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Statement by the Hon. **BASIL RAJAPAKSA**,
Governor of the Bank and the Fund for the **SRI LANKA**

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World Economy

The global economy continues to recover, although at an uneven pace, due to country differences in policy support and the speed of vaccination. The IMF forecast for global growth at 5.9 percent in 2021 and 4.9 percent in 2022, reflects a slight moderation in growth for the current year, due to supply disruptions and renewed pandemic concerns. The outlook for the global economy is underscored by divergences in economic growth, inflation and debt concerns, all of which are expected to hinder the balanced recovery going forward. These divergences are expected to have a lasting impact on medium term performance.

The multidimensional challenges have made policy choices more difficult, especially for countries with constrained policy space and little room to maneuver. Reducing the imbalance in the vaccination drive between advanced economies, emerging markets and low- income countries is a policy imperative at this juncture. Stronger multilateral cooperation is needed to speed up the global vaccination rollout and provide liquidity to ease financial constraints. We welcome the recently launched Multilateral Leaders Task Force - consisting of the IMF, WBG, WHO and the WTO – to tackle the task of accelerating the access to and delivery of COVID-19 tools.

Sri Lankan Economy

The Sri Lankan economy continued to be buffeted by the pandemic in 2021 with the advent of the Delta variant into the country in the third wave of the pandemic at end April. Mobility restrictions undertaken in 2021, however, were less stringent than the strict lockdown measures adopted in 2020. Consequently, businesses continued to function in the second quarter of 2021 although some disruptions occurred due to containment measures. The rapid rollout of the vaccine program during this period also created a favourable environment for the continuation of business activities. As at end September 2021, 56 percent of the Sri Lankan population was fully vaccinated and most of the mobility restrictions were lifted by the beginning of October 2021. The government and the Central Bank continued to lend support through fiscal, monetary and financial sector measures to mitigate the adverse economic fallout from the pandemic. Nevertheless, the surge in COVID cases both locally and globally, created a multitude of challenges for the Sri Lankan economy.

The Sri Lankan economy grew by 12.3 per cent, year-on-year, in real terms during the second quarter of 2021 with all sectors of the economy contributing to the growth performance. The industry and the services sectors, accounting for a combined share of about 85 percent of GDP, buttressed the growth momentum. The agriculture sector also enhanced its value addition, aided by the continuation of agricultural activities during the quarter despite lock down measures. During the first half of 2021, the economy grew by 8 percent, year-on-year, in real terms. The growth momentum, together with the successful rollout of the vaccination program, are expected to sustain growth going forward. The Sri Lankan economy is projected to grow by 5 percent in real terms in 2021.
Inflation, which remained moderate during the early part of 2021, accelerated during the latter months, driven by high food inflation as well as some acceleration in non-food prices. Headline

inflation (y-o-y), as measured by the Colombo Consumer Price Index (CCPI), decelerated to 5.7 percent in September 2021 from 6 percent in the previous month due largely to the statistical impact of a high base that prevailed in September 2020. Core inflation (CCPI y-o-y), which reflects underlying price pressures in the economy, accelerated to 5 percent in September 2021 from 4.1 percent in August 2021. Envisaged improvements to aggregate demand conditions among other developments, prompted the Central Bank to take preemptive policy action to maintain inflation at mid-single digit levels over the medium term, although in the near term, the continued escalation of international commodity prices is likely to challenge the Central Bank's target of maintaining inflation in mid-single digits.

The Central Bank, which maintained an accommodative monetary policy stance during the most part of 2021 to support the economic recovery, tightened monetary policy in August 2021 to proactively address emerging inflationary pressures and imbalances in the external sector. In August 2021, the Central Bank increased the SLFR and SDFR by 50 bps each to 6 percent and 5 percent respectively. The Statutory Reserve Requirement (SRR) applicable on Rupee deposit liabilities of commercial banks was also raised by 2 percentage points to 4 percent with effect from September 2021. Meanwhile, priority sector lending targets were set for banks in respect of lending to micro, small and medium scale enterprises (MSME), which comprise the backbone of the economy, to ensure the delivery of credit to productive sectors. To help deal with challenges arising from the third wave of the COVID-19 outbreak, the Central Bank granted further relief to businesses and individuals affected by the pandemic, including entities in the badly hit tourism sector. The Central Bank is considering the introduction of a facility to support the Government's drive towards sustainable development goals in general and developing the green economy, including organic agriculture.

Fiscal policy continued to support the economic recovery although the COVID-19 pandemic exerted pressure on budgetary operations. The government revenue increased in nominal terms owing to the improved tax revenue collection during the first seven months of 2021 vis-à-vis the corresponding period of the previous year. However, the increase in government revenue was outpaced by the increase in government expenditure in the seven months ending July 2021. On the expenditure front, recurrent expenditure increased during the first seven months of 2021 largely due to COVID related expenses, interest payments, salaries and pensions. Consequently, the budget deficit as a percentage of estimated GDP, for the period up to July 2021 was 6.2 percent. However, fiscal sector performance is expected to improve gradually with the measures that are being taken by the Government to strengthen the tax administration, rationalize government expenditure, among others, alongside the expected normalization of economic activity supported by the unprecedented policy stimuli provided amidst the pandemic. The National Budget is expected to be presented in early November 2021.

The pandemic continued to exert pressure on the external sector in 2021 presenting a multitude of challenges. Despite the buoyant performance in merchandise exports in 2021, the deficit in the trade account up to August 2021 widened as the increase in import expenditure outstripped export income. In the services account, the third wave of the pandemic continued to disrupt earnings from tourism although other services, especially the IT/BPO sector, performed relatively well. Workers' remittances moderated in recent months due to lower departures and the increased utilization of unofficial channels to remit such funds. In the financial account, foreign investment outflows from the government securities market as well as the Colombo Stock Exchange exerted pressure on the Balance of Payments (BOP). Mirroring these trends, the Sri Lankan Rupee depreciated by 8.2 percent against the USD up to 08 October 2021. Gross official reserves at end September 2021 stood at USD 2.6 billion. However, the country's gross official reserves are expected to increase in the near term supported by measures that are being taken by the Government and the Central Bank of Sri Lanka. Sri Lanka repaid the International Sovereign Bond (ISB) of USD 1 billion that matured in July 2021 and all other debt service payments during the year, maintaining the unblemished debt servicing record over the years.

The Central Bank and the government implemented policy measures to ease the excessive demand for foreign currency and the pressure in the domestic foreign exchange market. While policies implemented in 2020 to curtail outflows of foreign currency remained in place, further measures were taken in 2021 to improve the stability of the external sector. During the year, the Central Bank introduced a repatriation and conversion requirement for merchandise export proceeds with a view to enhancing the liquidity in the foreign exchange market. To incentivize workers' remittances, a scheme was introduced to provide a preferential exchange rate for conversion of such funds to Sri Lanka Rupees. In September 2021, the Central Bank imposed margin requirements on non-essential imports to mitigate the pressure on the exchange rate while maintaining foreign currency liquidity in the banking system. The margin requirement was removed with effect from 1st October 2021.

On 01 October 2021, the Central Bank announced a Road Map with a three tiered time framework to strengthen the economy and deliver macroeconomic stability. The Road Map proposes time-bound actions to be taken by key stakeholders, led by the Government and the Central Bank, to address three critical issues in the economy; debt and forex concerns; financial sector issues; and macroeconomic stability concerns. In the near-term six-month period from 01 October 2021 to 31 March 2022, steps will be taken to stabilize the economy with measures aimed at increasing liquidity in the foreign exchange market and ensuring timely debt servicing while supporting the recovery from the pandemic. During the one-year horizon from 01 January 2022 to 31 December 2022, (to be announced on 04 January 2022), action will be taken to improve the country's external debt profile and encourage non-debt inflows while delivering fiscal and external targets and improving the sovereign ratings and the ease of doing business. In the medium to long term, the Road Map proposes the building of buffers to strengthen the resilience of the economy while striving for higher growth within a low inflation environment.

The Role of the IMF and the World Bank

We welcome the historic Special SDR allocation of USD 650 billion effected in August this year to boost global liquidity. This resource injection has helped countries like ours to deal with the adverse fallout from the COVID-19 crisis. The new allocation has also benefited us tremendously by enhancing our reserves at a time when reserve accumulation has been difficult with the closure of avenues for foreign exchange such as tourism. We appreciate efforts by the IMF to magnify the impact of the historic SDR allocation by requesting members with strong external positions to voluntarily channel their SDRs to lower income and vulnerable middle-income countries to help recover from the pandemic. We appreciate the focus on the forgotten middle-income countries at this juncture as several MICs have not been able to avail the emergency financing facilities, even in extraordinary circumstances such as the pandemic, due to heightened vulnerabilities. In this context, we welcome the ongoing discussions on the establishment of a Resilience and

Sustainability Trust (RST). The establishment of such a Trust will help vulnerable middle-income countries like Sri Lanka to seek long-term financing for structural transformational challenges with a view to supporting the balance of payments in the medium term. We lend our support to this important initiative and urge the IMF to move forward in establishing this Trust without delay.

Adequate IMF resources are a vital stabilizing factor in a complex world economy fraught with heightened vulnerabilities and uncertainties. We see the need for a strong global financial safety net with an adequately resourced, quota-based IMF at its center. We favour a substantial quota increase in line with the evolving dynamics in the world economy. The review of quotas should lead to higher quota shares in favour of emerging market economies while protecting the shares of lower income countries. Enhanced quotas would reduce the reliance of the IMF on borrowed resources. Concluding the Sixteenth General Review of Quotas by end 2023 will also enable the IMF to preserve its financial strength over the medium term and its governance and legitimacy.

The seventy-year-old partnership between the Government of Sri Lanka (GOSL) and the World Bank Group (WBG) was established when the country became a member of the International Bank for Reconstruction and Development in 1950.

The active portfolio currently stands at USD 2.69 billion. Key sectors that are being funded under 19 IDA and IBRD projects include sustainable development, infrastructure, human capital development, equitable growth and finance. A major portion of this portfolio has been invested in urban, climate resilience, agriculture, environment, transport and water.
Sri Lanka was able to mobilize USD 453 million worth of loans and USD 28 million grants from the World Bank during the year 2021. Six loan agreements and one grant agreement were signed between the Government of Sri Lanka and the World Bank group during this year. The World Bank has approved USD 500 million for an Inclusive Connectivity and Development project, which will improve connectivity by providing an efficient and high-quality road network.

The World Bank responded immediately to the urgent requirements of COVID-19 with an emergency project of USD 128.6 million, which was approved on April 3, 2020. This was topped up with USD 88.96 million worth of additional financing, mostly reallocated from other ongoing projects (USD 60 million from three projects) to provide cash transfers to the vulnerable. Another USD 81 million in additional financing was provided to support procurement and deployment of COVID-19 vaccines. Further, USD 100 million has been provided as a third additional financing facility for the COVID 19 Emergency Response and Health Systems Preparedness Project to scale up the COVID 19 vaccination program.