IMF Staff Concludes Visit to Sri Lanka

September 18, 2015

> End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

A staff mission led by Todd Schneider visited Colombo from September 8 - 18 to conduct Post-Program Monitoring discussions. This enhanced surveillance is routine for countries that have had "exceptional access" to IMF resources, as is the case for Sri Lanka, which successfully completed a $2.6 billion IMF program in 2012. The mission met with the Prime Minister, Government, and Central Bank of Sri Lanka (CBSL) officials, as well as civil society and private sector representatives.

At the end of the visit, Mr. Schneider issued the following statement:

"First half GDP data indicate a pickup in growth—likely to continue in the range of 5 to 5.5 percent through end-2015—driven mainly by strong growth in services and a recovery in agricultural output. The increase in consumer spending created by the sharp rise in public wages and salaries has also contributed to a sizeable increase in imports of consumption and other goods—more than offsetting savings from lower oil prices. The resulting deterioration in the nonoil trade balance has contributed to persistent downward pressure on central bank foreign exchange reserves during the first eight months of the year. Headline inflation is currently near zero but is expected to end the year around 3 percent. Core inflation has risen steadily since the beginning of the year, consistent with higher demand for domestic non-tradables and a gradual reduction in economic slack. Risks to outlook are tilted to the downside with more volatile external financing conditions resulting from the expected monetary policy tightening in the U.S. and uncertainties over growth prospects in emerging markets.

"The mission welcomes the CBSL's recent decision to cease setting daily spot prices for the rupee and let market forces play a greater role in determining the exchange rate. Moving ahead, the commitment to exchange rate flexibility should continue in order to maintain competitiveness and facilitate an increase in CBSL foreign exchange reserves. The mission encouraged CBSL to work toward deepening foreign exchange markets and to revitalize a review of foreign exchange controls to enable inward investment. Additionally, the mission found the overall financial system stable and current monetary stance appropriate – but recommended vigilance given rising core inflation, the resurgence of private credit, and signs of receding slack in the economy. In this context, a tightening bias appears prudent.

"The mission agreed with the authorities on the need to take immediate and credible steps to reestablish fiscal consolidation and reduce of public debt. The mission projects a fiscal deficit in the range of 5.5 to 6 percent of GDP in 2015—higher than budgeted and financed mainly by domestic borrowing. Looking ahead, the 2016 budget is an opportunity to shift decisively back to a durable medium-term path of fiscal consolidation and to set macroeconomic priorities for 2016 and beyond. The mission strongly recommended to keep the 2016 fiscal deficit to 5.5 percent of GDP—and to base consolidation on a combination of expenditure restraint and durable revenue reforms. The mission emphasized the need to eliminate tax expenditures (exemptions, tax holidays and reduced rates) as the most important component in a strategy to make the tax system simple, fair, and efficient.

"The mission welcomes the authorities' attention to the need for market-based structural reforms and efforts to reinvigorate key initiatives. Fuel and electricity pricing, subsidies, trade policy, liberalization of factor markets (particularly land), and the investment environment are areas that could play an essential role in sustaining high rates of economic growth. Putting state firms on a commercial footing, allowing them to make market-based financial decisions (including pricing) and subjecting them to the greater financial discipline will also help to reduce risks to the budget and the financial system.

"A discussion on Post Program Monitoring by the IMF's Executive Board is expected in mid-November, 2015."