5

EXTERNAL SECTOR DEVELOPMENTS AND POLICIES

5.1 Overview

Sri Lanka's external sector faced unprecedented challenges in 2022 with severe Balance of Payments (BOP) pressures, amidst dwindling gross official reserves (GOR), large depreciation of the exchange rate, and the dearth of foreign exchange liquidity in the domestic market, among others. The shortage of liquidity in the domestic foreign exchange market constrained the importation of essential imports, such as petroleum oil, cooking gas, medicines, fertiliser, among others, thereby heightening social tensions and causing political instability. Significant policy intervention was warranted to stem the persistent negative spillovers across economic activity, including the sharp tightening of monetary policy, suspension of servicing of selected external debt for an interim period from mid-April 2022, temporary suspension of certain imports and payment terms, imposition of margin deposit requirements on selected imports, and capital flow management measures. Sri Lanka commenced negotiations with the International Monetary Fund (IMF) for an economic adjustment programme in April 2022, for which the staff level agreement was reached in September 2022, and the approval of the Executive Board of the IMF was received in March 2023. The Government initiated measures to restructure the public debt aimed to ensuring public debt sustainability as part of the process of securing the IMF funding. The Government and the Central Bank were compelled to resort to drawing down on GOR in order to facilitate the importation of essential commodities, while continuing the debt service payments unaffected by the temporary suspension amidst modest foreign financing inflows and highly unfavourable credit ratings. The assistance received from multilateral development partners and friendly nations by way of humanitarian credit lines and grants helped facilitate the provisioning of essential commodities. Meanwhile, a measured adjustment of the exchange rate was allowed by the Monetary Board in early March 2022, in view of the heightened pressures in the domestic foreign exchange market. However, the subsequent floating of the exchange rate caused a large depreciation due to the dearth of liquidity in the domestic foreign exchange market and unfavourable market sentiments. The Central Bank commenced *providing market guidance on the spot exchange rate by publishing a middle rate and a variation margin in mid-May 2022 that helped stabilise the exchange rate from significant intraday volatility.*

The external current account deficit moderated notably in 2022, mainly led by significant contraction in the trade deficit with import expenditure reducing sharply due to restrictive trade policies, sharp depreciation of the exchange rate and tight monetary and fiscal conditions that were necessary to manage pressures in the external sector. Merchandise exports increased, mainly driven by an increase in industrial exports, including apparel, among others. The surplus in the trade in services account increased to some extent due to the increase in earnings from tourism, while inflows to almost all other services sector subcategories recorded a notable decline during the year. Further, workers' remittances improved significantly towards the second half of 2022, while the deficit in the primary income account recorded a marginal moderation compared to that of 2021. Inflows to the financial account remained modest during the year.

Following the historically high depreciation recorded in 2022, the Sri Lanka rupee showed some appreciation in early 2023, thereby correcting the large overshooting to some extent. This appreciation was mainly supported by improved market sentiments towards the finalisation of the IMF-EFF arrangement, improvements in liquidity conditions of the domestic foreign exchange market, and the relaxation and subsequent removal of the mandatory sales requirement of foreign exchange by the licensed banks to the Central Bank. With the envisaged macroeconomic stability and easing of BOP pressures, external sector activity, including trade in goods and services, and workers' remittances is expected to

Table 5.1
Balance of Payments Analytical Presentation

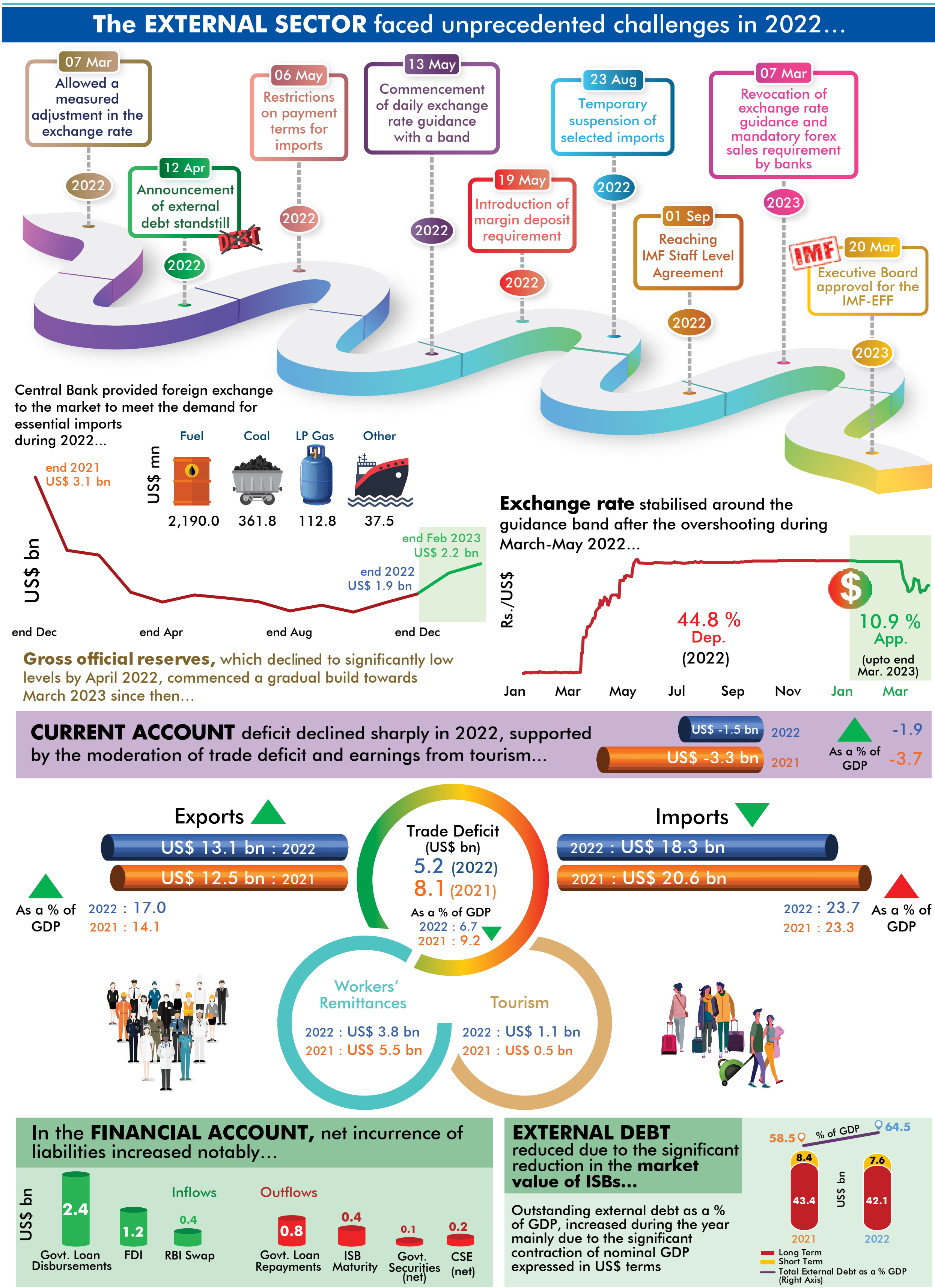
Item	US$ million		Rs. million	
	2021 (a)	2022 (b)	2021 (a)	2022 (b)
Current Account (net)	-3,284	-1,453	-656,314	-316,154
Trade Balance	-8,139	-5,185	-1,617,274	-1,502,420
Exports	12,499	13,106	2,486,943	4,234,913
Imports	20,637	18,291	4,104,218	5,737,333
Services (net)	1,586	2,110	316,424	644,934
Receipts	2,475	3,062	493,320	952,999
Payments	889	953	176,896	308,066
Primary Income (net)	-1,959	-1,874	-390,158	-618,071
Receipts	116	249	22,965	84,209
Payments	2,075	2,124	413,122	702,280
Secondary Income (net)	5,228	3,496	1,034,694	1,159,404
Secondary Income: Credit	5,498	3,793	1,088,388	1,253,677
Workers' Remittances	5,491	3,789	1,087,188	1,252,504
Government Transfers	6	3	1,200	1,173
Secondary Income: Debit	270	296	53,694	94,272
Capital Account (net)	25	19	5,009	6,123
Capital Account: Credit	50	38	9,850	11,909
Capital Account: Debit	24	19	4,841	5,786
Current and Capital Account (net)	-3,259	-1,433	-651,305	-310,030
Financial Account (net)	-4,211	-1,946	-844,973	-538,153
Direct Investment: Assets	17	15	3,468	4,892
Direct Investment: Liabilities	592	898	117,894	309,142
Portfolio Investment: Assets	-	-	-	-
Portfolio Investment: Liabilities	-1,547	355	-305,900	168,647
Equity	-232	137	-46,061	30,342
Debt Securities	-1,315	218	-259,838	138,305
Financial Derivatives	-	-	-	-
Other Investment: Assets	387	1,302	77,454	390,162
Currency and Deposits	306	514	62,761	152,168
Trade Credit and Advances	257	282	51,199	89,293
Other Accounts Receivable	-176	506	-36,506	148,700
Other Investment: Liabilities	3,053	776	615,978	183,589
Currency and Deposits	4,016	272	810,195	-9,248
Loans	-1,503	-92	-299,296	51,432
Central Bank	-57	-140	-11,377	-48,316
Deposit-taking Corporations	-2,152	-1,645	-429,506	-495,847
General Government	873	1,679	174,382	580,605
Other Sectors	-167	13	-32,795	14,989
Trade Credit and Advances	-426	-895	-87,405	-279,812
Other Accounts Payable	180	1,492	34,713	421,218
Special Drawing Rights (SDRs)	787	-	157,771	-
Reserve Assets	-2,517	-1,234	-497,923	-271,828
Monetary Gold	-212	-152	-42,734	-38,820
Special Drawing Rights	123	-118	24,635	-41,965
Reserve Position in the IMF	-	-58	-	-20,980
Other Reserve Assets	-2,428	-906	-479,823	-170,064
Currency and Deposits	1,536	-895	300,122	-166,305
Securities	-3,967	-11	-780,435	-3,691
Other Claims	3	...	490	-69
Net Errors and Omissions	-952	-513	-193,669	-228,122
Overall Balance (c)	-3,967	-2,806	-745,312	-1,087,831
As a Percentage of GDP				
Trade Balance	-9.2	-6.7		
Goods and Services (net)	-7.4	-4.0		
Current Account Balance	-3.7	-1.9		
Current and Capital Account (net)	-3.7	-1.9		

(a) Revised
(b) Provisional
(c) Refer Table 5.12 for the derivation of overall balance

Source: Central Bank of Sri Lanka

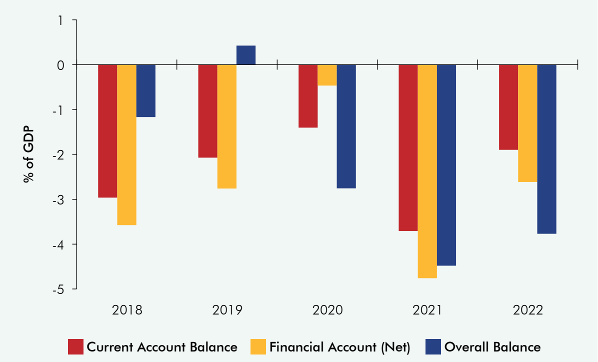
5

Figure 5.1
Performance of the External Sector



5

Figure 5.2
Balance of Payments



Source: Central Bank of Sri Lanka

normalise in the period ahead. This would help improve the external current account balance sustainably, thereby facilitating the buildup of GOR in the period ahead. The gradual buildup of GOR and stabilisation of the exchange rate, the receipt of additional financing from development partners, along with the successful implementation of the IMF-EFF supported programme, and the completion of the debt restructuring process in the near term are expected to bolster investor confidence and improve the country's credit ratings, thereby further strengthening the stability of the external sector in the period ahead.

5

5.2 Current Account Balance

The external current account deficit narrowed in 2022, compared to 2021, with a significant contraction in the merchandise trade deficit, recovery in trade in services, a slight moderation in the primary income account deficit despite a contraction in the surplus in the secondary income account. The trade deficit contracted sharply during 2022 with the expansion of earnings from merchandise exports and compression of expenditure on merchandise imports, which mainly reflected the impact of moderation of economic activity and policy measures to curtail imports amidst the severe BOP pressures. The increase in exports earnings, which benefited from the depreciation of the Sri Lanka rupee against the US dollar, was primarily reflected in categories such as garments, machinery and mechanical appliances, and gems, diamonds and jewellery. Meanwhile, merchandise imports recorded a notable reduction driven by a sizable contraction in consumer goods and investment goods, while importation of intermediate goods remained at similar levels, compared to the previous year. The reduction in imports was primarily due to several measures introduced by the Government and the Central Bank to prioritise essential imports amidst the unprecedented shortage of foreign currency liquidity in the banking system, as well as the reduction in import demand associated with the contraction of economic activity and increase in import costs due to the sharp depreciation of exchange rate. Concurrently, the surplus in the services account recorded an increase, mainly due to the recovery in earnings from tourism, as domestic supply side disruptions faded away, and global travel activity picked up significantly with the easing of pandemic related concerns. However, all other sectors in the services account, including air and sea freight transportation, and services inflows to the IT/BPO sector remained significantly subdued, compared to the previous year. The primary income account deficit marginally moderated compared to the previous year, due to higher interest income to the banking sector as a result of increased international interest rates and foreign asset positions of banks, despite a marginal increase in outflows from the primary income account. Meanwhile, due to significantly high migration of Sri Lankan workers in the latter part of 2022 and the resultant large remittance inflows, workers' remittances, which were the main contributor to the secondary income account, revived in the second half of

Table 5.2
Current and Capital Account

US$ million

Item	2021 (a)			2022 (b)		
	Credit	Debit	Net	Credit	Debit	Net
Goods and Services	**14,974**	**21,526**	**-6,552**	**16,169**	**19,244**	**-3,075**
Goods	**12,499**	**20,637**	**-8,139**	**13,106**	**18,291**	**-5,185**
General Merchandise	12,499	20,636	-8,138	13,106	18,289	-5,183
Non-monetary Gold	-	1	-1	-	2	-2
Services	**2,475**	**889**	**1,586**	**3,062**	**953**	**2,110**
Transport	608	256	352	676	333	343
Sea Transport	450	150	300	410	137	272
Freight	450	150	300	410	137	272
Air Transport	158	106	52	266	195	71
Passenger	108	89	19	221	180	41
Freight	50	17	33	46	15	30
Travel (c)	507	239	268	1,136	244	893
Construction	10	11	-1	9	11	-2
Insurance and Pension Services	20	37	-17	19	36	-18
Financial Services	95	102	-7	92	96	-5
Telecommunication and Computer Services	1,201	171	1,030	1,097	161	936
Telecommunications	32	31	2	31	28	3
Computer Services	1,168	140	1,028	1,066	133	933
Other Business Services	16	17	-1	15	16	-1
Government Goods and Services n.i.e.	19	57	-38	18	56	-38
Primary Income	**116**	**2,075**	**-1,959**	**249**	**2,124**	**-1,874**
Compensation of Employees	30	74	-43	30	69	-39
Investment Income	86	2,002	-1,916	220	2,055	-1,836
Direct Investment	16	567	-551	15	532	-517
Dividends	12	278	-266	12	418	-407
Reinvested Earnings	4	289	-285	3	114	-111
Portfolio Investment	-	830	-830	-	784	-784
Equity	-	25	-25	-	29	-29
Interest	-	805	-805	-	755	-755
Short Term	-	...	...	-	1	-1
Long Term	-	805	-805	-	754	-754
Other Investment	43	605	-562	200	738	-538
Reserve Assets	27	-	27	5	-	5
Secondary Income	**5,498**	**270**	**5,228**	**3,793**	**296**	**3,496**
General Government	6	-	6	3	-	3
Workers' Remittances	5,491	270	5,221	3,789	296	3,493
Current Account	**20,587**	**23,871**	**-3,284**	**20,211**	**21,664**	**-1,453**
Capital Account	**50**	**24**	**25**	**38**	**19**	**19**
Capital Transfers	50	24	25	38	19	19
General Government	11	-	11	6	-	6
Corporations and Households	38	24	14	32	19	13
Current and Capital Account	**20,637**	**23,896**	**-3,259**	**20,249**	**21,682**	**-1,433**

(a) Revised
(b) Provisional
(c) Passenger services provided to non-residents are included in transport services.

Source: Central Bank of Sri Lanka

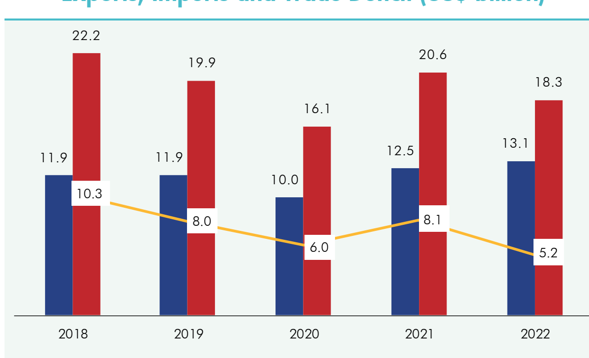
2022, but remained low, compared to 2021. Overall, the current account deficit contracted to US dollars 1,453 million in 2022 (1.9 per cent of GDP), compared to US dollars 3,284 million (3.7 per cent of GDP) in 2021.

5.2.1 Merchandise Trade Account

Trade Balance

The lowest merchandise trade deficit since 2010 was recorded in 2022, contributing mainly to the decline in the current account deficit for 2022. This reduction in the trade deficit to US dollars 5,185 million in 2022 from US dollars 8,139 million in 2021 was due to both the significant decrease in expenditure on merchandise imports and the notable growth in earnings from merchandise exports. The decline in import expenditure during 2022 was a result of multiple factors, including the significant forex liquidity constraints in the domestic forex market; impact of the sharp depreciation of the Sri Lanka rupee against the US dollar; subdued activity and aggregate demand conditions amidst the large decline in credit to the private sector, reflecting the high interest rates and deterioration of real income amidst the acceleration of inflation; and administrative measures to prioritise imports due to BOP pressures. The notable growth in export earnings was supported by the significant depreciation of the exchange rate that increased rupee income for exporters; prioritisation of the import of inputs for export industries; high commodity prices in the global market; high demand for major export items, such as garments during the first half of the year; and administrative

Figure 5.3
Exports, Imports and Trade Deficit (US$ billion)



Sources: Sri Lanka Customs
Central Bank of Sri Lanka

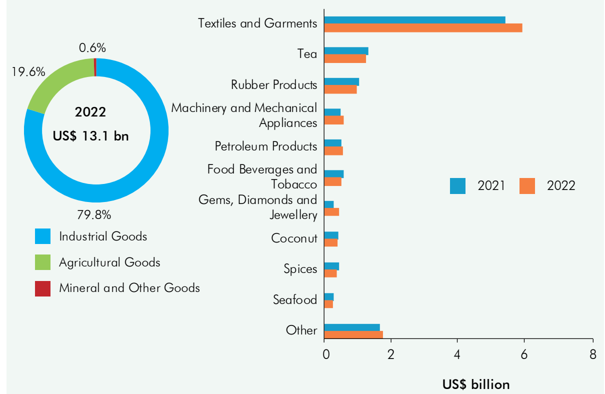
measures to streamline certain export procedures. As a percentage of GDP, the trade deficit contracted to 6.7 per cent in 2022, compared to 9.2 per cent in 2021.

Export and Import Performance, Terms of Trade and Direction of Trade

Export Performance

Despite heightened global and domestic challenges, merchandise exports recorded a notable increase and surpassed US dollars 13 billion during 2022 supported mainly by the favourable exchange rate, priority given for export industries when sourcing imported inputs and the rise of global commodity prices. Accordingly, earnings from merchandise exports reached US dollars 13,106 million in 2022, compared to US dollars 12,499 million in 2021, recording a growth of 4.9 per cent. An increase in the earnings of both industrial and mineral exports contributed to this improvement, while agricultural exports declined. The notable depreciation of the exchange rate and the higher demand in the global market, especially for garments during most of 2022, the significant improvement in exports of gems, diamonds and jewellery, supported by efforts to streamline and strengthen the procedures relating to the export of gems, and exports of machinery and mechanical appliances were the major contributors to this increase in industrial exports. A moderation of export earnings was observed from September 2022 across major export sectors amidst slowing global demand due to subdued global activity, particularly in major export markets of Sri Lanka. As evident in the movements of export indices, the increase in both volumes and prices contributed to the increase in the overall export earnings. As a percentage of GDP, export earnings improved to 17.0 per cent in 2022, compared to 14.1 per cent in 2021.

Figure 5.4
Composition of Exports



Sources: Sri Lanka Customs
Central Bank of Sri Lanka

Earnings from industrial exports, the major contributor with a share of about 80 per cent of total merchandise exports, grew by 7.9 per cent to US dollars 10,465 million in 2022, compared to US dollars 9,702 million in 2021. Textiles and garments exports continued to be the dominant export earner, accounting for more than 45 per cent of total exports, despite the moderation of earnings towards the latter part of 2022. Earnings from exports of gems, diamonds, and jewellery; and machinery and mechanical appliances (mainly machinery and equipment parts) also recorded a notable improvement in 2022. Earnings from petroleum product exports increased, reflecting the impact of price effect due to high crude oil prices, while the volume of bunker and aviation fuel recorded a marginal decline. Earnings from rubber products declined in 2022 remaining below the level of US dollars 1 billion in 2021, due to the lower demand for household rubber gloves amidst the diminishing of COVID-19 risks. A decline was also recorded in exports of food, beverages, and tobacco (mainly animal or vegetable fats and oils) during 2022.

Agricultural exports registered a decline in earnings resulting mainly from the lagged effect of inadequate fertiliser availability, with an overall contraction of 5.9 per cent in 2022, compared to 2021. Earnings from tea exports declined due to the larger drop in volumes, despite the increase in prices on average. The lower export earnings recorded by spices were driven both by lower volumes (mainly pepper and cloves) and lower prices (cinnamon). The decline in earnings from coconut-related products was due to lower kernel export prices. However, earnings from minor agricultural products recorded a notable increase during 2022, reflecting the impact of higher export volumes of certain products. The increase of areca nuts exports to India under the free trade agreement and sesame seeds led this growth in the minor agricultural products sector.

Mineral exports increased by 12.3 per cent to US dollars 50 million in 2022, compared to the previous year. Earnings from exports of titanium ores mainly contributed to this improvement, while almost all other subsectors under mineral exports declined during 2022. Sri Lanka's mineral exports accounted for a small share of 0.4 per cent of total exports in 2022.

Import Performance

Expenditure on merchandise imports declined notably despite higher global oil prices, reflecting the impact of the dearth of foreign exchange amidst significant BOP stresses, subdued demand conditions, significant depreciation of the exchange rate, and administrative measures to prioritise imports, among others. Expenditure on imports declined by 11.4 per cent to

Table 5.3
Composition of Exports

Category	2021		2022` (a)		Change in Value US$ million	Y-o-Y Change %	Contribution to Change %
	Value US$ million	Share %	Value US$ million	Share %			
Agricultural Exports	**2,729.5**	**21.8**	**2,568.0**	**19.6**	**-161.5**	**-5.9**	**-26.6**
Tea	1,324.4	10.6	1,258.8	9.6	-65.6	-5.0	-10.8
Coconut	425.2	3.4	400.3	3.1	-25.0	-5.9	-4.1
Spices	454.8	3.6	368.7	2.8	-86.0	-18.9	-14.2
Seafood	274.1	2.2	269.0	2.1	-5.1	-1.8	-0.8
Minor Agricultural Products	148.8	1.2	178.8	1.4	30.0	20.2	4.9
Rubber	42.2	0.3	41.4	0.3	-0.8	-1.8	-0.1
Vegetables	28.5	0.2	26.7	0.2	-1.9	-6.6	-0.3
Unmanufactured Tobacco	31.6	0.3	24.4	0.2	-7.2	-22.8	-1.2
Industrial Exports	**9,702.0**	**77.6**	**10,465.3**	**79.8**	**763.3**	**7.9**	**125.6**
Textiles and Garments	5,435.1	43.5	5,952.0	45.4	516.9	9.5	85.0
Rubber Products	1,050.4	8.4	977.0	7.5	-73.4	-7.0	-12.1
Machinery and Mechanical Appliances	500.9	4.0	580.9	4.4	80.1	16.0	13.2
Petroleum Products	506.4	4.1	568.0	4.3	61.6	12.2	10.1
Food, Beverages and Tobacco	586.9	4.7	519.5	4.0	-67.4	-11.5	-11.1
Gems, Diamonds and Jewellery	276.7	2.2	450.6	3.4	173.9	62.8	28.6
Chemical Products	223.2	1.8	223.5	1.7	0.3	0.1	0.1
Base Metals and Articles	156.4	1.3	176.7	1.3	20.3	13.0	3.3
Animal Fodder	149.4	1.2	170.5	1.3	21.1	14.1	3.5
Wood and Paper Products	129.9	1.0	136.9	1.0	7.0	5.4	1.2
Other Industrial Exports	686.8	5.5	709.6	5.4	22.8	3.3	3.8
Mineral Exports	**44.5**	**0.4**	**50.0**	**0.4**	**5.5**	**12.3**	**0.9**
Unclassified Exports	**22.6**	**0.2**	**23.2**	**0.2**	**0.6**	**2.6**	**0.1**
Total Exports (b) (c)	**12,498.6**	**100.0**	**13,106.4**	**100.0**	**607.9**	**4.9**	**100.0**

(a) Provisional
(b) Excludes re-exports
(c) Adjusted for lags and other factors of recording

Sources: Ceylon Petroleum Corporation and Other Exporters of Petroleum
National Gem and Jewellery Authority
Sri Lanka Customs
Central Bank of Sri Lanka

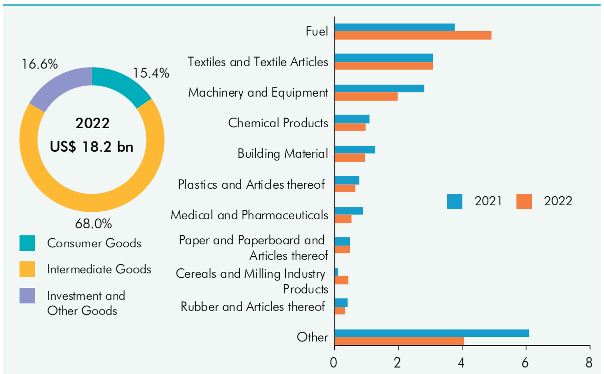
5

US dollars 18,291 million in 2022 from US dollars 20,637 million in 2021, driven by the significant decline in imports of investment goods and non-food consumer goods. The overall decline in import expenditure reflected the liquidity constraints that prevailed in the domestic foreign exchange market, subdued economic activities, increased domestic prices of imported goods led by the sharp depreciation of the exchange rate, administrative measures implemented by the Government (including the temporary suspension of certain imports, suspension of certain imports under various payment terms, imposition of import license requirements, increase of import taxes on certain goods, etc.) and the Central Bank (including margin deposit requirements on certain goods and maintaining tighter monetary and credit conditions). However, prices of major commodities in the global markets, including petroleum oil, remained elevated during 2022, resulting in higher expenditure on intermediate goods, led mainly by fuel imports. Import expenditure of consumer goods showed a rising trend towards the latter part of 2022, indicating the impact of the relaxation of certain restrictions by the Government and seasonal demand for imports. The decline in import expenditure in 2022 over the last year was reflected in lower volumes, despite the increase in unit value, as indicated by the movements in indices of import volume and unit value. However, as a percentage of GDP, import expenditure increased marginally to 23.7 per cent in 2022, compared to 23.3 per cent in 2021.

Import expenditure on food and beverages declined at a slower pace of 3.5 per cent in 2022, compared to 2021, resulting from lower import volumes despite higher global food commodity prices. Imports of most main food categories recorded a decline in 2022, compared to the previous year, except cereals and milling industry products (such as rice and wheat flour), beverages and spices. The considerable decline in the import volume of coconut oil in 2022 and the higher statistical base in 2021 led to the decline in expenditure on oils and fats imports in 2022. Further, expenditure on dairy products, lentils and sugar also declined in 2022 driven by lower import volumes, despite increases in average import prices. In contrast, expenditure on rice imports increased significantly in 2022 by about 300 per cent over 2021, as a result of the drop in the domestic production of rice since it was hampered by fertiliser shortages.

Expenditure on non-food consumer goods declined notably by 44.8 per cent, year-on-year, to US dollars 1,205 million, led by the considerable decline in the expenditure on medical and pharmaceuticals and telecommunication devices. Expenditure on medical and pharmaceuticals declined significantly, partly reflecting the statistical base effect of higher expenditure on COVID-19 vaccines in 2021. Further, imports of all other subsectors under the non-food consumer goods category declined in 2022, compared to 2021, reflecting the impact of measures taken to restrict non-urgent imports by the Government and the Central Bank and the acute shortage of foreign exchange that was prevalent in the banking system during 2022, among others.

Figure 5.5
Composition of Imports



Sources: Sri Lanka Customs
Central Bank of Sri Lanka

Expenditure on investment goods imports declined by 32.1 per cent, year-on-year, to US dollars 3,030 million in 2022, recording the lowest expenditure since 2010. The moderation of economic activity, and measures introduced to prioritise imports amidst significant foreign exchange liquidity constraints, mainly contributed to this decline in investment goods imports. Significant declines in import expenditure in all three main categories of investment goods, namely machinery and equipment, building material, and transport equipment, and most of their subcategories, were observed in 2022, compared to 2021. The decline in expenditure on machinery and equipment was led by office machines (mainly computers), machinery and equipment parts, and telecommunication devices (mainly transmission apparatus), while expenditure on electric motors and generating sets increased. Iron and steel, cement, and mineral products (mainly asbestos) caused building material imports to decline, while agricultural tractors, tankers and bowsers and railway equipment drove the decline in expenditure on transport equipment.

Import expenditure on intermediate goods, which accounted for 68 per cent of total imports, increased marginally due to higher expenditure on fuel, despite broad-based decline of most subcategories, arising from lower economic activity. Accordingly, expenditure on intermediate goods increased by 1.1 per cent to

Table 5.4
Composition of Imports

Category	2021 Value US$ million	2021 Share %	2022 (a) Value US$ million	2022 (a) Share %	Change in Value US$ million	Y-o-Y Change %	Contribution to Change %
Consumer Goods	**3,848.7**	**18.6**	**2,813.0**	**15.4**	**-1,035.7**	**-26.9**	**44.1**
Food and Beverages	1,666.5	8.1	1,607.9	8.8	-58.6	-3.5	2.5
Rice	73.0	0.4	292.5	1.6	219.4	300.5	-9.4
Sugar and Confectionery	288.8	1.4	257.8	1.4	-31.0	-10.7	1.3
Dairy Products	317.7	1.5	225.3	1.2	-92.4	-29.1	3.9
Lentils	143.0	0.7	116.9	0.6	-26.1	-18.2	1.1
Coconut Oil	166.1	0.8	27.2	0.1	-138.9	-83.6	5.9
Other	677.8	3.3	688.3	3.8	10.4	1.5	-0.4
Non-Food Consumer Goods	2,182.2	10.6	1,205.1	6.6	-977.1	-44.8	41.6
Medical and Pharmaceuticals	882.5	4.3	533.4	2.9	-349.1	-39.6	14.9
Clothing and accessories	221.3	1.1	215.6	1.2	-5.7	-2.6	0.2
Household and furniture items	161.2	0.8	116.3	0.6	-45.0	-27.9	1.9
Home Appliances	257.1	1.2	85.5	0.5	-171.6	-66.7	7.3
Telecommunication Devices	382.9	1.9	69.0	0.4	-313.9	-82.0	13.4
Other	277.2	1.3	185.4	1.0	-91.8	-33.1	3.9
Intermediate Goods	**12,308.9**	**59.6**	**12,438.8**	**68.0**	**129.8**	**1.1**	**-5.5**
Fuel	3,742.9	18.1	4,896.8	26.8	1,153.9	30.8	-49.2
Textiles and Textile Articles	3,066.9	14.9	3,065.2	16.8	-1.8	-0.1	0.1
Chemical Products	1,074.4	5.2	966.2	5.3	-108.2	-10.1	4.6
Plastics and Articles thereof	765.7	3.7	650.8	3.6	-114.9	-15.0	4.9
Paper and Paperboard and Articles thereof	468.9	2.3	465.9	2.5	-3.0	-0.6	0.1
Rubber and Articles thereof	400.7	1.9	334.7	1.8	-66.0	-16.5	2.8
Base Metals	866.4	4.2	323.2	1.8	-543.3	-62.7	23.2
Other Intermediate Goods	1,922.9	9.3	1,736.0	9.5	-186.9	-9.7	8.0
Investment Goods	**4,462.7**	**21.6**	**3,030.5**	**16.6**	**-1,432.2**	**-32.1**	**61.0**
Machinery and Equipment	2,809.5	13.6	1,969.0	10.8	-840.5	-29.9	35.8
Building Materials	1,248.9	6.1	926.3	5.1	-322.5	-25.8	13.7
Transport Equipment	398.5	1.9	132.1	0.7	-266.4	-66.8	11.4
Other Investment Goods	5.8	0.03	3.0	0.02	-2.8	-47.9	0.1
Unclassified Imports	**17.1**	**0.1**	**8.8**	**0.05**	**-8.3**	**-48.8**	**0.4**
Total Imports (b)(c)	**20,637.4**	**100.0**	**18,291.0**	**100.0**	**-2,346.4**	**-11.4**	**100.0**

(a) Provisional
(b) Excludes re-imports
(c) Adjusted for lags and other factors of recording

Sources: Ceylon Petroleum Corporation
Lanka IOC PLC
Sri Lanka Customs
Central Bank of Sri Lanka

5

Table 5.5
Volume of Major Imports

MT '000

Item	2018	2019	2020	2021	2022 (a)
Refined Petroleum (b)	4,959	4,740	4,028	4,553	3,927
1st Quarter	1,382	1,199	1,249	1,378	1,184
2nd Quarter	1,207	1,206	678	1,008	935
3rd Quarter	1,317	1,211	1,123	865	853
4th Quarter	1,054	1,124	978	1,302	954
Wheat	1,297	1,159	1,404	1,307	583
1st Quarter	412	164	272	323	208
2nd Quarter	329	318	285	288	129
3rd Quarter	285	292	498	335	80
4th Quarter	271	385	348	360	167
Crude Oil (b)	1,674	1,842	1,667	1,182	649
1st Quarter	283	461	464	274	179
2nd Quarter	459	460	265	368	80
3rd Quarter	461	461	568	362	199
4th Quarter	471	460	370	178	191
Sugar	645	556	683	582	460
1st Quarter	205	140	193	293	119
2nd Quarter	166	153	108	140	68
3rd Quarter	119	100	209	14	131
4th Quarter	154	164	172	136	143
Fertiliser	861	707	952	412	363
1st Quarter	256	148	88	114	37
2nd Quarter	154	142	294	182	32
3rd Quarter	225	238	126	17	84
4th Quarter	226	179	444	98	210
Rice	249	24	16	147	783
1st Quarter	203	8	8	3	270
2nd Quarter	37	3	2	4	156
3rd Quarter	2	5	2	3	249
4th Quarter	7	8	4	137	108

(a) Provisional
(b) Adjusted

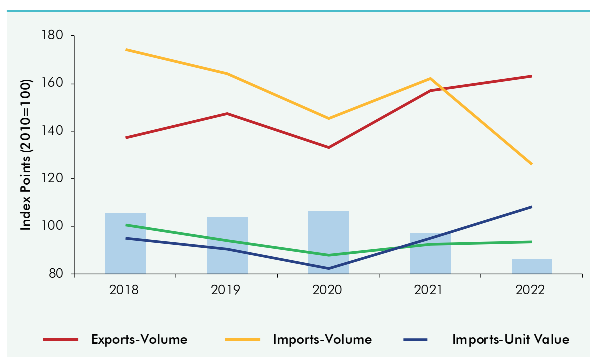
Sources: Ceylon Petroleum Corporation
Lanka IOC PLC
Sri Lanka Customs
Central Bank of Sri Lanka

US dollars 12,439 million in 2022 in comparison to 2021. Expenditure on fuel imports, the largest import item in the import basket, increased mainly due to the increase in import prices of all subsectors; crude oil, refined petroleum (including LP gas) and coal, although import volumes of all subsectors declined, compared to the previous year, reflecting the impact of demand management measures, such as fuel rationing and the cost reflective price adjustments. In line with the price movements in the international market, the average price of crude oil imports increased to US dollars 100.11 per barrel in 2022 from US dollars 68.86 per barrel in 2021. However, crude oil was imported intermittently, resulting in the bulk of the petroleum requirement of the country was fulfilled by importing refined petroleum in 2022. Expenditure on fertiliser imports exhibited a considerable increase in 2022 due to the increase in average import prices, despite low import volumes, compared to 2021. Meanwhile, import expenditure on textiles and textile articles, the second largest import item, broadly remained unchanged in 2022, compared to 2021. In contrast, import expenditure on most other subcategories under intermediate goods declined with base metals (mainly iron and steel) and wheat grain declining the most. As a result of the above, expenditure on non-fuel intermediate goods declined by 12.0 per cent in 2022, compared to 2021.

Terms of Trade

The terms of trade, which is the ratio of export prices to import prices, further deteriorated in 2022, as the import price index increased at a higher pace than the export price index. The increases in the price indices of all major categories of exports contributed to the increase in export prices, while higher prices of the importation of intermediate goods, led by higher global fuel prices, mainly accounted for the increase in the overall import price index. As such, the terms of trade deteriorated by 11.6 per cent to 86.1 index points in 2022, compared to 2021, indicating that the amount of imports that can be purchased from a unit of exports has declined.

Figure 5.6
Terms of Trade and Trade Indices



Source: Central Bank of Sri Lanka

Table 5.6
Trade Indices (a)

2010 = 100

Category	Value Index 2021	Value Index 2022 (b)	Value Index Y-o-Y Change %	Volume Index 2021	Volume Index 2022 (b)	Volume Index Y-o-Y Change %	Unit Value Index 2021	Unit Value Index 2022 (b)	Unit Value Index Y-o-Y Change %
EXPORTS									
Agricultural Exports	**118.4**	**111.4**	**-5.9**	**101.1**	**93.1**	**-7.9**	**117.1**	**119.7**	**2.1**
Tea	92.0	87.4	-5.0	87.2	76.6	-12.1	105.5	114.1	8.2
Rubber	24.3	23.9	-1.8	29.3	29.2	-0.01	83.2	81.7	-1.8
Coconut	256.7	241.7	-5.9	188.1	193.5	2.9	136.5	124.9	-8.5
Spices	219.5	178.0	-18.9	146.9	116.2	-20.9	149.4	153.1	2.5
Minor Agricultural Products	208.3	250.3	20.2	188.4	240.9	27.9	110.6	103.9	-6.0
Industrial Exports	**159.3**	**171.8**	**7.9**	**183.2**	**194.9**	**6.4**	**86.9**	**88.1**	**1.4**
Textiles and Garments	162.1	177.5	9.5	140.6	144.6	2.8	115.3	122.7	6.5
Petroleum Products	192.4	215.8	12.2	282.8	189.2	-33.1	68.0	114.1	67.7
Rubber Products	188.7	175.5	-7.0	112.6	106.6	-5.3	167.6	164.7	-1.7
Mineral Exports	**183.7**	**206.3**	**12.3**	**111.4**	**114.2**	**2.5**	**164.8**	**180.7**	**9.6**
Total Exports	**145.0**	**152.0**	**4.9**	**156.9**	**163.0**	**3.9**	**92.4**	**93.3**	**0.9**
IMPORTS									
Consumer Goods	**155.5**	**113.7**	**-26.9**	**127.8**	**104.8**	**-18.0**	**121.7**	**108.5**	**-10.9**
Food and Beverages	126.0	121.5	-3.5	125.5	133.4	6.3	100.4	91.1	-9.2
Non-Food Consumer Goods	189.5	104.7	-44.8	130.4	71.9	-44.8	145.3	145.5	0.1
Intermediate Goods	**152.9**	**154.5**	**1.1**	**152.0**	**121.1**	**-20.3**	**100.6**	**127.6**	**26.9**
Fuel	123.1	161.0	30.8	134.2	106.8	-20.4	91.7	150.7	64.3
Fertiliser	65.9	114.9	74.4	74.5	68.1	-8.6	88.4	168.6	90.7
Chemical Products	206.6	185.8	-10.1	177.3	142.8	-19.4	116.6	130.1	11.6
Wheat and Maize	157.6	114.2	-27.5	134.2	90.4	-32.7	117.4	126.4	7.6
Textiles and Textile Articles	169.5	169.4	-0.1	153.9	142.3	-7.6	110.2	119.1	8.1
Plastics and Articles thereof	181.0	153.9	-15.0	169.5	135.3	-20.2	106.8	113.7	6.5
Diamonds, Precious Stones and Metals	38.0	54.0	41.9	41.9	46.0	9.9	90.9	117.3	29.1
Investment Goods	**162.0**	**110.0**	**-32.1**	**230.6**	**162.8**	**-29.4**	**70.3**	**67.6**	**-3.8**
Building Materials	152.0	112.7	-25.8	154.5	99.2	-35.8	98.3	113.7	15.6
Transport Equipment	67.3	22.3	-66.8	46.7	19.8	-57.6	144.2	112.7	-21.9
Machinery and Equipment	210.1	147.2	-29.9	359.0	265.4	-26.1	58.5	55.5	-5.2
Other Investment Goods	174.5	90.8	-47.9	142.6	77.7	-45.5	122.3	116.9	-4.4
Total Imports	**153.9**	**136.4**	**-11.4**	**162.2**	**126.0**	**-22.4**	**94.9**	**108.3**	**14.1**
Terms of Trade							**97.4**	**86.1**	**-11.6**

(a) In terms of US dollars
(b) Provisional

Source: Central Bank of Sri Lanka

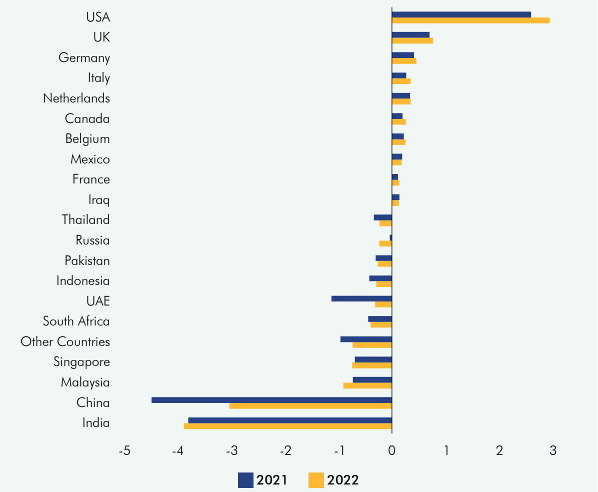
5

The trade volumes contributed significantly to the overall behaviour of export earnings and import expenditure during 2022. The volume indices for all main categories of exports improved, except for agricultural exports, while the import volume indices for all main categories declined, resulting in a decline in the overall expenditure during 2022.

Direction of Trade

Sri Lanka's major trading partners broadly remained unchanged, although total trade (both exports and imports) with some major trading partners declined in 2022, when compared to 2021. In value terms, India continued to be the major trading partner of Sri Lanka in 2022, followed by the USA and China, all of which together contributed to around 41 per cent of the total trade of Sri Lanka. Total trade with India exceeded US dollars 5.5 billion, mainly with the utilisation of credit lines provided by India to support imports and higher exports under the free trade agreement, while trade with the USA and China exceeded US dollars 3.5 billion each. Total trade with China declined significantly in 2022, driven by a notable reduction in imports from China partly due to supply chain disruptions in China due to COVID-19 and lower imports of consumer and investment goods amidst import restrictions and subdued economic activity.

Figure 5.7
Countrywise Trade Balances (US$ billion)



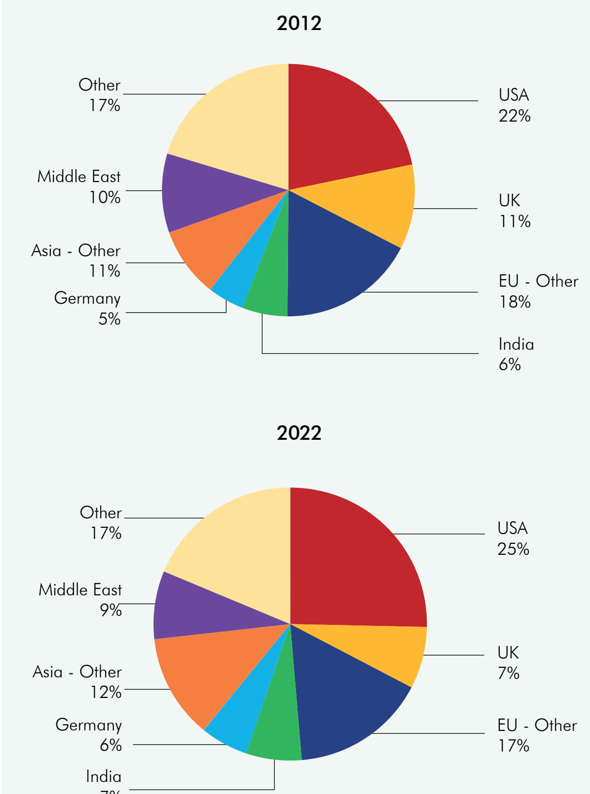
Source: Central Bank of Sri Lanka

The UK, Malaysia, Germany, the UAE and Singapore, were the other major trading partners,accounting for more than US dollars 1 billion each in 2022. The geo-political tensions between Russia and Ukraine resulted in the total trade with Ukraine halving in 2022, compared to 2021, although total trade with Russia increased during 2022, led by higher fuel imports. The major country-wise trade balances in 2022 remained almost unchanged, where notable trade surpluses were recorded with the USA, the UK, Germany, Italy, Netherlands, and Canada, while significant trade deficits were recorded with India, China, Malaysia, and Singapore. The direction of trade remains broadly the same over a decade and Sri Lanka may need to explore diversification to new markets for exports, particularly in the region.

The USA and European countries remained the major destinations for Sri Lankan exports, accounting for nearly half of the total export earnings in 2022. The USA continued to be the single largest buyer of Sri Lankan exports, with more than US dollars 3.3 billion worth of exports, which accounted for 25.3 per cent of total exports, followed by the UK (7.3 per cent), India (6.6 per cent), Germany (5.7 per cent) and Italy (4.9 per cent). In line with increased exports, earnings from most destinations, including the top ten export destinations of Sri Lanka (except Germany, Belgium and Australia), increased during 2022. The USA continued to be the single largest garment export destination for Sri Lanka, with a share of 42 per cent of total garment exports in 2022. In addition to garments, export earnings from the USA were mainly on account of rubber products, machinery and mechanical appliances, and chemical products. Garments, rubber products, machinery and mechanical appliances, and food, beverages and tobacco were major products exported to the UK. Exports to India were dominated by animal fodder, spices, textiles, and minor agricultural products. The EU, the most dominant region for Sri Lankan exports, accounted for about 23 per cent of total exports in 2022, including about 30 per cent of total garment exports. Other major items exported to the EU were rubber products, food, beverages and tobacco, and tea, most of which were exported under the EU Generalised System of Preferences Plus (GSP+) Scheme. In 2022, the Middle East and the Commonwealth of Independent States (CIS), led by Russia were the main export destinations for tea, jointly contributing to about 59 per cent of tea exports.

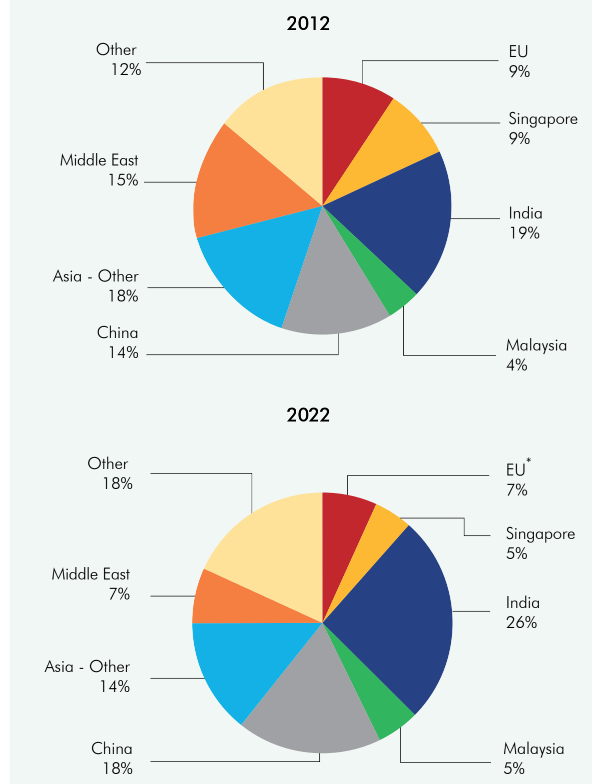
Asian countries continued to be the major source of Sri Lankan imports, despite overall imports from most of those countries declining in 2022, compared to 2021. India regained its position as the largest source of imports since 2018, recording more than US dollars 4.7 billion in imports in 2022, with a share of about 25.9 per cent of total imports, partly supported by imports made under the credit lines offered by India. Accordingly, import expenditure from India has marginally increased by 2.4 per cent, mainly with imports of petroleum products and rice. Meanwhile, China, the second largest, and Malaysia, the third largest, import sourcing countries in 2022, accounting for shares of

Figure 5.8
Exports by Destination



Source: Sri Lanka Customs

Figure 5.9
Imports by Origin



* Excluding the UK

Source: Sri Lanka Customs

about 18.0 per cent and 5.3 per cent, respectively. Expenditure on most major import items from China, such as machinery and equipment, medical and pharmaceuticals (COVID-19 vaccines), telecommunication devices (mainly mobile phones), and building materials declined in 2022. The major imports from Malaysia were petroleum products, chemical products, and food preparations, while petroleum products contributed to around 65 percent of the total imports from Malaysia. As import sources, Singapore and the UAE were at the fourth and fifth positions in 2022. The major import item from both Singapore and the UAE was petroleum products in 2022. In line with the decline in total import expenditure during 2022, expenditure related to most import sources, including the top ten import sources of Sri Lanka (except India, Malaysia, Russia and Singapore) recorded a decline.

External Trade Policies, Developments and Institutional Support

Despite the country registering the worst economic downturn ever in 2022, the merchandise trade sector remained buoyant supported by the efforts of all the stakeholders. The continuation of the implementation of the National Export Strategy (NES) 2018-2022 and the provisioning of institutional support helped the export sector to remain resilient, while the depreciation of the exchange rate largely benefitted the export sector. Certain policy measures, such as repatriation and conversion requirements of export proceeds, import restrictions, and imposition of margin requirements, among others, were warranted, despite being an inconvenience to the tradeable sector. This was in order to safeguard the interests of all stakeholders of the economy amidst the worst BOP crisis witnessed in the post-independence economy. Measures were taken to resume negotiations of free trade agreements in an expeditious manner, while initiating measures to improve on terms of existing trade agreements. The Government announced several trade supportive policies in the Budget 2023, such as establishing an International Trade Office to deal with all trade negotiations and an Agency for External Trade and Investment to coordinate with institutions engaged in external trade and reintroducing a Trade Adjustment Programme. There is a strong necessity for consistent and comprehensive policies to support exports and substitution of selected imports and their timely implementation as the economy recovers in the period ahead. The global economy rebounded from the negative spillovers of COVID-19 during the first half of 2022, although the Russia-Ukraine war, high inflation, tight monetary policy, and recessionary fears in global markets kept the second half of 2022 more challenging, with downside risks to the macroeconomic outlook. As a result, the World Trade Organization (WTO) estimated that the growth of world merchandise trade volume would have been limited to 3.5 per cent in 2022 (a decline from 9.7 per cent recorded in 2021) and that it would moderate to 1.0 per cent in 2023. Against this backdrop, aggressive policies to tackle issues in the near term are important, while providing more sustained policy interventions by authorities, in a consistent manner, to overcome future domestic and global challenges over the medium to long term. Priority should be given to alleviate supply side constraints, such as high production costs, while strengthening the export orientation, supported by Research and Development (R&D) led innovation to harness potential global value chains and product networks, improving value addition, rationalising the institutional framework, removing bureaucratic bottlenecks and creating a trade and investor friendly environment.

Significant trade policy measures were initiated to manage import expenditure in 2022. Considering the high import expenditure during the first quarter of 2022 and the unprecedented pressure on the exchange rate, the Government and the Central Bank initiated several measures to curtail the demand for imports during the first half of 2022. Accordingly, the Government imposed measures, such as licensing requirements, and an increase in import taxes from March 2022, while the Central Bank allowed more flexibility in the exchange rate in March 2022 and imposed a 100 per cent cash margin requirement on selected imports from May 2022. In view of curtailing import payments made through informal channels and the resultant pressures on the exchange rate emanating from parallel markets, the Imports and Exports Control Department introduced restrictions on the use of trade payment terms, including open accounts, consignment accounts, Documents against Acceptance (DA), and Documents against Payment (DP). Accordingly, with effect from 20 May 2022, importing on open account/consignment account payment terms was allowed for direct and indirect exporters only, while the use of DA and DP terms for imports, excluding those used for exports, were required to be made only under prior arrangements with the licensed banks. This helped manage the availability of foreign exchange within the banking system for the most essential imports. However, considering the possible shortages of essential food and raw materials in the domestic market due to such limitations, several relaxations were introduced for imports of selected essential food items and raw materials required for domestic production since June 2022. In view of the further build-up of pressure on the availability of foreign exchange and the exchange rate, the Government imposed further import restrictions by way of temporary suspensions, mainly targeting selected consumer and investment goods, in August 2022, although several relaxations were

BOX 7

Monitoring of Export Proceeds Repatriations and Conversions

Introduction

The external sector of Sri Lanka experienced heightened vulnerabilities with the decline in foreign exchange inflows due to unprecedented challenges in recent years, amidst the outbreak of the COVID-19 pandemic and adverse developments in the global economy. The current account deficit widened due to the increased imports led by the normalisation of economic activities, moderation in tourism earnings and slowdown in workers' remittances. Downgrading of the sovereign credit ratings of the country constrained the access to global capital markets despite high debt servicing requirements, further aggravating the situation. In view of mounting imbalances in the external sector due to the lack of foreign exchange inflows, several measures were taken to improve foreign currency liquidity in the domestic foreign exchange market and to replenish international reserves. These included establishing rules (Table B 7.1) mandating repatriation of export proceeds to the country within 180 days and conversion of such receipts into Sri Lanka rupees under the provisions of the Monetary Law Act No. 58 of 1949 (MLA) in 2021, with a view to effectively enforcing such requirements.

Evolution of Policies Related to Export Proceeds Repatriation and Conversion

For any economy, exports form a very important source of foreign exchange inflows that help build buffers against external shocks. Having identified the importance of the exports, successive Governments in Sri Lanka have put in place policies that are conducive for building a vibrant exports sector. However, to obtain the maximum benefits of the export sector, a country needs to ensure that export proceeds are repatriated so that there would be no strain on the Balance of Payments. The requirement to repatriate export proceeds into Sri Lanka was initially imposed during 1973 under the repealed Exchange Control Act No. 24 of 1953 (ECA) and continued until 1993. This requirement for repatriation and surrender was liberalised subsequent to accepting Article VIII of the International Monetary Fund (IMF) Articles of Agreement in 1994, as part of further liberalisation of current account transactions and continuation of the country's stabilisation programme. Accordingly, exporters were permitted to repatriate export proceeds and hold those in rupee or foreign currency accounts in Sri Lanka or retain them in foreign currency accounts in a bank abroad. However, the repatriation requirement was re-introduced in April 2016 under the ECA, requiring every exporter of goods to repatriate proceeds to Sri Lanka initially within 90 days from the date of exportation. This was subsequently extended up to 120 days. With the enactment of the Foreign Exchange Act, No. 12 of 2017 (FEA) these regulations were re-issued and in October 2019 further extended to 180 days. It is pertinent to mention that some of the regional economies which could be considered economic peers of Sri Lanka also have similar policies in place to ensure that such economies optimise the receipt of export proceeds (Table B 7.2).

How Export Proceeds Help to Build Reserves

Once export proceeds are repatriated, part of the proceeds will be utilised to meet obligations in foreign currency, such as authorized payments. If the balance is sold to Authorised Dealers[1] (ADs) in foreign exchange, such proceeds will be added to the domestic foreign exchange market increasing the liquidity. Similarly, inflows from other foreign exchange sources which are sold to ADs, such as workers' remittances, tourism earnings and foreign investments flows will also contribute to increase the domestic market liquidity. The banking system needs to accommodate various foreign exchange requirements of its customers, both of current and capital nature, for which the foreign currency so purchased will be utilised. The Central Bank of Sri Lanka (CBSL) may build up its reserves by purchasing foreign exchange from the domestic foreign exchange market. The major advantage of export proceeds is that they are non-debt creating inflows which exert no strain on the Balance of Payments.

Existing Rules on Repatriation of Export Proceeds into Sri Lanka issued under the MLA (Rules)

Considering the anticipated serious decline in the international reserves which could lead to an imminent threat to the stability of the Sri Lanka rupee, the CBSL took immediate measures to preserve the position by adopting necessary policies including introduction of Rules on export proceeds repatriation and conversion requirements under the provisions of the MLA (Table B 7.1).

In terms of the prevailing Rules (Table B 7.1), it is mandatory to receive the export proceeds into Sri Lanka,

1 A bank licensed under the Banking Act, No. 30 of 1988.

Table B 7.1
The Rules Issued in terms of the Provisions of the MLA

Name of the Rule	Key features
Repatriation of Export Proceeds into Sri Lanka Rules No. 1 of 2021, issued on 18.02.2021	• Receive the export proceeds in Sri Lanka in respect of all goods exported within 180 days from the date of shipment. • Convert 25% of the total exports proceeds into Sri Lanka rupees, immediately upon the receipt of such export proceeds into Sri Lanka.
Repatriation of Export Proceeds into Sri Lanka Rules No. 2 of 2021 (Amendment to Rules No.01), issued on 09.03.2021	• Convert 25% of the total exports proceeds received in Sri Lanka into Sri Lanka rupees within 14 days of receipt.
Repatriation of Export Proceeds into Sri Lanka Rules No. 3 of 2021 (Amendment to Rules No. 02), issued on 09.04.2021	• Convert 10% of the total exports proceeds received in Sri Lanka into Sri Lanka rupees within 30 days of receipt.
Repatriation of Export Proceeds into Sri Lanka Rules No. 4 of 2021 (Amendment to Rules No. 3), issued on 28.05.2021	• Convert not less than 25% of the total export proceeds received in Sri Lanka, into Sri Lanka rupees within 30 days of receipt.
Repatriation of Export Proceeds into Sri Lanka Rules No. 5 of 2021, (Rescinded previous Rules No. 1, 2, 3 & 4), issued on 28.10.2021	• Mandatorily receive the export proceeds in Sri Lanka, in respect of all goods exported or services provided outside Sri Lanka, within 180 days from the date of shipment or provisioning of services. • Mandatorily convert the residual of the export proceeds received in Sri Lanka into Sri Lanka rupees, upon utilising such proceeds only in respect of the authorised payments.
Repatriation of Export Proceeds into Sri Lanka Rules No. 1 of 2022 (Rescinded Rules No. 5 of 2021), issued on 11.03.2022	• Mandatorily receive the export proceeds in Sri Lanka, in respect of all goods exported or services provided outside Sri Lanka, within 180 days from the date of shipment or provisioning of services. • Mandatorily convert residual of the export proceeds received in Sri Lanka into Sri Lanka rupees, upon utilising such proceeds only in respect of the authorised payments. • Permitted payments to local suppliers and exemptions for exporters that are Strategic Development Projects.
Repatriation of Export Proceeds into Sri Lanka Rules No. 2 of 2022 (Amendment to Rules No. 1 of 2022), issued on 12.08.2022	• Remove the requirement to convert export proceeds repatriated into Sri Lanka in relation to service exports.

in respect of all goods exported or services provided outside Sri Lanka, within 180 days from the date of shipment or provisioning of services. Further, every exporter of goods who receives export proceeds in Sri Lanka, is required to mandatorily convert[2] the residual of the export proceeds received in Sri Lanka, into Sri Lanka rupees upon utilising such proceeds only in respect of the authorised payments, which could provide an immediate impact on the liquidity of the domestic exchange market whilst allowing for foreign currency requirements of the business. These authorized payments are, outward remittances for current transactions related to the particular export, withdrawal in foreign currency notes or transfer of funds for travel purposes, debt servicing expenses and repayments of permitted borrowings, payments for investments in Sri Lanka Development Bonds, authorised payments to local suppliers, payment of dividends to non-resident investors, salaries to expatriate employees and one month commitments related to export of goods and services.

Considering the developments in the domestic foreign exchange market, conversion requirements imposed by these Rules are reviewed and revised continuously.

2 Upon utilisation of export proceeds for permitted authorised payments, exporters convert export proceeds for their local currency requirements of day-to-day business activities and any residues of the export proceeds shall be mandatorily converted on or before the seventh (7th) day of the following month.

As per the requirements of the Rules, ADs are required to strictly monitor the monthly receipts of export proceeds, ensure that the conversion is within the stipulated period of repatriation and verify that the authorised payments are related to the particular export of goods/services. At present, periodic information related to repatriation of export proceeds and the conversions are reported manually to the CBSL and Department of Foreign Exchange (DFE) inspects and examines the records provided by ADs to ensure full and strict compliance with the provisions of the Rules. The Rules empower the Director of the DFE to monitor and initiate actions against any non-compliance by exporters and ADs.

Accordingly, all ADs must submit the following monthly information on export proceeds repatriation and its conversion to DFE on or before the 15th of the next month.

- Export proceeds repatriations in respect of all export of goods and/or services provided outside Sri Lanka received within 180 days from the date of shipment or provisioning of services.
- Conversions of foreign currency to Sri Lanka rupee out of the export proceeds received upon utilising such proceeds for allowed authorised payments.
- Details of authorised payments out of goods export proceeds repatriation within 180 days.

5

Table B 7.2
Main Forex Regulations Related to Exports Proceeds Repatriation and Conversion in Selected Countries

Country	Repatriation Requirement	Applicability to Goods/Services Exports	Conversion Requirement
India	Within 15 months	Both goods and services	Foreign exchange earners are allowed to credit 100% of their foreign exchange earnings to a foreign currency account. The accruals in the account should be converted into rupees on or before the last day of the succeeding month after adjusting for utilisation of the balances for approved purposes or forward commitments.
Bangladesh	Within 7 months	Both goods and services	85% of exports of ready-made garments and other goods with high import content and 40% of the proceeds from exports of other merchandise and services exports.
Pakistan	Within 6 months	Both goods and services	85%-98% of exports proceeds of goods and 65% of services exports proceeds.
Malaysia	Within 24 months if the amount of export proceeds does not exceed RM 200,000 and within 6 months in other cases	Goods only	Since April 2021, exporters may manage the conversion of export proceeds according to their foreign currency cash flow needs. Prior to 2018, 75% of exports proceeds were to be converted.
Thailand	Within 1 year	Both goods and services	Export proceeds of an amount equivalent to US dollars 1 million or above must be repatriated and converted into Thai baht immediately after payment is received.
Turkey	Within 180 days	Goods only	At least 80% of the export proceeds need to be sold to a bank.

Sources: 2020 Annual Report on Exchange Arrangements and Exchange Restrictions of the IMF and Respective Central Bank websites

- Permitted payments in foreign currency out of the export proceeds to the local suppliers and their conversions.
- Export proceeds not repatriated within 180 days from the date of shipment or provisioning of services, in line with the requirement of the Rules on export proceeds repatriation.
- Export proceeds repatriations received exceeding 180 days from the date of shipment or provisioning of services and conversions.

Monitoring of compliance with the Rules

Based on the information reported by ADs on monthly basis, the CBSL requests exporters who do not repatriate export proceeds within 180 days from the date of shipment or provisioning of services to provide explanations for same. Based on the responses, the possibility of initiating legal actions for exporters who do not comply with the Rules on requirement of repatriation of export proceeds into Sri Lanka, is considered by the CBSL. Further, the utilisation of export proceeds for authorised payments are strictly monitored and inquiries are made from ADs in order to ensure ADs permit payments which are authorised by the Rules.

In addition to the monthly monitoring of the repatriation and conversion of export proceeds, the CBSL carries out investigations on selected exporters on their repatriation and conversion of export proceeds by requesting information directly from such exporters. This has enabled the CBSL to verify the information reported by ADs and has facilitated streamlining of data reporting. Special investigations on foreign currency loans granted by ADs, payments to local suppliers, conversions by local suppliers etc. are also carried out by the CBSL to ensure that the utilisation and conversion of export proceeds are in line with the Rules.

Further, the CBSL conducts one-on-one meetings with exporters, sector wise meetings, meetings with compliance officers and discussions with other stakeholders of the export sector to enhance awareness on the prevailing Rules and ensure strict compliance with the same.

Timely imposition of Rules together with the subsequent stringent monitoring has resulted in a notable improvement in the repatriation of export proceeds since October 2021 (Figure B 7.1). Merchandise goods and service exports repatriation during the year 2022 amounted to US dollars 17,755.8 million, where the repatriation of goods amounted to US dollars 14,595.7 million and repatriation of services exports amounted to US dollars 3,160.1 million. The export value of merchandise goods and services for the year 2022 was US dollars 16,168.8 million.

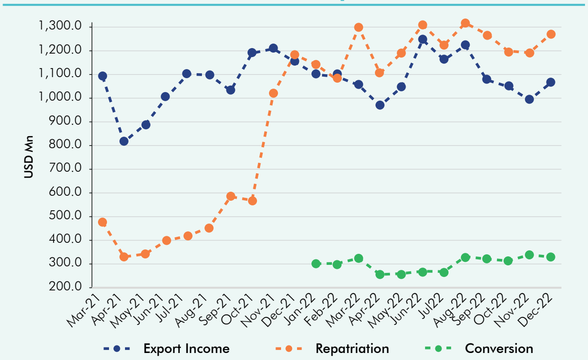
Meanwhile, monthly total conversions relating to exports of merchandise goods and services as a percentage of export proceeds repatriated have ranged between 20.6%-28.5% during the year 2022 (Figure B 7.2 and Figure B 7.3). Attentive surveillance on the utilisation of export proceeds for authorised payments enabled a gradual pickup in conversion of repatriations during the latter part of the year. The total converted value of merchandise goods and service exports amounted to US dollars 4,220.2 million for the year 2022, comprising conversion of merchandise goods amounting to US dollars 3,614.6 million and conversion of service exports amounting to US dollars 605.6 million.

Export Proceeds Monitoring System (EPMS)

In view of the need to efficiently monitor the repatriation of export proceeds, the Export Proceeds Monitoring System (EPMS), an IT based automated monitoring system, was launched in June 2022. This system facilitates monitoring of repatriation of export proceeds within the prescribed time period and conversion of export proceeds into the local currency in order to achieve the objective of introducing the Rules. The system is expected to enhance the efficiency of reporting and monitoring by minimising manual data processing and duplication of data entry at various stages.

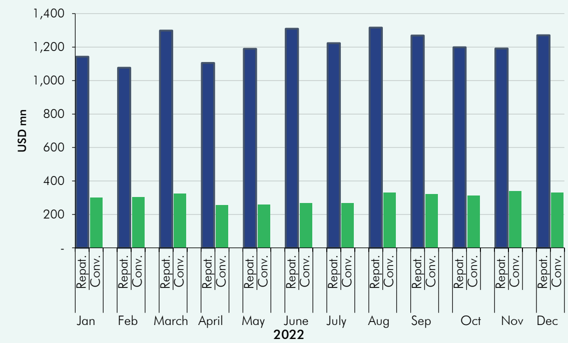
The CBSL, Sri Lanka Customs (SLC) and ADs are the three main participants in the system. SLC shares details

Figure B 7.1
Trends in Exports, Repatriation and Conversion of Merchandise Goods Export Proceeds



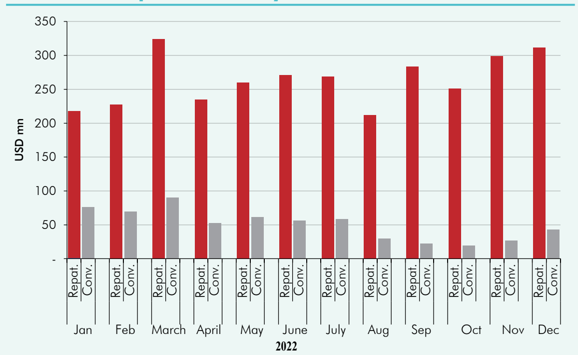
Sources: Central Bank of Sri Lanka & Sri Lanka Customs

Figure B 7.2
Trends in Repatriation and Conversion of Merchandise Goods: January - December 2022



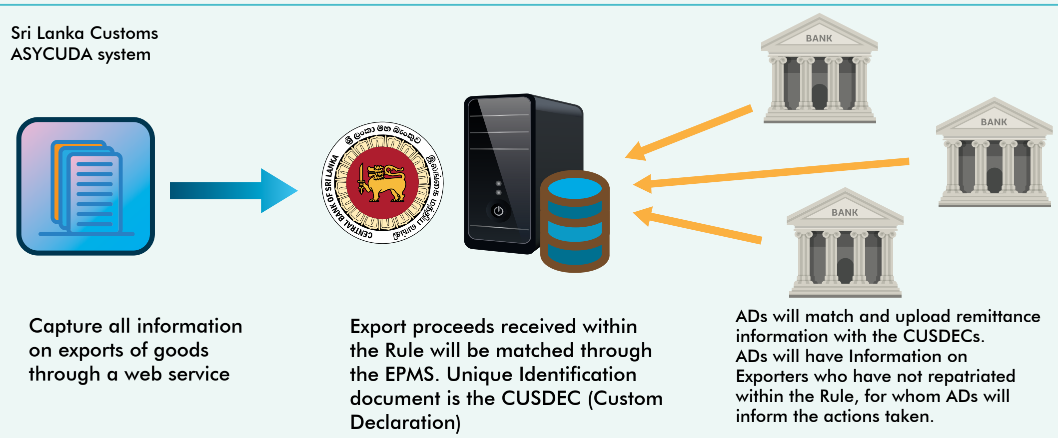
Source: Central Bank of Sri Lanka

Figure B 7.3
Trends in Repatriation and Conversion of Service Exports: January - December 2022



Source: Central Bank of Sri Lanka

Figure B 7.4: Overview of the EPMS



Source: Central Bank of Sri Lanka

of all exports which are shipped out of the country in the EPMS whilst ADs report details of repatriations and conversions linked to such exports to the EPMS (Figure B 7.4). Accordingly, more accurate details of exports will be available in the future. The system will facilitate detecting where proceeds have not been repatriated within the stipulated time period and taking actions against non-compliant exporters.

The EPMS has continued to evolve since its introduction in June 2022 and certain technical lapses, such as those in the process of uploading by ADs of export remittance data based on CUSDECs[3], have been successfully resolved. At present, IT solutions which link the exporters with ADs are being developed to simplify the provision of information. Accordingly, barriers in receiving and matching information on the export receipts against the CUSDECs, especially on open account transactions, will be minimised. Hence, this system will improve the efficiency of the export proceeds repatriation monitoring mechanism and streamline the repatriation of export proceeds into the country, through a national system linking related information of the CBSL, SLC and ADs in the future.

The success of monitoring and follow up of export transactions via this system can only be achieved by effective collaboration of all the stakeholders of the system. Hence, it is the responsibility of all participants of this system to work towards the success of this national effort.

3 Custom Declaration

References

1. The Central Bank of Sri Lanka Annual Reports
2. Rules on Repatriation of Export proceeds into Sri Lanka

made in September 2022, thereby reducing the effectiveness of such restrictions. However, these measures were paramount in managing stresses in the external sector during 2022.

Several measures were taken to improve institutional support to the external sector during 2022. The Export Development Board (EDB) continued with the implementation of the NES 2018-2022, while addressing bottlenecks that hamper faster implementation, such as lack of coordination among stakeholders and lack of authority rested with the EDB to implement NES action plan activities. Accordingly, the implementation process of the NES is expected to be revisited to introduce necessary adjustments that would align with current developments, to achieve its desired goals by 2027. The EDB continued web-based and physical promotional activities and provided trade information and market intelligence for exporters. Trade chambers also contributed towards export promotion by recognising exporters and conducting Export Awards ceremonies, while helping to link-up the public and private sector stakeholders in policymaking and grievance handling. The Sri Lanka Standards Institution (SLSI) continued the process of formulating and upgrading national standards. In this regard, the SLSI published 204 standards in 2022 and revised 128 standards. In order to improve the quality assurance of imported items, the SLSI registered several overseas manufacturers and laboratories, while new testing facilities and test methods were developed for various products. Amidst the challenging market environment, the Sri Lanka Export Credit Insurance Corporation (SLECIC) reported about Rs.70 billion worth of insured businesses, partly supported by the depreciated exchange rate. Since the National Single Window platform is not yet available, Sri Lanka Customs (SLC) continued its measures to integrate about 15 governmental regulatory agencies into the ASYCUDA system to facilitate trade. Meanwhile, SLC streamlined its activities further, in relation to the implementation of the Trade Facilitation Agreement (TFA) of the WTO in Sri Lanka that showed more than 70 per cent overall progress by January 2023. The Presidential Commission of Inquiry, which was appointed in February 2021, to investigate and report on matters related to SLC, handed over their final report to the President in June 2022. The report includes recommendations on how the administrative and operational processes of SLC can be effectively and efficiently carried out in the division of responsibilities.

Sri Lanka's exports under Generalised System of Preference (GSP) schemes remained unchanged in 2022, although overall earnings from exports improved over 2021. Sri Lanka continued to benefit from GSP schemes in 2022, while the facility offered by the EU, the USA and the UK contributed to approximately 72 per cent of total preferential exports of Sri Lanka. Sri Lanka is expected to benefit from the current EU GSP+ scheme until its validity period by end of 2023. Meanwhile, the new EU GSP+ 10-year cycle is expected to be in effect from 01 January 2024 to 31 December 2033 with six new International Conventions, in addition to the existing 27 conventions, in the current cycle. Sri Lanka is in a position to reapply for GSP+ as it has already ratified the six new conventions. Sri Lanka as an EU GSP+ beneficiary, continued to enjoy the same duty-free access to the UK under the UK's Global Tariffs (UKGT) during 2021 and UK GSP scheme in 2022. However, the UK introduced its new GSP Scheme "Developing Countries Trading Scheme (DCTS)" in August 2022, which will come into effect in 2023. Sri Lanka is expected to benefit from the DCTS Enhanced Preferences Scheme for 3 years from its launch. In addition, Sri Lanka continued to benefit from GSP schemes offered by several other countries, such as the Russian Federation, Australia, Canada, Turkey, Switzerland, Norway, and New Zealand, although their contribution to exports remained relatively low. The narrow export base of Sri Lanka and the low product coverage of GSP schemes prevent Sri Lanka from harnessing the full benefit of such GSP schemes.

5

The performance of bilateral and regional trade agreements remained unsatisfactory in 2022, while several initiatives were taken to resume trade negotiations that remained at a standstill since 2018. Under bilateral Free Trade Agreements (FTAs), Sri Lanka benefitted from the Indo-Sri Lanka Free Trade Agreement (ISFTA) and the Pakistan-Sri Lanka Free Trade Agreement (PSFTA). Exports through FTAs with India and Pakistan remained high in 2022, as a share of total exports to these countries, at 65 per cent and 73 per cent, respectively. Meanwhile, imports under ISFTA and PSFTA continued to be low during the year, with shares of only 3 per cent (US dollars 119 million) and 4 per cent (US dollars 13 million) of total imports from India and Pakistan, respectively. Meanwhile, the Department of Commerce (DOC) updated the Non-Tariff Measures dossier in 2022, incorporating suggestions proposed by stakeholders with regard to ISFTA implementation related issues, including either the removal of the current quota restriction of 8 million pieces on apparel or to further increase the quota. Trade under regional trade agreements declined during 2022 with a moderation of trade under the Asia Pacific Trade Agreement (APTA), due to lower exports to China, and the Global System of Trade Preferences (GSTP), due to lower cinnamon exports to Mexico. Exports under the SAARC Preferential Trade Arrangement (SAPTA) continued to remain at marginal levels, while exports under the South Asian Free Trade Area (SAFTA) declined during 2022. These factors highlight on the importance of strengthening trade ties with regional peers to effectively execute existing regional agreements, while essentially exploring possible entry to new and broader regional partnerships, such as Regional Comprehensive Economic Partnership (RCEP). Renewed measures were taken during 2022 to expedite the review process of the Singapore-Sri Lanka Free Trade Agreement (SLSFTA), which failed to take off

Table 5.7
Exports under Preferential Trade Agreements of Sri Lanka

Preferential Agreement	2021 Value (US$ million)	2022 (a) Value (US$ million)	Growth (%)	Share (%)	Major Export Products (Ordered by size of export)
Generalised System of Preferences (GSP)	4,312.6	4,314.7	0.05	81.4	Garments, Rubber products, Tea, Food beverages & tobacco, Machinery and mechanical appliances, Seafood,
o/w EU (including GSP+) (b)	2,402.1	2,440.3	1.6	46.0	Garments, Rubber products, Tea, Food beverages & tobacco, Seafood, Machinery and mechanical appliances
USA (c)	677.8	719.0	6.1	13.6	Garments, Rubber products, Chemical products, Food beverages & tobacco, Coconut kernel products
UK	680.7	659.0	-3.2	12.4	Garments, Machinery and mechanical appliances, Rubber products, Food beverages & tobacco, Seafood, Tea
Russian Federation (d)	132.9	125.7	-5.4	2.4	Tea, Rubber products, Coconut non-kernel products, Garments, Seafood
Australia	103.5	97.0	-6.2	1.8	Garments, Rubber products, Food beverages & tobacco, Tea, Coconut non-kernel products
Canada	87.9	86.2	-2.0	1.6	Garments, Rubber products, Coconut kernel products, Food beverages & tobacco, Seafood
Japan	87.6	80.7	-7.9	1.5	Tea, Seafood, Food beverages & tobacco, Coconut non-kernel products, Chemical products
Turkey	74.1	45.3	-38.8	0.9	Tea, Rubber products, Garments, Chemical products, Coconut Kernel products
Other GSP	66.1	61.6	-6.8	1.2	
Indo-Sri Lanka Free Trade Agreement (ISFTA) Implemented in 2000	525.8	561.5	6.8	10.6	Animal fodder, Minor agricultural products, Food beverages & tobacco, Garments, Wood and paper products
Asia-Pacific Trade Agreement (APTA) Implemented in 1975 (e)	238.6	228.4	-4.3	4.3	Garments, Tea, Chemical products, Coconut non-kernel products, Rubber products
Global System of Trade Preferences (GSTP) Implemented in 1989	91.8	62.5	-32.0	1.2	Spices, Animal fodder, Coconut non-kernel / kernel products, Base metals and articles
Pakistan-Sri Lanka Free Trade Agreement (PSFTA) Implemented in 2005	62.3	56.6	-9.0	1.1	Minor agricultural products, Coconut kernel products, Natural rubber, Coconut non-kernel products, Rubber products
South Asian Free Trade Area (SAFTA) Implemented in 2006	101.6	75.2	-26.0	1.4	Spices, Base metals and articles, Coconut kernel products, Garments, Textiles, Chemical products
SAARC Preferential Trading Arrangement (SAPTA) Implemented in 1995	1.4	1.5	1.9	0.03	Rubber products, Tea, Natural Rubber, Food beverages & tobacco
Total Exports under Preferential Agreements	**5,334.2**	**5,300.4**	**-0.6**	**100.0**	
As a Share of Sri Lanka's Total Exports	**42.7**	**40.4**			

(a) Provisional
(b) The EU-GSP provides preferential access for 66 per cent of the tariff lines on imported goods to the EU, while the EU-GSP+ provides zero duty access to the same tariff lines on imported goods to the EU.
(c) Shows GSP eligible exports since the US-GSP expired in 2020 and expected to re-authorised with retroactive basis.
(d) Includes Russia, Belarus and Kazakhstan
(e) Earlier known as the Bangkok Agreement (1975)

Sources: Department of Commerce
Sri Lanka Customs

since entering into the agreement in 2018. Accordingly, review meetings with Singapore are planned in early 2023 to discuss the amendments identified, with a view to implementing the SLSFTA at the earliest. Lack of consistency in trade policy changes, non-tariff barriers and lack of product diversification continue to hinder the potential of existing bilateral and regional trade agreements. Meanwhile, discussions on resuming negotiations on comprehensive bilateral trade agreements with Thailand (Sri Lanka-Thailand Free Trade Agreement-SLTFTA), China (China-Sri Lanka Free Trade Agreement-CSFTA) and India (Economic and Technology Cooperation Agreement-ETCA) continued in 2022. The third round of negotiations with Thailand was completed in January 2023 while further rounds of negotiations with China and India are expected to commence during the first half of 2023. A new National Trade Negotiation Committee (NTNC) has been appointed to carry out FTA negotiations in 2022. In addition, discussions are underway to negotiate and enter into preferential trade agreements (PTAs) with Indonesia and Bangladesh, where future trade potential is high, especially in the apparel sector. The 12th Ministerial Conference of the WTO was successfully concluded in Geneva in June 2022, securing multilaterally negotiated outcomes in the form of the "Geneva Package", which contained a series of decisions on fisheries subsidies, WTO response to emergencies and WTO reforms, among others.

5.2.2 Services Account

The trade in services account recorded a higher surplus in 2022, compared to the previous year, mainly due to the increase in earnings from tourism. However, inflows to almost all other sub sectors in the services account, including freight transportation services and IT/BPO services, recorded significant contractions. As a result of these developments, the surplus in the services account amounted to US dollars 2,110 million in 2022, compared to US dollars 1,586 million in 2021.

Travel and Tourism

Tourist arrivals in Sri Lanka recorded a steady recovery in 2022 despite significant headwinds due to unprecedented disruptions amidst heightened social tensions, fuel shortages and power outages, and travel advisories, among others. This recovery was supported mainly by high global vaccination rates, increased air connectivity, along with the lifting of travel restrictions issued by major source countries. The notable exchange rate depreciation and tourism promotion campaigns also helped position Sri Lanka as an attractive destination for travel. Tourist arrivals, which started to gather momentum from late 2021, peaked in March 2022, before being hampered by heightened social tensions, shortage of fuel for domestic travel, and resultant negative publicity and travel advisories issued by major source markets. In addition to domestic factors, the Russia-Ukraine war that caused spillovers to European countries, and the outward travel ban in China also negatively impacted the recovery in tourist arrivals. However, some countries reduced the severity of their travel advisories with the dissipation of social tensions, resulting in a gradual pickup of arrivals since October 2022, and increased momentum towards early 2023. The resumption of operations of many international airlines, charter flights and cruise tourism as well as the global promotions in many countries also contributed to the revival of tourist arrivals. Accordingly, tourist arrivals recorded a significant increase during 2022 to 719,978 from 194,495 in 2021. However, Sri Lanka has witnessed over 2 million tourist arrivals per year on average prior to the outbreak of the COVID-19 pandemic. This implies that Sri Lanka's tourism industry must recover faster to reach its maximum potential.

Europe continued to be the largest source region of tourists arrivals to Sri Lanka, while India remained the largest single country of tourist arrivals. According to the Sri Lanka Tourism Development Authority (SLTDA), tourist arrivals from across all major regions increased in 2022, compared to 2021, with Europe accounting for 60 per cent of total tourist arrivals, amounting to 432,226 tourists. Asia and the Pacific region recorded the second highest arrivals with 213,537 tourists in 2022, accounting for about 30 per cent of total tourist arrivals. In terms of tourist arrivals by countries, India was the leading tourist source market in 2022, with 123,004 arrivals, accounting for about 17 per cent of total arrivals, followed by Russia (91,272), the UK (85,187), Germany (55,542), and France (35,482), collectively accounting for 54 per cent of total arrivals.

Earnings from tourism in 2022 recorded a significant increase, compared to 2021. Earnings from tourism amounted to US dollars 1,136 million, compared to US dollars 507 million in 2021, recording an impressive annual growth of 124.2 per cent. However, earnings from tourism were far below the US dollars 4.4 billion level achieved in 2018. Based on revised estimates of the SLTDA on tourist spending and duration of stay, the average spending per tourist in 2022 amounted to US dollars 169.0 per day, compared to US dollars 172.6 per day in 2021. Meanwhile, the average duration of stay by a tourist was estimated at 9.3 days in 2022, in comparison to 15.1 days in 2021. The higher duration of stay in 2021 was mainly due to the quarantine requirements amidst COVID-19 related restrictions. Meanwhile, outward travel by Sri Lankan residents remained at moderate levels in 2022, compared to 2021, reflecting the impact of significant shortage of foreign exchange in the country.

Investment in the tourism sector was hampered in 2022, with delays and down-scaling of projects by investors, as well as disturbances in the construction industry amidst the challenging economic conditions. SLTDA received 42 new investment projects relating to the tourism sector for approval, amounting to US dollars 68 million in 2022, with a capacity of 1,054 rooms. There was a decline of 48.8 per cent in the investment value of the projects received in 2022, compared to 2021. In terms of approved projects, the SLTDA granted approvals for 20 tourism-related projects in 2022, amounting to US dollars 36 million, with a collective capacity of 363 rooms. In addition, 95 hotel projects with 5,424 rooms are currently under construction at different levels of completion, while 25 hotel projects with a capacity of 1,623 rooms are expected to be completed by 2023. Accordingly, graded establishments,

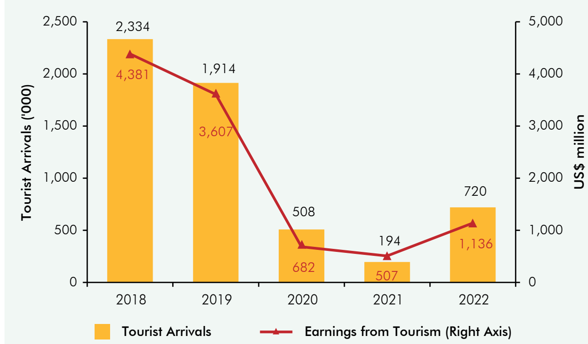
Table 5.8
Performance of the Tourism Sector

	2018	2019	2020	2021	2022(a)	Y-o-Y (%) 2022
Tourist Arrivals (No.)	2,333,796	1,913,702	507,704	194,495	719,978	270.2
Arrivals by Purpose of Visit						
Pleasure	1,979,819	1,592,212	444,328	157,766	428,838	171.8
Business	71,255	70,068	13,946	3,956	30,057	659.8
Other	282,722	251,422	49,430	32,773	261,083	696.6
Tourist Guest Nights ('000)	25,205	19,902	4,315	2,937	6,725	129.0
Room Occupancy Rate (%)	72.8	57.1	15.0	18.6	30.4	63.4
Gross Tourist Receipts (Rs. million)	711,961	646,362	124,189	101,903	338,052	231.7
Per Capita Tourist Receipts (Rs.)	305,066	337,755	244,609	523,936	469,531	-10.4
Total Employment (No.) (b)	388,487	402,607	347,751	357,927	386,236	7.9
Direct Employment	169,003	173,592	175,990	177,476	190,521	7.4
Indirect Employment	219,484	229,015	171,761	180,451	195,715	8.5

(a) Provisional
(b) Estimates

Sources: Sri Lanka Tourism Development Authority
Central Bank of Sri Lanka

Figure 5.10
Tourist Arrivals and Earnings from Tourism



Source: Sri Lanka Tourism Development Authority

amounting to 469, with a total capacity of 25,597 rooms, and supplementary establishments, including boutique villas, bungalows, guest houses, heritage bungalows, heritage homes, home stay units, rented apartments and rented homes amounting to 3,360, with a total capacity of 22,523 rooms, were in operation in 2022.

Several policy initiatives and various promotional programmes were carried out to attract more tourists in 2022. Sri Lanka's tourism will need to explore fresh niche markets and undertake a strong marketing campaign to take advantage of the thriving global tourism industry. Towards achieving this, SLTDA published a Strategic Plan for Sri Lanka Tourism 2022-2025 in April 2022, identifying issues, opportunities and actions proposed, in order to set an agenda for the recovery and future resilience of the tourism sector. In support of easing the arrival procedure, Sri Lanka resumed the visa-on-arrival facility for international travellers in January 2022 for most countries. Several measures were taken by SLTDA to address hardship faced by various tourism service providers amidst the pandemic and the economic crisis, such as extending the validity period of all types of tourist guide licenses, waiving off the annual registration fee of all tourist establishments and individuals listed under the SLTDA, etc. Preventive measures, which were

5

in place during the COVID-19 pandemic period, were removed in December 2022, including the requirement to produce a negative PCR test report on arrival. Meanwhile, the total number of SLTDA registered accommodations increased in 2022. The Central Bank requested the banks to provide concessions to affected borrowers in all economic sectors, including tourism, on a case-by-case basis, for a six month period till December 2022, taking into account the extraordinary macroeconomic circumstances that prevailed during 2022. The Sri Lanka Tourism Promotion Bureau (SLTPB) organised familiarisation campaigns for travel agents from Russia and Ukraine in order to attract more tourists from the CIS region, while such initiatives were expanded to the Middle Eastern region as well. Further, various promotional campaigns, such as film tourism and the hosting of road-shows were held, targeting the Indian market. Meanwhile, the Sri Lanka Wellness Tourism Stakeholder Project was officially launched in February 2022. Also, some of the hotels and resorts in Sri Lanka have received accolades in various forums within the global tourism industry. Accordingly, Sri Lanka was accredited as 'One of the world's safest countries to travel' by Worldpackers and 'Best destinations to travel in 2023' by Independent Magazine–UK. Moreover, Sri Lanka was recognised among the 'Top 20 places to travel' by Readers' Choice awards by Conde Nast Traveller during 2022. The tourism sector faced a multitude of challenges; an increase in electricity tariffs; taxes and levies pertaining to businesses engaging in the tourism sector; lack of skilled staff in hotels due to high labour migration; reduction in arrivals from the CIS region due to the Russia-Ukraine war; high inflation, globally and domestically; looming global recessionary conditions, and the current economic crisis in Sri Lanka. Overcoming these challenges would require combined efforts by all stakeholders of the industry.

Transport, Telecommunications, Computer and Information Services and Other Services

Most of the subsectors in the services account of the BOP, including transport, computer and information services, etc., recorded notable under performance in 2022. Both sea and air freight transport subsectors recorded negative growth. All indicators under sea freight, including cargo handling, transshipments, ship arrivals and container handling recorded negative growth during the year, particularly declining in the second half of 2022. The key reason for this decline was the gradual decline in merchandise imports after the first quarter of 2022. The depreciation of the Sri Lanka rupee, severe foreign currency liquidity shortage in the domestic foreign exchange market that led to the announcement of a debt standstill, import restrictions imposed by the Government as well as the moderation of global trade during the second half of 2022 exacerbated the aforementioned decline. This, combined with gradually decreasing international freight rates from record high prices in 2020 and 2021, due to COVID-19 disruptions, resulted in earnings from both sea and air freight transport services, declining during 2022, compared to the previous year. However, both inflows and outflows in the air passenger transport services recorded positive growth during the year, with increased tourist arrivals and the gradual resumption of Sri Lankan residents travelling abroad. Further, travel outflow remained at modest levels in 2022, similar to that of the previous year. The Information Technology led Business Process Outsourcing (IT/BPO) sector faced significant challenges during 2022. The economic instability that prevailed within the country prompted many professionals in the sector to explore better opportunities beyond the country, resulting in a significant dearth of experienced professionals in the industry. Further, the mandatory conversion of proceeds of exports of services, which was in force for a short period during 2022, was also perceived by the industry as unfavourable. This situation was aggravated with a general slowdown in global outsourcing sources and layoffs in technical level employees. As a result of these adverse developments, the export of computer services recorded a negative growth in 2022, compared to 2021. Inflows to other services exports subsectors, including financial services, construction services, government services and other business services, also recorded negative growths during the year, coinciding with the decline in economic activities and economic instability that prevailed during the year.

5.2.3 Primary Income

The primary income account deficit recorded a marginal moderation in 2022, compared to 2021. The primary income account outflows reflected all interest payments, including those interest payments in arrears due to the temporary suspension of related government external debt servicing since mid-April 2022.[1] Accordingly, the primary income account deficit amounted to US dollars 1,874 million in 2022, compared to US dollars 1,959 million in 2021. There was a notable increase in outflows of dividends from foreign direct investment enterprises during the year, compared to the previous year. This was mainly due to some large FDI companies, listed in the CSE, declaring sizable dividends. However, reinvested earnings of FDI companies were lower in 2022 compared to the previous year. Meanwhile, coupon payments of portfolio investments, including arrears, declined marginally, with the outstanding liability of International Sovereign Bonds (ISBs) reducing, consequent to the repayment of an ISB in July 2021 and January 2022. However, there was a notable increase in interest payments on foreign loans, including arrears, with all sectors including the Government, banking sector and private corporations paying higher interest expenses. This high level of interest expenses may be possibly due to higher interest payments on variable interest rate loans with the increase in global interest rates as well as the increased risk premia faced by Sri Lankan banks and corporations due to the suspension of selected external debt servicing and the downgrade of the country's credit ratings. Meanwhile, the income from reserve assets declined with the notable decline in the gross official reserves during 2022.

1 Based on the accrual principle of accounting, as per the 6th edition of the Balance of Payments and International Investment Position Manual (BPM6)

5.2.4 Secondary Income

The surplus in the secondary income account declined in 2022, compared to the previous year, despite a significant revival in workers' remittances in the second half of 2022. Workers' remittances amounted to US dollars 3,789 million in 2022, compared to US dollars 5,491 million in 2021. This was a decline of 31 per cent in 2022, compared to 2021, limiting the surplus in the secondary income account to US dollars 3,496 million in 2022, compared to US dollars 5,228 million in 2021. Workers' remittances to the banking system remained subdued, particularly in the first half of the year, amidst the large differences in exchange rates offered by the banking system and money changers. The adjustment in the exchange rate in early March 2022, which resulted in a significant overshooting and subsequent gradual alignment of the exchange rates offered by banks with those outside the banking system helped revive workers' remittances channelled through the banking system. There was also a possibility of workers' remittances being used for financing imports in informal markets, as forex liquidity in the banking system dried up significantly. With the economy gradually stabilising towards the latter part of the year, and with greater stability in the exchange rate supported by policy measures of the Central Bank, the higher margins offered in parallel markets reduced to a bare minimum, and gradual use of banking channels for repatriation of workers' remittances resumed. Consequently, workers' remittances in the fourth quarter of 2022 were notably high, averaging around US dollars 400 million per month, compared to a monthly average of around US dollars 286 million during January-September 2022. The number of migrant workers departed for foreign employment who registered with the Sri Lanka Bureau of Foreign Employment (SLBFE) amounted to 311,056, which was a significant increase, compared to 122,264 in 2021 and 53,711 in 2020. Several policy measures were undertaken by the CBSL and the Government, encouraging migrant workers to use official channels to repatriate their remittances, including incentive schemes, while the banking sector also promoted the use of official channels for remitting money. The CBSL, in collaboration with the banking sector, Lanka Clear and other stakeholders, introduced a digital app 'SLRemit' to promote the digitalisation of repatriation of workers' remittances.

5.3 Capital Account Balance

Net inflows to the capital account remained subdued in 2022. Capital transfers to both the Government and private sector decreased in 2022, compared to the previous year with capital grants to the Government remaining modest. Accordingly, the capital account recorded a surplus of US dollars 19 million in 2022, compared to a surplus of US dollars 25 million recorded in 2021.

5.4 Financial Account

In the financial account of the BOP, net incurrence of liabilities increased notably, while net acquisition of financial assets recorded a modest increase during 2022. Transactions in the financial account in 2022 were mainly characterised by the temporary suspension of selected external debt service payments of the Government from mid-April 2022, reflecting the unprecedented depletion of usable GOR levels. With the suspension of these debt service payments, the country's sovereign ratings applicable for external borrowing were categorised as default, causing significant difficulties in attracting financial flows to the country. Prior to the debt suspension, a maturing ISB of US dollars 500 million was repaid in January 2022, while an international swap facility of US dollars 400 million from the Reserve Bank of India (RBI) was received. With the suspension of selected external debt servicing, securing financing became extremely difficult even for meeting the funds required for essential imports. The regional countries provided prompt assistance during this period, with several credit lines to import fuel, medicine, fertiliser, etc., while extending the repayment dates of bilateral credit lines and international swap liabilities. Consequently, the Government received around US dollars 2,391 million in foreign loans during 2022, which was the major inflow to the financial account. This comprised of emergency credit facilities as well as emergency assistance of multilateral agencies by diverting and repurposing the contracted funds for development projects towards emergency funding assistance.

Net incurrence of liabilities recorded an increase during 2022. Net incurrence of liabilities recorded a net increase of US dollars 2,030 million in 2022, compared to a net increase of US dollars 2,098 million in 2021. FDI flows, including foreign loans to direct investment enterprises (DIEs), recorded an improvement in 2022, compared to the previous year, albeit remaining well below the country's potential and FDI flows to regional peers. The main contribution to FDI came in the form of increased equity investments, which was partly attributable to some major companies listed in the CSE opting to invest their profits due to the inability to repatriate dividends abroad because of the dearth of foreign exchange in 2022. Further, there was a notable increase in shareholder advances and intercompany loans to companies registered with the Board of Investment (BOI) of Sri Lanka. Meanwhile, foreign loans inflows from unrelated parties to BOI companies also recorded an increase in 2022. As a result, FDI, including foreign loans, amounted to US dollars 1,181 million in 2022, compared to US dollars 779 million in 2021. Out of the total FDI, including loans, US dollars 1,076 million were for companies registered with the BOI. Further, FDI, excluding loans, amounted to US dollars 898 million in 2022, compared to US dollars 592 million in 2021. On a sector-wise basis, FDI inflows to BOI registered companies were mainly to telecommunications, manufacturing and property development, while FDI flows to CSE companies, not registered with the BOI, were mainly to logistics and fuel, gas and petroleum sectors. Further, FDI flows to the West Container Terminals in the Colombo Port also started to materialise in the latter part of 2022. FDI flows to the Colombo Port City and the Hambantota Port project are expected to materialise in the near term.

Portfolio investment, including equity investments by minority shareholders to the CSE and foreign investments in government securities, increased during the year, compared to a reduction in the previous year. Non-resident holdings of rupee

Table 5.9.A
Financial Account

US$ million

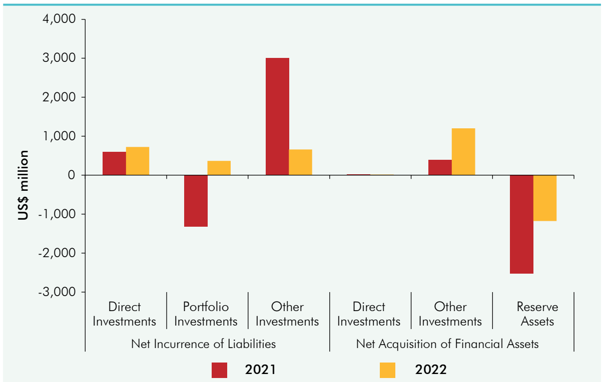
Item	2021 (a)		2022 (b)	
	Net Acquisition of Financial Assets	Net Incurrence of Liabilities	Net Acquisition of Financial Assets	Net Incurrence of Liabilities
Financial Account	**-2,113**	**2,098**	**84**	**2,030**
Direct Investment	**17**	**592**	**15**	**898**
Equity and Investment Fund Shares	13	312	11	289
Equity other than Reinvestment of Earnings	9	23	7	125
Reinvestment of Earnings	4	289	3	164
Debt Instruments	5	281	5	610
Portfolio Investment	**-**	**-1,547**	**-**	**355**
Equity and Investment Fund Shares	-	-232	-	137
Debt Securities	-	-1,315	-	218
General Government	-	-1,315	-	212
Short Term (Treasury Bills)	-	-2	-	30
Long Term	-	-1,313	-	183
Treasury Bonds	-	-25	-	21
Sri Lanka Development Bonds	-	-2	-	2
Sovereign Bonds	-	-1,285	-	159
Issuances	-	-	-	-
Maturities	-	-700	-	-391
Secondary Market Transactions	-	-586	-	-
Accrued Interest	-	-	-	551
Other Sectors	-	-	-	6
Long-term	-	-	-	6
Accrued Interest	-	-	-	6
Financial Derivatives	**-**	**-**	**-**	**-**
Other Investment	**387**	**3,053**	**1,302**	**776**
Currency and Deposits	306	4,016	514	272
Central Bank	-	1,375	-	403
Short Term	-	1	-	...
Long Term	-	1,374	-	403
International Swaps	-	1,374	-	400
Accrued Interest	-	-	-	3
Deposit-taking Corporations	306	2,641	514	-131
Short Term	256	2,641	605	-131
Long Term	50	-	-91	-
Memorandum Items				
Foreign Direct Investment (FDI)				
Equity other than Reinvestment of Earnings		23		125
BOI companies (c)		29		72
CSE companies (d)		-6		45
Other Companies		-1		8
Reinvestment of Earnings		289		164
BOI companies (c)		284		153
CSE companies (d)		5		-39
Other Companies		-		50
Intercompany Loans		281		610
BOI Shareholder Advances		162		204
BOI Intercompany Loans		119		365
Other Companies		-		41
Total FDI (1)		**592**		**898**
Loans to BOI Companies (2)		187		282
Total FDI, Including Loans to BOI Companies (1 + 2)(e)		**779**		**1,181**
Total Net Inflows to the CSE		**-238**		**182**
Direct Investment		-6		45
Portfolio Investment		-232		137
Net Foreign Investments in Rupee Denominated Government Securities (Treasury Bills and Bonds)		**-27**		**51**
Foreign Purchases		17		69
Foreign Sales		44		18

Continued on page - 180

(a) Revised
(b) Provisional
(c) Companies registered with the Board of Investment (BOI)
(d) Companies listed in the Colombo Stock Exchange (CSE) and not registered with the BOI
(e) Any difference with the estimates of BOI is due to differences in coverage and compilation methodologies.

Source: Central Bank of Sri Lanka

Figure 5.11
Financial Account



Source: Central Bank of Sri Lanka

denominated government securities remained significantly low due to high divestiture of these instruments by foreign investors in the past few years. In terms of ISB repayments, the Government repaid US dollars 500 million in early 2022. The ISB repayment of US dollars 1,000 million, which was due in July 2022, was subjected to the temporary suspension. As per the accrual concept of reporting BOP statistics, arrears due to non-payment of coupon payments and interest on foreign loans have to be added to the outstanding liability of the respective debt instrument. Accordingly, US dollars 551 million of ISB coupon payments were recorded as accrued ISB interest payments to non residents, while US dollars 149 million was recorded as accrued interest payment on foreign loans. Further, US dollars 6 million was recorded as accrued interest on international bonds to non residents, which were issued by state owned business enterprises (SOBEs). Meanwhile, trade credits and advances recorded a significant decline in liabilities as the Ceylon Petroleum Corporation (CPC) continued to repay its trade credit liabilities throughout the year, while being unable to secure new trade credit facilities during the year. Foreign loan exposure in the banking sector declined during the year due to fewer new foreign borrowings, while continuing to pay off existing borrowings, particularly with increased foreign exchange liquidity in the banking system in the latter part of 2022. Meanwhile, the Central Bank continued to repay the IMF-EFF arrangement obtained during 2015-2019, while the Government continued to repay foreign loans obtained from other multilateral organisations that were not subjected to the debt standstill.

Table 5.9.B
Financial Account

US$ million

Item	2021 (a)		2022 (b)	
	Net Acquisition of Financial Assets	Net Incurrence of Liabilities	Net Acquisition of Financial Assets	Net Incurrence of Liabilities
Continued from page - 179				
Other Investment				
Loans	-	-1,503	-	-92
Central Bank	-	-57	-	-140
Credit and Loans with the IMF	-	-57	-	-140
Extended Fund Facility	-	-57	-	-140
Deposit-taking Corporations	-	-2,152	-	-1,645
Short Term	-	-2,169	-	-1,301
Long Term	-	17	-	-344
General Government	-	873	-	1,679
Long Term	-	873	-	1,679
Disbursements	-	2,544	-	2,391
Accrued Interest	-	-	-	133
Repayments	-	-1,671	-	-845
Other Sectors (c)	-	-167	-	13
Long Term	-	-167	-	13
Disbursements	-	187	-	332
Accrued Interest	-	-	-	16
Repayments	-	-354	-	-335
Trade Credit and Advances	257	-426	282	-895
Deposit-taking Corporations	-3	-	-27	-
Short Term	-3	-	-27	-
Other Sectors (d)	260	-426	310	-895
Short Term	260	-426	310	-895
Other Accounts Receivable/Payable	-176	180	506	1,492
Central Bank	-	180	-	1,492
Short Term (e)	-	180	-	1,492
Deposit-taking Corporations	-176	-	506	-
Short Term	-176	-	506	-
Special Drawing Rights		787		-
Reserve Assets	**-2,517**		**-1,234**	
Monetary Gold	-212		-152	
Special Drawing Rights	123		-118	
Reserve Position in the IMF	-		-58	
Other Reserve Assets	-2,428		-906	
Currency and Deposits	1,536		-895	
Claims on Monetary Authorities	1,055		-526	
Claims on Other Entities	481		-369	
Securities	-3,967		-11	
Debt Securities	-3,967		-11	
Long Term	-3,967		-11	
Other Claims	3		...	
Financial Account (net)	**-4,211**		**-1,946**	
Memorandum Items				
Long Term Loans to the Government (net)		**873**		**1,679**
Disbursements		2,544		2,391
Accrued Interest		-		133
Repayments		-1,671		-845

Source: Central Bank of Sri Lanka

(a) Revised
(b) Provisional
(c) Includes State Owned Business Enterprises (SOBEs) and private sector companies
(d) Includes trade credits received by the Ceylon Petroleum Corporation (CPC) and other private companies
(e) Net transactions of Asian Clearing Union (ACU) liabilities

Corporate sector borrowings also remained significantly limited, and net inflows remained negligible to the sector during the year.

Net acquisition of financial assets recorded a marginal increase during 2022. Net acquisition of financial assets recorded a marginal increase of US dollars 84 million in 2022, compared to a net decline of US dollars 2,113 million in 2021. GOR declined by US dollars 1,234 million during the year, mainly due to the debt service payments prior to the debt suspension from mid-April 2022, and the need to supply foreign exchange to the banking system to facilitate imports of essential goods amidst significant BOP pressures. However, net acquisition of assets in terms of currency and deposits, and other accounts receivable, increased in the banking sector, particularly in the latter part of 2022. Trade credit and advances extended by Sri Lankan exporters to non-residents increased during the year with the increase in merchandise exports in 2022, compared to the previous year.

5.5 Overall Balance

The overall balance of the BOP, which represents the change in net international reserves, continued to record a significant deficit in 2022. GOR declined notably in 2022, due to the continued moderation of inflows to the financial account, external debt service payments made prior to the temporary suspension of external debt service payments of the Government and net sales to the domestic foreign exchange market by the Central Bank, primarily for importation of essential imports during the year. While the reserve assets declined during the year, the reserve related liabilities recorded a significant increase with the receipt of an international swap facility from the RBI of US dollars 400 million, as well as the accumulation of Asian Clearing Union (ACU) liabilities by US dollars 1,492 million during the year. Consequently, net international reserves recorded a substantial deficit by end 2022, resulting in a deficit of the overall balance of US dollars 2,806 million in 2022, compared to a deficit of US dollars 3,967 million in 2021.

5.6 International Investment Position (IIP)

Sri Lanka's external liability position declined, while the external asset position remained at similar levels at end 2022, compared to end 2021. The country's external liability position amounted to US dollars 58,862 million at end 2022, compared to US dollars 63,967 million at end 2021. This was mainly due to the decline in market value of ISBs held by the Government. Meanwhile, the country's external asset position amounted to US dollars 8,830 million at end 2022, compared to a similar level at end 2021. Reserve asset position recorded a significant decline, while the banking sector foreign assets increased, resulting in the total asset position remaining at around the same levels at the end of the year. Consequently, the net liability position of the IIP declined to US dollars 50,032 million at end 2022, compared to US dollars 55,210 million at end 2021.

Sri Lanka's external asset position with non-residents remained at similar levels during 2022. There was a notable decline in the GOR from US dollars 3,139 million as at end 2021 to US dollars 1,898 million, as at end 2022.[2] However, there was a significant increase in the asset position of deposit taking corporations, with currency and deposits positions, and other accounts' receivable position recording a notable increase during the year, mainly due to the gradual increase of foreign currency liquidity in the domestic foreign exchange market towards the end of 2022. Meanwhile, the outstanding asset position of trade credit and

2 Section 5.6.1 provides a detailed discussion of the reserve asset position.

Table 5.10
International Investment Position

US$ million
(End period position)

Item	2021 (a) Assets	2021 (a) Liabilities	2022 (b) Assets	2022 (b) Liabilities
Direct Investment (c)	**1,522**	**16,384**	**1,534**	**13,877**
Equity and Investment Fund Shares	1,482	11,050	1,489	7,933
Debt Instruments	40	5,334	45	5,944
Portfolio Investment	**...**	**7,502**	**...**	**5,285**
Equity and Investment Fund Shares		1,142		1,251
Other Sectors		1,142		1,251
Debt Securities (d)	...	6,360	...	4,035
Deposit-taking Corporations	...	-	...	-
Long Term	...	-	...	-
General Government		6,266		3,957
Short Term		1		31
Long Term		6,265		3,926
Other Sectors		94		78
Long Term		94		78
Financial Derivatives	**-**	**-**	**-**	**-**
Other Investment	**4,096**	**40,081**	**5,399**	**39,700**
Currency and Deposits	**1,142**	**5,749**	**1,656**	**5,880**
Central Bank		1,775		2,037
Short Term		1		1
Long Term		1,774		2,036
Deposit-taking Corporations	1,142	3,974	1,656	3,843
Short Term	878	3,974	1,483	3,843
Long Term	264		173	
Loans		**30,565**		**29,508**
Central Bank		1,265		1,062
Credit and Loans with the IMF		1,265		1,062
Deposit-taking Corporations		3,172		1,527
Short Term		2,005		704
Long Term		1,167		823
General Government		21,289		23,562
Long Term		21,289		23,562
Other Sectors (e)		4,838		3,357
Long Term		4,838		3,357
Trade Credit and Advances	**1,211**	**1,915**	**1,493**	**1,020**
Deposit-taking Corporations	98		70	
Short Term	98		70	
Other Sectors (f)	1,113	1,915	1,423	1,020
Short Term	1,113	1,915	1,423	1,020
Other Accounts Receivable/Payable	**1,744**	**523**	**2,250**	**2,028**
Central Bank (g)		523		2,028
Short Term		523		2,028
Deposit-taking Corporations	1,744		2,250	
Short Term	1,744		2,250	
Special Drawing Rights (SDRs)		**1,330**		**1,265**
Reserve Assets	**3,139**		**1,898**	
Monetary Gold	175		28	
Special Drawing Rights	124		2	
Reserve Position in the IMF	67		4	
Other Reserve Assets	2,773		1,864	
Currency and Deposits	2,729		1,834	
Claims on Monetary Authorities	899		373	
Claims on Other Entities	1,830		1,462	
Securities	44		30	
Debt Securities	44		30	
Total Assets / Liabilities	**8,758**	**63,967**	**8,830**	**58,862**
Net International Investment Position		**-55,210**		**-50,032**
Memorandum Items				
IIP- Maturity-wise Breakdown	8,758	63,967	8,830	58,862
Short Term	6,804	9,560	7,091	8,877
Long Term	1,954	54,407	1,739	49,985

(a) Revised
(b) Provisional
(c) Includes direct investment position of BOI, CSE and other private companies
(d) Foreign currency debt issuances are based on market value, while domestic currency issuances are based on book value.
(e) Includes loans outstanding position of project loans obtained by SOBEs.
(f) Includes outstanding trade credit position of Ceylon Petroleum Corporation and private sector companies.
(g) Outstanding balance of ACU liabilities managed by the Central Bank

Source: Central Bank of Sri Lanka

advances as at end 2022, increased from the position observed at end 2021, primarily due to the increase in trade credit advances given by Sri Lankan exporters to their customers during the year. Further, the foreign direct investment asset position recorded a marginal increase during the year.

Sri Lanka's total liability position to non-residents, declined by around US dollars 5.1 billion during the year. The main reason for this decline was the substantial reduction in the outstanding position of ISBs, which is reflected in IIP statistics in terms of market value, from US dollars 6,233 million as at end 2021 to US dollars 3,315 million as at end 2022. However, the outstanding ISB position, in terms of face value held by non-residents, amounted to US dollars 10,800 million as at end 2022, compared to US dollars 11,191 million as at end 2021. There was a substantial decline in the market value of Sri Lanka's outstanding ISBs with the announcement of the temporary suspension of repayment of certain external debt of the Government from mid-April 2022. The outstanding liability position of direct investments, which witnessed a significant increase in 2021 due to a substantial increase in market prices of a number of DIEs listed in the CSE, recorded a notable reduction with the decline in market prices of these publicly listed companies in 2022. The Central Bank's outstanding currency and deposit liability position increased during the year with the receipt of an international swap facility of US dollars 400 million from the RBI. Further, the Central Bank and the Bangladesh Bank agreed to rollover the swap facility of US dollars 200 million, to be settled in 2023. Meanwhile, there was a marginal decrease in the currency and deposit liability position of deposit taking corporations during the year. Further, there was a notable decline in the outstanding foreign loan liability position of commercial banks, as banks continued to reduce their foreign liability exposure, particularly during the latter part of the year. The outstanding foreign loan liability position of the Government increased, despite the announcement of the debt standstill, partly due to the receipt of a significant amount of emergency humanitarian assistance in the form of credit lines from India. Further, there was a significant increase in liabilities denominated as other accounts payable of the Central Bank, due to the deferment of settling the ACU liabilities during the year. Meanwhile, the Central Bank continued to repay the outstanding liability relating to IMF-EFF arrangement obtained during 2015-2019. The outstanding foreign loan liability position of the private sector, other than SOBEs, remained at similar levels during the year. In terms of liabilities of SOBEs, the Cabinet of Ministers granted approval to reclassify the foreign loan liabilities of several SOBEs that were thus far categorised under 'Other Sectors' of the IIP and external debt statistics, as 'Government' foreign loan liabilities. Accordingly, part of outstanding foreign loan liabilities of these SOBEs that were reflected under 'Other Sectors' as at end 2021 were reclassified under 'Government' as at end 2022.[3]

5.6.1 Reserve Asset Position

GOR declined to US dollars 1,898 million by end 2022, compared to US dollars 3,139 million recorded at end 2021. GOR at the end of 2021 and 2022 included the international swap facility from the Peoples' Bank of China (PBOC), which was valued in US dollar terms at US dollars 1,574 million and US dollars 1,433 million, respectively, due to cross currency movements. This swap facility remained inaccessible during the year as it was subject to conditionalities that could not be met during 2022. The decline in GOR during 2022 was a

Table 5.11
CBSL Intervention, Foreign Currency Debt Servicing and Gross Official Reserve

US$ million

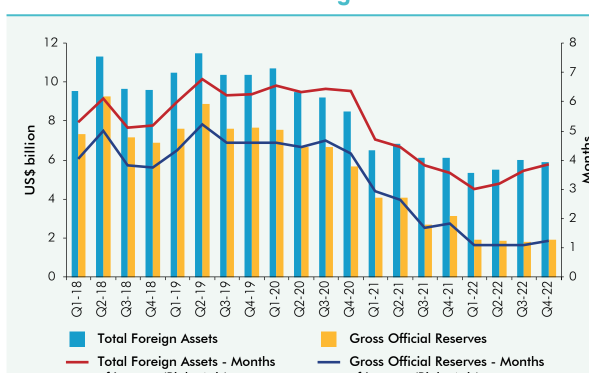
Item	2021	2022(a)
CBSL Absorption	**506**	**2,148**
Workers' Remittances Related Absorption	213	550
Exports Proceeds Related Absorption	214	1,184
Market Related Absorption	79	68
Financing Fuel Bills	-	68
Financing Coal Bills	-	278
CBSL Supply	**1,253**	**2,716**
Net Absorption	**-747**	**-568**
Foreign Currency Debt Service Payments (Interest + Capital)	**6,836**	**3,237**
Government (b)	6,354	3,077
Central Bank	481	160
Gross Official Reserves	**3,139**	**1,898**

(a) Provisional
(b) Includes foreign currency debt service payments to both residents and non-residents.

Source: Central Bank of Sri Lanka

combined result of foreign currency debt service payments, mostly in the early part of 2022, prior to the announcement of the suspension of servicing selected external debt by the Government, and the Central Bank's intervention in the domestic foreign exchange market by providing foreign exchange liquidity on net basis in order to facilitate essential imports. These early debt service obligations mainly included the repayment of the US dollars 500 million ISB, that matured in January 2022. The Central Bank's intervention in the domestic foreign exchange market by way of supplying foreign exchange to finance essential imports of US dollars 2,716 million also contributed to the decline in the GOR level during the year. Meanwhile, there

Figure 5.12
Quarterly Gross Official Reserves and Total Foreign Assets



Source: Central Bank of Sri Lanka

5

3 Out of the outstanding external liabilities of SOBEs, US dollars 1,427 million were reclassified as government liabilities as at end 2022.

Table 5.12
Gross Official Reserves, Total Foreign Assets and Overall Balance

US$ million
(End period position)

Item	2018	2019	2020	2021	2022 (a)
1. Government Foreign Assets	817	386	155	177	39
2. Central Bank Foreign Assets	6,102	7,256	5,510	2,962	1,858
3. Gross Official Reserves (1+2)	**6,919**	**7,642**	**5,664**	**3,139**	**1,898**
4. Foreign Assets of Deposit-taking Corporations	2,664	2,760	2,856	2,983	3,976
5. Total Foreign Assets (3+4) (b)	**9,583**	**10,402**	**8,521**	**6,122**	**5,874**
6. Reserve Related Liabilities (c)	1,425	1,771	2,121	3,562	5,127
7. Net International Reserves (NIR) (3-6)	**5,495**	**5,871**	**3,543**	**-423**	**-3,229**
8. Overall Balance (d)	**-1,103**	**377**	**-2,328**	**-3,967**	**-2,806**
9. Gross Official Reserves in Months of:					
9.1 Import of Goods	3.7	4.6	4.2	1.8	1.2
9.2 Import of Goods and Services	3.1	3.7	3.7	1.8	1.2
10. Total Foreign Assets in Months of:					
10.1 Import of Goods	5.2	6.3	6.4	3.6	3.9
10.2 Import of Goods and Services	4.3	5.1	5.6	3.4	3.7

(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

were only moderate foreign exchange inflows in 2022 other than the international swap facility from the RBI, inflows linked to ACU liabilities that remain unpaid, emergency credit lines of humanitarian assistance from India, and project loans and emergency assistance from multilateral institutions. Consequently, the GOR level at end 2022 was equivalent to 1.2 months of merchandise imports in comparison to the import cover of 1.8 months at end 2021.

The GOR level remained at critical levels due to the significant liquidity shortage in the domestic foreign exchange market and lack of access to foreign financing sources. The external sector was significantly strained due to the significant liquidity shortage in the domestic foreign exchange market, lack of access to foreign financing sources, and the critically low level of GOR. In this context, to gradually build-up GOR, the Central Bank continued to maintain the mandatory sales requirement from licensed banks (LBs) to the Central Bank from the converted workers' remittances and compulsorily converted export proceeds in 2022. In addition, the Central Bank also absorbed forex from the banking system on an intermittent basis in 2022 by establishing fuel and coal funds specifically to facilitate the financing of imports of fuel and coal. Accordingly, the Central Bank supplied US dollars 2,716 million to the domestic forex market to primarily facilitate the importation of essential imports, such as fuel, coal, LP gas, medicine, and essential food. This was accomplished by utilising the foreign exchange mobilised through the mandatory sales by LBs to the Central Bank, from the conversions on account of workers' remittances and export proceeds, as well as foreign exchange absorbed to the fuel and coal funds. These measures helped meet the basic needs of the country, even in the absence of specific bridging finances in 2022, thereby minimising the adverse impact of the BOP crisis to a certain extent. Further, the Central Bank continued with servicing foreign currency debt service payments of both the Central Bank and the Government, amounting to US dollars 3,237 million in 2022. These debt servicing included the external debt obligations to multilateral agencies that were continued to be honoured in 2022, despite the announcement of the debt standstill in mid-April 2022, causing a significant drain from GOR in 2022.

Foreign asset position of the banking sector recorded a significant increase, while the total international reserve position declined during 2022. The foreign asset position of the banking sector increased from US dollars 2,983 million as at end 2021 to US dollars 3,976 million by end 2022 particularly due to the gradual build up of foreign currency in the banking system during the latter part of 2022. Consequently, total international reserves, which comprise both

GOR and foreign assets of the banking sector, declined in 2022 mainly due to the decline in official reserves, although holdings of foreign assets of deposit taking corporations recorded an increase. Total foreign assets of the country were equivalent to 3.9 months of merchandise imports by end 2022, compared to 3.6 months of imports by end 2021.

5.7 External Debt and Debt Servicing

5.7.1 External Debt

Sri Lanka's external debt reduced by end 2022, mainly due to the significant reduction in the market values of ISBs that were issued by the Government. Total external debt of the country amounted to US dollars 49,678 million at end 2022, compared to US dollars 51,775 million by end of 2021. Despite a notable increase in the outstanding foreign loans, the total external debt of the Government remained at similar levels, due to the reduction in the outstanding value of ISBs issued by the Government, which are valued at market prices. Although the temporary suspension of foreign loans of the Government other than loans due to multilateral lenders provided some respite in terms of lesser foreign loan repayments, the Government obtained a number of emergency credit facilities for the importation of essential goods including fuel, medicine and fertiliser, from India, in the form of bilateral loans, resulting in a significant increase in foreign loan disbursements as a whole during 2022. Further, accrued interest of project loans and ISB coupon payments that are in arrears due to the suspension of servicing of selected external debt since mid-April 2022, have also been included in the outstanding debt of respective debt instruments.[4] This has resulted in further increasing outstanding government foreign loan liabilities, despite the lack of commercial borrowings by the Government subsequent to the debt standstill. The outstanding external debt of the Central Bank also recorded a significant increase with the receipt of an international swap facility from the RBI, categorised under currency and deposits, and the accumulation of ACU liabilities categorised under 'other accounts payable'. However, the outstanding external debt of deposit taking corporations declined significantly, with commercial banks reducing their outstanding foreign loans, and currency and deposit liability exposure, particularly in the latter part of the year. The commercial banks were unable to access credit lines with the sovereign ratings downgrade in

4 The non repayment of capital does not result in a change in outstanding debt liability position of the Government as reflected in the outstanding external debt statistics and the IIP.

Table 5.13. A
Outstanding External Debt Position

US$ million
(End period position)

Item	2021(a)	2022(b)
General Government	**27,556**	**27,518**
Short Term	**1**	**31**
Debt Securities	1	31
Treasury Bills (c)	1	31
Long Term	**27,555**	**27,488**
Debt Securities	6,265	3,926
Treasury Bonds (c)	8	34
Sri Lanka Development Bonds (d)	24	27
International Sovereign Bonds (e)	6,233	3,866
Market Price		3,315
Accrued Interest		551
Loans	21,289	23,562
Outstanding Foreign Loans		23,413
Accrued Interest of Government Foreign Loans		149
Central Bank	**4,892**	**6,391**
Short Term	**526**	**2,029**
Currency and Deposits	3	15
Other Accounts Payable	523	2,014
Asian Clearing Union Liabilities	523	2,014
Long Term	**4,367**	**4,362**
Special Drawing Rights (SDRs) Allocation	1,330	1,265
Currency and Deposits	1,774	2,036
RBI Swap Arrangement		400
Bank of Bangladesh Swap Arrangement	200	200
PBOC Swap Arrangement	1,574	1,433
Accrued Interest Applicable to Swap Arrangements		3
Loans	1,263	1,062
Credit and Loans with the IMF	1,263	1,062
Extended Fund Facility & Emergency Assistance	1,263	1,062
Deposit-taking Corporations	**7,146**	**5,370**
Short Term	**5,979**	**4,547**
Currency and Deposits (f)	3,974	3,843
Commercial Banks	3,974	3,843
Loans	2,005	704
Commercial Banks	2,005	704
Long Term	**1,167**	**823**
Loans	1,167	823
Commercial Banks	1,084	823
Other Deposit-taking Corporations	83	-

Continued on page 186

(a) Revised
(b) Provisional
(c) Based on book value
(d) Based on face value
(e) Based on market prices
(f) Includes deposits of personal foreign currency account holders

Source: Central Bank of Sri Lanka

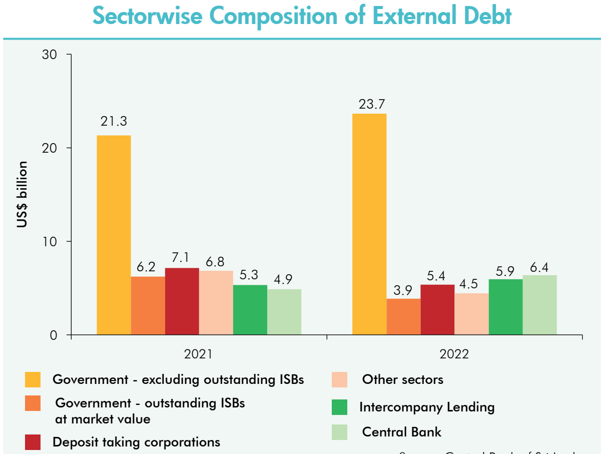
5

the aftermath of the debt standstill, while continuing to repay existing debt liabilities, contributing to the reduction of the external debt of the banking sector. The outstanding external debt of private corporations also declined, mainly as a result of reduced outstanding liabilities in terms of trade credits owed by the CPC. Further, outstanding external debt of several SOBEs was reclassified as outstanding external debt of the Government by end 2022, with a decision by the Cabinet of Ministers to reclassify such loans with the recommendations of the IMF. These loans included loans related to the Hambantota Port Development Project, Mattala Hambantota International Airport Project and the Puttalam Coal power project, resulting in a notable reduction in outstanding foreign loans under the 'other sector' of external debt statistics. Further, accrued interest also accumulated with the non-repayment of a coupon payment of an international debt security issued by SriLankan Airlines. Meanwhile, outstanding external debt of direct investment enterprises recorded an increase during the year.

5

The total outstanding external debt of the country, as a percentage of GDP, increased during the year. As a percentage of GDP, the total outstanding external debt stood at 64.5 per cent

Figure 5.13
Sectorwise Composition of External Debt



Source: Central Bank of Sri Lanka

Table 5.13.B
Outstanding External Debt Position

US$ million (End period position)

Item	2021(a)	2022(b)
Continued from page - 185		
Other Sectors (c)	6,847	4,454
Short Term	1,915	1,020
Trade Credit and Advances (d)	1,915	1,020
Long Term	4,932	3,435
Debt Securities (e)	94	78
Market Price of International Bonds		72
Accrued Interest of International Bonds		6
Loans	4,838	3,357
Private Sector Corporations	2,293	2,372
State Owned Business Enterprises (SOBEs)	2,545	985
Direct Investment: Intercompany Lending (f)	5,334	5,944
Gross External Debt Position	51,775	49,678
As a Percentage of GDP		
Gross External Debt	58.5	64.5
Short Term Debt	9.5	9.9
Long Term Debt	49.0	54.6
As a Percentage of Gross External Debt		
Short Term Debt	16.3	15.4
Long Term Debt	83.7	84.6
Total Accrued Interest to Non-Residents		709
Government - ISB coupons		551
Government - Foreign Loans		149
Central Bank - International Swaps		3
SOBEs - International Bond Coupons		6
Memorandum Items		
Non-Resident Holdings of Debt Securities - Sectorwise Breakdown at Face Value	11,400	11,622
General Government	11,225	11,447
Treasury Bills	1	34
Treasury Bonds	9	36
Sri Lanka Development Bonds	24	27
International Sovereign Bonds	11,191	10,800
Accrued Interest of ISB coupons due to non residents		551
Other Sectors	175	175
Face Value of Total Outstanding ISBs	13,050	12,550
Outstanding ISBs Held by Non Residents	11,191	10,800
Outstanding ISBs Held by Residents (g)	1,859	1,750

(a) Revised
(b) Provisional
(c) Includes private sector and State Owned Business Enterprises
(d) Includes trade credits outstanding of the Ceylon Petroleum Corporation and private sector companies
(e) Based on Market Prices
(f) Includes inter-company borrowings and shareholder advances of BOI registered companies
(g) Excluded from External Debt Statistics from December 2019 onwards

Source: Central Bank of Sri Lanka

as at end 2022, compared to 58.5 per cent as at end 2021. This increase is mainly due to the significant contraction in the nominal GDP value expressed in US dollar terms, despite a significant contraction in the nominal value of the total external debt during the year. Further, the outstanding external debt position of the Government out of the total external debt position also increased to 55.4 per cent as at end 2022, compared to 53.2 per cent as at end 2021. In terms of the debt maturity profile, long term debt as a percentage of total external debt stood at 84.6 per cent as at end 2022, compared to 83.7 per cent as at end 2021.

BOX 8
Post-Debt Restructuring Policy Priorities for Strengthening External Sector Balance

Introduction

The phenomenon of concurrent deficits in the Government budget and the external current account, emanating from the imbalances caused by excessive spending over and above a country's capacity, popularly known as Twin Deficits has remained the major structural impediment and key source of macroeconomic vulnerability in Sri Lanka for many years. Sri Lanka has been experiencing persistent external current account deficits mainly driven by large deficits in the merchandise trade account and primary income account over the years. Although the trade in services account and secondary income account (mainly workers' remittances) recorded surpluses, these surpluses have not been adequate to cushion the impact of ever widening deficits in the merchandise trade and primary income accounts in the current account. Further, Sri Lanka failed to attract non-debt creating foreign financial flows, such as Foreign Direct Investment (FDI), up to the expected levels even during the post war era due to structural and policy impediments. Moreover, during the last decade, the mounting external debt of the country and the resultant large debt service payments were major contributors to the external sector imbalances worsening debt sustainability concerns. Amidst these structural weaknesses in the external sector, imprudent and swift policy changes on the fiscal front, the COVID-19 pandemic, and related uncertainties intensified its macroeconomic fragilities leading to a series of calamities. Gross official reserves declined to historical lows, with the liquid reserves falling to almost zero levels by April 2022 and the exchange rate underwent a large overshooting in early March 2022. Against this backdrop, the Government announced a debt standstill in April 2022 for an interim period, pending a debt restructuring process while commencing negotiations with the International Monetary Fund (IMF) for a financing arrangement. As Sri Lanka's debt is evaluated as unsustainable, the success of the IMF-Extended Fund Facility (EFF) arrangement relies on the progress of ongoing debt restructuring. Once debt restructuring perimeters are negotiated and agreed upon with Sri Lanka's official and private creditors, the country will resume debt servicing, but on a smaller scale, with extended maturities. This first ever debt restructuring effort would offer a once in a lifetime opportunity for the country to correct past mistakes and decisively plan future actions to ensure that the country will not suffer from a repeated debt restructuring episode, as experienced by some countries. This stresses the fact that not only the debt restructuring process, but also the way forward in the post restructuring economy should be well planned and executed to strengthen the country's fiscal and external positions and build resilience in the period ahead.

Challenges in Debt Restructuring Processes

From the 1950s to 2010 there were more than 600 incidents of sovereign debt restructuring globally involving 95 countries (Das, Papaioannou, & Trebesch, 2012). Generally, it is expected that following successful debt restructuring, a country would manage the debt sustainably going forward and recover gradually. However, out of those, not all countries were able to sustainably manage their debt after a successful debt restructuring process and those who failed experienced further defaults subsequently. There are several reasons why some countries fail to reach their potential level of economic growth and ensure external sector stability through debt restructuring, as described below:

1. **Unfavourable economic conditions:** The external environment and broader economic conditions of the country during the rebuilding phase are instrumental in determining the outcome of debt restructuring. For example, if the global economy is slowing down or if major trading partners are experiencing an economic contraction during the post debt restructuring phase, the country may struggle to achieve its potential level of growth and Balance of Payments (BOP) sustainability. There are early signs that global economic stresses could heighten in 2023 amidst tight monetary and financial market conditions, making the post debt restructuring recovery of Sri Lanka challenging.
2. **Implementation challenges:** Given the diversity of external lenders and their interests as well as geopolitical concerns, the negotiation and implementation phases of debt restructuring could

5

be complex. This could make reaching agreements with creditors challenging, thereby raising the risk of delays due to lengthy negotiations. A protracted restructuring process could further erode investor confidence and be a major predicament for regaining stability of the external sector.

3. **Insufficient policy measures:** Recovery in the economy following debt restructuring involves adopting a policy combination that drives the economy towards a sustainable growth path in the short and medium term with emphasis on macro-fiscal reforms and required adjustments. However, if the policy responses are not planned out effectively or lack coordination in implementation, the desired outcome may not be achieved. Considering the legacy issues faced by the external sector of Sri Lanka, the reforms package needs to be sufficiently robust.

4. **Political instability:** The recovery in the economy following a debt restructuring process essentially depends on the success of the implementation of the reform package agreed upon with creditors and adherence to targets set out therein. As the major economic reforms lack popularity, governments come under severe pressure to implement such reforms and would possibly give into lobbying from the constituency. Political stability would help rebuild confidence in the economy among the stakeholders, including investors, multilateral and bilateral lenders, and creditors. Further, political instability may lead to policy inconsistency, which could be a major setback to implementing sustainable macroeconomic adjustments. Thus, post restructuring economic revival and resilience would be conditional on the continuation of the political resolve as well as public support for reforms.

5. **Weak institutions:** Weak institutions that lead to deterioration of the rule of law, lack of transparency and accountability, and increased corruption could create an environment that is unfavourable to economic growth, while limiting the effectiveness of policy measures and eroding investor confidence.

Against this backdrop, it will be pertinent to form a vigorous policy framework that aims at restoring stability in the external sector, while creating a conducive environment for the economic activities to thrive. Accordingly, a clear strategy needs to be articulated by the Government to implement the necessary structural reforms at the earliest possible timeframe and to source financing to repay debt obligations to creditors when the moratoria and concessions provided by creditors under the debt restructuring process come to a close and the debt obligations become due, in order to circumvent the need for repeated access to IMF bailouts and further rounds of debt restructuring in the future. Building permanent buffers on the external sector is the key to achieving a country's macroeconomic resilience. Such buffers could be a combined result of strengthening the external current and financial accounts through coordinated national policy drive and moving away from the orientation towards debt financing the budget deficit and current account deficit.

Policies for Strengthening the External Current Account

Sri Lanka's exports in the last few decades have seen no major growth drive or boom due to legacy issues, such as limited diversification, low value addition, lower integration to global value chains, and the lack of sophistication required to remain competitive amidst the overvalued exchange rate and inadequate investments in the tradable sector. In the meantime, expenditure on all categories of imports have increased at a faster pace leading to widening trade deficits, especially since 2011, mainly financed through external sector borrowings. Accordingly, any effort in addressing the external current account deficit should be focused on strategies to reduce the trade deficit by simultaneous measures to increase the earnings from merchandise exports while increasing the surplus in the services account. Demand management measures through rationalisation of imports and efforts on import substitution may be introduced only on a temporary basis to preserve economic stability, as long term adaptation of such measures might undermine the competitiveness of the economy. Further, product diversification through research and development led innovation, vertical and horizontal integration, participation in production sharing networks and linking with the global value chains through component manufacturing as well as reducing over reliance on traditional markets as export destinations by way of exploring new markets could be considered as vital initiatives. The export sector would have to be supported by conducive macroeconomic policies, particularly by maintaining a flexible exchange rate, consistent tax and investment policies, price stability and a thereby less volatile interest rate structure, and essential infrastructure facilities. Speedy and uninterrupted implementation of the actions outlined in the National Export Strategy is essential in the national interest to achieve the intended outcomes. Policy measures aimed at promoting domestic industries that supply intermediate goods required for key exports should be implemented promptly to enhance the domestic value addition in the export sector, while effectively substituting imports through integration. A level playing field created through free trade agreements would be an added advantage. Further, initiatives focused on moving towards renewable energy sources would also reduce the country's reliance on fossil fuels in the medium to long term thereby helping to minimise the pressure on the current account stemming from fuel imports.

Meanwhile, services exports are vital in cushioning the deficit in the external current account, and hence it is imperative to exploit their full potential. As the largest service export sector, the tourism sector is showing signs of revival and to reap the maximum benefits of the tourism industry, it is imperative to diversify the tourism sector to focus more on niche and non-traditional markets and tourists that travel for different purposes other than leisure. Also, certain services exports, especially in the Information Technology/Business Process Outsourcing (IT/BPO) sector, have considerable potential to bringing in net foreign exchange flows to the country. Growth opportunities in the IT/BPO sectors have expanded with the increased digitalisation of economies worldwide following the COVID-19 pandemic. Therefore, Sri Lanka should capitalise on the availability of a skilled labour force and state-of-the-art IT infrastructure to promote itself as a digital nation. Also, secondary and tertiary IT education needs to be aligned to market demands and complement the development of human capital required to keep up with the expansion in this sector. With debt restructuring, the primary income deficit is also expected to improve and needs to create a surplus in the non-interest income account.

Promotion of workers' remittance requires active stakeholder engagement to promote foreign employment, diversifying the foreign employment market and upskilling of migrant employees to secure more foreign employment opportunities with higher earning potential and incentivising official flows of remittances facilitated by low cost, real time, and convenient cross border fund flows. Although Sri Lanka has benefitted from workers' remittances sourced from the Middle Eastern region in the past, it is timely to promote alternative destinations offering employment for a wide range of job categories with high wage potential, especially in advanced economies, such as South Korea, Singapore, Japan, and European countries, thereby increasing the quantum of workers' remittances while reducing geopolitically driven vulnerabilities of remittance receipts. In the meantime, the large scale migration of white collar employees from Sri Lanka on a permanent basis, which will have a negative effect on workers remittances as well as long term economic repercussions due to brain drain, would have to be addressed urgently.

Policies for Strengthening External Financial Inflows

In addition to the targeted measures to address broader current account deficits, it is also necessary to supplement them by attracting more non-debt capital receipts, such as FDI and portfolio investments, into the financial account of the BOP in order to ensure greater external sector stability and improved macroeconomic stability. Attracting non-debt obligatory foreign financial inflows to improve external sector resilience will be instrumental in ensuring lasting stability of the external sector, amidst continuous foreign currency debt servicing requirements and lack of fiscal space for debt repayment. Beyond supporting the financing of the current account deficit and augmenting domestic investment, FDI fosters economic growth by generating technology spillovers, supporting human capital development, and enhancing international trade linkages through improved access to foreign markets. Sri Lanka's FDI remained acutely low compared to its regional peers over the past decades due to several legal, structural, and institutional deficiencies, such as rigid labour market regulations, difficulties in obtaining utilities, complex and inconsistent tax structures, and laborious regulatory structures, particularly related to contract enforcement, export import documentation, business startups, property acquisition, and the lack of well developed infrastructure facilities. Apart from these factors, policy uncertainty, institutional and governance weaknesses, such as perceived corruption and coordination failures continue to pose impediments to creating a conducive investment climate in Sri Lanka. Therefore, in order to foster investor confidence, Sri Lanka needs to establish a transparent and effective policy environment by articulating a comprehensive investment policy and build the required human competencies and institutional capacities to implement policy actions. Harmonisation of foreign investment policy with other development policies and strategies, such as trade and industrial policies as well as inter agency coordination in implementing these policies remain equally important. FDI and its fringe benefits will be instrumental in helping the economy to recover in the medium to long term under the macro-fiscal adjustment programme not only by contributing to the growth drive but also through economy wide efficiency gains. While efforts have already been taken to rectify these concerns by relevant authorities, it is imperative to expedite the implementation process before global FDI flows resume to pre-pandemic levels.

There is also a need to limit commercial project financing and encourage financing of tradable sectors capable of generating foreign exchange to service debt. A clear and transparent evaluation and selection mechanism for external loans should be established, while improving the transparency and accountability to the public on the external borrowing, their usage, and economic implications in order to enhance the effective utilisation of the borrowings and to reduce the pressure in the domestic foreign exchange market and external reserves of the country. Further, it is needed to articulate a strategy to improve sovereign ratings to reduce high risk premiums associated with external borrowings. Nevertheless, as country ratings improve in the period ahead, the tendency for increasing the share of commercial borrowings in the overall debt portfolio needs to be prevented. It is also possible to seek the feasibility of exploring the low cost funding options for essential projects, such as those in the areas of energy and food security, and climate adoption through sustainable financing options widely being made available globally while the use of green financing options would be beneficial. The IMF-EFF arrangement gives the opportunity to enhance market sentiments to attract foreign funds to the country which would support building up official reserves. Authorities need to restore debt sustainability by meeting targets setout over the medium to long term, such as by reducing the level of public debt below 95 per cent of GDP by 2032, reducing the average central government Gross Financing Needs (GFNs) in 2027–32, including the materialisation of contingent liabilities below 13 per cent of GDP so that rollover risks under stress are manageable, keeping foreign exchange debt servicing of the central government below 4.5 per cent of GDP in any year during 2027-32, and ensuring that the fiscal and external financing gaps are closed.

Conclusion

In view of the above, the implementation of structural reforms focusing not only on restoring near term stability but also on rebuilding the nation with adequate safeguards and resilience in the post-debt restructuring and post-IMF bailout era is vitally important for permanent revival from the current economic crisis. The persistent twin deficits experienced by Sri Lanka highlights the importance of addressing the BOP issues on a sustainable basis through a comprehensive national policy package formed in consultation with the relevant stakeholders and guarded from influences of changing political regimes. Further, non-debt creating foreign exchange generating sources need to be explored and encouraged, while reducing the need for financing of the current account deficit out of commercial external debt. Also, according to international experiences, the level of commitment by authorities towards the success of a reform programme is a key determinant of the outcome of debt restructuring and subsequent recovery of the economy. Moreover, the ongoing efforts to resolve the economic issues, including the debt restructuring process, and the macro-fiscal adjustment programme under the IMF-EFF arrangement are necessary conditions for the way forward, though these alone would not guarantee a permanent solution to the country's deep rooted structural weaknesses and macroeconomic complications unless the financing mix of government budget deficits and external current account deficits is augmented with non-debt creating financing in the period ahead.

Reference

1. Das, U., Papaioannou, M., & Trebesch, C. (2012). 'Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts'. IMF Working Paper, IMF.

5

5.7.2 Foreign Debt Service Payments

External debt repayments in 2022, compiled in terms of actual debt repayment of capital and interest in 2022, excluding arrears, recorded a significant reduction, with the temporary suspension of servicing of selected external debt since mid-April 2022. This reduction in debt servicing was mainly due to the non-payment of capital and interest payments to non-residents other than multilateral institutions by the Government, including bilateral foreign loans, and an ISB due to commercial creditors. Accordingly, total external debt service payments in 2022 amounted to US dollars 2,471 million, compared to US dollars 4,597 million in 2021. Capital repayments by the Government during 2022 amounted to US dollars 1,236 million, compared to US dollars 2,377 million in 2021. Further, interest repayment by the Government during 2022 amounted to US dollars 465 million, compared to US dollars 1,187 million in 2021. Only foreign loans due to multilateral institutions were repaid by the Government after the temporary suspension of servicing external debt. The Central Bank continued to service dues to the IMF under the previous EFF facility, while rolling over existing international swap arrangements with regional central banks. Meanwhile, the private sector continued to repay their foreign loan liabilities as usual. However, some SOBEs that had obtained foreign loans, repaid the foreign liabilities partially, and were affected by the debt suspension by the Government. These SOBEs include the National Water Supply and Drainage Board, Ceylon Electricity Board, Telecommunications Regulatory Commission of Sri Lanka and Airport and Aviation Services of Sri Lanka, while some of these non-repaid SOBE debt was reclassified to general government debt as mentioned in Section 5.7.1.

Table 5.14
External Debt Service Payments

US$ million

Item	2021(a)	2022 (b)
1. Debt Service Payments	**4,597**	**2,471**
1.1 Amortisation	**3,187**	**1,710**
General Government	2,377	1,236
Project Loans	1,671	845
Debt Securities	706	391
Central Bank	457	140
IMF	57	140
International Swaps	400	-
Private Sector and Deposit-taking Corporations	354	335
Foreign Loans	354	335
1.2 Interest Payments	**1,410**	**761**
General Government	1,187	465
Project Loans	394	273
Debt Securities	793	192
Central Bank	15	58
IMF	15	42
International Swaps	1	16
Private Sector and Deposit-taking Corporations	197	207
Foreign Loans	184	200
Debt Securities	12	6
Intercompany Debt of Direct Investment Enterprises	11	31
2. Earnings from Export of Goods and Services	**14,974**	**16,169**
3. Receipts from Export of Goods, Services, Income and Current Transfers	**20,587**	**20,211**
4. Debt Service Ratio		
4.1 As a Percentage of 2 above		
Overall Ratio	30.7	15.3
Excluding IMF Transactions	30.2	14.2
4.2 As a Percentage of 3 above		
Overall Ratio	22.3	12.2
Excluding IMF Transactions	22.0	11.3
5. Government Debt Service Payments		
5.1 Government Debt Service Payments (c)	3,564	1,701
5.2 As a Percentage of 1 Above	77.5	68.8

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

Source : Central Bank of Sri Lanka

5.8 Exchange Rate Movements

The Sri Lanka rupee experienced high volatility and registered the historically largest depreciation against the US dollar during the first half of 2022, before stabilising around the guidance band introduced in May 2022. The Central Bank's intervention in the domestic foreign exchange market and the continued use of moral suasion helped maintain the Sri Lanka rupee in the range of Rs.200-203 per US dollar during early 2022. However, significant shortage in liquidity in the domestic foreign exchange market, the widening spread between the official exchange rate and 'grey market rate,' and worsening

5

global conditions continued to exert pressures on the exchange rate, necessitating a measured adjustment in the exchange rate that was allowed in early March 2022. However, the subsequent large overshooting of the exchange rate by market forces, amidst uncertainties, caused the Sri Lanka rupee to depreciate substantially by 41.4 per cent against the US dollar by end April 2022. To reduce this significant volatility driven by excessive speculation and its adverse spillover effects on the economy, the Central Bank introduced a variation band, announced on a daily basis, as a temporary measure to manage the intraday volatility in the exchange rate. This helped curtail large fluctuations of the exchange rate, mostly driven by excessive speculation, amidst unprecedented BOP pressures. According to this new exchange rate determination arrangement, which was introduced from 13 May 2022, a middle exchange rate was announced by the Central Bank based on the weighted average spot market exchange rate of the USD/LKR interbank transactions, with a variation margin on either side of the middle spot exchange rate. Consequently, from 13 May 2022 to end December 2022, the Sri Lanka rupee recorded only a marginal depreciation against the US dollar. The inactive spot market, due to market uncertainties about the country's economic conditions, largely explained the broadly stable exchange rate during this period. Accordingly, the annual depreciation of the rupee was limited to 44.8 per cent against the US dollar during 2022. Meanwhile, the Central Bank supplied US dollars 568 million to the domestic foreign exchange market on a net basis during 2022, compared to a net supply of US dollars 747 million in 2021. Reflecting cross currency exchange rate movements, the Sri Lanka rupee depreciated against the euro (41.4 per cent), the pound sterling (38.1 per cent), Japanese yen (36.4 per cent) and the Indian rupee (38.6 per cent) by end 2022. The activity in the domestic foreign exchange market registered a notable improvement since late 2022 with increasing foreign exchange liquidity, positive developments on the finalisation of the EFF arrangement from the IMF, significant moderation of import demand amidst subdued activity and tight credit conditions, among others. With a view to encouraging activity in the domestic forex market and restoring a market

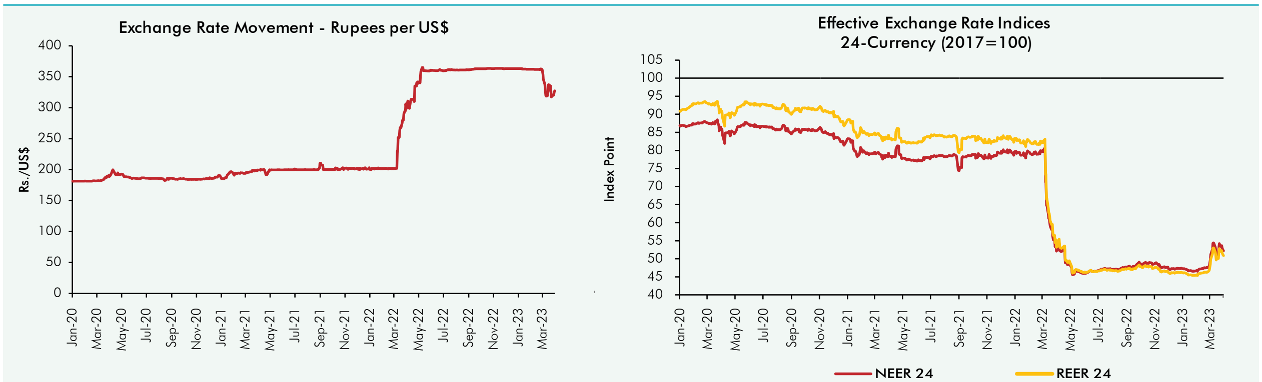
Table 5.15
Exchange Rate Movements

Currency	In Rupees per unit of Foreign Currency						Percentage Change over Previous Year (a)			
	End Year Rate			Annual Average Rate			End Year		Annual Average	
	2020	2021	2022	2020	2021	2022	2021	2022	2021	2022
Euro	229.42	226.86	386.93	212.07	235.10	339.04	1.13	-41.37	-9.80	-30.66
Indian Rupee	2.55	2.69	4.39	2.50	2.69	4.11	-5.33	-38.67	-6.96	-34.56
Japanese Yen	1.81	1.74	2.74	1.74	1.81	2.44	3.91	-36.46	-3.95	-25.93
Pound Sterling	254.35	270.60	437.35	238.22	273.51	396.89	-6.00	-38.13	-12.90	-31.09
US Dollar	186.41	200.43	363.11	185.52	198.88	324.55	-7.00	-44.80	-6.72	-38.72
Special Drawing Rights (SDR)	268.48	280.53	483.24	258.61	283.18	431.91	-4.29	-41.95	-8.68	-34.43
Effective Exchange Rate Indices (b) (c) (2017=100)	End Year Index			Annual Average Index			Percentage Change over Previous Year			
							End Year Index		Annual Average Index	
	2020	2021	2022	2020	2021	2022	2021	2022	2021	2022
NEER 24-currencies	83.12	79.65	47.32	85.93	78.64	53.99	-4.18	-40.59	-8.48	-31.34
REER 24-currencies	88.37	83.31	46.23	91.52	83.58	54.33	-5.72	-44.51	-8.67	-35.00

(a) Changes computed on the basis of foreign currency equivalent of Sri Lanka rupees. The sign (-) indicates depreciation of Sri Lanka rupee against each currency.
(b) 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.
(c) 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.

Source: Central Bank of Sri Lanka

Figure 5.14
Exchange Rate Movements



Source: Central Bank of Sri Lanka

driven exchange rate in line with the flexible inflation targeting framework of the Central Bank, the Central Bank commenced a gradual relaxation of the daily variation band, while also loosening the mandatory sales requirement. In consequence, the Central Bank lowered the mandatory forex sales requirement from conversions of export proceeds and workers' remittances, from 25 per cent to 15 per cent, on 27 February 2023, as the first step to allow increased foreign exchange liquidity in the banking system, followed by gradual widening of the variation band for the exchange rate. With these measures, steady foreign currency inflows to the services sector, workers' remittances and financial flows to portfolio investments and return of market confidence towards the finalisation of the IMF-EFF arrangement contributed towards a notable appreciation of the exchange rate during early March 2023, correcting the exchange rate overshooting witnessed in early 2022. However, the Central Bank intervened in the domestic foreign exchange market to allow for an orderly appreciation of the exchange rate amidst significant appreciation pressures in a relatively short period of time. Accordingly, the Central Bank purchased foreign exchange from the market amounting to US dollars 451 million on a gross basis during March 2023. Meanwhile, the Central Bank announced the complete removal of the guidance band and the mandatory sales requirement by licensed banks with effect from 7 March 2023. As a combined impact of these relaxation measures and enhanced external sector outlook in the near term, the Sri Lanka rupee appreciated gradually by 10.9 per cent to Rs. 327.29 per US dollar by end March 2023.

Other major currencies depreciated against the US dollar in line with the broad-based strengthening of the US dollar, amidst policy rate hikes by the US Federal Reserve Bank. Accordingly, at the end of 2022, the euro (5.9 per cent), the Japanese yen (13.2 per cent), the pound sterling (10.8 per cent), and Indian rupee (10.1 per cent) depreciated against the US dollar. Even though the Sri Lanka rupee depreciated against the SDR by 41.9 per cent during 2022 due to the combined effect of the depreciation of the rupee against most major currencies, the Sri Lanka rupee appreciated against the SDR by 9.8 per cent by end March 2023, with the appreciation of the rupee against most major currencies during the first quarter of 2023.

5.8.1 Nominal and Real Effective Exchange Rates

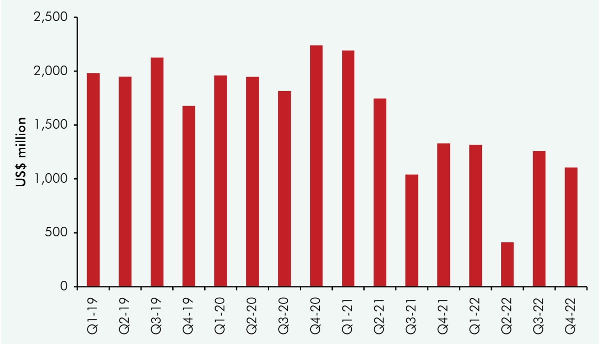
Both 5-currency and 24-currency Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) indices underwent substantial downward adjustment during 2022. NEER indices declined, reflecting the nominal depreciation of the Sri Lanka rupee against the selected major currencies together with the movements in cross currency exchange rates. Accordingly, the 5-currency NEER index declined by 41.1 per cent, while the 24-currency index declined by 40.6 per cent in 2022. Meanwhile, REER, which indicates Sri Lanka's external competitiveness, measured by the 5-currency and 24-currency indices, dropped during the year, by 13.5 per cent and 44.5 per cent, respectively. Overall, the REER indices remained remarkably below the threshold of 100 index points (2017=100), indicating that the exchange rate remained supportive of the country's trade competitiveness. With the sharp appreciation of the exchange rate in March 2023, both NEER and REER indices increased substantially, reflecting the nominal appreciation of the Sri Lanka rupee against the US dollar and other major currencies considered in the basket. Accordingly, 5-currency NEER indices increased by 9.4 per cent and 5-currency REER decreased by 15.5 per cent, and 24-currency NEER and REER indices increased by 10.3 per cent and 10.0 per cent, respectively, by end March 2023.

5

5.8.2 Developments in the Domestic Foreign Exchange Market

The transaction volumes in the domestic foreign exchange market further declined in 2022, compared to 2021. The volume of interbank foreign exchange transactions declined to US dollars 9,570 million in 2022, in comparison to US dollars 12,160 million in 2021. The total

Figure 5.15
Quarterly Inter-bank Forward Transaction Volumes



Source: Central Bank of Sri Lanka

volume of spot transactions declined to US dollars 5,479 million (57.3 per cent of total transactions) in 2022, in comparison to US dollars 5,852 million in 2021. The total volume of forward transactions decreased to US dollars 4,091 million in 2022 from US dollars 6,308 million in 2021. Meanwhile, the Central Bank intervened in the domestic foreign exchange market by supplying US dollars 568 million, on a net basis, in 2022. This was a result of purchases of US dollars 2,148 million and a supply of US dollars 2,716 million. The purchase of foreign exchange from the market was mainly through mandatory sales by licensed banks on the conversion of export proceeds and workers' remittances, while the sale of foreign exchange by the Central Bank was on account of facilitating import of essential commodities. The Central Bank intervened in the domestic foreign exchange market during the first quarter of 2023 by purchasing US dollars 861 million, on a net basis in order to mitigate excessive volatility in the exchange rate, while strengthening gross official reserves.