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

September 24, 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.

- *We welcome the authorities' commitment to fiscal discipline and institutional reforms to anchor debt sustainability, while providing space to support the ongoing recovery and social goals.*
- *The new Central Bank Act will be a landmark reform in the roadmap towards flexible inflation targeting, strengthening the Central Bank of Sri Lanka's mandate, governance, accountability, and transparency, in line with international best practice.*
- *Trade and investment liberalization, SOE reforms, and stepped-up anti-corruption efforts will be important to bolster Sri Lanka's competitiveness and medium-term growth.*

A staff team from the International Monetary Fund (IMF) led by Manuela Goretti visited Colombo during September 10-25, 2019 to conduct the sixth review under Sri Lanka's economic reform program supported by a four-year Extended Fund Facility (EFF) arrangement. At the end of the visit, Ms. Goretti made the following statement:

"The team reached understandings at the staff level with the Sri Lankan authorities on the sixth review of the EFF-supported program. The authorities are taking steps to complete all the pending actions and structural benchmarks for this review over the next few weeks.

"The team welcomed the authorities' efforts to normalize the security situation in the country after the tragic terrorist attacks in April and mitigate the impact of the shock on the economy. Real GDP growth was revised to 2.7 percent in 2019 and is projected to improve to 3.5 percent in 2020, as tourist arrivals and related activities gradually recover. Inflation is expected to remain stable at around 4.5 percent during 2019-20. Despite the recent fall in tourist arrivals and remittances, the current account balance is projected 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.

“Sustaining prudent policies and implementing institutional reforms remain critical to preserve macroeconomic stability, given the weak global outlook and Sri Lanka’s sizable public debt.

“The protracted impact of the 2018 political crisis and the Easter attacks are significantly impacting fiscal performance. The end-June fiscal target was missed by a large margin, due to frontloading of spending from the clearing of arrears and externally-financed capital projects carried over from 2018 as well as a sharp fall in indirect revenues following the terrorist attacks. While the program targets agreed at the time of the fifth review are no longer within reach, the authorities are committed to achieve a primary fiscal surplus of 0.2 percent of GDP in 2019, through implementation of remaining revenue measures in the 2019 budget and prudent expenditure management.

“The mission welcomed the authorities’ commitment to advance revenue-based fiscal consolidation in 2020 and over the medium term to preserve the gains achieved under the program, put the high public debt on a downward path, and provide space for better-targeted social and capital spending. Sustained efforts are needed to mobilize revenues, by broadening the tax base and enforcing compliance, and strengthen spending efficiency. To anchor public debt sustainability, the mission welcomed the authorities’ plans to revamp fiscal rules and establish an independent public debt management agency over the medium term, in line with international best practice. Improving the financial performance of SriLankan Airlines and advancing energy sector reforms, including by tackling cost inefficiencies and subsidies in the electricity sector, remain critical steps to reduce fiscal risks.

“The mission supported the Central Bank of Sri Lanka (CBSL)’s prudent and data-dependent monetary policy approach and their renewed commitment to strengthen reserve buffers in line with program understandings. The CBSL should continue to allow for exchange rate flexibility and limit FX intervention to smooth excess volatility, in the event pressures from tighter global financial conditions were to intensify. The new Central Bank Act will be a landmark reform in the roadmap towards flexible inflation targeting by strengthening the CBSL’s mandate, governance, accountability, and transparency, in line with international best practice.

“The CBSL adopted temporary measures to support the tourism sector and ease credit conditions in the aftermath of the terrorist attacks, including a debt service moratorium and caps on bank interest rates. These exceptional measures should be lifted as soon as credit conditions stabilize to avoid distortions to the financial system, amid weaker credit quality and falling profitability. The mission welcomed the ongoing efforts to strengthen the regulatory and supervisory regime for banks and non-bank financial institutions. The CBSL’s plans to enhance the macroprudential policy framework and stress testing capabilities and to upgrade the contingency framework would also contribute to financial stability. The authorities have made progress in strengthening the Anti-Money Laundering and Countering the Financing of Terrorism regime.

“The mission welcomed the authorities’ ongoing plans to bolster competitiveness and medium-term growth by gradually liberalizing the trade and investment regimes, while addressing any potential revenue impact. These plans would need to be supported by an unwavering commitment to strengthen governance and transparency, notably in state-owned enterprises, and tackle corruption as well as stepped-up efforts to promote women’s economic empowerment and targeting social transfers to those who need it the most.”

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, Secretary to the Treasury Samaratunga, Senior Deputy Governor Weerasinghe, other public officials, representatives of the Parliamentary Opposition, business community, civil society, and international partners.