked Sri Lanka among the top ten countries that are most affected by climate change in three consecutive years from 2016 to 2018. Vulnerability of Sri Lanka to climate change induced frequent and extreme natural disasters poses a major threat to the agricultural sector. Hence, these climate related risks have a direct effect on agricultural productivity and threaten food security and increase inequalities. Meanwhile, energy security of Sri Lanka is highly compromised during dry weather conditions, and the country faces significant external pressure during drought periods since hydropower generation has to be substituted with high cost and environment unfriendly thermal power generation. Further,

climate challenges can also disrupt the economy by diverting resources, especially from technology and innovation to reconstruction and replacement, while restricting funds available for other development projects. Therefore, a proactive and holistic disaster management and a sustainable development framework is essential to mitigate the adverse impact of climate change. Several measures have already been adopted to address emerging negative consequences of disasters, and these need to be strengthened within a framework with emphasis on policy reforms on disaster prevention, preparedness, response and recovery measures with a view to reducing the climate vulnerability of the economy while increasing the resilience of the entire community against climate risks. Moreover, special attention on comprehensive environmental impact assessments of development projects, development and promotion of environment related market instruments, such as polluter-payment systems, environmental taxes and green financial instruments, public awareness and involvement in environmental conservation, enforcement of regulations, and monitoring system with institutional support are essential to enhance the country's disaster management profile and drive the economy on a sustainable growth path.

**Accurate and timely data play a key role in information based societies.** While high quality data enable policymakers and stakeholders of the economy to evaluate alternatives and make informed decisions, poor and delayed data lead to the formation of misjudged public opinion as well as policy errors, incurring economic and social costs, thereby impacting economic progress and stability. Mitigating such implications relies on accurate and adequate coverage of samples, vigilant processing of data, and prompt dissemination. This requires increased transparency and adherence to internationally accepted data compilation

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methodologies and standards. Traditional data collection and compilation methods were challenged amidst the pandemic due to lockdown, mobility restrictions and inadequate tools and technical know-how to capture data through non-traditional methods. One key concern associated with the existing compilation methods of measuring GDP during the pandemic is about capturing data on new economic activities that emerged, such as work from home, and informal service provision using online platforms. Traditional structured approaches to obtain data in predefined frequencies will be insufficient to estimate the performance of a particular sector that adapts fast to changing circumstances. Therefore, it is vital to build the capacity of state agencies that are responsible for data collection and dissemination and empower relevant personnel with knowledge, expertise and technology required to overcome such challenges. Countries across the globe tend to use high frequency online surveys on indicators of economic activity. This became vital during the pandemic as delays in disseminating economic statistics and releasing highly provisional estimates at predefined deadlines and subsequent large revisions resulted in inaccurate signals to the market. Development of effective data management processes could be considered a central part of policy formulation assisted by proper sourcing, management, and analysis of data for the use of stakeholders of the economy. The use of decision supporting tools, such as artificial intelligence and automation, largely depends on timeliness and accuracy of data. This reiterates the need for high quality and timely

data, and the use of novel technologies for data collection as well as for data dissemination, thereby facilitating prompt and accurate decision making and informed opinion formation by stakeholders of the economy.

**The preceding non-exhaustive discussion highlights the necessity, urgency and complexity of required policy adjustments to ensure the country's progression along a high, sustainable and equitable growth path while enhancing macroeconomic stability.**

In 2020, amidst headwinds from multiple fronts, the Sri Lankan economy once again showed its resilience, supported by swift policy responses from the Government and the Central Bank. The COVID-19 pandemic, as well as the establishment of a Government with a strong mandate endorsed by a large majority of people, also provided an opportunity to reset policies to address longstanding vulnerabilities of the economy. As the economy carefully treads through rough terrain in the near term as it did in 2020, the implementation of the macroeconomic framework envisioned by the Government, including much needed reforms to enhance overall productivity and efficiency of the economy with the support of the private sector, is expected to strengthen the economic outlook for the medium term, thereby enabling the achievement of the Government's goals of prosperity and splendour for the country as a whole as well as the different segments of its people.