

# Sustaining Stability

**Annual Economic  
Review**

**2023**

**Central Bank of Sri Lanka**

Economic Research Department | 9 May 2024



ANNUAL  
ECONOMIC  
REVIEW  
2023



CENTRAL BANK OF SRI LANKA

## Central Bank of Sri Lanka Act was enacted in September 2023

Enactment of the CBA marked a significant milestone in enhancing the **Central Bank's independence** and **accountability**

### Central Bank of Sri Lanka Act, No. 16 of 2023 *Section 80(3)*

The Governor of the Central Bank shall ensure that the Central Bank shall, **within a period of four months** after the close of each financial year, **publish, and lay before Parliament through the Minister, a report** approved by the Governing Board, **on the state of the economy** during such financial year **emphasizing its policy objectives and the condition of the financial system**



# Annual Economic Review 2023 consists of...

Key Economic Indicators

Key Social Indicators

Executive Summary

Chapters

- 1: Macroeconomic Developments and Conditions of the Financial System
- 2: Review of Central Bank Policies
- 3: Macroeconomic Outlook

Major Economic Policy Measures Implemented by or Related to the Central Bank of Sri Lanka

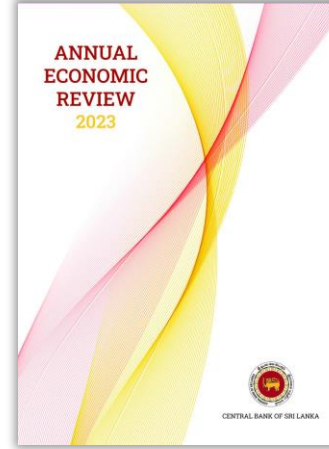
Box Articles (7)

Statistical Appendix (20)

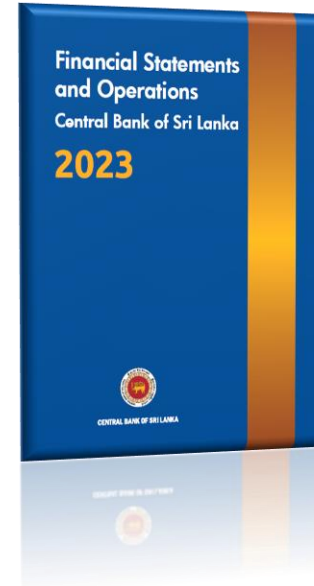
[142 Appendix Tables are available online in Excel, and all the tables in online version have additional historical data]

Special Statistical Appendix (9)

[11 Tables are available online in Excel, and all the tables in the online version have additional historical data]



**The Annual Economic Review includes the Central Bank's policy objectives and an assessment of the policies of the Central Bank and the condition of the financial system during 2023**



**The Central Bank's Financial Statements and Operations are covered in a separate publication**



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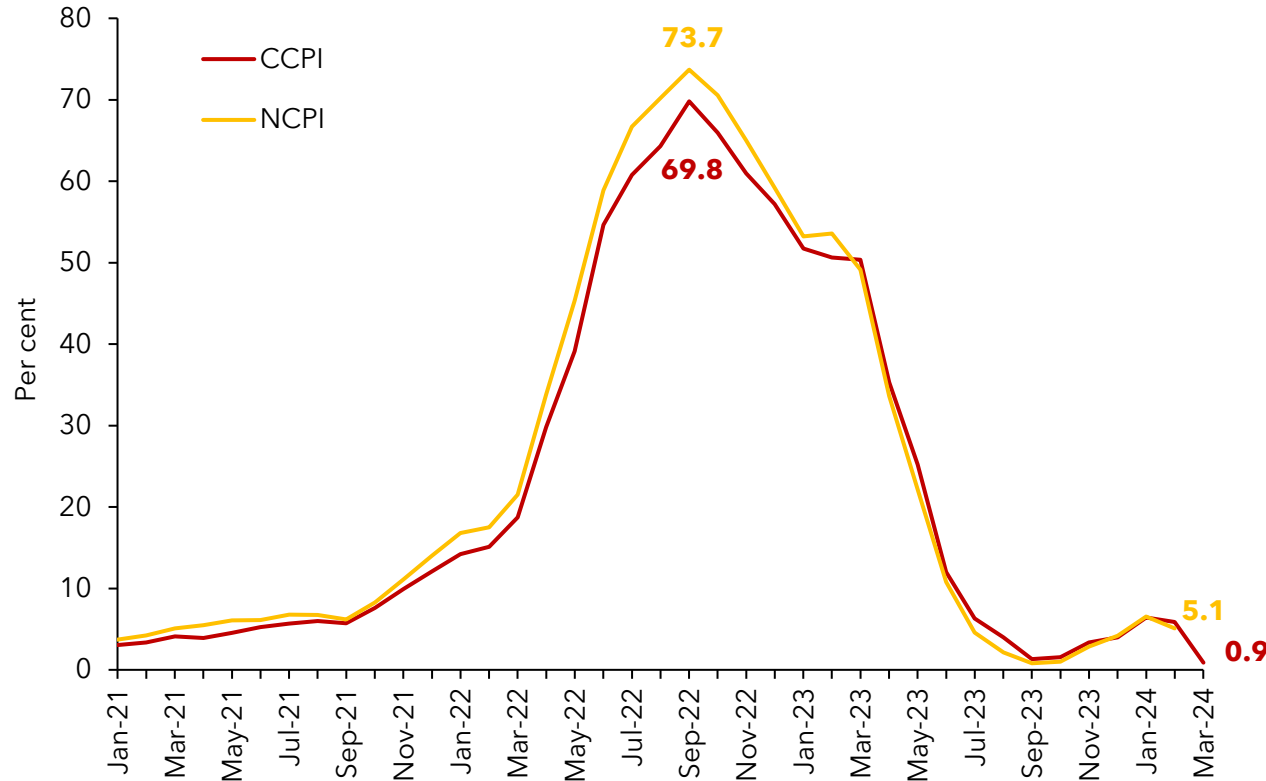
# Macroeconomic Developments, Conditions of the Financial System and Review of Central Bank Policies

# Decisive policy adjustments and structural reforms implemented by the Government and the Central Bank have helped restore macroeconomic stability to a great extent...

- Inflation controlled with rapid disinflation path
- Exchange rate stability reinforced
- Gross official reserves increased thereby building the much needed external buffers
- The financial sector demonstrated its resilience with high levels of crisis preparedness
- The fiscal sector performed remarkably well
- Economy commenced transitioning towards growth path, benefiting from restored stability

# Inflation, which reached the historically highest level in September 2022, recorded a rapid disinflation since then, reaching lower single-digit levels towards end 2023...

Movements in Headline Inflation (year-on-year)



**Core inflation also recorded a substantial disinflation**

**Domestic price stability was restored supported mainly by;**

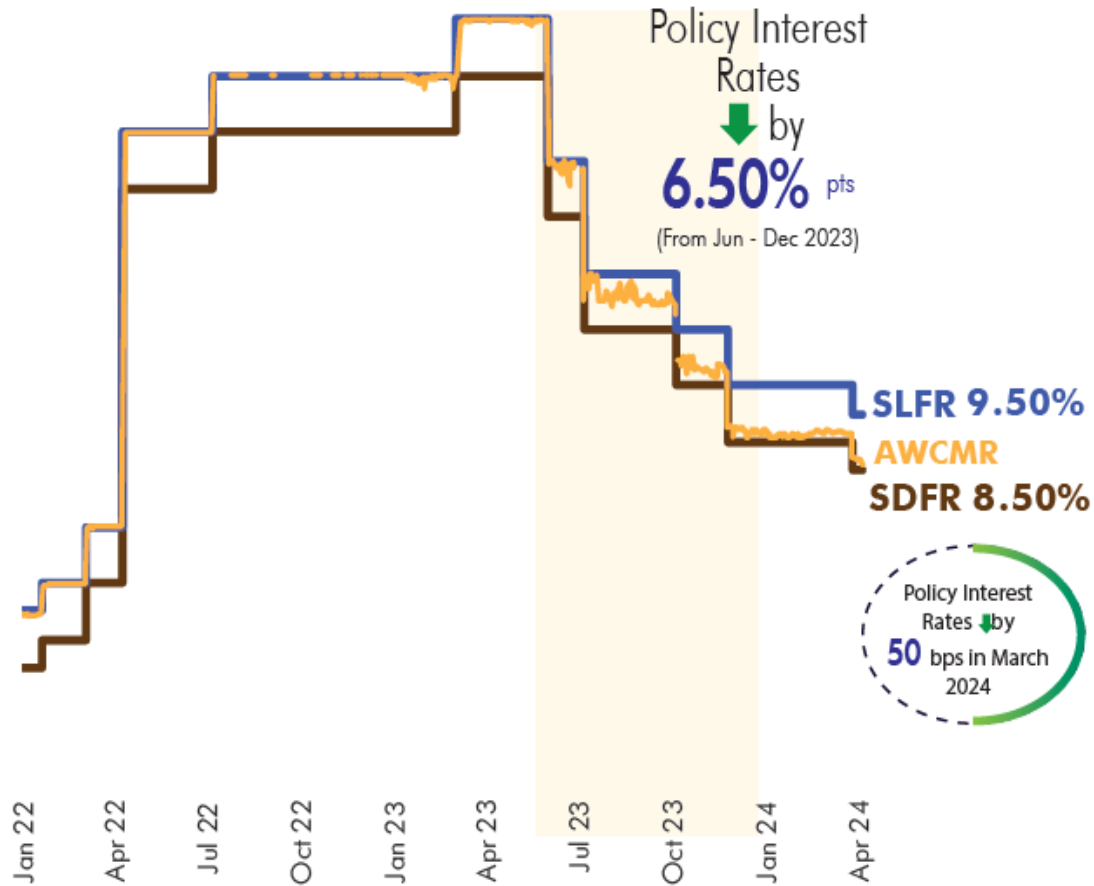
- Tight monetary conditions, complemented by tight fiscal measures
- Normalisation of domestic supply conditions
- Moderation of Global commodity prices
- Strengthening the Sri Lanka rupee

## Inflation Target

Following the enactment of the CBA, the Central Bank strives to maintain year-on-year headline inflation at 5%

# Following the restoration of price stability, monetary policy stance transitioned gradually to accommodative monetary policy in 2023...

Policy interest rates were reduced...

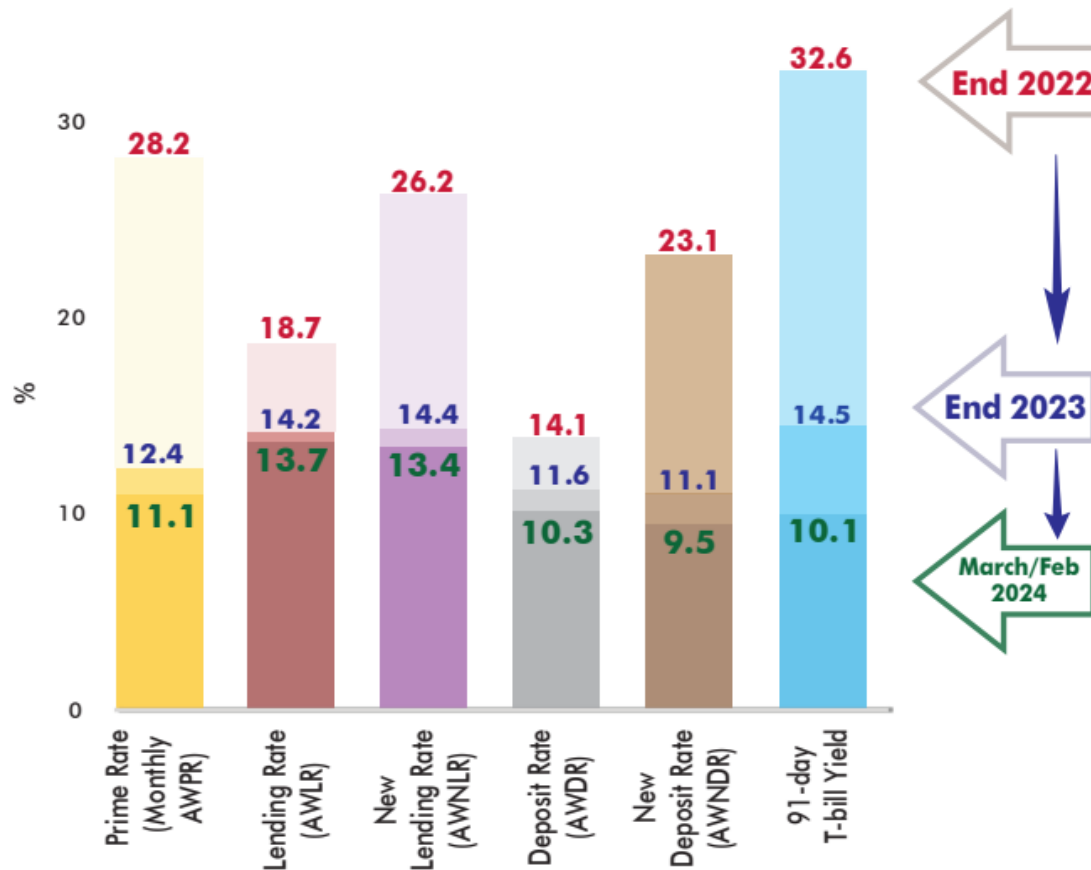


**A relaxed monetary policy stance was pursued in 2023 supported by;**

- The notable moderation of inflation and well anchored inflation expectations
- subpar economic activity amidst subdued domestic demand conditions
- Easing of external sector pressures

# Market interest rates declined significantly in 2023 from notably high levels recorded in 2022...

Notable decline in market interest rates...



The reduction of market interest rates was driven by the accommodative monetary policy measures implemented since June 2023

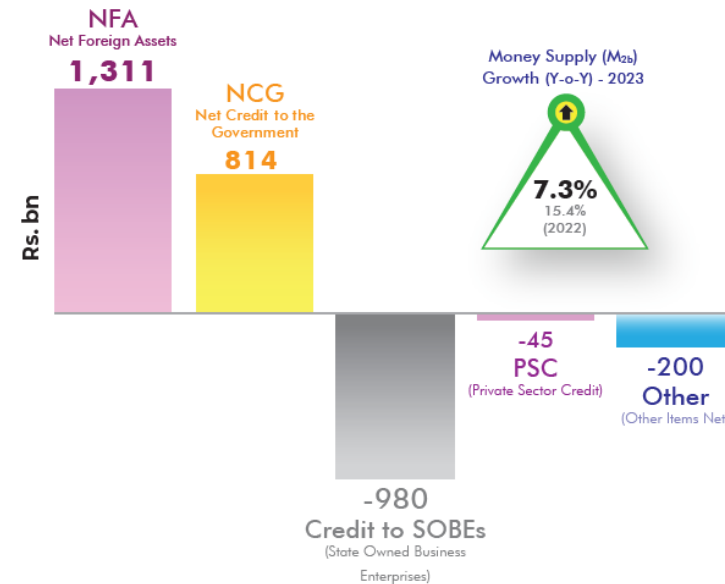
**Broad based reduction in market lending rates were further supported by,**

- Administrative measures and moral suasion that targeted the reduction of excessive market interest rates
- Decline in risk premia attached to yields on government securities following the DDO

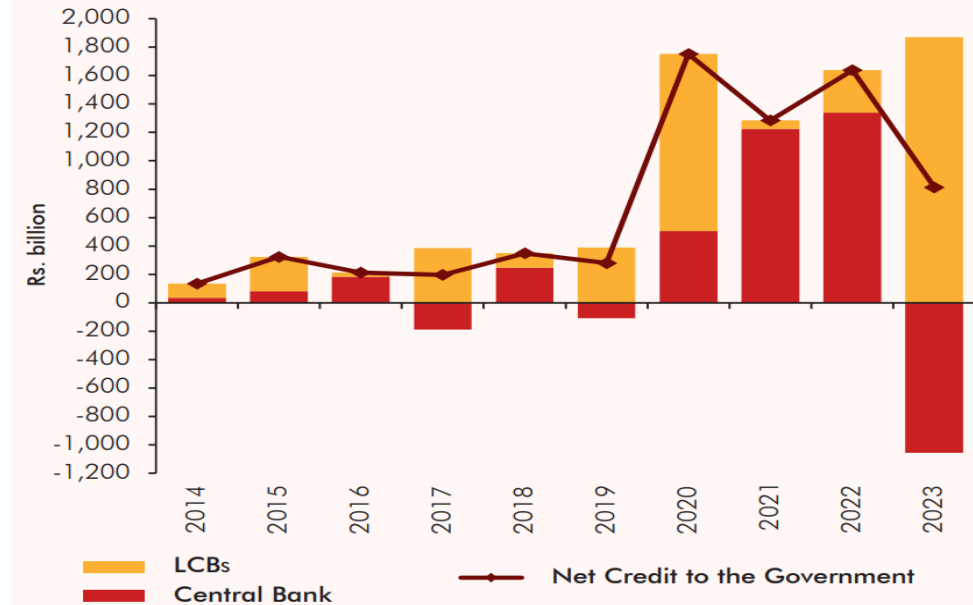


# Despite the expansions recorded in NCG and NFA of the banking system, the growth of broad money ( $M_{2b}$ ) supply remained moderate during 2023...

Monetary expansion remained subdued...



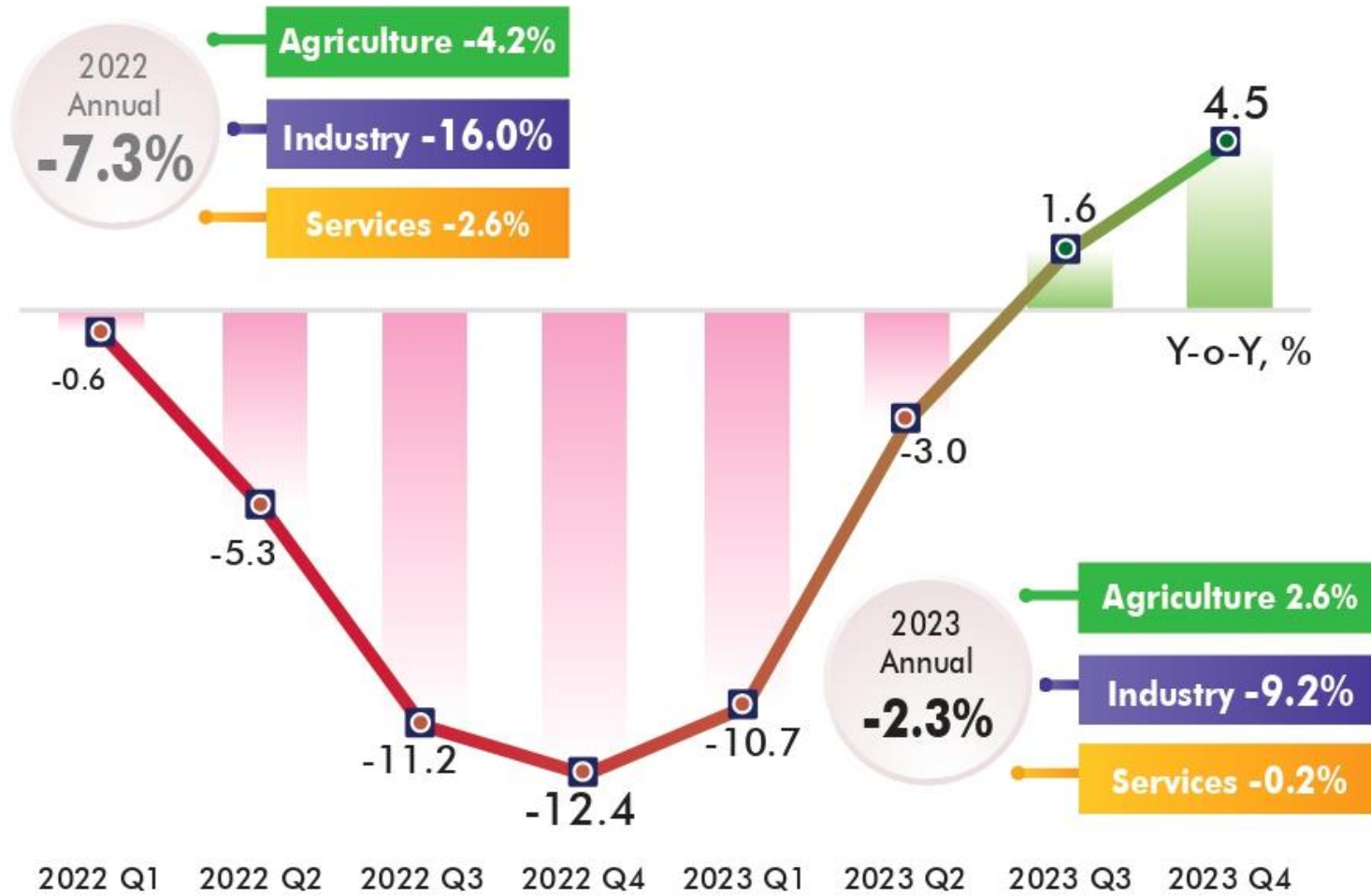
## Annual Change in NCG from the Banking System



- The turnaround in June 2023 ended the longest streak of monthly contractions of credit to the private sector
- Credit obtained by SOBEs from the banking system contracted in 2023
- NCG by LCBs continued to increase in 2023
- NCG by the Central Bank recorded a significant reduction (Rs. 1,056.3 bn) during 2023
- NFA of the banking system improved notably during 2023



# The Sri Lankan economy showed signs of rebound in the second half of 2023...



The recovery was underpinned by renewed macroeconomic stability amidst softening interest rates and easing of external sector pressures

# From an expenditure perspective, the growth in the total demand of the economy at current prices was contributed positively by both domestic and net external demand...

## As per the expenditure approach of GDP at current market prices in 2023 :

- **Consumption expenditure increased by 16.7%** attributable to the increase in both private and government consumption expenditures, driven by the price impact
- Despite the **increase in investment expenditure** during the year, fixed capital formation contracted, led by the decline in expenditure on construction activities
- **Net external demand registered a substantial increase of 51.9%**, reflecting the impact of the growth in expenditure on goods and services exports alongside the stagnation in expenditure on goods and services imports

2023  
Domestic Savings (as a % of GDP) **23.8**

2023  
National Savings (as a % of GDP) **27.2**

# The unemployment rate remained unchanged at 4.7% in 2023, compared to the previous year...

**Table 1.6 Household Population, Labour Force and Labour Force Participation**

Item	2022	2023 (a)
Household Population '000 Persons (b)	17,162	17,306
Labour Force '000 Persons	8,547	8,408
Employed	8,148	8,010
Unemployed	399	398
Unemployment Rate	4.7	4.7
Male	3.7	3.6
Female	6.5	7.0
Labour Force Participation Rate (c)	49.8	48.6
Male	70.5	68.6
Female	32.1	31.3

Source: Department of Census and Statistics

(a) Provisional

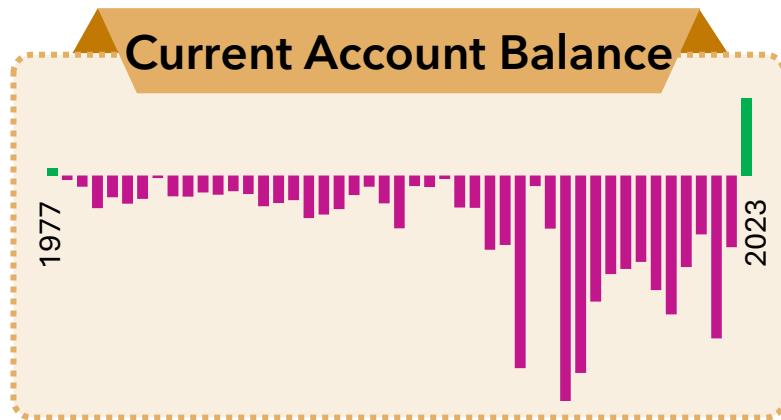
(b) Household population aged 15 years and above

(c) Labour force as a percentage of household population

- ❑ Unemployment rate **remained unchanged** in 2023, as a combined outcome of the **decline in both the unemployed population and labour force** during the year
- ❑ Further, the **employed population also decreased** in 2023 to 8.010 million, compared to 8.148 million in the previous year
- ❑ Departures for **foreign employment remained high**, but recorded a decline compared to 2022

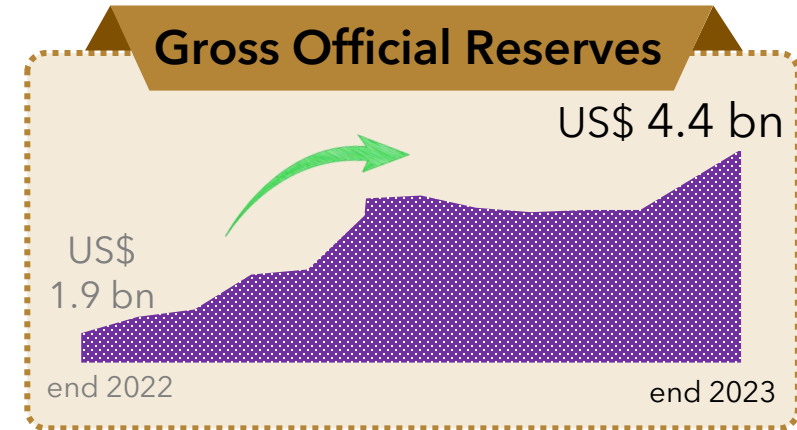


# The external sector improved notably in many fronts in 2023...



**Current account recorded a surplus in 2023 supported by**

- lower trade deficit
- higher earnings from tourism and
- workers' remittances



**Reserves more than doubled by end 2023 due to,**

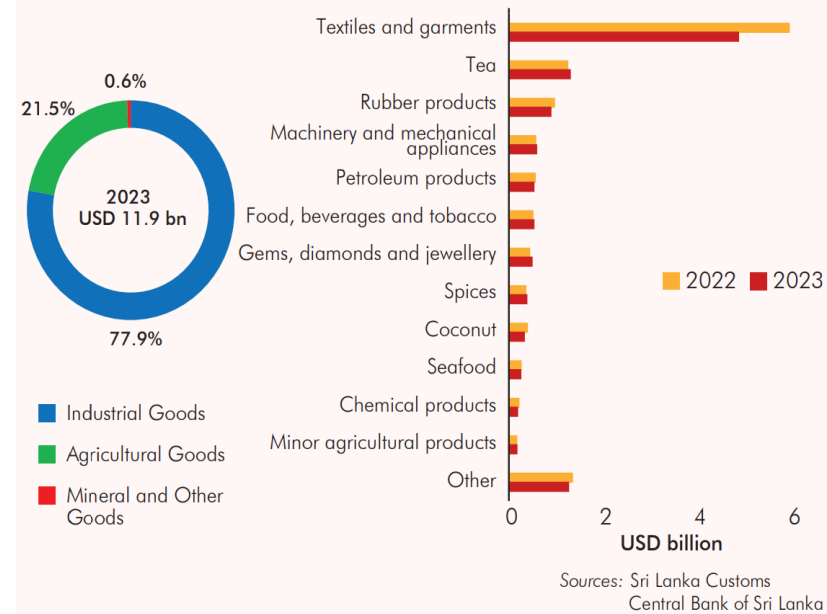
- net forex purchases by the Central Bank
- IMF-EFF funds and
- World Bank and ADB financing

**Following greater stability in external sector, the Central Bank and the Government gradually relaxed exchange restrictions, capital flow management measures and import restrictions in 2023**



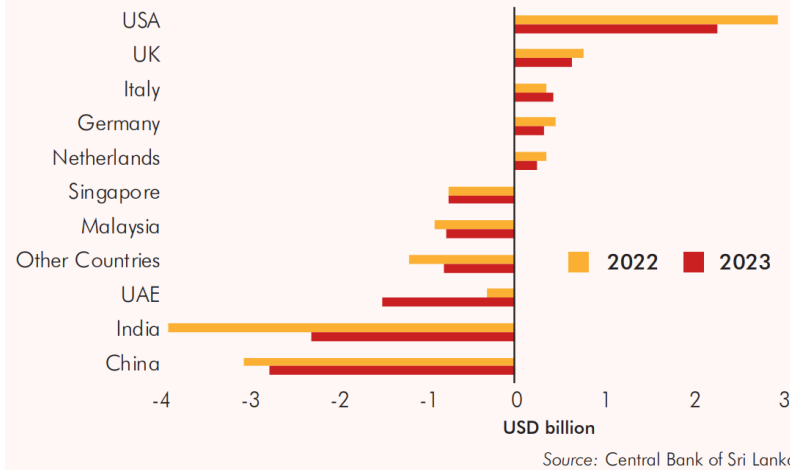
# The trade deficit narrowed due to the significant decrease in imports...

## Composition of Exports

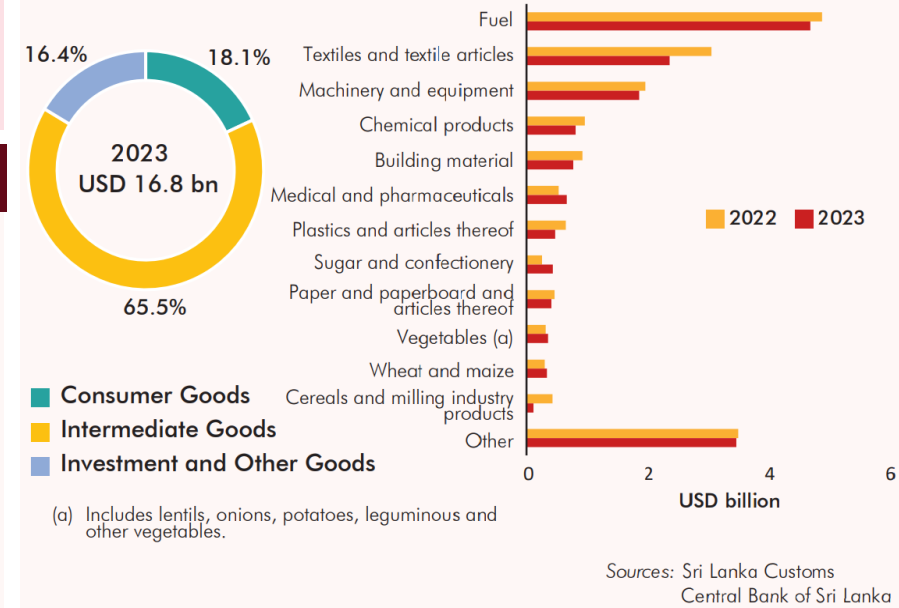


## Trade deficit in 2023 narrowed to the lowest since 2010

### Countrywise Trade Balances



## Composition of Imports



Earnings from exports declined by 9.1% (y-o-y) to USD 11,911 mn

Decline in export earnings was influenced by high cost of living and economic downturn in major export destinations and geopolitical tensions

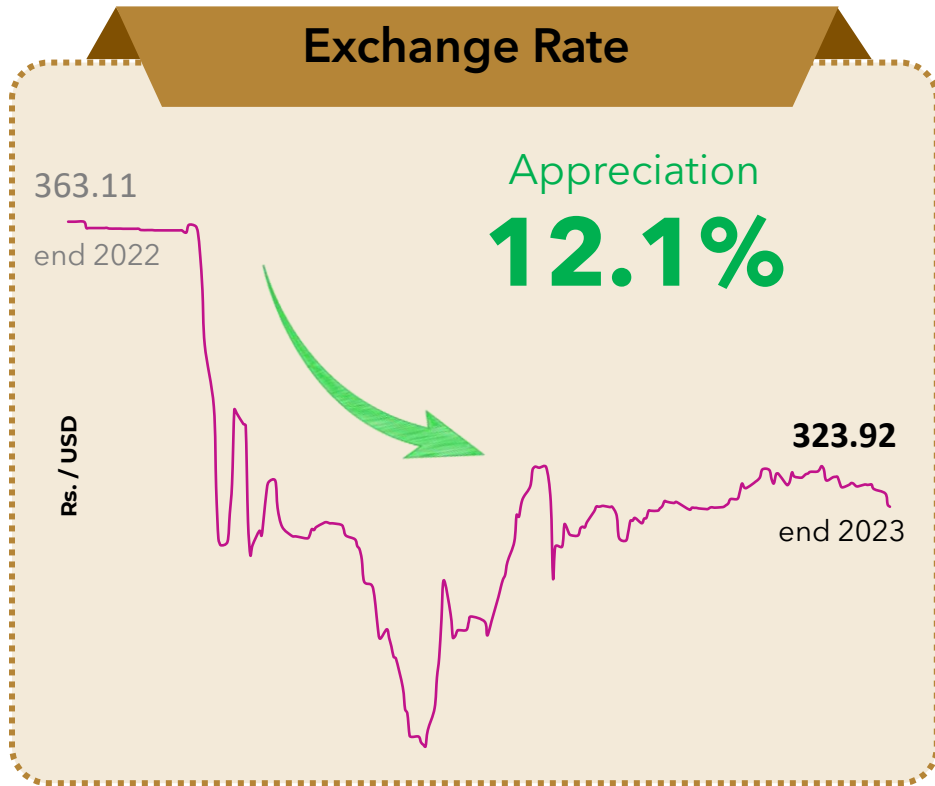
Bilateral trade with most major trading partners declined significantly, in line with lower total trade in 2023

Import expenditure decreased by 8.1% (y-o-y) to USD 16,811 mn

Decline in import expenditure was due to restrictions on non-essential imports, subdued economic activity, and tight monetary and fiscal policies

# The Sri Lanka rupee appreciated sharply in 2023 under a market based exchange rate policy...

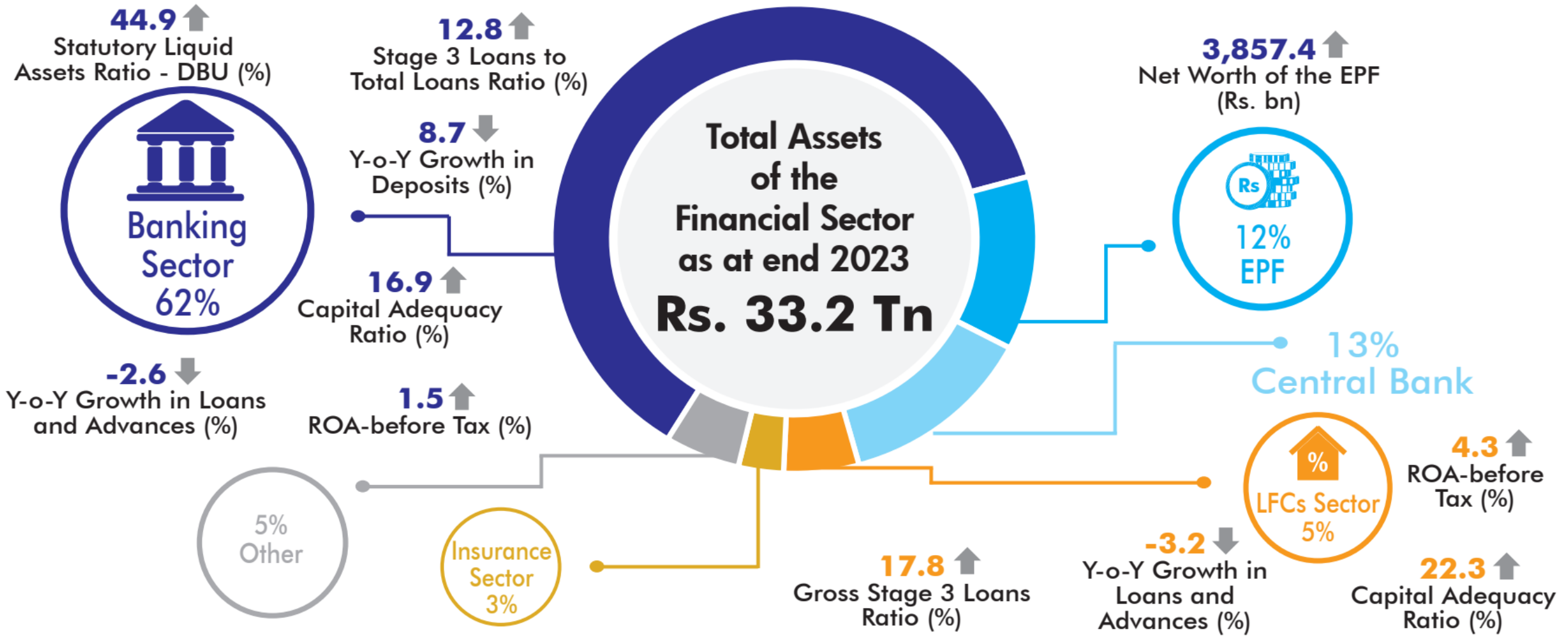
## Exchange Rate



## Policy Measures

- The newly enacted **Central Bank Act No 16 of 2023** requires the implementation of a **flexible exchange rate regime** in line with the FIT framework
- The Central Bank followed a **flexible exchange rate regime** in 2023
- Progressive **removal of restrictions** imposed on foreign exchange transactions

# Overall financial sector stability was maintained amidst challenging conditions...





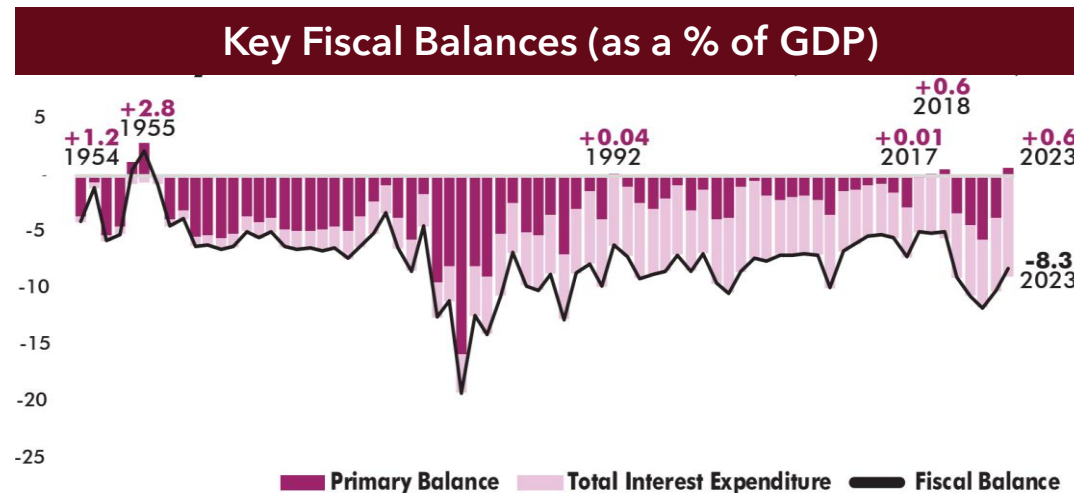
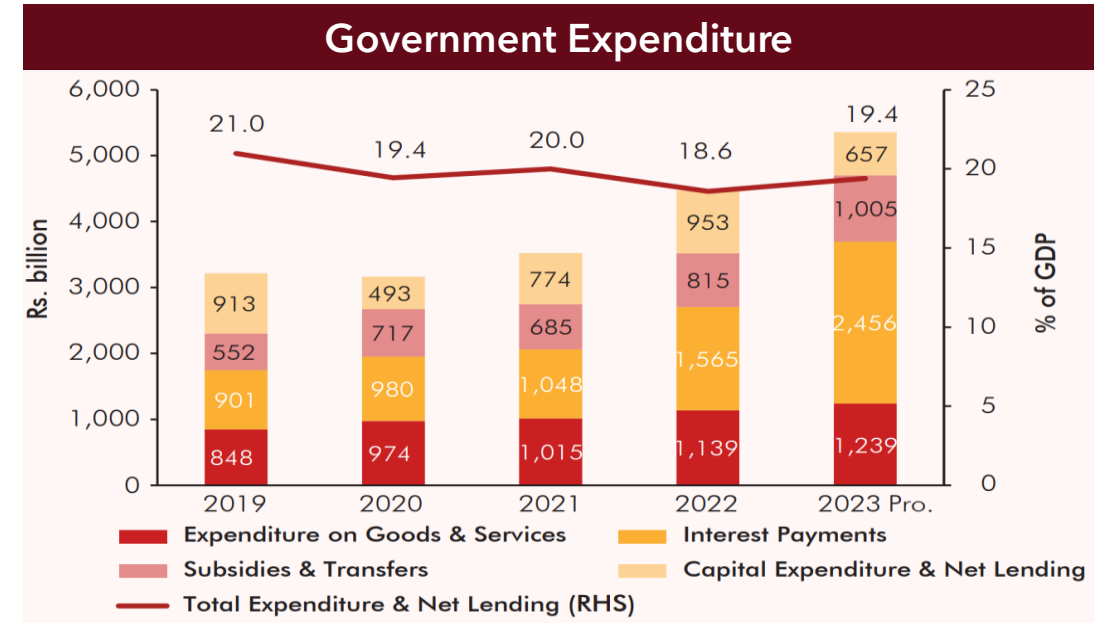
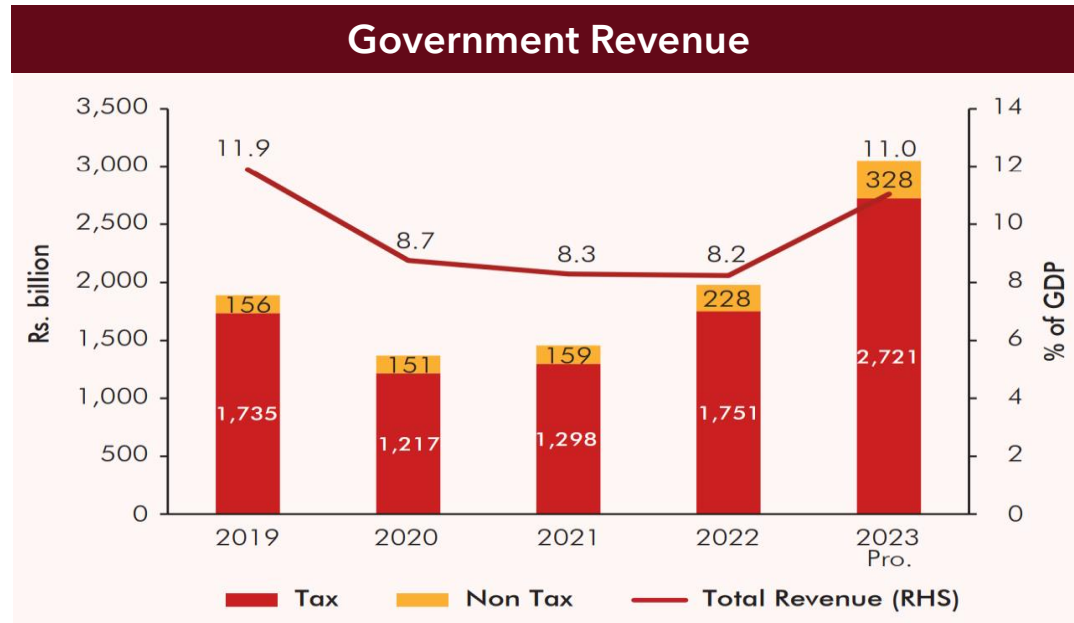
# Financial Sector Policy Measures...



- Designation of the Macroprudential Authority under the CBA
- Banking Act Directions on “Restrictions on discretionary payments of Licensed Banks” were introduced
- Several microprudential measures were also targeted at addressing issues pertaining to the liquidity conditions of banks
- A guideline on declaration of dividend/repatriation of profits was issued to streamline the existing approval process of LFCs
- The Masterplan for the Consolidation of Non-Bank Financial Institutions will continue to create strong, dynamic, and resilient LFCs over the medium term
- Banking, LFCs and SLCs sectors were requested to grant concessionary measures with a view of safeguarding MSMEs and individuals amid the challenging macroeconomic conditions
- Implemented various policy measures to promote digital payments
- Regulation on Financial Consumer Protection for Financial Service Providers was introduced
- Designation of the Resolution Authority of licensed financial institutions under the CBA



# The stellar fiscal performance in 2023, driven by stringent consolidation measures, enhanced key fiscal balances...



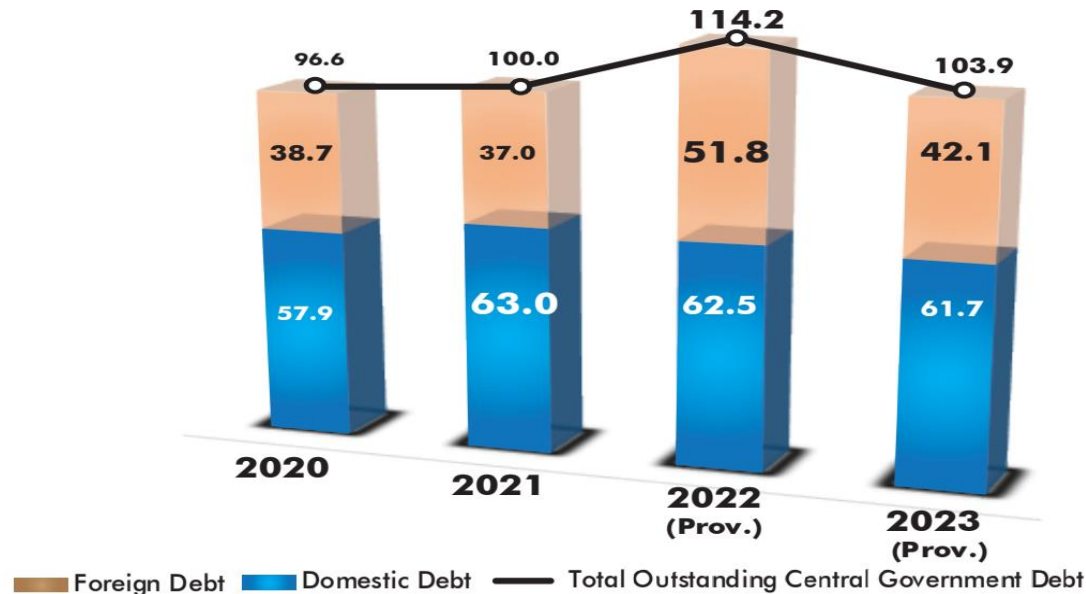
- Tax reforms boosted government revenue
- Despite the increased interest payments, rationalisation measures enabled to rein in expenditure to some extent
- A primary surplus was recorded after 5 years and for the 6th time since 1950

# In 2023, central government debt as a % of GDP declined while domestic debt service payments increased...

Central government debt as a percentage of GDP declined, primarily due to the **notable growth in nominal GDP** and the impact of **currency appreciation on foreign debt**

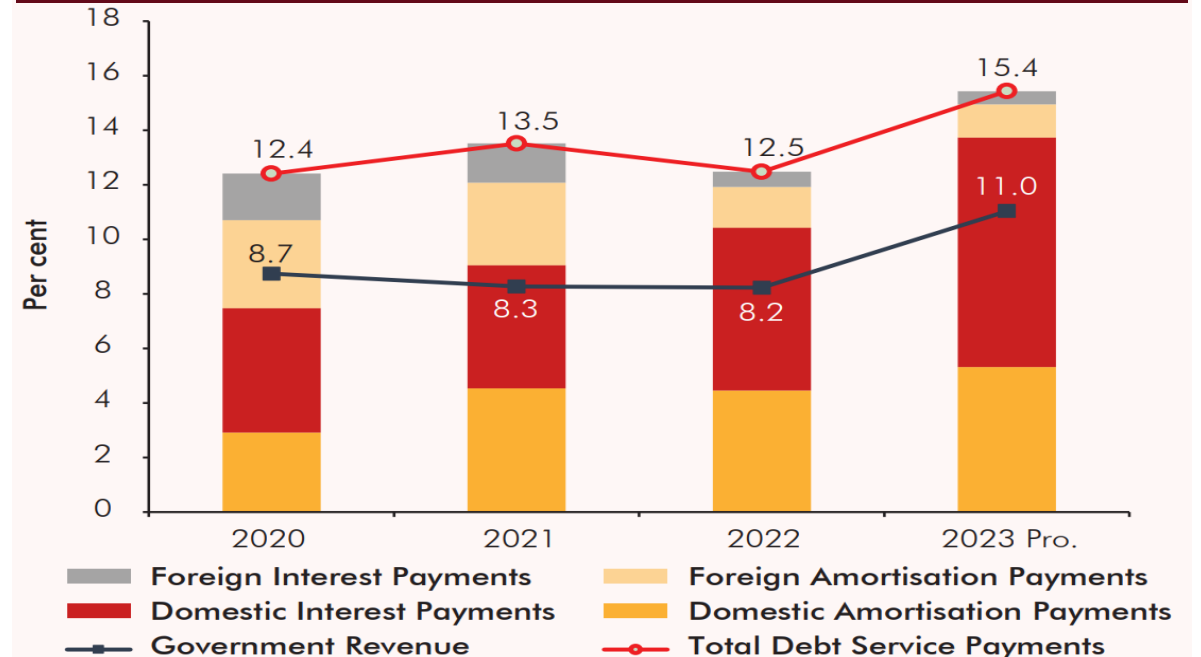
The **total debt service payments increased** in 2023 mainly driven by the increased **domestic interest payments**

## Outstanding Central Government Debt (as a % of GDP)



Sources: Ministry of Finance, Economic Stabilization and National Policies  
Central Bank of Sri Lanka

## Central Government Debt Service Payments (as a % of GDP)



Sources: Ministry of Finance, Economic Stabilization and National Policies  
Central Bank of Sri Lanka

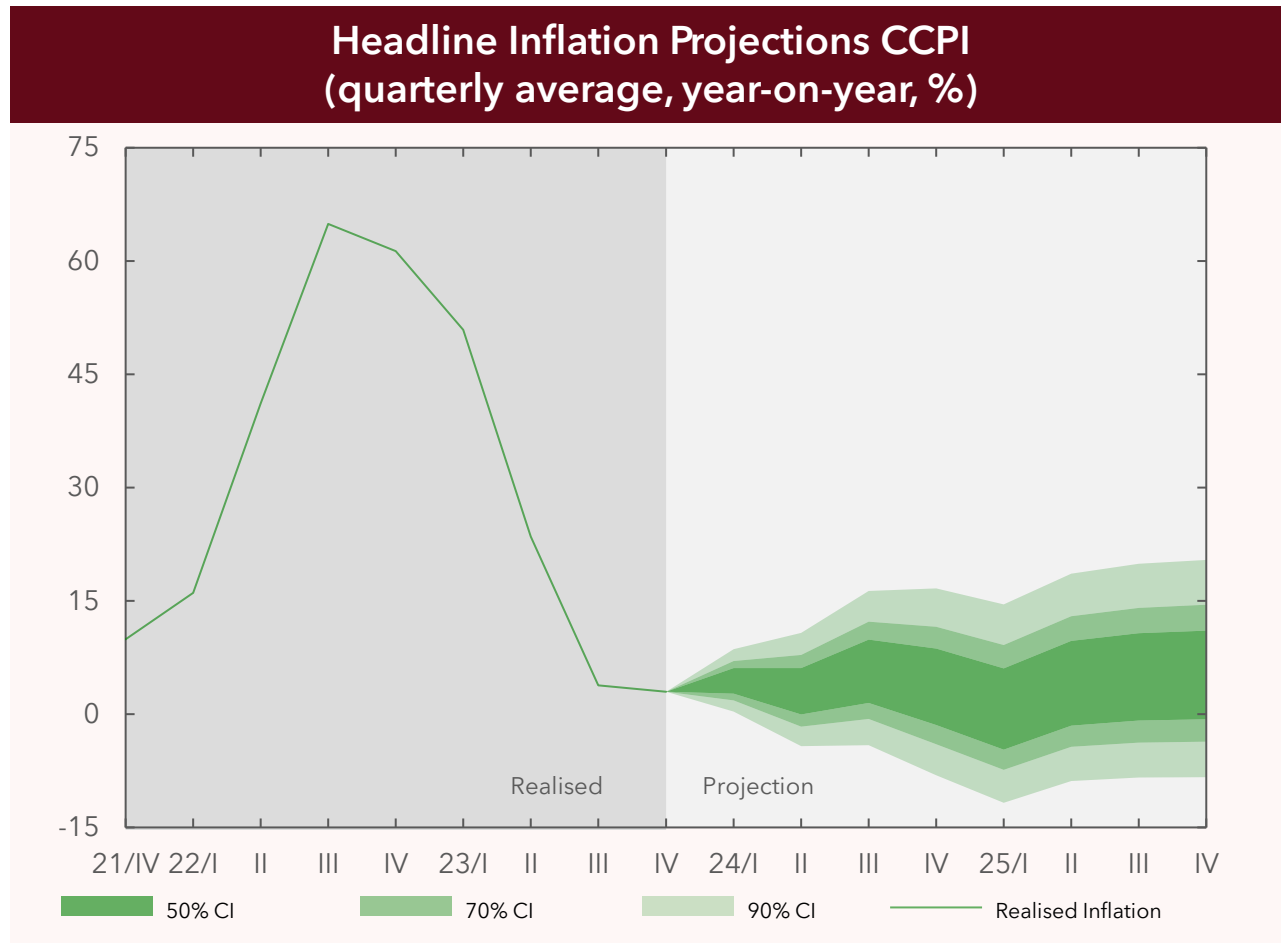
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# Macroeconomic Outlook

# Despite intermittent fluctuations, inflation is expected to stabilise around the targeted level of 5% over the medium term, supported by appropriate policy measures...



## ▲ Upside Risks



upward pressures on global food and energy prices



impact of adverse weather



upward revision to electricity prices

## ▼ Downside Risks



faster recovery of supply conditions



diminished purchasing power of the public

**Similar to headline inflation, core inflation is also expected to stabilise around 5% over the medium term**



# Near Term Macroeconomic Projections

Indicator	Unit	2022	2023	Projections
				2024
Real GDP Growth	%	-7.3	-2.3	3.0
Trade Balance	% of GDP	-6.7	-5.8	-7.8
Current Account Balance	% of GDP	-1.9	1.8	0.5
External Official Reserves	Months of Imports	1.2	3.1	3.4
Primary Account Balance	% of GDP	-3.7	0.6	0.8
Overall Budget Deficit	% of GDP	-10.2	-8.3	-7.3
Private Sector Credit Growth	%	6.2	-0.6	8.5
Annual Average Inflation	%	46.4	17.4	5.0



# Monetary and External Sector Outlook...

## Monetary

- The monetary policy stance is expected to remain accommodative
- Market interest rates to normalise further
- Expansionary momentum in credit to the private sector by the banking sector to continue
- Banking sector exposure to the public sector to be lower
- NFA of the banking system to improve
- M<sub>2b</sub> growth to accelerate to around 15.0% in 2024

## External

- Trade deficit to widen in 2024 with increased import demand and moderate export growth
- Services account surplus to increase with projected growth in tourism and other services exports
- Primary income account deficit to narrow in 2024, and widen subsequently
- Workers' remittances to remain elevated
- Financial account inflows to be supported by positive investor sentiments, multilateral financing and FDI
- A market-determined exchange rate and increased reserves



# Financial and Fiscal Sector Outlook...

## Financial

- Resilience of the financial sector to improve
  - *Credit quality of the banking sector to improve with the envisaged credit growth, easing of trade-related restrictions and improving repayment capacities*
- Structural, legal and policy-level reforms and innovations to be mobilised to ensure the stability
- Well sequenced-consistent policies to be deployed
  - *Shortfalls and weaknesses of the financial sector to be addressed along the IMF-EFF*

## Fiscal

- Revenue administration measures to be strengthened
- Expenditure to be managed with streamlined spending allocations to critical sectors
- New legislation related to public financial management and procurement to be implemented
- A separate Public Debt Management Office to be established
- The debt restructuring process to progress aiming for a sustainable debt trajectory
- Longstanding issues of SOBEs and other corruption and transparency vulnerabilities to be addressed





## List of Box Articles...

1. The Effects of Supply Side Inflation on Monetary Policy
2. International Monetary Fund's Extended Fund Facility (IMF-EFF) Programme - A Progress Update
3. The Establishment of Business Revival Units in Licensed Banks to Support Sustainable Economic Recovery
4. Market Conduct Supervision: Upholding Trust in the Financial System
5. Financial Literacy Roadmap of Sri Lanka (2024-2028): Towards A Financially Literate Sri Lanka
6. Mutual Evaluation of Sri Lanka 2025: Its National Significance
7. Making Sri Lanka's External Current Account Outcomes More Sustainable

# Concluding Remarks...

- Sri Lankan economy witnessed a gradual revival in 2023 from the deepest economic downturn in its post-independence history
- Inflation was contained at single-digit levels by end 2023 from its highest level recorded in 2022
- Domestic market interest rates declined substantially with the shift to an accommodative monetary policy stance since June 2023
- Sri Lanka rupee strengthened in 2023 and early 2024 along with greater flexibility in exchange rate and progressive removal of restrictions on forex transactions
- External buffers were gradually rebuilt in 2023 augmenting country's international reserves
- Financial sector was guided with prudential regulatory measures, preserving domestic financial system stability
- Surpluses were recorded in the primary balance of the Government and the external current account in 2023

# Concluding Remarks...

- A broadbased economic expansion is envisaged across all sectors in the future
- Domestic price stability to be preserved with greater Central Bank independence and prohibition of monetary financing
- External sector stability to be retained
- The resilience of the financial sector to improve further
- The Government to progress with its fiscal consolidation efforts

...The formidable recovery of the Sri Lankan economy hinges on the **continuity of the reforms** implemented thus far, and as part of this process, the **successful continuation of the IMF-EFF arrangement** and **completion of the debt restructuring process** remain paramount....



...Since the country has not fully exited the crisis, there is no space available for any slippages from the committed path including costly policy experiments...

...Building **strong institutional setup and a legal framework** will support the economic transition towards new normal, while broader **political and social consensus** on the economic reforms is **critical to permanently resolve structural hindrances and avoid recurring policy reversals and economic downturns** with a view to uplifting the welfare of the general public through sustained growth...



**...The Central Bank of Sri Lanka is committed to maintain domestic price stability, external sector stability and financial stability, thereby supporting sustaining economic stability and sustainable economic growth...**



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**Thank You**