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IMFC Statement by Nirmala Sitharaman
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India

On behalf of

Bangladesh, Bhutan, India, Sril Lanka

Statement by Ms. NIRMALA SITHARAMAN, Minister of Finance and Corporate Affairs, India, and Member, International Monetary and Financial Committee (IMFC), representing the Constituency consisting of Bangladesh, Bhutan, India, and Sri Lanka, to the 43rd Meeting of the IMFC at the Virtual Spring Meetings 2021

April 8, 2021

Impact of COVID 19 on Global Economy

1. During the past year, the world has witnessed widespread disruptions, including loss of lives and livelihoods as well as wealth destruction. Governments and Central Banks have rolled out conventional and unconventional policy support to combat the devastating impacts of the COVID-19 pandemic.

2. Rapid production and administration of COVID-19 vaccine is critical in this war against the pandemic. India as the largest producer of vaccines in the world is prepared and willing to augment international vaccination efforts. India has mustered all its resources to ensure availability of vaccines and other medical supplies, not only for its citizens, but also to support the international community, in particular, the vulnerable developing economies. Vaccines are being provided to more than 70 countries worldwide, and medical supplies from India are reaching out to more than 100 countries. India has firmly positioned itself as a global leader in terms of COVID-19 vaccine, visible in its vaccine production capacity and also in the speed of vaccination.

3. Amidst the pandemic, the struggle to save lives and safeguard livelihoods is universal. While extraordinary policy support by governments across the globe has helped limit the adverse impact on economies, we need to be vigilant against premature withdrawal of policies. It is evident that the pace of economic recovery and the course of containment of the pandemic will vary across countries. If we are looking for a durable and sustainable recovery, coordinating efforts and combining resources is the only way forward. Undoubtedly, the IMF would have to play a key role in this endeavor.

Role of the IMF

4. The IMF has provided emergency financing to more than80 countries since the onset of the pandemic. Timely financial support helped in upgrading the health infrastructure and insulating the vulnerable from slipping below the poverty line. A multi-speed recovery leading to an early policy normalization by the advanced economies may cause spillovers and significant economic disruption in developing and low-income market economies. This would require a far stronger and resilient international financial safety net. IMF may be called upon to provide much larger support to its membership as recovery starts taking shape in the post-pandemic world.

5. The post-pandemic global economic recovery is swifter and stronger than originally anticipated due to the unprecedented policy measures taken by the Governments and the central banks. The timely support of multilateral and regional financial institutions has been critical, with the IMF performing a pivotal role. The scarring effects of the crisis may have serious long-term consequences on the durability of recovery and financial stability, particularly in low-income emerging market economies. The G20 Debt Service Suspension Initiative (DSSI) has provided substantial debt relief to more than 40 low-income countries (LICs). Similarly, the common framework for debt treatment is expected to help needy LICs in enhancing their debt sustainability. Notwithstanding these enormous responses, the IMF must intensify its efforts in meeting the challenges ahead.

6. Therefore, it is necessary that the IMF remains adequately resourced. We have contributed to New Arrangement to Borrow (NAB) and Bilateral Borrowing Arrangements(BBAs) to help maintain the IMF's resource envelope. However, we would like to reiterate that continued dependence on borrowed resources can at best be a temporary and short-term arrangement. The failure of 15th General Review of Quotas (GRQ) has been disappointing. We should move swiftly and earnestly to complete the 16th GRQ process within the stipulated timeline. Apart from augmenting permanent resources, this is required to address the long pending issue of under-representation of emerging and developing economies and dynamic economies for their meaningful engagement in the governance of this institution.

7. We have an open mind on a new general allocation of SDRs, even though it is not a substitute for structural quota and governance reforms. We observe that SDR allocations are asymmetrical, with as much as 62 percent going to advanced economies and only 3 percent to LICs. Given this, why not then proceed with a limited SDR allocation targeted at LICs? We are open to discussions on the deployment of SDRs for low-income countries (LICs) to support healthcare and economic recovery. Priority should be accorded to modalities for channeling existing stocks of SDRs to the LICs on principles that are just and have traction with the entire membership.

8. Climate, and climate change policies, are the ultimate public good. India is among the few countries which is 2 degrees compliant and has taken many decisive actions in fighting climate change, at both the government, and private levels. India is on track to meet its Paris Agreement targets – to reduce emissions by 33-35% of its Gross Domestic Product (GDP) by 2030 from 2005 levels and achieve 40% of installed power capacity from non-fossil fuels by 2030. Only six countries are on track to meet their Nationally Determined Contributions (NDCs) announced in Paris, and India is on the top of this list. The current levels of emission of Green House Gases (GHG) and other effluents in the developing countries are driven by their developmental efforts to catch up with the income levels of advanced countries.

9. The current status of global climate change/damage is a result of industrialization and economic growth at least over the past one and half centuries. Thus, there is a need for evenhandedness in the treatment of the issues and the need for an unbiased yardstick that considers the stock of emissions that is now built into the atmosphere. This means that the excess polluters (primarily the rich countries) would have to compensate (via carbon financing and technology transfers) the poor countries – and that the roads to climate control will be different for different countries. The effects of adaptation and mitigation of climate change on developing countries could be minimized, if there is the availability of adequate, credible, and predictable climate finance for the developing countries and technology transfer and availability of low-cost technology, as agreed under the United Nations Framework Convention on Climate Change (UNFCCC). The developing countries will require new investments to adequately limit their growing greenhouse gas emissions. These countries will also require substantial financial resources to protect themselves from the worsening physical and economic impacts of greenhouse gases. Private capital playing a significant role in climate change mitigation and adaptation activities will also be difficult to achieve in the near future. Thus, to help developing countries fight against climate change, there is a need to encourage the implementation of the commitments by the developed countries to mobilize USD 100 billion per annum by 2020 in letter and spirit and to scale it up further. However, significant efforts on the climate finance front are yet to be seen in resource mobilization. Developed countries have to exhibit the spirit of cooperation with developing countries in sharing the burden of climate change mitigation and adaptation.

DEVELOPMENTS IN THE CONSTITUENCY

A. BANGLADESH

10. After economic fallout from the COVID-19 pandemic which had impacted the GDP growth rate of FY20 to decelerate at 5.2 percent, significantly lower than a record high of 8.15 percent growth rate in FY19. The government and Bangladesh Bank (BB) had taken timely and appropriate fiscal and monetary measures with a hefty stimulus package of Bangladeshi Taka (BDT) 1.24 trillion (4.44 percent GDP) to stimulate economic activities. As a result, Bangladesh economy witnessed a broad-based recovery in H1FY21. Sustained activities in the agriculture sector, rebound of industrial production backed by a turnaround of exports and construction activities reaching near to the pre-pandemic levels, and restoration in service sector activities with increased people's mobility including a rush in domestic tourism points are suggesting a recovery of economic activities during the H1FY21.

11. On the demand side, the pace of economic activities supported by robust domestic demand aided by strong remittance inflows (37.3 percent H1FY21) and significant growth in consumer credit (12.6 percent in H1FY21). The recent low levels of COVID infection rate and the acceleration of

vaccination program in addition to government's and BB's continued support to the economy against the pandemic are expected to help boost business confidence and economic activity, which would likely to have an expansionary effect on private credit demand in coming months. With all the protective and revival measures, it is expected that GDP growth in the coming fiscal years will attain closer to the targets of 7.40 percent in FY21 set by the government, assuming no major further disruption.

12. Headline Consumer Price Index (CPI) inflation (y-o-y annual average) stood at around 5.63% in February 2021, higher than the targeted 5.4% for FY21, reflecting a continued rise in international commodity and energy prices, an upturn in rice prices, increases in transport cost, agriculture wages, medical care, and health expenses in the recent months. Continued easy monetary condition, which intended to help rebound investment activities, presence of sizeable excess liquidity amid weak demand might have an implication on future inflation. Proper monitoring and strengthening of supply chains, particularly for essential food items is expected to contain inflation around the tolerable level for the remaining period of FY21.

13. The balance of payment witnessed a surplus of USD 6.41 billion in seven months of FY21, aided by a surplus in the current account balance to USD 2.24 billion on the back of hefty remittance inflows along with healthy inflows of FDI and medium and long-term loans. The nominal exchange rate remained broadly stable around 84.8 BDT per USD, thanks to the timely intervention of Bangladesh Bank. At the end of January 2021, foreign exchange reserves stood at USD 42.3 billion, which covers nearly 7.9 months of import payments. The government's 2.0 percent incentive has also contributed to the overall remittance income through the formal channel in recent months. However, the picture of overseas employment for Bangladesh is not so encouraging with thousands of migrants in the dark about their jobs due to the COVID-19 pandemic. This gloomy scenario in overseas employment is likely to bounce back in its normal trend as vaccination campaign is getting pace all over the world.

14. Preliminary estimated data indicate that revenue income was 4.1 percent of GDP in H1FY21, which amounted to BDT 1315.4 billion and met 34.8 percent of the annual budget target for FY21. Likewise, total budget expenditure was 5.8 percent of GDP in H1FY21, which amounted to BDT 1840.4 billion and met 32.4 percent of the annual budget target of BDT 5680.0 billion for FY21. The budget deficit is 1.7 percent of GDP H1FY21, which amounted to BDT 525.1 billion comprising domestic financing of BDT 329.1 billion and external financing of BDT 196.0 billion. The implementation of the new VAT law helped to generate higher tax revenue.

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

safeguard measures due to the global COVID-19 pandemic, and to achieve sustainable and environmentally friendly economic growth, Bangladesh would require adequate external supports in softer terms (particularly from the multilateral global institutions), including inter alia for attaining some of the key United Nations Sustainable Development Goals like climate change risk mitigation and adaptation, and for larger physical infrastructure projects.

B. BHUTAN

Macroeconomic Review

16. GDP recorded a growth of 5.5 percent in 2019, compared to 3.1 percent in 2018. The growth was largely contributed by the hydropower, and education and health sectors. The commissioning of the Mangdechhu hydro power project combined with favorable hydrological conditions supported the revival of the hydropower sector from negative 14.9 percent in 2018 to 12.1 percent in 2019. However, the growth momentum is expected to dip into negative in 2020 as a result of severe economic disruption caused by the COVID-19 pandemic. The contraction of economic activities has also caused large displacement in employment, bringing disruption in the labor market. The unemployment rate declined to 2.7 percent in 2019 from 3.4 percent in the previous year. However, it is expected to increase in 2020 with rise in uncertainty of COVID-19.

17. The overall CPI inflation recorded at 7.7 percent in December 2020 compared to 2.3 percent during the same month of the previous year. The increase in the overall inflation during the period was largely contributed by the increase in prices of food (14.8%) compared to non-food (2.0%).

18. The fiscal deficit recorded at 6.2 percent of GDP in the FY 2019/20 as compared to 1.6 percent in the FY 2018/19. The higher deficit was contributed by a substantial increase in budget outlay by 28 percent, on account of a significant increase of capital budget (31%) in the FY 2019/20.

19. On the external front, Current account deficit improved to 12.2 percent of GDP in FY 2019/20 from 21.2 percent in the previous year. This was mainly on account of reduction in trade deficit and net payments of primary income, followed by growth in secondary income receipts. In the trade account, the deficit decreased by 38.1 percent, due to increase in merchandise exports of Nu 47,056.96 million, against a lower merchandise imports of Nu 64,585.92 million.

20. The gross international reserves recorded at USD 1,433.9 million as of November 2020 which is sufficient to finance 18.7 months of merchandise imports.

21. The broad money (M2) recorded a significant growth at 21.4 percent in November 2020, as compared to 7.8 percent in the previous year. Higher growth in time and transferrable deposits

helped to drive the broad money supply. The net foreign assets grew by 37.8 percent in November 2020, as compared to 9.6 percent in the previous year.

Monetary measures in response to the COVID-19 Pandemic

22. The COVID-19 pandemic continues to pose unprecedented challenges globally, on both the health and economic fronts. Bhutan is truly fortunate to have His Majesty The King leading at the forefront and providing invaluable guidance and leadership to effectively manage the crisis. With the overall objective of maintaining the "hope and confidence of the people", interventions were guided by the principles of providing timely and inclusive relief support to individuals whose livelihoods were threatened by the pandemic and to ensure business continuity. Driven by such magnanimous foresight, as the pandemic reached Bhutan in March 2020, His Majesty The King set up the National Resilience Fund (NRF) of Nu 30 billion to provide the relief grants.

23. Monetary measures have been implemented to support the affected borrowers. In order to cushion the risks on the financial sector, timely monetary measures such as deferment of loan repayments, interest payment support and access to soft working capital, bridging loans and liquidity support have largely contributed to provide relief to borrowers and uninterrupted supply of credit in the economy. The monetary measures and easing of regulatory requirements in 2020 are as follows:

i) Reduction of the Cash Reserve Requirement from 10 percent to 9 percent on 17th March 2020 and further to 7 percent on 27th April 2020.
ii) Providing interest payment support.
iii) Extension of gestation period for projects under gestation.
iv) Deferment of loan repayment with 1 percent interest rate rebate for regular repayment during the deferment period.
v) Concessional term loans in the form of soft bridging loans to businesses.
vi) Release of the Capital Conservation Buffer of 2.5 percent (Nu. 25 billion) of Risk Weighted Average to increase the lending capacity of FIs.
vii) Provisioning of concessional term based working capital to wholesale distributors, tourism and related business, and manufacturing industries.
viii) Provisioning of micro loans for agriculture sector at 2 percent and for CSIs at 4 percent interest rates through the National CSI Development Bank.
ix) Implementation of the Domestic Liquidity Management System with the objective to ensure and provide undisrupted liquidity in the Banking system

C. INDIA

India's COVID response

24. World's largest COVID-19 vaccination drive is underway in India with 61.3million doses administered as on March 30, 2021. To increase the health stimulus, the vaccination capacity has been ramped up with 10,000 private hospitals under Ayushman Bharat, more than 600 private hospitals under the Central Government Health Scheme and several other private hospitals empanelled with state governments ready for deployment. While the vaccination drive remains the immediate focus, the health stimulus for the economy is not only about the COVID-19 vaccination program. The stimulus has in fact evolved into a comprehensive health care project in the country. Intensified Mission Indradhanush 3.0 launched in February 2021 for taking forward the Universal Immunisation Programme is an important pillar of the project. Budget 2021-22 has further expanded the health care project by more than doubling the health sector allocation over the previous year.

25. COVID-19 appeared to be on its way out after having peaked in September- October 2020 before surging again recently. The recent surge in COVID-19 infections is, however, largely restricted to a few states, and restrictions in terms of partial lockdowns, reduction in working hours and night curfews have been primarily local. Government of India in association with States/UTs is working on a five-fold strategy to curb the tide of new COVID cases in most affected districts via Exponential Increase in Testing, Effective Isolation and Contact Tracing of those infected, Re-invigoration of Public and Private Healthcare resources, Ensuring of COVID Appropriate Behaviour (CAB) and Targeted approach to Vaccination. As the vaccination drive continuously gains speed in India, the second wave of COVID-19 in India is expected to be short-lived. India is on the path to achieve the vaccination target of 300 million people in the next few months.

Macro-Economic Overview

26. India's GDP contraction of 24.4 per cent in Q1 of FY 2020-21 and 7.3 per cent in Q2 of FY2020-21 quarter reflect the unparalleled effect of the Covid-19 pandemic and the containment measures that were taken to control the pandemic. The contraction was consistent with the India's enforcement of one of the most stringent lockdowns as reflected in the Government Response Stringency Index measured by Oxford University.

27. Starting July, a resilient V-shaped recovery is underway, as demonstrated by the recovery in GDP growth in Q2 after the sharp decline in Q1 and a sustained resurgence in high frequency indicators. Overall movement of high frequency indicators over Q1, Q2 and Q3 indicated speedy pickup in Q2 and growing convergence to pre pandemic levels in Q3. The GDP grew by 0.4 percent in Q3 of 2020-21. As India's mobility and pandemic trends aligned and improved concomitantly, indicators like E-way bills, rail freight, GST collections and power consumption not only reached pre pandemic levels but also surpassed previous year levels.

28. Manufacturing activity continues its resurgent journey on the back of sales and output recovery and the Government's Self-Reliant India Package stimulus, thereby facilitating growth prospects and business sentiment. The beneficial wealth effect of booming equity markets are enabling consumption abilities of households with exposure to them. With rising capacity utilization, stronger demand conditions and relatively moderate costs, operating profits are rising across the board. Some services sectors like information technology, construction, real estate, finance, domestic trade and transport are gradually emerging from the shackles of the pandemic with government capital spending on roads, highways and metros, lower housing loan rates and reduced stamp duty rates benefitting the labour-intensive construction and real estate segment. Other categories of contact-sensitive services are expected to bounce back once the vaccination drive reaches a critical mass and infuses widespread macroeconomic certainty to boost consumption. The recent surge in COVID-19 cases, signifies that broad-based economic recovery is contingent on rapid vaccination and thereby containing the pandemic spread.

29. The Reserve Bank of India (RBI) undertook several conventional and unconventional measures in the wake of COVID-19. Other than conventional measures, the RBI introduced long term repo operations (LTROs) and targeted long-term repo operations (TLTROs) to augment system as well as sector-specific liquidity to meet sectoral credit needs and alleviate stress. Unlike many central banks, the RBI's asset purchases did not dilute its balance sheet and hence, did not compromise on core principles of central banking. These purchases were confined to risk-free sovereign bonds (including state government securities). The focus was to foster congenial financing conditions without jeopardizing financial stability. Further, forward guidance gained prominence in the Reserve Bank's communication strategy to realize cooperative outcomes. The commitment to ensure ample liquidity conditions supportive of recovery dispelled illiquidity fears and bolstered market sentiments.

30. After breaching the upper 6 percent tolerance threshold continuously since June 2020, CPI inflation moved below 6 percent in December 2020. The Monetary Policy Committee decided to continue with the accommodative stance as long as necessary – at least during the current financial year and into the next financial year – to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

Macro-Economic outlook

31. GDP growth is expected to be in positive territory in the second half of 2020-21, on the back of higher government expenditure, moderated contraction in private consumption and net exports emerging out of dismal retrenchment. An imminent pickup in foreign investment flows is visible.

On the supply side, agriculture and allied activities are clearly demonstrating resilience in the face of the pandemic with a normal monsoon, a bumper crop and government support. GDP growth is expected to rebound strongly in 2021-22 after a contraction by 8.0 percent in 2020-21. As per IMF projections, India is expected to grow at 11.5 percent in 2021-22, the fastest growth to be registered by any major country.

32. While India remains cognizant of the impact liberal fiscal and monetary policies may have on macro parameters, we are guarding against any premature withdrawal of stimulus. Several initiatives under the Self-Reliant Initiative, the production linked incentive scheme (PLI), and Union Budget 2021-22 with a focus on manufacturing, infrastructure, innovations, and health & well-being are intended to ensure that the recovery gainsfirm traction. Similarly, the accommodative monetary stance is being maintained till the prospects of sustained recovery are secured while closely monitoring the inflation outlook.

D. SRI LANKA

33. The Sri Lankan economy was severely challenged in 2020 with the onset of the COVID-19 pandemic. The outbreak occurred at a time when the country was experiencing low growth for a sustained period. While Sri Lanka took firm action including aggressive contact tracing, quarantining and lockdown measures to contain the spread of the first wave of the virus, second waves of infection with new variants have been more challenging to cope with the rapid transmission of the virus and an increase in the number of fatalities. The rollout of vaccines gives a glimmer of hope to curb the diffusion of the virus, however, uncertainties remain. Stringent domestic containment measures and negative spillovers from the global economic shutdown severely affected economic activity, particularly during the first wave. The government and the Central Bank implemented a series of fiscal, monetary and financial policy measures to spur economic activity and protect lives and livelihoods, while incurring health related expenditure to address the public health crisis.

Real Sector

34. The Sri Lankan economy contracted by 5.3 percent in real GDP terms during the first nine months of 2020 reflecting the adverse impact of COVID-19 pandemic measures adopted globally and domestically to halt the spread of the virus and unfavourable weather conditions experienced during the year. All sectors contributed to the deceleration in growth. Despite the positive expansion in value addition recorded in major subsectors such as wholesale and retail trade and financial services, the services sector, which accounts for nearly 60 percent of GDP, registered a negative growth of 2.6 percent largely due to the deceleration in transportation services, other

personal service activities and accommodation, food and beverage activities, all of which were severely impacted by the pandemic. The industry sector with a share of around 26.5 percent of the GDP, slowed down by 9.5 percent during the first nine months of 2020, as manufacturing activities, together with construction and mining and quarrying, registered a subdued performance. The agriculture sector, accounting for 7.2 percent of GDP, decelerated by 2.5 percent largely due to contractions in value addition in growing of tea, oleaginous fruits, forestry and logging, and fishing sub-sectors, despite the substantial positive growth rates witnessed in key agricultural activities such as growing of rice, cereals and vegetables. According to Central Bank projections, the economy is expected to contract by 3.9 percent in 2020 [Annual GDP data is expected to be released by DCS on 16 March 2021] This contraction is lower than envisaged by international agencies, and reflects the resilience of the Sri Lankan economy, and the rebound in the second half of 2020.

Inflation

35. Inflation was maintained broadly within mid-single digit levels in 2020 aided by subdued demand conditions and well anchored inflation expectations, although some upward pressure was observed intermittently due to the acceleration in food prices. Headline inflation (y-o-y) as measured by the National Consumer Price Index (NCPI), remained subdued at 4.6 percent in December 2020 while the Colombo Consumer Price Index (CCPI) registered 4.2 percent during the same month. Core inflation, which shows the underlying trend in inflation, remained at moderate levels registering 4.7 percent and 3.5 percent (y-o-y) respectively in terms of the NCPI and CCPI in December 2020, reflecting subdued demand pressures and the impact of tax and price reductions of certain items. Core inflation (y-oy) in January 2021 further decelerated to 4.2 percent and 2.7 percent in terms of the NCPI and CCPI respectively.

Monetary Sector

36. The Central Bank continued its accommodative monetary policy stance, given muted inflationary pressures, lending support to the recovery process. The COVID-19 crisis dealt a severe blow to economic activity necessitating substantial policy measures to cushion the adverse impact on businesses and households affected by the pandemic. In addition to the monetary policy easing measures adopted in January 2020, the Central Bank further lowered policy interest rates, namely the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by a total of 100 basis points in March, April and May 2020. As market lending rates remained downward rigid despite these easing measures, the Central Bank lowered policy interest rates by a further 100 basis points in July 2020 to historic low levels of 4.50 percent for the SDFR and 5.50 percent in respect of the SLFR. During the year, interest rate caps were also imposed to improve the monetary policy transmission process. To ease liquidity conditions in the domestic money market, the Central Bank reduced the Statutory Reserve Ratio (SRR) by 3.00 percentage points to

2 percent on two occasions during the year. Moreover, the Bank rate, an administratively determined rate that could be used in periods of emergency, was also lowered by 300 basis points in April 2020 and allowed to automatically adjust in line with the SLFR. Accordingly, the Bank rate declined by 650 basis points during 2020. Meanwhile, the Central Bank purchased Treasury Bills from the primary market easing the financing burden of the government during the exceptional pandemic period. In addition to the above measures, the Central Bank also implemented concessionary credit schemes for small and medium enterprises along with debt moratoria for businesses and individuals affected by the pandemic.

Fiscal Performance

37. Fiscal operations in 2020 were focused on mitigating the adverse impact of the COVID-19 pandemic and supporting the revival of economic activity. Accordingly, several measures were implemented by the government since January 2020 to revitalize the economy, provide tax relief to persons and businesses affected by the pandemic and protect lives and livelihoods through social protection programs. Tax reforms aimed at revitalizing the economy entailed several tax measures to ease the tax burden including the reduction in the VAT rate, lower income tax rates and the provision of tax incentives for identified sectors, while fiscal policy responses to the COVID-19 outbreak included the establishment of a COVID-19 Healthcare and Social Security Fund, relief measures for SMEs, extension of tax payment deadlines, cash allowances for targeted individuals and interest free advances to welfare program beneficiaries. The slowdown in economic activity due to lockdown measures, tax concessions granted, and restrictions imposed on imports significantly lowered the governments revenue mobilisation effort during the first eleven months of 2020. On the expenditure front, recurrent expenditure rose mainly due to an increase in salaries and wages and subsidies and transfers while capital expenditure reduced owing largely to the absence of budgetary provisions and lockdown conditions brought about by the COVID-19 pandemic. Despite the contraction in capital expenditure, the rise in recurrent expenditure resulted in an overall increase in expenditure for the first eleven months of 2020. The moderation in revenue and the increase in expenditure caused Key fiscal balances to deteriorate during the period under review. Domestic financing was used to bridge the fiscal gap, while reducing the reliance of the government on external financing.

External Sector

38. Sri Lanka's external sector, which was impacted severely by the COVID-19 pandemic in 2020, remained somewhat resilient, aided by policy measures implemented by the government and the Central Bank to improve the stability of the sector. The deficit in the trade account narrowed

considerably by USD 2.0 billion in comparison to the previous year as the reduction in merchandise imports outpaced the decline in goods exports reflecting the impact of lower international oil prices and policy measures to curtail non-essential imports. Meanwhile, the stoppage in tourist arrivals for the most part of 2020 due to pandemic related border closures, affected tourism earnings significantly impacting adversely the services account of the BOP, although the computer services sub-sector cushioned this to some extent with its healthy expansion. Worker's remittances recovered faster than expected, recording a notable growth over the previous year. As a result the current account deficit is estimated to have improved to USD 1.1 billion in 2020 compared to USD 1.8 billion in 2019. In the financial account, foreign investments in the government securities market as well as the Colombo Stock Exchange (CSE) showed a net outflow in 2020, although in January 2021 the government securities market recorded a marginal net inflow. The government is engaged with bilateral and multilateral partners to secure additional foreign financing. Gross official reserves stood at US dollars 5.7 billion at end December 2020 and US dollars 4.6 billion at end February 2021, equivalent to 4.2 and 3.4 months of imports respectively. The Central Bank has also taken measures to reduce unwarranted volatility in the exchange rate due to excessive speculation. Mirroring these trends, the Sri Lankan rupee depreciated by 2.6 percent against the US dollar in 2020 and 5.1 percent against the US dollar up to 12th March 2021. The Central Bank has taken several measures aimed at strengthening reserves through absorbing non-debt foreign exchange inflows, while continuing to work with the government and the private sector counterparts to enhance such inflows in the period ahead. The government continued to honour all its debt service obligations and remains committed to service such obligations in the period ahead while maintaining its unblemished debt service record.

Financing Support from the IMF

39. Sri Lanka's large fiscal gap and the balance of payments need necessitate external financing. The government is in the process of obtaining such financing from friendly nations to tide over the short term challenges, while introducing necessary reforms to enhance non-debt sources of foreign exchange inflows to both the current and financial accounts of the balance of payments.

40. The non-availability of emergency financing from the IMF, citing debt sustainability concerns based on strict assumptions excluded many countries from access to such funding when it was really needed. The Fund needs to show flexibility in its response to the COVID crisis for countries in this situation. As these are exceptional circumstances which demand exceptional measures, the IMF must find a way to address this issue if all countries are to benefit from emergency financing schemes.

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