

Further Drop in External Value of Sri Lanka Rupee

This column has already (September 1975 issue of the Economic Review) commented on the fact that since our exchange rate system is based on a fixed parity rate with the Pound Sterling (£ 1 = Rs. 15.60), the Sri Lanka Rupee has depreciated considerably against the world's major currencies, particularly the US Dollar. The Rupee equivalent of a US Dollar has risen from Rs. 6.69 at the end of 1974 to Rs. 7.71 at the end of 1975, reflecting a depreciation of the external value of the Rupee by over 13%.

In the second week of March this year, there occurred a further significant depreciation of the Rupee against the dollar. This was a result of the run on the Pound Sterling in world money markets which depressed the Pound from £2.02 to £1.94 in a matter of about four days. The Rupee-Dollar rate changed correspondingly to nearly Rs. 8.00 per Dollar which is a depreciation of nearly 4% from the level at the end of 1975. Compared with the level a year back, the new exchange rate represents a drop of over 16%. The resignation of British Prime Minister Mr. Wilson, announced on 15th March, led to a further confusion in money markets causing a decline in the Pound further to £1.90. The indications are that the Pound would go down further in the coming weeks and if this happens, the Sri Lanka Rupee is bound to depreciate further against the major currencies of the world.

In this context, several important questions may be posed: Are these depreciations in the Sri Lanka Rupee really necessary? Every time the Pound Sterling depreciates in world money markets (reflecting the relatively high rate of inflation in Britain), should we follow suit and depreciate the Rupee by a similar magnitude? In short, should the Sri Lanka Rupee continue to remain linked with the Pound at a fixed parity rate at a time when the value of the Pound is declining in world money markets? It is

time that our monetary authorities pay attention to these issues and examine the rationale of the present exchange rate system based on the Pound Sterling.

There have been many important changes in our trade and exchange situation in recent years. Our major trading partner is no longer Britain or the Sterling Area. Over the years, the importance of U.K. and the Sterling Area has shown a marked decline as a source of our imports and as markets for our exports. Whatever our trading pattern, all freight payments on our exports are made in US Dollars. Moreover, our exports fail to command a realistic value (in terms of purchasing power of imports) when export receipts are in Pounds which is declining in relation to other major currencies with which we have to pay for most of our imports. Most countries in the world today are trading in terms of US Dollars and in fact, some countries such as India, have taken steps to revalue their national currencies as a measure of offsetting the declining value of the Pound on their external trade. It may be noted here that, in the case of Sri Lanka, the effective exchange rate for the bulk of the imports and a sizeable part of exports, is the FEECs inclusive exchange rate rather than the official rate. The introduction of the FEEC Scheme in May 1968, the increase in the rate of FEECs from 45% to 65% coupled with an extension of the coverage of goods subject to FEECs have led to a substantial implicit devaluation of the Rupee over the years. Even the introduction of the Convertible Rupee Account Scheme has the effect of creating another (further depreciated) rate of exchange since the CRA funds command a premium over the FEECs inclusive rate of exchange. It is well known that the costing of goods imported with CRA funds is generally based on a much higher rate of exchange than the FEECs inclusive value of the Rupee.

Inflation and the Increase in the Issue of Currency Notes of Higher Denominations

The cost of living index (Colombo town) is an inadequate measure of the inflation in this country. It has moved up by only 2% during the period January-December 1975. (The index rose from 195 in January to 199 in December). However, compared with a rise of 34% in the cost of living index during the decade 1960-70, there has been a rise of over 40% during the five year period 1970-75. The sharp increase in the circulation of currency notes of higher denominations (Rs. 100 and Rs. 50 notes) relative to the smaller denominations (Rs. 10 and Rs. 5 notes) could also be taken as a rough indication of the high rate of inflation prevailing in the country in recent years. In a period of rising prices leading to a decline in the purchasing power of money, notes of higher denominations usually expand since they are now doing what the smaller denominations did earlier (at lower price levels).

Currency Notes Issue of the Central Bank

	<i>In millions</i>			
	Rs. 100	Rs. 50	Rs. 10	Rs. 5
End 1971	421	313	353	71
End 1972	532	351	354	75
End 1973	658	420	360	77
End 1974	778	440	374	82
End 1975	863	440	358	77

As seen in the above table, the issues of Rs. 100 notes have more than doubled during the period 1971-75 while Rs. 50 notes have risen by about 35%. The highest increases have taken place during 1973-77. On the other hand, the issue of Rs. 10 and Rs. 5 notes have remained relatively stable during the same period. In fact, there has been a decline in the issue of notes of smaller denominations in 1975.

WAGE INCREASES

The government revised the additional payments presently made to employees of the Central Government and State Corporations, Statutory Boards, including Universities of Sri Lanka and State Banks, with effect from January 1976. The additional payments will be extended to both monthly paid and daily paid employees.