

## THE IMPACT OF COVID-19 ON SRI LANKAN ECONOMY

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### Abstract

This paper examines the impact of Covid-19 on Gross Domestic Product, Monetary sector, Government income, and expenditure perspective and foreign sector. This study explores especially sectoral wise impact of the overall Sri Lankan Economy in the year of 2020 first three quarters. The Main objective of this paper identify the impact of Covid-19 on production, Monetary sector, fiscal sector, and foreign sector. This study mainly depends on the Secondary data and observatory. The descriptive statistics tools are used for this study. In 2020, when considering the economic growth, there was a slight decline during the first quarter. The second quarter showed a higher decline. Though the third quarter showed an improvement in the economy, due to the second wave of the corona virus, instability prevailed. During the last quarter a recovery was observed. The central bank aims at a 5.2% economic growth in 2021. It is believed that the flexible Monetary policy of the central bank and an accommodated fiscal policy of the government are an incentive towards achieving this. Though the inflation level is at the desired level and a slight highly fiscal sector deficit is recorded in the government's activities towards the fiscal sector in the economy is stable to a certain extent. Besides, in spite of the world wide challenges the foreign sector is able to keep it head afloat. The country's domestic economic policy and the economic recovery believe that the foreign sector will be strengthened in the future.

**Keywords-** Covid-19, Flexible Monetary policy, Fiscal sector, Recovery

## 1. Introduction

### Background of the Sri Lankan Economy in 2019

Sri Lanka entered to the upper middle income country level in terms of per capita Gross national income (GNP), as per the World Bank's classification in 2019. The value of the country's Gross Domestic Product (GDP) at current market prices was US dollars 84.0 billion in 2019, compared to US dollars 88.4 billion in 2018. Per capita GDP and per capita GNI at current market prices were estimated at US dollars 3,852 and US dollars 3,741, respectively, in 2019, in comparison to US dollars 4,079 and US dollars 3,968, respectively, in the previous year. The Sri Lankan economy has been enjoying single digit inflation continuously for over a decade as a result of proactive, forward looking monetary policy. Maintaining inflation at low and stable levels is considered to be an essential component to generate overall macroeconomic stability.

Though the internal conflict which prevailed in Sri Lanka ended in May 2009 and the average economy of the country reached 6% during 2017, 2018 and 2019. It was observed that the average economy of the country dropped

to 3%. The main reason for this drop was due to the belief in investors diminishing, policy and uncertainty in the political situation. Rewards show that the economy in 2017 was 3.6%, in 2018 was 3.3% and in 2019 after the Easter Sunday attacks it went down to the level of 2.3%. Further, the actions taken towards the stability of the macro environment also contributes towards this.

At the same time, when this reduced amount of trade deficit and this current account deficit were recorded in 2019 there seems to be increase in the total official reserve. Further, as the due to the decrease in taxes the budget deficit increased to 6.8%. Besides as a result of the slow economic activities in 2019 which resulted in a low state of demand, inflation of money too was at state at which it was expected to reach. At the same time, an accommodative Monetary policy was adopted to bring about a quick growth in economy.

In 2019, out of the total production of the country cultivation contributed 7% and showed a growth of 0.6%. The adverse acute climatic conditions attributed to this diminished growth. The industrial sector had recorded a 2.7% growth. The sectors which contributed 57% to the GDP had recorded a growth of 2.3%. Each of the total productions of the country which yielded 4079\$ in 2018 went down to 3852\$ in 2019. The slow economic growth and the depreciation of the rupees are the reason for this.

Due to the lessened economic activities in 2019, unemployment which was 4.4% in 2018 increased to 4.8% in 2019. Generally though there is a shortage of job opportunities, Sri Lanka continues to face certain general Structural problems. Sri Lanka continues to remain among the first 20 countries having a high level of 7.4% of employed women and a great difference in gender in the labour force. As the unemployment percentage continues to prevail at a high level among the youth, the women and people with educational qualifications this has turned out to be a problem of the job market.

When we take poverty into consideration according to poverty head count index, though 4.1% families under the poverty line, 35% of the people of the country receive Samurthi aid. In 2019, 433,504 families were newly included as Samurdhi beneficiaries in this year. Though the income from the tourism sector was high in the first quarter there was a fall following the Easter Sunday attacks which gradually decreased? In 2019, the arrival of tourists decreased by 18%.

## **2. Objective**

The Main objective of this paper identifies the impact of Covid-19 on Sri Lankan Economy. Special objective is impact of covid-19 on Gross domestic production, Monetary sector, fiscal sector and foreign sector.

### **Covid-19 and World Economic Perspective**

The world countries are facing a crucial moment in their economies due to the Covid-19. We are able to observe that the Covid-19 which was considered a health issue at the outset, gradually developed into an economic crisis. Though nearly 99.7 million people are affected by this on a world wide scale, nearly 2.14 million people have lost their lives. When considering Sri Lankan experiences, 59,167 people have been infected the death rate has risen to 287 till 23<sup>rd</sup> of January 2021.

From the report of the “world Economic Outlook” published by the international Monetary fund, we find that in October 2020. The world economy has dropped by 4.4%. When compared to 2019, the world's economic grown is 0.6% nearly 90 million people are facing a great challenge to reach the daily income level of \$1.90.

Developed economics have recorded a 5.8% economic drop in 2020 though has targeted a 3.9% increase in 2021. On the other hand, developing countries have recorded a 3.3% economic drop in 2020 and aims at a 6% economic growth in 2021. In 2020, the world economy has experienced a slump situation. To overcome this slump economic crisis the word central banks' governments have implemented many economic reforms. At the same time the central banks have been engaged in activities towards relaxing their Monetary policies. In this activity they are mostly following (nontraditional policies) unconventional policies. Central banks have reduced their interest rates. Governments with the particular view of reducing the stress faced by the affected businesses are helped by tax reforms. Though the Covid-19 has taken the world economy to an unstable position, yet the expectation of the Covid-19 vaccines have boosts up the morale of the economically affected countries.

### 3. Methodology

The study is mainly focused on secondary data and observatory. The data received from the “World Economic outlook- A long and difficult Ascent-2020 October” published by the international Monetary fund, Central Bank reports in 2019, Sri Lanka. The time period selected 2019 and 2020, and some expectation for 2021. Basic statistical tools as descriptive statistics are used for this study. Specially tables, charts, percentage methods are used for this analysis. This paper clearly analysis status of the Sri Lankan Economy in the first three quarters of the 2020 and some expectation of the 2021.

### 4. Findings

According to the real standards the GDP growth rate during the first 9 months in 2020 has recorded a 5.3% economic decline. In the first quarter it has been -1.65% and in the second quarter -16.3% decline of the economy. But in the third quarter economy recovered 1.5%. According to the Sri Lankan Experiences of Economic growth rates for last 10 years as follows,

| 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 1 <sup>st</sup> quarter | 2020 2 <sup>nd</sup> quarter | 2020 3 <sup>rd</sup> quarter |
|------|------|------|------|------|------|------|------|------|------|------------------------------|------------------------------|------------------------------|
| 8    | 8.4  | 9.1  | 3.4  | 5    | 5    | 4.5  | 3.6  | 3.3  | 2.3  | -1.65                        | -16.3                        | 1.5                          |

-20

In keeping with the Sri Lankan experience the first quarter of the year shows a small decline while the second quarter shows a tremendous drop. But we are able to observe a recovered in the third quarter.

#### Sector Wise Real Gross Domestic production Growth rate (%) (GDP Growth rate)

| Sectors                                     | 2018 | 2019 | 1 <sup>st</sup> quarter of 2020 | 2 <sup>nd</sup> quarter of 2020 | 3 <sup>rd</sup> quarter of 2020 | first 9 months |
|---------------------------------------------|------|------|---------------------------------|---------------------------------|---------------------------------|----------------|
| Agriculture<br>Reforestation<br>& Fisheries | 4.8  | 0.6  | -5.6                            | -5.9                            | 4.3                             | -2.5           |
| Industries                                  | 0.9  | 2.7  | -7.8                            | -23.1                           | 0.6                             | -9.5           |
| Services                                    | 4.7  | 2.3  | 3.1                             | -12.9                           | 2.1                             | -2.6           |
| GDP                                         | 3.2  | 2.3  | -1.6                            | -16.3                           | 1.5                             | -5.3           |

In the first quarter of 2020 records a negative growth where the two sectors are concerns except the service sector. In the second quarter from March 19 to May 2020 due to the complete lockdown to control the spread of corona in the country. Due to the complete lockdown the all sectors have recorded a great reduction. The GDP shows a 16.3% economic reduction. In the third quarter of the year from the slump state there has been a quick recovery in the economy. A totally 1.5% economic grown has been shown in third quarter.

Before the second wave of Covid-19 in October, a remarkable improvement was observed in the economy of Sri Lanka in the third quarter of 2020. The second wave of Covid-19 affected the speed of growth during the third quarter. In the fourth quarter as restrictions were imposed in selected place where the movement of people was concerned slightly fluctuated of the economy although, it's the effect on economic activities was not very much.

It is expected that the economy will improve by leaps and bounds in 2021 and would continue to prolong in the middle of that period. The efficiency and implementation of the economic policy which was proposed in the budget of 2021 with the view of kindling it's growth is believed to help in this venture.

#### Situations of inflation

| Months       | Headline inflation |                | Core inflation |                |
|--------------|--------------------|----------------|----------------|----------------|
|              | CCPI(2013=100)     | NCPI(2013=100) | CCPI(2013=100) | NCPI(2013=100) |
| March-20     | 5.4                | 7.0            | 2.9            | 3.2            |
| April-20     | 5.2                | 5.9            | 3.1            | 3.2            |
| May-20       | 4.0                | 5.2            | 2.9            | 3.7            |
| June-20      | 3.9                | 6.3            | 3.1            | 4.4            |
| July-20      | 4.2                | 6.1            | 3.2            | 4.5            |
| August-20    | 4.1                | 6.2            | 3.2            | 4.6            |
| September-20 | 4.0                | 6.4            | 2.9            | 4.8            |
| October-20   | 4.0                | 5.5            | 3.0            | 4.5            |

Source : Census and Statistical Department, November - 2020

Due to the slow activities of the Sri Lanka economy in 2019, the inflation and the expectation of the inflation have been continuously at a low level in 2020. This clearly shows that impact through the aggregate demand of the economy was low. We are also able to observe that the inflation continued to be in the desired range of 4% - 6%. Thereby, even during the Covid-19 period we have been able to see a favorable improvement where the inflation is concerned.

To recover from the effects of Covid-19, the world countries implemented a flexible Monetary policy through their central banks. Sri Lanka too, continues to uphold the flexible Monetary policy which was introduced in 2019. That is the Sri Lanka central bank reduced its policy interest rates such as Standing deposit facility rate(SDFR) and Standing lending facility rate (SLFR). Further, in August 2020, it reduced some interest rates which were high on loans of small amounts which won't felt to affect such people. It also reduced the interest rate of pawning to 10%. In November 2020 this highest interest rates on housing loans too were reduced. Even the interest rate on fixed deposits is continuously decreasing.

When we compare the first 10 months of 2019 and the first ten months of 2020 records show that the governments net lending has increased by 31.3% while to the government corporations net lending has increased by 28% and to the private sectors has increased by 5.6%. Further the net lending for government sectors has been continuing to expand. At the same time has increased remarkably and the expansion of domestic lending (M<sub>2b</sub>) broad money

supply has increased by 14.3%. The lending to the private sectors should increase continuously because the private sector plays an important role in the economy. This necessity has arisen for the loan extension.

As there was no budget in 2020 in Sri Lanka by way of Interim financial report and Government powers activities concerning the fiscal activities were carried out. When comparing the Government revenue of the first 7 months of 2020 and the first seven months of 2019 it had decreased by 26%. The tax flexibility granted following the presidential election, the reduction in the economic activities due to the spreading of Covid-19 recorded a drop in the collection of taxes. Though a drop was in the tax income, non tax income during this period shows a slight increase from 87.5 BR to 92.8 BR in a way of this replacement. When the expenditure, observing the recurrent expenditure of the first seven months of 2019 compared to the first seven months of 2020, an increase is visible in 2020. With the view of coming out of the Covid-19 Crisis the government by pursuing business activities has shown an increase in recurrent expenditure. Yet, a severe reduction has been recorded, where capital and net borrowing are concerned.

When comparing the first seven month of 2019 with the first seven months of 2020, the current account balance in 2019 has been -2.1% while in 2020 it has been -4.5% showing a greater deficit. Similarly, the primary balance in 2019 dropped to -0.8% while in 2020 it become 1.9% showing a high level of deficit. The cumulative balance in 2019 was -4.6% while in 2020 it showed a -5.6% which was a high level of the deficit. Covid-19 has terribly affected the fiscal balances.

From 2020 January to July 2020 the deficit in the budget was financed through domestic sources while foreign investments have recorded a net re-payment. Further, among the domestic financing, loans from the banking sector play the greatest part.

Due to the expansion in the deficit of the budget, the increase in net financing contributed to borrowing by the central government. For the increase of the foreign lending, the reason is depreciation of the exchange rate. Towards the end of July in 2019 domestic borrowing was 6509.8 BR (51%) but at the end of July 2020 it increased to 7708 BR (54%). At the same time foreign lending increases from 6192.8 BR (48.4%) to 6553 BR (46%). The total government borrowing during both these periods increased from 12702.6 BR to 14261.0 BR.

When comparing the first ten months of 2019 with the first ten months of 2020, we find that in 2020 the income from exports had dropped by 16.7. The second wave of Covid-19 affected the production in the textile industry and its allied services posing great difficulties. When comparing with the previous year, records show a 21.2% drop. The reason for this was the demand for Sri Lankan products in Sri Lankan's important export market going down. During the period under review, in the USA and in the European Union markets, there was a decrease in the textile are clothing exports.

By the export of personal safety equipment such as plastic products, surgical equipment, gloves etc. Even in the export of agricultural products when compared with the same period in the previous year, it recorded a 6.2% drop. In particular, the export of Sri Lankan tea recorded a 9.4% drop. Out of the total exports, 2020 showed a 16.7% drop.

When we review the imports of Sri Lanka the expenditure incurred during the first 10 months showed a great drop. The reason for this was the low prices of crude oil and the restrictions imposed by the government on the import of unessential items. Especially when compared to the first 10 months of 2019, the total import expenditure dropped by 19.9%.

he import of the 3 sections has shown a drop. The import of consumer products dropped by 11.8%. It caused by the import of vehicles dropped. The import of intermediate good dropped by 21.5%. This occurred even in fuel, textiles and garments.

During the period January 2020 to October, the trade balance had dropped from a deficit of 6451 million US dollars in 2019 during the same period to 4852 million US dollars.

When we review the arrival of tourists, it shows zero from April 2020 to October. During the first 10 months of 2020 the total number of tourist arrivals were 507, 311. During the same period of 2019 it was 14,95055. The cumulative income from the tourism sector during the first 10 months of 2020 was 956 million US dollars. It was 2818 US dollars in 2019.

During the period 2020 January to October the cumulative income through labour remittances was 5680 million US dollars recorded a 2.6% growth. So though the income earned through tourism lessens, it was balanced to some extent through the labour remittances.

If we view the financial sector basics, during the first ten months, in both government bonds and market and the Colombo stock exchange net withdrawal is recorded. From Colombo stock exchange, a net withdrawal of 194 million US dollars has been recorded. From the government bonds has a net withdrawal of 532 US dollars is recorded.

The extent of the total official reserves in October 2020 was 5.9 billion US dollars. Total official reserves was equal to the imports of 4.2 months. The total official reserves at the end of 2020 October, inclusive of the total official reserves and the foreign investments of the banking sector was 8.6 billion US dollars which was sufficient for the imports for 6.2 months.

On the whole, up to the period 2020 records show that the Sri Lankan rupee showed a depreciation of 2.4% against the US dollar, a 9.8% depreciation against the Euro a 3.7% depreciation against the Israeli pound a 9.2% depreciation against the Australian dollar and a 1% appreciation against the Indian rupee.

So if we on the whole view the development of the foreign sector, though there are favorable features are also unfavorable features. That is to say, that though the income lessened through exports, the drop in the import expenditure being more than this, trade deficit was reduced. Further, we are also able to see an advantageous nature in the exchange rate.

## **5. Conclusion**

Before the second wave of covid-19 took hold of Sri Lanka, in October 2020 the economy of the country had improved to a good extent. It is expected that the economy would improve greatly during the midterm of 2021 and have a continuous growth. Amidst the challenging economic development of the world, the foreign sector is in a position to keep pace with it. The uncertainly politics, constant policy and the expected recovery of the world economy and the methods introduced to improve the economy within our country are expected to strengthen the future of Sri Lankan's foreign sector.

In keeping with the monetary flexibility followed so far, the market interest rates are continuing to show a drop in it. In recent times the headline inflation has been at expected level of 4 - 6. At the same time it reflected slow demand pull shocks. The core inflation too was at a low level. Even though a drop in economy has been recorded during the second quarter of 2020, the third quarter of 2020 shows a very quickly recovered. Further, though a state lockdown due to covid-19 occurred in October, it was less compared to the second lockdown. So, even if there is a slight imbalance in the economy of the fourth quarter, it is expected that in 2021, there would be immense improvement in the Sri Lankan economy. Because it is expected that the flexible Monetary policy and the relaxed Monetary policy introduced by the central bank would jointly take the economy to great heights.

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