Forty-Second Meeting
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India

On behalf of
Bangladesh, Bhutan, India, Sri Lanka
1. The IMFC is having its virtual meeting against the backdrop of continuing efforts of the membership to contain the manifold impacts of the Covid-19 pandemic. The virus has taken a massive toll on human lives, which has exceeded the one million mark worldwide. It is worrisome that several countries appear to be potentially facing a second wave. The rapidity and scale of the spread of the virus has already stretched health systems and capacities, wearing out frontline professionals in healthcare, sanitation and law and order. Restrictive measures aimed at containment and prevention did result in arresting the spread and reducing the rate of fatality, but as an obvious corollary, they impeded normal economic activity, impacting supply chains, production networks, trade, capital investment, tourism and remittances.

State of the global economy

2. Economies across the globe are witnessing the worst slowdown in decades. In the IMF's assessment, global GDP has been projected to contract by 4.5 percent during 2020.

3. However, amidst the gloom and pessimism, there are initial signs in few countries recovering from the shocks of the crisis. Global financial markets are stabilizing, and some parts of the world are exhibiting signs of economic recovery, though the low-income and developing countries (LIDCs) could be struggling to ensure livelihood for millions who are slipping below poverty line. As LIDCs face an unprecedented crisis, their priorities are likely to be focused aggressively on poverty alleviation, job creation, and building up of a strong and resilient health infrastructure. Thus, the near and medium-term priorities of LIDCs would be to reallocate scarce resources to restart their economies, reinvesting in health services and providing financial assistance to impacted populations.

What we need to do in the context of the health and economic crises

4. We need to strengthen our capacities to save lives, businesses, and economies. The current health crisis is a fresh reminder to the global community to pay greater attention to strengthen pandemic responses and to improve public health interventions. We need to share, among all nations, the benefits of medical research and development; as well as develop adaptive, responsive, and affordable health care systems for the less developed countries. Medical solutions against this pandemic are paramount. International collaboration in terms of resources, knowledge, and human effort is needed to save humanity from its worst crisis in decades. India is a major producer of pharmaceuticals and the largest vaccine producing country. We stand ready to use our facilities to the fullest extent and help the world in all ways possible in fighting this crisis.
Global challenges in a post-Covid-19 scenario

5. The most important challenge for the world in the post-Covid-19 scenario is to re-invigorate growth and overcome the sudden spurt in poverty and inequality. The pandemic has affected the poor disproportionately, across continents. The most important tool to overcome these challenges is to restore global investment and trade. Experience suggests that countries achieved their highest sustained growth during periods of expanding investment and trade. This should be the overarching priority, wherein reduction of poverty and inequality would also be the key pillars.

6. The looming debt crisis is a potential threat in the post-COVID-19 recovery for low income countries (LICs). Therefore, debt sustainability should be an important agenda going forward. In this context, an area of growing concern is the lack of transparency and debt structures assuming multiple faces. Debt re-structuring becomes meaningful only if we know the contours of the debt – who owes what, to whom and on what terms. Hence, great effort is needed in ensuring transparency in all forms of debt. The role of international organizations is critical to steer this issue in order to have a more meaningful and pragmatic assessment of a country's debt distress and to suggest preventive measures for the incipient stages.

7. Another important challenge facing the global community is climate change. India recognizes that cleaner energy and energy efficiency are the way forward toward the path of low carbon-footprint in our developmental efforts. India has set for itself an ambitious target to reduce the emissions intensity of its GDP by 33-35 percent of the 2005 level by 2030; and also generate about 40 percent of electric power from non-fossil fuel-based energy resources by 2030. Underscoring the sustainable development goals, India is pursuing a low carbon and climate resilient development path in accordance with common but differentiated responsibilities, in the light of national circumstances. The availability of adequate, credible and predictable climate finance holds the key to a successful implementation of climate actions by developing countries. There is need for a serious discourse in international public finance, in particular - the scope, scale and speed of the finance required to yield meaningful results. However, the momentum is lagging and needs to pick up in order to take climate actions effectively as a shared global responsibility.

Expectations from the IMF

8. The IMF should remain the core of the International Financial Architecture. It has played a critical role in providing emergency financing to member countries to withstand the Covid-19 shock. Provision of Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI) with enhanced access limits has helped members in distress with instant relief. Though the pandemic is still unfolding, amidst continued uncertainty, and policies need to be reoriented toward recovery. In these circumstances, the IMF would have to play an important role in providing policy advice and capacity development, and coordinating debt relief, particularly to LICs. As the Fund relaxes its policies to provide flexibility to the members' access to Fund resources, adequate care should be taken in terms of provision of safeguards.

9. We expect the 16th General Review of the Quotas (GRQ) to augment Fund resources and address the long pending issue of under-representation of emerging market and developing economies (EMDEs) and dynamic economies for their meaningful engagement in the governance of this institution. The concerns expressed regarding the adequacy of resources to address the
current crisis once again underscore that the only source which IMF can rely upon with certainty is its permanent resources i.e. quotas. It has been disappointing that the 15th GRQ did not conclude successfully. It is imperative that we approach the 16th GRQ discussion in all earnest and urgency in order to complete it by its deadline of December 2023. New Arrangements to Borrow (NAB) and Bilateral Borrowing Arrangements (BBA) are temporary resources, and we must not deviate from the character of IMF as a quota-based institution. Further, to enhance traction of Fund policies, governance reforms should remain an essential part of our GRQ deliberations.

DEVELOPMENTS IN THE CONSTITUENCY COUNTRIES

A. BANGLADESH

10. Bangladesh's progression path of the government's pursuit of an ascending trajectory of sustained inclusive, equitable and environmentally benign economic growth and social development proceeded broadly on track from the beginning of FY21 (July 2020-August 2020). The pace of economic activities continued its normal trend due to robust domestic demand aided by strong remittance inflows and higher government investment, while decelerated private credit growth and weak external demand suggested some moderation. The growth in the industry sector was moderated as reflected in the large and medium scale manufacturing output growth. The agriculture sector remained vibrant, supported by favorable agricultural commodity prices and timely availability of inputs and finance. Growth outlook is positive due to lockdown measures being lifted in Bangladesh as well as in the advanced and emerging market economies and implementation of stimulus packages to cushion the economy from the pandemic crisis are in full swing. Cautiously accommodative monetary and fiscal stances with inclusivity bias have helped stabilize headline (y-o-y annual average) CPI inflation at around 5.65% in August slightly higher than the targeted 5.4% for FY21. With a significant drop in international commodity and energy prices along with domestic bumper production of crop and non-crop agriculture kept food inflation thereby general inflation well in check in the recent months. Looking ahead, upside risk to headline inflation in the near term may arise from the recent crop loss due to prolonged floods in the northern and central parts of the country.

11. Fiscal deficit (including grants) is projected at 6.0 percent of GDP for FY21. FY20 fiscal deficit (including grants) of 5.5 percent of GDP remains within its typically moderate lower single digit trend level, with more than half (3.5 percent of GDP) of it being funded by domestic borrowing. The implementation of new VAT law helped in generating tax revenue though the amount of tax revenue remained short of the target. The balance of payment witnessed a surplus of USD 3655 million in FY20, contributed by a decline in current account deficit to USD 4849 million on the back of hefty remittance inflows along with healthy inflows of FDI and medium and long-term loans. However, deficit in trade balance widened to USD 17861 million during this period, amid a decline in exports and imports by 16.93 percent and 8.56 percent respectively. The exchange rate remained broadly competitive aided by the timely intervention of Bangladesh Bank. Capital market during the second half of FY20 experienced a weak performance as reflected in price indices, market capitalization, and turnover. However, the current account balance was in a huge surplus of USD 3296 million in July-August FY21 mainly due to low import payments (negative growth of 13.80 percent) and an influx of a large amount of remittances (positive growth of 49.95 percent) and bounce back in export receipts (positive growth of 2.17 percent). Such higher surplus is helping to build up foreign exchange reserves. According to industry insiders, the
country is experiencing a spike in remittance inflow during the pandemic as the migrants are worried about job cuts and remitting more out of their saving before returning. The government's 2.0 percent incentive has also contributed to the overall remittance income through formal channel in recent months. However, the picture of the overseas employment sector in Bangladesh is bleak with thousands of migrants in the dark about their jobs due to coronavirus pandemic and the jobless workers' homecoming continues. Again, those who came home on leave before the virus outbreak remain stranded here. Such a volatile situation will impact remittance earnings in the coming days. The government is planning reintegration programme and implementing several projects for the returned jobless workers, which need huge involvement of funds.

12. Towards the end of calendar year 2019, the dark shadows of the hitherto wholly unknown new COVID-19 pandemic began to engulf the entire global community rapidly, bringing in its train deaths and disruptions on an unprecedented scale, Bangladesh also came under the cloud of the new scourge mainly via individuals from her diasporas abroad visiting home; although the pandemic's pace of expansion in Bangladesh had far remained relatively moderate, not going altogether out of hand yet. Like everywhere else, Bangladesh authorities had to adopt abrupt steps like community-wide extensive spells of mandatory quarantines and lockdowns from March 26 to May 30, 2020 to limit and contain the threat of COVID infection; bringing in its trail disruptions in domestic economic activities in massive scales. Similar disruptions were also observed in exports and imports and authorities had no option other than to line up massive support measures to help out affected businesses and weaker population segments facing a loss of work opportunities for their livelihood. However, the export scenario rebounded from the beginning of FY21. In addition, foreign exchange reserve balances were in strong position amid the COVID-19 pandemic.

13. A general slowdown in economic activities due to the pandemic worsened government's fiscal balances, with increased expenses for emergency relief measures for businesses and for poorer population segments losing daily wages during periods under lockdowns enforced to prevent community transmission of coronavirus infections.

14. To fill up the budgetary gaps, to afford new safeguard measures due to global COVID-19 pandemic and to achieve sustainable and environmentally friendly economic growth Bangladesh would require immediate and adequate external supports in softer terms (particularly from the multilateral global institutions), including inter alia for attaining some of the key UN SDGs like climate change risk mitigation and adaptation, and for larger physical infrastructure projects. Bangladesh looks forward to the continuing role of the Bretton-Woods Institutions and their subsidiaries in catalyzing such external financing support.

B. BHUTAN Macroeconomic review

15. Successive decline in hydro-electricity production and public investment have slowed down the growth to 3 percent in 2018 from 4.7 percent in 2017. Growth has dipped to its lowest level since 2014. The combined effect of low hydropower production and construction activities (which decreased by 8.0 percent) due to low spending by the government in capital expenditure and slowing hydropower construction activities contributed for the slippage in the growth by almost 2 percentage points in 2018. Moving forward, the projected growth, prior to COVID-19 pandemic effect for 2019 and 2020 is estimated at 5.4 percent and 6.9 percent, respectively. However, due to the effect of COVID-19 on the economy, particularly, the tourism and its allied
sectors contribution to GDP is expected to significantly decline, resulting into downward revision of GDP for the consecutive year.

16. The overall CPI inflation (measured by the year-on-year change of the consumer price index) recorded at 4.54 percent in June 2020 compared to 2.74 percent during the same month of the previous year. The increase in the overall inflation during the FY 2019/20 was contributed by the increase in prices of both food and non-food commodities.

17. During FY 2018/19, the fiscal deficit remained within the anticipated threshold of 3 percent of GDP. Persistent drop in external grants and lowered capital investment resulted into financing of the deficit through both external and market borrowings. Although, the capital expenditure has reduced by more than 40 percent, the deficit level remained at 2 percent of GDP (Nu. 3.78 billion) at the end of March 2019. The Government Contingency Measures to combat COVID-19 will increase the re-current expenditure and further widening the fiscal gap over the medium term.

18. On the external front, both the trade and current account deficits improved in FY 2019/20. The current account deficit decreased from 23.7 percent of GDP in FY 2018/19 to 16.9 percent of GDP in FY 2019/20, mainly on the account of the improvement in trade deficit, which has decreased to Nu. 20,234.02 from Nu. 29,880.30 million in the previous year, driven by lower imports and increase in export of goods. The gross international reserves were recorded at USD 1,343.5 million as of June 2020 which is sufficient to finance 17.9 months of merchandise imports. The immediate and after-effects of COVID-19 on external sector is yet to be assessed.

19. The broad money (M2) recorded a significant growth at 19.33 percent in June 2020 (p), as compared to the growth of 5.60 percent in previous year. Higher growth in time and transferrable deposits and currency in circulation helped to drive the broad money supply in 2020. The net foreign assets grew by 31.55 percent in June 2020 (p), as compared to -3.16 percent in the previous year. This growth was mainly contributed by the growth in private sector by 13.32 percent.

**Some Reflections**

20. Although the current macroeconomic situation looks comfortable, the uncertainty in timeliness and amount of resources needed to combat the ongoing COVID-19 pandemic poses a deep concern which will have strong adverse impact on our growth and employment situation. We are yet to make a clear assessment on the impact at this moment.

21. With the onset of COVID-19 pandemic, the economy remains vulnerable to both direct impact on the domestic economy and also from the spillover impact of COVID-19 originated from the regional economies, particularly related to India. It’s impact on country’s balance of payment, particularly in terms of managing the foreign exchange reserves becomes challenging for a small economy like Bhutan since a large portion of foreign exchange earnings are generated from tourism and its allied sectors.

22. Financial sector stability continues to be an overarching objective of the RMA. Since the tourism and allied sector are one of the major players in the financial sector, providing necessary support in the form of conventional monetary policy measures at this point of time becomes imperative. However, if the situation prolongs, the financial institutions will be stressed, posing further challenges for maintaining the financial sector stability.
23. Bhutan has two constitutional requirements (a) meeting all re-current Government expenditure from domestic revenue and (b) foreign exchange reserves to meet 12 months of essential import coverage. With the expected decrease in domestic tax revenue collection, the rising government re-current expenditure to combat COVID-19 crisis along with increasing pressure on essential imports and on foreign exchange reserves will potentially put tremendous pressure in meeting the above Constitutional requirements.

24. Further, with exchange rate peg between Ngultrum and INR, the spillover impact of INR depreciation will have adverse impact on our balance of payments particularly, in terms of external debt servicing denominated in foreign currency.

25. As we understand that all the International Financial Institutions (IFIs) are under tremendous pressure at the moment, it is critical to understand the ground realities of each country hit by the COVID-19. The comfort on policy guidance and financial assistance provided by the IFIs at this hour as well as going forward will be immensely beneficial to the member countries to fight back this unprecedented crisis of the moment and rebuilding our economy on a stronger foundation.

**Monetary measures in response to the COVID-19 pandemic**

26. On 11th August 2020, the Government declared a nationwide lockdown for a period of 21 days, followed by a gradual opening of the lock down, and strict measures are still implemented to ensure that the disease does not spread within the community.

27. While the COVID-19 pandemic has affected the tourism industry the hardest, other sectors are also beginning to feel pressures that will only heighten if the pandemic continues over a protracted period of time.

28. One of the immediate economic impacts of COVID-19 is the disruption of business operations resulting in loss of income and employment. The decrease, or even complete loss of earnings, pose difficulties in debt repayment and place added pressures on the financial health of the sectors and the economy as a whole. Therefore, monetary measures are aimed at providing short-term monetary relief to sectors facing such financial distress in addition to assisting businesses and local production, including RNR activities, to continue. Interventions are guided by His Majesty the King’s wisdom to ensure that relief measures are adequate and inclusive.

29. Monetary measures including deferment of loan repayment, loan interest waiver, extension of gestation period for projects under construction, term based soft working capital facility for tourism related sectors and loans for Cottage & Small Industries have been initiated to ensure that the impact of the pandemic is minimized for the Bhutanese.

C. INDIA

**Covid-19 health emergency and India**

30. India's strong response to Covid-19 reinforces faith in the human race's ability to surmount any challenge. The lockdown was necessary on many counts – more importantly, the period was gainfully utilized to ramp up the health and testing infrastructure in the country. Due to timely
tracing, treatment and reporting, the number of people recovering from the virus is continuously rising. Two fitting examples would underline India's response to COVID-19. First, from zero production of Personal Protection Equipment (PPE) before March 2020, India today has created a capacity of producing more than 0.2 million PPE kits daily. Second, re-purposing various automobile sector industries to collaborate in the making of life-saving ventilators.

31. Notwithstanding a large number of cases, the death rate in India continues to be one of the lowest in the world. The recovery rate has surpassed 87 percent. A strategy emphasizing ‘effective testing, tracing, treatment and surveillance’ rather than fresh rounds of lockdown, is the way forward to contain the spread of the pandemic and safeguard livelihoods. While policies have been oriented to guard against any scarring, healthcare capacity is being raised steadily, and the focus is on restoring employment, resurrecting the supply chains, reviving the economy, and returning life to normalcy.

**Early response to mitigate socio-economic impact of Covid-19 and its results**

32. The Pradhan Mantri Garib Kalyan Yojana (Prime Minister’s Scheme for the welfare of the poor), an emergency package worth INR 1,700 billion (approximately US$ 23 billion), was introduced in March this year to support the poor and vulnerable groups (especially women), till June 2020. By leveraging the existing social protection systems, the Government provided relief through direct cash transfers, free food and fuel, employment support, and insurance cover for health personnel. Direct cash transfers were provided to 90 million farmers, 206 million women, and 28 million elderly and disabled population. The Government provided free food-grains to almost 750 million people and free pulses to almost 187 million households between April – June, over and above the standard entitlements. For such in-kind transfer, the Government has relied upon the Public Distribution System operational across the country. Several modifications have been made to the normal distribution channel, like doing away with the need to show ration card for getting food-grains, increasing the grain quota for poor households, etc. The scheme has now been extended till November 2020. Daily wages under the employment guarantee scheme (MGNREGA) were increased by INR 20 ($0.26) from 1st April 2020. The scheme generated 1,050 million person-days of employment and offered work to 80.4 million wage earners during April - June 2020. The limit of collateral free lending to women’s self-help groups was increased from INR 1 to INR 2 million ($13,000 to $26,000), aimed at benefitting 6.3 million SHGs, supporting about 70 million households.

33. The Government has been able to bring speedy relief to the poorer sections of the population because of the pre-existence of a robust system for cash and kind subsidy handout program in the country – the Direct Benefit Transfer System. The Pradhan Mantri Jan Dhan Yojna, launched in 2014, had played a crucial role in increasing financial inclusion by giving access to a bank account to poor households. The Government uses the bank account to transfer cash subsidies to poor citizens. Also, the Aadhaar based payment system has been a game changer by doing away with the need to frequently update beneficiary database in Government systems every time a citizen changes his or her banking method. The use of post office accounts to transfer cash subsidies has helped as well.

**Policy reform measures toward a robust economic recovery and sustainable growth**
34. In May 2020, the Government announced a series of measures under the *Atma Nirbhar Bharat* (Self-Reliant India) initiative to support Indian Economy’s fight against the impact of COVID-19 pandemic. These included:

a) Measures for relief and credit support related to businesses, especially MSMEs;

b) Short-term and long-term measures for supporting the poor, including migrants, farmers, tiny businesses and street vendors;

c) Measures to strengthen agriculture infrastructure logistics, capacity building, governance and administrative reforms for agriculture, fisheries and food processing sectors;

d) New horizons of growth; structural reforms across eight sectors (coal, mineral, defence, civil aviation, power, social infrastructure, space and atomic energy) paving way for *Atma Nirbhar Bharat* (Self-Reliant India); and

e) Reforms and enablers like increased allocation for the existing rural employment guarantee scheme; increased investments in Public Health and other health reforms to prepare India for future pandemics; technology driven education with equity post-COVID; further enhancement of Ease of Doing Business, and Public Sector Enterprise Policy for a New, Self-reliant India.

35. The above measures are intended to foster a quick and more robust economic recovery. Relaxing FDI limit in defense manufacturing; reforms in power distribution; opening the space sector to private industry; reforms to enable the use of technology related to atomic energy for social welfare; incentivizing sectors such as solar PV manufacturing and advanced cell battery storage; reforms in company law; portable ration cards, usable in different jurisdictions; an equity fund of funds, or investment pool, to mobilize and provide equity funding for MSMEs; legal amendments to ensure that farmers receive competitive prices; an infrastructure fund for agriculture; etc. are reform measures with far-reaching impact. The agriculture market reform, upgrading of the industrial park infrastructure, and implementing the National Infrastructure Pipeline will also boost consumption as well as capital investment. The measures to promote foreign direct investment; to attract global supply chains will spawn opportunities for India to create modern manufacturing hubs that will spur investment, stimulate demand in the home market and create employment opportunities for millions across the country.

**Macroeconomic overview**

36. Mitigation efforts to contain the pandemic had a severe impact on the Indian economy, with growth declining by 23.9 percent in Q1 (April-June) of 2020-21. The higher contraction is a natural outcome of the strict lockdown India enforced in the April-June quarter. As per IMF estimates, during 2020-21, growth is likely to decline by 10.3 percent over the preceding year. While this is the lowest growth rate ever, it is broadly in line with the global contraction and decline in major economies' GDPs. As countries unlocked in the quarter starting July, recovery is underway globally. India, too, is likely to witness a sharp V-shaped recovery going forward. India’s manufacturing purchasing managers’ index (PMI) moved into expansionary zone in August for the first time since the lockdown began and reached 56.8 in September 2020, the highest since January 2012, presenting a much-needed recovery prospect for the manufacturing sector.
37. The V-shaped pattern of recovery is seen in several high-frequency indicators: auto sales, tractor sales, fertilizer sales, railway freight traffic, steel consumption and production, cement production, power consumption, e-way bills, GST revenue collection, daily toll collections on highways, retail financial transactions, capital inflows and exports. Agriculture has persistently been the brightest spot in the revival of growth. Industrial production is showing definite signs of recovery with year-on-year (YoY) growth in eight core industries output showing a smaller contraction in July than in June. Consumption is picking up with passenger vehicle sales rising to their highest level at 0.22 million in August as compared to 0.14 million in March. Some revival in demand is also seen in growing sales of small cars, two-wheelers and sports utility vehicles and fertilizers. GST collections have reached INR 954.8 billion in September, going past the previous year level by 3.9 percent for the first time this fiscal year. Manufacturing firms, responding to the Reserve Bank of India’s industrial outlook survey, expect domestic demand to recover gradually from Q2 and to sustain through Q1:2021-22. An early containment of the COVID-19 pandemic may impart an upside to the outlook.

38. Domestic financial conditions have eased substantially, and systemic liquidity remains in large surplus due to several measures taken by the Reserve Bank of India since February 2020. Cumulatively, these measures assured liquidity of the order of 5.5 percent of GDP. The cumulative reduction in policy rates of 250 basis points since February 2019 is working its way through the economy, lowering interest rates in money, bond and credit markets, and narrowing down spreads. Financing conditions have eased considerably, enabling financial flows via financial markets, especially at a time when banks remain highly risk averse. India’s retail inflation at 6.69 percent in August 2020, a shade lower than 6.73 percent in July 2020, with food prices, accounting for almost half of the CPI basket, is dominating the rise. The Monetary Policy Committee (MPC) has decided to stay on hold with regard to the policy rate and remain watchful for a durable reduction in inflation to use the available space to support the revival of the economy. Reliance on external finance was further reduced with the current account balance recording a surplus of 3.9 percent in Q1 of 2020-21 on top of a surplus of 0.1 percent in Q4 of 2019-20. India’s foreign exchange reserves have reached the highest level ever at US$ 545 billion, equivalent to import cover of more than 12 months. External debt has stayed modest at about 20 percent of GDP, one of the lowest globally. Though fiscal deficit and public debt are expected to be relatively high with a sharp pickup in pandemic related expenditures, it should not be of much concern as India's sovereign debt is predominantly (above 85 percent) denominated in local currency. Further, a sharp rebound in growth in the next year is expected to normalize the debt ratios.

**Macro outlook**

39. The outlook for the coming year remains positive. In 2021-22, India has been projected to grow by 8.8 per cent, the fastest growth expected to be registered by any major economy. While growth is expected to be supported by global demand as the world would move on to the recovery path, massive policy initiative by the Government along with the central bank would catalyze domestic demand and economic activity. The availability of adequate liquidity at reasonable cost would stimulate investment and consumption, and measures to support employment levels and adjustments to production processes would guard against scarring and impact on long-term growth prospects.
D. SRI LANKA

40. The Sri Lankan economy has been hard hit by the COVID-19 pandemic. The authorities took stern action, including aggressive contact tracing, quarantining and lockdown measures, to deal with the crisis. When compared to many countries in the world, Sri Lanka has fared remarkably well in managing the COVID-19 outbreak. While the death rate and the number of infected persons has remained low and community transmission averted to a great extent, isolated outbreaks are being proactively handled to curb any rapid spread of the virus. The resulting stringent domestic containment measures, in addition to the negative spillovers from the global economic shutdown have severely affected economic activity. Nevertheless, recent indicators show signs of a partial recovery.

Real Sector

41. The Sri Lankan economy contracted in the first quarter of 2020 registering a negative GDP growth of 1.6 percent in real terms. The agriculture sector, which accounts for approximately 7 percent of the GDP, decelerated by 5.6 percent as key agricultural activities such as the production of tea, rubber, oleaginous fruits and fishing contracted significantly. The industry sector with a GDP share of approximately 30 percent, slowed down considerably impacted by the pandemic, registering a contraction of 7.8 percent during the first three months of 2020 led by the negative performance of the manufacturing and construction subsectors. The services sector, with a GDP share of approximately 60 percent continued to expand at a slower pace of 3.1 percent, aided largely by the growth in wholesale and retail trade, telecommunications and financial services.

Inflation

42. Inflation has been maintained within mid-single digit levels although elevated levels have been witnessed during some months due to higher food prices and the low base effect. Headline inflation (y-o-y), as measured by the Colombo Consumer Price Index (CCPI), decelerated to 4.0 per cent in September 2020 from 4.1 per cent in August 2020. Core inflation, as per the CCPI index, decelerated to 2.9 per cent in September 2020 reflecting subdued demand pressures. Inflation is expected to remain broadly within the desired 4-6 per cent range in the near to medium term with appropriate policy measures.

Monetary Policy

43. The Central Bank continued to maintain an accommodative monetary policy stance in 2020 to weather the adverse effects of the COVID-19 pandemic and lend support to the economic recovery. Against the backdrop of well anchored inflation expectations and absence of demand driven pressures on inflation, the Central Bank reduced its policy rates by 250 bps during the year to 4.50 percent and 5.50 percent for the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) respectively, to support domestic economic activity. The Central Bank also lowered the Statutory Reserve Ratio (SRR) applicable on rupee deposit liabilities of commercial banks by 300 bps to 2 percent during the year to inject much needed liquidity to the domestic money market and enhance credit flows to the economy. To help revive economic activity, the Central Bank introduced relief measures for businesses and individuals affected by
the pandemic by funding working capital concessional loan schemes and imposed maximum interest rates on credit cards, pawning advances and pre-arranged overdraft facilities.

Fiscal Performance

44. Fiscal operations in 2020 reflected pressures arising from the COVID-19 pandemic. The slowdown in economic activities due to lockdown measures significantly reduced government revenue during the year. On the expenditure front, containment measures taken to arrest the spread of the COVID-19 virus along with healthcare expenses, increase in salaries and wages, interest payments and welfare outlays to protect the vulnerable, largely contributed to the increase in expenditure. Consequently, the budget deficit for 2020 is estimated at around 9 percent of GDP. The budget for 2021, to be announced in November 2020, is expected to be formulated with strict fiscal discipline to minimize the fallout from the COVID-19 outbreak. Stringent expenditure control measures, such as curbs on funding of new or stalled projects and a ban on construction of new buildings for government institutions for the next two years, are expected to reduce the pressure on budgetary operations going forward. The 2021 budget will also indicate the policy framework of the new government for the medium term.

External Sector

45. The COVID-19 pandemic and the imposition of stringent containment measures from March 2020 onwards severely impacted the country’s external sector. The government and the Central Bank implemented several policy measures, including restrictions on non-essential imports and outward remittances in respect of capital transactions, to curtail outflows of foreign currency with a view to improving the stability of the external sector. Exports and imports were adversely affected by disruptions to supply and demand chains and interruptions to production processes as a result of strict containment measures taken early on during the year to reduce the spread of COVID-19.

46. However, with the gradual relaxation of domestic containment measures and the return to near normalcy working conditions, earnings from merchandise exports recovered to pre-COVID levels of USD 1 billion by July 2020. Meanwhile, disruptions to global supply and logistic chains, lower commodity prices following the COVID-19 outbreak and restrictions imposed by the government on motor vehicles and non-essential imports to ease pressure on the exchange rate, largely contributed to the decline in imports. Consequently, the trade deficit for the period January – July 2020 notably narrowed in comparison to the corresponding period of the previous year. In the services account, the imposition of travel restrictions globally and the closure of the Bandaranaike International Airport (BIA) severely impacted the country’s tourism industry with earnings from tourism nonexistent from end March onwards with the cessation of tourist arrivals. However, other services exports such as IT and shipping remain robust. Workers’ remittances in the first half of 2020 declined by 8.9 per cent to US dollars 2,980 million compared to US dollars 3,270 million in the first half of 2019. However, it has recorded higher than expected growth in July and August 2020. In the financial account, foreign investments in the government securities market as well as the Colombo Stock Exchange (CSE) reflected a net outflow up to September 2020, although some inflows to the government securities market have been witnessed recently.
47. The introduction of the Special Deposit Account (SDA) facility with attractive interest rates for foreign inflows and the newly announced foreign exchange swap arrangement for foreign investments in government securities would increase the flow of foreign exchange to the country going forward. The Sri Lankan Rupee, which sharply depreciated against the US dollar during the height of the crisis in April this year, has since appreciated enabling the Central Bank to purchase foreign exchange from the market to enhance reserves. Gross official reserves, which include the SAARCFINANCE swap facility of USD 400 million, stood at US dollars 7.4 billion at end August 2020, but declined after the successful repayment of the matured International Sovereign Bond of US dollars 1 billion at the beginning of October 2020.

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