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The Central Bank of Sri Lanka Releases its Annual Report for the Year 2022

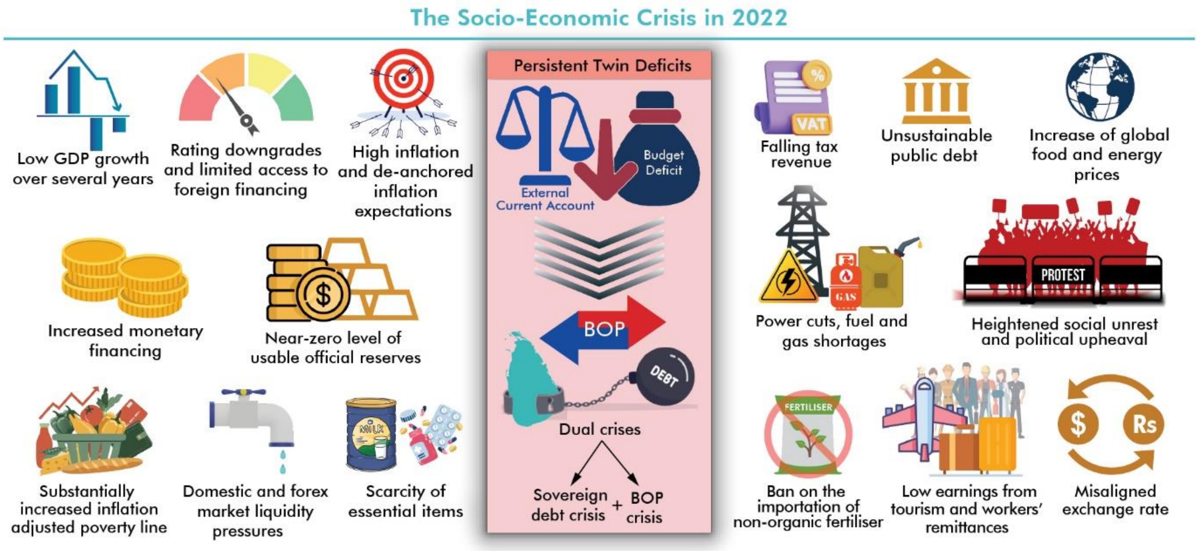
In terms of Section 35 of the Monetary Law Act No. 58 of 1949, the seventy third Annual Report of the Monetary Board of the Central Bank of Sri Lanka was presented today (27 April 2023) to Hon. Ranil Wickremesinghe, the President and Minister of Finance, Economic Stabilization and National Policies, by Dr. P Nandalal Weerasinghe, the Governor of the Central Bank of Sri Lanka.

[Dr. P Nandalal Weerasinghe, the Governor of the Central Bank of Sri Lanka presenting the Annual Report 2022 to Hon. Ranil Wickremesinghe, the President and Minister of Finance, Economic Stabilization and National Policies. Mr. K M M Siriwardana, Secretary to the Treasury, Dr. P K G Harischandra, Director of Economic Research, Dr. (Mrs.) S Jegajeevan and Dr. L R C Pathberiya, Additional Directors of Economic Research of the Central Bank were also present.]

A summary of the performance of the Sri Lankan economy in 2022 as reflected in the Annual Report is given below:

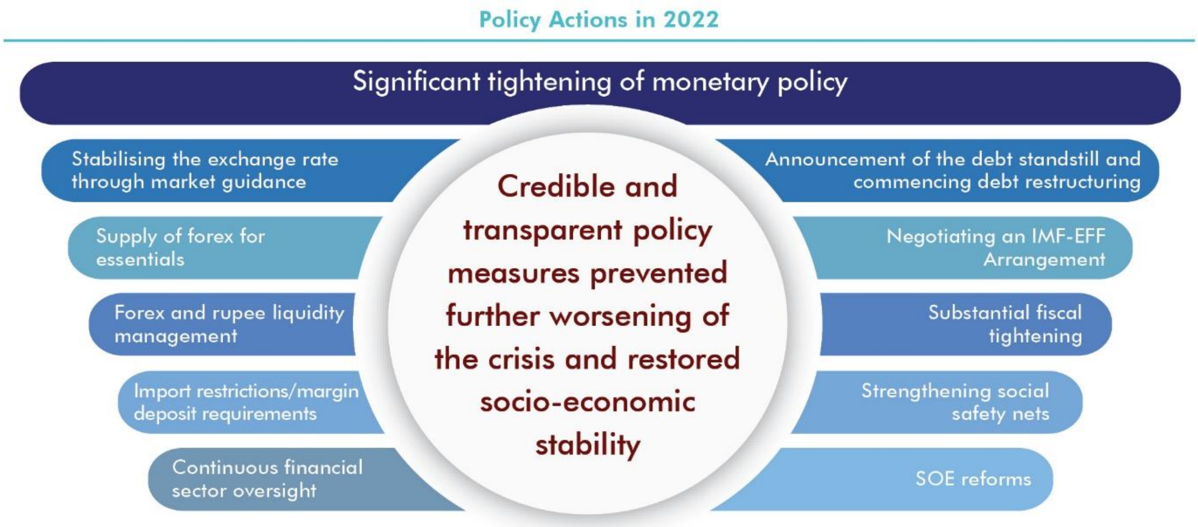
The Sri Lankan economy faced its most onerous year in its post-independence history in 2022, comprising severe economic hardship that led to both public anxiety and political upheaval. The impoverished conditions in the economy warranted immediate and coordinated policy initiatives by the Government and the Central Bank to preempt a further escalation of the situation. Although the corrective measures affected the vast citizenry in the near term, they were necessary to safeguard the economy and economic agents from potentially devastating consequences of unrestrained economic instability, such as hyperinflation, collapse of economic activity to a much deeper level, and a complete disconnect of the country from the rest of the world, with far worse consequences to the people and businesses. The outcomes of these efforts have eventuated since late 2022. The country managed to transition to a workable equilibrium in the near term, focused on restoring socio-economic stability, while the envisaged assistance from the international financial institutions begins to materialise.

Having run an unsustainable macroeconomic model in tandem with the longstanding deficits in the budget balance and the external current account, the economy had fully exhausted its buffers by early 2022 as it was straddled by a myriad of vulnerabilities that emanated from both global and domestic sources. Several inherent weaknesses of the economy, further exacerbated by policy lapses, steered the country towards a multifaceted disaster. Ill-timed tax reductions, an ill-equipped attempt to swiftly adopt organic agriculture, the depletion of the country’s official reserves amidst futile attempts to maintain an untarnished debt servicing record, the delay in the exchange rate adjustment, and the failure to pay heed to several early warning signals caused tremendous shockwaves across the economy. Consequently, the economy was battered by excessive balance of payments (BOP) pressures with acute shortage of foreign exchange liquidity and pressured exchange rate, spiralling inflation and dampened economic activity amidst mass loss of livelihoods, large fiscal imbalances, public debt reaching unsustainable levels with extraordinarily high risk premia, devastating sovereign rating downgrades that constrained access to external finance, unprecedented heightening of socio-economic and socio-political tensions, and rapidly deteriorating business confidence, among others. Businesses and the general public alike were in severe distress amidst shortages and rationing of essentials, the ballooning cost of living and cost of production, and the loss of welfare and livelihoods. Consequently, the rapid unfolding of social unrest resulted in political instability, warranting an urgent need for redefining policy priorities to steer the economy away from further turmoil.



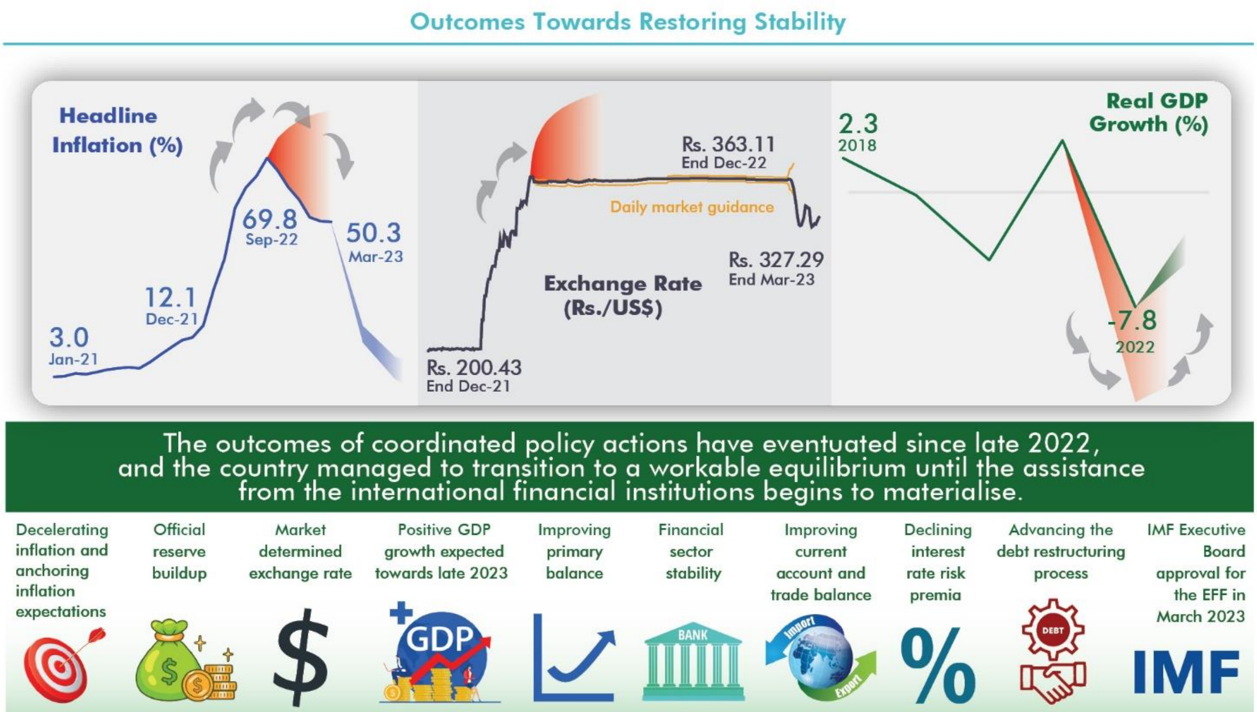
Amidst mounting BOP pressures, the exchange rate was allowed a measured adjustment in early March 2022. However, the subsequent floating of the exchange rate resulted in an overshooting, fuelled by speculative activity. The Central Bank adopted aggressive monetary policy tightening in April 2022 to rein in demand pressures, complemented by a robust communication strategy aimed at anchoring inflation expectations, while taking measures to stabilise the exchange rate amidst exhausted levels of useable reserves by April 2022. Meanwhile, the Central Bank provided foreign exchange to the market to meet the demand for essential imports to the greatest extent possible amidst a dearth of foreign exchange inflows and significantly low levels of official reserves. Moreover, the Central Bank initiated measures to prioritise essential imports and restrict capital outflows through appropriate control measures, while continuing the requirement for the mandatory sale of foreign exchange to the Central Bank by licensed banks, based on the conversion of repatriated foreign exchange, and commenced providing daily guidance on the exchange rate to curtail undue intraday volatilities. Moreover, the Central Bank's continuous financial sector oversight and adoption of appropriate regulatory measures along with effective communication ensured financial system stability amidst severe socio-economic distress.

The Government initiated measures in early 2022 to seek assistance from the International Monetary Fund (IMF) after months of indecisiveness. The IMF had already assessed that Sri Lanka's public debt had reached unsustainable levels, hence, any funding assistance from the IMF needed to be preceded by efforts to restructure public debt. Subsequently, when it reached a critical point of inability to service debt payments, the Government announced a debt standstill in mid-April 2022, thereby suspending the servicing of external debt, mainly bilateral and commercial debt, as an interim measure, while soliciting support from official and private creditors to restructure outstanding debt. Simultaneously, several initiatives were made by the Government to enhance government revenue, curtail expenditure, introduce reforms to major State Owned Enterprises (SOE), implement import controls, and ration energy supply, while exploring bridging finance from bilateral and multilateral partners for essential expenditures as well as supporting the most vulnerable segments. In September 2022, a staff level agreement was reached for an Extended Fund Facility (EFF) from the IMF, followed by efforts to secure financing assurances from official creditors towards the restructuring of debt, in line with the debt sustainability targets envisaged under the IMF-EFF supported programme. In March 2023, the Executive Board of the IMF approved the EFF supported programme of 48-months, amounting to approximately US dollars 3 billion, along with an economic adjustment programme that was aimed at putting Sri Lanka back on a recovery path, while addressing structural impediments that constrained the country's growth potential over the past decades. With a multitude of goals to be achieved under the IMF-EFF arrangement, restoring public debt sustainability through the debt restructuring process will be one of the key milestones in the path towards attaining a sustained growth in the economy. However, debt restructuring could pose near term challenges in the financial sector that need to be addressed proactively by the Government and Central Bank, thereby reinforcing the financial system stability in the period ahead.



Policy measures and reforms implemented by the Government and the Central Bank have yielded notable success thus far. Inflation returned to an impressive disinflation path following a historic peak in September 2022, and the exchange rate remained stable and registered an appreciation in early 2023, having depreciated sharply during the first half of 2022. Further, the external current account deficit remained modest alongside the gradual accumulation of official reserves, thereby enabling the reinstatement of exchange rate flexibility from early March 2023. The envisaged normalisation of foreign exchange flows and the completion of the debt restructuring process during 2023, and the sweeping reforms in the public sector, are expected to pave way for the country's progress towards improved and sustainable economic prospects.

The socio-economic crisis in 2022 underlined many lessons that the country failed to grasp, despite the recurrence of such macroeconomic failures throughout its post-independence history. This economic episode reiterated the essentiality of data-driven policymaking; devastating implications of ad hoc policy experiments; crippling welfare impacts of myopic populist policies; and the cost of policy delays, disregarding evidence-based policy analysis, well-established economic fundamentals and expert opinions. The general public and businesses at large had to bear the cost of a one-time adjustment of delayed structural reforms. Against this backdrop, the Government, the Central Bank, and all other stakeholders need to extend their support towards the implementation of essential reforms at this juncture, to resolve the structural hindrances that have rooted in the economy over the last seven and a half decades. Failing to execute such reforms would lead to perpetual bailouts, endless cycles of external borrowing and recurring debt restructuring alongside unsustainable and highly volatile business cycles, which would cause undue pressure on citizenry, preventing the country from achieving longstanding economic progress and prosperity. Hence, in the country's efforts to emerge from the current crisis, consistent and well-coordinated policies, including those outlined in the IMF-EFF supported programme, should be executed in a timely manner to avert another crisis in the period ahead.



Medium Term Macroeconomic Framework (a)

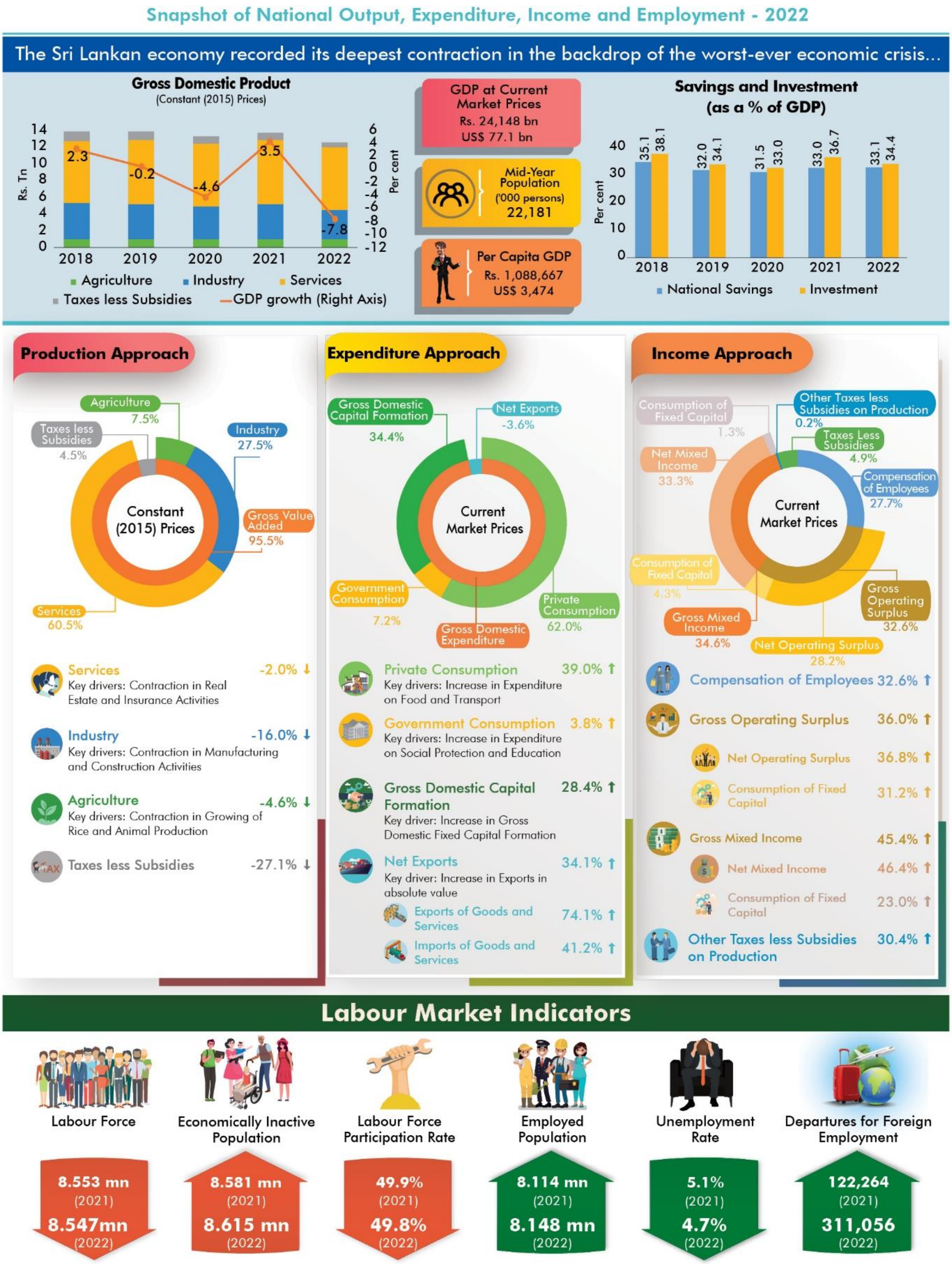
Indicator	Unit	2021 (b)	2022 (c)	2023	2024	2025	2026	2027
Real Sector (d)								
Real GDP Growth	%	3.5 (c)	-7.8	-2.0	3.3	4.0	4.5	5.0
GDP at Current Market Price	Rs. tn	17.6 (c)	24.1	28.5	31.0	33.8	37.1	40.9
Per Capita GDP	US$	3,997 (c)	3,474	3,489	3,621	3,811	4,030	4,281
Total Investment	% of GDP	36.7 (c)	34.4	34.9	35.4	35.9	36.4	36.9
Domestic Savings	% of GDP	29.4 (c)	30.8	30.9	30.8	32.0	33.0	33.8
National Savings	% of GDP	33.0 (c)	33.1	33.8	34.1	34.6	35.3	36.0
External Sector (d)								
Trade Gap	% of GDP	-9.2	-6.7	-6.9	-7.4	-6.7	-6.1	-5.9
Exports	US$ bn	12.5	13.1	14.1	15.5	17.1	18.8	20.2
Imports	US$ bn	20.6	18.3	19.4	21.6	22.9	24.4	26.0
Current Account Balance	% of GDP	-3.7	-1.9	-1.1	-1.3	-1.2	-1.1	-0.9
External Official Reserves	Months of Imports	1.8	1.2	3.0	3.4	3.8	4.2	4.5
Fiscal Sector (d)(e)								
Total Revenue and Grants	% of GDP	8.3	8.3	11.0	13.3	14.9	15.0	15.1
Expenditure and Net Lending	% of GDP	20.0	18.5	19.0	19.7	19.9	19.9	19.6
Current Account Balance	% of GDP	-7.3	-6.4	-4.5	-2.1	-0.7	-0.4	0.0
Primary Balance	% of GDP	-5.7	-3.7	-0.7	0.8	2.3	2.3	2.3
Overall Budget Deficit	% of GDP	-11.7	-10.2	-8.0	-6.4	-5.0	-4.8	-4.5
Central Government Debt	% of GDP	100.1	113.8	100.0	101.6	103.3	102.2	97.6
Monetary Sector and Inflation								
Broad Money Growth (M_{2b}) (f)	%	13.2	15.4	10.5	10.9	10.8	10.7	10.2
Private Sector Credit Growth (in M_{2b}) (f)	%	13.1	6.2	0.9	8.5	9.5	10.5	10.5
Annual Average Inflation	%	6.0 (g)	46.4 (g)	20.6 (h)	5.0 (h)	5.0 (h)	5.0 (h)	5.0 (h)

(a) Based on information available up to end March 2023.
(b) Revised
(c) Provisional
(d) GDP estimates (base year 2015) released in March 2023 by the Department of Census and Statistics have been used.
(e) IMF projections (Restructuring Scenario)
(f) Year-on-year growth based on end year values
(g) Based on the CCPI (2013=100)
(h) Based on the CCPI (2021=100)

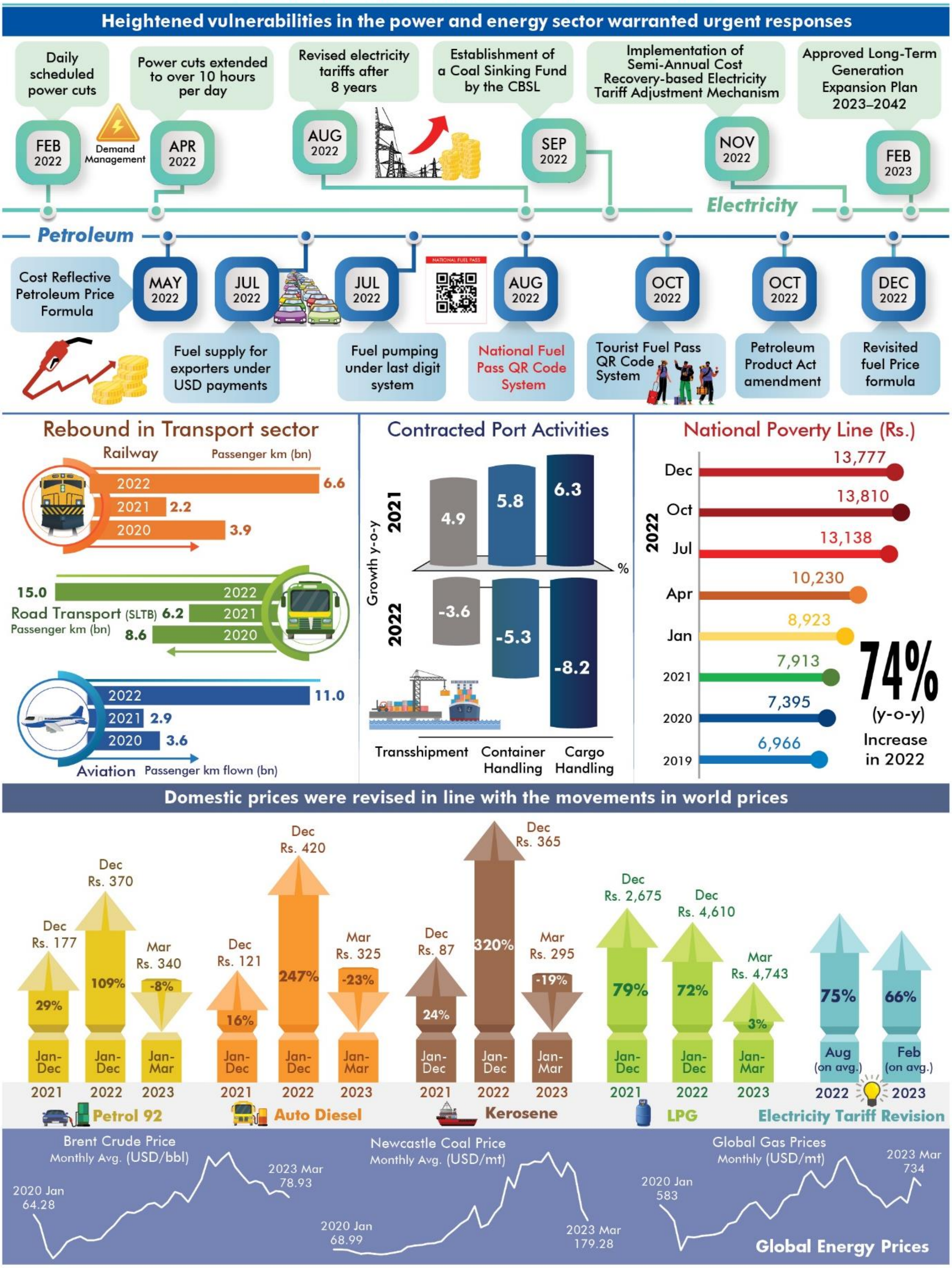
Sources: Department of Census and Statistics
Ministry of Finance, Economic Stabilisation and National Policies
Central Bank of Sri Lanka

The Medium term macroeconomic framework presented in the table above is based on the policy scenario with the assumption of successful continuation of the IMF-EFF supported programme, including the completion of the debt restructuring process before end of September 2023, thereby unlocking further assistance from international financial institutions. It is pertinent to mention that there could be differences in the medium term macroeconomic projections published by the international financial institutions for Sri Lanka based on information available at different timelines and underlying assumptions.

Annexure

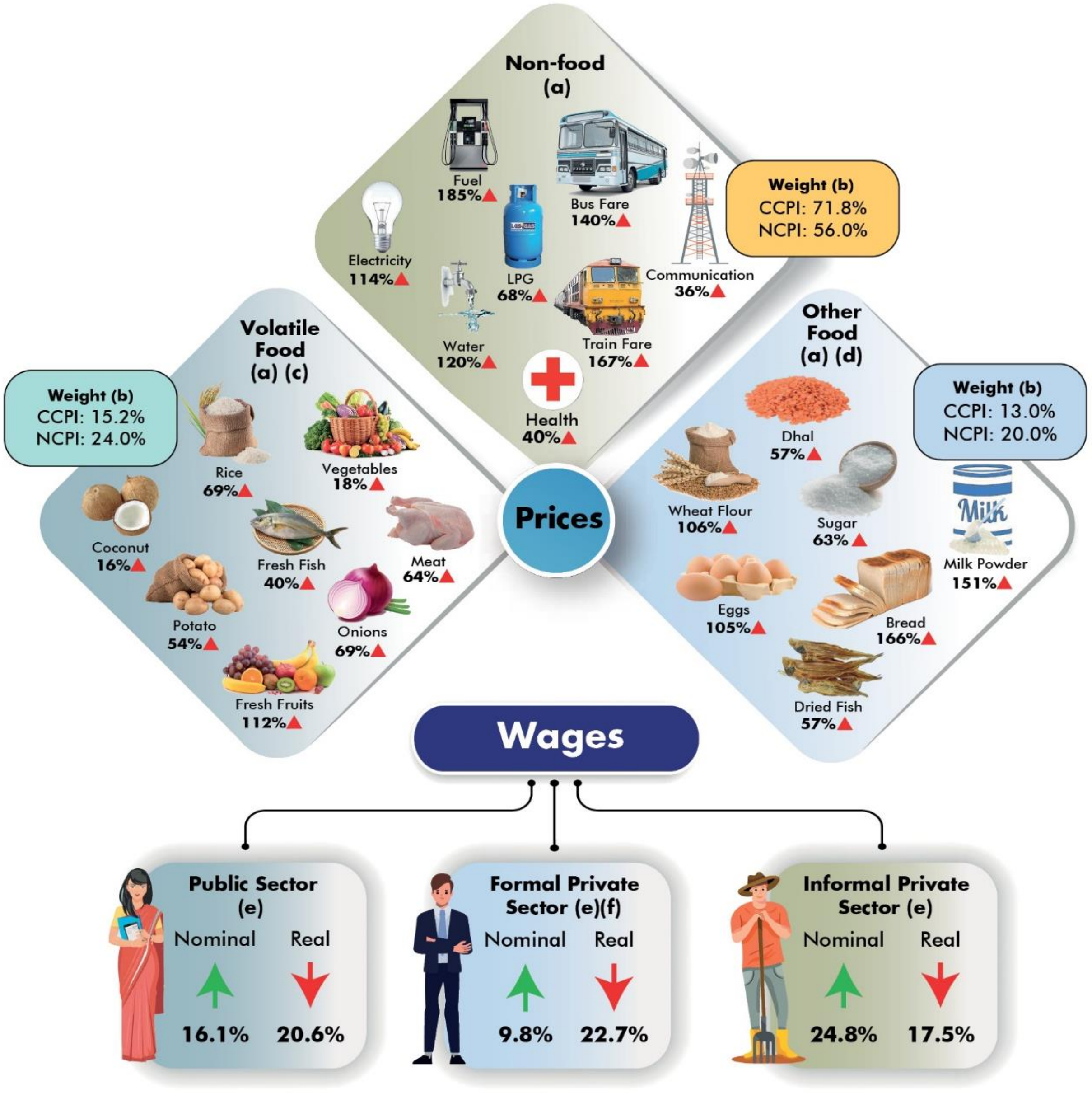

Snapshot of National Output, Expenditure, Income and Employment - 2022
The Sri Lankan economy recorded its deepest contraction in the backdrop of the worst-ever economic crisis...
Gross Domestic Product
(Constant (2015) Prices)
Rs. Tn
Per cent
2.3
-0.2
-4.6
3.5
-7.8
2018
2019
2020
2021
2022
Agriculture
Industry
Services
Taxes less Subsidies
GDP growth (Right Axis)
GDP at Current Market Prices
Rs. 24,148 bn
US$ 77.1 bn
Mid-Year Population
('000 persons)
22,181
Per Capita GDP
Rs. 1,088,667
US$ 3,474
Savings and Investment
(as a % of GDP)
35.1
38.1
32.0
34.1
31.5
33.0
33.0
36.7
33.1
34.4
National Savings
Investment
Production Approach
Agriculture 7.5%
Taxes less Subsidies 4.5%
Industry 27.5%
Gross Value Added 95.5%
Services 60.5%
Constant (2015) Prices
Services -2.0%
Key drivers: Contraction in Real Estate and Insurance Activities
Industry -16.0%
Key drivers: Contraction in Manufacturing and Construction Activities
Agriculture -4.6%
Key drivers: Contraction in Growing of Rice and Animal Production
Taxes less Subsidies -27.1%
Expenditure Approach
Gross Domestic Capital Formation 34.4%
Net Exports -3.6%
Current Market Prices
Government Consumption 7.2%
Private Consumption 62.0%
Gross Domestic Expenditure
Private Consumption 39.0%
Key drivers: Increase in Expenditure on Food and Transport
Government Consumption 3.8%
Key drivers: Increase in Expenditure on Social Protection and Education
Gross Domestic Capital Formation 28.4%
Key driver: Increase in Gross Domestic Fixed Capital Formation
Net Exports 34.1%
Key driver: Increase in Exports in absolute value
Exports of Goods and Services 74.1%
Imports of Goods and Services 41.2%
Income Approach
Consumption of Fixed Capital 1.3%
Other Taxes less Subsidies on Production 0.2%
Taxes Less Subsidies 4.9%
Net Mixed Income 33.3%
Compensation of Employees 27.7%
Current Market Prices
Consumption of Fixed Capital 4.3%
Gross Mixed Income 34.6%
Gross Operating Surplus 32.6%
Net Operating Surplus 28.2%
Compensation of Employees 32.6%
Gross Operating Surplus 36.0%
Net Operating Surplus 36.8%
Consumption of Fixed Capital 31.2%
Gross Mixed Income 45.4%
Net Mixed Income 46.4%
Consumption of Fixed Capital 23.0%
Other Taxes less Subsidies on Production 30.4%
Labour Market Indicators
Labour Force
8.553 mn (2021)
8.547mn (2022)
Economically Inactive Population
8.581 mn (2021)
8.615 mn (2022)
Labour Force Participation Rate
49.9% (2021)
49.8% (2022)
Employed Population
8.114 mn (2021)
8.148 mn (2022)
Unemployment Rate
5.1% (2021)
4.7% (2022)
Departures for Foreign Employment
122,264 (2021)
311,056 (2022)

Performance of the Economic and Social Infrastructure



Movements of Prices and Wages - 2022

Prices recorded unprecedented increases and real wages eroded sharply in 2022...



(a) Percentage price changes of items in CCPI (2013=100) in December 2022 compared to December 2021

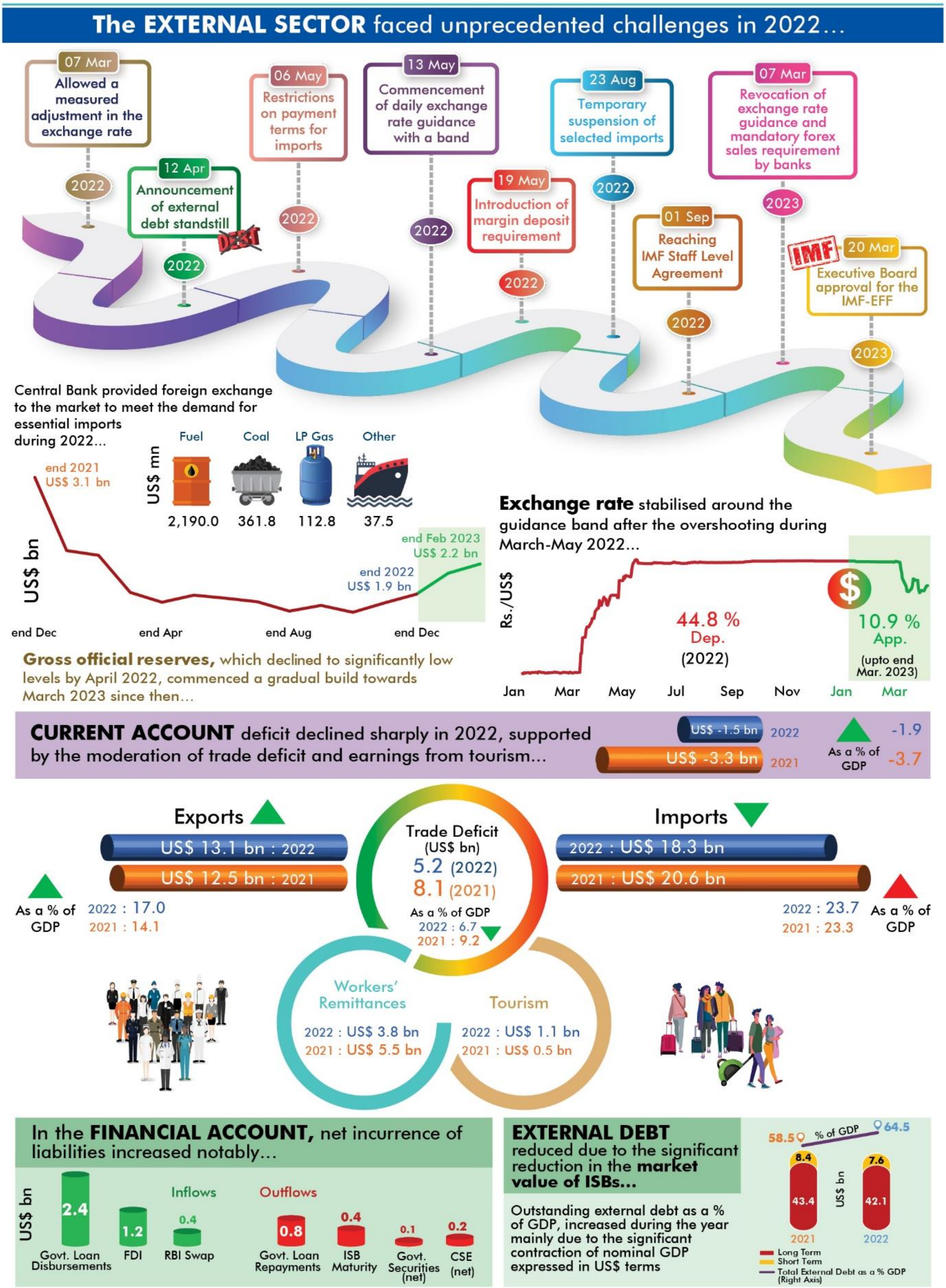
(b) Weights are based on CCPI (2013=100) series and NCPI (2013=100) series

(c) Volatile Food includes rice, meat, fresh fish and seafood, coconut, fresh fruits, vegetables, potatoes, onions and selected condiments

(d) Other food includes food items excluding Volatile Food items

(e) Change of nominal and real wages refers to the percentage change of the averages of 2022 and 2021

(f) Wages of the formal private sector employees, whose wages are governed by the wage boards


The EXTERNAL SECTOR faced unprecedented challenges in 2022...
07 Mar
Allowed a measured adjustment in the exchange rate
2022
12 Apr
Announcement of external debt standstill
DEBT
2022
06 May
Restrictions on payment terms for imports
2022
13 May
Commencement of daily exchange rate guidance with a band
2022
19 May
Introduction of margin deposit requirement
2022
23 Aug
Temporary suspension of selected imports
2022
01 Sep
Reaching IMF Staff Level Agreement
2022
07 Mar
Revocation of exchange rate guidance and mandatory forex sales requirement by banks
2023
IMF
20 Mar
Executive Board approval for the IMF-EFF
2023
Central Bank provided foreign exchange to the market to meet the demand for essential imports during 2022...
US$ mn
Fuel
Coal
LP Gas
Other
2,190.0
361.8
112.8
37.5
end 2021
US$ 3.1 bn
end 2022
US$ 1.9 bn
end Feb 2023
US$ 2.2 bn
US$ bn
end Dec
end Apr
end Aug
end Dec
Gross official reserves, which declined to significantly low levels by April 2022, commenced a gradual build towards March 2023 since then...
Exchange rate stabilised around the guidance band after the overshooting during March-May 2022...
Rs./US$
44.8 %
Dep.
(2022)
10.9 %
App.
(upto end Mar. 2023)
Jan
Mar
May
Jul
Sep
Nov
Jan
Mar
CURRENT ACCOUNT deficit declined sharply in 2022, supported by the moderation of trade deficit and earnings from tourism...
US$ -1.5 bn 2022
US$ -3.3 bn 2021
As a % of GDP
-1.9
-3.7
Exports
US$ 13.1 bn : 2022
US$ 12.5 bn : 2021
As a % of GDP
2022 : 17.0
2021 : 14.1
Trade Deficit
(US$ bn)
5.2 (2022)
8.1 (2021)
As a % of GDP
2022 : 6.7
2021 : 9.2
Imports
2022 : US$ 18.3 bn
2021 : US$ 20.6 bn
2022 : 23.7
2021 : 23.3
As a % of GDP
Workers' Remittances
2022 : US$ 3.8 bn
2021 : US$ 5.5 bn
Tourism
2022 : US$ 1.1 bn
2021 : US$ 0.5 bn
In the FINANCIAL ACCOUNT, net incurrence of liabilities increased notably...
US$ bn
Inflows
Outflows
2.4
Govt. Loan Disbursements
1.2
FDI
0.4
RBI Swap
0.8
Govt. Loan Repayments
0.4
ISB Maturity
0.1
Govt. Securities (net)
0.2
CSE (net)
EXTERNAL DEBT reduced due to the significant reduction in the market value of ISBs...
Outstanding external debt as a % of GDP, increased during the year mainly due to the significant contraction of nominal GDP expressed in US$ terms
58.5
% of GDP
64.5
8.4
43.4
7.6
42.1
US$ bn
2021
2022
Long Term
Short Term
Total External Debt as a % GDP (Right Axis)

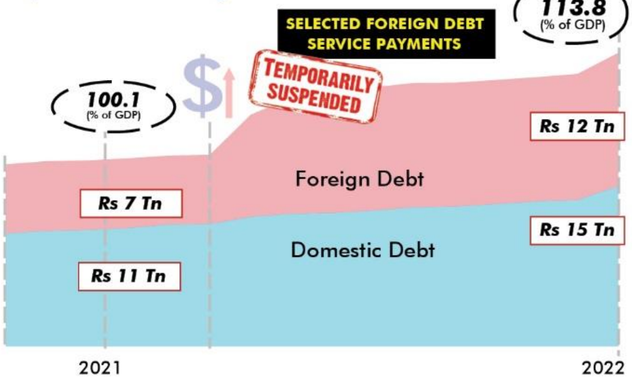
Debt sustainability issue warranted fiscal consolidation and restructuring of public debt...

Sovereign Credit Rating Downgrades

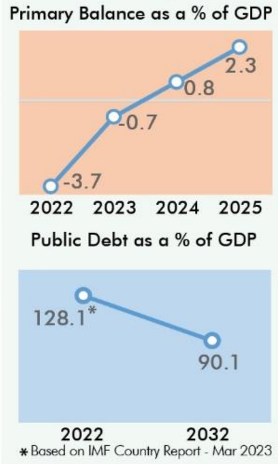
	S&P	Fitch	Moody's
2019 End	B(S)	B (N)	B2(S)
2020 End	CCC(+)(S)	CCC	Caa1(S)
2021 End	CCC+(N)	CC	Caa2(S)
2022 End	SD	RD	Ca(S)

Outstanding Central Government Debt

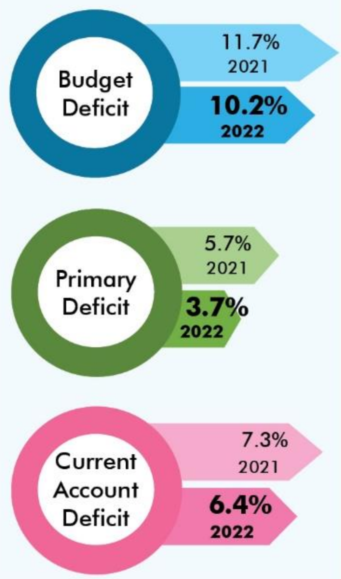
Fiscal imbalances that persisted for several decades resulted in unsustainable debt levels and the Government initiated **a debt restructuring** process while seeking **IMF** assistance...



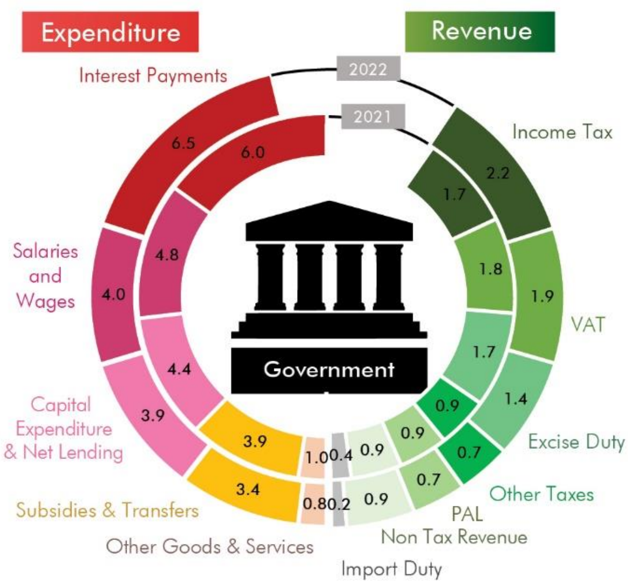
Medium to Long Term Targets



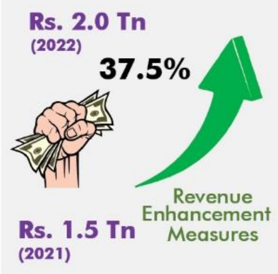
Key Fiscal Balances (as a % GDP)



Revenue and Expenditure (as a % of GDP)



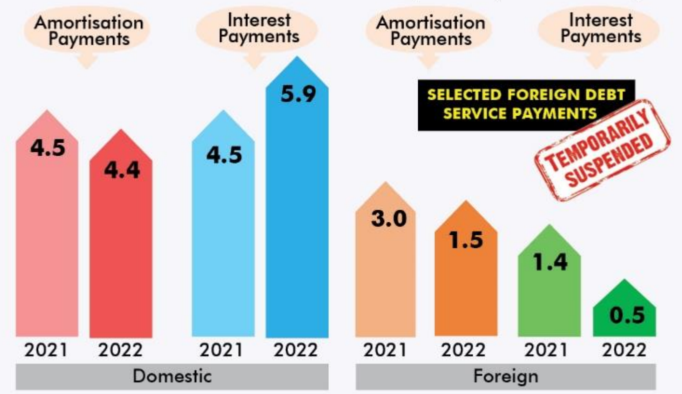
Government Revenue



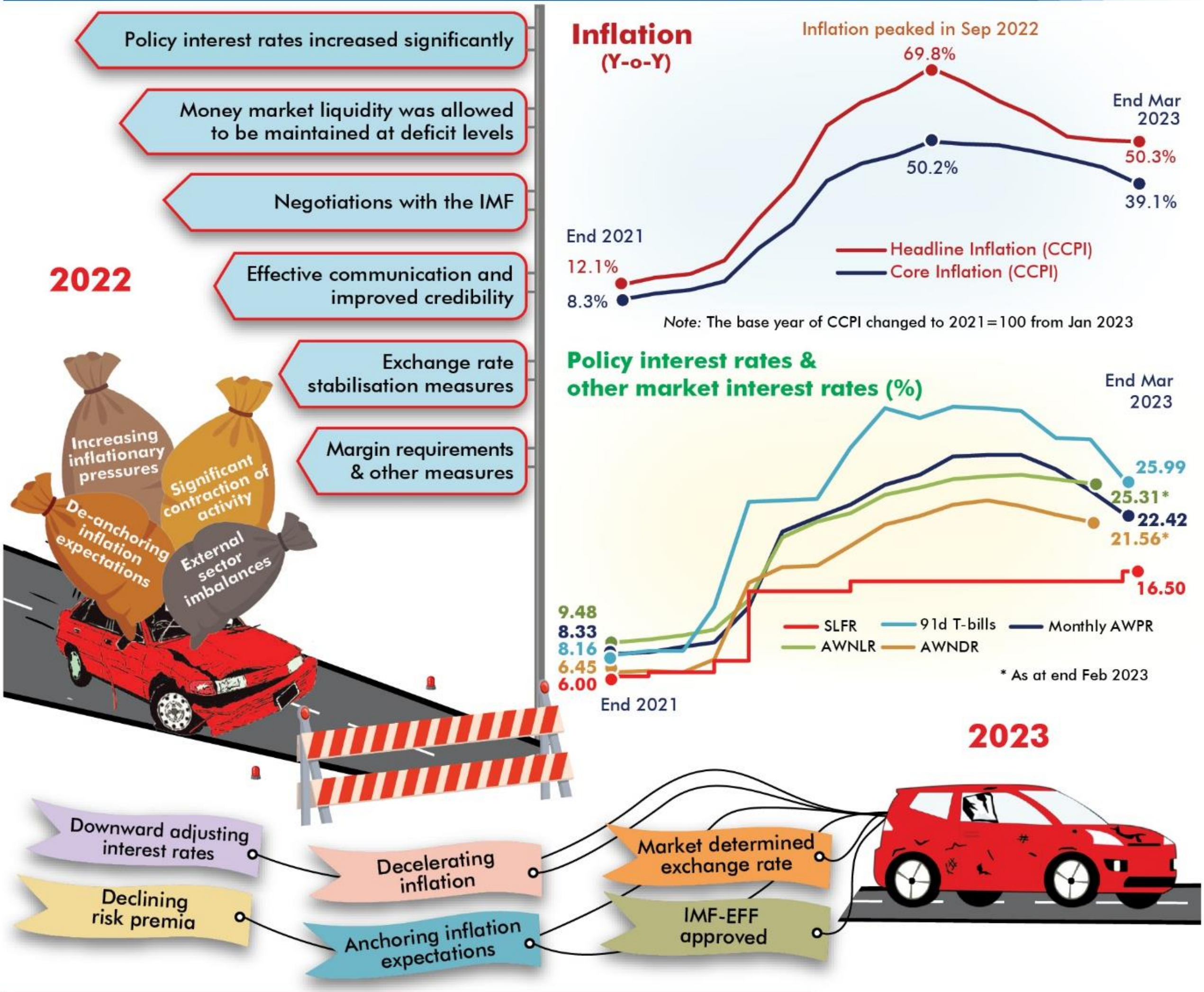
Government Expenditure

Net Financing (as a % GDP)

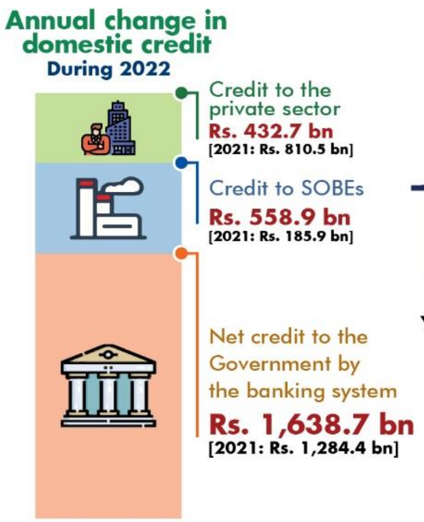
Central Government Debt Service Payments (as % of GDP)

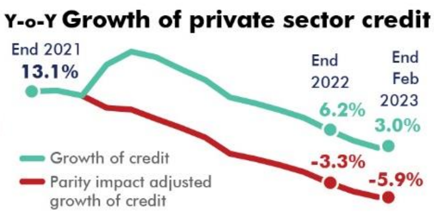


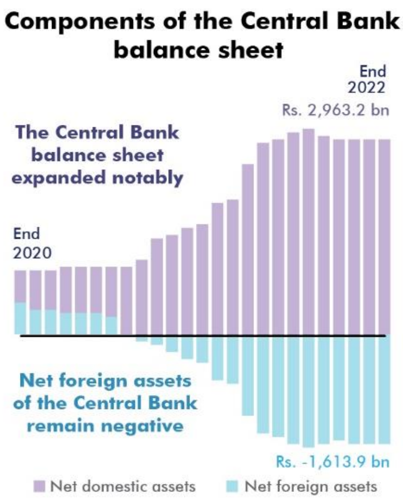
The Central Bank initiated several measures aimed at restoring price stability



Growth of credit to the private sector continued to decelerate







The financial system weathered headwinds from the most profound economic crisis since independence…