



# SRI LANKA

May 2019

## FIFTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT AND REPHASING OF PURCHASES—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SRI LANKA

In the context of the Fifth Review Under the Extended Arrangement Under the Extended Fund Facility, Request for Waivers of Nonobservance of Performance Criteria, Extension of the Arrangement and Rephasing of Purchases, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 13, 2019, following discussions that ended on February 28, 2019, with the officials of Sri Lanka on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on April 29, 2019.
- A **Statement by the Executive Director** for Sri Lanka.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 19/162  
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May 13, 2019

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

**IMF Executive Board Completes the Fifth Review under Sri Lanka's Extended Arrangement under the Extended Fund Facility; Grants Waivers of Nonobservance of Performance Criteria and Approves US\$ 164.1 million disbursement and Extension of the Arrangement<sup>1</sup>**

On May 13, 2019, the Executive Board of the International Monetary Fund (IMF) completed the Fifth Review of Sri Lanka's economic performance under the program supported by an extended arrangement under the Extended Fund Facility (EFF). Completion of this review, upon the granting of waivers of nonobservance for the end-December 2018 performance criteria on the primary balance and net official international reserves, makes available SDR 118.5 million (about US\$ 164.1 million), bringing total disbursements under the arrangement to SDR 833.73 million (about US\$ 1.155 billion). The Executive Board also approved an extension of the arrangement by one additional year, until June 2, 2020, with rephrasing of remaining disbursements.

Sri Lanka's three-year extended arrangement was approved on June 3, 2016, in the amount of about SDR 1.1 billion (US\$1.5 billion, or 185 percent of quota in the IMF at the time of approval of the arrangement. See Press Release No. 16/262).

Following the Executive Board's discussion of the review, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair of the Board, issued the following statement:

"We join Executive Directors in extending our condolences to the government and people of Sri Lanka for the loss of life and suffering caused by the recent terror attacks.

"The Sri Lankan authorities have successfully brought the program back on track, despite important setbacks, by advancing fiscal consolidation through a well-targeted 2019 budget,

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<sup>1</sup> The EFF was established to provide support of comprehensive programs that include policies of the scope and character required to correct structural imbalances over an extended period. For more details see <http://www.imf.org/en/about/factsheets/sheets/2016/08/01/20/56/extended-fund-facility>.

rebuilding reserves, while maintaining a prudent monetary policy under greater exchange rate flexibility, and reviving structural reforms. Sustaining policy discipline remains critical to strengthen resilience, given still sizable public debt and low external buffers, and support strong and inclusive growth.

“Sustained revenue mobilization is needed to place public debt on a downward path, while making space for critical public investment and an expansion of the social safety net under well-defined selection criteria. Strengthening the selection and appraisal process of large-scale investment projects and assessing their fiscal affordability is critical, given Sri Lanka’s high public debt. Stronger fiscal rules and a medium-term debt management strategy will support medium-term fiscal consolidation and debt reduction efforts.

“The authorities should renew their efforts to strengthen SOE governance and transparency, including by advancing a restructuring plan for SriLankan Airlines and completing energy pricing reforms, building on important progress with the implementation of the fuel pricing formula.

“The Central Bank of Sri Lanka should continue to pursue a prudent and data-dependent monetary policy. The amendments to the central bank law will be a major step in the transition to flexible inflation targeting. Efforts to build reserves should be sustained, under greater exchange rate flexibility, to protect the economy against shocks. Harmonizing regulation and supervision of financial institutions, strengthening the macroprudential policy framework, and enhancing the crisis-preparedness toolkit will help further strengthen financial sector stability.

“Continued implementation of structural reforms is essential to support strong and inclusive growth. Efforts should focus on liberalizing trade, improving the business environment and promoting investment, strengthening governance, encouraging female and youth labor force participation, enhancing social protection, and improving crisis preparedness to natural disasters.”



# SRI LANKA

April 26, 2019

## FIFTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA, EXTENSION OF THE ARRANGEMENT AND REPHASING OF PURCHASES

### EXECUTIVE SUMMARY

**Recent developments and outlook.** Higher fuel prices and global financial volatility generated strong balance-of-payment pressures in 2018, which were exacerbated by a political crisis late in the year. The Central Bank of Sri Lanka (CBSL) maintained a tight monetary policy stance, intervening in the FX market and allowing for greater exchange rate flexibility in response to rising pressures. Growth slowed to 3.2 percent in 2018, but is expected to recover gradually to 5 percent over the medium-term.

**Program performance.** Amid external shocks and a weak domestic environment, program performance suffered important setbacks in 2018. Following the resolution of the political crisis by end-2018 and in the aftermath of the terrorist attacks of April 2019, the authorities remain committed to the program and are requesting an extension of the EFF arrangement by one additional year to allow more time to complete the reform agenda, recalibrating program targets and rephasing purchases. A well-targeted 2019 budget was submitted to Parliament as a prior action for this review, while the CBSL resumed FX purchases to rebuild reserve buffers as a corrective action for the requested waiver on the reserve target. The authorities also implemented five structural benchmarks for this review, despite the delays.

**Key challenges ahead.** The Sri Lankan economy remains vulnerable to shocks, given high public debt, large refinancing needs, and low external buffers. Although domestic uncertainty remains elevated, the authorities are committed to strengthen the resilience of the economy through a strong policy mix, with prudent monetary policy, greater exchange rate flexibility, and revenue-based fiscal consolidation. They are also advancing their structural reform agenda to secure the hard-won gains under the program and support strong and inclusive growth.

**Staff supports the authorities' request.** The purchase available upon completion of this review will be equivalent to SDR 118.5 million, bringing total purchases under the Extended Fund Facility (EFF) to SDR 833.73 million.

Approved By  
**Anne-Marie Gulde-  
 Wolf (APD) and  
 Martin Sommer (SPR)**

Discussions were held in Colombo during September 13–27, 2018 and February 14–28, 2019. The missions met with Prime Minister Wickremesinghe, Minister of Finance Samaraweera, State Minister of Finance Wickramaratne, Minister of Economic Reforms and Public Distribution De Silva, Governor of the Central Bank of Sri Lanka Coomaraswamy, other senior public officials, and representatives of the business community, civil society, and international partners. The teams included Manuela Goretti (head), Pablo Morra, Andrew Hodge, Sarwat Jahan, Masahiro Nozaki (all APD), Saji Thomas (FAD), Peter Lindner (MCM), Fei Liu (SPR), Tubagus Feridhanusetyawan, Eteri Kvintradze (resident representatives), and Amitha Sundararaj (local economist). Mr. Siriwardana (OED) participated in the discussions. Guli Gamwalla-Khadivi, Cormac Sullivan, Biying Zhu, and Nimarjit Singh also contributed to the preparation of this report.

## CONTENTS

<b>CONTEXT</b>	<b>4</b>
<b>RECENT MACROECONOMIC DEVELOPMENTS</b>	<b>4</b>
<b>OUTLOOK AND RISKS</b>	<b>6</b>
<b>PROGRAM PERFORMANCE AND POLICY DISCUSSIONS</b>	<b>6</b>
A. Advancing Fiscal Consolidation and Strengthening Institutions	6
B. Strengthening SOE Governance and Reducing Fiscal Risks	9
C. Modernizing the Monetary Policy Framework and Rebuilding Reserves	11
D. Advancing Financial Sector Reforms	15
E. Accelerating Structural Reforms to Promote Sustainable Growth	16
<b>PROGRAM MODALITIES</b>	<b>19</b>
<b>STAFF APPRAISAL</b>	<b>20</b>
<b>BOXES</b>	
1. Status of China’s Belt and Road Initiative Projects in Sri Lanka	10
2. Social Safety Net Reforms in Sri Lanka	17
<b>FIGURES</b>	
1. Real Sector	22
2. Fiscal Sector	23

3. Financial Market	24
4. Foreign Exchange and Reserves	25
5. Monetary and Financial Sector	26

## TABLES

1. Selected Economic Indicators, 2016–24	27
2a. Summary of Central Government Operations, 2016–24 (In billions of rupees)	28
2b. Summary of Central Government Operations, 2016–24 (In percent of GDP)	29
2c. Summary of Central Government Operations, 2018–19 (In billions of rupees)	30
3. Central Government Financing Needs, 2019–20 (In billions of rupees)	31
4a. Monetary Accounts, 2016–20 (In billions of rupees)	32
4b. Monetary Accounts, 2018–19 (In billions of rupees)	33
5a. Balance of Payments, 2016–24 (In millions of U.S. dollars)	34
5b. Balance of Payments, 2018–19 (In millions of U.S. dollars)	35
6. Gross External Financing, 2016–24	36
7. Financial Soundness Indicators—All Banks, 2016–18	37
8. Proposed Reviews and Purchases Under the Arrangement	38
9. Projected Payments to the Fund, 2019–33	39

## ANNEXES

I. Supporting Sri Lanka’s Female and Youth Employment	40
II. Debt Sustainability Analysis	43
III. Capacity Development Integration Matrix	55

## APPENDICES

I. Letter of Intent	63
Attachment I. Memorandum of Economic and Financial Policies	65
Attachment II. Technical Memorandum of Understanding	94

## CONTEXT

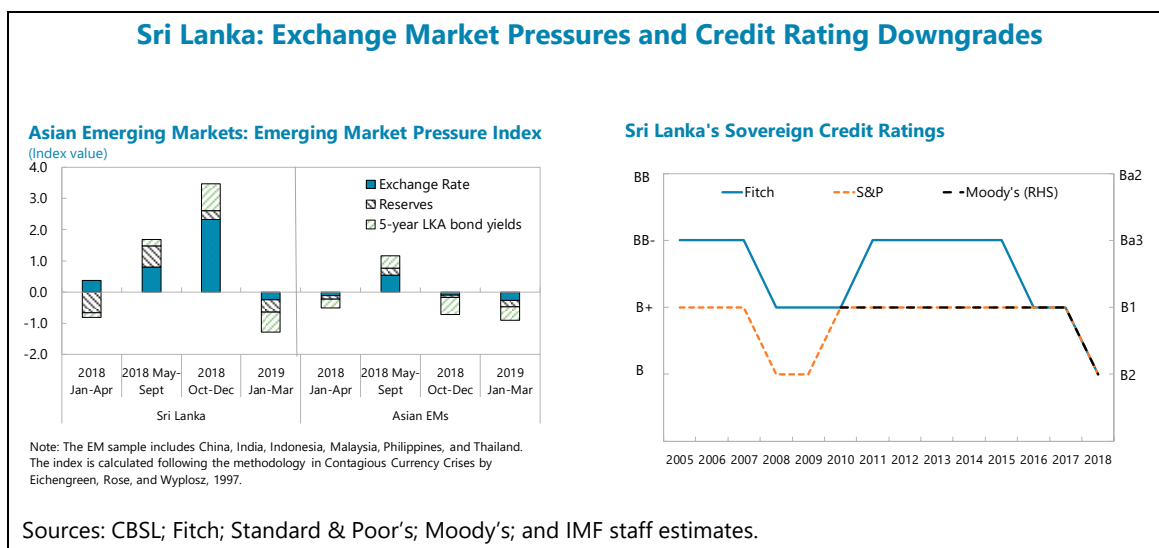
1. **External shocks and a political crisis in late 2018 disrupted program performance, delaying the completion of the fifth review.** Since April 2018, tighter global financial conditions and higher fuel prices generated strong balance-of-payment pressures and led to significant reserve losses. These shocks were exacerbated by political turmoil in October 2018, when President Sirisena replaced Ranil Wickremesinghe with former President Mahinda Rajapaksa as Prime Minister (PM). As the newly-appointed PM could not secure a parliamentary majority and the Supreme Court ruled against early elections, Ranil Wickremesinghe was reinstated as PM in late December. The political crisis delayed the 2019 budget and intensified market pressures, amid concerns about the government's ability to refinance upcoming debt maturities in early 2019, leading to additional reserve losses and a marked slowdown in growth.
2. **On April 21, 2019, Sri Lanka was hit by multiple terrorist attacks.** Suicide bombers hit churches and high-end hotels, with over 250 casualties and hundreds more injured. The President called a nationwide state of emergency, tightening security, and launching investigations with support from the international community. The authorities are resolved to stabilize the security situation and minimize the impact on the economy.
3. **Following the resolution of the political crisis and in the aftermath of the terrorist attacks, the authorities are committed to bring the economic reform program back on track.** This includes advancing revenue-based fiscal consolidation to place the high public debt on a downward path, through a well-targeted 2019 budget; resuming FX purchases and promoting greater exchange rate flexibility to rebuild reserve buffers; and reviving the structural reform agenda to support debt sustainability and inclusive growth. The authorities have requested a one-year extension of the EFF arrangement, with rephrasing of purchases, to allow more time for the completion of the economic reform agenda and provide a strong policy anchor in the run up to the presidential and parliamentary elections in late 2019 and mid-2020.

## RECENT MACROECONOMIC DEVELOPMENTS

4. **Economic performance weakened in 2018, in the context of higher oil prices, volatile market conditions, and domestic political turmoil, with a mild recovery in early 2019.**
  - *Real GDP growth* slowed to 3.2 percent in 2018, driven by a marked slowdown in manufacturing, mining and quarrying and a contraction in construction, which were exacerbated in the last quarter of the year by disruptions associated with the political crisis. High-frequency indicators,

including industrial production and purchasing managers indices, point to a gradual improvement in manufacturing activities in early 2019.<sup>1</sup>

- *Headline inflation* fell to 2.8 percent (y-o-y) by end-2018, below the CBSL's inner consultation band (115), driven by lower food and transport prices, with core inflation at 3.1 (y-o-y) percent. Headline and core inflation rose back within the band in January, to 3.7 and 5.5 percent respectively, with the release of new surveys on housing rental prices and education tuition fees, and recovered further to 4.3 and 5.6 percent (y-o-y) in March, largely driven by tax increases on liquor, tobacco, and gasoline (118).
- The *current account deficit* widened to 3.2 percent of annual GDP in 2018, from 2.6 percent of GDP in 2017, reflecting lower agricultural exports, higher oil prices, and a temporary surge in imports of vehicles. The *real effective exchange rate* depreciated by 13 percent in 2018, amid strong market pressures, and stabilized in 2019Q1.
- *Gross international reserves* (GIR) declined to US\$6.9 billion by end-2018, as the CBSL sold US\$1.1 billion, on a net basis, in 2018 to stem balance-of-payment pressures.<sup>2</sup> The EMBI spread widened to 445 basis points as of end-2018, amid downgrades by all major credit rating agencies. External pressures started easing in early 2019. GIR recovered to US\$7.6 billion as of end-March 2019, as the CBSL resumed FX purchases and the government tapped international bond markets in March, raising US\$2.4 billion at 5- and 10-year maturities (6.9 and 7.9 percent yields). The EMBI spread narrowed to 405 basis points as of end-March. The market reaction in the week following the terrorist attacks was contained, with modest FX intervention by the CBSL to curb rupee volatility and some pressures in the international bond market.



<sup>1</sup> The authorities plan to rebase and publish new GDP series later this year, incorporating methodological improvements, including to better capture construction activities. Staff will review any program implications.

<sup>2</sup> The CBSL publishes monthly FX intervention data in its Weekly Economic Indicators report.



## OUTLOOK AND RISKS

**5. The economic recovery is expected to be gradual.** Real GDP growth is projected to recover to 3.6 percent in 2019 (compared to 4.5 percent at the time of the fourth review), driven by agriculture and manufacturing, and to gradually reach 5 percent over the medium term. Inflation is expected to rise to 4.5 percent by end-2019, as economic activity recovers and food prices stabilize, following weather-related supply disruptions in 2018. The current account deficit is projected to narrow to 2.8 percent of GDP in 2019, driven by export growth, supported by the exchange rate correction and recently-signed free trade agreements, and lower oil prices.<sup>3</sup>

**6. The balance of risks remains tilted to the downside.** The economy remains vulnerable to adverse shocks given the high public debt, large refinancing needs, and low reserves. A tightening in global financial conditions and capital flow pressures could raise refinancing risks. Trade tensions in key economies, coupled with weaker global growth, could reduce export growth, FDI, and remittances. On the domestic front, political uncertainty in the run up to the elections poses risks to program implementation, while security concerns following the terrorist attacks might negatively affect tourism and investor sentiment. On the upside, stronger external demand and FDI, an easing of trade tensions and global financial conditions could support growth and facilitate the adjustment. Lower energy prices would reduce the current account deficit and support the implementation of energy pricing reforms.

## PROGRAM PERFORMANCE AND POLICY DISCUSSIONS

### A. Advancing Fiscal Consolidation and Strengthening Institutions

*The authorities are committed to advance revenue mobilization to reduce public debt, while making space for critical spending and growth-enhancing reforms, supported by stronger rules and institutions.*

**7. The 2018 primary balance fell short of target due to weak revenue collection.** The primary surplus improved from a balance in 2017 to a 0.6 percent of GDP surplus in 2018, compared to a 1 percent target at the time of the fourth review. The underperformance stemmed from a 1.4 percentage-point-of-GDP shortfall in tax revenues due to weaker growth, a waiver on fuel import duties (amid rising global oil prices and implementation of the fuel subsidy reform), and

Sri Lanka: Summary of Central Government Operations (In percent of GDP)						
	2017	2018		2019		2020
		EFF 4th review	Est.	EFF 4th review	Proj.	
Total revenue and grants	13.7	14.6	13.4	15.9	15.1	16.0
Of which: tax revenue	12.4	13.3	11.9	14.6	13.4	14.3
Total expenditure and net lending	19.2	19.2	18.6	19.5	19.6	19.6
Current expenditure	14.4	14.5	14.5	14.6	14.9	14.9
Of which: interest	5.5	5.6	5.9	5.6	6.0	5.9
Capital expenditure and net lending	4.8	4.7	4.2	4.9	4.7	4.6
Overall balance	-5.5	-4.6	-5.3	-3.6	-4.5	-3.5
Primary balance	0.0	1.0	0.6	2.0	1.5	2.4
Non-interest expenditure	13.7	13.7	12.7	13.9	13.6	13.6

Sources: Sri Lankan authorities; and IMF staff estimates.

<sup>3</sup> The staff report was finalized on April 26 and the baseline scenario does not make assumptions about the potential impact of the April 21 terrorist attacks.

delayed implementation of some of the 2018 budget measures. Revenue shortfalls were partly offset by lower execution of capital projects.

### 8. The 2019 budget submitted to Parliament as a prior action for this review advances revenue-based consolidation, while making space for key social and development spending.

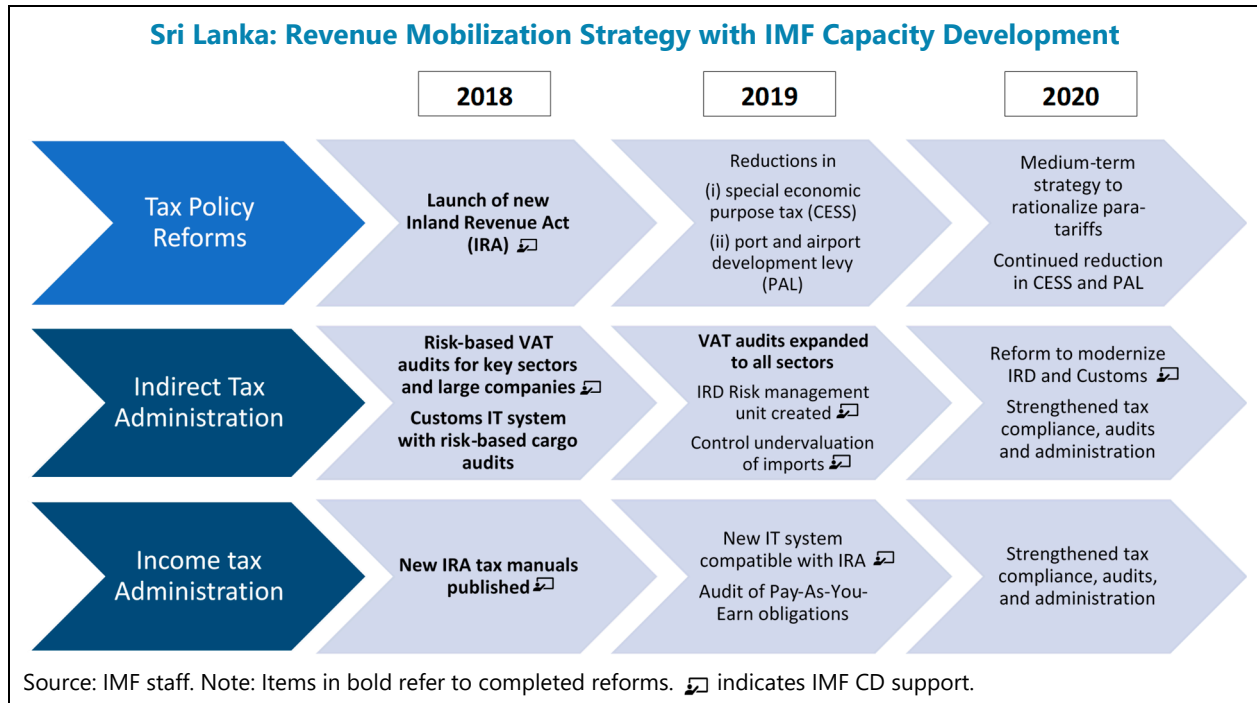
The 2019 budget targets a primary surplus of 1.5 percent of GDP, with a structural adjustment broadly in line with the one envisaged in the fourth review. Specifically,

- Revenue measures.** The budget contains new revenue measures for 0.7 percent of GDP, mainly through increases in excises and unwinding of customs duty waivers, following the major reforms to the VAT and income taxes over the past two years. Moreover, the delayed implementation of the IRA and some of the 2018 budget measures last year is expected to carry over significant revenue gains to 2019. The authorities are also implementing, in consultation with IMF staff, well-targeted amendments to the IRA, for an annual cost of up to 0.1 percent of GDP, to support private sector investment and mitigate the distributional income of the reforms.

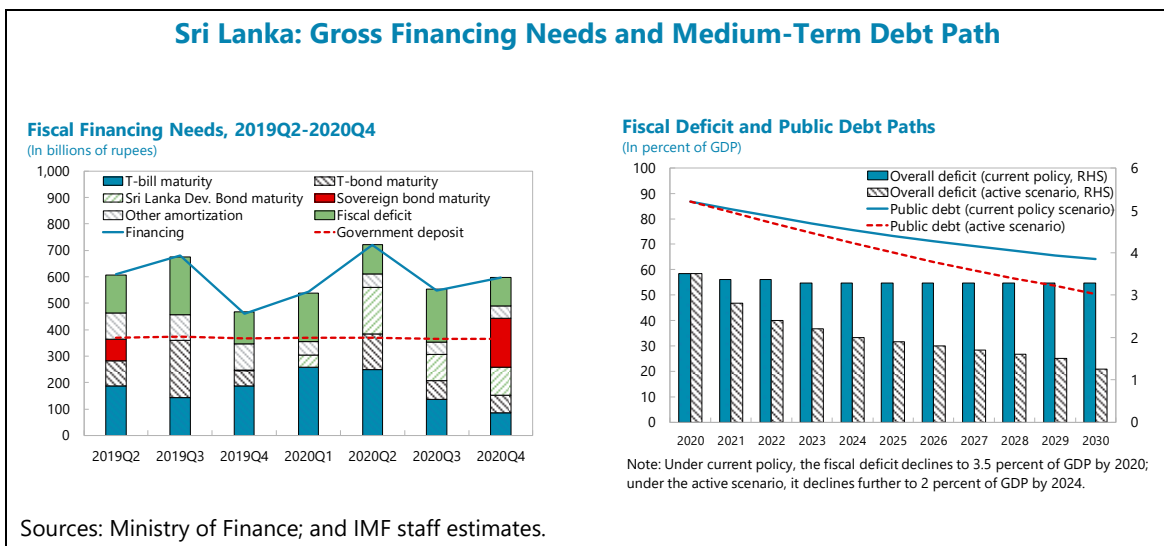
<b>Sri Lanka: Fiscal Consolidation in the 2019 Budget</b>	
(In percent of GDP, change from 2018 outturn, unless otherwise noted)	
<b>Revenue</b>	<b>+1.7</b>
<b>Base effect from IRA and 2018 budget measures</b>	<b>+0.8</b>
<b>New revenue measures</b>	<b>+0.8</b>
<b>Tax policy package</b>	<b>+0.7</b>
Increase excises (incl. vehicles, tobacco, liquor)	+0.4
Gasoline and diesel (increase excise and customs duty)	+0.08
Increase indirect taxes on selected items (VAT, NBT, ESC)	+0.1
Increase customs duty/CESS (incl. tobacco, liquor)	+0.05
Increase fees and tolls (incl. departure tax)	+0.1
<b>IRA amendments</b>	<b>-0.1</b>
<b>Non-tax Revenue</b> (dividends/adjustment of fees & charges)	<b>+0.2</b>
<b>Non-interest expenditure</b>	<b>+0.85</b>
- Wages and salaries	+0.1
- Subsidies and transfers	+0.25
- Capital spending (incl. natural disaster contingency)	+0.5
<b>Primary balance adjustment</b>	<b>+0.85</b>
<i>Memorandum item:</i>	
Primary surplus in 2019 (percent of GDP)	1.5
Source: IMF staff estimates.	

- Expenditure policy.** Some of the space created by the revenue measures will be used to strengthen social safety nets and help mitigate the impact of the adjustment on eligible beneficiaries (¶22). Specifically, the budget allocation to the Samurdhi cash transfer program will be increased by 25 percent, expanding its coverage to an estimated 600,000 additional beneficiaries. Civil service wages and pensions are being increased gradually under a policy in place since 2016. The expenditure envelope will accommodate part of the capital spending not executed in 2018, although full implementation of the capital budget will need to be contingent on revenue performance and attainment of the primary surplus target. The budget also envisages a new Disaster Management Contingency Fund, in response to natural disasters, in line with earlier IMF and World Bank (WB) recommendations ([CR/18/176](#)).

**9. Ongoing efforts to modernize revenue administration are critical to support recent tax policy reforms.** A reform plan to modernize the Inland Revenue Department (IRD) and Customs administration with enhanced risk assessment and improvements in organizational structure and management is expected to be approved by cabinet by June 2019, with support from IMF TA. A VAT compliance strategy, with risk-based audits for large taxpayers, was successfully piloted for specific sectors and will be rolled out by end-December to maximize collections under the recently expanded VAT base. The IRD should expedite work to make its systems fully compatible with the new IRA, given recent delays to the IT system upgrade.



**10. Fiscal institutions are being strengthened to anchor fiscal consolidation efforts and reduce debt vulnerabilities over the medium term.** Despite the improvement in the primary balance, Sri Lanka’s public debt rose to 90 percent of GDP in 2018, due to weaker growth and rupee depreciation. The debt profile remains vulnerable to currency and interest rate shocks, while lumpy repayments pose rollover risks in coming years (Annex II). The authorities are committed to lowering the fiscal deficit to 3.5 percent of GDP in the 2020 budget, in line with program objectives (proposed SB). In the 2019 budget speech, the authorities also announced their plans to reduce the deficit further to 2 percent of GDP by 2024, bringing public debt below 70 percent of GDP, although specific measures are yet to be identified. To support these efforts, the authorities approved in early April a Medium-Term Debt Strategy, with IMF and WB TA, to optimize debt management, mitigating



FX exposure and supporting maturity transformation (end-October 2018 SB). A plan to establish an independent debt management agency is expected to be approved by end-September (proposed to reset the end-March 2019 SB). Cabinet is also planning to approve the key elements of a revised fiscal responsibility framework with strong fiscal rules by end-May (proposed to reset the end-March 2019 SB), and relevant legislation by end-September (proposed SB), with IMF TA.

**11. Reforms to public financial and investment management should be stepped up, including to mitigate fiscal risks from large-scale projects.** The authorities are working, with WB support, on a new Public Financial Management Act to improve the budget process and control risks from Public Private Partnerships (PPPs). New PPP guidelines to strengthen the project selection and appraisal process are also being finalized. The authorities are taking steps to better integrate all projects under the Public Investment Program, with a dedicated unit recently established within the MOF to oversee fiscal risks and affordability of PPP projects, given Sri Lanka's debt sustainability risks. It is also important to ensure transparency and evenhandedness across all investment development projects, allowing investors to access the generous incentive regime under the IRA, while avoiding any ad hoc tax exemptions. These efforts are critical to help Sri Lanka effectively manage large-scale capital projects, including ongoing development initiatives under China's Belt and Road Initiative (Box 1).

## B. Strengthening SOE Governance and Reducing Fiscal Risks

*Building on the progress to date, further efforts are needed to reduce fiscal risks from SOEs, improving governance and transparency, completing energy pricing reforms, and restructuring SriLankan Airlines.*

**12. Fiscal risks from SOEs remain elevated, despite the introduction of a new fuel pricing mechanism in mid-2018.** The three main SOEs—Ceylon Petroleum Corporation (CPC), Ceylon Electricity Board (CEB), and SriLankan Airlines—recorded a combined loss of 1.3 percent of GDP in 2018, compared to 0.5 percent of GDP in 2017. The deterioration in performance was primarily driven by CPC's increased financing costs associated with the higher oil prices and FX depreciation, although losses were partly mitigated by the implementation of the fuel pricing formula during May-October 2018.

<b>Sri Lanka: Financial Performance of Major SOEs</b>						
<b>(in percent of GDP)</b>						
	Ceylon Electricity Board (CEB)		Ceylon Petroleum Corp. (CPC)		SriLankan Airlines (SLA)	
	2017	2018	2017	2018	2017	2018
Revenue	1.7	1.7	3.4	4.2	1.1	1.2
Expenditure	2.0	1.9	3.4	4.9	1.3	1.6
Balance	-0.4	-0.2	0.0	-0.7	-0.1	-0.4

Note: Data for 2018 are based on preliminary information supplied by the Sri Lankan Ministry of Finance.

Sources: Sri Lankan authorities; and IMF staff estimates.

### Box 1. Status of China's Belt and Road Initiative Projects in Sri Lanka

China is emerging as a lead creditor in Sri Lanka, providing both project-linked and commercial loans. China's outstanding official loans to the Sri Lankan central government amount to approximately US\$3 billion based on end-2018 data or 9 percent of external central government debt,<sup>1</sup> compared to 13 percent by the Asian Development Bank, 10 percent by Japan, and 10 percent by the World Bank. Infrastructure-related FDI from China amounted to about US\$2.3 billion over 2013–2018, of which US\$1.5 billion took place in 2017–2018.<sup>2</sup>

Under China's Belt and Road Initiative, the Sri Lankan Government has undertaken the development of two large-scale capital projects:

- *Hambantota Port.* The port is located on the southern coast of Sri Lanka, close to the east-west shipping route, in the main Indian Ocean sea lane linking the Suez Canal and Malacca Straits. The project was originally financed with Chinese bilateral loans (US\$1.1 billion or 1.3 percent of GDP). The loans have a maturity of 15 to 20 years, with interest rates ranging from 2 to 6.3 percent. The port began commercial operations in 2012 but suffered from low utilization. In 2017, the government restructured the original loans and reached a 99-year concession agreement with China Merchant Port Holdings (CMPH). Under the concession agreement, CMPH paid the Sri Lankan government a total of US\$1.1 billion, broadly equivalent to the original loan amount, and in return acquired an 85 percent share of the company in charge of developing and operating the port.<sup>3</sup> CMPH and the Sri Lankan government plan to develop an economic zone in the port, with investment projects currently under discussion. An oil refinery, with an investment of US\$3.85 billion supported by the Sultanate of Oman, and a cement manufacturing plant, with an investment of US\$100 million, were announced in March 2019.
- *Colombo Port City.* The ongoing project involves developing an urban city center on reclaimed land of 269 hectares adjacent to the Colombo Harbor. When completed, the city would accommodate residential, retail, financial, and commercial activities. A project company owned by China Harbor Engineering Company (CHEC) oversaw the land reclamation, with FDI totaling US\$1.4 billion (1.5 percent of GDP). In return, CHEC is granted 116 hectares of the reclaimed land as a 99-year leasehold. The government is responsible for connecting the city with utilities such as electricity, water, and sewage, up to the boundary of the reclaimed land. The introduction of a special regulatory regime for the Port City is currently under consideration.

Aside from the BRI-sponsored projects, Exim Bank of China has provided loan assistance of US\$1.6 billion for the extension of the Southern Expressway to connect Matara and Hambantota. A Central Expressway (CEP) has also been proposed to link Colombo with Kandy and Exim Bank of China has agreed to provide concessional financing for US\$989 million for section 1 of the CEP.

<sup>1</sup> China's loans to the Sri Lankan public sector, including SOEs, are around US\$5 billion (15 percent of external debt).

<sup>2</sup> Based on data provided by the authorities, including Ministry of Finance Annual Reports, and IMF staff estimates.

<sup>3</sup> Based on disclosed information on the concession agreement published in the CMPH website (<http://www.cmpport.com.hk/en/>).

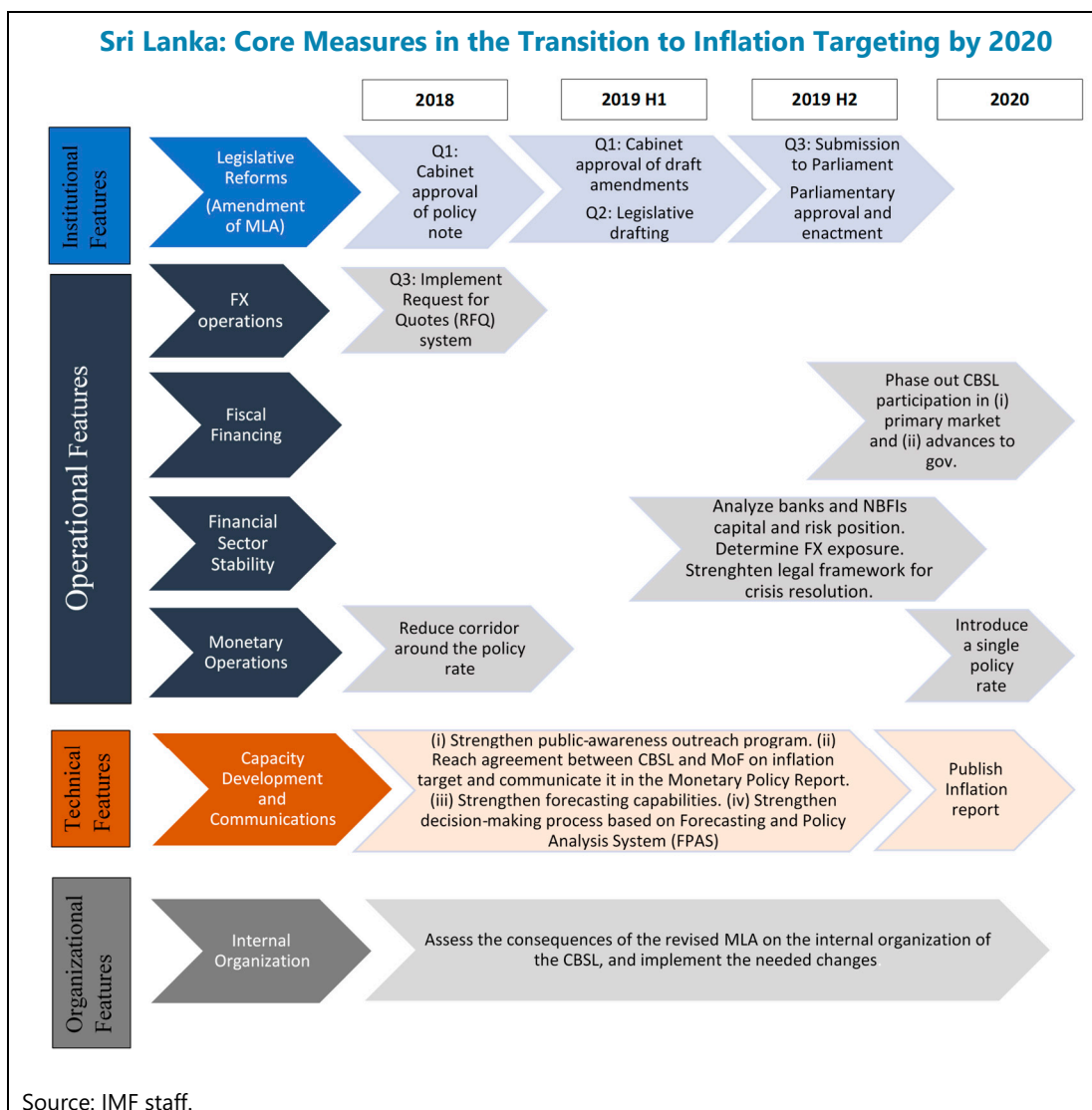
### 13. The authorities are taking concrete steps to bring the SOE reform agenda back on track:

- **Energy pricing reforms.** The political crisis in October disrupted the monthly implementation of the fuel pricing formula for gasoline and diesel, with unwarranted price reductions. The authorities reinstated the formula in late December and are committed to achieve full cost recovery by June 2019. The planned approval by cabinet of a pricing mechanism for electricity has been delayed to the second half of the year, to allow adequate time for consultation with stakeholders after the political crisis (end-September 2018 SB; proposed to be reset for end-October 2019).
- **SriLankan Airlines restructuring.** Following the political crisis last year, the President appointed a committee to prepare a new report to advance the restructuring of SriLankan Airlines. Cabinet is expected to discuss a paper in May, including key recommendations for a joint venture with a strategic partner and measures to strengthen corporate governance and accountability. Based on the cabinet decision, the Board of SriLankan Airlines will prepare an effective strategic plan and operating business model with measures to reduce the company's operational and financial costs and minimize future losses by end-September 2019 (proposed SB).
- **SOE Statements of Corporate Intent.** As part of the ongoing efforts to strengthen governance, accountability, and transparency of SOEs, biannual compliance reports against key performance indicators (KPIs) in the Statements of Corporate Intent (SCIs) for the 5 major SOEs have been submitted to cabinet for 2017 and those for 2018 are being prepared. Ten additional SOEs are expected to sign and publish SCIs by mid-2019, outlining multiyear corporate plans and establishing KPIs. The mission also stressed the need to expedite the publication of the audited financial statements for SOEs, starting with the major ones.

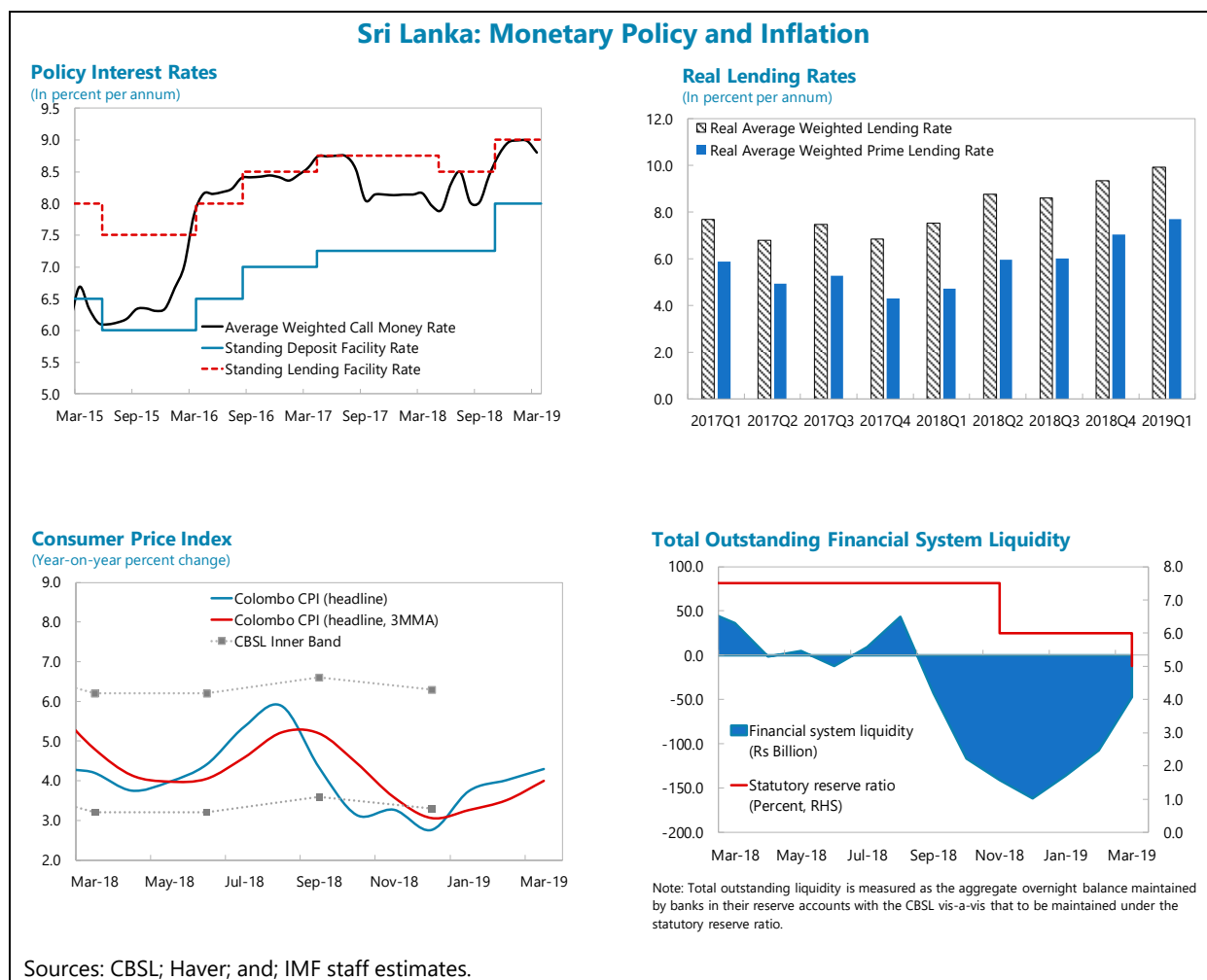
## C. Modernizing the Monetary Policy Framework and Rebuilding Reserves

*In the transition to flexible inflation targeting, the CBSL is committed to maintaining a prudent monetary stance and strengthening reserves, supported by greater exchange rate flexibility.*

**14. The reform of the Central Bank law is a key milestone in Sri Lanka's roadmap to flexible inflation targeting.** Cabinet approved in March 2019 the draft amendments to the Monetary Law Act (MLA) (end-December 2018 SB). The amendments, prepared with IMF TA, will establish price stability as the CBSL's primary objective and a flexible exchange rate regime; phase out CBSL's participation in the primary market and provision of advances to the government, and eliminate other quasi fiscal functions; strengthen the CBSL's autonomy, governance, transparency, and accountability frameworks, consistently with the 2016 safeguards recommendations; and introduce an explicit macroprudential policy mandate for the CBSL. Submission to Parliament of the final bill, in line with IMF staff recommendations, is expected by end-July 2019 (proposed SB).



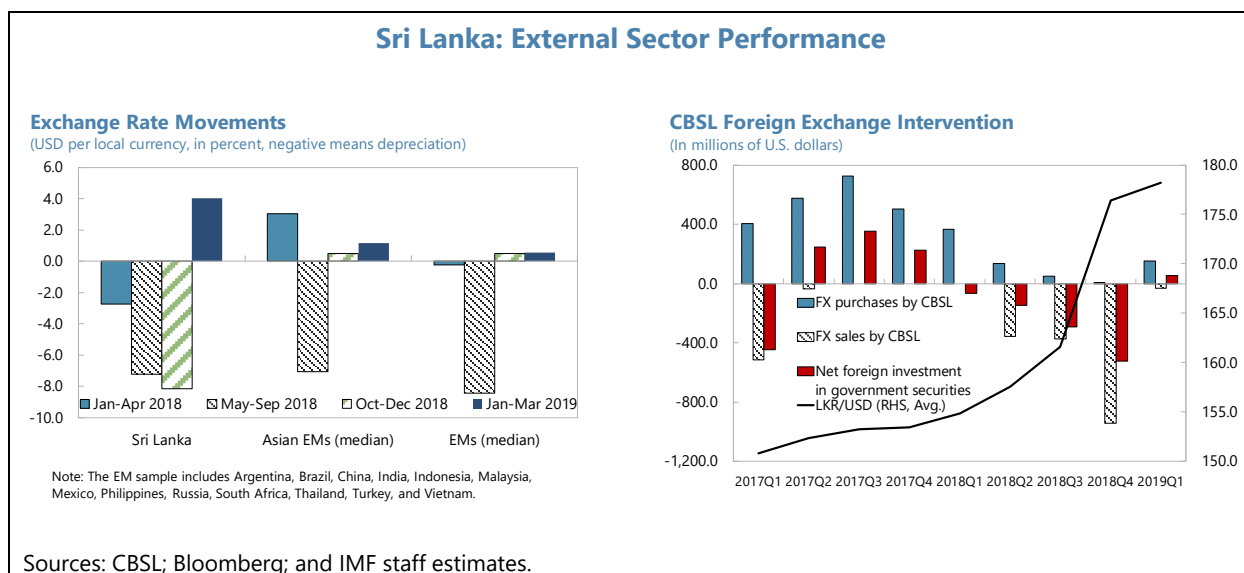
**15. The CBSL should continue to follow a prudent data-dependent approach.** The CBSL raised the policy rate corridor to 8-9 percent in November 2018 and has since maintained policy rates unchanged. To address a persistent liquidity shortage in the financial system, triggered by FX pressures amid the political crisis, the CBSL reduced the statutory reserve ratio from 7½ to 5 percent since November. The policy approach helped keep inflation expectations well-anchored, while avoiding financial disruptions from tight liquidity conditions. In late 2018, inflation fell below the CBSL's inner band, triggering a monetary policy consultation. Staff and the authorities agreed that the current monetary policy stance remained broadly appropriate in view of temporary factors affecting the inflation slowdown and remaining external pressures. Inflation was back within the target range in early 2019 and is expected to converge gradually towards the 5 percent target. Going forward, the CBSL agreed to remain vigilant and stand ready to adjust policy rates as warranted by evolving macroeconomic conditions.



**16. The CBSL is committed to rebuild reserves and allow for greater exchange rate flexibility to protect the economy against shocks.** After strong purchases in early 2018, the CBSL's reserve buildup strategy was derailed by global market volatility and rising balance-of-payments pressures. The CBSL intervened in the market to limit rupee volatility and sold US\$1.1 billion on a net basis in 2018, resulting in a sizable breach of the NIR target. Nonetheless, as FX pressure intensified, exacerbated by the political crisis in late 2018, the CBSL also allowed for greater exchange rate flexibility, as reflected by a 13 percent depreciation of the rupee in real effective terms. With the strengthening in market conditions following the resolution of the political crisis, the CBSL resumed FX purchases to rebuild reserves. In the week following the terrorist attacks, modest FX intervention by the CBSL helped stem market volatility. With nearly US\$150 million purchased on a net basis as of April 26, the CBSL remains on track to meet the recalibrated NIR target for end-June. The CBSL will consult monthly with IMF staff on FX market and reserve developments, or on a higher frequency in case of significant deviations from the envisaged reserve path. These efforts are supported by the CBSL's introduction since July 2018 of a market-based and transparent Request for Quotes system for direct dealing (end-December 2018 SB).



**17. In response to balance-of-payment pressures, the authorities temporarily introduced exchange restrictions.** During September–October 2018, the authorities issued administrative measures which gave rise to exchange restrictions inconsistent with Sri Lanka’s Article VIII obligations and resulted in nonobservance of the continuous PC on non-introduction of exchange restrictions (MEFP 126).<sup>4</sup> The measures were eliminated in March 2019 and staff supports the authorities’ request for a waiver of nonobservance.



**18. Removal of capital flow management measures (CFMs) should be properly sequenced with macroeconomic adjustment and supporting reforms.** Staff welcomed the authorities’ plan to remove the repatriation requirement of export proceeds introduced in 2016 as progress is made in the macroeconomic adjustment envisaged under the program, starting with the planned extension of the period required to repatriate export proceeds. Following sizable capital outflows from the local-currency bond market during the political crisis, the CBSL lowered the threshold for foreign investment in rupee-denominated government securities from 10 to 5 percent of the total outstanding stock, tightening a long-standing residency-based capital flow measure. In the absence of a capital inflow surge, staff advised to loosen the measure back and take advantage of portfolio inflows to build reserves and deepen the domestic bond market, in line with the Fund’s Institutional View on capital flows.<sup>5</sup> The authorities expressed concerns about capital flow volatility and agreed to review the foreign investment threshold as reserves reach more comfortable levels.<sup>6</sup>

<sup>4</sup> The measures aimed at restricting payments for imports of some items by imposing cash margins on letters of credit and imports under documents-against-acceptance terms, and by restricting FX conversion for advance payments.

<sup>5</sup> See *The Liberalization and Management of Capital Flows – An Institutional View* (IMF, 2012).

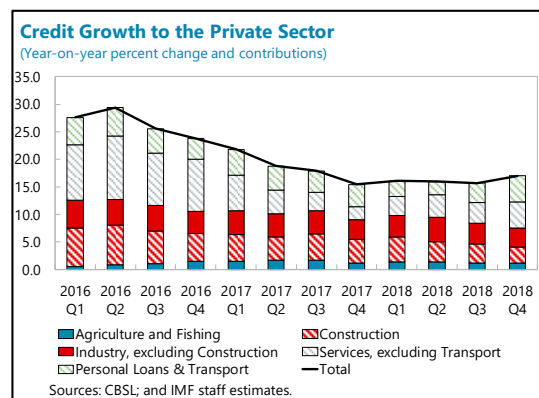
<sup>6</sup> The CBSL tightened banks’ FX net-open-position limits in September 2018 amid FX pressures, which constituted a CFM under the Fund’s Institutional View on capital flows, and adjusted them back in October.

## D. Advancing Financial Sector Reforms

Steps are ongoing to strengthen financial sector resilience, harmonizing regulation and supervision of banks and non-banks as well as enhancing the macroprudential policy and contingency framework.

### 19. Credit growth strengthened in the second half of the year, largely due to temporary factors.

Credit to the private sector grew at 16 percent in 2018. The uptick in 2018Q4 was mainly driven by the impact of the currency depreciation on FX-denominated loans—mainly for trade financing—as well as strong demand for motor vehicles, following the extension of duty-free import permits to public employees and ahead of expected tax increases in the 2019 budget. Nevertheless, credit growth moderated to 13½ percent in February and is projected at 13 percent for 2019, given tighter financial conditions.

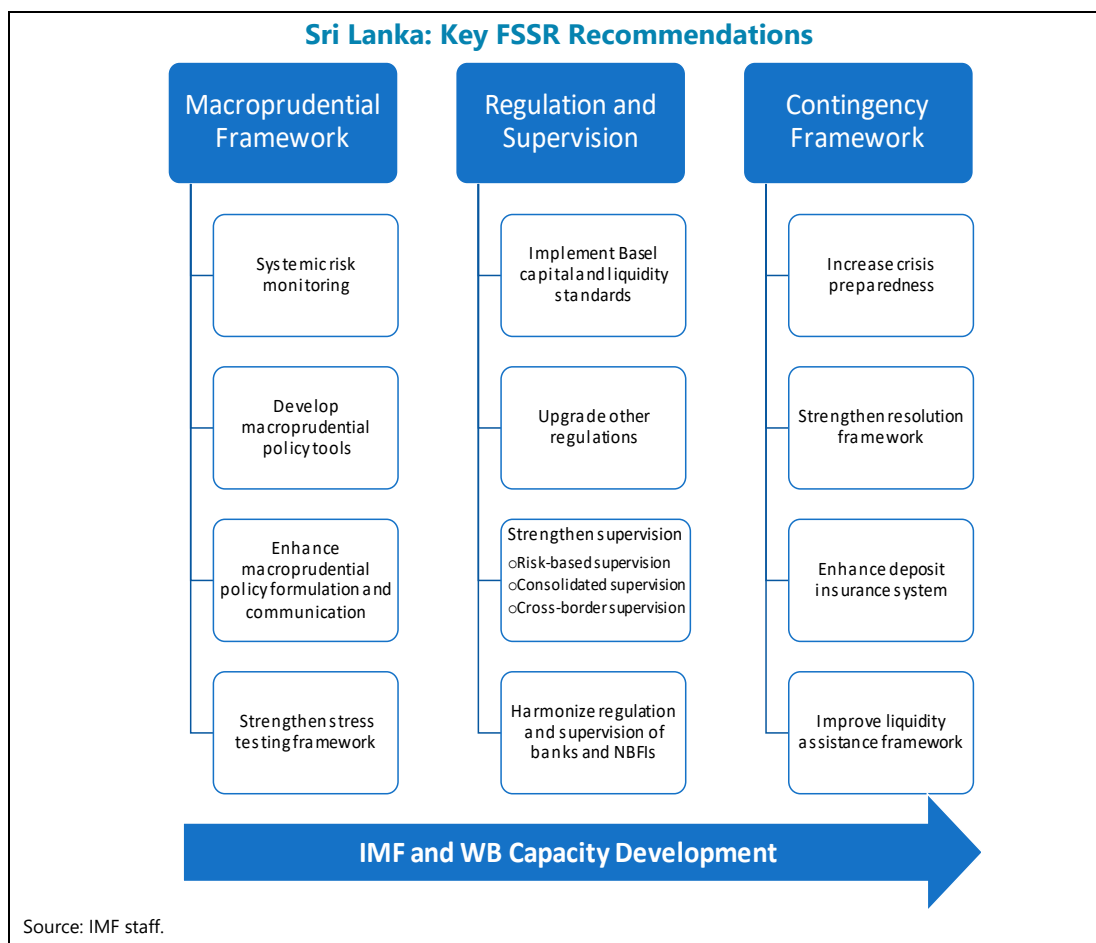


**20. The financial system is adjusting to the new regulatory and accounting requirements, with weaknesses remaining in non-bank financial institutions (NBFIs).** While capital and liquidity indicators remain adequate, non-performing loans increased to 3.4 percent in the banking sector and 7.7 percent in NBFIs as of end-2018 due to the economic slowdown, with provision coverage declining to 57 percent in both sectors. Moreover, the phased introduction in January 2019 of new capital and liquidity requirements under Basel III and the ongoing adoption of IFRS 9, with stricter asset classification and provisioning, will require additional efforts to meet capital requirements. Challenges will be greater in the NBFIs sector, which accounts for 7.6 percent of financial system's assets, where further consolidation is expected to meet capital needs. The authorities viewed the financial system as sound and stable but agreed to remain vigilant given these challenges.

### 21. The CBSL is committed to implement the recommendations of the recent Financial Sector Stability Review (FSSR).

- **Enhancing the macroprudential policy framework.** The CBSL plans to strengthen the financial stability framework, by enhancing the monitoring of systemic financial risks, developing macroprudential tools to contain systemic risk, and aligning stress testing methodologies with best practices, with support from IMF TA and a resident advisor.
- **Strengthening regulation and supervision.** The authorities are working, with support from the WB, on a new Banking Act to strengthen banks' regulation and supervision. Cabinet approval of the draft legislation is planned by end-December 2019. In parallel, they are taking steps to harmonize regulatory and supervisory requirements for banks and NBFIs, with relevant CBSL Directions to be issued by end-March 2020.

- Upgrading the contingency framework.** The existing framework for crisis preparedness and management is incomplete, with scope to strengthen the resolution regime and the deposit insurance system in line with international standards. The new Banking Act will include a new resolution regime for banks and NBFIs. It will also include a separate chapter to provide a stronger legal foundation to the deposit insurance system.



## E. Accelerating Structural Reforms to Promote Sustainable Growth

*Sri Lanka's middle-income objective rests on further efforts to support trade and the investment climate, combat corruption, promote female and youth employment, and enhance social safety nets.*

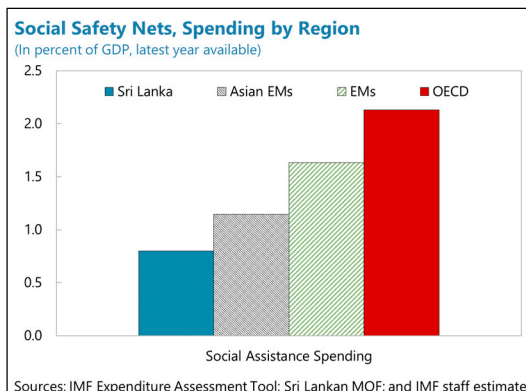
**22. Ongoing reforms to strengthen social safety nets and support youth and women economic empowerment are important to promote inclusive growth.** The 2019 budget increases allocations to the Samurdhi cash transfer program to expand coverage to additional beneficiaries, eligible based on the new criteria developed with WB support and recently approved by cabinet in March (end-August 2018 SB). The deployment of a new social registry will allow to better target social safety net programs and help mitigate the impact of the reform program on the most vulnerable segments of the population (Box 2). Staff also welcomed initiatives to encourage

female and youth employment, including through gender-responsive budgeting and vocational training, supporting Sri Lanka's aging challenges over the medium term (Annex 1).

### Box 2. Social Safety Net Reforms in Sri Lanka<sup>1</sup>

Sri Lanka has several social safety net (SSN) programs, although their resources remain low compared to peers. The largest one, Samurdhi, provides cash transfers, microfinance, and various community and livelihood development activities to approximately 19 percent of the population. In 2015, the Samurdhi transfers were significantly increased by more than doubling individual benefits. SSN spending currently totals about 0.8 percent of GDP.

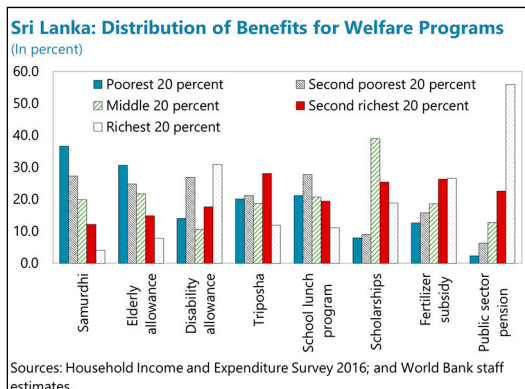
Sri Lanka's SSNs suffer from low coverage and inadequate targeting. Samurdhi, for example, leaves around 63 percent of the poorest quintile group out of the program. In terms of benefit incidence, under Samurdhi, around two-thirds of the benefits accrue to the poorest 40 percent, while the rest goes to higher-income households. These weaknesses partly reflect lack of a centralized and integrated framework to determine eligibility.



**Sri Lanka: Share of Households Benefiting from Major Welfare Programs (In percent)**

Program	Overall	Poorest 20 percent	Second Poorest 20 percent
Civil service pension	7.8	2.0	4.4
Samurdhi	18.8	37.1	25.2
Disability allowance	0.8	1.5	1.0
Elderly allowance	5.6	10.3	6.9
Scholarships	0.9	0.6	1.3
Thriposha	3.7	4.1	4.8
School lunch program	4.4	5.5	5.9
Fertilizer subsidy	10.9	11.0	12.6
<b>Any of the above</b>	<b>41.2</b>	<b>54.5</b>	<b>45.6</b>

Note: Number of households receiving benefits in the quintile divided by the number of total households in that quintile.  
Sources: Household Income and Expenditure Survey 2016; and World Bank staff estimates.



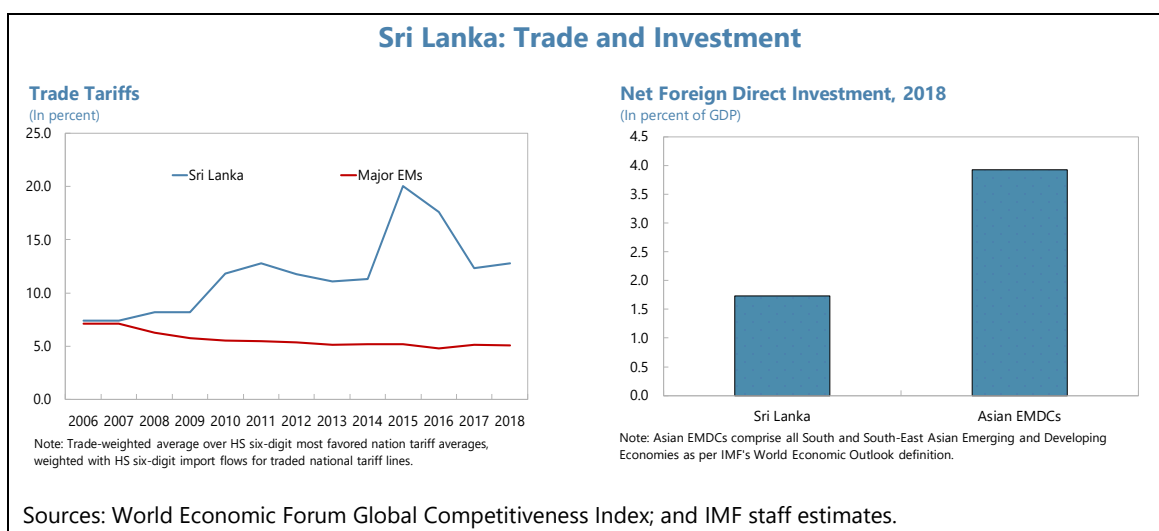
Against this backdrop, the authorities are reforming their SSNs with support from the World Bank's Social Safety Net Project. The reforms include:

- *Better targeting:* Cabinet approved new means-tested eligibility criteria in March 2019, following public outreach and consultations. Means-testing is based on objective household characteristics such as household size, age, education, type of housing and assets.
- *More beneficiaries:* The 2019 budget appropriates a 25 percent increase in Samurdhi spending to allow the enrollment under the new criteria of an estimated 600,000 additional eligible applicants, currently not covered by SSNs, starting in the second half of 2019.
- *Electronic database:* A digital social registry of SSN applicants is being established. The development of the software to support the registry is being finalized. After thorough testing of the software platform, the government plans to start populating the registry with applicants' information in the second half of 2019.

<sup>1</sup> Prepared in collaboration with World Bank staff.

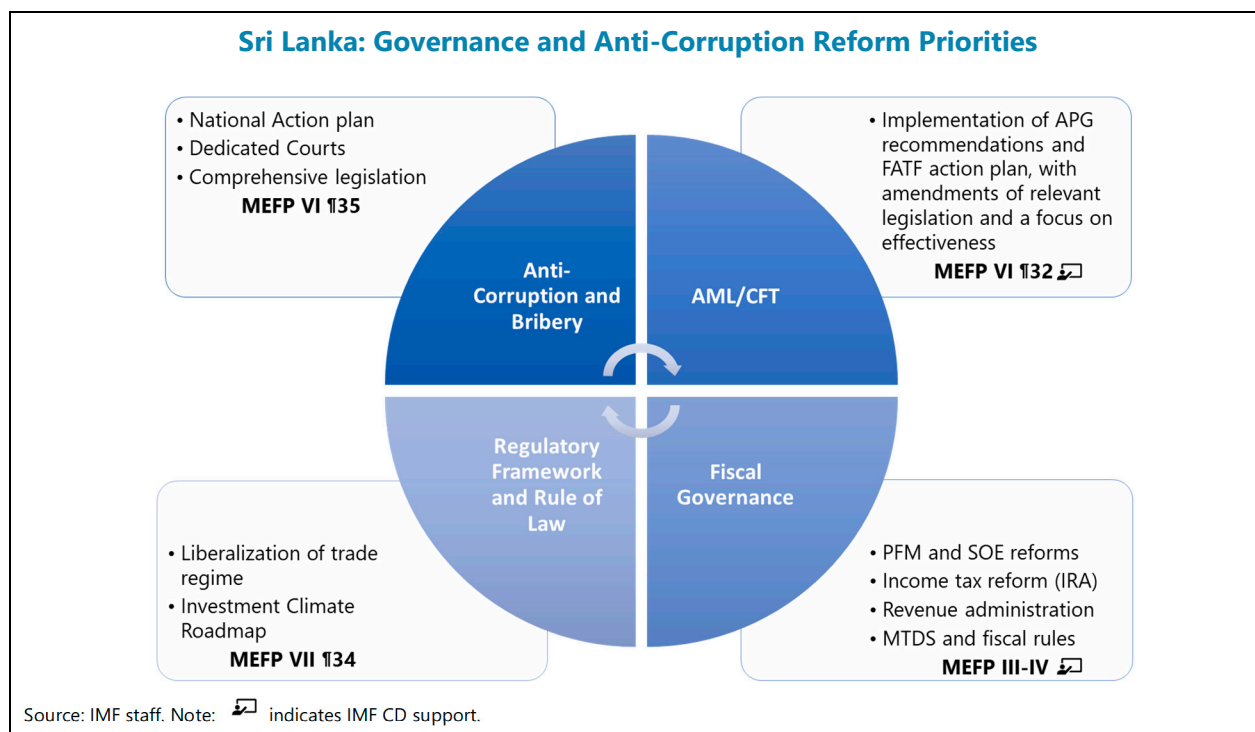
### 23. Efforts to liberalize trade and attract investment remain critical to spur exports.

Elevated trade restrictions and anemic FDI have hindered the development of the export sector ([CR/18/176](#)). Investment-based tax incentives under the IRA, as enhanced under the 2019 budget, are expected to promote private investment while making income taxes more predictable and transparent. The WB is supporting the authorities in their efforts to improve the business environment through regulatory, institutional, and legal reforms identified in the Investment Climate Roadmap. These include enhancing the contractual framework, including by developing a verifiable and comprehensive system of statistics related to the courts and the judicial system, and strengthening debt enforcement. In July 2018, the authorities presented a new National Export Strategy to facilitate trade, attract investment, and promote export diversification. With support from the WB, they developed a Trade Information Portal to improve efficiency and transparency of trade-related regulatory and procedural information, a blueprint for automating import and export processing through a National Single Window, and a web portal to streamline the investment approval process. The authorities have already removed 1,200 para-tariffs since 2017. This process will continue under the 2019 budget, with the phasing out of both the special economic purpose tax (CESS) and the Port and Airport Development Levy (PAL) over a five-year period beginning in September 2019. A strategy to gradually rationalize remaining para-tariffs is expected to be approved by cabinet by March 2020 (proposed to reset the end-March 2019 SB).



**24. The authorities are taking important steps to strengthen governance and combat corruption.** A National Action Plan for Combating Bribery and Corruption in Sri Lanka was approved by cabinet and launched last March, with a concrete and actionable roadmap for 2019–23. The plan envisages (i) prevention measures; (ii) value-based education and community engagement; (iii) institutional strengthening of Sri Lanka's anti-corruption commission and other law enforcement agencies; and (iv) law and policy reforms to strengthen anti-corruption efforts and compliance with international obligations. The authorities already amended the Bribery Act in July 2018 and established new courts to try bribery and corruption cases. Staff welcomed the plan to consolidate all laws related to bribery and corruption into a comprehensive piece of legislation to comply with the United Nations Convention against Corruption treaty. The authorities have also made

considerable progress in implementing the recommendations made by the Asia/Pacific Group on Money Laundering and the Financial Action Task Force (FATF) action plan to address deficiencies in the AML/CFT framework (MEFP ¶132). The FATF Plenary is planning an on-site visit to Sri Lanka to verify the implementation of the action plan and its traction. This could result in Sri Lanka exiting the FATF's list on Improving Global AML/CFT Compliance. Ongoing efforts to support transparent fiscal management and stringent SOE governance are also critical to prevent corruption (¶111, ¶113).



## PROGRAM MODALITIES

**25. The authorities requested to extend the EFF arrangement by one year to allow for adequate time to complete their reform agenda.** They also requested to rephase undisbursed purchases evenly among the three remaining reviews (Table 8), together with waivers for non-observance of missed fiscal and NIR QPCs and the continuous PC on non-introduction of exchange restrictions, on the basis of the prior and corrective actions discussed in this report.<sup>7</sup> The attached Letter of Intent (LoI) and Memorandum of Economic and Financial Policies (MEFP) describe the authorities' progress and commitments to implement their economic reform program (Appendix I).

**26. Program conditionality is proposed to be recalibrated accordingly.** New QPCs and ITs are proposed for the sixth and seventh reviews, as well as new adjustors on project loans and grants and interest payments by the central government to address projection issues (MEFP, Table 1, and

<sup>7</sup> Given the delay in completing the fifth review, end-December 2018 QPCs have become controlling.

Technical Memorandum of Understanding). Pending SBs are proposed to be rescheduled and new SBs to be added for the sixth and seventh reviews (MEFP, Table 2).

**27. Capacity to repay the Fund remains adequate and the program is fully financed on a forward-looking basis, but risks remain elevated.** Fund's exposure is relatively low, with outstanding Fund credit peaking at 6.6 percent of exports in 2020 under the proposed extension and rephasing of the arrangement (Table 9). Despite large refinancing needs, the program remains fully financed, thanks to ongoing fiscal consolidation, efforts to rebuild buffers, assurances from IFIs, and favorable market access prospects, as evidenced by the recent bond issuance. Nevertheless, need for further macroeconomic adjustment and/or additional financing could emerge if downside risks were to materialize including (i) renewed market and FX pressures; (ii) lower growth; or (iii) implementation delays in fiscal or SOE reforms (Annex 2). The political window for enacting major reforms might also narrow in the run-up to the elections, exacerbating these risks.

## STAFF APPRAISAL

**28. The economy is expected to recover gradually in 2019, but downside risks remain.** Growth is projected to recover to 3.6 percent in 2019, and gradually reach 5 percent over the medium-term, with inflation in the mid-single digits. Nevertheless, important downside risks remain, stemming from a tightening of global financial conditions and weaker external demand, as well as domestic uncertainty after the recent terrorist attacks and in the run up to the elections.

**29. Program performance has been brought back on track, despite important setbacks.** The authorities' renewed commitment to the EFF-supported program is evidenced by the ongoing efforts to advance revenue-based fiscal consolidation, with a well-targeted 2019 budget, and to strengthen reserves, under greater exchange rate flexibility, while maintaining a prudent monetary stance. The authorities have also revived their structural reform agenda despite some delays, completing five benchmarks for this review. Sustained policy discipline is necessary to strengthen resilience to shocks, given still significant vulnerabilities, while supporting competitiveness and growth.

**30. Sustained fiscal consolidation through domestic revenue mobilization and prudent spending remains a priority to maintain public debt sustainability.** Implementation of the 2019 budget and the new IRA, together with a modernization of tax administration, are expected to bring revenue-based fiscal consolidation back on track, while making space for critical public investment and allowing for broader coverage of vulnerable families under the social safety net based on well-defined selection criteria. Stronger fiscal rules and the new medium-term debt strategy will support the authorities' medium-term fiscal consolidation plans and place public debt on a downward path.

**31. Prudent monetary policy by the CBSL should continue, together with greater exchange rate flexibility, consistent with the roadmap towards flexible inflation targeting.** The CBSL should continue to maintain a prudent and data-dependent monetary policy, standing ready to adjust policy rates should inflationary pressures re-emerge. A sustained commitment towards

greater exchange rate flexibility and renewed efforts to strengthen reserves are critical to protect the economy against shocks. The MLA amendments will support the transition to flexible inflation targeting by strengthening the CBSL's mandate, autonomy, and governance and accountability frameworks.

**32. Renewed efforts to improve transparency, accountability, and cost-efficiency of large state-owned enterprises are needed.** The implementation of the fuel pricing reform has been a major step to mitigate fiscal risks from CPC. The authorities should move forward with plans to bring SriLankan Airlines on a sound commercial and financial footing and complete energy pricing reforms to address remaining risks from SOEs.

**33. Efforts to strengthen financial sector stability, in line with the recommendations of the recent Financial Sector Stability Review, should advance.** The CBSL's plans to harmonize the regulatory and supervisory regimes for financial institutions and strengthen the macro-prudential policy and crisis-preparedness toolkit are critical steps in this area. Sri Lanka has made important progress in strengthening the AML/CFT regime.

**34. Structural reforms should continue to support strong and inclusive growth and mitigate the distributional impact of the economic adjustment.** Priorities include promoting trade openness and investment, strengthening the governance and anti-corruption framework, encouraging female labor force participation, enhancing social protection and crisis preparedness in response to natural disasters.

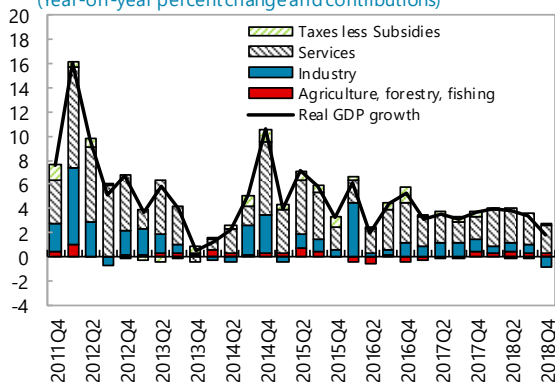
**35. Staff supports the completion of the fifth review and the extension and rephasing of the arrangement,** in light of the progress so far and the authorities' commitment to strong policies and reforms. Staff also supports the authorities' request for the waivers of nonobservance of performance criteria and modification of program conditionality.



Figure 1. Real Sector

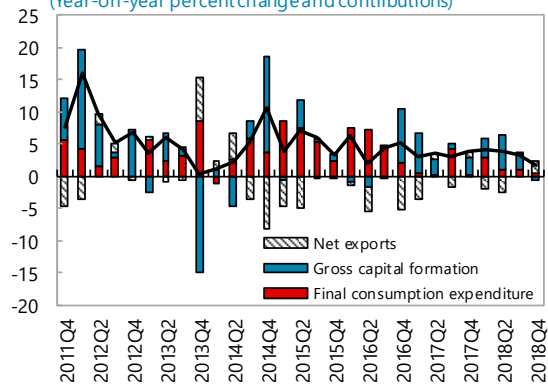
Real GDP Growth by Sector

(Year-on-year percent change and contributions)



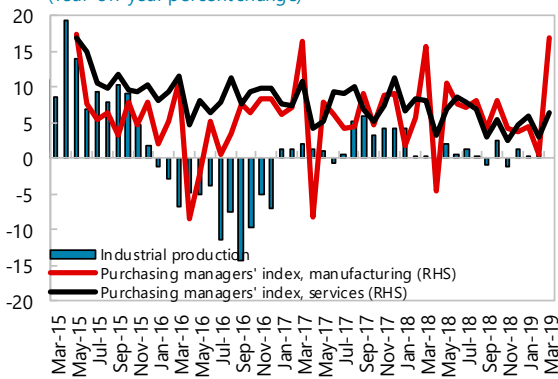
Real GDP Growth by Type of Expenditure

(Year-on-year percent change and contributions)



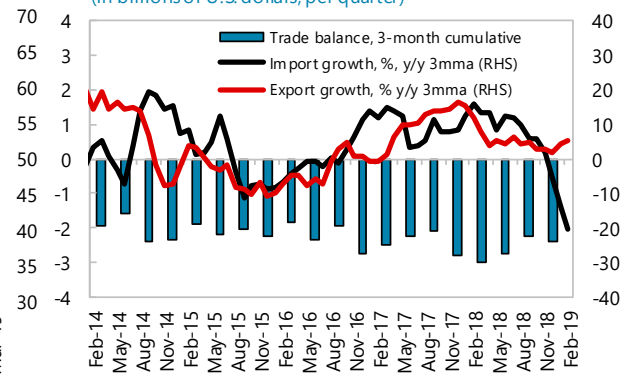
Economic Activity

(Year-on-year percent change)



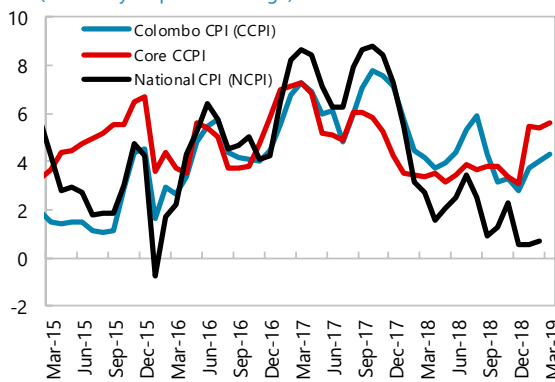
Trade

(In billions of U.S. dollars, per quarter)



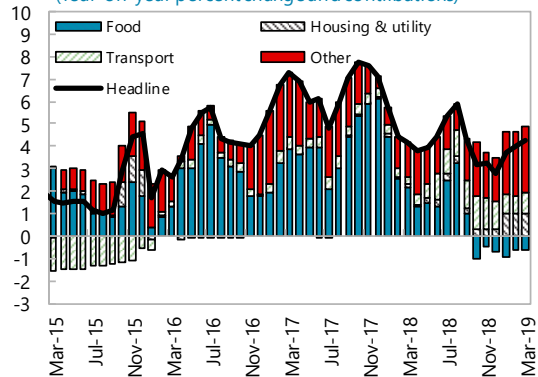
Consumer Price Index

(Year-on-year percent change)



Colombo Consumer Price Index

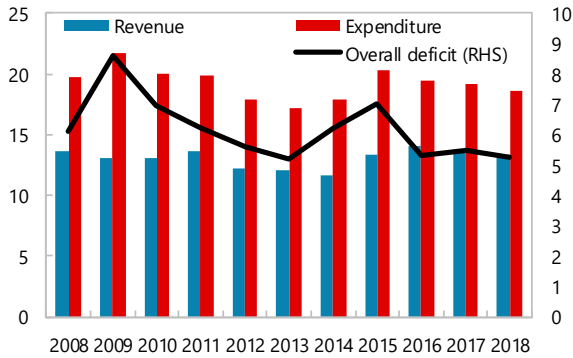
(Year-on-year percent change and contributions)



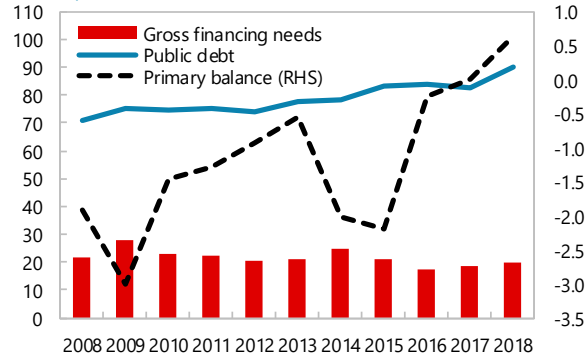
Sources: CBSL; and IMF staff estimates.

Figure 2. Fiscal Sector

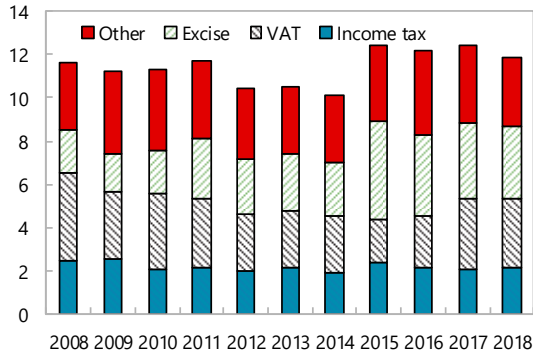
Central Government Operations  
(In percent of GDP)



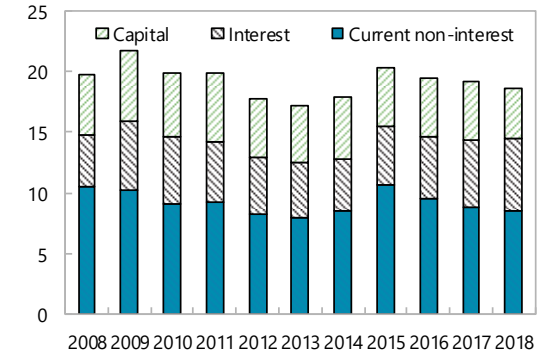
Public Debt and Gross Financing Needs  
(In percent of GDP)



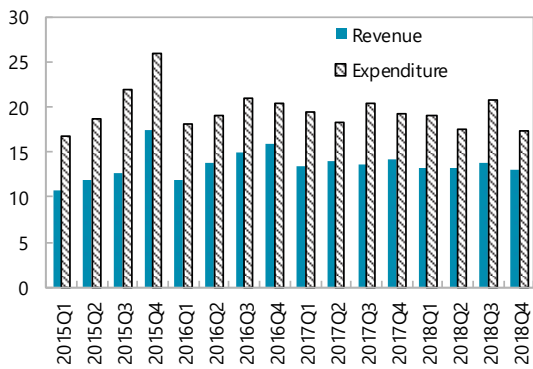
Tax Revenue  
(In percent of GDP)



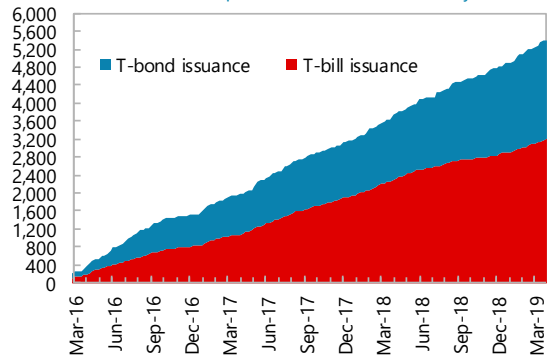
Current and Capital Expenditure  
(In percent of GDP)



Revenue and Expenditure  
(In percent of GDP)

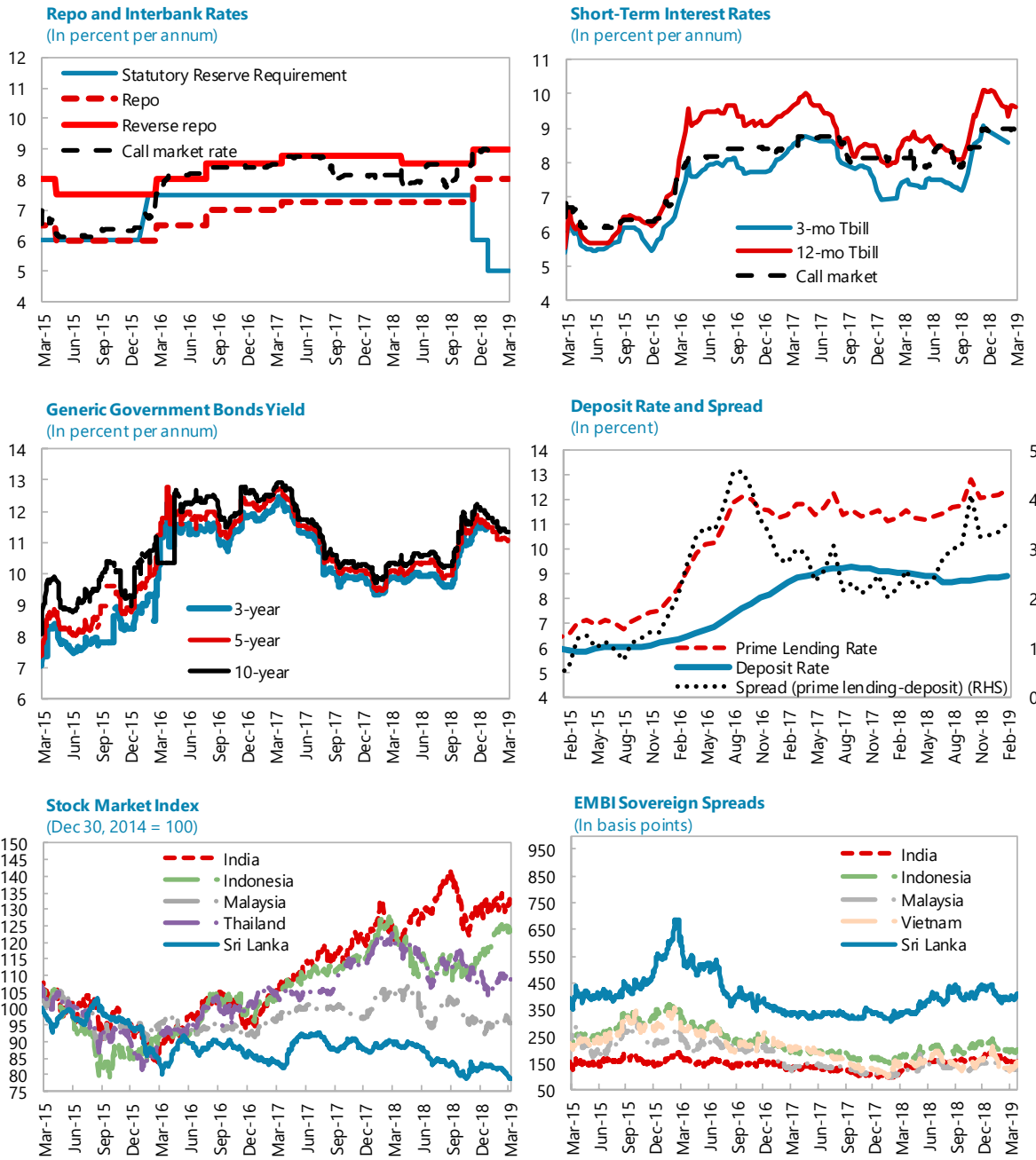


Government Securities  
(In billions of LKA rupees, cumulative from January 2016)



Sources: CBSL; Ministry of Finance; and IMF staff estimates.

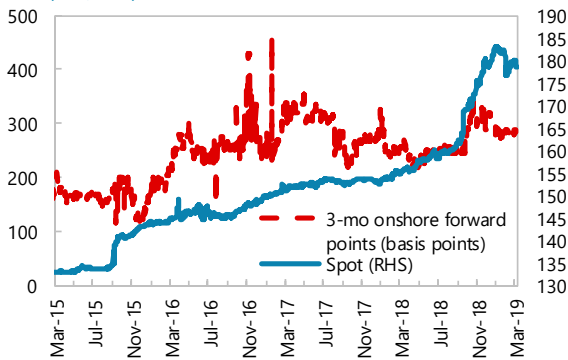
Figure 3. Financial Market



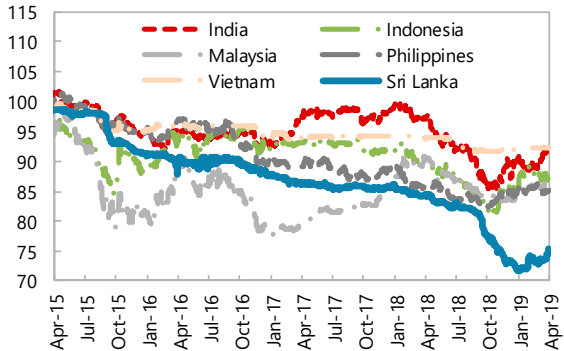
Sources: CBSL; CEIC Daily Database; Bloomberg Data LP; and IMF staff estimates.

### 4. Foreign Exchange and Reserves

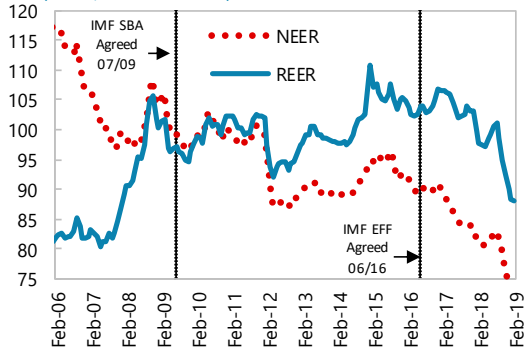
**Exchange Rate**  
(LCU/USD)



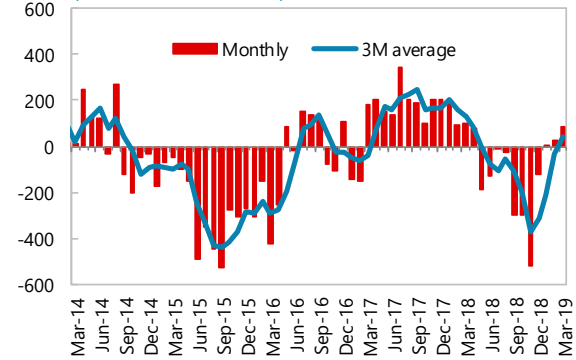
**Exchange Rates**  
(USD/LCU, Index, Jan 2015=100)



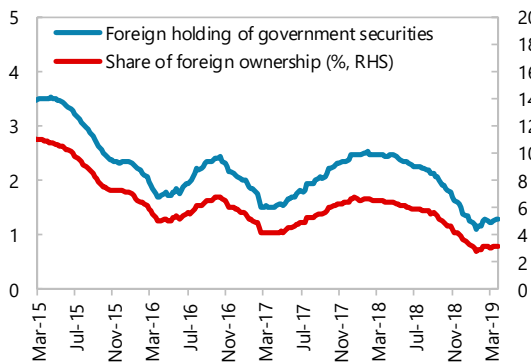
**Effective Exchange Rate**  
(Index, June 2009=100)



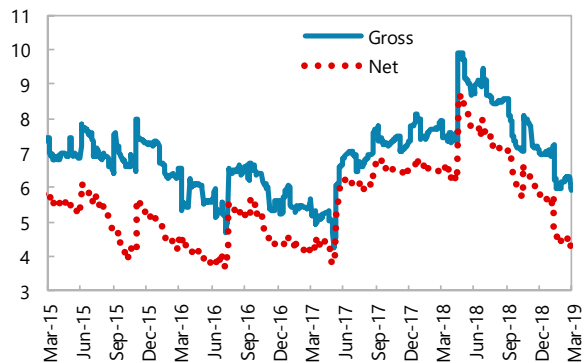
**CBSL Foreign Exchange Net Purchases**  
(In millions of U.S. dollars)



**Foreign Ownership of Government Securities**  
(In billions of U.S. dollars)

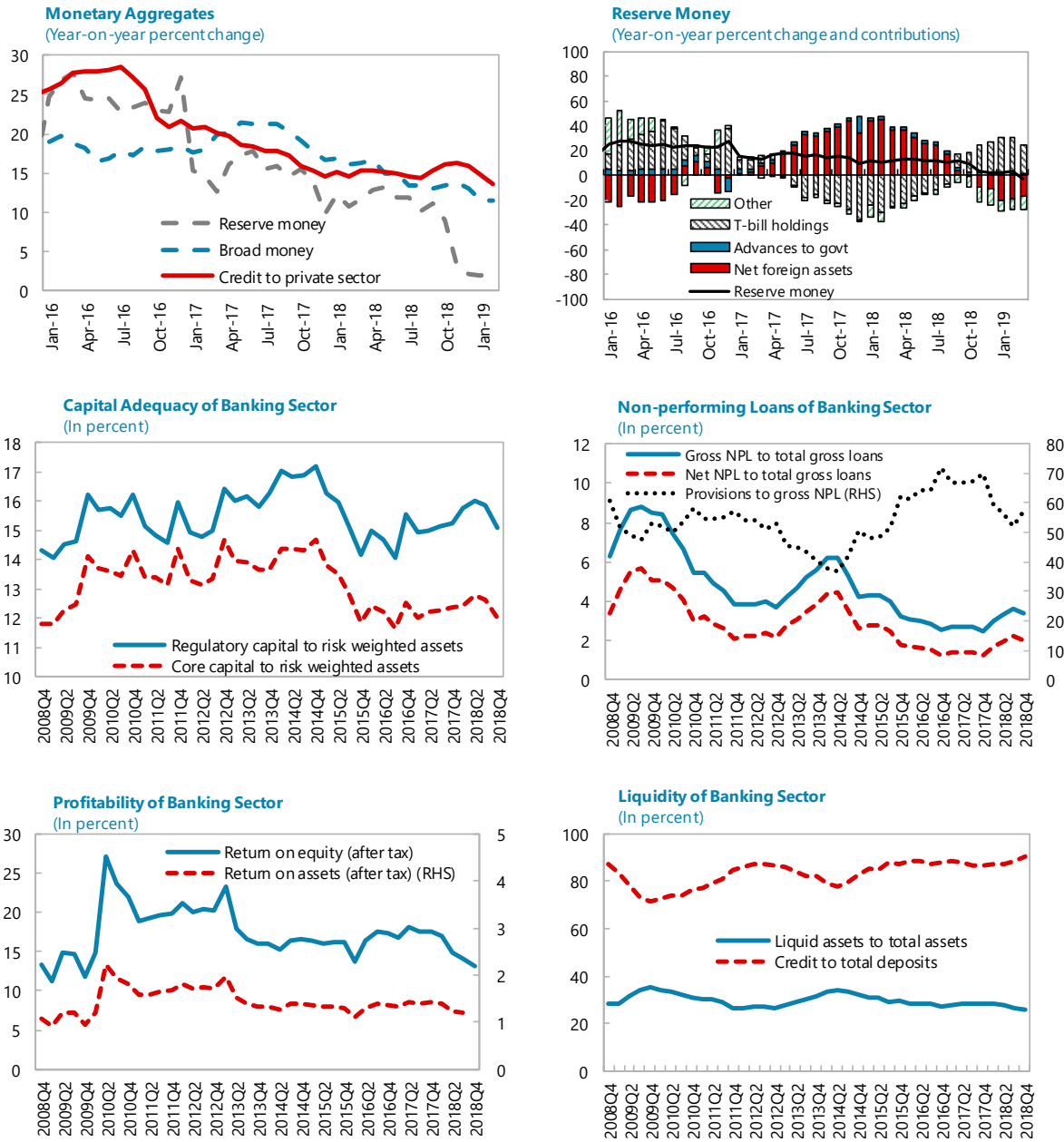


**International Reserves**  
(In billions of U.S. dollars)



Sources: CBSL; INS; Bloomberg Data LP; and IMF staff estimates.

Figure 5. Monetary and Financial Sector



Sources: CBSL; and IMF staff estimates.

Table 1. Sri Lanka: Selected Economic Indicators, 2016–24

	2016	2017	2018		2019		2020	2021	2022	2023	2024
			CR/18/175	Est.	CR/18/175	Proj.					
<b>GDP and inflation (in percent)</b>											
Real GDP growth	4.5	3.4	4.0	3.2	4.5	3.6	4.0	4.3	4.5	4.6	4.8
Inflation (average) 1/	4.0	6.6	4.8	4.3	4.8	4.5	4.7	4.9	5.0	5.0	5.0
Inflation (end-of-period) 1/	4.5	7.1	4.7	2.8	4.8	4.5	4.8	4.9	5.0	5.0	5.0
Core inflation (end-of-period)	5.8	4.3	4.6	3.1	4.6	5.5	5.0	4.8	4.7	4.7	4.7
<b>Savings and investment (in percent of GDP) 2/</b>											
National savings	25.7	26.2	34.4	25.4	35.0	26.4	26.9	27.5	27.9	28.4	28.8
Government	-0.5	-0.7	0.1	-1.1	1.3	0.1	1.1	1.4	1.4	1.5	1.5
Private	26.3	26.9	34.3	26.5	33.7	26.3	25.8	26.1	26.6	27.0	27.4
National Investment	27.9	28.8	36.9	28.6	37.5	29.2	29.5	29.9	30.3	30.6	31.0
Government	5.6	6.1	7.4	5.5	7.4	5.9	5.9	6.0	5.9	5.9	5.9
Private	22.2	22.7	29.5	23.0	30.1	23.2	23.6	24.0	24.3	24.7	25.0
Savings-Investment balance	-2.1	-2.6	-2.5	-3.2	-2.5	-2.8	-2.6	-2.4	-2.3	-2.2	-2.1
Government	-6.1	-6.7	-7.3	-6.6	-6.1	-5.8	-4.8	-4.6	-4.6	-4.4	-4.5
Private	4.1	4.1	4.8	3.5	3.6	3.0	2.2	2.1	2.3	2.2	2.3
<b>Public finances (in percent of GDP)</b>											
Revenue and grants	14.1	13.7	14.6	13.4	15.9	15.1	16.0	16.2	16.2	16.2	16.2
Expenditure	19.5	19.2	19.2	18.6	19.5	19.6	19.6	19.5	19.5	19.4	19.4
Primary balance	-0.2	0.0	1.0	0.6	2.0	1.5	2.4	2.4	2.4	2.4	2.4
Central government balance	-5.3	-5.5	-4.6	-5.3	-3.6	-4.5	-3.5	-3.4	-3.4	-3.3	-3.3
Central government net domestic financing	2.1	2.2	2.1	3.0	2.9	0.8	2.0	2.3	2.2	1.9	2.2
Central government gross financing needs	17.4	18.4	18.6	19.7	15.9	18.0	15.4	12.3	11.6	11.3	10.9
Central government debt 3/	79.0	77.4	77.3	83.3	75.2	82.2	79.9	77.4	74.8	72.2	69.5
Public debt 4/	84.1	82.7	83.7	90.0	81.8	88.9	86.8	84.0	81.2	78.4	75.4
<b>Money and credit (percent change, end of period)</b>											
Reserve money	27.1	9.8	13.8	2.3	12.6	11.3	11.5	11.7	11.9	12.3	12.3
Broad money	18.4	16.7	14.0	13.0	13.7	12.8	12.5	12.2	12.1	12.0	12.0
Domestic credit	16.4	12.5	10.6	17.7	11.0	11.2	11.0	10.8	10.6	10.4	10.4
Credit to private sector	21.6	14.7	13.7	15.9	12.6	12.9	12.7	12.5	12.2	12.1	12.1
Credit to central government and public corporations	8.5	8.8	5.1	20.9	7.9	8.3	8.1	7.6	7.5	7.0	7.0
<b>Balance of payments (in millions of U.S. dollars)</b>											
Exports	10,310	11,360	11,922	11,890	12,504	12,566	13,251	13,970	14,721	15,509	16,344
Imports	-19,183	-20,980	-22,294	-22,233	-23,848	-23,437	-24,681	-25,950	-27,245	-28,603	-30,033
Current account balance	-1,742	-2,309	-2,308	-2,814	-2,514	-2,380	-2,378	-2,370	-2,410	-2,416	-2,552
Current account balance (in percent of GDP)	-2.1	-2.6	-2.5	-3.2	-2.5	-2.8	-2.6	-2.4	-2.3	-2.2	-2.1
Export value growth (percent)	-2.2	10.2	4.9	4.7	4.9	5.7	5.4	5.4	5.4	5.4	5.4
Import value growth (percent)	1.3	9.4	6.3	6.0	7.0	5.4	5.3	5.1	5.0	5.0	5.0
<b>Gross official reserves (end of period)</b>											
In millions of U.S. dollars	6,019	7,959	9,268	6,919	9,710	8,650	9,580	10,403	11,003	11,646	11,996
In months of prospective imports of goods & services	2.8	3.6	3.9	3.0	3.9	3.5	3.7	3.9	3.9	4.0	4.0
In percent of ARA composite metric	54.8	68.8	74.2	56.4	74.5	68.2	72.6	75.1	75.9	78.5	79.0
<b>External debt (public and private)</b>											
In billions of U.S. dollars	46.4	50.6	55.0	52.3	58.3	56.2	57.5	59.6	62.2	64.5	67.1
As a percent of GDP	56.3	57.5	58.9	58.8	58.5	66.2	63.4	61.4	59.7	57.7	55.9
<b>Memorandum items:</b>											
Nominal GDP (in billions of rupees)	11,996	13,418	14,524	14,450	15,899	15,644	17,002	18,559	20,319	22,312	24,550
Unemployment Rate	4.4	4.2	...	4.5	...	...	...	...	...	...	...
Exchange Rate (period average)	145.6	152.5	...	162.5	...	...	...	...	...	...	...

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

1/ Colombo CPI.

2/ In April 2019, the Department of Census and Statistics revised the estimates on the composition of GDP on the expenditure side, with upward revisions to final consumption expenditure and downward revisions to gross capital formation.

3/ End-2017 figure includes treasury bonds issued in the past to settle dues for CPC and capitalize SriLankan Airlines.

4/ Comprising central government debt, publicly guaranteed debt, and Fund credit outstanding.

**Table 2a. Sri Lanka: Summary of Central Government Operations, 2016–24**  
(In billions of rupees)

	2016	2017	2018		2019		2020	2021	2022	2023	2024
			CR/18/175	Est.	CR/18/175	Proj.					
Total revenue and grants	1,694	1,840	2,124	1,932	2,531	2,358	2,723	3,000	3,283	3,606	3,966
Total revenue	1,686	1,832	2,114	1,920	2,520	2,344	2,709	2,984	3,266	3,586	3,945
Tax revenue	1,464	1,670	1,934	1,712	2,323	2,094	2,437	2,687	2,941	3,230	3,553
Income taxes	259	275	343	310	478	391	497	551	637	741	836
VAT	283	444	515	462	624	583	704	799	876	971	1,096
Excise taxes	455	469	554	484	647	566	631	689	754	804	860
Other trade taxes	212	208	190	173	210	261	290	346	349	361	380
Other	254	275	332	283	364	293	314	302	326	352	381
Nontax revenue	222	161	180	208	197	250	272	297	325	357	392
Grants	7	8	10	12	11	14	15	16	18	19	21
Total expenditure and net lending	2,334	2,573	2,791	2,693	3,102	3,067	3,325	3,624	3,968	4,333	4,768
Current expenditure	1,758	1,928	2,111	2,090	2,328	2,338	2,539	2,744	3,007	3,279	3,608
Civil service wages and salaries	334	348	354	375	388	410	445	486	532	584	643
Other civilian goods and services	86	78	100	73	109	78	81	88	96	106	116
Security expenditure	307	309	343	317	375	361	392	428	469	515	566
Subsidies and transfers	419	458	507	473	572	552	612	668	735	807	888
Interest payments	611	736	807	852	885	937	1,009	1,073	1,176	1,268	1,395
Capital expenditure and net lending	576	645	680	604	774	729	786	881	960	1,054	1,160
Overall balance	-640	-733	-667	-761	-571	-709	-602	-624	-684	-728	-802
Financing	640	733	667	761	571	709	602	624	684	728	802
Net external financing	392	439	359	324	114	580	253	197	238	314	270
Net domestic financing	248	294	307	437	457	130	348	427	446	414	532
Memorandum items:											
Central government primary balance	-29	2	141	91	314	228	407	449	492	540	593
Nonfinancial SOE balance 1/	36	-31	...	...	...	...	...	...	...	...	...
Ceylon Electricity Board	-14	-47	...	-30	...	...	...	...	...	...	...
Ceylon Petroleum Corporation	70	4	...	-104	...	...	...	...	...	...	...
Sri Lankan Airlines	-30	-18	...	-53	...	...	...	...	...	...	...
Other	11	31	...	...	...	...	...	...	...	...	...
Central government debt	9,479	10,383	11,233	12,034	11,963	12,852	13,585	14,356	15,193	16,104	17,055
Domestic currency	5,121	5,349	5,463	5,619	6,075	6,041	6,028	7,095	7,684	8,404	8,821
Foreign currency	4,358	5,034	5,770	6,415	5,888	6,811	7,558	7,261	7,509	7,700	8,234
Publicly guaranteed debt	524	590	...	...	...	...	...	...	...	...	...
Financial obligations of nonfinancial SOEs 2/	1,414	1,583	...	...	...	...	...	...	...	...	...
Fund credit outstanding	83	117	203	226	251	245	279	275	252	221	177
Nominal GDP (in billion of rupees)	11,996	13,418	14,524	14,450	15,899	15,644	17,002	18,559	20,319	22,312	24,550

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

1/ For 42 nonfinancial SOEs reported in MOF Annual Reports.

2/ The figure does not cover all nonfinancial SOEs. It covers financial obligations of Ceylon Electricity Board, Ceylon Petroleum Corporation, Road Development Authority, Sri Lanka Ports Authority, Sri Lankan Airlines, and other SOEs.

**Table 2b. Sri Lanka: Summary of Central Government Operations, 2016–24**  
(In percent of GDP)

	2016	2017	2018		2019		2020	2021	2022	2023	2024
			CR/18/175	Est.	CR/18/175	Proj.					
Total revenue and grants	14.1	13.7	14.6	13.4	15.9	15.1	16.0	16.2	16.2	16.2	16.2
Total revenue	14.1	13.6	14.6	13.3	15.9	15.0	15.9	16.1	16.1	16.1	16.1
Tax revenue	12.2	12.4	13.3	11.9	14.6	13.4	14.3	14.5	14.5	14.5	14.5
Income taxes	2.2	2.0	2.4	2.1	3.0	2.5	2.9	3.0	3.1	3.3	3.4
VAT	2.4	3.3	3.5	3.2	3.9	3.7	4.1	4.3	4.3	4.3	4.5
Excise taxes	3.8	3.5	3.8	3.4	4.1	3.6	3.7	3.7	3.7	3.6	3.5
Other trade taxes	1.8	1.5	1.3	1.2	1.3	1.7	1.7	1.9	1.7	1.6	1.5
Other	2.1	2.0	2.3	2.0	2.3	1.9	1.8	1.6	1.6	1.6	1.6
Nontax revenue	1.9	1.2	1.2	1.4	1.2	1.6	1.6	1.6	1.6	1.6	1.6
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total expenditure and net lending	19.5	19.2	19.2	18.6	19.5	19.6	19.6	19.5	19.5	19.4	19.4
Current expenditure	14.7	14.4	14.5	14.5	14.6	14.9	14.9	14.8	14.8	14.7	14.7
Civil service wages and salaries	2.8	2.6	2.4	2.6	2.4	2.6	2.6	2.6	2.6	2.6	2.6
Other civilian goods and services	0.7	0.6	0.7	0.5	0.7	0.5	0.5	0.5	0.5	0.5	0.5
Security expenditure	2.6	2.3	2.4	2.2	2.4	2.3	2.3	2.3	2.3	2.3	2.3
Subsidies and transfers	3.5	3.4	3.5	3.3	3.6	3.5	3.6	3.6	3.6	3.6	3.6
Interest payments	5.1	5.5	5.6	5.9	5.6	6.0	5.9	5.8	5.8	5.7	5.7
Capital expenditure and net lending	4.8	4.8	4.7	4.2	4.9	4.7	4.6	4.7	4.7	4.7	4.7
Overall balance	-5.3	-5.5	-4.6	-5.3	-3.6	-4.5	-3.5	-3.4	-3.4	-3.3	-3.3
Financing	5.3	5.5	4.6	5.3	3.6	4.5	3.5	3.4	3.4	3.3	3.3
Net external financing	3.3	3.3	2.5	2.2	0.7	3.7	1.5	1.1	1.2	1.4	1.1
Net domestic financing	2.1	2.2	2.1	3.0	2.9	0.8	2.0	2.3	2.2	1.9	2.2
Memorandum items:											
Central government primary balance	-0.2	0.0	1.0	0.6	2.0	1.5	2.4	2.4	2.4	2.4	2.4
Cyclically adj. primary balance (in percent of potential GDP)	-0.3	0.1	1.0	0.7	2.0	1.5	2.4	2.4	2.4	2.4	0.0
Nonfinancial SOE balance 1/	0.3	-0.2	...	...	...	...	...	...	...	...	...
Ceylon Electricity Board	-0.1	-0.4	...	-0.2	...	...	...	...	...	...	...
Ceylon Petroleum Corporation	0.6	0.0	...	-0.7	...	...	...	...	...	...	...
Sri Lankan Airlines	-0.3	-0.1	...	-0.4	...	...	...	...	...	...	...
Other	0.1	0.2	...	...	...	...	...	...	...	...	...
Central government debt	79.0	77.4	77.3	83.3	75.2	82.2	79.9	77.4	74.8	72.2	69.5
Domestic currency	42.7	39.9	37.6	38.9	38.2	38.6	35.5	38.2	37.8	37.7	35.9
Foreign currency	36.3	37.5	39.7	44.4	37.0	43.5	44.5	39.1	37.0	34.5	33.5
Publicly guaranteed debt	4.4	4.4	...	...	...	...	...	...	...	...	...
Financial obligations of nonfinancial SOEs 2/	11.8	11.8	...	...	...	...	...	...	...	...	...
Fund credit outstanding	0.7	0.9	1.4	1.6	1.6	1.6	1.6	1.5	1.2	1.0	0.7
Nominal GDP (in billion of rupees)	11,996	13,418	14,524	14,450	15,899	15,644	17,002	18,559	20,319	22,312	24,550

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

1/ For 42 nonfinancial SOEs reported in MOF Annual Reports.

2/ The figure does not cover all nonfinancial SOEs. It covers financial obligations of Ceylon Electricity Board, Ceylon Petroleum Corporation, Sri Lanka Ports Authority, Road Development Authority, Sri Lankan Airlines, and other SOEs.



**Table 2c. Sri Lanka: Summary of Central Government Operations, 2018–19**  
(In billions of rupees)

	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4
						Proj.		
Total revenue and grants	469	456	497	510	451	478	678	750
Total revenue	469	452	496	503	450	477	677	741
Tax revenue	425	420	433	434	418	421	629	627
Income taxes	72	65	96	78	71	71	206	43
VAT	117	113	111	121	117	121	146	199
Excise taxes	124	136	112	112	113	118	142	194
Other trade taxes	42	41	45	44	58	52	63	88
Other	70	65	69	79	59	59	72	103
Nontax revenue	44	32	63	69	32	56	48	113
Grants	0	5	1	7	1	1	2	9
Total expenditure and net lending	675	596	748	674	674	625	896	873
Current expenditure	528	468	582	512	590	525	632	590
Civil service wages and salaries	92	103	91	89	103	103	103	103
Other civilian goods and services	19	15	13	27	14	19	17	28
Security expenditure	76	77	78	86	83	91	91	96
Subsidies and transfers	121	102	124	126	125	135	133	159
Interest payments	221	171	276	185	266	178	289	204
Capital expenditure and net lending	148	128	166	162	84	100	263	282
Capital expenditure	140	125	184	163	90	101	263	284
Net lending	8	3	-19	-1	-6	-1	0	-2
Overall balance	-206	-140	-251	-163	-223	-147	-217	-123
Primary balance	15	31	24	22	44	31	71	82

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

**Table 3. Sri Lanka: Central Government Financing Needs, 2019–20**  
(In billions of rupees)

	2019					2020				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Proj.					Proj.				
<b>Gross financing needs</b>	<b>947</b>	<b>608</b>	<b>675</b>	<b>468</b>	<b>2,698</b>	<b>539</b>	<b>720</b>	<b>553</b>	<b>597</b>	<b>2,409</b>
Debt amortization	724	461	458	345	1,988	355	610	353	490	1,808
T-bill	280	188	144	188	800	257	250	136	87	730
T-bond	81	94	215	56	446	0	134	72	66	271
Sri Lanka Development Bond	100	0	0	3	102	48	176	100	105	429
International sovereign bond	164	83	0	0	247	0	0	0	185	185
Other	99	96	99	98	393	50	50	45	48	193
Fiscal deficit	223	147	217	123	709	185	110	200	107	602
<b>Financing</b>	<b>947</b>	<b>611</b>	<b>680</b>	<b>459</b>	<b>2,698</b>	<b>543</b>	<b>720</b>	<b>549</b>	<b>597</b>	<b>2,409</b>
Debt disbursement	947	611	680	459	2,698	543	720	549	597	2,409
Commercialization of public assets	0	0	0	0	0	0	0	0	0	0
<b>Balance</b>	<b>0</b>	<b>3</b>	<b>6</b>	<b>-9</b>	<b>0</b>	<b>4</b>	<b>0</b>	<b>-4</b>	<b>0</b>	<b>-1</b>
Memorandum item:										
Government deposits	366	369	375	366	366	370	370	366	366	366

Sources: IMF staff estimates.

**Table 4a. Sri Lanka: Monetary Accounts, 2016–20**  
(In billions of rupees, unless otherwise indicated, end of period)

	2016	2017	2018		2019	2020
			CR/18/175	Est.	Proj.	
<b>Central Bank of Sri Lanka</b>						
Net foreign assets	559	846	978	751	1,024	1,225
Net domestic assets	298	94	91	211	45	-33
Net claims on central government	413	225	211	471	234	271
Net claims on banks	-2	3	3	-11	-11	-11
Other items, net	-113	-134	-123	-250	-178	-292
Reserve Money	856	940	1,069	961	1,070	1,192
<b>Monetary survey</b>						
Net foreign assets	-231	122	186	-67	180	365
Monetary authorities	559	846	978	751	1,024	1,225
Deposit money banks	-790	-725	-792	-818	-845	-860
Net domestic assets	5,637	6,187	7,005	7,195	7,863	8,684
Net claims on central government	1,972	2,169	2,236	2,515	2,558	2,674
Credit to corporations	4,700	5,336	6,064	6,317	7,265	8,234
Public corporations	514	537	584	755	985	1,156
Private corporations	4,186	4,799	5,481	5,561	6,281	7,078
Other items (net)	-1,035	-1,318	-1,295	-1,637	-1,960	-2,225
Broad money	5,406	6,308	7,190	7,128	8,043	9,048
<b>Memorandum Items</b>						
Gross international reserves (in millions of U.S. dollars)	6,019	7,959	9,268	6,919	8,650	9,580
Net international reserves (in millions of U.S. dollars)	4,529	6,597	7,475	5,495	6,888	7,847
Net Foreign Assets (in millions of U.S. dollars)	3,725	5,513	6,215	4,104	5,410	6,342
Private credit (in percent of GDP)	34.9	35.8	37.7	38.5	40.1	41.6
Money multiplier	6.3	6.7	6.7	7.4	7.5	7.6
Broad money velocity 1/	2.4	2.3	2.0	2.1	1.9	1.9
<b>Money and credit (percent change, end of period)</b>						
Broad money	18.4	16.7	14.0	13.0	12.8	12.5
Reserve money	27.1	9.8	13.8	2.3	11.3	11.5
Credit to public corporations	-3.2	4.5	13.4	40.7	30.4	17.4
Credit to private sector	21.6	14.7	13.7	15.9	12.9	12.7
Sources: Central Bank of Sri Lanka; and IMF staff estimates. 1/ Calculated using end-period quarterly GDP, annualized.						

**Table 4b. Sri Lanka: Monetary Accounts, 2018–19**  
(In billions of rupees, unless otherwise indicated, end of period)

	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4
							Proj.	
<b>Central Bank of Sri Lanka</b>								
Net foreign assets	859	821	811	751	692	799	845	1,024
Net domestic assets	139	177	199	211	271	226	208	45
Net claims on central government	262	307	368	471	503	423	400	234
Net claims on banks	-1	-1	-6	-11	3	-11	-11	-11
Other items, net	-123	-129	-163	-250	-235	-186	-181	-178
Reserve Money	997	999	1,011	961	963	1,025	1,052	1,070
<b>Monetary survey</b>								
Net foreign assets	106	101	8	-67	103	207	251	180
Monetary authorities	859	821	811	751	692	799	845	1,024
Deposit money banks	-753	-720	-804	-818	-589	-591	-594	-845
Net domestic assets	6,500	6,646	6,926	7,195	7,100	7,306	7,556	7,863
Net claims on central government	2,278	2,273	2,427	2,515	2,526	2,537	2,547	2,558
Credit to corporations	5,579	5,775	6,012	6,317	6,519	6,711	6,978	7,265
Public corporations	557	619	656	755	813	870	927	985
Private corporations	5,022	5,156	5,356	5,561	5,706	5,841	6,051	6,281
Other items (net)	-1,357	-1,402	-1,513	-1,637	-1,945	-1,942	-1,970	-1,960
Broad money	6,607	6,748	6,933	7,128	7,203	7,513	7,807	8,043
<b>Memorandum Items:</b>								
Gross international reserves (in millions of U.S. dollars)	7,320	9,267	7,164	6,919	7,629	9,052	8,985	8,650
Net international reserves (in millions of U.S. dollars)	6,286	7,746	5,948	5,495	6,407	6,972	7,201	6,888
<b>Money and credit (percent change, end of period)</b>								
Broad money	16.4	14.9	13.1	13.0	9.0	11.3	12.6	12.8
Reserve money	11.8	12.0	11.2	2.3	-3.4	2.6	4.1	11.3
Credit to private sector	15.3	14.9	15.4	15.9	13.6	13.3	13.0	12.9
Sources: CBSL; and IMF staff estimates.								

**Table 5a. Sri Lanka: Balance of Payments, 2016–24**  
(In millions of U.S. dollars, unless otherwise indicated)

	2016	2017	2018		2019		2020	2021	2022	2023	2024
			CR/18/175	Est.	CR/18/175	Proj.					
<b>Current account</b>	<b>-1,743</b>	<b>-2,309</b>	<b>-2,308</b>	<b>-2,814</b>	<b>-2,514</b>	<b>-2,380</b>	<b>-2,378</b>	<b>-2,370</b>	<b>-2,410</b>	<b>-2,416</b>	<b>-2,552</b>
Balance on goods	-8,873	-9,619	-10,372	-10,343	-11,345	-10,871	-11,431	-11,980	-12,525	-13,094	-13,689
Credit (exports)	10,310	11,360	11,922	11,890	12,504	12,566	13,251	13,970	14,721	15,509	16,344
Debit (imports)	-19,183	-20,980	-22,294	-22,233	-23,848	-23,437	-24,681	-25,950	-27,245	-28,603	-30,033
Balance on services	2,879	3,302	3,932	3,766	4,384	4,013	4,571	5,060	5,623	6,186	6,532
Credit (exports)	7,138	7,724	8,535	8,375	9,218	8,668	9,240	9,822	10,480	11,141	11,586
Debit (imports)	-4,259	-4,421	-4,603	-4,609	-4,833	-4,655	-4,669	-4,762	-4,858	-4,955	-5,054
Primary income, net 1/	-2,201	-2,319	-2,422	-2,399	-2,510	-2,360	-2,367	-2,343	-2,364	-2,376	-2,378
Secondary income, net 2/	6,452	6,327	6,555	6,163	6,956	6,838	6,848	6,893	6,856	6,868	6,982
Of which: workers' remittances (net)	6,434	6,316	6,543	6,156	6,945	6,832	6,843	6,888	6,851	6,864	6,976
<b>Capital account (+ surplus / - deficit)</b>	<b>25</b>	<b>11</b>	<b>20</b>	<b>14</b>	<b>16</b>	<b>20</b>	<b>16</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>
<b>Balance from current account and capital account</b>	<b>-1,718</b>	<b>-2,298</b>	<b>-2,288</b>	<b>-2,799</b>	<b>-2,498</b>	<b>-2,360</b>	<b>-2,362</b>	<b>-2,358</b>	<b>-2,398</b>	<b>-2,404</b>	<b>-2,541</b>
<b>Financial account (+ net lending / - net borrowing) 3/</b>	<b>-1,649</b>	<b>-4,542</b>	<b>-2,856</b>	<b>-1,912</b>	<b>-2,455</b>	<b>-3,536</b>	<b>-3,140</b>	<b>-3,237</b>	<b>-3,146</b>	<b>-3,231</b>	<b>-3,133</b>
Direct investments	-661	-1,301	-1,309	-1,541	-931	-1,956	-1,711	-1,490	-1,340	-1,340	-1,340
Portfolio investments	-993	-1,772	-1,610	-129	-968	-2,042	-970	-950	-1,040	-1,310	-1,060
Equity and investment Fund shares	-24	-359	-378	5	-340	450	80	-170	-260	-280	-280
Debt instruments	-969	-1,413	-1,232	-134	-628	-2,491	-1,050	-780	-780	-1,030	-780
Of which: deposit taking corporations	0	500	290	1,350	172	300	250	0	0	0	0
Of which: general government	-969	-1,913	-1,522	-1,484	-800	-2,791	-1,300	-780	-780	-1,030	-780
T-bills, T-bonds, and SLDBs	531	-413	978	1,016	-300	108	-300	-280	-280	-280	-280
Sovereign bonds	-1,500	-1,500	-2,500	-2,500	-500	-2,899	-1,000	-500	-500	-750	-500
Other investments 4/	5	-1,469	63	-242	-555	461	-459	-797	-766	-581	-734
Of which:											
Currency and deposits	614	307	123	714	-39	400	-10	-20	-60	-60	-70
Central bank	701	402	0	1	0	0	0	0	0	0	0
Deposit taking corporations	-87	-95	123	713	-39	400	-10	-20	-60	-60	-70
Loans 4/	-732	-1,520	-217	-1,189	-286	-3	-371	-782	-1,041	-1,141	-1,211
Central bank 4/	0	0	0	0	0	0	0	0	0	0	0
Deposit taking corporations	507	-271	-28	-696	-454	-70	-100	-230	-300	-300	-350
General government	-1,103	-1,038	27	-432	573	97	-51	-252	-441	-541	-541
Disbursements 4/	-2,120	-2,248	-1,863	-1,420	-1,175	-1,693	-1,600	-1,450	-1,600	-1,700	-1,700
Amortizations	1,017	1,211	1,890	1,917	1,748	1,790	1,549	1,198	1,159	1,159	1,159
Other sectors	-136	-211	-216	-61	-405	-30	-220	-300	-300	-300	-320
Errors and omissions	-465	175	0	-529	0	0	0	0	0	0	0
<b>Overall balance (- = need of inflow) 3/</b>	<b>-534</b>	<b>2,419</b>	<b>567</b>	<b>-1,416</b>	<b>-44</b>	<b>1,176</b>	<b>778</b>	<b>879</b>	<b>748</b>	<b>827</b>	<b>593</b>
<b>Total financing (- = inflow)</b>	<b>-536</b>	<b>2,415</b>	<b>567</b>	<b>-1,416</b>	<b>-44</b>	<b>1,176</b>	<b>778</b>	<b>879</b>	<b>748</b>	<b>826</b>	<b>589</b>
<b>Financing (- = inflow)</b>	<b>-17</b>	<b>3,012</b>	<b>1,310</b>	<b>-1,039</b>	<b>441</b>	<b>1,731</b>	<b>944</b>	<b>879</b>	<b>748</b>	<b>826</b>	<b>589</b>
Change in reserve assets	-472	2,778	1,310	-1,039	441	1,731	930	823	600	643	350
Use of Fund credit, net	455	235	0	0	0	0	14	56	148	183	238
Purchases/Disbursements	0	0	0	0	0	0	0	0	0	0	0
Repurchases/repayments	455	235	0	0	0	0	14	56	148	183	238
Gross international reserves	-1,285	1,940	1,310	-1,039	441	1,731	930	823	600	643	350
<b>Financing gap (- = inflow)</b>	<b>-518</b>	<b>-598</b>	<b>-742</b>	<b>-377</b>	<b>-485</b>	<b>-554</b>	<b>-166</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
IMF	-333	-413	-517	-252	-260	-329	-166	0	0	0	0
Other IFIs	-185	-185	-225	-125	-225	-225	0	0	0	0	0
Memorandum items:											
Current account (in percent of GDP)	-2.1	-2.6	-2.5	-3.2	-2.5	-2.8	-2.6	-2.4	-2.3	-2.2	-2.1
Gross official reserves	6,019	7,959	9,268	6,919	9,710	8,650	9,580	10,403	11,003	11,646	11,996
In months of prospective imports of goods and	2.8	3.6	3.9	3.0	3.9	3.5	3.7	3.9	3.9	4.0	4.0
In percent of ARA composite metric	54.8	68.8	74.2	56.4	74.5	68.2	72.6	75.1	75.9	78.5	79.0
Net international reserves	4,529	6,597	7,475	5,495	7,656	6,888	7,847	8,726	9,474	10,301	10,893
In percent of ARA composite metric	41.2	57.0	59.8	44.8	58.7	54.3	59.5	63.0	65.3	69.4	71.7

Sources: Data provided by the CBSL; and IMF staff estimates.

1/ Under BPMS known as Income.

2/ Under BPMS known as Transfers.

3/ Excluding changes in reserves assets and credit and loans with the IMF.

4/ Excluding credits and loans with the IMF, other than reserves (net purchases and repurchases), and other international institutions' loan disbursement.

**Table 5b. Sri Lanka: Balance of Payments, 2018–19**  
(In millions of U.S. dollars, unless otherwise indicated)

	2018					2019				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Est. Est.					Proj.				
Current account	-586	-1,022	-389	-816	-2,814	-816	-533	-439	-592	-2,380
Balance on goods	-2,982	-2,727	-2,244	-2,390	-10,343	-2,821	-2,656	-2,621	-2,773	-10,871
Credit (exports)	2,989	2,743	3,166	2,992	11,890	3,196	2,939	3,166	3,265	12,566
Debit (imports)	-5,971	-5,470	-5,410	-5,382	-22,233	-6,017	-5,596	-5,787	-6,038	-23,437
Non-oil imports	-4,896	-4,452	-4,339	-4,395	-18,081	-5,122	-4,631	-5,045	-5,232	-20,030
Oil imports	-1,075	-1,018	-1,072	-987	-4,152	-895	-964	-742	-806	-3,407
Balance on services	1,175	719	953	919	3,766	1,060	844	1,075	1,035	4,013
Credit (exports)	2,360	1,888	2,100	2,027	8,375	2,208	2,005	2,202	2,253	8,668
Debit (imports)	-1,185	-1,169	-1,147	-1,108	-4,609	-1,148	-1,161	-1,128	-1,218	-4,655
Primary income, net 1/	-547	-445	-539	-868	-2,399	-628	-421	-606	-705	-2,360
Secondary income, net 2/	1,768	1,431	1,441	1,523	6,163	1,573	1,701	1,712	1,851	6,838
Capital account (+ surplus / - deficit)	6	4	4	0	14	5	5	5	5	20
Balance from current account and capital account	-580	-1,018	-385	-816	-2,799	-811	-528	-434	-587	-2,360
Financial account (+ net lending / - net borrowing) 3/	-50	-2,570	1,086	-378	-1,912	-1,420	-1,786	-242	-88	-3,536
Direct investments	-214	-892	-101	-334	-1,541	-221	-924	-105	-705	-1,956
Portfolio investments	-90	-1,884	1,083	762	-129	-1,136	-1,210	91	214	-2,042
Debt instruments	26	-1,850	1,067	623	-134	-1,281	-1,285	40	35	-2,491
Of which: general government	26	-2,350	317	523	-1,484	-1,281	-1,485	-10	-15	-2,791
T-bills, T-bonds, and SLDBs	26	150	317	523	1,016	118	15	-10	-15	108
Sovereign bonds	0	-2,500	0	0	-2,500	-1,399	-1,500	0	0	-2,899
Other investments 4/	254	206	104	-806	-242	-63	348	-228	403	461
Of which: Currency and deposits	-397	370	288	453	714	220	-300	40	440	400
Central bank	0	1	0	0	1	0	-400	0	400	0
Loans 4/	353	222	-426	-1,338	-1,189	-154	1,075	-780	-144	-3
Central bank 4/	0	0	0	0	0	0	0	0	0	0
Deposit taking corporations	251	-46	-483	-418	-696	-496	386	139	-100	-70
General government	54	289	71	-846	-432	443	635	-928	-53	97
Disbursements	-65	-119	-119	-1,119	-1,420	17	-135	-1,225	-350	-1,693
Amortizations	430	680	452	354	1,917	426	770	297	297	1,790
Other sectors	48	-21	-14	-74	-61	-101	54	9	9	-30
Errors and omissions	-234	143	-632	193	-529	0	0	0	0	0
Overall balance (- = need of inflow) 3/	-764	1,696	-2,103	-245	-1,416	610	1,258	-192	-499	1,176
<b>Total financing</b> (- = inflow)	-764	1,696	-2,103	-245	-1,416	610	1,258	-192	-499	1,176
<b>Financing</b> (- = inflow)	-639	1,947	-2,103	-245	-1,039	710	1,423	-67	-335	1,731
Change in reserve assets	-639	1,947	-2,103	-245	-1,039	710	1,423	-67	-335	1,731
Use of Fund credit, net	0	0	0	0	0	0	0	0	0	0
Purchases/Disbursements	0	0	0	0	0	0	0	0	0	0
Repurchases/repayments	0	0	0	0	0	0	0	0	0	0
<b>Financing gap</b> (- = inflow)	-125	-252	0	0	-377	-100	-165	-125	-165	-554
IMF	0	-252	0	0	-252	0	-165	0	-165	-329
Other IFIs	-125	0	0	0	-125	-100	0	-125	0	-225
<b>Memorandum items:</b>										
Gross official reserves	7,320	9,267	7,164	6,919	6,919	7,629	9,052	8,985	8,650	8,650
In months of prospective imports of goods and services	3.1	4.0	3.1	3.0	3.0	3.1	3.7	3.7	3.5	3.5
In percent of ARA composite metric	59.6	75.5	58.4	56.4	56.4	60.1	71.3	70.8	68.2	68.2
Net international reserves	6,286	7,746	5,948	5,495	5,495	6,407	6,972	7,201	6,888	6,888
In percent of ARA composite metric	51.2	63.1	48.5	44.8	44.8	50.5	55.0	56.8	54.3	54.3

Sources: Data provided by the CBSL; and IMF staff estimates.

1/ Under BPM5 known as Income.

2/ Under BPM5 known as Transfers.

3/ Excluding changes in reserves assets and credit and loans with the IMF.

4/ Excluding credits and loans with the IMF, other than reserves (net purchases and repurchases), and other international institutions' loan disbursement.

**Table 6. Sri Lanka: Gross External Financing, 2016–24**  
(In millions of U.S. dollars, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
			Est.			Proj.			
Current account	-1,742	-2,309	-2,814	-2,380	-2,378	-2,370	-2,410	-2,416	-2,552
Balance on goods	-8,873	-9,619	-10,343	-10,871	-11,431	-11,980	-12,525	-13,094	-13,689
Credit (exports)	10,310	11,360	11,890	12,566	13,251	13,970	14,721	15,509	16,344
Debit (imports)	-19,183	-20,980	-22,233	-23,437	-24,681	-25,950	-27,245	-28,603	-30,033
Balance on services	2,879	3,302	3,766	4,013	4,571	5,060	5,623	6,186	0
Primary and secondary income, net	4,252	4,008	3,764	4,478	4,481	4,550	4,492	4,492	4,604
Amortization	-2,256	-2,043	-2,603	-3,513	-3,194	-2,872	-3,177	-2,837	-2,897
General government	-1017	-1211	-1917	-3291	-2549	-2198	-2659	-2409	-2659
Sovereign bonds	0	0	0	-1501	-1000	-1000	-1500	-1250	-1500
Syndicated loans	0	-280	-613	-473	-333	0	0	0	0
Bilateral and multilateral	-1017	-930	-1304	-1317	-1216	-1198	-1159	-1159	-1159
Central bank	-1156	-636	-1	0	-14	-56	-148	-183	-238
IMF repurchases/repayments	-455	-235	0	0	-14	-56	-148	-183	-238
Other central bank liabilities, net	-701	-402	-1	0	0	0	0	0	0
Private sector loans	-83	-196	-685	-222	-631	-618	-370	-244	0
Gross external financing needs	-3,998	-4,351	-5,416	-5,893	-5,572	-5,242	-5,587	-5,253	-5,450
Sources of financing	3,998	4,351	5,416	5,893	5,572	5,242	5,587	5,253	5,450
Borrowing	3,007	6,531	4,000	7,069	6,336	6,065	6,187	5,895	5,800
General government	3,123	4,180	2,904	5,985	3,900	3,230	3,880	3,980	3,980
T-bills, T-bonds, and SLDBs, net	-532	413	-1,016	-108	300	280	280	280	280
Sovereign bonds	1,500	1,500	2,500	4,400	2,000	1,500	2,000	2,000	2,000
Syndicated loans	700	985	1,000	1,000	1,000	0	0	0	0
Bilateral and multilateral 1/	1,420	1,263	420	693	600	1,450	1,600	1,700	1,700
Official capital transfers	35	19	0	0	0	0	0	0	0
Other capital inflows, net	-116	2,351	1,096	1,084	2,436	2,835	2,307	1,915	1,820
Deposit-taking corporations, excl. central ba	-797	-120	-1,505	-318	195	370	610	480	0
FDI inflows, net	661	1,301	1,541	1,956	1,711	1,490	1,340	1,340	1,340
Private sector loans	0	0	400	585	900	980	980	980	0
Other capital inflows, net	20	1,170	660	-1,139	-370	-5	-623	-885	480
Change in reserve assets	472	-2,778	1,039	-1,731	-930	-823	-600	-643	-350
External financing gap	518	598	377	554	166	0	0	0	0
Financing	518	598	377	554	166	0	0	0	0
IMF	333	413	252	329	166	0	0	0	0
Other IFIs	185	185	125	225	0	0	0	0	0

Sources: CBSL; and IMF staff estimates.

1/ Based on existing and expected commitments (incl. ADB, China, and Japan).

**Table 7. Sri Lanka: Financial Soundness Indicators—All Banks, 2016–18**

	2016	2016	2016	2016	2017	2017	2017	2017	2018	2018	2018	2018
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>Capital adequacy</b>												
Regulatory capital to risk weighted assets	15.0	14.7	14.1	15.6	14.9	15.1	15.1	15.2	15.7	16.0	15.9	15.1
Tier 1 capital/risk weighted assets	12.4	12.2	11.7	12.6	12.0	12.3	12.3	12.4	12.4	12.8	12.6	12.0
Equity capital and reserves to assets ratio	7.8	7.9	7.8	7.8	7.7	8.0	8.3	8.4	8.4	8.6	8.6	8.7
<b>Asset quality</b>												
Gross nonperforming loans to total gross loans (without interest in suspense)	3.1	3.0	2.9	2.6	2.7	2.7	2.7	2.5	3.0	3.3	3.6	3.4
Net nonperforming loans to total gross loans	1.7	1.6	1.6	1.2	1.4	1.4	1.4	1.3	1.7	1.9	2.2	2.0
Provision coverage ratio (total)	61.2	64.3	64.5	71.8	66.8	66.8	67.2	69.9	59.0	56.6	52.3	57.4
<b>Earnings and profitability</b>												
Return on equity (after tax)	13.7	16.4	17.6	17.3	16.8	18.2	17.5	17.6	17.2	14.8	14.1	13.2
Return on assets (after tax)	1.1	1.3	1.4	1.4	1.3	1.4	1.4	1.4	1.4	1.2	1.2	1.1
Net Interest income to gross income	75.0	75.4	75.3	74.7	74.4	72.7	73.1	73.6	72.4	74.4	73.7	72.9
Staff expenses to noninterest expenses	39.9	44.8	45.4	44.9	45.1	46.7	46.2	46.4	44.8	45.2	45.0	44.1
Total cost to total income	78.4	76.0	75.8	75.6	77.7	76.2	76.5	76.3	76.0	76.7	76.8	76.8
Net interest margin	3.6	3.6	3.5	3.6	3.6	3.5	3.5	3.5	3.7	3.7	3.6	3.6
<b>Liquidity</b>												
Liquid assets to total assets	28.5	28.3	28.3	27.3	27.6	28.3	28.8	28.8	28.5	27.9	26.6	25.7
<b>Assets/funding structure</b>												
Deposits to total assets	66.7	67.5	68.7	69.6	69.4	70.4	71.2	71.9	72.3	73.2	72.6	72.0
Borrowings to total assets	21.9	21.0	19.8	18.8	19.0	17.8	16.4	15.6	15.1	14.1	14.6	15.0
Credit to deposits (loans net of interest in suspense to deposits)	88.4	88.5	87.1	88.0	88.7	88.1	86.7	86.9	87.2	87.5	88.7	90.6

Source: CBSL.



**Table 8. Sri Lanka: Proposed Reviews and Purchases Under the Arrangement**

Availability date	Amount (SDR millions)	Percent of Quota (%)	Conditions
June 3, 2016	119.894	20.714	Board Approval of the Extended Arrangement
November 18, 2016	119.894	20.714	Completion of the first review based on end-June 2016 and continuous performance criteria
April 20, 2017	119.894	20.714	Completion of the second review based on end-December 2016 and continuous performance criteria
November 20, 2017	177.774	30.714	Completion of the third review based on end-June 2017 and continuous performance criteria
April 20, 2018	177.774	30.714	Completion of the fourth review based on end-December 2017 and continuous performance criteria
April 3, 2019	118.500	20.473	Completion of the fifth review based on end-December 2018 and continuous performance criteria 1/
October 20, 2019	118.500	20.473	Completion of the sixth review based on end-June 2019 and continuous performance criteria 1/
April 3, 2020	118.550	20.485	Completion of the seventh review based on end-December 2019 and continuous performance criteria 1/
<b>Total</b>	<b>1070.780</b>	<b>185.000</b>	

Source: IMF staff.

1/ The fifth, sixth, and seventh reviews are proposed to be rephased.

**Table 9. Sri Lanka: Projected Payments to the Fund, 2019–33 1/**  
(In millions of SDR, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
<b>Fund repurchases and charges</b>															
In millions of SDR	17.4	37.1	67.2	130.4	152.8	189.3	195.4	181.6	148.1	81.1	54.9	14.5	4.6	4.6	4.6
In millions of U.S. dollars	24.1	52.0	94.6	183.7	215.3	266.7	275.3	255.9	208.7	114.2	77.3	20.5	6.4	6.4	0.0
In percent of exports of goods and services	0.1	0.2	0.4	0.7	0.8	1.0	0.9	0.8	0.6	0.3	0.2	0.1	0.0	0.0	0.0
In percent of quota	3.0	6.4	11.6	22.5	26.4	32.7	33.8	31.4	25.6	14.0	9.5	2.5	0.8	0.8	0.8
In percent of gross official reserves	0.3	0.5	0.9	1.7	1.8	2.2	2.2	1.9	1.5	0.8	0.5	0.1	0.0	0.0	0.0
<b>Fund credit outstanding 2/</b>															
In millions of SDR	952.2	1,060.8	1,020.8	916.4	787.4	618.8	440.3	271.8	133.3	59.3	9.9	0.0	0.0	0.0	0.0
In millions of U.S. dollars	1,329	1,490	1,443	1,296	1,113	875	623	384	189	84	14	0.0	0.0	0.0	0.0
In percent of exports of goods and services	6.3	6.6	6.1	5.1	4.2	3.1	2.1	1.2	0.6	0.2	0.0	0.0	0.0	0.0	0.0
In percent of quota	164.5	183.3	176.4	158.3	136.0	106.9	76.1	47.0	23.0	10.2	1.7	0.0	0.0	0.0	0.0
In percent of GDP	1.6	1.6	1.5	1.2	1.0	0.7	0.5	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0
In percent of gross official reserves	15.3	15.5	13.8	11.7	9.5	7.2	4.9	2.9	1.4	0.6	0.1	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>															
Exports of goods and services (in millions of U.S. dollars)	21,234	22,491	23,792	25,201	26,650	27,982	29,382	30,851	32,393	34,013	35,713	37,499	39,374	41,343	43,410
Quota 2/	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8
Quota (in millions of U.S. dollars) 2/	808	813	818	824	829	829	829	829	829	829	829	829	829	829	829
Gross official reserves (in millions of U.S. dollars) 2/	8,685	9,615	10,438	11,038	11,681	12,181	12,681	13,181	13,681	14,181	14,681	15,181	15,681	16,181	16,681

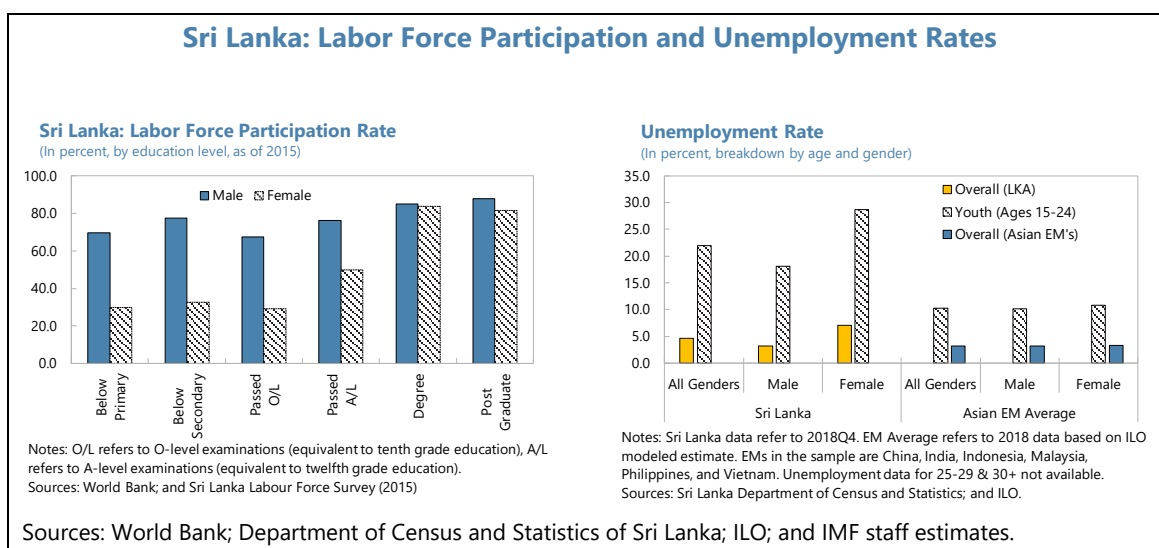
Source: IMF staff estimates.

1/ As of March 31, 2019. Reflects rephased purchases.

2/ As of the end of the year.

## Annex I. Supporting Sri Lanka's Female and Youth Employment

**1. Sri Lanka has low female labor force participation (FLFP) and high youth unemployment.** The FLFP rate was 34.3 percent, compared to 73.2 percent for men, in 2018Q4, and has remained broadly unchanged over the past decade. Despite important advances in achieving gender parity in education and health, Sri Lanka ranks below ASEAN countries and several low-income developing countries in terms of economic opportunity for women according to the World Economic Forum's Global Gender Report. The overall youth unemployment rate (age 15–24) was 21.9 percent in 2018Q4 (28.7 percent for young women), well-above the adult rate (age over 30 years) of 1.5 percent.



**2. Several elements are behind low FLFP and high youth unemployment.** Some common causes include skill mismatches, preference for the public sector, and inequality in access to quality education, especially among poorer households and regions. Low FLFP is also affected by a low proportion of technically-skilled female workers despite an overall high level of education; inadequate maternity and paternity leave benefits; insufficient good-quality and affordable childcare facilities; outdated clauses in labor laws that inhibit part-time and flexible work arrangements; and lack of safe transport.

**3. Increasing FLFP and reducing youth unemployment is important to boost growth and mitigate the challenges from population aging.** The exclusion of women and youth from the labor market poses a drag on economic efficiency, resulting in a lower level of output than Sri Lanka could otherwise have. Staff estimates, for example, indicate that fully closing gender gaps could generate overall income gains of about 21 percent over the long term.<sup>1</sup> In addition, given Sri Lanka's rising dependency ratio—defined as the size of the non-working-age population to the working-age

<sup>1</sup> See also [Female Labor Force Participation: A New Engine of Growth for Sri Lanka, IMF Country Report No. 18/186](#).

population, boosting FLFP would help mitigate the adverse effects of these demographic trends on growth and public finances.

<b>Policies to Support Female Labor Force Participation and Youth Employment</b>	
<b>Objective</b>	<b>Policies</b>
<b>Female Labor Force Participation</b>	<ul style="list-style-type: none"> <li>· Improve <i>gender-responsive budgeting</i> by assessing in a systematic way the performance of line ministries based on the identified twelve key performance indicators.</li> <li>· Expand <i>childcare facilities</i> and develop a <i>childcare policy</i>. Proceed with existing plans to establish After-School and Vacation Care centers in public schools, open 2000 daycare centers and train 10,000 daycare center operators.</li> <li>· <i>Amend relevant legislation</i> to facilitate flexible work arrangements, including allowing women to work at night in specific sectors.</li> <li>· Improve <i>maternity and paternity leave benefits</i>. Provide <i>maternity benefits</i> irrespective of number of children.</li> <li>· Improve access to <i>safe transportation</i>.</li> </ul>
<b>Youth Employment</b>	<ul style="list-style-type: none"> <li>· Encourage the <i>participation of women in the boards of listed companies</i>.</li> <li>· Improve <i>quality and access to education</i> to reduce the skills mismatch, including through Technical and Vocational Education and Training.</li> <li>· Improve <i>opportunities for innovation and entrepreneurship</i>, including through access to finance and incubation facilities in early-stages of development.</li> <li>· Implement the investment climate reform agenda to reduce obstacles for the <i>creation of Small and Medium-sized Enterprises</i> that can generate jobs.</li> <li>· Create a more <i>level playing field between the public and private sectors</i> to reduce bias towards public sector employment.</li> <li>· Implement structural reforms to increase competitiveness and remove bottlenecks for trade to <i>create jobs in the export sector</i>.</li> </ul>
Sources: IMF staff based on information provided by the Sri Lankan authorities.	

**4. The authorities are taking steps to remove barriers that constrain FLFP, including through gender-responsive budgeting and an expansion of childcare facilities.** Gender-responsive budgeting<sup>2</sup> was launched in 2018, with the development of twelve key performance indicators (KPIs) to assess progress, with support from USAID. The authorities are also conducting awareness programs and establishing focal points in each ministry to monitor KPI compliance in a systematic way. In March 2019, the cabinet approved a national policy to support early childhood care and development, especially among the most vulnerable and disadvantaged, with support from the WB Group. The policy includes initiatives to expand access to childcare services and training of staff. Amid ongoing efforts to support maternity leave and expand benefits,<sup>3</sup> the 2019 budget included a proposal to reduce their tax cost for employers, to strengthen incentives for hiring female workers. Measures are also ongoing to improve access to safe transportation, with dedicated training and awareness programs.

<sup>2</sup> Gender-responsive budgeting identifies the differential gender-impact of policies with a view to take into consideration gender-equality objectives in fiscal policy formulation.

<sup>3</sup> Paternity leave benefits remain limited, reducing opportunities to share childcare responsibilities.

**5. Further efforts are needed to amend labor laws and support the economic empowerment of women.** The authorities are committed to review existing labor laws, addressing current rigidities and facilitating part time and flexible working arrangements. This can help open new job opportunities for women and encourage their participation in the work force. Part-time work is currently not widely used. Employers are expected to provide the same compensation to part-time and full-time workers upon termination, discouraging to offer part-time jobs. Provisions regulating night shifts also reduce FLFP, for example in the IT sector.

**6. The authorities have also launched specific initiatives to support youth employment.** The 2019 budget includes a series of proposals to support the youth. The authorities' strategy focuses on improving access to education, particularly among poorer households and regions, including by expanding technical and vocational education and training, to reduce skills mismatches. The expansion of vocational training can also support FLFP in non-traditional jobs. Other initiatives to support youth employment aim at increasing access to finance for projects in early stages of development to support innovation and entrepreneurship and at facilitating the creation of small and medium-sized enterprises.

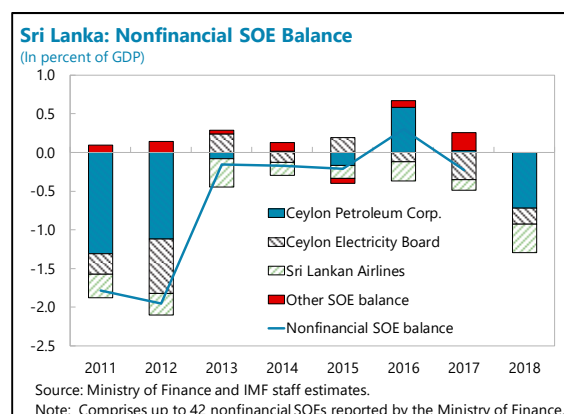
## Annex II. Debt Sustainability Analysis

*Sri Lanka's public debt remains high compared with peers, with one of the largest ratios of gross financing needs to GDP among emerging economies. Fiscal consolidation envisaged under the EFF-supported program would steadily reduce them. Downside risks, including from slower-than-expected fiscal consolidation, contingent liabilities, and currency shocks, remain significant, with stress tests indicating high risks to public debt sustainability. External debt remains sustainable, though with high currency and rollover risks.*

### A. Background and Key Assumptions

**1. Public debt increased in 2018.** Public debt is estimated to have increased significantly to about 90 percent of GDP at end-2018, reflecting weaker economic performance and the sizable depreciation of the rupee. Based on disaggregated data for 2018, the composition of public debt includes debt owed by the central government (83.3 percent of GDP), outstanding amount of loans guaranteed by the central government (5.2 percent of GDP), and outstanding Fund credit (1.6 percent of GDP). Domestic debt (mostly treasury bills and bonds) accounted for about 42 percent of GDP. External debt consisted of multilateral and bilateral loans (20.6 percent of GDP), international sovereign bonds and syndicated loans (15.4 percent of GDP), and nonresidents' holdings of treasury bills and bonds (1.1 percent of GDP). Foreign-currency denominated debt accounted for about 50 percent of total, while debt owed to official and multilateral creditors accounted for about a quarter of the total. Sri Lanka's debt to GDP ratio remains higher than the median for emerging economies (53 percent; excluding major oil exporters), and gross funding needs are the third largest among them.

**2. The financial obligations of non-financial state-owned enterprises (SOEs) are estimated to be 11.8 percent of GDP based on the latest available data as of end-2017.** Sri Lanka has more than 200 state-owned enterprises, and the Ministry of Finance publishes financial performance of 42 non-financial SOEs. Three major SOEs—the Ceylon Petroleum Corporation (CPC), the Ceylon Electricity Board (CEB), and Sri Lankan Airlines (SLA)—recorded a combined loss of 1.3 percent of GDP in 2018 (SR ¶111). There is scope to improve the quality of public debt data by adopting the 2014 Government Financial Statistics Manual and publishing audited SOE financial data promptly. Nonfinancial SOEs' financial obligations without central government guarantees<sup>1</sup> are not included in the public debt outstanding under this



<sup>1</sup> About 40 percent of SOE financial obligations are guaranteed by the central government.

DSA, but the impact from possible realization of the contingent liabilities is assessed under a customized shock scenario.

### Sri Lanka: Public Debt, 2016–18

	2016		2017		2018	
	Actual 1/		Actual 1/		Prel. 2/	
	Rs. Bn	% GDP	Rs. Bn	% GDP	Rs. Bn	% GDP
<b>Public debt</b>	<b>10,086</b>	<b>84.1</b>	<b>11,090</b>	<b>82.7</b>	<b>13,009</b>	<b>90.0</b>
<b>Central government debt</b>	<b>9,479</b>	<b>79.0</b>	<b>10,383</b>	<b>77.4</b>	<b>12,034</b>	<b>83.3</b>
Domestic	5,433	45.3	5,664	42.2	6,075	42.0
Treasury Bills	780	6.5	697	5.2	747	5.2
Treasury Bonds	3,806	31.7	3,892	29.0	4,197	29.0
Other	847	7.1	1,075	8.0	1,130	7.8
External	4,046	33.7	4,719	35.2	5,960	41.2
Multilateral and bilateral	2,437	20.3	2,691	20.1	2,974	20.6
International sovereign bonds	1,221	10.2	1,475	11.0	2,220	15.4
Nonresident holdings of T-Bills and T-Bonds	260	2.2	323	2.4	159	1.1
Other	128	1.1	230	1.7	606	4.2
<b>Publicly guaranteed debt 3/</b>	<b>524</b>	<b>4.4</b>	<b>590</b>	<b>4.4</b>	<b>750</b>	<b>5.2</b>
Ceylon Electricity Board	20	0.2	15	0.1	9	0.1
Ceylon Petroleum Corporation	212	1.8	208	1.5	359	2.5
National Water Supply and Drainage Board	35	0.3	69	0.5	86	0.6
Road Development Authority	135	1.1	163	1.2	182	1.3
SriLankan Airlines	27	0.2	27	0.2	27	0.2
Other	95	0.8	109	0.8	86	0.6
<b>Fund credit outstanding</b>	<b>83</b>	<b>0.7</b>	<b>117</b>	<b>0.9</b>	<b>226</b>	<b>1.6</b>
<b>Financial obligations of SOEs 4/ 5/</b>	<b>1,414</b>	<b>11.8</b>	<b>1,583</b>	<b>11.8</b>	...	...
Ceylon Electricity Board	230	1.9	307	2.3	...	...
Ceylon Petroleum Corporation	385	3.2	387	2.9	...	...
Road Development Authority	135	1.1	163	1.2	...	...
Sri Lanka Ports Authority	237	2.0	213	1.6	...	...
SriLankan Airlines	317	2.6	369	2.8	...	...
Other	108	0.9	144	1.1	...	...
Memorandum item:						
Central government debt, Fund credit outstanding, and financial obligations of SOEs 6/	10,976	91.5	12,083	90.1	...	...
Nominal GDP	11,996	...	13,418	...	14,450	...

Sources: Sri Lankan authorities; and IMF staff estimates.

(1) Central government debt includes treasury bonds amounting to Rs 78,447 million issued to settle dues to CPC in January 2012 and Rs 13,125 million issued to capitalize SriLankan Airlines (SLA) in March 2013.

(2) Central government domestic debt includes treasury bonds amounting to Rs. 56,662 million, which is the outstanding amount remaining from the original debt to settle CPC dues. SLA bonds issued in 2013 have matured.

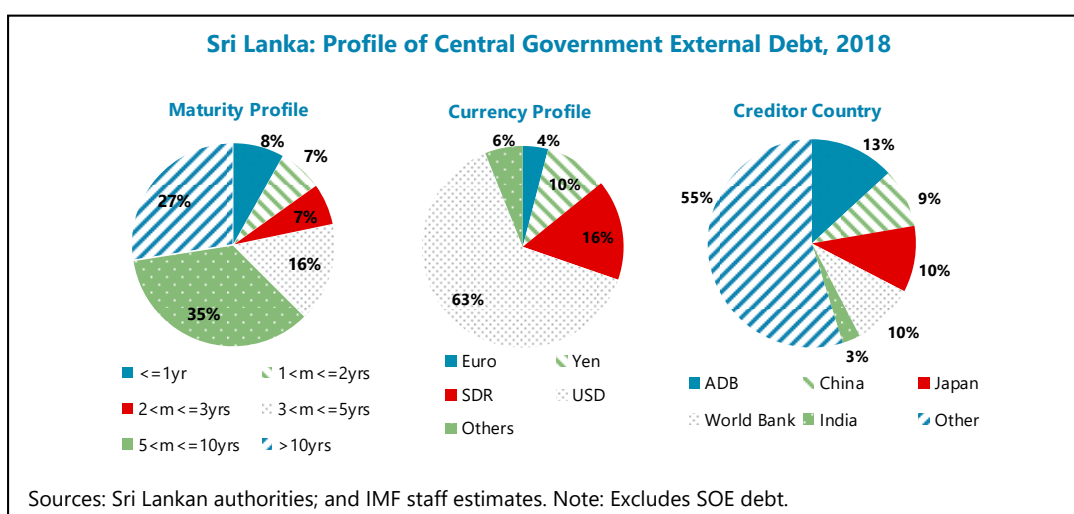
(3) Publicly guaranteed debt includes the Eurobond amounting to US\$175 million issued by SLA.

(4) Financial obligations of SOEs include publicly guaranteed debt. Hambantota port related debt is recorded under the Sri Lanka Ports Authority (SLPA). Following the agreement on the long lease of the Hambantota Port, the Treasury will make an annual transfer payment to SLPA for meeting the related debt obligations until SLPA becomes profitable and can service the debt.

(5) Financial obligations of SLA include lease commitment on aircrafts on order.

(6) IMF staff estimates, including short-term debt, project loans, and SLA liabilities related to aircraft lease.

**3. External debt is estimated at 59 percent of GDP at end-2018.** External debt is predominantly owed by the public sector (36 percent of GDP by the general government and 2 percent by the central bank). Private external debt remained broadly stable at around 21 percent of GDP. The ratio of external debt to exports of goods and services is high, at 258 percent in 2018. Although rollover risks remain contained, as 85 percent of private and public debt is medium or long term, several sovereign bond repayments fall due in 2019–22. More than half of the central government’s external debt stock is denominated in U.S. dollars. In terms of composition of central government debt, the largest creditors include the Asian Development Bank (13 percent of external central government debt), World Bank (10 percent), Japan (10 percent) and China (9 percent). Chinese loans to the Sri Lankan public sector, including SOEs, amount to 15 percent of central government external debt, or 7 percent of total public debt.



**4. The baseline scenario of the DSA reflects the medium-term macroeconomic projections and the proposed policies under the EFF-supported program.** Real GDP growth is projected to recover from 3.2 percent in 2018 to 4.8 percent by 2024. Inflation is estimated to reach 5 percent over the medium term. Fiscal deficits are programmed to decrease from 5.3 percent of GDP in 2018 to the authorities’ target of 3.5 percent of GDP in 2020. The primary balance is projected to improve from 0.6 percent of GDP in 2018 to 1.5 percent of GDP in 2019, and 2.4 percent of GDP in 2020. Interest payments are projected based on the interest payments for existing debt and interest rates in the primary and secondary government security markets prevailing in 2019 for newly issued debt. Interest rates for newly issued debt are assumed to decrease gradually over the medium term. Publicly guaranteed debt is projected at 5.4 percent of GDP at end-2019, in line with the indicative target under the program, and kept constant as a percent of GDP through 2024. External debt projections are based on a projected reduction in the current account deficit from 3.2 percent of GDP in 2018 to around 2 percent of GDP over the medium term and incorporate planned purchases under the Fund’s Extended Arrangement and disbursements of program loans by multilateral and bilateral creditors.



## B. Public Debt Sustainability

**5. Fiscal consolidation envisaged under the EFF-supported program would steadily reduce public debt.** The consolidation path envisaged under the program scenario is projected to bring down the ratio of public debt to GDP from 90 percent in 2018 to 75.4 percent in 2024. The reduction in the debt to GDP ratio beyond 2019 is supported by favorable debt dynamics, with a negative interest-rate-and-growth differential and primary surpluses. Gross financing needs are projected to decrease to 11 percent of GDP by 2024, as fiscal consolidation reduces the overall deficit and debt amortization over the medium term.

**6. Nevertheless, there are significant downside risks to the program scenario.** If fiscal consolidation were to stall and the primary balance to return to its historical level (-1.5 percent of GDP), the debt-to-GDP ratio would remain at about 90 percent until 2024.<sup>2</sup> Debt reductions would become less significant under individual shock scenarios on primary balance (lower primary surplus by 0.5 percentage points of GDP for 2019–20), GDP growth (2 percentage points lower than in the program scenario for 2019–20), the exchange rate (15 percent real depreciation in 2019 vis-à-vis the program scenario), and the interest rate (an increase by 300 basis points for new borrowings during 2018–21 vis-à-vis the program scenario). When these shocks are combined, the debt to GDP ratio would reach 97 percent in 2024. Similarly, in a SOE-related customized contingent liability shock scenario where the central government becomes liable for additional debt of 7 percent of GDP in 2019, the debt to GDP ratio would initially jump to 99 percent of GDP and gradually decline to 92 percent of GDP in 2024. In the combined shock scenario and the contingent liability shock scenario, gross financing needs would remain elevated at 15 percent of GDP in 2024. Also, the debt level is high relative to revenues, constraining repayment capacity. In terms of the realism of baseline assumptions, the envisaged improvement in the cyclically-adjusted primary balance of around 3 percentage points of GDP over 2019–24 is higher than in 74 percent of international experiences, highlighting the challenges of the fiscal consolidation plan.

**7. Heat map analysis indicates high risks to debt sustainability.** The debt burden benchmark of 70 percent of GDP and gross financing need benchmark of 15 percent of GDP are exceeded in the program and the shock scenarios during the projection period. Debt profile analysis indicates a moderate degree of vulnerabilities related to market perception, external financing requirement, debt held by non-residents, and debt denominated in foreign currency.

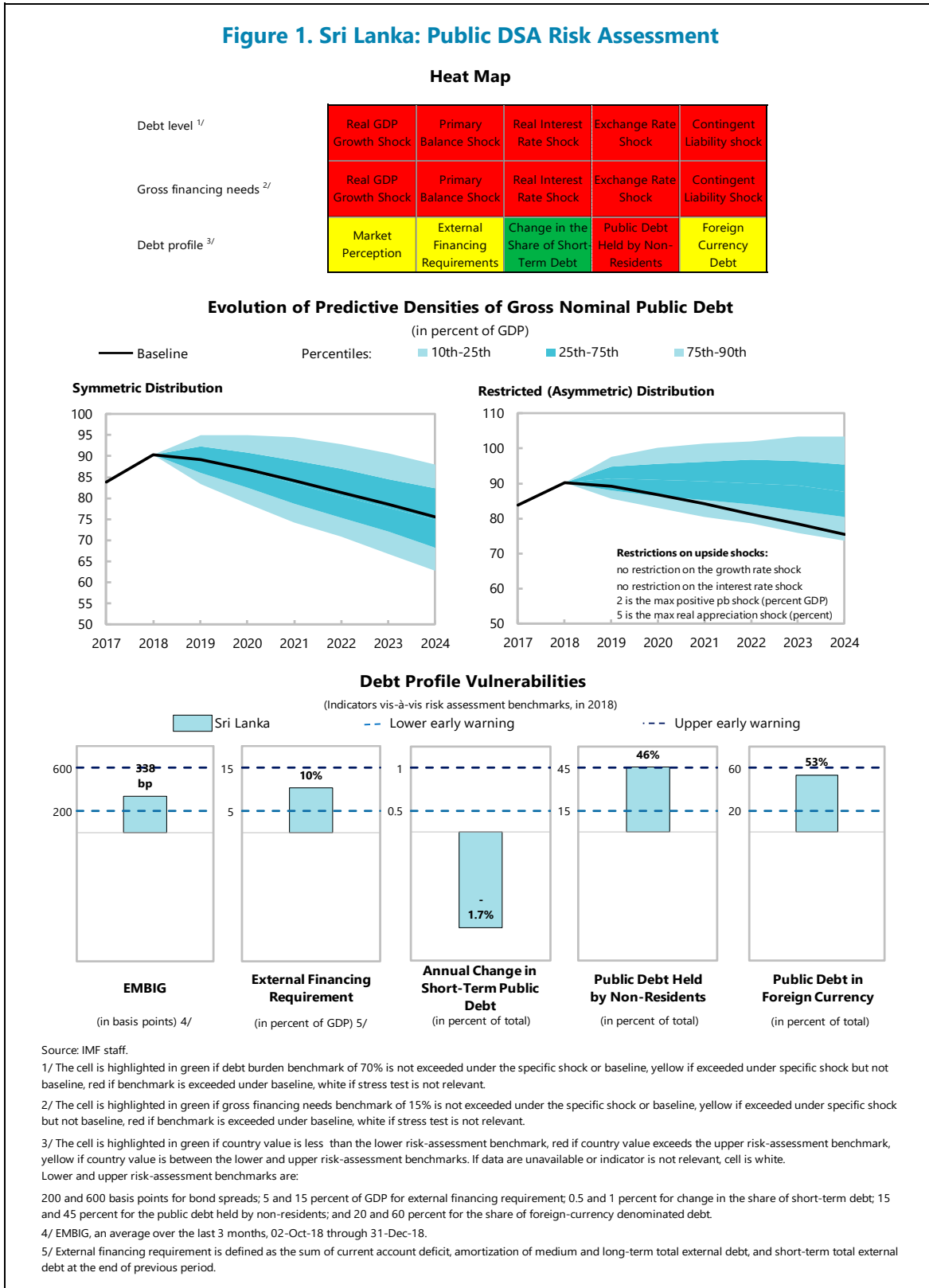
## C. External Debt Sustainability

**8. The ratio of external debt to GDP is projected to gradually decline over the medium term.** Under the program scenario, external debt is projected to decrease from about 59 percent of GDP in 2018 to around 56 percent in 2024. The decline is driven by GDP growth, a steady pace of fiscal consolidation, and gradual current account adjustments.

<sup>2</sup> Under this scenario, real GDP growth and the effective interest rate on debt are also set at their historical levels.

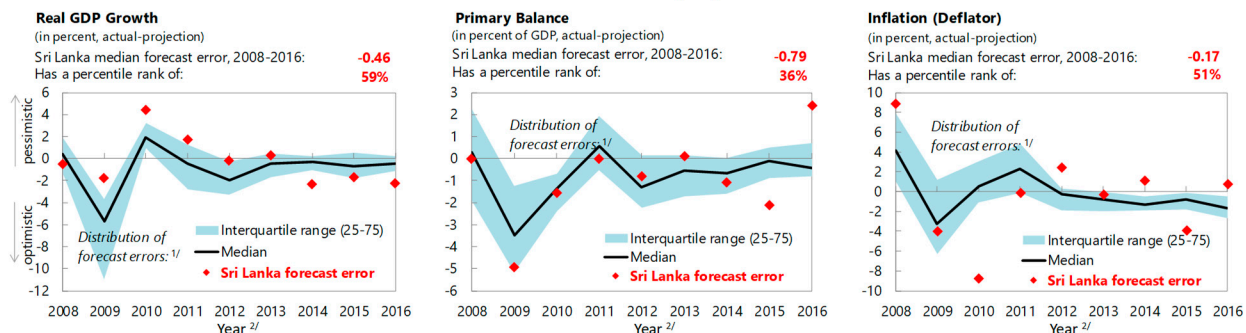
**9. Nevertheless, vulnerabilities linked to inadequate reserve coverage, exchange rate depreciation, and deleveraging could pose a risk for debt servicing.** Currency risk, notably related to the U.S. dollar, is high. Large rupee depreciation could pose a significant risk, if sustained, as stress tests show that a 30 percent real depreciation could raise the external debt-to-GDP ratio to about 83 percent by 2024. In the short run, tighter global liquidity and shifts in investor confidence could raise rollover risks and costs. Despite the high share of medium- and long-term debt, lumpy repayments and external financing at non-concessional terms gradually substituting concessional financing point to the need to speedily build buffers. Lower-than-expected GDP or export growth would also deteriorate debt dynamics.

**Figure 1. Sri Lanka: Public DSA Risk Assessment**



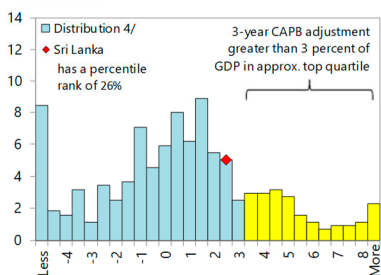
**Figure 2. Sri Lanka: Public DSA—Realism of Baseline Assumptions**

**Forecast Track Record, versus program countries**

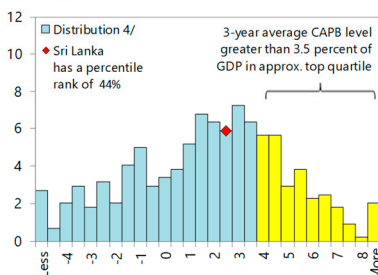


**Assessing the Realism of Projected Fiscal Adjustment**

**3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)**  
(Percent of GDP)

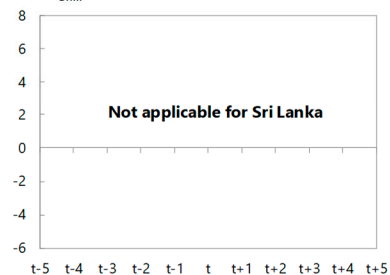


**3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)**  
(Percent of GDP)



**Boom-Bust Analysis<sup>3/</sup>**

**Real GDP growth**  
(in percent)



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Sri Lanka, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

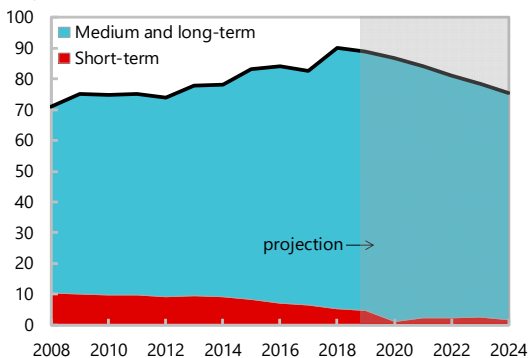


**Figure 4. Sri Lanka: Public DSA—Composition of Public Debt and Alternative Scenarios**

**Composition of Public Debt**

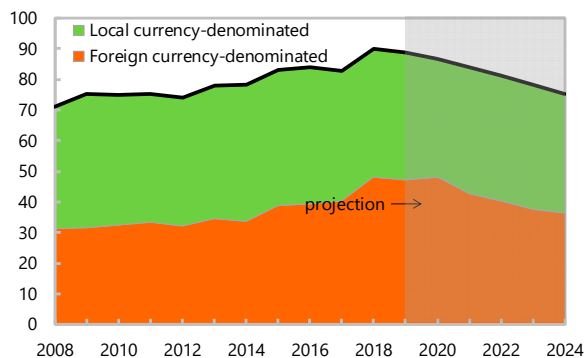
**By Maturity**

(in percent of GDP)

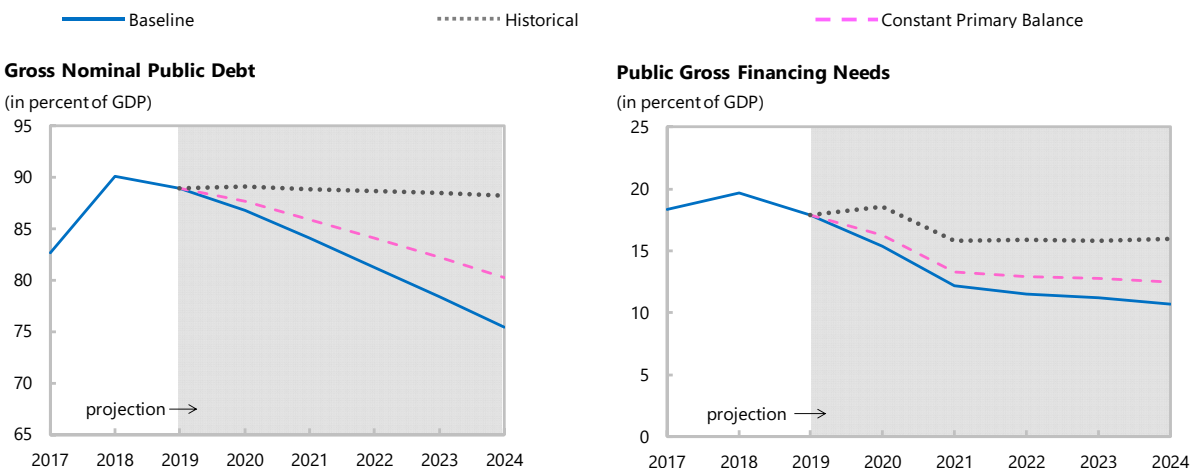


**By Currency**

(in percent of GDP)



**Alternative Scenarios**



**Underlying Assumptions**

(in percent)

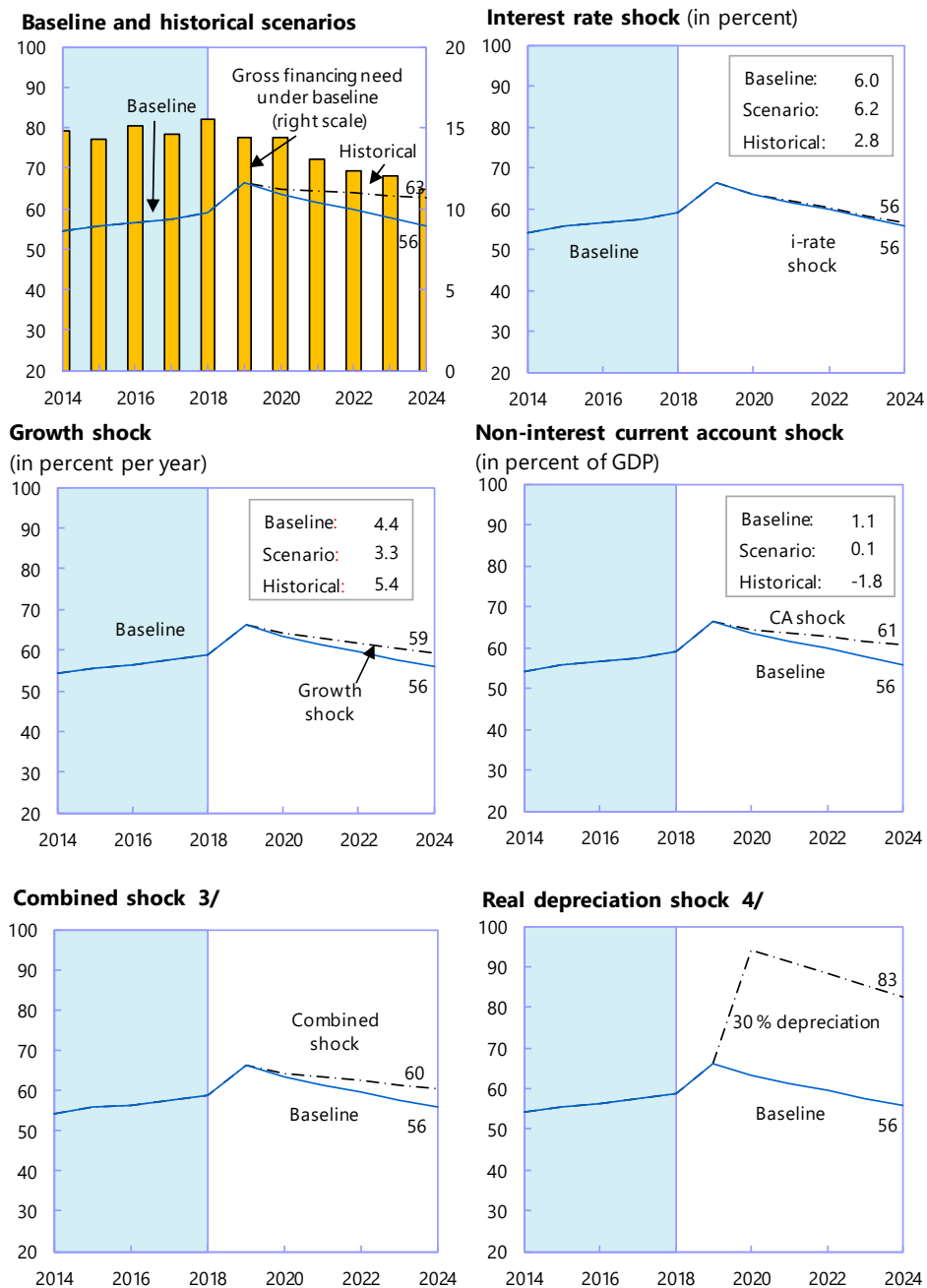
Scenario	2019	2020	2021	2022	2023	2024
<b>Baseline Scenario</b>						
Real GDP growth	3.6	4.0	4.3	4.5	4.6	4.8
Inflation	4.5	4.5	4.7	4.8	5.0	5.0
Primary Balance	1.5	2.4	2.4	2.4	2.4	2.4
Effective interest rate	7.8	7.9	7.9	8.2	8.3	8.4
<b>Constant Primary Balance Scenario</b>						
Real GDP growth	3.6	4.0	4.3	4.5	4.6	4.8
Inflation	4.5	4.5	4.7	4.8	5.0	5.0
Primary Balance	1.5	1.5	1.5	1.5	1.5	1.5
Effective interest rate	7.8	7.8	7.9	8.2	8.4	8.5
<b>Historical Scenario</b>						
Real GDP growth	3.6	5.4	5.4	5.4	5.4	5.4
Inflation	4.5	4.5	4.7	4.8	5.0	5.0
Primary Balance	1.5	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	7.8	7.8	7.8	8.0	8.0	8.0

Source: IMF staff.

Figure 5. Sri Lanka: Public DSA—Stress Tests



**Figure 6. Sri Lanka: External Debt Sustainability: Bound Tests 1/ 2/**  
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.  
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.  
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.  
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.  
 4/ One-time real depreciation of 30 percent occurs in 2017.



**Table 1. Sri Lanka: External Debt Sustainability Framework, 2014–24**  
(In percent of GDP, unless otherwise indicated)

	Actual				Prel.	Projections						Debt-stabilizing non-interest current account 6/ -2.2	
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024		
<b>Baseline: External debt</b>	54.3	55.7	56.3	57.5	58.8	<b>66.2</b>	<b>63.4</b>	<b>61.4</b>	<b>59.7</b>	<b>57.7</b>	<b>55.9</b>		
Change in external debt	0.5	1.4	0.7	1.2	1.3	7.4	-2.8	-2.0	-1.7	-2.1	-1.8		
Identified external debt-creating flows (4+8+9)	-2.2	0.6	-0.2	-3.0	0.7	-1.2	-1.7	-1.8	-1.8	-1.9	-1.8		
Current account deficit, excluding interest payments	1.0	0.9	0.6	1.0	1.0	0.1	-0.6	-1.1	-1.5	-1.3	-1.1		
Deficit in balance of goods and services	8.1	7.5	7.3	7.2	7.4	8.1	7.6	7.1	6.6	6.2	6.0		
Exports	21.1	21.0	21.2	21.7	22.8	25.0	24.8	24.5	24.2	23.8	23.3		
Imports	29.2	28.6	28.5	28.9	30.2	33.1	32.4	31.6	30.8	30.0	29.2		
Net non-debt creating capital inflows (negative)	-1.3	-0.7	-0.8	-1.9	-1.7	-1.8	-1.8	-1.7	-1.5	-1.4	-1.3		
Automatic debt dynamics 1/	-2.0	0.5	0.0	-2.1	1.4	0.4	0.7	1.0	1.2	0.9	0.6		
Contribution from nominal interest rate	1.5	1.5	1.5	1.6	2.1	2.7	3.2	3.5	3.8	3.5	3.2		
Contribution from real GDP growth	-2.5	-2.7	-2.4	-1.8	-1.8	-2.2	-2.5	-2.5	-2.6	-2.6	-2.6		
Contribution from price and exchange rate changes 2/	-1.0	1.7	1.0	-1.9	1.1	...	...	...	...	...	...		
Residual, incl. change in gross foreign assets (2-3) 3/	2.7	0.8	0.9	4.1	0.6	8.6	-1.1	-0.2	0.1	-0.2	0.0		
External debt-to-exports ratio (in percent)	257.2	264.7	266.1	265.2	258.1	264.5	255.5	250.4	246.8	241.9	240.2		
<b>Gross external financing need (in billions of US dollars) 4/</b>	11.7	11.5	12.4	12.8	13.8	12.2	13.0	12.7	12.8	13.4	13.5		
in percent of GDP	14.8	14.2	15.1	14.6	15.5	10-Year	10-Year	14.4	14.4	13.1	12.3	12.0	11.2
<b>Scenario with key variables at their historical averages 5/</b>						<b>66.2</b>	<b>64.7</b>	<b>64.2</b>	<b>63.9</b>	<b>63.2</b>	<b>62.7</b>	<b>-3.8</b>	
<b>Key Macroeconomic Assumptions Underlying Baseline</b>						Historical Average	Standard Deviation						
Real GDP growth (in percent)	5.0	5.0	4.5	3.4	3.2	5.4	2.3	3.6	4.0	4.3	4.5	4.6	4.8
GDP deflator in US dollars (change in percent)	1.7	-3.3	-2.1	3.3	-2.1	1.6	5.6	-7.9	2.7	2.7	2.7	2.6	2.5
Nominal external interest rate (in percent)	2.9	2.8	2.7	3.0	3.7	2.8	0.4	4.3	5.2	6.0	6.6	6.2	6.0
Growth of exports (US dollar terms, in percent)	11.0	1.2	3.0	9.4	6.2	7.7	10.6	4.8	5.9	5.8	5.9	5.7	4.8
Growth of imports (US dollar terms, in percent)	7.6	-0.6	1.9	8.4	5.7	7.0	19.3	4.7	4.5	4.6	4.5	4.5	4.6
Current account balance, excluding interest payments	-1.0	-0.9	-0.6	-1.0	-1.0	-1.8	2.0	-0.1	0.6	1.1	1.5	1.3	1.1
Net non-debt creating capital inflows	1.3	0.7	0.8	1.9	1.7	1.3	0.4	1.8	1.8	1.7	1.5	1.4	1.3

1/ Derived as  $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $r$  = change in domestic GDP deflator in US dollar terms,  $g$  = real GDP growth rate,

$e$  = nominal appreciation (increase in dollar value of domestic currency), and  $a$  = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as  $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$  times previous period debt stock.  $r$  increases with an appreciating domestic currency ( $e > 0$ ) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Part I: Reform Progress under the EFF-Supported Program and IMF Capacity Development<sup>1</sup>

Specific Area	Objectives	TA/Training engagement	Achieved outcomes	Future program outcomes
<b>Advancing Fiscal Consolidation and Strengthening Institutions</b>				
<i>Advance revenue-based fiscal consolidation to reduce the still sizable public debt, while safeguarding social and infrastructure spending, supported by stronger fiscal institutions and reform of state-owned enterprises.</i>				
<b>Tax Policy Reforms</b>	Mobilize revenue through base-broadening tax policy reforms on VAT, income tax, excises, and other taxes.	<ul style="list-style-type: none"> <li>• FAD: tax system diagnostics and reform options;</li> <li>• LEG: assistance with new IRA draft, regulations, and manuals; training.</li> </ul>	<ul style="list-style-type: none"> <li>• VAT collections boosted by 2016 and 2018 VAT amendments;</li> <li>• New IRA implemented in April 2018;</li> <li>• Tax expenditure statements published in 2017-2019 budgets.</li> </ul>	<ul style="list-style-type: none"> <li>• Submit 2020 budget with a plan to rationalize tax expenditures and related statement;</li> <li>• Cabinet to approve medium term strategy to rationalize para-tariffs by March 2020.</li> </ul>
<b>Indirect Tax Administration</b>	Mobilize revenue through risk-based VAT and customs administration.	<ul style="list-style-type: none"> <li>• FAD: indirect tax administration TA;</li> <li>• SARTTAC: support to FAD in providing TA on selected topics;</li> <li>• WB: TA on customs valuation of imports.</li> </ul>	<ul style="list-style-type: none"> <li>• Dedicated unit to perform risk-based VAT audits established in 2018;</li> <li>• New RAMIS IT system rolled out in 2016;</li> <li>• Risk-based VAT compliance strategy with KPIs on audits adopted in 2016 and piloted for key sectors in 2018;</li> <li>• Risk management unit for customs established.</li> </ul>	<ul style="list-style-type: none"> <li>• Establish a risk-management unit in IRD by June 2019;</li> <li>• Rollout of risk-based audits to all sectors by end-2019;</li> <li>• Expand VAT compliance strategy and risk-based audits to small and medium enterprises;</li> <li>• Automate risk-based customs audits of cargo using the ASYCUDA system.</li> </ul>

<sup>1</sup> This matrix has been developed to illustrate the integration of capacity development and program objectives, guided by key recommendations in the IMF Board Paper [2018 Review of the Fund's Capacity Development Strategy](#). The acronyms in the table refer to the following IMF CD providers: Fiscal Affairs Department (FAD), Institute for Capacity Development (ICD); Legal Department (LEG), Monetary and Capital Markets Department (MCM); South Asia Regional Training and Technical Assistance Center (SARTTAC); Statistics Department (STA); World Bank (WB).

### Part I: Reform Progress under the EFF-Supported Program and IMF Capacity Development

Specific Area	Objectives	TA/Training engagement	Achieved outcomes	Future program outcomes
<b>Income Tax Administration</b>	Mobilize revenue by consistently implementing the new IRA.	<ul style="list-style-type: none"> <li>• SARTTAC: coordination of hands-on TA on new IRA implementation;</li> <li>• FAD: support to SARTTAC in finding long-term and short-term experts;</li> <li>• LEG: legal support to implement the new IRA.</li> </ul>	<ul style="list-style-type: none"> <li>• Manual accompanying new IRA published;</li> <li>• Media campaign rolled out on IRA, with call centers fielding taxpayer queries;</li> <li>• Business process redesign for withholding taxes;</li> <li>• Contract signed with software developer to upgrade RAMIS IT system to be fully IRA compatible.</li> </ul>	<ul style="list-style-type: none"> <li>• Continue to strengthen tax administration capacity of MOF's Inland Revenue Department (IRD);</li> <li>• Develop a plan for audit of withholding obligations by employers by June 2019;</li> <li>• Cabinet to approve a plan to reform the IRD and Customs departments by June 2019.</li> </ul>
<b>Fiscal Rules and Macro-Fiscal Policy Framework</b>	Upgrade fiscal rules to anchor debt sustainability beyond 2020; Strengthen capacity for macro-fiscal policy making in MOF.	<ul style="list-style-type: none"> <li>• FAD: design of new fiscal rules and assistance with medium-term budgeting;</li> <li>• FAD/SARTTAC: set up of macro-fiscal unit in MOF;</li> <li>• SARTTAC/ICD: Capacity development of MOF macro-fiscal policy analysis and forecasting.</li> </ul>	<ul style="list-style-type: none"> <li>• Plans to upgrade the fiscal rule discussed in the authorities' Vision 2025 reform strategy and the 2019 budget speech;</li> <li>• Medium-term fiscal consolidation path for 2020-24 included in 2019 budget.</li> </ul>	<ul style="list-style-type: none"> <li>• Cabinet to approve key elements of new fiscal rules by May 2019 and approve related legal amendments by September 2019;</li> <li>• Credible MTFP to be regularly updated to guide the budget process.</li> </ul>
<b>Public Debt Management</b>	Strengthen capacity for public debt management with Medium-Term Debt Strategy (MTDS) and an independent public debt management agency (PDMA).	<ul style="list-style-type: none"> <li>• MCM: support to the development of MTDS and PDMA, with the WB;</li> <li>• FAD: support to MCM TA as needed.</li> </ul>	<ul style="list-style-type: none"> <li>• Strategy to manage sovereign bond maturities for 2019-22 approved by cabinet in March 2018;</li> <li>• Liability Management Act enacted in March 2018;</li> </ul>	<ul style="list-style-type: none"> <li>• Cabinet to approve a plan to establish a PDMA by end-September 2019;</li> <li>• Annual Borrowing Plan consistent with MTDS to be prepared by December 2019.</li> </ul>

## Part I: Reform Progress under the EFF-Supported Program and IMF Capacity Development

Specific Area	Objectives	TA/Training engagement	Achieved outcomes	Future program outcomes
<b>Public Financial Management</b>	Transition from cash-based to commitment-based expenditure management. Improve quality of infrastructure spending through better public investment management.	<ul style="list-style-type: none"> <li>• WB (lead): support to new PFM Act development;</li> <li>• FAD: TA on commitment control and follow up on 2017 PIMA. TA on cash buffers in 2019;</li> <li>• SARTTAC: support to FAD on selected topics.</li> </ul>	<ul style="list-style-type: none"> <li>• MTDS launched by MOF and CBSL in April 2019.</li> <li>• New IT system (ITMIS) piloted for MOF and Ministry of Health in 2016;</li> <li>• MOF introduced commitment recording and control systems by Jan 2018 by modifying the existing CIGAS IT system.</li> </ul>	<ul style="list-style-type: none"> <li>• Initial roll out of ITMIS to 60 major spending agencies by September 2019;</li> <li>• Roll out ITMIS for fully IT-based commitment control by June 2020.</li> </ul>
<b>Fiscal Risks Mitigation and SOE reforms</b>	Mitigate fiscal risks by reforming SOE governance, energy pricing, and PPP framework, while improving transparency and oversight of the SOE sector.	<ul style="list-style-type: none"> <li>• FAD: diagnostics and reform proposals for electricity and fuel pricing as well as PPP framework. TA on draft Statements of Corporate Intent (SCI).</li> </ul>	<ul style="list-style-type: none"> <li>• SCIs published for 5 major SOEs in 2017;</li> <li>• Report on fuel and electricity non-commercial obligations in 2018 and 2019 budgets;</li> <li>• Establishment of Bulk Supply Transaction Account for electricity and introduction of automatic fuel pricing mechanism in May 2018;</li> <li>• New MOF unit to assess PPP fiscal risks established in April 2019.</li> </ul>	<ul style="list-style-type: none"> <li>• Compliance reports based on KPIs of 5 SOEs with SCIs for up to 2018H1 to be submitted to cabinet by end-May 2019;</li> <li>• SCIs for additional 10 SOEs to be published in May 2019.</li> <li>• Cabinet to approve an automatic pricing mechanism for electricity by October 2019;</li> </ul>

## Part I: Reform Progress under the EFF-Supported Program and IMF Capacity Development

Specific Area	Objectives	TA/Training engagement	Achieved outcomes	Future program outcomes
<b>Statistics</b>	Transition fiscal reporting from the 1986 Government Financial Statistics Manual (GFSM) to GFSM 2014 and the 2011 Public Sector Debt Statistics Guide for Compilers and Users (PSDSG), while expanding coverage beyond budgetary central government.	<ul style="list-style-type: none"> <li>• SARTTAC: assistance with the transition to 2014 GFSM through training and TA;</li> <li>• STA: assistance to SARTTAC as required based on past STA TA on GFS.</li> </ul>	<ul style="list-style-type: none"> <li>• Cabinet approval in October 2018 of a multi-year plan to transition to accrual-based accounting for general government;</li> <li>• Dedicated unit within MOF established in April 2019 to manage transition to fiscal reporting consistent with GFSM 2014.</li> </ul>	<ul style="list-style-type: none"> <li>• MOF to compile GFSM cash and debt tables for budgetary and extra-budgetary central government by June 2019.</li> </ul>

### Modernizing Monetary, Exchange Rate, and Financial Frameworks

*Transition to inflation targeting with a flexible exchange rate regime and strengthen the financial sector to ensure price stability and resilience against shocks.*

<b>Transition to Inflation Targeting</b>	Develop legal framework and capacity for inflation targeting.	<ul style="list-style-type: none"> <li>• MCM: diagnostics and support in developing inflation targeting roadmap;</li> <li>• LEG: assistance to draft amendments to Monetary Law Act (MLA);</li> <li>• ICD: assistance to develop a Forecasting and Policy Analysis System (FPAS) and align monetary policy communication with best practices.</li> </ul>	<ul style="list-style-type: none"> <li>• CBSL's roadmap to transition to inflation targeting and a flexible exchange rate regime adopted in 2017;</li> <li>• Amendments to MLA approved by cabinet in March 2019;</li> <li>• CBSL developed model-based FPAS and uses it to inform policy formulation.</li> </ul>	<ul style="list-style-type: none"> <li>• Cabinet to submit to parliament the amendments to the Monetary Law Act (MLA) by July 2019;</li> <li>• CBSL to continue improving forecasting capacity and integrate FPAS more firmly into policy decision-making and communication.</li> </ul>
<b>Transition to Flexible</b>	Promote greater exchange rate flexibility to help reserve	<ul style="list-style-type: none"> <li>• MCM: diagnostics on exchange rate policy;</li> </ul>	<ul style="list-style-type: none"> <li>• CBSL's roadmap to transition to inflation targeting and a</li> </ul>	<ul style="list-style-type: none"> <li>• CBSL to continue to strengthen external buffers</li> </ul>

## Part I: Reform Progress under the EFF-Supported Program and IMF Capacity Development

Specific Area	Objectives	TA/Training engagement	Achieved outcomes	Future program outcomes
<b>Exchange Rate Regime</b>	buildup and improve resilience to external shocks.	<ul style="list-style-type: none"> <li>• SARTTAC: hands-on operational assistance on the implementation of the CBSL's FX intervention strategy.</li> </ul>	<p>flexible exchange rate regime adopted in 2017;</p> <ul style="list-style-type: none"> <li>• CBSL operationalized a Request for Quotes system in July 2018.</li> </ul>	and promote greater exchange rate flexibility.
<b>Financial Sector Stability, Regulation, and AML/CFT</b>	Strengthen the resilience of the financial sector, including non-banks. Strengthen macroprudential surveillance and implement effective macroprudential policies. Improve the AML/CFT regime. Improve contingency planning for crisis prevention, preparedness and management.	<ul style="list-style-type: none"> <li>• WB (lead): Support draft of new Banking Act;</li> <li>• MCM: diagnostics and reform priority on financial sector issues, including through Financial Sector Stability Review in January 2019;</li> <li>• LEG: AML/CFT diagnostics and reforms to enhance the AML/CFT regime roadmap;</li> <li>• SARTTAC: assistance in providing TA and training on selected topics.</li> </ul>	<ul style="list-style-type: none"> <li>• Basel III migration started in 2017.</li> <li>• New Resolution and Enforcement Department established in CBSL in 2018;</li> <li>• Banks and finance companies started adoption of International Financial Reporting Standard 9 (IFRS 9) in 2018;</li> <li>• Higher capital and liquidity standards, in line with Basel III, established for banks and finance companies in 2019.</li> </ul>	<ul style="list-style-type: none"> <li>• CBSL to strengthen macroprudential policy framework and stress testing capabilities, under new MLA;</li> <li>• CBSL to harmonize regulation and supervision for banks and non-banks;</li> <li>• Cabinet approval by end-2019 of Banking Act, including new resolution regime;</li> <li>• Financial Intelligence Unit and other stakeholders to implement AML/CFT measures identified by FATF and LEG TA.</li> </ul>
<b>Statistics</b>	Improve price statistics and national accounts.	<ul style="list-style-type: none"> <li>• SARTTAC: assistance to produce new price statistics and national accounts.</li> </ul>	<ul style="list-style-type: none"> <li>• National consumer price index released in 2018.</li> </ul>	<ul style="list-style-type: none"> <li>• Department of Census and Statistics to release rebased and improved national accounts in 2019, and a rebased consumer price index in 2020.</li> </ul>

Part II: IMF Capacity Development Missions since May 2017<sup>2</sup>

TA/Training Mission	Provider	Date
<b>Tax Policy Reforms</b>		
Design of new Inland Revenue Act	LEG	Jul 17-25, 2017; Jan 24-31, 2018
Simplify and modernize VAT and NBT	FAD	Apr 27-May 11, 2017
Streamline indirect tax system	FAD	May 30-Jun 12, 2018
<b>Indirect Tax Administration</b>		
VAT gap analysis	FAD	Apr 27-May 11, 2017; Sep 12-18, 2017
VAT administration reforms	FAD	May 30-June 19, 2017; Oct 2-13, 2017
Provide guidance to tax department on VAT compliance pilot	FAD	May 25-30, 2018
Revenue Analysis	FAD/STX	Jun 13-26, 2018
Customs administration diagnostic	FAD	Jul 3-16, 2018
Auditing techniques course	FAD/STX/SARTTAC	Jul 9-13, 2018 back-to-back with Jul 16-20 income tax course
Evaluate the VAT compliance strategy pilot in the construction sector	FAD	Aug 8-21, 2018
Expand pilot project to all large file sectors based on recommendations of HQ mission and develop medium taxpayer compliance pilot project.	FAD/STX	Mar 4-15, 2019
<b>Income Tax Administration</b>		
Preparation for new Inland Revenue Act	SARTTAC	Jun 9-29, 2017; Jul 20-Aug 14, 2017; Sep 13-Oct 10, 2017,
Implementation advice on new Inland Revenue Act	SARTTAC/FAD	Jan 10-23, 2018
Drafting new IRA manual	SARTTAC/STX	Feb-Mar 2018
Process design and implementation of IRD test forms and instructions.	SARTTAC/STX	May 2-15, 2018
Auditing techniques course	FAD/STX/SARTTAC	Jul 16-29, 2018 back-to-back with Jul 9-13, 2018 income tax course

<sup>2</sup> LTX and STX refer to long-term and short-term experts, respectively.

## Part II: IMF Capacity Development Missions since May 2017

TA/Training Mission	Provider	Date
Training course on collections and arrears management	SARTTAC – Regional Training	Nov 12-16, 2018
Training course on taxpayer registration	SARTTAC – Regional Training	Jan 21-25, 2019
Review of IRA implementation readiness	SARTTAC/FAD	Jan 23 – Feb 5, 2019
Training course on compliance risk	SARTTAC – Regional Training	Feb 11-15, 2019
Training course on organizational design and governance	SARTTAC – Regional Training	Mar 4-8, 2019
<b>Fiscal Rules and Macro-Fiscal Policy Framework</b>		
Fiscal Analysis and Forecasting (FAF) customized training course for MOF staff	SARTTAC/FAD	Apr 22-26, 2019
Design of new fiscal rules and macro fiscal unit	FAD	Mar 13-26, 2019
<b>Public Debt Management</b>		
Medium-Term Debt Strategy (MTDS)	MCM	Jul 30-Aug 10, 2018
<b>Public Financial Management</b>		
PFM TA scoping mission	SARTTAC	May 22-26, 2017
Public investment management assessment (PIMA)	FAD/SARTTAC	Dec 7-20, 2017
Strengthening internal audit	SARTTAC	Jan 22-26, 2018
<b>Fiscal Risks Mitigation and SOE Reforms</b>		
Fuel and electricity pricing reforms	FAD	Apr 18-May 2, 2018
PPP framework diagnostics and PFRAM introduction	FAD	Sep 26-Oct 9, 2018
<b>Transition to Inflation Targeting</b>		
Macroeconomic modeling (FPAS) for monetary policy	ICD	Apr 24-May 5, 2017; Jul 20-Aug 2, 2017; Apr 25-May 11, 2018;
Exchange rate and monetary policy design and implementation	MCM	May 17-29, 2017
Training on monetary policy operations	SARTTAC	Apr 3-6, 2017
Design of new central bank law	LEG	Jun 24-Jul 2, 2018; Aug 13-21, 2018
<b>Transition to Flexible Exchange Rate Regime</b>		



## Part II: IMF Capacity Development Missions since May 2017

<b>TA/Training Mission</b>	<b>Provider</b>	<b>Date</b>
Exchange rate and monetary policy design and implementation	MCM	May 17-29, 2017
Foreign exchange intervention policy	SARTTAC	Sep 18-29, 2017; Jul 9-16, 2018
<b>Financial Sector Stability, Regulation, and AML/CFT</b>		
Enhancing the AML/CFT regime	LEG	Sep 25-Oct 4, 2017; Feb 24-Mar 7, 2018; Nov 26-Dec 4, 2018; Mar 25-29, 2019
Capital market investigations and enforcement	MCM	Oct 3-10, 2017
Institutional framework for macroprudential policy	MCM	Jul 9-16, 2018
Financial Sector Stability Review (FSSR)	MCM	Aug 2-6, 2018; Jan 10-23, 2019
<b>Statistics</b>		
Price statistics	SARTTAC	Nov 6-17, 2017; Aug 20-31, 2018;
National accounts	SARTTAC	Nov 6-10, 2017; May 28-Jun 1, 2018; and Jan 7-18, 2019
Government finance statistics	SARTTAC	Sep 17-21, 2018

## Appendix I. Letter of Intent

April 25, 2019  
Colombo

Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Ms. Lagarde:

This letter serves as an update to our previous Letters of Intent (LOI) for the Extended Arrangement. Our economic program, supported by the extended arrangement, has been instrumental in stabilizing the economy and achieving important structural reforms such as the implementation of the new Inland Revenue Act and automatic fuel pricing mechanism as well as the recent cabinet approval of the amended Monetary Law Act, a new Medium-Term Debt Strategy, and reforms to strengthen coverage of well-targeted social transfer programs.

For this review, we have taken several steps to bring program performance back on track, after recent political developments and macroeconomic setbacks, through corrective actions and important progress in structural reforms. The end-December quantitative performance criterion (QPC) for the primary balance was missed, in the context of sizable revenue underperformance. As a prior action for the completion of the fifth EFF review, we have submitted the 2019 budget to Parliament in line with program targets and staff recommendations. Parliament approved the 2019 budget on April 5, 2019. The end-December net official international reserves (NIR) target was also missed, reflecting mostly foreign exchange (FX) sales in response to market pressure and shortfalls in project loans. As corrective actions, as market conditions stabilized, we have resumed net FX purchases and revamped our FX strategy to allow for exchange rate flexibility as the first line of defense to external shocks, in line with program understandings. Inflation fell below the inner band for December, triggering consultation with IMF staff, but has since moved back within the band. On the structural reform front, we have implemented five structural benchmarks, albeit with some delay.

We complied with the continuous PC on no new external payment arrears by the non-financial public sector and the CBSL and with the continuous PC on non-introduction/intensification of import restrictions. We have removed the exchange restrictions that resulted in temporary nonobservances of the PC on non-introduction/intensification of exchange restrictions under the arrangement and were inconsistent with Article VIII, Section 2(a).

The attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) update the versions dated May 16, 2018 and set out the economic policies that we intend to implement under the Fund-supported program. We believe that the policies set forth in the attached MEFP, together with the previously issued MEFP and LOI, are adequate to achieve the objectives of our economic program, but we stand ready to take

additional measures as appropriate to ensure achievement of its objectives. We will continue to consult in advance with the Fund on adoption of new measures or revisions of the policies contained in the MEFP and in this letter, in accordance with the Fund's policies on such consultations. We will provide the Fund with the information it requests for monitoring program implementation.

In view of both the macroeconomic policies implemented to achieve the main program objectives and the progress on the agreed structural reforms, we request the completion of the Fifth Review under the extended arrangement and the disbursement of SDR 118.5 million. In completing the review, we request a one-year extension of the current arrangement until June 2, 2020 adding one review, and a rephrasing of purchases evenly over the remainder of the arrangement to anchor our macroeconomic policy throughout the 2019–20 election period, support investor confidence, and enable the implementation of additional reforms. We also request waivers on the nonobservance of the end-December 2018 QPC on the primary balance, NIR, and the continuous PC on non-introduction/intensification of exchange restrictions under the arrangement and Article VIII, Section 2(a) of the Fund's Articles of Agreement. In keeping with its policy of transparency, we authorize the publication of this letter and its attachments as well as the associated staff report.

Sincerely yours,

/s/

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Mangala Samaraweera  
Minister of Finance and Mass Media

/s/

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Indrajit Coomaraswamy  
Governor, Central Bank of Sri Lanka

#### Attachments

Memorandum of Economic and Financial Policies  
Technical Memorandum of Understanding

## Attachment I. Memorandum of Economic and Financial Policies

### I. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

**1. Economic performance weakened in 2018 in the context of external shocks and political uncertainty.** High fuel prices and tighter global financial conditions led to strong balance-of-payment pressures and weaker economic activity in 2018, exacerbated by the political crisis by end-year. Real GDP growth decelerated to 3.2 percent, from 3.4 percent in 2017, driven by a contraction in construction and mining and quarrying activities and a slowdown in manufacturing activities. Annual inflation fell to 2.8 percent at end-2018, below the inner consultation band, from 7.1 percent at end-2017. The current account deficit widened to 3.2 percent of GDP, from 2.6 percent of GDP in 2017, largely driven by higher fuel prices and a surge in vehicle imports. The rupee depreciated by 13 percent in real effective terms in 2018, while gross international reserves fell to US\$6.9 billion as of end-2018, as the CSBL intervened to counter strong market pressures.

**2. We expect the economy to recover gradually in 2019 and over the medium term.** Domestic political conditions have stabilized, and the external environment improved in the first quarter of 2019. These trends, supported by strong macroeconomic policies, are expected to facilitate a gradual economy recovery, with growth projected at 3.6 percent in 2019, reaching 5 percent over the medium term. Annual inflation, which recovered to 4.3 percent as of March, is expected to reach 4.5 percent in 2019 and hover at 5 percent over the medium term. Improved market conditions have allowed the authorities to issue US\$2.4 billion in the international bond market in March 2019, while the CBSL resumed foreign exchange purchases to rebuild reserve buffers.

### II. PROGRAM PERFORMANCE

**3. We are committed to bringing the program back on track after the setbacks in 2018, with a strong 2019 budget, sustained efforts to rebuild reserves, and implementation of key structural reforms.** After meeting the end-June 2018 Quantitative Performance Criterion (QPC) on the primary balance through expenditure restraint, the end-December QPC on the primary balance was missed by Rs 50 billion. The shortfall reflects weaker growth, the delay in implementing the 2018 budget measures, and an underperformance in trade tax collections due to import duty waivers. As a result, the end-December IT on tax revenue was missed. The end-December IT on the cost of non-commercial obligations (NCOs) for fuel and electricity (net of government transfers), as of end-September, was also missed, although SOE performance is expected to improve going forward given implementation of the automatic retail fuel pricing mechanism and our commitment to introduce a similar mechanism for electricity tariffs later this year. The end-December IT on outstanding guarantees issued by the central government was also missed, although by a small margin. The end-December NIR target was missed by US\$2,392 million, reflecting foreign exchange sales by the CBSL in response to market pressure in EMs, as well as, to a lower extent, shortfalls in project loans. Amid ongoing market pressures, the CBSL has revamped its foreign exchange (FX) strategy to allow for more

exchange rate flexibility, while resuming FX purchases as market conditions allow, in line with program understandings. The exchange restrictions which were temporarily introduced on certain products in 2018 have been removed. The reserve money target was below the adjusted indicative target by Rs 46 billion as of end-December 2018. Looking ahead, we are committed to advancing fiscal consolidation and have submitted the 2019 budget to parliament, in line with updated program targets and staff recommendations, as a prior action for the review. We have made progress on structural measures, especially on central bank reform, debt management, and targeted social protection policies, albeit with delays. We will take necessary corrective actions to ensure future structural benchmarks are met in a timely manner.

### III. FISCAL POLICY

#### Fiscal Stance

**4. The main priority for fiscal policy remains a sustainable reduction of the fiscal deficit and public debt through domestic revenue mobilization.** The government reduced the overall fiscal deficit to 5.5 percent of GDP in 2017. This consolidation was achieved by rationalizing current expenditure and bolstering VAT collections, which offset the unwinding of one-off tax increases in 2015. Fiscal consolidation continued in 2018, with a further reduction in the fiscal deficit to 5.3 percent of GDP, supported by the introduction of the new Inland Revenue Act (IRA) in April 2018 and additional reductions in VAT tax expenditures. The primary balance improved to a surplus of 0.6 percent of GDP in 2018, from a balance in 2017, although this was 0.4 percentage points of GDP lower than programmed at the time of the Fourth Review. Looking ahead, we remain committed to a steady deficit-reducing path to ensure a sustained decline in the public debt to GDP ratio over the medium term. As first indicated in the Prime Minister's November 2015 speech to parliament, we aim to bring the overall central government deficit down to at least 3.5 percent of GDP by 2020. To achieve this, we are committed to reach a primary surplus of 1.5 percent of GDP by 2019 and 2.4 percent of GDP by 2020, in line with program understandings. The planned adjustment will be achieved by increasing the revenue to GDP ratio by 1.7 and 0.9 percentage points of GDP in 2019 and 2020 respectively, while making space for critical social and capital spending. The annual budget proposals for 2019 are in line with the program targets as described in Table 2 (**prior action; end-November 2018 SB**).

**5. Fiscal consolidation will rely mainly on broadening the tax base, strengthening tax compliance, and improving the efficiency of spending.** Sri Lanka's fiscal deficits stem not from exceptionally high expenditures, but from a steady erosion of the tax base over the last two decades. Sri Lanka's tax-to-GDP ratio fell to one of the lowest in the world, and the nation's tax efficiency ratio is also below that of comparator countries. Our strategy thus focuses on: (i) broadening the tax base; (ii) rationalizing the tax system and removing the many exemptions, holidays, and special rates that have undermined fair and effective tax administration; (iii) strengthening capacity for risk-based revenue administration to improve tax compliance; and (iv) bolstering public financial management, notably commitment control, and financial planning and discipline. We have improved transparency and accountability of the budget execution process by submitting quarterly reports to Parliament since 2017Q1.

**6. For 2018, we achieved a primary surplus of Rs 91 billion (0.6 percent of GDP), short of the program target of 1 percent of GDP, due to revenue underperformance.** The ratio of tax revenue to GDP declined by 0.6 percentage points to 11.9 percent in 2018, falling short of the program's end-December indicative target by 1.4 percentage points. This reflects weaker domestic demand, the delay in implementing the 2018 budget measures, and an underperformance in trade tax collections due to the removal of some para-tariffs and import duty waivers for (i) fuel, in response to rising oil prices, while advancing fuel pricing reforms, and (ii) other consumer goods to stabilize domestic prices. Reductions in external taxes and the introduction of VAT exemptions on certain items announced during the political crisis also made a small contribution to the shortfall. On the expenditure side, spending on goods and services and capital projects was backloaded through tight commitment control to meet the end-June primary balance target, and reduce the December target underperformance. The political crisis in late 2018 caused further delays to capital projects, which are now re-scheduled for 2019. We have missed the end-December indicative target on non-commercial obligations (NCOs) for fuel and electricity (net of government transfers). However, we expect the performance of Ceylon Petroleum Corporation (CPC) and Ceylon Electricity Board (CEB) to gradually improve in 2019, given the launch of the monthly fuel price adjustment formula in May 2018 and the planned introduction of a similar mechanism for electricity in late 2019.

**7. The 2019 budget targets a primary surplus of Rs 228 billion (1.5 percent of GDP).** The budget speech was submitted to Parliament on March 5, resulting in a delay of the end-November 2018 structural benchmark, due to the political crisis. A Vote on Accounts was passed by Parliament in December 2018 to authorize government operations for the first four months of 2019, pending passage of the 2019 budget. The primary surplus targeted by the 2019 budget will be achieved by an increase in the revenue-to-GDP ratio by about 1.7 percentage points, underpinned by full implementation of the IRA and VAT reforms launched in 2018 as well as a new package of measures yielding about Rs 116 billion (0.7 percent of GDP). The revenue package consists of increasing excise rates for vehicles, tobacco, alcohol, diesel, and other goods and services, unwinding import duty waivers for fuel and other goods, and other revenue measures. Revenue mobilization will be supported by tax administration measures including risk-based VAT audit for large taxpayers (paragraph 13). All the excise rates for vehicles, tobacco and alcohol in the package have already been implemented in March 2019. In consultation with IMF staff, we have also identified amendments to the IRA listed in paragraph 12 to support investment and inclusive growth, with an annual fiscal cost of at most 0.1 percent of GDP, to be offset by other budget measures. No other changes to the IRA are envisaged under the 2019 budget. Space for social and productive capital spending will be preserved, including to allow for the delayed implementation of 2018 capital projects, while we rationalize low-priority spending. Among others, the budget for Samurdhi cash transfers is increased by Rs 10 billion to start enrolling new families that are currently not covered but eligible under the new means-tested criteria as soon as the new social registry becomes operational (paragraph 15). We will also start implementing contingency budgeting against weather-related natural disasters for emergency cash support and infrastructure rehabilitation. For this purpose, we will allocate Rs 20 billion (0.2 percent of GDP) over the medium term to a Disaster Management Contingency Fund. If retail

fuel prices or electricity tariffs dip below cost-recovery levels, the government will compensate CPC or CEB for the cost of the NCOs within the 2019 budget envelope. We are committed to promote the economic empowerment of women by pursuing gender budgeting and other initiatives to boost female labor force participation (paragraph 37). To improve public investment management, the budget envisages to strengthen the process to appraise and select capital projects. We will continue to report fiscal performance to Parliament on a quarterly basis, and any revenue shortfalls will prompt us to reprioritize expenditure under Parliamentary oversight. The published budget speech contains a tax expenditure statement, a plan to rationalize tax expenditures and the estimated fiscal cost of NCOs for SOEs (**prior action; end-November 2018 SB**).

**8. We are committed to advancing fiscal consolidation in 2020 and over the medium term to put debt on a sustainable path.** We will submit to Parliament a 2020 budget consistent with program targets and understandings by end-November 2019 (**proposed structural benchmark**), to bring the overall fiscal deficit for 2020 down to 3.5 percent of GDP. This will require a primary balance of 2.4 percent of GDP, implying an additional 0.9 percentage points of GDP in fiscal effort in 2020, to be achieved through new revenue measures. Over the medium term, we will aim to reduce the overall fiscal deficit to 2 percent of GDP, with a view to bringing public debt, including government guarantees, down to 70 percent of GDP by 2024 and 50 percent of GDP by 2030.

**9. We will strengthen our fiscal rule legislation to lock in the hard-won gains of fiscal consolidation and help achieve our medium-term targets.** As highlighted in the 2019 budget speech submitted to Parliament, we intend to revise the Fiscal Management (Responsibility) Act of 2003 (FM(R)A), with technical assistance from the IMF, so that our fiscal rules are consistent with our medium-term debt-reduction objectives and contain effective enforcement mechanisms, in line with our Vision 2025 document and in view of the significant fiscal risks from the SOE sector. We plan to obtain cabinet approval of a policy note outlining key elements of amendments to the Fiscal Management (Responsibility) Act of 2003, with a view to strengthening fiscal rules, in consultation with the IMF by end-May 2019 with a delay (**end-March 2019 structural benchmark**). These will include legally binding fiscal targets, a clearly defined escape clause, and an automatic correction mechanism in case of target breach. This will allow for the preparation of relevant amendments and/or legislation and their approval by cabinet by end-September 2019 (**proposed structural benchmark**), paving the way for Parliamentary approval of the new framework of rules before the 2020 budget cycle begins. Supported by IMF technical assistance, we will upgrade our Medium-Term Fiscal Framework (MTFF) to provide realistic and effective top-down guidance for budgeting and investment planning consistent with the fiscal rules, starting with the 2020 budget cycle. We will ensure that the MTFF serves as a binding constraint over the annual budget and guides the multi-year investment planning cycle.

**10. We continue to develop our medium-term debt management framework and strengthen technical capacity with multilateral and bilateral support.**

- A cabinet paper outlining a strategy to manage international sovereign bond maturities between 2019 and 2022 was approved in January 2018 (end-June 2018 structural benchmark). The Active Liability Management Act was approved by Parliament in March 2018. This enables the Government of Sri Lanka (GOSL) to be proactive and address refinancing requirements ahead of time (reducing rollover peaks) and extend maturities through liability management operations, especially in the case of international sovereign bonds. Proceeds from commercializing public assets will be used to smooth debt service payments and will be earmarked for future payments.
- We have approved a Medium-Term Debt Strategy (MTDS) for 2019–23 in early April 2019 with a delay (**end-October 2018 structural benchmark**), supported by technical assistance from the IMF and the World Bank. The MTDS (i) quantifies the main risks of Sri Lanka's public debt portfolio; (ii) specifies an appropriate currency and maturity composition of debt issuance and a strategy to achieve it; (iii) presents debt issuance options based on cost-risk tradeoffs; and (iv) is consistent with monetary and fiscal policy objectives. The MTDS was published in April on the MOF and CBSL websites. A working group comprising staff from the CBSL and MOF has been tasked to translate the recently approved MTDS into an Annual Borrowing Plan (ABP) by end-December 2019 and coordinate the implementation of the MTDS and the ABP. Beginning with the 2020 budget cycle, the budget will include a review of debt management activities during the past year, benchmarked against the MTDS. Quarterly reviews of debt management outturns against the ABP will be prepared starting in 2020Q1 and published from 2020Q1 onwards.
- To further strengthen public debt management, we will submit for cabinet approval by end-September 2019, rather than the previously agreed end-March deadline, a plan with a clear timetable for the establishment of an independent debt management agency, in line with international best practices, with technical assistance from the IMF and the World Bank (**end-March 2019 structural benchmark**). The agency will (i) be endowed with financial and administrative autonomy, (ii) conduct, in line with an MTDS, all operations related to the issuance of debt and secondary market activities, and (iii) participate in the evaluation and approval of all debt, derivatives, and guarantees.
- To keep contingent liabilities in check, an indicative target has been set for end-December 2019 on government guarantees at Rs 838 billion to limit the ratio of outstanding guarantees to GDP to 5.4 percent of GDP. Outstanding guarantees increased from 4.2 percent of GDP as of end-December 2017 to 5.2 percent of GDP at end-December 2018, due to new guarantees for water and transportation development projects, breaching the IT ceiling of Rs 718 billion.

#### **11. We will continue to make progress with improving transparency in fiscal reporting.**

Beginning in the first quarter of 2017, we began reporting fiscal performance to Parliament on a quarterly basis. Tax expenditure statements were included for the first time in the 2017 Budget—a policy that was continued in 2018 and 2019 and strengthened further with the inclusion of



non-commercial obligations of CPC and CEB in 2018. While we are committed to maintaining these good practices, we have room to improve our fiscal statistics, in line with the 2014 Government Finance Statistics Manual (GFSM). Supported by IMF technical assistance, we are on track to compile by June 2019 GFSM-compatible tables on the cash operations and debt stock of the budgetary and extra-budgetary central government and obtained cabinet approval in October 2018 of a strategy with a clear timetable to transition to accrual-based accounting for the general government, with support from IMF TA and other external consultants. We have established and staffed a dedicated unit within the MOF to support the multiyear transition to the 2014 GFSM. We will make annual reports to cabinet on progress in achieving the transition.

## Revenue Mobilization

### 12. A number of tax policy measures have been implemented to improve revenue performance.

- As an initial step towards rationalizing tax incentives, the Cabinet suspended the Board of Investment Act in May 2016, annulling its capacity to grant tax exemptions and other forms of preferential treatment and instead concentrating these powers in the Ministry of Finance, which has ultimate oversight of tax policy.
- The VAT amendment enacted in November 2016 raised the VAT rate from 11 percent to 15 percent and broadened the VAT base by eliminating exemptions for telecommunication and private healthcare, excluding diagnostic tests, dialysis and services provided by the Outpatient Department (OPD), while the VAT continues to apply to wholesale and retail trade. A diagnostic review of the VAT system (end-June 2017 structural benchmark), completed with delay in November, concluded that VAT expenditure is 1.3 percent of GDP. Informed by the review, a further VAT amendment, approved by Parliament in August 2018, broadened the VAT base by eliminating exemptions including for textiles, electronic goods and mobile phones, and condominiums. Pending removal of corresponding para-tariffs, we have temporarily reinstated an exemption by regulation for imported fabric. A temporary exemption for imported timber was also introduced in November 2018.
- On the personal and corporate income tax side, an important policy milestone was reached when the legislation of the Inland Revenue Act (IRA) came into force on April 1<sup>st</sup>, 2018. The Act creates a predictable, stable, and transparent income tax system, and promotes revenue mobilization in coming years. Notable features include: removal of tax exemptions to broaden the tax base; a modernized legal framework that utilizes a principle-based drafting style helping to streamline the law's structure and simplify its language; introduction of a capital gains tax on immovable property; increased taxes on dividends and interest income; and a transparent set of investment-based tax incentives.
- In consultation with IMF staff, we plan to amend the IRA to (i) exempt from withholding tax the earnings from both local and foreign currency government securities; (ii) exempt

from withholding tax the interest paid on ordinary loans and advances from non-resident financial institutions for a period of five years; (iii) exempt from withholding tax the payment of royalty for those earnings below Rs 50,000 per month, subject to a maximum of Rs 500,000 per year. This exemption will apply only to individuals in certain occupations central to Sri Lankan culture, such as artists and writers. (iv) withholding tax rate on rents of 10 percent to apply only to rents above a threshold of Rs 50,000 per month; (v) exempt from withholding tax the interest earned by children less than 18 years of age, up to a threshold of Rs 50,000 per year. (vi) exempt from withholding tax the interest earned on foreign currency deposits for a period of 5 years; (vii) allow the additional deduction of 35 percent of salary costs for start-up IT companies, irrespective of the number of employees, but otherwise on the same terms provided in the Sixth Schedule for a period of 5 years; (viii) expansion of income tax concessions available under the Second and Sixth schedule by way of accelerated depreciation to cover existing businesses for 5 years, provided accelerated depreciation applies instead of (rather than in addition to) regular depreciation deductions under the Fourth Schedule. The coverage will exclude land and be limited to depreciable assets such as those arising under finance lease rentals and the acquisition costs of manufacturing equipment, plant and machinery. These measures have been calibrated not to exceed 0.1 percent of GDP, with offsetting measures identified within the budget envelope for 2019, in line with program understandings. No other amendments to the IRA are planned under the 2019 budget.

**13.** We are stepping up our efforts to strengthen tax administration to support revenue mobilization.

- **Income tax.** The new IRA was successfully launched on April 1, 2018. We will continue our outreach strategy to ensure the IRA is well understood by taxpayers, including available investment incentives. All the new forms and associated instructions manuals needed to support implementation have been completed, including those related to Pay-As-You-Earn (PAYE) and withholding taxes. They are being tested, evaluated, and revised as necessary. Call centers are operational to assist taxpayers. Cabinet approved a contract to upgrade the revenue administration IT system (RAMIS) in February 2019, to make it compatible with electronic filing of returns under the IRA. The IRD is in the process of making the new system fully compatible with the new IRA. To enforce taxpayer compliance and boost income tax collections, IRD will develop a plan to implement audit of employers' obligation to withhold income taxes for employees (including identification of employers currently not in the PAYE database, using third-party data) and service fees paid to professionals such as doctors, accountants, and lawyers, by June 2019.
- **VAT.** IRD cleared a backlog of 79,000 unprocessed VAT returns in the final quarter of 2018 and will settle all associated payments by end-June 2019. Electronic filing of VAT returns will help prevent similar backlogs going forward. IRD adopted a VAT compliance strategy with risk-based audits, which has been implemented in the construction,

banking, housing, and hotel industries. Risk-based audit will be extended to large taxpayers in the remaining sectors by December 2019. To institutionalize risk-based VAT administration, IRD has established a dedicated division for risk-based audit and will set up a risk management unit by June 2019 to analyze data and identify priority compliance risks.

- **Customs.** The Customs Department is strengthening customs administration, including by improving controls, intelligence, and capacity for risk assessment. The IT system for customs administration (ASYCUDA) has been improved. The Department is undertaking reforms to shift away from physical controls to risk based system audits, supported by automation of risk management and improvements in organization structure and HR management. Risk-based criteria are used to select cargo for audit and work is underway to automate this process within the ASYCUDA system. A risk management directorate has been established and the number of staff members dedicated to risk management activities has been increased to more than 20 officers. The government's effort to develop a single window for trade services will enhance tax collections at customs through information sharing among government agencies.
- **IT and organizational reform.** In the initial stages of the launch of RAMIS IT system, we encountered several glitches related to the new user forms, products, and documentation. However, we have rectified many of the problems and we are addressing the emerging problems. To modernize tax administration, IRD also began organizational and business procedure reform, including restructuring along functional lines, creating a design and monitoring unit, making management structure more efficient to speed up interaction with taxpayers, strengthening the Large Taxpayer Unit, and enhancing the use of taxpayer identification numbers. To support such efforts, we are developing, with IMF technical assistance, a plan to reform Inland Revenue and Customs Departments. A note describing the key elements of the reforms will be approved by Cabinet in June 2019.

## Expenditure Reforms

**14. A disciplined and prioritized approach to government spending complements revenue-based fiscal consolidation.** We intend to keep the overall spending envelope under control, while reallocating spending within this envelope to areas that will bolster our medium-term prospects for robust and inclusive economic growth, such as social protection, health, education, and infrastructure. The frequency of weather-related natural disasters has increased due to climate change, inflicting severe damage to both private and public sectors. We plan to cope with this challenge through mitigation and adaptation measures, which include contingent budgeting and enhanced insurance schemes for natural disasters. We also aim to foster female labor force participation through gender budgeting (see paragraph 36).

**15. We are enhancing social safety nets to ensure more effective and better targeted social welfare schemes.** We have established a Welfare Benefits Board (WBB) under the MOF that aims at rationalizing and broadening the coverage of the various social assistance schemes

through a consolidated national database for social assistance beneficiaries. Under the Social Safety Nets Project, the WBB is developing a new Social Registry, an online database of applicants for welfare programs, which will be used from now on to select beneficiaries for the programs. The WBB will be responsible for assessing applications, starting with the four major welfare programs: Samurdhi, Elderly Benefit, Disabled Benefit, and Chronic Kidney Disease Benefit. To improve coverage and targeting of these programs, new selection criteria based on objective and verifiable characteristics have been developed with technical support from the World Bank. We obtained cabinet approval of the eligibility criteria for the four programs in March 2019 with a delay (**end-August 2018 structural benchmark**), following public outreach and consultations with academia and stakeholders. These are planned to be gazetted along with regulations laying out a clear and transparent process for selection of beneficiaries by the WBB by end-June. The neediest applicants will be selected by the WBB based on the newly approved selection criteria, and enrollment in the four programs will be expanded to include these most needy applicants within the 2019 budget appropriation. The expansion of social safety nets will help mitigate the distributional impact of ongoing reforms on poor and vulnerable families. We plan to have the new Social Registry in place by May 2019 and begin collecting new applications for the programs as soon as the regulations are gazetted. Pending the operationalization of the new Social Registry, we will be using the existing database of potential beneficiaries maintained by the Samurdhi Department to process new applications for entry into the welfare programs, according to the new eligibility criteria.

#### **16. Reforms to improve public financial management (PFM) are underway.**

- We have issued in September 2018 new guidelines for public development-project proposals, which provide practical guidance on the project appraisal process for line ministries, provincial councils, and state-owned enterprises, as well as the preparation of sectoral project pipelines and the Public Investment Programme to be published in July each year. To further improve public investment management and the quality of the project pipeline, we plan to develop a database of investment projects to identify those with long implementation delays and introduce stringent selection criteria and appraisal processes.
- MOF has modified the existing PFM IT system (CIGAS) and it is now capable of imposing quarterly spending ceilings for all ministries (end-January 2018 structural benchmark). This will help prevent spending units from contracting with vendors beyond the commitment ceiling and allow the government to adjust and reallocate spending should the need arise during the year.
- The new Integrated Treasury Management Information System (ITMIS) should significantly expand PFM capabilities, including commitment control, budget preparation, treasury operations, expenditure management, and accounting. The adoption process has been prolonged due to delays in requirements finalization with interfacing external agencies and customizing ITMIS software. A detailed rollout plan has been developed and, during the transition, the CIGAS will remain operational. The ITMIS roll-out will be

implemented on a staggered basis, with full roll-out expected by June 2020. The first phase began in January 2019 with the Ministry of Finance being the first agency to use ITMIS. The roll out will be extended to other agencies from April 2019, beginning with 20 priority agencies. Staff at each agency are trained on how to use ITMIS. The first phase will be completed by September 2019, with ITMIS rolled out to at least 60 spending agencies that account for approximately 65 percent of the total budget.

- Cabinet approved a note in October 2018 outlining a new Public Financial Management (PFM) Act, with support from the World Bank. The new law is designed to improve the budget process and control fiscal risks, including from Public Private Partnerships (PPPs). The law will also align the public investment management process, for publicly funded projects and PPPs, and include any necessary provisions to enable the government to maintain cash buffers for budgetary operations that can be carried across financial years. We are now finalizing the legislative drafting and plan to submit the draft law to Parliament by end- 2019.
- The government is taking steps to strengthen the institutional framework to manage PPPs and better align PPP planning with the budget process. The National Agency for PPPs was created in 2017 to support PPP implementation. It plans to upgrade the legal framework and guidelines for PPPs by end-March 2019, to ensure integration of PPP projects in the Public Investment Programme and a well-designed gateway process with the MOF acting as a gatekeeper to contain fiscal risks. A unit has been established and staffed in April 2019 under the Ministry of Finance to coordinate and carry out the assessment of fiscal risks associated with PPPs. As we develop some of our large-scale projects, including the Colombo Port City, we will continue to share our plans with the IMF and discuss any implications under the program, including any proposals for special tax and financial regimes.

#### IV. STATE ENTERPRISES

**17. The financial condition of some of our state enterprises and ultimate responsibility for their existing obligations are long-standing challenges we seek to address and resolve as part of the program.** Sri Lanka currently has about 200 public enterprises representing a substantial share of the nation’s economic activity. With technical assistance from the IMF, we identified outstanding financial obligations of SOEs totaling Rs 1.4 trillion by end-2017, including Rs 1.1 trillion for CPC, CEB, SriLankan Airlines, and the Sri Lanka Ports Authority. Collectively they represent a risk to public finances (either directly or through the state banks which fund the largest SOEs).

**18. To enhance fiscal discipline, we plan to improve financial disclosure of SOEs and step up monitoring of KPIs contained in their Statements of Corporate Intent.** To enhance oversight and financial discipline, Statements of Corporate Intent (SCIs) were signed and published in April 2017 for the five largest SOEs (CPC, CEB, National Water Supply and Drainage Board (NWSDB), Airport and Aviation Services Limited (AASL), and Sri Lanka Ports

Authority (SLPA)). The SCIs encompass the SOE's mission, high level objectives, and multiyear corporate plan; capital expenditure and financing plans; and explicit financial and non-financial key performance indicators (KPIs). The first compliance report on performance against KPIs was submitted to cabinet in May 2018, covering the period 2017H1, while the report covering 2017H2 was submitted in early April 2019. We will submit the third report on the 2018H1 period by end-May 2019. We also plan to expand the coverage of the SCIs to an additional 10 SOEs by end-April 2019. Among SOEs with SCIs, the 2016 audited financial statements were published only for NWSDB, AASL, and SLPA, while NWSDB and SLPA have yet to have 2017 financial statements audited. We will ensure, in close coordination with the Auditor General's office, the audit and publication of the remaining 2016 and 2017 statements by June 2019. Starting in 2020, we will aim to ensure that audited statements are readily available by September of the following year.

**19. We have taken steps to advance a restructuring plan to ensure SriLankan Airlines' commercial viability and increase its attractiveness to potential investors.** After careful consideration of potential options, we determined that a comprehensive restructuring would be the least risky and most cost-effective way to resolve the financial issues of SriLankan Airlines. A new Board and CEO were appointed in May 2018 and approved a restructuring plan. However, cabinet approval of the plan (**end-July 2018 structural benchmark**) was delayed and the Board was replaced during the political crisis. In early January 2019, a committee was formed to prepare a new report to the President on options for restructuring. The cabinet paper based on the report and observations by the Ministry of Finance containing key recommendations to advance SriLankan Airlines' restructuring plan was submitted to cabinet for approval in April 2019. These include entering into a joint venture with a strategic partner which could be an airline not in competition with SriLankan Airlines and introducing measures to strengthen corporate governance and accountability, by establishing a clear separation of responsibilities between the Board and the Management and developing a Statement of Corporate Intent with KPIs. Cabinet approval is expected by end-May 2019. Based on the cabinet decision, the Board of SriLankan Airlines is also expected to prepare an effective strategic plan and operating business model with measures to reduce the company's operational and financial costs and minimize future losses by end-September 2019 (**proposed structural benchmark**). The Board will oversee the restructuring process and ensure timely implementation of these measures.

**20. We plan to complete energy pricing reforms in 2019.** We have pursued a sequence of steps to advance the reform process, after an initial delay:

- We completed a report outlining the cost of non-commercial obligations (NCOs) for fuel and electricity in November 2017 with a delay (end-September 2017 structural benchmark), supported by IMF TA. To estimate the cost of non-commercial obligations for electricity correctly, the CEB and the Public Utilities Commission (PUC) established a Bulk Supply Transactions Account (BSTA) in May (end-March 2018 structural benchmark) and are using it to settle transactions between generators, the transmission operator, and distributors as specified in the November 2015 tariff methodology. Updating of the BSTA

- requires regular reporting by CEB to PUC of its cash flow. Reporting arrangements broke down in 2018, delaying the updating of the BSTA. We have updated the BSTA for end-September 2018 in March 2019 and plan to have the BSTA for end-December 2018 updated by June 2019. Going forward, we will also ensure monthly submissions by CEB to PUC of related bank statements and other transactions.
- We have recognized the quasi-fiscal cost of fuel and electricity NCOs as central government expenditure by explicitly accounting for them in the EFF program targets. Specifically, a quarterly indicative target has been set on the cost of NCOs for fuel and electricity (net of government transfers) for 2018Q1-Q4, 2019Q1-Q4 and 2020Q1 (see the Technical Memorandum of Understanding for detail).
  - Finally, to reduce the possibility of future financial losses by CPC and CEB and avoid large ad hoc adjustments in retail prices, cabinet approved the automatic pricing mechanism for fuel in May 2018 (end-March 2018 structural benchmark), based on a cost reflective pricing formula developed by a governmental technical committee in 2015. Since approval of the fuel pricing mechanism, we have been computing cost-reflective prices based on the formula and implementing price changes when warranted in line with the Cabinet decision. After the process was temporarily disrupted during the political crisis of late 2018, we have reinstated the pricing formula and are implementing necessary price changes to bring fuel prices back to cost-reflective levels by end-June 2019. The political crisis has also delayed electricity pricing reform. In October 2018, cabinet appointed a technical committee authorized to identify an automatic electricity pricing mechanism that aims to ease the impact on cost of electricity generation due to fluctuations in oil prices. This work was delayed by the political crisis and the committee is now expected to present its report to cabinet by June 2019. Cabinet approval of implementation of the electricity pricing mechanism based on the 2015 tariff methodology is expected by end-October 2019 (**end-September 2018 structural benchmark**). The mechanism will have the following features: (i) January 2020 as the starting date of the formula-based tariff adjustment; (ii) regular, formula-based updates of end-user tariffs on a biannual basis, based on the guidance from the technical committee; and (iii) the government's commitment to cover within the budget envelope any remaining electricity subsidies during the transition to full-cost recovery. To monitor progress, we will continue to report the financial performance of CPC and CEB on a quarterly basis (see the Technical Memorandum of Understanding).
  - We also seek to strengthen governance and regulation of CPC and CEB further to improve their operational efficiency, reduce cost, and promote investment. For fuel, we plan to carry out a detailed market study on fuel product cost and margins and reference prices, led by independent third parties. For electricity, CEB and PUC plan to undertake necessary studies and audits to validate the inputs to the tariff methodology, including CEB's dispatch practice.

## V. MONETARY AND EXCHANGE RATE POLICY

**21. The focus of monetary policy will remain on keeping inflation in the mid-single digits.** The CBSL raised the interest rates on its lending and deposit facilities by 50 and 75 basis points, respectively, in November 2018. With inflation expected to gradually converge towards the 5 percent target, the CBSL maintained the policy rates unchanged in the last monetary policy meeting held in March. To address a persistent liquidity shortage in the financial system, the CBSL reduced the statutory reserve ratio (SRR) from 7½ to 5 percent since November. Going forward, we will maintain a prudent data-dependent approach and stand ready to tighten the policy interest rates as warranted by evolving macroeconomic conditions. We plan to maintain the SRR at the current level. Monetary policy will continue to be monitored through the MPCC (see the Technical Memorandum of Understanding), supported by monitoring of reserve money developments.

**22. We are taking important steps to further strengthen the CBSL's legal framework.** Currently, the CBSL's effectiveness is hampered by monetary financing, non-core activities, and inadequate autonomy. These factors are structural impediments in the transition path towards flexible inflation targeting (FIT) and will also need to be addressed in response to the 2016 safeguards assessment, as described below. To remedy those issues, Cabinet approved a note (end-March 2018 structural benchmark) in early April 2018 outlining broad areas for amendment in the Monetary Law Act (MLA). As a next step, we drafted amendments to the MLA to strengthen CBSL's mandate, decision-making structures, autonomy, accountability, transparency, and instruments for implementing inflation targeting in consultation with IMF staff. The amended MLA draft was approved by cabinet in March 2019 with a delay (**end-December 2018 structural benchmark**). We plan to submit the bill to amend the MLA to Parliament by July 2019, in line with the amendments approved by cabinet in March 2019 and IMF staff recommendations (**proposed structural benchmark**). Specifically, the amendments to the MLA will, among other issues: (i) establish domestic price stability as the primary objective of the CBSL, with monetary policy decision-making functions shifted to a new Monetary Policy Board to be created; (ii) establish financial system stability as a core objective of the CBSL (iii) address the issue of central bank lending to the government related to purchases of treasury bills in the primary market and advances to the government; (iv) eliminate quasi-fiscal activities of the CBSL; (v) strengthen the CBSL's institutional, personal (e.g., removing government's representatives from the CBSL's decision-making Boards) and financial (e.g. on recapitalization and profit distribution) autonomy, accountability, and transparency; and (vi) streamline the decision-making and monetary policy formulation process.

**23. We are making progress on the roadmap towards flexible inflation targeting and a flexible exchange rate regime formulated in October 2017.** The roadmap, which aims to establish inflation as the nominal anchor allowing for greater exchange rate flexibility, identifies time-bound reform measures, consistent with IMF staff recommendations (TA in May 2017), and has been approved by the Monetary Board. These time-bound measures are being incorporated into program reviews. By implementing the roadmap, we will also: (i) ensure there is a clear



separation between fiscal and monetary policies; (ii) retain a role for the CBSL in smoothing excessive exchange rate volatility, while guarding against a real or perceived conflict of objectives; (iii) adopt FX intervention policies consistent with a flexible exchange rate regime; (iv) improve foreign exchange market functionality, including by gradually liberalizing financial account transactions, while strengthening regulatory compliance under the Foreign Exchange Act; (v) safeguard financial sector stability, including by addressing the risks associated with greater FX flexibility; (vi) develop technical infrastructure, including through improved forecasting and modeling capabilities with continued support from IMF TA; (vii) establish a policy decision making process anchored on the choice of the inflation targets and how unanticipated shocks would be addressed; and (viii) strengthen public-awareness through an outreach program, which will be the cornerstone of CBSL's communication strategy during the IT transition.

**24. In parallel with the move towards flexible inflation targeting, the CBSL will strengthen its market-oriented approach to exchange rate policy.** It is the CBSL's plan to transition durably to a more flexible exchange rate regime. In this context, the CBSL will continue to develop (i) a deeper and more liquid foreign exchange market which facilitates the role of the exchange rate as a shock absorber and increases the resilience of the FX market; and (ii) adequate systems to review and manage exchange rate risks. Our FX strategy aims at allowing for greater exchange rate flexibility in line with market conditions while rebuilding foreign reserves and maintaining them at adequate levels. The operationalization of this strategy is supported by the CBSL's implementation in July of a Request for Quotes (RFQ) system for direct dealing (**end-December 2018 structural benchmark**). This setup allows a marked-based and transparent implementation of CBSL FX transactions at best price, as envisioned under the program.

**25. The CBSL is committed to rebuild reserves and allow the exchange rate to function as the first line of defense to external shocks.** After purchasing US\$460 million in January-April 2018, overperforming the end-March NIR target, the tightening in global financial conditions and the political developments in 2018Q4 derailed the CBSL's reserve buildup strategy for the remainder of the year. The FX intervention by the CBSL in response to market pressures was sizable in 2018Q4, resulting in a breach of the end-December NIR target. Nevertheless, the CBSL also allowed for increasing exchange rate flexibility during this period, which is expected to facilitate external adjustment in 2019. The CBSL recognizes the urgent need to step up efforts to enhance reserve coverage through FX purchases and limit FX sales to dampening excessive volatility. In this context, we will:

- Resume FX purchases to rebuild net international reserves (NIR) to US\$6.9 billion by end-December 2019. The CBSL is on track to meet the revised NIR target for end-June, with US\$100.5 million already purchased in 2019Q1, on the back of a resumption of capital inflows and is committed to build NIR at a faster pace should market conditions improve more than expected.
- Limit FX sales to stemming excessive volatility in the event of disorderly market conditions.

- Consult with the IMF staff monthly on FX market developments and reserves building, or on a higher frequency in case of significant deviations from the envisaged reserves path and the proposed policy response.
- Strengthen communications to help clarify the interaction between the intervention strategy and reserve accumulation plans to provide the market with a better understanding of the CBSL transactions in the FX market.

We have gradually wound down FX swaps with domestic commercial banks, from \$1.4 billion at end-February 2018 to \$0.88 billion at end-March 2019. We plan to further reduce swap liabilities gradually.

**26. The exchange restrictions on certain products temporarily introduced in 2018 to ease balance of payment pressures have been removed.** In September 2018, we advised licensed commercial banks to open letters of credit only if covered by a minimum cash margin for some vehicles and specified non-essential consumer goods. In October 2018, we also required a minimum cash margin for importation of certain non-essential consumer goods under Documents Against Acceptance terms. This temporary measure for motor vehicles was also introduced to ensure that banks do not take excessive risk in providing loans for car imports, given a surge in demand. In addition, in October 2018, we advised authorized dealers not to release FX for conversion of Sri Lankan Rupees for making advance payments for the importation of certain non-essential consumer goods. These measures, which resulted in nonobservances of the continuous PC on non-introduction/intensification of exchange restrictions under the arrangement and were inconsistent with our Article VIII obligations, were eliminated in March 2019. No further measures inconsistent with Article VIII obligations were introduced. For the remainder of the program, we will not impose or intensify restrictions on the making of payments and transfers for current international transactions; introduce or modify multiple currency practices; conclude bilateral payments agreements that are inconsistent with Article VIII; or impose or intensify import restrictions for balance of payments reasons. The CBSL and the government will also abstain from providing subsidized exchange guarantees for foreign currency borrowing. Recently, Sri Lanka enacted the Foreign Exchange Act which modernized FX-related regulations.

**27. We will assess removing existing capital flow management measures (CFMs).** In 2016, we introduced a repatriation requirement of export proceeds with the aim of encouraging exporters to keep FX within the domestic financial system and reduce the imbalance of the FX market in the face of substantial balance of payment pressures. In January 2019, we lowered the threshold for foreign investments in rupee-denominated government securities to 5 percent of the total outstanding stock, from 10 percent before, to reduce capital flow volatility. We understand that these measures constitute CFMs under the IMF's Institutional View on capital flows. We plan to loosen the repatriation requirement by extending the period to repatriate the export proceeds from 120 to 180 days, with funds in the business foreign currency accounts maintained by exporters of goods freely remittable, and we will assess removing it with the timing linked to progress with the macroeconomic adjustments (especially net international

reserves) envisaged under the program. We will also consider loosening back the threshold for nonresident investments in rupee-denominated government securities as market volatility declines and the CBSL's reserve position strengthens.

## VI. FINANCIAL SECTOR POLICIES

**28. We have recently implemented several measures to strengthen the financial system.** We: (i) introduced new capital and liquidity requirements, effective January 2019, for banks in line with Basel III standards; (ii) implemented a new capital adequacy framework for licensed finance companies and specialized leasing companies; (iii) required banks and finance companies to adopt the International Financial Reporting Standard 9 (IFRS 9) accounting standards entailing a new approach to asset classification and provisioning based on expected rather than incurred loss; and (iv) adopted a more risk-based approach to financial system supervision. In January 2019, the IMF conducted a Financial Sector Stability Review (FSSR) and provided recommendations to further strengthen the financial system, which we plan to implement with IMF technical assistance.

**29. To ensure greater stability of the financial sector, we will amend regulations to harmonize the regulatory and supervisory regime for banks and non-bank financial institutions (NBFIs).** In 2018, the CBSL issued Directions harmonizing financial customer protection, loan-to-value ratios for motor vehicle-related credit facilities, credit ratings, capital adequacy requirements, valuation of immovable properties, and the outsourcing of business operations. The CBSL will issue Directions to harmonize provisioning for bad and doubtful debts by end-September 2019, and the corporate governance framework by end-March 2020. With support from the World Bank, we are working on a new Banking Act, which will facilitate consolidated supervision, have stronger provisions for mergers, acquisitions and consolidation, support digital banking, and strengthen corporate governance. We also intend to: (i) continue monitoring credit growth and non-performing loans (NPLs), and report to the Monetary Board to analyze emerging issues and developments in both banks and NBFIs; (ii) ensure that all banks and NBFIs abide by the new capital requirements and fully adopt the IFRS 9 accounting standards, enhancing their models with support from IMF technical assistance; (iii) continue with the development of regulations and processes that govern real estate purchases to minimize the possibility of investment of illicitly obtained funds on real estate sector and encourage regulators of the condominium sector to establish a framework in line with international best practices to safeguard deposits of condominium buyers; (iv) improve the management of exchange rate risk in the financial sector in the context of the move towards greater exchange rate flexibility; and (v) review and update the Finance Business Act and the Microfinance Act to modernize the financial sector.

**30. We will strengthen the macroprudential policy framework and stress testing capabilities.** The approval of the MLA will give the CBSL a macroprudential mandate. With support from IMF technical assistance and a resident advisor, we will continue strengthening the framework for macroprudential surveillance and policy by: (i) enhancing the collection and analysis of data to improve the monitoring of systemic financial stability; (ii) developing

additional macroprudential tools that can be implemented as needed to contain systemic financial risks; (iii) aligning stress-testing methodologies with best international practices, including by developing a macro-financial scenario-based approach, conducting stress tests for liquidity, contagion and indirect foreign exchange risks, enhancing bottom-up stress tests procedures, and introducing dynamic elements to solvency stress tests; (iv) extending stress tests to non-bank deposit taking institutions; and (v) increasing the resources devoted to the macroprudential function and stress-testing, including by establishing a dedicated stress-testing unit.

**31. We will upgrade the contingency framework for financial institutions, consistently with recent FSSR recommendations.** As part of the Banking Act amendments, being prepared with support from the World Bank, we plan to (i) institute a resolution regime for banks and NBFIs based on international best practices; and (ii) include a separate chapter to provide a stronger legal foundation to the deposit insurance system. Cabinet is expected to approve draft legislation by end-December 2019. We will also: (i) strengthen the CBSL's emergency liquidity assistance (ELA) framework by issuing guidelines that prescribe the preconditions for ELA; (ii) develop resolution plans for all systemic banks; (iii) require all financial institutions to prepare recovery plans for review and approval by the CBSL; (iv) establish a dedicated committee to cover crisis preparedness and management in coordination with the Ministry of Finance; and (v) develop a communication strategy and a regular program of crisis exercises to simulate how the relevant authorities would react to specific stress situations.

**32. We have made progress to ensure effective implementation of Sri Lanka's Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) regime.** During 2018, the Financial Intelligence Unit (FIU), together with relevant ministries and stakeholders, has made progress in addressing recommendations made by the Asia/Pacific Group on Money Laundering (APG) and an action plan by the Financial Action Task Force (FATF). As a result, Sri Lanka received upgraded ratings from the APG for six FATF Recommendations in July 2018. Amendments to the Mutual Assistance in Criminal Matters Act (MACMA) No. 24 of 2018 passed in August 2018 allows assistance to be provided on the basis of reciprocity. Amendments to Trust Act, No. 6 of 2018 passed in March 2018 establish a central register of trusts and empowers the collection of beneficial ownership (BO) information of trusts. Also, in 2018, customer due diligence (CDD) rules and guidelines for the designated non-financial businesses and professions (DNFBPs) were issued and cabinet approval was obtained to amend the Companies Act No 7 of 2007, which will require BO disclosures to a BO registry that will be operationalized in the near future. Financial institutions are jointly being supervised on a risk-sensitive basis by the FIU and the respective sector regulators. Sri Lanka has also issued regulations implementing UN targeted financial sanctions (TFS) relating to proliferation financing (PF) concerning the Democratic People's Republic of Korea (DPRK) and Iran in October 2017 and July 2018, respectively. Given Sri Lanka's progress in AML/CFT reforms, in February 2019, the FATF Plenary scheduled an on-site visit to Sri Lanka for May 2019 to verify the implementation of the FATF action plan and ascertain traction. The on-site team will make recommendations to the June 2019 FATF Plenary, which could result in Sri Lanka exiting FATF's improving global AML/CFT compliance lists. Going

forward, we will further enhance implementation of AML/CFT measures by: enforcing provisions relating to TFS relating to terrorist financing and PF and requirements regarding BO and politically-exposed persons; and by strengthening risk-based supervision over the financial sector and high-risk DNFBPs, such as real estate dealers, casinos, and the gem and jewelry dealers, including by imposing actions where appropriate. We will also ensure adequate resources are available for the FIU.

## VII. STRUCTURAL REFORMS TO BOOST TRADE, INVESTMENT, AND INCLUSIVE GROWTH

**33. Greater integration into regional and global supply chains, higher levels of FDI, and enhanced prospects for private sector investment are critical to achieve our medium-term macroeconomic objectives.** In addition to better infrastructure, improvements are necessary in the trade regime and investment climate. We entered into a Free Trade Agreement with Singapore in January 2018, started negotiations on new Free Trade Agreements with China, and Thailand, as well as an Economic and Technology Cooperation Agreement with India. The GSP plus trade status with EU—reinstated in May 2017—has already started to have a positive impact on our exports.

**34. To boost trade and private sector development, we will seek to reduce costs and bolster competitiveness.** We removed around 1,200 para-tariffs since 2017 and plan to reduce the special economic purpose tax, CESS, by 20-30 percent on most items in 2019, while the Ports and Airports Levy (PAL) will be reduced by 5 percentage points on selected imports of machinery and equipment to reduce investment costs. We have conducted a stock-taking review of Sri Lanka's trade regime, including an evaluation of tariffs and para-tariffs and other nontariff barriers that have led to a high level of effective protection and hampered trade. Based on this review, we will prepare a strategy to rationalize remaining para-tariffs over the medium term, together with new revenue sources to offset revenue losses and obtain cabinet approval by March 2020 with a delay (**end-March 2019 structural benchmark**). We are also working with the World Bank to strengthen our structural competitiveness. With support from the World Bank we have launched a Trade Information Portal to improve transparency and a National Single Window is being developed to simplify border clearance procedures and support trade. We have formulated a new Trade Policy along with a National Export Strategy which aims to increase the efficiency of trade facilitation, remove barriers to foreign investment entry and establishment (including access to land), enhance access to finance, and strengthen financial market infrastructure. We have launched a web portal to streamline and fast track the investment approval process under a single window virtual platform to strengthen the one-stop shop to facilitate foreign direct investment under the Board of Investment in 2018. These steps should help create a predictable, consistent, and transparent trade regime which will improve competitiveness, attract FDI, and unlock new sources of growth. To improve the business environment, we continue to make progress under the Roadmap on Investment Climate Reforms and have launched single windows to streamline the process of registering property and getting construction permits.

**35. We will continue to step-up efforts to strengthen our governance and anti-corruption framework.** In July 2018, we amended a section of our Bribery Act to allow High Courts to hear bribery and corruption cases. We have also recently approved a law to establish lower courts dedicated to bribery and corruption cases to strengthen the enforcement of fraud and high-profile corruption cases. Appeals will be handled by a three-member special High Court, following an amendment of the Judicature Act. By end-July 2019, we will draft a comprehensive piece of legislation that consolidates all laws related to bribery and corruption to comply with the United Nations Convention against Corruption (UNCAC) treaty. The draft law will (i) reform the Bribery Act, widening the definition of bribery offenses; (ii) amend the Declaration of Assets and Liabilities Act by covering assets legally owned and beneficially owned by a comprehensive range of public officials and their close family members, enforcing dissuasive sanctions for non-compliance or false declarations, and verifying and making publicly available online relevant data; and (iii) clarify the mandates and expand the powers of the Commission to Investigate Allegations of Bribery or Corruption (CIABOC). It is expected to be submitted to cabinet and subsequently to Parliament in 2020. We have established a task force to prepare a policy paper to formulate a law on the recovery of assets. We launched the National Action Plan for Combating Bribery and Corruption in Sri Lanka in March 2019, with a concrete and actionable roadmap for 2019-23. The plan envisages prevention measures, value-based education and community engagement, institutional strengthening of CIABOC and law enforcement agencies, and law and policy reforms to strengthen anti-corruption efforts and compliance with international obligations. We have prepared manuals to serve as guidelines for investigators and prosecutors and training staff at the CIABOC.

**36. We are undertaking several measures to remove barriers that constrain female labor force participation.** We have launched gender budgeting in all ministries in 2018 by developing twelve key performance indicators (KPIs) focusing on a wide range of issues from encouraging women entrepreneurs in small-medium enterprises to providing greater vocational training. We have also placed focal contact staff in each ministry to monitor its compliance and conducted awareness programs in 10 ministries. We will evaluate the effectiveness of the KPIs in improving the implementation of gender budgeting and delivering tangible outcomes and prepare an assessment report by May 2019. With a view to improving access to good-quality and affordable child care facilities, the cabinet approved the establishment of 2000 new child care facilities in collaboration with the private sector in June 2018. With support from the World Bank, we will train 10,000 staff that will be employed in these child care facilities. We also plan to open After-School and Vacation Care Centers (ACVC) in selected public schools. We obtained cabinet approval in March 2019 of a national policy on early childhood care and development. The policy addresses integration of services for children including health, education, child care, child protection, and children with disabilities. We are also formulating a National Day Care Policy to enhance the policy framework for child care services, which is expected to be approved by cabinet in June. We will facilitate part-time and flexible work arrangements by taking legislative measures as needed. Actions will be considered to facilitate greater participation of women in boards of listed companies. We will also improve access to tertiary education and vocational training, including by conducting training programs to motivate women towards non-traditional

income generation avenues and awareness programs to promote vocational and technical education for women and girls. These measures, by facilitating female labor force participation, are expected to boost growth in the long run.

## VIII. RISKS AND CONTINGENCIES

**37. The high degree of uncertainty continues to pose economic and financial risks to the program.** The main domestic risks include: (i) weaker than projected revenues due to implementation delays in fiscal reforms; (ii) lower-than-expected growth and/or new pressures on the trade account; (iii) weaker than expected performance of state-owned enterprises; and (iv) a reacceleration of credit growth, particularly in construction which would add to macro-financial vulnerabilities. External risks mainly stem from trade tensions in key economies leading to weaker global growth and lower demand for Sri Lankan exports, foreign direct investment and remittances; and a resumption of market volatility and portfolio outflows which could raise government borrowing costs and hamper the buildup of foreign reserves. These risks could further challenge public debt and external sustainability. Should such risks materialize, the government stands ready to adjust promptly its policies, in close consultation with the IMF staff.

## IX. PROGRAM MONITORING

**38. Our program will be subject to semiannual reviews** with performance criteria and indicative targets set out in Table 1 attached to this MEFP and the Technical Memorandum of Understanding (TMU). Completion of the sixth and seventh reviews will require observance of the quantitative performance criteria for end-June 2019 and end-December 2019, respectively, as well as continuous performance criteria, as specified in Table 1 attached to this MEFP. The reviews will also assess progress toward observance of the structural benchmarks specified in Table 2 attached to this MEFP.

**Table 1. Sri Lanka: Quantitative Performance Criteria (PC) and Indicative Targets (IT)**  
(Cumulative from the beginning of the year, unless otherwise noted)

	2018												2019			2020
	end-Jun.				end-Sep. (IT)				end-Dec. 6/				end-Jun.	end-Sep.(IT)	end-Dec.	end-Mar.(IT)
	Prog.	Adj. Prog.	Act.	Met / not met	Prog.	Adj. Prog.	Act.	Met / not met	Prog.	Adj. Prog.	Act.	Met / not met	Prog.	Prog.	Prog.	Prog.
<b>Quantitative performance criteria</b>																
Central government primary balance (floor, in billion rupees)	45	45	46	Met	90	90	70	Not Met	141	141	91	Not Met	75	146	228	43
Program net official international reserves (Program NIR, floor, in million US\$) 1/ 2/	1,133	2,427	1,799	Not Met	2,098	1,493	231	Not Met	1,771	2,072	-320	Not Met	1,352	1,881	1,568	106
<b>Continuous performance criteria (cumulative from beginning of the program)</b>																
New external payment arrears by the nonfinancial public sector and the CBSL (ceiling, in million US\$)	0	0	0	Met	0	0	0	Met	0	0	0	Met	0	0	0	0
<b>Monetary policy consultation clause</b>																
Year-on-year inflation in Colombo Consumers Price Index (in percent) 3/																
Outer band (upper limit)	7.7	7.7	...		8.1	8.1	...		7.8	7.8	...		7.6	7.7	7.8	7.8
Inner band (upper limit)	6.2	6.2	...	Within	6.6	6.6	...	Within	6.3	6.3	...	Outside	6.1	6.2	6.3	6.3
Actual / Center point	4.7	4.7	4.1	inner	5.1	5.1	5.2	inner	4.8	4.8	3.1	inner	4.6	4.7	4.8	4.8
Inner band (lower limit)	3.2	3.2	...	band	3.6	3.6	...	band	3.3	3.3	...	band	3.1	3.2	3.3	3.3
Outer band (lower limit)	1.7	1.7	...		2.1	2.1	...		1.8	1.8	...		1.6	1.7	1.8	1.8
<b>Indicative targets</b>																
Central government tax revenue (floor, in billion rupees)	924	924	845	Not Met	1,428	1,428	1,278	Not Met	1,934	1,934	1,712	Not Met	838	1,466	2,094	487
Reserve money of the CBSL (ceiling, end of period stock, in billion rupees) 4/	1,025	1,025	999	Met	1,045	1,045	1,015	Met	1,069	1,007	961	Met	1,025	1,052	1,070	1,145
Cost of non-commercial obligations (NCOs) for fuel and electricity (net of government transfers) (ceiling, in billion rupees) 5/	0	0	54	Not Met	0	0	74	Not Met	0	0	116	Not met	0	0	0	0
Treasury guarantees (ceiling, in billion rupees)	...	...	...		...	...	...		718	...	750	Not met	...	...	838	...
<b>Memorandum items:</b>																
Net official international reserves (CBSL's conventional definition, end of period stock, in million US\$, market exchange rate) 1/	7,424	...	7,746		7,877	...	5,948		7,475	...	5,495		6,972	7,201	6,888	6,994
CBSL's outstanding liabilities in FX swaps with domestic commercial banks (in million US\$)	...	...	885		...	...	702		...	...	723		...	...	...	...
Foreign program financing by the central government (in million US\$) 2/	0	...	125		125	...	125		225	...	125		0	0	0	0
Net borrowings from SLDBs and FCBUs by the central government (in million US\$) 2/	-150	...	-195		-1,118	...	-685		-685	...	-687		-108	-108	-108	0
External commercial loans by the central government (in million US\$) 2/	1,500	...	2,497		3,500	...	2,497		3,497	...	3,497		2,426	3,426	3,426	500
Proceeds from commercialization of public assets to non-residents (in million US\$) 2/	400	...	682		682	...	682		682	...	682		0	0	0	0
Amortization of official external debt by the central government (in million US\$) 2/	572	...	637		1,055	...	1,089		1,276	...	1,304		645	1,044	1,288	440
Interest payments of official external debt by the central government (in million US\$) 2/	...	...	...		...	...	...		...	...	...		827	1,230	1,654	404
Project loans and grants disbursed to the central government (in million US\$) 2/	...	...	...		...	...	...		...	...	...		218	353	488	210
Cost of NCOs for fuel (net of government transfers) 5/	0	...	22		0	...	33		0	...	66		0	0	0	0
Cost of NCOs for fuel	...	...	22		...	...	33		...	...	66		...	...	...	...
Government transfers for NCOs for fuel	...	...	0		...	...	0		...	...	0		...	...	...	...
Cost of NCOs for electricity (net of government transfers) 5/	0	...	32		0	...	41		0	...	50		0	0	0	0
Cost of NCOs for electricity	...	...	32		...	...	41		...	...	50		...	...	...	...
Government transfers for NCOs for electricity	...	...	0		...	...	0		...	...	0		...	...	...	...

1/ The CBSL's conventional definition of net official international reserves (NIR) includes outstanding liabilities in foreign exchange swaps with domestic commercial banks. The Program NIR excludes the outstanding liabilities in foreign exchange swaps with domestic commercial banks from the CBSL's conventional NIR definition. See TMU for details.

2/ Program NIR will be adjusted upward/downward by the cumulative amounts of (i) foreign program financing by the central government, (ii) net borrowings from SLDBs and FCBUs by the central government, (iii) external commercial loans (including Eurobonds and syndicated loans) by the central government, (iv) the amount of project loans and grants, and (v) proceeds from commercialization of public assets to non-residents, that are higher/lower than assumed under the program; and by the cumulative amount of amortization and interest payment of official external debt by the central government that is lower/higher than assumed under the program. Program NIR will be adjusted upward/downward by the cumulative amounts of 50 percent of the government securities

3/ See the TMU for how to measure year-on-year inflation.

4/ See TMU for details on the calculation of reserve money for the test date.

5/ NCOs refer to the obligation of CPC and CEB to supply fuel and electricity at administered prices. See TMU for how to measure the cost of NCOs.

6/ Given the delay in completing the Fifth review, end-December QPCs have become controlling.



Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program

Structural Benchmarks	Target Completion Date	Status	Comment
<b>A. Proposed New Structural Benchmarks</b>			
Submit to Parliament the bill to amend the Monetary Law Act, in line with the amendments approved by cabinet in March 2019 and IMF staff recommendations.	End-July 2019		
Cabinet approval of amendments to relevant legislation to strengthen fiscal rules, in line with IMF staff recommendations.	End-September 2019		
Board of SriLankan Airlines to prepare an effective strategic plan and operating business model with measures to reduce the company's operational and financial costs and minimize future losses.	End-September 2019		
Submit to Parliament the 2020 budget that is in line with the program targets and includes: (i) a tax expenditure statement, (ii) a plan to rationalize tax expenditures in 2020 as agreed with IMF staff, and (iii) the estimated fiscal cost of non-commercial obligations (including subsidies) for SOEs.	End-November 2019		
<b>B. Existing Structural Benchmarks</b>			
<b>Fiscal Policy Management</b>			
Senior management at the Ministry of Finance and CBSL to approve a Medium-Term Debt Strategy (MTDS) for 2019-23.	End-October 2018	Not met (implemented with a delay)	The MTDS, prepared by a joint CBSL-MOF taskforce, with IMF and WB support, was approved on April 5, 2019.
Submit to Parliament the 2019 budget that is in line with the program targets and includes: (i) a tax expenditure statement, (ii) a plan to rationalize tax expenditures in 2019 as agreed with IMF staff, and (iii) the estimated fiscal cost of non-commercial obligations (including subsidies) for SOEs.	End-November 2018	Not met (implemented as a <b>prior action</b> ).	The 2019 budget submission was delayed due to the political crisis in October 2018. The 2019 budget was submitted to Parliament on March 5, 2019 as <b>prior action for the fifth review</b> .

**Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)**

Cabinet to approve a policy note outlining key elements of amendments to the Fiscal Management (Responsibility) Act of 2003, with a view to strengthening fiscal rules with legally binding fiscal targets, a clearly defined escape clause, and correction mechanisms in case of a target breach, in line with staff recommendations.	End-March 2019. <b>Proposed to be reset to end-May 2019.</b>	Not met.	An IMF technical assistance mission took place in March 2019. It is proposed that this benchmark be reset to end-May 2019 to allow time for the policy note to be finalized following the mission.
Cabinet to approve a plan with a clear timetable for the establishment of an independent debt management agency, in line with international best practices, which consolidates public debt management functions currently belonging to CBSL, MOF, and Ministry of National Policies and Economic Affairs.	End-March 2019. <b>Proposed to be reset to end-September 2019.</b>	Not met.	An IMF/WB technical assistance mission is scheduled for July 2019. It is proposed that this benchmark be reset to end-September 2019 to allow time for the plan to be finalized following the mission.
<b>State Enterprise Reform</b>			
Cabinet to approve measures to reduce operational and financial costs of Sri Lankan Airlines and eliminate future losses.	End-July 2018	Not met.	In January 2019, an expert committee presented to the President policy recommendations on restructuring SriLankan Airlines. Building on the report, a paper was submitted to cabinet in April with key recommendations to advance the restructuring plan for approval by end-May 2019. The Board of SriLankan Airlines is expected to prepare a strategic plan and operating business model (see proposed new structural benchmark) and oversee the restructuring process.
Cabinet to approve automatic electricity pricing mechanism (agreed with IMF staff) that ensures retail prices above cost-recovery levels and a financial position of Ceylon Electricity Board capable of covering debt service.	End-September 2018. <b>Proposed to be reset to end-October 2019.</b>	Not met.	It is proposed that the benchmark be reset for end-October 2019 to allow time for further consultation with stakeholders.

Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)

<b>Structural Reforms</b>			
Cabinet to approve eligibility criteria for four major targeted cash transfer programs (Samurdhi, Elderly Benefit, Disabled Benefit, and Chronic Kidney Disease Benefit), based on objective and verifiable characteristics of beneficiaries.	End-August 2018	Not met (implemented with a delay).	New eligibility criteria were approved by cabinet in March 2019, in consultation with the World Bank.
Cabinet to approve a strategy to rationalize para-tariffs over the medium term, together with new revenue sources to offset revenue losses.	End-March 2019. <b>Proposed to be reset to end March 2020.</b>	Not met.	More time is needed to identify new revenue sources to offset the revenue loss from para-tariff removal. It is proposed that this benchmark be reset to March 2020.
<b>Monetary and Exchange Rate Policies</b>			
Cabinet to approve the amended Monetary Law Act (MLA), for submission to Parliament by March 2019, to strengthen the CBSL's mandate, decision-making structures, autonomy, accountability, transparency, and instruments for implementing inflation targeting, in line with IMF staff recommendations.	End-December 2018	Not met (implemented with a delay)	The amended MLA, prepared with IMF TA, was approved by cabinet in March 2019.
CBSL to operationalize a "Request for Quotes" (RFQ) system, which operates under transparent rules and permits competitive bidding by all banks that participate in FX trading.	End-December 2018	Met.	The CBSL implemented the RFQ system ahead of schedule in July 2018.

**Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)**

<b>C. Past Structural Benchmarks</b>			
<b>Fiscal Policy Management</b>			
Submit to Parliament the 2017 budget in line with the program targets.	End-November 2016	Met	The 2017 budget was submitted to Parliament on November 10, 2016.
Submit to Parliament the 2018 budget that is in line with the program targets and includes: (i) a tax expenditure statement, (ii) a plan to rationalize tax expenditures in 2018 as agreed with IMF staff, and (iii) the estimated fiscal cost of non-commercial obligations (including subsidies) for SOEs.	End-November 2017	Met	At the second review, the structural benchmark for the 2018 budget was updated to incorporate the unmet structural benchmarks for a tax expenditure rationalization plan and publication of the noncommercial obligations for SOEs.
<b>Tax Policy Reform</b>			
Publish a tax expenditure statement as part of the official government budget.	End-December 2016	Met	Published as part of the 2017 budget.
Approve by cabinet a time-bound strategy (agreed with IMF staff) to reduce or eliminate tax expenditures.	End-December 2016	Not met.	In the context of the 2017 budget, Cabinet approved a plan to rationalize profit-based corporate tax incentives and tax exemptions for financial income in 2017. However, a comprehensive multi-year plan for reducing or eliminating tax expenditures has not been adopted. This remaining step was built into the benchmarks for the 2018-2020 budgets.
Submit to Parliament a new Inland Revenue Act with a view to simplifying and broadening the income tax.	End-March 2017	Not met (implemented as a prior action)	The new IRA was submitted to Parliament on July 5 <sup>th</sup> satisfying the prior action for the second review.

**Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)**

Complete by Ministry of Finance (MOF) a diagnostic review of the VAT system.	End-June 2017	Not met (implemented with delay)	MOF completed the review in November 2017 with inputs from IMF TA on VAT gap analysis.
<b>Tax Administration Reform</b>			
Fully roll out by MOF Inland Revenue Department new IT systems (RAMIS) for major domestic taxes (including income tax and VAT), including web- based tax filings for income tax and VAT.	End-December 2016	Met	
Adopt by MOF Inland Revenue Department Key Performance Indicators on the number of risk- based VAT audit.	End-December 2016	Met	The Key Performance Indicators for risk-based VAT audit were included in the VAT compliance strategy for large taxpayers.
Adopt by MOF Inland Revenue Department a VAT compliance strategy that includes a time-bound plan to implement risk-based audit.	End-December 2016	Met	Draft VAT compliance strategies for large, medium and small taxpayers were developed with support from IMF TA in October 2016.
Adopt by MOF Inland Revenue Department compliance strategies for corporate and personal income taxes.	End-June 2017	Not met	The authorities will not design compliance strategies for corporate and personal income taxes until the new IRA is fully implemented. However, the new Act contains increased powers for the Inland Revenue Department (e.g., interest and penalties on late filings) which should improve compliance in general.
MOF to publish a detailed IRA tax manual with practical tax and administrative examples.	End-January 2018	Not met (implemented with delay).	The manual was published in May 2018 after the entry into force of the IRA in April 2018.

**Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)**

<b>Public Financial Management</b>			
Establish by MOF a commitment record system (with quarterly reports produced no later than one month after the end of each quarter) and quarterly expenditure commitment ceilings for the 2016 budget and the 2017 budget.	End-December 2016	Not met (implemented partially)	Through modification of the existing IT system (CIGAS) and manual reporting from line ministries, the MOF is now capable of tracking spending commitment for each line ministry monthly.
MOF to roll out ITMIS with an automated commitment control module for Ministry of Finance.	End-January 2017	Met	The system has been fully rolled out to all ministries including Ministries of Finance and Health. It is being operated in parallel to the existing IT system to ensure it is functioning properly.
MOF to implement an IT-based commitment control system with commitment ceilings for line ministries for the 2018 budget.	End-January 2018	Met.	Given delays in implementing the ITMIS modules for commitment control, the existing CIGAS system was modified so that quarterly commitment ceilings will be operational for the 2018 budget.
Cabinet to approve a debt management strategy for international sovereign bonds maturing over 2019-22.	End-June 2018	Met.	In January 2018, cabinet approved tender offers and parallel new issues to refinance maturing sovereign bonds from 2019 onwards.

Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)

State Enterprise Reform			
Record the fiscal cost of non-commercial obligations (including subsidies) for SOEs in the central government budget, starting in 2017.	End-November 2016	Not met (implemented in effect for major SOEs)	The 2017 budget did not report the cost of the non-commercial obligations. Nonetheless, the Statement of Corporate Intent includes information on non-commercial obligations of the respective SOE. Therefore, the benchmark has been effectively fulfilled since the SCIs for the 5 large SOEs were published in April 2017. Publication of the non-commercial obligations is built into the benchmarks for the 2018-2020 budgets.
Cabinet to approve a resolution strategy for Sri Lankan Airlines.	End-December 2016	Met	Substantial reforms have been undertaken under a strategy approved by the Cabinet in June 2015. The airline has taken restructuring measures (e.g., route and fleet optimization) and reduced operational losses under the oversight of the Ministry of Public Enterprise Development and a Cabinet Committee. The authorities will report the airline's financial performance to IMF staff on a quarterly basis.
MOF, line ministries, and SOEs to sign and publish Statements of Corporate Intent for the six largest SOEs (Ceylon Petroleum Corporation, Ceylon Electricity Board, Sri Lankan Airlines, National Water Supply and Drainage Board, Airport and Aviation Services Limited, and Sri Lanka Ports Authorities).	End-December 2016	Met with delay	Draft Statement of Corporate Intents (SCIs) were finalized in December 2016 for each of the 6 SOEs except for Sri Lankan Airlines. Following Cabinet approval, the SCIs were signed in March 2017 and published in April 2017.

**Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (concluded)**

MOF to complete a report outlining the cost of non-commercial obligations for fuel and electricity.	End-September 2017	Not met (implemented with delay)	A step in a sequence of reforms to put the automatic fuel and electricity pricing reform back on track. The report was published as an annex to the 2018 budget speech in November.
Cabinet to approve automatic fuel pricing mechanism (agreed with IMF staff) that ensures retail prices above cost-recovery levels and a financial position of Ceylon Petroleum Corporation capable of covering debt service.	End-March 2018	Not met (implemented with delay).	Cabinet approved adoption of a cost-reflective fuel pricing mechanism in May 2018. The target date had been reset to March 2018 at the second review to allow time for public consultation and education, followed by a sequence of reforms.
CEB and the Public Utilities Commission (PUC) to establish a Bulk Supply Transactions Account and start using it to settle transactions between generators, the transmission operator, and distributors as specified in the November 2015 tariff methodology.	End-March 2018	Not met (implemented with delay).	The CEB and the PUC established a Bulk Supply Transactions Account in May 2018 and the PUC published monthly data on the account for 2016-17. This is a step in a sequence of reforms to put the automatic electricity pricing reform back on track.
<b>Monetary and Exchange Rate Policies</b>			
Develop a roadmap for flexible inflation targeting and flexible exchange rate regime that identifies timebound reform measures to be taken during the program period.	End-October 2017	Met	An IMF TA mission for designing the roadmap took place in May 2017. The Monetary Board approved this roadmap.
Approval by cabinet of a policy note outlining the key elements of amendments (or replacement) to the Monetary Law Act (MLA), in consultation with the IMF.	End-March 2018	Not met (implemented with delay).	The cabinet approved of a policy note to amend the MLA in April 2018.



## Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out a framework for monitoring the performance of Sri Lanka under the program supported by the Extended Arrangement under the Extended Fund Facility (EFF). It specifies the performance criteria and indicative targets (including adjustors) under which Sri Lanka's performance will be assessed through semiannual reviews. Monitoring procedures and reporting requirements are also specified.
2. The quantitative performance criteria and indicative targets specified in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP) are listed as follows.
  - a) a quantitative performance criterion on central government primary balance (floor);
  - b) a quantitative performance criterion on net official international reserves (floor);
  - c) a continuous quantitative performance criterion on new external payment arrears by the nonfinancial public sector and the CBSL (ceiling);
  - d) a monetary policy consultation clause;
  - e) an indicative target on central government tax revenue (floor);
  - f) an indicative target on reserve money of the CBSL (ceiling);
  - g) an indicative target on cost of non-commercial obligations for fuel and electricity (net of government transfers) (ceiling); and
  - h) an indicative target on treasury guarantees (ceiling).
3. Throughout this TMU, the central government is defined to include line ministries, departments, and other public institutions. The Central Bank of Sri Lanka (CBSL), state-owned enterprises, parastatals and other agencies that do not receive subventions from the central government are excluded from the definition of central government. Debt is defined in accordance with paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), adopted December 5, 2014.

### I. PERFORMANCE CRITERIA

#### A. Performance Criterion on Central Government Primary Balance

4. The primary balance of the central government on cash basis is defined as central government revenues and grants minus expenditures and net lending, plus interest payments. The proceeds from privatization or commercialization of public assets to residents or non-

residents (as defined in paragraph 10) will not be recorded as part of central government revenues. Spending will be recorded in the period during which cash disbursements are made.

**5.** For the purpose of program monitoring, the primary balance of the central government on cash basis will be measured as the overall balance of the central government plus the interest payment of the central government. The overall balance of the central government is measured from the financing side, as the negative of the sum of the items listed below. Here, net borrowings refer to gross disbursements minus principal repayments. For 2015, the primary balance of the central government on cash basis measured in this manner was Rs –241 billion (the overall balance was Rs –768 billion and the interest payment was Rs 527 billion).

- a) Net borrowings from issuances of Treasury Bills, Treasury Bonds, and Rupee Loans.<sup>1</sup> In 2015, the total amount of such net borrowings was Rs 257.6 billion.
- b) Net borrowings from Sri Lankan Development Bonds (SLDBs) and commercial borrowings including international sovereign bonds and syndicated loans. In 2015, the total amount was Rs 455.7 billion.
- c) Net borrowings from project and program loans. In 2015, the total amount was Rs 69.7 billion, after adjustment for program loans that were contracted and disbursed during 2014 but were recorded in the 2015 fiscal account (Rs 61.6 billion).
- d) Net increases in non-market borrowings, CBSL advances, government import bills, government overdraft from the banking system, cash items in process of collection, and borrowings from offshore banking units of domestic commercial banks. In 2015, the total amount was Rs –10.1 billion.
- e) Net decreases in the deposit of the central government in the banking system. In 2015, the total amount was Rs –4.4 billion (an increase in deposit).
- f) Net borrowings from all other bonds, loans, and advances contracted by the central government. In 2015, the total amount was Rs –0.5 billion (net repayment).
- g) Proceeds from privatization or commercialization of public asset to residents and non-residents. In 2015, the total amount was Rs 0 billion.

**The following adjustment will apply:**

**6.** If the actual amount of gross cash disbursement of project loans by end-June/end-December 2019 is higher than Rs 45/95 billion, the floor on the primary balance of the central government for end-June/end-December 2019 will be adjusted downward by the difference

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<sup>1</sup> Rupee Loans are a medium to long-term debt instruments issued with maturities more than two years on tap basis or as private placements by the CBSL on behalf of the government under the Registered Stock and Securities Ordinance.

between the actual amount and Rs 45/95 billion. The downward adjustment of the primary balance target will be capped at Rs 20 billion. If the actual amount of gross cash disbursement of project loans by end-June/end-December 2019 is lower than Rs 45/95 billion, the floor on the primary balance of the central government for end-June/end-December 2019 will not be adjusted.

## **B. Performance Criterion on Net Official International Reserves**

7. For the purpose of program monitoring, net official international reserves (NIR) will be measured as the difference between (a) and (b) below, and will be called the “Program NIR.” At end-2015, the Program NIR, evaluated at market exchange rates, stood at US\$2,893.1 million. At end-2016, the Program NIR, evaluated at market exchange rates, stood at US\$2,032.1 million. At end-2017, the Program NIR, evaluated at market exchange rates, stood at US\$5,104.0 million. At end-2018, the Program NIR, evaluated at market exchange rates, stood at US\$4,773.0 million. Targets for the Program NIR are set for cumulative flows from the end of the previous year. To calculate the cumulative flows, the Program NIR at the test dates and the end of the previous year are evaluated at the program exchange rates and gold price specified in paragraph 9.

a) The CBSL’s conventional definition of the NIR, that is, (i) the difference between the gross foreign assets and liabilities of the CBSL and (ii) the balance of State Treasury’s (DSTs) Special Dollar, Japanese Yen, and Chinese Yuan Revolving accounts, both expressed in terms of market values. Gross foreign assets of the CBSL consists of monetary gold; foreign exchange balances held outside Sri Lanka; foreign securities (valued in market prices); foreign bills purchased and discounted; the reserve position at the IMF and SDR holdings; and the Crown Agent’s credit balance. Foreign exchange balances, securities, and bills denominated in Chinese Yuan are part of the gross foreign assets of the CBSL. Excluded from gross foreign assets will be participation in international financial institutions; holdings of nonconvertible currencies; holdings of precious metals other than monetary gold; claims on residents (e.g., statutory reserves on foreign currency deposits of commercial banks and central bank foreign currency deposits with resident commercial banks); pledged, non-liquid, collateralized or otherwise encumbered foreign assets (such as the government’s war risk insurance deposit with Lloyds during 2001/02); and claims in foreign exchange arising from derivative transactions (such as futures, forwards, swaps and options). Gross foreign liabilities are all foreign currency denominated liabilities of the CBSL to non-residents (including currency swap arrangements with foreign central banks); the use of Fund credit; and Asian Clearing Union debit balance. Commitments to sell foreign exchange to residents arising from derivatives such as futures, forwards, swaps, and options, such as commitments arising from currency swaps with domestic commercial banks, are not included in the gross foreign liabilities. DST accounts are foreign currency accounts held by the Treasury and managed by the CBSL as an agent of the government. At end-December 2015, the NIR as per the CBSL’s conventional definition, evaluated at market exchange rates, stood at US\$ 5,028.8 million. At end-December 2016, this amount was US\$4,529.0 million (evaluated at market exchange rates). At end-December 2017, this amount was US\$6,597.4 million (evaluated at market exchange rates). At end-December 2018, this amount was US\$5,494.6 million.

b) The CBSL's outstanding liabilities (i.e., net short positions) in foreign exchange swaps with domestic commercial banks, which stood at US\$ 2,135.7 million at end-December 2015, \$2,496.9 million at end-December 2016, and US\$1,495.2 million at end-December 2017, and US\$723.2 million at end-December 2018.

8. The framework to wind down outstanding liabilities in foreign exchange swaps with domestic commercial banks will include discontinuing the provision of FX swaps on concessional terms and gradually reducing outstanding net short positions of FX swaps with commercial banks as described in the MEFP.

9. For the purpose of measuring the program NIR, all foreign-currency related assets and liabilities will be converted into U.S. dollar terms at the exchange rates prevailing on Jan 2, 2019, as specified in Table 1. Monetary gold will be valued at US\$1,281.295 per troy ounce, which was the price prevailing on Jan 2, 2018.

<b>Table 1. Sri Lanka: Exchange Rates</b> (Rates as of January 2, 2019)	
Currency	Sri Lankan Rupee per currency unit
U.S. dollar	182.5464
British pound	231.113
Japanese yen	1.673
Canadian dollar	134.225
Euro	208.705
Chinese yuan	26.578
SDR	253.8563
Source: CBSL and IMF.	

**The following adjustment will apply:**

10. If (i) the amount of foreign program financing by the central government, (ii) the amount of net borrowings from SLDBs and FCBU by the central government, (iii) the amount of external commercial loans (including international sovereign bonds and syndicated loans) by the central government, (iv) the amount of project loans and grants disbursed to the central government, and (v) proceeds from commercialization of public assets to non-residents—as set out in Table 2—are higher/lower in U.S. dollar terms than assumed under the program, the floor on the program NIR will be adjusted upward/downward by the cumulative differences on the test date. The proceeds from commercialization of public assets are defined as cash receipts from the sale or lease of publicly held assets. Such assets will include, but not be limited to, publicly held land,

public holdings of infrastructure or commercial real estate, and public or quasi-public enterprises. These adjustors will apply to the NIR floor for end-June 2019 and thereafter.

**11.** If the sum of amortization of official external debt and interest payments on official external debt by the central government in U.S. dollar terms—as set out in Table 2—is higher/lower than assumed under the program, the floor on the program NIR will be adjusted downward/upward by the cumulative differences on the test date. Official external debt refers to external debt owed to multilateral and official bilateral creditors, as defined in the *2013 External Debt Statistics: Guide for Compilers and Users*. These adjustors will apply to the NIR floor for end-June 2019 and thereafter.

	June-2019	Sept-2019	Dec-2019	Mar-2020
Foreign program financing by the central government	0	0	0	0
Net borrowings from SLDBs and FCBUs by the central government	-108	-108	-108	0
External commercial loans (including Eurobonds and syndicated loans) by the central government	2,426	3,426	3,426	500
Proceeds from commercialization of public assets to non-residents	0	0	0	0
Amortization of official external debt by the central government	645	1,044	1,288	440
Interest payments of official external debt by the central government	827	1,230	1,654	404
Project loans and grants disbursed to the central government	218	353	488	210

## II. CONTINUOUS PERFORMANCE CRITERIA

### A. Performance Criterion on New External Payment Arrears by the Nonfinancial Public Sector and the CBSL

**12.** A continuous performance criterion applies to the non accumulation of new external payments arrears on external debt contracted or guaranteed by the nonfinancial public sector and the CBSL. The nonfinancial public sector is defined following the 2001 Government Finance Statistics Manual and the 1993 System of National Accounts. It includes (but is not limited to) the central government as defined in paragraph 3 and nonfinancial public enterprises, i.e., boards, enterprises, and agencies in which the government holds a controlling stake. External payments arrears consist of debt-service obligations (principal and interest) to nonresidents that have not been paid at the time they are due, as specified in the contractual agreements, subject to any applicable grace period. However, overdue debt and debt service obligations that are in dispute will not be considered as external payments arrears for the purposes of program monitoring.

### III. MONETARY POLICY CONSULTATION CLAUSE

**13.** The inflation target bands around the projected 12-month rate of inflation in consumer prices, as measured by the headline Colombo Consumers Price Index (CCPI) published by the Department of Census and Statistics of Sri Lanka, are specified in Table 1 attached to the MEFP. The new CCPI index (2013=100) will be used to measure actual inflation. For this purpose, the year-on-year inflation for each test date is measured as follows:

$$\{ \text{CCPI}^*(t) - \text{CCPI}^*(t-12) \} / \text{CCPI}^*(t-12)$$

where

t = the month within which the test date is included

CCPI(t) = CCPI index (all items) for month t

CCPI(t-k) = CCPI index (all items) as of k months before t

CCPI\*(t) = { CCPI(t-2) + CCPI(t-1) + CCPI(t) } / 3

CCPI\*(t-12) = { CCPI(t-14) + CCPI(t-13) + CCPI(t-12) } / 3

If the observed year-on-year inflation for the test date of end-June 2019 or end-December 2019 falls outside the outer bands specified in Table 1 attached to the MEFP, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) on proposed policy response. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. In addition, if the observed year-on-year inflation falls outside the inner bands specified in Table 1 attached to the MEFP for the test date of end-June 2019, end-September 2019, end-December 2019, and end-March 2020, the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

### IV. INDICATIVE TARGETS

#### A. Indicative Target on Central Government Tax Revenue

**14.** Central government tax revenue refers to revenues from taxes collected by the central government. It excludes all revenues from asset sales, grants, and non tax revenues. The revenue target is calculated as the cumulative flow from the beginning of the year. For 2015, central government tax revenue defined in this manner was Rs. 1,356 billion.

## B. Indicative Target on Reserve Money of the CBSL

**15.** Reserve money of the CBSL consists of currency in circulation (with banks and with the rest of the public), financial institutions' domestic currency deposits at the CBSL, and the deposits of the following government agencies: the National Defense Fund (General Ledger Acc. No. 4278), the Buddha Sasana Fund A/C (General Ledger Acc. No. 4279); and the Road Maintenance Trust Fund (General Ledger Acc. No. 4281). At end-December 2015, reserve money defined in this manner stood at Rs. 673.4 billion. From December 2017 onwards, reserve money for each test date is measured as the average reserve money from 16th to end of the month.

**The following adjustment will apply:**

**16.** If any bank fails to meet its legal reserve requirement, the ceiling on reserve money will be adjusted downward to the extent of any shortfall in compliance with the requirement.

**17.** Changes in required reserve regulations will modify the reserve money ceiling according to the formula:

$$\Delta M = \Delta r B_0 + r_0 \Delta B + \Delta r \Delta B$$

where  $\Delta M$  denotes the change in reserve money,  $r_0$  denotes the reserve requirement ratio prior to any change;  $B_0$  denotes the reservable base in the period prior to any change;  $\Delta r$  is the change in the reserve requirement ratio; and  $\Delta B$  denotes the immediate change in the reservable base as a result of changes to its definition.

## C. Indicative Target on Cost of Non-Commercial Obligations for Fuel and Electricity (Net of Government Transfers)

**18.** The non-commercial obligations (NCOs) for fuel and electricity refer to the obligations of Ceylon Petroleum Corporation (CPC) and Ceylon Electricity Board (CEB) to supply fuel and electricity at prices below cost-recovery levels. The indicative target is set on the cost of fuel and electricity NCOs net of government transfers, which corresponds to the cost of the NCOs that are not compensated by the central government budget.

**19.** The cost of NCOs for fuel during each quarter is measured as the cost of sales (including fuel cost, terminal charges, transport charges, personnel cost, other operational expenses, exchange rate variation, and finance cost; excluding sales taxes) minus revenues (net of sales taxes) with regard to fuel supplies by CPC for transport, power generation, aviation, industries, kerosene and LPG, and agrochemicals. If the revenues (net of taxes) exceed the cost of sales, the cost of NCOs for fuel is zero. The government transfers to cover the cost of fuel NCOs are measured as central government current transfers disbursed to CPC.

**20.** The cost of NCOs for electricity during each quarter is measured as total expenditures (including energy purchases and allowed revenue for transmission) minus total sales revenues from 5 distribution licensees under CEB, as shown in the statement of the Bulk Supply Transaction Account managed by CEB. If the total sales revenues exceed the total expenditures,

the cost of NCOs for electricity is zero. The government transfers to cover the cost of electricity NCOs are measured as central government current transfers disbursed to CEB.

**21.** For the purpose of program monitoring, the cost of fuel and electricity NCOs net of government transfers is calculated as follows. This takes account of a time lag in estimating the cost of fuel and electricity NCOs.

For the test date of end-June 2018:

$$\{ \text{NCO}(2017\text{Q4}) + \text{NCO}(2018\text{Q1}) \} - \{ \text{G}(2018\text{Q1}) + \text{G}(2018\text{Q2}) \}$$

For the test date of end-September 2018:

$$\{ \text{NCO}(2017\text{Q4}) + \text{NCO}(2018\text{Q1}) + \text{NCO}(2018\text{Q2}) \} \\ - \{ \text{G}(2018\text{Q1}) + \text{G}(2018\text{Q2}) + \text{G}(2018\text{Q3}) \}$$

For the test date of end-December 2018:

$$\{ \text{NCO}(2017\text{Q4}) + \text{NCO}(2018\text{Q1}) + \text{NCO}(2018\text{Q2}) + \text{NCO}(2018\text{Q3}) \} \\ - \{ \text{G}(2018\text{Q1}) + \text{G}(2018\text{Q2}) + \text{G}(2018\text{Q3}) + \text{G}(2018\text{Q4}) \}$$

For the test date of end-June 2019:

$$\{ \text{NCO}(2018\text{Q4}) + \text{NCO}(2019\text{Q1}) \} - \{ \text{G}(2019\text{Q1}) + \text{G}(2019\text{Q2}) \}$$

For the test date of end-September 2019:

$$\{ \text{NCO}(2018\text{Q4}) + \text{NCO}(2019\text{Q1}) + \text{NCO}(2019\text{Q2}) \} \\ - \{ \text{G}(2019\text{Q1}) + \text{G}(2019\text{Q2}) + \text{G}(2019\text{Q3}) \}$$

For the test date of end-December 2019:

$$\{ \text{NCO}(2018\text{Q4}) + \text{NCO}(2019\text{Q1}) + \text{NCO}(2019\text{Q2}) + \text{NCO}(2019\text{Q3}) \} \\ - \{ \text{G}(2019\text{Q1}) + \text{G}(2019\text{Q2}) + \text{G}(2019\text{Q3}) + \text{G}(2019\text{Q4}) \}$$

For the test date of end-March 2020:

$$\text{NCO}(2019\text{Q4}) - \text{G}(2020\text{Q1})$$

where

NCO(q) = cost of NCOs for fuel and electricity during quarter "q"

NCO\_fuel(q) = cost of NCOs for fuel during quarter "q"



$NCO\_electricity(q)$  = cost of NCOs for electricity during quarter “q”

$NCO(q)$  =  $NCO\_fuel(q)$  +  $NCO\_electricity(q)$

$G(q)$  = central government current transfers to CPC and CEB disbursed during quarter “q”

$G\_fuel(q)$  = central government current transfers to CPC disbursed during quarter “q”

$G\_electricity(q)$  = central government current transfers to CEB disbursed during quarter “q”

$G(q)$  =  $G\_fuel(q)$  +  $G\_electricity(q)$ .

#### D. Indicative Target on Treasury Guarantees

**22.** Treasury guarantees are defined as outstanding debt guarantees issued by the central government. A guarantee of a debt refers to any explicit legal obligation of the central government to service such a debt in the event of nonpayment by the recipient. Treasury guarantees exclude letters of credit. Outstanding guarantees are defined as the drawn amounts of guaranteed debts. They differ from issued guarantees, which are defined as the total amount of guaranteed debts (including for debts that are not disbursed yet). Treasury guarantees include outstanding treasury guarantees published in the Statement of Contingent Liabilities contained in the Annual Report of the Ministry of Finance and the guarantee issued for the SriLankan Airlines’ \$175 million Eurobond. Rupee values for guarantees issued in other currencies will be calculated using the exchange rate for the last day of the calendar year as it appears in the Statement of Contingent Liabilities in the Annual Report of the Ministry of Finance. As of end-2017, the outstanding treasury guarantees were valued at Rs 591 billion (including the guarantee issued for the SriLankan Airlines’ Eurobond amounting to Rs. 27 billion).

### V. DATA REPORTING REQUIREMENTS

**23.** Sri Lanka shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Sri Lanka in achieving the objectives and policies set forth in the Memorandum of Economic and Financial Policies and Letters of Intent. All the program monitoring data will be provided by the Ministry of Finance and the CBSL. For the purpose of monitoring the fiscal performance under the program, data will be provided in the format as shown in Tables 3 and 4. For the purpose of monitoring the monetary targets under the program, data will be provided in the format shown in Table 5. For the purpose of monitoring the external sector performance under the program, data will be provided in the format shown in Tables 6 and 7. For the purpose of monitoring the financial performance of three state-owned enterprises—CEB, CPC, and SriLankan Airlines—data will be provided in the format shown in Tables 8, 9, and 10, respectively, on a quarterly basis. For the purpose of monitoring the performance against the indicative target on the cost of fuel and electricity NCOs (net of government transfers), data will be provided in the format shown in Tables 11 and 12 on a quarterly basis. For the purpose of monitoring the performance against

the indicative target on treasury guarantees, data will be provided in the format shown in Table 13 on a quarterly basis.

**24.** Data relating to the fiscal targets (Table 3 and Table 4) will be furnished within no more than five weeks after the end of each month, except for the data on salaries and wages, goods and services, subsidies and transfers (and its subcomponents) that will be furnished within no more than seven weeks after the end of each month (the data on total recurrent expenditure and interest payments will be furnished within no more than five weeks after the end of each month). Data relating to the external and monetary targets (Tables 5, Table 6, and Table 7) will be furnished within no more than three weeks after the end of each month. Data relating to the three state-owned enterprises (Tables 8–10) will be furnished within no more than 2 months after the end of each quarter. Data relating to the indicative target on the cost of fuel and electricity NCOs (net of government transfers) (Table 11 and Table 12) will be furnished within no more than 5 weeks after the end of each quarter. Data relating to the indicative target on treasury guarantees (Table 13) will be furnished within no more than two months after the end of each quarter.

**Table 3. Sri Lanka: Central Government Operations 1/**  
(In millions of rupees)

(In millions of rupees)

<b>Total Revenue &amp; Grants</b>
Total Revenue
Tax revenue
Income Tax
Personal & Corporate
Corporate & non-corporate
PAYE
Economic Service Charge
Tax on interest income
Taxes on goods & services
VAT
Excise Taxation
Liquor
Cigarettes
Motor vehicles
Petroleum
Other
Other Taxes & Levies
NBT
Stamp duties
Telecommunication Levy
Motor vehicles Taxes & Other
Sales tax
Debit tax
Telephone Subscriber Levy
National Security Levy
Tax on treasury bills
Taxes on External Trade
Imports
Cess
Special Commodity Levy
PAL
Non-Tax Revenue
Property income
Fines, Fees & Charges
Other
Grants
<b>Total Expenditure</b>
Recurrent Expenditure
Salaries & wages
Goods & Services
Interest Payments
Subsidies & Transfers
Public Corporations
Public Institutions
Households
Capital Expenditure
Net lending
<b>Primary Balance</b>
<b>Overall balance</b>
<b>Total Financing</b>
Total Foreign Financing (Net)
Total Domestic Financing (Net)
Privatization

1/ As agreed for the purpose of monitoring the program.

**Table 4. Sri Lanka: Central Government Financing 1/**  
(In millions of rupees)

**1. Domestic instrument borrowings**

T-Bills (net)  
T-Bonds  
Rupee Loans  
Other

**2. Domestic non-instrumental borrowings**

Sri Lankan Development Bonds (SLDB)  
Non market borrowings  
CBSL advances  
Government deposit at CBSL  
Government import bills  
Cash items in process of collection (CIPC)  
Overdraft to government  
Short term loans  
Deposit with commercial banks  
Overseas Banking Units  
Other

**3. Net foreign financing**

Net T-Bill purchase by nonresidents  
Net T-Bond purchase by nonresidents  
International sovereign bonds  
Project loans  
Other

**Total financing (1+2+3)**

Memorandum items:

T-Bonds  
Gross borrowings  
Repayments  
Net borrowings  
SLDBs  
Gross borrowings  
Repayments  
Net borrowings  
ISBs  
Gross borrowings  
Repayments  
Net borrowings  
Project loans  
Gross borrowings  
Repayments  
Net borrowings

1/ As agreed for the purpose of monitoring the program.

**Table 5. Sri Lanka: Balance Sheet of the Central Bank of Sri Lanka 1/**  
(In millions of rupees)

**Net foreign assets**

**Foreign assets**

Cash and balances abroad  
 Foreign securities  
 Claims on ACU  
 IMF Related Assets  
 SDRs  
 RR on FCDs of banks  
 Receivables (Accrued Interest)  
 Derivative Financial Instruments

**Foreign liabilities**

IMF & nonresident a/c  
 SDRs  
 Liabilities to ACU  
 Payables  
 Derivative Financial Instruments

**Net domestic assets**

**Claims on Government**

Advances  
 Treasury bills & Treasury Bonds  
 Treasury Bonds  
 Cash items in collection

**Government deposits**

**Claims on commercial banks**

Medium and long-term  
 Short-term

**Other assets (net)**

**Reserve money**

Currency in circulation  
 Commercial bank deposits  
 Government agencies deposits

1/ As agreed for the purpose of monitoring the program.

**Table 6. Sri Lanka: Foreign Exchange Cashflows of the Central Bank and the Government 1/**

(In millions of U.S. dollars)

**1. Total inflows**

Loans  
 Program  
 IMF  
 Project (cash component only)  
 Commercial borrowing (incl. new and rolled over SLDBs)  
 Interest earnings, forex trading profits, cap gains  
 Purchases of foreign exchange  
 Change in balances in DST's A/Cs  
 Of which: Proceeds from commercialization of public assets  
 Other inflows  
 Borrowing from SLDBs  
 Loans from FCBUs  
 Syndicated Loans  
 International Swaps/Commercial Loans/Sovereign Bonds  
 OMO FX swap transactions

**2. Total outflows**

Public Debt Service Payments  
 Amortization  
 Principal (foreign loans)  
 Settlement SLDBs  
 Settlement FCBU  
 Settlement of syndicated loans  
  
 Interest  
 Foreign loans  
 Domestic foreign currency loans  
 SWAP/Loan interest  
 ISB interest  
 Payments to the IMF/ change in valuation of liabilities  
 Foreign exchange sales to commercial banks  
 OMO FX swap transactions

**3. SWAP**

Inflow  
 Outflow Including Interest

**3. Net flow at current rates (1-2)**

**Net International Reserves (at market exchange rates)**

**Net International Reserves (at program exchange rates)**

**Gross International Reserves (at market exchange rates)**

1/ As agreed for the purpose of monitoring the program.

**Table 7. Sri Lanka: Gross Official Reserve Position 1/**  
(In millions of U.S. dollars)

Date	Central Bank		Reserve Position at I.M.F. & SDR hol.	Total	Government			Total	Gross Official Reserves		Liabilities				Net International Reserves	Overall balance	Memorandum Items - Swaps with Commercial Banks		
	Reserves managed by IOD				Total	Total	(without ACU & DA & with Swap)		(with ACU & SWAP & without DA)	Other Deposits	Asian Clearing Union	Drawings from the IMF	International Currency Swap	Total			1st Leg (New)	2nd Leg (Maturity)	Outstanding stock (Short position)
	Foreign Assets (FA) (with ACU & Without DA)	Domestic Assets (DA) (BOC & PB)	Crown Agent's Credit Balance	D S T's Special Dollar Revolving Cr.balance				DST's Yen Accounts							(6) - (10)	(3) + (7)			
	1	2	(1)+(2)	3	4	5	6	7	8										

1/ As agreed for the purpose of monitoring the program.

**Table 8. Sri Lanka: Financial Outturn of Ceylon Electricity Board 1/**  
(In millions of rupees)

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**Total revenue**

Sale of electricity  
Other income

**Total expenditure**

Direct generation cost  
Generation, transmission, and distribution O&M cost  
Corporate expenses  
Interest on borrowings and delayed payments  
Depreciation  
Other cost

**Operating profit/loss**

**Liquidity position**

Borrowings from banks  
Payments to banks  
Outstanding debt to banks  
Purchases from CPC and IPP  
Payments to CPC and IPP  
Outstanding to CPC and IPP

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1/ As agreed for the purpose of monitoring the program.



**Table 9. Sri Lanka: Financial Outturn of Ceylon Petroleum Corporation 1/**  
(In millions of rupees)

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**Total revenue**

Octane 90  
Diesel  
Other products  
Other income

**Total expenditure**

Cost of sales  
Sales and distribution  
Administration  
Finance cost  
Depreciation  
Other cost

**Operating profit/loss**

Outstanding dues to state banks

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1/ As agreed for the purpose of monitoring the program.

**Table 10. Sri Lanka: Financial Outturn of Sri Lankan Airlines 1/**  
(In millions of rupees)

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**Total revenue**

Passenger  
Cargo  
Other income

**Total expenditure**

Aircraft fuel cost  
Employee cost  
Other operating expenses  
Financial cost

**Operating profit/loss**

Capital contribution

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1/ As agreed for the purpose of monitoring the program.

**Table 11. Sri Lanka: Cost of Non-Commercial Obligations for Fuel 1/**  
(In millions of rupees, unless otherwise noted)

Product	a=e-b	b=c-d	c	d	e=f+g+h+i +j+k+l	f	g	h	i	j	k	l	m
	Cost of NCOs	(net of sales	Sales revenue	Sales taxes	(net of sales taxes)	Cost of sales	Terminal charge	Transport charge	Personnel cost	Other expenses	Exchange rate variation	Finance cost	Sales quantity
	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Million liters
<b>A.TRANSPORT</b>													
Super petrol (92 octane)													
Unladen petrol (95 octane)													
Auto diesel													
Super diesel													
<b>B.POWER GENERATION</b>													
Auto diesel													
Fuel oil 800 <sup>1</sup>													
Fuel oil 1500 <sup>1</sup>													
Fuel oil 1500 <sup>1</sup> low sulphur													
Fuel oil 200 <sup>1</sup>													
Naphtha													
<b>C.AVIATION</b>													
Jet A-1 (Foreign)													
Jet A-1 (Sri Lankan Airline)													
Jet A-1 (Local)													
Avgas													
<b>D.INDUSTRIES</b>													
Ind Kero													
Fuel oil 800 <sup>1</sup>													
S.B.P.													
Bitumen													
Lubricant													
<b>E.DOMESTIC</b>													
Kerosene													
LPG													
<b>F.AGRO</b>													
Agro chemicals													
<b>Total (A-F)</b>													
<b>Memorandum item:</b>													
<b>Central government current transfers to CP</b> [x]													
1/ As agreed for the purpose of monitoring the program.													

**Table 12. Sri Lanka: Statement of Bulk Supply Transaction Account 1/**  
(In millions of rupees)

<b>a Total revenue</b>	
	Sales by DL1, 2, 3, 4, 5
	UNT adjustment
<b>b Expenditures</b>	
	Energy purchases
	Mahawell complex
	Laxapana complex
	Other hydro complex
	Thermal complex
	Coal complex
	Old Chunnakam+ Islands
	Uturu janani
	IPP plants
	NCRE
	Other
	UNT adjustment
	Transmission allowed revenue
	BSOB allowed revenue
	Other
	<b>Subsidy Requirement from General Treasury/(surplus)</b>
c=b-a	<b>Cost of electricity NCOs</b>
<b>Memorandum item:</b>	
<b>Central government current transfers to CEB</b>	
1/ As agreed for the purpose of monitoring the program.	

**Table 13. Treasury Guarantees 1/**

(In millions of rupees)

	<b>Treasury Guarantees Issued</b>	<b>Treasury Guarantees Outstanding</b>
<b>Total Treasury Guarantees</b>		
Ceylon Electricity Board		
Ceylon Petroleum Corporation		
National Water Supply and Drainage Board		
Road Development Authority		
SriLankan Airlines		
Other		
1/ As agreed for the purpose of monitoring the indicative target under the program.		

**Statement by Subir Gokarn, Executive Director for Sri Lanka  
and Mahinda Siriwardana, Alternate Executive Director  
May 13, 2019**

Our Sri Lankan authorities wish to place on record their appreciation of the Fund staff for the candid and fruitful discussions held in Colombo during September 13–27, 2018 and February 14–28, 2019 and for the well-focused report that has been produced in connection with the 5<sup>th</sup> Review of the Extended Fund Facility (EFF) arrangement. The analysis in the Staff Report reflects the current economic scenario in Sri Lanka. Our authorities appreciate the Fund’s constructive engagement with them and reiterate their strong commitment to the overall objectives of the program as well as the specific performance criteria aimed at maintaining macroeconomic stability and promoting inclusive growth. Accordingly, the authorities have taken several steps to bring program performance back on track following the setbacks experienced in the recent past. They look forward to continued support and cooperation of the management and the Executive Board of the IMF in their future endeavors.

**Recent Incidents**

Sri Lanka experienced two major incidents after the completion of the 4<sup>th</sup> Review under the EFF arrangement in June 2018.

***Political Tensions:*** The 51-day political tensions commenced with the removal of the sitting Prime Minister and appointment of a new Prime Minister by the President on October 26, 2018. It ended with the reinstatement of the ousted Prime Minister by the President on December 16, 2018, following a Supreme Court ruling. The peaceful resolution of the situation as a result of all parties accepting the court ruling is testimony to the strength of the country’s democracy and the robustness of the institutional framework. Nevertheless, the short-lived political tensions had several important economic implications, including the downgrading of the country’s sovereign rating by the three major rating agencies and putting the EFF program on-hold by the IMF. It also led the Parliament to pass a Vote on Account to undertake expenditures during the first 4 months of 2019 as the Budget for 2019 could not be presented as scheduled in November.

Following the reinstatement of the Prime Minister, the EFF program negotiations were recommenced, and staff level agreement was reached in February 2019. A complete budget for 2019 was presented to the Parliament in March 2019, which was also a Prior Action for the 5<sup>th</sup> Review of the program. With these positive developments, the government returned to the international sovereign bond market in March 2019 and raised US\$ 2.4 billion at competitive interest rates, reflecting the investor community’s continued support for Sri Lanka.

***Easter Sunday Attacks:*** The Sri Lankan economy was on a gradual recovery path following a series of natural disasters in the form of droughts and floods in 2016/2017, and the political tensions of 2018 while benefiting from the reform initiatives when terrorist attacks took place on Easter Sunday morning of April 21, 2019. These tragic

incidents saw over 250 innocent people losing their lives, including about 44 from 14 foreign nationalities, and injuring hundreds of civilians, including tourists.

This incident prompted the government to put in place a series of decisive measures, including the reintroduction of emergency regulations, to reassure safety and security of the country and the people, including tourists, and other appropriate measures to prevent further incidents. Since then, normalcy is being restored gradually.

The attacks have had an impact on confidence and sentiment, which could lead to renewed challenges for the economy. However, the extent of the impact will depend on the speed of restoring normalcy and stabilization of the situation. Tourism, which has been growing steadily in the recent past, will be adversely affected in the short-term. However, our authorities expect to get through this incident expeditiously, putting the country back on track to benefit from improving economic fundamentals. Although it is too early to assess the full impact of the Easter Sunday attacks, both fiscal and external current account deficits could be widened than projected before the event.

Following the resolution of the political tensions and aftermath of the terrorist attacks, our authorities remain committed to consolidating on previous reforms and continuing ongoing reforms to support sustainable growth and stability. Hence, Sri Lanka's near-term priorities are to restore normalcy, address still prevailing vulnerabilities, implement much-needed structural reforms and put the monetary and fiscal management frameworks in place to strengthen the macroeconomic management process to achieve these objectives.

### **Program Performance**

Despite recent disruptions and external shocks, Sri Lanka's EFF program is progressing. As per the end-December 2018 Quantitative Performance Criteria (QPC), although inflation fell below the lower inner band under the Monetary Policy Consultation Clause (MPCC) for December, inflation remained within the outer band. Although the QPC on the primary balance was not met in the context of sizable revenue underperformance, it has improved compared to the previous year. The QPC on NIR was also missed due to the significant intervention in the foreign exchange market amidst external pressures and political tensions. The end-December Indicative Target (IT) on reserve money was met, while the IT on tax revenues was missed. The continuous QPC of accruing no new external arrears was also met. Five Structural Benchmarks (SBs) were completed, albeit with some delays.

Sri Lanka has implemented important structural reforms, supported by the ongoing EFF arrangement. Hence, based on the progress achieved, Sri Lankan authorities request the approval of the 5<sup>th</sup> Review of the EFF with an extension of the program period by one year, recalibrating program targets and re-phasing of foreign exchange purchases, to allow for adequate time to complete the reform agenda and to secure the hard-won gains under the program.

### **Economic Growth and Outlook**

Economic growth has fallen below expectations. It was subdued at 3.2 percent in 2018, reflecting the vulnerability of the Sri Lankan economy to global and domestic disturbances.

Although the recent terrorist attacks could slow down the economy in the near term, the growth momentum is expected to improve gradually over the medium-term to around 5 percent. The successful implementation of the authorities' growth strategy as well as the benefits of improved fiscal discipline, implementation of structural reforms, realization of higher FDI inflows, a conducive low inflation environment and a competitive exchange rate are expected to drive faster medium-term growth with higher participation from the private sector.

### **Monetary Policy**

Headline and core inflation remained well-anchored within the targeted range of 4-6 percent, despite the sharp depreciation of the rupee, transitory fluctuations arising from the impact of volatile food prices and the introduction of the new pricing formula for domestic petroleum price adjustments. The year-on-year headline inflation as per the National Consumer Price Index (NCPI) decelerated sharply from 7.3 percent at end 2017 to 0.4 percent by end 2018, before accelerating to 2.9 percent by March 2019. Meanwhile, headline inflation as per the Colombo Consumer Price Index (CCPI) decelerated sharply from 7.1 percent (year-on-year) at end 2017 to 2.8 percent by end 2018, before accelerating to 4.5 percent by April 2019.

With the objective of the tight monetary policy stance being realized, the Central Bank of Sri Lanka (CBSL) signaled an end to the monetary tightening cycle in April 2018 and transited to a neutral monetary policy stance since then. At the latest monetary policy review, the CBSL also provided forward guidance of possible monetary policy easing in the near future. Despite the well-contained inflation and inflation expectations and the sharp deceleration in credit flows in the recent past, interest rates on deposits and lending in both nominal and real terms remained excessively high. Hence, on April 29, 2019, the CBSL directed the licensed banks and non-bank financial institutions regulated by the CBSL to reduce deposit rates by linking short-term rates to standing deposit facility rate of the CBSL and long-term rates to Treasury bill rate to expedite monetary transmission through the financial market. Going forward, the monetary policy stance will remain prudent and data dependent, and our authorities stand ready to take appropriate action if inflationary pressures emerge.

Sri Lanka aspires to maintain inflation at mid-single digit levels with the envisaged adoption of the flexible inflation targeting (FIT) framework by 2020. In this regard, the amendments to the Monetary Law Act (MLA), which constitute a centerpiece of the ongoing reforms, have already been approved by the Cabinet and will be submitted to the Parliament in July 2019. These amendments encompass strengthening the Central Bank's mandate of price stability, strengthening Central Bank independence, improving fiscal monetary co-ordination, restricting CBSL financing of the fiscal deficit, improving governance in the CBSL, facilitating the adoption of FIT as the monetary policy framework to sustain price stability and strengthening the financial sector oversight through the introduction of new provisions to enhance CBSL's macroprudential authority.

The CBSL follows a market-based exchange rate policy to facilitate necessary adjustments as the first line of defense against shocks, while intervening in the domestic foreign exchange market, particularly at times when there is excessive volatility and to build up foreign reserves. In this context, during the latter part of 2018, amidst political tensions, the foreign



exchange market experienced heightened pressures due to outflows from the government securities market. Hence, our authorities had to supply around US\$ 1.1 billion to the market during the year on a net basis to reduce excessive volatility which was driven by speculation. Simultaneously, with more flexibility being allowed, the exchange rate, in nominal terms, depreciated by 16.4 percent in 2018. The Request for Quotes (RFQ) system, introduced for CBSL intervention in the forex market, has deepened forex market activity, while allowing a market-based and transparent implementation of CBSL forex transactions.

The pressure on the BOP and exchange rate subsided during late 2018 and early 2019 in response to various measures taken by the CBSL and the government, including the initiatives to curtail non-essential imports, as well as the global financial markets becoming more favorable. Consequently, the Sri Lankan rupee, in nominal terms, appreciated by 4.2 percent during the first quarter of 2019 and the CBSL resumed foreign exchange purchases to rebuild reserve buffers. The cumulative appreciation of the exchange rate up to April 22, 2019 was 4.8 percent. However, following the unexpected terrorist attacks on 21 April, there was significant pressure on the exchange rate, also driven by notable foreign investment outflows from the government securities market, prompting the CBSL to intervene in the forex market by supplying foreign exchange to curb excessive volatility in the exchange rate and maintain the confidence in the currency during this period. Since April 21, 2019, the Sri Lankan rupee has depreciated by 1.4 percent against the US dollar.

Going forward, authorities will continue to maintain a flexible and competitive exchange rate within the envisaged flexible inflation targeting regime. Foreign exchange sales will be limited to stemming excessive volatility in the event of disorderly market conditions. The reserve accumulation, which has been a key policy objective of the CBSL's market intervention, will also be continued to rebuild adequate and quality reserve buffers over the medium-term.

## **Financial Sector**

Sri Lanka's financial sector remains sound with high levels of capital and adequate liquidity buffers, despite some increase in non-performing loans (NPLs). Authorities remain vigilant on the emergence of vulnerabilities in the sector. The ongoing efforts towards implementing Basel III regulatory requirements and IFRS 9 are expected to enhance the resilience of the banking sector. A new Banking Act is being drafted with the assistance from the World Bank to strengthen the regulation and supervision framework of banks. Resolution and enforcement actions are being taken to proactively address concerns on distressed licensed finance companies and other lingering problems. Macroprudential measures, such as LTVs on motor vehicles, continued to be operational to curtail the buildup of systemic imbalances. A Roadmap for Sustainable Finance in Sri Lanka was launched on 10 April 2019, with the support of the IFC, providing broad directions to financial regulators and financial institutions with the view of scaling up their contribution in building a more resilient, sustainable green economy. Progress has been made in formulating the National Financial Inclusion Strategy to improve financial inclusion across the country.

Measures are being taken to strengthen the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime of the country. The authorities, with the

coordination of other stakeholders, are actively engaged in working towards successful completion of the time-bound action plan provided to Sri Lanka to address the strategic deficiencies identified in the AML/CFT activities by Financial Action Task Force (FATF). The FATF has assessed Sri Lanka's progress in implementing the Action Plan through the Asia Pacific Joint Group (AP/JG). The AP/JG acknowledged that Sri Lanka has made significant progress and has largely addressed the action plan given by the FATF. Accordingly, it is expected that Sri Lanka will be able to exit the "Grey List" during the second half of 2019.

### **Fiscal Policy and SOE Reforms**

Given the relatively high public debt compared with peers, the need for credible fiscal consolidation for steady reduction in public debt has been well recognized. Revenue-based fiscal consolidation remains as a cornerstone of the fiscal reforms to bring down the budget deficit and public debt to a sustainable path, given the substantial resource needs for better-targeted social and capital spending. The committed efforts during the last three years have resulted in significant improvements in the fiscal situation. A primary surplus of 0.6 percent of GDP was achieved in 2018, following the surplus of 0.02 percent in 2017. This reflected the gradual adjustments in non-interest recurrent spending and the commitment of the government towards a sound fiscal consolidation program amidst challenging conditions. Going forward, the budget deficit is expected to reduce to 3.2 percent of GDP by 2023 with central government debt declining to 70 percent of GDP. The recent tax policy reforms, including the VAT reforms introduced in 2016/17 and the introduction of new Inland Revenue Act in 2018, are expected to strengthen domestic revenue mobilization in 2019 and beyond. The tax administration is also being strengthened to avoid evasion, improve efficiency and effectiveness of tax collection and enhance taxpayer services. Specific measures, including the more effective social protection schemes, are being taken to protect the vulnerable segments in the society from any adverse short-term impact of reforms.

Our authorities are also working on deepening the institutionalization of the fiscal framework by introducing revisions to the Fiscal Management (Responsibility) Act with Technical Assistance (TA) from the Fund. It would include binding fiscal rules, accountability provisions for performance against the operational target(s), clearly defined escape clauses and automatic correction mechanisms in case of a breach of fiscal targets. Our authorities are working, with the World Bank support, on a new Public Financial Management Act to improve the budget process and control risks from Public Private Partnerships (PPPs). New PPP guidelines to strengthen the project selection and appraisal process are also being finalized.

The authorities are committed to mitigate fiscal risks emanating from contingent liabilities of SOEs. The two key measures in this regard are, first, the introduction of an automatic fuel pricing formula and the establishment of a bulk supply transaction account (BSTA) as a key step towards revising electricity prices to reflect costs. Taking this forward, the automatic electricity pricing mechanism is expected to be submitted to the Cabinet in October 2019.

Second, attempts are being made to restructure the SriLankan Airlines (SLA). Building on an expert committee report presented to the President in January 2019, a paper was submitted to

the Cabinet in April 2019 with key recommendations to advance the restructuring plan. A strategic plan and an operating business model are expected to be prepared by the Board of SLA while overseeing the restructuring process.

The divestiture of the Hambantota Port constitutes another key measure taken to improve public sector performance in Sri Lanka. Our authorities welcome the analysis in Box 1 of the Staff Report on the Hambantota Port-related transaction, which has been articulated in a broader context of the “*Status of China’s Belt and Road Initiative Projects in Sri Lanka*”. They consider the analysis in Box 1 as a clear reflection of the true picture of the BRI related projects in Sri Lanka.

The Statements of Corporate Intent (SCIs), which created a framework to monitor the SOE performance under specific KPIs and initially signed with key 5 SOEs, are expected to expand to another 10 SOEs.

### **Debt Management**

Our authorities are fully cognizant of the outstanding debt liabilities and the challenges in meeting large refinancing needs in coming few years. The introduction of the Active Liability Management Act (ALMA) constitutes a significant milestone in Sri Lanka’s debt management process, particularly in dealing with rollover risks. The ALMA will smoothen the redemption cycle. It also permits acting in advance, to re-finance and/ or pre-finance debt repayable beyond any financial year covered under the Annual Appropriation Act. The debt management process was reinforced by the Medium-Term Debt Management Strategy (MTDS), launched in April 2019. The work related to the establishment of an independent debt management agency in line with international best practices is also in progress.

### **External Sector**

The increase in the current account deficit to 3.2 percent of GDP in 2018 was due to the deficit in the merchandise trade balance, stagnant workers’ remittances and rising foreign interest payments. However, services exports, including tourism and computer services, are estimated to have grown substantially. Going forward, our authorities expect that the current account deficit will be tapered over the medium-term with the expected improvements in the trade account, inflows to the services account and a recovery of workers’ remittances. The expected increase in foreign direct investment, which has already shown a considerable increase in recent years, will help finance the deficit in the current account with lower reliance on debt related financial inflows. Foreign reserves of US\$ 7.2 billion by end-April 2019, were equivalent to about 4.1 months of imports.

### **Trade Policy**

Improving exports and investments by facilitating greater integration with global markets is a priority for our authorities. This is expected mainly through the ongoing bilateral trade negotiations with several countries, including China, India and Thailand, aimed at widening market access and diversifying the products and markets. With the view of strengthening policy and institutional support for export promotion, a New Trade Policy (NTP) has been initiated, with particular attention on trade liberalization, investment promotion and

participation in production sharing networks. A Trade Adjustment Program (TAP) has been introduced in support of a smooth transition of firms and workers to the new market conditions, which could indirectly affect domestic industries through the reforms proposed by the NTP. In March 2019, the Cabinet approved the establishment of the Trade and Productivity Commission and a Joint Steering Committee to enable the implementation of the TAP in a productive manner. Para tariffs are also being phased out.

### **Conclusion**

Our authorities' policy agenda towards achieving rapid, inclusive and sustainable growth has been continuously supported by the Fund's technical assistance (TA) as well as by the policy reforms implemented. The authorities also value the efforts towards integration of capacity development and program objectives by the IMF along with the World Bank. The continuation of the EFF arrangement will boost investor confidence and help the country, particularly in passing through this challenging period. Our authorities are confident that with the implementation of envisaged reform agenda, Sri Lanka's economy will gradually return to a trajectory of high growth with greater macroeconomic stability.