



# Insights

March 2022

## Restoring forex market stability – would a mere currency devaluation suffice?

On 7<sup>th</sup> March 2022, the Central Bank of Sri Lanka (CBSL) [announced](#) that it would allow greater flexibility in the exchange rate and hence devalued the currency to Rs. 230 per US dollar. ICRA Lanka in the past has warned that the earlier peg was unsustainable and that devaluation was inevitable, on several occasions. It is our view that the current devaluation alone is less likely to restore the stability in the domestic forex market and confidence in the rupee, ultimately necessitating further measures.

In the past, there have been several instances where inadequate and mistimed exchange rate policy eventually pushed the nation to adopt more drastic and complex measures. For instance, in the early 1960s it became apparent that even stringent import controls did little to contain the nation's external troubles and subsequently, the exchange rate was eventually depreciated by 20% in the latter part of 1967. Similar to the current context, this devaluation was indeed prudent and vital but the poor-timing and the inadequacy of it made its effectiveness questionable. In 1968 the government in consultation with the International Monetary Fund (IMF) introduced the Foreign Exchange Entitlement Certificate (FEEC) scheme. Much like the official and premium rate at play at present, this scheme introduced a dual exchange rate system; one 'official' rate and another 'floating' rate. The floating rate was a depreciated rate in comparison to the official rate and was especially extended to small-scale export industries, ensuring competitive prices in the international market. On the payment side, essentialities like rice, wheat flour, and fertilizer were imported at the lower official rate. Initially, FEECs were sold on tender, the price determined by market forces and the price settled at LKR 44 per Re. 100, a 31% depreciation from the official rate. This price was then raised to LKR 55 in 1969 and LKR 65 in 1972. Despite the adaptation of such intricate measures to safeguard the country's external sector from gradual downfall, Sri Lanka's external troubles persisted calling for a radical shift in 1977. Sri Lanka then adapted a managed floating system which evolved into a free float system in 2001.

It is apparent that in the years following independence, Sri Lanka suffered major set-backs as a result of delayed and inadequate policy measures. In retrospect, the country certainly has many lessons to learn from the evolution and the consequences of its exchange rate policy, one can only hope that these lessons are duly learnt and that Sri Lanka escapes the vicious cycle of short lived prosperity and diving in and out of near economic collapse.

Published date: Mar 10, 2022

Document #: ins22mar10

©Copyright, 2022- ICRA Lanka Limited. All Rights Reserved. Contents may be used freely with due acknowledgement to ICRA Lanka. All information contain herein are from sources deemed reliable; however, no representation or warranty is made to the accuracy of thereof.

# About ICRA

ICRA Lanka Limited (ICRA Lanka) is a Credit Rating Agency licensed by the Securities and Exchange Commission of Sri Lanka (SEC). ICRA Lanka is a fully owned subsidiary of ICRA Limited ("ICRA") of India. The ultimate parent company of the international credit rating agency, Moody's Investors Service, is the indirect majority shareholder of ICRA.



Subsidiary of  
**ICRA Limited**

#### CORPORATE OFFICE

Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka

Tel: +94 11 4339907; Fax: +94 11 2333307

Email: [info@icralanka.com](mailto:info@icralanka.com); Website: [www.icralanka.com](http://www.icralanka.com)

#### Disclaimer

This publication has been prepared by ICRA Lanka solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ICRA Lanka does not represent that it is accurate or complete. ICRA Lanka does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication.

# Contacts

Rasanga Weliwatta  
Head of Ratings  
+94 773553564  
[rasanga@icralanka.com](mailto:rasanga@icralanka.com)

Access more of our research content at  
<https://www.icralanka.com/research/>

#### Follow us on



IcraLanka



icra-lanka