5

EXTERNAL SECTOR DEVELOPMENTS AND POLICIES

5.1 Overview

Sri Lanka's external sector suffered a major setback in 2020 with the outbreak of the COVID-19 pandemic, requiring swift policy measures by the Government and the Central Bank. Merchandise exports declined sharply in the months in which the spread of the virus and the resultant containment measures were more intense, but reached close to the pre-pandemic levels sooner than expected. In response to the policy measures taken by the Government to restrict most non-essential imports and low crude oil prices, merchandise imports reported a significant decline in 2020. The combined effect of the gradual recovery in earnings from merchandise exports and the continuous decline in expenditure on merchandise imports resulted in the trade deficit to contract notably to record the lowest trade deficit since 2010. The tourism sector was incapacitated by the global isolation measures and the closure of borders of the country for tourists since mid March 2020. However, Sri Lanka opened its borders to tourists from January 2021 as one of the few countries in Asia that opened borders for tourism following pandemic related disruptions. A notable increase in growth of the computer services sector was observed in 2020 with the environment created by the new normal, though other inflows to the services sector, particularly sea and air freight services, moderated. Workers' remittances rebounded quicker than expected from a fall recorded during the early months of the pandemic to record an overall increase during the year. Outflows from the primary income account moderated in 2020 with lower interest and coupon payments on foreign holdings of government securities as well as moderated payments in terms of dividends and reinvested earnings from direct investment enterprises (DIEs). These developments led the external current account deficit in 2020 to contract notably to US dollars 1.1 billion, accounting for 1.3 per cent of GDP. With *heightened uncertainties, limited foreign direct investments (FDIs) were observed in 2020 and these relatively small FDI inflows were mainly on account of ongoing projects. Meanwhile, outflows were recorded from the government securities market and the Colombo Stock Exchange (CSE), induced by the pandemic driven turmoil in global financial markets. The exchange rate depreciated but remained relatively stable in 2020 despite intermittent volatilities observed in March and April and since end November. The Central Bank actively intervened in the domestic foreign exchange market by supplying foreign exchange and engaging in interbank sell-buy swap arrangements during periods of volatility. However, on a net basis, the Central Bank was able to absorb foreign exchange from the domestic foreign exchange market in 2020. Despite the obstacles to access the international financial markets for foreign borrowings, Sri Lanka maintained its unblemished record of debt servicing. Nevertheless, the large debt service payments falling due each year for the next few years remains a challenge. Realising this challenge and aiming to ensure the continuous stability of the external sector and to gradually reduce the country's external debt burden, a target driven programme to strengthen the domestic economy by enhancing non-debt creating foreign exchange inflows is being implemented in coordination with the public and private sectors, as the major policy initiative of the Government in strengthening the external sector. It is also expected that the planned fiscal consolidation in line with the Government's policy agenda will dampen the spillover effects of excessive fiscal expansion on the balance of payments (BOP), thereby enhancing external sector stability in the period ahead.*

Table 5.1
Balance of Payments Analytical Presentation

Item	US$ million		Rs. million	
	2019 (a)	2020 (b)	2019 (a)	2020 (b)
Current Account (net)	**-1,843**	**-1,083**	**-330,114**	**-220,370**
Trade Balance	**-7,997**	**-6,008**	**-1,430,232**	**-1,115,988**
Exports	11,940	10,047	2,134,796	1,858,927
Imports	19,937	16,055	3,565,028	2,974,915
Services (net)	**2,849**	**819**	**510,822**	**150,014**
Receipts	7,474	3,035	1,337,540	559,615
Payments	4,625	2,216	826,718	409,601
Primary Income (net)	**-2,462**	**-2,101**	**-441,394**	**-405,184**
Receipts	252	198	44,989	36,766
Payments	2,713	2,300	486,383	441,951
Secondary Income (net)	**5,766**	**6,207**	**1,030,690**	**1,150,789**
Secondary income: credit	6,726	7,117	1,202,334	1,319,377
Workers' remittances	6,717	7,104	1,200,766	1,317,007
Government transfers	9	13	1,568	2,371
Secondary income: debit	960	910	171,644	168,589
Capital Account (net)	**23**	**28**	**4,095**	**5,193**
Capital account: credit	51	51	9,054	9,472
Capital account: debit	28	23	4,959	4,279
Current and Capital Account (net)	**-1,820**	**-1,055**	**-326,019**	**-215,178**
Financial Account (net)	**-2,460**	**-260**	**-441,794**	**-52,625**
Direct Investment: Assets	**77**	**15**	**13,830**	**2,699**
Direct Investment: Liabilities	**743**	**434**	**132,916**	**80,556**
Portfolio Investment: Assets	**-**	**-**	**-**	**-**
Portfolio Investment: Liabilities	**2,313**	**-2,383**	**408,854**	**-441,886**
Equity	-4	-217	-1,106	-40,187
Debt securities	2,317	-2,166	409,960	-401,700
Financial Derivatives	**-**	**-**	**-**	**-**
Other Investment: Assets	**100**	**-136**	**17,823**	**-27,446**
Currency and deposits	-93	64	-16,796	11,666
Trade credit and advances	-4	-224	-680	-41,647
Other accounts receivable	196	24	35,299	2,535
Other Investment: Liabilities	**-82**	**383**	**-12,878**	**66,980**
Currency and deposits	167	-15	31,079	-3,519
Loans	-245	327	-43,494	57,980
Central Bank	327	-14	58,277	-2,689
Deposit-taking corporations	-281	75	-50,904	10,390
General government	-89	169	-14,387	31,961
Other sectors	-203	96	-36,479	18,319
Trade credit and advances	-28	185	-5,577	32,565
Other accounts payable	24	-114	5,114	-20,046
Special Drawing Rights (SDRs)	-	-	-	-
Reserve Assets	**337**	**-1,704**	**55,445**	**-322,229**
Monetary gold	-14	-667	-2,614	-123,485
Special Drawing Rights	6	-5	1,080	-825
Reserve position in the IMF	-	-	-	-
Other reserve assets	346	-1,032	56,979	-197,919
Currency and deposits	361	-177	59,518	-37,326
Securities	-19	-856	-3,039	-160,807
Net Errors and Omissions	**-640**	**795**	**-115,775**	**162,553**
Overall Balance (c)	**377**	**-2,328**	**62,296**	**-405,854**
As a Percentage of GDP				
Trade Balance	-9.5	-7.4		
Goods and Services	-6.1	-6.4		
Current Account	-2.2	-1.3		
Current and Capital Account	-2.2	-1.3		

(a) Revised
(b) Provisional
(c) Refer Table 5.11 for the derivation of overall balance

Source: Central Bank of Sri Lanka

Figure 5.1
External Sector Performance

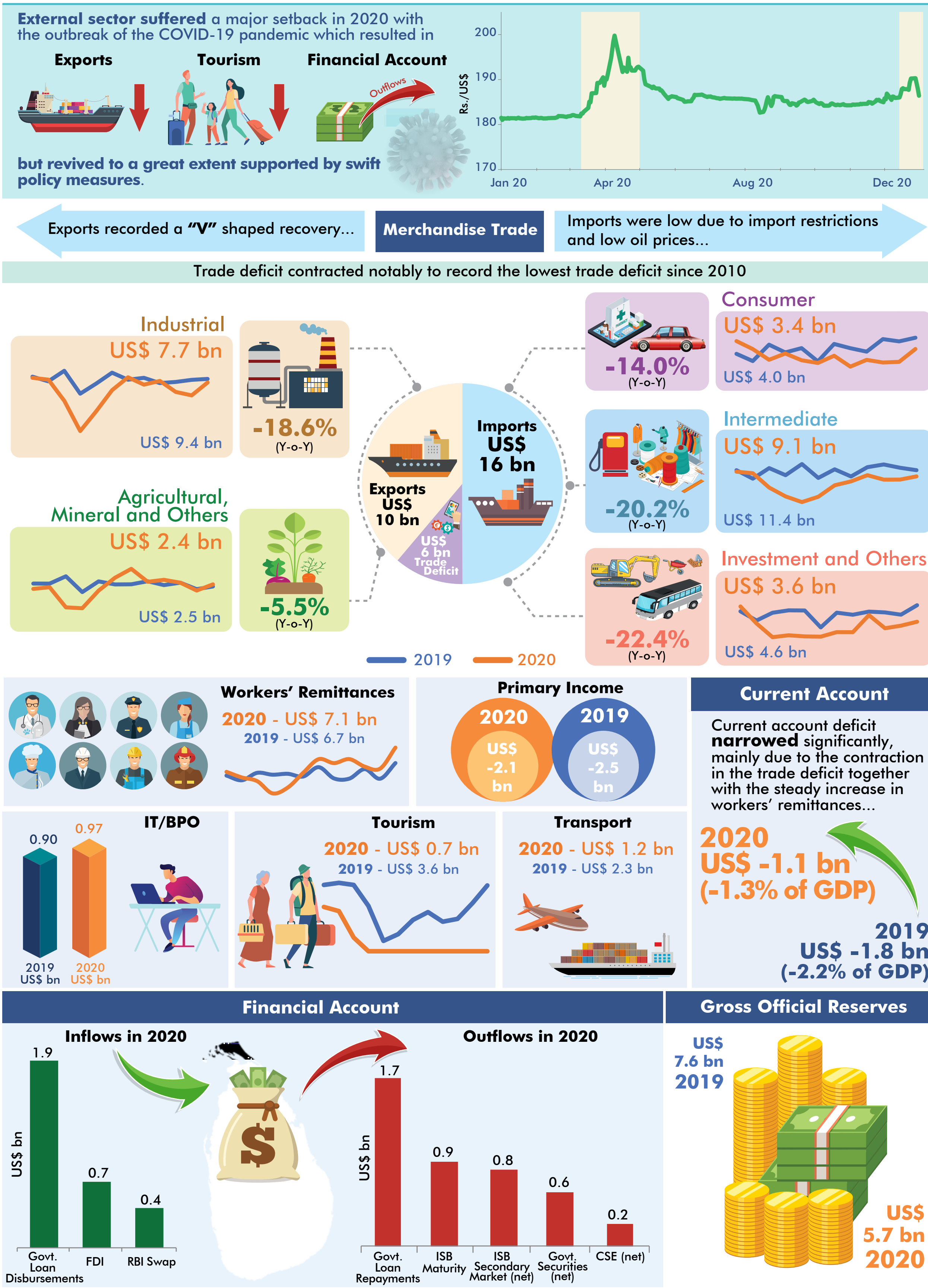

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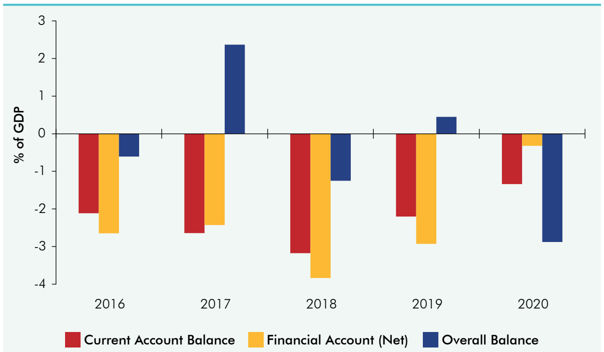
Figure 5.2
Balance of Payments



Source : Central Bank of Sri Lanka

5.2 Current Account Balance

The current account deficit narrowed notably in 2020, supported by the significantly reduced trade deficit, increased workers' remittances and relatively low primary income deficit, despite the notable reduction reported in the surplus of the services account. The trade deficit declined by around US dollars 2.0 billion in 2020, mainly due to reduced import expenditure following the restrictions imposed on the importation of non-essential goods as well as the eased crude oil prices. The surplus in the services account declined sharply as a result of the downturn in the tourism industry and disruptions to air and sea freight transport services, despite the increased inflows observed on account of information technology led business process outsourcing (IT/BPO) related services. The deficit in the primary income account contracted with the decline in interest and coupon payments on foreign investment in government securities and payments related to dividends and reinvested earnings of DIEs. Inflows to the secondary income account increased, with higher than expected workers' remittances, particularly in the second half of 2020. These developments led the external current account deficit to narrow to US dollars 1.1 billion in 2020, from US dollars 1.8 billion in 2019. As a percentage of GDP, the current account deficit was at 1.3 per cent in 2020, compared to 2.2 per cent in 2019.

Table 5.2
Current and Capital Account

US$ million

Item	2019 (a)			2020 (b)		
	Credit	Debit	Net	Credit	Debit	Net
Goods and Services	19,414	24,562	-5,148	13,083	18,271	-5,189
Goods	11,940	19,937	-7,997	10,047	16,055	-6,008
General merchandise	11,940	19,935	-7,995	10,047	16,047	-5,999
Non-monetary gold	-	3	-3	-	9	-9
Services	7,474	4,625	2,849	3,035	2,216	819
Transport	2,339	1,710	630	1,174	1,059	114
Sea transport	1,155	820	335	702	635	67
Freight	1,155	820	335	702	635	67
Air transport	1,184	889	295	472	424	48
Passenger	1,056	798	258	394	354	40
Freight	128	91	37	78	71	7
Travel (c)	3,607	1,638	1,969	682	449	234
Construction	67	35	32	7	10	-3
Insurance and pension services	137	102	36	39	82	-42
Financial services	213	470	-258	96	220	-125
Telecommunications and computer services	1,054	515	539	995	288	706
Telecommunications	155	135	21	24	32	-8
Computer services	899	380	519	971	257	714
Other business services	35	78	-43	16	37	-21
Government goods and services n.i.e.	21	77	-56	26	70	-44
Primary Income	252	2,713	-2,462	198	2,300	-2,101
Compensation of employees	31	130	-99	36	132	-96
Investment income	220	2,583	-2,363	162	2,167	-2,006
Direct investment	26	855	-828	17	619	-602
Dividends	14	595	-581	14	428	-414
Reinvested earnings	13	260	-247	3	191	-188
Portfolio investment	-	1,044	-1,044	-	932	-932
Equity	-	67	-67	-	18	-18
Interest	-	976	-976	-	914	-914
Short term	-	8	-8	-	2	-2
Long term	-	969	-969	-	911	-911
Other investment	97	685	-588	56	617	-560
Reserve assets	97	-	97	89	-	89
Secondary Income	6,726	960	5,766	7,117	910	6,207
General government	9	-	9	13	-	13
Workers' remittances	6,717	960	5,757	7,104	910	6,194
Current Account	26,392	28,236	-1,843	20,398	21,481	-1,083
Capital Account	51	28	23	51	23	28
Capital transfers	51	28	23	51	23	28
General government	16	-	16	24	-	24
Corporations and households	34	28	7	27	23	4
Current and Capital Account	26,443	28,263	-1,820	20,449	21,504	-1,055

(a) Revised
(b) Provisional
(c) Passenger services provided to non-residents are included in transport services.

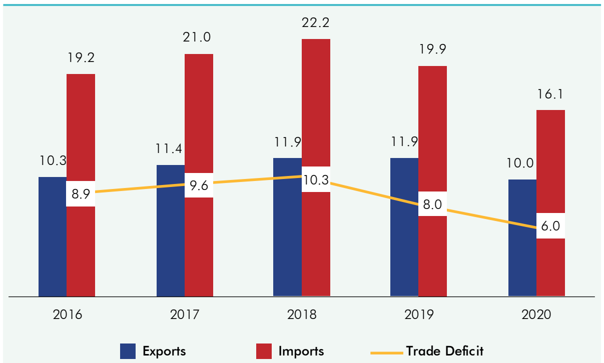
Source: Central Bank of Sri Lanka

5.2.1 Merchandise Trade Account

Trade Balance

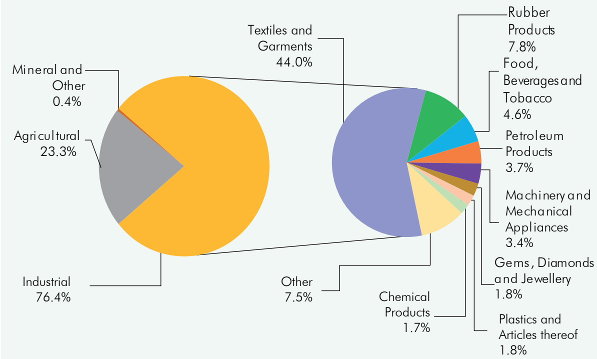
The deficit in the trade account contracted substantially to US dollars 6,008 million in 2020 from US dollars 7,997 million in 2019. This improvement in the trade account was a combined

Figure 5.3
Exports, Imports and Trade Deficit (US$ billion)



Sources : Sri Lanka Customs
Central Bank of Sri Lanka

Figure 5.4
Composition of Exports - 2020



Sources : Sri Lanka Customs
Central Bank of Sri Lanka

result of export earnings reaching the pre-pandemic levels sooner than expected following the COVID-19 pandemic-related setbacks, and import expenditure declining in response to the policy measures introduced to curtail non-essential imports along with relatively low global oil prices. As a result, the smallest trade deficit since 2010 was recorded in 2020. As a percentage of GDP, the trade deficit declined to 7.4 per cent in 2020, from 9.5 per cent in 2019.

Export and Import Performance, Terms of Trade and Direction of Trade

Export Performance

Earnings from merchandise exports were severely impacted during the months in which containment measures were more intense with the spread of the COVID-19 pandemic, but recovered towards the pre-pandemic levels faster than expected. Lockdowns and other public health restrictions enforced in Sri Lanka to combat the spread of COVID-19 negatively affected the production of exportable goods in 2020. Meanwhile, subdued external demand, disruptions to shipping and supply chains, issues in importing necessary inputs due to lockdown measures in foreign countries and adverse price movements also affected the overall export performance during the year. As a result, earnings from exports fell to US dollars 10,047 million in 2020, a 15.9 per cent decline compared to 2019. As a percentage of GDP, export earnings in 2020 declined to 12.4 per cent from 14.2 per cent in 2019. The largest year-on-year declines in exports were recorded in the months of March, April and May 2020, while considerable reductions were also recorded in June, October and November 2020 when COVID-19 related health restrictions were more intense. In July and September, export earnings were higher than the corresponding months in the previous year with a notable increase in the export of personal protective equipment (PPE). Compared to 2019, most of the industrial goods registered a decline in exports, while agricultural exports showed a mixed performance with notable increases in some products.

Industrial exports registered a broad-based decline in earnings, with an overall reduction of 18.6 per cent in 2020 compared to 2019. The export of textiles and garments, the single largest export of Sri Lanka, registered a decline in earnings of 21.0 per cent in 2020. Earnings from petroleum product exports declined due to a reduction in quantities supplied and prices in relation to bunker and aviation fuel. Disruption to maritime and aviation activities across the world contributed to this decline. However, the food, beverages and tobacco category recorded an increase in earnings mainly due to the export of value-added coconut products. Further, PPE, such as textile face masks, surgical and other gloves, and plastic clothing articles categorised under textiles and garments, rubber products and plastics and articles thereof, increased during 2020. Sri Lanka's exports of PPE related items increased to US dollars 942 million in 2020 compared to US dollars 693 million in 2019.

Agricultural exports registered a decline in earnings of 5.1 per cent in 2020 compared to 2019, due to weaker earnings from tea, seafood and unmanufactured tobacco, while earnings from spices, coconut, minor agricultural products, rubber and vegetables increased. Both volumes and unit values of tea exports weakened substantially during the first wave of the COVID-19 spread, but recovered to some extent later in the year. Agricultural exports such as cinnamon, pepper, dried vegetables, arecanuts, coconut oil and fibres and natural rubber registered increases in earnings during the year, mostly driven by higher volumes.

Earnings from mineral exports declined by 25.9 per cent in 2020 compared to 2019. Earnings from mineral exports remained low and made up only 0.2 per cent of total export earnings

Table 5.3
Composition of Exports

Category	2019		2020 (a)		Change in Value US$ million	Y-o-Y Change %	Contribution to Change %
	Value US$ million	Share %	Value US$ million	Share %			
Agricultural Exports	**2,461.9**	**20.6**	**2,336.2**	**23.3**	**-125.6**	**-5.1**	**6.6**
Tea	1,346.4	11.3	1,240.9	12.4	-105.5	-7.8	5.6
Coconut	329.5	2.8	345.2	3.4	15.7	4.8	-0.8
Spices	312.5	2.6	333.5	3.3	20.9	6.7	-1.1
Seafood	262.5	2.2	189.8	1.9	-72.6	-27.7	3.8
Minor Agricultural Products	120.0	1.0	134.7	1.3	14.6	12.2	-0.8
Vegetables	32.0	0.3	36.6	0.4	4.6	14.3	-0.2
Rubber	24.2	0.2	30.1	0.3	5.9	24.4	-0.3
Unmanufactured Tobacco	34.7	0.3	25.5	0.3	-9.2	-26.6	0.5
Industrial Exports	**9,426.3**	**78.9**	**7,672.0**	**76.4**	**-1,754.3**	**-18.6**	**92.7**
Textiles and Garments	5,596.5	46.9	4,423.1	44.0	-1,173.4	-21.0	62.0
Rubber Products	866.1	7.3	786.1	7.8	-80.0	-9.2	4.2
Food, Beverages and Tobacco	447.0	3.7	464.0	4.6	17.0	3.8	-0.9
Petroleum Products	521.1	4.4	373.6	3.7	-147.6	-28.3	7.8
Machinery and Mechanical Appliances	400.0	3.3	337.5	3.4	-62.5	-15.6	3.3
Gems, Diamonds and Jewellery	305.7	2.6	181.5	1.8	-124.3	-40.6	6.6
Transport Equipment	145.9	1.2	71.4	0.7	-74.5	-51.0	3.9
Leather, Travel Goods and Footwear	102.9	0.9	53.9	0.5	-48.9	-47.6	2.6
Printing Industry Products	48.3	0.4	47.9	0.5	-0.4	-0.8	0.02
Ceramic Products	30.1	0.3	24.0	0.2	-6.1	-20.2	0.3
Other Industrial Exports	962.8	8.1	909.0	9.0	-53.8	-5.6	2.8
Mineral Exports	**33.9**	**0.3**	**25.1**	**0.2**	**-8.8**	**-25.9**	**0.5**
Unclassified Exports	**17.9**	**0.2**	**14.1**	**0.1**	**-3.8**	**-21.4**	**0.2**
Total Exports (b) (c)	**11,940.0**	**100.0**	**10,047.4**	**100.0**	**-1,892.6**	**-15.9**	**100.0**
Annual Average Exchange Rate (d)	**178.78**		**185.52**				

(a) Provisional
(b) Excludes re-exports
(c) Adjusted for lags and other factors of recording
(d) Rupee/US dollar exchange rate

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

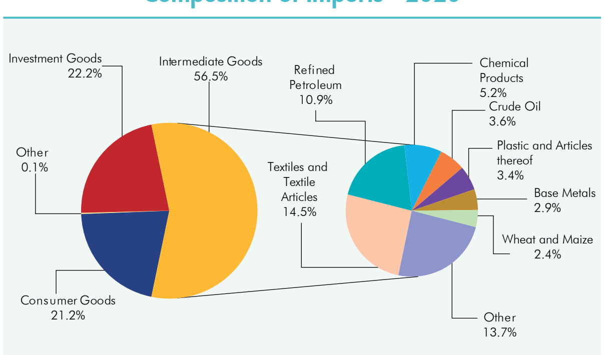
in 2020, although importing countries use these resources for high value-adding production activities. Recognising this, the Government aims to discourage the export of minerals in low value-added form and encourage the domestic production of goods with local minerals.

Import Performance

Expenditure on imports declined by 19.5 per cent to US dollars 16,055 million in 2020 compared to 2019, with declines in imports of intermediate goods, investment goods and non-food consumer goods. The overall decline in import expenditure was a result of restrictions imposed by the Government on the importation of non-essential goods, low oil prices in the global market, and the reduction in the importation of intermediate goods due to subdued economic activity in the country and disruptions to global supply chains.

Expenditure on intermediate goods declined by 20.2 per cent to US dollars 9,076 million in 2020. Expenditure on crude and refined petroleum, the largest import item among intermediate goods, declined to US dollars 2,325 million in 2020 from US dollars 3,677 million in 2019, mainly due to the decline in prices. Volumes imported of crude oil and refined petroleum also declined by 9.3 per cent and 15.0 per cent, respectively, in the year under review. Meanwhile, import volumes of coal increased by 8.8 per cent in 2020, with the average price per metric tonne declining to US dollars 83.60 from US dollars 89.79 in 2019, leading to an increase of 1.3 per cent in the import value of coal. Import expenditure on textiles and textile articles fell by 19.7 per cent in 2020 compared to 2019, due to the decline in the production volumes of garments as well as the difficulties in sourcing textiles when the global COVID-19 spread was acute. Among other intermediate goods, a broad-based decline in import expenditure was observed in 2020, though with increased expenditure on some items, such as wheat, fertiliser and agricultural inputs.

Figure 5.5
Composition of Imports - 2020



Sources : Sri Lanka Customs
Central Bank of Sri Lanka

Expenditure on investment goods declined by 22.6 per cent to US dollars 3,563 million in 2020. Declines in import expenditure in all three main categories of investment goods, i.e., machinery and equipment, building material and transport equipment, were observed in 2020 compared to 2019. Import restrictions as well as other effects of the pandemic on the global and local economy resulted in this outcome. Although import expenditure on almost all items under the abovementioned categories of investment goods declined during the year, increases were noted in machinery and equipment parts, machinery and mechanical appliances, turbines, agricultural tractors, agricultural machinery and computers.

Expenditure on non-food consumer goods registered a broad-based decline, except medical and pharmaceutical goods and telecommunication devices. Accordingly, the decline in the non-food consumer goods category was 27.0 per cent in 2020 compared to the previous year, with the largest contribution to the decline arising from motor vehicles for personal use. Import restrictions imposed by the

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Table 5.4
Composition of Imports

Category	2019 Value US$ million	2019 Share %	2020 (a) Value US$ million	2020 (a) Share %	Change in Value US$ million	Y-o-Y Change %	Contribution to Change %
Consumer Goods	**3,956.5**	**19.8**	**3,401.7**	**21.2**	**-554.9**	**-14.0**	**14.3**
Food and Beverages	1,426.9	7.2	1,554.4	9.7	127.5	8.9	-3.3
Rice	12.8	0.1	10.5	0.1	-2.3	-17.7	0.1
Sugar and Confectionery	201.2	1.0	277.1	1.7	75.9	37.7	-2.0
Dairy Products	311.9	1.6	333.8	2.1	21.9	7.0	-0.6
Lentils	79.9	0.4	96.9	0.6	17.0	21.3	-0.4
Other	821.2	4.1	836.0	5.2	14.9	1.8	-0.4
Non-Food Consumer Goods	2,529.6	12.7	1,847.3	11.5	-682.3	-27.0	17.6
Personal Vehicles	815.7	4.1	282.9	1.8	-532.8	-65.3	13.7
Medical and Pharmaceuticals	552.6	2.8	595.5	3.7	42.9	7.8	-1.1
Home Appliances	206.6	1.0	174.2	1.1	-32.4	-15.7	0.8
Clothing and Accessories	275.1	1.4	200.7	1.2	-74.5	-27.1	1.9
Other	679.6	3.4	594.0	3.7	-85.5	-12.6	2.2
Intermediate Goods	**11,369.6**	**57.0**	**9,076.5**	**56.5**	**-2,293.1**	**-20.2**	**59.1**
Fuel	3,891.6	19.5	2,542.6	15.8	-1,349.0	-34.7	34.8
Textiles and Textile Articles	2,909.4	14.6	2,335.1	14.5	-574.3	-19.7	14.8
Diamonds, Precious Stones and Metals	201.4	1.0	117.2	0.7	-84.2	-41.8	2.2
Chemical Products	831.5	4.2	831.5	5.2	0.03	0.004	-0.001
Wheat and Maize	346.4	1.7	384.4	2.4	38.0	11.0	-1.0
Fertiliser	221.4	1.1	258.9	1.6	37.5	16.9	-1.0
Other Intermediate Goods	2,967.9	14.9	2,606.8	16.2	-361.1	-12.2	9.3
Investment Goods	**4,602.6**	**23.1**	**3,563.2**	**22.2**	**-1,039.4**	**-22.6**	**26.8**
Machinery and Equipment	2,489.7	12.5	2,176.1	13.6	-313.6	-12.6	8.1
Building Materials	1,508.7	7.6	1,035.6	6.5	-473.1	-31.4	12.2
Transport Equipment	596.6	3.0	348.3	2.2	-248.3	-41.6	6.4
Other Investment Goods	7.6	0.04	3.2	0.02	-4.4	-57.8	0.1
Unclassified Imports	**8.3**	**0.04**	**14.0**	**0.1**	**5.7**	**68.8**	**-0.1**
Total Imports (b)(c)	**19,937.1**	**100.0**	**16,055.4**	**100.0**	**-3,881.7**	**-19.5**	**100.0**
Annual Average Exchange Rate (d)	**178.78**		**185.52**				

(a) Provisional
(b) Excludes re-imports
(c) Adjusted for lags and other factors of recording
(d) Rupee/US dollar exchange rate

Sources: Ceylon Petroleum Corporation
Lanka IOC PLC
Sri Lanka Customs
Central Bank of Sri Lanka

Government on non-essential imports during the year, together with other factors mentioned above resulted in the decline in expenditure on most of the non-food consumer goods.

Sri Lanka's food and beverages import bill stood at US dollars 1,554 million in 2020, with an increase of 8.9 per cent over the previous year. The three categories that recorded the largest increase in value were; oils and fats (due to the increase in the import of coconut oil); sugar (mainly in the second half of the year); and dairy products (due to the increase in import expenditure on milk powder). Coconut oil, though classified as a consumer good, is also used as an intermediate good. Meanwhile, expenditure on vegetable imports increased during the year, mainly due to increases recorded in relation to lentils, garlic and other onions, chickpeas and potatoes. Expenditure on spices increased, mainly because of expenditure on chillies, coriander seeds, cumin, fennel seeds and vanilla, while expenditure on turmeric and pepper declined. Import expenditure on seafood and beverages also declined substantially.

Terms of Trade

Terms of trade, which depict Sri Lanka's export prices in terms of import prices, improved in 2020. Terms of trade stood at 106.5 index points in 2020, having improved by 2.5 per

Table 5.5
Volume of Major Imports

MT '000

Item	2016	2017	2018	2019	2020 (a)
Refined Petroleum (b)	3,885	4,895	4,959	4,740	4,028
1st Quarter	830	1,275	1,382	1,199	1,249
2nd Quarter	1,163	1,123	1,207	1,206	678
3rd Quarter	749	1,336	1,317	1,211	1,123
4th Quarter	1,142	1,161	1,054	1,124	978
Crude Oil (b)	1,685	1,591	1,674	1,842	1,667
1st Quarter	372	282	283	461	464
2nd Quarter	456	376	459	460	265
3rd Quarter	384	464	461	461	568
4th Quarter	473	469	471	460	370
Wheat	948	1,250	1,297	1,159	1,404
1st Quarter	171	291	412	164	272
2nd Quarter	326	334	329	318	285
3rd Quarter	271	359	285	292	498
4th Quarter	179	265	271	385	348
Fertiliser	527	399	861	707	952
1st Quarter	139	78	256	148	88
2nd Quarter	135	73	154	142	294
3rd Quarter	126	129	225	238	126
4th Quarter	127	119	226	179	444
Sugar	651	498	645	556	683
1st Quarter	147	108	205	140	193
2nd Quarter	144	158	166	153	108
3rd Quarter	179	101	119	100	209
4th Quarter	181	132	154	164	172
Rice	30	748	249	24	16
1st Quarter	6	259	203	8	8
2nd Quarter	9	79	37	3	2
3rd Quarter	6	160	2	5	2
4th Quarter	8	250	7	8	4

(a) Provisional
(b) Adjusted

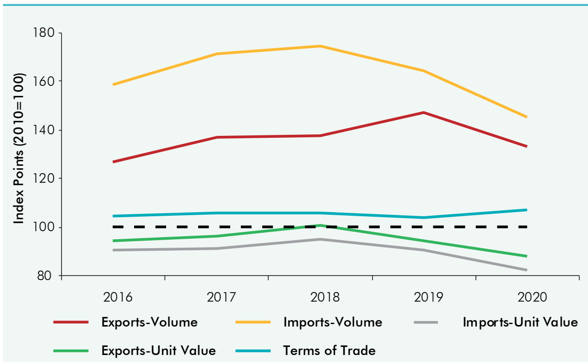
Sources: Ceylon Petroleum Corporation
Lanka IOC PLC
Sri Lanka Customs
Central Bank of Sri Lanka

cent from the 103.9 points recorded in 2019. This improvement was a result of the import price index falling by 8.2 index points or 9.1 per cent (driven to a large extent by the reduction in crude oil and refined petroleum prices, among others), and the export price index falling by 6.4 index points or 6.8 per cent during the year.

The overall export price index declined in 2020 due to the decline in the price index for industrial exports, despite the improvement in the price index for agricultural exports. The price index of industrial exports declined by 8.6 index points or 9.4 per cent during the year, mainly due to the decline in the price index for petroleum exports (bunkering, aviation fuel and other petroleum products), which was a result of lower global oil prices in 2020 compared to 2019. In addition, price indices relating to base metals and articles; transport equipment; wood and paper products; leather, travel goods and footwear; ceramic products; and animal fodder were among the other exports that recorded a decline during the year. A few key exports marked modest increases in 2020, such as textiles and apparel; gems, diamonds and jewellery; and food, beverages and tobacco. The price index for agricultural exports increased by 2.7 index points or 2.5 per cent in 2020, driven by increases in the price indices for tea, coconut, spices, seafood and minor agricultural products. However, price indices for unmanufactured tobacco and vegetables decreased during the year. Meanwhile, the price index for mineral exports increased by 8.7 index points or 6.1 per cent in 2020.

The overall import price index declined in 2020 with price indices for intermediate, investment and consumer goods declining. The import price index of intermediate goods declined by 10.1 index points or 11.1 per cent, due to declines in prices recorded in most of the subcategories, including fuel, fertiliser, plastic and articles thereof and chemical products during the year. However, the price indices of wheat and maize; diamonds, precious stones and metals; and food preparations

Figure 5.6
Terms of Trade and Trade Indices



Source : Central Bank of Sri Lanka

Table 5.6
Trade Indices (a)

2010 = 100

Category	Value Index			Volume Index			Unit Value Index		
	2019	2020 (b)	Y-o-Y Change %	2019	2020 (b)	Y-o-Y Change %	2019	2020 (b)	Y-o-Y Change %
EXPORTS									
Agricultural Exports	**106.8**	**101.3**	**-5.1**	**97.7**	**90.5**	**-7.4**	**109.3**	**112.0**	**2.5**
Tea	93.5	86.2	-7.8	88.8	80.7	-9.2	105.3	106.8	1.5
Rubber	14.0	17.4	24.4	24.0	29.4	22.7	58.3	59.1	1.4
Coconut	198.9	208.4	4.8	177.6	168.0	-5.4	112.0	124.0	10.7
Spices	150.9	161.0	6.7	115.0	114.5	-0.4	131.2	140.6	7.1
Minor Agricultural Products	168.1	188.6	12.2	163.0	173.1	6.2	103.1	108.9	5.6
Industrial Exports	**154.7**	**125.9**	**-18.6**	**170.8**	**153.5**	**-10.1**	**90.6**	**82.1**	**-9.4**
Textiles and Garments	166.9	131.9	-21.0	143.2	111.5	-22.1	116.6	118.3	1.5
Petroleum Products	198.0	141.9	-28.3	246.7	238.5	-3.3	80.3	59.5	-25.9
Rubber Products	155.6	141.2	-9.2	109.4	100.0	-8.7	142.2	141.3	-0.6
Mineral Exports	**139.9**	**103.6**	**-25.9**	**98.2**	**68.6**	**-30.2**	**142.4**	**151.2**	**6.1**
Total Exports	**138.5**	**116.5**	**-15.9**	**147.2**	**132.9**	**-9.7**	**94.1**	**87.7**	**-6.8**
IMPORTS									
Consumer Goods	**159.9**	**137.5**	**-14.0**	**145.4**	**128.0**	**-12.0**	**110.0**	**107.4**	**-2.3**
Food and Beverages	107.9	117.5	8.9	120.5	127.4	5.7	89.5	92.2	3.0
Non-Food Consumer Goods	219.7	160.4	-27.0	174.0	128.7	-26.0	126.3	124.7	-1.3
Intermediate Goods	**141.3**	**112.8**	**-20.2**	**156.0**	**140.2**	**-10.2**	**90.5**	**80.5**	**-11.1**
Fuel	128.0	83.6	-34.7	151.8	133.1	-12.3	84.3	62.8	-25.5
Fertiliser	92.2	107.8	16.9	119.5	160.2	34.1	77.1	67.3	-12.8
Chemical Products	159.9	159.9	0.004	155.7	157.9	1.4	102.7	101.3	-1.4
Wheat and Maize	130.5	144.8	11.0	127.5	138.9	8.9	102.3	104.3	1.9
Textiles and Textile Articles	160.8	129.1	-19.7	153.9	126.8	-17.6	104.5	101.8	-2.6
Plastics and Articles thereof	144.9	127.7	-11.9	158.5	148.9	-6.1	91.4	85.8	-6.2
Diamonds, Precious Stones and Metals	53.3	31.0	-41.8	66.5	36.5	-45.1	80.2	85.1	6.0
Investment Goods	**167.1**	**129.3**	**-22.6**	**211.5**	**183.4**	**-13.3**	**79.0**	**70.5**	**-10.7**
Building Materials	183.6	126.0	-31.4	215.1	147.7	-31.4	85.3	85.4	0.01
Transport Equipment	100.7	58.8	-41.6	93.7	50.4	-46.2	107.5	116.6	8.5
Machinery and Equipment	186.1	162.7	-12.6	261.5	264.5	1.1	71.2	61.5	-13.6
Total Imports	**148.7**	**119.7**	**-19.5**	**164.2**	**145.5**	**-11.4**	**90.5**	**82.3**	**-9.1**
Terms of Trade							**103.9**	**106.5**	**2.5**

(a) In terms of US dollars
(b) Provisional

Source : Central Bank of Sri Lanka

increased in 2020. The price index of investment goods declined by 8.5 index points or 10.7 per cent in 2020 mainly due to the decline in prices of machinery and equipment. However, the price index of transport equipment increased. The import price index of consumer goods declined by 2.6 index points or 2.3 per cent during the period under review due to a decline in the price index for non-food consumer goods, which surpassed the increase in the food and beverages price index. Within the non-food consumer goods category, almost all subcategories recorded declines in price indices in 2020 except household and furniture items and telecommunication devices. Meanwhile, the price index of food and beverages increased by 2.7 index points or 3.0 per cent during the year, with most of the indices for subcategories increasing, including spices; sugar and confectionery; vegetables, oils and fats; and seafood. However, the import price index for beverages declined during the year.

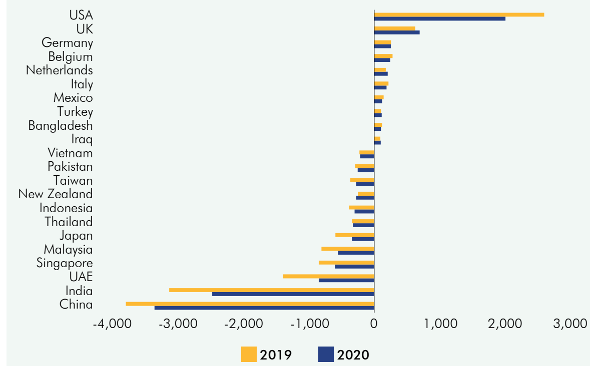
The reduction in trade volumes drove down both export earnings and import expenditure to a considerable extent in 2020. The export volume indices for all three main categories of exports i.e., industrial, agricultural and mineral exports, declined during the year, while import volume indices for all three main categories of imports i.e., consumer, intermediate and investment goods, declined as well.

Direction of Trade

Sri Lanka's major trading partners broadly remained unchanged from the previous year, despite the significant decline in both exports and imports and the disruptions caused to the supply chains across the world during 2020. In value terms, China surpassed India as the major trading partner of Sri Lanka in 2020, followed by the USA, and these three countries contributed around 40 per cent of the total trade (both exports and imports) of Sri Lanka. Total trade with China, India and USA, which was at US dollars 12.6 billion in 2019, declined to US dollars 10.5 billion during the period under consideration driven by the impact of the pandemic. Total trade with most of the other top trading partners also declined during 2020, while total trade with some smaller trading partners, such as Oman, Kuwait and South Africa, improved. Considering the countrywise trade balances in 2020, notable trade surpluses were recorded with countries such as the USA (US dollars 2 billion), the UK (US dollars 698 million), Germany (US dollars 254 million), as well as Belgium, Netherlands and Italy. Sri Lanka recorded significant trade deficits with Asian countries such as China (US dollars 3.4 billion), India (US dollars 2.5 billion), the UAE (US dollars 845 million), followed by Singapore, Malaysia and Japan. This shows the requirement of focused measures on increasing export earnings and reducing import expenditure from the countries in the Asian region to improve the trade balances with them.

The USA and European countries continued to be major destinations for Sri Lankan exports in 2020. The USA remained the single largest buyer of Sri Lankan exports with more than US dollars 2.5 billion worth of exports in 2020, which accounted for 24.9 per cent of total exports, followed by the UK (9.0 per cent), India (6.0 per cent), Germany (5.7 per cent) and Italy (4.5 per cent). In line with

Figure 5.7
Countrywise Trade Balances (US$ million)

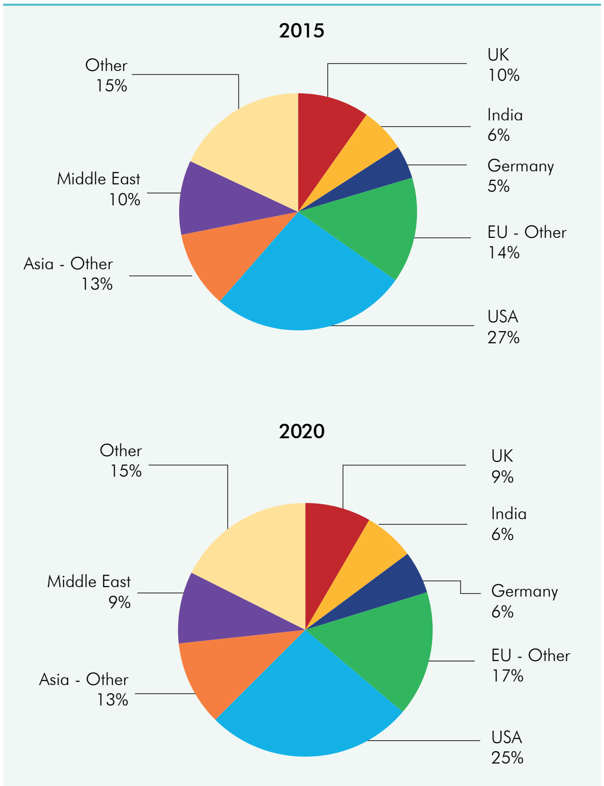


Source : Central Bank of Sri Lanka

the decline in total export earnings, exports related to most destinations, including the top ten export destinations of Sri Lanka, declined during 2020. However, export earnings from several smaller export destinations recorded marginal increases during the year. Export earnings from the USA were mainly on account of garments, rubber products, made up textile articles (such as face masks), food, beverages and tobacco, and spices. Despite recording a decline of about US dollars 700 million compared to 2019, the USA continued to be the single largest garment export destination for Sri Lanka, accounting for about 42 per cent of total garment exports in 2020. Exports to the UK in 2020 mainly consisted of garments (about 14 per cent of total garment exports), plastics and articles thereof (such as plastic clothing articles), made up textile articles, rubber products, and food, beverages and tobacco. Exports to India included animal fodder, spices, textiles, petroleum products, and minor agricultural products. Meanwhile, exports to Germany and Italy were dominated by garments, rubber products, food, beverages and tobacco, tea, and seafood. Exports to the EU (including the UK), the most dominant region for Sri Lankan exports, accounted for about 32 per cent of total exports in 2020, and consisted mainly of garments (about 44 per cent of total garment exports). Other major items exported to the EU were rubber products, food, beverages and tobacco, tea, plastics and articles thereof and seafood, most of which were exported under the EU Generalised System of Preferences (GSP) + Scheme. In 2020, the Middle East and the Commonwealth of Independent States (CIS) led by Russia were the main export destinations for tea, contributing about 60 per cent of total tea exports of the country. Taken together, the USA and the EU accounted for about 57 per cent of the total export earnings of Sri Lanka in 2020, reflecting the lack of market diversity of the export sector of Sri Lanka.

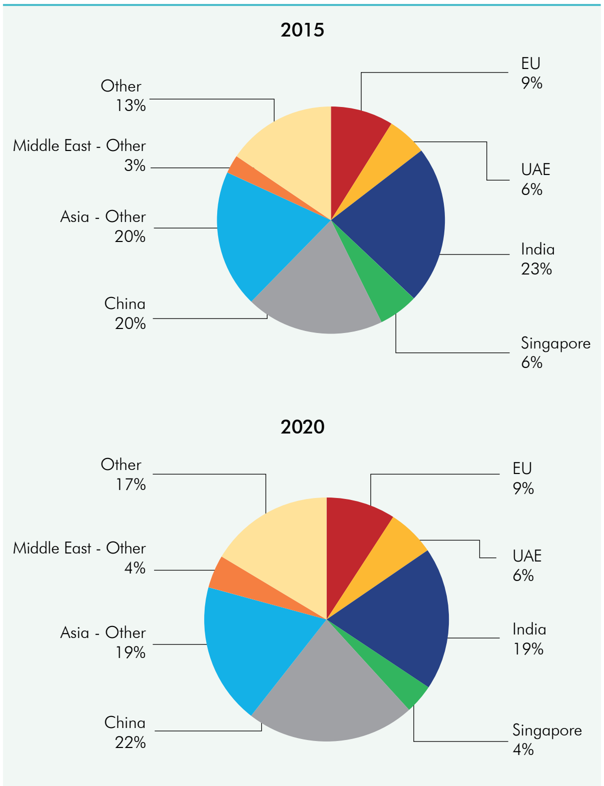
Countries in the Asian region continued to be the major sources for Sri Lankan imports in 2020. China continued to be the main source of imports for the second consecutive year, recording more than US dollars 3.5 billion of imports in 2020, with a share of about 22 per cent of total imports. This was followed by India (19.2 per cent), the UAE (6.4 per cent), Singapore (4.3 per cent) and Malaysia (3.8 per cent). In line with the decline in total import expenditure during 2020, expenditure related to most import sources, including the top ten import sources of Sri Lanka, recorded a decline. Expenditure on most major import items from China, such as textiles and textile articles, machinery and equipment, building material, and chemical products, declined in 2020, although expenditure on telecommunication devices (such as mobile phones) increased. Similarly, expenditure on textiles and textile articles; building materials; and machinery and equipment imports from India declined, although expenditure on medical and pharmaceuticals; and sugar and confectionery increased. The major import item from the UAE, Singapore and Malaysia was petroleum in 2020.

Figure 5.8
Exports by Destination



Source : Sri Lanka Customs

Figure 5.9
Imports by Origin



Source : Sri Lanka Customs

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Other major import items from the UAE were base metals, seafood and mineral products, while machinery and equipment, chemical products, plastics and articles thereof were among the other top imported items from Singapore. Food preparations (such as palm oil), chemical products, machinery and equipment, building material and oils and fats (such as coconut oil) were the other major import items from Malaysia. Japan, as an import source, declined to the 6th position in 2020 from the 5th position in 2019, mainly due to lower vehicle imports resulting from import restrictions that were in place.

External Trade Policies, Developments and Institutional Support

The COVID-19 pandemic resulted in an unprecedented disruption to the global economy and world trade, prompting the Government to take several measures to mitigate its adverse effects. While taking urgent mitigation measures, the Government focused on a trade policy that supports domestic producers through the development of import alternatives and export promotion. The Government established a Tariff Determination Committee (TDC) in April 2020, consisting of major stakeholders related to international trade, mandated to design a trade and tariff policy in line with the priorities identified in the policy framework of the Government. The extreme economic conditions in the first half of 2020 led to the adoption of unprecedented measures, including import controls by the Government and the Central Bank. Imposing restrictions on the importation of non-essential goods as a temporary measure helped ease the pressure on the exchange rate and the BOP of the country to a great extent. The reduction in expenditure on items subject to import restrictions accounted for about 36 per cent (approximately US dollars 1.3 billion) of the decline in overall import expenditure during the period from April to December 2020 when compared with the corresponding period of 2019. The Export Development Council of Ministers meeting was chaired by His Excellency the President in September 2020 after a lapse of 28 years. In 2021, the Presidential Task Force on Economic Revival and Poverty Alleviation focused its attention on encouraging export earnings and other non-debt inflows of foreign exchange through a combined effort of relevant stakeholders to align their activities in a streamlined and targeted manner.

Several measures were taken to improve the institutional support to the external sector during 2020. The Export Development Board (EDB) continued the implementation of the National Export Strategy (NES) 2018-2022, while paying special attention to revive export sectors impacted by COVID-19. Meanwhile, the EDB continued market development programmes through online methods during the pandemic period. The trade chambers also contributed towards export promotion, which helped link the public and private sector stakeholders in policymaking and grievance handling. Formulation and upgrade of national standards helped local manufacturers to compete with foreign products. Accordingly, to improve national standards to be in line with international standards, the Sri Lanka Standards Institution published 327 standards by end 2020. On the implementation of the World Trade Organisation's (WTO) Trade Facilitation Agreement (TFA), the Sri Lanka Customs (SLC) streamlined its activities further. Accordingly, the SLC is revamping the system based post clearance audit, which allows the SLC to further simplify customs procedures and minimise cost of facilitation, while maintaining internal controls. Modifications were done on the Automated System for Customs Data (ASYCUDA) system to handle scanned images of Customs Declarations, which became useful to continue work without interruptions at ports during COVID-19 related lockdowns. Meanwhile, a committee has been appointed to analyse and advise on modernising the SLC and a Presidential Commission of Inquiry was appointed in February 2021 to investigate and report on matters related to the SLC with a view to improve processes and prevent revenue leakages.

Sri Lanka's exports under trade agreements declined in 2020 in line with the decline in overall earnings from exports. During the period under review, interactions with the main trading partners, namely, the EU and the USA, under GSP schemes were expected to pave the way for increased market opportunities. Sri Lanka is expected to benefit from the current EU GSP+ scheme till its validity period ends in 2023, after Sri Lanka was reclassified as a lower middle income country in July 2020. The US GSP scheme expired on 31 December 2020 and is expected to be re-authorised as per the general practice of the US Government. The GSP scheme offered by Japan, which expired on 31 March 2021, is currently undergoing a review process. In addition, Sri Lanka continued to benefit from GSP schemes offered by several other countries, such as the Russian Federation, Turkey, Australia, Canada, Switzerland, Norway and New Zealand, although their contribution to exports remained relatively low. The UK's Global Tariffs (UKGT), which is a separate tariff system

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Table 5.7
Exports under Preferential Trade Agreements of Sri Lanka

Preferential Agreement	2019 Value (US$ million)	2020 (a) Value (US$ million)	2020 (a) Growth (%)	2020 (a) Share (%)	Major Export Products (Ordered by size of export)
Generalised System of Preferences (GSP)	4,020.0	3,671.8	-8.7	83.1	Garments, Rubber products, Tea, Plastics and articles thereof, Food beverages & tobacco, Seafood
o/w EU (including GSP+) (b)	2,766.3	2,597.9	-6.1	58.8	Garments, Rubber products, Tea, Plastics and articles thereof, Food beverages & tobacco, Seafood
USA	709.4	585.7	-17.4	13.2	Garments, Rubber products, Food beverages & tobacco, Spices, Chemical products
Russian Federation (c)	150.3	142.2	-5.4	3.2	Tea, Rubber products, Garments, Coconut non-kernel products, Chemical products
Turkey	85.3	80.3	-5.9	1.8	Tea, Rubber products, Chemical products, Garments, Textiles
Australia	89.7	79.2	-11.8	1.8	Garments, Rubber products, Food beverages & tobacco, Tea, Coconut kernel products
Japan	84.9	71.0	-16.4	1.6	Tea, Coconut non-kernel products, Food beverages & tobacco, Rubber products, Chemical products
Canada	73.5	61.0	-17.0	1.4	Rubber products, Coconut kernel / non-kernel products, Garments, Food beverages & tobacco, Tea
Other GSP	60.6	54.6	-9.9	1.2	
India-Sri Lanka Free Trade Agreement (ISFTA) Implemented in 2000	489.6	358.4	-26.8	8.1	Animal fodder, Minor agricultural exports, Food beverages & tobacco, Spices, Wood and paper products
Asia-Pacific Trade Agreement (APTA) implemented in 1975 (d)	179.3	204.7	14.2	4.6	Garments, Tea, Coconut non-kernel products, Chemical products, Rubber products
Global System of Trade Preferences (GSTP) Implemented in 1989	80.5	89.5	11.2	2.0	Spices, Base metals and articles, Coconut kernel / non-kernel products, Rubber products, Animal fodder
Pakistan-Sri Lanka Free Trade Agreement (PSFTA) Implemented in 2005	60.8	53.0	-12.8	1.2	Minor agricultural exports, Natural rubber, Coconut kernel products, Wood and paper products, Rubber products
South Asian Free Trade Area (SAFTA) Implemented in 2006	55.9	42.2	-24.4	1.0	Spices, Coconut kernel products, Base metals and articles, Textiles, Wood and paper products
South Asian Preferential Trading Arrangement (SAPTA) implemented in 1995	1.7	0.8	-55.6	0.02	Rubber products, Chemical products, Textiles, Coconut kernel products
Total Exports under Preferential Agreements	**4,887.8**	**4,420.4**	**-9.6**	**100.0**	
As a Share of Sri Lanka's Total Exports	**40.9**	**44.0**			

(a) Provisional
(b) The EU-GSP provides preferential access for 66 per cent of the tariff lines on imported goods to the EU, while the EU-GSP+ provides zero duty access to the same tariff lines on imported goods to the EU. Includes the UK.
(c) Includes Russia, Belarus and Kazakhstan
(d) Earlier known as the Bangkok Agreement (1975)

Sources: Department of Commerce
Sri Lanka Customs

from the EU, came into effect on 01 January 2021. However, export of EU GSP+ eligible Sri Lankan products to the UK will continue to enjoy duty free access, as long as Sri Lanka continues to benefit from duty free market access under the EU GSP+ scheme. Under bilateral Free Trade Agreements (FTAs), the Indo-Sri Lanka Free Trade Agreement (ISFTA) and the Pakistan-Sri Lanka Free Trade Agreement (PSFTA) continued to benefit Sri Lanka, although exports under these FTAs declined in 2020. However, exports through FTAs with India and Pakistan remained high in 2020 as a share of total exports to these countries at 59 per cent and 71 per cent, respectively. Meanwhile, imports under the ISFTA and the PSFTA continued to be low during the year, with shares of only 5.2 per cent (US dollars 159 million) and 3.3 per cent (US dollars 11 million) of total imports from India and Pakistan, respectively. Under regional trade agreements, exports under the Asia Pacific Trade Agreement-APTA (due to higher exports to China, South Korea and Bangladesh) and Global System of Trade Preferences-GSTP (due to higher cinnamon exports to Peru) improved during 2020. However, exports under the SAARC Preferential Trading Arrangement (SAPTA) and the South Asian Free Trade Area (SAFTA), continued to remain at low levels during 2020, requiring engagement with regional preferential trade agreements to be further strengthened given the importance of enhancing cooperation among regional trade and services networks. Lack of product diversification, ad hoc policy changes and non-tariff barriers, such as procedural delays, continue to hinder the full potential of bilateral and regional trade agreements. In 2020, the Department of Commerce (DOC) took several steps to address the issues of the possible misuse of FTA concessions through re-routing of third country origin products under FTAs. Sri Lanka's multilateral trade engagement with the WTO continued in 2020 although the 12th Ministerial Conference, which was scheduled to be held in June 2020, was postponed due to the COVID-19 pandemic until June 2021.

Opinions of stakeholders about the desirability of FTAs vary significantly, but there is widespread recognition that conditions therein should not be harmful to local industries and enterprises. Official bilateral negotiation rounds on proposed partnership agreements with China, India and Thailand have shown little progress since 2018. Several scheduled meetings on bilateral and regional agreements were postponed during 2020 due to the disruptions caused by the pandemic, while some meetings were held virtually. In addition, in response to concerns raised by several stakeholders over the Singapore-Sri Lanka Free Trade Agreement (SSLFTA), a review process was carried out during 2018/19, through which recommendations for amendments to the existing FTA, had been provided. Accordingly, as per approval granted by the Cabinet of Ministers in January 2021, a technical support committee was formulated to carry out proposed amendments and to conduct negotiations with Singapore. Meanwhile, varied views have been expressed by stakeholders on the potential costs and benefits of comprehensive agreements with major trading partners of Sri Lanka, including India and China. Such views highlight the requirement of consulting all relevant stakeholders and arrive at a broad consensus in national interest, prior to commencing negotiations with the foreign counterparts, in order to reap desired benefits to Sri Lanka through trade negotiations. Such consensus should be embodied in the national trade policy of the country that is being formulated, in order to drive future actions on FTAs.

5.2.2 Services Account

The surplus in the services account recorded a notable decline in 2020 owing to the effects of the COVID-19 pandemic. The surplus in the services account reduced by US dollars 2.0 billion in 2020 with the shrinkage in earnings from tourism and transport services.

Travel and Tourism

Earnings from tourism recorded a sharp decline in 2020, with the suspension of all passenger flights and ship arrivals from 18 March 2020 together with the issuance of tourist visas. During the year, the total number of tourist arrivals was limited to 507,704, which comprised 507,311 tourists that arrived during the first three months of 2020, and a group of 393 tourists from Ukraine, who arrived under a pilot project based on the 'bio bubbles' concept in December 2020. Accordingly, tourist arrivals recorded a decline of 73.5 per cent compared to the previous year. Earnings from tourism in 2020, which are estimated based on tourist arrivals, recorded a decline of 81.1 per cent to US dollars 682 million.

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Several measures were taken by the Government and the Central Bank to support the stakeholders in the tourism sector who were affected by the COVID-19 pandemic, including measures to extend relief granted following the Easter Sunday attacks in 2019. The debt moratoria granted by Licensed Banks, Licensed Finance Companies and Specialised Leasing Companies at the request of the Central Bank on account of the Easter Sunday attacks, which were initially effective until 31 March 2020, were extended until 31 March 2021 in view of the adverse effects on the sector from the pandemic. These moratoria were extended again by another six months from 01 April 2021. Moratoria on lease rentals of tourism related vehicles were also provided and extended in tandem with the debt moratoria. Furthermore, businesses and individuals involved in the sector were able to avail loans under the 4.00 per cent Saubagya COVID-19 Renaissance Facility implemented by the Central Bank, which helped a range of tourism sector entities to manage their liquidity, solvency and maintain employment opportunities. The Government also provided a host of relief measures to various parties involved in the sector. The Government allowed the tourism sector to operate quarantine centres and implemented health and safety standards and checks, which helped the tourism sector to some extent during this period. A grace period to pay electricity bills was provided such that bills accrued from 01 March 2020 to 28 February 2021 can be paid on an instalment basis from 01 April 2021. Measures carried out through the SLTDA during the year included one off payments to tour guides and tourist drivers registered with the SLTDA; waivers on the annual renewal fee for the accommodation sector, travel agents, tour guides and tourist drivers for 2020; and provisional registration to support the informal sector within the industry. VAT exemptions provided in December 2019 for hotels, guest houses, restaurants or other similar businesses registered with the SLTDA, and in April 2020 for services of inbound tours by travel agents registered with the SLTDA, also helped the sector.

Sri Lanka was able to open up the country for tourists in January 2021 due to extensive measures undertaken by the Government together with the private sector to implement novel methods to welcome tourists while ensuring the safety of the local community. Following the issuance of tourism safety protocols by the Ministry of Tourism with the help of the

Ministry of Health and the World Health Organisation (WHO), Sri Lanka was able to obtain the "Safe Travel Stamp" from the World Travel and Tourism Council in August 2020. An independent auditing firm was appointed to conduct detailed audits for the "Safe and Secure" certification, which includes a QR code allowing tourists to provide feedback on health and safety protocols followed by hotels. The costs related to such audits are borne by the SLTDA. Supporting this initiative, the first "Sri Lanka Tourism Travel App Mobile Version 0" is being developed with the support of the Information and Communication Technology Agency (ICTA), and the United Nations Development Programme (UNDP). This application, which will share some links with the Electronic and Travel Authorisation (ETA) web portal of the Department of Immigration and Emigration, will be used to provide travel information for tourists while maintaining information on adherence to health protocols. In this background, the Government piloted a programme to welcome tourists under the 'bio bubble' concept in December 2020. Under this concept, tourists must stay in approved hotels and visit tourist sites on approved days and times in regulated transport. Thus, contact with the local community is curtailed, while tourists do not have to undergo conventional quarantine requirements of staying in one building/ place for 14 days. Apart from the 393 tourists who

Figure 5.10
Tourist Arrivals and Earnings from Tourism

Source : Sri Lanka Tourism Development Authority

visited Sri Lanka under the pilot programme for bio bubbles in 2020, a further 9,629 tourists visited Sri Lanka under bio bubbles in the first three months of 2021. Meanwhile, the SLTDA granted approval for 29 projects worth US dollars 118 million during 2020, which are mainly related to the construction of tourism facilities. Further, efforts were made to develop lesser known attractions with the support of respective Provincial Councils, and to expand and develop existing tourist destinations and attractions. The 'national sustainable destination certification' was initiated with the destinations proposed by Provincial Councils for all nine Provinces. With these planned tourism revival strategies adopted by Sri Lankan authorities together with the private sector, earnings from tourism are expected to gradually normalise in 2021, and pick up substantially thereafter as the vaccination programmes worldwide subside the pandemic fear.

Transport, Telecommunications, Computer and Information Services and Other Services

In 2020, computer and information services subsector was a key contributor to earnings from services, while earnings from the transport sector declined substantially with the disruptions to global logistical networks. With IT/BPO services increasing notably in 2020, particularly after the initial pandemic period, the computer services subsector recorded higher inflows during the year. There was a notable decline in container handling as well as some moderation in transshipment carried out in the Colombo and Hambantota Ports, due to supply chain disruptions and restrictions on non-essential imports, especially motor vehicles. In line with the cessation of tourist arrivals with the pandemic, there was a substantial reduction in earnings from air passenger services. Passenger services outflows also reduced due to limited operations of non-resident airlines due to the pandemic. Most of the other subsectors, including insurance, financial services, construction services and other business services recorded declines in both inflows and outflows in 2020 due to low economic activity globally. With these developments, the surplus in the services account contracted substantially to US dollars 819 million in 2020, compared to US dollars 2,849 million in 2019.

5.2.3 Primary Income

The deficit in the primary income account, which has continuously increased over the past decade, recorded a notable contraction in 2020. This contraction was mainly a result of the significant decline in interest and coupon payments on foreign investment in government securities and the reduction in dividend payments and reinvested earnings of DIEs. There was a notable reduction in coupon and interest payments as the outstanding amount of Treasury bills and Treasury bonds owned by non-residents declined drastically during the year. With the significant increase in the purchases of ISBs in the secondary market by resident banks and other financial institutions, during the year, the coupon payments on ISBs paid to non-residents in 2020 increased only marginally compared to the previous year. Further, interest payments on foreign loans of the Government, increased with the increase in outstanding foreign loans of the Government during the year, whereas interest payments on foreign loans by the private sector, state owned business enterprises and Board of Investment (BOI) companies declined during the year. The combined effect of these developments resulted in an overall decrease in interest payments on foreign loans in 2020 compared to the previous year. A notable reduction in reinvested earnings and dividend payments of DIEs also contributed to the contraction in the deficit in the primary income account. FDIs in the form of reinvested earnings, which are considered as outflows from the primary income account, declined in 2020, in line with the general reduction in FDIs observed during the year. Due to subdued economic activity, DIEs declared lower dividends compared to the previous year, contributing favourably to the reduction in the primary account deficit. It is envisaged that the deficit in the primary income account would contract further in the period ahead, with the emphasis of the Government to further limit the dependence on external debt in the medium term. Meanwhile, in terms of inflows to the primary income account, the return on investment of reserve assets decreased in 2020, with the decline in gross official reserves during the year.

5.2.4 Secondary Income

The secondary income account strengthened in 2020 with a healthy growth in workers' remittances. Although a growth was recorded during the first two months of 2020 compared to the previous year, remittances declined during the period from March to May 2020 with the return of migrant workers from countries affected by the COVID-19 pandemic, job terminations of some workers abroad as well as the cessation of new departures for employment. However, workers' remittances increased continuously thereafter to record a 5.8 per cent growth in 2020 compared to a decline of 4.3 per cent in 2019. This growth may be attributed to the increased stay period of migrant workers as a result of the closure of most international borders, increased use of formal channels, and a possible increase in the amount remitted by migrant workers to families in Sri Lanka to manage the pandemic driven hardships. Meanwhile, personal transfers and related

BOX 4

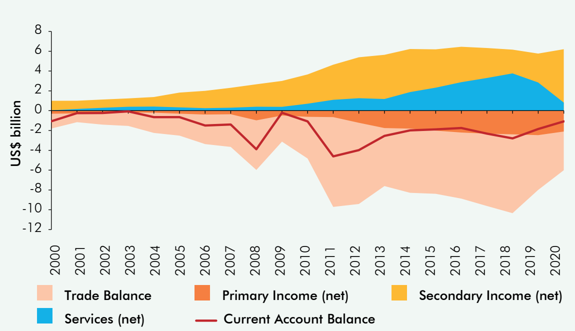
Workers' Remittances: Trends, Issues and Way Forward

Workers' remittances have been the largest single source of foreign exchange inflow in Sri Lanka's balance of payments (BOP) over the past decade. Contrary to the global expectation of a possible slowdown in workers' remittances in the face of the COVID-19 pandemic, Sri Lanka and a few other countries in South Asia stood out as exceptions, recording healthy remittance flows in 2020, demonstrating a sharp recovery from a dip recorded during the first half of the year. In this backdrop, it is imperative to recognise the importance of workers' remittances as a non-debt creating external financing source and the socio-economic challenges related to labour migration that need to be resolved in enhancing remittances to be a sustainable foreign exchange inflow to the country. Accordingly, this article discusses the historical trends and economic benefits of workers' remittances as well as social considerations related to labour migration while highlighting the challenges in enhancing remittances and measures to improve remittances.

Historical Trends in Workers' Remittances

Workers' remittances have long been a cushion against the current account shortfall, which emanated from the deficits in the trade and primary income accounts. Workers' remittances constitute almost 100 per cent of the inflows to the secondary income account of the external current account. Over the past two decades, annual remittances have represented nearly one fourth of the total credits to the external current account, on average, and exceptionally, this share exceeded more than one third (35 per cent) in 2020, reiterating the significance of remittances in mitigating external sector vulnerabilities and in maintaining macroeconomic stability. Being a major source of financing the trade deficit, workers' remittances have covered around 80 per cent of the annual trade deficit on average over the past two decades and remittance inflow has exceeded the trade deficit in 2020 accounting for around 118 per cent of the trade deficit. In 2020, the increase in workers' remittances helped abate the impact of the sharp decline in tourist earnings.

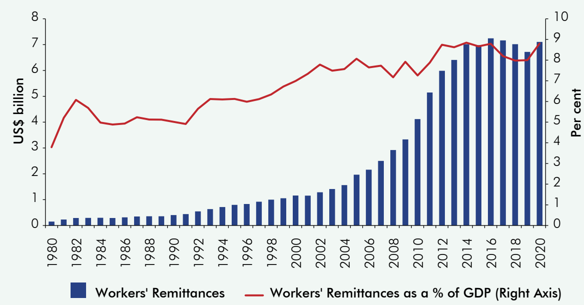
Figure B 4.1
Composition of the Current Account



Source: Central Bank of Sri Lanka

Workers' remittances as a percentage of GDP, which averaged around 5.7 per cent during 1981-2000 period, increased to around 8.0 per cent of GDP during the period from 2001-2020, reflecting the increased importance of workers' remittances in relation to Sri Lanka's GDP. Nevertheless, remittances have shown a declining trend during the past six years, except for 2016 and 2020. In the second half of 2020, workers' remittances increased significantly and recorded the highest monthly remittances in the history in December 2020. Accordingly, during 2020, workers' remittances increased by 5.8 per cent, year-on-year, to US dollars 7.1 billion. Sri Lanka's regional peers, i.e. Bangladesh and Pakistan have also started to demonstrate a partial recovery in remittances since the third quarter of 2020.

Figure B 4.2
Workers' Remittances



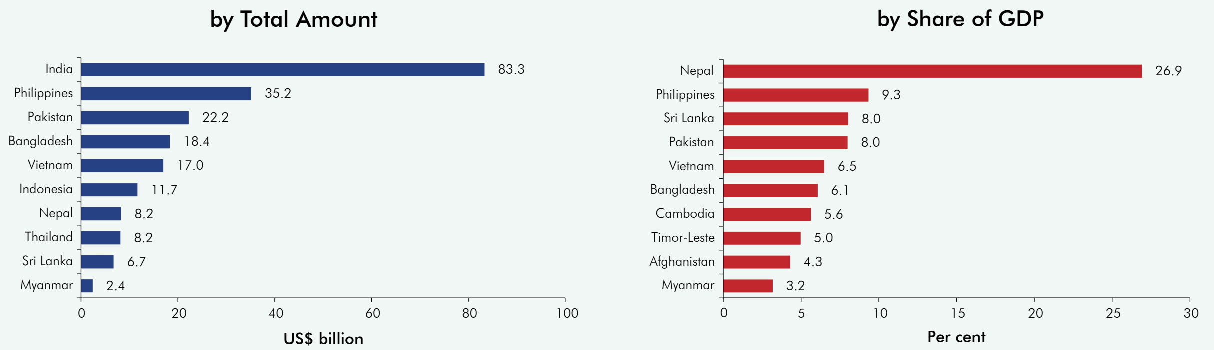
Source: Central Bank of Sri Lanka

In the global context, several Asian countries take the lead as top remittance recipients. While India is the highest remittance recipient in the world with US dollars 83 billion recorded in 2019, China, Philippines, Pakistan, Bangladesh and Vietnam are also amongst the top ten nations receiving remittances (World Bank, 2019). Although Sri Lanka is behind its regional peers in South and South East Asia in terms of nominal inward remittances, Sri Lanka's performance of workers' remittances in relation to GDP places it amongst the top five remittance recipients in the two regions.

Economic Benefits of Workers' Remittances and Social Considerations Related to Labour Migration

Workers' remittances deliver clearly visible and tangible benefits particularly to low- and middle-income countries like Sri Lanka. Remittances augment the recipients' incomes and generate positive multiplier effects while increasing their country's foreign exchange reserves (Ratha and Maimbo, 2005). Further, in contrast to capital flows which tend to be cyclical, remittances are relatively stable and often consumption smoothing, acting as an

Figure B 4.3
Top Remittance Recipients in South and South East Asia-2019



Source: World Bank

insurance during economic crises or after natural disasters (Bettin and Zazzaro, 2016 and De et al., 2016, cited in World Bank, 2019). Remittances have also become a way of sharing prosperity in various aspects such as its ability to reduce poverty and improve the standard of living of the beneficiary households.

Migration for foreign employment is often associated with social and financial costs which hinder the realisation of maximum benefits to the country. The foremost cost of labour migration is the social cost emanating from the impact on the wellbeing of the family members, especially the children who are left behind in the country. Most of the time, the health, nutrition and security of children are compromised in the families of migrant employees, especially with maternal migration. Moreover, lack of financial literacy of some migrant workers as well as their family members often leads to poor management of remittances for productive purposes making it difficult to attain the expected improvement in the standard of living of their households. In some households, remittances are spent on consumption of alcohol or drugs by the family members rather than on education of the children or for investment purposes. These issues are more prominent in the families of women who migrate for housemaid jobs.

Barriers to Enhance Remittances and Policy Prescriptions

Apart from social issues, several other factors act as impediments to improving the earning capacity of migrant employees and thus affecting remittances. In terms of the skills profile of migrant employees, Sri Lanka is heavily dependent on housemaids. However, the housemaids category, which accounted for the largest share of annual migrations of over 50 per cent two decades ago, has declined drastically to a share of below 30 per cent by 2020. In contrast, the share of labour migration under professional and skilled employee categories combined has almost doubled from 21 per cent to 37 per cent during the same period. Even though an upward trend in skilled labour migration can be witnessed, there exists a large mismatch between the international demand for jobs and Sri Lanka's supply capabilities. A higher demand is generated in advanced economies for specialised services such as nursing and elderly care with the changes in demographics including population ageing and increased female labour force participation rates. These jobs have a relatively high earning potential than in the case of housemaids. However, Sri Lanka has limited training institutions with international accreditation, recognised by foreign employers, to provide job-oriented training to bridge the skills gap and increase the readiness of Sri Lankan migrant employees to international markets.

Despite being a relatively stable source of foreign exchange, workers' remittances to Sri Lanka are highly vulnerable to economic and political volatilities in source countries due to over reliance on the Middle Eastern region as a destination for labour migration. The Middle Eastern region remains the primary market for Sri Lankan migrant workers, accounting for 80-90 per cent of annual departures for foreign employment from the country and more than half of the total remittance receipts. As such, the declining trend in remittances observed since 2015 may be partly attributed to the fall in the income of oil exporting countries in the Middle East. Unavailability of social security programmes for migrant employees also discourages employees from searching for employment opportunities abroad. Moreover, COVID-19 has also adversely impacted migrant workers as some employers have terminated employment of migrant workers during the first round of the pandemic. These workers faced many hardships due to COVID-19 related travel restrictions. Sri Lanka currently does not operate any contributory job loss insurance scheme for migrants that would ensure a minimum income to migrant workers even if they lose employment due to various factors, including a pandemic or a retirement benefit scheme that would ensure a continuous income stream for these workers in the latter stages of their lives.

High remittance costs are one of the major concerns of migrant employees across the globe. The 2030 Sustainable Development Goals (SDGs) set forth by the United Nations also include a target for reducing remittance costs to 3 per cent by 2030 to achieve the SDG of reducing inequality within and among countries. However, remittance costs still remain higher than the target where globally, sending remittances costs an average of 6.51 per cent and South Asia remains the lowest cost receiving region, with an average cost of 4.88 per cent (World Bank, 2020).

In view of enhancing remittance inflows to the country by overcoming the existing challenges related to foreign employment, the Government introduced several policy initiatives in Budget 2021. These measures included proposals to implement an integrated programme with the participation of all stakeholders to direct skilled workers for foreign employment and diversify the foreign employment market, establishing a contributory pension scheme for migrant employees and to pay Rs. 2 per dollar above the normal exchange rate for the foreign exchange remittances converted at licensed banks. Further, the Government, in consultation with the Monetary Board of the Central Bank, introduced a Special Deposit Account scheme to attract more inward remittances to the country in 2020. The Government together with the cooperation of other relevant stakeholders has established a Task Force to propose recommendations aiming at improving remittances.

Way Forward

The importance of remittance inflows as a non-debt creating source of foreign exchange has increased in the face of the pandemic and calls for immediate actions to keep remittances flowing. Promoting financial inclusion to improve access to the banking sector, strengthening competition and developing financial infrastructure could substantially reduce remittance costs and increase remittances while shifting a larger share of remittances from informal to formal financial channels. Incentivising digital money transfers such as online remittance channels, mobile money and transfers through Fintech would also contribute to reduce transaction costs.

There is a dire necessity to find alternative destinations for migrant workers rather than relying upon the Middle Eastern region, which is often subjected to economic crises driven by the swings in oil prices and geopolitical tensions. In this regard, exploring new labour markets and entering into bilateral agreements with other advanced economies, including Singapore, Japan and European countries are imperative to reduce the exposure of Sri Lankan foreign remittances being sourced largely from one single region. Progressive up-skilling of migrant workers through investments in competency development through vocational training and by providing high quality training on par with international standards, is beneficial in securing employment opportunities with higher and stable earnings. In addition, attention should also be drawn to improving the language proficiency, financial literacy and cultural preparation of migrant employees at the pre-departure training programmes. Raising awareness of family members of migrant employees in Sri Lanka on remittance management is also imperative to ensure the proper utilisation of remittances for the betterment of the households. Most importantly, continuous monitoring systems and other measures to support families left behind, such as childcare and education support for children are required at the grass root level. With the support of other relevant authorities, the regional offices of Sri Lanka Bureau of Foreign Employment could help establish a continuous monitoring programme and provide counselling services for family members of migrant employees.

The economic crisis that originated from the pandemic has exposed significant data gaps that restricted real time monitoring of remittance flows as well as movements of migrants. Hence, there is a pressing need to improve the data collection systems on remittances. In this regard, the Central Bank is in the process of implementing an International Transactions Reporting System (ITRS), which is a comprehensive cross border and foreign currency transactions monitoring system that will be executed through licensed banks. This will help improve BOP statistics including but not limited to a wide range of data on workers' remittances while also supporting to reconcile any statistical discrepancies. The ITRS will provide disaggregated workers' remittances data based on the country of origin, currency, remittance receiving districts, demographics of remitters and recipient banks which will enable to better estimate the distribution of remittances and identify emerging trends that would be of use in devising policies to enhance remittances.

The Government envisions achieving a robust economic growth while enhancing non-debt sources of foreign exchange earnings and inflows to fill the resource gap of the country. In this regard, workers' remittances play a vital role by contributing to offset BOP deficits, improved liquidity conditions in the domestic foreign exchange market, augment the international reserve levels and thereby improve the country's credit worthiness, poverty reduction and promotion of savings and investments. In order to maximise the positive effects of remittances on economic growth and development, the role of the Government and the policy makers should be focused on making remittances and labour migration cheaper, safer and more productive with the collective effort of all the relevant stakeholders.

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payments by non-residents living in Sri Lanka also declined during the year. With these developments, net inflows to the secondary income account increased to US dollars 6.2 billion compared to US dollars 5.8 billion in 2019.

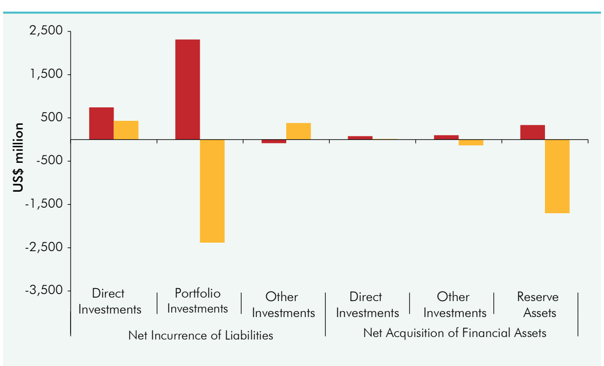
5.3 Capital Account Balance

Inflows to the capital account remained broadly unchanged in 2020. Capital transfers to the Government increased marginally, while those to the private sector recorded a decline in 2020, compared to the previous year. Consequently, the capital account recorded a surplus of US dollars 28 million in 2020 compared to a surplus of US dollars 23 million in 2019.

5.4 Financial Account

In the financial account of the BOP, both net incurrence of liabilities and net acquisition of assets recorded a significant reduction in 2020. Net incurrence of liabilities recorded a net reduction of US dollars 1,566 million in 2020 compared to a net increase of US dollars 2,974 million in 2019. Meanwhile, net acquisition of assets recorded a decline of US dollars 1,825 million in 2020 compared to an increase of assets of US dollars 514 million in 2019.

Figure 5.11
Financial Account



Source : Central Bank of Sri Lanka

The net incurrence of liabilities reduced significantly in 2020 with lower inflows of both equity and debt, and higher outflows for debt service payments compared to 2019. The

Table 5.8.A
Financial Account

US$ million

Item	2019 (a) Net acquisition of financial assets	2019 (a) Net incurrence of liabilities	2020 (b) Net acquisition of financial assets	2020 (b) Net incurrence of liabilities
Financial Account	514	2,974	-1,825	-1,566
Direct Investment	77	743	15	434
Equity and investment fund shares	65	370	10	211
Equity other than reinvestment of earnings	52	110	7	20
Direct investor in direct investment enterprise	52	110	7	20
Reinvestment of earnings	13	260	3	191
Debt instruments	13	374	4	223
Direct investor in direct investment enterprise	13	374	4	223
Portfolio Investment	-	2,313	-	-2,383
Equity and investment fund shares	-	-4	-	-217
Debt securities	-	2,317	-	-2,166
Deposit-taking corporations	-	-250	-	-
Long term	-	-250	-	-
General government	-	2,567	-	-2,166
Short term (Treasury bills)	-	55	-	-122
Long term	-	2,513	-	-2,044
Treasury bonds	-	-388	-	-431
Sri Lanka Development bonds	-	1	-	22
Sovereign bonds	-	2,900	-	-1,635
Issuances		4,400		-
Maturities	-	-1,500	-	-859
Secondary market transactions	-	-	-	-776
Financial Derivatives	-	-	-	-
Other Investment	100	-82	-136	383
Currency and deposits	-93	167	64	-15
Central Bank	-	...	-	400
Short term	-	...	-	...
Long term	-	-	-	400
Deposit-taking corporations	-93	168	64	-415
Short term	6	168	259	-415
Long term	-99	-	-194	-

Continued on page - 137

Memorandum Items	2019 (a)	2020 (b)
Foreign Direct Investment (FDI)		
Equity	110	20
Reinvestment of earnings	260	191
Intercompany loans	391	223
Intercompany loan repayments	-17	-
Total FDI (1)	743	434
Loans to BOI companies (2)	445	236
Total FDI, including loans to BOI companies (1 + 2)(c)	1,189	670
Total net inflows to the CSE	-35	-225
Direct investment	-31	-9
Portfolio Investment	-4	-217
Net Foreign investments in rupee denominated government securities (Treasury Bills and Bonds)	-334	-553
Foreign purchases	596	120
Foreign sales	930	673

(a) Revised
(b) Provisional
(c) Any difference with the estimates of BOI is due to differences in coverage and compilation methodologies.

Source: Central Bank of Sri Lanka

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decline in liabilities in 2020 was mainly due to higher net outflows of foreign investments from the rupee denominated government securities market, maturity of an ISB, net outflows of foreign investments from the CSE, lower FDI inflows, as well as net sales of Sri Lanka's ISBs by non-residents in the secondary market. Notable inflows to the financial account were the receipt of the foreign currency term financing facility from the China Development Bank in March 2020, and the SAARCFINANCE swap arrangement provided by the Reserve Bank of India in July 2020. FDIs, including foreign loans to BOI companies, were limited to US dollars 670 million in 2020, in comparison to US dollars 1,189 million in 2019. The moderation in FDIs could be primarily attributed to the COVID-19 pandemic related uncertainties in global financial markets that led to global FDI flows recording a significant decline in 2020. FDIs, excluding foreign loans to DIEs, also declined in 2020. FDIs in 2020 were primarily in the form of intercompany borrowings and reinvested earnings from existing FDI companies, while FDIs to new companies were negligible as a result of the pandemic related investment uncertainties and travel restrictions that affected foreign investors in general. On a sector wise breakdown, major FDIs were received by projects related to property development, telecommunications, textile and hotels sectors. Despite the moderation in FDIs in 2020, the Government expects FDIs, particularly to the Colombo port city and the Hambantota port project, to materialise in the near term, with the finalisation of the Colombo port city legislative framework and the interest shown by foreign investors in recent times. Portfolio investments in equity, which consist of foreign residents' investments in the CSE other than direct investment transactions, recorded a net outflow of US dollars 217 million in 2020, compared to a net outflow of US dollars 4 million in 2019. The net outflow of US dollars 217 million comprised net outflows of US dollars 276 million from the secondary market and inflows of US dollars 59 million to the primary market. Portfolio investments in the form of ISBs recorded a significant net outflow of US dollars 1,635 million in

Table 5.8.B
Financial Account

US$ million

Item	2019 (a)		2020 (b)	
	Net acquisition of financial assets	Net incurrence of liabilities	Net acquisition of financial assets	Net incurrence of liabilities
Other Investment (Continued from page - 136)				
Loans	-	-245	-	327
Central Bank	-	327	-	-14
Credit and loans with the IMF	-	327	-	-14
Extended Fund Facility	-	327	-	-14
Deposit-taking corporations	-	-281	-	75
Short term	-	-1	-	403
Long term	-	-280	-	-328
General government	-	-89	-	169
Long term	-	-89	-	169
Other sectors (c)	-	-203	-	96
Long term	-	-203	-	96
Trade credit and advances	-4	-28	-224	185
Deposit-taking corporations	-8	-	9	-
Short term	-8	-	9	-
Other sectors (d)	4	-28	-233	185
Short term	4	-28	-233	185
Other accounts receivable/payable	196	24	24	-114
Central Bank	-	24	-	-114
Short term (e)	-	24	-	-114
Deposit-taking corporations	196	-	24	-
Short term	196	-	24	-
Special Drawing Rights	-	-	-	-
Reserve Assets	337		-1,704	
Monetary gold	-14		-667	
Special Drawing Rights	6		-5	
Reserve position in the IMF	-		-	
Other reserve assets	346		-1,032	
Currency and deposits	361		-177	
Claims on monetary authorities	-174		-1,092	
Claims on other entities	535		914	
Securities	-19		-856	
Debt securities	-19		-856	
Long term	-19		-856	
Other Claims	3		1	
Financial Account (net)	-2,460		-260	
Memorandum Items				
Long term loans to the government (net)		-89		169
Inflows (Disbursements)		1,573		1,882
Project Loans		1,573		1,382
Foreign Currency Term Financing Facilities		-		500
Repayments		1,662		1,713

(a) Revised
(b) Provisional
(c) Includes State Owned Business Enterprises and private sector companies
(d) Includes trade credits received by the Ceylon Petroleum Corporation and other private companies
(e) Net transactions of Asian Clearing Union (ACU) liabilities

Source: Central Bank of Sri Lanka

2020, with the maturity of an ISB in October 2020 and net sales made by non-residents to residents from secondary market transactions related to ISBs as per the data collected from a new survey conducted by the Central Bank. Meanwhile, the changing landscape of global capital flows as a result of the COVID-19 pandemic caused a sizeable net outflow of US dollars 553 million from the rupee denominated government securities market during the year. Meanwhile, currency and deposit liabilities of deposit taking corporations declined. However, the currency and deposit liabilities of the Central Bank increased due to the receipt of the SAARCFINANCE swap arrangement of US dollars 400 million in July 2020, which matured in February 2021. Net loans obtained by deposit taking corporations recorded an increase in 2020. Further, a net foreign loan inflow to the Government was recorded in 2020 with the receipt of the foreign currency term financing facility of US dollars 500 million from the China Development Bank in March 2020. Foreign liabilities of the Government in the form of ISBs, Treasury bills, and Treasury bonds, recording net outflows during the year demonstrated constraints faced by the Government in terms of foreign financing. The net incurrence of liabilities of trade credit and advances increased in 2020. Further, other accounts payable, mainly consisting of Asian Clearing Union (ACU) liabilities managed by the Central Bank, recorded a decline in 2020.

Table 5.9
Major Projects Financed with Foreign Borrowings during 2020

Lender and Project	Amount Disbursed US$ million
Government Projects - Total	1,382
of which;	
Asian Development Bank	305
of which;	
Second Integrated Road Investment Program - Tranch 1 and Tranch 2	68
Export Import Bank of China	266
of which;	
Extension of Southern Expressway Project	149
Hambantota Hub Development Project (Extension of Southern Expressway-Section 3)	40
International Development Association	253
of which;	
COVID 19 Emergency Response & Health Systems Preparedness Project	72
Social Safety Nets Project	50
Agriculture Sector Modernisation Project	19
Government of Japan	161
of which;	
New Bridge Construction Project over the Kelani River	72
Kandy City Wastewater Management Project	24
Greater Colombo Transmission and Distribution Loss Reduction Project	15
HSBC Limited (Hongkong)	89
Procurement of Diesel Multiple Units for Upcountry Line Operation of Sri Lanka Railways	59
Upgrading Health Facilities in Selected Hospitals	30
Calyon Credit Agricole	74
Greater Matale Water Supply Project	43
Kelani Right Bank Water Supply Project- Phase II	31
International Bank for Reconstruction & Development	70
of which;	
Metro Colombo Urban Development Project	32
Primary Health Care System Strengthening Project	24
Government of India	39
of which;	
Restoration of Northern Railway Services	38
Export Import Bank of India	17
Credit Line for the Development of the Railway Sector	17

Source: Ministry of Finance

The net acquisition of financial assets declined in 2020, primarily driven by the decline in gross official reserves. The net acquisition of financial assets declined by US dollars 1,825 million in 2020 compared to an increase of US dollars 514 million in 2019. The decline in financial assets was mainly due to the significant decline in gross official reserves by US dollars 1,704 million in 2020, with sizeable foreign debt service payments made on behalf of the Government during the period amidst moderate foreign financing to the Government. Reserve related transactions during the year were characterised by a notable strategic reduction in monetary gold assets by the Central Bank. Currency and deposit assets of the banking sector also recorded an increase in 2020. Meanwhile, the net acquisition of assets on trade credit and advances, which represents trade credit and advances given by Sri Lankan exporters to their overseas trading partners, also recorded a decline during the year. Other accounts receivable of Licensed Commercial Banks (LCBs) recorded a marginal net increase during the year.

5.5 Overall Balance

The overall balance, which is equal to the change in net international reserves, recorded a deficit in 2020 following the surplus recorded in 2019. The moderation of inflows to the financial account during the year and the significant external debt service payments resulted in a notable reduction in gross official reserves during the year. Net international reserves also recorded a notable decline, resulting in the overall balance recording a deficit of US dollars 2,328 million in 2020.

5.6 International Investment Position

Sri Lanka's net International Investment Position (IIP), which is the difference between the total external asset and liability positions held with non-residents, improved in 2020. Accordingly, the IIP improved from a net liability position of US dollars 51.2 billion at end 2019 to a net liability position of US dollars 47.9 billion at end 2020. This was as a result of a notable reduction in the country's external liability position to US dollars 58.8 billion as at end 2020 from US dollars 64.1 billion as at end 2019, while the country's external asset position declined to US dollars 10.9 billion as at end 2020 from US dollars 13.0 billion as at end 2019.

Sri Lanka's external asset position with non-residents recorded a significant decline during 2020. The stock position of external assets decreased primarily due to the decline in gross official reserves to US dollars 5.7 billion at end 2020 from US dollars 7.6 billion at end 2019.[1] Total international reserves, which comprise gross official reserves and foreign assets of the banking sector, also decreased in 2020, primarily due to the

[1] Refer Section 5.6.1 for a detailed analysis of the reserve asset position.

Table 5.10
International Investment Position

US$ million (End period position)

Item	2019 (a) Assets	2019 (a) Liabilities	2020 (b) Assets	2020 (b) Liabilities
Direct Investment (c)	**1,497**	**13,065**	**1,509**	**13,832**
Equity and investment fund shares	1,466	8,287	1,473	8,831
Debt instruments	31	4,778	36	5,001
Portfolio Investment	...	**15,855**	...	**8,420**
Equity and investment fund shares		1,049		708
Other sectors		1,049		708
Debt securities (d)	...	14,806	...	7,712
Deposit-taking corporations	...		...	
Short term	...		...	
General government		14,632		7,616
Short term		119		4
Long term		14,513		7,613
Other sectors		174		96
Long term		174		96
Financial Derivatives	-	-	-	-
Other Investment	**3,846**	**35,227**	**3,710**	**36,499**
Currency and Deposits	**771**	**1,748**	**835**	**1,734**
Central Bank		...		400
Short term		...		...
Long term		-		400
Deposit-taking corporations	771	1,748	835	1,333
Short term	363	1,748	622	1,333
Long term	408		214	
Loans		**30,320**		**31,512**
Central Bank		1,315		1,378
Credit and loans with the IMF		1,315		1,378
Deposit-taking corporations		5,249		5,324
Short term		3,771		4,174
Long term		1,478		1,150
General government		19,617		20,570
Long term		19,617		20,570
Other sectors (e)		4,139		4,240
Long term		4,139		4,240
Trade Credit and Advances	**1,178**	**2,156**	**954**	**2,341**
Deposit-taking corporations	92		101	
Short term	92		101	
Other sectors (f)	1,086	2,156	853	2,341
Short term	1,086	2,156	853	2,341
Other Accounts Receivable/Payable	**1,896**	**456**	**1,920**	**343**
Central Bank (g)		456		343
Short term		456		343
Deposit-taking corporations	1,896		1,920	
Short term	1,896		1,920	
Special Drawing Rights (SDRs)		**547**		**570**
Reserve Assets	**7,642**		**5,664**	
Monetary gold	955		409	
Special Drawing Rights	7		3	
Reserve position in the IMF	66		69	
Other reserve assets	6,614		5,184	
Currency and deposits	2,387		2,210	
Claims on monetary authorities	1,952		861	
Claims on other entities	435		1,350	
Securities	4,227		2,974	
Debt securities	4,227		2,974	
Total Assets / Liabilities	**12,985**	**64,148**	**10,883**	**58,750**
Net International Investment Position		**-51,162**		**-47,868**
Memorandum Items				
IIP- Maturity-wise breakdown	12,985	64,148	10,883	58,750
Short term	6,846	9,299	6,184	8,902
Long term	6,139	54,849	4,699	49,848

(a) Revised
(b) Provisional
(c) Includes direct investment position of BOI, CSE and other private companies
(d) Foreign currency debt issuances are based on market value while domestic currency issuances are based on book value.
(e) Includes loans outstanding position of project loans obtained by State Owned Business Enterprises.
(f) Includes outstanding trade credit position of Ceylon Petroleum Corporation and the private sector companies.
(g) Outstanding position of ACU liabilities managed by the Central Bank

Source: Central Bank of Sri Lanka

decrease in gross official reserves, while holdings of commercial bank foreign assets recorded a modest increase. Meanwhile, the direct investment asset position that represents direct investments abroad by Sri Lankan residents increased marginally during the year. The asset position in the form of currency and deposits and other accounts receivable of deposit taking corporations also increased in 2020, resulting in an increase in the foreign asset position of the banking sector during 2020. Meanwhile, the outstanding asset position of trade credit and advances at end 2020, which reflects the trade credit and advances given to non-residents by deposit taking corporations and the private sector, decreased from the position observed at end 2019.

Sri Lanka's total liability position to non-residents, as reflected in the IIP, recorded a significant decline by end 2020, mainly due to the valuation reduction in Sri Lanka's ISBs as well as a reclassification of a part of Sri Lanka's ISB holdings as resident holdings. The total liability position declined to US dollars 58.8 billion as at end 2020, compared to US dollars 64.1 billion recorded as at end 2019. This decline is mainly attributable to the significant decline in portfolio investment liability position due to the decline in market prices of outstanding Government ISBs coinciding with high secondary market yields triggered by uncertainties in international capital markets exaggerated by the COVID-19 pandemic and the downgrade of Sri Lanka's sovereign ratings. Furthermore, based on a new survey conducted by the Central Bank on outstanding holding of Sri Lanka's ISBs by resident entities, the reclassification of part of the country's ISBs as domestic liabilities at end 2019 and end 2020 also contributed to the reduction to the portfolio investment liability position at end 2020 and revised position at end 2019. In addition, outflows of foreign investments recorded from the rupee denominated government securities market as well as from the CSE also contributed to the decline in portfolio investment liability position. As a result of these developments, the outstanding portfolio investment liability position amounted to US dollars 8.4 billion at end 2020 compared to US dollars 15.9 billion at end 2019. However, the direct investment liability position increased to US dollars 13.8 billion at end 2020 with net direct investment inflows during the year. Further, the liability position of debt instruments of DIEs increased, reflecting the increase in loans and advances given by direct investors. The foreign loan liability position of the IIP increased as at end 2020, contributed by modest increases in foreign loan liabilities of the Government, the Central Bank, deposit taking corporations and the other sector, which consist of private sector corporations and State Owned Business Enterprises (SOBEs). Although the currency and deposits liability position of the Central Bank increased by end 2020 with the SAARCFINANCE swap arrangement, the total currency and deposit liability position declined marginally as the currency and deposit liability position of deposit taking corporations declined notably due to the reduction in deposit liabilities of non-residents. Further, outstanding trade credits received by Sri Lankan importers increased despite a reduction in trade credits received by the Ceylon Petroleum Corporation (CPC), while the outstanding position of other accounts payable declined with a reduction in ACU related liabilities of the Central Bank during 2020.

5.6.1 Reserve Asset Position

Gross official reserves declined to US dollars 5.7 billion by end 2020, in comparison to US dollars 7.6 billion recorded at end 2019, due to substantial debt service payments of the Government amidst reduced inflows. Foreign currency debt service payments, which included

Table 5.11
Gross Official Reserves, Total Foreign Assets and Overall Balance

US$ million

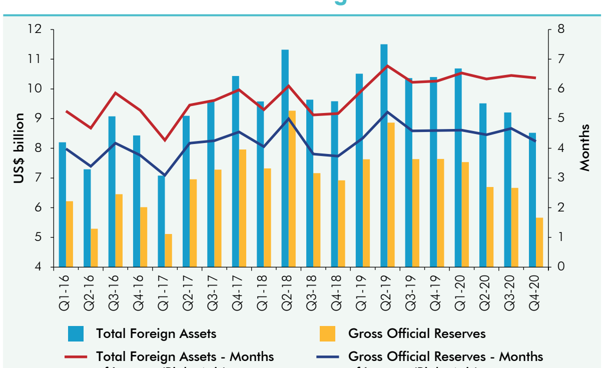
Item	(End period position)				
	2016	2017	2018	2019	2020 (a)
1. Government foreign assets	289	488	817	386	155
2. Central Bank foreign assets	5,730	7,470	6,102	7,256	5,510
3. Gross official reserves (1+2)	6,019	7,959	6,919	7,642	5,664
4. Foreign assets of deposit-taking corporations	2,414	2,478	2,664	2,760	2,856
5. Total foreign assets (3+4) (b)	8,433	10,436	9,583	10,402	8,521
6. Reserve related liabilities (c)	1,490	1,361	1,425	1,771	2,121
7. Net International Reserves (NIR) (3-6)	4,529	6,597	5,495	5,871	3,543
8. Overall balance (d)	-500	2,068	-1,103	377	-2,328
9. Gross official reserves in months of					
9.1 Import of goods	3.8	4.6	3.7	4.6	4.2
9.2 Import of goods and services	3.1	3.8	3.1	3.7	3.7
10. Total foreign assets in months of					
10.1 Import of goods	5.3	6.0	5.2	6.3	6.4
10.2 Import of goods and services	4.3	4.9	4.3	5.1	5.6

(a) Provisional
(b) Excludes foreign assets in the form of 'Direct investment abroad' and 'Trade credit and advances granted'
(c) The total outstanding debt of the Central Bank, excluding outstanding Special Drawing Rights (SDRs)
(d) Change in NIR position during the period

Source: Central Bank of Sri Lanka

repayment of a matured ISB of US dollars 1 billion, principal payments of foreign project loans, foreign currency term financing facility related repayments, Sri Lanka Development Bonds (SLDBs), Offshore Banking Units (OBUs) related loan repayments, and interest payments mainly accounted for the decline in gross official reserves during the year. Main inflows that replenished gross official reserves during the year included the foreign currency term financing facility of US dollars 500 million, OBU loans of US dollars 720 million, and the SAARCFINANCE swap arrangement of US dollars 400 million. Accordingly, the end year gross official reserve level was equivalent to 4.2 months of imports and 43 per cent of the country's short term debt and liabilities on remaining maturity basis. Meanwhile, total international reserves, which comprise gross official reserves and foreign assets of the banking sector, also declined by end 2020 primarily due to the decline in gross official reserves, while holdings of commercial bank foreign assets recorded a modest increase. Total foreign assets were equivalent to 6.4 months of imports by end 2020.

Figure 5.12
Quarterly Gross Official Reserves and Total Foreign Assets



Source : Central Bank of Sri Lanka

5.7 External Debt and Debt Servicing

5.7.1 External Debt

Sri Lanka's outstanding external debt declined significantly in 2020. The external debt stock position of the country, based on market value of tradable debt instruments, declined to US dollars 49.2 billion at end 2020 from US dollars 54.8 billion at end 2019, mainly due to the significant decline in market prices of Sri Lanka's outstanding ISBs, the repayment of the ISB that matured in October 2020, the reclassification of a portion of outstanding ISBs as domestic liabilities, and the decline in the non-resident holding of rupee denominated government securities. The foreign currency term financing facility of US dollars 1 billion obtained in 2017 was fully repaid in 2020 with the repayment of the final instalment of US dollars 333 million in May 2020. With these developments, the outstanding external debt of the Government reduced substantially to US dollars 28.2 billion by end 2020 compared to US dollars 34.2 billion as at end 2019. However, it must be noted that in spite of the reduction in the market price of ISBs that is taken in to consideration in arriving at this computation, the actual liability in terms of outstanding ISBs remains higher at their face value. Meanwhile, the outstanding external debt of the Central Bank increased by end 2020 in comparison to end 2019 with the SAARCFINANCE swap arrangement of US dollars 400 million from the Reserve Bank of India. The outstanding external debt of the banking sector decreased by end 2020 compared to end 2019, owing to the significant reduction in currency and deposits and long term foreign loans despite the increase in short term foreign loans obtained by banks. Also, the outstanding external debt of the private sector and SOBEs increased in 2020 with the increase in foreign loans, and outstanding trade credits received by the private sector, despite a modest reduction in foreign loans of SOBEs. Market price of the outstanding international bond issued by SriLankan Airlines also reduced significantly during the period, contributing to the reduction of the outstanding external debt liability of the private sector and SOBEs during the year. Further, intercompany borrowing of DIEs recorded an increase during 2020, with a number of DIEs receiving intercompany loans and shareholder advances during the year.

The total outstanding external debt of the country as a percentage of GDP recorded a notable decline during 2020. The total outstanding external debt as a percentage of GDP stood at 60.9 per cent by end 2020, compared to 65.3 per cent by end 2019, as the stock of outstanding external debt, depicted in market prices of tradable debt instruments, declined substantially compared to the reduction in GDP. The total external debt with long term maturities as well as short term maturities, when depicted in nominal terms, declined in 2020. In line with the above

Table 5.12
Outstanding External Debt Position

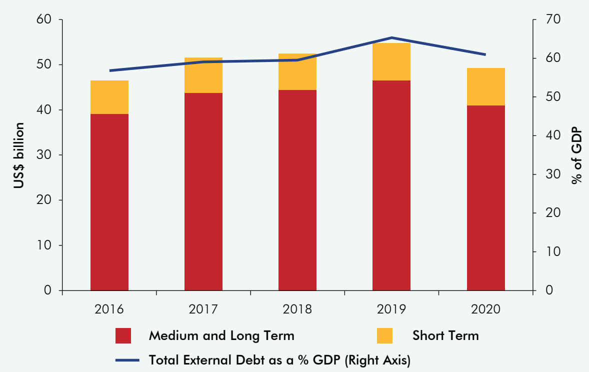
US$ million
(End period position)

Item	2019(a)	2020(b)
General Government	**34,249**	**28,187**
Short term	**119**	**4**
Debt securities	119	4
Treasury bills (c)	119	4
Long term	**34,130**	**28,183**
Debt securities	14,513	7,613
Treasury bonds (c)	406	31
Sri Lanka Development bonds (d)	5	27
International sovereign bonds (e)	14,102	7,555
Loans	19,617	20,570
Central Bank	**2,318**	**2,690**
Short term	**456**	**343**
Currency and deposits	...	...
Other accounts payable	456	343
Asian Clearing Union liabilities	456	343
Long term	**1,862**	**2,348**
Special Drawing Rights (SDRs) allocation	547	570
Currency and deposits	-	400
Loans	1,315	1,378
Credit and loans with the IMF	1,315	1,378
Extended Fund Facility	1,315	1,378
Deposit-taking Corporations	**6,997**	**6,657**
Short term	**5,519**	**5,507**
Currency and deposits (f)	1,748	1,333
Commercial banks	1,748	1,333
Loans	3,771	4,174
Commercial banks	3,771	4,174
Long term	**1,478**	**1,150**
Loans	1,478	1,150
Commercial banks	1,412	1,109
Other deposit-taking corporations	66	41
Other Sectors (g)	**6,469**	**6,676**
Short term	**2,156**	**2,341**
Trade credit and advances (h)	2,156	2,341
Long term	**4,313**	**4,335**
Debt securities (e)	174	96
Loans	4,139	4,240
Private sector corporations	2,235	2,458
State owned business enterprises and public corporations	1,904	1,781
Direct Investment: Intercompany Lending (i)	**4,778**	**5,001**
Gross External Debt Position	**54,811**	**49,212**
As a Percentage of GDP		
Gross external debt	65.3	60.9
Short term debt	9.8	10.1
Long term debt	55.5	50.8
As a Percentage of Gross External Debt		
Short term debt	15.1	16.7
Long term debt	84.9	83.3
Memorandum Items		
Non Resident Holdings of Debt Securities - Sectorwise Breakdown at Face Value	**14,690**	**12,058**
General government	14,515	11,883
Treasury bills	131	4
Treasury bonds	442	33
Sri Lanka development bonds	5	27
International sovereign bonds	13,937	11,820
Other sectors	175	175
Face Value of Total Outstanding ISBs	**15,050**	**14,050**
Outstanding ISBs held by non residents	13,937	11,820
Outstanding ISBs held by residents (excluded from External Debt Statistics from December 2019 onwards)	1,113	2,230

(a) Revised
(b) Provisional
(c) Based on book value
(d) Based on face value
(e) Based on market prices
(f) Includes deposits of non-resident foreign currency holders
(g) Includes private sector and State Owned Business Enterprises
(h) Includes trade credits outstanding of the Ceylon Petroleum Corporation and private sector companies
(i) Includes inter-company borrowings and shareholder advances of BOI registered companies

Source: Central Bank of Sri Lanka

Figure 5.13
External Debt



Source : Central Bank of Sri Lanka

developments, the outstanding government foreign debt, which remains the largest component of total external debt, declined to 57.3 per cent of total external debt by end 2020, in comparison to 62.5 per cent at end 2019. Despite these reductions in nominal values and ratios of external debt, the country's external debt, particularly that of the Government, remains significantly high compared to peer countries. Recognising this challenging situation, the Government has already taken a number of steps to reduce the economy's reliance on foreign financing and enhance non-debt foreign exchange inflows, while ensuring that the servicing of outstanding loans are continued.

5.7.2 Foreign Debt Service Payments

Sri Lanka's external debt service payments were lower in 2020 compared to the previous year, with lower capital repayments and a marginal decrease in interest payments. Capital repayments on external debt declined to US dollars 2,851 million in 2020, compared to US dollars 4,096 million in 2019 mainly with the repayment of only one matured ISB, of which US dollars 859 million was owed to non-residents in 2020, compared to two ISBs amounting to US dollars 1.5 billion repaid in 2019. Based on a recent survey of the Central Bank on ISB holdings of the domestic commercial banks, it has been identified that a sizeable portion of the country's previously paid sovereign bonds is owned by domestic commercial banks at the time of maturity. Accordingly, of the US dollars 1 billion ISB settled in 2020, US dollars 859 million were paid to non-residents upon maturity while the remaining settlement was received by residents. However, this information is not available for the previous year for comparison purposes. Further, capital repayments of foreign loans of the Government increased during the year, which included the repayment of foreign project loans of US dollars 1,380 million and

Table 5.13
External Debt Service Payments

US$ million

Item	2019 (a)	2020 (b)
1. Debt Service Payments	5,757	4,382
1.1 Amortisation	4,096	2,851
General Government	3,176	2,577
Project Loans	1,662	1,713
Debt securities	1,514	864
Central Bank	-	14
IMF	-	14
Private sector and deposit taking corporations	903	260
Foreign loans	653	260
Debt securities	250	-
Intercompany debt of direct investment enterprises	17	-
1.2 Interest Payments	1,661	1,530
General Government	1,389	1,397
Project Loans	430	483
Debt securities	959	914
Central Bank	37	19
IMF	28	18
Swap and other liabilities	9	2
Private sector and deposit taking corporations	224	114
Foreign loans	207	114
Debt securities	18	-
Intercompany debt of direct investment enterprises	11	-
2. Earnings from Export of Goods and Services	19,414	13,083
3. Receipts from Export of Goods, Services, Income and Current Transfers	26,392	20,398
4. Debt Service Ratio		
4.1 As a percentage of 2 above		
Overall Ratio	29.7	33.5
Excluding IMF transactions	29.5	33.2
4.2 As a percentage of 3 above		
Overall ratio	21.8	21.5
Excluding IMF transactions	21.7	21.3
5. Government Debt Service Payments		
5.1 Government debt service payments (c)	4,565	3,974
5.2 As a percentage of 1 above	79.3	90.7

(a) Revised
(b) Provisional
(c) Excludes transactions with the IMF

Source : Central Bank of Sri Lanka

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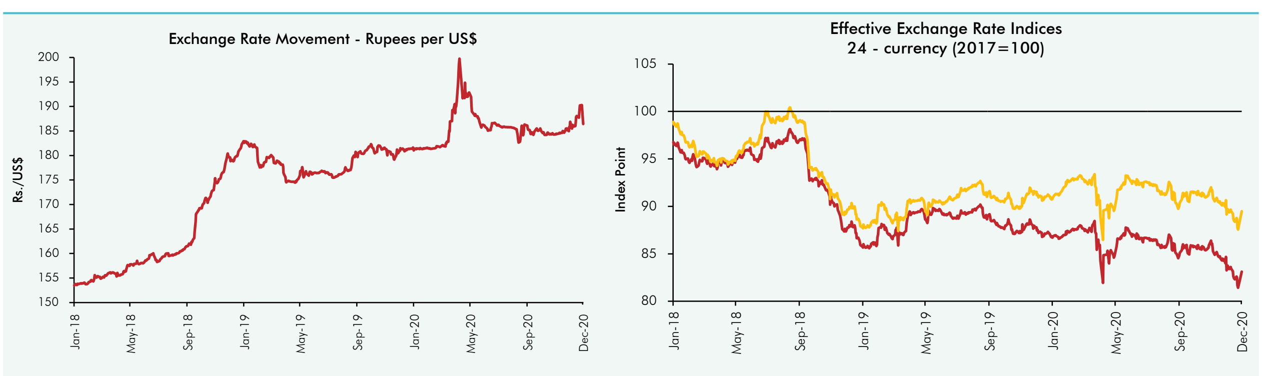
the repayment of the final instalment of a foreign currency term financing facility of US dollars 333 million. Meanwhile, capital repayments of foreign loans by the private sector, SOBEs and deposit taking corporations declined significantly during the year, compared to 2019, possibly due to extensions received by private corporations on their outstanding debt due to the pandemic related financial difficulties. During 2020, the Central Bank serviced the first instalment of US dollars 14 million of the International Monetary Fund–Extended Fund Facility (IMF-EFF) obtained over the period 2016-2019. Meanwhile, interest payments on external debt recorded a decline during the year to US dollars 1,530 million, from US dollars 1,661 million in 2019. Further, coupon payments of ISBs issued and interest payments on foreign loans of the Government recorded a modest increase during the year. However, interest payments on foreign investments in the rupee denominated government securities market declined during the year, with the decline in the outstanding stock of Treasury bills and Treasury bonds held by non-residents. Since earnings from merchandise exports and services were significantly lower in 2020 compared to the previous year, total external debt service payments as a percentage of export of goods and services increased to 33.5 per cent in 2020 from 29.7 per cent in 2019. Further, with the Government's external debt representing the majority of the country's debt stock, the Government's debt service payments accounted for 90.7 per cent of total debt service payments in 2020.

5.8 Exchange Rate Movements

The exchange rate, which remained relatively stable prior to the domestic spread of the pandemic and the initial lockdown, came under significant pressure in March – April 2020, and during the latter part of 2020. The Sri Lankan rupee depreciated significantly during the period from mid-March to mid-April 2020, reaching a peak of Rs. 199.75 per US dollar on 09 April 2020. In addition to the measures taken by the Central Bank and the Government to curtail non-essential imports and other outflows from mid-March 2020, the depreciation pressure that prevailed during this period necessitated active intervention by the Central Bank in the domestic foreign exchange market through supply of foreign exchange and entering in to sell-buy swap agreements with LCBs in view of enhancing foreign exchange liquidity in the market. However, the situation reversed from mid-April and the exchange

Figure 5.14
Exchange Rate Movements



Source : Central Bank of Sri Lanka

Table 5.14
Exchange Rate Movements

Currency	In Rupees per unit of Foreign Currency						Percentage Change over Previous Year (a)			
	End Year Rate			Annual Average Rate			End Year		Annual Average	
	2018	2019	2020	2018	2019	2020	2019	2020	2019	2020
Euro	208.99	203.67	229.42	191.71	200.14	212.07	2.62	-11.23	-4.21	-5.62
Indian rupee	2.61	2.55	2.55	2.38	2.54	2.50	2.61	0.00	-6.40	1.46
Japanese yen	1.65	1.67	1.81	1.47	1.64	1.74	-1.02	-7.54	-10.36	-5.65
Pound sterling	231.86	238.46	254.35	216.67	228.20	238.22	-2.77	-6.25	-5.05	-4.21
US dollar	182.75	181.63	186.41	162.54	178.78	185.52	0.61	-2.56	-9.08	-3.64
SDR	253.51	251.17	268.48	229.90	246.97	258.61	0.93	-6.45	-6.91	-4.50
Effective Exchange Rate Indices (b) (c) (2017=100)	End Year Index			Annual Average Index			Percentage Change over Previous Year			
							End Year Index		Annual Average Index	
	2018	2019	2020	2018	2019	2020	2019	2020	2019	2020
NEER 24-currencies	85.81	86.74	83.12	94.05	88.17	85.93	1.09	-4.17	-6.28	-2.54
REER 24-currencies	87.81	90.74	89.49	95.45	90.42	91.36	3.33	-1.37	-5.31	1.05

(a) Changes computed on the basis of foreign currency equivalent of Sri Lanka rupees. The sign (-) indicates depreciation of Sri Lanka rupee against each currency, respectively.
(b) The Nominal Effective Exchange Rate (NEER) is a weighted average of nominal exchange rates of 24 trading partner and competitor countries. Weights are based on the trade shares reflecting the relative importance of each currency in each of the currency baskets. The Real Effective Exchange Rate (REER) is computed by adjusting the NEER for inflation differentials with respect to each currency in the basket. A minus sign indicates depreciation. CCPI was used for REER computation.
(c) The exchange rate has been defined in terms of indices so that the appreciation/depreciation of the rupee relative to other currencies is directly reflected by a rise/fall in the values of the effective exchange rate indices, respectively.

Source: Central Bank of Sri Lanka

rate remained stable until November 2020. Since end November 2020, driven by speculative market behaviour due to Sovereign rating downgrades and the gradual increase in imports, a build up of pressure on the exchange rate was observed, prompting further measures by the Central Bank. Accordingly, the annual depreciation of the rupee was limited to 2.6 per cent against the US dollar at end 2020. Reflecting cross currency exchange rate movements, the Sri Lankan rupee depreciated against the euro (11.2 per cent), the Japanese yen (7.5 per cent) and the pound sterling (6.2 per cent) by end 2020, and remained unchanged against the Indian rupee.

Other major currencies showed mixed movements against the US dollar. Accordingly, at the end of 2020, the euro (9.8 per cent), the Japanese yen (5.4 per cent) and the pound sterling (3.9 per cent) appreciated against the US dollar, whilst the Indian rupee (2.6 per cent) depreciated. With the combined effect of the depreciation of the rupee against most major currencies, the Sri Lankan rupee depreciated against the SDR by 6.4 per cent during the year.

5.8.1 Nominal and Real Effective Exchange Rates

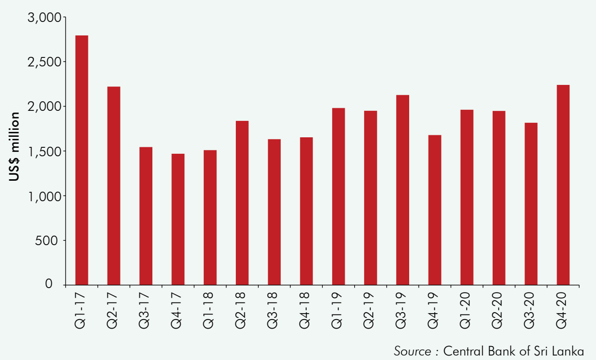
Effective exchange rate indices, which measure the movement of the Sri Lankan rupee against a basket of currencies, declined during the year. Nominal Effective Exchange Rate (NEER) indices declined, reflecting the nominal depreciation of the Sri Lankan rupee against the US dollar and other major currencies considered in the baskets. Accordingly, the 5-currency and the 24-currency NEER indices declined by 5.3 per cent and 4.2 per cent, respectively. Meanwhile, the 5-currency and the 24-currency Real Effective Exchange Rate (REER) indices, which indicate Sri Lanka's external competitiveness implied by the inflation differential between countries along with the variation in nominal exchange rates, also dropped during the year, by 2.4 per cent and 1.4 per cent, respectively.

REER indices remained well below the base year level (2017=100), indicating the continued support of the exchange rate to the country's external competitiveness.

5.8.2 Developments in the Domestic Foreign Exchange Market

The transaction volumes in the domestic foreign exchange market declined in 2020. Accordingly, the volume of interbank foreign exchange transactions declined to US dollars 18,408 million in 2020, in comparison to US dollars 19,377 million in 2019. Notably, the total volume of spot transactions declined to US dollars 10,445 million (56.7 per cent of total transactions) in 2020, in comparison to US dollars 11,643 million in 2019. In contrast, the total volume of forward transactions increased to US dollars 7,964 million in 2020 from US dollars 7,734 million in 2019. Meanwhile, the Central Bank intervened in the domestic foreign exchange market by purchasing US dollars 282.5 million, on a net basis, in 2020, to build up the international reserves. This was a result of purchases of US dollars 685.4 million and a supply of US dollars 402.9 million.

Figure 5.15
Quarterly Inter-bank Forward Transaction Volumes



Source : Central Bank of Sri Lanka

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