

5

External Sector Developments

The external sector faced heightened challenges in 2021, reflecting the effects of the COVID-19 pandemic, which dampened foreign exchange inflows amidst large foreign currency debt servicing obligations. Earnings from merchandise exports marked a notable improvement thus far in 2021. Expenditure on imports also increased substantially, reflecting the recovery of economic activity and the surge in global commodity prices. The merchandise trade deficit widened during the eight months ending August 2021, compared to the same period in 2020 and 2019. Trade in services, particularly earnings from tourism, was significantly affected by the pandemic. Workers' remittances, which recorded a healthy growth during January to May 2021, y-o-y, moderated thereafter. Interest and dividend payments showed some moderation, resulting in a relatively low deficit in the primary income account. The deficit in the external current account widened, reflecting the expansion of merchandise trade deficit and the moderation of trade in services. The financial account recorded net foreign outflows, and gross official reserves declined. The BOP recorded a notable overall deficit during the period ending September 2021. However, with the ongoing efforts of the Government and the Central Bank, some sizeable foreign inflows are expected in the near term, including proceeds from monetisation of underutilised or non-strategic assets, bilateral swap arrangements, syndicated loans, G2G financing and FDI flows. The exchange rate witnessed some intermittent volatility during the year thus far, while remaining relatively stable in recent weeks. The Central Bank intervened in the domestic foreign exchange market to dampen excessive volatility in the exchange rate, while providing foreign exchange liquidity to meet the cost of imports of certain essential commodities.

5.1 Balance of Payments

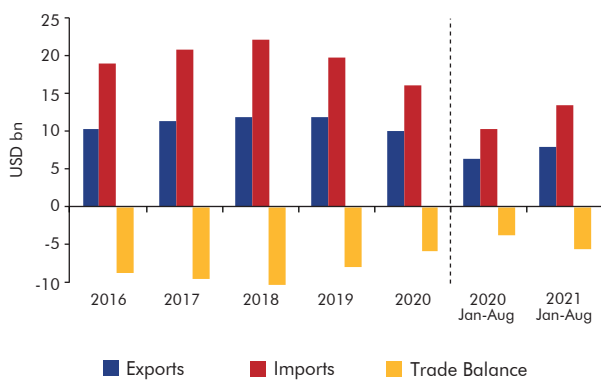
Current Account

The current account deficit expanded due to the widening merchandise trade deficit, moderation of the surplus in trade in services amidst subdued earnings from tourism, despite the improvements in the primary income account and workers’ remittances during the first half of 2021. Consequently, the current account recorded a deficit of USD 1.5 bn in the first half of 2021, compared to the deficit of USD 1.1 bn in the first half of 2020.

Trade Account

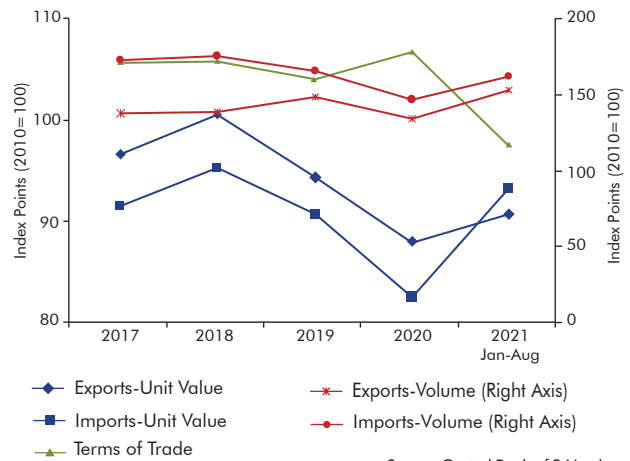
The deficit in the merchandise trade account in the eight months ending August 2021 widened to USD 5.5 bn from USD 3.8 bn and USD 4.9 bn recorded in the corresponding periods of 2020 and 2019, respectively. Earnings from exports amounted to USD 7.9 bn during the eight months ending August 2021, increasing by 22.6% compared to the same period in 2020. Import expenditure increased to USD 13.4 bn during January-August 2021, from USD 10.3 bn in the same period last year, recording an increase of 30.7%. As shown by movements in the export and import volume and unit value indices, the increase in export volumes contributed significantly to the increase in export earnings. The effect of volume and price changes varied across the different types of imports though in general, import expenditure was influenced by both volume and price increases.

Figure 5.1
External Trade Performance



Sources: Sri Lanka Customs
National Gem and Jewellery Authority
Ceylon Petroleum Corporation
Lanka IOC PLC
Other Exporters of Petroleum
Central Bank of Sri Lanka

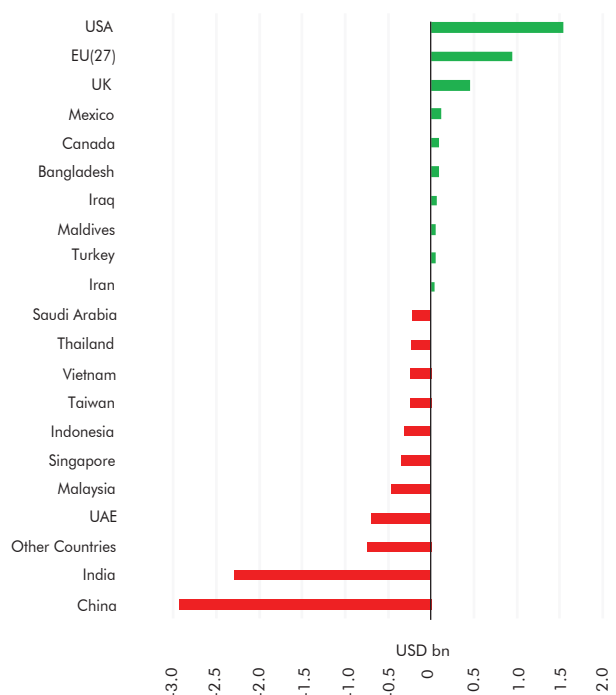
Figure 5.2
Terms of Trade and Trade Indices



Source: Central Bank of Sri Lanka

Earnings from exports recovered to pre-pandemic levels, supported by policy measures and gradual normalisation of global activity, while expenditure on imports reflected the recovery of domestic activity and the increase in global commodity prices...

Figure 5.3
Bilateral Trade Balances during Jan-Aug 2021



Source: Central Bank of Sri Lanka

Table 5.1
Developments in International Trade

USD mn

Category	2019	2020 (a)	2020 Jan-Aug (a)	2021 Jan-Aug (a)	y-o-y Change % Jan-Aug 2020/2021	Share % Jan-Aug 2021
EXPORTS						
Agricultural Exports	2,461.9	2,336.2	1,516.0	1,765.5	16.5	22.3
Tea	1,346.4	1,240.9	805.6	882.4	9.5	11.2
Rubber	24.2	30.1	17.9	27.3	52.7	0.3
Coconut	329.5	345.2	221.5	276.9	25.0	3.5
Kernel Products	161.1	163.1	101.4	125.6	23.9	1.6
Other	168.4	182.1	120.1	151.3	26.0	1.9
Spices	312.5	333.5	194.5	282.4	45.2	3.6
Vegetables	32.0	36.6	26.1	18.4	-29.7	0.2
Unmanufactured Tobacco	34.7	25.5	16.9	21.4	26.6	0.3
Minor Agricultural Products	120.0	134.7	100.3	91.1	-9.1	1.2
Seafood	262.5	189.8	133.2	165.5	24.3	2.1
Industrial Exports	9,426.3	7,672.0	4,905.5	6,093.2	24.2	77.1
Textiles and Garments	5,596.5	4,423.1	2,853.1	3,434.8	20.4	43.5
Rubber Products	866.1	786.1	488.9	681.7	39.4	8.6
Petroleum Products	521.1	373.6	268.1	294.9	10.0	3.7
Food, Beverages and Tobacco	447.0	464.0	302.9	354.0	16.9	4.5
Machinery and Mechanical Appliances	400.0	337.5	209.5	329.1	57.1	4.2
Gems, Diamonds and Jewellery	305.7	181.5	102.7	178.0	73.4	2.3
Base Metals and Articles	176.5	110.9	76.0	100.1	31.8	1.3
Transport Equipment	145.9	71.4	46.2	74.8	61.8	0.9
Chemical Products	176.3	172.7	107.7	143.7	33.4	1.8
Leather, Travel Goods and Footwear	102.9	53.9	38.2	33.8	-11.4	0.4
Printing Industry Products	48.3	47.9	25.9	35.5	37.0	0.4
Plastics and Articles Thereof	73.5	176.3	72.6	50.7	-30.2	0.6
Other Industrial Exports	566.6	473.2	313.7	382.3	21.8	4.8
Mineral Exports	33.9	25.1	14.3	30.7	115.3	0.4
Unclassified Exports	17.9	14.1	9.3	13.6	45.5	0.2
Total Exports	11,940.0	10,047.4	6,445.0	7,903.0	22.6	100.0
IMPORTS						
Consumer Goods	3,956.5	3,401.7	2,300.3	2,579.3	12.1	19.2
Food and Beverages	1,426.9	1,554.4	1,023.7	1,151.9	12.5	8.6
Rice	12.8	10.5	6.3	8.4	34.2	0.1
Sugar	199.7	276.0	161.9	210.5	30.0	1.6
Dairy Products	311.9	333.8	228.9	231.2	1.0	1.7
Lentils	79.9	96.9	65.7	105.7	60.8	0.8
Other	822.7	837.2	560.8	596.1	6.3	4.4
Non-food Consumer Goods	2,529.6	1,847.3	1,276.7	1,427.3	11.8	10.6
Personal Vehicles	815.7	282.9	280.8	7.8	-97.2	0.1
Medical and Pharmaceuticals	552.6	595.5	385.3	532.0	38.1	4.0
Home Appliances	206.6	174.2	100.4	179.8	79.1	1.3
Clothing and Accessories	275.1	200.7	137.6	138.7	0.8	1.0
Other	679.6	594.0	372.5	569.0	52.7	4.2
Intermediate Goods	11,369.6	9,076.5	5,692.4	7,942.4	39.5	59.2
Fuel	3,891.6	2,542.6	1,691.2	2,395.9	41.7	17.9
Textiles and Textile Articles	2,909.4	2,335.1	1,457.2	1,943.7	33.4	14.5
Diamonds, Precious Stones and Metals	201.4	117.2	57.4	81.7	42.3	0.6
Chemical Products	831.5	831.5	518.3	732.6	41.3	5.5
Wheat and Maize	346.4	384.4	229.3	265.9	15.9	2.0
Fertilizer	221.4	258.9	124.3	104.0	-16.4	0.8
Base Metals	562.8	460.3	246.6	499.2	102.4	3.7
Plastics and Articles Thereof	612.9	540.2	323.9	518.6	60.1	3.9
Other Intermediate Goods	1,792.3	1,606.3	1,044.2	1,400.9	34.2	10.4
Investment Goods	4,602.6	3,563.2	2,253.2	2,882.3	27.9	21.5
Machinery and Equipment	2,489.7	2,176.1	1,324.6	1,822.5	37.6	13.6
Building Materials	1,508.7	1,035.6	671.4	803.9	19.7	6.0
Transport Equipment	596.6	348.3	255.3	252.1	-1.2	1.9
Other Investment Goods	7.6	3.2	2.0	3.7	90.6	0.03
Unclassified Imports	8.3	14.0	11.4	7.6	-33.8	0.1
Total Imports	19,937.1	16,055.4	10,257.4	13,411.5	30.7	100.0

(a) Provisional

Sources: Sri Lanka Customs
National Gem and Jewellery Authority
Ceylon Petroleum Corporation
Lanka IOC PLC
Other Exporters of Petroleum
Central Bank of Sri Lanka

Export performance showed a broad-based improvement compared to 2020. Almost all export sectors across industrial, agricultural, and mineral exports recorded increases. Although the effects of the COVID-19 pandemic have not fully dissipated globally, the growth momentum in advanced economies helped secure a faster than expected recovery for Sri Lanka's exports. Domestically, the support provided by the Government helped address issues faced by industries amidst the pandemic, and the continued provision of infrastructure facilities and support services enabled businesses to record this growth.

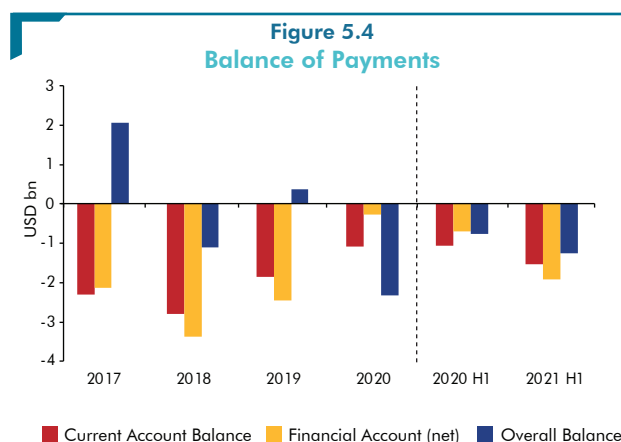
Import expenditure grew despite the continuation of some of the import restrictions imposed by the Government in 2020. The recovery of activity, alongside the increase in global prices, particularly of fuel, contributed to record an increase of import expenditure on account of all major sectors, namely, consumer goods, investment goods, and intermediate goods.

Services Account

The services sector remained subdued in the first half of 2021 with limited earnings from tourism despite a healthy growth in the IT/BPO sector. The tourism sector witnessed a limited number of tourist arrivals. The total number of tourist arrivals from January to September 2021 amounted to 37,924 while earnings from tourism in the period were restricted at USD 51 mn. The Central Bank, the Government and tourism authorities provided significant support to the tourism sector to weather the impact of the pandemic. They included debt moratoria, working capital loans, waivers of license fees, facilities for new tourism trends, such as 'digital nomadism', promotional campaigns in target markets, development of mobile apps for tourists, improvements to hard and soft tourism infrastructure, etc.

The surplus in trade in services moderated, mainly reflecting subdued earnings from tourism...

The computer and information services subsector contributed mainly to earnings from services during the first half of 2021, reflecting the increased business



Source: Central Bank of Sri Lanka

opportunities that became available due to the pandemic. Meanwhile, the rapid expansion of ITES, which include BPO and KPO services, continued to contribute towards the healthy growth in this sector in addition to software development services. Net earnings from the transport sector gradually increased in the first half of 2021 with container handling and cargo handling in the port services subsector recording

Item	2019 (a)	2020 (b)	2020 H1 (b)	2021 H1 (b)
Trade Balance	-7,997	-6,008	-3,262	-4,316
Exports	11,940	10,047	4,413	5,699
Growth (%)	0.4	-15.9	-26.4	29.1
Imports	19,937	16,055	7,675	10,015
Growth (%)	-10.3	-19.5	-20.0	30.5
Services (net)	2,849	819	729	549
Receipts	7,474	3,035	2,036	1,372
of which;				
Transportation, net	630	114	145	185
Growth (%)	-16.0	-81.8	-59.2	27.4
Tourist earnings	3,607	682	682	23
Growth (%)	-17.7	-81.1	-64.1	-96.7
IT/BPO	899	971	486	576
Growth (%)	6.1	8.0	6.4	18.4
Payments	4,625	2,216	1,307	823
Primary Income (net)	-2,462	-2,101	-1,101	-957
Receipts	252	198	111	69
Payments	2,713	2,300	1,212	1,026
Secondary Income (net)	5,766	6,207	2,580	3,187
of which;				
Workers' Remittances	6,717	7,104	2,980	3,324
Growth (%)	-4.3	5.8	-8.9	11.6
Current Account Balance	-1,843	-1,083	-1,054	-1,536
Capital Account (net)	23	28	16	11
Current Account and Capital Account (net)	-1,820	-1,055	-1,037	-1,525

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

a continuous growth during the year, due to increased economic activity both globally and domestically and high global tariff rates for cargo handling.

Primary Income and Secondary Income Accounts

The deficit in the primary income account moderated marginally, as dividend payments of direct investment enterprises as well as interest payments on foreign loans by the Government remained below the levels recorded in the first half of 2020. Interest payments declined, due to the limited outstanding liabilities in rupee denominated government securities held by foreigners and the repayment of maturing ISBs.

Workers' remittances slowed down notably since June 2021, partly due to the increased use of informal channels...

The growth in workers' remittances remained relatively high during the five months ending May 2021, y-o-y, thereby supporting the secondary income account. However, workers' remittances moderated from June 2021, y-o-y, reflecting the possible increase of the use of informal channels for remitting money amidst pressures in the domestic foreign exchange market. However, with the gradual dissipation of the pandemic, worker migration showed signs of improvement with monthly increases in migrant workers registering with the SLBFE. Further, in view of attracting more workers' remittances to the banking system, the Government continued to pay additional Rs. 2 per USD above the market rate for workers' remittances converted to Sri Lanka rupees at licensed banks. In addition, the continuation of the Special Deposit Account scheme, introduced in 2020 to attract higher inward remittances, is expected to strengthen further foreign exchange inflows to the country. The active stakeholder engagement to promote foreign employment is expected to secure more foreign employment opportunities, thereby strengthening workers' remittances in the period ahead.

Financial Account

Limited inflows were recorded to the financial account during the first half of 2021. FDI, including foreign loans to DfEs, remained modest in both 2020 and in the first half of 2021. Gradual outflows were recorded in terms of foreign investment in both the government securities market and the CSE on a net basis. The main financial inflow during the first half of the year was the receipt of the second tranche of the syndicated loan facility from CDB in April 2021. Since then, the financial account of the BOP has been augmented with the receipt of the SDR allocation from the IMF in August, the bilateral swap facility with the Bangladesh Bank in August and the balance portion of the syndicated loan from CDB. Further, the Central Bank entered into a bilateral swap facility equivalent to approximately USD 1.5 bn with the PBOC in March 2021, which has been kept as a standby arrangement. Outflows from the financial account remained significantly high relative to inflows, mainly due to the country's foreign debt servicing obligations. Significant external debt service payments were made so far in 2021, including the maturity of an ISB. In terms of future expected inflows to the financial account, significant progress is also expected in the Colombo Port City project. The

Table 5.3
Financial Account

USD mn

Item	2019 (a)	2020 (b)	2020 H1 (b)	2021 H1 (b)
Financial Account (net)	-2,460	-260	-693	-1,920
Net Acquisition of Assets	514	-1,825	-1,566	-1,535
Direct Investment	77	15	7	9
Other Investment	100	-136	-58	37
Currency and Deposits	-93	64	22	-52
Trade Credit and Advances	-4	-224	-137	100
Other Accounts Receivable	196	24	58	-11
Reserve Assets	337	-1,704	-1,515	-1,581
Net Incurrence of Liabilities	2,974	-1,566	-873	385
Direct Investment	743	434	242	302
Portfolio Investment	2,313	-2,383	-771	-84
Equity	-4	-217	-103	-116
Debt Securities	2,317	-2,166	-669	32
Other Investment	-82	383	-344	167
Currency and Deposits	167	-15	-636	-177
Loans	-245	327	723	-12
Trade Credit and Advances	-28	185	-248	238
Other Accounts Payable	24	-114	-183	118
Errors and Omissions	-640	795	344	-395
Overall Balance	377	-2,328	-760	-1,261
Gross Official Reserves	7,642	5,664		4,060
Months of Imports	4.6	4.2		2.6
Total Foreign Assets	10,402	8,521		6,824
Months of Imports	6.3	6.4		4.5

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

Government has already secured FDI to the energy sector and efforts are also underway to monetise underutilised assets under the Urban Development Authority. Further, as detailed in the Central Bank’s Road Map for the next six months, published in early October 2021, the Government and the Central Bank have identified a number of short-term funding sources as well as non debt creating or low cost long term financing in order to successfully navigate the next six months period as well as to ensure stability of the external sector in the medium and long term. Further, the Task Force to Strengthen Foreign Exchange Inflows, established under the Presidential Task Force for Economic Revival and Poverty Alleviation, continued to facilitate the stakeholders in identified sectors, including selected goods and services exports sectors, workers’ remittances, foreign investment, etc. The foreign inflows on account of such identified sectors are expected to increase in the period ahead. Further, the enactment of the Securities and Exchange Commission Act is expected to attract foreign equity and portfolio investment.

5.2 Overall Balance and Gross Official Reserves

The overall balance of the BOP recorded a notable deficit during the nine months ending September 2021. Widening of the current account deficit, limited inflows to the financial account, and large external debt service payments, which were partly met by drawing on gross official reserves, resulted in the moderation of gross official reserves to USD 2.7 bn by

end September 2021, which was equivalent to an estimated 1.7 months of imports. This level of gross official reserves does not include the 3-year bilateral currency swap facility equivalent to approximately USD 1.5 bn between the PBOC and the CBSL. Meanwhile, the absorption of foreign exchange on account of conversion of export proceeds and workers’ remittances enabled the Central Bank to buttress gross official reserves through non debt creating sources to some extent.

Total international reserves, which comprise gross official reserves and foreign assets of the banking sector amounted to USD 6.1 bn by end September 2021, providing an estimated import cover of 3.8 months.

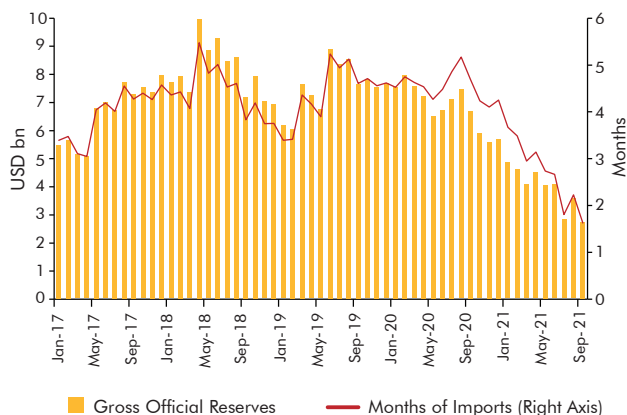
5.3 International Investment Position

The IIP recorded an increase in the net liability position by end June 2021. Sri Lanka’s external asset position with non residents declined as at end June 2021, compared to the beginning of the year. The stock position of external assets decreased primarily as a result of the decline in gross official reserves. Sri Lanka’s total liabilities position to non residents increased as at end June 2021, compared to the beginning of the year, mainly due to the increase in market prices of Sri Lanka’s outstanding ISBs. The direct investment liability position of FDI companies also increased marginally during the period. Foreign loan liabilities of deposit taking corporations reduced, while foreign loan liabilities of the Government and outstanding trade credits received by the private sector and SOBEs increased. Meanwhile, the outstanding liabilities of the Central Bank declined mainly with the settlement of the swap facility with the RBI in February 2021.

5.4 External Debt Position

Sri Lanka’s total outstanding external debt increased by end of the first half of 2021 in comparison to end 2020, mainly due to the increase in market price of Sri Lanka’s outstanding ISBs. The outstanding foreign loans of the Government also increased marginally during the first half of the year. The ACU liabilities managed by the Central

Figure 5.5
Gross Official Reserves and Months of Imports



Source: Central Bank of Sri Lanka

Table 5.4
Outstanding External Debt

Item	2019 (a)	2020 (b)	2021 H1 (b)
Gross External Debt Position based on Market Value	54,811	49,212	50,438
General Government	34,249	28,187	29,670
Central Bank	2,318	2,690	2,342
Deposit-Taking Corporations	6,997	6,657	6,511
Other Sectors	6,469	6,676	6,768
Direct Investment:			
Intercompany Lending	4,778	5,001	5,148
Memorandum Items			
Gross External Debt Position of the General Government Based on Face Value	34,084	32,452	32,928

(a) Revised
(b) Provisional
Source: Central Bank of Sri Lanka

Bank also increased. Despite the increase in currency and deposits, outstanding external debt of the banking sector declined due to the substantial reduction in outstanding short term loans. The outstanding external debt of the private sector and SOBEs increased with an increase in trade credits and advances received by SOBEs, although outstanding foreign loans of the private sector and SOBEs declined marginally. However, intercompany borrowing of DIES recorded an increase by end of the first half of the year. With the repayment of maturing ISBs in 2020 and 2021, the outstanding balance of ISBs as a share of GDP has declined significantly. A further reduction of outstanding ISBs as a share of GDP is expected in the period ahead, as per the financing strategy of the Government.

5.5 Exchange Rate Movements

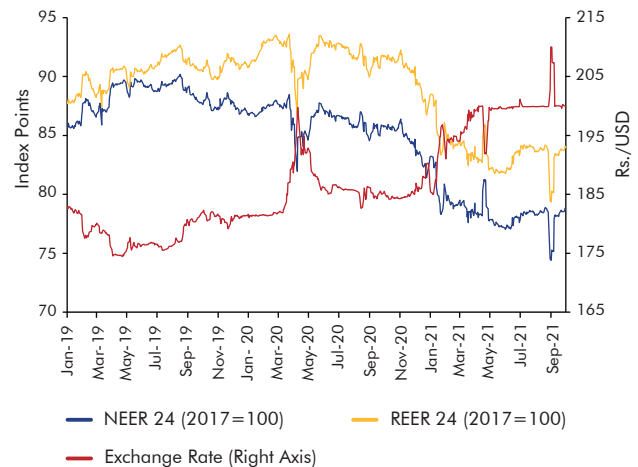
The Sri Lanka rupee, which depreciated significantly during the four months ending April of

Table 5.5
Exchange Rate Movements

Currency	End Period Rate -In Rupees per unit of Foreign Currency		% Change
	2020	Sep - 2021	
Euro	229.42	232.10	-1.16
Indian rupee	2.55	2.69	-5.32
Japanese yen	1.81	1.79	1.10
Pound sterling	254.35	268.96	-5.43
USD	186.41	199.99	-6.79
SDR	268.48	281.75	-4.71
Effective Exchange Rate Indices (2017=100)			
NEER 24-currencies	83.12	78.76	-5.25
REER 24-currencies	88.37	83.99	-4.95

Source: Central Bank of Sri Lanka

Figure 5.6
Exchange Rate Movements



Source: Central Bank of Sri Lanka

the year due to heightened pressures in the domestic foreign exchange market, showed relative stability thereafter, despite some intermittent volatility. The Central Bank's intervention in the domestic foreign exchange market and moral suasion supported stabilising the rupee. Accordingly, the weighted average spot exchange rate in the interbank market remained broadly stable at around Rs. 200 per USD. The Sri Lanka rupee depreciated against the USD by 6.8% by end September 2021. The pressures observed in the domestic foreign exchange market could be partly attributable to the inadequate conversion of foreign exchange earnings. With the continuation of the regulation on conversion requirement of export proceeds, foreign exchange liquidity condition in the domestic market is expected to improve somewhat in the period ahead. Since the announcement of the Six-Month Road Map by the Central Bank, undue speculation on the exchange rate has also subsided to a great extent. Reflecting cross currency exchange rate movements, the Sri Lanka rupee depreciated against the pound sterling, the euro and the Indian rupee, while appreciating against the Japanese yen by end September 2021.

“As reflected by real effective exchange rate indices, the Sri Lanka rupee remains undervalued...”

The NEER and REER indices, which measure the movement of the Sri Lanka rupee against a basket of currencies, declined during the nine months ending September 2021. Overall, REER

indices remained below the base year level (2017=100), indicating that the exchange rate remained supportive of the country's trade competitiveness.

Abbreviations and Acronyms

ACU	: Asian Clearing Union	ITES	: Information Technology Enabled Services
bn	: Billion	KPO	: Knowledge Process Outsourcing
BOP	: Balance of Payments	mn	: Million
CBSL	: Central Bank of Sri Lanka	NEER	: Nominal Effective Exchange Rate
CDB	: China Development Bank	PBOC	: People's Bank of China
CSE	: Colombo Stock Exchange	RBI	: Reserve Bank of India
DIEs	: Direct Investment Enterprises	REER	: Real Effective Exchange Rate
FDI	: Foreign Direct Investment	Rs.	: Sri Lanka Rupee
G2G	: Government to Government	SDR	: Special Drawing Rights
IIP	: International Investment Position	SLBFE	: Sri Lanka Bureau of Foreign Employment
IMF	: International Monetary Fund	SOBEs	: State Owned Business Enterprises
ISB	: International Sovereign Bond	USD	: United States Dollar
IT/BPO	: Information Technology & Business Process Outsourcing	y-o-y	: Year-on-Year