# EXECUTIVE SUMMARY

The Sri Lankan economy witnessed a gradual revival in 2023 from the deepest economic downturn in its post-independence history. Decisive policy adjustments and structural reforms implemented by the Government and the Central Bank helped restore macroeconomic stability to a great extent, despite the short run hardships faced by economic stakeholders. These measures were essential to prevent further deepening of the crisis and to navigate the economy along a sustainable path of recovery. With risks abound, the unwavering commitment of policymakers along with wider public acceptance remains imperative to continue with the economic reform agenda and efforts to regain debt sustainability.

The economic adjustment programme has already yielded promising outcomes in 2023. Inflation was contained at single-digit levels by end 2023 from its highest level recorded in 2022, enabling the commencement of monetary policy normalisation. The economy recorded an expansion in the second half of 2023 bringing an end to the longest streak of economic contraction of six consecutive quarters. The persistent twin deficit of the overall government budget and the external current account, which was the root cause of the economic downturn, showed signs of correction in 2023. While a surplus was recorded in the primary balance of the Government, the external current account also recorded a surplus in 2023. External buffers, which were almost exhausted during the crisis, were gradually rebuilt during the year. Improved foreign exchange inflows received from tourism and other services exports as well as workers' remittances, amidst subdued import demand, supported the country in alleviating the severe foreign exchange crunch that prevailed at the time of the crisis. The Central Bank's net purchases from foreign exchange inflows along with receipts from the multilateral partners helped augment the country's international reserves. In light of these developments, along with enhanced confidence in the market, the Sri Lanka rupee witnessed a strengthening in 2023 and early 2024. Concerted efforts to restructure the Government's external debt portfolio would provide the required space for the country to make a sustainable recovery, once the process is completed. Meanwhile, domestic market interest rates declined substantially with the easing of monetary policy and reduction of risk premia attached to yields on government securities following the successful finalisation of the Domestic Debt Optimisation (DDO) operation. This downward adjustment in the market interest rate structure and improved market sentiments reversed the contractionary spell of credit extended to the private sector since June 2023. Meanwhile, the financial sector demonstrated its resilience stemming from the proactive and prudent policies of the Central Bank and the greater crisis preparedness of the financial institutions.

Moving towards international best standards and capitalising on lessons learnt, the Central Bank's mandate was redefined with the enactment of the Central Bank of Sri Lanka Act, No. 16 of 2023 (CBA) in September 2023, marking a significant milestone in enhancing the Central Bank's independence and accountability towards the Parliament and the public. The Central Bank implemented an array of policies in 2023, initially to bring stability to the economy and then to buttress the economic recovery. This encompassed the shift from a tight monetary policy stance to an accommodative stance since June 2023, allowing greater flexibility in exchange rate determination and progressive removal of administrative restrictions imposed on certain foreign exchange transactions. The Central Bank guided the financial sector with prudential regulatory measures, preserving domestic financial system stability. With the enactment of CBA, in addition to its strengthened role as the supervisory and resolution authority of financial institutions, the Central Bank's role in macroprudential policy formulation was solidified, while its contribution to improving financial inclusion was recognised. Meanwhile, several policy measures were introduced to strengthen the safety and soundness of the banking and non-bank financial sector. At the same time, the Central Bank continued its efforts to develop digital payment systems in the economy, which would help enhance the efficiency and accessibility of payment methods for the public.

The economic progression witnessed in the latter half of 2023 is expected to continue in the years ahead, supported by the continuation of the reform agenda under the International Monetary Fund's Extended Fund Facility (IMF-EFF) arrangement. While a broadbased economic expansion is envisaged across all sectors, domestic price stability is expected to be preserved with greater independence and accountability of the Central Bank in monetary policymaking and the prohibition of monetary financing of the government budget deficit. The external sector is anticipated to retain its stability, supported by augmenting external buffers, normalisation of foreign inflows and completion of the restructuring of the foreign debt portfolio of the Government. Reinforced by the legislative amendments and greater consolidation, the financial sector is expected to remain resilient. While continuing the implementation of much needed institutional and policy reforms aimed at enhancing productivity and efficiency, the Government is expected to strive with its fiscal consolidation efforts to ensure the transition of the economy towards a sustainable path. However, the formidable recovery of the Sri Lankan economy hinges on the continuity of the reforms implemented thus far, and as part of this process, the successful continuation of the IMF-EFF arrangement and completion of the debt restructuring process remain paramount. Since the country has not fully exited the crisis, there is no space available for any slippages from the committed path. Recent experiences proved the devastating socioeconomic costs of uncharted policy experiments. Moreover, backtracking from the implemented and planned critical reforms will tip the economy to a state of instability. Thus, continuing with the broader political and social consensus on economic reforms will be critical to avoid recurring policy reversals and resultant economic downturns, to ensure uplifting the welfare of the general public through sustained growth.