Chapter 1

MACROECONOMIC DEVELOPMENTS AND CONDITIONS OF THE FINANCIAL SYSTEM

Summary

The Sri Lankan economy entered a path towards recovery in 2023 following its deepest economic catastrophe encountered in the preceding year. The recovery was buttressed by rapid disinflation, improved external resilience, stronger fiscal balances, and preserved financial system stability. Prompt and coordinated implementation of a suite of policy measures by the Government and the Central Bank and the structural reform agenda alongside the International Monetary Fund's Extended Fund Facility (IMF-EFF) arrangement reinforced overall macroeconomic stability. Having benefited from restored stability, the economy commenced transitioning to a growth trajectory. After six consecutive quarters of contraction, the economy recorded an expansion in the second half of 2023, limiting the annual economic contraction during the year. The growth in aggregate demand was driven by both domestic demand and net external demand. Although unemployment remained unchanged in comparison to the preceding year, labour force participation declined further in 2023. Inflation that had peaked at an all-time high in September 2022 reverted to single-digit levels within a year and continued to remain in the vicinity of the target by end 2023. With the adoption of accommodative monetary policy stance by the Central Bank since mid-2023 and the decline in risk premia following the finalisation of the Domestic Debt Optimisation (DDO) operation, market interest rates including yields on government securities recorded a notable decline in 2023. Credit to the private sector experienced a positive shift from mid-2023, ending the longest streak of monthly contractions. The external current account recorded a surplus in 2023 supported by a significant contraction in the trade deficit amidst increased services exports and improved workers' remittances. Gross official reserves improved with the support of net purchases of foreign exchange by the Central Bank and financing support from multilateral partners. Despite intermittent volatility, the Sri Lanka rupee recorded an overall appreciation in 2023, which broadly reflected the market behaviour and sentiments, as the Central Bank adopted a market-based exchange rate policy. Notwithstanding a series of domestic and external shocks, the financial sector demonstrated its resilience stemming from the proactive and prudent policies and greater crisis-preparedness. Amidst challenges, the banking sector, which dominates the

1

financial sector, was able to maintain stability by preserving capital adequacy level, supported by the decline in risk weighted assets, while liquidity was maintained above the regulatory minimum. Total assets of the banking sector improved along with profitability, while credit risk as indicated by the Stage 3 loans ratio increased during 2023. The fiscal performance in 2023 was commendable, driven by rigorous consolidation measures for revenue enhancement and expenditure rationalisation. The primary balance showed a surplus in 2023, while the overall budget deficit declined compared to previous year. The Government continued to rely primarily on domestic sources to finance the budget deficit, amidst constraints in accessing foreign sources. The central government debt as a percentage of GDP declined by end 2023, primarily due to the growth in nominal GDP and partly due to the impact of rupee appreciation on foreign debt.

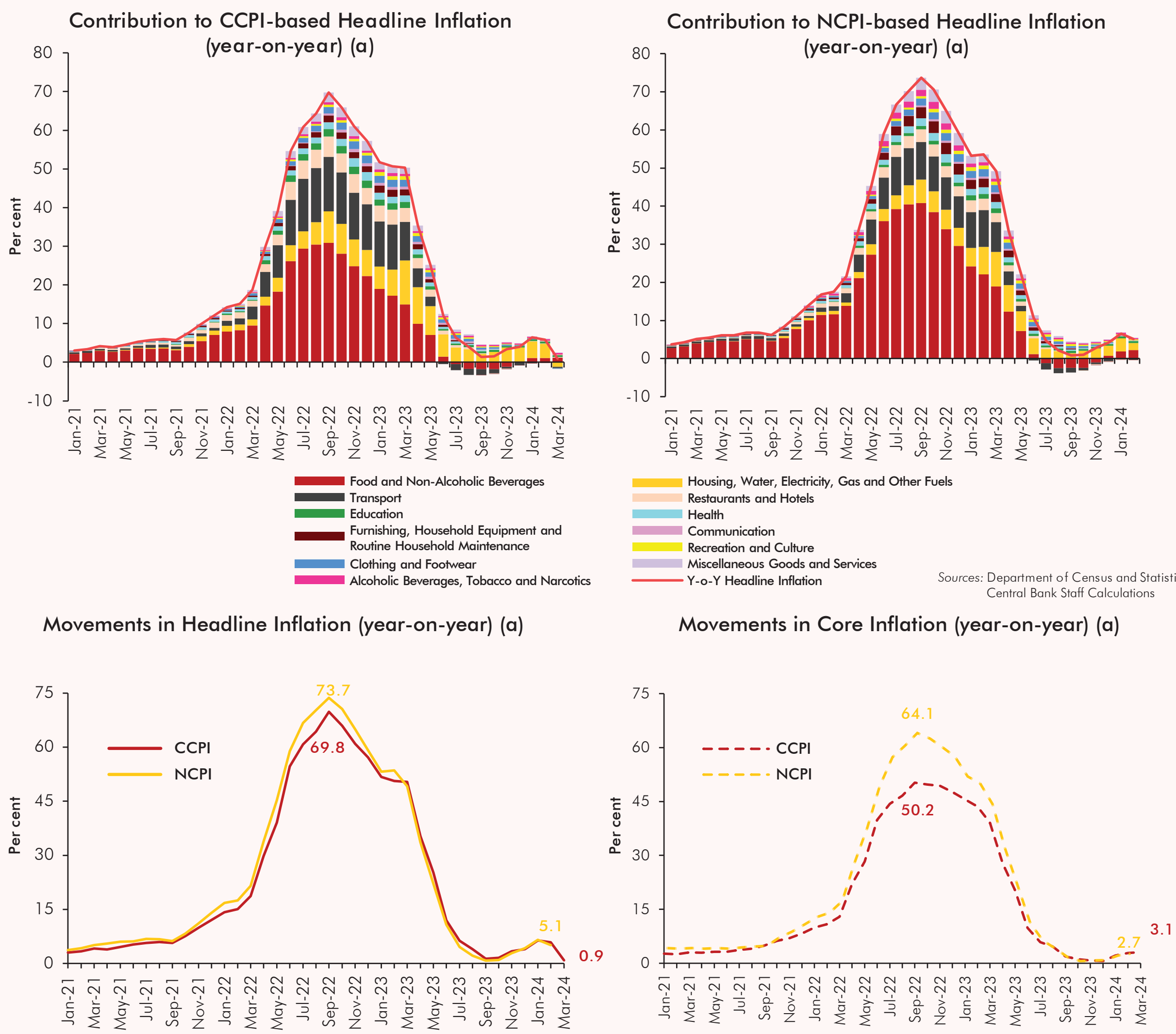
1.1 Inflation and Price Developments

1.1.1 Inflation

Inflation, which reached the historically highest level in September 2022, recorded a rapid disinflation process since then, reaching lower single-digit levels towards end 2023. Subdued demand due to the gradual transmission of the effects of the tight monetary conditions to the wider economy was the major contributor to this transition on the demand side that prevented the escalation of price pressures. This was further complemented by tight fiscal measures. Further, the normalisation of domestic supply conditions, moderation of global commodity prices, and the strengthening of the Sri Lanka rupee, alongside the favourable statistical base effect created by the large month-on-month increases in prices seen in 2022 also contributed to this rapid disinflation process. Consequently, year-on-year headline inflation, measured by the Colombo Consumer Price Index (CCPI, 2021=100), decelerated to 1.3 per cent in September 2023. The prices of food items and the transport sector, which were two of the largest contributors to the high inflation episode during the preceding year, recorded deflation during several months in 2023. This was primarily due to the normalisation of supply bottlenecks and cost-reflective fuel price adjustments, amidst the normalisation of global crude oil prices, together with the impact of the appreciation of the exchange rate. The frequent changes in electricity tariffs, due to the implementation of cost-reflective pricing, also contributed to the dynamics of inflation during 2023. In particular, the pace of disinflation slowed during the first quarter of 2023 due to the upward adjustment to the electricity tariffs, while the subsequent reduction of tariffs in July 2023 supported the decline in inflation. However, since September 2023, inflation has been moving upward towards the targeted level, as anticipated, due to energy price hikes, particularly the electricity tariff increase, while weather related disruptions to the agriculture sector also contributed to the pickup in inflation, particularly towards the end of the year. Accordingly, CCPI-based year-on-year headline inflation was recorded at 4.0 per cent (2021=100) by end 2023 compared to 57.2 per cent (2013=100)[1] by end 2022, while

1 The Department of Census and Statistics (DCS) commenced publishing NCPI and CCPI with the new base year, 2021=100, from the data releases of January 2023 and February 2023, respectively, and discontinued the publication of NCPI and CCPI with the old base year, 2013=100.

Figure 1.1 **Recent Inflation Dynamics in Sri Lanka**



Sources: Department of Census and Statistics; Central Bank Staff Calculations

Source: Department of Census and Statistics

Source: Department of Census and Statistics

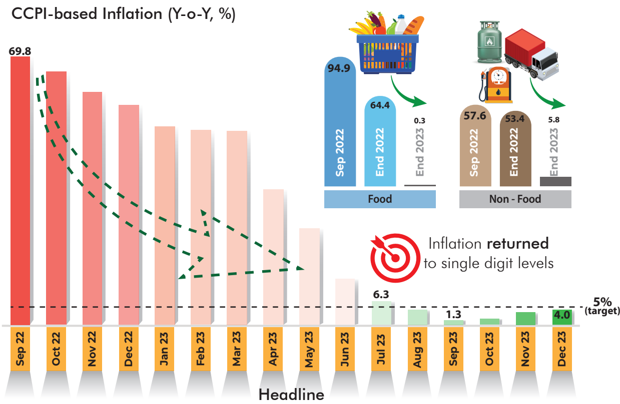
(a) The Department of Census and Statistics (DCS) commenced publishing NCPI and CCPI with the new base year, 2021=100, from the data releases of January 2023 and February 2023, respectively, and discontinued the publication of NCPI and CCPI with the old base year, 2013=100. Accordingly, data commencing January 2023 in the charts are based on the series with the new base year, 2021=100.

CCPI-based annual average headline inflation in 2023 decelerated to 17.4 per cent (2021=100) from 46.4 per cent (2013=100) recorded in 2022. The National Consumer Price Index (NCPI) based year-on-year headline inflation also followed a similar path, dropping to 4.2 per cent (2021=100) by end 2023, compared to 59.2 per cent (2013=100) recorded at end 2022, while NCPI-based annual average headline inflation in 2023 decelerated to 16.5 per cent (2021=100), compared to 50.4 per cent (2013=100) in 2022. Meanwhile, the increase in the Value Added Tax (VAT) rate from 15 per cent to 18 per cent alongside the removal of certain exemptions at the beginning of 2024, led to a brief surge in inflation from January 2024. However, the reduction of electricity tariffs in early March 2024 and several subsequent responsive price reductions are expected to partly negate the immediate impacts as well as spillovers of the tax amendments. This was evidenced through the large reduction of inflation in March 2024, which was partially due to these reasons, along with a favourable statistical base effect.

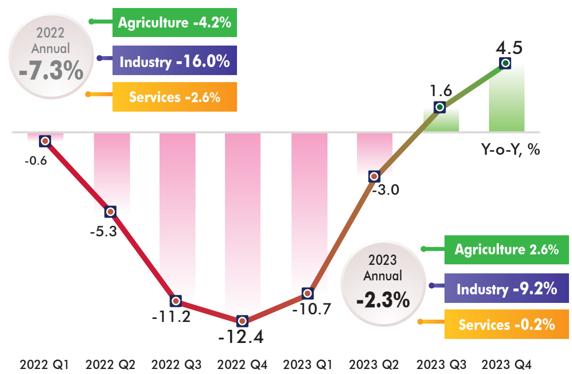
1

SNAPSHOT OF THE

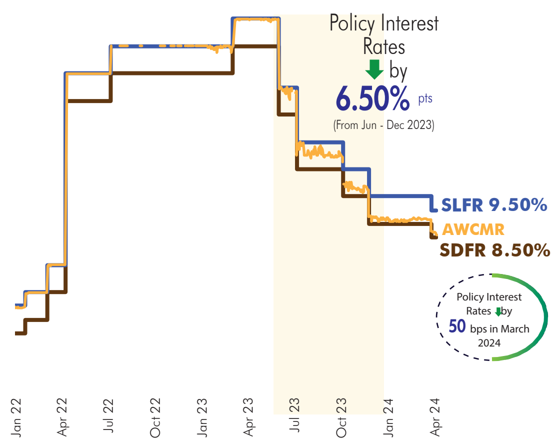
Inflation registered a rapid disinflation process...



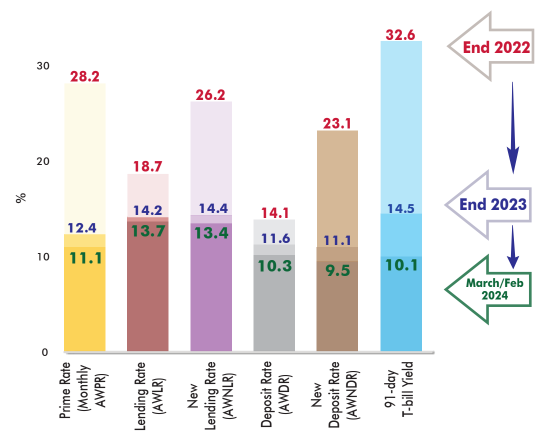
Steady rebound in real GDP growth...



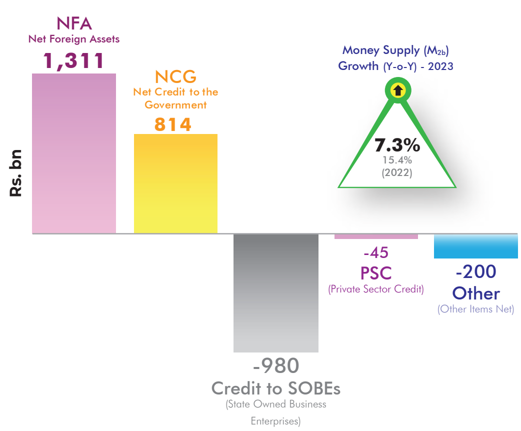
Policy interest rates were reduced...



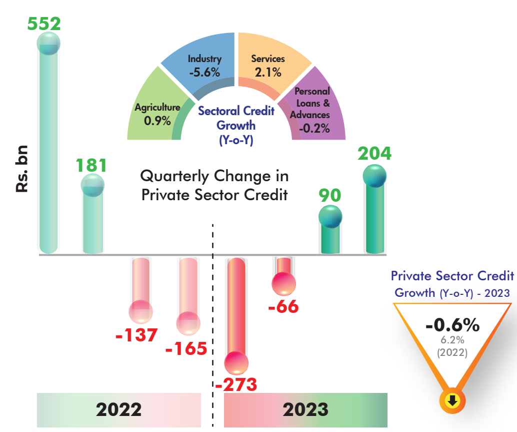
Notable decline in market interest rates...



Monetary expansion remained subdued...



Private sector credit recovered in 2H-2023...



Progress of the IMF-EFF Programme

Sep 2022
Staff-level agreement with the IMF on EFF programme

Mar 2023
IMF Executive Board approval and receipt of the first tranche

SRI LANKAN ECONOMY 2023

Sri Lanka's external sector rebounded strongly in 2023...

Current Account Balance

recorded a surplus in 2023

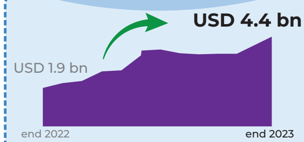
Exports
2022 USD 13.1 bn
2023 **USD 11.9 bn**

Imports
2022 USD 18.3 bn
2023 **USD 16.8 bn**

Earnings from Tourism

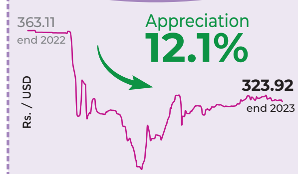
Workers' Remittances
2022 USD 3.8 bn
2023 **USD 6.0 bn**

Gross Official Reserves



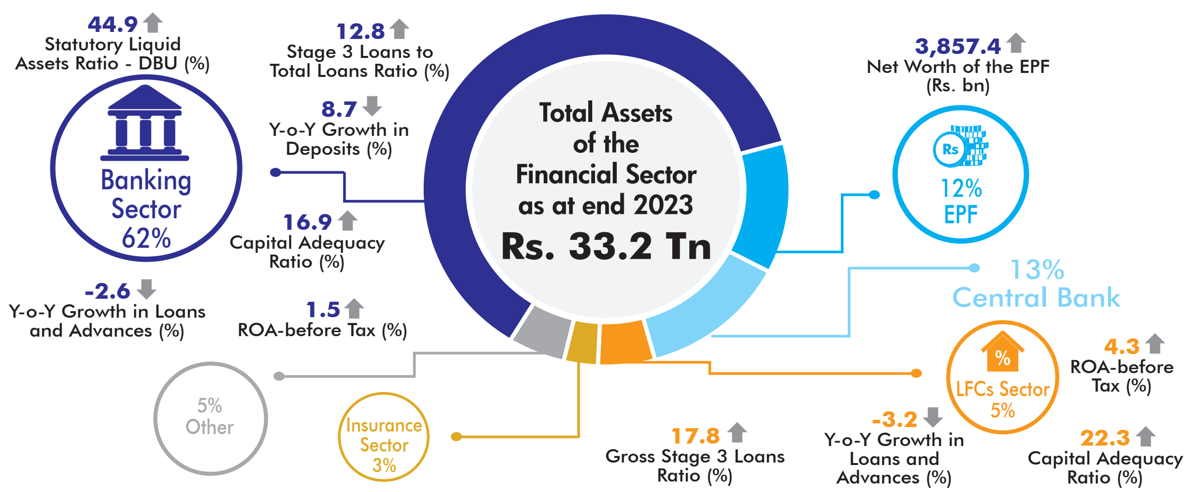
GOR increased with,
CBSL Net Intervention
2023 USD 1.7 bn
(based on value date)
and
Receipts from multilateral institutions
IMF **World Bank** **ADB**

Exchange Rate



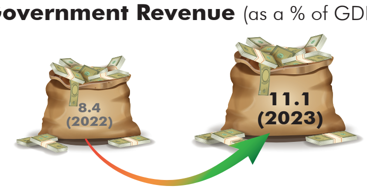
appreciation was **supported by,**
Higher inflows
Lower outflows
and
Market sentiments

Overall financial sector stability was maintained in 2023...

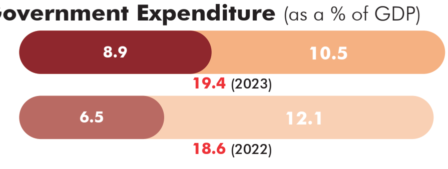


Pronounced fiscal adjustments towards sustainability…

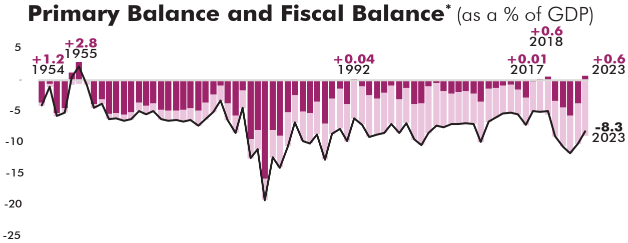
Government Revenue (as a % of GDP)



Government Expenditure (as a % of GDP)

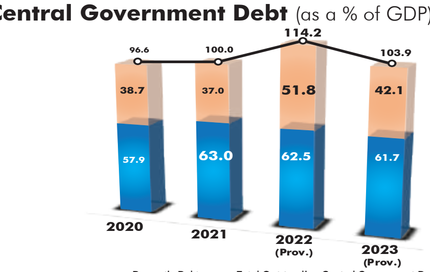


Primary Balance and Fiscal Balance* (as a % of GDP)



*The fiscal balance equals to primary balance minus interest expenditure

Central Government Debt (as a % of GDP)



Oct 2023
Staff-level agreement with the IMF on the first review

Dec 2023
IMF Executive Board approval and receipt of the second tranche

Mar 2024
Staff-level agreement with the IMF on the second review

Table 1.1

Macroeconomic Performances (2018-2023)

Indicator	Unit	2018	2019	2020	2021 (a)	2022 (a)	2023 (b)
Real Sector (c)							
Real GDP Growth	%	2.3	-0.2	-4.6	4.2	-7.3 (b)	-2.3
GDP at Current Market Price	Rs. bn	15,352	15,911	15,646 (a)	17,612	24,064 (b)	27,630
Per Capita GDP (d)(e)	USD	4,372	4,082	3,851 (a)	3,999	3,464 (b)	3,830
External Sector							
Trade Balance (c)	% of GDP	-10.9	-9.0	-7.1	-9.2	-6.7	-5.8
Current Account Balance (c)	% of GDP	-3.0	-2.1	-1.4	-3.7	-1.9	1.8
Overall Balance	USD mn	-1,102.9	376.6	-2,327.7	-3,966.6	-2,806.1	2,825.6
External Official Reserves	USD mn	6,919.2	7,642.4	5,664.3	3,139.2	1,897.6	4,392.1
Fiscal Sector (c)							
Current Account Balance	% of GDP	-1.1	-3.4	-7.5	-7.3	-6.4	-6.0
Primary Balance	% of GDP	0.6	-3.4	-4.4	-5.7	-3.7	0.6
Overall Balance	% of GDP	-5.0	-9.0	-10.7	-11.7	-10.2	-8.3
Central Government Debt (f)	% of GDP	78.4	81.9	96.6	100.0	114.2	103.9
Monetary Sector and Inflation							
Broad Money Growth (M_{2b}) (g)	%	13.0	7.0	23.4	13.2	15.4	7.3
Private Sector Credit Growth (in M_{2b}) (g)	%	15.9	4.2	6.5	13.1	6.2	-0.6
Annual Average Inflation (h)	%	4.3	4.3	4.6	6.0	46.4	17.4

(a) Revised
(b) Provisional
(c) GDP estimates (base year 2015) released in March 2024 by the Department of Census and Statistics have been used.
(d) Estimates updated with latest population figures
(e) Based on quarterly GDP in USD terms calculated using quarterly average exchange rate.
(f) Debt statistics are presented on net basis (net of deposits).
(g) Year-on-year growth based on end year values.
(h) Based on CCPI (2013=100) until 2022, and based on CCPI (2021=100) in 2023

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

Core inflation also underwent a substantial disinflation process in 2023. The fall in core inflation mirrored the underlying subdued demand conditions in the economy, amidst the tight monetary conditions until June 2023 and prevailing tight fiscal conditions, and the persistent impact of the erosion of the purchasing power of the public. Unlike headline inflation, which picked up during the latter part of 2023, CCPI-based core inflation continued to decelerate throughout 2023 and has accelerated somewhat since then. This behaviour reflects that the acceleration in headline inflation in late 2023 was mainly due to the price increases in energy and volatile food items, which are excluded when calculating core inflation. Accordingly, CCPI-based year-on-year core inflation fell to 0.6 per cent (2021=100) by end 2023 compared to 47.7 per cent (2013=100) by end 2022, while CCPI-based annual average core inflation in 2023 was recorded at 14.5 per cent (2021=100) compared to 34.6 per cent (2013=100) in 2022. Meanwhile, NCPI-based year-on-year core inflation decelerated to 0.9 per cent (2021=100) by end 2023, compared to 57.5 per cent (2013=100) at end 2022, whereas NCPI-based annual average core inflation in 2023 slowed to 15.8 per cent (2021=100) compared to 43.9 per cent (2013=100) recorded in 2022. In the meantime, the impact of increased prices due to VAT adjustments in early 2024 was visible in core inflation as well since most items in the core consumer basket were subject to VAT.

As indicated by the inflation expectations survey of the Central Bank during the year, inflation expectations of both corporate and household sectors declined from the elevated levels observed in 2022. Meanwhile, medium term inflation expectations remained broadly anchored despite some volatility observed in the near term. The downward adjustment in inflation

BOX 1
The Effects of Supply Side Inflation on Monetary Policy

Supply side inflation, often referred to as cost push inflation, is typically driven by changes in production costs, caused by factors such as disruptions to the availability of inputs, changes to global commodity prices, revisions to taxes and regulatory measures of the Government, unfavourable weather conditions, supply chain disruptions due to global economic conditions and geopolitical tensions, and inefficiencies of production processes. In the Sri Lankan context, irregular weather patterns are a major factor affecting inflation through the supply side, causing frequent volatilities in food inflation. Similar to many other countries, Sri Lanka is also threatened by the effects of climate change on economic activity and social wellbeing. Additionally, changes in global supply chains, as well as the increase of production costs amidst supply bottlenecks are the main causes for the recent volatility in inflation through the supply side. If these supply side pressures are short lived, they may not pose any major monetary policy implications. However, persistent acceleration of inflation due to supply factors could complicate the conduct of monetary policy, mainly due to the possible de-anchoring of inflation expectations and it can have an adverse impact on a central bank's credibility. Literature shows that when the supply shock is transitory, inflation returns to the equilibrium without the need for any monetary policy action, while repeated supply shocks trigger second round effects, warranting pre-emptive monetary policy action (John, Kumar and Patra, 2022).

The Impact of Weather Patterns and Climate Change on Inflation in Sri Lanka

Climate change encompasses enduring alterations in temperature and various facets of the earth's climate system, largely attributed to human activities. Its impacts are extensive and diverse, spanning environmental, social, economic, and health implications. Irregular weather patterns and climate change can result in significant fluctuations in food inflation. In turn, it could lead to higher volatility in headline inflation, particularly in a country like Sri Lanka, where food items account for a large share of the consumption basket.[1] The agricultural sector could be affected mainly by changes in rainfall patterns and rising temperatures. Major crops in Sri Lanka, including rice and coconut, are significantly affected[2] by variations in temperature and rainfall. An increase in nighttime temperatures, particularly due to global warming, significantly decreases rice yields. For example, based on the field experiments conducted at the International Rice Research Institution in the Philippines, rice yields are found to decline by 10 per cent for every 1°C increase in the minimum temperature during the dry season (Peng et al., 2004). Although the trend of vegetable and fruit prices can be usually predicted during normal weather seasons, the impact of climate change or the abnormal weather patterns on rice, vegetables, and fruits make their pricing unpredictable. In addition to the above, prolonged drought conditions could impact electricity prices due to a shift from low cost hydro power to costly fuel based electricity generation, thus transmitting weather and climate related disturbances to the wider economy, creating large supply disruptions.

Therefore, extreme weather events can have significant macroeconomic effects. These effects were perceived to be largely transitory and less of a concern for central banks in the past. However, the increased frequency and intensity of weather fluctuations, such as heatwaves, prolonged droughts, or flooding, can lead to a more persistent impact on inflation and inflation expectations through the combined impact of direct and second round impacts. This remains a major concern for policymakers and makes forecasting inflation increasingly challenging. Meanwhile, given the enhanced emphasis placed on climate change, central banks are gradually incorporating climate related variables and/or climate specific scenarios into their macroeconomic models to better capture the potential impacts of climate change on key economic indicators.

The Impact of Other Supply Side Factors and Government Policies on Inflation

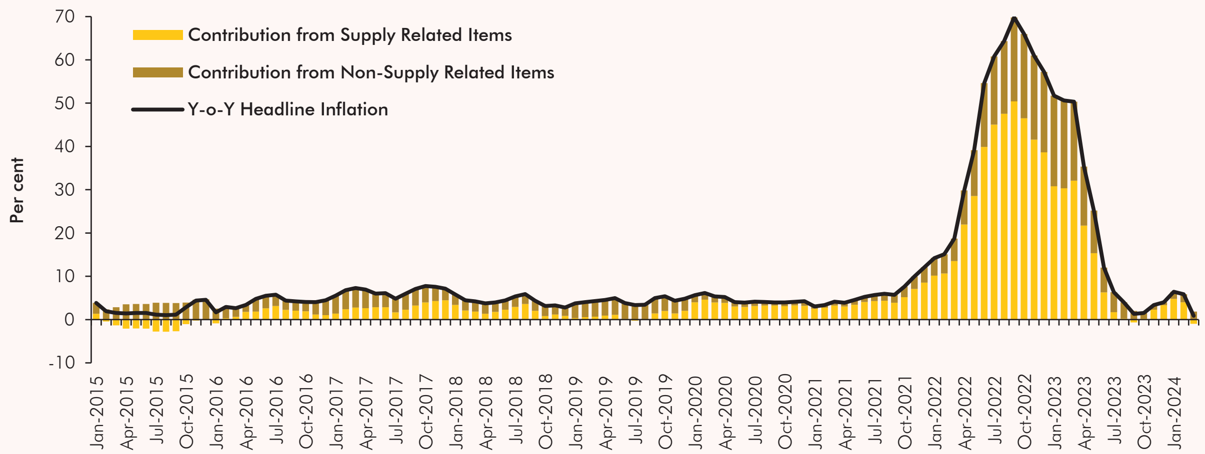
As an oil importing country for both transportation and electricity generation, the impact of global oil prices on Sri Lanka is substantial and alters inflation dynamics through direct and indirect channels. In Sri Lanka, energy, oil, and gas prices are now revised regularly and are determined broadly on a cost recovery basis. As a result, changes in global commodity prices and shipping costs due

1 The Colombo Consumer Price Index (CCPI) and the National Consumer Price Index (NCPI) are the measures of inflation in Sri Lanka. Out of 12 categories, the food category has the most significant weight in both indices, accounting for 26.2 per cent in CCPI and 39.2 per cent in NCPI.

2 The weight for the rice category in the CCPI basket is 2.72 per cent, and for the coconut category, it is 1.38 per cent.

1

Figure B 1.1 Contribution to Headline Inflation: Supply vs. Non-Supply Related Items (CCPI-based, year-on-year) (a)



(a) Supply items contain the set of items in CCPI whose prices are predominantly determined by supply factors, while the remaining items are considered as non-supply items (based on staff judgement).

Sources: Department of Census and Statistics
Central Bank Staff Judgement

to geopolitical tensions and global economic conditions affect domestic prices and may now have a greater impact on domestic prices than before.[3] Based on recent experiences, the indirect impact of price changes in electricity, fuel, and gas on inflation could be greater than the direct impact amidst uncertainty. However, such regular adjustments to domestic prices of energy will eliminate the risks of one time drastic corrections to domestic prices, similar to the domestic fuel price adjustment and electricity price adjustments in 2022 and 2023. This would help mitigate large swings in inflation in the period ahead and would promote forward looking economic decisions by the stakeholders of the economy, thereby assisting the anchoring of inflation expectations.

Further, frequent changes to the tax structure can significantly affect inflation volatility, even if they are one off events. The recent adjustments in the Value Added Tax (VAT) had a notable direct impact on the prices of many items in the consumer basket, including fuel prices, thereby having a greater impact on inflation. Moreover, the direct and indirect impacts of these policies can be unpredictable, as businesses could use these tax amendments to arbitrarily change prices. Further, the lack of competition for essential items, along with downward price rigidities could lead to persistent price pressures. An oligopoly in markets for essentials, such as rice and eggs, could exert considerable pressure on the prices of these items directly and several other prices indirectly.

3 This impact was earlier absorbed by the relevant State Owned Business Enterprise (SOBE), which in turn had implications on the fiscal sector or the financial sector, thereby burdening the public indirectly.

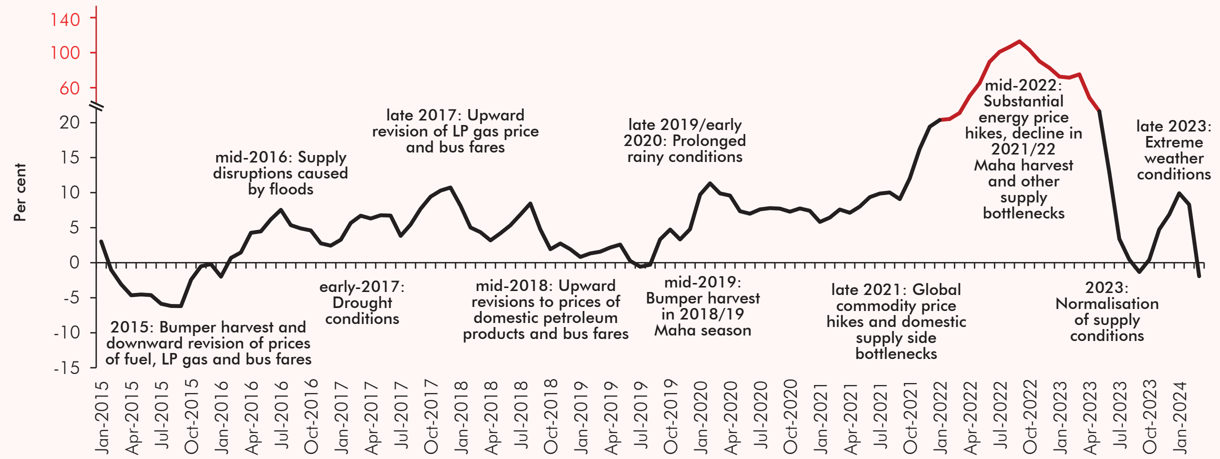
The Contribution from Supply Side Factors on Overall Inflation

Disentangling demand and supply factors behind inflation dynamics is a challenging process due to the complexity of identification. Food inflation is generally considered to be largely driven by supply side factors. In addition to the food category of the Colombo Consumer Price Index (CCPI) basket, prices of certain items in the non-food category could also be classified as supply/cost driven contributors to inflation, given the increased frequency and magnitude of price adjustments in these categories.[4]

Supply side inflation is often characterised by its increased volatility (Table B 1.1) compared to non-supply inflation. Given the transitory nature of supply side inflation in general, central banks may adopt a cautious approach in using monetary policy actions to address it. Moreover, supply disturbances move output and prices in opposite directions, and the central bank may not be able to maintain both output and price stability (Amarasekara, 2009). In such circumstances, extreme policies aimed purely at price stability aggravate the effect of the supply disturbance on the real economy. Certain supply side shocks may be better left to correct themselves over time without the need for immediate and aggressive policy responses. For instance, if the impact stems from transitory weather related factors, it will gradually diminish. Conversely, if it results from adjustments to taxes on goods and services or

4 In this estimate, the supply/cost driven category represents food and non-alcoholic beverages and selected administered price categories such as fuels for personal transport equipment; electricity, gas and other fuels; water bill; and transport services categories of the CCPI basket of goods and services, whereas non-supply driven category represents all other subcategories of the CCPI basket.

Figure B 1.2 **Supply Side Inflation (CCPI-based, year-on-year) (a)**



(a) Based on the aggregate price movements of the set of items in CCPI whose prices are predominantly determined by supply factors.

Sources: Department of Census and Statistics
Central Bank Staff Judgement

administrative changes, the direct impact of it will be mainly a one time occurrence. Even in the case of transitory or one off supply shocks, central bank communications play a key role by providing clarity, assurance, and guidance on the future trajectory of inflation and anchoring inflation expectations.

Why are Central Banks Less Aggressive in Handling the Supply Side Issues of Inflation?

Central banks usually do not respond to supply side shocks as their primary control lies with affecting demand side inflationary pressures. Supply side issues can have an immediate effect on prices and inflation. In addition, many supply side factors are essentially structural and weather related, and not simply a consequence of the business cycle. Addressing these may necessitate longer term policy measures or structural reforms, such as supply side policies of the Government aimed at improving the productive capacity and efficiency of the economy. Central banks, which aim at addressing business cycle fluctuations through demand driven policies, may not be able to tackle underlying structural issues. Therefore, attempting to address supply side price pressures through monetary policy may result in adverse consequences. Raising interest rates to ease inflation could slow down economic activity, thereby further worsening the supply side pressures.

However, central banks closely monitor supply side inflation, as persistent or severe disruptions could have broader implications for overall price and economic stability. In some cases, where supply side shocks have secondary effects on inflation expectations or lead to a more persistent inflationary environment, central banks may consider appropriate actions to mitigate these impacts. In this regard, the optimal monetary policy response to a single supply shock depends on the nature and duration of the shock, its second round effects, and the impact on real incomes (Bandera et al., 2023). These factors, taken together, determine whether monetary policy should be 'looked through' (no policy response) or 'lean against the shock' (policy adjustment). A sequence of inflationary supply shocks would call for a tighter policy response. In such instances, responding to each shock individually, trading off near term over medium term inflation deviations from target, could result in undesirable outcomes. Therefore, any monetary policy response to a series of supply shocks should be based on the overall macroeconomic impact of such shocks and should also incorporate a careful assessment of the dynamics of inflation expectations. Moreover, amidst larger and persistent supply shocks, frontloading of monetary policy actions can keep inflation expectations firmly anchored thus maintaining the credibility of the central bank (John et al., 2022).

Table B 1.1 **Standard Deviation of Supply Side and Non-Supply Side Inflation (CCPI-based, year-on-year, %)**

Year	Headline Inflation	Supply	Non-Supply
2015	1.3	2.8	1.3
2016	1.1	2.5	0.8
2017	0.9	2.2	1.0
2018	1.0	2.1	0.2
2019	0.6	1.7	0.5
2020	0.8	1.3	0.5
2021	2.6	3.9	1.6
2022	20.3	32.0	11.0
2023	20.1	29.9	12.9

Source: Department of Census and Statistics
Central Bank Staff Calculations

1

The Government's Role in Managing Supply Side Inflation

Governments play a crucial role in managing supply side inflation through various policies and interventions. By prioritising investments in infrastructure like transportation and energy, the Government could enhance productivity and efficiency of the economy. In addition, the Government, together with the private sector, could focus on increasing investments in agricultural infrastructure, such as storage facilities, to boost domestic food production while preventing post harvest losses and stabilising food prices. On the other hand, regulatory measures can be implemented to bolster market competition, dismantle barriers for businesses, and streamline bureaucratic processes, fostering an environment conducive to investments. In the short run, to address sudden price pressures emanating from supply side shocks, the Government could take proactive measures to facilitate the importation of food items that are in short supply due to supply disruptions and shortages, as and when required, and take preventive measures to minimise the upward price movements. The Inflation Reduction Act of 2022 in the USA is an example of a recent Government initiative to address supply side issues. The Act aims to curtail inflation by lowering drug prices, and investing in domestic energy production while promoting clean energy.

Conclusion

There is an intricate interplay between supply side dynamics, such as weather patterns, global commodity prices, and Government policies, and their profound impacts on inflation. The complexities surrounding supply driven inflation present significant challenges for monetary policymaking, particularly in small open economies like Sri Lanka, where a multitude of factors originating from the domestic and global environment contribute to volatility in prices. While transitory supply shocks may not necessitate immediate monetary policy action, persistent disruptions can complicate the task of maintaining price stability. Moreover, the structural nature of some supply side issues demands longer term policy measures and structural reforms, often beyond the scope of traditional monetary policy tools. Despite the limitations in directly addressing supply driven inflation, central banks remain vigilant, aiming to mitigate adverse impacts on economic stability and inflation expectations. Ultimately, navigating the intricacies of supply driven inflation requires a balanced strategy that considers both short term stabilisation and long term economic sustainability. Clear and proactive communication by a central bank on the impact of supply side disturbances on inflation is expected to manage expectations and ensure domestic price stability, along with appropriate monetary policy actions to manage demand pressures on inflation.

References

1. Amarasekara, C. (2009) Central bank objectives and aggregate disturbances. *Proceedings of the Central Bank of Sri Lanka International Research Conference – 2009*, pp. 41-55.
2. Bandera, N., Barnes, L., Chavaz, M., Tenreyro, S., and von dem Berge, L. (2023) Monetary policy in the face of supply shocks: The role of inflation expectations. In *ECB Forum on Central Banking*, pp. 26-28.
3. John, J., Kumar, D., and Patra, M.D., (2022) Monetary policy: Confronting supply-driven inflation, *RBI Bulletin*, 76(7), July 2022, pp. 97-109.
4. Peng, S., Huang. J., Sheehy. J., Laza. R., Visperas. R., Zhong. X., Centeno. G., Khush.G. and Cassman. K. (2004) Rice yields decline with higher night temperature from global warming, *Proceedings of the National Academy of Sciences*, 101(27), pp. 9971-9975.

Table 1.2

Movements of Inflation (year-on-year)

Per cent

		2013=100					2021=100				
		Dec-2019	Dec-2020	Dec-2021	Sep-2022	Dec-2022	Sep-2023	Dec-2023	Jan-2024	Feb-2024	Mar-2024
Headline	CCPI	4.8	4.2	12.1	69.8	57.2	1.3	4.0	6.4	5.9	0.9
Inflation	NCPI	6.2	4.6	14.0	73.7	59.2	0.8	4.2	6.5	5.1	
Core	CCPI	4.8	3.5	8.3	50.2	47.7	1.9	0.6	2.2	2.8	3.1
Inflation	NCPI	5.2	4.7	10.8	64.1	57.5	1.7	0.9	2.2	2.7	
Food	CCPI	6.3	9.2	22.1	94.9	64.4	-5.2	0.3	3.3	3.5	3.8
Inflation	NCPI	8.6	7.5	21.5	85.8	59.3	-5.2	1.6	4.1	5.0	
Non-Food	CCPI	4.3	2.0	7.5	57.6	53.4	4.7	5.8	7.9	7.0	-0.5
Inflation	NCPI	4.2	2.2	7.6	62.8	59.0	5.9	6.3	8.5	5.1	

Note: The Department of Census and Statistics (DCS) commenced publishing NCPI and CCPI with the new base year, 2021=100, from the data releases of January 2023 and February 2023, respectively, and discontinued the publication of NCPI and CCPI with the old base year, 2013=100.

Source: Department of Census and Statistics expectations was driven by a variety of factors, including the deceleration in realised inflation supported by stringent fiscal and monetary policies. In addition, the appreciation of the Sri Lanka rupee against the US dollar, eased supply side disruptions, moderation of global commodity prices, and relaxation of import restrictions contributed to driving inflation expectations downward. Accordingly, the inflation expectations of the corporate sector reached single digit levels by August 2023. Subsequently, inflation expectations declined further with the exception of marginal increases in October 2023 attributed to the electricity tariff adjustments and in December 2023 following the announcement of VAT amendments. Meanwhile, inflation expectations of the household sector reached single digit levels by November 2023 followed by a slight uptick in December 2023.

1.1.2 Prices

The general price level, measured by both CCPI and NCPI, exhibited a modest increase in 2023 from substantially high levels in the preceding year. Prices of both domestically produced and imported food items increased, though at a slower rate compared to the substantial price hikes witnessed in 2022. Moreover, price movements of non-food items were primarily impacted by the cost-reflective pricing adjustments made throughout the year. In line with these developments, the cost of living of the economy, as indicated by the consumer price indices, continued to increase in 2023, but at a slower rate compared to 2022.

Prices of food items, which were primarily driven by supply side factors, albeit with periodic influence from demand side factors during festive seasons, exhibited a modest increase compared to the substantial price hikes witnessed in 2022. With the adequate supply of chemical fertiliser and decreased input costs, in line with reductions in fuel prices, a favourable harvest was realised. This translated into a decline in the prices of certain domestically produced food items during the year. Nevertheless, in the latter part of the year, extreme weather conditions across the entire island coupled with festive demand, led to substantial increases in volatile food prices. Meanwhile, prices of imported food items, which recorded significant increases in 2022, moderated to some extent during 2023, which is attributable to the strengthening of the Sri Lanka rupee and the softening of global commodity prices despite export restrictions imposed by some countries.

The cost-reflective pricing formula played a pivotal role in shaping the price movements of non-food items. The prices of items in the non-food category exhibited an overall increasing trend in 2023, yet at a moderate pace compared to the substantial increases observed in 2022. Accordingly, non-food prices increased until March 2023 primarily due to the upward revision to electricity tariff by 146 per cent for bills consuming 90 units[2] effective from 16 February 2023, while domestic consumers experienced a tariff hike of 66 per cent on average. However, starting from March 2023, non-food prices experienced a decrease until July, followed by an increase until November 2023, primarily driven by price adjustments in several administrative items. There was a downward adjustment to the electricity tariff by 24 per cent for bills consuming 90 units effective from 01 July 2023 followed by an upward revision of 18 per cent effective from 20 October 2023. Further, water tariffs underwent an upward price revision of 102 per cent for bills consuming 22 units effective from 01 August 2023, partially reflecting the changes in electricity tariff revisions. During 2023, the prices of Petrol (92 Octane), Auto Diesel, and Kerosene

2 The expenditure related to using 90 units is considered in the CCPI basket.

1

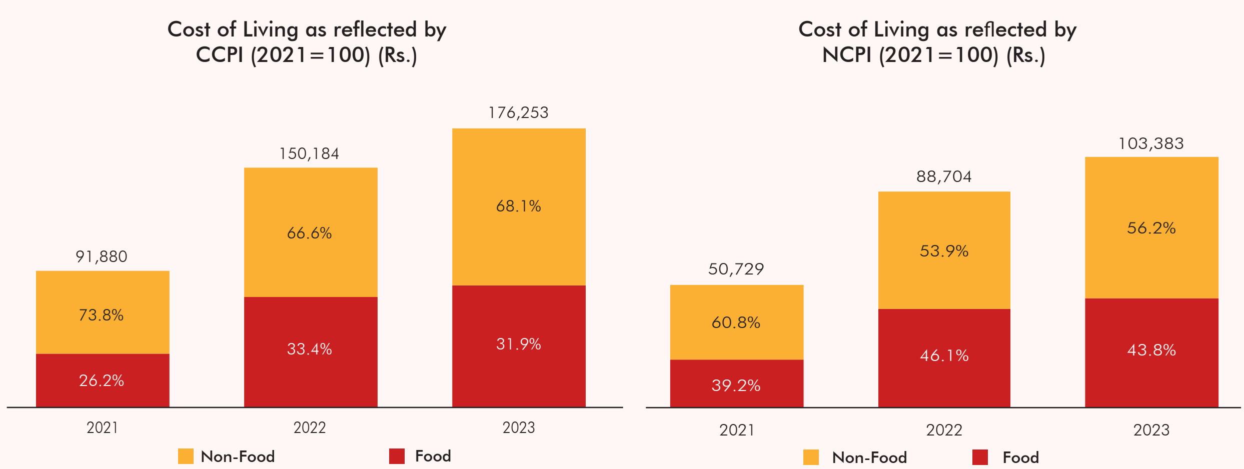
exhibited overall downward trends, although there were intermittent increases observed in February and during the period from July to October 2023. These adjustments were made adhering to the cost-reflective pricing formulas amid fluctuating global crude oil prices. Further, LP Gas prices demonstrated an overall decline in 2023, despite increases in the months of February, September, October, and November. Aligning with changes in fuel prices, bus fares were reduced by 7 per cent effective from 31 March 2023 and subsequently increased by 4 per cent effective from 03 September 2023. However, no revision was made to train fares in 2023.

In addition, prices of alcoholic beverages and tobacco increased following the upward revision to Excise Duty effective from 01 July 2023.

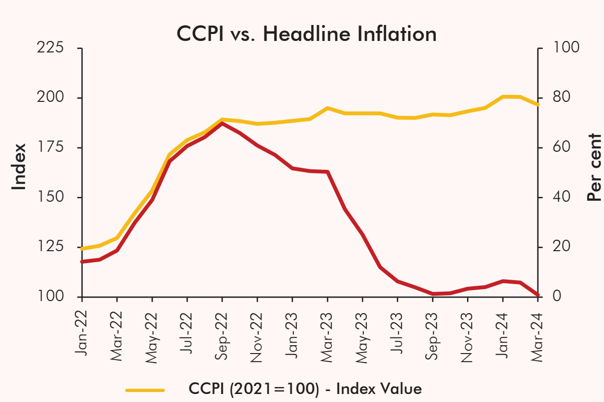
1.1.3 Consumer Price Indices and Cost of Living

Against this backdrop, it was observed that both official Consumer Price Indices (CPIs), which measure changes in the general price level, exhibited a modest rise throughout 2023. Accordingly, CCPI (2021=100) increased at a slower pace during 2023 compared to the previous year, recording 195.1 index points in December 2023. The movement in CCPI was largely in line with the movement of prices of

Figure 1.2 Cost of Living, Consumer Price Index and Inflation



Sources: Department of Census and Statistics
Central Bank of Sri Lanka



Source: Department of Census and Statistics

Following the high inflation episode in 2022, the role of monetary policy has been to minimise further increases in the general price level, thereby bringing headline inflation (year-on-year) to the targeted level, in line with the Central Bank's primary objective of achieving domestic price stability. Without such appropriate policy measures, the sharp escalation in price levels observed in late 2021 and 2022 could have continued further, leading to hyperinflation. By ensuring price stability, the Central Bank supports the overall health and stability of the economy, which is necessary for sustainable economic growth over the long run.

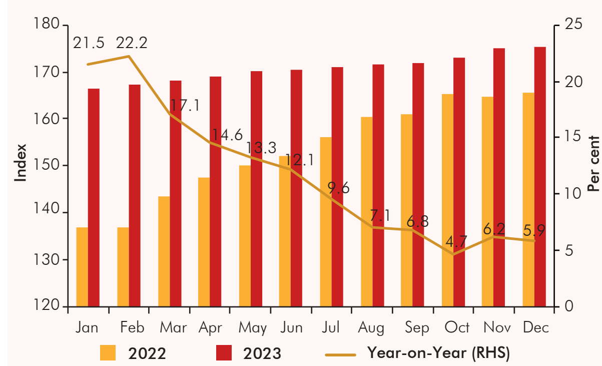
*Note: Year-on-year Inflation for 2022 is based on CCPI (2013=100) items in the non-food category except for June, August, October and December 2023. The NCPI (2021=100) also increased at a slower pace during 2023 compared to 2022 recording 208.8 index points in December 2023. The movement of NCPI was mainly attributed to fluctuations in prices of items in the non-food category except for May, June, September, November and December 2023.

The cost of living, as reflected by the consumer price indices,[3] continued to increase in 2023, although at a slower pace compared to the surge witnessed in 2022. The estimated average monthly consumption expenditure for a household,[4] based on CCPI (2021=100), increased from Rs. 150,184 in 2022 to Rs. 176,253 in 2023 by 17.4 per cent. This indicates a considerable slowdown compared to the 63.5 per cent increase recorded in 2022 compared to 2021. Similarly, based on NCPI (2021=100), the estimated average monthly household[5] consumption expenditure increased from Rs. 88,704 in 2022 to Rs. 103,283 in 2023 by 16.5 per cent highlighting a notable easing from the 74.9 per cent increase recorded in 2022. Considering the distribution of consumption expenditure between food and non-food items, it is evident that a major share is allocated to non-food items. Further, the notable increase observed in the share of monthly household consumption expenditure allocated to the food category in 2022 moderated in 2023 due to the improved supply conditions in the country.

1.1.4 Wages

Available information[6] shows that wages remained largely stagnant throughout 2023 except in the informal private sector, which recorded an increase during the year compared to 2022. This increase in nominal wages of employees in the informal private sector was mainly attributable to the demand for higher wages by daily wage earners, due to the rising cost of living and shortage of labour supply. Meanwhile, on an annual average basis, real wages recorded an erosion during the year across both the private and public sectors. Nevertheless, available wage indices i.e., informal private sector wage rate index (2018=100), formal private sector minimum wage rate index (1978 December=100), and public sector wage rate index (2016=100) exhibit certain limitations in capturing the overall wage developments of the economy.

Figure 1.3 Movements of the Informal Private Sector Wage Rate Index during 2023 (Nominal)



Source: Central Bank of Sri Lanka

Private Sector Wages

Nominal wages of informal private sector employees, as indicated by the informal private sector wage rate index (2018=100), exhibited an increasing trend throughout 2023. Notably, the index increased in nominal terms by 11.4 per cent in 2023 compared to the previous year. In terms of the sub-activities, namely, agriculture, industry, and services, the informal private sector wage rate index increased in nominal terms by 13.0 per cent, 9.9 per cent and 13.1 per cent, respectively, in 2023,

3 Consumer price indices are based on fixed consumption baskets derived from Household Income and Expenditure Survey (HIES) (2019) conducted by DCS. Hence do not reflect the changes in the household consumption patterns over the period.

4 An average household in Colombo District consists of 3.8 persons based on the HIES (2019) conducted by DCS.

5 An average household in Sri Lanka consists of 3.7 persons based on HIES (2019) conducted by DCS.

6 Information in this section is primarily based on the public sector wage rate index (2016=100) and informal private sector wage rate index (2018=100) compiled by CBSL, and the formal private sector minimum wage rate index (1978 December=100) compiled by the Department of Labour.

1

compared to 2022. This was driven by the continuous demand from daily wage earners for higher compensation in response to the rising cost of living. As a result, employers were compelled to increase daily wages to retain particularly experienced workers ensuring continuity of their business operations. Further, a significant labour shortage across all sectors, attributed to the migration of workers to other countries, created a competitive environment for experienced workers, resulting in wage increases. However, owing to the high inflation environment that prevailed until early 2023, employees in the informal private sector experienced a real wage erosion of 7.1 per cent in 2023, compared to the previous year.

Nominal wages of employees in the formal private sector, as measured by the minimum wage rate index (1978 December=100) compiled by the Department of Labour, of employees whose wages are governed by wage boards, recorded a slight increase in 2023. Accordingly, the nominal minimum wage rate index increased by 0.4 per cent in 2023 compared to the previous year. Nevertheless, the minimum real wage rate index decreased by 17.6 per cent in 2023 compared to 2022.

Public Sector Wages

Nominal wages of public sector employees, as measured by the public sector wage rate index (2016=100), remained unchanged in 2023, recording a real wage erosion of 17.5 per cent compared to the previous year. Nevertheless, as proposed by the Budget 2024, the Cost of Living Allowance (COLA) for public sector employees was increased by Rs. 10,000.00 from January 2024. Due to fiscal constraints, public sector employees were given a partial payment of Rs. 5,000.00 from January to March 2024. The full payment of Rs. 10,000.00 will be made from April 2024 onwards. Meanwhile, arrears for the initial three months will be paid in three equal instalments, starting from January 2025.

1.2 Real Sector Developments

1.2.1 Economic Growth

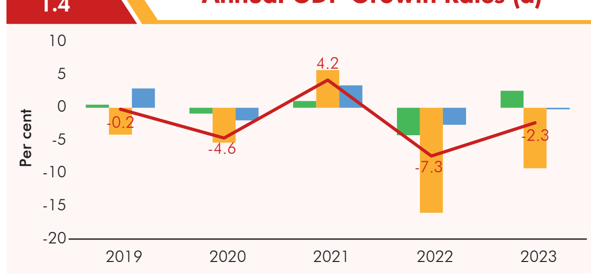
In 2023, the Sri Lankan economy showed signs of rebound with a moderate contraction of 2.3 per cent, in comparison to a significant contraction of 7.3 per cent observed in 2022. The gradual yet steady rebound in 2023 was evident, particularly in the second half of the year, during which the Gross Domestic Product (GDP)[7] recorded positive growth rates. This was underpinned by renewed macroeconomic stability amidst softening inflation and easing of external sector pressures.

GDP at current market prices grew by 14.8 per cent to Rs. 27,629.7 billion in 2023, owing to the price impact, as reflected by the GDP deflator of 17.5 per cent. Further, Gross National Income (GNI), estimated by adjusting GDP for the net primary income from the rest of the world, grew by 14.1 per cent at current prices in 2023. In US dollar terms, GDP increased to 84.4 billion in 2023 from 76.8 billion in 2022, supported by the appreciation of the Sri Lanka rupee during the year.

Driven by the growth in nominal GDP and the decline in mid-year population, GDP per capita increased to Rs. 1,253,785 in 2023, compared to Rs. 1,084,882 in 2022. Meanwhile, GNI per capita also increased to Rs. 1,213,159 in 2023, compared to

7 DCS estimates GDP in production, expenditure and income approaches.

Figure 1.4 Annual GDP Growth Rates (a)



(a) Based on the GDP estimates (base year 2015)

Source: Department of Census and Statistics

Rs. 1,056,424 in 2022. In US dollar terms, GDP per capita in 2023 was 3,830, compared to 3,464 in 2022, while GNI per capita was 3,706, compared to 3,378 in 2022.

1.2.2 Production

Agriculture

Agricultural activities exhibited a notable resurgence, with a 2.6 per cent increase in value added in 2023, marking a significant turnaround from the 4.2 per cent contraction witnessed in 2022, mainly driven by the improved supply conditions, especially fertiliser, other agrochemical inputs and fuel. The growing of rice, fruits, vegetables, and fishing activities were the main contributors to this growth. However, the growing of tea, rubber and coconut contracted during the year, largely due to the adverse impact of weather anomalies.

Industry

Although a gradual recovery in supply conditions was observed throughout the year, the subdued demand conditions continued to impact all industry activities, resulting in a 9.2 per cent contraction in Industry activities during 2023. This was driven by the notable decline in the construction industry, which is highly vulnerable to economic downturns, mainly due to the holdback of construction projects. Further, manufacturing activities, the largest segment of the Industry sector, contracted during the year mainly due to the significant decline in global demand for the manufacture of textiles, wearing apparel and leather-related products. However, most of the other manufacturing activities recorded a strong recovery in the latter part of the year, mainly supported by the manufacture of food, beverages and tobacco products, and the manufacture of coke and refined petroleum products.

Services

A notable growth in accommodation, food and beverage services, and transport activities, mainly attributable to the gradual revival of the tourism sector and the uninterrupted provisioning of power and energy, played a pivotal role in limiting the

Table 1.3

Gross National Income by Industrial Origin at Constant (2015) Prices (a)(b)

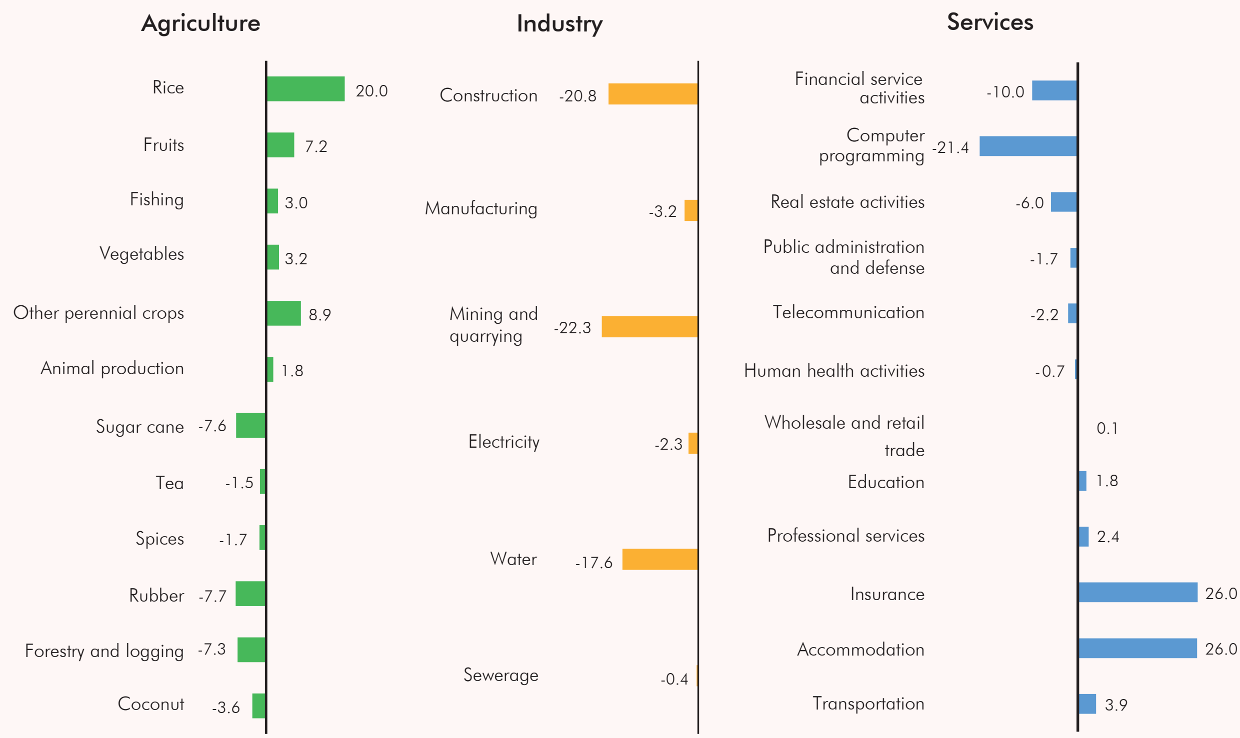
Economic Activity	Rate of Change (%)		Contribution to Growth (%)		As a Percentage of GDP (%)	
	2022 (c)	2023	2022 (c)	2023	2022 (c)	2023
Agriculture, Forestry and Fishing	- 4.2	2.6	- 0.3	0.2	7.5	7.9
Manufacturing, mining and quarrying and other industry	- 13.9	- 4.7	- 2.9	- 0.9	19.6	19.1
Of which: Manufacturing activities	- 12.7	- 3.2	- 2.2	- 0.5	16.1	16.0
Construction	- 20.9	- 20.8	- 1.9	- 1.6	7.6	6.2
Wholesale and retail trade, transportation and storage, accommodation and food service activities	2.4	3.1	0.6	0.8	26.5	28.0
Information and communication	- 0.4	- 13.2	- 0.0	- 0.5	3.4	3.0
Financial and insurance activities	- 18.3	- 5.3	- 1.0	- 0.3	5.0	4.8
Real estate activities (including ownership of dwelling)	- 12.1	- 6.0	- 0.6	- 0.3	4.6	4.4
Professional, scientific, technical, administration and supporting service activities	- 17.7	2.4	- 0.4	0.0	2.0	2.1
Public administration, defense, education, human health and social work activities	- 0.3	- 0.6	- 0.0	- 0.1	9.6	9.8
Other services (excluding own-services)	0.3	0.4	0.0	0.0	8.2	8.4
Equals Gross Value Added (GVA) at Basic Price	- 7.0	- 2.6	- 6.6	- 2.5	94.1	93.7
Taxes less subsidies on products	- 12.4	2.8	- 0.8	0.2	5.9	6.3
Equals Gross Domestic Product (GDP) at Market Price	- 7.3	- 2.3	- 7.3	- 2.3	100.0	100.0
Net primary income from rest of the world	- 4.5	- 23.7				
Gross National Income at Market Price	- 7.6	- 3.0				

(a) Based on the GDP estimates (base year 2015)
(b) Provisional
(c) Revised

Source: Department of Census and Statistics

1

Figure 1.5 Growth in Economic Activities - 2023 (a)



(a) Based on the GDP estimates (base year 2015)

Source: Department of Census and Statistics

contraction in overall Services activities to 0.2 per cent in 2023. However, financial services and real estate activities, which were largely affected by the high-interest-rate environment, particularly during the first half of the year, and the continued contraction in computer programming activities, weighed negatively on the growth of services activities during the year.

1.2.3 Expenditure

From an expenditure perspective, the growth in the total demand of the economy at current prices was contributed positively by both domestic and net external demand. In terms of domestic demand, consumption expenditure, the dominant expenditure component, grew by 16.7 per cent, while investment expenditure grew by 1.6 per cent in 2023. The overall growth in consumption expenditure is attributable to the increase in both private and government consumption expenditures, driven by the price impact. Despite the increase in investment expenditure during the year, fixed capital formation contracted, led by the decline in expenditure on construction activities. Further, the growth in expenditure on goods and services exports alongside the stagnation in expenditure on goods and services imports, resulted in a substantial improvement in net external demand.

Considering expenditure estimates at constant prices in 2023, consumption expenditure contracted due to decreased purchasing power, while investment expenditure contracted owing to the unfavourable investment climate. Meanwhile, the net external demand recorded a significant growth at constant prices during the year, helping to limit the GDP contraction in real terms to 2.3 per cent.

Table 1.4

Aggregate Demand and Savings at Current Market Prices (a)(b)

Item	Rs. billion		% Change		As a Percentage of GDP	
	2022 (c)	2023	2022 (c)	2023	2022 (c)	2023
1. Domestic Demand	24,921.2	28,042.4	31.8	12.5	103.6	101.5
1.1 Consumption	18,038.2	21,051.6	45.0	16.7	75.0	76.2
Private	16,311.0	19,158.5	51.3	17.5	67.8	69.3
Government	1,727.3	1,893.1	3.8	9.6	7.2	6.9
1.2 Investment (Gross Capital Formation)	6,883.0	6,990.8	6.4	1.6	28.6	25.3
Gross Fixed Capital Formation	5,724.1	4,859.6	23.4	-15.1	23.8	17.6
Changes in inventories and Acquisitions less disposals of valuables	1,159.0	2,131.2	-36.7	83.9	4.8	7.7
2. Net External Demand	-857.5	-412.7	34.1	51.9	-3.6	-1.5
Export of Goods and Services	5,187.9	5,634.2	74.1	8.6	21.6	20.4
Import of Goods and Services	6,045.4	6,046.9	41.2	0.0	25.1	21.9
3. Total Demand (GDP) (1+2)	24,063.8	27,629.7	36.6	14.8	100.0	100.0
4. Domestic Savings (3-1.1)	6,025.5	6,578.1	16.6	9.2	25.0	23.8
Private	7,566.0	8,228.9	17.1	8.8	31.4	29.8
Government	-1,540.4	-1,650.9	-19.4	-7.2	-6.4	-6.0
5. Net Primary Income from Rest of the World (d)	-631.2	-895.3	-59.6	-41.8	-2.6	-3.2
6. Net Current Transfers from Rest of the World (d)	1,159.4	1,836.2	12.1	58.4	4.8	6.6
7. National Savings (4+5+6)	6,553.7	7,519.0	12.8	14.7	27.2	27.2
8. Savings Investment Gap						
Domestic Savings - Investment (4-1.2)	-857.5	-412.7			-3.6	-1.5
National Savings - Investment (7-1.2)	-329.3	528.2			-1.4	1.9
9. External Current Account Balance (2+5+6) (d)	-329.3	528.2			-1.4	1.9

(a) Based on the GDP estimates (base year 2015)
(b) Provisional
(c) Revised
(d) Any difference with the BOP estimates is due to the time lag in compilation.

Sources : Department of Census and Statistics
Central Bank of Sri Lanka

In 2023, the country's domestic savings grew by 9.2 per cent at current prices, while national savings grew by 14.7 per cent. The higher growth in national savings was attributable to the notable increase in net current transfers from the rest of the world in rupee terms, while net primary income from the rest of the world continued to contract. As a percentage of GDP, domestic savings was recorded at 23.8 per cent in 2023, while national savings stood at 27.2 per cent. Further, the national savings-investment gap turned positive in 2023, owing to relatively higher growth in national savings compared to investment, with the notable improvement in external sector performance.

1.2.4 Income

Considering the income estimates in 2023, the Gross Operating Surplus, the largest income component of the economy, grew by 21.2 per cent at current prices during the year, compared to the growth of 39.8 per cent recorded in 2022, accounting for 37.9 per cent of Gross Value Added (GVA). Gross Mixed Income, the second largest income component, grew by 13.8 per cent in 2023, compared to the growth of 43.4 per cent in 2022. In terms of other major sources of income, Other Taxes less Subsidies on Production continued to expand during the year, while Compensation of Employees, driven by the Non-Financial Corporations (NFC), contracted during the year. Considering the institutional sector classification of GVA, NFC was the largest income generator, followed by Household and Non-Profit Institutions Serving Households, Financial Corporations, and General Government, respectively.

1

Table 1.5

Income Components by Economic Sector at Current Market Prices (a)(b)

Item	Percentage Share (%)									
	2022 (c)					2023				
	Non-Financial Corporations	Financial Corporations	General Government	Households and Non-Profit Institutions Serving Households	Gross Value Added at basic price	Non-Financial Corporations	Financial Corporations	General Government	Households and Non-Profit Institutions Serving Households	Gross Value Added at basic price
Compensation of Employees	48.2	10.3	23.4	18.1	27.0	44.7	11.1	23.7	20.6	23.8
Gross Operating Surplus	85.7	12.0	2.3	-	35.4	84.3	13.8	2.0	-	37.9
Gross Mixed Income	-	-	-	100.0	37.3	-	-	-	100.0	37.6
Other Taxes less Subsidies on Production	71.2	11.1	-	17.7	0.2	64.1	14.6	-	21.3	0.7
Gross Value Added at basic price	43.5	7.1	7.1	42.3	100.0	43.0	7.9	6.4	42.6	100.0

(a) Based on the GDP estimates (base year 2015)
(b) Provisional
(c) Revised

Source : Department of Census and Statistics

1.2.5 Population, Labour Force and Employment

As estimated by the Registrar General's Department, the mid-year population in Sri Lanka in 2023 declined by 0.6 per cent to 22.037 million, due to a decrease in births and increases in both deaths and net migration. In line with this decline in population, the country's population density decreased to 351 people per square kilometre in 2023 from 354 people per square kilometre recorded in 2022.

As shown in the Sri Lanka Labour Force Survey conducted by the Department of Census and Statistics (DCS), the economically active[8] population (labour force) decreased to 8.408 million in 2023 from 8.547 million recorded in 2022. The Labour Force Participation Rate (LFPR), which is the ratio of the labour force to the household population, also decreased to 48.6 per cent in 2023, compared to 49.8 per cent in 2022.

The unemployment rate remained unchanged at 4.7 per cent in 2023, compared to the previous year, as a combined outcome of the decline in both the unemployed population[9] and labour force during the year. In 2023, the unemployed population decreased marginally to 0.398 million compared to 0.399 million in 2022. Further, the employed population[10] also decreased in 2023 to 8.010 million, compared to 8.148 million in the previous year.

Departures for foreign employment remained high, but recorded a decline of 4.3 per cent to 297,656 in 2023 from 311,056 in 2022. The departures of males and females for foreign employment accounted for 55.3 per cent and 44.7 per cent, respectively, of the total departures for foreign employment during the year.

8 This is the current economically active population, i.e., the number of persons (aged 15 years and above), who are employed or unemployed during the reference one-week period.

9 Persons available and/or looking for work, and who did not work and took steps to find a job during the last four weeks and are ready to accept a job given a work opportunity within next two weeks are said to be unemployed.

10 Persons who worked at least one hour during the reference period, as paid employees, employers, own account workers or contributing family workers are said to be employed. This also includes persons with a job but not at work during the reference period.

Table 1.6

Household Population, Labour Force and Labour Force Participation

Item	2022	2023 (a)
Household Population '000 Persons (b)	17,162	17,306
Labour Force '000 Persons	8,547	8,408
Employed	8,148	8,010
Unemployed	399	398
Unemployment Rate	4.7	4.7
Male	3.7	3.6
Female	6.5	7.0
Labour Force Participation Rate (c)	49.8	48.6
Male	70.5	68.6
Female	32.1	31.3

Source: Department of Census and Statistics

(a) Provisional
(b) Household population aged 15 years and above
(c) Labour force as a percentage of household population

1.2.6 Economic Infrastructure

Power and Energy

Petroleum

Although geopolitical tensions exerted upward price pressures during the latter part of the year, the overall downward trend observed in global prices of crude oil in 2023 together with the appreciation of the Sri Lanka rupee translated into lower domestic prices of petroleum products, compared to 2022. Global crude oil prices recorded declines in 2023, when compared to 2022, largely on account of subdued global demand offsetting voluntary production cuts by OPEC+ countries. Accordingly, the average Brent crude oil price decreased by 17.0 per cent to US dollars 82.22 per barrel in 2023 from US dollars 99.06 per barrel in 2022. In line with this downward trend in global crude oil prices, the annual average import price of crude oil of the Ceylon Petroleum Corporation (CPC) decreased to US dollars 89.60 per barrel in 2023, while the gradual appreciation of the Sri Lanka rupee also supported the decline in import prices in rupee terms. Throughout the year, monthly adjustments were made to domestic prices of petroleum products in line with the cost-reflective pricing formula. Consequently, by the end of the year, the prices of Petrol 92, Auto Diesel, and Kerosene retailed by the CPC recorded overall reductions of 6.5 per cent, 21.7 per cent, and 32.3 per cent, respectively, compared to the end of 2022. However, further reductions were capped due to the imposition of an Excise Duty of Rs. 25.00 per litre, on imports of key refined petroleum products, in two rounds in January and June 2023 by the Government.[11]

Petroleum sales increased in 2023, reflecting the gradual restoration of economic activity in the aftermath of the economic crisis and the improved availability of fuel with the improved foreign currency liquidity status. Sales volumes of petroleum products recorded a year-on-year growth of 7.1 per cent in 2023. Moreover, with the abatement of supply constraints, the Government took measures to relax demand management strategies, which were in place since mid 2022, by increasing the weekly quotas under the National Fuel Pass QR code system in the months of April and May 2023 and subsequently abolishing these quotas with effect from 01 September 2023.

CPC saw a significant turnaround in its financial performance during the year. The implementation of the cost-reflective pricing formula paved the way to improve the financial performance of CPC, with the entity recording a profit of Rs. 120.3 billion in 2023, in comparison to the loss of Rs. 617.6 billion recorded in 2022. At the end of 2022, the Government decided to transfer government guaranteed foreign currency debt stock of CPC amounting to around US dollars 2.5 billion to the government balance sheet as a measure to improve the financial viability of CPC. The CPC's outstanding trade receivables from government entities decreased by Rs. 206.0 billion to stand at Rs. 17.7 billion by the end of December 2023, with the restructuring of the CPC's trade debt receivables from SriLankan Airlines (SLA) and Ceylon Electricity Board (CEB) in December 2023. Meanwhile, the settlement of dues from SLA and CEB enabled CPC to settle its liabilities in relation to the Indian credit line by end December 2023.

Several reforms were undertaken in 2023 to liberalise the domestic petroleum market with the view of improving the competitiveness and efficiency of the petroleum sector in Sri Lanka. In March 2023, the Cabinet of Ministers granted approval to

11 VAT exemptions on major petroleum products of Petrol 92, Petrol 95, Auto Diesel, and Super Diesel were removed with effect from 01 January 2024, while the VAT exemption on Kerosene was continued.

award contracts to three private companies for the importation, storage, distribution, and sale of petroleum products through a predetermined dealer-operated distribution network in Sri Lanka. Accordingly, two foreign suppliers commenced their retail business operations in 2023 and in early 2024. Under the new arrangement, retail prices of petroleum products sold by the CPC, which are determined by the Ministry of Power and Energy through the cost-reflective pricing formula, serve as a ceiling price in the market and new suppliers may determine their prices subject to the same.

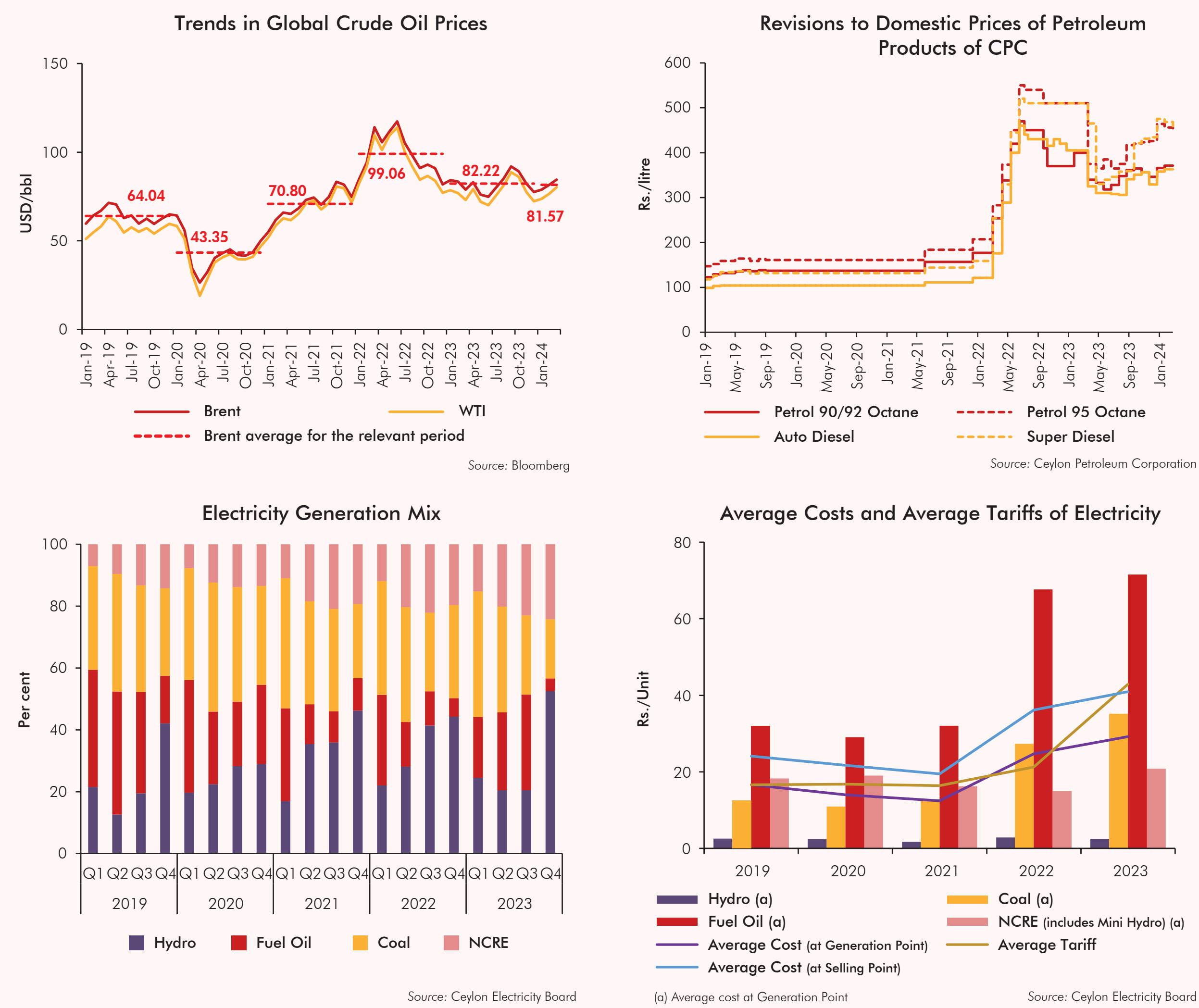
Electricity

The daily scheduled power cuts that were undertaken from February 2022 as a demand management strategy amidst fuel and coal shortages on account of foreign exchange liquidity crunch and the poor reservoir levels, were phased out and uninterrupted supply of electricity resumed from mid-February 2023, supported by the sufficient availability of thermal sources for electricity generation. Despite the favourable statistical base impact stemming from a low level of electricity generation amidst scheduled power outages in 2022, electricity generation witnessed a year-on-year contraction of 2.2 per cent in 2023. This reflected the weak energy demand in the economy stemming from the combined impact of cost-reflective electricity tariffs and subdued economic activity. The power sector faced pressures during the second and third quarters of 2023 due to the delayed onset of the South-West monsoon as a result of the *El Niño* effect. This resulted in an increased usage of expensive thermal sources for electricity generation. However, this trend reversed towards the end of the third quarter of 2023, with improved reservoir levels amidst unusually high rainfall reported from the latter part of September 2023. During the year, hydro, fuel, coal, and Non-Conventional Renewable Energy (NCRE) sources contributed to 29 per cent, 20 per cent, 30 per cent, and 21 per cent, respectively, of overall electricity generation.

Cost-reflective pricing in electricity resulted in improvements in the financial performance of CEB. In 2023, the Government established a semi-annual tariff revision mechanism to address the financial woes of CEB through cost-reflective pricing. However, due to the volatility in the generation mix, electricity tariffs were revised three times during the year, with two upward revisions in February and October, and a downward revision in July 2023. Accordingly, the average electricity tariff was revised upward by around 66 per cent and 18 per cent, respectively, in February and October 2023, while it was revised downward by around 14 per cent in July 2023. Further, based on these developments, the Government decided to reduce the tariff revision cycle to three months, commencing from the first quarter of 2024. Accordingly, electricity tariffs were revised downward effective from 05 March 2024. Regular tariff revisions contributed to a notable improvement in CEB's cash flow, leading to a sizeable profit of Rs. 61.2 billion in 2023, subsequent to recording continuous losses for around seven years since 2016. This improved financial performance of CEB in 2023 was also supported by the increased share of hydro in total generation, particularly in the latter part of 2023.

The Government initiated several policy measures to reform the domestic power sector with a view to improving its competitiveness and efficiency to cater to emerging demand. Amid the ongoing reforms of State Owned Business Enterprises (SOBEs), the proposed new legislation for the power sector is expected to catalyse necessary reforms within the sector, thereby paving the way for an efficient

Figure 1.6 **Energy and Power Sector Developments**



While the downward trend in global crude oil prices and appreciation of the Sri Lanka rupee translated into lower domestic prices of petroleum products, electricity tariffs were higher on account of volatilities that were observed in the generation mix during the year.

and financially viable sector that will ensure energy security. Moreover, the Government's priority to diversify energy sources and expand generation capacity through various power projects, especially renewable energy initiatives, which are financed through foreign investments, is expected to facilitate the country's commitment to source 70 per cent of energy from renewable sources by 2030, while enabling the meeting of growing energy demand in a cost-effective and sustainable manner. Recent improvements in the financial performance of CPC and CEB have helped reduce the burden on the fiscal sector to some extent. The improved financial performance of these key SOBEs has, however, reduced their excessive reliance on the financial system. In turn, this is expected to enable the rechannelling of valuable resources of the financial system, that were previously locked in the losses of SOBEs, into productive sectors across the economy. However, the Government's commitment to the continued implementation of cost-reflective pricing along with continued reforms towards diversification, improved competition, and transparency across the power and energy sectors will be vital to preventing any crisis in these sectors in the future.

Transport Sector

During the year, transportation activities regained their momentum as fuel availability normalised and economic activity began to recover. The operations of the Sri Lanka Transport Board (SLTB), in terms of operated kilometrage, reported a year-on-year growth of 11.2 per cent, while passenger kilometrage reported a contraction of 4.6 per cent during the year. Meanwhile, both passenger kilometrage and operated kilometrage of private bus operators witnessed notable year-on-year growth rates of 23.7 per cent and 94.3 per cent, respectively, in 2023. In the rail transportation sector, the estimated passenger kilometrage and goods kilometrage recorded year-on-year increases of 6.7 per cent and 15.0 per cent, respectively, in 2023. Across the civil aviation sector, there were 7.5 million passenger movements (excluding transit passengers) in 2023, reflecting a notable year-on-year growth of 35.8 per cent. However, cargo handling recorded a contraction of 5.0 per cent during the year. Meanwhile, the Government continued the restructuring of SLA with the calling for Expressions of Interest from potential investors for the divestiture of SLA in October 2023. The port sector, which experienced a significant setback in early 2023, gathered pace during the period thereafter supported by the gradual relaxation of import restrictions and increased trade activity. Accordingly, container handling and cargo handling activities reported year-on-year growth rates of 1.3 per cent and 3.4 per cent, respectively, while ship arrivals also recorded a year-on-year growth of 18.4 per cent in 2023. This positive performance was also driven by the surge in transshipment volumes due to the diversion of vessels away from the Red Sea, particularly towards the latter part of the year.

Other Developments

Other infrastructure development activities gradually resumed in 2023. The Colombo Port City reached the final stages in relation to Phase I, pertaining to the construction of ground infrastructure, including roads and utilities, and is expected to attain completion by mid-2024. Further, several measures were undertaken during the year to continuously strengthen the legal framework of the Colombo Port City, and a key milestone in this regard was the establishment of the International Commercial Dispute Resolution Centre. Infrastructure development activities in the Port of Colombo pertaining to the East Container Terminal Phase II and West Container Terminal Phase I continued during the year and are expected to enable capacity expansion by around 6 million TEUs by 2027. During the year, through the Urban Infrastructure and Township Development Programme *Siyak Nagara*, the Urban Development Authority completed several regional development projects that sought to convert regional town centres into citizen centric cities, including those in Nuwara Eliya, Kurunegala, and Galle. The National Housing Development Authority took steps to restart the *Mihindupura* housing project under a public-private partnership in 2023. Several water supply projects were completed during the year by the National Water Supply and Drainage Board. Meanwhile, initiatives under the *DIGIECON 2030* programme of the Government were also underway, and these are expected to contribute to the acceleration of Sri Lanka's transformation into a digital economy.

1.2.7 Social Infrastructure

Education

Despite the seeming return to normalcy, inequalities in the education system which were aggravated during the crisis period remain unaddressed. Education sector activities recommenced 'in-person' in 2023 after approximately three years of hybrid learning, with the dissipation of disruptions caused by the COVID-19 pandemic and the economic crisis. The Government continued to conduct all national level exams, despite the delay of an academic year continuing to remain unaddressed resulting in two overlapping batches of students for Grades 11 and 13 with those facing the exam potentially disadvantaged in terms of availability of resources to them from their respective schools. As per the findings of the survey of the DCS, schooling of 54.9 per cent of individuals aged 3-21 years has been affected by the crisis. In light of this, the Government continued to invest in student welfare and subsidy programmes during 2023 with a view to minimising student dropout from school education, and improving access to and participation in quality education. These measures include the continuation of the school meal programme, provision of free textbooks, and free school uniforms and school shoes. However, it must be reiterated that these measures can only mitigate the scarring impact of the aftermath of the crisis on academic outcomes, especially among the vulnerable segments of the population for whom education is of even more importance to break generational cycles of vulnerability and poverty.

Health

The health sector continued to grapple with the burden of both communicable and non-communicable diseases, facing additional financial strains to treat these diseases amid limited resources, necessitating comprehensive strategies and resources for efficient management and prevention of these diseases. In 2023, the number of dengue cases in Sri Lanka increased substantially, with the country reporting its third largest outbreak of 89,799 cases, following the substantially large outbreaks in 2017 (186,101 cases) and 2019 (105,049 cases). Further, Sri Lanka reported 62 imported malaria cases in 2023 raising concerns about a potential malaria resurgence. Recent nutrition related indicators highlight the disconcerting and worsening nutritional status of the country, particularly among children and women, amid existing socioeconomic challenges and particularly among those belonging to vulnerable groups. In this context, authorities continued to provide child nutrition services during the year with the collaboration of development partners in an attempt to curb the long lasting impact of such issues. However, a more comprehensive and better targeted strategy is essential in this regard as the effects of malnutrition are long term and can trap individuals across generations in the vicious circle of poor productivity and thereby, poverty.

Lapses in the health sector are becoming increasingly disconcerting raising serious concerns about the efficacy of the sector. Service delivery in the public health sector had been severely impacted by the economic crisis with the foreign exchange liquidity affecting the procurement of medicines and required equipment, alike. While pressures in this regard have been alleviated to a great extent, issues pertaining to the quality of medicines have been recurring regularly in recent times on account of poor quality controls and the lack of a stringent regulatory mechanism in relation to the same. Further, there are growing concerns of negligence in the provisioning of health services. Both aforementioned developments have resulted in casualties which are reprehensible in light of the country's long standing commitment to universal health care. These developments threaten to underestimate the health outcomes that have been achieved thus far. This underscores the critical need to focus on strengthening the country's healthcare system, as it is an essential pillar of the human capital base of the economy. In addition to urgent prioritisation of adequate budgetary allocations for investments in the health sector, stringent regulatory mechanisms at every stage of the supply chain pertaining to pharmaceutical products and medical equipment are of utmost importance considering that the sector deals with the wellbeing and lives of individuals. The timely implementation of sustainable health financing policy is also an essential measure that needs to be undertaken in the short term. Over the medium term, sustainable healthcare provisioning will hinge on the active encouragement of public-private partnerships in relation to not only service delivery but also other aspects of healthcare provisioning, including infrastructure development, production of medicines and medical equipment and even research and development in this sector. Meanwhile, there is also an urgent need for action to address issues pertaining to the loss of human capital as well as the lack of infrastructure for the production of necessary personnel to ensure that achievements made thus far are not wounded by these recent developments.

Social Safety Nets

Considering the disproportionate and prolonged effect of the economic crisis on vulnerable households, measures were taken to strengthen the country's social safety nets in line with the macroeconomic adjustment programme under the IMF-EFF. Accordingly, the *Aswesuma* welfare benefit scheme was initiated in July 2023 under the purview of the Welfare Benefits Board (WBB) with the intention of replacing the Samurdhi Development Programme. The programme was designed after developing the welfare benefit information system, considering multidimensional parameters, with an improved verification approach to ensure the effective targeting of needy sectors, while providing opportunities for appeals in the event of non-inclusion in the benefit scheme. At the outset, around 1.4 million applicants out of 3.7 million applicants were selected to receive benefits under four major categories, namely, transitional, vulnerable, poor, and severely poor, as classified under the Aswesuma programme. Further, several measures were taken to strengthen the selection criteria, along with data recertification and verification procedures as well as regular reviews, to improve the targeting of the programme. Under this programme, around Rs. 53.8 billion was disbursed in 2023. Meanwhile, the Cabinet granted approval in July 2023 to continue the Samurdhi Subsidy Programme until the appeal process under the new benefit scheme was completed. Accordingly, as at end 2023, the number of beneficiary families under the Samurdhi Programme stood at 363, 214 families compared to 1.7 million families at the beginning of the year. While the Government's efforts to improve the efficacy of social assistance programmes are commendable, the lack of post crisis national statistics on the status of poverty, vulnerability and inequality is disconcerting as it hinders timely poverty alleviation and social assistance efforts.

1.3 Monetary Sector Developments

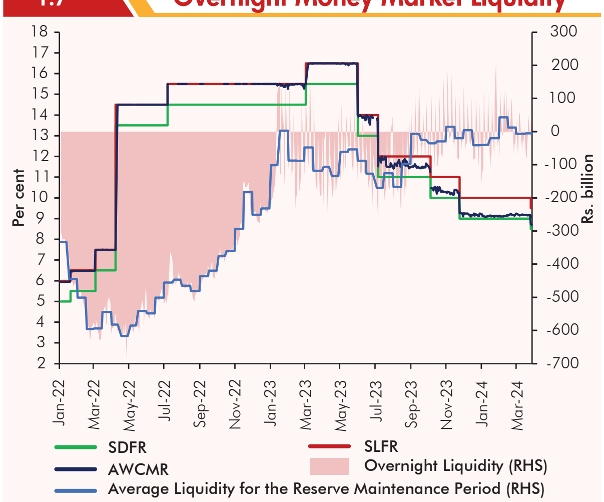
1.3.1 Domestic Money Market Liquidity and Short Term Interest Rates

Overnight liquidity in the domestic money market improved notably in 2023 from deficit levels to broadly balanced levels. Liquidity provision to the market through term reverse repo auctions under open market operations (OMO), in addition to the overnight liquidity provision, in line with the accommodative monetary policy stance and provision of special liquidity assistance to certain licensed banks, which had experienced persistent liquidity deficits were the measures taken by the Central Bank to improve market liquidity. In addition, substantial net purchases of foreign exchange by the Central Bank also released rupee liquidity. Further, the reduction of the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of Licensed Commercial Banks (LCBs) by 200 basis points to 2.00 per cent with effect from 16 August 2023 injected additional liquidity of around Rs. 200 billion into the domestic money market. Consequently, domestic money market liquidity, which remained in deficit, on average, of around Rs. 450 billion during 2022, improved to an average deficit of around Rs. 70 billion during 2023. Overnight liquidity remained volatile during the period under consideration due to restrictions imposed on the Standing Facilities by the Central Bank.[12] However, the volatility and uncertainty on liquidity are expected to normalise in the period ahead as a result of the removal of the aforementioned restrictions[13] in February/ March 2024. The asymmetric distribution of liquidity among LCBs continued, with foreign banks maintaining large liquidity surpluses. In response to the easing of the monetary policy stance[14] and the gradual improvements in domestic money market liquidity conditions, the Average Weighted Call Money Rate (AWCMR),[15] which hovered around the upper bound of the Standing Rate Corridor (SRC) during the period of significantly tight monetary policy, adjusted downwards towards the lower bound of SRC. In turn, this facilitated the overall downward adjustment in the market interest rate structure.

12 Effective from the reserve maintenance period commencing 16 January 2023, the Standing Deposit Facility (SDF) was limited to a maximum of five (5) times per calendar month, while the Standing Lending Facility (SLF) was limited to 90% of the Statutory Reserve Ratio (SRR) of each LCB on any given day.

13 The restrictions on the Standing Facilities were relaxed/ removed in two stages. Initially, with effect from the reserve maintenance period commencing 16 February 2024, the restriction on SLF was removed and the restriction on SDF was relaxed from five times (5) to ten times (10) during a calendar month. Finally, the remaining restriction on SDF was removed with effect from the reserve maintenance period commencing 01 April 2024.

Figure 1.7 Key Policy Interest Rates, AWCMR and Overnight Money Market Liquidity



Source: Central Bank of Sri Lanka

1.3.2 Market Interest Rates

Market interest rates declined significantly in 2023 from notably high levels recorded in 2022. The reduction of market interest rates was driven by the accommodative monetary policy measures implemented since June 2023, supported by several other factors.[16] Administrative measures and moral suasion that targeted the reduction of excessive market interest rates supported by the rapid disinflation process and moderation of inflation expectations, and the decrease in risk premia attached to yields on government securities following the Domestic Debt Optimisation (DDO) operation are other important factors that contributed to the broad based reduction in market lending rates. The administrative measures introduced in August 2023 to reduce excessive lending interest rates, and broader guidelines that were introduced to induce a gradual reduction in other market lending

14 Since the commencement of the monetary policy easing cycle in June 2023, policy interest rates of the Central Bank were reduced by 650 basis points in 2023, and a further 50 basis points thus far in 2024, totalling a cumulative reduction of 700 basis points.

15 The short term interest rate closely monitored by the Central Bank as the operating target to guide the market interest rates under the Flexible Inflation Targeting (FIT) framework.

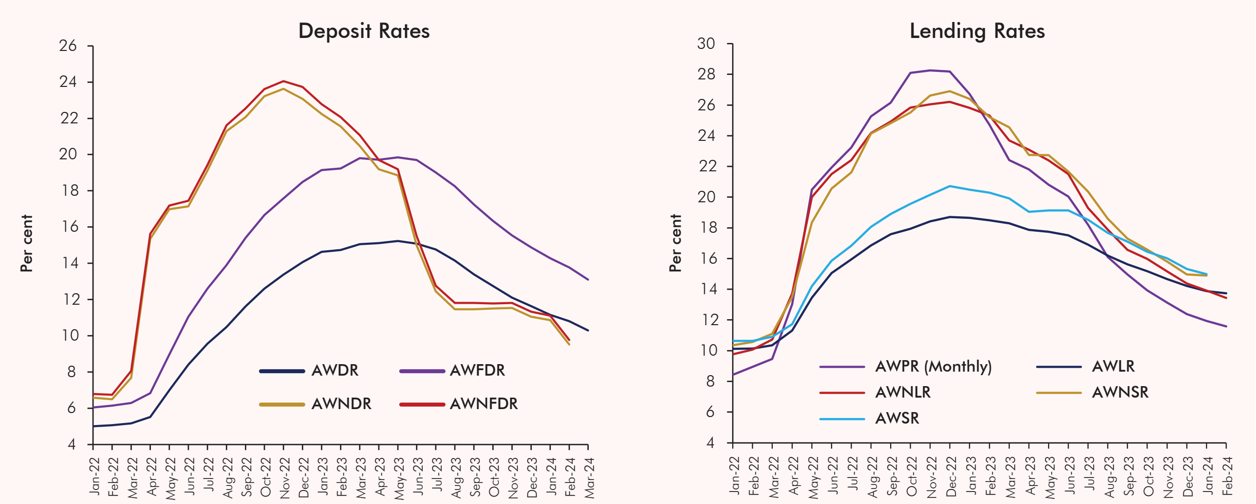
16 The Central Bank increased its policy interest rates by 100 basis points in March 2023 marking it as the last policy interest rate hike in the tight monetary policy cycle which started in August 2021.

1

interest rates on rupee loans and advances during the latter part of the year resulted in a decline in market lending rates reflecting an appreciable passthrough. Market lending interest rates displayed some downward stickiness as yields on government securities remained at relatively elevated levels. The interest rates based on the outstanding stock of interest bearing rupee deposits held with LCBs (Average Weighted Deposit Rate (AWDR) and Average Weighted Fixed Deposit Rate (AWFDR)) declined by a range of 2.42 – 3.61 percentage points, while the interest rates on new interest-bearing rupee deposits mobilised by LCBs (Average Weighted New Deposit Rate (AWNDR) and Average Weighted New Fixed Deposit Rate (AWNFDR)) during a particular month declined by a range of 12.01 – 12.40 percentage points during 2023. Lending rates, particularly interest rates applicable on short term rupee loans and advances granted by LCBs to their prime customers during a particular week (Average Weighted Prime Lending Rate (AWPR)), which is one of the benchmark interest rates in the retail market, declined notably by 15.11 percentage points in 2023. Meanwhile, the lending interest rate based on all outstanding rupee loans and advances extended by LCBs (Average Weighted Lending Rate (AWLR)), and the lending interest rate based on all new rupee loans and advances extended by LCBs (Average Weighted New Lending Rate (AWNLR)) during a particular month declined by 4.49 and 11.82 percentage points, respectively, in 2023. The interest rates applicable on loans to Small and Medium Sized Entrepreneurs (SMEs) also declined during the year in line with the moderation of other market lending interest rates. Accordingly, the interest rate based on all outstanding rupee loans and advances extended by licensed banks to the SME sector (Average Weighted SME Lending Rate (AWSR)) and the interest rate based on all new rupee loans and advances extended by licensed banks during a particular month to the SME sector (Average Weighted New SME Lending Rate (AWNSR)) declined by 5.40 and 11.95 percentage points, respectively. Although, there was an overall reduction in lending interest rates to SMEs, interest rates charged from SMEs remained relatively high, particularly for smaller loans, due to the nature of lending and risks associated.

Figure 1.8

Movement of Selected Market Interest Rates



Source: Central Bank of Sri Lanka

The downward trend in market interest rates continued in early 2024, highlighting the space available for market interest rates to decline further in response to accommodative monetary conditions. In spite of these developments, real market interest rates remained positive, given the low level of inflation, indicating that monetary conditions from an interest rate perspective remained somewhat tight. Meanwhile, interest rates offered on foreign currency deposits recorded a moderation during 2023 compared to the previous year owing to improvements in foreign exchange balances in the banking sector supported by inflows from the merchandise and services sector exports as well as workers' remittances, although the global stance of monetary policy remained tight.

Yields on government securities, which declined notably with the announcement of the DDO operation in July 2023, reduced further underpinned by the easing of monetary policy and the gradual dissipation of risk premia associated with government securities. Further, fiscal consolidation efforts and improvement in government revenue, the buildup of buffer funds for cashflow operations by the Government, the deceleration of inflation and reduction in inflation expectations, and improved market sentiments also supported the normalisation of yields on government securities. Accordingly, yields on Treasury bills across all maturities decreased by 16.34 – 18.13 percentage points during 2023, while Treasury bond yields also moderated. In the meantime, the secondary market yield curve, which had shown unusual movements since April 2022 triggered by uncertainties that arose from domestic debt restructuring concerns and the heightened borrowing requirement of the

Table 1.7

Movements of Interest Rates

Per cent per annum

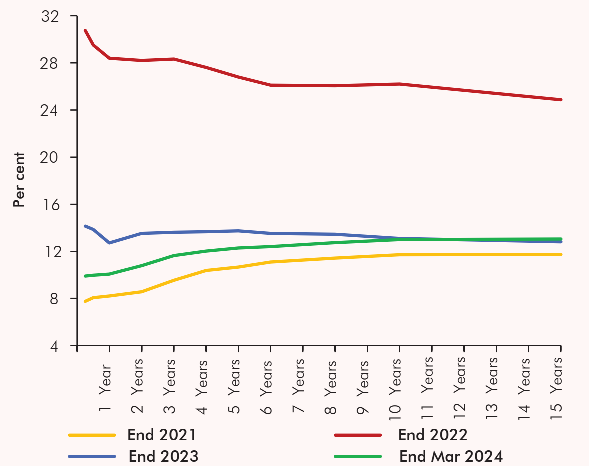
Interest Rate	End 2022	End 2023	Change in % pts
Key Policy Interest Rates			
Standing Deposit Facility Rate (SDFR)	14.50	9.00	-5.50
Standing Lending Facility Rate (SLFR)	15.50	10.00	-5.50
Average Weighted Call Money Rate (AWCMR)	15.50	9.24	-6.26
Yield Rates on Government Securities			
Primary Market (a)			
Treasury bills			
91-day	32.64	14.51	-18.13
182-day	32.20	14.16	-18.04
364-day	29.27	12.93	-16.34
Treasury bonds			
2-year	33.01 (b)	13.87 (c)	-19.14
3-year	31.36 (b)	14.07 (c)	-17.29
4-year	-	14.21 (c)	-
5-year	31.78 (b)	14.32 (c)	-17.46
10-year	30.86 (b)	-	-
Secondary Market			
Treasury bills			
91-day	30.75	14.13	-16.62
182-day	29.50	13.86	-15.64
364-day	28.39	12.71	-15.68
Treasury bonds			
2-year	28.19	13.52	-14.67
3-year	28.32	13.62	-14.70
4-year	27.60	13.66	-13.94
5-year	26.78	13.74	-13.04
10-year	26.18	13.10	-13.09
Interest Rates on Deposits			
Licensed Commercial Banks (d)			
Savings Deposits	0.25-6.00	0.25-13.00	-
1 Year Fixed Deposits (e)	4.50-30.00	1.00-22.00	-
AWDR (f)	14.06	11.64	-2.42
AWFDR (f)	18.49	14.88	-3.61
AWNDR (f)	23.07	11.06	-12.01
AWNFDR (f)	23.73	11.33	-12.40
Other Financial Institutions (g)			
National Savings Bank			
Savings Deposits	3.00	3.00	-
1 Year Fixed Deposits	12.00	8.00	-4.00
Licensed Finance Companies (h)			
Savings Deposits	4.63-8.03	4.33-6.62	-
1 Year Fixed Deposits	20.48-27.15	11.88-13.56	-
Interest Rates on Lending			
Licensed Banks (i)			
AWSR	20.73	15.33	-5.40
AWNSR	26.91	14.96	-11.95
Licensed Commercial Banks (d)			
AWPR (Monthly)	28.19	12.39	-15.80
AWLR	18.70	14.21	-4.49
AWNLR	26.20	14.38	-11.82
Licensed Specialised Banks (g)			
National Savings Bank	28.00-32.00	15.00-20.00	-
State Mortgage and Investment Bank (j)	18.00-27.25	9.50-21.00	-
Licensed Finance Companies (h)			
Finance Leasing	21.53-35.37	14.98-32.48	-
Loans against Immovable Properties	26.80-28.43	14.18-23.86	-
Corporate Debt Market			
Debentures	15.42-28.00	13.50-29.50	-
Commercial Papers	11.00-36.00	17.00-26.50	-

(a) Weighted average yield rates at the latest available auction
(b) Last primary auction during 2022: 2 yr - 13 Dec | 3 yr - 29 Dec | 5 yr - 28 Oct | 10 yr - 11 Nov
(c) Last primary auction during 2023: 2 yr - 28 Dec | 3 yr - 12 Dec | 4 yr - 28 Dec | 5 yr - 12 Dec
(d) Based on the rates quoted by LCBs
(e) Maximum rate is a special rate offered by certain LCBs
(f) Since July 2018, AWDR and AWFDR were calculated by replacing senior citizens' special deposit rate of 15% with relevant market interest rates to exclude the impact of special rates. Same method was applied to calculate AWNDR and AWNFDR since June 2018. However, senior citizens' special deposit rate of 15% was discontinued from 01.10.2022.
(g) Based on the rates quoted by other selected Financial Institutions
(h) Interest rate ranges are based on the average maximum and average minimum rates quoted by LFCs which are applicable for deposits mobilised and loans granted during the respective months. Data for 2023 are provisional
(i) Based on the rates quoted by LCBs and LSBs
(j) Lending for housing purposes only

Sources: Respective Financial Institutions
Colombo Stock Exchange
Central Bank of Sri Lanka

1

Figure 1.9 Secondary Market Yield Curve for Government Securities



Source: Central Bank of Sri Lanka

Government, continued to exhibit a double humped inverted yield curve during the most part of 2023. However, with the moderation of yields on government securities following the DDO operation and improved fiscal outturn, it transitioned to a normal upward sloping yield curve since early 2024.

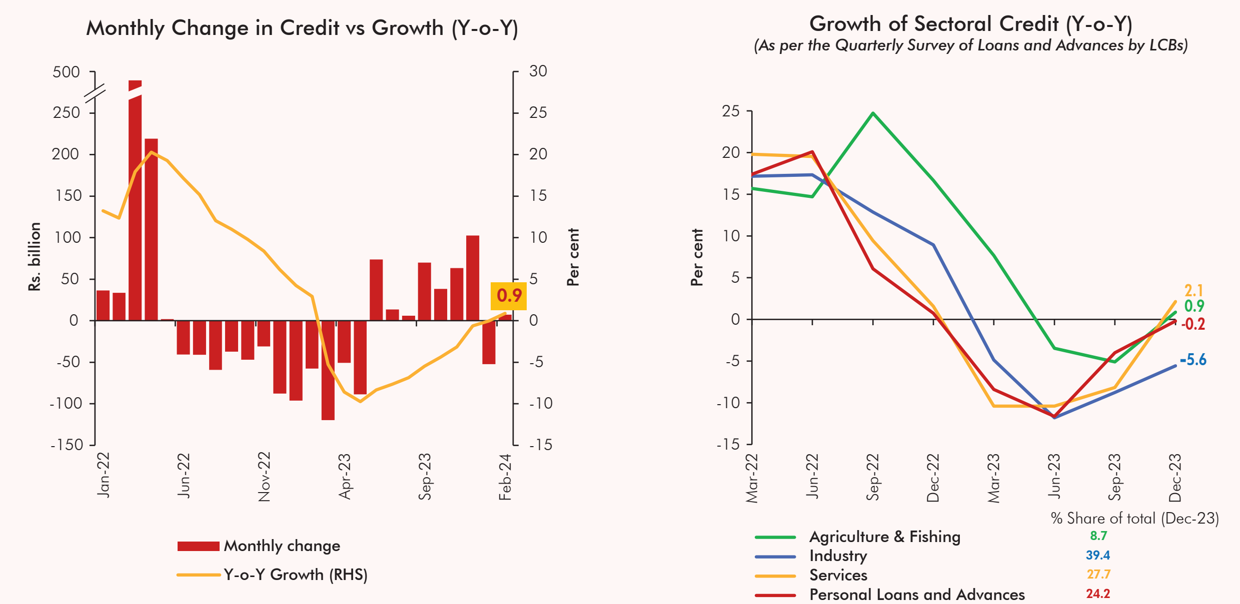
1.3.3 Credit Aggregates

The turnaround of credit to the private sector by LCBs recorded in June 2023 ended the longest streak of monthly contractions of credit to the private sector. The turnaround was supported by the gradual relaxation of the monetary policy stance and improvements in economic activity and market sentiments. Accordingly, the cumulative increase in outstanding credit to the private sector by LCBs during June-December 2023 was Rs. 367.4 billion. Despite the recovery during the second half of 2023, credit to the private sector by LCBs recorded a cumulative contraction of Rs. 45.0 billion during 2023, registering a year-on-year contraction of 0.6 per cent by end 2023 compared to the growth of 6.2 per cent (year-on-year) recorded at end 2022. However, the increasing trend in credit to the private sector by LCBs experienced an unexpected monthly contraction in January 2024 (a contraction of Rs. 52.2 billion) partly due to the advancing of spending in view of the implementation of VAT adjustments effective January 2024 and the settlement of short term borrowings obtained by businesses during the end-year festive season. Further, the valuation impact arising from the appreciation of the Sri Lanka rupee exacerbated the contraction in January 2024. Nevertheless, credit to the private sector expanded in February 2024 to some extent and is anticipated to expand in the period ahead, aligning with the envisaged further reduction in market interest rates and improvements in economic activity. Meanwhile, credit to the private sector by Licensed Specialised Banks (LSBs) contracted by Rs. 32.9 billion during 2023, recording a year-on-year contraction of 2.8 per cent by end 2023 amidst relatively tight liquidity conditions of those banks and comparatively high interest rates. Private sector credit by Licensed Finance Companies (LFCs) also contracted by Rs. 24.2 billion during 2023, recording a year-on-year contraction of 1.8 per cent by the end of 2023.

Credit to the major sectors of the economy[17] suffered contractions during the first half of 2023 but commenced recovering thereafter. During the year, an improvement was observed in credit extended to productive sectors, excluding credit to the Industry sector, which experienced a setback. Accordingly, on a year-on-year basis, credit to the Agriculture and Services sectors grew by 0.9 per cent and 2.1 per cent, respectively, during 2023. Within the Agriculture sector, the tea, paddy, and fisheries subsectors recorded credit expansions during the year, reflecting a broad based expansion in

17 Findings are based on the Quarterly Survey on Loans and Advances extended to the Private Sector by LCBs.

Figure 1.10 **Credit Extended to the Private Sector by LCBs**



Source: Central Bank of Sri Lanka

agriculture activities. In the Services sector, the wholesale and retail trade, communication and information technology, and shipping, aviation and freight forwarding subsectors recorded expansions in credit during the year, showing signs of a rebound in service related economic activity in the economy. However, credit granted to the Industry sector remained weak on account of the construction subsector being severely affected by the lack of government and private sector projects stemming from fiscal constraints, rising raw material prices, and associated finance costs due to the high interest rate environment in 2022 and early 2023. A contraction in credit was also observed across the textiles and apparel, and food and beverages subsectors, followed by some recovery during the second half of the year. However, on a year-on-year basis, credit to the Industry sector contracted by 5.6 per cent in 2023. Meanwhile, credit extended in the form of personal loans and advances suffered a marginal contraction of 0.2 per cent in 2023, although a resumption was observed in the second half of the year driven by the substantial increase in pawning related credit, which has been growing continuously since the onset of COVID-19.

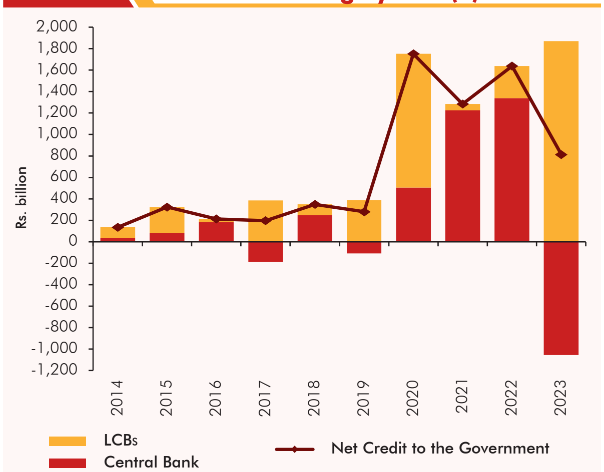
Credit obtained by SOBEs from the banking system contracted in 2023, in contrast to the notable expansion recorded during 2022. Credit to SOBEs by LCBs contracted by Rs. 979.9 billion during 2023 mainly due to the Government taking over the government guaranteed foreign currency debt obligations of CPC, provided by LCBs, and improved financial performance of key SOBEs following the implementation of cost-reflective price adjustments thus reducing their reliance on bank financing.

Net Credit to the Government (NCG) by LCBs continued to increase in 2023 as the banking system was one of the main sources of domestic financing of the Government. NCG by the banking system

1

increased by Rs. 813.9 billion during 2023 but remained lower than the expansion recorded during 2022 (an expansion of Rs. 1,638.7 billion). NCG by LCBs recorded an increase of Rs. 1,870.1 billion during the year reflecting the increase in investments in government securities by LCBs amidst the reduction in credit provided to the private sector, and the transfer of government guaranteed outstanding foreign currency debt of CPC to the Government. In contrast, NCG by the Central Bank recorded a significant reduction of Rs. 1,056.3 billion during 2023 mainly due to the offloading of Treasury bills held by the Central Bank and reduction in the use of SLF of the Central Bank by LCBs with the gradual improvements of the liquidity position of LCBs. The reduction in NCG by the Central Bank was partly due to the restrictions on monetary financing introduced in the Central Bank of Sri Lanka Act, No. 16 of 2023 (CBA), which prohibited monetary financing and created a commitment to reduce the government securities holding of the Central Bank. Meanwhile, the expansion of NCG based

Figure 1.11 **Annual Change in NCG from the Banking System (a)**



(a) With the approval of the Cabinet of Ministers at its meeting held on 30 January 2023, the outstanding foreign currency guaranteed debt of CPC was absorbed into central government debt with effect from December 2022. Accordingly, this adjustment was implemented in two phases, first in April 2023 and subsequently in December 2023, hence, was reflected in the balance sheets of the particular state owned commercial banks, which caused a reduction in credit to public corporations/ SOBEs and a corresponding expansion in NCG.

Source: Central Bank of Sri Lanka

on the Financial Survey (M_4)[18] amounted to Rs. 1,038.6 billion during 2023, of which Rs. 140.7 billion was through LSBs and Rs. 84.0 billion was through LFCs.

1.3.4 Money Aggregates

Reserve money recorded a marginal contraction in 2023, although high volatility was observed in its levels since early 2023 due to the impact of administrative measures taken by the Central Bank to reduce the overdependence of LCBs on the standing facilities of the Central Bank. The restricted access to Standing Deposit Facility (SDF) resulted in LCBs maintaining large excess reserves with the Central Bank at irregular intervals. This created daily volatility in LCBs' deposits with the Central Bank causing reserve money to be volatile. With the reduction in SRR by 200 basis points in August 2023, LCBs' deposits with the Central Bank declined notably, although volatility continued as restrictions were still in force during 2023. Meanwhile, currency in circulation, which declined significantly after the festival season of April 2023, recorded some expansion towards end June 2023, mainly reflecting the uncertainties surrounding the DDO operation. However, with the public gaining greater clarity on DDO, a return of currency to the banking system was observed since mid-July 2023, albeit moderately. As in the past, currency in circulation increased notably towards the end of the year due to festive demand, although part of the seasonal demand for currency returned to the banking system. However, currency in circulation continued to increase thereafter as the preference to hold currency remained elevated as recent tax related measures are likely to have increased cash based transactions,

18 The Financial Survey provides a broader measure of money supply, covering all deposit taking institutions, including LSBs and LFCs, in addition to LCBs and the Central Bank.

Table 1.8

Developments in Money Aggregates

Rs. billion

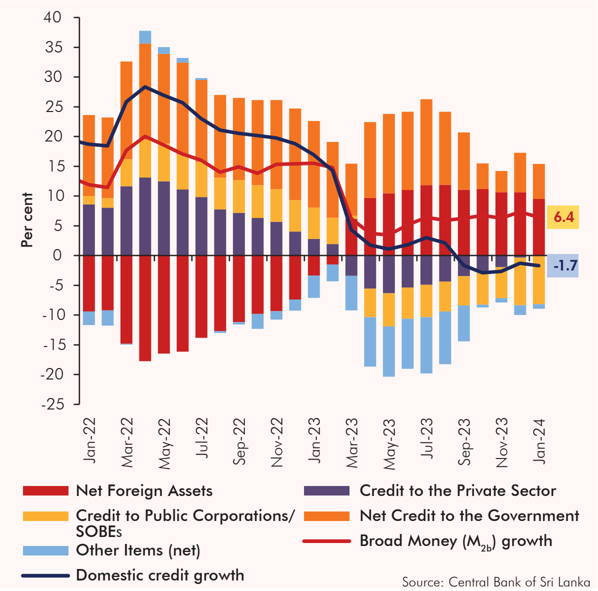
Item	End 2019	End 2020	End 2021	End 2022	End 2023 (a)
1. Reserve Money	933	964	1,306	1,349	1,329
(% change Y-o-Y)	-3.0	3.4	35.4	3.3	-1.5
Net Foreign Assets of the Central Bank	896	527	-387	-1,614	-837
Net Domestic Assets of the Central Bank	37	438	1,693	2,963	2,166
2. Narrow Money (M_1)	865	1,177	1,460	1,454	1,658
(% change Y-o-Y)	4.2	36.0	24.0	-0.4	14.1
3. Broad Money (M_{2b})	7,624	9,406	10,647	12,290	13,189
(% change Y-o-Y)	7.0	23.4	13.2	15.4	7.3
3.1 Net Foreign Assets (NFA)	101	-209	-982	-1,767	-456
Monetary Authorities (b)	896	527	-387	-1,614	-837
Licensed Commercial Banks (LCBs)	-795	-736	-595	-153	381
3.2 Net Domestic Assets (NDA)	7,523	9,615	11,629	14,056	13,645
Domestic credit	9,411	11,721	14,002	16,632	16,421
Net Credit to the Government (NCG)	2,796	4,548	5,832	7,471	8,285 (c)
Central Bank	363	869	2,094	3,432	2,376
Licensed Commercial Banks (LCBs)	2,433	3,679	3,738	4,039	5,909
Credit to Public Corporations / SOBEs	818	1,002	1,188	1,750 (d)	770 (c)
Credit to the Private Sector	5,797	6,171	6,981	7,411 (d)	7,366
(% change Y-o-Y)	4.2	6.5	13.1	6.2	-0.6
Other Items (net)	-1,887	-2,106	-2,373	-2,576	-2,776
4. Broad Money (M_4)	9,445	11,462	12,985	14,840	15,829
(% change Y-o-Y)	8.2	21.4	13.3	14.3	6.7
4.1 Net Foreign Assets (NFA)	89	-217	-999	-1,767	-456
Monetary Authorities (b)	896	527	-387	-1,614	-837
Licensed Commercial Banks (LCBs)	-795	-736	-595	-153	381
Licensed Specialised Banks (LSBs)	-12	-8	-17	0	0
4.2 Net Domestic Assets (NDA)	9,356	11,679	13,984	16,607	16,285
Net Credit to the Government (NCG)	3,483	5,366	6,769	8,469	9,507 (c)
Central Bank	363	869	2,094	3,432	2,376
Licensed Commercial Banks (LCBs)	2,433	3,679	3,738	4,039	5,909
Licensed Specialised Banks (LSBs)	614	742	845	881	1,022
Licensed Finance Companies (LFCs)	73	75	92	116	200
Credit to Public Corporations / SOBEs by (LCBs)	818	1,002	1,188	1,750 (d)	770 (c)
Credit to the Private Sector	7,793	8,285	9,339	9,917 (d)	9,815
(% change Y-o-Y)	3.9	6.3	12.7	6.2	(1.0)
Licensed Commercial Banks (LCBs)	5,797	6,171	6,981	7,411 (d)	7,366
Licensed Specialised Banks (LSBs)	814	936	1,094	1,159	1,126
Licensed Finance Companies (LFCs)	1,182	1,177	1,264	1,347	1,323
Other items (net)	-2,738	-2,973	-3,312	-3,529	-3,807
Memorandum Items:					
Money Multiplier (M_{2b})	8.18	9.75	8.15	9.11	9.93
Velocity (M_{2b} average) (e)	2.16	1.84	1.73	2.04 (d)	2.19

(a) Provisional
(b) This includes NFA of the Central Bank as well as the Government's Crown Agent's balance reported by the Department of State Accounts
(c) With the approval of the Cabinet of Ministers at its meeting held on 30 January 2023, the outstanding foreign currency guaranteed debt of the Ceylon Petroleum Corporation (CPC) was absorbed into central government debt with effect from December 2022. Accordingly, this adjustment was implemented in two phases, first in April 2023 and subsequently in December 2023, hence, was reflected in the balance sheets of the particular state owned commercial banks, which caused a reduction in credit to Public Corporations/ SOBEs and a corresponding expansion in Net Credit to the Government (NCG).
(d) Revised
(e) Based on rebased GDP estimates (base year 2015) by the Department of Census and Statistics

Source: Central Bank of Sri Lanka

1

Figure 1.12 Contribution to Y-o-Y Growth of Broad Money (M_{2b})



Source: Central Bank of Sri Lanka

together with lower opportunity cost of holding currency due to reduced deposit interest rates. Accordingly, reserve money contracted marginally to Rs. 1,328.7 billion by end 2023, recording a year-on-year contraction of 1.5 per cent. Meanwhile, with the relaxation of the restrictions imposed on the standing facilities in February and March 2024, the volatility of daily reserve money reduced somewhat.

On the assets side of the Central Bank's balance sheet, a contraction of reserve money was recorded during 2023 entirely due to the contraction in Net Domestic Assets (NDA) of the Central Bank surpassing the expansion of its Net Foreign Assets (NFA) during the year. NDA of the Central Bank declined by Rs. 797.2 billion during 2023 mainly due to the decline in net claims on the Government, particularly the decline in the government securities holdings of the Central Bank (net of repo). Nevertheless, this decline was somewhat negated as retained earnings turned negative from September 2023 as a result of accounting for the upfront day one loss incurred following DDO, and reduction in the SDF placements by LCBs, which led to the expansion of other items (net). Meanwhile, NFA of the Central Bank, which turned negative in August 2021, gradually improved in 2023, reflecting the combined effect of increased foreign assets with the accumulation of foreign reserves and decreasing foreign liabilities of the Central Bank. During 2023, NFA of the Central Bank improved by Rs. 776.5 billion, albeit remaining negative by the end of the year.

Despite the expansions recorded in NCG and NFA of the banking system, the growth of broad money (M_{2b}) supply remained moderate during 2023 mainly due to the contractions recorded in credit extended by LCBs to the private sector and SOBEs. NFA of the banking system improved notably by Rs. 1,310.7 billion during 2023 due to the decline in foreign liabilities and the build-up of foreign assets, reflecting an improvement in external sector performance and gross official reserves (GOR). Settlement of foreign currency liabilities by the Central Bank as well as LCBs, helped reduce foreign currency liabilities of the banking system, while the receipts from multilateral agencies as well as the retention of foreign exchange within the banking system due to lower demand for foreign exchange augmented the foreign currency assets of the banking system. Accordingly, driven by these developments, the year-on-year growth of broad money (M_{2b}) decelerated gradually to 7.3 per cent by end 2023 and further to 6.4 per cent by end January 2024 from 15.4 per cent at end 2022. On the liabilities side of M_{2b}, the increase in time and savings deposits held by the public with LCBs contributed 77 per cent to the year-on-year expansion of M_{2b} during 2023. Meanwhile, an expansion of currency and demand deposits held by the public with

LCBs was also recorded during 2023, partly due to increased holdings of currency and demand deposits amidst increased cost of living and declining interest rates which reduced the opportunity cost of holding currency and demand deposits. Following the similar trend observed in M_{2b}, the growth of M_4 broad money supply, as measured by the Financial Survey, remained moderate during 2023.

1.4 External Sector Developments

Sri Lanka's external sector rebounded strongly in 2023 and demonstrated greater stability, having recorded positive developments on many fronts towards the latter part of the year. The commencement of the IMF-EFF programme in March 2023 and its successful continuation thus far have been instrumental in achieving stability in the external sector. The external current account recorded a surplus in 2023. This was supported by the notable contraction in the trade deficit and significant inflows in terms of services exports and workers' remittances. The merchandise trade deficit for 2023 recorded its lowest since 2010, supported by a larger contraction in import expenditure than that of export earnings. The increase in services account surplus is mainly attributed to the notable improvement in earnings from tourism with the robust recovery in tourist arrivals after facing repeated challenges over the past four years. The deficit in the primary income account, compiled on an accrual basis, widened in 2023 due to higher interest payments on foreign loans, including arrears. Further, workers' remittances recorded a notable improvement as a result of continuous departures for foreign employment and higher inflows through official channels. On the other hand, the financial account performance

Table 1.9 **Current and Capital Account**

Item	USD million	
	2022 (a)	2023 (b)
Current Account (net)	**-1,448**	**1,559**
Receipts	20,228	23,780
Payments	21,677	22,221
Trade Balance	**-5,185**	**-4,900**
Exports	13,106	11,911
Imports	18,291	16,811
Services (net)	**2,110**	**3,404**
Receipts	3,062	5,416
Of which;		
Transport	676	1,550
Travel	1,136	2,068
Computer Services	1,066	795
Construction Services	9	355
Payments	953	2,012
Of which;		
Transport	333	732
Travel	244	152
Computer Services	133	198
Construction Services	11	111
Primary Income (net)	**-1,870**	**-2,564**
Receipts	266	463
Compensation of employees	30	53
Investment Income	237	410
Direct Investment	15	12
Portfolio Investment	-	-
Other Investment	217	349
Payments	2,136	3,027
Compensation of employees	69	30
Investment Income	2,068	2,997
Direct Investment	549	888
Portfolio Investment	778	866
Other Investment	741	1,243
Secondary Income (net)	**3,496**	**5,619**
Receipts	3,793	5,989
Of which;		
Workers' Remittances	3,789	5,970
Payments	296	371
Capital Account (net)	**19**	**63**
Receipts	38	94
Payments	19	31
Current and Capital Account (net)	**-1,429**	**1,622**
As a Percentage of GDP		
Trade Balance	-6.7	-5.8
Goods and Services	-4.0	-1.8
Current Account	-1.9	1.8

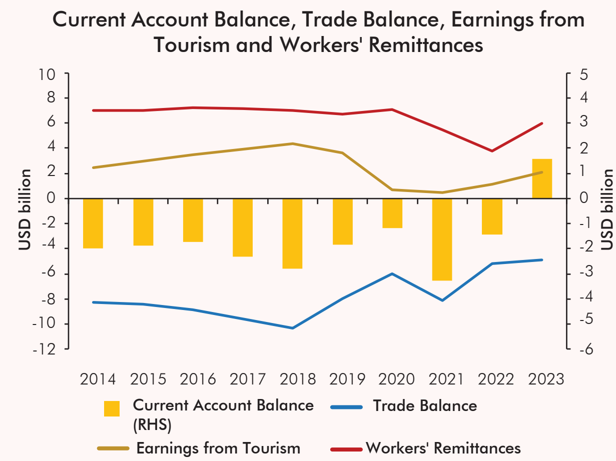
(a) Revised
(b) Provisional

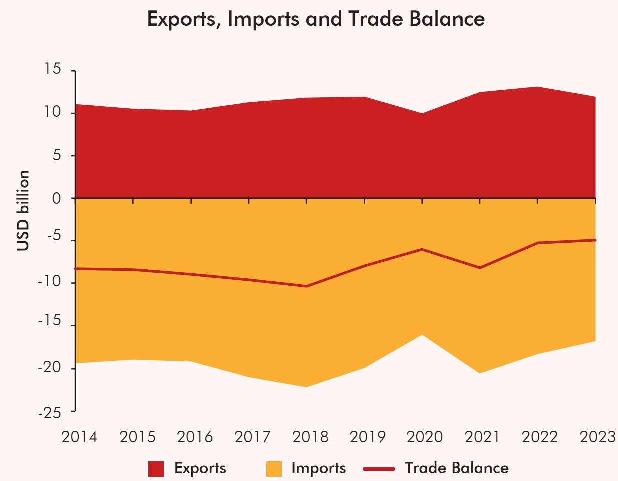
Source: Central Bank of Sri Lanka

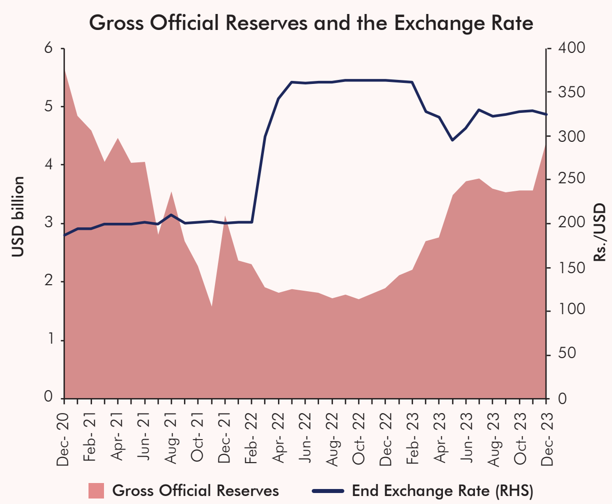
1

Figure 1.13

Highlights of the External Sector







A moderate level of trade deficit, rebounding workers' remittances, earnings from tourism and other net inflows to the services sector contributed to the current account surplus in 2023, resulting in a stable exchange rate and increased gross official reserves.

Source: Central Bank of Sri Lanka

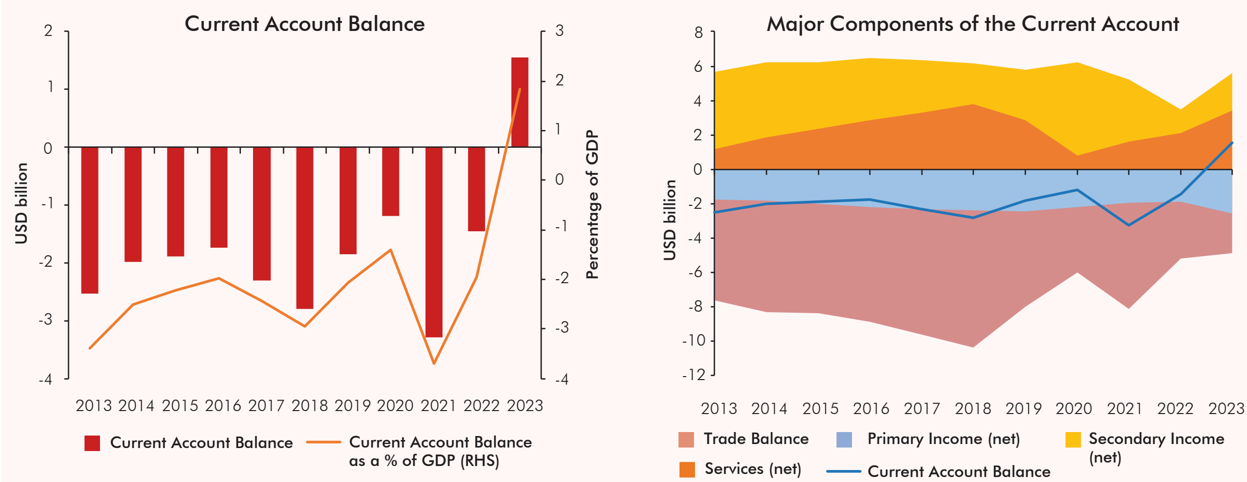
remained subdued with modest foreign direct investment (FDI) inflows. However, foreign investments in the government securities market and the stock market recorded net inflows in 2023. Meanwhile, notable net forex purchases by the Central Bank from the domestic forex market, disbursements under the IMF-EFF, and foreign financing from multilateral agencies such as the World Bank and the Asian Development Bank (ADB) helped augment GOR substantially by end 2023. As opposed to the significant depreciation recorded in 2022, the Sri Lanka rupee appreciated notably during 2023 due to improved liquidity conditions and market sentiments in the domestic foreign exchange market.

1.4.1 Balance of Payments

Current and Capital Account

The external current account recorded a surplus of US dollars 1,559 million in 2023, compared to a deficit of US dollars 1,448 million in 2022. This surplus was mainly driven by a lower trade deficit of US dollars 4.9 billion in 2023, compared to a trade deficit of US dollars 5.2 billion recorded in 2022, improved trade in services, particularly earnings from tourism, and a higher surplus in the secondary income account, despite a notable widening of the primary income account deficit.

Figure 1.14 **Current Account Balance and its Composition**



Source: Central Bank of Sri Lanka

Merchandise Trade Account

The merchandise trade deficit for 2023 reached its lowest level since 2010, largely driven by a notable decline in import expenditure relative to the decline observed in export earnings. Export earnings dipped in 2023, with a sizeable contraction of industrial exports, driven by garment exports. Meanwhile, a significant drop in import expenditure was observed due to subdued economic activity, lower disposable income, import restrictions, and tight monetary and fiscal conditions. Accordingly, the deficit in the trade account narrowed to US dollars 4,900 million compared to US dollars 5,185 million recorded in 2022. As a percentage of GDP, the trade deficit narrowed to 5.8 per cent in 2023 from 6.7 per cent in 2022. Terms of trade, i.e., the ratio of the price of exports to the price of imports, deteriorated marginally, since both export and import unit value indices deteriorated close to similar levels in 2023, compared to 2022. Meanwhile, total trade, i.e., the total of export earnings and import expenditure, declined significantly by 8.5 per cent (year-on-year) in 2023.

Table 1.10 **Summary of Merchandise Trade Performance**

Category	2022 Value (USD million)	2023 Value (USD million)	Y-o-Y Change %
Exports	**13,106.4**	**11,910.7**	**-9.1**
Industrial	10,465.3	9,277.7	-11.3
Agricultural	2,568.0	2,566.5	-0.1
Mineral	50.0	38.5	-23.1
Unclassified	23.2	28.0	20.8
Imports	**18,291.0**	**16,811.1**	**-8.1**
Consumer	2,813.0	3,043.9	8.2
Food and beverages	1,607.9	1,693.0	5.3
Non-food consumer	1,205.1	1,350.9	12.1
Intermediate	12,438.8	11,006.6	-11.5
Investment	3,030.5	2,744.6	-9.4
Unclassified	8.8	16.0	82.9
Trade Balance	**-5,184.6**	**-4,900.4**	
Total Trade	**31,397.4**	**28,721.8**	**-8.5**

Sources: Sri Lanka Customs
Petroleum Exporters and Importers
National Gem and Jewellery Authority
Central Bank of Sri Lanka

Export Performance

The performance of merchandise exports was subdued in 2023. Earnings from exports recorded US dollars 11,911 million in 2023, which declined by 9.1 per cent compared to 2022. This decline was influenced by global factors, including high cost of living and economic downturn in major export destinations and geopolitical tensions, which resulted in reduced demand for Sri Lankan exports. On the other hand, domestic factors, such as higher operating expenses and supply constraints of intermediate goods adversely impacted the overall competitiveness of exports. Further, as a percentage of GDP, export earnings in 2023 declined to 14.1 per cent from 17.1 per cent in 2022.

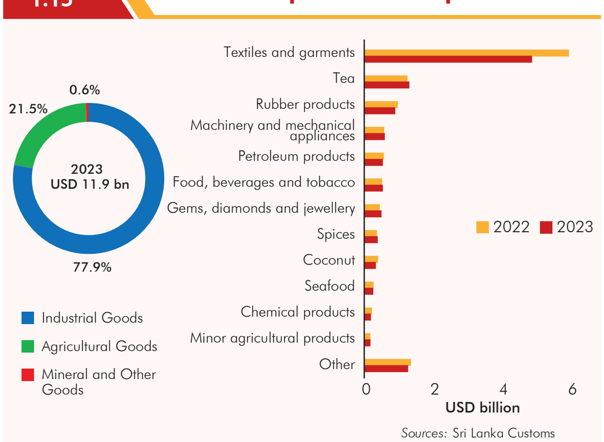
The decline in industrial exports largely contributed to the contraction in export earnings, though the decline was broad-based. The export of textiles and garments, the single largest export of Sri Lanka, registered an 18.0 per cent decline in 2023 compared to 2022, thereby emerging as a key contributor to the overall decline in exports. A notable decline was observed in petroleum product exports in 2023, attributed to the lower prices of bunker and aviation fuel. Earnings from most other industrial goods also experienced subdued performance. However, gems, diamonds and jewellery, transport equipment and machinery, and mechanical appliances exports recorded a growth in 2023. Meanwhile, agricultural exports reported a marginal dip in earnings in 2023 compared to 2022. Of the agricultural exports, the increases in mainly tea, spices, and unmanufactured tobacco were offset by weaker performances in coconut, rubber, and seafood exports. The notable increase in earnings from tea exports reflected higher export prices despite a decline in export volumes. Mineral exports recorded a decline compared to 2022, led by lower titanium ores exports in 2023.

Import Performance

A notable contraction in import expenditure was observed in 2023. Expenditure on imports declined by 8.1 per cent to US dollars 16,811 million in 2023 compared to 2022, driven by several factors, including restrictions on non-essential imports, subdued economic activity, and constrained spending capabilities of the public due to tight monetary and fiscal policies. As a percentage of GDP, import expenditure declined to 19.9 per cent in 2023 compared to 23.8 per cent in 2022.

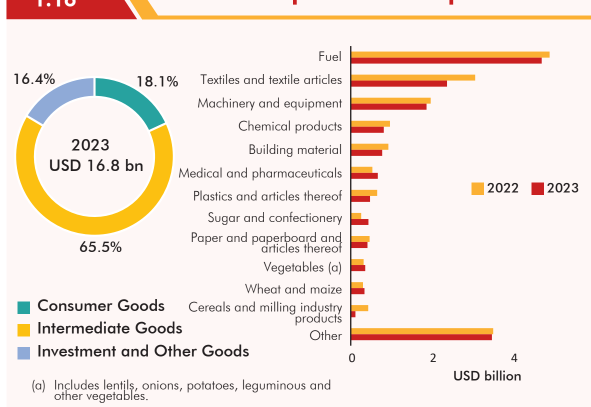
The decline in import expenditure was a result of lower intermediate and investment goods imports, while expenditure on both food and non-food consumer goods imports increased. Expenditure on rice imports declined significantly due to lower volumes of rice imports in 2023 compared to 2022 although this decline was offset by higher expenditure on imports of most other food commodities, such as sugar, oils and fats, and milk powder. Meanwhile, expenditure on non-food consumer goods increased largely due to imports of

Figure 1.15 Composition of Exports



Sources: Sri Lanka Customs
Central Bank of Sri Lanka

Figure 1.16 Composition of Imports



(a) Includes lentils, onions, potatoes, leguminous and other vegetables.

Sources: Sri Lanka Customs
Central Bank of Sri Lanka

medical and pharmaceutical products, and mobile phones. In addition, most other items categorised under non-food consumer goods showed an increasing trend during the latter part of 2023 due to the relaxation of import restrictions. Expenditure on intermediate goods declined with textiles and textile articles accounting for a significant portion of the decline, in line with the reduction of apparel exports. Expenditure on fuel imports, the largest item in the import basket, declined primarily due to lower import prices across all products: crude oil, refined petroleum (including LP gas), and coal, though import volumes of crude oil and coal recorded an increase. Reflecting lower economic activities, expenditure on most other intermediate goods declined in 2023. Expenditure on imports of investment goods declined with notable reductions in all three main categories of investment goods, namely machinery and equipment (mainly engineering equipment), building material (mainly iron and steel), and transport equipment, and most of their subcategories, in 2023 compared to 2022, mainly attributable to import restriction and lower levels of economic activity, especially in the construction sector.

Terms of Trade

The terms of trade, which is the ratio of export prices to import prices, deteriorated marginally in 2023. Export price and import price indices declined by 11.3 per cent and 10.8 per cent to 82.7 index points, and 96.6 index points, respectively, causing the terms of trade to deteriorate by 0.6 per cent in 2023 compared to 2022. The decline in the price indices of industrial exports and mineral exports contributed to the decline in export prices, while lower prices of the importation of intermediate goods and investment goods, accounted for the decline in the overall import price index. The volume indices for all main categories of exports deteriorated, except industrial exports, whereas the import volume indices of all main categories, except for consumer goods, showed improvement during 2023.

Table 1.11 **Summary of Terms of Trade (2010=100)**

Category	Y-o-Y change 2022/ 2023 (%) Value Index	Volume Index	Unit Value Index
Total Exports	**-9.1**	**2.4**	**-11.3**
Agricultural goods	-0.1	-0.3	0.3
Industrial goods	-11.3	3.0	-13.9
Mineral goods	-23.1	-15.0	-9.5
Total Imports	**-8.1**	**3.0**	**-10.8**
Consumer goods	8.2	-1.4	9.7
Intermediate goods	-11.5	0.7	-12.1
Investment goods	-9.4	10.6	-18.1
Terms of Trade			**-0.6**

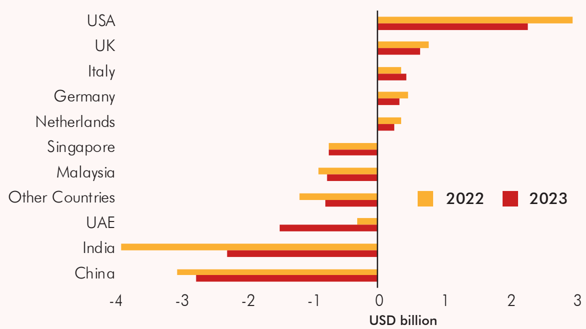
Source: Central Bank of Sri Lanka

Direction of Trade

Bilateral trade with most major trading partners declined significantly, in line with lower total trade in 2023. India continued to be the major trading partner of Sri Lanka, followed by China and the USA. Accordingly, these three key trading partners together contributed to around 37 per cent of the total trade of Sri Lanka in 2023. During the year, total trade with India was around US dollars 4 billion, while trade with both China and the USA exceeded US dollars 3 billion each. Total trade with most countries declined in line with the decline in imports in general. The major countrywise trade balances in 2023 remained almost unchanged, with notable trade surpluses recorded with the USA, the UK, Italy, Germany, and the Netherlands, while significant trade deficits were recorded with China, India, the UAE, Malaysia, and Singapore.

1

Figure 1.17 Countrywise Trade Balances



Source: Central Bank of Sri Lanka

External Trade Policies, Developments, and Institutional Support

Amidst subdued merchandise trade sector performance, the trade policy sphere moved ahead with renewed momentum during 2023. Negotiations of Free Trade Agreements (FTA), which were on hold since October 2018, were fast tracked in 2023. As a result, FTA between Sri Lanka and Thailand (SLTFTA) was signed in February 2024. Most of the import restrictions imposed in 2020-2022 were eased in 2023 with the improvement in liquidity conditions in the domestic foreign exchange market. Accordingly, the 100 per cent cash margin deposit requirement, imposed by the Central Bank in May 2022, on the importation of selected non-essential items was removed in May 2023. Meanwhile, import restrictions to temporarily suspend selected non-essential items were also gradually relaxed by the Government in June, July, and October 2023. Thereafter, only motor vehicles remained on the suspended list. The restriction on payment terms that was imposed in May 2022 mainly on open account terms continued throughout 2023, although the requirement to obtain prior approval from commercial banks for Documents against Acceptance (DA) and Documents against Payment (DP) terms imports was removed in February 2024.

Sri Lanka signed its fourth bilateral FTA with Thailand, while negotiations of several other FTAs were fast tracked. Negotiations on SLTFTA were resumed in January 2023 for the 3rd round and the negotiations concluded at the 8th round held in November 2023. This comprehensive FTA covers both trade in goods and services, in addition to investments, customs procedures, intellectual property rights, etc. Negotiations on the Economic and Technology Cooperation Agreement with India (ETCA) resumed with the 12th round taking place during October 2023 in Sri Lanka, and the 13th round in January 2024. ETCA has a broader scope than the Indo-Sri Lanka Free Trade Agreement (ISFTA) and these negotiations are expected to deepen the current trade of goods, technology cooperation, economic cooperation, liberalising services and investments. In line with lower export earnings, exports under ISFTA, Pakistan-Sri Lanka Free Trade Agreement (PSFTA) as well as most other regional trade agreements

Table 1.12 Exports under Preferential and Free Trade Agreements of Sri Lanka

Preferential Agreement	2022 Value (USD million)	2023 (a) Value (USD million)	2023 (a) Growth (%)	2023 (a) Share (%)
GSPs	4,314.7	3,803.5	-11.8	79.7
o/w EU (including GSP+)	2,440.3	2,094.5	-14.2	43.9
USA (b)	719.0	663.4	-7.7	13.9
UK	659.0	562.4	-14.7	11.8
Russian Federation (c)	125.7	127.9	1.7	2.7
Australia	97.0	93.3	-3.8	2.0
Canada	86.2	72.9	-15.4	1.5
Japan	80.7	68.3	-15.3	1.4
Turkey	45.3	62.6	38.1	1.3
Other GSP	61.6	58.2	-5.5	1.2
ISFTA	561.5	536.4	-4.5	11.2
APTA (d)	228.4	213.9	-6.4	4.5
SAFTA	75.2	93.2	23.9	2.0
GSTP	62.5	79.1	26.7	1.7
PSFTA	56.6	46.1	-18.6	1.0
SAPTA	1.5	1.1	-24.5	0.0
Total	**5,300.4**	**4,773.4**	**-9.9**	**100.0**
As a Share Total Exports	**40.4**	**40.1**		

(a) Provisional
(b) Shows GSP eligible exports since the US-GSP expired on 31.12.2020
(c) Includes Russia, Belarus and Kazakhstan
(d) Earlier known as the Bangkok Agreement (1975)

Sources: Department of Commerce
Sri Lanka Customs

declined in 2023. However, exports under the Global System of Trade Preference (GSTP) increased, driven by cinnamon exports to Mexico, and exports under the South Asian Free Trade Area (SAFTA) increased due to pepper exports to India. Negotiations on a Preferential Trade Agreement (PTA) with Bangladesh completed 4 rounds, while negotiations on several other PTAs with Indonesia, Malaysia, and Vietnam are in the pipeline. In other trade related arrangements, the 14th US-Sri Lanka Trade and Investment Framework Agreement (TIFA) Council Meeting was held in September 2023 in Colombo, while in October 2023, Sri Lanka assumed the chairmanship of Indian Ocean Rim Association (IORA) for the period 2023 to 2025.

Despite the subdued performance of garment exports, and other major export items to the EU, the UK, and the USA, Sri Lanka continued to benefit from the Generalised System of Preference (GSP) schemes offered by these key trading partners. The EU GSP scheme was set to expire on 31 December 2023 with a proposed new EU GSP+ 10-year scheme to be in effect from 01 January 2024 until 31 December 2033, which contains six additional International Conventions, that Sri Lanka has already ratified. However, in September 2023, the European Commission extended the validity period of the current EU GSP scheme until the end of 2027. The new GSP Scheme of the UK named "Developing Countries Trading Scheme" (DCTS) came into effect in June 2023, under which Sri Lanka would benefit from its Enhanced Preferences Scheme for 3 years. The US GSP scheme, which expired on 31 December 2020 has not yet been reauthorised by the US Government, although it is expected to be reauthorised on a retroactive basis as per the general practice of the US Government. Export performance under most other GSP schemes remained weak during 2023.

Institutional support was the cornerstone of progress in trade policy initiatives during 2023. In this regard, an International Trade Office was established under the Presidential Secretariat to deal with all international trade negotiations. The Office also spearheaded the combined efforts of several line agencies to conclude negotiations of the SLTFTA in an expeditious manner. The Department of Commerce took necessary steps for the continuation of GSP schemes and other existing FTAs, while supporting trade negotiation processes. The Export Development Board (EDB) launched the National Export Brand "Your Vital Island - Sri Lanka" in November 2023 to position Sri Lanka as a recognised sourcing destination to increase exports. The implementation period of the National Export Strategy (NES) expired at end 2022 and a revitalisation of the NES project is currently in progress. Meanwhile, Sri Lanka Customs (SLC) initiated its Strategic Plan for 2024-2028, focusing on four strategic areas: revenue, trade facilitation, eco-social protection, and organisational development. To create a more favourable environment for investment and export promotion, the Cabinet of Ministers granted approval in November 2023 to establish the Sri Lanka Economic Commission with the expectation to consolidate the Board of Investment (BOI) and the EDB. Meanwhile, to provide the overall policy direction, a new National Trade Policy is being drafted by the Ministry of Trade, Commerce and Food Security. Such initiatives are key for the sustainable development of the tradable sector of the economy.

Services Account

The surplus in the services account recorded a notable increase in 2023. The surplus in the services account amounted to US dollars 3,404 million in 2023, compared to US dollars 2,110 million in 2022. The performance of the services sector, including the travel, transport, construction and telecommunications services sectors improved significantly. Net inflows to insurance and pension services and other business services remained modest, while inflows to the other sub sectors including computer services contracted significantly. Having commenced data collection under the International Transactions Reporting System (ITRS) in January 2023, the Central Bank initiated publishing monthly services sector data based on ITRS for the first time in January 2024. Notably, under the newly established ITRS, there has been a significant refinement of already existing data series such as computer services, air transport, sea transport, and construction services. Tourism continued to recover in 2023 recording 1,487,303 arrivals, which is more than double the arrivals recorded in 2022. Accordingly, earnings from tourism increased to US dollars 2,068 million in 2023 compared to US dollars 1,136 million in 2022.

Primary Income Account

Deficit in the primary income account widened in 2023. All interest payments, including arrears accrued as a result of the debt standstill, and interest payments made by the Central Bank on account of outstanding liability of Asian Clearing Union (ACU) and international currency swap arrangements with the Bangladesh Bank and Reserve Bank of India (RBI) mainly contributed to outflows in the primary income account. Accordingly, the primary income account deficit amounted to US dollars 2,564 million in 2023 compared to US dollars 1,870 million in 2022. Despite an increase in the dividends paid out by direct investment enterprises (DIEs) during the year, an increase was observed in reinvested earnings in 2023 compared to 2022. However, interest payments on account of debt securities remained at similar levels. Nevertheless, there was a notable increase in interest payments on foreign loans, including arrears of the Government and the Central Bank, particularly due to the new swap arrangement under which the swap liabilities of RBI and payment arrears of the ACU were combined. Meanwhile, the income from reserve assets increased with the notable increase in gross official reserves during 2023.

Secondary Income Account

The surplus in the secondary income account increased in 2023 with continuous improvement in workers' remittance inflows since the second half of 2022. Increased workers' remittances were supported by the continued departures for foreign employment abroad. Increased inflows through official channels, supported by the correction in the large disparity that prevailed between the official exchange rate and informal rates, also supported the improved levels of remittances. Hence, workers' remittances increased notably by 57.5 per cent to US dollars 5,970 million in 2023, compared to US dollars 3,789 million in 2022. Consequently, the secondary income account recorded a surplus of US dollars 5,619 million in 2023, compared to US dollars 3,496 million in 2022.

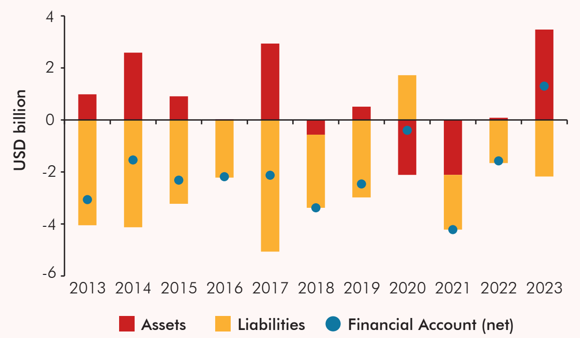
Capital Account Balance

Net inflows to the capital account increased in 2023. Capital transfers to both the Government and private sector increased in 2023, with capital grants to the Government remaining modest. Accordingly, the capital account recorded a surplus of US dollars 63 million in 2023, compared to a surplus of US dollars 19 million in 2022.

Financial Account

In the financial account of the Balance of Payments (BOP), both the net incurrence of liabilities and net acquisition of financial assets recorded notable increases during 2023. Net incurrence of liabilities recorded an increase of US dollars 2,171 million in 2023

Figure 1.18 **Financial Account**



Source: Central Bank of Sri Lanka

compared to US dollars 1,652 million in 2022. Main inflows to the financial account during 2023 included the receipt of the proceeds of the IMF-EFF arrangement amounting to around US dollars 670 million and the receipts from the World Bank and ADB amounting to around US dollars 500 million and US dollars 550 million, respectively.

Direct Investments

FDI inflows, including foreign loans to DIEs, remained modest during the year. Although equity investments and reinvestment of earnings recorded an increase in 2023, related party loans to DIEs recorded a notable decline. Meanwhile, foreign loan inflows to BOI companies moderated in 2023. Accordingly, FDI, including foreign loans, amounted to US dollars 758 million in 2023, compared to US dollars 1,167 million in 2022. Further, FDI, excluding loans, amounted to US dollars 712 million in 2023, compared to US dollars 884 million in 2022. On a sectoral basis, FDI inflows to BOI registered companies were mainly to logistics services, telecommunications, hotels and manufacturing sectors, while FDI inflows to companies listed in the Colombo Stock Exchange (CSE), but not registered with BOI, were mainly to the telecommunications and, fuel, gas, and petroleum sectors.

Table 1.13 **Financial Account**

Item	USD million	
	2022 (a)	2023 (b)
Financial Account (net)	-1,569	1,304
Net Acquisition of Financial Assets	84	3,474
Net Incurrence of Liabilities	1,652	2,171
Direct Investment: Assets	15	34
Equity	11	29
Debt Instruments	5	5
Direct Investment: Liabilities	884	712
Equity	275	496
Debt Instruments	610	216
Portfolio Investment: Assets	-	173
Debt Securities	-	173
Portfolio Investment: Liabilities	370	931
Equity	151	8
Debt Securities	218	923
General Government	212	910
Short Term (Treasury Bills)	30	132
Long Term	183	778
Treasury Bonds	21	78
Sri Lanka Development Bonds	2	-27
Sovereign Bonds	159	727
Other Sectors	6	12
Long-term	6	12
Financial Derivatives	-	-
Other Investment: Assets	1,302	1,022
Currency and Deposits	514	114
Trade Credit and Advances	282	186
Other Accounts Receivable	506	721
Other Investment: Liabilities	398	528
Currency and Deposits	-583	-143
Loans	385	1,056
Trade Credit and Advances	-895	-555
Other Accounts Payable	1,492	171
Special Drawing Rights (SDRs)	-	-
Reserve Assets	-1,234	2,245
Net Errors and Omissions	-139	-318
Overall Balance (c)	-2,806	2,826

(a) Revised
(b) Provisional
(c) Refer Table 1.15 for the derivation of overall balance

Source: Central Bank of Sri Lanka

Portfolio Investment

Portfolio investment, in the form of equity and investment fund shares in CSE, remained modest, while foreign investment in government securities increased notably during 2023. The notable increase in foreign investment in government securities was primarily due to the accrued interest on International Sovereign Bonds (ISBs), the repayment of which was suspended temporarily since early 2022. Non resident investments in the government securities market, particularly in Treasury bills increased substantially in 2023. Arrears due to non-payment of coupon payments and interest on foreign loans were added to the outstanding liability of the relevant instrument. Accordingly, US dollars 727 million of coupon payments of ISBs were recorded as accrued interest of ISBs. Further, during 2023, US dollars 12 million was recorded as accrued interest on international bonds to non-residents, which were issued by SOBEs.

Other Investment and Reserve Assets

Meanwhile, trade credits and advances recorded a decline in liabilities as CPC continued to repay its trade credit liabilities throughout the year, while being unable to secure new trade credit facilities during the year. The banking industry's exposure to foreign loans decreased during 2023 as a result of obtaining fewer new foreign borrowings while paying off previous borrowings, especially in light of the banking system's higher foreign exchange liquidity in 2023. In the meantime, borrowings by the corporate sector continued to be constrained, resulting in insignificant net inflows into the sector during the year.

Net acquisition of financial assets recorded a notable increase during 2023 amounting to US dollars 3,474 million, compared to a marginal net increase of US dollars 84 million in 2022. This was mainly due to the increase in GOR by US dollars 2,245 million in 2023 compared to the decline of GOR by US dollars 1,234 million in 2022. The increase in GOR was mainly due to the substantial net purchases of forex from the domestic market by the Central Bank and the receipts from IMF, World Bank, and ADB. However, net acquisition of assets in terms of currency and deposits, trade credits and advances and other accounts receivable increased in the banking sector in 2023.

1.4.2 International Investment Position, Reserve Assets, and Overall Balance

International Investment Position (IIP)

Sri Lanka's net international investment position deteriorated in 2023. There was a notable increase in both the total external liability position and total external asset position of the country by end 2023 compared to end 2022. However, the increase in the total liability position exceeded the increase in the total asset position by end of 2023, compared to end 2022.

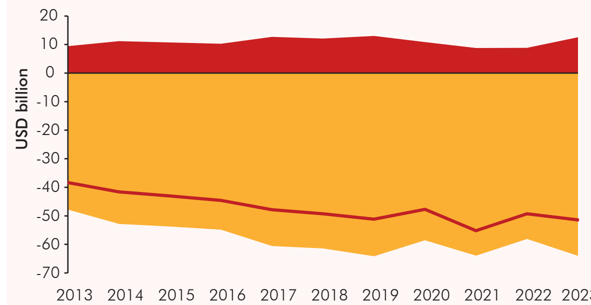
In terms of the outstanding external liability position of the country, the Central Bank entered into a special swap arrangement with RBI to issue a new debt instrument, replacing the outstanding RBI international swap arrangement and the outstanding liability of ACU. This instrument was reflected in outstanding currency and deposits of the Central Bank and replaced ACU outstanding amount classified under other accounts payable as at end 2023. The outstanding liability position as direct investments increased only modestly during the year, as FDI inflows remained low and market prices of publicly listed companies remained subdued. The increase in liability position of the debt securities was a result of the increased market prices[19] and accrued coupon payments of ISBs. The increase in foreign loans was due to the receipt of IMF, World Bank and ADB funding by the Government as well as the increase in accrued interest of unpaid foreign loans by the Government. Consequently, the country's total external liability position increased

19 The market prices of ISBs are based on market prices available in international trading platforms and may not necessarily be attributed to secondary market trades in international markets during the year.

from US dollars 58.1 billion as at end 2022 to US dollars 64.0 billion as at end 2023.

The country's external asset position improved during 2023. The external asset position in the form of reserve assets and banking sector external assets increased during the year. The reserve asset position of the Central Bank more than doubled during the year. Further, the external asset position of the banking sector also increased due to increases in banks' currency and deposits and other accounts receivable. Accordingly, the country's total asset position increased from US dollars 8.8 billion as at end 2022 to US dollars 12.5 billion as at end 2023. As the increase in the total liability position was higher than the increase in the total asset position, the country's net liability position as reflected by the IIP increased to US dollars 51.4 billion as at end 2023 from US dollars 49.3 billion as at end 2022.

Figure 1.19 International Investment Position



Source: Central Bank of Sri Lanka

Table 1.14 International Investment Position (Summary) (a)

USD million (End period position)

Item	2022 (b) Assets	2022 (b) Liabilities	2023 (c) Assets	2023 (c) Liabilities
Direct Investment	**1,534**	**14,047**	**1,560**	**14,831**
Equity and Investment Fund Shares	1,489	8,103	1,511	8,671
Debt Instruments	45	5,944	50	6,160
Portfolio Investment	**0.1**	**4,366**	**174**	**7,744**
Equity and Investment Fund Shares		332		484
Debt Securities	0.1	4,035	174	7,260
Other Investment	**5,399**	**39,689**	**6,420**	**41,412**
Currency and Deposits	1,656	5,880	1,770	7,941
Loans		29,497		31,721
Trade Credit and Advances	1,493	1,020	1,679	464
Other Accounts Receivable / Payable	2,250	2,028	2,971	-
Special Drawing Rights (SDRs)		1,265		1,285
Reserve Assets	**1,898**		**4,392**	
Total Assets / Liabilities	**8,830**	**58,102**	**12,546**	**63,986**
Net International Investment Position		**-49,272**		**-51,440**
Memorandum Items				
IIP- Maturity-wise Breakdown	8,830	58,102	12,546	63,986
Short Term	7,091	7,957	9,330	5,516
Long Term	1,739	50,145	3,216	58,471

Source: Central Bank of Sri Lanka

(a) Refer Appendix Table 12 for a detailed breakdown of the IIP
(b) Revised
(c) Provisional

Reserve Asset Position

GOR[20] improved and reached a healthy level of US dollars 4,392 million as at end 2023, compared to US dollars 1,898 million as at end 2022, reflecting favourable developments in the external sector observed during 2023. The buildup of GOR was mainly due to the absorption of foreign exchange by the Central Bank from the domestic foreign exchange market and the receipt of other foreign exchange inflows, such as the first and second tranches of the ongoing IMF-EFF arrangement and financing support from the World Bank and the ADB. The Central Bank's intervention in the domestic foreign exchange market by way of absorbing foreign exchange amounted to US dollars 1,683 million on a net basis (based on value date) during the year, while net foreign exchange swap arrangements with domestic banks amounted to around US dollars 861

20 These levels of GOR at the end of 2022 and 2023 also included the international swap facility of Chinese Yuan 10 billion from the People's Bank of China (PBOC) which was valued at US dollars 1,433 million and US dollars 1,420 million, respectively.

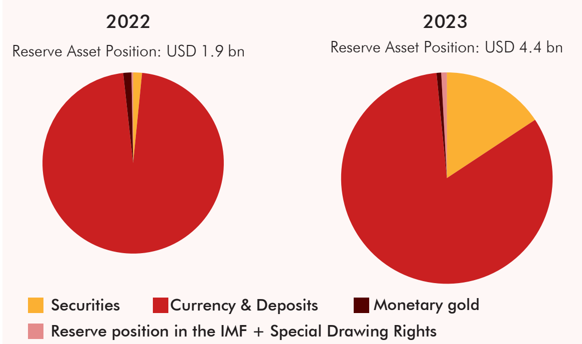
1

million (based on value date). The buildup of GOR through direct absorption of foreign exchange from the domestic foreign exchange market enabled the Central Bank to overperform on the net international reserve targets under the IMF-EFF arrangement. Net foreign asset position of the banking sector stood at a positive level as a result of recording a higher foreign assets position than foreign liabilities position. The foreign asset position of the banking sector increased to US dollars 4,981 million by end 2023 from US dollars 3,976 million as at end 2022. Consequently, total international reserves, which comprise both GOR and foreign assets of the banking sector, increased significantly by end 2023.

Overall Balance

The overall balance of the BOP, which represents the change in net international reserves, recorded a significantly higher surplus by end 2023, after recording higher deficits in previous years since 2020. GOR increased significantly mainly due to the significant net absorption of foreign exchange by the Central Bank from the domestic foreign exchange market and receiving significant inflows from multilateral institutions.

Figure 1.20 Major Components of Reserve Asset Position



Source: Central Bank of Sri Lanka

Consequently, there was an improvement in the net international reserve position by end 2023 compared to the previous year, resulting in the overall balance recording a surplus of around US dollars 2,826 million in 2023, compared to a deficit of US dollars 2,806 million in 2022.

1.4.3 External Debt and Debt Service Payments

External Debt

Sri Lanka's external debt expressed in terms of market value,[21] increased in 2023. There was a notable increase in the external debt of

21 Since 2012, external debt statistics for official publication purposes are calculated in terms of market value in line with international standards on BOP compilation as per the 6th edition of the Balance of Payments and International Investment Position Manual (BPM6).

Table 1.15 Gross Official Reserves, Total Foreign Assets and Overall Balance

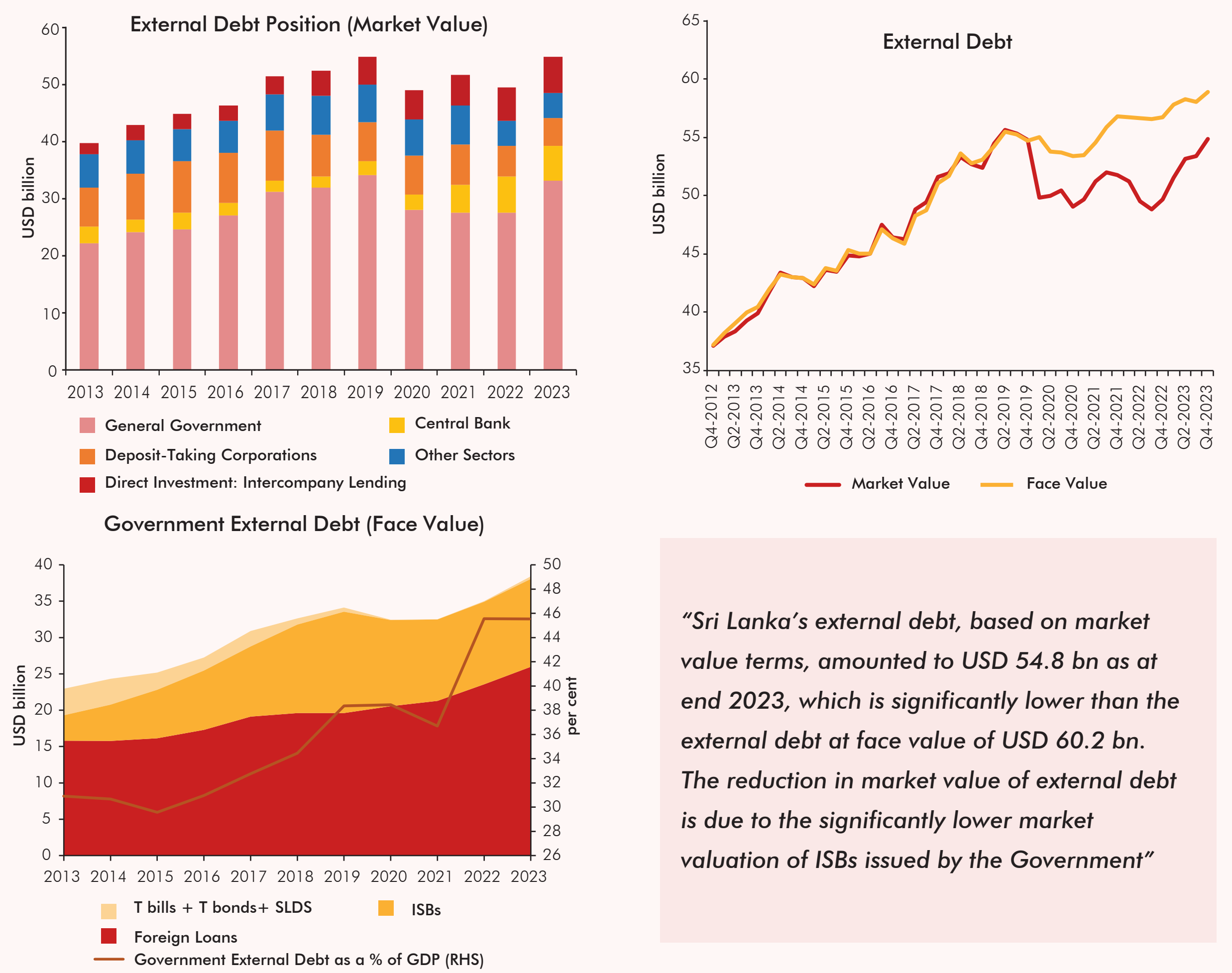
USD million
(End period position)

Item	2019	2020	2021	2022	2023 (a)
1. Government Foreign Assets	386	155	177	39	875
2. Central Bank Foreign Assets	7,256	5,510	2,962	1,858	3,517
3. Gross Official Reserves (1+2)	**7,642**	**5,664**	**3,139**	**1,898**	**4,392**
4. Foreign Assets of Deposit-taking Corporations	2,760	2,856	2,983	3,976	4,981
5. Total Foreign Assets (3+4) (b)	**10,402**	**8,521**	**6,122**	**5,874**	**9,373**
6. Reserve Related Liabilities (c)	1,771	2,121	3,562	5,127	4,796
7. Net International Reserves (NIR) (3-6)	**5,871**	**3,543**	**-423**	**-3,229**	**-404**
8. Overall Balance (d)	**377**	**-2,328**	**-3,967**	**-2,806**	**2,826**
9. Gross Official Reserves in Months of Imports of Goods	4.6	4.2	1.8	1.2	3.1
10. Total Foreign Assets in Months of Import of Goods	6.3	6.4	3.6	3.9	6.7

(a) Provisional
(b) Excludes foreign assets in the form of 'Direct investment abroad' and 'Trade credit and advances granted'
(c) The total outstanding debt of the Central Bank, excluding outstanding Special Drawing Rights (SDRs)
(d) Change in NIR position during the period

Source: Central Bank of Sri Lanka

Figure 1.21 **Outstanding External Debt**



"Sri Lanka's external debt, based on market value terms, amounted to USD 54.8 bn as at end 2023, which is significantly lower than the external debt at face value of USD 60.2 bn. The reduction in market value of external debt is due to the significantly lower market valuation of ISBs issued by the Government"

Source: Central Bank of Sri Lanka

the Government in 2023 compared to 2022 mainly due to an increase in market value of ISBs issued by the Government compared to the significantly lower market values that prevailed in 2022. Further, the external debt of the private sector and SOBEs and DIEs recorded a moderate increase. Meanwhile, external debt of the Central Bank and the banking sector recorded a decline.

The external debt of the Government recorded a marked increase in 2023. The increase in the market value of ISBs issued by the Government, increase in accrued coupons of outstanding ISBs, increase in outstanding foreign loans of the Government associated with the receipts from multilateral partners, increase in accrued interest of bilateral foreign loans of the Government, and a modest increase in foreign investments in Treasury bills and Treasury bonds contributed to the increase in outstanding external debt of the Government. Consequently, the outstanding external debt of the Government, expressed in market value for tradable debt instruments, amounted to US dollars 33.1 billion as at end 2023, compared to US dollars 27.5 billion as at end 2022. In terms of face value, the external debt of the Government was around US dollars 38.4 billion as at end 2023.

The outstanding external debt of the Central Bank decreased modestly with the gradual repayment of the IMF-EFF obtained in 2016

1

Table 1.16 **Outstanding External Debt Position**

USD million (End period position)

Item	2022 (a)	2023 (b)
General Government	**27,518**	**33,117**
Treasury Bills (based on book value)	31	210
Treasury Bonds (based on book value)	34	124
Sri Lanka Development Bonds (based on face value)	27	-
International Sovereign Bonds (based on market price including accrued interest)	3,866	6,794
Outstanding Foreign Loans (including accrued interest)	23,562	25,988
Central Bank	**6,391**	**6,081**
Currency and Deposits (short term)	0.2	0.3
Asian Clearing Union (ACU) Liabilities	2,028	-
Special Drawing Rights (SDRs) Allocation	1,265	1,285
RBI Swap Arrangement	400	-
RBI and ACU Combined Swap Arrangement (RBI Special Swap)		2,451
Bangladesh Bank Swap Arrangement	200	-
PBOC Swap Arrangement	1,434	1,420
Accrued Interest Applicable to Swap Arrangements	3	20
Credit and Loans with the IMF	1,062	904
Deposit-taking Corporations	**5,370**	**4,933**
Currency and Deposits (c)	3,843	4,050
Loans - short term	704	307
Loans - long term	823	576
Other Sectors (d)	**4,443**	**4,542**
Trade Credit and Advances (e)	1,020	464
Debt Securities (based on market price and including accrued interest)	78	132
Loans by Private Sector Corporations	2,361	2,966
Loans by State Owned Business Enterprises and Public Corporations	985	980
Direct Investment: Intercompany Lending (f)	**5,944**	**6,160**
Gross External Debt Position	**49,667**	**54,832**
As a Percentage of GDP		
Gross External Debt	64.6	65.0
Short Term Debt	9.9	6.0
Long Term Debt	54.7	59.0
As a Percentage of Gross External Debt		
Short Term Debt	15.4	9.2
Long Term Debt	84.6	90.8
Memorandum Items		
Non-Resident Holdings of Debt Securities - Sectorwise	**11,622**	**12,615**
Breakdown at Face Value		
General Government	11,447	12,440
Treasury Bills	34	233
Treasury Bonds	36	130
Sri Lanka Development Bonds	27	-
International Sovereign Bonds	10,800	10,800
Accrued Interest of ISB Coupons due to Non-Residents	551	1,278
Other Sectors	175	175
Face Value of Total Outstanding ISBs	**12,550**	**12,550**
Outstanding ISBs held by Non-Residents	10,800	10,800
Outstanding ISBs held by Residents	1,750	1,750

Source: Central Bank of Sri Lanka

(a) Revised
(b) Provisional
(c) Includes deposits of personal foreign currency account holders
(d) Includes private sector and State Owned Business Enterprises
(e) Includes trade credits outstanding of the Ceylon Petroleum Corporation and private sector companies
(f) Includes inter-company borrowings and shareholder advances of BOI registered companies

and the commencement of repayment of the special swap arrangement with RBI. Meanwhile, the outstanding external debt of the banking sector decreased with a significant decline in outstanding short term and long term loans. Although there was a notable reduction in the outstanding trade credits of the private sector, the outstanding foreign loans of the private sector increased and the outstanding foreign loans of SOBEs remained at similar levels. Outstanding foreign loans with related parties by DIEs also increased during 2023.

The country's external debt position as a percentage of GDP remained at similar levels as at end 2022 and 2023. The external debt position as a percentage of GDP was 65.0 per cent as at end 2023, compared to 64.6 per cent as at end 2022. Further, the proportion of loans that are short term in nature recorded a reduction during the year. Moreover, as the government debt standstill continued, there was no change in the face value of outstanding ISBs to non-residents during the year.

Foreign Debt Service Payments

Sri Lanka's external debt service payments remained modest in both 2022 and 2023 since the announcement of the debt standstill on selected government debt in April 2022. The country's external debt service payments, which averaged close to US dollars 5.0 billion per year in 2019, 2020, and 2021 reduced to US dollars 2.5 billion in 2022 and US dollars 2.6 billion in 2023. External debt service payments in 2023 were marginally higher than 2022 due to increased external debt servicing of the Central Bank. Government external debt servicing was significantly lower in 2023 as there were no repayments of ISBs in 2023 due to the debt standstill. However, external debt servicing of foreign loans of the Government increased as capital and interest

Table 1.17 External Debt Service Payments

USD million

Item	2022 (a)	2023 (b)
1. Debt Service Payments	**2,483**	**2,589**
1.1 Amortisation	**1,714**	**1,869**
General Government	1,236	1,043
Project Loans	845	1,041
Debt Securities	391	2
Central Bank	140	522
IMF	140	172
International Swaps	-	350
Private Sector and Deposit-taking Corporations	339	304
Foreign Loans	339	304
1.2 Interest Payments	**769**	**720**
General Government	465	405
Project Loans	273	377
Debt Securities	192	28
Central Bank	57	118
IMF	20	57
International Swaps	36	60
Private sector and Deposit-taking Corporations	216	185
Foreign Loans	204	173
Debt Securities	12	12
Intercompany Debt of Direct Investment Enterprises	31	12
2. Earnings from Export of Goods and Services	**16,169**	**17,327**
3. Receipts from Export of Goods, Services, Income and Current Transfers	**20,228**	**23,779**
4. Debt Service Ratio		
4.1 As a Percentage of 2 above		
Overall Ratio	15.4	14.9
Excluding IMF Transactions	14.4	13.6
4.2 As a Percentage of 3 above		
Overall Ratio	12.3	10.9
Excluding IMF Transactions	11.5	9.9
5. Government Debt Service Payments		
5.1 Government Debt Service Payments (c)	1,701	1,448
5.2 As a Percentage of 1 Above	68.5	55.9

Source: Central Bank of Sri Lanka

(a) Revised
(b) Provisional
(c) Excludes transactions with the IMF

payments of the multilateral institutions were repaid during 2023. The Central Bank repaid an international swap facility of US dollars 200 million owed to the Bangladesh Bank and started repaying outstanding liabilities on account of the special swap arrangement with the RBI. Further, the Central Bank continued to repay IMF-EFF liabilities initiated in 2016. Debt service payments of private sector corporations in 2023 remained around similar levels to that of 2022.

1.4.4 Exchange Rate Movements

The Sri Lanka rupee appreciated sharply in 2023 under a market based exchange rate policy implemented by the Central Bank despite some intermittent volatility. The Sri Lanka rupee, which depreciated by 44.8 per cent against the US dollar in 2022, appreciated by 12.1 per cent in 2023. During the first two months of 2023, the Sri Lanka rupee remained stable at around Rs. 362 per US dollar as the Central Bank continued to provide daily guidance on the spot exchange rate by publishing a middle spot exchange rate and a variation margin, which helped stabilise the exchange rate from significant intraday volatility. The Sri Lanka rupee appreciated notably thereafter, helped by the policy measures taken by the Central Bank to enhance forex liquidity in the market and to provide greater flexibility in the determination of exchange rate. From 27 February 2023, the Central Bank commenced gradually relaxing the requirement imposed on licensed banks on mandatory sales of foreign exchange to the Central Bank out of the converted export proceeds and workers' remittances and later revoked the said requirement with effect from 07 March 2023 with a view to enhancing forex liquidity in the banking system. Further, the Central Bank discontinued the provision of daily guidance on exchange rates with effect from 07 March 2023, in order to allow greater flexibility in the determination of the exchange rate and encourage market driven activity in the domestic forex market in line with the flexible inflation targeting framework of the Central Bank. Subsequently, liquidity in the domestic forex market improved and spot market activity picked up. Favourable market sentiments subsequent to the commencement of the IMF-EFF arrangement in March 2023 also helped the exchange rate to appreciate.

A notable appreciation of the Sri Lanka rupee was registered during the second quarter, particularly in May and early June 2023 due to several favourable developments. Improved market liquidity as a result of increased forex inflows in the form of export proceeds, workers' remittances

1

Table 1.18

Exchange Rate Movements

Currency	In Rupees per unit of Foreign Currency						Percentage Change over Previous Year (a)			
	End Year Rate			Annual Average Rate			End Year		Annual Average	
	2021	2022	2023	2021	2022	2023	2022	2023	2022	2023
Euro	226.86	386.93	358.75	235.10	339.04	354.11	-41.37	7.86	-30.66	-4.26
Indian rupee	2.69	4.39	3.90	2.69	4.11	3.97	-38.59	12.57	-34.57	3.63
Japanese yen	1.74	2.74	2.29	1.81	2.44	2.34	-36.41	19.53	-25.92	4.54
Pound sterling	270.60	437.35	412.61	273.51	396.89	407.07	-38.13	5.99	-31.09	-2.50
US dollar	200.43	363.11	323.92	198.88	324.55	327.53	-44.80	12.10(b)	-38.72	-0.91(b)
Special Drawing Rights (SDRs)	280.53	483.24	434.60	283.18	431.91	436.88	-41.95	11.19	-34.43	-1.14

Source: Central Bank of Sri Lanka

(a) Changes computed on the basis of foreign currency equivalent of Sri Lanka rupees. The sign (-) indicates depreciation of the Sri Lanka rupee against each currency.
(b) For analytical purposes, the appreciation/depreciation of the Sri Lanka rupee is calculated by the Central Bank based on the year end exchange rate. Accordingly, the Sri Lanka rupee recorded an appreciation in terms of end 2023 exchange rate compared to that of end 2022. However, the Sri Lanka rupee recorded a marginal depreciation in 2023 based on the annual average exchange rate compared to 2022.

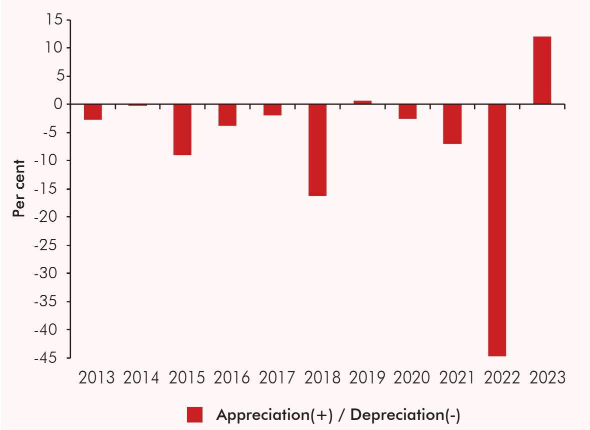
and foreign investments to the government securities market along with subdued demand for imports, reflecting tight monetary conditions, were the major factors that contributed to this appreciation. Further, the receipts of the special policy based loan for budget support from ADB in May 2023 and the World Bank financing in June 2023 were conducive to the improvement in market sentiments. Overall, the Sri Lanka rupee recorded the highest appreciation of 24.8 per cent against the US dollar since the beginning of the year by 08 June 2023. Thereafter, the Sri Lanka rupee showed some volatility and recorded a depreciation during the third quarter of 2023, reflecting relatively tight liquidity conditions that prevailed in the domestic foreign exchange market. The main factor that contributed to the depreciation pressure was the drain in liquidity due to increased demand from banks to cover their foreign currency position associated with rupee settlement of the Sri Lanka Development Bonds (SLDBs). Consequently, the Central Bank intervened by providing liquidity support to the affected bank and to the market from time to time during the third quarter of 2023. However, pressure on the exchange rate that was expected to have arisen out of the pent up demand for imports at the commencement of the gradual relaxation of import controls from June 2023 onwards did not have a major impact. In the latter part of the year, improved workers' remittances and services sector inflows were observed. Market sentiments continued to improve, mainly as a result of receiving the second tranche of the IMF-EFF arrangement and receipts from ADB and the World Bank, towards the latter part of the year. Accordingly, the rupee recorded an appreciation in the latter part of the year despite some intermittent volatility. Meanwhile, the intervention of the Central Bank in the domestic foreign exchange market resulted in an absorption of US dollars 1,896 million, on a net basis (based on trade date), in 2023. This included an absorption of US dollars 2,722 million and a supply of US dollars 826 million. In contrast, in 2022, the Central Bank supplied foreign exchange amounting to

Figure 1.22

CBSL Intervention and Annual Average Exchange Rate

Source: Central Bank of Sri Lanka

Figure 1.23 Exchange Rate Appreciation / Depreciation



Source: Central Bank of Sri Lanka

US dollars 2,726 million to the market while purchasing US dollars 2,147 million.

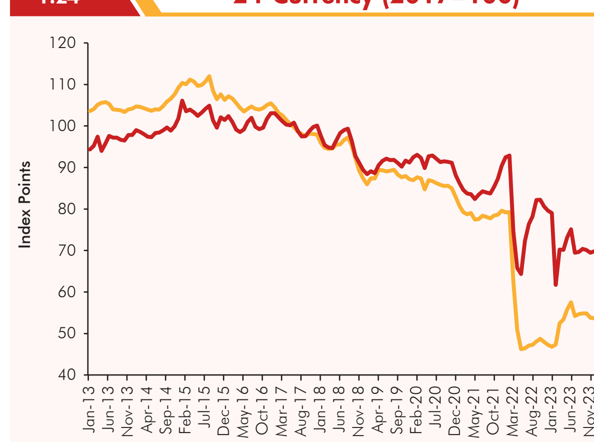
The appreciation trend of the Sri Lanka rupee continued in 2024 as well. Accordingly, the Sri Lanka rupee appreciated by 7.6 per cent against the US dollar as of end March 2024. This appreciation was mainly due to robust inflows in the form of earnings from tourism, workers' remittances, and reduced import expenditure. Consequently, the Central Bank has also been able to purchase a significant amount of foreign exchange of around US dollars 1,200 million on net basis (based on the trade date) during the first quarter of 2024 which helped prevent excessive appreciation pressure that prevailed in the market.

Reflecting movements in cross-currency exchange rates against the US dollar in international markets, the rupee appreciated markedly against all other major currencies in 2023, in comparison to the previous year. Accordingly, the Sri Lanka rupee appreciated against the euro (7.9 per cent), the pound sterling (6.0 per cent), the Japanese yen (19.5 per cent) and the Indian rupee (12.6 per cent) during 2023. With the combined effect of the appreciation of the rupee against major currencies, the Sri Lanka rupee also appreciated against the Special Drawing Rights (SDR) by 11.2 per cent during the year.

Nominal and Real Effective Exchange Rates

During 2023, the Nominal Effective Exchange Rate (NEER) indices increased while the Real Effective Exchange Rate (REER) indices decreased. The 5-currency NEER index increased by 10.52 per cent while the 24-currency NEER index increased by 13.39 per cent. The increase in NEER indices reflects the nominal appreciation of the Sri Lanka rupee against the selected major currencies together with the movements in cross currency exchange rates. Further, 5-currency REER index decreased by 12.87 per cent and the 24-currency REER index decreased by 12.42 per cent. Overall, both REER indices remained significantly below the level that prevailed in the base year 2017, indicating the continued competitiveness of the Sri Lanka rupee.

Figure 1.24 Effective Exchange Rate Indices 24-Currency (2017=100)



Source: Central Bank of Sri Lanka

1

Table 1.19

Nominal and Real Effective Exchange Rates

Effective Exchange Rate Indices (a) (b) (2017=100)	End Year Index			Annual Average Index			Percentage Change over Previous Year			
							End Year Index		Annual Average Index	
	2021	2022	2023	2021	2022	2023	2022	2023	2022	2023
NEER - 24 currencies	79.65	47.32	53.66	78.64	53.99	53.30	-40.59	13.39	-31.34	-1.28
REER - 24 currencies	90.51	79.74	69.84	84.76	77.49	71.39	-11.90	-12.42	-8.58	-7.87

Source: Central Bank of Sri Lanka

(a) The Nominal Effective Exchange Rate (NEER) is a weighted average of nominal exchange rates of 24 trading partner and competitor countries. Weights are based on the trade shares reflecting the relative importance of each currency in each of the currency baskets. The Real Effective Exchange Rate (REER) is computed by adjusting the NEER for inflation differentials with respect to each currency in the basket. A minus sign indicates depreciation. CCPI was used for REER computation.

(b) The exchange rate has been defined in terms of indices so that the appreciation/depreciation of the rupee relative to other currencies is directly reflected by a rise/fall in the values of the effective exchange rate indices, respectively.

1.5 Financial Sector Developments

During 2023, overall financial sector stability was maintained amidst challenging conditions particularly emanating from the economic crisis. The banking sector which dominates the financial sector was able to maintain stability by preserving capital supported by the decline in risk weighted assets while liquidity was maintained above the regulatory minimum with increased investments in government securities. Moreover, total assets of the banking sector improved along with profitability while default risk as indicated by the Stage 3 loans ratio increased during 2023 compared to 2022. Similarly, the asset base of the LFCs sector also improved while the default risk of the sector recorded an increase in terms of the Stage 3 loans ratio in 2023. Accordingly, elevated credit risk as reflected by the Stage 3 loans ratio remained a concern for both the banking and LFCs sectors. Meanwhile, the insurance sector, which includes long term and general sub-sectors, showed varying financial performance during the year. Within financial markets, liquidity shortage in the domestic money market declined considerably by the end of the year while liquidity conditions in the domestic foreign exchange market also improved. Moreover, the yields of the government securities market witnessed a decline in both primary and secondary markets. The domestic equity market recorded mixed performance in terms of price indices, market capitalisation and daily turnover while foreign participation declined in 2023, compared to 2022. The Central Bank continued to engage in activities relating to financial inclusion and in ensuring the provisioning of robust financial infrastructure for the smooth functioning of the financial sector. Further, new regulations on Financial Consumer Protection aimed at fortifying the financial consumer protection framework for Financial Service Providers under the regulatory purview of the Central Bank were issued during 2023. Further details about the conditions of the financial system could be obtained from the Financial Stability Review 2023.[22]

1.5.1 Banking Sector

The banking sector, which dominates the financial sector, accounting for 61.5 per cent of total assets as at end 2023, managed to withstand challenges that emanated from the economic crisis and adverse global conditions, with the support of preserving capital and liquidity above the regulatory minimum. By end 2023, the banking sector comprised 30 banks, i.e., 24 LCBs including 11 branches of foreign banks, and 6 LSBs. The banking sector continued to support financial intermediation by expanding the banking network and enhancing banking

22 *https://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/financial-system-stability-review*

BOX 2
International Monetary Fund's Extended Fund Facility (IMF-EFF) Programme – A Progress Update

Sri Lanka commenced discussions with the International Monetary Fund (IMF) on obtaining a funding arrangement linked to a macroeconomic adjustment programme to restore macroeconomic stability, debt sustainability and to rebuild the linkages with the world, following the historic socio-economic and political crisis in 2022. In September 2022, the IMF staff and the Sri Lankan authorities reached a staff level agreement for a 48-month arrangement under the EFF amounting to SDR 2.286 billion (about US dollars 3 billion). Subsequently, on 20 March 2023, the Executive Board of the IMF approved the EFF as budget support to assist Sri Lanka's economic policies and reforms denoting the commencement of the seventeenth IMF programme in Sri Lanka. Accordingly, the first and second tranches of the IMF-EFF totaling SDR 508 million (about US dollars 670 million) were disbursed in March and December 2023, respectively. The IMF and relevant authorities regularly monitor the progress under the EFF in terms of Quantitative Performance Criteria (QPCs), Continuous Performance Criteria (CPCs), Monetary Policy Consultative Clause (MPCC), Indicative Targets (ITs), and Structural Benchmarks (SBs) as set out in the EFF programme. Achievement of these targets on behalf of Sri Lanka is the responsibility of the Government and the Central Bank. In terms of performance, all QPCs and ITs for end December 2023 were met except for the IT on social spending, while most SBs falling due before end February 2024 were either met or implemented with delay. On 21 March 2024, a staff level agreement was reached on economic policies to conclude the second review of the IMF-EFF programme. Once the review is approved by the IMF Executive Board, Sri Lanka will have access to a further SDR 254 million (about US dollars 337 million) in financing.

To restore macroeconomic stability and public debt sustainability in Sri Lanka, the IMF-EFF programme was designed as a comprehensive economic reform programme that rests on several key pillars. These pillars include revenue based fiscal consolidation, a stronger social safety net to protect the most vulnerable, a sovereign debt restructuring strategy aimed at restoring public debt sustainability, a multi-pronged strategy to restore price stability and rebuild international reserves under greater exchange rate flexibility, policies to safeguard financial stability, focused reforms to address governance and corruption vulnerabilities, and growth enhancing broader structural reforms.

The key targets and elements of the current IMF-EFF programme, are discussed below.

Net International Reserves (NIR) Target

The NIR target is a QPC under EFF to gauge the reserve level maintained by the Central Bank excluding the reserve related liabilities. The reserves remained at depleted levels in 2022 and early 2023 as GOR declined notably, due to the continued moderation of inflows to the financial account, external debt service payments to the multilateral creditors, and net sales to the domestic foreign exchange market by the Central Bank primarily for importation of essential imports during the year. At the beginning of the programme, as at end March 2023, the reserve related liabilities were far higher than the reserve assets and thus NIR stood at largely negative levels. The primary aim of achieving the NIR target under EFF is to ensure that the gross official reserve assets increase surpassing the liabilities and thereby maintaining NIR at positive levels. Thus far in the EFF programme, the Central Bank has continued to build up reserves by purchasing foreign exchange from the domestic foreign exchange market on a net basis. As a result, the gross official reserve level also witnessed a notable increase from US dollars 1.9 billion as at end 2022 to around US dollars 4.4 billion by end 2023, and further to around US dollars 5.0 billion by end March 2024.

The Central Bank's Net Credit to the Government (NCG) Target

Historically, successive Governments have resorted to monetary financing from the Central Bank, which was one of the main causes for the elevation of inflation to significantly high levels in 2022. The Central Bank's NCG is measured as the difference between the Central Bank's claims against the central government and deposits made by the central government in rupees at the Central Bank. Prior to the IMF programme, the Central Bank was compelled to regularly engage in monetary financing of the budget deficit of the Government. One of the main purposes of the IMF programme is to prevent any avenues that would enable the Government to obtain monetary financing from the Central Bank, and this was achieved through the enactment of the Central Bank of Sri Lanka Act No. 16 of 2023 (CBA). With no new monetary financing and gradual offloading of existing holdings of the government securities of the Central Bank, end December 2023 NCG target set out by the IMF was also achieved.

Monetary Policy Consultation Clause (MPCC)

Sri Lanka's inflation escalated to historically high levels in 2022. The MPCC has been set to closely monitor the developments in inflation to ensure that Sri Lanka achieves the targeted level of inflation in line with its objective of maintaining domestic price stability. It monitors quarterly inflation on predetermined target dates. Accordingly, quarterly average year-on-year inflation calculated based on the Colombo Consumer Price Index (CCPI) (2021=100), as per the method specified in the Technical Memorandum of Understanding (TMU) of the IMF Staff Report was at 3.0 per cent by December 2023. Hence, realised inflation by December 2023 was within the lower outer band of MPCC of 2.0-3.5 per cent.

Primary Balance Target, Revenue, and Overall Budget Balance

Sri Lanka's central government revenue collection is identified to be one of the lowest in the world and has led to significant primary balance deficits historically. The IMF-EFF programme requires Sri Lanka to implement revenue based fiscal consolidation measures and introduce reforms to social safety nets, fiscal institutions, and State Owned Enterprises (SOEs) that are aimed at enhancing the efficiency and reducing the burden on government coffers. Supported by stringent fiscal consolidation efforts, the Government achieved a primary surplus in 2023, which is well over the primary deficit target set under the IMF-EFF for 2023. Meanwhile, the overall budget deficit for 2023 improved as a result of the significant increase in revenue despite an increase in government expenditure.

In addition, the central government tax revenue is specified as an indicative target under the IMF-EFF programme. During the recently concluded programme review mission of the IMF, the notable improvement in tax revenue collection was commended.

Continuous Performance Criteria (CPCs) and Indicative Targets (ITs)

The IMF-EFF programme has specified two CPCs. These include (i) non-accumulation of new external payments arrears by the nonfinancial public sector and the Central Bank and (ii) no new Central Bank purchases of government securities in the primary market. These CPCs have been met by the Sri Lankan authorities so far. In addition, the programme has specified ITs related to central government tax revenue, social spending by the central government, cost of non-commercial obligations (NCOs) for fuel and electricity, and Treasury guarantees. All ITs except for social spending by the central government have been met under the programme as of December 2023.

Progress on Debt Restructuring

The Government has been engaging with the external creditors to negotiate relief on external debt with the intention of bringing down the debt trajectory towards a sustainable path as envisaged by the IMF-EFF arrangement. There is significant progress in the external debt restructuring process. In November 2023, an agreement in principle was reached between the authorities and the Official Creditors Committee (OCC) and a preliminary agreement with the China EXIM Bank and Sri Lanka was also reached to restructure its claims on Sri Lanka. Currently, Sri Lanka is engaging closely with OCC and China EXIM Bank to reach debt agreements consistent with the programme parameters and in a comparable manner. Sri Lanka is also engaging closely with external commercial creditors in good faith through continuous dialogues and information sharing, aiming to reach a consensus on the debt treatment at the earliest.

Additionally, the Government launched its Domestic Debt Optimisation (DDO) programme in July 2023 and its key aspects were concluded in September 2023. The debt exchanges that were initiated were geared towards providing significant liquidity relief to the Government, while contributing to reducing future annual gross financing needs of the Government to sustainable levels.

Key Structural Benchmarks (SBs)

The ongoing IMF-EFF programme includes SBs in areas such as fiscal, SOEs, and social safety net reforms, financial sector and governance. Significant progress has been made thus far with respect to achieving these SBs. Major SBs applicable to the Central Bank that have been met include the enactment of the CBA, completion of the asset quality review component of the bank diagnostic exercise for the two largest state owned banks and the three largest private sector banks, the development of a roadmap for addressing banking system capital and forex liquidity shortfalls and recapitalisation plan. Further, Parliamentary approval for the amendments to the Banking Act was obtained although with a delay. With respect to SOE reforms, setting cost-reflective fuel pricing and electricity tariff schedules with formula based adjustments among others are important SBs that were met. These efforts have already shown successful outcomes with improved profitability of chronically loss making entities such as the Ceylon Electricity Board (CEB) and the Ceylon Petroleum Corporation (CPC). Parliamentary approval of the 2024 Appropriation Act, obtaining Cabinet approval of a reduction in the limit on government guarantees to 7.5 per cent of GDP, obtaining Cabinet approval on a strategy to build a Value Added Tax (VAT) refund system and to achieve a full repeal of Simplified Value Added Tax (SVAT) and introducing key performance indicators for tax compliance are some of the fiscal sector related SBs that have been met so far.

Governance

Addressing corruption vulnerability is critical to ensure sustainable and inclusive economic recovery in Sri Lanka. Sri Lanka remains committed to advancing governance and anti-corruption reforms as a main central pillar of the programme. In this regard, Sri Lanka published the Governance Diagnostic Report in September 2023 making Sri Lanka the first country in Asia to undergo the IMF Governance Diagnostic exercise. Further, Sri Lanka recently published the Action Plan to implement the key recommendations of the Governance Diagnostic Report, and this was commended by the IMF at the recent review. The IMF has emphasised the need for sustained efforts to implement these reforms to address corruption risks, rebuild economic confidence, and make growth more robust and inclusive.

Table 1.20

Total Assets of the Financial System

	2022 (a)		2023 (b)	
	Rs. bn	Share (%)	Rs. bn	Share (%)
Banking Sector	**23,928.0**	**76.2**	**24,611.5**	**74.1**
Central Bank	4,510.3	14.4	4,205.4	12.7
Licensed Commercial Banks (LCBs)	17,226.3	54.9	18,121.0	54.6
Licensed Specialised Banks (LSBs)	2,191.4	7.0	2,285.0	6.9
Other Deposit Taking Financial Institutions	**1,812.1**	**5.8**	**1,914.1**	**5.8**
Licensed Finance Companies (LFCs)	1,610.2	5.1	1,692.0	5.1
Co-operative Rural Banks (c)	201.2	0.6	221.3	0.7
Thrift and Credit Co-operative Societies	0.8	0.0	0.9	0.0
Specialised Financial Institutions	**328.9**	**1.0**	**728.7**	**2.2**
Specialised Leasing Companies (SLCs)	1.0	0.0	1.2	0.0
Licensed Microfinance Companies	9.9	0.0	11.7	0.0
Primary Dealers	131.7	0.4	270.8	0.8
Stock Brokers	24.8	0.1	24.3	0.1
Unit Trusts / Unit Trust Management Companies	153.5	0.5	411.6	1.2
Market Intermediaries (d)	8.0	0.0	9.1	0.0
Venture Capital Companies	N/A	N/A	N/A	N/A
Contractual Savings Institutions	**5,320.3**	**16.9**	**5,945.5**	**17.9**
Insurance Companies	947.3	3.0	1,086.9	3.3
Employees' Provident Fund	3,491.8	11.1	3,895.1	11.7
Employees' Trust Fund	465.0	1.5	520.5	1.6
Approved Pension and Provident Funds	330.4	1.1	347.2	1.0
Public Service Provident Fund	85.9	0.3	95.8	0.3
Total	**31,389.4**	**100.0**	**33,199.8**	**100.0**

(a) Revised
(b) Provisional
(c) Due to unavailability of data, asset base of Co-operative Rural Banks as at end 2023 was taken to be same as the asset base as at end 2023 Q3.
(d) Excluding Licensed Banks, Licensed Finance Companies & Specialised Leasing Companies, which are registered as Market Intermediaries

Sources: Central Bank of Sri Lanka
Department of Co-operative Development
Department of Labour
Department of Pensions
Employees' Trust Fund Board
Insurance Regulatory Commission of Sri Lanka
SANASA Federation
Securities and Exchange Commission of Sri Lanka
Unit Trust Association of Sri Lanka

1

Table 1.21 **Composition of Assets and Liabilities of the Banking Sector**

Item	2022 (a) Rs. bn	2022 (a) Share (%)	2023 (b) Rs. bn	2023 (b) Share (%)	Change (%) 2022	Change (%) 2023
Assets						
Loans & Advances	11,312.5	58.3	11,017.6	54.0	5.5	-2.6
Investments	5,931.7	30.5	7,314.0	35.8	19.4	23.3
Others (c)	2,172.4	11.2	2,074.4	10.2	92.1	-4.5
Liabilities						
Deposits	15,298.7	78.8	16,623.6	81.5	18.8	8.7
Borrowings	1,871.6	9.6	1,389.0	6.8	-13.9	-25.8
Capital Funds	1,598.1	8.2	1,766.9	8.7	18.5	10.6
Others	648.2	3.3	626.5	3.1	52.2	-3.4
Total Assets/Liabilities	19,416.6	100.0	20,406.0	100.0	15.4	5.1

(a) Revised
(b) Provisional
(c) Includes cash and bank balances, placements, reverse repurchase agreements and fixed assets

Source: Central Bank of Sri Lanka

Table 1.22 **Composition of Deposits of the Banking Sector**

	2022 (a) Rs. bn	2022 (a) Share (%)	2023 (b) Rs. bn	2023 (b) Share (%)	Change (%) 2022	Change (%) 2023
Demand Deposits	1,060.0	6.9	1,079.0	6.5	19.4	1.8
Savings Deposits	3,713.0	24.3	4,293.0	25.8	-7.4	15.6
Time Deposits	10,393.0	67.9	11,042.3	66.4	32.2	6.2
Other Deposits	133.2	0.9	209.3	1.3	12.0	57.2
Total Deposits	**15,299.1**	**100.0**	**16,623.6**	**100.0**	**18.8**	**8.7**

Source: Central Bank of Sri Lanka

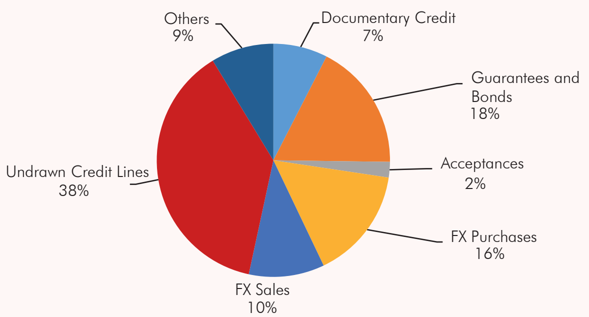
(a) Revised
(b) Provisional

services, thereby promoting financial inclusion. In 2023, 07 bank branches and 272 ATMs were established, while 04 bank branches and 31 ATMs were closed. Accordingly, the total number of banking outlets and ATMs had increased to 7,517 and 6,943, respectively, by the end of 2023. Total assets of the banking sector increased by Rs. 989.4 billion during the year and surpassed Rs. 20.0 trillion by end December 2023. Year-on-year growth of assets recorded 5.1 per cent as at end 2023 compared to that of 15.4 per cent as at end 2022. This slowdown in growth was mainly due to the conversion of foreign currency denominated loans and receivables and investments to Sri Lanka rupee, with the appreciation of the exchange rate. The tight monetary policy stance that prevailed during the first half of 2023 led to a year-on-year contraction of loans and receivables by 2.6 per cent as at end 2023 compared to a growth of 5.5 per cent as at end 2022. Meanwhile, the year-on-year growth in investments accelerated from 19.4 per cent at end 2022 to 23.3 per cent as at end 2023. The increase in investments during the period under review was mainly due to an increase in financial assets at fair value through other comprehensive income by Rs. 828.2 billion and financial investments at amortised cost by Rs. 311.2 billion.

Deposits continued to be the main source of funding in the banking sector, representing 81.5 per cent of total on-balance sheet liabilities as at end 2023, while borrowings accounted for 6.8 per cent. The share of time deposits accounted for 66.4 per cent, while the savings and demand deposits accounted for 25.8 per cent and 6.5 per cent, respectively, of total deposits as at end 2023. Accordingly, the Current and Savings Account (CASA) ratio increased from 31.2 per cent in 2022 to 32.3 per cent in 2023. Total borrowings of the banking sector decreased by Rs. 482.5 billion (negative 25.8 per cent) in 2023 compared to a decrease of Rs. 301.4 billion (negative 13.9 per cent) in 2022. This decrease was mainly attributed to foreign currency borrowings which reported a negative growth of 40.8 per cent (US dollars 514.5 million) reflecting the impact of sovereign rating downgrades, while rupee borrowings decreased by 19.4 per cent (Rs. 256.0 billion) during 2023.

Off-balance sheet exposures of the banking sector reported a growth of 15.6 per cent (increase of Rs. 724.4 billion) during 2023 compared to a negative growth of 0.6 per cent (decrease of Rs. 26.3 billion) recorded during 2022. Significant increases were observed in foreign currency (FX) related off-balance sheet purchases (Rs. 415.0 billion), FX related off-balance sheet sales (Rs. 261.0 billion), undrawn credit lines (Rs. 118.4 billion) and documentary credit (Rs. 52.3 billion), while guarantees and bonds (Rs. 223.8 billion), and acceptances (Rs. 3.8 billion) reported decreases during 2023.

Figure 1.25 **Off-Balance Sheet Exposure of the Banking Sector as at end 2023**



Source : Central Bank of Sri Lanka

As indicated by the Stage 3 Loans Ratio, credit risk of the Banking Sector remained at an elevated level at end 2023. Stage 3 Loans Ratio of the banking sector increased to 12.8 per cent at end 2023, compared to 11.3 per cent at end 2022 mainly due to increased Stage 3 loans and contraction of loans and receivables, indicating concerns about the credit quality of the sector. However, impairment for Stage 3 loans (including undrawn amounts) grew by 18.4 per cent (year-on-year), improving the Stage 3 Impairment Coverage Ratio to 49.3 per cent at end 2023 compared to 44.9 per cent at end 2022.

Liquidity of the banking sector, as indicated by the Statutory Liquid Assets Ratio (SLAR) and Liquidity Coverage Ratios (LCRs), improved during 2023, mainly due to the high growth in liquid assets in the form of rupee-denominated government securities. The SLAR increased to 44.9 per cent at end 2023 and remained well above the minimum regulatory requirement. Furthermore, Liquid Assets to Total Assets also improved to 35.9 per cent at end 2023 compared to 23.6 per cent at end 2022. A considerable improvement was observed in LCRs of the banking sector during 2023. The Rupee and All Currency LCRs of the banking sector stood at 340.9 per cent and 286.4 per cent, respectively, at end 2023. In addition, the Net Stable Funding Ratio (NSFR) introduced in 2019, which requires banks to maintain sufficient stable funding sources, stood at 158.4 per cent at end 2023, well above the regulatory requirement of 100 per cent.

Profitability improved during the year mainly due to the decline in new impairment charges. Interest income of the banking sector increased by 25.5 per cent, while the interest expenses increased by 42.7 per cent during 2023, resulting in a decrease in net interest income by 4.9 per cent. As a result, the net interest margin decreased from 4.0 per cent at end 2022 to 3.6 per cent as at end 2023. Non-interest expenses increased by Rs. 49.2 billion, largely due to the increase in staff costs by Rs. 16.8 billion, while impairment for loans and other losses decreased by Rs. 305.0 billion during 2023. As a result, profit before tax was Rs. 294.4 billion in 2023 as per the regulatory reporting, which was Rs. 116.6 billion higher than the previous year. Profit after tax of the banking industry was Rs. 188.9 billion during 2023 which was an increase of 22.8 per cent compared to the previous year. The increase in profits was reflected in the Return on Assets (ROA) before tax, which increased from 1.0 per cent as at end 2022 to 1.5 per cent as at end 2023, while Return on Equity (ROE) after tax increased from 10.2 per cent in 2022 to 10.6 per cent in 2023. Further, the efficiency of the banking sector deteriorated from 31.5 per cent as at end 2022 to 40.5 per cent as at end 2023, mainly due to the increase in operating costs.

Table 1.23 **Profit of the Banking Sector**

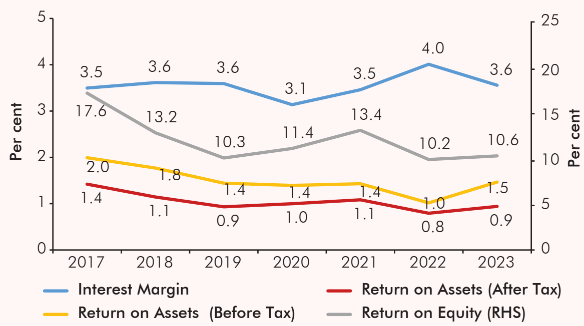
Item	2022 (a) Amount (Rs. bn)	2022 (a) As a % of Avg. Assets	2023 (b) Amount (Rs. bn)	2023 (b) As a % of Avg. Assets
Net Interest Income	**750.8**	**4.0**	**713.8**	**3.6**
Interest Income	2,079.4	11.0	2,609.0	13.0
Interest Expenses	1,328.6	7.0	1,895.2	9.4
Non-Interest Income	**280.6**	**1.5**	**206.8**	**1.0**
Net Fee & Commission Income	127.0	0.7	132.1	0.7
Non-Interest Expenses	**324.0**	**1.7**	**373.2**	**1.9**
Staff Cost	173.2	0.9	190.0	0.9
Impairment for Loans & Other Losses	**468.8**	**2.5**	**163.8**	**0.8**
Profit Before Tax (after VAT)	**177.8**	**0.9**	**294.4**	**1.5**
Profit After Tax	**153.8**	**0.8**	**188.9**	**0.9**

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

1

Figure 1.26 **Profitability Ratios of the Banking Sector**



Source: Central Bank of Sri Lanka

Table 1.24 **Composition of Regulatory Capital of the Banking Sector**

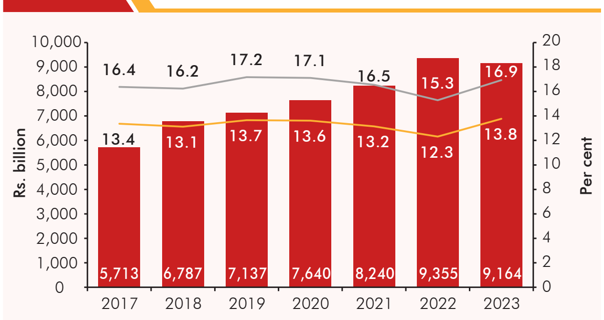
Item	Rs. bn 2022 (a)	Rs. bn 2023 (b)	Composition (%) 2022 (a)	Composition (%) 2023 (b)
Tier I: Capital	**1,152.0**	**1,261.6**	**100.0**	**100.0**
Share Capital	366.7	385.3	31.8	30.5
Statutory Reserve Funds	74.3	81.1	6.4	6.4
Retained Profits	544.5	627.2	47.3	49.7
General and Other Reserves	295.2	312.4	25.6	24.8
Others	67.2	77.2	5.8	6.1
Regulatory Adjustments	(195.9)	(221.6)	(17.0)	(17.5)
Tier II: Capital	**277.7**	**290.2**	**100.0**	**100.0**
Revaluation Reserves	35.4	42.4	12.7	14.6
Subordinated Term Debt	135.4	148.8	48.8	51.3
General Provisions and Other	107.3	99.6	38.6	34.3
Regulatory Adjustments	(0.5)	(0.6)	(0.2)	(0.2)
Total Regulatory Capital Base	**1,429.6**	**1,551.8**		

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

The banking sector was largely in compliance with the minimum capital requirements during 2023. Capital adequacy of the sector recorded an improvement at end 2023 compared to end 2022, as risk weighted assets declined during the period, mainly due to the overall credit contraction, increased investments in government securities, and the appreciation of the Sri Lanka rupee. Banks were encouraged to raise high quality capital buffers to absorb the potential losses from the risks arising from challenging business conditions and impact due to external sovereign debt restructuring. As a result, banks increased Tier I capital through retention of profits (Rs. 82.7 billion), issuance of new shares (Rs. 18.6 billion), and increase in reserves (Rs. 17.2 billion) during 2023. The regulatory capital of the banking sector reported a growth of 8.5 per cent during the year, of which Tier I capital contributed 89.7 per cent of the increase.

Figure 1.27 **Capital Ratios of the Banking Sector**



Source: Central Bank of Sri Lanka

Meanwhile, the banking sector increased its Tier 2 capital through issuance of subordinated debentures.

1.5.2 Non-Bank Financial Institutions Sector

Licensed Finance Companies (LFCs)

Despite the challenges stemming from adverse economic conditions, the LFCs sector remained resilient with adequate capital and liquidity buffers throughout the year. The sector recorded growth in terms of assets, deposit base, and profitability. However, the asset quality of the sector deteriorated as reflected by increasing Stage 3 loans. The LFCs sector comprised 33 LFCs[23] accounting for 5.1 per cent of total assets as of end 2023. There were 1,827 branches, of which 1,198 branches (65.6 per cent) were located outside the Western Province. The asset base of the sector recorded growth of 5.1 per cent (Rs. 81.8 billion) reaching Rs. 1,692.0 billion by end 2023, compared to the 10.9 per cent growth in 2022. This was mainly driven by the significant growth of the investment portfolio with increased investments in government securities.

Loans and advances accounted for 68.6 per cent of the total assets of the LFCs sector. During 2023, the loans and advances portfolio

23 Excluding ETI Finance Limited (The Commercial High Court of Colombo ordered that the winding up of ETI Finance Limited be carried out subject to the Supervision of the Court on the 15th day of December 2023).

BOX 3

The Establishment of Business Revival Units in Licensed Banks to Support Sustainable Economic Recovery

Background

The challenging macroeconomic environment that prevailed during the recent years disrupted many business entities limiting their income-generating capabilities and hence forcing them to avoid making timely payments of loans, which resulted in impairing the recovery process of licensed banks (LBs)[1]. As evidenced by the increase of non-performing loans[2] of LBs from 5.2 per cent at end-2019 to 13.6 per cent by the end of Quarter 3 in 2023, which marginally improved later to 12.8 per cent by the end of 2023, the credit quality of the banking sector has deteriorated significantly. The revival of such businesses would enhance economic activities and employment opportunities and hence, contribute to the rebound of the national economy.

With the negative impact of the Easter Sunday attacks in 2019, COVID-19 pandemic and adverse macroeconomic conditions that prevailed during the economic crisis, the Central Bank of Sri Lanka (CBSL) issued multiple guidelines from time to time to LBs to provide relief to the affected borrowers whose debt servicing capacities were impaired. Currently, LBs have established Post COVID-19 Revival Units, and it is a timely requirement for considering a more standardised framework with an enhanced scope in reviving fundamentally viable borrowers, by guiding LBs on eligibility criteria for selection of borrowers, revival mechanisms, corporate workout frameworks and governance framework.

With the onset of slowing down of economies owing to multiple reasons, the business revival frameworks became widely accepted in many countries. The "Out-of-Court Workouts" are negotiated restructurings between the borrower and lender/s with or without the administrative guidelines. The main advantages of "Out-of-Court Workouts" are the expeditious implementation, relatively low-cost, preservation of confidentiality and greater flexibility with respect to the terms and conditions of the restructuring.

Alternatively, some countries practice the business revival processes through the involvement of judicial procedures usually within the legal framework provided by the insolvency laws.

By considering the above factors, to facilitate the sustainable economic revival of businesses affected by the extraordinary macroeconomic circumstances and to ensure a transparent and effective resolution policy framework on reviving the stressed borrowers of LBs, the CBSL issued a Circular in March 2024 on "Guidelines for the Establishment of Business Revival Units in Licensed Banks". The Circular includes broad guidelines to give effect to further strengthen the already established Post COVID-19 Revival Units of LBs on Governance Framework and Resources, Eligibility Criteria for Selection of Borrowers, Revival Mechanisms, Framework for Corporate Workouts, Accounting Considerations and Regulatory Reporting.

Objectives of Establishing Business Revival Units in Licensed Banks

The purpose of Business Revival Units is to identify and assist performing and non-performing borrowers of LBs who are facing challenges or may face potential financial (and/or business) difficulties due to a reduction of income, cash flows or sales, reduction or impairment of business operations or temporary closure of business emanating from extraordinary macroeconomic circumstances.

The Unit aims to revive businesses that are facing actual or potential financial difficulties but are fundamentally viable, intending to provide benefits to such borrowers, leading to the revival of such businesses, enhancing economic activities and contributing to the development of the national economy.

Governance and Operational Framework of Business Revival Units

With a view to reviving viable businesses of borrowers of banks, LBs shall formulate a revival and rehabilitation policy for borrowers who are facing actual or potential financial difficulties but are fundamentally viable, and these policies need to be reviewed and updated, at least annually.

A Business Revival Unit is expected to work in an orderly and an independent manner with Loan Origination, Legal, Risk Management and Credit Enforcement units to ensure that all relevant information and system access for the loans that may fall under the purview of the Business Revival Unit are shared effectively. Further, LBs are required to provide the necessary staff and other resources to establish Business Revival Units, and LBs whose operations are geographically spread across the island are encouraged to have the units regionally, based on the effectiveness of the operation.

Fundamental viability assessment will be a crucial task under the business revival process as the viability assessment procedures should be both effective and transparent. Under the fundamental viability assessment, both quantitative and qualitative indicators will be considered on a prudential basis. These indicators may include the assessment regarding the profitability, leverage, liquidity, maturity profile of liabilities and other relevant qualitative criteria. The viability assessment, to the extent possible, needs to be based on the audited financial statements of the borrower. However, in the absence of audited financial statements for the borrower owing to justifiable reasons, LBs may use appropriate and credible sources of information at the discretion of the bank. In this regard, it will be important for LBs to ensure that borrowers are cooperative, as LBs will consider only such borrowers for revival.

Further, LBs are encouraged to disclose their governance framework, operational procedures and viability assessment methodologies in their Annual Report or any other published reports to enhance accountability and transparency.

Revival Mechanisms: Financial and Operational

The Business Revival Unit shall use financial and/ or operational restructuring tools and techniques or any combination thereof to revive distressed but viable businesses.

- Financial restructuring tools would include debt forgiveness, debt rescheduling including grace periods for the payment of principal and interest, adjustment of interest rates, maturity extensions, and provision of new financing, including interim financing and exit financing.

- Under operational restructuring, the Business Revival Unit may consider proposing fundamental changes in the business's operations or assets to restore commercial viability, developing a new business plan/strategy, and enhancing operational efficiency and profitability of such businesses, improving cash management systems, reviewing pricing strategy, and reviewing customer retention and/or acquisition strategies. Moreover, the Unit may also conduct awareness programmes on rehabilitation initiatives, and provide credit counselling and business advisory services, in reaching out to potential investors.

A Framework for Corporate Workouts

Under the business revival process a Framework for Corporate Workouts is a newly introduced mechanism as an overarching framework for a mutually agreeable business revival plan between a borrower and multiple banks as creditors. Since this is a mutual agreement between parties, a court intervention would not be required. LBs may adopt a collaborative approach to develop a common model for a Framework Agreement for Corporate Workouts that will govern negotiations of a workout agreement between LBs and any eligible corporate borrower that seeks to avail of the Corporate Workout Framework. Currently, a common model is being developed by LBs. Given due consideration to the possible complexities and cost involvement that may arise in the process of negotiating mutually agreeable conditions, this framework is recommended for corporate borrowers.

Way Forward

As per the proposed business revival mechanism of LBs, it is expected that distressed borrowers who are engaged in business activities will be able to revive their businesses with the guidance of LBs, and improved cash flows will be utilised to repay their non-performing loans and thereby improving asset quality of the banking sector.

Further, with the improvement in the macroeconomic environment of the country, the revival of businesses, especially the Micro, Small & Medium Enterprises (MSMEs), would promote sustainable economic growth and employment opportunities and hence, contribute to the sustained development of the national economy. In addition, the other measures, which are in progress, such as establishment of National Credit Guarantee Institution (NCGI), implementation of an enhanced legal framework through the Secured Transactions Act and the expansion of MSME definition to cover a wide scale of businesses will be conducive to revive the affected businesses and accordingly, to contribute the enhancement of economic activities.

Notes

1. Licensed Banks include both licensed commercial banks and licensed specialised banks, licensed under the Banking Act No.30 of 1988, as amended.
2. Non-performing loan means where contractual payments of a customer are past due for more than 90 days or have remained in excess of the sanctioned limit for more than 90 days and any other credit facilities classified as Stage 3 credit facilities under Sri Lanka Accounting Standard 9 (SLFRS 09) (based on potential risk and impaired status at origination).

Figure 1.28 **Total Loans and Advances (Gross) by Productwise for 2022 and 2023**

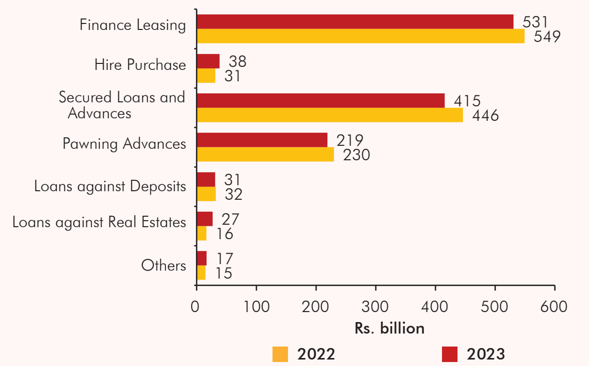


Figure1.28 has been replaced due to a labelling error in the printed version.

Source: Central Bank of Sri Lanka

of the sector recorded a contraction of 3.2 per cent (Rs. 38.0 billion) and amounted to Rs. 1,160.4 billion compared to a growth of 7.7 per cent in 2022. Finance leases dominated the loans and advances portfolio of the sector and accounted for 41.5 per cent of total loans and advances by end 2023, compared to 41.6 per cent by end 2022. Other secured loans including vehicle loans accounted for 32.5 per cent of total loans and advances by end 2023, compared to 33.8 per cent by end 2022. Loans against gold and loans against deposits also contracted by 4.7 per cent and 3.2 percent, respectively, during the year. Meanwhile, other assets that mainly include cash and balances with banks and financial institutions increased by 3.2 per cent in 2023 compared to the 23.2 per cent growth in 2022.

The asset quality of the LFCs sector deteriorated as indicated by the elevated Gross Stage 3 Loans Ratio of 17.8 per cent at end 2023 compared to 17.4 per cent at end 2022. Stage 3 Loans classification where LFCs were required to adopt 120 days past the due date for classification of Stage 3 loans was tightened to 90 days instead of the earlier classification of 120 days on 01 April 2023. Meanwhile, the sector reported an impairment coverage ratio of 32.5 per cent for Stage 3 loans at end 2023. Accordingly, the net Stage 3 Loans Ratio improved to 12.0 per cent by end 2023 from 12.3 per cent as at end 2022.

The LFCs sector's Profit After Tax (PAT) increased by 11.3 per cent from Rs. 42.8 billion in 2022 to Rs. 47.7 billion in 2023, due to increased net interest income and non-interest income. The increase in profitability was reflected in increased ROA to 4.3 per cent in 2023, compared to 3.7 per cent in 2022. However, ROE of the sector marginally reduced to 12.4 per cent in 2023, compared to 12.7 per cent in 2022, due to a comparatively higher increase in equity capital. The cost to income ratio increased to 81.1 per cent in 2023, from 79.9 per cent in 2022.

The capital base of the LFCs sector improved marginally by 3.9 per cent (Rs. 12.3 billion) to Rs. 329.0 billion by end 2023 compared to Rs. 317.0 billion recorded by end 2022. The sector's core capital and total capital ratios increased to 21.1 per cent and 22.3 per cent, respectively, by end 2023 from the levels of 20.6 per cent and 22.0 per cent, respectively, by end 2022. However, 6 LFCs[24] were non-compliant with the minimum core capital requirement and/or capital adequacy requirement.

On an aggregate basis, the LFCs sector maintained liquidity well above the minimum required level during 2023. The overall regulatory liquid assets available in the sector was Rs. 254.9 billion as at end 2023, against the stipulated minimum requirement of Rs. 103.4 billion recording a liquidity surplus of Rs. 151.5 billion as at end 2023, compared to Rs. 86.9 billion recorded as at end 2022.

Customer deposits continued to dominate the liabilities of the LFCs sector accounting for 55.3 per cent. The deposits increased by 8.2 per cent (Rs. 70.8 billion) to Rs. 935.3 billion, while borrowings declined by 17.9 per cent (Rs. 57.8 billion) to Rs. 264.6 billion during 2023.

24 Regulatory restrictions such as deposit caps, lending caps, freeze acceptance of new deposits, and caps on granting new loans have been imposed on LFCs which were non-compliant with the minimum core capital requirement and/or capital adequacy requirements.

Specialised Leasing Company (SLC)

There was only one SLC with an asset base of Rs.1.2 billion and loans and advances of Rs. 0.7 billion by end December 2023. Its gross and net Stage 3 loans ratios stood at 57.8 per cent and 33.6 per cent, respectively. PAT of this SLC reduced by 94.3 per cent from Rs. 1.1 billion in 2022 to Rs. 0.1 billion in 2023 due to reduced net interest income.

Primary Dealer Companies in Government Securities

By end 2023, there were 5 LCBs[25] and 5 Primary Dealer Companies (PDCs)[26] active in the government securities market as Primary Dealers (PDs). Total assets of PDCs increased by 105.7 per cent to Rs. 270.8 billion in 2023, compared to Rs.131.7 billion in 2022. The total investment portfolio of government securities amounted to Rs. 261.9 billion by end 2023, which recorded a year-on-year increase of 107.7 per cent from that of Rs. 126.1 billion recorded in 2022.

PDCs reported a PAT of Rs. 35.8 billion during 2023 compared to that of Rs. 1.7 billion reported during 2022, indicating a significant increase in profitability due to increase in interest income, capital gains and increased revaluation gains. ROA and ROE of PDCs enhanced to 25.7 per cent and 139.3 per cent, respectively, by end 2023 from 3 per cent and 19.9 per cent, respectively, recorded in 2022. Equity of PDCs increased by 142.4 per cent mainly due to profits earned during the year. The Risk Weighted Capital Adequacy Ratio of PDCs was well above the minimum required amount of 10 per cent despite a marginal reduction in the ratio to 22.3 per cent by end 2023 from 23.2 per cent reported by end 2022.

Licensed Microfinance Companies

The Licensed Microfinance Companies (LMFCs) sector consisted of 4 companies and reported 18.2 per cent growth of its asset base, reaching Rs. 11.7 billion by end 2023. Micro loans accounted for the largest share of total assets and amounted to Rs. 8.9 billion by end 2023 in comparison to Rs. 7.4 billion by end 2022, reporting a growth of 8.4 per cent. The total deposit base of the sector grew by 31.7 per cent in 2023 to Rs. 812.8 million in 2023 from Rs. 648.3 million in 2022. The core capital level of the sector was Rs. 2.6 billion and all LMFCs were in compliance with the minimum prudential regulations.

Unit Trusts

The number of Unit Trusts (UTs) in operation increased to 84 as at end 2023 from 80 reported as at end 2022 while recording a significant increase in total assets. The number of UT management companies remained unchanged at 16 as at end 2023 compared to end 2022. The funds of the UTs were dominated by Money Market Funds and Income Funds jointly accounting for 84.9 per cent of the UT industry. Total assets of the UTs increased significantly by 171.0 per cent to Rs. 406.5 billion by end 2023 from Rs. 150 billion at end 2022. The number of units issued also increased to 13,371 million as at end 2023 from 6,283 million reported as at end 2022. In addition, the total number of unit holders increased to 93,450 at end 2023 from 67,912 reported as at end 2022. The share of investments in government securities by UTs as a percentage of total assets significantly increased to 77.2 per cent as at end 2023 from 56.7 per cent reported as at end 2022. Meanwhile, investment in equity as a share of UT assets

25 Excluding Pan Asia Banking Corporation (participation in government securities at primary auction was suspended w.e.f. 15.08.2017).

26 Excluding Entrust Securities PLC (participation in government securities at primary auction has been restrained w.e.f. 24.07.2017. A creditor winding up was filed by one of the unsecured investors and on 17.06.2022 the winding up order was given by the courts. However, the winding up case is still pending before the courts due to other legal proceedings), and Perpetual Treasuries Ltd. (business was initially suspended on 06.07.2017 and extended for a further period of 06 months w.e.f. 05.01.2024)

decreased to 4.5 per cent as at end 2023 compared to 7.9 per cent as at end 2022.

Insurance Sector

The insurance sector, which comprises long term and general subsectors, showed mixed performance during 2023. The sector comprised 28 companies in operation as at end 2023, of which 14 operated as exclusive long term insurance companies and 12 as exclusive general insurance companies, while 2 as long term and general insurance businesses. In addition, 78 insurance brokering companies were in operation as at end 2023. The insurance sector recorded an increased gross written premium (GWP) in 2023 compared to 2022. During the year, GWP in the long term and general insurance sectors grew by 12.9 per cent and 3.4 per cent, year-on-year. Insurance penetration in the country, measured by annualised GWP as a percentage of GDP was only 1.0 per cent by end 2023. Assets of the long term insurance sector expanded whilst assets of the general insurance sector contracted. Asset growth of the long term insurance sector was 22.6 per cent (year-on-year) whilst the assets of general insurance contracted by 4.2 per cent (year-on-year) at end 2023. However, given the higher asset base of the long term insurance sector, total insurance sector assets grew by 14.7 per cent, year-on-year, in 2023. Profitability of general insurance sector was low in 2023 compared to 2022. Profit before tax of the long term insurance sector grew by 30.6 per cent in 2023 compared to 2022. However, profit before tax of general insurance sector decreased by 25.6 per cent during this period. Similarly, return on assets and return on equity of general insurance deteriorated during 2023 compared to the previous year whilst the same indicators for long term insurance improved. During the period under review, the capital position of both long term and general insurance sectors improved. Capital Adequacy Ratio (CAR) of general insurance increased to 252.0 per cent by end 2023 from 210.0 per cent a year ago. In long term insurance, CAR improved to 358.0 per cent from 303.0 per cent, a year ago.

Employees' Provident Fund

The net worth of the Employees' Provident Fund (EPF) significantly increased by 11.5 per cent, year-on-year, by end 2023 compared to end 2022. This growth is attributed to the income generated through the prudent investments of the Fund. The total liability to the members also increased by 12.9 per cent during this period. Meanwhile, total contributions received for the year 2023 increased by 8.2 per cent, while the total amount of refunds disbursed to the members and their legal heirs significantly increased by 32.4 per cent. Consequently, the net contribution of the Fund was reported at a negative Rs. 5.3 billion in 2023, compared to a positive contribution of Rs. 31.6 billion recorded in 2022.

The total investment income of the Fund amounted to Rs. 469.3 billion in 2023, registering a notable increase of 48.6 per cent compared to Rs. 315.8 billion in 2022. Interest income continued to be the predominant source of income for the Fund, growing by 26.7 per cent to Rs. 442.4 billion in 2023 from Rs. 349.3 billion in 2022. However, dividend income witnessed a decline of 60 per cent to Rs. 3 billion in 2023, compared to Rs. 7.5 billion in 2022. Despite a substantial increase in the prices of goods and services, the Fund successfully maintained the operating expenses to gross income ratio at 0.49 per cent in 2023. Nevertheless, the tax expenditure of the Fund increased due to increased investment income during 2023.

EPF chose to pursue the Debt Exchange option after carefully considering the two alternatives provided under the DDO operation. On 04 July 2023, the Ministry of

1

Table 1.25 **Five-year Performance Summary of EPF**

Item	2019	2020	2021	2022	2023*
Net Worth of the Fund (Rs. bn)	2,540.4	2,824.3	3,166.1	3,459.9	3,857.4
Total Liability to the Members (Rs. bn)	2,497.6	2,767.8	3,066.9	3,380.6	3,817.9
Total Contributions (Rs. bn)	157.2	150.7	165.7	194.6	210.6
Total Refunds (Rs. bn)	126.3	109.7	118.2	163.0	215.9
Net Contribution (Rs. bn)	30.9	41.0	47.5	31.6	(5.3)
Interest Rate on Member Balance (%)	9.25	9.00	9.00	9.00	13.00
Total Number of Member Accounts (mn)	19.4	19.8	20.3	20.4	20.9
Active Number of Member Accounts (mn)	2.9	2.6	2.5	2.7	2.7

* Provisional

Source: EPF Department, Central Bank of Sri Lanka

Finance, Economic Stabilization and National Policies announced the DDO operation, offering two options for Superannuation Funds. The first option allowed EPF to exchange a minimum required amount of its existing Treasury bonds for 12 new series maturing between 2027 and 2038. This exchange would subject EPF to an income tax rate of 14 per cent per annum on its taxable income derived from the Treasury bond portfolio. Alternatively, if EPF chose not to exchange its existing Treasury bonds, a fixed 30 per cent tax rate would be applied to the taxable income generated from its Treasury bond portfolio. After carefully considering these options, the Monetary Board of the CBSL, acting as the custodian of the EPF, chose to pursue the Debt Exchange offer. This decision, made with a long-term perspective and in the best interest of the Fund's members, involved the EPF tendering Rs. 2,667.5 billion face value of Treasury bonds for Debt Exchange.

Employees’ Trust Fund

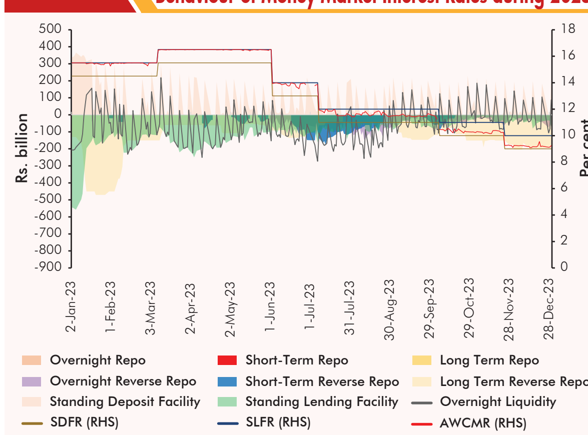
The total assets of the Employees’ Trust Fund (ETF) increased by 11.9 per cent, year-on-year, to Rs. 520.5 billion at end 2023. Investments made by the ETF increased by 8.3 per cent. Out of these investments, 93.8 per cent was invested in government securities as at end 2023. ETF managed to earn a return on investment of 12.3 per cent on its member balances in 2023. Out of 15.5 million member accounts of the ETF, only 2.5 million accounts were active as at end 2023. The number of employers contributing to the fund increased to 75,485 as at end 2023 from 68,488 as at end 2022. The total member balance of the ETF decreased by 0.2 per cent and reached Rs. 458.5 billion as at end 2023. The total contributions received to ETF increased by 7.4 per cent (year-on-year) and reached Rs. 37.1 billion, while total benefits paid to members increased by 53.0 per cent (year-on-year) and reached Rs. 38.3 billion during 2023.

1.5.3 Performance of Financial Markets

Domestic Money Market

Liquidity shortage in the domestic money market declined considerably by end 2023. This was due to liquidity injections through foreign exchange purchases of the Central Bank, liquidity provision through term reverse repurchase auctions to LCBs, reduction in the SRR and liquidity provision through the Liquidity Assistance Facility (LAF) to certain licensed banks. The permanent liquidity injection through SRR reduction during 2023 was around Rs. 200 billion. In addition, the Central Bank conducted outright auctions to purchase Treasury bonds from secondary market and injected Rs. 8.5 billion liquidity on a permanent basis. Therefore, the market liquidity indicated an asymmetric distribution in 2023, where certain domestic banks recorded liquidity deficits while most

Figure 1.29 **Open Market Operations, Standing Rate Corridor and Behaviour of Money Market Interest Rates during 2023**



Source: Central Bank of Sri Lanka

foreign banks recorded a notable liquidity surplus. Daily average transaction value in the call money market decreased to Rs. 8.6 billion in 2023 from Rs. 15.7 billion in 2022. However, daily average transaction value in the repo market increased to Rs. 14.4 billion in 2023 from Rs. 6.8 billion in 2022 indicating increased preference for collateralised lending by financial institutions.

Domestic Foreign Exchange Market

The rupee appreciated by 12.1 per cent against the US dollar during 2023. The USD/LKR exchange rate, which was 363.11 at end 2022, was at 323.92 at end 2023. The Central Bank has allowed the exchange rate to be determined by market forces since 07 March 2023. Meanwhile, domestic FX market liquidity conditions improved following the gradual relaxation of the mandatory FX sales requirement by licensed banks to the Central Bank and inflows under the IMF-EFF. These developments caused market participants' anticipation of further appreciation and induced more conversions of remittances and export proceeds. However, rupee depreciation pressures surfaced during the early part of the second half of 2023 as banks bought FX in the domestic market to cover their FX liabilities as the Government was settling US dollar denominated Sri Lanka Development Bonds held by banks in rupees under the DDO programme. However, Central Bank interventions in the FX market reduced the pressure on the rupee, and the exchange rate stabilised. Further, trading volumes in the domestic FX inter-bank market increased by 56.7 per cent to US dollars 15.0 billion in 2023 compared to US dollars 9.6 billion recorded in 2022.

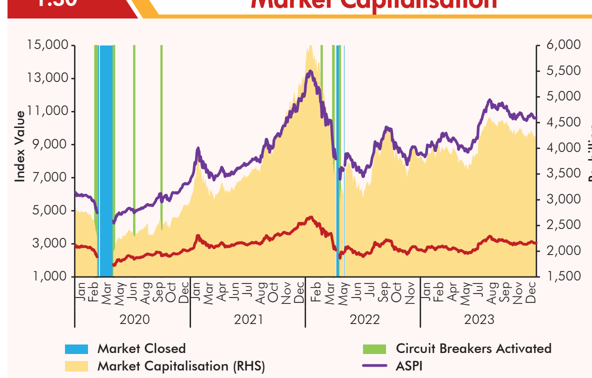
Government Securities Market

In line with policy rate reductions, secondary market yields also decreased resulting in a downward shift in the yield curve. The secondary market yield curve indicated signs transitioning to the regular shaped curve by the end of 2023. Further, liquidity in the secondary market of government securities marginally improved during 2023 which was observed through increased daily average trade volumes and daily average number of trades in the market. Accordingly, during 2023 daily average trade volumes and daily average number of trades increased to Rs 25.7 billion and 80.6 respectively, from Rs 12.5 billion and 39 recorded in 2022. However, the secondary market transactions were skewed towards short term maturities. During 2023, a net foreign inflow of US dollars 210 million into the government securities market was recorded despite a net foreign outflow of US dollars 216 million during the second half of 2023.

Equity Market

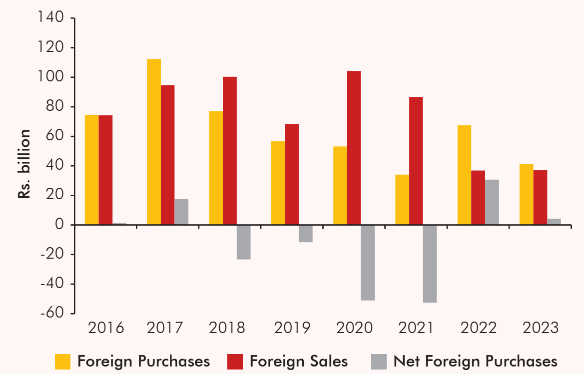
The domestic equity market demonstrated a mixed performance during 2023 in terms of price indices, market capitalisation and daily turnover. Overall, both All Share Price Index (ASPI) and Standard & Poor's Sri Lanka 20 (S&P SL20) indices demonstrated positive momentum throughout the year. The increase in price indices was significant following the announcement of the DDO perimeter excluding the banking sector during July-August period. However, the movement of the indices stalled towards the end of 2023 with a negative

Figure 1.30 Movements of Price Indices and Market Capitalisation



Source: Colombo Stock Exchange

Figure 1.31 Foreign Participation in CSE



Source: Colombo Stock Exchange

movement in ASPI owing to proposed tax amendments, increased food inflation and upward revision of energy prices. Accordingly, ASPI and S&P SL20 indices grew by 24.9 per cent and 15.7 per cent respectively, during the year 2023 while market capitalisation enhanced by 9.7 per cent and stood at Rs. 4,233.3 billion by end 2023. The Colombo Stock Exchange (CSE) recorded an average daily turnover of Rs. 1,696.81 million in 2023, which was a 43 per cent decline compared to Rs.2,972.3 million recorded in 2022. Foreign participation in the domestic equity market in terms of net foreign purchases declined in 2023 compared to the previous year. Accordingly, the market recorded Rs. 4.3 billion (approximately US dollars 13.27 million) net foreign inflows during the year 2023 compared to an inflow of Rs. 30.6 billion (approximately US dollars 74.3 million) recorded during the previous year.

Corporate Debt Securities Market

Commercial Paper (CP) issues were less in 2023 compared to 2022. During 2023, only Rs. 1.3 billion was raised through CPs compared to Rs. 2.0 billion raised through CPs in 2022. The interest rates of CPs varied between 17.0 and 26.5 per cent during 2023 compared to the range of 11.0 to 36.0 per cent reported in the previous year. Throughout 2023, 16 IPOs of corporate debentures were launched by 5 companies in the CSE, collectively raising Rs. 34.6 billion. This marked a notable increase from the Rs. 12.7 billion raised in 2022, spread across 10 IPOs by 4 companies. Notably, debentures featuring both fixed and floating interest rates were issued during the year. The fixed interest rates varied from 13.50 to 29.50 per cent, compared to the previous year's range of 15.42 to 28.00 per cent.

1.5.4 Financial Inclusion

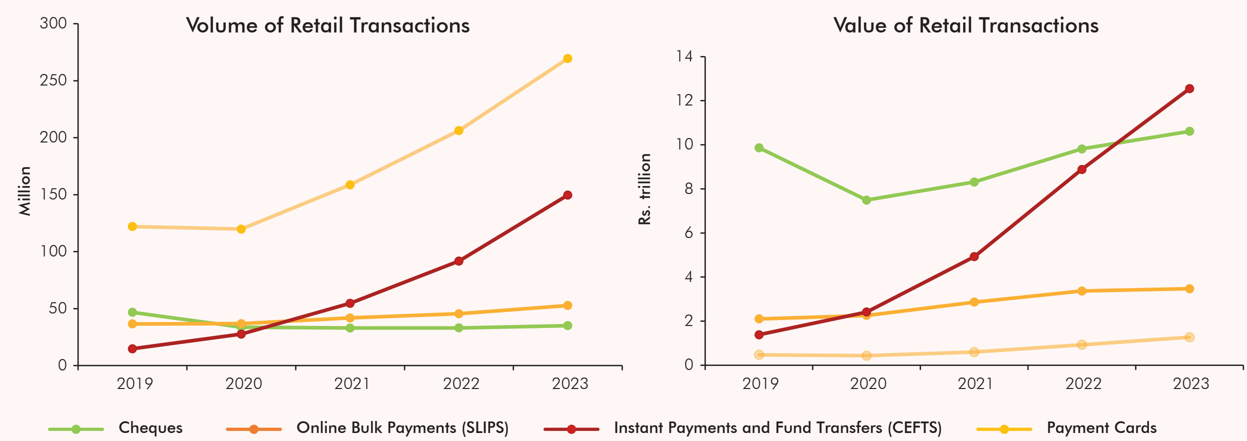
The Central Bank continued to promote financial inclusion during 2023. However, the enactment of the CBA resulted in a discontinuation of the Central Bank funded loan schemes for Micro, Small and Medium Sized Entrepreneurs (MSMEs) and the decision of the Governing Board to phase-out loan schemes carried on behalf of the Government will further scale down the MSME lending activities of the Central Bank. Promoting financial inclusion has become one of the statutory functions of the Central Bank. Further, Phase I of National Financial Inclusion Strategy (NFIS) will be concluded in 2024 and the Central Bank expects to implement the Phase II of the NFIS from 2025. A comprehensive Financial Literacy Roadmap for Sri Lanka has been developed and will be launched in May 2024 with the objective of improving the financial behaviour of the public. Moreover, the Central Bank conducted awareness programmes during the year to enhance financial literacy throughout the country.

1.5.5 Financial Infrastructure

Payment and Settlement Systems

In 2023, Sri Lanka's economy witnessed a significant acceleration in digitalisation, evident from sustained high growth in retail payment systems. This trend reflects a growing preference for digital payment methods in the country. The success of this shift can be attributed to the Central Bank's digital payment

Figure 1.32 **Retail Transactions**



promotion policy as well as strategies developed by the National Payments Council (NPC), the industry consultative committee on payment and settlement systems.

To ensure the smooth functioning of payment systems, the Central Bank implemented policies to ensure continuous system availability and sufficient liquidity in order to meet the growing demand for digital payment channels. The increasing popularity of online real time fund transfers among the public led to the country's Instant Payment System, i.e., Common Electronic Fund Transfer Switch (CEFTS), recording the highest growth among digital payment systems in 2023. Accordingly, CEFTS based payment channels including LankaPay Online Payment Platform (LPOPP), which facilitates payments to government institutions such as tax payments and customs duties directly from bank accounts, LANKAQR transactions, and JustPay, which allows customers to pay by linking multiple bank accounts to any mobile payment app, including Fintech apps, as well as payment card use experienced a significant growth in 2023.

During the year 2023, there was a notable shift towards online instant payments via CEFTS, as value of instant payments and fund transfers surpassed transactions carried out through more traditional other payment instruments such as payment cards and cheques. Transactions carried out through the Real Time Gross Settlement (RTGS) system, which enables large value transactions for individuals and corporates, as well as interbank transactions, continued to increase. Due to the significant improvement in market liquidity observed in 2023, transactions related to the Intraday Liquidity Facility, which facilitates participants intraday liquidity requirements for RTGS operations and the Standing Lending Facility, which is settled through the RTGS system, decreased in both value and volume. Further, embarking on a policy of regional integration of payment systems, LANKAQR was integrated with Unified Payments Interface (UPI) in India and UnionPay International in China in 2023, enabling visitors using those systems to seamlessly pay via LANKAQR in Sri Lanka.

The Central Bank ensured payment and settlement systems stability via closely monitoring market trends, taking swift policy decisions when necessary and increasing stakeholder awareness as appropriate to mitigate the emerging risks in the payment sector in the country. Accordingly, the Central

Bank continues to develop the digital payment infrastructure in close coordination with the industry. This effort aims to ensure that Sri Lanka possesses an inclusive and competitive payment industry that supports both the stability of the financial system and the economic recovery.

Anti-Money Laundering and Countering the Financing of Terrorism

Money Laundering and Terrorism Financing (ML/TF) present substantial risks to a nation's financial stability, causing distrust, market distortions, regulatory complexities, reputational damage, and systemic hazards. In 2023, the Central Bank through the Financial Intelligence Unit (FIU) carried out its duties mandated by the Financial Transactions Reporting Act, No. 6 of 2006 (FTRA), by receiving and analysing 1,369 Suspicious Transaction Reports (STRs) and disseminating 236 STRs to LEAs/RAs. Under the risk based supervisory approach, FIU conducted 23 onsite inspections, resulting in issuance of 15 show cause letters and 13 penalty letters to Financial Institutions (FIs), collecting Rs. 21.2 million as penalties. Further, in September 2023, FIU published the 2021/22 National Risk Assessment (NRA) on ML/TF, outlining significant threats, vulnerabilities, and risks encountered by Sri Lanka. Following the NRA findings, the National AML/CFT Policy for 2023-2028 was prepared and approved by the Cabinet of Ministers. Aiming at preparing the key stakeholders for the AML/CFT Mutual Evaluation in 2025, Institution-wise Action Plans were prepared and shared among the stakeholders for implementation. Furthermore, a Task Force for AML/CFT was appointed by the Cabinet of Ministers to monitor the progress of the implementation of these Action Plans.

Legal Reforms Related to the Financial Sector

During September/November 2023, CBA and Banking (Special Provisions) Act, No. 17 of 2023 (BSPA) were enacted and came into operation. Amendments to the Banking Act No. 30 of 1988 were introduced for further strengthening and streamlining the provisions and currently it is under submission to the Parliament. Further, during the year 2023, the Central Bank provided technical assistance to the Ministry of Finance in drafting of the Micro Finance and Credit Regulatory Act and Financial Asset Management Companies Act. Other legal reforms undertaken during the year 2023 include drafting of amendments to the Finance Business Act, No. 42 of 2011; Finance Leasing Act, No. 56 of 2000; Payment and Settlement Systems Act, No. 28 of 2005; Foreign Exchange Act, No. 12 of 2017; and drafting of a new law, namely, Trading Clearing and Netting Act (TCN Act) for development of the Capital Market.

Financial Consumer Protection

In 2023, the Central Bank implemented a significant initiative aimed at fortifying the financial consumer protection framework for Financial Service Providers under its regulatory purview. The new Regulations on Financial Consumer Protection, No. 1 of 2023 was issued under Section 10(c) of the Monetary Law Act, No. 58 of 1949 (MLA) on 8 August 2023. The strengthened framework encompasses comprehensive measures designed to enhance transparency, fairness, and responsible business conduct within the financial sector, thereby fostering a more resilient and consumer-centric financial system. In addition to the robust two-tier complaint handling procedure, these Regulations also provide necessary authority and framework for the Central Bank to carry out market conduct supervision, which is one of the effective mechanisms available for the regulators in supervising financial consumer protection and the Regulations will come into force gradually in 2024. These steps by the Central Bank are aimed at maintaining the integrity and stability of the financial system while prioritising the welfare of financial consumers in Sri Lanka.

Deposit Insurance and Resolution Authority

The Central Bank has been designated as the authority responsible for the resolution of financial institutions under Section 62 of CBA. Accordingly, the Central Bank contributed to the enactment of the BSPA and established the Deposit Insurance and Resolution Department for the efficient exercise of its resolution powers strengthening the Central Bank's resolution authority and enhancement of the financial system stability framework through the administration of a Deposit Insurance Scheme, aligning with global standards.

The Sri Lanka Deposit Insurance Scheme (SLDIS) was re-established under the provisions of BSPA to uphold the public confidence in the financial system and to promote and contribute to the stability of the financial system. The SLDIS comprised 63 Member Institutions and had paid compensation of Rs. 505.0 million during 2023 upholding the confidence of the depositors in the financial system safety net. Further, the Government of Sri Lanka, the World Bank and the Central Bank are engaged in the Financial Sector Safety Net Strengthening Project which aims at strengthening the financial and institutional capacity of SLDIS in line with international best practices for development of an effective deposit insurance system which is vital for financial sector performance and system stability.

Regulation and Supervision of Foreign Exchange

As the government agent for implementing the provisions of the Foreign Exchange Act, No. 12 of 2017, the Central Bank is held responsible for regulating and promoting foreign exchange transactions of the country. Throughout the year, significant enhancements were made to the Export Proceeds Monitoring System (EPMS), a collaborative effort with the Sri Lanka Customs, Licensed Banks and selected large exporters aimed at capturing relevant information to monitor repatriation of export proceeds into Sri Lanka, as per the Rules on "Repatriation of Export Proceeds into Sri Lanka" issued under the Monetary Law Act No. 58 of 1949. These measures helped in reaching an export proceed repatriation figure of US dollars 14,997 million, of which US dollars 4,009 million was converted into Sri Lanka rupees, thereby providing liquidity to the domestic foreign exchange market.

Further, the activities of Restricted Dealers (RDs) who are authorised to engage in money changing business, underwent stringent monitoring. As a result, the performance of such RDs notably improved, with a figure of US dollars 388 million deposited into the banking system as compared to that of US dollars 159.8 million in 2022.

Credit Information

The CRIB continued to play a pivotal role in mitigating default risk of the Financial Institutions and fortifying the financial sector's resilience. Accordingly, CRIB credit scoring provides a holistic assessment of individuals' creditworthiness beyond traditional metrics which empowers borrowers to proactively manage their credit profiles and enables lenders to expedite lending decisions

BOX 4

Market Conduct Supervision: Upholding Trust in the Financial System

Introduction

Recent financial debacles and crises, even in several advanced and well-regulated economies over the past couple of decades, have highlighted the criticality of upholding the trust and confidence of public, especially financial consumers, on financial institutions, financial authorities and the financial system as a whole. Hence, financial authorities around the world have been compelled to reinforce and reshape the scope and approaches to the financial system oversight function with an increased focus on widening financial inclusion and strengthening the financial consumer protection provided to the financial consumers by Financial Service Providers (FSPs). In this context, strengthening the financial consumer protection framework through effective regulations, supervision, and consumer empowerment is becoming one of the priorities of financial authorities worldwide. For example, as per the 2022 Global State of Financial Inclusion and Consumer Protection Survey conducted by the World Bank, out of 113 responded jurisdictions, 109 jurisdictions have regulations on financial consumer protection.

Market Conduct Supervision

Market Conduct Supervision (MCS) is one of the pillars of financial consumer protection and is used by regulators in achieving the overarching goal of market integrity and trust among depositors, borrowers, investors, stakeholders, and the public, contributing to financial system stability and economic growth. A comprehensive or full scope MCS involves a continuous review of FSPs' products, services, systems and procedures, and practices with prompt corrective and enforcement actions. Despite some similarities in its goals, approach process, MCS is different from prudential supervision of financial institutions in terms of its concepts and focus areas and tries to provide fair outcomes for both financial consumers and FSPs.

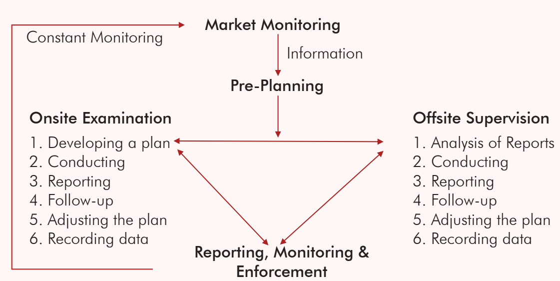
MCS Approaches

As MCS is designed and implemented under different operating environments and structures, two main approaches can be adapted to suit the regulatory objectives, resources, and skill levels as well as the development of the industry and economy as a whole. In a compliance-based approach, supervisors focus on non-compliance with laws and regulations of FSPs and take appropriate enforcement actions to ensure full compliance. In the risk-based approach, supervisors focus on risk analysis and mitigations. Accordingly, the risk-based approach of MCS is more forward looking and the supervisory activities are fine tuned according to the risk levels identified prior and during the supervisory cycle.

Main Supervisory Tools

MCS encompasses a range of supervisory tools such as media watch and product reviews, thematic reviews, mystery shopping and calls, self-assessments by FSPs and direct engagement with FSP leadership focusing on market conduct risks and controls to emerging issues, validating specific practices, and gauging control adequacy. These tools collectively facilitate supervisors to have an effective MCS.

Figure B 4.1 **The Market Conduct Supervision Process**



Source: Central Bank of Sri Lanka

The Market Conduct Supervision of the Central Bank

Pursuing the development of global financial consumer protection regulations, the Central Bank established the Financial Consumer Relations Department (FCRD) in 2020 and issued the Regulations on Financial Consumer Protection, No. 01 of 2023, under Section 10(c) of the then Monetary Law Act in August 2023, covering all financial institutions under its purview. The Regulations, which will be fully effective from August 2024, integrate and strengthen the existing customer protection frameworks issued under different statutes and empower the Central Bank to supervise the market conduct of FSPs regulated by it.

With the empowerment by the Regulations, the Central Bank has arranged to commence its MCS under a risk-based approach while giving due consideration to the reported non-compliances and malpractices of FSPs. As a precursor to MCS, FCRD conducted a thematic review on the complaint handling mechanism of FSPs. The assessment helped set the background for the MCS process while providing an opportunity for FSPs to improve their internal redress mechanism.

Conclusion and Way Forward

As countries navigate through increased risk and complexities of modern financial products and services, upholding public confidence in the financial system is a key element in achieving financial inclusiveness and system stability. A robust MCS as the main mechanism in regulating financial consumer protection always fosters fair treatment for financial consumers and responsible market conduct of FSPs. This will pave the way for increased public trust in the overall financial system.

In this regard, the Central Bank is developing the necessary mechanisms, competencies, and procedures for conducting MCS of FSPs in terms of the Regulations No. 01 of 2023. As of 2023, the Central Bank has developed a market conduct supervisory manual integrating its supervisory approach, tools, and process with required details and is expected to commence the first full scope MCS during second half of 2024. Going forward, the Central Bank expects to have greater co-operation from market conduct supervisors in other countries and international networks such as Alliance for Financial Inclusion (AFI) and the International Financial Consumer Protection Organisation (FinCoNet) to gain necessary experience and expertise for effective implementation of MCS contributing to a more resilient and stable financial system upholding the trust and confidence of the financial consumers.

References

1. An Introduction to Developing a Risk-Based Approach to Financial Consumer Protection Supervision (2022) - World Bank
2 Establishing a Financial Consumer Protection Supervision Department (2021) – World Bank
3. Financial Consumer Protection and New Forms of Data Processing Beyond Credit Reporting (2018) – World Bank
4 Good Practices for Financial Consumer Protection (2017) – World Bank
5. Market Conduct Supervision in Small Countries: The Case of Armenia (2013) – World Bank
6. Market Conduct Supervision of Financial Services Providers A Risk-Based Supervision Framework (2016) - Alliance for Financial Inclusion
7. Market Conduct Supervision – A Toolkit (2023) - Alliance for Financial Inclusion
8. The Global State of Financial Inclusion and Consumer Protection (2022) - World Bank

based on reliable predictive models. CRIB also focuses on leveraging advanced technology to analyse lending market data, providing insights into future market developments, changes in consumer behaviour, and evolving societal needs. Users of lending institutions have full access to this value-added analytical product offered by CRIB for objective and structured evaluation of SMEs and MSMEs. Further, to enhance financial inclusivity and encompass the informal sector, which lacks comprehensive credit data and documentation, CRIB is exploring alternative data sources. These sources, such as insurance data, utility payments and telecommunications payments, and e-commerce data are considered formal data sources for assessing reputational collateral. Moreover, the enactment of the Secured Transactions Act (STR Act), will create a secure transaction lending framework to mortgage movable assets in Sri Lanka. This framework will protect the rights of all types of regulated financial institutions, encouraging them to provide financing on moveable collateral.

1.6 Fiscal Sector Developments

1.6.1 Key Fiscal Balances

Despite the challenging socio-political environment, the stellar fiscal performance in 2023, driven by stringent consolidation measures such as revenue enhancement and expenditure rationalisation, noticeably enhanced key fiscal balances, ensuring the continuation of the IMF-EFF programme and bolstering overall macroeconomic stability. Accordingly, the primary balance, which excludes interest payments from the overall deficit and reflects the discretionary component of fiscal policy, recorded a surplus of 0.6 per cent of GDP (Rs.173.3 billion) in 2023,

Table 1.26 Summary of Government Fiscal Operation

Item	2022	2023 (a)	2023/2022 Absolute Change	2023/2022 % Change
		Rs. million		
Total Revenue and Grants	**2,012,589**	**3,074,324**	**1,061,735**	**52.8**
Total Revenue	1,979,184	3,048,822	1,069,638	54.0
Tax Revenue	1,751,132	2,720,563	969,431	55.4
Non Tax Revenue	228,052	328,259	100,207	43.9
Grants	33,405	25,502	(7,903)	(23.7)
Expenditure and Net Lending	**4,472,556**	**5,356,591**	**884,035**	**19.8**
Recurrent	3,519,633	4,699,679	1,180,046	33.5
Interest Payments	1,565,190	2,455,600	890,410	56.9
o/w Domestic	1,436,569	2,332,208	895,639	62.3
Foreign	128,621	123,391	(5,230)	(4.1)
Capital and Net Lending	952,923	656,912	(296,011)	(31.1)
o/w Public Investment	1,014,293	932,745	(81,548)	(8.0)
Current Account Balance	**-1,540,448**	**-1,650,857**		
Primary Balance	**-894,777**	**173,332**		
Overall Fiscal Balance	**-2,459,967**	**-2,282,267**		
Total Financing	**2,459,967**	**2,282,267**	**(177,700)**	**(7.2)**
Foreign Financing	424,822	494,655	69,833	16.4
Domestic Financing	2,035,145	1,787,612	(247,533)	(12.2)
		As a Percentage of GDP (b)		
Total Revenue and Grants	**8.4**	**11.1**		
Total Revenue	8.2	11.0		
Tax Revenue	7.3	9.8		
Non Tax Revenue	0.9	1.2		
Grants	0.1	0.1		
Expenditure and Net Lending	**18.6**	**19.4**		
Recurrent	14.6	17.0		
Interest Payments	6.5	8.9		
o/w Domestic	6.0	8.4		
Foreign	0.5	0.4		
Capital and Net Lending	4.0	2.4		
o/w Public Investment	4.2	3.4		
Current Account Balance	**-6.4**	**-6.0**		
Primary Balance	**-3.7**	**0.6**		
Overall Fiscal Balance	**-10.2**	**-8.3**		
Total Financing	**10.2**	**8.3**		
Foreign Financing	1.8	1.8		
Domestic Financing	8.5	6.5		

(a) Provisional
(b) GDP estimates (base year 2015) released by the Department of Census and Statistics on 15 March 2024 have been used.

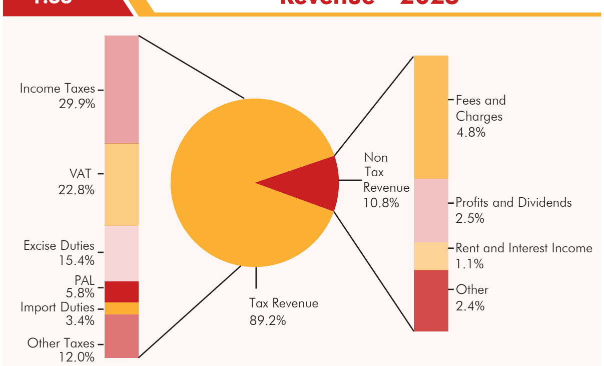
Source: Ministry of Finance, Economic Stabilization and National Policies

compared to the deficit of 3.7 per cent (Rs. 894.8 billion) recorded in 2022, overachieving the Quantitative Performance Criteria (QPC) set under the IMF-EFF arrangement. A primary surplus was recorded last in 2018, and since 1950 the country has registered a primary surplus only in six years. Maintaining a positive primary balance is crucial for fostering fiscal sustainability and effectively controlling the accumulation of debt. In the meantime, although the current account[27] deficit widened in nominal terms on account of higher interest payments, the same in GDP terms narrowed marginally. The overall budget deficit narrowed to 8.3 per cent of GDP (Rs. 2,282.3 billion) in 2023, in comparison to 10.2 per cent of GDP (Rs. 2,460.0 billion) recorded in the preceding year. The initial estimate for the overall deficit was 7.9 per cent of GDP (Rs. 2,404.0 billion).

1.6.2 Government Revenue, Expenditure, and Net Lending

Reflecting Government's commitment to fiscal consolidation, a substantial increase in government revenue was recorded in both nominal terms and as a percentage of GDP in 2023, compared to 2022. Accordingly, in nominal terms government revenue recorded a year-on-year growth of 54.0 per cent, while in GDP terms revenue increased by 2.8 percentage points to 11.0 per cent of GDP in 2023. Numerous tax reforms implemented in the second half of 2022 and in 2023 supported the expansion in revenue collection. The significant rise in tax revenue was mainly due to the increased collections from income taxes, VAT, excise duties, import duties, and Special Commodity Levy (SCL). The Social Security Contribution Levy (SSCL) that was introduced in October 2022 also contributed to this increase in government revenue. The significant increase in income taxes in 2023 was

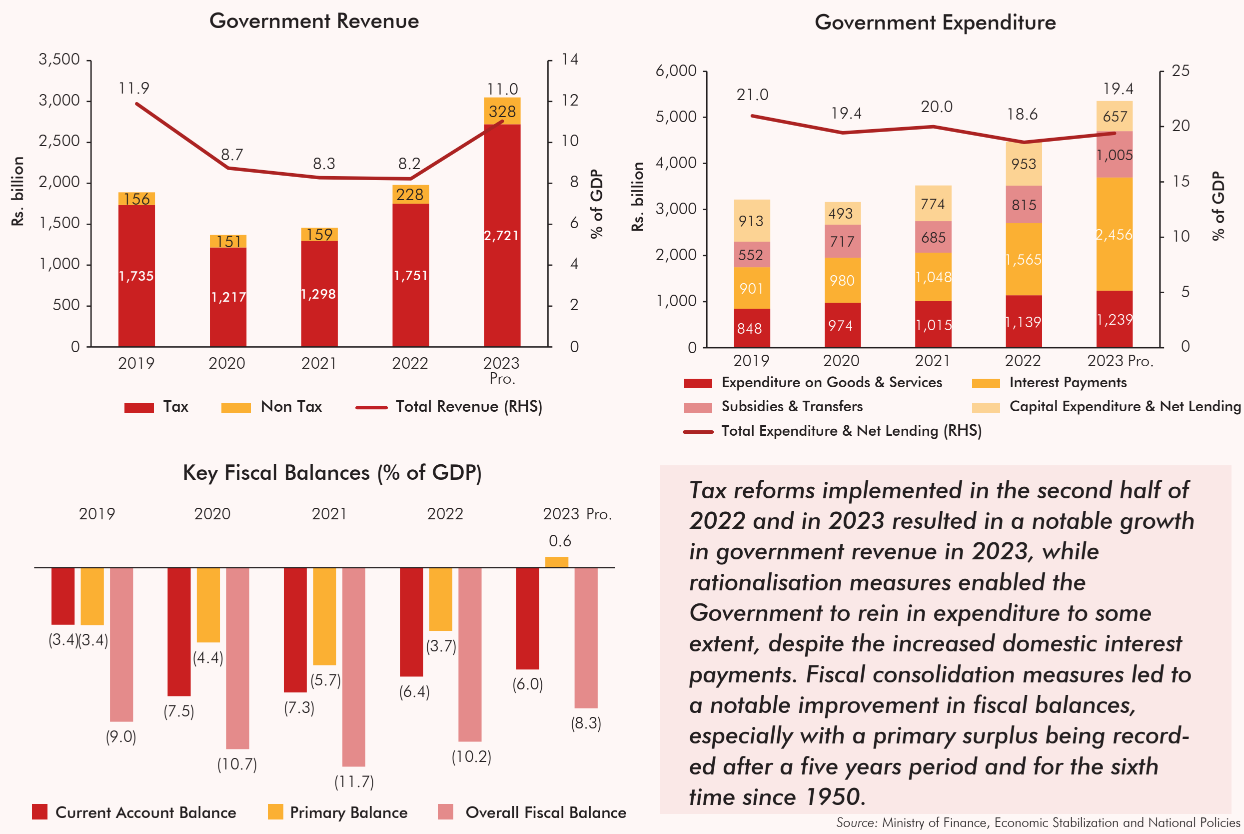
Figure 1.33 Composition of Government Revenue - 2023



Source: Ministry of Finance, Economic Stabilization and National Policies

27 The current account balance represents the difference between the total revenue and the total recurrent expenditure.

Figure 1.34 **Government Revenue, Expenditure and Key Fiscal Balances**



Tax reforms implemented in the second half of 2022 and in 2023 resulted in a notable growth in government revenue in 2023, while rationalisation measures enabled the Government to rein in expenditure to some extent, despite the increased domestic interest payments. Fiscal consolidation measures led to a notable improvement in fiscal balances, especially with a primary surplus being recorded after a five years period and for the sixth time since 1950.

Source: Ministry of Finance, Economic Stabilization and National Policies

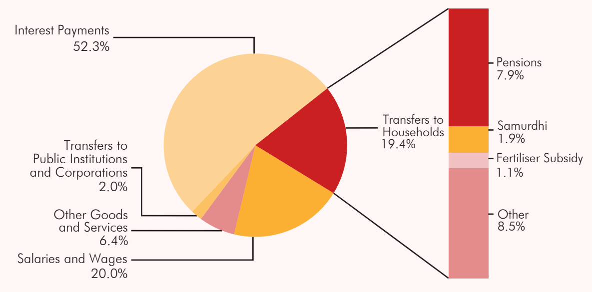
achieved through key policy measures including revisions to the personal income tax structure in terms of the tax-free threshold, tax rates, and tax brackets, mandatory registration requirement for specific professionals under the Inland Revenue Department (IRD), upward revision of the standard corporate income tax rate, and the elimination of concessionary rates related to corporate income taxes. Consequently, income tax collection increased from 2.2 per cent of the GDP in 2022 to 3.3 per cent of GDP in 2023. Meanwhile, the incremental adjustment of the VAT rate in two phases during 2022, coupled with the downward revision to the VAT registration threshold in the latter part of the same year that widened the tax net related to VAT, contributed to the notable growth in VAT collection in 2023. Accordingly, VAT revenue collection increased to 2.5 per cent of GDP in 2023 from 1.9 per cent of GDP in the preceding year. Excise duty structures on liquor, cigarettes, petrol, and diesel were revised several times during 2023 leading to the revenue collection from excise duties to increase from 1.4 per cent of GDP in 2022 to 1.7 per cent of GDP in 2023. International trade related taxes, including import duties and SCL, exhibited a substantial year-on-year growth in nominal terms due to upward revisions to the rates during 2023. However, when measured in GDP terms, their increase was only marginal, constrained by subdued imports due to restrictions on non-urgent imports maintained during most part of 2023, and reduced affordability. At the same time, the collection from SSCL amounted to 0.8 per cent of GDP in 2023. Revenue from Ports and Airports Development Levy (PAL) and Cess levy experienced a decline during the year under review due to the steps taken in 2023 to gradually phase out both para tariffs.

1

Meanwhile, non-tax revenue also increased during 2023 both in nominal and real terms, mainly driven by higher revenue collection from sources such as fees and charges, as well as profit and dividend transfers from State Owned Enterprises (SOEs). According to the initial budget estimates for 2023, total revenue was projected to be 12.5 per cent of GDP, with tax revenue and non-tax revenue estimated at 11.3 per cent and 1.2 per cent of GDP, respectively. Despite the notable improvement in revenue collection in 2023 compared to the previous year, there was an underperformance of revenue relative to the initial ambitious budget estimates for 2023. The realised revenue for 2023 amounted to 88.4 per cent, with realised tax revenue standing at 86.9 per cent of the initial projections. This shortfall could be attributed to faster deceleration in inflation than anticipated in the budget, continued subdued import demand, exchange rate appreciation, and issues related to revenue administration. Tax measures such as the upward revisions to the income tax structure have led to an increase in the share of direct tax collection, reaching 33.5 per cent in 2023 compared to 30.5 per cent in 2022.

The total expenditure and net lending increased both in nominal terms and as a percentage of GDP, mainly driven by the substantial escalation in domestic interest expenditure, despite the notable reduction in capital expenditure and net lending. Accordingly, in nominal terms, government expenditure recorded a year-on-year growth of 19.8 per cent, while in GDP terms expenditure increased only by 0.8 percentage points in 2023. The significant nominal rise in domestic interest expenditure was influenced by elevated domestic interest rates stemming from tight monetary conditions prevailed until June 2023 and high risk premia attached to government securities amidst uncertainties over DDO. In addition, overreliance on domestic financing due to the Government's limited access to foreign financing also contributed to the rise in domestic interest cost. Interest cost accounted for 80.5 per cent of the total government revenue and 45.8 per cent of total government expenditure in 2023 compared to 79.1 per cent and 35.0 per cent recorded in 2022, respectively. Meanwhile, expenditure on pension payments rose considerably during 2023, with the increased retirements during the year due to revisions implemented in the preceding year in relation to reducing retirement age for public sector employees from 65 to 60. Further, free medicine, and implementation of the Aswesuma Welfare Benefit Scheme contributed for the increase in subsidies and transfers. On the other hand, salaries and wages declined marginally in nominal terms as well as in GDP terms, as a result of freezing of new recruitments to the public sector and sizeable retirements of public servants from the workforce. Meanwhile, capital expenditure and net lending recorded a notable decline both in nominal terms as well as GDP terms. This reduction was primarily attributed to a significant decrease in net lending, caused by the settlement of the on-lending facility provided to CPC in 2022 through the Indian Credit Line. Capital expenditure excluding the impact of net lending as a percentage of GDP increased to 3.3 per cent in 2023 from 3.0 per cent in 2022. According to the initial budget estimates

Figure 1.35 **Composition of Government Recurrent Expenditure - 2023**



Source: Ministry of Finance, Economic Stabilization and National Policies for 2023, total expenditure was projected to be 21.2 per cent of GDP, with recurrent expenditure and capital expenditure and net lending estimated at 16.8 per cent and 4.4 per cent of GDP, respectively. The Government's efforts in curbing non-urgent and non-essential expenditure through the continuation of expenditure rationalisation measures kept total expenditure in check, preventing recurrent expenditure rising far above the budget estimates, despite higher than expected domestic interest payments.

1.6.3 Financing the Budget Deficit

In 2023, the Government continued to rely primarily on domestic sources to finance the budget deficit, largely due to existing constraints in accessing international capital markets. Accordingly, net domestic financing accounted for 78.3 per cent of the total debt financing during the period under review. Although this share has slightly reduced compared to the past two years, where it exceeded 100 per cent in 2021, the current percentage still remains relatively high in comparison to the 62.3 per cent and 57.5 per cent recorded for 2019 and 2018, respectively, when similar restrictions were not in effect. Once the impact of the transactions in relation to the DDO operation is eliminated, the total net domestic financing was predominantly sourced through Treasury bills, reflecting a strong market preference for short term instruments over long term instruments due to uncertainties and higher Treasury bill rates prevailed during the first half of the year.[28] In 2023, net financing from Treasury bills amounted to 7.5 per cent of GDP (Rs. 2,058.6 billion), up from 6.7 per cent of GDP (Rs. 1,608.2 billion) recorded in 2022. Conversely, net financing from Treasury bonds decreased to 2.5 per cent of GDP (Rs. 692.3 billion) in 2023, down from 6.0 per cent of GDP (Rs. 1,440.2 billion) in 2022. Net domestic financing from the banking sector experienced a significant contraction, with a net prepayment of 0.02 per cent of GDP (Rs. 6.4 billion).[29] This reduction was offset by non-bank sources, which accounted for 6.5 per cent of GDP (Rs. 1,798.5 billion) in 2023. Meanwhile, the share of net foreign financing in total net financing increased to 21.7 per cent in 2023, in comparison to 17.3 per cent in the preceding year. The net foreign financing in 2023 includes gross funds received under the two tranches of the IMF-EFF facility, which was granted as budget support. Additionally, notable receipts were received from other multilateral agencies such as ADB and the International Development Association (IDA) of the World Bank. These funds were provided in support of the Government's economic stabilisation programme and to support expenditure on social safety nets.

Sovereign rating agencies maintained their downgraded rating status for Sri Lanka due to the standstill on selected foreign debt service payments. Accordingly, Fitch Ratings and S&P Global Ratings maintained the long term foreign currency Issuer Default Rating (IDR) for Sri Lanka at RD (Restricted Default) and SD (Selective Default), respectively. Moody's Ratings maintained the long term foreign currency issuer credit rating at 'Ca' (Stable). In the meantime, the announcement of the DDO operation prompted the international sovereign credit rating agencies to downgrade the ratings of local currency domestic debt of the Government, while the same were upgraded with the successful completion of the DDO operation.

28 During the year, Sri Lanka Development Bonds and Central Bank Provisional Advances were settled as part of the DDO operation.

29 In contrast to the contraction recorded in net domestic financing from the banking sector under this section, NCG figures given under the Monetary Sector Developments of this Chapter show an expansion. This discrepancy can be attributed to the timing of recording the debt transfer associated with CPC's public guaranteed debt to the central government debt stock which was accounted for in the banking sector records only in 2023, despite being transferred by end 2022 as per the records of Ministry of Finance.

1

1.6.4 Central Government Debt and Public Debt [30]

Central government debt as a percentage of GDP declined to 103.9 per cent by end 2023 from 114.2 per cent in 2022, primarily due to the notable growth in nominal GDP driven by high inflation and the impact of currency appreciation on foreign debt. Accordingly, domestic debt and foreign debt as a percentage of GDP declined from 62.5 per cent and 51.8 per cent, respectively, in 2022 to 61.7 per cent and 42.1 per cent, respectively, in 2023.[31] However, nominal value of the total debt[32] increased by 4.4 per cent driven solely by a rise in domestic debt, while outstanding foreign debt, valued in domestic currency, decreased from the levels observed in 2022. The nominal increase in total domestic debt reflects the substantial financing needs fulfilled from the domestic market amidst limited foreign financing options. The share of medium and long term domestic debt as a percentage of total domestic debt increased to 74.2 per cent by the end of 2023 from 65.7 per cent at the end of December 2022. This change was primarily due to the conversion of the Central Bank's Treasury bill holding and provisional advances to the Government into longer term Treasury bonds under the DDO operation, increasing the share of medium to long term debt, thereby extending the maturity period of the debt stock, assist in lowering the Gross Financing Needs (GFN) for the Government. This is crucial in achieving debt sustainability targets agreed with the IMF. Furthermore, during the first half of 2023, the Government settled the outstanding stock of Rupee Loans, while the outstanding balance of the government guaranteed foreign currency debt stock of CPC, which was absorbed into central government debt by end December 2022, remains unchanged by end of 2023. Meanwhile, the decrease in foreign debt in nominal terms by end 2023 compared to end 2022 was due to the appreciation of the rupee against major foreign currencies. The parity related reduction of foreign debt in 2023 amounted to Rs.1,431.4 billion. However, the decline in the rupee value of the foreign debt stock was partially offset by funds received from multilateral organisations, including the two tranches of the IMF-EFF facility received in March and December 2023. In previous IMF programmes, IMF financing was treated as a liability of the Central Bank. However, in the latest arrangement, which focused on providing budget support to the Government, proceeds are transferred to the Government, thereby being treated as a liability of the Government, increasing the overall central government debt. As of end 2023, the relative share of outstanding foreign debt of the central government decreased to 40.6 per cent of total central government debt, compared to 45.3 per cent recorded at the end of 2022.

The outstanding public debt[33] decreased to 110.8 per cent of GDP at end 2023 from 119.2 per cent of GDP at end 2022, in line

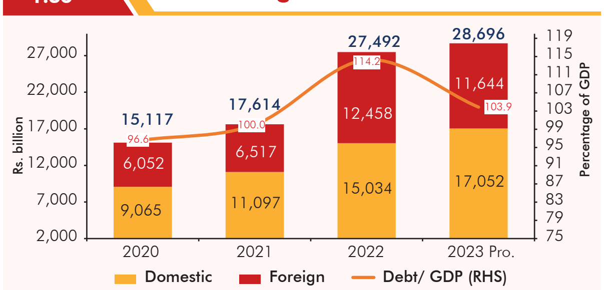
30 Government Debt Statistics are presented net of bank deposits of the Government.

31 As per the guidelines of compiling government debt statistics in the Manual of Government Finance Statistics 2014 of the IMF, non-resident holding of debt have been classified as foreign debt while resident holdings of debt have been classified as domestic debt.

32 In the context of ongoing discussions on external debt restructuring, the outstanding central government debt as at end 2022 and end 2023 excludes several debt service payments that became overdue after 12 April 2022, the date on which the Interim Policy regarding the servicing of Sri Lanka's external public debt was announced by the Ministry of Finance, Economic Stabilization, and National Policies. These debt service payments comprise overdue interest payments of affected debt, which are deemed to be capitalised as per the Interim Policy. Further, the balance as at end December 2022 excludes the value of certain coupon payments in relation to Sri Lanka Development Bonds that became overdue from April 2022 till end 2022.

33 The outstanding public debt includes debt of the central government and public guaranteed debt.

Figure 1.36 Outstanding Central Government Debt



Sources: Ministry of Finance, Economic Stabilization and National Policies
Central Bank of Sri Lanka

Table 1.27

Outstanding Government Debt (a) (b)

Rs. billion

Item	2022	2023 (c)
Domestic Debt (d)	**15,033.9**	**17,051.9**
By Maturity Period		
Short Term (e)	4,267.7	3,616.2
Medium and Long Term (f)	9,882.1	12,646.9
Other Domestic (g)	884.1	788.7
By Institution (h)		
Bank (h)	8,525.7	9,102.8
Non Bank (h)	6,164.0	7,506.3
Repurchase Transaction Allocations (i) (j)	344.1	442.7
Foreign Debt (k) (l)	**12,458.2**	**11,644.1**
Multilateral	3,611.6	3,817.0
Bilateral and Commercial	8,846.6	7,827.1
By Currency		
SDR	1,604.7	1,737.1
US Dollars	8,716.9	7,943.9
Japanese Yen	979.6	819.4
Euro	417.4	396.6
Other	739.6	747.1
Total Outstanding Central Government Debt	**27,492.0**	**28,695.9**
Public Guaranteed Debt (m) (n)	**1,180.7**	**1,931.3**
Public Debt	**28,672.7**	**30,627.3**
As a percentage of GDP (o)		
Total Outstanding Central Government Debt	**114.2**	**103.9**
Domestic Debt	**62.5**	**61.7**
Foreign Debt	**51.8**	**42.1**
Public Guaranteed Debt	**4.9**	**7.0**
Public Debt	**119.2**	**110.8**

Sources: Ministry of Finance, Economic Stabilization and National Policies
Central Bank of Sri Lanka

(a) As per the guidelines of compiling government debt statistics in the Manual of Government Finance Statistics 2014 of the IMF, non resident holdings of outstanding SLDBs have been classified under foreign debt and resident holdings of outstanding ISBs of the Sri Lankan Government have been classified under domestic debt. Further, debt statistics are presented on net basis (net of deposits).

(b) The outstanding central government debt as at end 2022 and end 2023 excludes several debt service payments that became overdue after 12 April 2022, the date on which the Interim Policy regarding the servicing of Sri Lanka's external public debt was announced by the Ministry of Finance, Economic Stabilization and National Policies. These debt service payments comprise of overdue interest payments of affected debt which are deemed to be capitalised as per the Interim Policy. Further, the balance as at end December 2022 excludes the value of certain coupon payments pending settlement in relation to Sri Lanka Development Bonds that became overdue from April 2022 till end 2022.

(c) Provisional

(d) From 2023 onwards, domestic debt compilation method was changed and is based on the data confirmed by the Ministry of Finance, Economic Stabilization and National Polices.

(e) Excludes Treasury bills held by non resident investors

(f) Excludes Treasury bonds held by non resident investors

(g) Data from 2022 includes outstanding balance of the government guaranteed foreign currency debt of the Ceylon Petroleum Corporation that was absorbed into central government debt.

(h) Institution wise classification was revised from Annual report 2022 based on the records of the Central Depository System

(i) Includes security holdings under Repurchase agreements for which absolute ownership could not be established

(j) Holdings under repurchase transactions with respect to Open Market Operations, have been allocated to the respective Licensed Commercial Bank or Standalone Primary Dealer

(k) Foreign loan debt statistics and classification of foreign debt for 2022 and 2023 are prepared based on the data sourced from the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) maintained by the Ministry of Finance, Economic Stabilization and National Policies, and extracted on 09 March 2023, 10 March 2023 and 26 February 2024.

(l) From December 2022 onwards, several outstanding project loans which were previously classified under Ceylon Electricity Board, Airport and Aviation Services Ltd. and Sri Lanka Ports Authority were absorbed into central government debt.

(m) Compilation of public guaranteed debt is based on data received from the Ministry of Finance, Economic Stabilization and National Policies as of 29 February 2024.

(n) Includes an international bond amounting to US dollars 175 million issued by the SriLankan Airlines in June 2014. This was matured in June 2019 and re-issued for a period of 5 years.

(o) GDP estimates (base year 2015) released by the Department of Census ad Statistics on 15 March 2024 have been used.

1

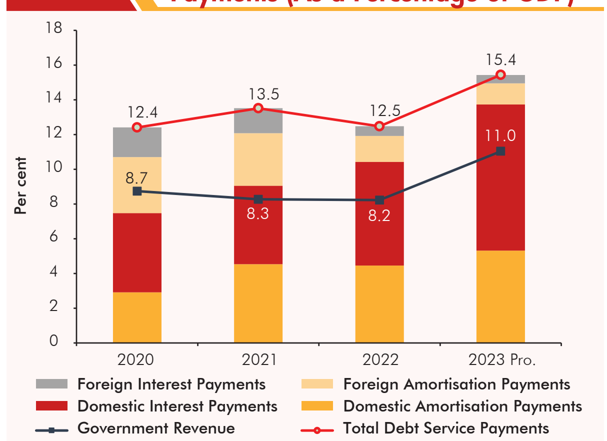
with the reduction in central government debt in GDP terms. In absolute terms, the total outstanding public debt increased to Rs. 30,627.3 billion at end 2023 from Rs. 28,672.7 billion at end of 2022, which was an increase of 6.8 per cent, year-on-year.

The Government successfully implemented the DDO operation in 2023 with the aim of achieving debt sustainability alongside other measures in this regard. Accordingly, eligible Sri Lanka Development Bonds (SLDBs) holdings were converted into five new variable coupon Sri Lanka rupee denominated Treasury bonds while Treasury bonds held by Superannuation Funds were converted into new Treasury bonds featuring medium to long term maturities. Furthermore, outstanding Treasury bill holdings of the Central Bank and outstanding provisional advances from the Central Bank to the Government were converted into ten new step down fixed coupon Treasury bonds and into twelve existing Treasury bills. The successful implementation of the DDO operation has led to the conversion of short term debt maturities into medium to long term maturities, thereby mitigating refinancing risk while lengthening the average time to maturity of the domestic debt portfolio. Spreading repayment obligations over an extended period alleviates immediate financial pressures and facilitates the establishment of a more manageable and sustainable debt structure. Meanwhile, the Government is actively engaging with external creditors to negotiate relief on external debt. Accordingly, an Agreement in Principle (AIP) has been reached with the Official Creditors Committee (OCC) and China EXIM Bank, leading to the current process of signing a Memorandum of Understanding (MOU). The Government also continues its efforts in negotiating with private debt holders to restructure external commercial debt, complying with comparability of treatment and the agreed debt sustainability targets.

1.6.5 Central Government Debt Service Payments

The total debt service payments increased to 15.4 per cent of GDP in 2023 from 12.5 per cent of GDP in 2022, mainly driven by the increased domestic interest payments. Domestic debt services rose to 13.7 per cent of GDP in 2023 compared to 10.4 per cent in 2022, marking a nominal increase of Rs. 1,283.1 billion. At the same time, the rise in domestic amortisation payments was associated with increased settlement of Treasury bonds, an increase of Rs. 468.7 billion during 2023 compared to 2022. In comparison, a decrease in foreign debt service payments to 1.7 per cent of GDP in 2023 from 2.0 per cent of GDP in 2022 was recorded due to continued suspension of certain foreign debt commitments following the Government's debt standstill announcement in 2022.

Figure 1.37 Central Government Debt Service Payments (As a Percentage of GDP)



Sources: Ministry of Finance, Economic Stabilization and National Policies
Central Bank of Sri Lanka