INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/335

SRI LANKA

November 2019

SIXTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND REQUESTS FOR WAIVER OF NONOBERSERVANCE AND MODIFICATION OF PERFORMANCE CRITERION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE ALTERNATE EXECUTIVE DIRECTOR FOR SRI LANKA

In the context of the Sixth Review Under the Extended Arrangement Under the Extended Fund Facility and Requests for Waiver of Nonobservance and Modification of Performance Criterion, 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 November 1, 2019, following discussions that ended on September 25, 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 October 21, 2019.
- A **Statement by the Alternate 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.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 19/390
FOR IMMEDIATE RELEASE
November 1, 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Completes the Sixth Review of Sri Lanka's Extended Arrangement under the Extended Fund Facility

- Sri Lanka successfully completed the sixth review, enabling the next disbursement of supporting funds.
- Sustaining policy discipline remains critical to strengthen resilience and support strong and inclusive growth.
- Mobilizing revenue will be central to place public debt on a downward path while preserving space for social and investment spending.

On November 1, 2019, the Executive Board of the International Monetary Fund (IMF) completed the Sixth Review of Sri Lanka's economic performance under the program supported by an extended arrangement under the Extended Fund Facility (EFF)[1]. The completion of the Sixth review, upon the granting of a waiver of non-observance for the end-June 2019 performance criterion on the primary balance, enables the disbursement of SDR 118.5 million (about US$164 million), bringing total disbursements under the arrangement to SDR 952.23 million (about US$1.31 billion).

Sri Lanka's 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 that time of approval of the arrangement. See Press Release No. 16/262). On May 13, 2019, the Executive Board approved an extension of the arrangement by one additional year, until June 2, 2020, with rephasing of remaining disbursements (See Press Release No. 19/162).

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:

[1] 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.

“The Sri Lankan economy is gradually recovering from the impact of the Easter Sunday terrorist attacks. Growth is projected to strengthen to 3.5 percent in 2020, from 2.7 percent in 2019, as tourist arrivals and related activities gradually recover. Sustaining fiscal policy discipline remains critical to strengthen resilience and support growth, as important downside risks remain, amid heightened external and domestic uncertainty.

The authorities are taking actions to mitigate the revenue shortfalls caused by the terrorist attacks and preserve the hard-won gains made under the program. Sustained efforts to mobilize revenues will be needed in 2020 to place public debt on a downward path, while preserving space for critical social and investment spending. The new fiscal rule framework and the establishment of an independent public debt management agency over the medium term will help anchor public debt sustainability. Advancing SOE reforms in the electricity sector will also be critical to reduce fiscal risks.

The Central Bank of Sri Lanka should maintain a data dependent monetary policy. The new Central Bank Act will be a milestone reform towards the adoption of flexible inflation targeting. Efforts to build reserves should be sustained to protect the economy against shocks, allowing for exchange rate flexibility in the event of market pressures.

Sri Lanka has made important progress in strengthening the AML/CFT regime. Harmonizing regulation and supervision of financial institutions, strengthening the macroprudential policy framework, and upgrading the contingency framework will help to safeguard financial stability. Further progress in the structural reform agenda is essential to bolster competitiveness and achieve stronger and inclusive growth. Efforts should focus on liberalizing trade, by gradually removing para tariffs while addressing their revenue impact, strengthening the governance and anti corruption framework, promoting women’s economic empowerment, building climate resilience and enhancing social protection.

INTERNATIONAL MONETARY FUND

SRI LANKA

October 21, 2019

SIXTH REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY AND REQUESTS FOR WAIVER OF NONOBSERVANCE AND MODIFICATION OF PERFORMANCE CRITERION

EXECUTIVE SUMMARY

Recent developments and outlook. The Sri Lankan economy is gradually recovering from the severe impact of the Easter Sunday terrorist attacks. Real GDP growth was revised to 2.7 percent in 2019, from 3.6 percent at the fifth review, and is expected to strengthen to 3.5 percent in 2020 as tourism and related activities normalize. The slowdown in growth and decline in imports have significantly impacted fiscal revenues.

Program performance. The authorities remain committed to complete the EFF-supported program, despite recent setbacks. While the fiscal targets are no longer within reach, due to the significant revenue shortfalls after the attacks, they are taking corrective actions to mitigate the fiscal underperformance. The end-June net international reserve target was met and the Central Bank of Sri Lanka (CBSL) is committed to rebuild reserves, while allowing for greater exchange rate flexibility. The authorities have also made significant progress on their structural reform agenda, implementing five key structural benchmarks under the program, albeit with some delays.

Key challenges ahead. The Sri Lankan economy is gradually recovering, supported by the authorities' security and policy efforts to mitigate the impact of the attacks. Nevertheless, the economy remains vulnerable to shocks, given high public debt and low external buffers, with higher downside risks since the attacks, amid heightened external and domestic uncertainty. Sustained policy discipline and efforts to rebuild reserve buffers remain critical to address Sri Lanka's vulnerabilities and strengthen the economy's resilience, while supporting investment and growth.

Staff supports the authorities' request for completion of the sixth review. 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 952.23 million.

Approved By
Anne-Marie Gulde-Wolf (APD) and Vitaliy Kramarenko (SPR)

Discussions were held in Colombo during September 10–25, 2019. The mission met with Prime Minister Wickremesinghe, Minister of Finance Samaraweera, State Minister of Finance Wickramaratne, Governor of the Central Bank of Sri Lanka Coomaraswamy, Secretary to the Treasury Samaratunga, Senior Deputy Governor Weerasinghe, other public officials, representatives of the Parliamentary Opposition, the business community, civil society, and international partners. The team included Manuela Goretti (head), Pablo Morra, Andrew Hodge (all APD), Saji Thomas (FAD), Vassili Prokopenko (MCM), Fei Liu (SPR), Tubagus Feridhanusetyawan (resident representative), and Amitha Sundararaj (local economist).
Mr. Siriwardana (OED) participated in the discussions.
Guli Gamwalla-Khadivi and Biying Zhu also contributed to the preparation of this report.

CONTENTS

TABLES

ANNEXES

APPENDICES

CONTEXT

1. **The Sri Lankan economy is gradually recovering from the severe impact of the Easter Sunday terrorist attacks.** Tourist arrivals are steadily increasing, after a sharp decline in the aftermath of the April 2019 attacks, thanks to the authorities' efforts to normalize the security situation.[1] Nevertheless, the growth slowdown and import contraction have impacted tax revenues and further weakened fiscal performance, which was already being affected by the prolonged impact of the 2018 political crisis, calling for a recalibration of the program targets.

2. **Despite recent shocks, the authorities remain committed to prudent policies and structural reforms to support stability and growth.** They are taking corrective actions to mitigate the fiscal underperformance, while preserving space to support the ongoing recovery and social priorities. The CBSL maintains a data-dependent monetary policy and remains committed to strengthening reserve buffers, despite recent market pressures, while allowing for greater exchange rate flexibility. The authorities are also advancing critical institutional reforms. In particular, the new Central Bank Act will set the legal foundation for the adoption of flexible inflation targeting, while a stronger fiscal rule and debt management framework will be critical to anchor debt consolidation over the medium term.

3. **Looking forward, Sri Lanka has a busy electoral calendar ahead.** Presidential elections are scheduled for November 16, and general elections could take place as early as February and no later than August 2020. The extension of the EFF arrangement until June 2020, as agreed at the time of the fifth review, will provide the authorities with a policy anchor to bridge the electoral period. While the 2020 budget process will be delayed due to the elections, an interim expenditure plan for the first four months of 2020 (Vote on Account) was submitted to Parliament, in line with program understandings. The mission met and had constructive discussions with members of Parliament from both the government and opposition parties.

RECENT MACROECONOMIC DEVELOPMENTS

4. **After a short-lived recovery in 2019Q1, the Easter Sunday attacks have led to a significant economic slowdown:**

- *Real GDP growth* rebounded to 3.7 percent (y-o-y) in 2019Q1, from 1.8 percent in 2018Q4, following the resolution of last year's political crisis. However, the sharp decline in tourism and related services as well as temporary disruptions in the industrial sector in the wake of the attacks slowed growth to 1.6 percent (y-o-y) in 2019Q2. While industrial

[1] A country-wide state of emergency was declared immediately following the April 21 terrorist attacks, which cost the lives of over 250 people, and was lifted in late August (see IMF Country Report 19/135).

production has since recovered, tourist arrivals year-to-date remain 20 percent lower as of end-September compared to the same period of 2018, despite a positive trend (Box 1).

Box 1. The Economic Impact of the Easter Sunday Terrorist Attacks

Tourism is an important sector of the Sri Lankan economy. It has grown fast since 2010, with tourist arrivals reaching 2.3 million people and generating foreign inflows of US$4.4 billion (5 percent of GDP) in 2018. Before the attacks, the authorities projected tourist arrivals to rise by 7 percent to 2.5 million in 2019.

The Easter Sunday attacks led to a sharp decline in tourism and related activities, while the impact on other sectors was temporary. Tourist arrivals declined by 71 percent (y-o-y) in May, but started recovering gradually thereafter, with the decline moderating to 27 percent (y-o-y) as of end-September. The shock to tourism propagated to related sectors, reducing activity in the accommodation, wholesale and retail trade, and transportation sectors. These sectors, which combined account for about 23 percent of GDP, fell by 0.6 percent (y-o-y) in 2019Q2, compared to a growth rate of 3.3 percent (y-o-y) in 2019Q1. The attacks had only a temporary impact on other sectors. Industrial production fell by 0.8 percent (y-o-y) in April, as business activities were disrupted due to the heightened security risks and mobility constraints, but fully recovered in subsequent months.

The authorities took temporary measures to support the tourism sector. The Ministry of Finance reduced VAT rates (from 15 to 7 percent) on tourism until end-March 2020 and lowered custom duties to import security equipment, as security was tightened across the country, including hotels and public spaces. The CBSL launched a program, allowing banks to offer a one-year moratorium on loans held by the tourism sector (¶22). The authorities also launched a tourism promotion campaign, cut airline charges, and eased visa requirements to attract tourists.

Tourism is expected to recover in 2020. The authorities expect monthly tourist arrivals to return to last year's levels by late 2019. Total arrivals would reach about 2 million in 2019, recording a decline of about 14 percent relative to 2018, and are expected to fully recover by 2020.

- After falling to 3.4 percent (y-o-y) in August, headline *inflation* rose to 5 percent in September, driven by weather-related increases in food prices, while core inflation remained stable at 5.6 percent. The 3-month moving-average inflation rate stood at 3.9 percent (y-o-y), within the inner target band.

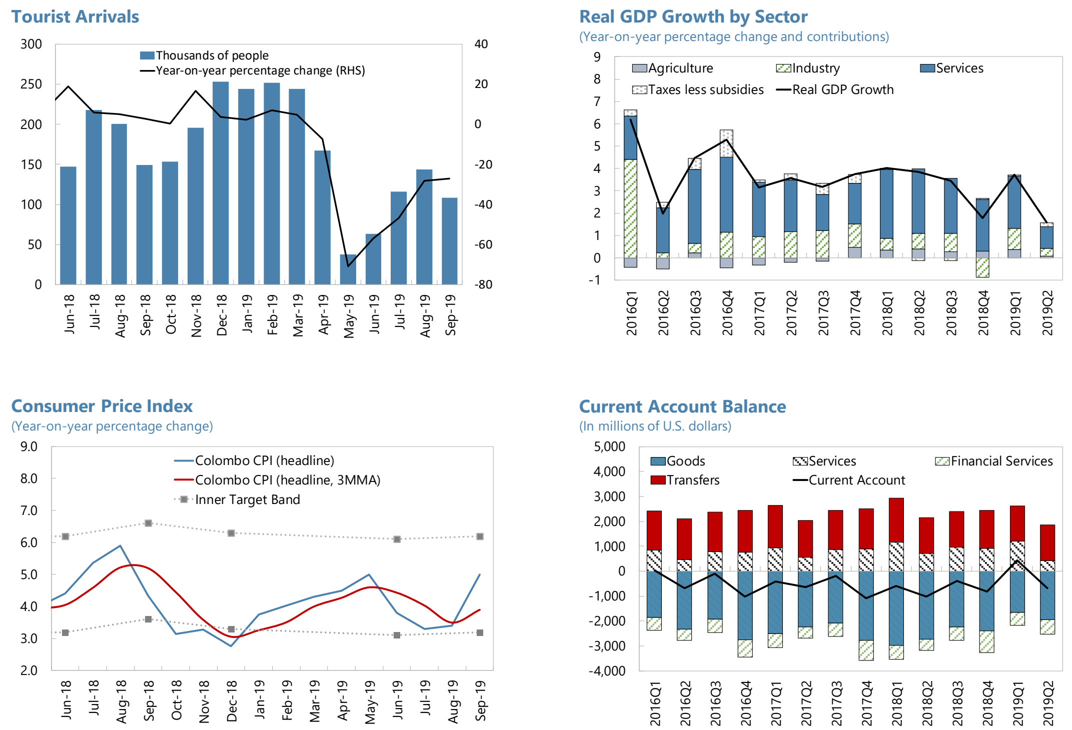
- The *current account balance* recorded a US$448 million surplus in 2019Q1, driven by a decline in imports of nearly 20 percent, notably of vehicles and gold,[2] and strong export growth, supported by the 2018 exchange rate correction. However, the fall in tourist arrivals after the attacks and weak remittance inflows, associated with a decline in emigration, turned the current account balance back into a deficit, of US$581 million in 2019Q2 and US$133 million in 2019H1.

- The *financial market* turmoil after the attacks was short-lived, with net portfolio outflows of nearly US$80 million and limited intervention by the CBSL to contain FX volatility. By

[2] Vehicle imports fell due to administrative measures introduced in late 2018 (see IMF Country Report 19/135, ¶17) to curb the import surge, and gold imports due to an increase in import duties in April 2018.

mid-May, market conditions had stabilized, allowing the CBSL to resume FX purchases and the authorities to return to international bond markets. Pressures resumed in late August, amid global financial volatility, with renewed CBSL intervention to curtail excess volatility amid net portfolio outflows of over US$150 million. The rupee depreciated by over 4 percent since the attacks as of end-September, partly offsetting earlier gains.

Sri Lanka: Economic Activity, Inflation, and External Sector



Sources: CBSL; and Haver Analytics.

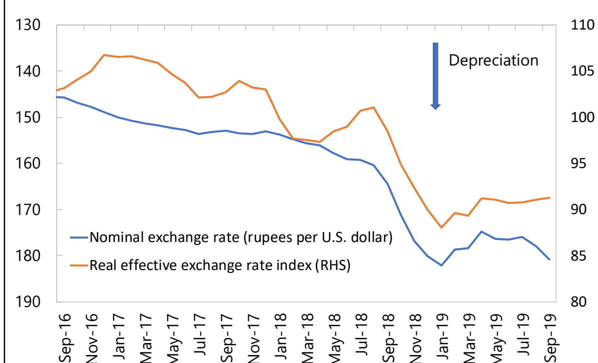
OUTLOOK AND RISKS

5. The economic outlook is expected to gradually strengthen, supported by the recovery in tourism. Due to the contraction in tourism and related activities, real GDP growth is now projected at 2.7 percent in 2019, compared to 3.6 percent at the time of the fifth review. Inflation is projected at 5.4 percent by end-year and to remain in the mid-single digits in the medium term. Despite the fall in tourism and remittances, the current account deficit is expected to improve to 2.6 percent of GDP in 2019 on the back of lower imports and stronger exports supported by the exchange rate correction in late-2018. As tourism recovers, real GDP growth is projected to strengthen to 3.5 percent in 2020, gradually returning to the medium-term trends envisaged at the time of the fifth review.

6. Risks have intensified in the aftermath of the attacks, amid high external and domestic uncertainty. The economy remains vulnerable to adverse shocks given the high public debt and low reserves (Annex II). A tightening in global financial conditions could trigger capital flow pressures, while trade tensions and weaker-than-expected global growth could lower exports, tourism, and growth. On the domestic front, the recovery of the tourism sector could take longer than projected, further weighing on credit quality and bank profitability, while protracted political uncertainty could impact program implementation and affect investor sentiment. The Sri Lankan economy also remains vulnerable to natural disasters. On the upside, lower energy prices would reduce the current account deficit and support the implementation of energy pricing reforms.

7. **Sri Lanka's external position was broadly in line with fundamentals and desirable policy settings in 2018, although it remains vulnerable to shocks.** Following a depreciation of 13 percent in 2018, the real effective exchange rate (REER) appreciated by 1.5 percent as of September 2019. The EBA-based current account gap was estimated at -0.9 percent of GDP, and the REER gap at 5–7 percent for 2018 under EBA and EBA lite (Annex I). Based on year-to-date developments, the external position is expected to remain broadly in line with fundamentals in 2019. External debt is sustainable, but rollover risks remain high over the medium term, in the context of relatively low reserve coverage—at 3.3 months of imports and 61 percent of the IMF Assessing Reserve Adequacy (ARA) metric as of end-September—and volatile financial markets. The authorities broadly concurred with the external sector assessment, while noting that the short-term external liability component of the ARA metric may be overstated by FX deposits of commercial banks on account of workers' remittances, which are stable and do not pose risks to reserves. The CBSL will continue to strengthen its market-oriented approach to exchange rate policy.

Sri Lanka: Exchange Rate



Sources: CBSL; and IMF staff estimates.

PROGRAM PERFORMANCE AND POLICY DISCUSSIONS

A. Advancing Fiscal Consolidation

8. **Fiscal performance in 2019 has been significantly affected by the prolonged impact of the 2018 political crisis and the Easter attacks.** The primary balance fell short of the end-June quantitative performance criterion (QPC) by 0.9 percent of GDP and of the end-September indicative target (IT) by 1.3 percent of GDP:

- In 2019Q1, the shortfall was largely driven by a frontloading of expenditure (0.6 percent of GDP), from the clearing of arrears and externally-financed capital projects carried over from 2018, following the resolution of the end-2018 political crisis. Revenues were also slightly lower than expected in 2019Q1, due to weaker-than-projected imports, notably of vehicles, which were still subject to exchange and other restrictions.[3]

- The fiscal underperformance widened in 2019Q2 and 2019Q3, despite a correction in public spending, due to the sharp fall in imports and indirect tax revenues following the attacks. Tax revenues were 0.2 percent of GDP short of the indicative target (IT) in June and 1.0 percent of GDP in September. Nevertheless, income tax receipts remained robust, thanks to the broadening of the tax base from the recent Inland Revenue Act (IRA).

Sri Lanka: Fiscal Performance in 2019 Q1-Q3

	In Rs billion			In percent of GDP		
	5th EFF Review	Act.	Diff.	5th EFF Review	Act.	Diff
Revenue and grants	**1,608**	**1,406**	**-202**	**10.3**	**9.1**	**-1.2**
Q1	451	443	-9	2.9	2.9	0.0
Q2	478	448	-30	3.1	2.9	-0.2
Q3	678	516	-162	4.3	3.3	-1.0
Expenditure	**2,194**	**2,152**	**-42**	**14.0**	**13.9**	**-0.1**
Non-interest	**1,461**	**1,456**	**-5**	**9.3**	**9.4**	**0.1**
Current	**1,015**	**1,020**	**5**	**6.5**	**6.6**	**0.1**
Q1	324	335	11	2.1	2.2	0.1
Q2	347	330	-17	2.2	2.1	-0.1
Q3	344	354	11	2.2	2.3	0.1
Capital	**447**	**437**	**-10**	**2.9**	**2.8**	**0.0**
Q1	84	154	71	0.5	1.0	0.5
Q2	100	141	42	0.6	0.9	0.3
Q3	263	141	-122	1.7	0.9	-0.8
Interest	733	696	-37	4.7	4.5	-0.2
Overall balance	**-587**	**-746**	**-159**	**-3.8**	**-4.8**	**-1.1**
Primary balance	**146**	**-50**	**-197**	**0.9**	**-0.3**	**-1.3**

Sources: Ministry of Finance; and IMF staff estimates.

9. **The authorities are taking remedial measures to mitigate the 2019 fiscal underperformance and preserve the gains made under the program.** The impact of the attacks is projected to reduce overall revenues by approximately 2.3 percent of GDP in 2019 relative to the fifth review.[4] The authorities are offsetting the indirect revenue shortfalls by curtailing non-critical recurrent and capital spending, implementing delayed revenue proposals in the 2019 budget, and introducing new revenue measures. Overall, the

Sri Lanka: Summary of Central Government Operations
(in percent of GDP)

	2018	2019		2020		2020 VOA
		5th EFF review	Proj.	5th EFF review	Proj.	Proj.
Total revenue and grants	13.4	15.1	12.8	16.0	13.9	4.4
Tax revenue	11.9	13.4	11.4	14.3	12.4	4.1
Of which: Direct tax revenue	2.1	2.5	2.6	2.9	2.7	0.9
Of which: Indirect tax revenue	9.7	10.9	8.8	11.4	9.7	3.1
Total expenditure and net lending	18.6	19.6	18.6	19.6	19.2	6.6
Non-interest current expenditure	8.6	9.0	8.7	9.0	8.9	2.9
Capital expenditure and net lending	4.2	4.7	3.9	4.6	4.4	1.5
Interest payments	5.9	6.0	5.9	5.9	6.0	2.1
Overall balance	-5.3	-4.5	-5.7	-3.5	-5.3	-2.1
Primary balance	0.6	1.5	0.2	2.4	0.7	0.0

Sources: Ministry of Finance; and IMF staff estimates.

[3] Exchange restrictions introduced in 2018 were removed by April 2019 (see IMF country report 19/135).

[4] The impact of the VAT rate reduction (from 15 to 7 percent) on tourism to support the recovery is estimated at around 0.1 percent of GDP in 2019.

authorities are committed to mitigate the losses and still achieve a primary surplus of 0.2 percent of GDP in 2019.

10. Fiscal policy will remain geared towards revenue-based consolidation in 2020 to place the still elevated public debt on a downward path. Due to the electoral calendar in late 2019 and 2020H1, cabinet delayed the submission of the 2020 budget to Parliament and submitted a Vote on Account (VOA) in its place to authorize government expenditure for the first four months of 2020 (Box 2). The 2020 budget is expected to be approved and submitted to Parliament after the elections (end-November 2019 Structural Benchmark, SB, proposed to be reset to end-April 2020). The authorities will target a primary surplus for 2020 of 0.7 percent of GDP, to be achieved mostly through new revenue measures (0.6 percent of GDP). Revenue mobilization through greater reliance on broad-based indirect taxation and reductions in tax expenditures, while gradually phasing out para-tariffs, will preserve space for critical social spending and public investment.

Box 2. The Vote on Account in Sri Lanka's Budget Process

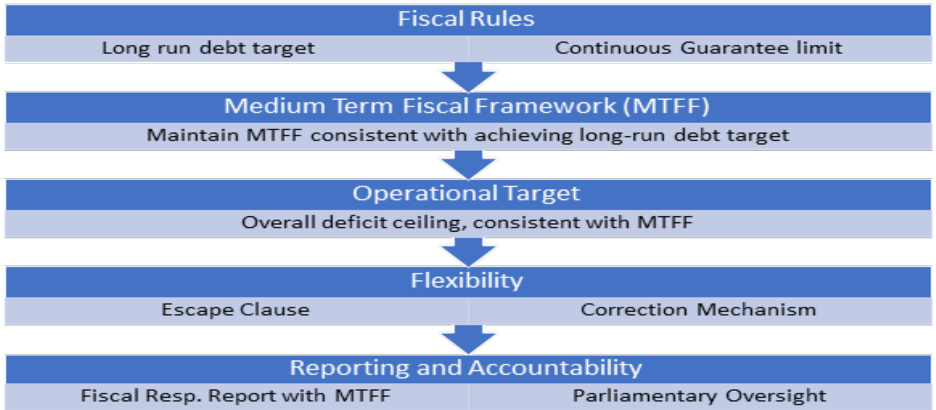
In Sri Lanka, the Budget (Appropriation Bill) for the next calendar year is usually approved by the Parliament in October or November. However, if a general election is called at this time of the year, or if a new government has recently been appointed and has not had time to prepare the budget, the Parliament may pass a Vote on Account (VoA), instead of a budget. A VoA authorizes expenditure for essential government services and continues funding of existing capital projects until a budget can be prepared. New capital projects do not receive funding and Parliament does not approve any new revenue measures.

A VoA was recently used to authorize spending for the first four months of 2019, with the 2019 budget approved by Parliament only in April. This occurred because budget preparations were disrupted by the political crisis in late 2018. In August 2019, cabinet approved use of a VoA for the first four months of 2020, deferring the preparation of the 2020 budget to the new government after the elections. Under the Constitution, the President could authorize spending for an additional three months, if the new government needs more time for budget preparation.

Source: Parliament of Sri Lanka.

11. Stronger fiscal rules will be pivotal to anchor debt sustainability over the medium-term. Public debt is projected to remain broadly unchanged at 90 percent of GDP in 2019, amid a weak macro and fiscal outlook (Annex II). The authorities plan to revamp their fiscal responsibility framework to anchor debt reduction efforts. The reform, which was prepared with IMF TA and endorsed by cabinet in July (end-May SB), envisages a long-run debt anchor for central government debt of 50 percent of GDP, to be achieved through annual operational targets on the fiscal deficit and supported by an automatic correction mechanism and well-defined escape clauses (Annex III). Cabinet approved the draft legislation to implement the new fiscal responsibility framework, prepared with IMF TA, in October (end-September SB).

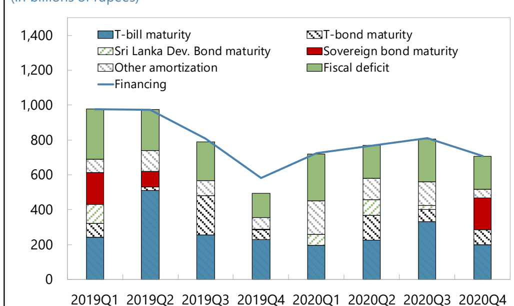
A New Fiscal Responsibility Framework for Sri Lanka



Sources: IMF staff.

12. The authorities have pre-financed their borrowing needs throughout the election period, while advancing reforms to debt management. The authorities began implementing their new Medium-Term Debt Strategy, managing FX exposures and supporting maturity transformation (Annex II). External repayments for 2019 were fully financed with international bond issuances in March (US$2.4 billion) and June (US$2 billion) and the authorities have started to pre-finance the 2020 borrowing needs under the Active Liability Management Act. The next international bond redemption (US$1 billion) is not due until October 2020. A multi-year plan to establish an independent debt management agency, with IMF TA, was also approved by cabinet in October (end-September SB).

Sri Lanka: Fiscal Financing Needs, 2019-20
(In billions of rupees)



Sources: Ministry of Finance; and IMF staff estimates.

13. Structural fiscal reforms to support domestic revenue mobilization and management of public investment projects are continuing:

- ***Revenue Administration.*** The authorities are advancing critical reforms to support revenue yields from the IRA and other tax policy reforms that broadened the income tax and the VAT base. A reform plan to modernize the Inland Revenue Department and Customs administration, supported by IMF TA, is being prepared. Key elements of the plan to be implemented by end-December 2020 include more strategic and risk-based tax administration, modernized human resources practices, and improved communication with taxpayers.

- ***Public Financial Management (PFM) and Public Investment Management (PIM).*** The authorities are working, with World Bank (WB) support, on a PFM Act to improve the regulatory framework and lower risks from public-private partnerships (PPPs). New PPP guidelines are also being finalized to strengthen project selection and appraisal, especially for large-scale projects, while the new fiscal unit dedicated to assessing related fiscal risks is being operationalized. The authorities are working to enhance fiscal transparency by compiling fiscal statistics in accordance with GFSM2014, with IMF TA.

B. Strengthening SOE Governance and Reducing Fiscal Risks

14. Despite recent improvements, fiscal risks from SOEs remain elevated. After a combined loss of 1.1 percent of GDP in 2018, Ceylon Petroleum Corporation (CPC) and SriLankan Airlines (SLA) realized a profit of 0.35 percent of GDP in 2019Q1, as higher retail fuel prices and a stronger rupee relieved financial pressure on CPC, while SLA reduced operating costs. However, performance deteriorated in 2019Q2, as the Easter attacks depressed SLA's sales and CPC's import and debt service costs rose. Ceylon Electricity Board (CEB) continued to record losses throughout 2019H1 (-0.5 percent of GDP), due to hydro-power shortages, high generation costs, and lack of adjustments in retail prices. The end-June and end-September ITs on Non-Commercial Obligations of CPC and CEB were both missed. Compliance reports, as of end-June 2018, for the five largest SOEs with Statements of Corporate Intent (SCIs) showed progress on operational efficiency but still limited success in meeting financial targets. Eight additional SOEs signed SCIs in June.

Sri Lanka: Financial Performance of Major SOEs
(in percent of GDP)

	Ceylon Electricity Board (CEB)			Ceylon Petroleum Corp. (CPC)			SriLankan Airlines (SLA)		
	2018	2019Q1	2019Q2	2018	2019Q1	2019Q2	2018	2019Q1	2019Q2
Revenue	1.7	0.8	0.9	4.2	2.3	2.3	1.2	0.7	0.6
Expenditure	1.9	1.0	1.2	4.9	1.9	2.5	1.6	0.6	0.7
Balance	-0.2	-0.2	-0.3	-0.7	0.3	-0.2	-0.4	0.04	-0.1

Sources: Sri Lankan authorities; and IMF staff estimates.

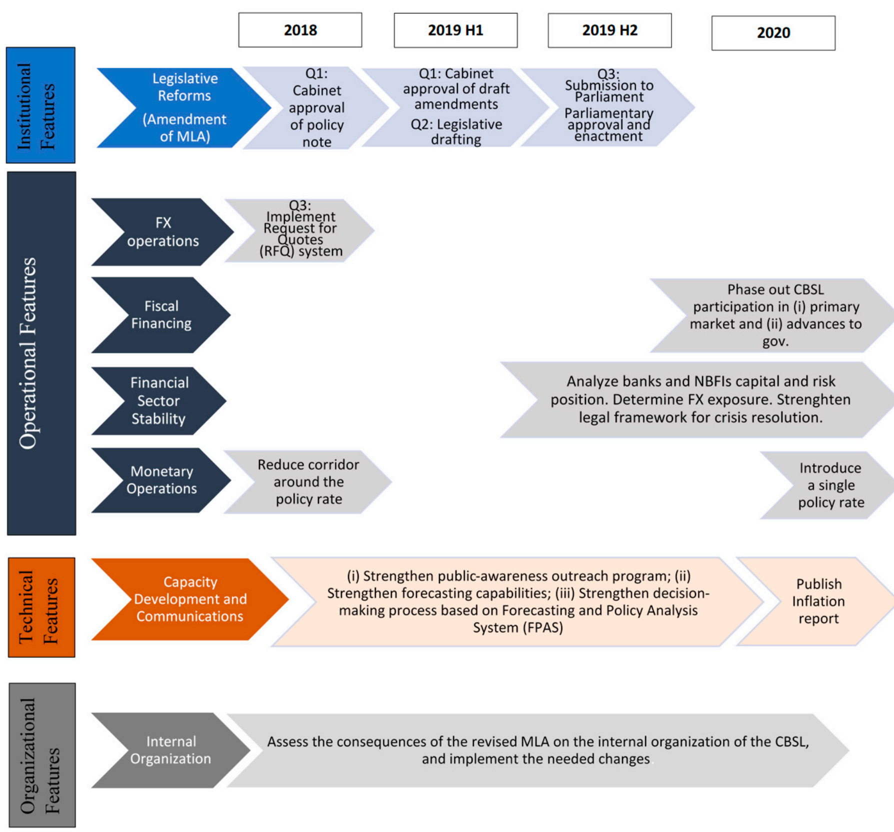
15. The authorities have agreed on a strategy to bring SriLankan Airlines back on a sound commercial footing. The Board of SLA approved a strategic plan and new operating business model in August, to reduce costs and minimize future losses (end-September 2019 SB). Cabinet endorsed key measures to support the plan in October, including options to recapitalize the company, bringing in a strategic partner with a Sri Lankan majority, and restructure some of the airline's financial liabilities. As a next step, the authorities will launch a request for qualifications from investors to commence the PPP process.

16. Stepped-up reform efforts are critical to tackle the inefficient and loss-making electricity sector and reduce fiscal risks. Following the reinstatement of the fuel price adjustment formula in December 2018, retail gasoline and diesel prices were gradually brought back to cost recovery levels by June 2019, in line with program understandings. The authorities are restarting complementary reforms in the electricity sector, after significant delays. A new technical committee will be tasked to develop a plan to phase in an automatic electricity pricing mechanism, while appropriately calibrating cross-subsidization across sectors to minimize the distributional impact of the reforms on the lower segments of the population. The mission also urged the authorities to address outstanding power generation and governance issues in the sector, in line with earlier WB advice, to avoid passing through inefficiency costs to retail consumers, starting with a special external audit of CEB's heat rates and dispatch methodology, in line with the recommendations of the Public Utility Commission. Cabinet approval of a plan to introduce an electricity pricing mechanism based on the recommendations of the technical committee is now expected to be implemented with a delay by end-April 2020 (end-October 2019 SB). These reform efforts should continue to proceed in parallel with further strengthening of social safety nets (¶24).

C. Modernizing the Monetary Policy Framework and Rebuilding Reserves

17. The new Central Bank Act will mark a milestone reform in the roadmap towards flexible inflation targeting (FIT). The new Act will set the legal and institutional foundations for the implementation of FIT. Among its key elements, the reform: (i) clarifies the mandate of the CBSL, establishing price stability as its primary objective, with financial stability as a core

Sri Lanka: Core Measures in the Transition to Flexible Inflation Targeting



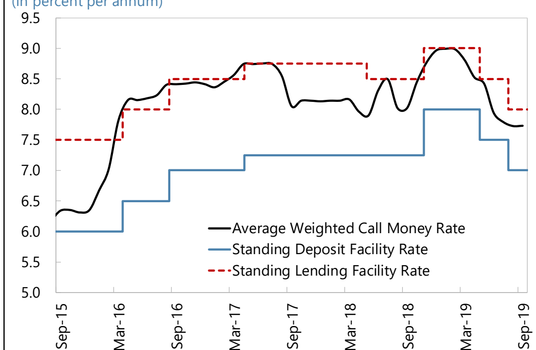
Source: IMF staff.

objective; (ii) adopts a flexible exchange rate regime; (iii) ends monetary financing of the fiscal deficit; (iv) gives the CBSL a clear macroprudential policy mandate; and (v) strengthens its autonomy, governance, and accountability frameworks (Annex IV). While staff had advised the authorities not to have any government representation in the CBSL's new decision-making bodies in line with best practices, upon recommendation by the Parliament's Committee on Public Finance, the Secretary to the Treasury was maintained in the new Governing Board as a voting member. The authorities are currently finalizing the legal draft, in coordination with the office of the Attorney General, with final cabinet approval and submission to Parliament expected in the coming weeks, with a delay (end-July SB). The CBSL also plans to further strengthen economic modeling and policy analysis and to enhance communication, with IMF TA, including through the publication of an inflation report in 2020.

18. The CBSL should maintain a prudent, data-dependent monetary policy. The CBSL reduced the policy rate corridor by 100 basis points to 7–8 percent since May, amid weak domestic demand, tight credit conditions, and subdued inflation. In the last monetary policy review held on October 10, the CBSL maintained policy rates unchanged. With economic activity expected to gradually recover and inflation expectations well-anchored within the target range, the current wait-and-see policy stance appears broadly appropriate. Staff and the authorities agreed that monetary policy should remain prudent and data-driven going forward, with the CBSL standing ready to adjust policy rates as warranted by evolving macroeconomic conditions, taking also into consideration the impact of global external conditions.

Sri Lanka: Policy Interest Rates

(In percent per annum)

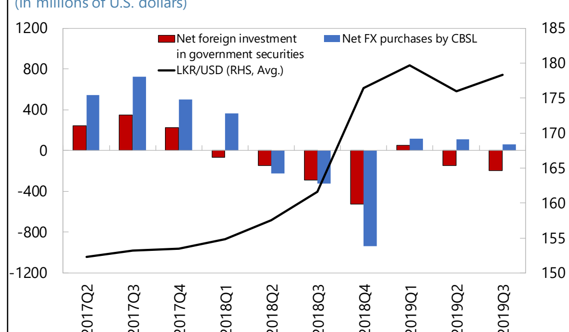


Source: CBSL.

19. The CBSL remains committed to rebuilding reserves, supported by greater exchange rate flexibility. Reserve accumulation by end-June 2019 was in line with the program target, with net FX purchases of US$212 million. Preliminary data indicate that the end-September indicative NIR target was also met by a small margin, amid renewed market pressures and CBSL intervention to curb excess volatility. The CBSL remains committed to allow for exchange rate flexibility in response to external pressures and resume FX purchases as soon as market conditions stabilize to meet the end-December NIR target. Gross international reserves are expected to reach US$8.2 billion by year-end, equivalent to 3.6 months of imports or 65

Sri Lanka: CBSL Foreign Exchange Intervention

(In millions of U.S. dollars)



Sources: CBSL.

percent of the Fund's reserve adequacy metric, up from US$6.9 billion as of end-2018. Staff welcomed the recent decision by cabinet to increase the period to repatriate export proceeds from 120 to 180 days and reiterated the advice to phase out the requirement based on progress with macroeconomic adjustments envisaged under the program, including reserve accumulation as well as to loosen back the limit on foreign investment in rupee-denominated government securities (Annex I).

D. Safeguarding Financial Sector Stability

20. Deteriorating credit quality and tighter regulation are weighing on profitability, particularly among non-bank financial institutions (NBFIs). The capital and liquidity ratios of both banks and NBFIs increased in 2019H1, with the introduction of higher requirements.[5] However, vulnerabilities are growing. Slower economic growth has markedly raised non-performing loan (NPL) ratios, which coupled with the phased introduction of stricter accounting standards (IFRS 9) over a four-year period, are lowering profitability. Risks are greater for NBFIs, which cater to higher-risk borrowers and have lower capital buffers. The license of one small NBFI with longstanding financial difficulties was canceled in September.

Sri Lanka: Selected Financial Soundness Indicators
(in percent)

	Banks				NBFIs			
	CAR	Gross NPLs	ROA	Liquid Assets/ Total Assets	CAR	Gross NPLs	ROA	Liquid Assets/ Total Assets
2016Q4	15.6	2.6	1.4	27.3	11.7	5.3	3.6	7.1
2017Q4	15.2	2.5	1.4	28.8	13.1	5.9	3.0	8.9
2018Q4	15.1	3.4	1.1	25.7	11.1	7.7	2.7	7.5
2019Q2	16.5	4.8	0.9	29.0	12.0	9.1	1.5	8.4

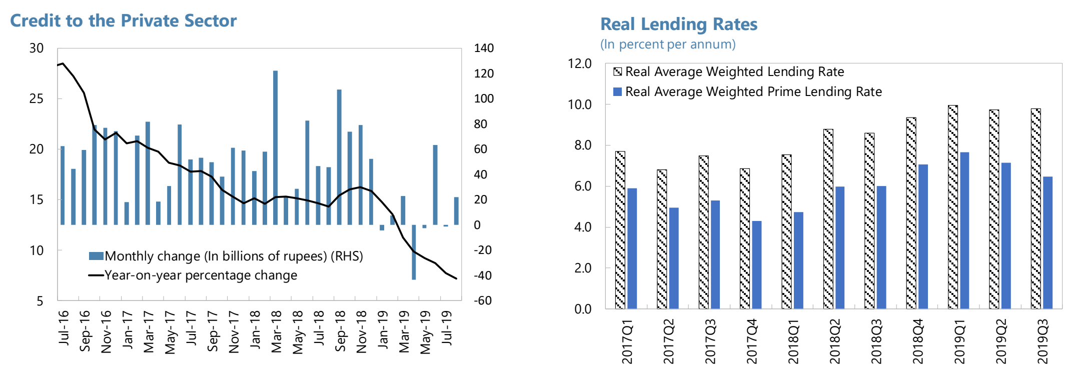
Source: CBSL.

21. Credit growth decelerated sharply in 2019, amid weaker demand and tighter lending standards. Credit growth to the private sector slowed to 7.2 percent (y-o-y) as of August 2019, from 15 percent on average in 2018, decelerating across all sectors, except personal loans. Credit slowed due to a combination of weaker credit demand and more cautious lending behavior by banks, amid tighter financial conditions and slower economic growth following the 2018 political crisis and the Easter attacks. Political uncertainty is also reportedly contributing to the credit slowdown ahead of the elections. Credit conditions are expected to gradually improve over the medium term as the economic recovery takes hold and the domestic uncertainty dissipates.

[5] Since January 2019, banks are subject to higher capital and liquidity requirements, in line with Basel III standards. The minimum capital requirement for NBFIs was raised from Rs 1 billion to Rs 1.5 billion and is scheduled to increase further to Rs 2.5 billion by 2021.

22. The CBSL adopted temporary measures to support the tourism sector and ease credit conditions. In May 2019, in the aftermath of the attacks, the CBSL launched a moratorium on performing loan payments, due through March 2020, by the tourism industry, which account for about 3½ percent of total credit to the private sector. Rescheduled payments are rolled into a new loan at a concessionary rate, with no change to the credit risk classification. In addition, to facilitate a faster reduction in lending rates and support credit to the private sector, the CBSL introduced caps on deposit rates in April. These were removed and replaced by caps on lending rates in September, which in turn are to be reviewed in March 2020.[6] The mission cautioned the authorities about the distortionary impact of these measures on the functioning of the financial system, as well as the potential unintended negative effects of interest rate caps on private credit and financial inclusion, and welcomed the authorities' intention to phase out and/or review the measures by March 2020.

Sri Lanka: Credit Market Developments



Sources: CBSL; and IMF staff estimates.

23. The authorities are making efforts to improve the financial sector policy framework. The authorities are preparing, with WB support, a new Banking Act, which is expected to be finalized by December 2019. The new Banking Act will strengthen bank regulation and supervision and upgrade the resolution framework for banks and NBFIs, including the deposit insurance framework. Despite some convergence in the regulatory framework, there remain many areas where prudential requirements applied to banks differ from those applied to deposit-taking NBFIs. For example, these include the minimum capital requirement, various liquidity requirements, large exposure limits, and risk management. In addition, the supervisory approach for banks is more risk-oriented, while NBFIs are subject to compliance-based methods. The CBSL continues harmonizing these requirements for banks and NBFIs, with a new Direction on provisioning for bad and doubtful debts being finalized and one on corporate governance expected to be issued by March 2020. In line with the recommendations of the recent Financial System Stability Review, the authorities plan to enhance the macroprudential policy framework, with support from an IMF resident advisor.

[6] The CBSL directed banks to reduce lending rates by at least 200 basis points in comparison with those prevailing as of end-April.

The focus will be to improve data collection and analysis, enhance stress testing capabilities and analysis of macroprudential policy instruments, and strengthen internal organization.

E. Pursuing Structural Reforms Towards Stronger and Inclusive Growth

24. Strengthening social safety nets and supporting female employment are key reforms to promote inclusive growth. Together with a new electronic social registry, the new eligibility criteria for welfare benefits, prepared with WB support and submitted for ratification to Parliament last September, will help better target and support the expansion of social programs and protect the most vulnerable from recent shocks and the distributional impact of ongoing reforms. The authorities are also making progress in the implementation of gender-responsive budgeting, appointing gender focal points in all government agencies and collecting key performance indicators. To promote female labor force participation, the authorities have prepared a National Policy on Day Care Centers and commenced training of early childcare development officers, with WB support.

25. Efforts to liberalize trade and improve the investment climate remain critical to spur growth over the medium term. Despite recent reductions, Sri Lanka still has a significant number of para-tariffs, which discourage trade and investment. In October, cabinet approved ahead of schedule (**end-March 2020 SB**) a 5-year plan to rationalize remaining para-tariffs, with IMF TA. To compensate for revenue losses, the plan envisages replacing suspended-VAT with an automated VAT refund system, broadening the excise tax base, auctioning government licenses, and removing duty exemptions for SOE projects. The authorities have also recently approved a National Innovation and Entrepreneurship Strategy, to support research and development by SMEs. They continue implementing the National Export Strategy, including with the simplification of border clearance procedures to facilitate trade. The Trade Information Portal, set up with WB support, already has information from more than 40 different regulatory agencies, while virtual platforms are helping streamline and fast-track investment approval processes.

26. These plans need to be supported by stepped-up governance and anti-corruption efforts, building on the important progress achieved on AML/CFT. Recognizing the progress made in strengthening the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework, in October, the Financial Action Task Force (FATF) removed Sri Lanka from the Improving Global AML/CFT Compliance list, after an on-site visit in September verified implementation of the FATF action plan. The authorities have started implementing the National Action Plan for Combating Bribery and Corruption. In addition, work is ongoing on consolidating all laws related to bribery and corruption and establishing a Directorate of Assets Declaration within the Commission to Investigate the Allegation of Bribery or Corruption (CIABOC) to verify declarations through electronic systems, with further plans to widen the definition of bribery, broaden the scope of the Declaration of Assets and Liabilities Act and expand the powers of CIABOC. With the strengthening of anti-corruption courts, the number of convictions has increased from around 20 per year during 2009-16 to nearly 60 per year during 2017-18. Ongoing efforts to support sound and transparent fiscal governance (¶13, ¶16), especially in SOEs, are also critical to prevent corruption.

PROGRAM MODALITIES

27. Program conditionality is proposed to be recalibrated. The attached Letter of Intent (LoI) and Memorandum of Economic and Financial Policies (MEFP) describe the authorities' progress and commitments on their economic reform agenda (Appendix I).

- **Quantitative targets.** Based on the corrective actions, the authorities requested a waiver of nonobservance of the end-June QPC on the primary balance, which was missed due to the exceptional circumstances described in this report. The QPC and/or ITs for end-December and end-March have been recalibrated as warranted to reflect recent developments (MEFP, Table 1).
- **Structural benchmarks.** The submission to Parliament of the 2020 budget (¶10) is proposed to be reset to end-April 2020 (MEFP, Table 2).

28. Capacity to repay the Fund is adequate and the program is fully financed, but risks remain elevated. The Fund's exposure is relatively low, with outstanding Fund credit peaking at 6.7 percent of exports in 2020 (Table 9). The program remains fully financed for the remainder of the program period, thanks to the authorities' corrective actions to mitigate the fiscal impact of the Easter Sunday attacks, existing cash buffers, and ongoing efforts to pre-finance the first half of 2020, together with expectations of continued access to capital markets, as evidenced by recent bond issuances. Nevertheless, risks to the outlook have risen in the aftermath of the terrorist attacks, in the context of high public debt, and further macroeconomic adjustment and/or additional financing could be required if these were to materialize, including due to (i) renewed market and FX pressures; (ii) lower growth; or (iii) implementation delays in fiscal or SOE reforms. The authorities remain committed to the program, as evidenced by the ongoing remedial actions and progress with the structural agenda, despite recent setbacks. The mission's constructive discussions with members of Parliament from both the government and opposition parties provide additional assurances ahead of the elections.

STAFF APPRAISAL

29. Growth is projected to strengthen to 3.5 percent in 2020, as tourist arrivals and related activities gradually recover from recent shocks. The Easter Sunday terrorist attacks led to a significant economic slowdown and import contraction, which has in turn impacted tax revenues and fiscal performance. The economy is gradually recovering, supported by the authorities' security and policy efforts to mitigate the impact of the attacks.

Nevertheless, important downside risks remain, amid heightened external and domestic uncertainty.

30. The authorities remain committed to complete the EFF-supported program, despite recent setbacks. Efforts are ongoing to mitigate the fiscal underperformance, targeting a primary surplus of at least 0.2 percent of GDP in 2019, to preserve the hard-won gains under the program. The authorities' commitment is also evidenced by the important progress made on five structural benchmarks, albeit with some delays. Sustained policy discipline and efforts to rebuild reserve buffers are critical going forward to address Sri Lanka's still high vulnerabilities and strengthen the economy's resilience to shocks, while supporting investment and growth.

31. Revenue-based fiscal consolidation should advance in 2020 to place public debt on a downward path, while providing space for critical social and investment spending. Sustained efforts are needed to mobilize revenues, broadening the tax base and improving compliance, while increasing spending efficiency. The authorities' plans to revamp fiscal rules and establish an independent public debt management agency will contribute to anchoring public debt sustainability. Advancing energy sector reforms, by tackling cost inefficiencies and subsidies in the electricity sector, is critical to reduce fiscal risks from SOEs.

32. The CBSL should maintain a data-dependent monetary policy, while continuing to rebuild reserve buffers supported by a flexible exchange rate. The CBSL should stand ready to adjust policy rates as warranted by evolving macroeconomic conditions. Renewed efforts to rebuild reserves remain critical to protect the economy against shocks. In the event of market pressures, the CBSL should allow for exchange rate flexibility, limiting FX intervention to smoothing excess volatility.

33. The approval of the new Central Bank Act will be a landmark reform in the roadmap towards flexible inflation targeting. It will strengthen the CBSL's mandate, governance, accountability, and transparency frameworks, while establishing a sound legal and institutional infrastructure for the implementation of flexible inflation targeting.

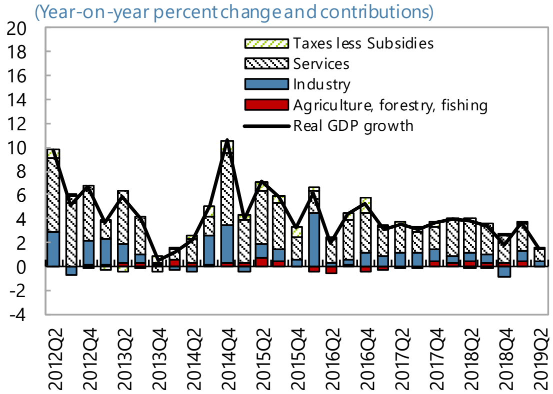
34. Efforts to strengthen the financial stability framework should continue. The CBSL should move ahead with plans to harmonize supervision and regulation of financial institutions, enhance the macroprudential policy framework and stress testing capabilities, and upgrade the contingency framework, in line with international best practices. Recent temporary measures on regulatory forbearance and lending rates to support the tourism sector and ease credit conditions should be promptly removed as conditions stabilize, to avoid unintended distortions to the operation of the financial system.

35. Further progress in the structural reform agenda is key to bolster competitiveness and achieve stronger and inclusive growth. The authorities' plan to remove the still large number of para-tariffs, while addressing their revenue impact, would be a critical step to advance trade liberalization and attract investment. These efforts should proceed in parallel with the authorities' governance and anti-corruption agenda, with a special focus on SOEs, building on the progress already achieved in strengthening the AML/CFT regime. Other priorities to support strong and inclusive growth include promoting women's economic empowerment and enhancing social protection.

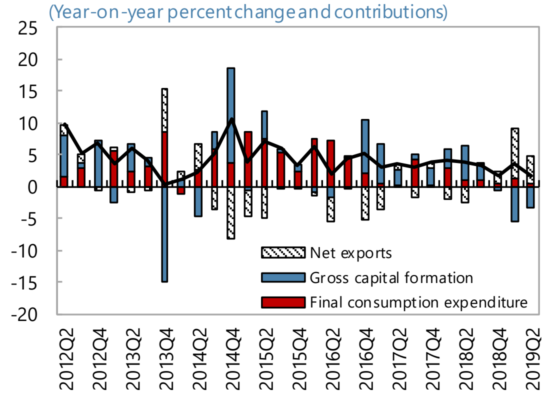
36. Staff supports the completion of the sixth review, considering the progress so far and the authorities' continued commitment to strong policies and reforms. Staff also supports the authorities' request for a waiver of nonobservance of a performance criterion and modification of program conditionality.

Figure 1. Sri Lanka: Real Sector

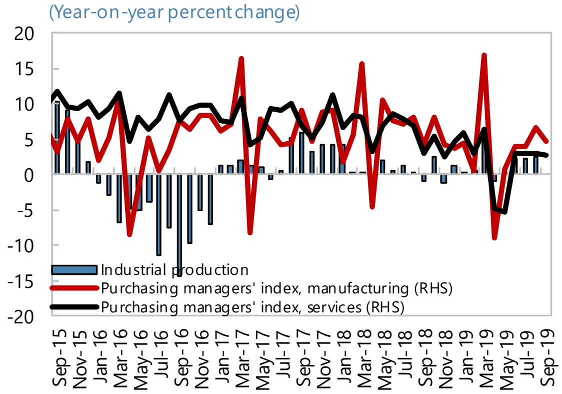
Real GDP Growth by Sector
(Year-on-year percent change and contributions)



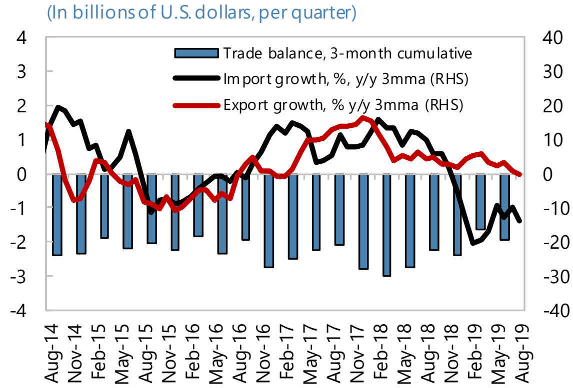
Real GDP Growth by Type of Expenditure
(Year-on-year percent change and contributions)



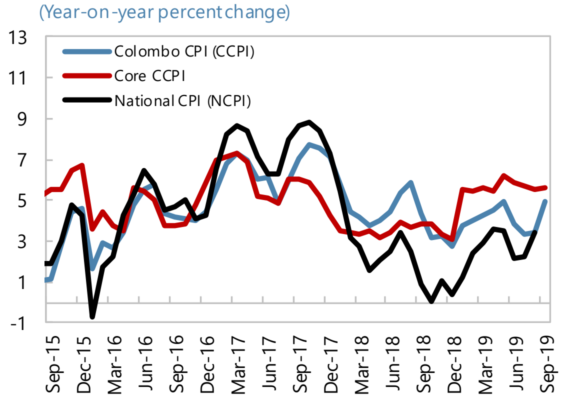
Economic Activity
(Year-on-year percent change)



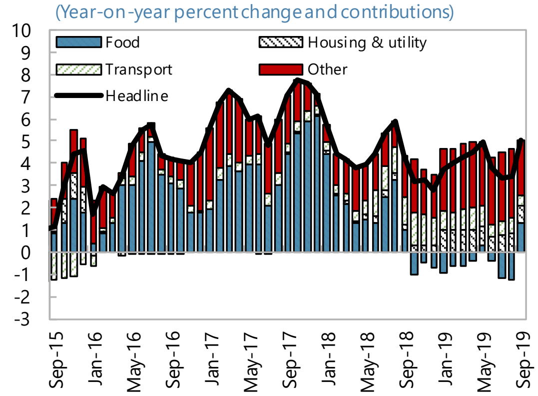
Trade
(In billions of U.S. dollars, per quarter)



Consumer Price Index
(Year-on-year percent change)

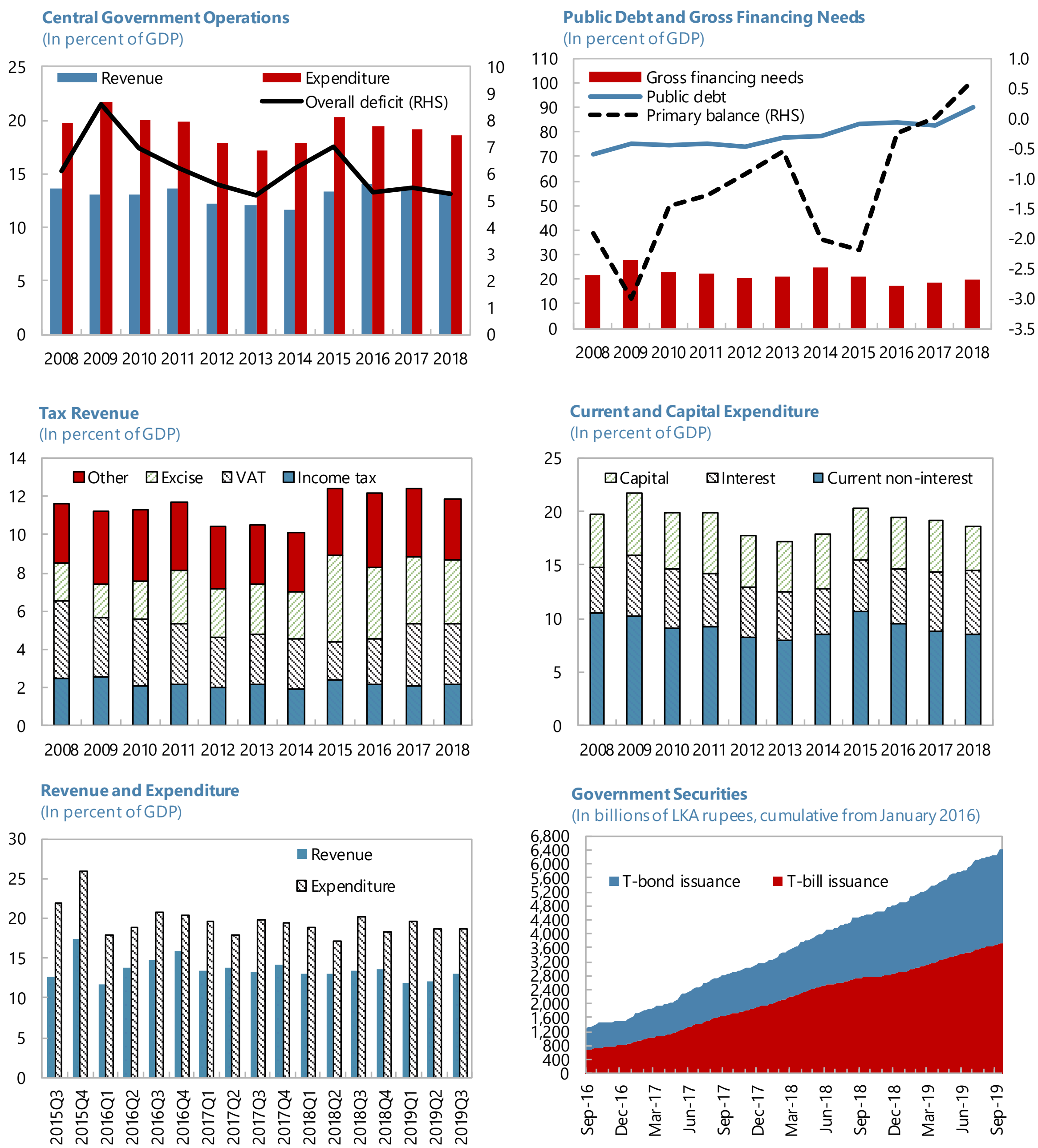


Colombo Consumer Price Index
(Year-on-year percent change and contributions)



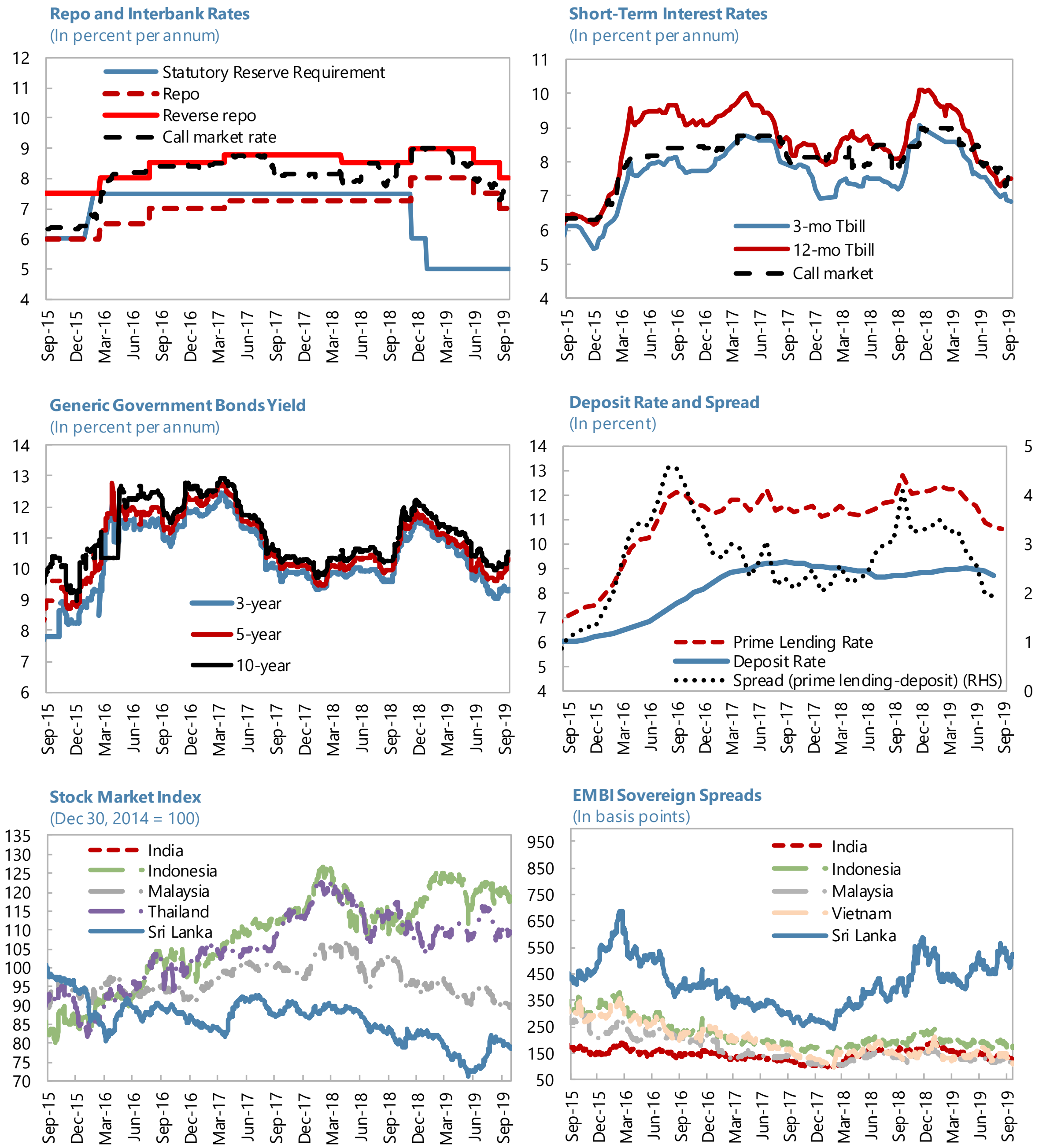
Sources: CBSL; and IMF staff estimates.

Figure 2. Sri Lanka: Fiscal Sector



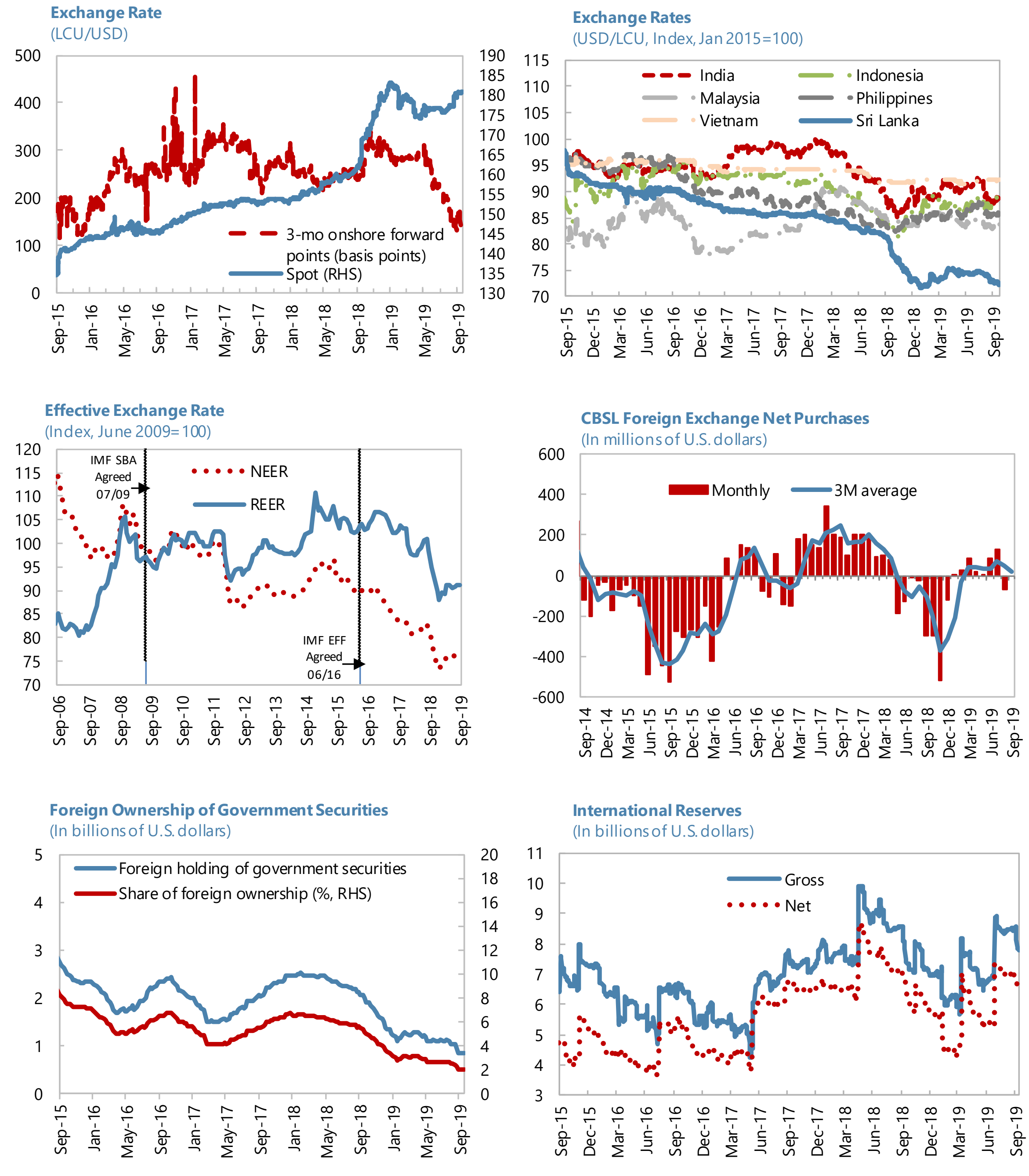
Sources: CBSL; Ministry of Finance; and IMF staff estimates.

Figure 3. Sri Lanka: Financial Market



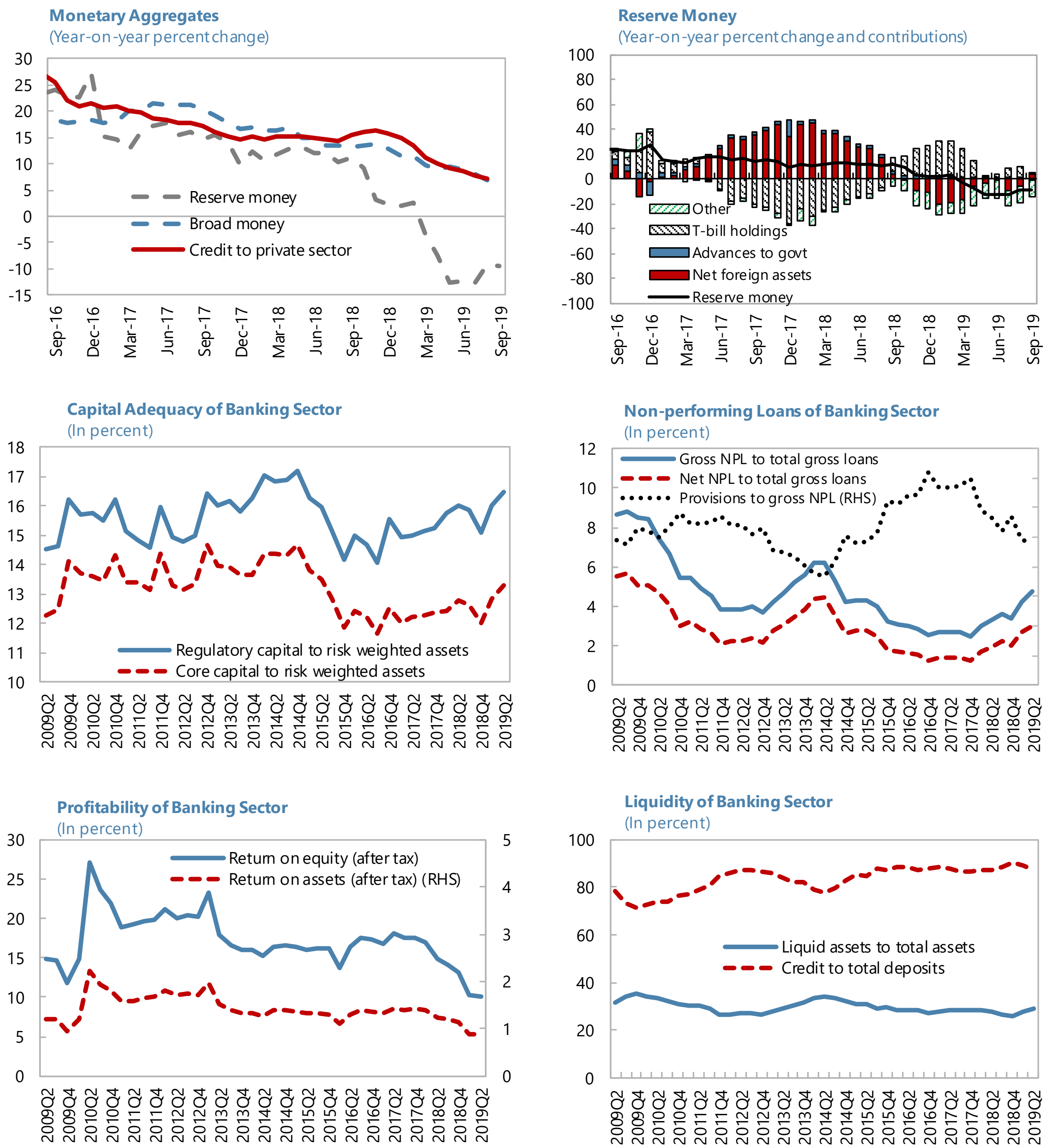
Sources: CBSL; CEIC Daily Database; Bloomberg Data LP; and IMF staff estimates.

Figure 4. Sri Lanka: Foreign Exchange and Reserves



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

Figure 5. Sri Lanka: 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/19/135	Proj.	CR/19/135	Proj.		Proj.		
GDP and inflation (in percent)											
Real GDP growth	4.5	3.4	3.2	3.6	2.7	4.0	3.5	4.3	4.5	4.6	4.8
Inflation (average) 1/	4.0	6.6	4.3	4.5	4.4	4.7	4.8	5.0	5.0	5.0	5.0
Inflation (end-of-period) 1/	4.5	7.1	2.8	4.5	5.4	4.8	4.8	5.0	5.0	5.0	5.0
Core inflation (end-of-period)	5.8	4.3	3.1	5.5	5.5	5.0	5.0	4.8	4.7	4.7	4.7
Savings and investment (in percent of GDP)											
National savings	25.7	26.2	25.4	26.4	25.6	26.9	25.8	26.5	26.9	27.4	27.8
Government	-0.5	-0.7	-1.1	0.1	-1.8	1.1	-1.0	0.0	0.7	1.0	1.0
Private	26.3	26.9	26.5	26.3	27.4	25.8	26.8	26.5	26.2	26.5	26.8
National Investment	27.9	28.8	28.6	29.2	28.3	29.5	28.6	29.1	29.3	29.6	30.0
Government	5.6	6.1	5.5	5.9	5.1	5.9	5.5	5.4	5.5	5.6	5.6
Private	22.2	22.7	23.1	23.2	23.1	23.6	23.1	23.6	23.8	24.1	24.4
Savings-Investment balance	-2.1	-2.6	-3.2	-2.8	-2.6	-2.6	-2.8	-2.6	-2.3	-2.2	-2.1
Government	-6.2	-6.8	-6.6	-5.8	-6.9	-4.8	-6.5	-5.4	-4.7	-4.6	-4.5
Private	4.0	4.2	3.4	3.0	4.3	2.2	3.6	2.8	2.4	2.4	2.4
Public finances (in percent of GDP)											
Revenue and grants	14.1	13.7	13.4	15.1	12.8	16.0	13.9	14.8	15.4	15.5	15.6
Expenditure	19.5	19.2	18.6	19.6	18.6	19.6	19.2	19.1	19.1	19.2	19.3
Primary balance	-0.2	0.0	0.6	1.5	0.2	2.4	0.7	1.5	2.0	2.0	2.0
Central government balance	-5.3	-5.5	-5.3	-4.5	-5.7	-3.5	-5.3	-4.4	-3.8	-3.7	-3.7
Central government net domestic financing	2.1	2.2	3.0	0.8	3.4	2.0	3.7	3.8	2.6	2.3	2.6
Central government gross financing needs	17.4	18.3	19.6	18.0	20.9	15.4	17.9	18.5	18.7	15.4	14.8
Central government debt 2/	79.0	77.4	83.3	82.2	83.2	79.9	82.4	80.7	78.2	75.8	73.3
Public debt 3/	84.1	82.7	90.0	88.9	89.9	86.8	89.2	87.3	84.6	82.0	79.2
Money and credit (percent change, end of period)											
Reserve money	27.1	9.8	2.3	11.3	-0.8	11.5	9.9	11.0	11.3	11.5	11.8
Broad money	18.4	16.7	13.0	12.8	7.0	12.5	10.6	11.7	12.0	12.2	12.5
Domestic credit	16.4	12.5	17.7	11.2	7.1	11.0	9.7	9.9	9.6	10.0	10.1
Credit to private sector	21.6	14.7	15.9	12.9	5.7	12.7	10.7	11.4	11.5	12.2	12.2
Credit to central government and public corporations	8.5	8.8	20.9	8.3	9.6	8.1	8.0	7.3	6.4	6.0	6.0
Balance of payments (in millions of U.S. dollars)											
Exports	10,310	11,360	11,890	12,566	12,306	13,251	12,798	13,480	14,219	14,994	15,816
Imports	-19,183	-20,980	-22,233	-23,437	-20,694	-24,681	-22,764	-24,128	-25,482	-26,883	-28,356
Current account balance	-1,743	-2,309	-2,814	-2,380	-2,282	-2,378	-2,595	-2,522	-2,466	-2,471	-2,614
Current account balance (in percent of GDP)	-2.1	-2.6	-3.2	-2.8	-2.6	-2.6	-2.8	-2.6	-2.3	-2.2	-2.1
Export value growth (percent)	-2.2	10.2	4.7	5.7	3.5	5.4	4.0	5.3	5.5	5.5	5.5
Import value growth (percent)	1.3	9.4	6.0	5.4	-6.9	5.3	10.0	6.0	5.6	5.5	5.5
Gross official reserves (end of period)											
In millions of U.S. dollars	6,019	7,959	6,919	8,650	8,168	9,580	9,120	9,707	10,492	11,222	11,678
In months of prospective imports of goods & services	2.8	3.6	3.3	3.5	3.6	3.7	3.8	3.8	3.9	4.0	4.0
In percent of ARA composite metric	54.7	68.7	56.3	68.2	65.3	72.6	69.8	71.3	73.6	76.8	77.9
External debt (public and private)											
In billions of U.S. dollars	46.4	50.6	52.3	56.2	55.3	57.5	57.0	58.6	61.4	63.9	66.7
As a percent of GDP	56.3	57.5	58.8	66.2	63.8	63.4	62.3	59.7	58.1	56.2	54.4
Memorandum items:											
Nominal GDP (in billions of rupees)	11,996	13,418	14,450	15,644	15,496	17,002	16,813	18,405	20,196	22,179	24,416
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/ From 2017 onwards, central government debt includes treasury bonds issued in the past to settle dues for CPC and capitalize SriLankan Airlines.
3/ 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/19/135	Proj.	CR/19/135	Proj.	Proj.			
Total revenue and grants	1,694	1,840	1,932	2,358	1,989	2,723	2,337	2,717	3,108	3,448	3,808
Total revenue	1,686	1,832	1,920	2,344	1,975	2,709	2,325	2,704	3,094	3,432	3,790
Tax revenue	1,464	1,670	1,712	2,094	1,772	2,437	2,093	2,450	2,815	3,126	3,454
Income taxes	259	275	310	391	407	497	458	549	666	759	859
VAT	283	444	462	583	473	704	566	671	791	914	1,055
Excise taxes	455	469	484	566	408	631	522	629	712	766	806
Other trade taxes	212	208	173	261	179	290	202	228	262	292	305
Other	254	275	283	293	304	314	345	373	383	396	429
Nontax revenue	222	161	208	250	204	272	232	254	279	306	337
Grants	7	8	12	14	13	15	12	13	14	16	17
Total expenditure and net lending	2,334	2,573	2,693	3,067	2,875	3,325	3,233	3,518	3,867	4,268	4,712
Current expenditure	1,758	1,928	2,090	2,338	2,268	2,539	2,499	2,715	2,960	3,235	3,560
Civil service wages and salaries	334	348	375	410	403	445	437	478	524	576	634
Other civilian goods and services	86	78	73	78	64	81	82	89	98	108	119
Security expenditure	307	309	317	361	361	392	391	428	470	516	568
Subsidies and transfers	419	458	473	552	527	612	579	633	697	766	843
Interest payments	611	736	852	937	913	1,009	1,010	1,086	1,169	1,269	1,396
Capital expenditure and net lending	576	645	604	729	607	786	734	803	907	1,033	1,152
Overall balance	-640	-733	-761	-709	-886	-602	-896	-801	-758	-820	-904
Financing	640	733	761	709	886	602	896	801	758	820	904
Net external financing	392	439	324	580	354	253	282	107	230	318	275
Net domestic financing	248	294	437	130	532	348	614	694	529	502	629
Memorandum items:											
Central government primary balance	-29	2	91	228	27	407	114	285	411	449	492
Nonfinancial SOE balance 1/	36	-31	-131	…	…	…	…	…	…	…	…
Ceylon Electricity Board	-14	-47	-30	…	…	…	…	…	…	…	…
Ceylon Petroleum Corporation	70	4	-105	…	…	…	…	…	…	…	…
Sri Lankan Airlines	-30	-18	-55	…	…	…	…	…	…	…	…
Other	11	31	59	…	…	…	…	…	…	…	…
Central government debt	9,479	10,383	12,034	12,852	12,893	13,585	13,854	14,844	15,798	16,812	17,888
Domestic currency	5,121	5,349	5,619	6,041	6,246	6,028	6,642	7,763	8,581	9,248	10,026
Foreign currency	4,358	5,034	6,415	6,811	6,646	7,558	7,212	7,081	7,217	7,564	7,863
Publicly guaranteed debt	524	590	750	…	…	…	…	…	…	…	…
Financial obligations of nonfinancial SOEs 2/	1,414	1,583	1,879	…	…	…	…	…	…	…	…
Fund credit outstanding	83	117	226	245	234	279	269	265	243	213	171
Nominal GDP (in billion of rupees)	11,996	13,418	14,450	15,644	15,496	17,002	16,813	18,405	20,196	22,179	24,416

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/19/135	Proj.	CR/19/135	Proj.	Proj.			
Total revenue and grants	14.1	13.7	13.4	15.1	12.8	16.0	13.9	14.8	15.4	15.5	15.6
Total revenue	14.1	13.6	13.3	15.0	12.7	15.9	13.8	14.7	15.3	15.5	15.5
Tax revenue	12.2	12.4	11.9	13.4	11.4	14.3	12.4	13.3	13.9	14.1	14.1
Income taxes	2.2	2.0	2.1	2.5	2.6	2.9	2.7	3.0	3.3	3.4	3.5
VAT	2.4	3.3	3.2	3.7	3.1	4.1	3.4	3.6	3.9	4.1	4.3
Excise taxes	3.8	3.5	3.4	3.6	2.6	3.7	3.1	3.4	3.5	3.5	3.3
Other trade taxes	1.8	1.5	1.2	1.7	1.2	1.7	1.2	1.2	1.3	1.3	1.2
Other	2.1	2.0	2.0	1.9	2.0	1.8	2.1	2.0	1.9	1.8	1.8
Nontax revenue	1.9	1.2	1.4	1.6	1.3	1.6	1.4	1.4	1.4	1.4	1.4
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	18.6	19.6	18.6	19.6	19.2	19.1	19.1	19.2	19.3
Current expenditure	14.7	14.4	14.5	14.9	14.6	14.9	14.9	14.8	14.7	14.6	14.6
Civil service wages and salaries	2.8	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Other civilian goods and services	0.7	0.6	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Security expenditure	2.6	2.3	2.2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Subsidies and transfers	3.5	3.4	3.3	3.5	3.4	3.6	3.4	3.4	3.5	3.5	3.5
Interest payments	5.1	5.5	5.9	6.0	5.9	5.9	6.0	5.9	5.8	5.7	5.7
Capital expenditure and net lending	4.8	4.8	4.2	4.7	3.9	4.6	4.4	4.4	4.5	4.7	4.7
Overall balance	-5.3	-5.5	-5.3	-4.5	-5.7	-3.5	-5.3	-4.4	-3.8	-3.7	-3.7
Financing	5.3	5.5	5.3	4.5	5.7	3.5	5.3	4.4	3.8	3.7	3.7
Net external financing	3.3	3.3	2.2	3.7	2.3	1.5	1.7	0.6	1.1	1.4	1.1
Net domestic financing	2.1	2.2	3.0	0.8	3.4	2.0	3.7	3.8	2.6	2.3	2.6
Memorandum items:											
Central government primary balance	-0.2	0.0	0.6	1.5	0.2	2.4	0.7	1.5	2.0	2.0	2.0
Cyclically adj. primary balance 1/	-0.3	0.1	0.7	1.5	0.2	2.4	0.7	1.6	2.0	2.0	2.0
Nonfinancial SOE balance 2/	0.3	-0.2	-0.9	…	…	…	…	…	…	…	…
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	0.4	…	…	…	…	…	…	…	…
Central government debt	79.0	77.4	83.3	82.2	83.2	79.9	82.4	80.7	78.2	75.8	73.3
Domestic currency	42.7	39.9	38.9	38.6	40.3	35.5	39.5	42.2	42.5	41.7	41.1
Foreign currency	36.3	37.5	44.4	43.5	42.9	44.5	42.9	38.5	35.7	34.1	32.2
Publicly guaranteed debt	4.4	4.4	5.2	…	…	…	…	…	…	…	…
Financial obligations of nonfinancial SOEs 3/	11.8	11.8	13.0	…	…	…	…	…	…	…	…
Fund credit outstanding	0.7	0.9	1.6	1.6	1.5	1.6	1.6	1.4	1.2	1.0	0.7
Nominal GDP (in billion of rupees)	11,996	13,418	14,450	15,644	15,496	17,002	16,813	18,405	20,196	22,179	24,416

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.
1/ In percent of potential GDP.
2/ For 42 nonfinancial SOEs reported in MOF Annual Reports.
3/ 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, 2018–20

(In billions of rupees)

	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4
							Prel.			Proj.		
Total revenue and grants	469	456	497	510	443	448	516	582	556	557	620	604
Total revenue	469	452	496	503	442	447	515	570	555	556	618	595
Tax revenue	425	420	433	434	407	407	483	476	507	504	544	538
Income taxes	72	65	96	78	75	100	171	61	97	101	138	122
VAT	117	113	111	121	119	109	108	136	140	142	142	143
Excise taxes	124	136	112	112	95	99	96	119	130	131	131	131
Other trade taxes	42	41	45	44	43	39	43	54	52	48	49	52
Other	70	65	69	79	75	59	65	106	88	83	85	90
Nontax revenue	44	32	63	69	36	41	33	95	48	52	74	57
Grants	0	5	1	7	0	0	1	12	1	1	2	8
Total expenditure and net lending	675	596	748	674	730	685	737	722	826	746	866	795
Current expenditure	528	468	582	512	576	544	596	552	635	561	676	627
Civil service wages and salaries	92	103	91	89	99	108	111	86	109	109	109	109
Other civilian goods and services	19	15	13	27	22	11	21	10	24	20	18	20
Security expenditure	76	77	78	86	83	76	83	119	90	99	99	104
Subsidies and transfers	121	102	124	126	132	135	140	120	141	142	139	157
Interest payments	221	171	276	185	241	214	241	217	270	192	311	237
Capital expenditure and net lending	148	128	166	162	154	141	141	170	191	185	189	168
Capital expenditure	140	125	184	163	156	138	144	192	206	189	189	172
Net lending	8	3	-19	-1	-2	4	-2	-22	-14	-3	1	-4
Overall balance	-206	-140	-251	-163	-288	-237	-221	-140	-270	-189	-246	-191
Primary balance	15	31	24	22	-47	-24	20	78	0	3	65	46

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 Q1	2019 Q2	2019 Q3	2019 Q4	2019 Annual	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2020 Annual
			Prel.	Proj.				Proj.		
Gross financing needs	**978**	**976**	**788**	**495**	**3,237**	**720**	**770**	**806**	**707**	**3,003**
Debt amortization	690	739	566	355	2,351	450	581	560	516	2,107
T-bill	242	510	256	229	1,237	195	225	330	200	950
T-bond	81	21	225	56	383	0	144	72	83	299
Sri Lanka Development Bond	109	0	0	3	112	64	87	23	0	174
International sovereign bond	180	88	0	0	268	0	0	0	185	185
Other	79	119	85	68	351	191	125	135	47	498
Fiscal deficit	288	237	221	140	886	270	189	246	191	896
Financing	**977**	**974**	**807**	**583**	**3,341**	**725**	**769**	**809**	**709**	**3,011**
Debt disbursement	977	974	807	583	3,341	725	769	809	709	3,011
Commercialization of public assets	0	0	0	0	0	0	0	0	0	0
Balance	**-1**	**-2**	**19**	**88**	**104**	**5**	**-1**	**3**	**2**	**8**

Sources: Ministry of Finance; and 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/19/135	Proj.	Proj.
Central Bank of Sri Lanka						
Net foreign assets	559	846	751	1,024	907	1,105
Net domestic assets	298	94	211	45	47	-57
Net claims on central government	413	225	471	234	371	360
Net claims on banks	-2	3	-11	-11	-11	-11
Other items, net	-113	-134	-250	-178	-313	-406
Reserve Money	856	940	961	1,070	954	1,048
Monetary survey						
Net foreign assets	-231	122	-67	180	101	287
Monetary authorities	559	846	751	1,024	907	1,105
Deposit money banks	-790	-725	-818	-845	-805	-819
Net domestic assets	5,637	6,187	7,195	7,863	7,527	8,151
Net claims on central government	1,972	2,169	2,515	2,558	2,806	3,059
Credit to corporations	4,700	5,336	6,317	7,265	6,656	7,320
Public corporations	514	537	755	985	778	813
Private corporations	4,186	4,799	5,561	6,281	5,878	6,508
Other items (net)	-1,035	-1,318	-1,637	-1,960	-1,935	-2,229
Broad money	5,406	6,308	7,128	8,043	7,628	8,438
Memorandum Items						
Gross international reserves (in millions of U.S. dollars)	6,019	7,959	6,919	8,650	8,168	9,120
Net international reserves (in millions of U.S. dollars)	4,529	6,597	5,495	6,888	6,428	7,433
Net Foreign Assets (in millions of U.S. dollars)	3,725	5,513	4,103	5,410	4,891	5,842
Private credit (in percent of GDP)	34.9	35.8	38.5	40.1	37.9	38.7
Money multiplier	6.3	6.7	7.4	7.5	8.0	8.0
Broad money velocity 1/	2.4	2.3	2.1	1.9	2.0	2.0
Money and credit (percent change, end of period)						
Broad money	18.4	16.7	13.0	12.8	7.0	10.6
Reserve money	27.1	9.8	2.3	11.3	-0.8	9.9
Credit to public corporations	-3.2	4.5	40.7	30.4	3.0	4.5
Credit to private sector	21.6	14.7	15.9	12.9	5.7	10.7

Sources: Central Bank of Sri Lanka; and IMF staff estimates.
1/ Calculated using end-period quarterly GDP, annualized.

Table 4b. Sri Lanka: Monetary Accounts, 2018–20
(In billions of rupees, unless otherwise indicated, end of period)

	2018Q1	2018Q2	2018Q3	2018Q4	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4
							Proj.					
Central Bank of Sri Lanka												
Net foreign assets	859	821	811	751	692	808	852	907	956	1,006	1,056	1,105
Net domestic assets	139	177	199	211	271	67	63	47	21	-15	-41	-57
Net claims on central government	262	307	368	471	503	341	373	371	368	365	363	360
Net claims on banks	-1	-1	-6	-11	3	6	2	-11	-11	-11	-11	-11
Other items, net	-123	-129	-163	-250	-236	-281	-312	-313	-336	-369	-393	-406
Reserve Money	997	999	1,011	961	963	875	915	954	977	991	1,015	1,048
Monetary survey												
Net foreign assets	106	101	8	-67	23	99	-38	101	148	194	240	287
Monetary authorities	859	821	811	751	692	808	852	907	956	1,006	1,056	1,105
Deposit money banks	-753	-720	-804	-818	-669	-709	-890	-805	-809	-812	-815	-819
Net domestic assets	6,500	6,646	6,926	7,195	7,230	7,239	7,538	7,527	7,670	7,733	8,079	8,151
Net claims on central government	2,278	2,273	2,427	2,515	2,613	2,667	2,739	2,806	2,870	2,933	2,996	3,059
Credit to corporations	5,579	5,775	6,012	6,317	6,290	6,335	6,420	6,656	6,772	6,858	7,054	7,320
Public corporations	557	619	656	755	703	730	736	778	786	795	804	813
Private corporations	5,022	5,156	5,356	5,561	5,588	5,605	5,684	5,878	5,986	6,063	6,250	6,508
Other items (net)	-1,357	-1,402	-1,513	-1,637	-1,673	-1,763	-1,621	-1,935	-1,971	-2,058	-1,972	-2,229
Broad money	6,607	6,748	6,933	7,128	7,253	7,338	7,500	7,628	7,818	7,927	8,319	8,438
Memorandum Items:												
Gross international reserves (in millions of U.S. dollars)	7,320	9,267	7,164	6,919	7,629	8,865	7,635	8,168	7,767	9,097	9,919	9,120
Net international reserves (in millions of U.S. dollars)	6,286	7,746	5,948	5,495	6,407	7,322	6,284	6,428	6,230	7,397	8,218	7,433
Money and credit (percent change, end of period)												
Broad money	16.4	14.9	13.1	13.0	9.8	8.7	8.2	7.0	7.8	8.0	10.9	10.6
Reserve money	11.8	12.0	11.2	2.3	-3.4	-12.4	-9.5	-0.8	1.5	13.3	10.9	9.9
Credit to private sector	15.3	14.9	15.4	15.9	11.3	8.7	6.1	5.7	7.1	8.2	10.0	10.7

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/19/135	Proj.	CR/19/135	Proj.		Proj.		
Current account	**-1,743**	**-2,309**	**-2,814**	**-2,380**	**-2,282**	**-2,378**	**-2,595**	**-2,522**	**-2,466**	**-2,471**	**-2,614**
Balance on goods	-8,873	-9,619	-10,343	-10,871	-8,388	-11,431	-9,966	-10,648	-11,262	-11,889	-12,540
Credit (exports)	10,310	11,360	11,890	12,566	12,306	13,251	12,798	13,480	14,219	14,994	15,816
Debit (imports)	-19,183	-20,980	-22,233	-23,437	-20,694	-24,681	-22,764	-24,128	-25,482	-26,883	-28,356
Balance on services	2,879	3,302	3,766	4,013	2,901	4,571	4,294	5,073	5,741	6,364	6,921
Credit (exports)	7,138	7,724	8,375	8,668	7,340	9,240	8,955	9,850	10,638	11,383	12,066
Debit (imports)	-4,259	-4,421	-4,609	-4,655	-4,439	-4,669	-4,661	-4,777	-4,897	-5,019	-5,145
Primary income, net 1/	-2,201	-2,319	-2,399	-2,360	-2,666	-2,367	-2,805	-2,840	-2,847	-2,854	-2,909
Secondary income, net 2/	6,452	6,327	6,163	6,838	5,871	6,848	5,882	5,893	5,902	5,909	5,914
Of which: workers' remittances (net)	6,434	6,316	6,156	6,832	5,856	6,843	5,871	5,883	5,892	5,899	5,903
Capital account (+ surplus / - deficit)	**25**	**11**	**14**	**20**	**21**	**16**	**16**	**12**	**12**	**12**	**12**
Balance from current account and capital account	**-1,718**	**-2,298**	**-2,799**	**-2,360**	**-2,261**	**-2,362**	**-2,579**	**-2,510**	**-2,454**	**-2,459**	**-2,602**
Financial account (+ net lending / - net borrowing) 3/	**-1,648**	**-4,538**	**-1,912**	**-3,536**	**-3,182**	**-3,140**	**-3,256**	**-3,152**	**-3,384**	**-3,369**	**-3,295**
Direct investments	-661	-1,302	-1,541	-1,956	-1,449	-1,711	-1,538	-1,608	-1,340	-1,340	-1,340
Portfolio investments	-993	-1,772	-129	-2,042	-3,112	-970	-1,160	-950	-1,040	-1,310	-1,060
Equity and investment Fund shares	-24	-359	5	450	221	80	140	-170	-260	-280	-280
Debt instruments	-969	-1,412	-134	-2,491	-3,333	-1,050	-1,300	-780	-780	-1,030	-780
Of which: deposit taking corporations	0	500	1,350	300	100	250	0	0	0	0	0
Of which: general government	-969	-1,912	-1,484	-2,791	-3,433	-1,300	-1,300	-780	-780	-1,030	-780
T-bills, T-bonds, and SLDBs	531	-412	1,016	108	-33	-300	-300	-280	-280	-280	-280
Sovereign bonds	-1,500	-1,500	-2,500	-2,899	-3,400	-1,000	-1,000	-500	-500	-750	-500
Other investments 4/	5	-1,465	-242	461	1,378	-459	-558	-594	-1,004	-719	-896
Of which:											
Currency and deposits	614	308	712	400	229	-10	20	72	-66	-67	-74
Central bank	701	403	1	0	0	0	0	0	0	0	0
Deposit taking corporations	-87	-95	711	400	229	-10	20	72	-66	-67	-74
Loans 4/	-732	-1,521	-1,189	-3	1,693	-371	-201	-338	-1,080	-1,260	-1,280
Central bank 4/	0	0	0	0	0	0	0	0	0	0	0
Deposit taking corporations	507	-272	-696	-70	211	-100	-105	-285	-400	-400	-400
General government	-1,103	-1,038	-432	97	1,452	-51	14	207	-420	-600	-600
Other sectors	-136	-211	-61	-30	30	-220	-110	-260	-260	-260	-280
Errors and omissions	-465	175	-529	0	0	0	0	0	0	0	0
Overall balance (- = need of inflow) 3/	**-534**	**2,415**	**-1,416**	**1,176**	**921**	**778**	**677**	**643**	**930**	**910**	**693**
Total financing (- = inflow)	**-536**	**2,411**	**-1,416**	**1,176**	**921**	**778**	**677**	**643**	**930**	**910**	**690**
Financing (- = inflow)	**-17**	**3,008**	**-1,039**	**1,731**	**1,249**	**944**	**965**	**643**	**930**	**910**	**690**
Change in reserve assets	-472	2,774	-1,039	1,731	1,249	930	952	587	785	730	456
Use of Fund credit, net	455	235	0	0	0	14	14	55	145	180	234
Purchases/Disbursements	0	0	0	0	0	0	0	0	0	0	0
Repurchases/repayments	455	235	0	0	0	14	14	55	145	180	234
Gross international reserves	-1,285	1,940	-1,039	1,731	1,249	930	952	587	785	730	456
Financing gap (- = inflow)	**-518**	**-598**	**-377**	**-554**	**-328**	**-166**	**-288**	**0**	**0**	**0**	**0**
IMF	-333	-413	-252	-329	-328	-166	-163	0	0	0	0
Other IFIs	-185	-185	-125	-225	0	0	-125	0	0	0	0
Memorandum items:											
Current account (in percent of GDP)	-2.1	-2.6	-3.2	-2.8	-2.6	-2.6	-2.8	-2.6	-2.3	-2.2	-2.1
Gross official reserves	6,019	7,959	6,919	8,650	8,168	9,580	9,120	9,707	10,492	11,222	11,678
In months of prospective imports of goods and	2.8	3.6	3.3	3.5	3.6	3.7	3.8	3.8	3.9	4.0	4.0
In percent of ARA composite metric	54.7	68.7	56.3	68.2	65.3	72.6	69.8	71.3	73.6	76.8	77.9
Net international reserves	4,529	6,597	5,495	6,888	6,428	7,847	7,433	8,075	9,006	9,916	10,609
In percent of ARA composite metric	41.2	56.9	44.7	54.3	51.4	59.5	56.9	59.3	63.2	67.8	70.8

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 5b. Sri Lanka: Balance of Payments, 2018–20

(In millions of U.S. dollars, unless otherwise indicated)

	2018					2019					2020				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
						Actual	Actual		Proj.				Proj.		
Current account	-586	-1,022	-389	-816	-2,814	448	-581	-760	-1,389	-2,282	-858	-576	-495	-665	-2,595
Balance on goods	-2,982	-2,727	-2,244	-2,390	-10,343	-1,661	-1,936	-2,264	-2,527	-8,388	-2,589	-2,441	-2,396	-2,540	-9,966
Credit (exports)	2,989	2,743	3,166	2,992	11,890	3,156	2,843	3,167	3,140	12,306	3,255	2,994	3,224	3,325	12,798
Debit (imports)	-5,971	-5,470	-5,410	-5,382	-22,233	-4,817	-4,779	-5,431	-5,667	-20,694	-5,844	-5,435	-5,620	-5,864	-22,764
Balance on services	1,175	719	953	919	3,766	1,209	430	652	610	2,901	1,131	908	1,146	1,108	4,294
Credit (exports)	2,360	1,888	2,100	2,027	8,375	2,430	1,539	1,666	1,705	7,340	2,281	2,071	2,275	2,327	8,955
Debit (imports)	-1,185	-1,169	-1,147	-1,108	-4,609	-1,221	-1,109	-1,014	-1,095	-4,439	-1,150	-1,163	-1,129	-1,219	-4,661
Primary income, net 1/	-547	-445	-539	-868	-2,399	-499	-598	-703	-866	-2,666	-746	-510	-719	-829	-2,805
Secondary income, net 2/	1,768	1,431	1,441	1,523	6,163	1,399	1,523	1,555	1,395	5,871	1,346	1,467	1,474	1,596	5,882
Capital account (+ surplus / - deficit)	6	4	4	0	14	5	4	6	6	21	4	4	4	4	16
Balance from current account and capital account	-580	-1,018	-385	-816	-2,799	453	-577	-754	-1,383	-2,261	-854	-572	-491	-661	-2,579
Financial account (+ net lending / - net borrowing) 3/	-50	-2,570	1,086	-378	-1,912	-257	-1,649	476	-1,752	-3,182	-454	-1,614	-1,312	124	-3,256
Direct investments	-214	-892	-101	-334	-1,541	-92	-212	-425	-720	-1,449	-114	-238	-440	-747	-1,538
Portfolio investments	-90	-1,884	1,083	762	-129	-1,330	-1,538	41	-286	-3,112	-415	-1,515	-115	885	-1,160
Debt instruments	26	-1,850	1,067	623	-134	-1,344	-1,515	-9	-465	-3,333	-575	-1,575	-75	925	-1,300
Of which: general government	26	-2,350	317	523	-1,484	-1,344	-1,515	-59	-515	-3,433	-575	-1,575	-75	925	-1,300
T-bills, T-bonds, and SLDBs	26	150	317	523	1,016	56	-15	-59	-15	-33	-75	-75	-75	-75	-300
Sovereign bonds	0	-2,500	0	0	-2,500	-1,400	-1,500	0	-500	-3,400	-500	-1,500	0	1,000	-1,000
Other investments 4/	254	206	104	-806	-242	1,165	101	859	-746	1,378	75	139	-757	-15	-558
Of which: Currency and deposits	-398	369	288	453	712	-30	259	0	0	229	20	-10	-10	20	20
Central bank	0	1	0	0	1	0	0	0	0	0	0	0	0	0	0
Loans 4/	353	222	-426	-1,338	-1,189	891	576	355	-128	1,693	-83	548	-768	103	-201
Central bank 4/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Deposit taking corporations	251	-46	-483	-418	-696	488	2	-11	-268	211	-123	-9	78	-51	-105
General government	54	289	71	-846	-432	377	570	366	140	1,452	94	612	-846	154	14
Other sectors	48	-21	-14	-74	-61	26	4	0	0	30	-55	-55	0	0	-110
Errors and omissions	-234	143	-632	193	-529	0	0	0	0	0	0	0	0	0	0
Overall balance (- = need of inflow) 3/	-764	1,696	-2,103	-245	-1,416	710	1,072	-1,230	369	921	-401	1,042	821	-785	677
Total financing (- = inflow)	-764	1,696	-2,103	-245	-1,416	710	1,072	-1,230	369	921	-401	1,042	821	-785	677
Financing (- = inflow)	-639	1,947	-2,103	-245	-1,039	710	1,236	-1,230	533	1,249	-401	1,330	821	-785	965
Change in reserve assets	-639	1,947	-2,103	-245	-1,039	710	1,236	-1,230	533	1,249	-401	1,330	821	-799	952
Use of Fund credit, net	0	0	0	0	0	0	0	0	0	0	0	0	0	14	14
Purchases/Disbursements	0	0	0	0	0	0	0	0	0	0 0	0	0	0	0	0
Repurchases/repayments	0	0	0	0	0	0	0	0	0	0	0	0	0	14	14
Financing gap (- = inflow)	-125	-252	0	0	-377	0	-164	0	-164	-328	0	-288	0	0	-288
IMF	0	-252	0	0	-252	0	-164	0	-164	-328	0	-163	0	0	-163
Other IFIs	-125	0	0	0	-125	0	0	0	0	0	0	-125	0	0	-125
Memorandum items:															
Gross official reserves	7,320	9,267	7,164	6,919	6,919	7,629	8,865	7,635	8,168	8,168	7,767	9,097	9,919	9,120	9,120
In months of prospective imports of goods and services	3.5	4.4	3.4	3.3	3.3	3.3	3.9	3.3	3.6	3.6	3.2	3.8	4.1	3.8	3.8
In percent of ARA composite metric	59.5	75.4	58.3	56.3	56.3	61.0	70.9	61.1	65.3	65.3	59.4	69.6	75.9	69.8	69.8
Net international reserves	6,286	7,746	5,948	5,495	5,495	6,407	7,322	6,284	6,428	6,428	6,230	7,397	8,218	7,433	7,433
In percent of ARA composite metric	51.1	63.0	48.4	44.7	44.7	51.3	58.6	50.3	51.4	51.4	47.7	56.6	62.9	56.9	56.9

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

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
						Proj.			
Current account	-1,743	-2,309	-2,814	-2,282	-2,595	-2,522	-2,466	-2,471	-2,614
Balance on goods	-8,873	-9,619	-10,343	-8,388	-9,966	-10,648	-11,262	-11,889	-12,540
Credit (exports)	10,310	11,360	11,890	12,306	12,798	13,480	14,219	14,994	15,816
Debit (imports)	-19,183	-20,980	-22,233	-20,694	-22,764	-24,128	-25,482	-26,883	-28,356
Balance on services	2,879	3,302	3,766	2,901	4,294	5,073	5,741	6,364	6,921
Primary and secondary income, net	4,251	4,008	3,764	3,205	3,077	3,053	3,055	3,055	3,005
Amortization	-2,256	-2,043	-2,603	-3,907	-3,144	-2,920	-3,034	-2,514	-2,818
General government	-1017	-1211	-1917	-3337	-2549	-2207	-2480	-2050	-2300
Sovereign bonds	0	0	0	-1500	-1000	-1000	-1500	-1250	-1500
Syndicated loans	0	-280	-613	-474	-333	0	0	0	0
Bilateral and multilateral	-1017	-930	-1304	-1364	-1216	-1207	-980	-800	-800
Central bank	-1156	-637	-1	0	-14	-55	-145	-180	-234
IMF repurchases/repayments	-455	-235	0	0	-14	-55	-145	-180	-234
Other central bank liabilities, net	-701	-403	-1	0	0	0	0	0	0
Private sector loans	-83	-195	-685	-570	-581	-658	-410	-284	-284
Gross external financing needs	-3,999	-4,351	-5,416	-6,189	-5,738	-5,442	-5,500	-4,985	-5,432
Sources of financing	3,999	4,351	5,416	6,189	5,738	5,442	5,500	4,985	5,432
Borrowing	3,008	6,527	4,000	7,111	6,402	6,029	6,285	5,714	5,888
General government	3,124	4,179	2,904	5,318	3,835	2,780	3,680	3,680	3,680
T-bills, T-bonds, and SLDBs, net	-531	412	-1,016	33	300	280	280	280	280
Sovereign bonds	1,500	1,500	2,500	4,900	2,000	1,500	2,000	2,000	2,000
Syndicated loans	700	985	1,000	0	1,000	0	0	0	0
Bilateral and multilateral	1,420	1,263	420	385	535	1,000	1,400	1,400	1,400
Official capital transfers	35	19	0	0	0	0	0	0	0
Other capital inflows, net	-116	2,348	1,096	1,793	2,567	3,249	2,605	2,034	2,208
Deposit-taking corporations, excl. central bank, net	-797	-119	-1,506	40	715	633	866	547	784
FDI inflows, net	661	1,302	1,541	1,449	1,538	1,608	1,340	1,340	1,340
Private sector loans	0	0	400	683	740	980	980	980	1,000
Other capital inflows, net	21	1,165	661	-380	-426	28	-580	-832	-916
Change in reserve assets	472	-2,774	1,039	-1,249	-952	-587	-785	-730	-456
External financing gap	518	598	377	328	288	0	0	0	0
Financing	518	598	377	328	288	0	0	0	0
IMF	333	413	252	328	163	0	0	0	0
Other IFIs	185	185	125	0	125	0	0	0	0

Sources: CBSL; and IMF staff estimates.

Table 7. Sri Lanka: Financial Soundness Indicators—All Banks, 2016–19Q2

	2016				2017				2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Capital adequacy														
Regulatory capital to risk weighted assets	15.0	14.7	14.1	15.6	14.9	15.2	15.1	15.2	15.7	16.0	15.9	15.1	16.0	16.5
Tier 1 capital/risk weighted assets	12.4	12.3	11.7	12.6	12.0	12.3	12.3	12.4	12.5	12.8	12.6	12.0	12.9	13.3
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	8.9	9.0
Asset quality														
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	4.2	4.8
Net nonperforming loans to total gross loans	1.7	1.6	1.6	1.3	1.4	1.4	1.4	1.3	1.7	1.9	2.3	2.0	2.7	3.0
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	48.9	48.5
Earnings and profitability														
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	10.3	10.1
Return on assets (after tax)	1.1	1.3	1.4	1.4	1.3	1.4	1.4	1.4	1.4	1.3	1.2	1.1	0.9	0.9
Net Interest income to gross income	75.0	75.4	75.3	74.7	74.4	72.7	73.2	73.7	72.4	74.4	73.7	72.9	78.7	76.6
Staff expenses to noninterest expenses	39.9	44.8	45.4	44.9	45.1	46.7	46.3	46.5	44.8	45.2	45.0	44.1	43.8	44.5
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	79.3	78.3
Net interest margin	3.6	3.6	3.6	3.6	3.6	3.5	3.5	3.5	3.7	3.7	3.6	3.6	3.7	3.7
Liquidity														
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	27.3	29.0
Assets/funding structure														
Deposits to total assets	66.7	67.5	68.7	69.6	69.4	70.4	71.2	71.9	72.3	73.2	72.7	72.0	73.1	73.6
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	13.6	13.1
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	89.4	87.4

Source: CBSL.

Table 8. Sri Lanka: Reviews and Purchases Under the Three-Year Extended 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
October 20, 2019	118.500	20.473	Completion of the sixth review based on end-June 2019 and continuous performance criteria
April 3, 2020	118.550	20.485	Completion of the seventh review based on end-December 2019 and continuous performance criteria
Total	1070.780	185.000	

Source: IMF staff.

Table 9. Sri Lanka: Projected Payments to the Fund, 2019–33 1/

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Fund repurchases and charges															
In millions of SDR	5.5	32.8	62.8	126.2	148.9	185.8	192.4	179.2	146.2	79.5	53.5	13.3	3.3	3.3	3.3
In millions of U.S. dollars	7.6	45.2	86.9	174.6	206.1	257.2	266.4	248.0	202.4	110.1	74.1	18.4	4.6	4.6	0.0
In percent of exports of goods and services	0.0	0.2	0.4	0.7	0.8	0.9	0.9	0.8	0.6	0.3	0.2	0.0	0.0	0.0	0.0
In percent of quota	0.9	5.7	10.8	21.8	25.7	32.1	33.2	31.0	25.3	13.7	9.2	2.3	0.6	0.6	0.6
In percent of gross official reserves	0.1	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
Fund credit outstanding 2/															
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	1,310	1,464	1,416	1,272	1,092	859	611	377	185	82	14	0.0	0.0	0.0	0.0
In percent of exports of goods and services	6.7	6.7	6.1	5.1	4.1	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	1.5	1.6	1.4	1.2	1.0	0.7	0.5	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
In percent of gross official reserves	16.0	16.1	14.6	12.1	9.7	7.3	5.0	3.0	1.4	0.6	0.1	0.0	0.0	0.0	0.0
Memorandum items:															
Exports of goods and services (in millions of U.S. dollars)	19,646	21,753	23,331	24,857	26,377	27,696	29,081	30,535	32,062	33,665	35,348	37,116	38,971	40,920	42,966
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/	796	799	803	807	811	811	811	811	811	811	811	811	811	811	811
Gross official reserves (in millions of U.S. dollars) 2/	8,168	9,120	9,707	10,492	11,222	11,722	12,222	12,722	13,222	13,722	14,222	14,722	15,222	15,722	16,222

Source: IMF staff estimates.
1/ As of October 4, 2019. Reflects rephased purchases.
2/ As of the end of the year.

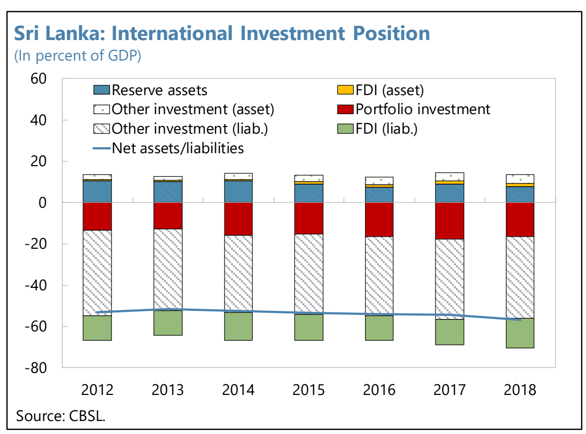
Annex I. External Sector Assessment

Sri Lanka's external position in 2018 was broadly in line with fundamentals and desirable policies, though lower-than-adequate reserve coverage continues to pose vulnerabilities to shocks. Year-to-date external sector developments and current account projections point to a largely unchanged assessment for 2019. Policies under the EFF program, including continued fiscal consolidation, a prudent monetary policy with greater exchange flexibility, buildup of international reserves, and steady progress in structural reforms, will help further strengthen the external position.

1. **Sri Lanka's balance of payments faced negative shocks in 2018 amid volatile global financial conditions.** The current account deficit widened to 3.2 percent of GDP in 2018, from 2.6 percent in 2017, due to lower agricultural exports and higher oil prices. A temporary surge in vehicle imports fueled by the extension of duty-free import permits to public employees and ahead of expected tax increases in the 2019 budget also contributed to widen the current account deficit. While FDI inflows strengthened, reflecting large-scale capital projects such as the Hambantota Port and the Colombo Port City project, portfolio flows declined amid global financial volatility and a political crisis. Gross international reserves (GIR) decreased from US$7.9 billion at end-2017 to US$6.9 billion at end-2018.

2. **The balance of payments is expected to strengthen gradually over the medium term.** The current account deficit is projected to narrow to 2.6 percent of GDP in 2019 driven by lower imports and stronger export growth following the depreciation of the rupee in 2018. GIR is expected to strengthen to US$8.2 billion in 2019, reflecting sovereign bond issuance and FX purchases by the CBSL. The current account deficit is expected to gradually decline to around 2 percent of GDP by 2024, as fiscal consolidation advances. Capital inflows are expected to continue at around 3-4 percent of GDP per year over the next five years.

3. **Sri Lanka remains a net debtor country, with large external liabilities and small external assets.** Sri Lanka's net external liabilities increased slightly from 53 percent of GDP in 2012 to 57 percent of GDP in 2018, with FDI accounting for nearly 25 percent of external liabilities and other investment (debt portfolios or bank loans) accounting for about 60 percent of external liabilities. About 85 percent of the total liabilities are long-term, with the government being the largest debtor, accounting for about 2/3 of the total external liabilities.



External Position

4. Sri Lanka's external position in 2018 was broadly in line with medium-term fundamentals and desirable policies.

- Based on the External Balance Assessment (EBA) CA model, Sri Lanka's current account norm stands at -2.4 percent of GDP. With the cyclically-adjusted current account balance estimated at -3.4 percent of GDP in 2018 (against an outturn of -3.2 percent of GDP), the EBA-based current account gap for 2018 was -0.9 percent of GDP. Policy gaps (mainly a large fiscal deficit and above-trend credit growth) explained -0.3 percent of GDP, while -0.6 percent of GDP was a residual.[1] The estimated current account gap points to a REER overvaluation of about 5 percent.[2]

- The EBA-lite REER model yields a slightly higher REER overvaluation of about 7 percent, while the External Sustainability (ES) approach points to a REER undervaluation of about 9 percent.

- Placing greater weight on the EBA CA and EBA-lite REER models, which use a rich set of cross-country information, staff assesses Sri Lanka's external position to be broadly in line with macroeconomic fundamentals and desirable policy settings. While Sri Lanka still had a negative current account gap in 2018, it was lower than 1 percent of GDP, and consistent with a small REER overvaluation of about 5 percent. With the current account deficit projected to narrow to 2.6 percent of GDP in 2019, preliminary estimates suggest that the external position will remain broadly in line with medium-term fundamentals and desirable policies in 2019, assuming a broadly unchanged current account norm.

Sri Lanka: External Balance Assessment
(In percent of GDP)

Actual CA	-3.2
Cyclical adjusted CA	-3.4
Cyclical adjusted CA norm	-2.4
Total gap	-0.9
Of which:	
Policy gaps	-0.3
Fiscal balance	-0.3
Health expenditure	0.3
Change in FX reserves	0.0
Private credit	-0.6
Capital controls	0.3
Unexplained residual	-0.6

Source: IMF staff estimates.

Sri Lanka: EBA-lite REER Model

Ln(REER) Actual (1)	4.6
Ln(REER) Fitted (2)	4.6
Ln(REER) Norm (3)	4.5
Residual (1) - (2)	0.0
REER Gap (1)- (3)	7%
of which: Policy Gap	0.0

Source: IMF staff estimates.

Sri Lanka: External Sustainability Approach

Benchmark NFA/GDP (1)	-56.8%
Adjusted medium-term CA/GDP (2)	-2.1%
CA/GDP Stabilizing NFA at benchmark (3)	-3.8%
CA/GDP gap (2) - (3)	1.7%
Corresponding REER Gap	-9.0%

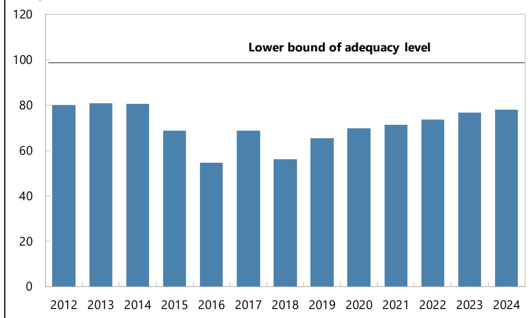
Source: IMF staff estimates.

[1] The residual likely reflects the temporary surge in vehicle imports in 2018, as well as structural factors hindering external competitiveness. If the current account balance were to be adjusted for the temporary surge in vehicle imports of about 0.5 percent of GDP, the estimated current account gap would decline to about 0.4 percent of GDP and would be primarily explained by the policy gaps.

[2] Cross-country elasticities are estimated at 0.71 for exports and 0.92 for imports.

Reserve Adequacy

Sri Lanka: Gross International Reserves
(In percent of ARA metric)



Source: IMF staff estimates.

5. **Sri Lanka's international reserve position remains lower than adequate but is improving.** Gross international reserves (GIR) declined from 69 percent of the Fund's Assessing Reserve Adequacy (ARA) metric at end-2017 to 56 percent at end-2018, further below the recommended adequacy range of 100-150 percent. GIR are expected to increase back to about 65 percent of the ARA metric at end-2019, equivalent to about 3.6 months of imports, and continue improving over the medium term.

6. **The CBSL is strengthening its market-oriented approach to exchange rate policy.** The CBSL is transitioning to flexible inflation targeting, which is planned to be fully adopted by 2020, with a more flexible exchange rate regime. The latter is being supported by the implementation of a Request for Quotes (RFQ) system for direct dealing since July 2018. The RFQ allows for a more market-based and transparent implementation of the CBSL's FX transactions, facilitating the development of a deeper and more liquid foreign exchange market.

Capital Flow Management

7. **Removal of capital flow management measures (CFMs) should be properly sequenced with macroeconomic adjustment and supporting reforms.** The authorities plan to remove the repatriation requirement of export proceeds introduced in 2016 as progress is made with macroeconomic adjustments envisaged under the EFF program, especially the strengthening of net international reserves. Cabinet agreed in October to extend the period required to repatriate the export proceeds from 120 to 180 days. Following sizable capital outflows from the local currency bond market in 2018, in January 2019, the CBSL lowered the threshold for foreign investments in rupee-denominated government bonds from 10 to 5 percent of the total outstanding stock, tightening a long-standing CFM on inflows.[3] In the absence of a capital inflow surge, staff advised to loosen back the measure, recommending to take advantage of portfolio inflows to build reserves and deepen the domestic bond market.

[3] As of September 2019, foreign investors hold about 2 percent of the total outstanding stock of rupee-denominated government bonds.

Annex II. Debt Sustainability Analysis

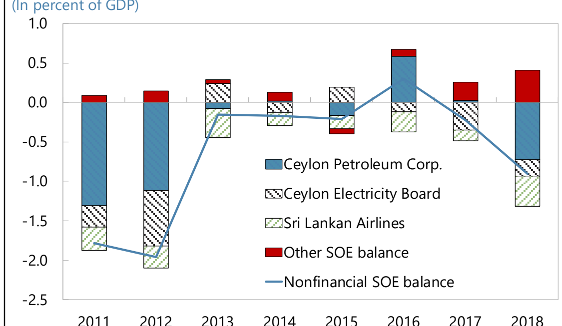
Sri Lanka's public debt remains high compared with peers, with one of the largest ratios of gross financing needs to GDP among emerging economies. Advancing the fiscal consolidation envisaged under the EFF-supported program would steadily reduce them. Downside risks, including from slower-than-expected 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), with still sizable gross funding needs.

2. The financial obligations of non-financial state-owned enterprises (SOEs) are estimated to be 14.6 percent of GDP based on the latest available data as of end-2018. 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. 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[1] are not included in the public debt outstanding under this DSA,

Sri Lanka: Nonfinancial SOE Balance
(In percent of GDP)



Source: Ministry of Finance and IMF staff estimates.
Note: Comprises up to 42 nonfinancial SOEs reported by the Ministry of Finance.

[1] About 40 percent of SOE financial obligations are guaranteed by the central government.

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
Public debt	**10,086**	**84.1**	**11,090**	**82.7**	**13,009**	**90.0**
Central government debt	**9,479**	**79.0**	**10,383**	**77.4**	**12,034**	**83.3**
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
Publicly guaranteed debt 3/	**524**	**4.4**	**590**	**4.4**	**750**	**5.2**
Ceylon Electricity Board	20	0.2	15	0.1	21	0.1
Ceylon Petroleum Corporation	212	1.8	208	1.5	334	2.3
National Water Supply and Drainage Board	35	0.3	69	0.5	87	0.6
Road Development Authority	135	1.1	163	1.2	189	1.3
SriLankan Airlines	27	0.2	27	0.2	32	0.2
Other	95	0.8	109	0.8	87	0.6
Fund credit outstanding	**83**	**0.7**	**117**	**0.9**	**226**	**1.6**
Financial obligations of SOEs 4/ 5/	**1,414**	**11.8**	**1,583**	**11.8**	**2,104**	**14.6**
Ceylon Electricity Board	230	1.9	307	2.3	533	3.7
Ceylon Petroleum Corporation	385	3.2	387	2.9	612	4.2
Road Development Authority	135	1.1	163	1.2	199	1.4
Sri Lanka Ports Authority	237	2.0	213	1.6	304	2.1
SriLankan Airlines	317	2.6	369	2.8	250	1.7
Other 6/	108	0.9	144	1.1	207	1.4
Memorandum item:						
Central government debt, Fund credit outstanding, and financial obligations of SOEs 7/	10,976	91.5	12,083	90.1	14,364	99.4
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.

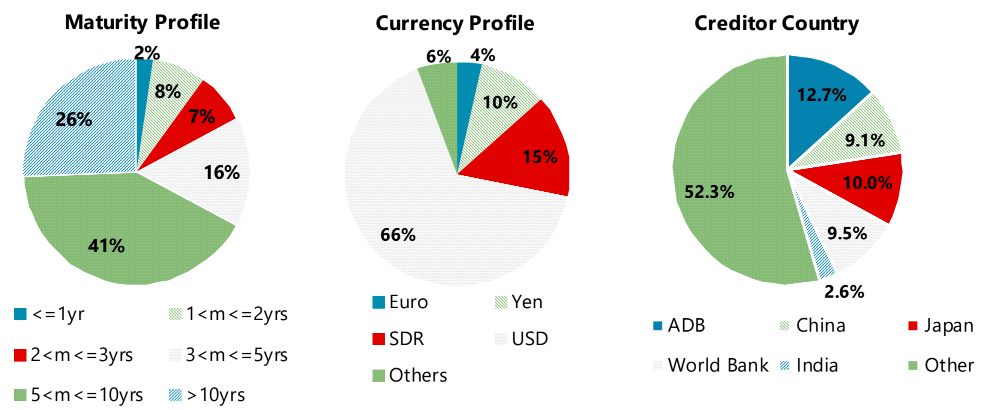
5/ Financial obligations of SLA include lease commitment on aircrafts on order, except in 2018. SLA debt for 2018 is reported as of end-March 2019.

6/ Financial obligations of other SOEs reported for 2018 include debt to banks only.

7/ IMF staff estimates, including short-term debt, project loans, and SLA liabilities related to aircraft lease (except in 2018).

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 (12.7 percent of external central government debt), Japan (10 percent), World Bank (9.5 percent), and China (9.1 percent). Chinese loans to the Sri Lankan public sector, including SOEs, amounted to 15 percent of central government external debt, or 7 percent of total public debt at end-2018.

Sri Lanka: Profile of Central Government External Debt, End-June 2019



Sources: Sri Lankan authorities; and IMF staff estimates. Note: Excludes SOE 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 rise 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 3.7 percent of GDP by 2023. Given weaker than expected growth in 2019 following the Easter attacks, the primary balance is projected to fall to 0.2 percent of GDP this year, before increasing to 0.7 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 securities markets prevailing in 2019 for newly issued debt. Interest rates for newly-issued debt are assumed to decrease gradually over the medium term, although the composition of debt will shift towards more costly domestic instruments, to mitigate FX exposure and rollover risks. Publicly guaranteed debt is projected at 5.2 percent of GDP at end-2019, consistent 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 79.2 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 around 15 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 (-1.1 percent of GDP), the debt-to-GDP ratio would decline to about 87 percent in 2024.[2] Debt reductions would become less significant under individual shock scenarios on the primary balance (lower primary surplus by 0.5 percentage points of GDP for 2019–20), GDP growth (around 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 101 percent in 2024. Similarly, in a SOE-related customized contingent liability shock scenario where the central government becomes liable for additional debt of 8 percent of GDP in 2019, the debt to GDP ratio would initially jump to 101 percent of GDP and gradually decline to 94 percent of GDP in 2024. In the combined shock scenario and the contingent liability shock scenario, gross financing needs would remain elevated ranging between 18 to 24 percent of GDP by 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 2 percentage points of GDP over 2019−24 is higher than in 69 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 requirements and debt denominated in foreign currency. The share of debt held by non-residents is above the high-risk threshold.

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

[2] Under this scenario, real GDP growth and the effective interest rate on debt are also set at their historical levels.

GDP in 2018 to around 54 percent in 2024. The decline is driven by GDP growth, a steady pace of fiscal consolidation, and gradual current account adjustments.

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 80 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 for concessional financing point to the need to speedily build buffers. Lower-than-expected GDP or export growth would also deteriorate debt dynamics.

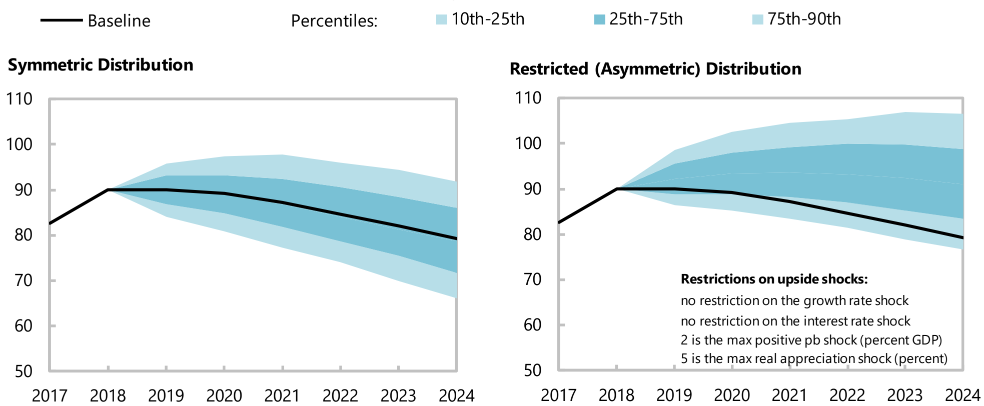
Figure 1. Sri Lanka: Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

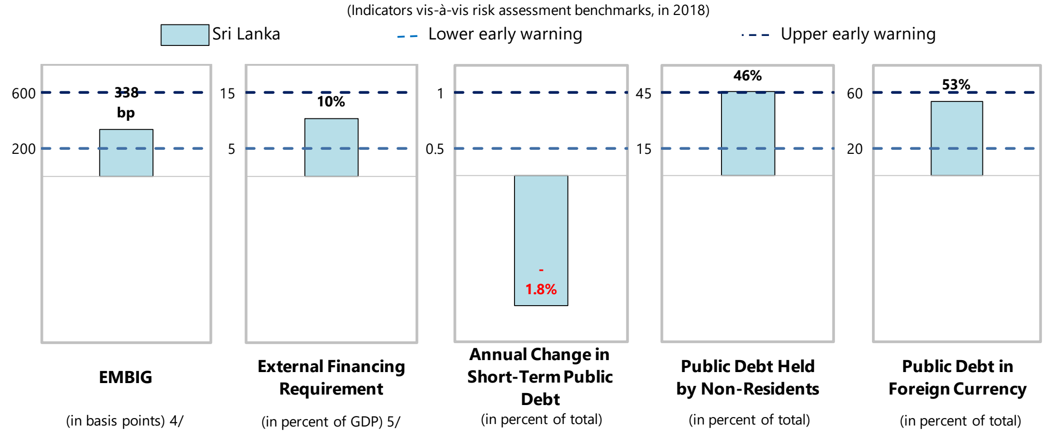
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

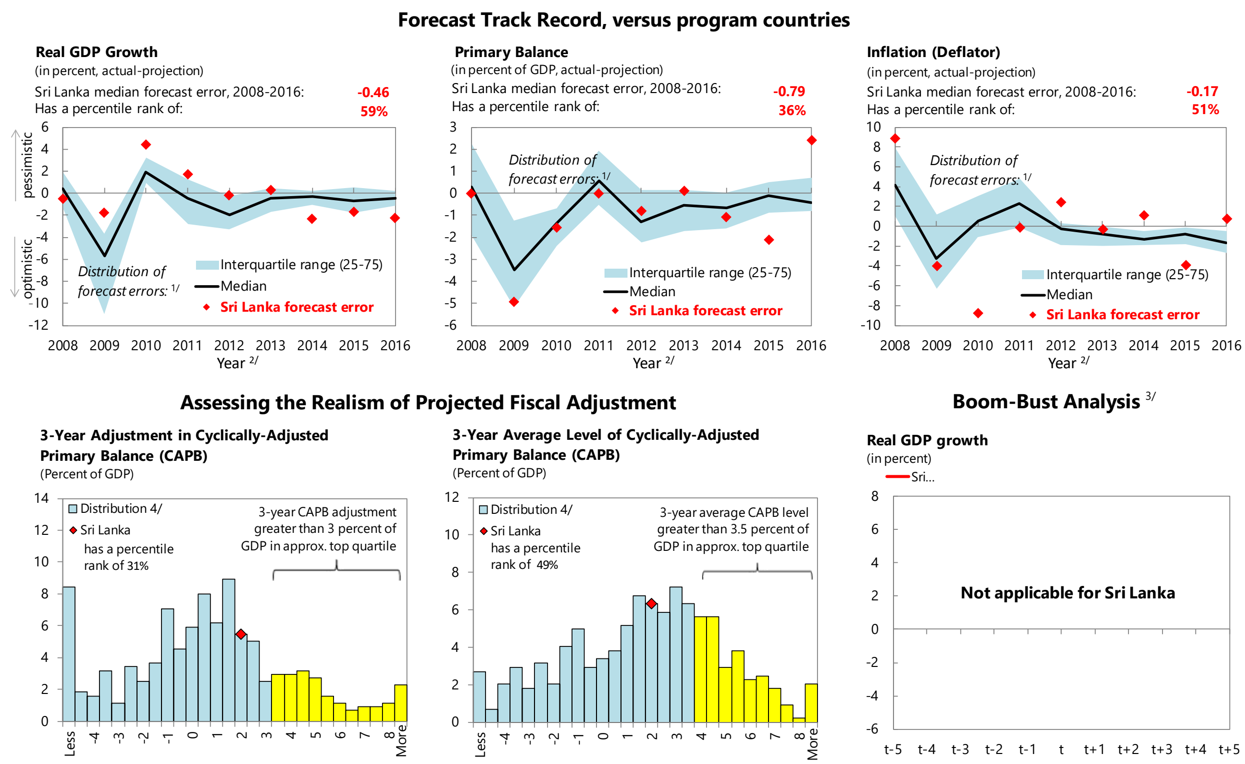
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 01-Apr-19 through 30-Jun-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

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



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 obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 3. Sri Lanka: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

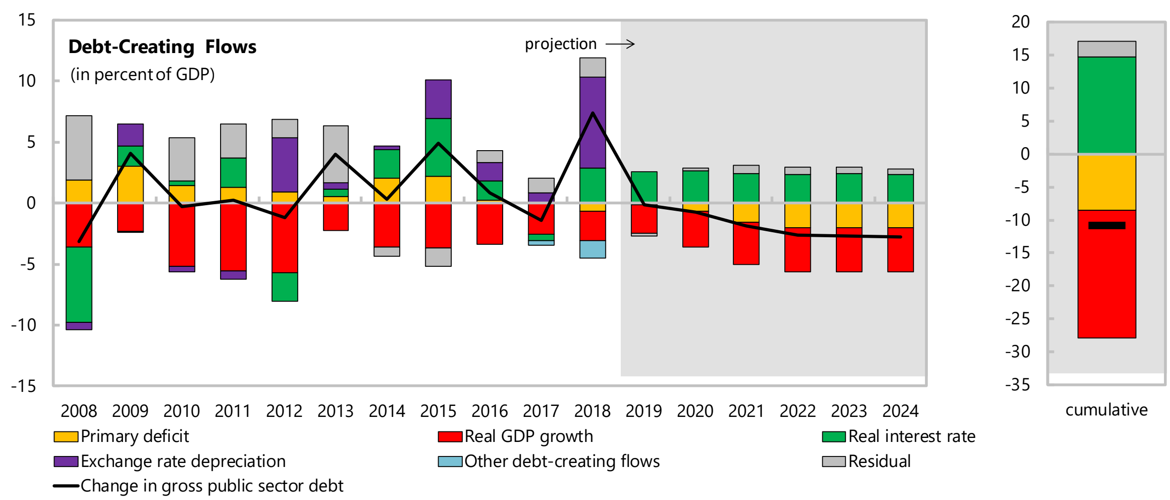
Debt, Economic and Market Indicators [1/]

	Actual		Prel.	Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	77.1	82.7	90.0	89.9	89.2	87.3	84.6	82.0	79.2
o/w: guarantees & Fund credit	3.7	5.3	6.8	6.7	6.8	6.6	6.4	6.2	5.9
Public gross financing needs	22.0	18.3	19.6	20.9	17.9	18.5	18.7	15.4	14.8
Real GDP growth (in percent)	5.9	3.4	3.2	2.7	3.5	4.3	4.5	4.6	4.8
Inflation (GDP deflator, in percent)	6.5	8.2	4.3	4.4	4.8	5.0	5.0	5.0	5.0
Nominal GDP growth (in percent)	12.8	11.9	7.7	7.2	8.5	9.5	9.7	9.8	10.1
Effective interest rate (in percent) [4/]	7.5	7.8	8.2	7.6	8.1	8.1	8.2	8.3	8.4

As of September 30, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		400
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	B2	n.a.
S&Ps	B	B
Fitch	B	B

Contribution to Changes in Public Debt

	Actual		Prel.	Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.1	-1.4	7.4	-0.1	-0.7	-1.9	-2.7	-2.7	-2.8	-10.9	
Identified debt-creating flows	-0.7	-2.6	5.8	0.1	-1.0	-2.6	-3.3	-3.2	-3.3	-13.2	
Primary deficit	1.5	0.0	-0.6	-0.2	-0.7	-1.5	-2.0	-2.0	-2.0	-8.5	-1.3
Primary (noninterest) revenue and grants	13.0	13.7	13.4	12.8	13.9	14.8	15.4	15.5	15.6	88.0	
Primary (noninterest) expenditure	14.5	13.7	12.7	12.7	13.2	13.2	13.4	13.5	13.6	79.6	
Automatic debt dynamics [5/]	-2.2	-2.2	7.8	0.3	-0.3	-1.1	-1.2	-1.2	-1.3	-4.7	
Interest rate/growth differential [6/]	-3.4	-3.1	0.4	0.3	-0.3	-1.1	-1.2	-1.2	-1.3	-4.7	
Of which: real interest rate	0.6	-0.5	2.9	2.6	2.6	2.4	2.4	2.4	2.3	14.7	
Of which: real GDP growth	-3.9	-2.6	-2.5	-2.3	-2.9	-3.5	-3.6	-3.6	-3.6	-19.4	
Exchange rate depreciation [7/]	1.1	0.8	7.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	-0.3	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization proceeds (negative)	0.0	-0.3	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	1.8	1.2	1.6	-0.2	0.3	0.7	0.6	0.5	0.5	2.4	



Source: IMF staff.

1/ Public sector is defined as central government and includes public guarantees, defined as outstanding amount of loans guaranteed by the central government and Fund credit outstanding.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

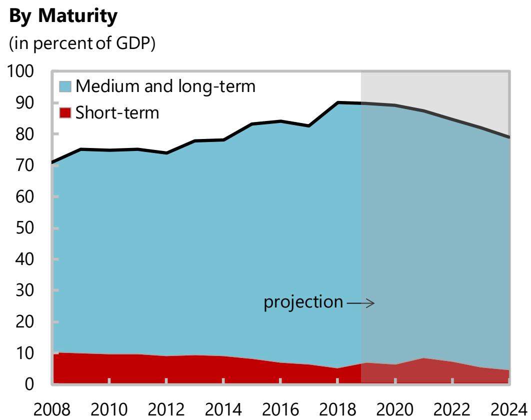
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

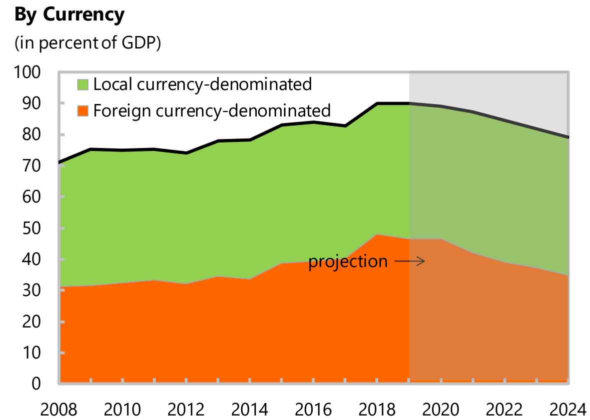
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues. For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

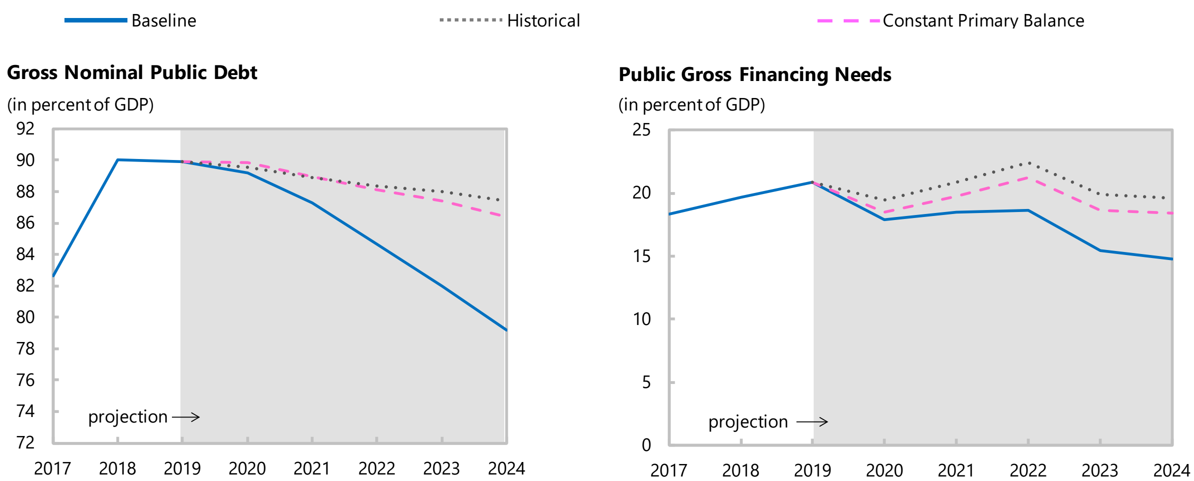
Figure 4. Sri Lanka: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt





Alternative Scenarios



Underlying Assumptions

(in percent)

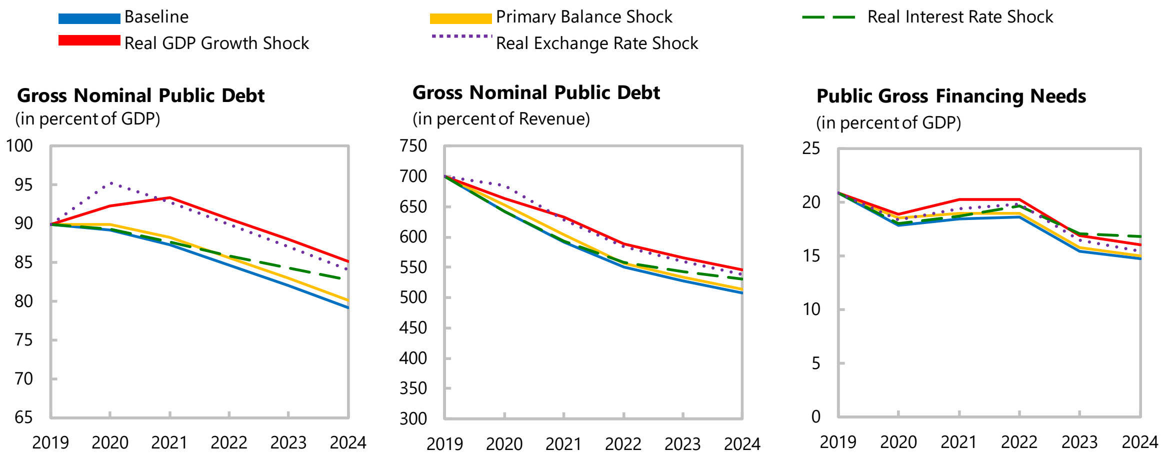
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.7	3.5	4.3	4.5	4.6	4.8
Inflation	4.4	4.8	5.0	5.0	5.0	5.0
Primary Balance	0.2	0.7	1.5	2.0	2.0	2.0
Effective interest rate	7.6	8.1	8.1	8.2	8.3	8.4
Constant Primary Balance Scenario						
Real GDP growth	2.7	3.5	4.3	4.5	4.6	4.8
Inflation	4.4	4.8	5.0	5.0	5.0	5.0
Primary Balance	0.2	0.2	0.2	0.2	0.2	0.2
Effective interest rate	7.6	7.5	7.7	8.2	8.4	8.4

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	2.7	5.4	5.4	5.4	5.4	5.4
Inflation	4.4	4.8	5.0	5.0	5.0	5.0
Primary Balance	0.2	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	7.6	7.5	7.5	7.8	8.0	7.8

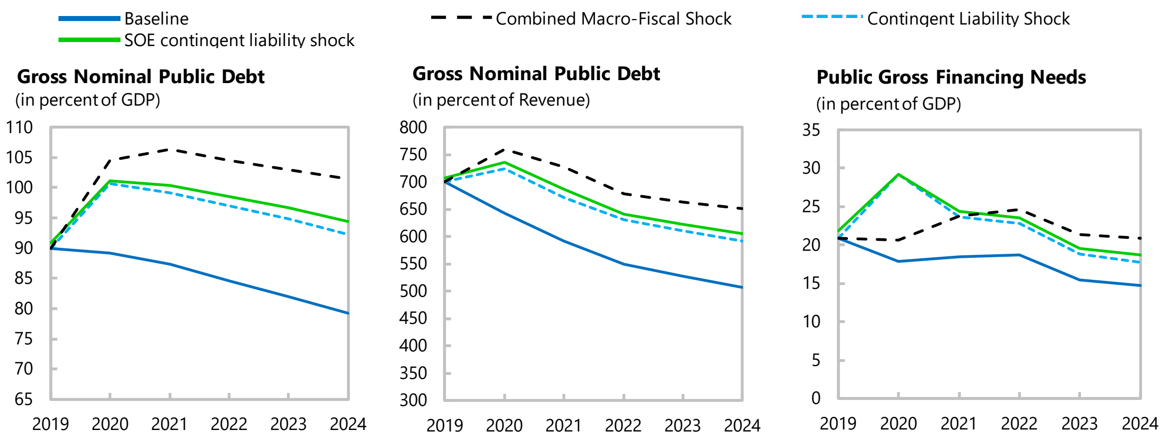
Source: IMF staff.

Figure 5. Sri Lanka: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



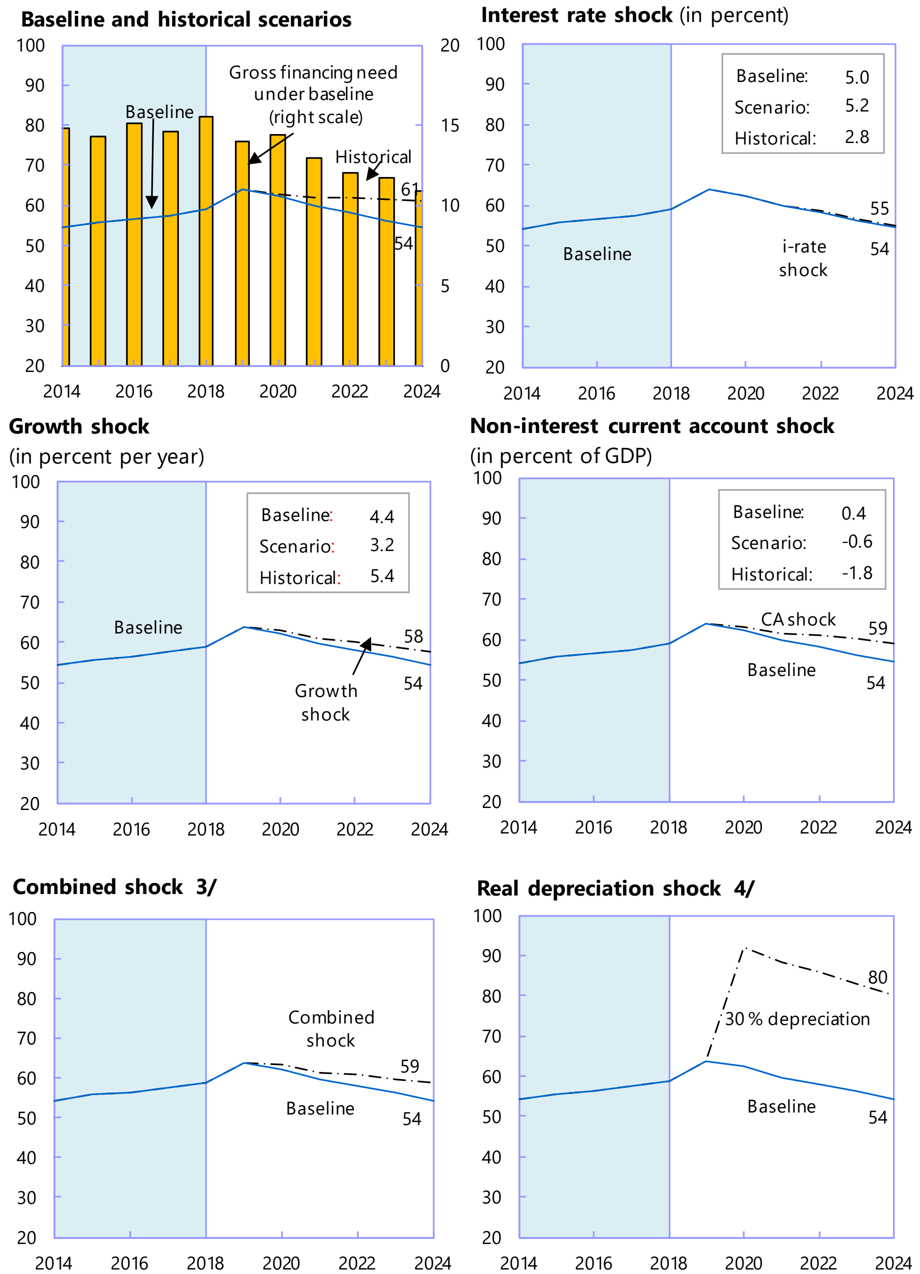
Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	2.7	3.5	4.3	4.5	4.6	4.8
Inflation	4.4	4.8	5.0	5.0	5.0	5.0
Primary balance	0.2	0.1	1.0	2.0	2.0	2.0
Effective interest rate	7.6	7.5	7.8	8.2	8.4	8.4
Real Interest Rate Shock						
Real GDP growth	2.7	3.5	4.3	4.5	4.6	4.8
Inflation	4.4	4.8	5.0	5.0	5.0	5.0
Primary balance	0.2	0.7	1.5	2.0	2.0	2.0
Effective interest rate	7.6	7.5	8.4	9.3	9.9	10.2
Combined Shock						
Real GDP growth	2.7	1.2	2.0	4.5	4.6	4.8
Inflation	4.4	4.2	4.4	5.0	5.0	5.0
Primary balance	0.2	0.1	0.7	2.0	2.0	2.0
Effective interest rate	7.6	8.2	8.1	9.0	9.7	10.0

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	2.7	1.2	2.0	4.5	4.6	4.8
Inflation	4.4	4.2	4.4	5.0	5.0	5.0
Primary balance	0.2	0.3	0.8	2.0	2.0	2.0
Effective interest rate	7.6	7.5	7.7	8.2	8.4	8.4
Real Exchange Rate Shock						
Real GDP growth	2.7	3.5	4.3	4.5	4.6	4.8
Inflation	4.4	11.2	5.0	5.0	5.0	5.0
Primary balance	0.2	0.7	1.5	2.0	2.0	2.0
Effective interest rate	7.6	8.2	7.4	7.9	8.2	8.2
Contingent Liability Shock						
Real GDP growth	2.7	3.5	4.3	4.5	4.6	4.8
Inflation	4.4	4.8	5.0	5.0	5.0	5.0
Primary balance	0.2	-9.3	1.5	2.0	2.0	2.0
Effective interest rate	7.6	9.2	8.8	8.8	8.9	8.9

Source: IMF staff.

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						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	54.3	55.7	56.3	57.5	58.8			**63.8**	**62.3**	**59.7**	**58.1**	**56.2**	**54.4**	**-2.9**
Change in external debt	0.5	1.4	0.7	1.2	1.3			5.0	-1.6	-2.6	-1.6	-1.9	-1.9	
Identified external debt-creating flows (4+8+9)	-2.2	0.6	-0.2	-3.0	0.7			-0.4	-0.8	-1.7	-1.7	-1.8	-1.7	
Current account deficit, excluding interest payments	1.0	0.9	0.6	1.0	1.0			0.1	-0.3	-0.3	-0.3	-0.5	-0.4	
Deficit in balance of goods and services	8.1	7.5	7.3	7.2	7.4			6.3	6.2	5.7	5.2	4.9	4.6	
Exports	21.1	21.0	21.2	21.7	22.8			22.7	23.8	23.7	23.5	23.2	22.8	
Imports	29.2	28.6	28.5	28.9	30.2			29.0	30.0	29.4	28.8	28.1	27.3	
Net non-debt creating capital inflows (negative)	-1.3	-0.7	-0.8	-1.9	-1.7			-1.4	-1.5	-1.8	-1.5	-1.4	-1.3	
Automatic debt dynamics 1/	-2.0	0.5	0.0	-2.1	1.4			0.9	1.0	0.4	0.2	0.1	0.0	
Contribution from nominal interest rate	1.5	1.5	1.5	1.6	2.1			2.6	3.1	2.9	2.7	2.6	2.6	
Contribution from real GDP growth	-2.5	-2.7	-2.4	-1.8	-1.8			-1.6	-2.1	-2.5	-2.5	-2.5	-2.5	
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/	2.8	0.8	0.9	4.1	0.6			5.4	-0.7	-0.9	0.1	-0.1	-0.1	
External debt-to-exports ratio (in percent)	257.2	264.7	266.1	265.2	258.1			281.3	262.0	251.4	247.0	242.3	239.1	
Gross external financing need (in billions of US dollars) 4/	11.7	11.5	12.4	12.8	13.8			12.1	13.2	12.7	12.7	13.3	13.3	
in percent of GDP	14.8	14.2	15.1	14.6	15.5	10-Year	10-Year	14.0	14.4	12.9	12.0	11.7	10.9	
Scenario with key variables at their historical averages 5/								**63.8**	**62.6**	**61.7**	**61.7**	**61.4**	**61.1**	**-3.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	5.0	5.0	4.5	3.4	3.2	5.4	2.3	2.7	3.5	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	1.4	4.4	-5.2	2.1	3.0	2.9	2.8	2.9	
Nominal external interest rate (in percent)	2.9	2.8	2.7	3.0	3.7	2.8	0.4	4.3	5.2	5.0	4.8	4.9	4.9	
Growth of exports (US dollar terms, in percent)	11.0	1.2	3.0	9.4	6.2	7.7	10.6	-3.1	10.7	7.3	6.5	6.1	5.7	
Growth of imports (US dollar terms, in percent)	7.6	-0.6	1.9	8.4	5.7	7.0	19.3	-6.4	9.1	5.4	5.1	5.0	5.0	
Current account balance, excluding interest payments	-1.0	-0.9	-0.6	-1.0	-1.0	-1.8	2.0	-0.1	0.3	0.3	0.3	0.5	0.4	
Net non-debt creating capital inflows	1.3	0.7	0.8	1.9	1.7	1.3	0.4	1.4	1.5	1.8	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.

Annex III. Proposed Fiscal Framework

The authorities are revamping their fiscal-rules framework to underpin public debt reduction over the medium to long term. Sri Lanka's existing system of fiscal rules under the *Fiscal Management (Responsibility) Act (FMRA)* has been in place since 2003. It is poorly calibrated and there has been frequent non-compliance (see Selected Issues Paper in IMF Country Report 18/176). The new framework has been developed with IMF technical assistance. Sri Lanka's Cabinet approved a note outlining the key elements of the new framework in July and the necessary legislation in October. The new fiscal rules will be supported by an improved Medium-Term Fiscal Framework (MTFF), as well as by enhanced reporting and oversight, which the authorities will develop with further IMF technical assistance.

There are three main components to the new fiscal-rules framework:

- **Fiscal Rules:** The new framework will contain a debt rule and a ceiling on guarantees. Under the debt rule, central government debt should be reduced to the long-run objective of 50 percent of GDP by 2035. A ceiling will also be placed on guarantees to contain contingent liabilities. Achieving compliance with the debt rule will be supported by a procedural rule, requiring the authorities to present a MTFF before each budget, consisting of medium term macroeconomic and fiscal forecasts that imply a steady pace of debt reduction on average over the medium term towards the long-run objective by the 2035 target date. There must also be a minimum amount of debt reduction in each year over the medium term. The overall fiscal balance in the MTFF becomes a binding operational target for the next year and both the budget passed by Parliament and the final outturn should be consistent with the target.

- **Correction Mechanism and Escape Clause:** The fiscal rules embody an automatic correction mechanism, since the MTFF must be updated each year. The impact of fiscal slippages or shocks affecting the debt level (e.g. exchange rate depreciation) must be reflected in the updated MTFF, with the projected pace of debt reduction updated as required to remain on track to achieve the long-run debt objective. An escape clause will allow for temporary deviation from the fiscal rules in precisely defined circumstances, including a major economic slowdown, natural disasters, or crystallization of contingent liabilities.

- **Reporting and Oversight**: The MTFF should be presented each year before the budget in a new Fiscal Responsibility Report (FRR), which will be a high-level document designed to communicate the government's fiscal strategy, separate to other reports that present more detailed information on public spending items. The Minister of Finance will be responsible for compliance with the fiscal rules framework and there will be an increased role for Parliament's Committee on Public Finance, to review the FRRs and examine performance against the fiscal rules.

Annex IV. The New Central Bank Act

The reform of the Central Bank Act will set an important milestone in Sri Lanka's transition to Flexible Inflation Targeting (FIT). The reform, supported by IMF TA, will replace the existing Monetary Law Act (MLA) from 1949, adopting best international central banking practices and setting the legal and institutional underpinnings for the implementation of FIT, planned for 2020, as Sri Lanka's new monetary policy framework.

The most important elements of the reform include:

- **CBSL's objectives.** Sets price stability as the CBSL's primary objective, with financial stability as a core objective.
- **Inflation target.** The target is to be set by the CBSL and the Ministry of Finance and reviewed every three years, except for exceptional circumstances.
- **Governance.** Establishes a Governing Board, Monetary Policy Board, and Executive Board as the new governance structure of the CBSL. The Governing Board, to be chaired by the Governor and composed by the Secretary to the Treasury and three non-executive members, will be the main governing body of the CBSL. The Monetary Policy Board will be the monetary policy decision-making authority, to be chaired by the Governor and composed by three Deputy Governors of the CBSL and four external experts, all with voting rights. The Executive Board, to be chaired by the Governor and composed by the Senior Deputy Governor and other Deputy Governors of the CBSL, will be responsible for managing the operations of the CBSL and implementing the decisions of the Governing Board and the Monetary Policy Board.
- **Exchange rate regime.** Adopts a flexible exchange rate regime, to be managed by the CBSL.
- **Accountability.** Mandates several disclosure requirements, including an inflation report every six months, a financial stability report once a year, a report on the state of the economy once a year, and a statement of the financial situation and operations of the CBSL. If the CBSL fails to meet the inflation target within a certain margin, a report is also due to Parliament.
- **Government financing.** Prohibits CBSL financing of the fiscal deficit. The provisional advances by the CBSL, under the current MLA, to provide credit to the government will be also phased out through a transitional arrangement.
- **Macroprudential role.** Recognizes the CBSL as the macroprudential authority of the country. Macroprudential policy will be coordinated through the establishment of a Financial System Oversight Committee, composed of the Governor, the two Deputy Governors in charge of macroprudential policy and of regulation and supervision, a Deputy Secretary to the Treasury, the Chief Executive Officer of the Insurance Regulatory Commission, the Chief Executive Officer of the Securities and Exchange Commission and another person appointed by the Governing Board of the CBSL.

- **Coordination Council.** Introduces a new Council for the Coordination of Fiscal, Monetary, and Financial Stability Policies, with members of the CBSL and the Ministry of Finance, with no decision-making authority, to promote exchange of information and views on recent macroeconomic developments, outlook, and risks.

Annex V. Capacity Development Integration Matrix

Part I: Reform Progress Under the EFF-Supported Program and IMF Capacity Development[1]				
Specific Area	**Objectives**	**TA/Training engagement**	**Achieved outcomes**	**Future program outcomes**
		Advancing Fiscal Consolidation and Strengthening Institutions *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.*		
Tax Policy Reforms	Mobilize revenue through base-broadening tax policy reforms on VAT, income tax, excises, and other taxes.	• FAD: tax system diagnostics and reform options; • LEG: assistance with new IRA draft, regulations, and manuals; training.	• VAT collections boosted by 2016 and 2018 VAT amendments; • New IRA launched in April 2018; • Tax expenditure statements published in 2017-2019 budgets; • Strategy to rationalize para-tariffs approved by cabinet in October 2019.	• Submit 2020 budget with a plan to rationalize tax expenditures and related statement.
Indirect Tax Administration	Mobilize revenue through risk-based VAT and customs administration.	• FAD: indirect tax administration TA; • SARTTAC: support to FAD in providing TA on selected topics; • WB: TA on customs valuation of imports.	• RAMIS IT system rolled out in 2016; • Risk-based VAT compliance strategy with KPIs on audits adopted in 2016 and piloted for key sectors in 2018; • Risk management unit for customs established; • Dedicated strategy unit for risk-based VAT audits established.	• Establish dedicated IRD unit for risk-based audit; • Rollout of risk-based audits to all major business segments by end-2019; • Expand VAT compliance strategy and risk-based audits to medium enterprises; • Automate risk-based customs audits of cargo using the ASYCUDA system.
Income Tax Administration	Mobilize revenue by consistently implementing the new IRA.	• SARTTAC: coordination of hands-on TA on new IRA implementation; • FAD: support to SARTTAC in finding long-term and short-term experts; • LEG: legal support to implement the new IRA.	• Manual accompanying new IRA published; • Media campaign rolled out on IRA, with call centers fielding taxpayer queries; • Business process redesign for withholding taxes; • RAMIS IT system upgrade to be fully IRA-compatible approved by cabinet.	• Continue to strengthen tax administration capacity of MOF's Inland Revenue Department (IRD); • Cabinet to approve a plan to reform the IRD and Customs departments; • Development of plan for audit of withholding obligations by employers.

[1] This matrix illustrates 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**
Fiscal Rules and Macro-Fiscal Policy Framework	Upgrade fiscal rules to anchor debt sustainability beyond 2020; Strengthen capacity for macro-fiscal policy making in MOF.	• FAD & LEG: design of new fiscal rules and assistance with medium-term budgeting; • FAD/SARTTAC: set up of macro-fiscal unit in MOF; • SARTTAC/ICD: Capacity development of MOF macro-fiscal policy analysis and forecasting.	• Cabinet approved key elements of new fiscal rules in July 2019; • Medium-term fiscal consolidation path for 2020–24 included in 2019 budget; • Cabinet approval of legal amendments for new fiscal rules in October 2019.	• Credible MTFF to be regularly updated to guide the budget process.
Public Debt Management	Strengthen capacity for public debt management with Medium-Term Debt Strategy (MTDS) and an independent public debt management agency (PDMA).	• MCM: support to the development of MTDS and PDMA, with the WB; • FAD: support to MCM TA as needed.	• Strategy to manage sovereign bond maturities for 2019-22 approved by cabinet in January 2018; • Liability Management Act enacted in March 2018; • MTDS launched by MOF and CBSL in April 2019; • Cabinet approval of a plan to establish a PDMA in October 2019.	• Annual Borrowing Plan for January-April 2020 consistent with MTDS to be prepared by end-December 2019 and for the full year 2020 by end-May 2020.
Public Financial Management	Transition from cash-based to commitment-based expenditure management. Improve quality of infrastructure spending through better public investment management.	• WB (lead): support to new PFM Act development; • FAD: TA on commitment control and follow up on 2017 PIMA. TA on cash buffers in 2019; • SARTTAC: support to FAD on selected topics.	• New IT system (ITMIS) piloted for MOF and Ministry of Health in 2016; • MOF introduced commitment recording and control systems by Jan 2018 by modifying the existing CIGAS IT system.	• Roll out ITMIS for fully IT-based commitment control by December 2020.
Fiscal Risks Mitigation and SOE reforms	Mitigate fiscal risks by reforming SOE governance, energy pricing, and PPP framework, while improving transparency and oversight of the SOE sector.	• FAD: diagnostics and reform proposals for electricity and fuel pricing as well as PPP framework. TA on draft Statements of Corporate Intent (SCI).	• SCIs published for 5 major SOEs in 2017 and compliance reports submitted to cabinet covering 2017 & 2018H1; SCIs for an additional 8 SOEs published in 2019; • Report on fuel and electricity non-commercial obligations in 2018 and 2019 budgets;	• Cabinet to approve an automatic pricing mechanism for electricity by April 2020.

Part I: Reform Progress Under the EFF-Supported Program and IMF Capacity Development				
Specific Area	**Objectives**	**TA/Training engagement**	**Achieved outcomes**	**Future program outcomes**
			• Establishment of Bulk Supply Transaction Account for electricity and introduction of automatic fuel pricing mechanism in May 2018; • New MOF unit to assess PPP fiscal risks established in April 2019.	
Statistics	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.	• SARTTAC: assistance with the transition to 2014 GFSM through training and TA; • STA: assistance to SARTTAC as required based on past STA TA on GFS.	• Cabinet approval in October 2018 of a multi-year plan to transition to accrual-based accounting for general government; • Dedicated unit within MOF established in April 2019 to manage transition to fiscal reporting consistent with GFSM 2014.	• MOF to compile GFSM cash and debt tables for budgetary and extra-budgetary central government by December 2020.
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.*				
Transition to Inflation Targeting	Develop legal framework and capacity for inflation targeting.	• MCM: diagnostics and support in developing inflation targeting roadmap; • LEG: assistance to draft amendments to Monetary Law Act (MLA); • ICD: assistance to develop a Forecasting and Policy Analysis System (FPAS) and align monetary policy communication with best practices.	• CBSL's roadmap to transition to inflation targeting and a flexible exchange rate regime adopted in 2017; • CBSL developed model-based FPAS and uses it to inform policy formulation.	• New Central Bank Act (to replace MLA) to be finalized and submitted to Parliament in the coming weeks; • CBSL to continue improving forecasting capacity and integrate FPAS more firmly into policy decision-making and communication.
Transition to Flexible Exchange Rate Regime	Promote greater exchange rate flexibility to help reserve buildup and improve resilience to external shocks.	• MCM: diagnostics on exchange rate policy; • SARTTAC: hands-on operational assistance on the implementation of	• CBSL's roadmap to transition to inflation targeting and a flexible exchange rate regime adopted in 2017; • CBSL operationalized a	• CBSL to continue to strengthen external buffers and promote greater exchange rate flexibility; • Publication of inflation report in 2020.

Part I: Reform Progress Under the EFF-Supported Program and IMF Capacity Development				
Specific Area	**Objectives**	**TA/Training engagement**	**Achieved outcomes**	**Future program outcomes**
		the CBSL's FX intervention strategy.	Request for Quotes system in July 2018.	
Financial Sector Stability, Regulation, and AML/CFT	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.	• WB (lead): Support draft of new Banking Act; • MCM: diagnostics and reform priority on financial sector issues, including through Financial Sector Stability Review in January 2019; • LEG: AML/CFT diagnostics and reforms to enhance the AML/CFT regime roadmap; • SARTTAC: TA and training on selected topics.	• Basel III migration started in 2017; • New Resolution and Enforcement Department established in CBSL in 2018; • Banks and finance companies started adoption of International Financial Reporting Standard 9 (IFRS 9) in 2018; • Higher capital and liquidity standards, in line with Basel III, established for banks and finance companies in 2019.	• CBSL to strengthen macroprudential policy framework and stress testing capabilities, under new Central Bank Act; • CBSL to harmonize regulation and supervision for banks and non-banks; • Draft of Banking Act, including new resolution regime by end-2019; • Financial Intelligence Unit and other stakeholders to implement AML/CFT measures identified by FATF and LEG TA.
Statistics	Improve price statistics and national accounts.	• SARTTAC: assistance to produce new price statistics and national accounts.	• National consumer price index released in 2018.	• Department of Census and Statistics to release rebased and improved national accounts and a rebased consumer price and producer price index in 2020.

Part II: IMF Capacity Development Missions since May 2017[1]		
TA/Training Mission	**Provider**	**Date**
Tax Policy Reforms		
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
Indirect Tax Administration		
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;
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
Develop a compliance strategy for Medium Enterprises, including support with taxpayer segmentation and risk management	FAD/STX	Jul 21–Aug 9, 2019
Registration and filing – review registration and filing processes and provide recommendations for improvement	FAD/STX	Sep 9–20, 2019
Evaluation of reform progress with revenue and customs administration and proposal for further reforms, including organizational changes	FAD/STX/SARTTAC	Aug 21–Sep 3, 2019
Income Tax Administration		
Preparation for new Inland Revenue Act (IRA)	SARTTAC	Jun 9–29, 2017; Jul 20–Aug 14, 2017; Sep 13–Oct 10, 2017
Implementation advice on new IRA	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; Jul 9–13, 2018
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

[1] 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**
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
Fiscal Rules and Macro-Fiscal Policy Framework		
Design of new fiscal rules and macro fiscal unit	FAD	Mar 13–26, 2019
Draft amendments to FM(R)A	LEG	Sep 9-16, 2019
Public Debt Management		
Medium-Term Debt Strategy (MTDS)	MCM	Jul 30-Aug 10, 2018
Institutional framework for public debt management	MCM	Aug 5–19, 2019
Public Financial Management		
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
Cash management	FAD	Mar 26-Apr 3, 2019
Fiscal Risks Mitigation and SOE Reforms		
Fuel and electricity pricing reforms	FAD	Apr 18–May 2, 2018
PPP framework diagnostics and PFRAM introduction	FAD	Sep 26–Oct 9, 2018
Transition to Inflation Targeting and Flexible Exchange Rate Regime		
Macroeconomic modeling (FPAS) for monetary policy	ICD	Apr 24–May 5, 2017; Jul 20–Aug 2, 2017; Apr 25–May 11, 2018; June 24-July 5 2019
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
Foreign exchange intervention policy	SARTTAC	Sep 18–29, 2017; Jul 9–16, 2018
Financial Sector Stability, Regulation, and AML/CFT		
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
Statistics		
Price statistics	SARTTAC	Nov 6–17, 2017; Aug 20–31, 2018
National accounts	SARTTAC	Nov 6–10, 2017; May 28–Jun 1, 2018; Jan 7–18, 2019;
Government finance statistics	SARTTAC	Sep 17–21, 2018; Jul 22–Aug 2, 2019

Appendix I. Letter of Intent

Colombo, October 20, 2019

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Georgieva:

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, achieving important structural reforms, and will anchor our macroeconomic policy throughout the 2019–20 election period while we complete our structural reform agenda. Further reform progress has been made for this review, including with cabinet approval of a new Fiscal Management (Responsibility) Act to strengthen fiscal rules, of a medium-term plan to establish an independent debt management agency, a strategy to liberalize trade by gradually eliminating para-tariffs, and a strategic plan to reduce operational and financial costs of SriLankan Airlines.

The economy was just recovering from the impact of the political crisis in late 2018, when on April 21 terrorist attacks shocked the country, with tragic life losses. The sharp decline in tourism and related activities, in the aftermath of the attacks, has resulted in a significant economic slowdown and revenue shortfalls. Nonetheless, we have taken resolute measures to stabilize the security situation and a prudent set of macroeconomic policies to support the economic recovery.

For this review, we have taken important steps to ensure program performance remains on track. The end-June quantitative performance criterion (QPC) on net official international reserves (NIR) target has been met. The CBSL implemented a prudent, data-dependent monetary policy, which allowed inflation to remain within the inner target band both in 2019Q2 and 2019Q3. The end-June QPC for the primary balance was missed, mainly due to faster-than-expected clearance of domestic arrears and execution of externally financed capital spending, and lower-than-expected revenue after the terrorist attacks. To strengthen fiscal performance, we have taken corrective measures which would ensure achieving a revised primary balance of 0.2 percent of GDP in 2019. We also submitted to Parliament a Vote on Account in line with program understandings. On the structural reform front, we have implemented five structural benchmarks, albeit with some delay, and we are finalizing the pending benchmark on the submission of the new Central Bank Act to Parliament.

We complied with the continuous PC on no new external payment arrears by the non-financial public sector and the CBSL, the continuous PC on non-introduction/non-intensification of exchange restrictions, non-introduction/non-modification of multiple currency practices under the arrangement, and the PC on non-introduction/intensification of import restrictions under the arrangement.

The attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) update the versions dated April 25, 2019 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. We also 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 Sixth Review under the EFF arrangement and the disbursement of SDR 118.5 million. We also request waivers on the nonobservance of the end-June 2019 QPC on the primary balance. 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/

Mangala Samaraweera
Minister of Finance

/s/

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. **The Easter attacks were a significant shock to the Sri Lankan economy**. After rebounding to 3.7 percent (y-o-y) in 2019Q1, from 1.8 percent in 2018Q4, following the resolution of last year's political crisis, real GDP growth slowed to 1.6 percent in 2019Q2, driven by a sharp decline in tourism and related services in the wake of the April 21 attacks. Inflation increased to 5 percent (y-o-y) in September 2019, within the inflation target band, from 3.4 percent in August, driven by higher food prices and the base effect. Despite an improvement in the goods trade balance, the sharp fall in tourism turned the current account balance into a deficit of US$581 million in 2019Q2, from a surplus of US$448 million in 2019Q1. Lower imports and economic activity reduced tax revenues, affecting fiscal performance. After recovering from the shocks of 2018, the rupee was temporarily affected by the Easter attacks and renewed capital outflows from emerging markets in August, recording a net appreciation of 0.5 percent for the year, as of end-September 2019.

2. **We expect the economy to recover gradually.** Due to the shock to tourism and weaker global growth outlook, real GDP growth is now projected at 2.7 percent in 2019, compared to 3.6 percent at the time of the fifth review. Inflation is projected to be 5.4 percent at end-2019 due to weather-related increases in food prices. As tourism recovers, supported by ongoing security and policy efforts, real GDP growth is projected to strengthen to 3.5 percent in 2020, and gradually return to the medium-term trends envisaged at the time of the fifth review, with inflation in mid-single digits. Benefiting from benign market conditions, we issued US$4.4 billion in the international bond market in 2019, covering remaining external financing needs for 2019, and we are starting to pre-finance 2020.

II. PROGRAM PERFORMANCE

3. **We are resolved to keep the program on track, notwithstanding the recent shocks to the economy, through strong macroeconomic policies and institutional reforms.** The end-June net international reserves (NIR) target was met, reflecting the prompt resumption of foreign exchange (FX) purchases by Central Bank of Sri Lanka (CBSL) as market conditions stabilized after the attacks. Preliminary data indicate that the end-September indicative target on NIR was also met, despite renewed capital outflow pressures in late August. The reserve money target was met, being below the indicative target by Rs 150 billion as of end-June 2019 and Rs 137 billion at end-September. The end-June 2019 Quantitative Performance Criterion (QPC) on the primary balance was missed by Rs 145 billion. The shortfall reflects re-scheduling of payments delayed by the political crisis of 2018 as well as significantly weaker-than-expected revenue collection after the Easter attacks, with the end-June indicative target (IT) on tax revenue missed by Rs 25 billion. The end-September IT on the primary balance and tax revenues were also missed by Rs 197 billion and Rs 171 billion, respectively. The end-June and end-September ITs on the cost of non-commercial obligations (NCOs) for fuel and electricity (net of government transfers) were also missed, although by a smaller margin than in December 2018, as Ceylon

Petroleum Corporation (CPC) recorded improved profitability in 2019H1 due to lower fuel import costs and monthly fuel price adjustments. Despite these setbacks, we remain committed to advancing fiscal consolidation and submitted to Parliament in October an interim expenditure plan (Vote on Account) for the first four months of 2020, given that upcoming elections will delay the budget process. The Vote on Account is in line with updated program targets and staff recommendations and will be followed by a full-fledged 2020 budget after the elections are concluded. We are making progress on structural measures, including towards the reform of the Central Bank law and the fiscal responsibility framework, a plan for the creation of a debt management agency and the restructuring of SriLankan Airlines, albeit with some delays.

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. In the 2019 budget, we committed to reach a primary surplus of 1.5 percent of GDP. However, these ambitious objectives are no longer achievable because of the prolonged impact of the 2018 political crisis and the Easter attacks on economic performance, which generated a significant revenue shortfall. We are taking remedial revenue and expenditure measures to mitigate the underperformance and reach a primary surplus of at least 0.2 percent of GDP in 2019. We remain committed to advance fiscal consolidation in 2020 and over the medium term, to achieve a primary surplus of 2 percent of GDP by 2022.

5. **Our fiscal consolidation strategy relies 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. **We have taken measures to mitigate the impact of the 2018 political crisis and Easter attacks on our fiscal performance in 2019.** We missed the end-June QPC on the

primary balance by 0.9 percent of GDP. The slippage was largely driven by a frontloading of expenditure, due to clearance of arrears to suppliers and externally financed capital spending carried over from 2018 due to the political crisis, and a significant revenue underperformance due to the slowdown in economic activity after the Easter attacks. The latter resulted in a breach of the end-June IT on tax revenue by 0.2 percent of GDP. The end-September ITs on the primary balance and tax revenue were also missed. Weaker economic growth and lower imports are causing a significant underperformance of indirect tax revenues, estimated at over 2 percent of GDP over the full year, despite the positive impact of the new Inland Revenue Act (IRA) on direct tax revenues. To mitigate the fiscal underperformance and avoid any new buildup of arrears, we are taking corrective actions of around 1 percent of GDP, including by reprioritizing current and capital spending, fully implementing the delayed revenue measures announced in the 2019 budget, and approving some additional revenue measures. On this basis, we propose to reset the primary surplus target for 2019 to Rs. 27 billion (0.2 percent of GDP).

7. **We remain committed to advance fiscal consolidation in 2020, with a revised primary surplus target of 0.7 percent of GDP, to anchor public debt sustainability.** Due to the electoral calendar in late 2019 and 2020H1, Parliament delayed the 2020 budget and approved in October a Vote on Account in its place to authorize government expenditure for the first four months of 2020. Under the Vote on Account, capital expenditure will be limited to implementing ongoing projects delayed in 2019. The 2020 budget is expected to be approved and submitted to Parliament after the elections (end-November 2019 structural benchmark, proposed to be reset to end-April 2020). In line with earlier program commitments, the revised primary surplus target for 2020 of 0.7 percent of GDP will be achieved through new revenue measures (0.6 percent of GDP). Revenue mobilization through greater reliance on broad-based indirect taxation, reductions in tax expenditures, and the gradual phasing out of para-tariffs will preserve space for critical social spending and public investment. We will continue implementing contingency budgeting against weather-related natural disasters for emergency cash support and infrastructure rehabilitation, contributing Rs. 10 billion (0.1 percent of GDP) to a Disaster Management Contingency. Any new expenditure items, including any change in the timeline of planned wage and salary adjustments, will be accommodated within the total expenditure envelope for 2020 agreed under the program. We remain committed to promote the economic empowerment of women by pursuing gender budgeting and other initiatives to boost female labor force participation (paragraph 36). The 2020 Vote on Account and budget will be prepared with ITMIS. 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 2020 budget speech will contain a tax expenditure statement, a plan to rationalize tax expenditures and the estimated fiscal cost of NCOs for SOEs.

8. **We remain committed to advancing fiscal consolidation over the medium term to put debt on a sustainable path, supported by a revamped fiscal rules framework.** We will aim to increase the primary balance to 2 percent of GDP by 2022, in line with our new fiscal rules framework. Our longer-term objective is to reduce central government debt to 50 percent of GDP by 2035, strengthening the resilience of public debt to shocks and avoid risks of sovereign

debt distress. We obtained cabinet approval in July of a policy note outlining key elements of amendments to the fiscal rules framework in the Fiscal Management (Responsibility) Act of 2003, (end-May 2019 structural benchmark). These include legally binding fiscal targets, a clearly defined escape clause, and an automatic correction mechanism in case of target breach. Supported by IMF technical assistance, we prepared a new Fiscal Management (Responsibility) Act which was approved by cabinet in October 2019 (end-September 2019 structural benchmark). We will also 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 2021 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. IMF technical assistance will support this effort.

9. 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 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. Following approval of a Vote on Account, we will prepare a preliminary Annual Borrowing Plan (ABP) for January-April 2020 by end-December 2019. Beginning with the 2020 budget cycle, the budget will include a review of debt management activities during the past year, benchmarked against the MTDS. A working group comprising staff from the CBSL and MOF will update the MTDS and translate it into an Annual Borrowing Plan (ABP) for the full year 2020 during the 2020 budget cycle, by end-May 2020 at the latest. 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, cabinet approved in October 2019 a plan with a clear timetable for the establishment of a public debt management agency (PDMA), in line with international best practices (end-September 2019 structural benchmark). The PDMA (i) will report to and be accountable to the Ministry of Finance but have significant operational autonomy; (ii) assume overall policy responsibility for debt management by formulating medium-term debt strategies and annual borrowing plans; and (iii) direct the implementation of annual borrowing plans, including taking decisions on auction cut-offs. The PDMA will oversee all domestic and international market-based financing decisions and participate in the evaluation of all debt, derivatives, and guarantees. A new Sovereign Debt Management Committee, chaired by the head of the PDMA, will replace the current Domestic Debt Management Committee. CBSL will continue to act as the fiscal agent for the government and provide operational support for bond auctions, trade settlement and clearing, and maintenance of the debt registry.

- 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.

10. 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). The Terms of Reference (TOR) for the GFS Coordination Committee (CC), the Memorandum of Understanding (MOU) between CC members and the GFS Migration Plan will be signed and approved by all relevant parties by end-December 2019. Supported by IMF technical assistance, we are on track to compile by December 2020 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. The number of staff assigned permanently to this unit will be increased to four by January 2020. We will make annual reports to cabinet on progress in achieving the transition.

Revenue Mobilization

11. 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 lower rate for imported timber was also introduced in November 2018, on a temporary basis.

- 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 1st, 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 order to support investment and inclusive economic growth, as approved in the 2019 budget, 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, in consultation with IMF staff and in line with program understandings. No other amendments to the IRA are planned under the 2019 and 2020 budget.

12. 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, and these were made available electronically in October 2018. 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. Financial negotiations on the contract were completed in September 2019. 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 December 2019.

- **VAT.** IRD cleared a backlog of 79,000 unprocessed VAT returns and will settle all associated payments in October 2019. Electronic filing of VAT returns will help prevent similar backlogs and improve the on-time filing rates. IRD adopted a VAT compliance strategy with risk-based audits, which has been implemented in the construction, banking, housing, and hotel industries, although the strategy was temporarily suspended in the hotel industry following the Easter Attacks. It will be reinstated by March 2020. Risk-based audit will be extended to large taxpayers in all other remaining sectors by December 2019. To institutionalize risk-based VAT administration, IRD established a strategy division for risk-based audit in February 2019, to analyze data and identify priority compliance risks and will also establish a dedicated unit to carry out risk-based audits in November 2019.

- **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 used more effectively. 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. Undervaluation of imported goods is a major source of revenue loss and we are planning to strengthen customs valuation through data verification from major trading partners and enhanced use of valuation databases. 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. We will develop our next medium-term strategic plan, with a focus on further strengthening risk-based audit and valuation, with support from IMF TA.

- **IT and organizational reform.** To modernize tax administration, IRD and Customs have begun organizational reform. By January 2020, Cabinet will approve a note summarizing the key reforms and a reform steering committee will be established, answerable to the Secretary to the Treasury (ST), to oversee progress. Reforms under consideration by end-December 2020 include: (i) IRD will make electronic filing by corporations compulsory; (ii) IRD will also re-establish a large taxpayer unit, focusing on the largest 500-700 taxpayers comprising 60-70 percent of total revenue collected by IRD; and (iii) the Ministry of Finance will modify HR practices at IRD and Customs to allow recruitment of qualified experts, incorporate bonuses into the regular pay scales and review the pay rates for each position, to ensure they are aligned to the degree of difficulty and responsibility involved. The Ministry of Finance will also ensure that traders will be given a minimum notice period in advance of changes to customs duty rates or waivers. By end-December 2019, the MOF will clarify in writing that Customs shall inspect all high-risk cargo, irrespective of whether a trader benefits from Customs Duty deferments granted by the Board of Investment.

Expenditure Reforms

13. A disciplined and prioritized approach to government spending complements revenue-based fiscal consolidation. We intend to keep the overall spending envelope under control, avoiding any accumulation of arrears, 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).

14. 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 electronic 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 eligibility criteria were submitted to Parliament in September 2019. Regulations laying out a clear and transparent process for selection of beneficiaries by the WBB will be approved by cabinet and gazetted by December 2019. We have also received the Social Registry software from the developer and we plan to eliminate several remaining deficiencies with support from a local university. We expect that the new Social Registry will be available for use by January 2020. As soon as the new registry is operational, the neediest applicants will be selected by the WBB based on the newly approved selection criteria. The expansion of social safety nets according to the new eligibility criteria will help mitigate the distributional impact of ongoing reforms on poor and vulnerable families.

15. 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. The ITMIS roll-out will be implemented on a staggered basis, with full roll-out expected by December 2020. During the first year of ITMIS implementation, CIGAS will remain operational in parallel for final account cross-checking. The first phase began in January 2019 with the Ministry of Finance and was completed in April 2019. In November 2019, the roll out will begin to be extended to other agencies, beginning with 20 priority agencies. Staff at each agency are being trained on how to use ITMIS.

- 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. 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. We upgraded the legal framework and guidelines for PPPs in 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. The legal framework and guidelines have been submitted to the National Procurement Commission. 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

16. 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-2016, 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).

17. 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 March 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. The report covering 2017H2 was submitted in early April 2019, while the third report on 2018H1 was submitted in July 2019. The fourth report on the 2018H2 period will be submitted in November 2019, and the fifth report on the 2019H1 period by end-December 2019. We also expanded the coverage of the SCIs to an additional 8 SOEs in June 2019 and are in the process of selecting an additional 10 SOEs to have

SCIs. Among the 13 SOEs currently with SCIs, the 2016 audited financial statements were published only for six SOEs and only one has had a financial statement for 2017 published. We will ensure, in close coordination with the Auditor General's office, the audit and publication of the remaining 2016 and 2017 statements by March 2020. Starting in 2020, we will aim to ensure that audited statements are readily available by September of the following year.

18. We have commenced the process of restructuring SriLankan Airlines,' to ensure its commercial viability. 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 were approved by cabinet in May 2019. These recommendations included 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 after completion of the re-structuring process. Based on the cabinet decision, the Board of SriLankan Airlines prepared in August an updated strategic plan and operating business model with measures to reduce the company's operational and financial costs and minimize future losses (end-September 2019 structural benchmark), with key actions endorsed by cabinet in early October. The Board will oversee timely implementation of these measures. The Ministry of Finance has also outlined options to recapitalize SriLankan airlines, bringing in a strategic partner, while maintaining a Sri Lankan majority in the company, and restructuring some of the airline's financial liabilities through a special purpose vehicle. Based on the new business model and the options for recapitalization, cabinet authorized the Ministry of Finance to call for requests for qualification from strategic investors.

19. We plan to complete energy pricing reforms in 2020. 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 2018 (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 to end-June 2019 in early October and plan to update the BSTA for end-December 2019 by April 2020. 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). The end-June indicative target on non-commercial obligations (NCOs) for fuel and electricity (net of government transfers) was missed by 0.35 percent of GDP, while the end-September target was missed by 0.6 percent of GDP.

- To reduce the possibility of future financial losses by CPC 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 reinstated the pricing formula and gradually implemented the necessary price changes to bring fuel prices back to cost-reflective levels by June 2019 and maintain them at the level determined by the formula. We will continue to adjust fuel prices according to the formula. We also seek to strengthen governance and regulation of CPC further to improve its operational efficiency, reduce cost, and promote investment. Specifically, we plan to carry out a detailed market study on fuel product cost and margins and reference prices, led by independent third parties.

- The electricity pricing reform aimed at addressing the significant losses being incurred by CEB and enhance energy consumption efficiency was significantly delayed by the political crisis and the Easter attacks. A new technical committee will be tasked to assess energy efficiency and affordability. As part of its mandate, the committee will present proposals to phase in an automatic electricity pricing mechanism that aims to ease the impact on cost of electricity generation due to fluctuations in oil prices, while appropriately calibrating cross-subsidization across sectors and households to minimize the distributional impact of the reforms on the lower segments of the population. These efforts will be supported by a national survey by PUC on energy efficiency and affordability for households and industry, expected to be completed by March 2020 as well as a plan to improve cost efficiency in CEB. Specifically, CEB will conduct a special external audit of heat rates and dispatch methodology by end-April 2020, in line with PUC recommendations. The technical committee will present its report to cabinet by end-March 2020. Cabinet approval of an implementation plan to introduce the electricity pricing mechanism based on the 2015 tariff methodology and the recommendations of the technical committee is expected with a delay by end-April 2020 (end-October 2019 structural benchmark). 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).

V. MONETARY AND EXCHANGE RATE POLICY

20. The focus of monetary policy will remain on keeping inflation in the mid-single digits. The CBSL reduced the interest rates on its deposit and lending facilities by 100 basis points since May 2019, to 7 and 8 percent respectively, amid weak domestic demand conditions and subdued inflation. Going forward, we will maintain a prudent data-dependent approach and stand ready to adjust the policy interest rates as warranted by evolving macroeconomic conditions. Monetary policy will continue to be monitored through the Monetary Policy Consultation Clause (MPCC) (see the Technical Memorandum of Understanding), supported by monitoring of reserve money developments.

21. We are making further progress on the roadmap towards flexible inflation targeting and a flexible exchange rate regime formulated in October 2017. The roadmap 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 are: (i) ensuring there is a clear separation between fiscal and monetary policies; (ii) retaining a role for the CBSL in smoothing excessive exchange rate volatility, while guarding against a real or perceived conflict of objectives; (iii) adopting FX intervention policies consistent with a flexible exchange rate regime; (iv) improving foreign exchange market functionality, including by gradually liberalizing financial account transactions, while ensuring regulatory compliance under the Foreign Exchange Act; (v) safeguarding financial sector stability, including by addressing the risks associated with greater FX flexibility; (vi) developing technical infrastructure, including through improved forecasting and modeling capabilities with continued support from IMF TA; (vii) establishing a policy decision making process anchored on the choice of the inflation targets and how unanticipated shocks would be addressed; and (viii) strengthening public-awareness through an outreach program.

22. As part of the roadmap towards flexible inflation targeting, we have taken important steps to further strengthen the CBSL's legal framework. In the transition path towards flexible inflation targeting (FIT) and in response to the 2016 safeguards assessment, we have made important progress towards addressing remaining structural impediments to CBSL's effectiveness resulting from monetary financing, non-core activities, and inadequate autonomy. Cabinet approved a note (end-March 2018 structural benchmark) in early April 2018 outlining broad areas for amendment in the Monetary Law Act (MLA). The draft amendments approved by cabinet in March 2019 (end-December 2018 structural benchmark) have been discussed with key stakeholders and benefited from the recommendations of the Parliament's Committee on Public Finance. The new Central Bank Act (replacing the MLA) is currently being finalized based on feedback from the Attorney General's Office and is expected to be submitted to cabinet for final approval and submission to Parliament in the coming weeks, with a delay (end-July 2019 structural benchmark). The new Central Bank Act aims at strengthening CBSL's mandate, decision-making structures, autonomy, accountability, transparency, and instruments for implementing inflation targeting. Specifically, they 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 including 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, 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. In parallel with the move towards flexible inflation targeting, the CBSL will strengthen its market-oriented approach to exchange rate policy. Under the new Central Bank Act, the CBSL will implement the flexible inflation targeting mandate under a 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 market-based and transparent implementation of CBSL FX transactions at best price, as envisioned under the program.

24. The CBSL is committed to rebuild reserves and allow the exchange rate to function as the first line of defense to external shocks. Despite limited intervention in the FX market to curb currency volatility in the aftermath of the Easter attacks, the CBSL's net FX purchases in 2019H1 exceeded the programmed amount, overperforming the end-June NIR target by US$122 million. Preliminary data indicate that the end-September NIR IT was also met, with NIR exceeding the target by about US$13.7 million, despite renewed capital outflows and limited CBSL intervention in late August. The CBSL remains committed to meet the end-December NIR target. In this context, the CBSL recognizes the need to step up efforts to continue strengthening reserve coverage through FX purchases and to allow for greater exchange rate flexibility. Specifically, the CBSL will:

- Continue FX purchases to rebuild gross official reserves to US$8.2 billion by end-December 2019. The CBSL 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 US$1.4 billion at end-February 2018 to US$0.42 billion at end-September 2019. We plan to further reduce swap liabilities gradually.

25. The CBSL and the government will not impose or intensify any exchange restrictions or other measures that are inconsistent with Article VIII obligations. By April 2019, we eliminated all measures introduced in 2018 that had 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. 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.

26. 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. Cabinet approved in October 2019 an extension of the period to repatriate export proceeds from 120 to 180 days. Further, funds in the business foreign currency accounts maintained by exporters of goods are freely remittable in respect of current transactions and capital transactions. We will assess removing the repatriation requirement 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

27. We have recently implemented several measures to strengthen the financial system. We: (i) introduced new capital and liquidity requirements, i.e. leverage ratio and net stable funding ratio, 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.

28. In the aftermath of the Easter attacks, we implemented temporary measures to support the tourism sector and ease credit conditions. The CBSL issued a regulation mandating financial institutions to grant a debt service moratorium on performing loans as of April 18, 2019, by the tourism industry through March 2020 to help borrowers withstand the significant drop in cash flows. To facilitate a faster reduction in lending rates, enhance monetary policy transmission, and ensure an adequate provision of credit, the CBSL provided directions on deposit interest rates in April, which were revoked following the issuance of directions on interest rates on lending by licensed banks in September 2019. The latter will be reviewed in March 2020. In line with IMF staff recommendations, these measures are of a temporary nature and will be removed as soon as credit market conditions improve to avoid protracted distortions to the financial system.

29. To ensure greater stability of the financial sector, we will strengthen 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 is finalizing a Direction harmonizing provisioning for bad and doubtful debts, and will issue a Direction harmonizing 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 risk-based and consolidated supervision, have stronger provisions for mergers, acquisitions and consolidation, support digital banking, and strengthen corporate governance. The implementation of these broader regulatory and supervisory powers will be supported by IMF TA. We will also: (i) continue monitoring credit growth and non-performing loans (NPLs), and report to the Monetary Board on emerging issues and developments in both banks and NBFIs; (ii) ensure that all banks and NBFIs abide by the prudential requirements and facilitate adoption of the IFRS 9 accounting standards; (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) ensure sound management of exchange rate risk in the financial sector in the context of the move towards greater exchange rate flexibility; and (iv) review and update the Finance Business Act; repeal the existing Microfinance Act and propose to establish an authority for regulation of microfinance and lending businesses in Sri Lanka, namely, the Credit Regulatory Authority through an Act of Parliament, administered by the Ministry of Finance.

30. We will strengthen the macroprudential policy framework and stress testing capabilities. The new Central Bank Act will strengthen the CBSL's role in the macroprudential policy setting. With support from IMF technical assistance and a resident advisor, we will (i) strengthen the organizational efficiency and effectiveness of the CBSL's macroprudential surveillance framework, including by establishing a dedicated stress-testing unit, (ii) expand data collection on households, the non-financial corporate sector, and the property market, (iii) improve systemic risk monitoring, (iv) enhance analysis of macroprudential policy tools, and (v) develop macro-financial scenario-based stress tests of banks, extend stress tests to deposit-taking NBFIs, and upgrade the existing stress testing methodologies and models.

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, which will be extended to NBFIs, based on international best practices; and (ii) include a separate chapter to provide a stronger legal foundation to the deposit insurance system. Specifically, the resources of the deposit insurance fund will not be allowed to be used for emergency liquidity assistance to member institutions of the deposit insurance scheme. We plan to prepare 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 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. The Financial Intelligence Unit (FIU), together with relevant ministries and stakeholders, has made significant progress in addressing recommendations made by the Asia/Pacific Group on Money Laundering (APG) and an action plan developed by the Financial Action Task Force (FATF) and Sri Lanka. As a result, Sri Lanka received upgraded ratings from the APG for six FATF Recommendations in July 2018 and five FATF Recommendations in August 2019. Amendments to the Mutual Assistance in Criminal Matters Act (MACMA) No. 24 of 2018 passed in August 2018 allow 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 empower the collection of beneficial ownership (BO) information of trusts, with implementing regulations issued in January 2019. Also, customer due diligence (CDD) rules and guidelines for designated non-financial businesses and professions (DNFBPs) were issued, and implementation has begun. 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 (FIs) and DNFBPs are being supervised on a risk-based basis by the FIU, in collaboration with the respective sector regulators. The FIU has taken enforcement actions where deficiencies have been identified. 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) (in October 2017 and June 2019) and Iran (in July 2018). Given

Sri Lanka's progress in implementing and sustaining AML/CFT reforms, the FATF removed Sri Lanka from its improving global AML/CFT compliance lists in the October 2019 Plenary meeting, after an on-site visit in September 2019 verified implementation of the FATF action plan. 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 have also ensured 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 and continue to negotiate 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. In the 2019 budget, we announced a five-year phase-out period for the removal of para-tariffs, such as the Port and Airport Development Levy (PAL) and the special economic purpose tax (CESS), on a staggered basis. The CESS reduction for construction, tourism, and manufacturing sectors will be fast-tracked to be fully removed in three years. We have reviewed 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 have prepared a cabinet paper to rationalize remaining para-tariffs over the medium term, together with new revenue sources to offset revenue losses, and obtained cabinet approval ahead of time, in October 2019 (end-March 2020 structural benchmark). The approved paper is a first step towards a broader reform of indirect taxation to be developed by the Ministry of Finance in 2020. In March 2019, the Cabinet approved the Trade Adjustment Program to assist local industries to become more competitive and help them adjust during the phasing out period of para-tariffs. In May 2019, the Cabinet launched the Innovation and Entrepreneurship Strategy 2018-2022 to support export competitiveness of SMEs, promote start-ups, and align public research and development with private sector needs. 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 (NES), 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 established a dedicated NES Management Unit to coordinate and monitor the NES, working closely with the relevant agencies, industry associations, the private sector and development partners. 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. We have drafted 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). After conducting public consultations in recent months, we are now working on the second draft of the consolidated law, and we plan to submit it to cabinet and subsequently to Parliament in the first half of 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 (NAP) 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. The NAP is being implemented, with integrity officers appointed in government departments. CIABOC has prepared manuals to serve as guidelines for investigators and prosecutors and training staff, and is in the process of recruiting 250 investigators and prevention officers to increase its capacity.

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 11 entities and 3 provincial councils to monitor KPI compliance and conducted awareness programs, and we are expanding this to all ministries and provincial councils. We will prepare a report to assess the effectiveness of the KPIs in improving the implementation of gender budgeting by end-2019 and we will use it to inform the 2020 budget process. 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 are training 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. We will facilitate part-time and flexible work arrangements by taking legislative measures as needed. We are preparing a draft law to consolidate four labor laws (Shops and Offices Employees Act, Wages Boards Ordinance, Employment of Women, Children and Young Persons Act, and Maternity Benefits Ordinance) into one law. 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) lower-than-expected growth and/or new pressures on the trade account; (ii) weaker-than-expected revenue performance and losses in state-owned enterprises and (iii) rising vulnerabilities in the financial sector, amid weakening profitability; and (iv) climate-related risks, which have risen in recent times, threatening growth, inflation and fiscal performance. External risks mainly stem from trade tensions in key economies leading to weaker global growth and lower demand for Sri Lankan exports, as well as lower foreign direct investment and remittances; and a tightening in global financial conditions, triggering capital flow pressures, raising government borrowing costs, and hampering 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. **The completion of the program will be subject to a final review,** 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 seventh and final review will require observance of the quantitative performance criteria for end-December 2019, as well as continuous performance criteria, as specified in Table 1 attached to this MEFP. The review 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)

	2019									2020	
	end-Jun.				end-Sep.(IT)			end-Dec.		end-Mar.(IT)	
	Prog.	Adj. Prog	Act.	Met / not met	Prog.	Adj. Prog	Prel.	Prog.	Revised	Prog.	Revised
Quantitative performance criteria											
Central government primary balance (floor, in billion rupees)	75	75	-71	Not met	146	146	-50	228	27	43	0
Program net official international reserves (Program NIR, floor, in million US$) 1/ 2/	1,352	1,502	1,624	Met	1,881	957	971	1,568	1,568	106	106
Continuous performance criteria (cumulative from beginning of the program)											
New external payment arrears by the nonfinancial public sector and the CBSL (ceiling, in million US$)	0	0	0	Met	0	0	0	0	0	0	0
Monetary policy consultation clause											
Year-on-year inflation in Colombo Consumers Price Index (in percent) 3/											
Outer band (upper limit)	7.6	7.6	...		7.7	7.7	...	7.8	8.0	7.8	8.0
Inner band (upper limit)	6.1	6.1	...	Within	6.2	6.2	...	6.3	6.5	6.3	6.5
Actual / Center point	4.6	4.6	4.4	inner	4.7	4.7	3.9	4.8	5.0	4.8	5.0
Inner band (lower limit)	3.1	3.1	...	band	3.2	3.2	...	3.3	3.5	3.3	3.5
Outer band (lower limit)	1.6	1.6	...		1.7	1.7	...	1.8	2.0	1.8	2.0
Indicative targets											
Central government tax revenue (floor, in billion rupees)	838	838	813	Not met	1,466	1,466	1,296	2,094	1,772	487	507
Reserve money of the CBSL (ceiling, end of period stock, in billion rupees) 4/	1,025	1,025	875	Met	1,052	1,052	915	1,070	954	1,145	977
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	99	0	0	0	0
Treasury guarantees (ceiling, in billion rupees)	...	...			...	...		838	838	...	
Memorandum items:											
Net official international reserves (CBSL's conventional definition, end of period stock, in million US$, market exchange rate) 1/	6,972	...	7,322		7,201	...	6,284	6,888	6,888	6,994	6,994
CBSL's outstanding liabilities in FX swaps with domestic commercial banks (in million US$)	...	...	838		...	...	419	...	...	...	...
Foreign program financing by the central government (in million US$) 2/	0	...	0		0	...	0	0	0	0	0
Net borrowings from SLDBs and FCBUs by the central government (in million US$) 2/	-108	...	56		-108	...	105	-108	-108	0	0
External commercial loans by the central government (in million US$) 2/	2,426	...	2,420		3,426	...	2,420	3,426	3,426	500	500
Proceeds from commercialization of public assets to non-residents (in million US$) 2/	0	...	0		0	...	0	0	0	0	0
Amortization of official external debt by the central government (in million US$) 2/	645	...	642		1,044	...	1,116	1,288	1,288	440	440
Interest payments of official external debt by the central government (in million US$) 2/	827	...	790		1,230	...	1,233	1,654	1,654	404	404
Project loans and grants disbursed to the central government (in million US$) 2/	218	...	169		353	...	298	488	488	210	210
Cost of NCOs for fuel (net of government transfers) 5/	0	...	25		0	...	38	0	0	0	0
Cost of NCOs for fuel	...	...	25		...	...	38	...	...	...	...
Government transfers for NCOs for fuel	...	...	0		...	...	0	...	...	...	...
Cost of NCOs for electricity (net of government transfers) 5/	0	...	30		0	...	61	0	0	0	0
Cost of NCOs for electricity	...	...	30		...	...	61	...	...	...	...
Government transfers for NCOs for electricity	...	...	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.

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.

Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program			
Structural Benchmarks	**Target Completion Date**	**Status**	**Comment**
Monetary and Exchange Rate Policies			
Submit to Parliament the bill to amend the Monetary Law Act, in line with IMF staff recommendations.	**End-July 2019**	**Not met**	The new Central Bank Act (replacing the MLA) is being finalized and is expected to be submitted to Parliament in the coming weeks.
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.
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 a policy note to amend the MLA in April 2018.
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	The Monetary Board approved this roadmap, with support from an IMF TA mission in May 2017.
Fiscal Policy Management			
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**	**Not met (proposed to be reset to end-April 2020)**	Parliament delayed the 2020 budget because of the electoral calendar and has approved a Vote on Account in its place during January-April. The 2020 budget will be approved after the elections.

Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)			
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-September 2019**	**Not Met (implemented with a delay)**	Cabinet approved the plan in October 2019.
Cabinet approval of amendments to relevant legislation to strengthen fiscal rules, in line with IMF staff recommendations.	**End-September 2019**	**Not met (implemented with delay)**	Relevant amendments were approved by cabinet in early October 2019.
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-May 2019**	**Not met (implemented with delay)**	Cabinet approval took place in July 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 prior action)	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 a prior action for the fifth review.
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 TA support, was approved on April 5, 2019.
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.

Table 2. Sri Lanka: Structural Benchmarks under the EFF-Supported Program (continued)			
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 was updated to incorporate the unmet structural benchmarks for a tax expenditure rationalization plan and publication of the noncommercial obligations for SOEs. The 2018 budget was submitted to Parliament on October 9, 2017.
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.
State Enterprise Reform			
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-October 2019**	**Not met**	The authorities will finalize the reform proposal and obtain cabinet approval by end-April 2020.
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**	**Met**	Prepared ahead of time in August. Key actions of the strategic plan were endorsed by cabinet in October.

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

Cabinet to approve measures to reduce operational and financial costs of Sri Lankan Airlines and eliminate future losses.	End-July 2018	Not met	Cabinet approved in May a policy paper with key recommendations on restructuring SriLankan Airlines, including tasking the Board of SriLankan Airlines to prepare a strategic plan and operating business model by end-September 2019 (structural benchmark).
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.
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.
MOF to complete a report outlining the cost of non-commercial obligations for fuel and electricity.	End-September 2017	Not met (implemented with delay)	The report was published as an annex to the 2018 budget speech in November.
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) for each of the 6 SOEs, except Sri Lankan Airlines were signed in March 2017 and published in April 2017.
Cabinet to approve a resolution strategy for Sri Lankan Airlines.	End-December 2016	Met	

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

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, although this information was included in the SCIs of the respective SOE. This benchmark was also built into the benchmarks for the 2018-2020 budgets.
Revenue Mobilization			
Cabinet to approve a strategy to rationalize para-tariffs over the medium term, together with new revenue sources to offset revenue losses.	**End-March 2020**	**Met**	Cabinet approval obtained ahead of time in October 2019.
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.
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 until the new IRA is fully implemented. However, the new Act contains increased powers for the Inland Revenue Department to improve compliance in general.
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.
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 5th satisfying the prior action for the second review.

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

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 2017 budget, Cabinet approved a plan to rationalize profit-based corporate tax incentives and tax exemptions for financial income in 2017. A comprehensive multi-year plan for reducing or eliminating tax expenditures was not adopted. This remaining step was built into the benchmarks for the 2018-2020 budgets.
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	A draft VAT compliance strategy for large taxpayers was developed with support from IMF TA in October 2016.
Public Financial Management			
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 (concluded)

MOF to implement an IT-based commitment control system with commitment ceilings for line ministries for the 2018 budget.	End-January 2018	Met	The existing CIGAS system was modified so that quarterly commitment ceilings were implemented for the 2018 budget.
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. It is being operated in parallel to the existing IT system to ensure it is functioning properly.
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.

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.[1] 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 between the actual amount and Rs 45/95 billion. The downward adjustment of the primary

[1] 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.

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, 2019.

Table 1. Sri Lanka: Exchange Rates
(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 FCBUs 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.

Table 2. Sri Lanka: Program Assumptions
(Cumulative from the beginning of the year, in million US$)

	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:

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

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 ΔM 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; Δr is the change in the reserve requirement ratio; and ΔB 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:

{ NCO(2017Q4) + NCO(2018Q1) } – { G(2018Q1) + G(2018Q2) }

For the test date of end-September 2018:

{ NCO(2017Q4) + NCO(2018Q1) + NCO(2018Q2) }

– { G(2018Q1) + G(2018Q2) + G(2018Q3) }

For the test date of end-December 2018:

{ NCO(2017Q4) + NCO(2018Q1) + NCO(2018Q2) + NCO(2018Q3) }

– { G(2018Q1) + G(2018Q2) + G(2018Q3) + G(2018Q4) }

For the test date of end-June 2019:

{ NCO(2018Q4) + NCO(2019Q1) } – { G(2019Q1) + G(2019Q2) }

For the test date of end-September 2019:

{ NCO(2018Q4) + NCO(2019Q1) + NCO(2019Q2) }

– { G(2019Q1) + G(2019Q2) + G(2019Q3) }

For the test date of end-December 2019:

{ NCO(2018Q4) + NCO(2019Q1) + NCO(2019Q2) + NCO(2019Q3) }

– { G(2019Q1) + G(2019Q2) + G(2019Q3) + G(2019Q4) }

For the test date of end-March 2020:

NCO(2019Q4) – G(2020Q1)

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)

Total Revenue & Grants
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
Total Expenditure
Recurrent Expenditure
Salaries & wages
Goods & Services
Interest Payments
Subsidies & Transfers
Public Corporations
Public Institutions
Households
Capital Expenditure
Net lending
Primary Balance
Overall balance
Total Financing
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
Oversee 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				Government				Gross Official Reserves		Liabilities					Net International Reserves	Overall balance	Memorandum Items - Swaps with Commercial Banks		
	Reserves managed by IOD		Reserve Position at I.M.F. & SDR hol.	Total	Crown Agent's Credit Balance	D S T's Special Dollar Revolving Cr.balance	DST's Yen Accounts	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
	Foreign Assets (FA) (with ACU & Without DA)	Domestic Assets (DA) (BOC & PB)		(1)+(2)				(4)+(5)+(6)	(8) - (10)	(3)+(7)										(Short position)
	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)

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

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)

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	

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)

Total revenue
Passenger
Cargo
Other income
Total expenditure
Aircraft fuel cost
Employee cost
Other operating expenses
Financial cost
Operating profit/loss
Capital contribution

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

a	**Total revenue**
	Sales by DL1, 2, 3, 4, 5
	UNT adjustment
b	**Expenditures**
	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
	Subsidy Requirement from General Treasury/(surplus)
c=b-a	**Cost of electricity NCOs**
	Memorandum item:
	Central government current transfers to CEB

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

Table 13. Treasury Guarantees 1/
(In millions of rupees)

	Treasury Guarantees Issued	Treasury Guarantees Outstanding
Total Treasury Guarantees		
Ceylon Electricty 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 Mahinda Siriwardana, Alternate Executive Director for Sri Lanka
November 1, 2019

Overview

My Sri Lankan authorities would like to express their sincere appreciation to the IMF team for the constructive and engaging dialogue held in Colombo during September 10-25, 2019 and for the well-focused report that has been produced in connection with the 6th Review of the Extended Fund Facility (EFF) arrangement. On their behalf, I would also like to thank the management, Executive Board and staff for their sustained and supportive engagement with Sri Lanka. The authorities are in broad agreement with staff's assessment of the economy as well as the proposed policy and reform priorities to ensure macroeconomic stability and broad-based sustainable growth in the Sri Lankan economy.

The heinous terrorist attacks on Easter Sunday, April 21, 2019, which killed and injured hundreds of civilians, including tourists, impacted heavily on Sri Lanka's economic performance since then. Consequent to resolute measures taken by the government, the safety and security of the country, and normalcy has now been restored. However, the economic growth, which was on a path to recovery in the first quarter of 2019, was slowed significantly following the attacks. The fiscal performance was also impacted mainly owing to the significant shortfall in the revenue collection due to the impact of attacks and the compression of imports. There was, however, less pressure on the external sector as a result of the declined imports and improved exports although the earnings from tourism declined after the attacks. The authorities are in the process of implementing critical institutional reforms to strengthen the foundation for sustainable and inclusive growth in the medium to long-term. Meanwhile, Sri Lanka is currently passing through an election period where the Presidential election is scheduled to be held in November 16, 2019 and the next Parliamentary election will be held somewhere between February – August 2020. The authorities' reform agenda, supported by the ongoing EFF arrangement, is expected to anchor macroeconomic policy, particularly through the 2019-20 election period.

Program Performance

Sri Lanka's EFF arrangement is progressing despite recent disruptions. As per the Quantitative Performance Criteria (QPC) and Indicative Targets (IT), the QPC on NIR for end-June and the IT for end-September was met while inflation was within the envisaged band under the Monetary Policy Consultation Clause (MPCC) throughout 2019. The QPC on the primary balance for both end-June and end-September were not met, mainly due to the significant revenue underperformance. The continuous QPC of accruing no new external payment arrears was met. Five Structural Benchmarks (SBs) were implemented, albeit with some delay.

Since the program performance was severely affected by the Easter Sunday attacks and in particular, the fiscal targets are no longer within reach, the program targets were to be recalibrated to reflect post-attack developments. My authorities are appreciative of the flexibility shown by staff in this regard and would like to reiterate their strong commitment to continue the program. Hence, based on the progress achieved amidst significant challenges, my Sri Lankan authorities request the completion of the 6th Review of the EFF arrangement.

Economic Growth and Outlook

The Easter Sunday attacks had a significant impact on the economic growth, particularly in the second quarter of 2019, which recorded a 1.6 percent growth compared to the 3.7 percent growth in the first quarter of the year. The impact was mainly on the country's tourism industry and its supply chains. Since the attacks, tourist arrivals are recovering faster than expected. The economy is envisaged to regain its growth momentum gradually in the medium-term with the implementation of pro-growth policies and ongoing structural reforms aimed at enhancing trade and investment, supported by stabilization measures implemented in the past few years. In the medium-term, the economy is projected to move towards its potential, which is currently estimated at around 5 percent.

Monetary and Exchange Rate Policy

Headline inflation broadly remained in, or below, the desired mid-single digit levels so far during 2019, reflecting the favorable developments on the supply side and muted demand pressures. Core inflation experienced a one-off increase in January 2019 mainly due to adjustment in house rentals after a lapse of several years and is expected to remain elevated until the beginning of 2020. Both Colombo Consumer Price Index (CCPI) and National Consumer Price Index (NCPI) based year-on-year headline inflation were at 5.0 percent in September 2019.

Given the deceleration of the credit and monetary aggregates, well anchored inflation expectations and subdued growth, monetary policy in the near term has been pragmatically geared towards supporting the economy. Accordingly, the Central Bank of Sri Lanka (CBSL) moved to a relaxed monetary policy stance in 2019 after maintaining a neutral policy stance since April 2018. Despite the liquidity surplus recorded in the domestic money market following the reduction of Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of commercial banks by 2.50 percentage points, in total, in November 2018 and March 2019, market interest rates, in both nominal and real terms, remained elevated. In view of this, the CBSL provided forward guidance on a possible reduction of policy rates in April 2019. Subsequently, the CBSL relaxed monetary policy by reducing policy interest rates, namely the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by 100 basis points in two steps in May and August 2019 to 7.00 percent and 8.00 percent, respectively.

The imposition of the temporary deposit caps on deposit products in April 2019 was based on the high real interest rates on deposits and lending products, despite the reduction in policy interest rates and the need for expediting the monetary policy transmission through the financial system. These caps were removed in September 2019 after the realization of more than 280 basis points decline in deposit rates. Given the rigidity in market lending rates relative to deposit interest rates amidst the eased monetary conditions, the CBSL imposed temporary caps on lending rates in September 2019, aiming at reducing the excessively high nominal and real interest rates, which in turn would result in increased credit flows, increased economic activity and reduced stresses in the financial sector. The lending caps are expected to be reviewed in March 2020. Meanwhile, the private sector credit growth remained sluggish at 7.2 percent by end August 2019. Going forward, the monetary policy of the

CBSL will continue to be data-dependent, and the CBSL stands committed to adjust policy rates as warranted.

The institutionalization of key reforms to introduce necessary legislative changes for a smooth transition to a full-fledged flexible inflation targeting framework by 2020 to maintain inflation at mid-single digit levels displayed notable progress in 2019. The new reforms will also strengthen the CBSL's mandate, governance, accountability and transparency frameworks. The amendments to the Monetary Law Act (MLA), which were approved by the Cabinet early this week, are expected to submit to the Parliament within next several days.

Sri Lanka's exchange rate regime will continue to be flexible and market oriented within the envisaged flexible inflation targeting regime. Foreign exchange sales will be limited to stemming excessive volatility in the event of disorderly market conditions and to build up foreign reserves. Continued measures are being taken to strengthen the foreign exchange market. Sri Lankan Rupee, which depreciated considerably in the fourth quarter of 2018, appreciated notably in the first four months of 2019. However, consequent to the disruptions of Easter Sunday attacks and foreign outflows from the government securities market, the appreciation of the rupee has been marginal so far during the year.

Financial Sector

My authorities recognize the importance of a vibrant and stable financial sector. Accordingly, the financial stability continues to be strengthened and remains a key priority. Sri Lanka's financial sector remains sound with high levels of capital and adequate liquidity buffers despite some increase in non-performing loans (NPLs) in the recent past due to subdued economic activity and resultant low credit growth amidst high interest rates. The subdued economic activity, measures aimed at macroeconomic stabilization and high nominal and real interest rates added some stress on financial institutions, particularly in the non-bank sector. Meanwhile, the Easter Sunday attacks led the authorities to implement temporary measures to support the tourism sector and ease credit conditions.

My authorities remain vigilant on the emergence of vulnerabilities in the financial sector and the CBSL remains closely engaged with financial system stakeholders. Several measures have been implemented to further strengthen the sector, which include the introduction of new capital requirements in line with Basel III standards, implementation of a new capital adequacy framework and IFRS9 accounting standards. The regulatory and supervisory regime for banks and non-bank financial institutions is also being strengthened further while the macroprudential policy framework and the stress testing capabilities will be strengthened under the new Central Bank Act. The contingency framework for financial institutions is also being upgraded in line with recent FSSR recommendations as a part of the Banking Act amendments, which are being prepared with the assistance from the World Bank. The Roadmap for Sustainable Finance in Sri Lanka, which was launched on 10 April 2019, with the support of the IFC, provides broad directions to financial regulators and financial institutions to enhance their contribution towards building a sustainable green economy. Progress has been made in formulating the National Financial Inclusion Strategy to improve financial inclusion across the country. Longstanding issues with a few weak non-bank financial institutions are being resolved with the support of the stronger resolution and enforcement framework that has been introduced for this purpose.

Reflecting the strong and committed efforts made by my authorities towards successful completion of the time-bound action plan provided to Sri Lanka to address the strategic deficiencies identified in the anti-money laundering and countering the financing of terrorism (AML/CFT) activities, Sri Lanka was removed from the improving global AML/CFT compliance lists of the Financial Action Task Force (FATF) in mid-October 2019. Accordingly, the country will no longer be subject to the FATF's monitoring under its on-going global AML/CFT compliance process. Nonetheless, my authorities will continue to implement measures to further strengthen the AML/CFT framework in the country.

Fiscal Policy and SOE Reforms

My authorities are firmly committed to the path of revenue-based fiscal consolidation to reduce the relatively high government debt in the medium-term while meeting relatively high debt service obligations in the next several years and ensure the meeting of substantial resource needs for better-targeted social and capital spending. Deviating from the gradual progress made in the recent past, the fiscal performance was severely affected by the Easter Sunday attacks, uncertainties caused by political developments, and subdued economic activity in 2019. Lower than expected government revenue as well as the clearance of unpaid bills and execution of externally financed capital projects, resulted in a lower primary surplus and an expansion of the budget deficit.

The authorities have taken several corrective measures to meet the revised primary surplus target of 0.2 percent of GDP in 2019 and they are committed to return to the envisaged fiscal consolidation path in the medium-term. As highlighted in the Report, the revenue enhancement measures, including the Inland Revenue Act enacted in 2018 and revenue administration reforms, improved fiscal discipline through further strengthening the framework for fiscal rules and envisaged improvements in the public financial management are expected to facilitate the achievement of this objective. Social safety nets are also being enhanced with the assistance from the World Bank, and mainly through the newly established Welfare Benefits Board (WBB), aiming at ensuring more effective and better targeted social welfare schemes, particularly to protect the vulnerable segments in the society from any adverse short-term impact of reforms.

In the absence of a budget for 2020 due to the ongoing Presidential elections, a Vote on Account was approved by the Parliament in October 2019 to incur government expenditure during the first four months of 2020, which could be extended further by the President for a period of three months, if required. A full budget for 2020 is expected to be presented after the ending of the general elections in 2020.

The envisaged strengthening of the fiscal framework by introducing revisions to the Fiscal Management (Responsibility) Act was progressed with the TA from the Fund. Public Financial Management (PFM) and Public Investment Management (PIM) are also being strengthened through the working on a PFM Act with the World Bank support to improve the regulatory framework and lower the risks from public-private partnerships (PPPs). In order to strengthen project selection and appraisal, new PPP guidelines are also being finalized.

Efforts to mitigate fiscal risks emanating from contingent liabilities of SOEs are being continued. The introduction of an automatic fuel pricing formula and the establishment of the bulk supply transaction account (BSTA) as a key step towards revising electricity prices to reflect costs are significant milestones achieved in this regard. The introduction of an automatic electricity pricing mechanism, while taking measures to minimize its distributional impact on the lower segments of the society, is expected to complete in 2020 to reduce the significant losses incurred by the Ceylon Electricity Board (CEB) and enhance energy consumption efficiency. The progress reporting of the Statements of Corporate Intent (SCIs), which created a framework to monitor the SOE performance under specific KPIs to enhance their oversight and financial discipline, is continuing. The SCIs, which were initially signed with key 5 SOEs in March 2017, were extended to another 8 in 2019 and further 10 SOEs are being selected to have SCIs. Meanwhile, after careful consideration of potential options, the process of comprehensive restructuring SriLankan Airlines (SLA) has been commenced towards ensuring its commercial viability.

Debt Management

The Active Liability Management Act (ALMA), introduced in 2018, has created a strong mechanism in dealing with the challenge of rollover risks related to the government debt, particularly in the next several years. The ALMA permits taking actions in advance, to pre-finance debt repayable beyond any financial year covered under the Annual Appropriation Act while helping to smoothen the redemption cycle. The Medium-Term Debt Management Strategy (MTDS), developed with the technical assistance from the Fund and World Bank, and launched in April 2019, is also being implemented with the view of making public debt more sustainable, while allowing the necessary fiscal space for much needed socio-economic infrastructure and social safety net programs. In addition, the multi-year plan to establish an independent debt management agency in line with international best practices is also progressing. These measures, coupled with the alignment of the debt levels in the medium-term with the MTDS and fiscal rules, are expected to help in effectively dealing with the relatively high debt service obligations in the next several years.

External Sector

Sri Lanka’s external sector strengthened during 2019, supported by decisive measures to address vulnerabilities experienced in 2018. The trade deficit contracted significantly in the first half of 2019, due to a significant reduction in import expenditure and a growth in export earnings. However, the negative impact on earnings from tourism following the Easter attacks, which would be a reduction from the originally envisaged US dollars 5 billion to US dollars 3.7 billion in 2019, and the moderation of workers’ remittances, resulted in a marginal deficit in the current account during the first half of 2019, despite the improvement in the trade deficit. Going forward, my authorities expect that the current account deficit will reach to a sustainable level of around 2 percent of GDP over the medium-term with the expected improvements in the trade account, inflows to the services account and a recovery of workers’ remittances. Sri Lanka’s gross official reserves stood at US$ 7.6 billion by end-

September 2019, sufficient to cover over 4.6 months of imports. The Central Bank is committed to strengthen the reserves further in the medium-term.

Trade and Investment

Boosting trade and investment by facilitating greater integration with regional and global value chains is a priority for the authorities. The Free Trade Agreement (FTA) entered in to with Singapore in January 2018 and the ongoing trade negotiations with several countries, including China, India and Thailand, as well as the new trade policy and the trade adjustment package that has been initiated, are expected to play a catalytic role in this regard. Para tariffs are also being phased out to complement these efforts.

Other Key Structural Reforms

My authorities are working on strengthening the governing and anti-corruption framework in the country. In line with this, a comprehensive piece of legislation that consolidates all laws related to bribery and corruption to comply with the United Nations Convention against Corruption (UNCAC) has been drafted. The National Action Plan (NAP) for combating Bribery and Corruption in Sri Lanka, launched in March 2019, includes a concrete and actionable road map for 2019-23 to strengthen anti-corruption efforts and compliance with international obligations. Meanwhile, measures are also being taken to increase the female labor force participation in the economy by removing barriers that restricts such participation.

Conclusion

The policy reform agenda of my authorities, supported by the ongoing EFF arrangement, has been instrumental in gradually restoring macroeconomic stability and strengthening the investor confidence. The TA from the Fund, and the assistance from the World Bank and other IFIs has played an important role in these endeavors. Going forward, my authorities are committed to continue the structural reforms for Sri Lanka to ensure greater macroeconomic stability, gradually return to a high growth trajectory and build buffers to improve resilience.