IMF Reaches Staff-Level Agreement on the Fifth Review of Sri Lanka's Extended Fund Facility

March 1, 2019

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 findings so far, staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

- Revenue-based fiscal consolidation and SOE reforms are needed to put Sri Lanka's high public debt on a downward path, while providing space for critical social and development goals.
- Efforts to rebuild foreign exchange reserve buffers, supported by a prudent policy mix and exchange rate flexibility, are critical to strengthen resilience to shocks and market confidence.
- Strengthening institutions and accelerating structural reforms can lay the foundation for strong, sustainable, and inclusive growth in Sri Lanka.

A staff team from the International Monetary Fund (IMF) led by Manuela Goretti visited Colombo during February 14-28, 2019 to resume discussions on the fifth review under Sri Lanka's economic reform program supported by a three-year Extended Fund Facility (EFF) arrangement. At the end of the visit, Ms. Goretti made the following statement:

"The team welcomes the Sri Lankan authorities' ongoing efforts to bring their economic reform program back on track following the political turmoil of late 2018. The team reached understandings at the staff level with the Sri Lankan authorities on the fifth review and their request to extend the EFF arrangement for an additional year with the remaining disbursements being evenly spread over this period to allow more time for the completion of the economic reform agenda. Subject to the planned submission to Parliament of the 2019 budget consistent with the EFF-supported program, the Board is expected to consider Sri Lanka's request for completion of the fifth review in May 2019. The authorities are taking steps to complete all the pending actions and structural benchmarks for this review over the next few weeks.

“The economy is gradually stabilizing after the weak economic performance in 2018, in the context of external shocks and domestic political uncertainty. Real GDP growth is expected to improve to about 3.5 percent this year, from 3 percent in 2018. Inflation recovered in January and is projected to reach 4.5 percent in 2019. The current account deficit widened to 3.2 percent of GDP in 2018, on the back of higher fuel prices, lower agricultural exports, and a surge in imports of vehicles, but is expected to narrow in 2019 benefiting from the correction in the exchange rate.

“Program performance suffered a setback in the second half of 2018, delaying the completion of the fifth review under the IMF-supported program. The primary fiscal surplus fell short of program targets in December, largely due to weak revenues. The foreign exchange reserve target was also missed by a sizable margin, as market pressures from tight global financial conditions were exacerbated by the political crisis in late 2018.

“At this difficult juncture, a concerted effort is needed by all stakeholders to preserve the hard-won gains of the economic reform program, support macroeconomic stability, and strengthen the economy’s resilience to shocks, given the high level of public debt and low reserve buffers. The authorities’ unwavering commitment to revive the reform momentum is critical to restore market confidence and meet the large refinancing needs coming due.

“Sustained fiscal consolidation through domestic revenue mobilization and prudent spending remains a priority to maintain public debt sustainability. Consistent implementation of the 2018 Inland Revenue Act (IRA) and modernization of the Inland Revenue and Customs departments are needed to achieve this goal. The team welcomed the authorities’ commitment to raise the primary surplus to 1.5 percent of GDP in the 2019 budget. Under the EFF-supported program, greater revenue mobilization is expected to make space for better-targeted social and capital spending, while a more business-friendly tax regime under the IRA can support investment and growth. The team welcomed the authorities’ commitment to put the high public debt on a downward path, bringing the fiscal deficit to 3.5 percent of GDP in 2020, in line with the reform program objectives, and 2 percent of GDP over the medium term, by adopting a sound fiscal rule and launching a new medium-term debt strategy.

“Renewed efforts to improve transparency, accountability, and cost-efficiency of large state-owned enterprises are needed to help safeguard fiscal sustainability and catch up with delays in reform implementation. The authorities should move forward with plans to bring SriLankan Airlines on a sound commercial and financial footing and complete energy pricing reforms to address rising fiscal risks.

“The team supported the Central Bank of Sri Lanka (CBSL)’s commitment to rebuild reserve buffers to adequate levels and allow exchange rate flexibility to protect the economy against shocks. The CBSL should continue to maintain a prudent and data-dependent monetary policy, standing ready to tighten policy rates should inflationary pressures re-emerge. The team urged the authorities to finalize the amendments to the Monetary Law Act with a view to strengthen the CBSL's mandate, decision-making structures, autonomy, accountability, and transparency in the roadmap towards inflation targeting.

"Ongoing steps to strengthen financial sector stability, in line with the recommendations of the recent Financial System Stability Review, are welcome. These should include efforts to harmonize the regulatory and supervisory regimes and strengthen the crisis-preparedness toolkit for financial institutions. The CBSL has also made progress in strengthening the Anti-Money Laundering and Countering the Financing of Terrorism regime.

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

The team met with Prime Minister Wickremesinghe, Minister of Finance Samaraweera, State Minister of Finance Wickramaratne, Governor of the Central Bank of Sri Lanka Coomaraswamy, other public officials, and representatives of the business community, civil society, and international partners.