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Statement by the Hon. **INDRAJIT COOMARASWAMY,**
Alternate Governor of the Fund for **SRI LANKA**

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Alternate Governor of the Fund for Sri Lanka

Mr. Chairman,

The year 2019 has become even more challenging for policymakers globally. Central banks, that were in a tightening cycle in 2018, have become increasingly accommodative in 2019 considering sluggish global growth resulting from rising trade and geopolitical tensions, and subdued inflationary pressures with the waning of global demand and low commodity prices.
Mr. Chairman, allow me to briefly highlight recent economic developments and prospects in my own country.

The Sri Lankan economy, which was on a path to recovery in the first quarter of 2019, was heavily impacted by the heinous terrorist attacks on Easter Sunday. The attacks, which killed and injured hundreds of civilians, including tourists, mainly affected the tourism industry of the country as well as its supply chains. They disrupted livelihoods of the people and required responsive measures by the government, which in turn increased demand for public funds. Consequently, economic growth decelerated to 1.6 per cent, year-on-year, in the second quarter of 2019, from 3.7 per cent in the previous quarter. Understandably, the highest contraction, of 9.9 per cent, was observed in accommodation, food and beverage service activities. However, we observe signs of resilience and gradual recovery, and we expect the economy to record a growth of around 3 per cent in 2019, before accelerating towards its potential growth path in the medium term, supported by stable macroeconomic conditions, ongoing structural reforms, improved productivity and enhanced investments with improved investor confidence.

The Extended Fund Facility (EFF) program of US$ 1.5 billion that Sri Lanka entered into with the IMF in June 2016 has been extended for a four-year horizon to support structural reforms whilst strengthening the external and fiscal balances of the economy. Under the program, notable progress has been made in institutionalizing frameworks related to monetary policy in line with flexible inflation targeting as well as the revenue enhancement based fiscal consolidation process, including the strengthening of debt management. It is expected that improved frameworks will help the country to sustain the improvements in macroeconomic stabilization, whilst supporting its economic transformation to a higher growth path.

Headline inflation remained subdued in low single digits levels until the recent escalation of domestic food prices which caused inflation to move to the middle of the desired 4-6 per cent band in September 2019. Inflation is likely to remain closer to upper bound of the desired target band during the remainder of 2019 in view of supply side disruptions before stabilizing thereafter. Increased volatility in domestic food production and food prices is a direct result of climate change, and it is essential that world leaders take this threat seriously for the betterment of the entire population of the planet.

The fiscal front has seen significant improvements in relation to the policy and institutional framework aimed at increasing revenues, rationalizing expenditure, reforming state-owned enterprises (SOEs), and debt management. However, fiscal performance is likely to deviate from original targets with increased government expenditure as well as lower revenue collection, which are both significantly attributable to the impact of Easter Sunday attacks on domestic economic activity. Nevertheless, the government is committed to the fiscal consolidation process, and the budget is expected to record a primary surplus, albeit marginal, in 2019, and bring back the fiscal path to the originally envisaged consolidation trajectory without much delay.

Supported by stabilization measures, the external sector performance improved to a great extent in the first quarter of 2019, before being disrupted by the Easter Sunday attacks. The country recorded a surplus in the external current account in the first quarter with exports growing at a reasonable pace, given slowing global economic performance. Imports contracted notably in response to the fiscal and macroprudential measures in place, and the trade deficit continued to narrow. Although earnings from tourism contracted since April 2019 following the terrorist attacks, arrivals have shown a steady recovery, and we expect the tourism sector to recover to a great extent by end-2019, with supportive policies by the government and aggressive promotional campaigns.

Meanwhile, outflows of foreign holdings from the government securities market were observed during some months of 2019, although these were substantially low compared to the outflows observed in the previous year. There were marginal inflows to the Colombo Stock Exchange (CSE), when both primary and secondary purchases are considered. Foreign direct investment inflows were lower than envisaged, with confidence of such investors being impacted to some extent by the Easter Sunday attacks and domestic political developments.
The country's gross official reserves stood at US$ 7.6 billion by end September 2019, sufficient to cover over 4.5 months of imports.

The exchange rate regime in Sri Lanka continues to be flexible and market-oriented. The Central Bank's intervention in the foreign exchange market has been limited to dampen excessive volatility and to build up reserves. Following the sharp depreciation in the fourth quarter of 2018, the Sri Lankan rupee appreciated notably in the first four months of 2019, before being disrupted by the impact of Easter Sunday attacks and foreign outflows from the government securities market. Accordingly, on a net basis, the rupee has displayed a marginal cumulative appreciation against the US dollar thus far during the year.

Subdued economic activity, measures aimed at macroeconomic stabilization and high nominal and real interest rates have impacted the performance of the financial sector. In particular, the non-bank financial sector was disproportionately impacted by these developments, while non-performing advances showed some increase across the bank and non-bank financial sectors. Nevertheless, the financial sector continued to expand with measures being taken to strengthen its resilience in line with international best practices. Measures are being taken to decisively address the weaknesses, particularly in the non-bank financial sector, especially through the improvement of the resolution and enforcement framework.

Meanwhile, the Central Bank took a number of measures to ease monetary policy and monetary conditions in view of decelerating growth of credit and monetary aggregates and subdued economic growth, amidst well anchored inflation expectations. Amongst these measures, the reduction in the Statutory Reserve Ratio has reduced the cost of funds of banks, increased the credit multiplier and improved rupee liquidity in the domestic money market. The reduction of policy interest rates and the temporary imposition of deposit caps enabled banks to access funds from the market at lower interest rates. Following these measures, the Central Bank imposed temporary caps on lending rates by licensed banks in September 2019, which are aimed to reduce the excessively high nominal and real interest rates, which in turn would result in increased credit flows, increased economic activity and reduced stresses in the financial sector.

I would like to thank the World Bank for a more than six decades old partnership with the government of Sri Lanka and the financial and technical assistance for the projects as prescribed in country's public investment program promoting competitiveness, inclusiveness and resilience.

The World Bank Group's Country Partnership Framework (CPF), in Sri Lanka, for the IDA 18 cycle is aimed at the development of the country through a more systematic, evidence-based and selective approach, which will focus on the World Bank's twin goals of ending extreme poverty and increasing shared prosperity in a sustainable manner. We were able to achieve most of these objectives during the last couple of years and want to expand further in a more productive and realistic manner in the next Country Partnership Strategy which will be implemented from July 2020.

Sri Lanka graduated from "International Development Association (IDA) eligible" status to "International Bank for Reconstruction and Development (IBRD) eligible" status in 2017 with the increase in country's income levels. The World Bank granted IDA transitional support along with IBRD financing during IDA 18 cycle with the objective of smoothening the transition associated with the graduation. The government has already committed the total IDA transitional financing for development projects in the education, irrigation and local government support sectors.

We are grateful to the World Bank for the postponement of Accelerated Repayment of IDA Credits under two Acceleration Clauses during the IDA 18 cycle. However, the acceleration will trigger in the mid-2020 and this will add an additional burden on our external debt service obligations. The government has started the process of selecting the most appropriate option for accelerated repayment from the options suggested by the World Bank, involving a careful analysis of the consequences on the debt repayment schedule especially during 2022-2030. Therefore, we hope to start the accelerated repayments in mid-2021, thereby contributing to IDA's capacity to provide development funding to countries with lower per capita income.

Also, the government has initiated the actions necessary to contribute to the capital increase of the IBRD, endorsing the World Bank Group's support for the development challenges of a growing number of middle-income countries, as well as deliver on the global public goods agenda.

Thank you, Mr. Chairman!