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CENTRAL BANK OF SRI LANKA

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Press Release

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The Annual Report of the Central Bank of Sri Lanka for the Year 2016

In terms of Section 35 of the Monetary Law Act No. 58 of 1949, the sixty seventh Annual Report of the Monetary Board of the Central Bank of Sri Lanka was presented to Hon. Ravi Karunanayake, the Minister of Finance, by Dr. Indrajit Coomaraswamy, the Governor of the Central Bank of Sri Lanka.

[Dr. Indrajit Coomaraswamy, the Governor of the Central Bank of Sri Lanka presenting the Annual Report 2016 to Hon. Ravi Karunanayake, the Minister of Finance. Dr. R.H.S. Samaratunga, Secretary to the Ministry of Finance and ex-officio member of the Monetary Board, Mr. S. Lankathilake, Deputy Governor of the Central Bank, Mr. C.J.P. Siriwardana and Mr. K.D. Ranasinghe, Assistant Governors of the Central Bank, and Dr. Yuthika Indraratna, Director of Economic Research of the Central Bank are also in the photo.]

A summary of the performance of the Sri Lankan economy in 2016 as reflected in the Annual Report is given below:

Overview: *Following a period of uncertainty, the Sri Lankan economy showed early signs of stabilisation during the year 2016 in response to corrective actions adopted by the government and the Central Bank. Unfavourable weather conditions and sluggish global economic recovery caused the economy to grow at a slower rate of 4.4 per cent in 2016 in real terms, in comparison to 4.8 per cent in the previous year, although a steady acceleration in quarterly growth was observed from the second quarter of the year amidst tightened fiscal and monetary policies. Increased investment expenditure, especially in the construction sector, drove economic growth during the year, while consumption expenditure slowed in response to the policy environment in place.*

Inflation, which remained low in the first four months of the year, increased thereafter to record an annual average of 4.0 per cent in 2016 (both National Consumer Price Index (NCPI, 2013=100) and Colombo Consumer Price Index (CCPI, 2013=100) based). The high levels of inflation observed during some months in 2016 as well as in the first quarter of 2017 were mainly due to the adverse impact of weather related disruptions, tax adjustments and rising international commodity prices, but the increasing demand pressures of the economy were evident in core inflation remaining at elevated levels.

Movements in external sector balances reflected the continued domestic demand for imports from certain sectors of the economy, weak external demand for the limited basket of domestic products, persistent failure of the country to attract increased direct investment flows as well as the impact of rising global interest rates particularly on the government securities market. These developments resulted in the balance of payments (BOP) recording a deficit for the second consecutive year in spite of improvements in earnings from tourism and other service exports as well as workers' remittances. The Central Bank's heavy intervention in the foreign exchange market continued in the first four months of the year resulting in a broadly stable exchange rate during this period. However, the exchange rate was increasingly allowed to reflect market conditions thereafter by limiting Central Bank intervention to dampen the pressure on the exchange rate arising from outflows of foreign investments from the government securities market.

Considering the possible rise in demand driven inflationary pressures, the Central Bank continued to tighten monetary policy and monetary conditions throughout the year. Accordingly, in addition *to increasing the Statutory Reserve Ratio (SRR) applicable on rupee deposit liabilities of licensed commercial banks (LCBs) in December 2015 to be effective from January 2016 and the continued application of the loan-to-value (LTV) ratio as a selective macroprudential demand management tool, the Central Bank raised its key policy interest rates by a total of 100 basis points in two steps during 2016, the first in February 2016 and the second in July 2016. Open market operations of the Central Bank also guided the short term market interest rates to move to the upper bound of the policy interest rate corridor, resulting in a considerable increase in the market interest rate structure. In response to tightened monetary conditions, the acceleration of broad money growth subsided while the growth of credit extended to the private sector by LCBs that peaked at 28.5 per cent in July 2016, on a year-on-year basis, also decelerated to 21.9 per cent by end 2016. However, the deceleration of monetary and credit expansion was below expectations, and the Central Bank again adjusted its policy interest rates upwards by 25 basis points in March 2017 with the view of signalling to the market the intent of the Central Bank in maintaining inflation in mid single digits in the medium term, within its increasingly forward looking monetary policy framework in which the management of inflation expectations plays a vital role. The financial sector, in the meantime, continued to expand during the year whilst exhibiting resilience amidst challenging market conditions both globally and domestically.*

Meanwhile, fiscal operations registered a notable improvement in both revenue and expenditure fronts, resulting in the containment of the overall budget deficit at the envisaged level of 5.4 per cent of Gross Domestic Product (GDP). In spite of these achievements, central government debt as a percentage of GDP increased, illustrating the narrowing fiscal manoeuvrability within the overall macroeconomic policy framework and highlighting the necessity of continued efforts to sustain the fiscal consolidation process.

Real Sector Developments: **In 2016, the Sri Lankan economy grew by 4.4 per cent in real terms, amidst numerous global and domestic challenges.**[1] Unfavourable weather conditions that prevailed during the year adversely impacted economic activity, primarily in the Agriculture

[1] As also highlighted in the Central Bank of Sri Lanka Annual Report 2015, in July 2015, the Department of Census and Statistics (DCS) changed the base year for national account statistics to 2010 from 2002, while adopting the United Nations' System of National Accounts (SNA) 2008 standard. The improved compilation procedure captures the changes in the economic structure of Sri Lanka over the past decade and introduces new economic activities to the national accounts system. The rebased GDP estimates had varying effects on macroeconomic indicators. The analysis of the state of the Sri Lankan economy provided in the Central Bank Annual Reports from 2015 is based on new GDP estimates, which are provisional.

sector. Services related activities, which constitute 56.5 per cent of real GDP, grew by 4.2 per cent in 2016, on a year-on-year basis, supported by the expansion in financial services, insurance, telecommunications, as well as transportation, and wholesale and retail trade. Industry related activities, which account for 26.8 per cent of real GDP, recorded a notable growth of 6.7 per cent, year-on-year, driven by the subsectors of construction, and mining and quarrying. Within the Industry sector, the growth in manufacturing activities was low at 1.7 per cent. Agriculture, Forestry and Fishing related activities contracted by 4.2 per cent in 2016, resulting in a reduction in their share in real GDP to 7.1 per cent in 2016. Adverse weather conditions that prevailed in 2016 resulted in a contraction, mainly in paddy, tea and rubber subsectors.

As per expenditure approach estimates, economic growth in 2016 was primarily driven by the expansion in investment expenditure during the year. Accordingly, gross domestic capital formation, which represents the level of investment activity of the economy, grew by 19.6 per cent, while accounting for 31.5 per cent of the nominal GDP. Higher investment growth predominantly emanated from the expansion in construction activities during the year. Meanwhile, consumption expenditure, which is the largest expenditure category of the economy, recorded a modest growth of 4.1 per cent in nominal terms, which was a considerable moderation compared to the growth of 10.3 per cent recorded in the previous year. The slowdown in consumption was driven by the moderation in private sector consumption expenditure due to tightened monetary and fiscal policies, while public sector consumption expenditure also moderated in 2016 with ongoing fiscal consolidation efforts. Although domestic demand grew by 8.2 per cent in nominal terms (6.2 per cent in real terms) during the year, net external demand declined by 9.6 per cent in nominal terms (22.5 per cent in real terms) in 2016 reflecting both weakness in Sri Lanka's export markets and a decline in the competitiveness of the economy as evidenced by the continued fall in the country's share of global exports. Amidst these developments, domestic savings increased to 23.8 per cent of nominal GDP, with an improvement in both private sector savings and government dissavings during the year. National savings also improved in 2016 as a result of the expansion in net current transfers from the rest of the world while net primary income from the rest of the world declined. Consequently, national savings as a percentage of nominal GDP improved to 28.9 per cent in 2016 compared to 26.0 per cent in 2015. With the increase in both investment and savings, the domestic savings-investment gap as well as the national savings-investment gap remained broadly unchanged from the previous year at 7.6 per cent of GDP and 2.5 per cent of GDP, respectively, in 2016.

The unemployment rate declined to 4.4 per cent in 2016 from 4.7 per cent in the previous year, while the number employed, increased by 1.5 per cent during the year with the expansion in the Industry and Services related activities in the economy. Both female and male unemployment rates declined, to 7.0 per cent and 2.9 per cent, respectively, in 2016, from 7.6 per cent and 3.0 per cent, respectively, in 2015. During 2016, the unemployment rates by level of education, declined across all categories, although unemployment amongst youth (15-24 years) increased to 21.6 per cent in 2016 from 20.8 per cent in 2015. Meanwhile, the Labour Force Participation Rate (LFPR) remained unchanged in 2016 at 53.8 per cent. Responding to policy actions by the government to minimise the social impact of unskilled female migration and the subdued economic performance in a majority of Middle Eastern economies and other labour destinations, departures for foreign employment declined in 2016. However, the improvement in the skill profile of the temporary migrants contributed to a moderate increase in remittance inflows. Meanwhile, labour productivity increased marginally during the first three quarters of 2016. Labour productivity in the Agriculture sector remained at a level significantly lower than in the Industry and Services sectors.

Inflation: **Consumer price inflation moved upwards during the first half of 2016, although it stabilised somewhat during the remainder of the year, while core inflation broadly followed an upward trend in 2016.** Headline inflation, as measured by the year-on-year change in NCPI was subdued in the first quarter of the year as a result of imported deflationary effects associated with low international commodity prices. Headline inflation registered an increase during the second quarter of the year reflecting the impact of domestic supply side disruptions, particularly due to adverse weather conditions, and tax adjustments. However, some deceleration in inflation was observed during the third quarter due to the suspension of the implementation of changes to the government tax structure and the recovery in domestic supply conditions. Inflation remained broadly stable thereafter, although the implementation of new Value Added Tax (VAT) rates with effect from November 2016, exerted some upward pressure on prices. Accordingly, year-on-year headline inflation based on the NCPI, which peaked at 6.4 per cent in June 2016, gradually decelerated to 4.2 per cent by end 2016, thus registering the same rate as at end 2015. Following a similar trend, CCPI based headline inflation also reached a peak of 5.8 per cent in July 2016, before registering 4.5 per cent at end 2016. Core inflation, which measures the underlying inflationary pressures in the economy, displayed an upward trend in 2016 although some volatility was observed on a monthly basis. The impact of demand driven inflationary pressures arising from the continued expansion in monetary and credit aggregates was shrouded by relatively low international commodity prices and administered price revisions, while the revision made to the tax structure had an upward effect on core inflation during the first half of 2016. Although core inflation stabilised for a few months, as a result of the suspension of the changes made to the government tax structure, the reimposition of the tax changes caused core inflation to move upwards towards end 2016. Accordingly, NCPI based core inflation stood at 6.7 per cent by end 2016, year-on-year, remaining higher than 5.8 per cent recorded at end 2015. Year-on-year core inflation based on the CCPI declined from 6.7 per cent at end 2015 to 5.8 per cent by end 2016. The prevailing drought conditions, the effect of the tax changes and rising international commodity prices affected the movements in inflation in the first quarter of the year 2017 as well, although tightened monetary and fiscal policies enabled reining in of demand pressures on inflation to a great extent.

External Sector Developments: **Sri Lanka's external sector performance remained subdued in 2016, with foreign exchange outflows exceeding the moderate inflows during the year.** Monetary policy normalisation in the United States of America (USA), subdued external demand due to the slow pace of economic recovery in several advanced economies and emerging market economies, and persisting geopolitical tensions in the Middle East, significantly dampened the performance of the external sector. The trade deficit as a percentage of GDP expanded to 11.2 per cent in 2016 compared to 10.4 per cent in 2015. Although the services account and the secondary income account recorded surpluses, the increase in the trade deficit and the primary income account deficit, caused the current account deficit to widen to 2.4 per cent of GDP in 2016 from 2.3 per cent of GDP in 2015. The subdued performance of the financial account of the BOP stemmed from continued outflows on account of debt repayments amidst modest non debt inflows. In July 2016, Sri Lanka successfully raised US dollars 1,500 million through its 10th International Sovereign Bond (ISB), which was its first dual-tranche issuance as well. Meanwhile, in view of the deterioration in the BOP and to obtain support for the government's reform agenda, Sri Lanka requested a three year Extended Fund Facility (EFF) of Special Drawing Rights (SDR) 1.1 billion (approximately US dollars 1.5 billion) from the International Monetary Fund (IMF), and the first and the second tranches under this facility amounting to US dollars 332 million were received during the year. The overall balance of the BOP recorded a deficit in 2016 reflecting the widening of the current account deficit and relatively low level of inflows to the financial account. The overall deficit amounted to US dollars 500 million in 2016 compared to the deficit of US dollars

1,489 million recorded in 2015. Meanwhile, Sri Lanka's gross reserve asset position declined to US dollars 6.0 billion, as at end 2016, equivalent to 3.7 months of imports of goods and 3.1 months of imports of goods and services. The decline in gross official reserves was primarily due to foreign currency debt service payments, settlement of international foreign currency swap arrangements, repayments under the IMF Standby Arrangement (SBA) facility and the supply of liquidity to the domestic foreign exchange market, particularly in the first half of the year. Total foreign assets stood at US dollars 8.4 billion at end 2016, which was adequate to cover 5.2 months of imports of goods and 4.3 months of imports of goods and services. The rupee depreciated against all major currencies except the pound sterling in 2016. The depreciation pressure on the rupee was a result of increased imports, continued foreign debt service payments and outflows on account of reversal of foreign investments from the government securities market amidst monetary policy normalisation in the USA. The Central Bank supplied foreign currency liquidity to the market heavily in the first four months of the year, and to a lesser extent thereafter, resulting in a net supply of US dollars 768 million during the year, compared to US dollars 3,250 million in 2015. This intervention was primarily to dampen the pressure on the exchange rate arising from foreign outflows from the government securities market. The rupee, which remained broadly stable with heavy intervention by the Central Bank in the first four months of the year, was allowed to reflect market demand and supply conditions to a great extent in the second half of the year, resulting in an overall depreciation of the rupee against the US dollar by 3.83 per cent in 2016. In spite of this nominal depreciation, the 5-currency and 24-currency Real Effective Exchange Rate (REER) indices, which take into account the variations in nominal exchange rates and the inflation differentials among countries, appreciated by 2.83 per cent and 2.70 per cent, respectively, by the end of the year, reflecting an erosion in the external competitiveness of the rupee.

Fiscal Sector Developments: **The increase in government revenue stemming from the broadened tax base, structural reforms in tax administration and the rationalisation of government expenditure, in tandem with the government's commitment to strengthen the fiscal consolidation process contributed to the overall improvement of the fiscal sector during 2016.** The improvements in fiscal operations, achieved under the government's revenue based fiscal consolidation process, helped contain the overall budget deficit at the targeted level of 5.4 per cent of GDP in 2016 in comparison to the deficit of 7.6 per cent in the previous year. In line with this, the current account deficit, that reflects government dissaving, declined to 0.6 per cent of GDP in 2016, significantly below the level of 2.3 per cent of GDP recorded in 2015. The primary deficit, which excludes interest payments from the overall deficit, declined to 0.2 per cent of GDP in 2016 from 2.9 per cent recorded in 2015. Government revenue as a percentage of GDP increased for the second consecutive year to 14.2 per cent in 2016 from 13.3 per cent recorded in 2015, mainly due to the increase in non tax revenue during the year. Tax revenue increased by 8.0 per cent in 2016, although tax revenue as a percentage of GDP remained unchanged from the previous year at 12.4 per cent. In 2016, non tax revenue as a percentage of GDP increased to 1.9 per cent from 0.9 per cent recorded in 2015, while in nominal terms, it increased by more than two fold during the year. This was mainly due to the increase in profit and dividend transfers from state owned business enterprises (SOBEs) mainly as a result of the improved performance of those in the banking and insurance sectors, and the Telecommunications Regulatory Commission of Sri Lanka (TRCSL). While the share of tax revenue in total revenue accounted for 86.8 per cent, indirect taxes continued to be the key constituent of government tax revenue, accounting for 82.3 per cent of tax revenue. Total expenditure and net lending as a percentage of GDP declined to 19.7 per cent in 2016 from 20.9 per cent in 2015, reflecting the decline in recurrent expenditure as well as capital expenditure and net lending. The efforts of the government to rationalise recurrent expenditure and prioritise capital expenditure led to a reduction in government expenditure. Accordingly, recurrent expenditure as a percentage of GDP declined to 14.8 per cent in 2016 from 15.5 per cent in 2015. In nominal terms, however, recurrent expenditure increased by 3.3 per cent in 2016, primarily due to the increase in interest payments, followed by the increase in expenditure on salaries and wages, current transfers and subsidies. Meanwhile, reflecting the streamlining and prioritising of public investment programmes, capital expenditure and net lending as a percentage of GDP, declined to 4.9 per cent in 2016 from 5.4 per cent in 2015. Public investment declined to 5.0 per cent of GDP in 2016 from 5.5 per cent of GDP in 2015. During the year, the overall budget deficit of Rs. 640.3 billion was largely financed from foreign sources. Accordingly, foreign financing contributed 61.2 per cent of total financing, while the remainder was financed through domestic sources. The central government debt to GDP ratio increased to 79.3 per cent by end 2016 from 77.6 per cent as at end 2015. This was mainly due to the increase in net borrowings and the modest economic growth during the year. In nominal terms, outstanding central government debt increased to Rs. 9,387.3 billion as at end 2016 from Rs. 8,503.2 billion as at end 2015. Within this, total outstanding domestic debt increased by 7.7 per cent to Rs. 5,341.5 billion, while total outstanding foreign debt increased significantly by 14.2 per cent to Rs. 4,045.8 billion by end 2016. In spite of improvements in many fronts, several drawbacks were observed in fiscal operations primarily due to the sluggish implementation of structural reforms in tax administration. At the same time, current expenditure, which includes interest payments, salaries and wages, and subsidies and transfers to the household sector remained high despite some rationalisation observed during the year. Moreover, the fiscal sector was affected, to some extent, by the increasing cost of borrowing as a result of rising interest rates in both the domestic and international markets and also the depreciation of the rupee against major foreign currencies. These developments, along with the accumulation of substantial amounts of commercial foreign debt across short to medium term maturities, highlight the need for a national consensus on sustained fiscal consolidation through the timely implementation of urgent fiscal and structural reforms.

Monetary Policy and Monetary Sector Developments: **The conduct of monetary policy in 2016 was aimed at stabilising the economy through the containment of the possible rise in excessive demand pressures in the economy.** During 2016, monetary aggregates grew at a faster pace than projected, underpinned by excessive expansion in credit to both the government and the private sector. The Central Bank commenced monetary tightening from end 2015, by raising the SRR applicable on all rupee deposit liabilities of LCBs by 1.50 percentage points to 7.50 per cent with effect from 16 January 2016, to absorb excess liquidity in the domestic money market on a permanent basis. Furthermore, policy interest rates of the Central Bank viz., the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) were raised by 50 basis points each in February 2016 to 6.50 per cent and 8.00 per cent, respectively, in light of rising inflationary pressures. Despite monetary tightening measures, credit to the private sector continued to expand while inflation indicated an upward trend, although a significant portion of inflation was attributable to tax revisions and disruptions to domestic supply conditions. To pre-empt the escalation of inflationary pressures and to support the BOP, the Central Bank further tightened the monetary policy stance in July 2016, by increasing the SDFR and the SLFR by an additional 50 basis points to 7.00 per cent and 8.50 per cent, respectively. Alongside the increased policy interest rates, open market operations (OMO) guided overnight interest rates towards the upper bound of the policy rate corridor. These efforts were complemented by the macroprudential measures adopted in late 2015 as well as the gradual adjustment in the exchange rate throughout the period. During 2016, market interest rates adjusted upwards reflecting tight monetary conditions in the economy. Although the growth of credit disbursements to the private sector by commercial banks decelerated to some extent, the continued supply- and tax-driven rise in inflation, particularly in early 2017, prompted the Central Bank to tighten monetary policy further in March 2017 as a precautionary measure to contain the build-up of adverse inflation expectations and second round effects within its increasingly forward looking approach to the conduct of monetary policy.

Underpinned by the expansion in credit to both the government and the private sector, broad money supply (M_{2b}) continued to increase at a rate higher than projected in 2016. Accordingly, the year-on-year growth of broad money was at 18.4 per cent by end December 2016, compared to 17.8 per cent at end 2015, while the average growth also remained elevated at 18.1 per cent. Net foreign assets (NFA) of the banking system contributed positively to the expansion in broad money supply, reversing the trend observed in the previous year. However, net domestic assets (NDA) of the banking system remained the key factor contributing 92 per cent of the expansion in broad money. This was mainly driven by the expansion in credit flows to both the government and the private sector. In contrast, credit extended by the banking system to public corporations declined during 2016, reflecting improvements in the financial position of a number of SOBEs, particularly the Ceylon Petroleum Corporation (CPC). Credit extended to the private sector by commercial banks continued to expand during 2016 while some slowdown was observed towards the end of the year. The year-on-year growth of credit to the private sector, which was at 25.1 per cent at end 2015 peaked at 28.5 per cent by July 2016, before declining to 21.9 per cent by end 2016 in response to the monetary policy measures adopted by the Central Bank. In absolute terms, the increase in credit extended to the private sector was Rs. 754.9 billion during 2016 compared to the increase of Rs. 691.4 billion in the previous year. As per the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector, credit disbursed to all major sectors of the economy expanded considerably in 2016.

Financial Sector Developments: **The financial sector continued to expand during the year whilst exhibiting resilience amidst challenging market conditions both globally and domestically.** In 2016, assets of the banking sector grew at a slower pace than in the previous year mainly reflecting the tighter monetary conditions that prevailed during the year, while the sector continued to maintain its capital and liquidity levels well above the minimum statutory requirements. The asset base of the banking sector recorded a growth of 12.0 per cent driven by increased loans and advances. Deposits of the banking sector expanded by 16.5 per cent during 2016 mainly on account of the growth in time deposits in the backdrop of a high interest rate environment, although borrowings by the banking sector recorded a decline of 3.5 per cent during the year mainly due to a reduction in foreign currency borrowings. Profitability of the banking sector as measured by the Return on Assets (ROA) and Return on Equity (ROE) improved during 2016 reflecting the increase in net interest income of the banking sector. Meanwhile, the banking sector maintained capital and liquidity at levels higher than the minimum regulatory requirements, and continued to manage risks prudently during the year. Asset quality improved during 2016 recording the lowest non performing loans (NPL) ratio in the past two decades. In the meantime, the banking sector expanded its operations during 2016 through the establishment of new banking outlets and installation of new Automated Teller Machines (ATMs). The licensed finance companies (LFCs)/specialised leasing companies (SLCs) sector grew in terms of assets and the branch network during 2016. The LFC/SLC sector placed more emphasis on other loan products, gradually moving away from the core business of financing the purchase of motor vehicles. This growth was mainly funded through domestic borrowings as the sector's reliance gradually shifted towards bank borrowings from retail deposits considering its flexibility and cost. Increased business volumes and improved operational efficiency coupled with a moderately increasing net interest income enabled the LFC/SLC sector to post an increased level of profits in 2016. Risks in the LFC/SLC sector as a whole remained at manageable levels as reflected by comfortable levels of NPL, liquidity and capital. Meanwhile, Primary Dealers in government securities recorded a decline in their total investment portfolio as well as total assets. However, total capital and profitability of the Primary Dealer industry recorded a growth. In the Unit Trust industry, total assets as well as the number of units issued recorded a decline in 2016. Investments in government securities by Unit Trusts increased significantly, while investments in equities recorded a marginal decline. Meanwhile, total assets of the insurance sector expanded in 2016 with the contribution of both long term insurance and general insurance business categories. Total profits earned by the insurance sector marked a considerable growth in 2016 led by an impressive performance in the general insurance sector. With regard to superannuation funds, total assets of the sector recorded a modest growth in 2016 as a combined result of the increase in income generated through investments and net contributions by the members of these funds.

The regulatory agencies including the Central Bank, initiated several measures to strengthen the supervisory and regulatory framework for financial institutions with a view to further enhancing their safety and soundness, thereby promoting public confidence in the financial sector. The Central Bank further increased the capital requirements for licensed banks under Basel III to be effective from July 2017. All licensed banks were requested to disclose key information on regulatory capital, liquidity and risk management with published financial statements, while greater disclosure of fees charged for fund transfers were also requested. All licensed banks were also requested to submit reports on cyber security events to the Central Bank with a view to addressing risks emanating in relation to cyber security. Further, measures were taken to promote the secondary market for government securities among the banking sector by enhancing transparency and price discovery. With regard to the LFC/ SLC sector, the Central Bank continued to take prudential measures keeping in line with improved local and international standards and procedures, while taking regulatory measures to resolve the concerns with respect to weak finance companies with a view to maintaining financial system stability. Meanwhile, a regulatory framework for microfinance companies was introduced by the Central Bank during 2016 in terms of the powers vested under the newly enacted Microfinance Act, No. 6 of 2016, which is intended for licensing, regulating and supervising unregulated microfinance companies and microfinance non governmental organisations (MNGOs). In the insurance sector, the Insurance Board of Sri Lanka (IBSL) took several regulatory measures in 2016 with a view to safeguarding the interests of policyholders while promoting the professionalism and reputation of the industry.

Way Forward: **The performance of the Sri Lankan economy in 2016 reconfirmed the necessity of addressing the deep rooted structural issues, in order to enable the country to progress towards a higher growth trajectory, as envisaged.** While the government's recent efforts, with the support of multilateral agencies including the IMF, to formulate policy frameworks required to address these issues as well as emerging challenges are commendable, it is essential that such policies are implemented swiftly with consistency in order to improve productivity and efficiency of the economy and to attract much needed foreign direct investments (FDIs) and boost investments from the domestic private sector, while seamlessly integrating with the global production networks. The structural challenges faced by the Sri Lankan economy have been consistently highlighted by the Central Bank of Sri Lanka in its previous Annual Reports and regular reports to the government, and also by the research community and international development agencies on numerous occasions in the past. Along with strengthening macroeconomic fundamentals through improved fiscal performance and the conduct of monetary policy in a forward looking framework, it is essential that these structural issues are addressed decisively without delay with broad public consensus, as the postponement of these essential reforms is no longer feasible if the country is to progress along a sustainable and equitable growth trajectory.