



ANNUAL REPORT 2019

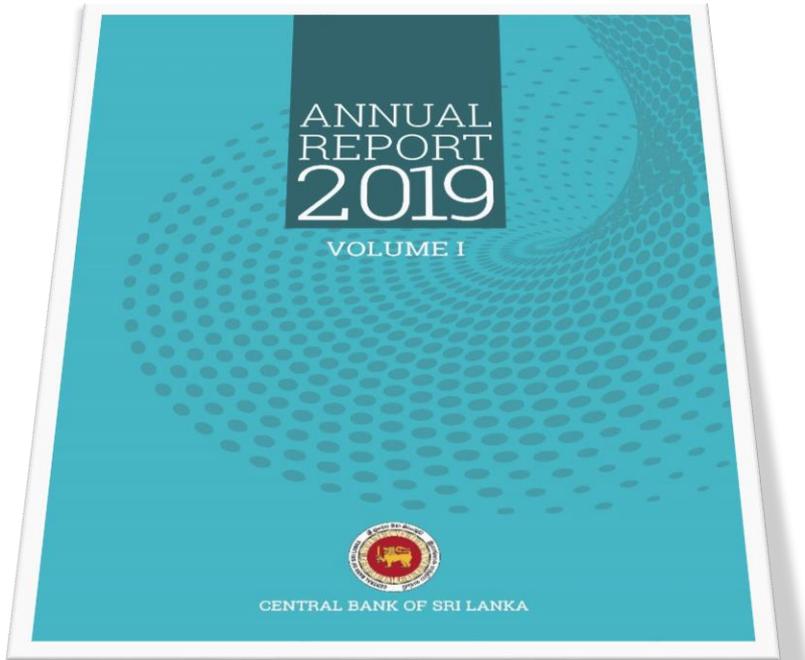


Dr. Chandranath Amarasekara
Director of Economic Research
Central Bank of Sri Lanka
May 2020

The Statutory Requirement

Section 35 of the Monetary Law Act:

... Within four months after the end of each financial year, the Monetary Board shall submit to the Minister in charge of the subject of Finance and shall publish an annual report on the condition of the Central Bank and a review of the policies and measures adopted by the Monetary Board during the financial year and an analysis of the economic and financial circumstances which prompted those policies and measures...



**This is the 70th Annual Report
of the Monetary Board of the Central Bank for the year 2019**

Content of the Annual Report

- Volume I** - State of the economy, its performance, policies and issues
- Statistical Appendix
- Special Statistical Appendix
-
- Volume II** - Accounts and Operations of the Central Bank
- Major Administrative Measures adopted by the Government and the Monetary Board during the year relating to the Functions and Operations of the Central Bank and Banking Institutions in Sri Lanka
 - Major Legislative Enactments of 2019 relating to the Functions and Operations of the Central Bank and Banking Institutions in Sri Lanka

State of the Economy, Its Performance, Policies and Issues

1. Economic, Price and Financial System Stability, Outlook and Policies
2. National Output and Expenditure
3. Economic and Social Infrastructure
4. Prices, Wages, Employment and Productivity
5. External Sector Developments and Policies
6. Fiscal Policy and Government Finance
7. Monetary Policy, Interest Rates, Money and Credit
8. Financial Sector Developments and System Stability

Chapter 1

Economic, Price and
Financial System Stability,
Outlook and Policies

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VOLUME I



CENTRAL BANK OF SRI LANKA

SRI LANKA'S ECONOMIC STORY IN 2019

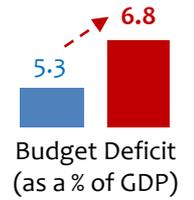
Macroeconomic stabilisation measures

Inflation

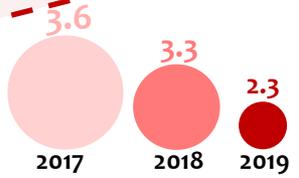
Greater External Sector Stability

- Narrowed trade and current account deficits
- Stable Exchange rate
- Higher Reserves

Fiscal Slippages



LOW Growth



Growth dampened further

Business Confidence ↓

Subdued demand

Quarter	GDP Growth (%)
2019-Q1	3.7
2019-Q2	1.1
2019-Q3	2.4
2019-Q4	2.0



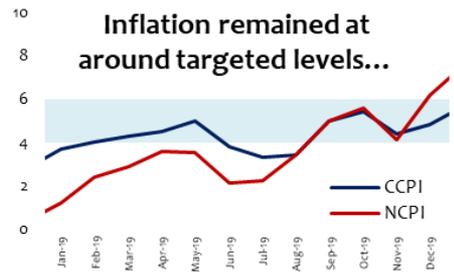
Easter Attacks



Despite weather related disruptions causing transitory upticks

Poor financial sector performance

Private Sector Credit Growth ↓



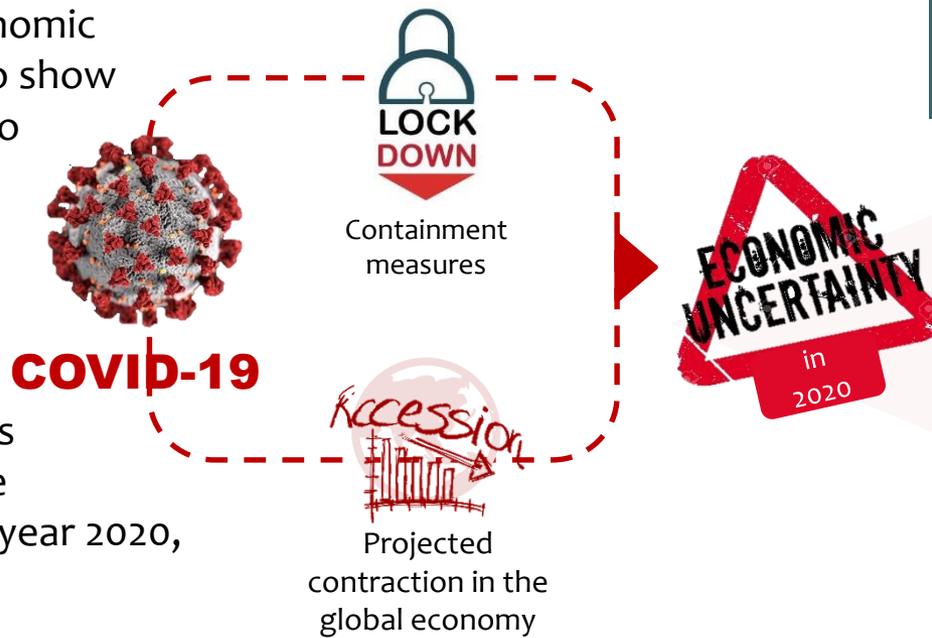
Global developments also had significant effects on the domestic economy

CBSL's Policy Stance : **ACCOMMODATIVE MONETARY POLICY**
Supported by regulatory action

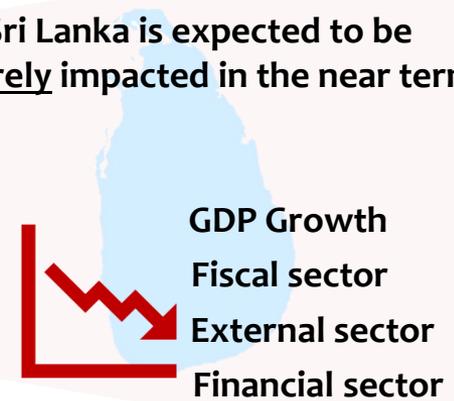
To support economic activity in Sri Lanka

SRI LANKA'S WAY FORWARD: 2020 AND BEYOND

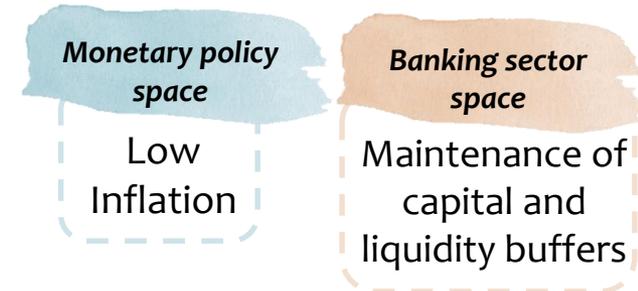
As domestic economic activity started to show early responses to the policy measures taken to revive the economy and improving business sentiments at the beginning of the year 2020, the onset of...



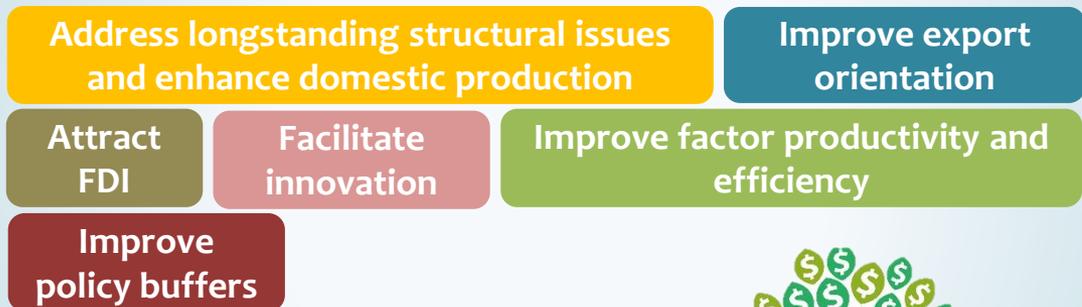
Sri Lanka is expected to be severely impacted in the near term



The CBSL was able to support the government's efforts to ease the burden on affected businesses and individuals through the spaces built...



Despite the **temporary setback** posed by the pandemic, timely implementation of appropriate growth supportive reforms to...



Sustainable and equitable economic growth in Sri Lanka



Chapter 2

National Output,
Expenditure and Income

Chapter 3

Economic and Social
Infrastructure

Chapter 4

Prices, Wages, Employment
and Productivity

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CENTRAL BANK OF SRI LANKA

Economic growth moderated in 2019 with the economy expanding by 2.3% in real terms...

- All major sectors of the economy recorded positive, but modest growth rates in 2019
 - Extreme weather conditions affected the **agriculture sector**, particularly tea, rubber, marine fishing and marine aquaculture
 - **Industry sector** registered a growth of 2.7% supported by a revival in construction and mining and quarrying activities
 - Growth of the **services sector** decelerated significantly to 2.3% due to contraction in accommodation, food and beverage services activities and slow down in wholesale and retail trade activities

Sri Lanka was classified as an upper-middle income country...

- However, per capita GDP declined to USD 3,852 in 2019 from USD 4,079 in 2018 due to
 - Subdued economic growth
 - Depreciation of the rupee, in terms of annual average

Annual GDP Growth Rate (a)

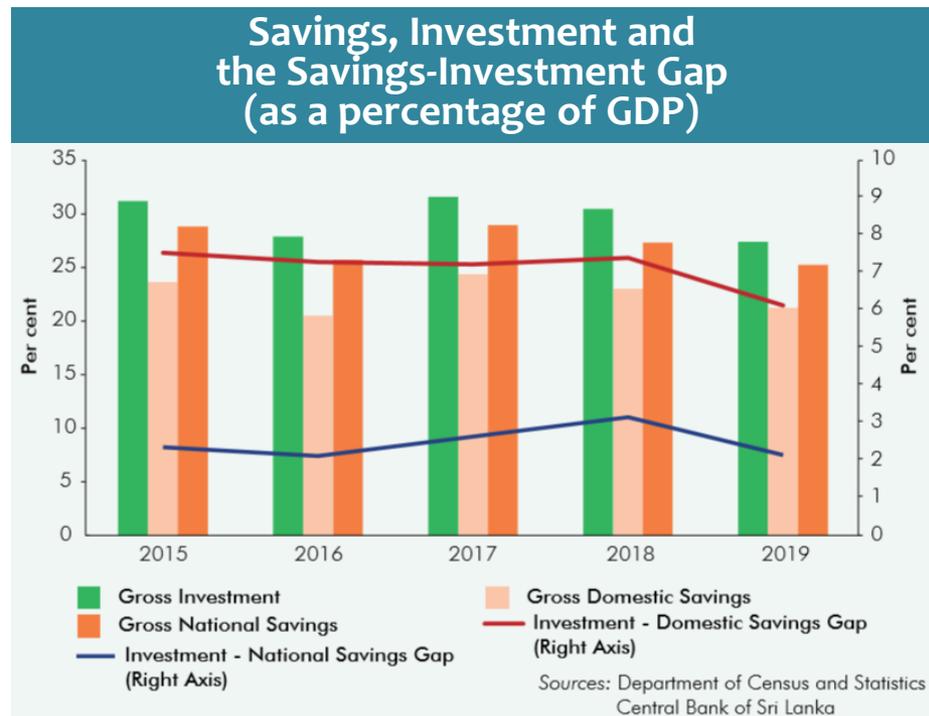


Per Capita GDP (a)



Growth was supported by expansion in consumption expenditure and improvement in net external demand...

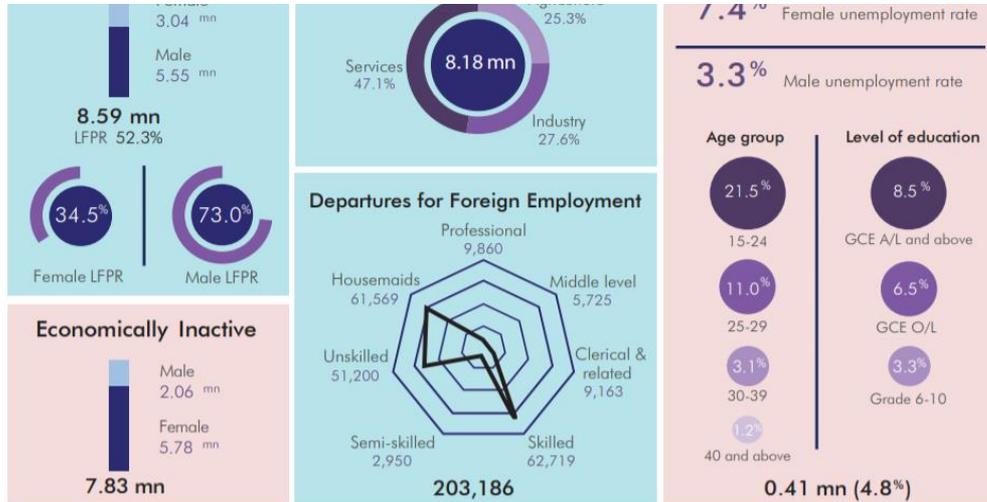
- **As per the expenditure approach of GDP, in 2019**
 - Consumption expenditure (78.7% of GDP) registered a 6.9% growth
 - Investments continued to decline recording a 5.9% contraction
 - Investments as a percentage of GDP declined to 27.4% from 30.4% share registered in 2018
- **Net external demand continued to be negative, though an improvement in trade balance was recorded with a sharp decline in imports**
- **Domestic savings as a percentage of GDP declined to 21.3% in 2019 from 23.0% recorded in 2018**
- **But due to higher contraction in investment expenditure,**
 - Domestic savings-investment gap as a % of GDP narrowed to 6.1% in 2019 from 7.4% in 2018
 - National savings-investment gap as a % of GDP narrowed to 2.1% in 2019 from 3.1% in 2018



Reflecting subdued economic activity, unemployment rate increased to 4.8% in 2019 from 4.4% in 2018...

- Sri Lanka remains among the top 20 countries with the highest gender gaps in the LFPR
- Unemployment among youth, female and educationally qualified categories continued to remain at high levels

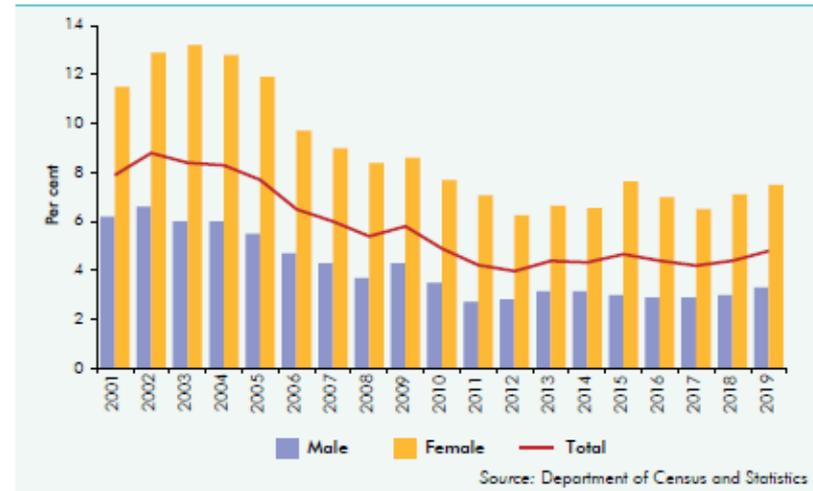
Labour Market - 2019 (a)



(a) Provisional

Sources: Department of Census and Statistics
Sri Lanka Bureau of Foreign Employment

Unemployment Rate



Government continued its efforts to expand the country's economic infrastructure in 2019 despite tight fiscal constraints...

- Southern Expressway Extension project and Phase III of the Outer-Circular Highway project were completed
- Four reservoirs under the Uma Oya project were vested with the public in October 2019



- Land reclamation activities of the Port City project were completed in January 2019
- Land reclaimed under the project was declared as a part of the Colombo District and as an urban development area under the purview of Urban Development Authority



Government Investment in Infrastructure

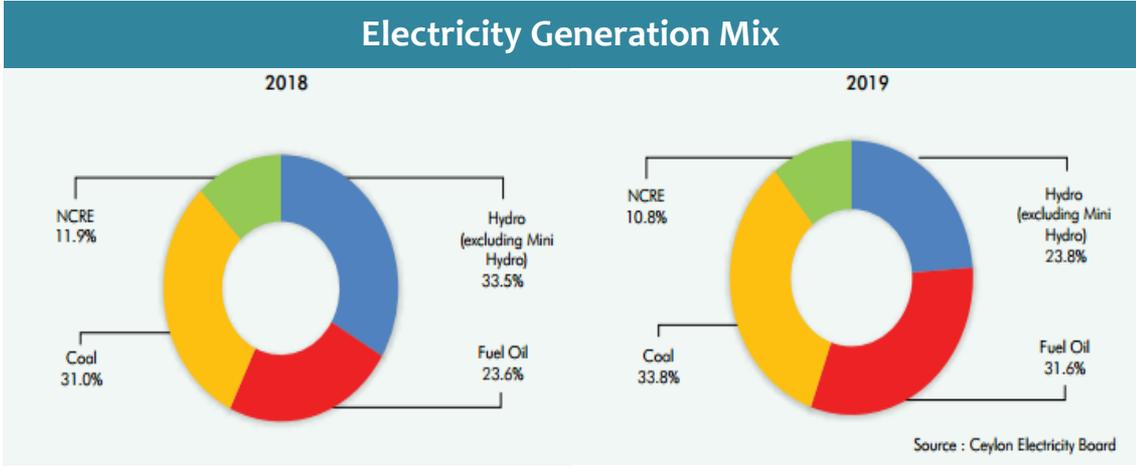
Year	Economic Services		Social Services		Total	
	Rs. billion	As a % of GDP	Rs. billion	As a % of GDP	Rs. billion	As a % of GDP
2015	429.0	3.9	124.4	1.1	553.4	5.1
2016	424.0	3.5	117.3	1.0	541.3	4.5
2017 (a)	474.1	3.6	135.4	1.0	609.5	4.6
2018 (a)	437.9	3.3	133.2	1.0	571.1	4.3
2019 (b)	475.9	3.4	112.9	0.8	588.8	4.1

(a) Revised
(b) Provisional

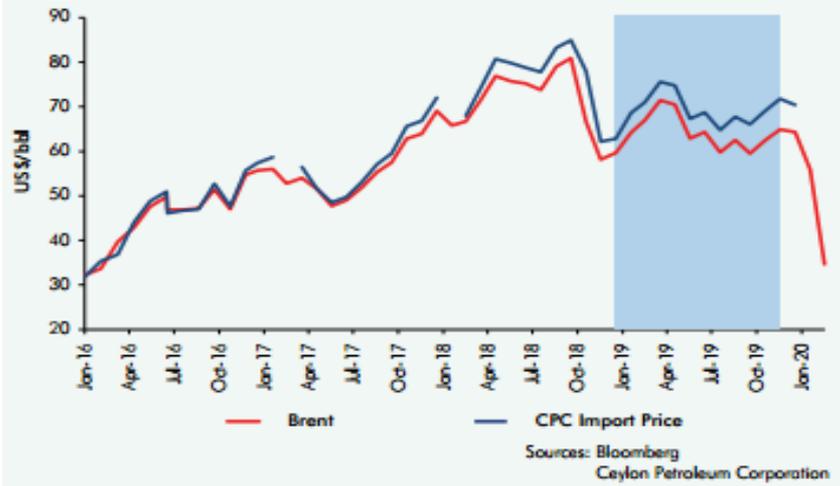
Sources: Ministry of Finance, Economic and Policy Development
Department of Census and Statistics
Central Bank of Sri Lanka

Country faced challenges in meeting growing energy demand...

- Electricity generation grew by 3.3% to 15,879 GWh
- Electricity sales grew by 3.7% to 14,612GWh
- Dry weather conditions resulted in low hydropower generation, but growing electricity demand was met by fuel oil and coal power generation
- CEB opted for scheduled power cuts during March and early April in 2019



Average Price of Crude Oil (Brent) in the International Market and the Crude Oil Import Price of the CPC



- Average Brent price fell by 10.7% to USD 64.04 per barrel in 2019, from US dollars 71.76 per barrel in 2018
- Domestic retail prices of petroleum products were revised regularly until September 2019
- Sales of petroleum products in the domestic market grew by 4.8% in 2019 with increased fuel oil based power generation and higher demand from the transportation sector
- Since the third week of January 2020, a sharp reduction in oil prices was observed with the spread of the COVID-19 pandemic

Communication sector expanded in 2019 while the government strived to enhance access to water supply...

Telephone Penetration



- Telephone penetration: 161.4 connections per 100 persons
- Internet penetration: 61.5 connections per 100 persons

Access to safe drinking water

– 91.9% (2019)

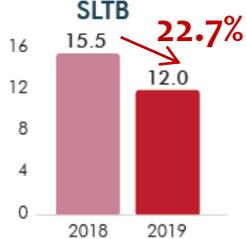
Access to pipe borne water

– 51.8% (2019)

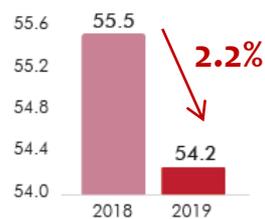


Although domestic transport activities slowed down in 2019 due to Easter Sunday attacks, port operations recorded an expansion...

Passenger km (billion) - SLTB

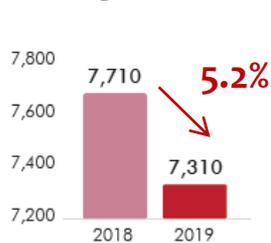


Passenger km (billion) - Private Sector



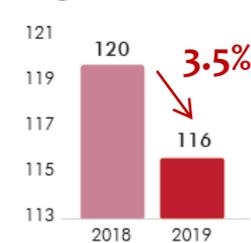
Road Transport

Passenger km (million)

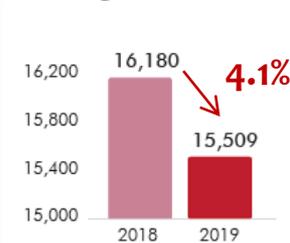


Rail Transport

Freight Ton km (million)



Passenger km (million)



Freight (MT '000)



Aviation

Both passenger and goods transportation through road, railway and aviation modes declined in 2019 due to low people movement over security concerns and reduced activities in the economy after the Easter Sunday attacks

Container Handling, Transshipment Volume and Ship Arrivals



Source : Sri Lanka Ports Authority

Total cargo handling –
Increased by 1.9% to 106.98 mn mt

Container handling –
Increased by 2.6% 7.2 mn TEUs

Transshipment handling –
Increased by 4.4% to 5.96 mn TEUs

SLPA won the *Ports Authority of the Year 2019 Award* by the Global Ports Forum (GPF) for the second consecutive year

CICT was voted as the *Best Container Terminal in Asia* in the 'under 4 million TEUs category' for the third consecutive year

Government continued its efforts to improve education and health services...



- The '13 years of guaranteed education' and the 'Nearest school is the best school' programmes continued during the year with a view to improving equitable access to education and to meet dynamic skill demand in the job market



- In June 2019, the *Higher Education (Quality Assurance and Accreditation Commission) Bill* was gazetted and was forwarded to relevant stakeholders for their comments and observations



- Under the *13 years of Guaranteed Education Programme*, 798 students were recruited for graphic designing, construction, web designing, automobile and electrical courses offered by the state sector Colleges of Technology and Technical Colleges

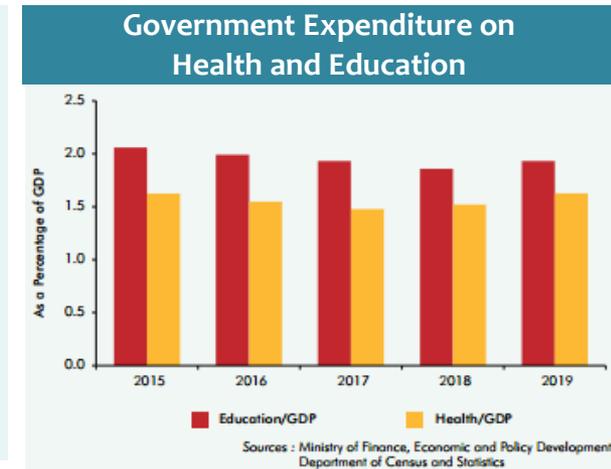


WHO declared that Sri Lanka

- is free of mother to child transmission of the Human Immunodeficiency Virus (HIV) and Syphilis
- has eliminated endogenous Measles and has controlled Rubella



- Sri Lanka is still burdened by certain communicable diseases such as Dengue, Leptospirosis and Influenza
- COVID-19 has created serious health concerns in Sri Lanka in 2020, which will pose a notable impact on the socio-economic front as well
- In order to control acute and chronic non communicable diseases, the government carried out various risk reduction, screening and health education and health promotion programmes



With a view to eradicating poverty, Government continued to expand social assistance programmes...

Poverty Headcount Ratio (per cent)

Sector	2002	2006/07	2009/10	2012/13	2016
Sri Lanka	22.7	15.2	8.9	6.7	4.1
Urban	7.9	6.7	5.3	2.1	1.9
Rural	24.7	15.7	9.4	7.6	4.3
Estate	30.0	32.0	11.4	10.9	8.8

Source: Department of Census and Statistics

- Although poverty headcount ratio has been declining over time, a large number of people live just above the poverty line
- 433,594 families were newly granted Samurdhi benefits in August 2019
- With the addition of these new families, approximately 35% of Sri Lankan households are receiving the Samurdhi benefits

Main Welfare Programmes - Number of Beneficiary Families and Value of Grants

Year	Divineguma / Samurdhi Subsidy Programme		Nutrition Allowance Programme		Dry Ration Programme
	Families (No.) (a)	Value (Rs. million) (b)	Beneficiaries (No.) (a)	Value (Rs. million)	Value (Rs. million)
2015	1,453,078	39,994	101,200	2,422	118
2016	1,407,235	40,740	337,554	5,746	111
2017	1,388,242	39,707	372,407	5,408	84
2018	1,384,021	39,239	329,047	5,490	58
2019	1,800,182	44,660	300,246	5,279	105

(a) As at year end

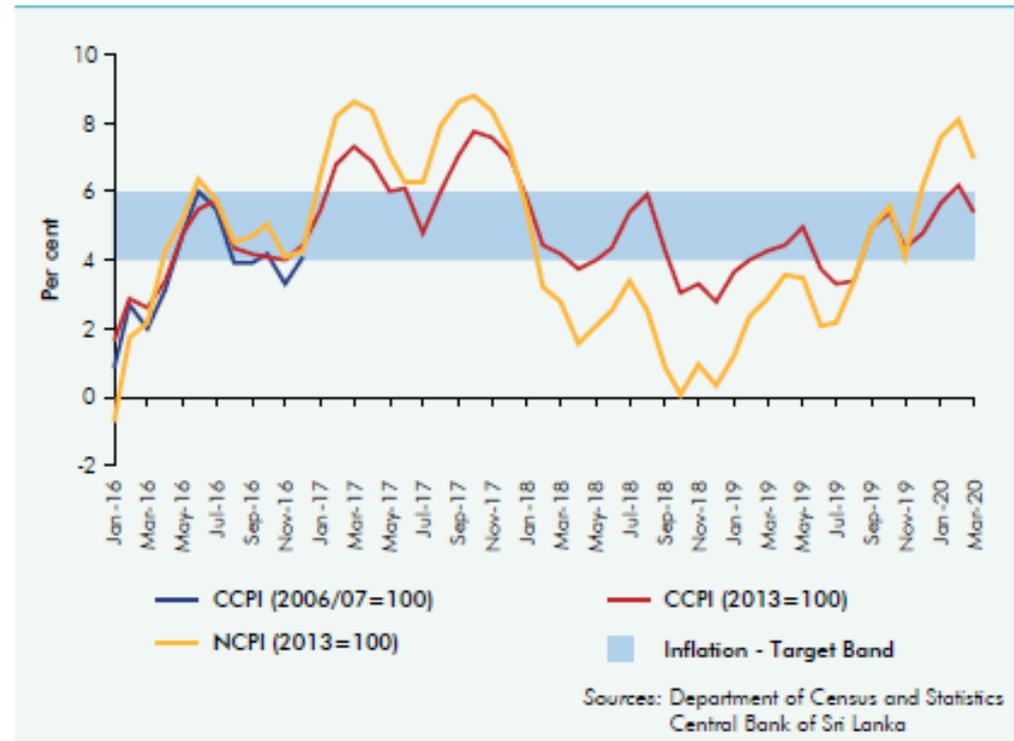
(b) Including the kerosene subsidy

Sources: Department of Samurdhi Development
Ministry of Women & Child Affairs and Social Security
Ministry of Finance, Economic and Policy Development

Inflation remained broadly in low levels during 2019, but supply driven uptick was observed towards end 2019...

- Headline inflation exhibited an overall increasing trend during 2019
- CCPI based headline inflation (y-o-y), increased to 4.8% by end 2019 from 2.8% at end 2018, while NCPI based headline inflation (y-o-y), recording the highest since 2017, increased to 6.2% by end 2019 from 0.4% at 2018
- Core inflation elevated in January 2019 mainly due to the increase in housing rentals and remained broadly in mid single digit levels thereafter
- Inflation expectations of the corporate sector mostly remained below mid single digit levels in 2019, aligning well with the trends of headline inflation
- Demand pressure arising from wages on the general price level remained subdued during 2019

Headline Inflation (Year-on-Year)



Chapter 5

External Sector Developments and Policies

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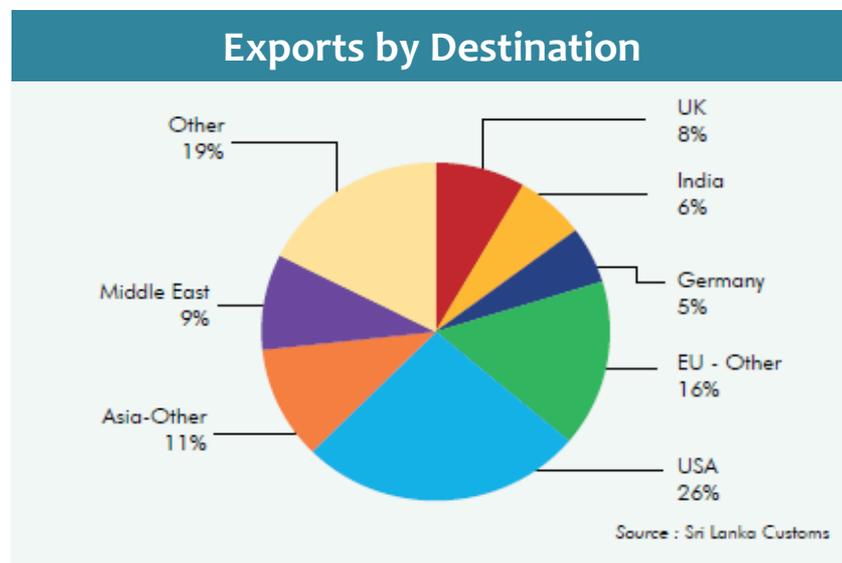
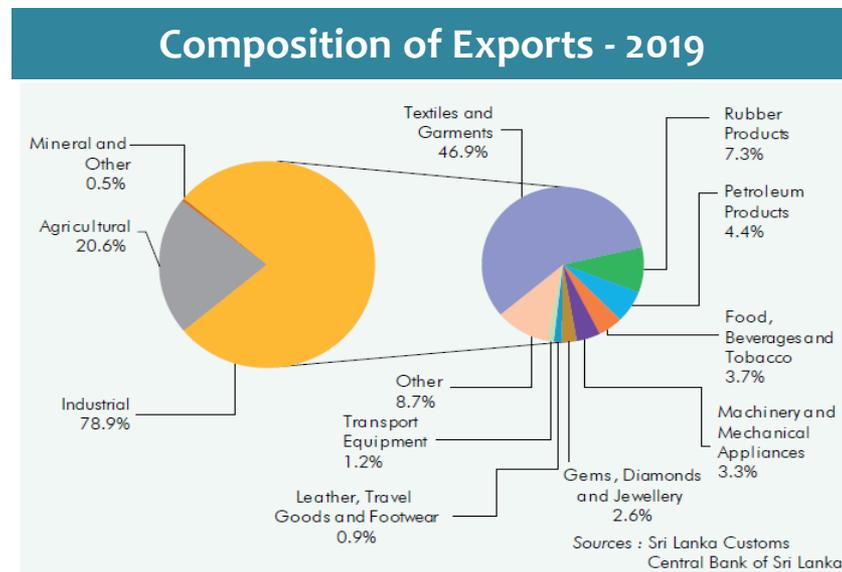


CENTRAL BANK OF SRI LANKA

Earnings from exports continued to grow in 2019, albeit marginally...



- **Earnings from exports increased by 0.4% to USD 11,940 mn:**
 - earnings from Industrial exports increased while agricultural and mineral exports declined
- **Increase in exports was driven by:**
 - textiles and garments (5.2%)
 - gems, diamonds and jewellery (10.0%)
 - transport equipment (21.3%)
 - animal fodder (19.7%)
 - coconut (6.0%)
- **Reductions were recorded in:**
 - tea (-5.7%)
 - spices (-13.2%)
 - petroleum products (-16.2%)
 - Leather, travel goods & footwear (-30.3%)
- **The USA continued to be the main buyer of Sri Lankan exports (26%) followed by the UK (8%) and India (6%)**



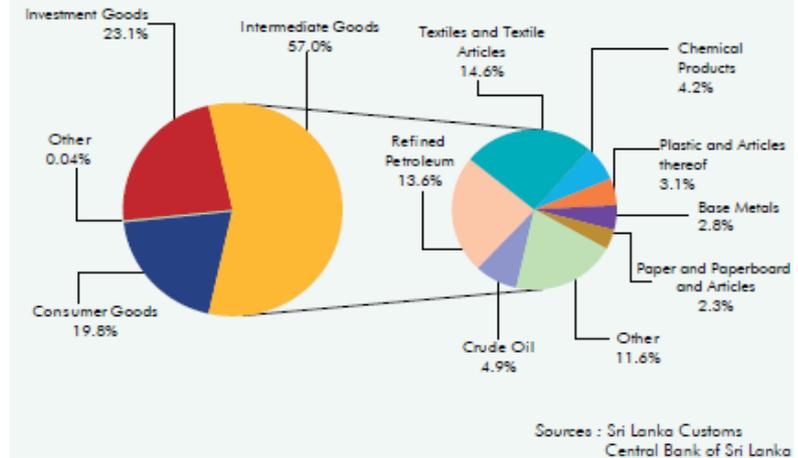
Expenditure on imports recorded a substantial reduction in 2019 mainly driven by policy measures implemented...



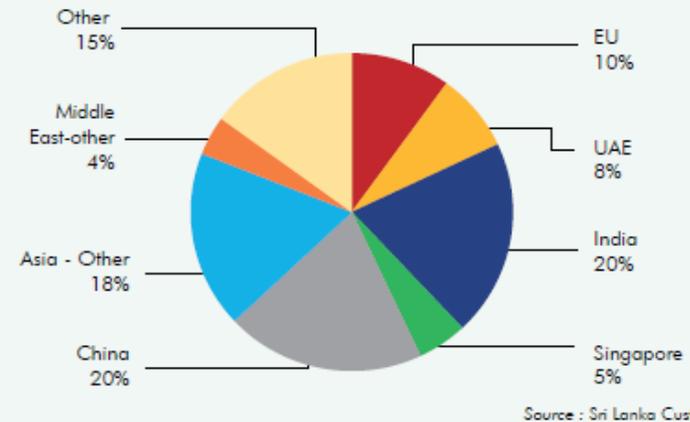
- **Import expenditure decreased by 10.3% to USD 19,937 mn:**
 - Imports of all major categories decreased
- **Lower imports were led by:**
 - Personal vehicles (-48.2%)
 - Fuel (-6.3%)
 - Rice (-88.0%)
 - Gold (-99.4%)
 - Base metals (-17.6%)
- **Increases were recorded in:**
 - Textiles and textile articles (1.8%)
 - Medical and pharmaceuticals (3.9%)
 - Mineral products (34.1%)
- **China and India continued to dominate as main import origins of Sri Lanka (20% each) followed by the UAE (8%)**



Composition of Imports - 2019

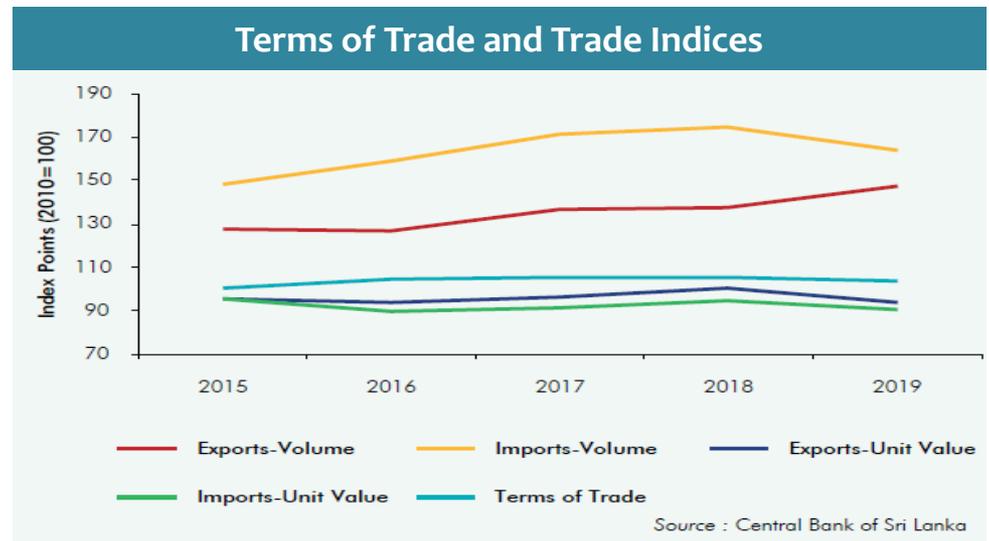
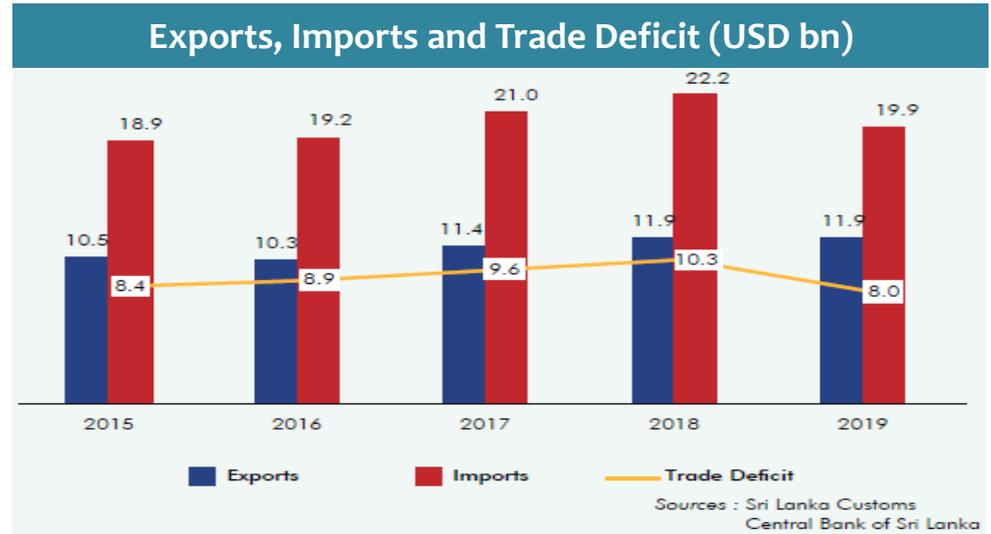


Imports by Origin



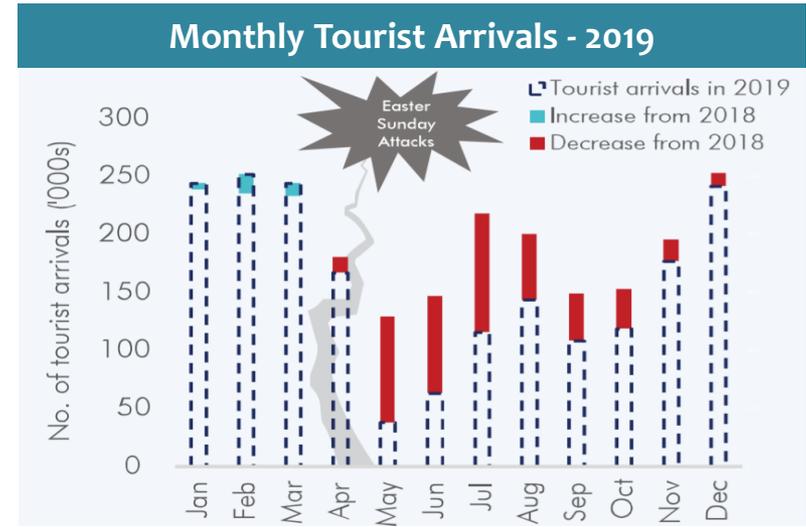
Deficit in the trade account, which expanded continuously during the previous five years, contracted substantially in 2019...

- Trade deficit reduced by USD 2,346 mn to USD 7,997 mn in 2019 from USD 10,343 mn in 2018
- Trade deficit as a % of GDP decreased to 9.5% in 2019 from 11.7% in 2018
- Terms of trade declined by 1.6% to 103.9 in 2019, as both export (-6.3%) and import (-4.8%) unit value indices decreased in 2019 compared to 2018



Earnings from tourism recovered gradually after a significant decline following the Easter Sunday attacks...

- Tourist arrivals recorded the highest ever quarterly arrivals in Q1 2019
- However, with the **Easter Sunday attacks**, tourist arrivals declined significantly, from end April 2019 onwards
- Consequently, **tourist arrivals declined by 18.0%** in 2019
 - 2019: 1,913,702
 - 2018: 2,333,796
- **Earnings from tourism also declined by 17.7%** to USD 3.6 bn
- **Tourist arrivals recovered gradually** by end 2019 with the **swift actions** taken on the policy front, while enhancing local security conditions and providing financial support for businesses and tourism promotion
- However, the **COVID-19** pandemic has brought tourist arrivals to a standstill at present



Surplus in the services account and workers' remittances moderated, while the primary income account deficit broadly remained unchanged in 2019...

- Net inflows to the services account moderated to USD 2,849 mn in 2019 (2018: USD 3,766 mn)

- Deficit in the primary income account widened marginally to USD 2,426 mn in 2019 (2018: USD 2,385 mn)



Tourist earnings declined notably while transport services moderated in 2019:

- Earnings from tourism: **declined by 17.7%**
- Transport services inflows amounted to **USD 2,339 mn** in 2019 (2018: USD 2,486 mn)
- Computer services sector (IT/BPO) continued to grow at a healthy rate and amounted to **USD 899 mn** in 2019 (2018: USD 848 mn)

Major increase in outflows from the primary income account was due to:

- Increased dividend payments by direct investment enterprises (DIEs)
- Increased coupon payments on international sovereign bonds (ISBs)

However, interest payments on loans and debt securities only increased marginally compared to 2018

- **Workers' remittances also moderated...**

Workers' remittances **declined by 4.3%** to **USD 6,717 mn** (2018: USD 7,015 mn) impacted by geopolitical developments in Middle Eastern economies

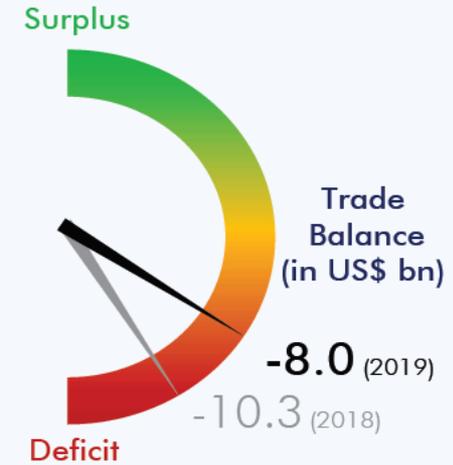


Overall, with a significant contraction in the trade deficit, external current account deficit declined significantly in 2019...

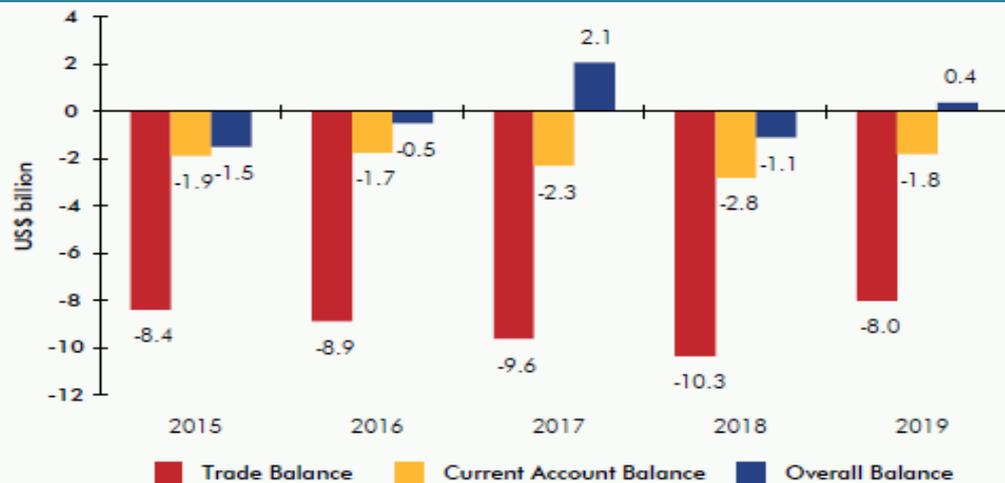
Composition of the Current Account in 2019:

- **Trade Deficit: USD 7,997 mn**
(2018: USD 10,343 mn)
- **Services a/c Surplus: USD 2,849 mn**
(2018: USD 3,766 mn)
- **Primary Income a/c Deficit: USD 2,426 mn**
(2018: USD 2,385 mn)
- **Secondary Income a/c Surplus: USD 5,766 mn**
(2018: USD 6,163 mn)

Trade Balance



Trade Balance, Current Account Balance and Overall Balance



Current Account Balance



COVID-19 pandemic is likely to result in a significant widening of the current account deficit in 2020...

Financial account was augmented with higher inflows in 2019 amidst significant debt repayment by the government...

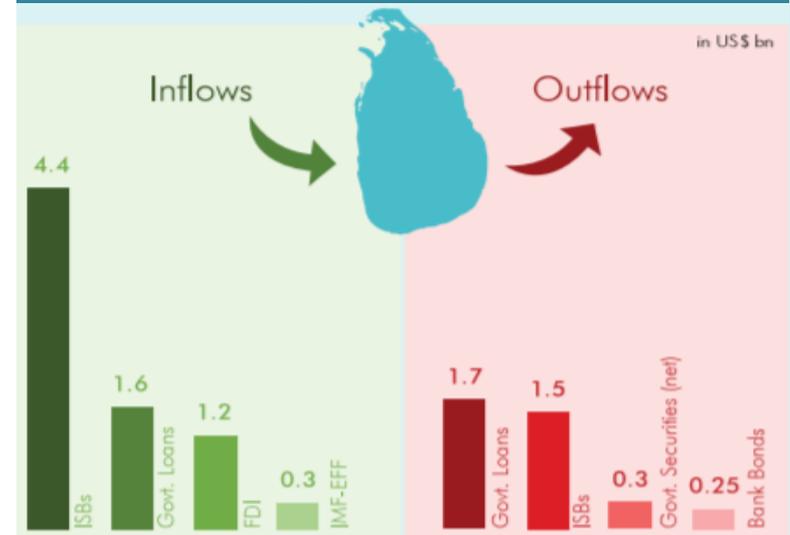
Major inflows to the financial account in 2019:

- Two issuances of ISBs amounting to USD 4.4 bn
- Government loan inflows of USD 1.6 bn
- FDI, including loans to BOI companies, of USD 1.2 bn
- Sixth and seventh tranches of the IMF-EFF of USD 327 mn

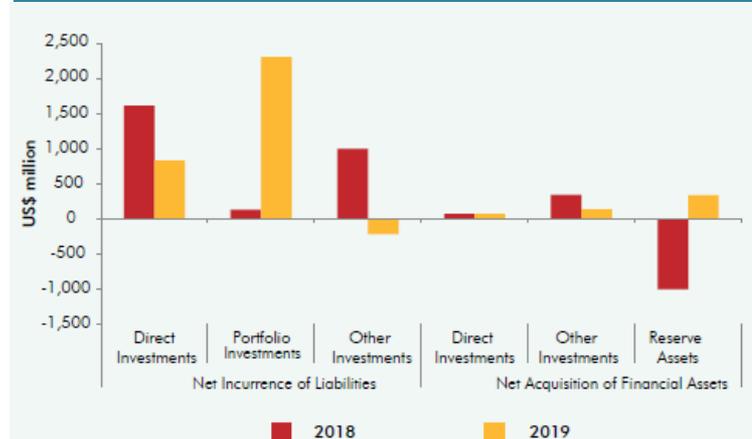
Major outflows from the financial account in 2019:

- Government foreign loan repayments USD 1.7 bn
- Repayment of two matured ISBs of USD 1.5 bn
- Government securities (T-bills and T-bonds) of USD 333 mn (net)
- Repayment of matured international bond issued by NSB of USD 250 mn

Financial Account: Major Inflows and Outflows



Financial Account (Net)



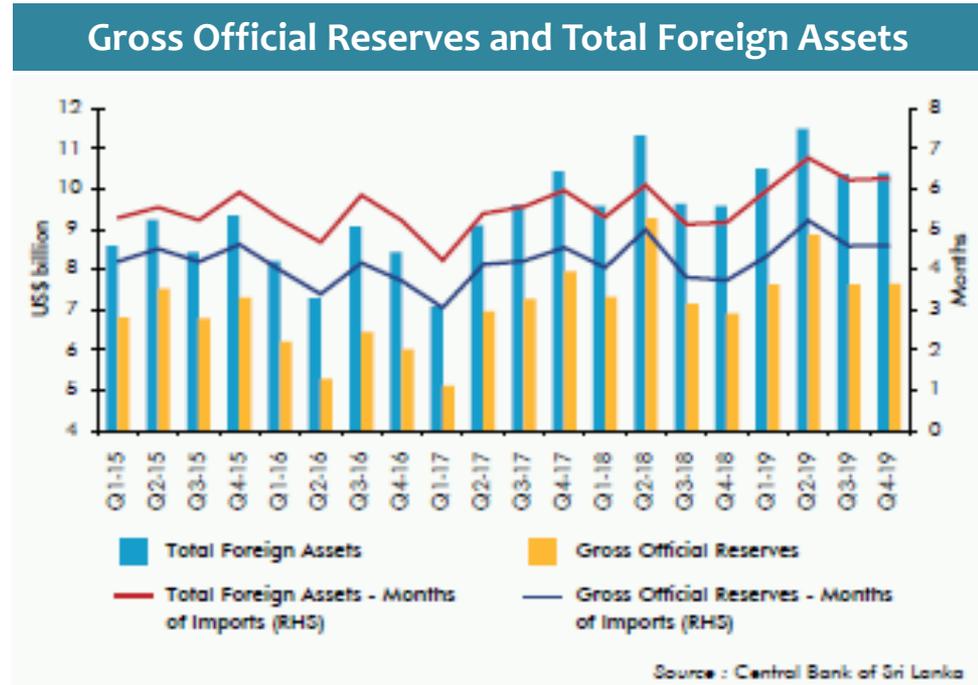
Balance of Payments recorded an overall surplus, while gross official reserves increased by end 2019...

- Overall Balance

- 2019: Surplus of USD 377 mn
- 2018: Deficit of USD 1,103 mn

- Gross Official Reserves

- 2019: USD 7.6 bn
(4.6 months of imports)
- 2018: USD 6.9 bn
(3.7 months of imports)



- Gross official reserve position increased by end 2019 due to;

- receipt of the proceeds of two new ISBs
- receipt of the two tranches of the IMF-EFF
- purchase of foreign exchange from the domestic foreign exchange market



Sri Lankan rupee appreciated by 0.6% in 2019...

- After the sharp depreciation in 2018, rupee exhibited a correction in 2019, despite some intermittent volatility
- Central Bank absorbed USD 387 mn, on net basis, from the domestic foreign exchange market in 2019 (2018: net supply of USD 1.12 bn)
- REER indices increased in 2019 but remained below the base year levels
- However, with the spread of the COVID-19 pandemic, the exchange rate experienced significant volatility in March and April of 2020

Exchange Rate Movements



Chapter 6

Fiscal Policy and Government Finance

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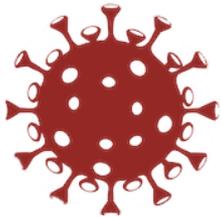
The government initiated several rounds of fiscal easing measures during 2019-2020...



- **Measures commenced in response to the devastating impact of the Easter Sunday attacks**
 - reduction of the VAT rate from 15% to 7% on hotels & tour operators
 - tax exemptions on the importation of security equipment



- **Measures taken after the Presidential election to address persistent subpar economic growth**
 - amendments to the Inland Revenue Act, No. 24 of 2017
 - a broadbased reduction of the VAT rate to 8% except for financial services
 - removal of NBT & WHT
 - curtail government expenditure of both recurrent & capital nature

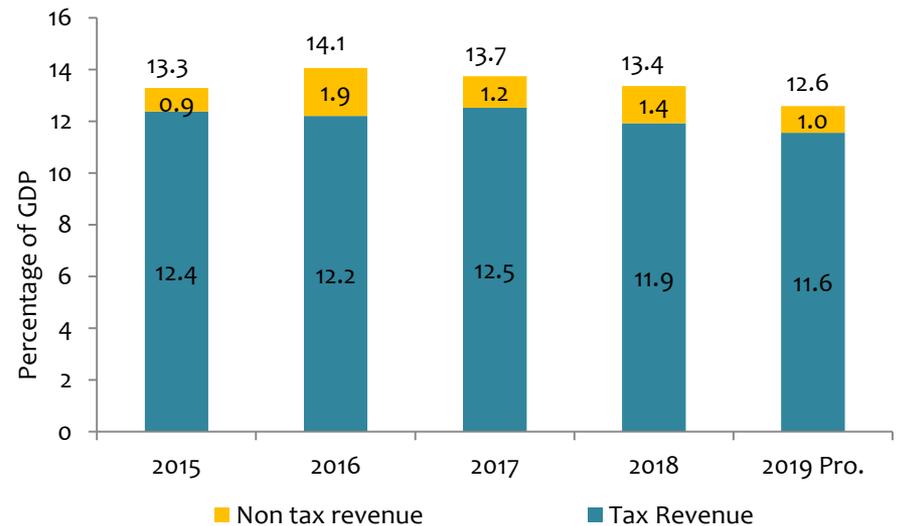


- **Measures initiated in response to the spread of COVID-19 pandemic**
 - provision of necessary expenditure allocations for health facilities
 - imposing maximum retail prices (MRPs) for essential food items
 - facilitating the distribution of food items during periods of social distancing
 - other regulatory measures to contain the spread of the pandemic
 - implementing a cash grant scheme of Rs. 5,000 for low income and vulnerable families and individuals as a lump sum allowance

Government revenue declined both in nominal terms and as a % of GDP...

- Government revenue declined to 12.6% of GDP in 2019 from 13.4% of GDP in 2018
- In nominal terms, total revenue declined by 1.5% to Rs.1,890.9 bn
- Despite a significant increase in revenue collection from income taxes, the lower revenue collection from excise duties, VAT, SCL, Cess and PAL resulted in a decline in revenue collection

Government Revenue (as a percentage of GDP)

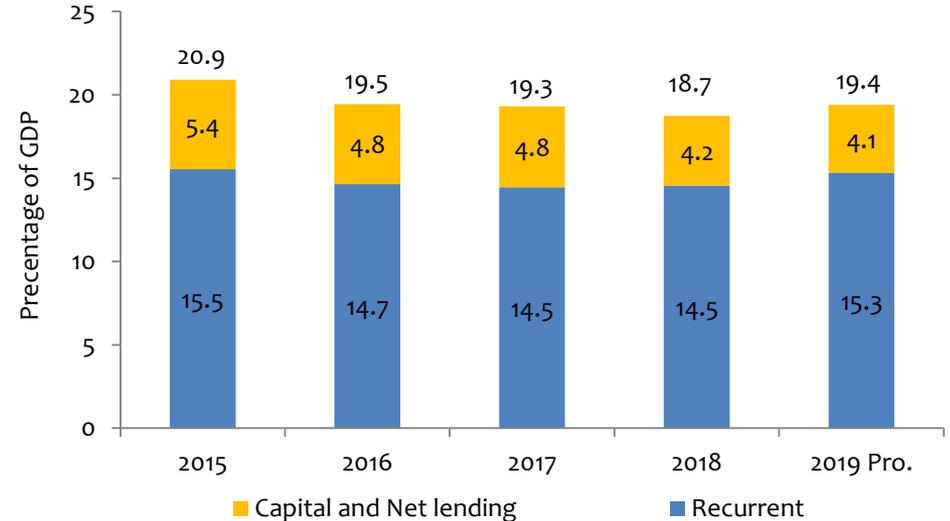


Source: Ministry of Finance, Economic and Policy Development

Total expenditure & net lending increased in nominal terms & as a % of GDP due to the increase in recurrent expenditure despite the decline in public investment...

- Total expenditure & net lending as a % of GDP increased to 19.4% in 2019 from 18.7% in 2018, while in nominal terms, it increased by 8.2% to Rs. 2,915.3 bn
- Recurrent expenditure as a % of GDP, increased to 15.3% in 2019 from 14.5% in 2018, while in nominal terms, recurrent expenditure increased by 10.1% to Rs. 2,301.2 bn
- Higher expenditure on subsidies & transfers, salaries & wages, and interest payments contributed to the increase in recurrent expenditure
- Capital & net lending declined to 4.1% of GDP in 2019 from 4.2% in 2018

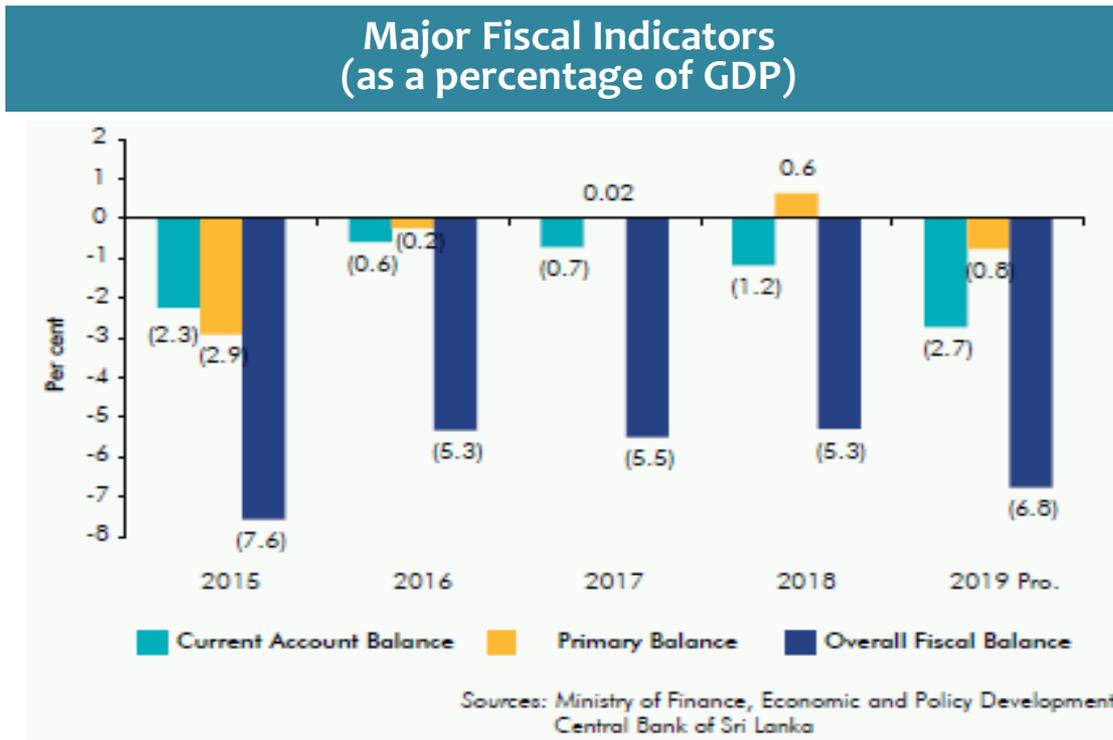
Government Expenditure (as a percentage of GDP)



Source: Ministry of Finance, Economic and Policy Development

Key fiscal balances deteriorated in 2019, amidst a notable decline in government revenue and rise in the recurrent expenditure...

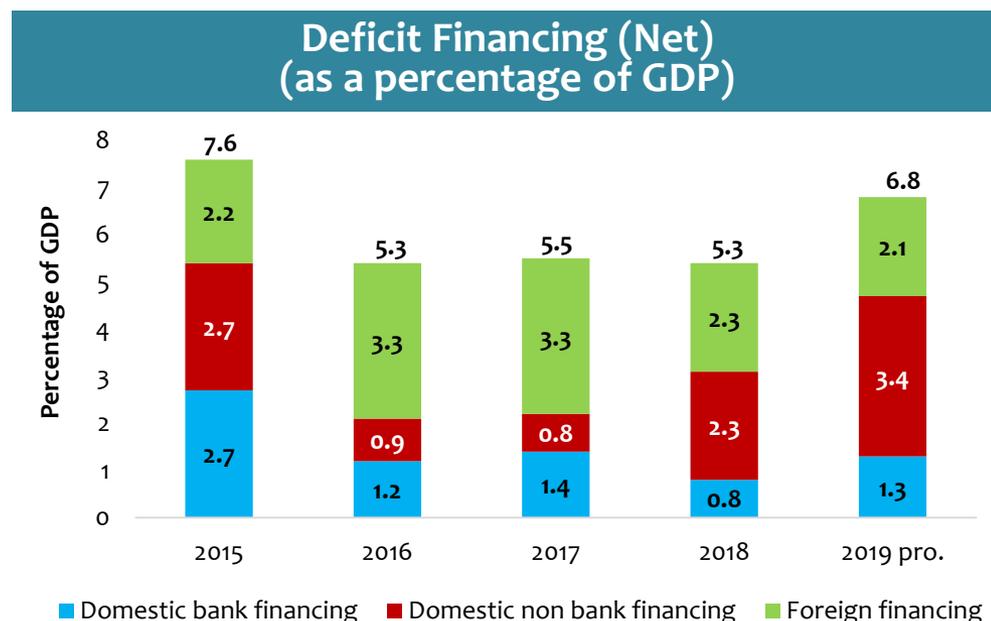
- The overall budget deficit as a % of GDP increased to 6.8% (Rs. 1,016.5 bn) in 2019 from 5.3% (Rs. 760.8 bn) in 2018



- Current account deficit expanded to 2.7% of GDP (Rs. 410.3 bn) in 2019 from 1.2% of GDP (Rs. 169.7 bn) in 2018
- Primary balance turned to a deficit of 0.8% of GDP (Rs. 115.1 bn) compared to a surplus of 0.6% of GDP (Rs.91.4 bn) in 2018

The government relied more on domestic sources in financing the budget deficit in 2019...

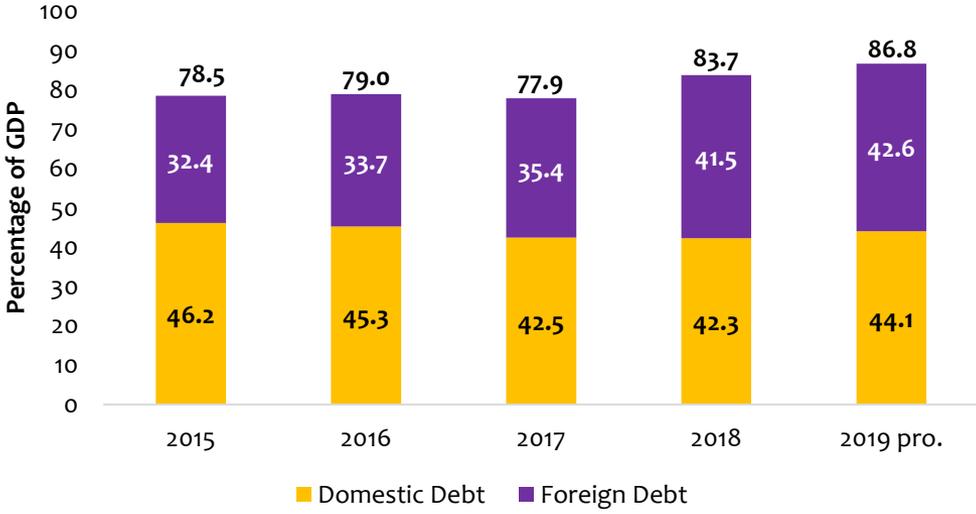
- Net domestic financing contributed 69.1% (Rs. 702.4 bn) of the total financing requirement in 2019 in comparison to 57.5% (Rs. 437.2 bn) in 2018
 - Of the total net domestic financing, non bank financing increased significantly to Rs. 509.3 bn, accounting for 72.5% in 2019, compared to 75.0% (Rs. 327.8 bn) in 2018
 - Financing from the banking sector amounted to Rs. 193.1 bn in 2019, representing 27.5% of total net domestic borrowings
- Share of net financing through foreign sources declined significantly to 30.9% (Rs. 314.1 bn) in 2019 from 42.5% (Rs. 323.5 bn) in 2018



Source: Ministry of Finance, Economic and Policy Development

Central government debt to GDP ratio increased, reflecting the impact of higher net borrowings to finance the enlarged budget deficit & relatively low nominal GDP...

**Outstanding Central Government Debt
(as a percentage of GDP)**



Sources: Ministry of Finance, Economic and Policy Development
Central Bank of Sri Lanka

- The total outstanding central government debt to GDP ratio increased to 86.8% at end 2019 from 83.7% at end 2018
 - The share of domestic and foreign debt as a % of GDP rose to 44.1% and 42.6%, respectively, at end 2019 from 42.2% and 41.5%, respectively, at end 2018
- In nominal terms, total outstanding central government debt increased by 8.3% (Rs. 1,001 bn) to Rs. 13,031.5 bn at end 2019

Chapter 7

Monetary Policy, Interest Rates, Money and Credit

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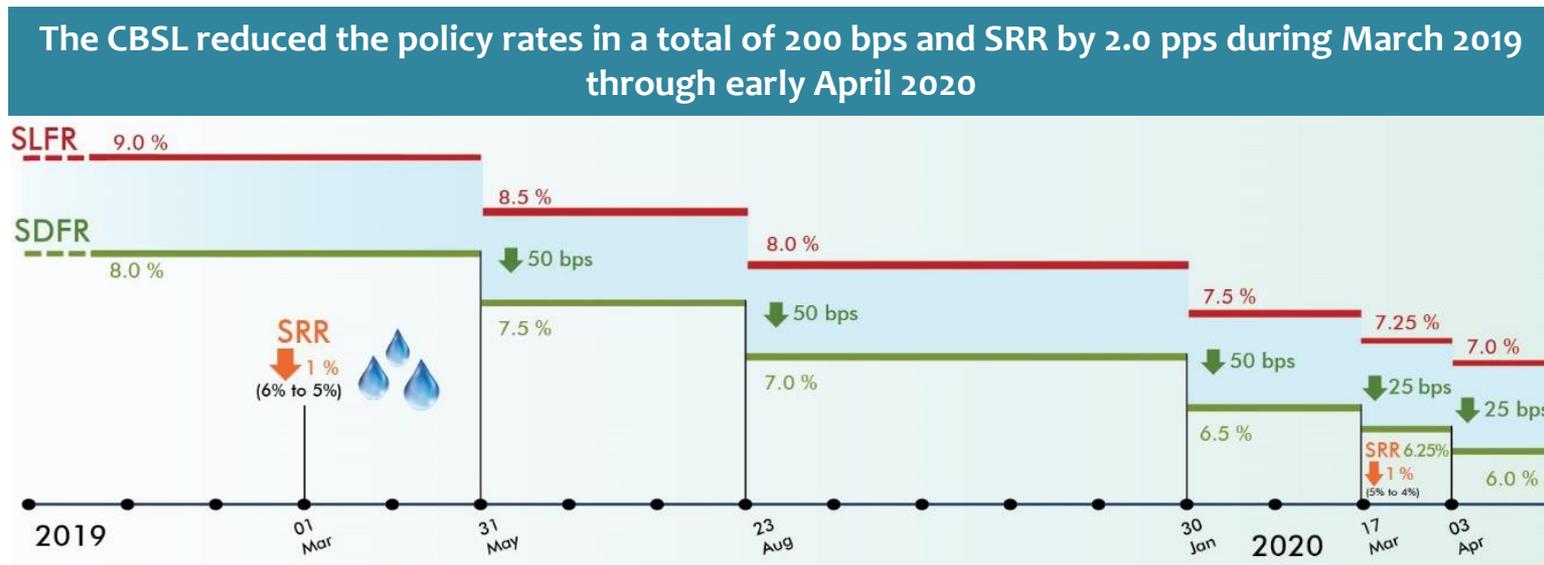
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CENTRAL BANK OF SRI LANKA

With the view to reviving subpar economic activity, the Central Bank adopted an accommodative monetary policy in May 2019 and reinforced it in August 2019 and early 2020...

- Supported by muted inflation, well-anchored inflation expectations, a relatively stable external sector and increasingly easing monetary policy globally
- The Central Bank eased Monetary Policy in March and April 2020 to support economic activity with the spread of the COVID-19 pandemic

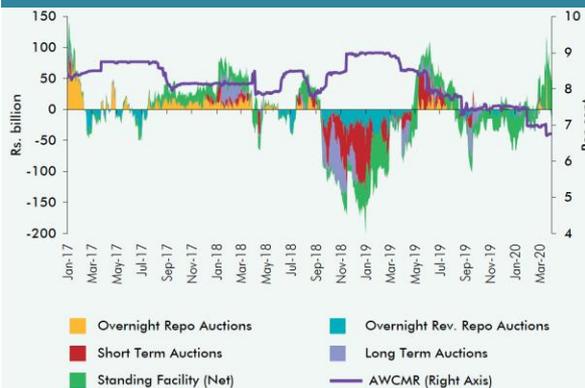


- The Central Bank conducted monetary policy in line with a FIT framework aimed at stabilising inflation at mid single digit levels over the medium term while supporting economic growth to reach its potential

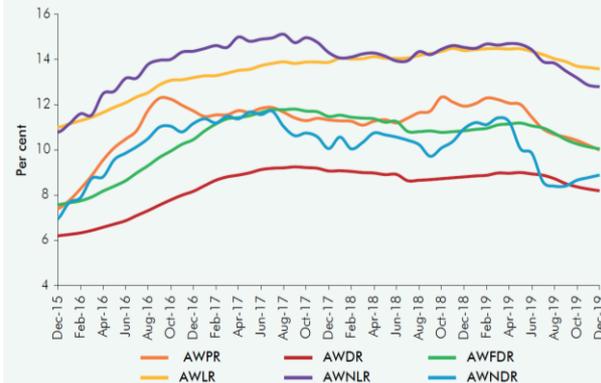
Since market interest rates were downward rigid in spite of policy rate reduction, the Central Bank imposed ceilings on interest rates...

- In order to reduce the cost of funds, the Central Bank imposed ceilings on deposit rates in April 2019 while maintaining adequate levels of liquidity in the domestic money market
- Yet, lending rates remained downward rigid, and as a temporary measure, the Central Bank imposed ceilings on lending rates of licensed banks in September 2019 while withdrawing deposit caps
- Consequently, market lending rates started to decline gradually
- Yields on government securities declined substantially during 2019

Rupee Liquidity in the Domestic Money Market and Liquidity Management



Commercial Bank Lending and Deposit Rates

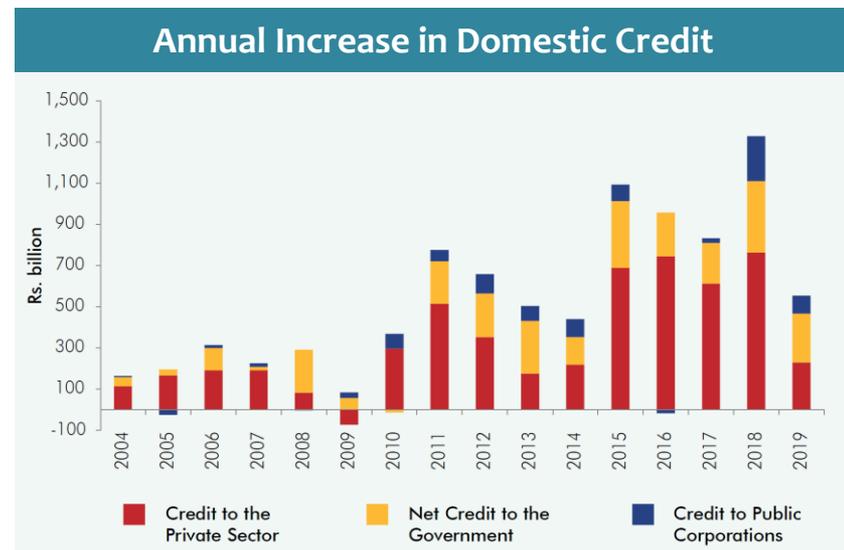
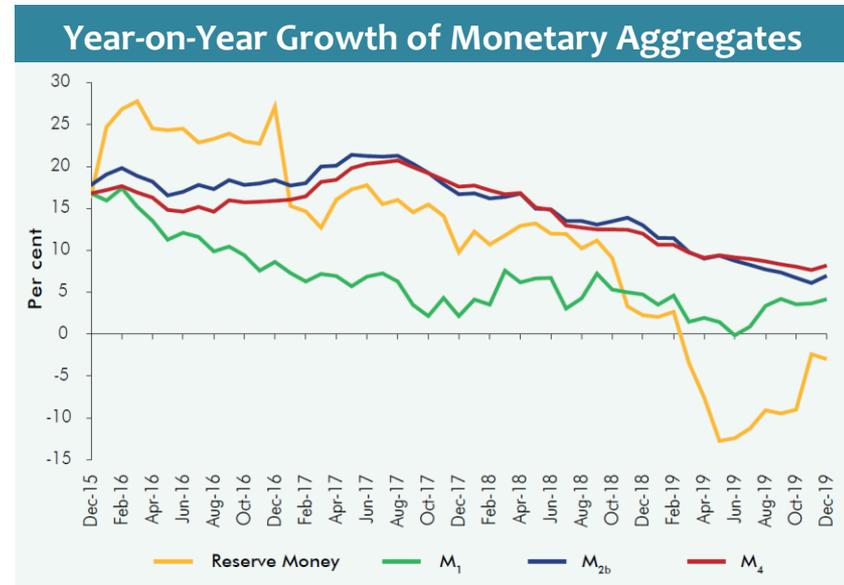


Primary Market Treasury Bill Yields



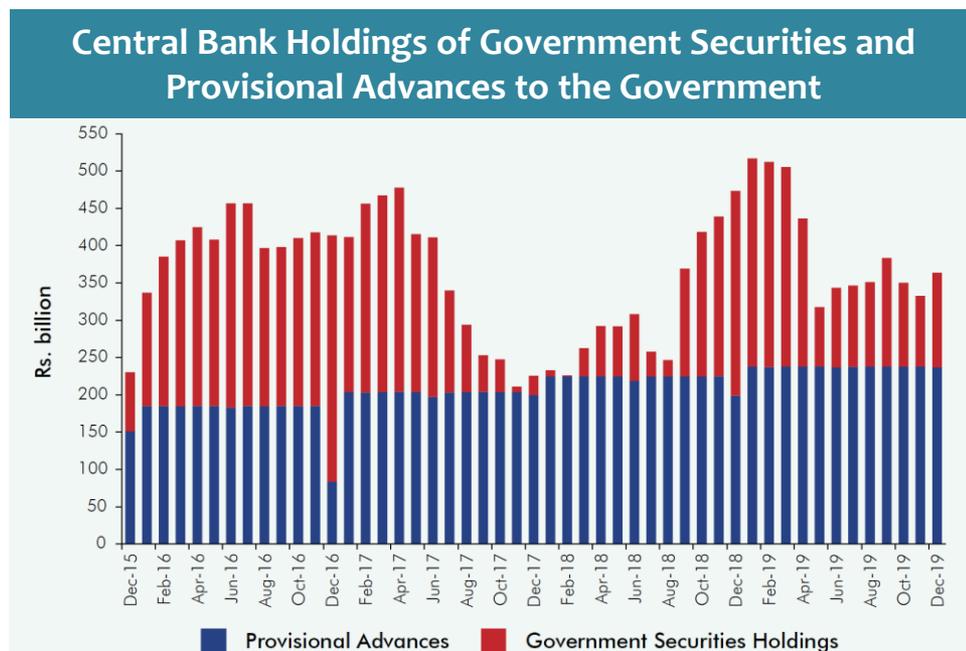
Growth of monetary aggregates decelerated in 2019...

- Reflecting the impact of the reduction in the SRR by 1.00 pp in March 2019, reserve money recorded a contraction during 2019
- Broad money growth (M_{2b}) continued to decelerate during 2019, owing to the moderation in the growth of NDA of the banking system
 - NDA of the banking system expanded at a slower pace during the year, due to the slowdown in credit extended to both private and public sectors
 - NFA of the banking system recorded an increase in 2019



Net Credit to the government (NCG) by the banking system continued to increase in 2019, albeit at a slower pace compared to 2018...

- NCG by the banking system increased by Rs. 250.4 bn in 2019 compared to an increase of Rs. 348.2 bn in 2018
- NCG by LCBs increased
 - due to the increase in investments in government securities, despite the decline in government overdraft balances with commercial banks during the year
- NCG by the Central Bank contracted
 - due to the decline in government securities holdings as the decline in reverse repo transactions of the Central Bank with improved liquidity in the money market



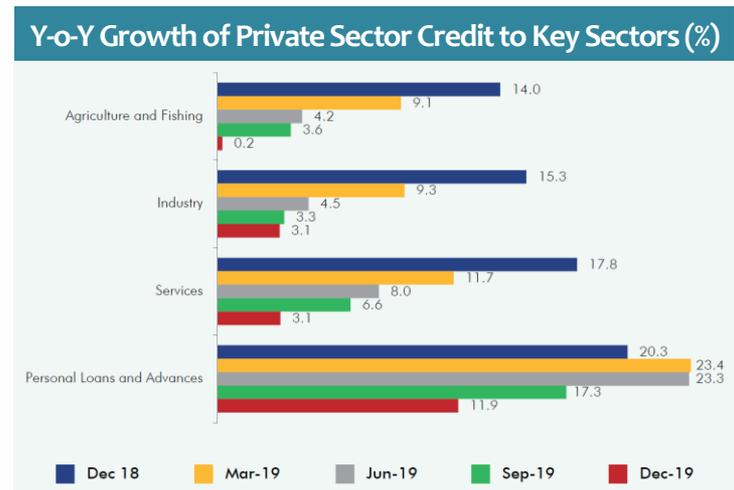
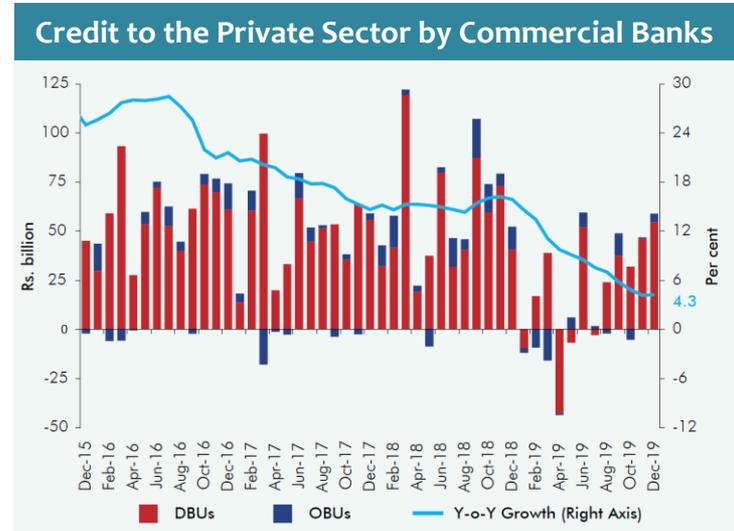
Credit obtained by the State Owned Business Enterprises (SOBEs) from the banking system also increased during 2019 at a slower pace compared to 2018...

- Borrowings of SOBEs in 2019 recorded an increase of Rs. 62.6 bn, partly reflecting the deteriorated financial position of most SOBEs towards the end of 2019, in comparison to an expansion of credit to SOBEs by Rs. 218.4 bn in 2018
 - Credit obtained by the RDA, CEB, CPC, NWS&DB and SPC increased during the year, reflecting weakened financial performance
 - However, CWE, SLPA and the Ceylon Fertilizer Corporation repaid their liabilities to LCBs, by a total of Rs. 5.7 bn during the year

Credit obtained by Key Public Corporations – 2019 (Rs. mn)			
Public Corporation	Dec-18	Dec-19	Change
			(Dec-19/Dec-18)
Total Amount	755,380	817,953	62,574
Of which,			
Road Development Authority	139,666	167,571	27,905
Ceylon Electricity Board	67,265	88,249	20,983
Ceylon Petroleum Corporation	293,231	307,676	14,445
National Water Supply & Drainage Board	64,949	73,450	8,502
State Pharmaceuticals Corporation	1,882	3,670	1,788
Cooperative Wholesale Establishment	8,959	7,035	(1,924)
Sri Lanka Ports Authority	12,803	10,919	(1,884)
Ceylon Fertilizer Corporation	15,086	13,203	(1,883)

Reflecting subdued economic activity during the year and weak business confidence that prevailed during early 2019, growth of credit extended to the private sector decelerated significantly in 2019...

- Credit extended to the private sector decelerated to 4.3% by end 2019, recording the lowest annual growth since 2009
- However, some recovery in credit disbursements was observed towards the end of 2019 supported by the monetary policy easing measures
- Growth of credit to all major economic sectors continued to decelerate during 2019
 - Growth of credit to Agriculture decelerated substantially to 0.2 % by end 2019 compared to 14.0 % at end 2018
 - Growth of credit to Industry sector decelerated to 3.1% by end 2019, from 15.3% at end 2018
 - Growth of credit to the Services sector decelerated to 3.1% by end 2019, compared to the growth of 17.8% at end 2018
 - Personal Loans and Advances, which grew by over 20% during the first half of 2019, recorded a moderate growth of 11.9% by end 2019



Chapter 8

Financial Sector Developments and System Stability

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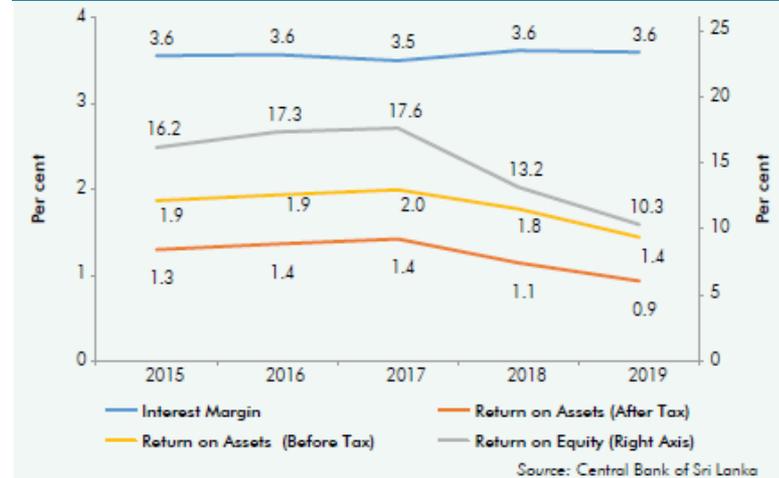


CENTRAL BANK OF SRI LANKA

The banking sector expanded at a slower pace in 2019...

- The lower growth in banking sector assets was an outcome of lower demand for credit and tightened credit screening by banks due to increasing NPLs
- Profitability of the banking sector declined significantly due to deteriorating asset quality, rise in operating costs and increase in taxes
- Banking system maintained capital and liquidity levels well above the regulatory minimum requirements, demonstrating the resilience of the sector

Profitability Ratios of the Banking Sector



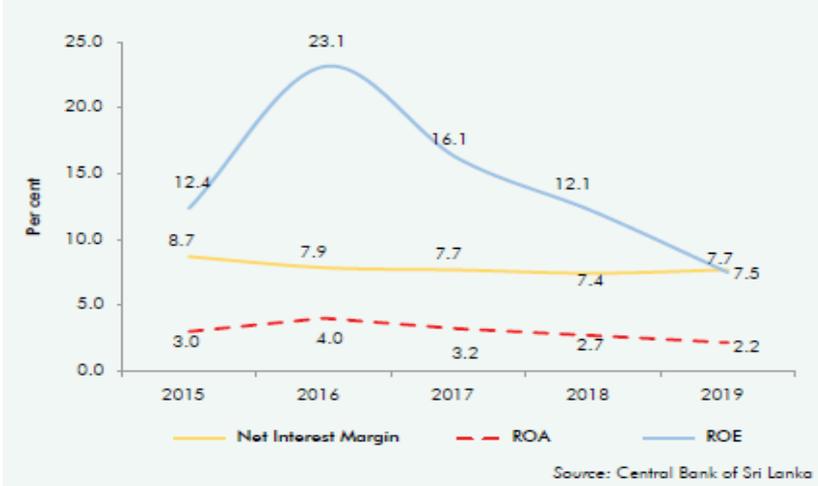
Capital Adequacy of the Banking Sector



Performance of the LFCs and SLCs sector deteriorated in 2019...

- The LFCs and SLCs sector performance deteriorated with negative credit growth, declined profitability and increased NPLs
- The profitability of the sector declined significantly in 2019 mainly due to increased non-interest expenses and higher loan loss provisions against the increasing NPLs
- The NPL ratio increased amidst the slow down in economic activities following the Easter Sunday attacks, declined lending activities and spillover effects of the Debt Relief Program
- The sector as a whole remained stable, with capital maintained at healthy levels along with adequate liquidity buffers well above the regulatory minimum levels

Profitability Indicators of the LFCs and SLCs Sector

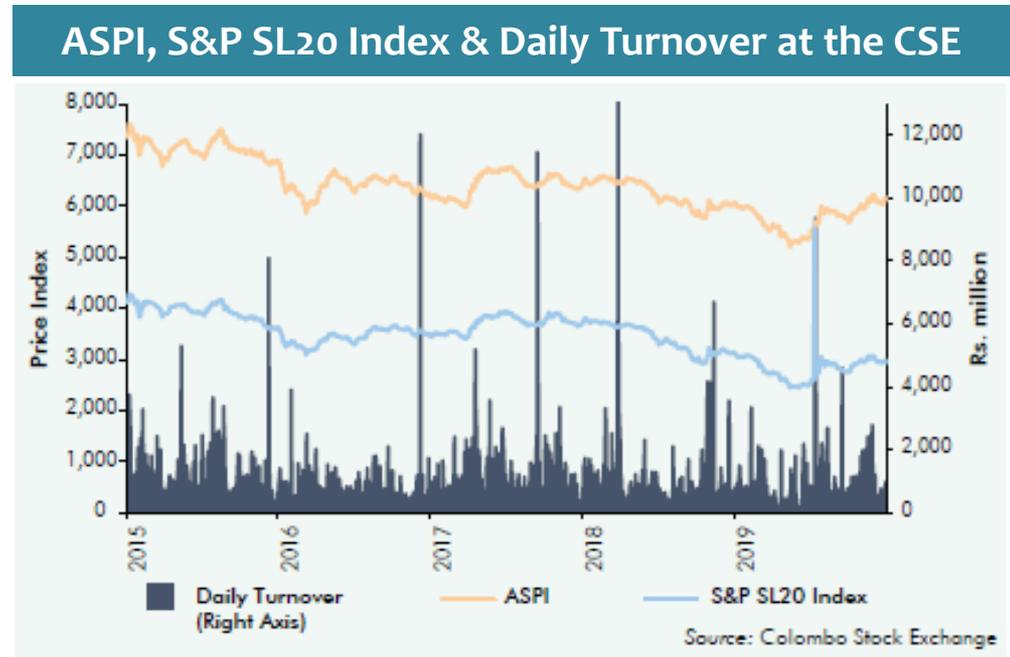


Non Performing Loans and Provision Coverage of the LFCs and SLCs Sector



The Colombo Stock Exchange (CSE) showed a mixed performance in 2019...

- The CSE showed improvements in terms of All Share Price Index (ASPI), market capitalisation, Price Earnings Ratio (PER) and market capitalisation as a % of GDP in 2019 while S&P SL20 index declined during the year
- Foreign investment outflow from the CSE continued during 2019 albeit at a lower rate than 2018
 - Secondary market of the CSE recorded a net foreign outflow of Rs. 11.7 bn in 2019 (2018 : net foreign outflow of 23.2 bn)



Medium Term Projections, Issues and Challenges

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CENTRAL BANK OF SRI LANKA

Medium Term Macroeconomic Framework: 2020-2024^(a)

Indicator	Unit	2018 (b)	2019 (c)	Projections					
				2020	2021	2022	2023	2024	
Real Sector (d)									
Real GDP Growth	%	3.3 (c)	2.3	1.5	4.5	6.0	6.2	6.5	
GDP at Current Market Price	Rs. bn	14,366 (c)	15,016	15,925	17,466	19,443	21,690	24,245	
Per Capita GDP	US\$	4,079 (c)(e)	3,852	3,940	4,166	4,473	4,813	5,190	
Total Investment	% of GDP	30.4 (c)(f)	27.4	26.8	27.3	27.8	28.1	28.4	
Domestic Savings	% of GDP	23.0 (c)(f)	21.3	20.7	21.3	22.5	23.6	24.5	
National Savings	% of GDP	27.3 (c)(f)	25.3	23.7	24.7	25.6	26.2	26.8	
External Sector									
Trade Gap (d)	% of GDP	-11.7	-9.5	-7.7	-9.8	-9.7	-9.5	-9.2	
Exports	US\$ mn	11,890	11,940	8,740	11,117	12,421	13,594	15,380	
Imports	US\$ mn	22,233	19,937	15,415	20,135	22,092	23,815	26,135	
Current Account Balance (d)	% of GDP	-3.2	-2.2	-3.1	-2.6	-2.2	-1.9	-1.6	
External Official Reserves	Months of Imports	3.7	4.6	5.6	4.6	4.6	4.6	4.6	
Fiscal Sector (d)									
Total Revenue and Grants	% of GDP	13.5 (g)	12.6	9.8	11.8	13.5	14.1	14.5	
Expenditure and Net Lending	% of GDP	18.7 (g)	19.4	17.7	18.6	19.1	19.2	19.4	
Current Account Balance	% of GDP	-1.2 (g)	-2.7	-5.1	-3.6	-2.1	-1.5	-1.0	
Primary Balance	% of GDP	0.6 (g)	-0.8	-2.8	-1.0	0.5	0.7	1.1	
Overall Fiscal Balance	% of GDP	-5.3 (g)	-6.8	-7.9	-6.8	-5.6	-5.2	-4.9	
Central Government Debt	% of GDP	83.7 (g)	86.8	92.4	89.4	84.3	80.5	76.3	
Monetary Sector and Inflation									
Broad Money Growth (M_{20}) (h)	%	13.0	7.0	9.3	12.9	12.7	12.5	12.5	
Private Sector Credit Growth (in M_{20}) (h)	%	15.9	4.3	4.0	10.0	12.2	13.0	13.0	
Annual Average Inflation (i)	%	4.3	4.3	4.5	5.0	5.0	5.0	5.0	

(a) Based on information available up to end March 2020

(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 % of GDP in 2018 were revised by the Department of Census and Statistics from 28.6%, 21.2% and 25.4%, respectively.

(g) Based on the revised GDP estimates for 2018 released on 31 March 2020 by the Department of Census and Statistics

(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, Economic and
Policy Development
Central Bank of Sri Lanka

Issues and Challenges...

1. **Increasing foreign debt servicing obligations** could pose risks to Sri Lanka's macroeconomic stability in the medium term, requiring urgent measures to enhance the country's foreign exchange earnings.
2. Measures to strengthen **fiscal consolidation** are essential over the medium term following inevitable fiscal slippages in the near term owing to the spread of the COVID-19 pandemic, also highlighting the need to efficiently and effectively transmit the benefits of such stimulus to intended economic participants.
3. Enhancing domestic production and increasing **participation in regional and global value chains (GVCs)** are of paramount importance in strengthening the export sector performance of Sri Lanka amidst significant volatility in prices of its exports of primary commodities.
4. Looking beyond the setbacks from the Easter Sunday attacks and the COVID-19 pandemic, Sri Lanka's **tourism industry needs to embrace new technology** to promote and sustain the industry over the medium term.

Issues and Challenges...

5. Implementation of a comprehensive **national industrial policy** with emphasis on improving national competitiveness and **ensuring the continuity of national policies** are essential for Sri Lanka to increase its growth potential.
6. The manufacturing sector of Sri Lanka is affected by low productivity, resulting in slow growth in the sector and **low competitiveness of Sri Lanka's exports in global markets**, emphasising the need for improving quality of the workforce and increasing productivity through R&D.
7. In spite of Sri Lanka's past achievements in the areas of social and human capital development, the graduation in the income status of the economy brings a novel set of challenges, which **requires an assessment of whether the labour force is sufficiently equipped to facilitate a high and sustainable growth trajectory**.
8. **Inadequate warehousing facilities for agriculture products** and lack of agriculture commodity financing options have resulted in sharp fluctuations in food prices and lower farmgate prices for producers.

Issues and Challenges...

9. The progress of many **infrastructure development projects has slowed in recent years**, despite their significance in ensuring a faster and inclusive economic growth, which requires promoting **private sector engagement**, while also considering any negative externalities of such projects.
10. **Ensuring energy security** through a consistent policy on energy generation mix and timely implementation of the long term Generation Expansion Plan, is crucial to reduce the financial burden on the economy while sustaining economic growth.
11. **Underperforming state owned business enterprises (SOBEs)**, which depend largely on financial support from the government, continue to burden the national budget, thus making reforms on such SOBEs imperative.
12. **Water security** has become a serious concern in Sri Lanka amidst erratic weather patterns and increasing demand for water, **prompting the need for urgent implementation of improved water management strategies** including drip irrigation systems and rain water harvesting techniques.

Issues and Challenges...

13. Sri Lanka's vulnerability to climate change risks seems rising rapidly, causing a significant burden on the government budget, thus requiring to address them with reforms such as, **environmental tax reforms** and **Green Finance initiatives**.
14. **Price pressures caused by frequent supply side disruptions** could weigh on the Central Bank's efforts to maintain low and stable inflation, requiring fiscal policy support as monetary policy is not a good tool to address food inflation.
15. Undue **delays in the monetary transmission process** continue to hinder the efficiency in the passthrough of monetary policy measures to the real economy.
16. As Sri Lanka transitions to a **low interest rate regime**, the **introduction of new financial products with a reasonable return** becomes vital in order to ensure the living standards of savers, particularly senior citizens.
17. Proactive and timely measures to promote the **consolidation of the financial sector** are required in order to enhance the resilience and the ability of the financial system to facilitate growth of the economy.

Issues and Challenges...

18. As Sri Lanka aspires to become a global financial hub with the development of the 'New Colombo', **enhancing the efficiency and depth of the financial sector becomes essential.**
19. As Sri Lanka is becoming increasingly connected to the rest of the world via movements of people and goods, **implementation of a coherent policy framework for surveillance and quarantine is essential**, as evidenced by the rapid contagion of the COVID-19 pandemic.
20. The **importance of strengthening disaster management plans and social protection programmes** is underscored to tackle the socio-economic effects arising from hazards, such as the spread of the COVID-19 pandemic and other emergencies.
21. The **COVID-19 pandemic** and the subsequent response by individual countries and globally highlights the **presence of several fault lines** that have necessitated policy responses which are substantially different from those observed in crisis episodes seen in the past.
 - Although many countries may seek protectionist measures in the short term to face the multifaceted effects of the pandemic, in the long term all countries are likely to reembrace globalisation, although in a modified form.

Box Articles

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CENTRAL BANK OF SRI LANKA

B2: COVID-19 and Sri Lanka: Challenges, Policy Responses and Outlook

- The COVID-19 outbreak that was first detected in China in late 2019, rapidly spread across the globe prompting the World Health Organization (WHO) to declare it as a ‘pandemic’
- While Sri Lanka has been relatively successful in combatting its domestic outbreak thus far, it is likely to have a notable impact on the Sri Lankan economy during the year

Economic Impact on Sri Lanka

- Domestic virus containment measures will affect several key economic sectors
- Growth of Sri Lanka’s key trading partners projected to slow rapidly and likely to affect the country’s exports
- Adverse impact on tourism industry to exacerbate if the current pandemic lasts long
- Remittances from the Middle East, European Union, and Far East Asia to be severely affected
- Uncertainties surrounding the outbreak to affect FDI inflows and cost of raising debt
- Diversion of financial resources to contain the outbreak will slow the progress of the economy

Implementation of Revival Measures

Monetary and Financial Sector Measures

- Policy rates, SRR and Bank Rate reduced
- Debt repayment moratoria for several sectors
- **Saubagya COVID-19 Renaissance Facility and New Comprehensive Rural Credit Scheme**
- Non-essential goods imports restricted
- Temporary restriction on capital outflows
- **Special Deposit Account** to attract FCY deposits from diaspora

Border Control and Health Sector Policies

COVID-19



- **Concessions** for businesses engaged in **tourism, textile and garments** and **wholesale and retail trade** sectors
- **Introduction of MRPs** for selected essential items
- **Cash grant of Rs. 5,000 as a lump sum payment** for the low income families
- **Allocations of funds** to settle **payment arrears**
- Established a **fuel price stabilisation fund**
- Granted **grace period for VAT payments**

Fiscal Measures

Measures to achieve normalcy in domestic economic activities could enable Sri Lanka to achieve a faster recovery, as domestic demand account for a significant portion of aggregate demand in Sri Lanka.

B3: Sri Lanka's Economic Takeoff – The Need and The Readiness

- With the ending of the internal conflict in 2009, Sri Lanka was making steady progress, recording above 8% growth in the 3 years that followed
 - However, progress slowed amidst subdued economic growth over the subsequent years

Issues and Challenges

- *Misaligned fiscal operations*
- *Subpar export performance and FDI*
- *Low female labour force participation and low skilled labour*
- *Unsupportive legal frameworks*
- *Ageing population*
- *Political instability and policy uncertainty*

Policies

- Fiscal consolidation and other reforms
- **Product and market diversification** of exports
- Multilateral **strategic economic partnerships**
- **Legal, institutional and labour market reforms**
- Investment in **high skilled education**
- **Widen access to tertiary education**
- Need for **improved intellectual property rights**
- **Promote innovation**
- Improve **access to advanced infrastructure** (Eg: Telecommunications, broadband)
- **Enhance entrepreneurship and promote doing business**
- Need for **national policies and consensus on long term economic goals**

It is essential that Sri Lanka adopts sound economic policies in order to avoid the “Middle Income Trap” and takeoff to become a high-income nation with equitable and sustained growth

■ Thank You

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1950-2020 **Stability**
Sustainability
Shared Prosperity

