



External Sector Developments

The external sector challenges, which aggravated in recent years amidst headwinds on the global and local fronts, culminated in an unprecedented BOP crisis in 2022. Gross official reserves declined to historical lows, the exchange rate underwent a large overshooting, following a measured adjustment allowed in March 2022, import restrictions were imposed, and restrictions imposed on certain financial account transactions continued through 2022. Further, a debt standstill was announced in April 2022 for an interim period, pending a debt restructuring process, while negotiations commenced with the IMF for a bailout package, for which a staff level agreement was reached in early September 2022. The debt restructuring process, which began with the assistance of financial and legal advisors, has come to an advanced level, where financing assurances from official creditors are expected in the near future. Meanwhile, export performance has continued to remain robust despite heightened challenges thus far in 2022. Consequently, the deficit in the trade account narrowed until August 2022. Earnings from tourism have shown notable improvement so far during the year, while workers' remittances have recorded considerable revival in recent months, despite being modest during the first half of 2022. The current account deficit widened in the first half of 2022, compared to the corresponding period in 2021, reflecting the impact of modest workers' remittances and the increase in primary income account deficit, despite the moderation in trade deficit and improvement in the surplus in the services account. Inflows to the financial account remained modest due to the decline in foreign inflows to the Government and private sector in terms of direct investments, while foreign investment in the CSE, including the primary market purchases, and the government securities market recorded net inflows. Meanwhile, the Central Bank started providing guidance for the interbank foreign exchange market in mid-May 2022 in view of curtailing any large intraday volatility, subsequent to which a greater stability in the exchange rate was observed. Gross official reserves continued to remain at critically low levels primarily due to limited foreign exchange inflows and continued supply of foreign exchange by the Central Bank to partly finance essential imports. BOP pressures are expected to ease in the period ahead with the realisation of envisaged financial flows, following the approval of the EFF by the Executive Board of the IMF.

5.1 Balance of Payments

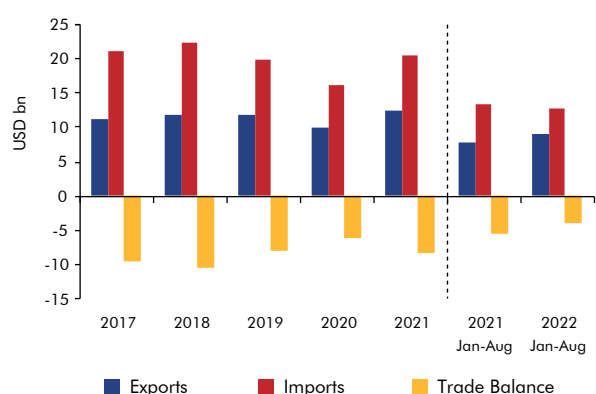
Current Account

The current account deficit expanded during the first half of 2022 due to the widening primary income account deficit, moderation of the surplus in the secondary income account, amidst subdued performance of worker's remittances, despite the contraction of the merchandise trade deficit and improved surplus in the services account. Consequently, the current account recorded a deficit of USD 1.8 bn in the first half of 2022, compared to the deficit of USD 1.4 bn in the first half of 2021.

Trade Account

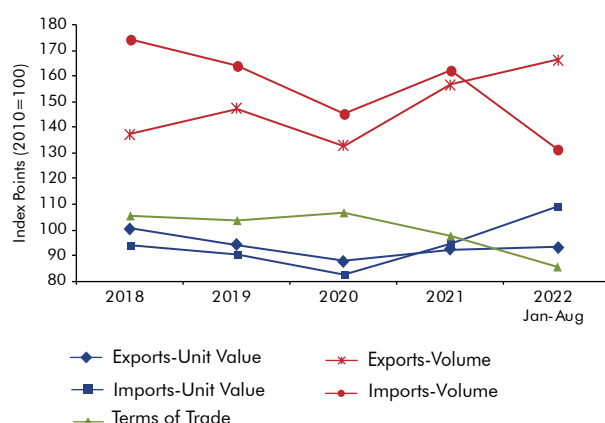
The merchandise trade deficit during January-August 2022 narrowed to USD 3.9 bn from USD 5.5 bn recorded in the same period of 2021. During this period, export earnings increased by nearly USD 1.0 bn, while import expenditure declined by USD 611 mn, compared to the same period in 2021. As shown by the movements of volume and unit value indices of exports and imports, the increase in exports as well as the decline in imports were driven by the impact of volume rather than the price effect. The terms of trade deteriorated, as the increase in the export price index was offset by the increase in the import price index, which was significantly led by higher fuel prices.

Figure 5.1
External Trade Performance



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

Figure 5.2
Terms of Trade and Trade Indices

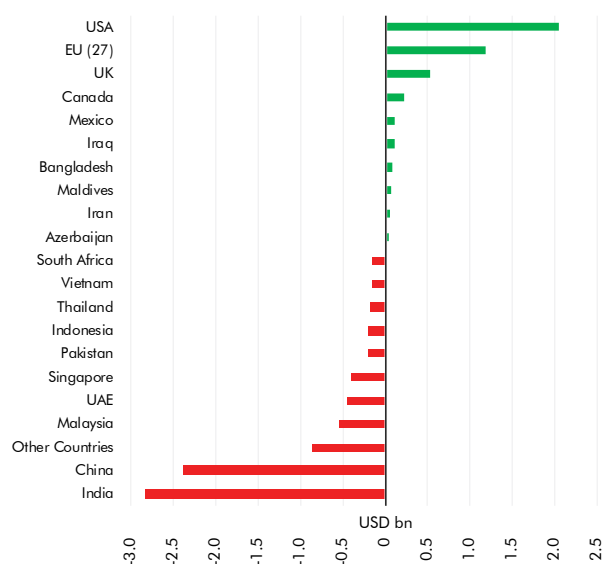


Source: Central Bank of Sri Lanka

The merchandise trade deficit narrowed, supported by higher exports and import compression aided by the policy measures to discourage non urgent imports...

Merchandise export earnings during January-August 2022 amounted to USD 8.9 bn, compared to USD 7.9 bn in the same period in 2021. Growth in export earnings was mainly led by industrial exports, such as garments, petroleum products, and gems, diamonds and jewellery. The notable depreciation of the exchange

Figure 5.3
Bilateral Trade Balances during Jan-Aug 2022



Source: Central Bank of Sri Lanka

Table 5.1
Developments in International Trade

USD mn

Category	2020	2021 (a)	2021 Jan-Aug (a)	2022 Jan-Aug (a)	Growth % Jan-Aug 2021/2022	Share % Jan-Aug 2022
EXPORTS						
Agricultural Exports	2,336.2	2,729.5	1,765.5	1,708.5	-3.2	19.2
Tea	1,240.9	1,324.4	882.4	819.3	-7.2	9.2
Coconut	345.2	425.2	276.9	284.3	2.7	3.2
Kernel Products	163.1	200.9	125.6	128.1	2.0	1.4
Other	182.1	224.3	151.3	156.2	3.3	1.8
Spices	333.5	454.8	282.4	233.5	-17.3	2.6
Seafood	189.8	274.1	165.5	188.4	13.8	2.1
Minor Agricultural Products	134.7	148.8	91.1	120.4	32.0	1.4
Rubber	30.1	42.2	27.3	29.4	7.9	0.3
Vegetables	36.6	28.5	18.4	17.5	-4.6	0.2
Unmanufactured Tobacco	25.5	31.6	21.4	15.7	-26.8	0.2
Industrial Exports	7,672.0	9,702.0	6,094.3	7,157.8	17.5	80.4
Textiles and Garments	4,423.1	5,435.1	3,434.8	4,095.6	19.2	46.0
Rubber Products	786.1	1,050.4	681.7	676.3	-0.8	7.6
Petroleum Products	373.6	506.4	294.9	409.8	39.0	4.6
Machinery and Mechanical Appliances	337.5	500.9	329.1	375.9	14.2	4.2
Food, Beverages and Tobacco	464.0	586.9	354.0	366.0	3.4	4.1
Gems, Diamonds and Jewellery	181.5	276.7	179.1	278.7	55.7	3.1
Chemical Products	172.7	223.2	143.7	150.8	5.0	1.7
Base Metals and Articles	110.9	156.4	100.1	120.2	20.1	1.4
Animal Fodder	102.9	149.4	77.5	109.2	40.9	1.2
Wood and Paper Products	99.3	129.9	82.6	95.7	15.9	1.1
Other Industrial Exports	620.5	686.8	417.0	479.5	15.0	5.4
Mineral Exports	25.1	44.5	30.7	21.1	-31.3	0.2
Unclassified Exports	14.1	22.6	13.6	14.8	8.8	0.2
Total Exports	10,047.4	12,498.6	7,904.0	8,902.2	12.6	100.0
IMPORTS						
Consumer Goods	3,401.7	3,848.7	2,579.3	1,945.7	-24.6	15.2
Food and Beverages	1,554.4	1,666.5	1,151.9	1,106.2	-4.0	8.6
Rice	10.5	73.0	8.4	229.5	2,618.0	1.8
Dairy Products	333.8	317.7	231.2	174.5	-24.5	1.4
Sugar	276.0	287.5	210.5	147.9	-29.7	1.2
Lentils	96.9	143.0	105.7	81.0	-23.4	0.6
Other	837.2	845.2	596.1	473.3	-20.6	3.7
Non-food Consumer Goods	1,847.3	2,182.2	1,427.3	839.4	-41.2	6.6
Medical and Pharmaceuticals	595.5	882.5	532.0	347.5	-34.7	2.7
Clothing and Accessories	200.7	221.3	138.7	158.6	14.4	1.2
Home Appliances	174.2	257.1	179.8	71.3	-60.3	0.6
Telecommunication Devices	268.4	382.9	283.1	49.9	-82.4	0.4
Personal Vehicles	282.9	12.8	7.8	5.7	-26.5	0.04
Other	325.6	425.7	286.0	206.5	-27.8	1.6
Intermediate Goods	9,076.5	12,308.9	7,942.4	8,584.0	8.1	67.1
Fuel	2,542.6	3,742.9	2,395.9	3,317.9	38.5	25.9
Textiles and Textile Articles	2,335.1	3,066.9	1,943.7	2,175.7	11.9	17.0
Chemical Products	831.5	1,074.4	732.6	682.1	-6.9	5.3
Plastics and Articles Thereof	540.2	765.7	518.6	464.9	-10.4	3.6
Paper and Paperboard and Articles Thereof	383.1	468.9	319.4	325.5	1.9	2.5
Base Metals	460.3	866.4	499.2	270.0	-45.9	2.1
Rubber and Articles Thereof	218.7	400.7	265.8	257.6	-3.1	2.0
Vehicle and Machinery Parts	239.4	349.4	235.5	188.1	-20.1	1.5
Wheat and Maize	384.4	418.3	265.9	170.3	-36.0	1.3
Fertilizer	258.9	158.2	104.0	98.2	-5.5	0.8
Other Intermediate Goods	882.3	997.1	661.9	633.8	-4.3	5.0
Investment Goods	3,563.2	4,462.7	2,882.3	2,263.5	-21.5	17.7
Machinery and Equipment	2,176.1	2,809.5	1,822.5	1,462.4	-19.8	11.4
Building Materials	1,035.6	1,248.9	803.9	689.2	-14.3	5.4
Transport Equipment	348.3	398.5	252.1	109.2	-56.7	0.9
Other Investment Goods	3.2	5.8	3.7	2.7	-27.8	0.02
Unclassified Imports	14.0	17.1	7.6	7.7	2.2	0.1
Total Imports	16,055.4	20,637.4	13,411.5	12,800.9	-4.6	100.0

(a) Provisional

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

rate and high global commodity prices had favourable effects on export sector performance. The main export destinations during January-August 2022 were USA (26%), EU (23%), UK (8%) and India (6%).

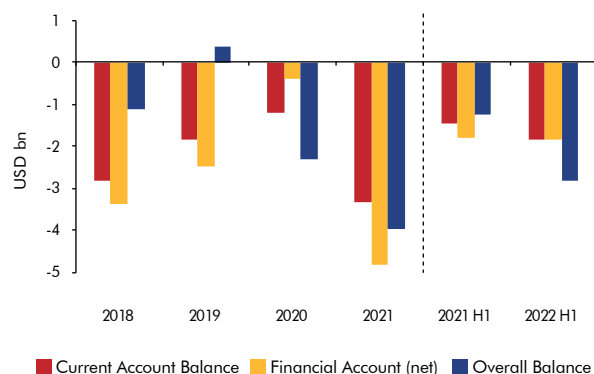
The export sector could face challenges in the near term amidst changes in consumer spending patterns in major export destinations owing to high inflation, tight monetary conditions and recessionary concerns...

Import expenditure during January-August 2022 contracted to USD 12.8 bn, compared to USD 13.4 bn recorded in the same period of 2021. However, import expenditure in the first quarter of 2022 was higher than that in 2021, which necessitated the introduction of policy measures to curb import expenditure in order to make foreign exchange available for essential imports. In addition, the foreign exchange liquidity shortage in the banking system, the considerable increase in import prices due to the sharp depreciation of the exchange rate and subdued demand caused by significant monetary tightening also contributed to the reduction in import expenditure since March 2022. The main import source countries during January-August 2022 were India (27%), China (20%), UAE (5%) and Malaysia (5%). Since the global economic environment is shrouded with uncertainties at present due to the looming global recession and geopolitical tensions, fluctuations in commodity prices are likely in the period ahead, requiring import expenditure to be strictly managed during the rest of 2022 and up until foreign exchange inflows resume with the envisaged financial assistance from the IMF-EFF and other multilateral agencies.

Services Account

The surplus in the services account improved in the first half of 2022, compared to the same period in 2021, driven by a recovery in the tourism sector, despite subdued performance in the IT/BPO sector relative to 2021. Earnings from tourism have shown a notable improvement so far during the year, recording over half a million tourist arrivals from January to September 2022, while earnings from tourism during this period

Figure 5.4
Balance of Payments



Source: Central Bank of Sri Lanka

have been estimated at USD 946 mn. Unfavorable conditions, such as fuel shortages, power outages and travel advisories issued by certain countries, negatively impacted the momentum observed at the beginning of the year on tourist arrivals. However, there have

Table 5.2
Current and Capital Account

USD mn

Item	2020 (a)	2021 (b)	2021 H1 (b)	2022 H1 (b)
Trade Balance	-6,008	-8,139	-4,316	-3,514
Exports	10,047	12,499	5,699	6,514
Growth (%)	-15.9	24.4	29.1	14.3
Imports	16,055	20,637	10,015	10,028
Growth (%)	-19.5	28.5	30.5	0.1
Services (net)	819	1,586	597	1,336
Receipts	3,035	2,475	985	1,766
of which;				
Transportation, net	114	352	158	211
Growth (%)	-81.8	207.8	8.8	33.2
Tourist earnings	682	507	44	740
Growth (%)	-81.1	-25.7	-93.5	1,578.9
IT/BPO	971	1,168	574	567
Growth (%)	8.0	20.4	17.9	-1.1
Payments	2,216	889	387	430
Primary Income (net)	-2,205	-2,018	-918	-1,111
Receipts	198	116	69	109
Payments	2,404	2,134	987	1,220
Secondary Income (net)	6,207	5,228	3,199	1,461
of which;				
Workers' Remittances	7,104	5,491	3,324	1,610
Growth (%)	5.8	-22.7	11.6	-51.6
Current Account Balance	-1,187	-3,343	-1,437	-1,828
Capital Account (net)	28	25	12	7
Current Account and Capital Account (net)	-1,159	-3,318	-1,425	-1,821

(a) Revised

(b) Provisional

Source: Central Bank of Sri Lanka

been some favourable developments on those fronts recently, thereby raising expectations of a faster recovery of the tourism sector in the period ahead.

The surplus in trade in services showed a notable increase, primarily reflecting the impact of tourism sector performance...

The computer and information services subsector also contributed to earnings from trade in services during the first half of 2022, albeit its contribution remained modest compared to the first half of 2021. In addition, net earnings from the transport sector have also improved during this period with increased passenger fares, compared to the corresponding period in 2021.

Primary Income and Secondary Income Accounts

The deficit in the primary income account expanded in the first half of 2022, due to outflows in the forms of dividends of direct investments and employee compensations, which remained above the levels compared to the first half of 2021.¹

Workers' remittances showed an upward trend recently, probably as a result of an increase in the number of migrant workers and the relatively narrow gap between the official and grey market exchange rates...

Following the declining trend in most of 2021, workers' remittances showed a notable decline in the first half of 2022 as well, on a y-o-y basis, weakening the secondary income account surplus. However, with a steady increase in the number of migrant workers and a relatively narrower gap between the official and grey market exchange rates, workers' remittances showed an upward momentum since the second half of this year.

¹ Despite the temporary suspension of external debt repayments on account of ISBs, bilateral project loans and commercial debt, as per the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6), the coupon/interest payments accrued have been recorded in the primary income account.

Financial Account

The financial account recorded subdued inflows during the first half of 2022. The main financial inflows during the first half of the year were the receipt of USD 400 mn under the SAARCFINANCE swap facility with the RBI and marginally high FDI inflows. Meanwhile, marginal net inflows were recorded in terms of foreign investments in both the government securities market and the CSE. Despite these limited inflows, outflows from the financial account remained significant. Further, significant external debt service payments, including the maturity of an ISB, were made in the first half of 2022 prior to the announcement of a debt standstill on 12 April 2022. Meanwhile, part financing of imports of essential goods was continued by utilising gross official reserves amidst limited foreign currency inflows. Accordingly, the level of gross official reserves declined to around USD 1.8 bn at end September 2022 from USD 3.1 bn at the end of 2021. At the end of 2021 and end September 2022 levels of gross official reserves included the swap facility from the PBOC, which was equivalent to around USD 1.6 bn and USD 1.4 bn respectively, and is subject to conditionalities on usability.

Table 5.3

Financial Account

USD mn

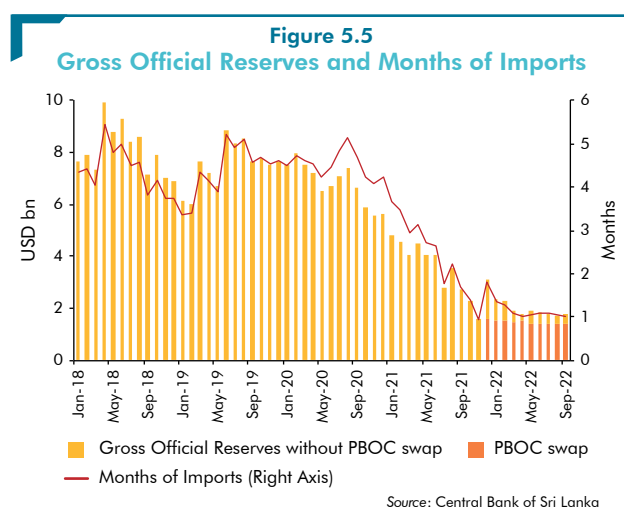
Item	2020 (a)	2021 (b)	2021 H1 (b)	2022 H1 (b)
Financial Account (net)	-394	-4,816	-1,802	-1,840
Net Acquisition of Assets	-2,113	-2,122	-1,535	-355
Direct Investment	15	17	9	8
Other Investment	-136	387	37	813
Currency and Deposits	64	306	-52	488
Trade Credit and Advances	-224	257	100	132
Other Accounts Receivable	24	-176	-11	193
Reserve Assets	-1,992	-2,526	-1,581	-1,176
Net Incurrence of Liabilities	-1,718	2,694	267	1,485
Direct Investment	434	598	258	297
Portfolio Investment	-2,383	-906	-89	-62
Equity	-217	-236	-127	135
Debt Securities	-2,166	-670	37	-197
Other Investment	231	3,003	99	1,250
Currency and Deposits	-15	4,016	-177	455
Loans	174	-1,552	25	-340
Trade Credit and Advances	185	-428	133	-302
Other Accounts Payable	-114	180	118	1,398
Errors and Omissions	765	-1,498	-377	-19
Overall Balance	-2,328	-3,967	-1,261	-2,814
Gross Official Reserves	5,664	3,139	4,060	1,854
Months of Imports	4.2	1.8	2.6	1.1
Total Foreign Assets	8,521	6,122	6,824	5,521
Months of Imports	6.4	3.6	4.5	3.2

(a) Revised

(b) Provisional

Source: Central Bank of Sri Lanka

5.2 Overall Balance and Gross Official Reserves



The overall balance of the BOP recorded a notable deficit during the nine months ending September 2022, compared to the corresponding period of 2021. Lower inflows to the financial account and significantly high debt service payments resulted in a depletion of gross official reserves to USD 1.8 bn by end September 2022, compared to USD 3.1 bn recorded at end 2021. The main inflow to supplement the reserves during January to September 2022 was the receipt of a swap facility of USD 400 mn from the RBI. Gross official reserves by end September 2022 were equivalent to an estimated 1.1 months of imports.

5.3 International Investment Position

Sri Lanka's net liability position of the IIP, which is the difference between Sri Lanka's total external asset and liability positions held with non residents, declined to USD 48.9 bn at the end of June 2022 from USD 55.7 bn as at the end of 2021. The stock position of external assets decreased primarily as a result of the decline in gross official reserves by USD 1.3 bn by end June 2022, compared to end 2021. Sri Lanka's total liabilities position to non residents also decreased as at end June 2022, compared to end 2021. This is mainly due to decreases in direct investment liabilities, portfolio investment liabilities and foreign loan liabilities of deposit taking corporations. The outstanding liabilities of the Government decreased mainly with the settlement of the ISB in January 2022. Despite the temporary suspension of external debt repayments on account of ISBs and project loans of

bilateral and commercial nature, as per the BPM6, the coupon/interest payments accrued have been added in determining the outstanding liabilities on account of these debt instruments. Further, outstanding trade credits received by the private sector and SOBEs increased marginally. The outstanding liabilities of the Central Bank increased as a result of the swap facility with the RBI.

5.4 External Debt Position

Sri Lanka's total outstanding external debt position decreased marginally to USD 48.7 bn as at end June 2022 from USD 50.7 bn as at end 2021, mainly due to the repayment of the ISB that matured in January 2022. Further, the market value of outstanding ISBs declined mainly reflecting the debt restructuring concerns. The outstanding external debt position of the Central Bank increased by end June 2022 in comparison to end 2021 with the SAARCFINANCE swap arrangement of USD 400 mn from the RBI. The ACU liabilities of the Central Bank also increased by end June 2022, compared to the beginning of the year. Despite an increase in currency and deposits, outstanding external debt of the banking sector declined due to the substantial decline in outstanding short term loans. The outstanding external debt of the private sector and SOBEs decreased during the first half of 2022 with a decline in trade credits and advances received by SOBEs and the outstanding foreign loans of the SOBEs. However, intercompany borrowing of DIEs recorded an increase during the first half of the year.

Table 5.4
Outstanding External Debt

	USD mn		
Item	2020 (a)	2021 (b)	2022 H1 (b)
Gross External Debt Position based on Market Value	49,041	50,724	48,731
General Government	28,187	27,344	24,990
Central Bank	2,690	4,892	6,364
Deposit-Taking Corporations	6,657	7,146	6,112
Other Sectors	6,517	6,078	5,715
Direct Investment:			
Intercompany Lending	4,990	5,264	5,550
Memorandum Items			
Gross External Debt Position of the General Government Based on Face Value	32,452	32,302	32,177

(a) Revised

(b) Provisional

Source: Central Bank of Sri Lanka

5.5 Exchange Rate Movements

The Sri Lanka rupee broadly remained at stable levels in early 2022, before a measured adjustment in the exchange rate was allowed in early March 2022. The Central Bank's intervention in the domestic foreign exchange market and the continued use of moral suasion helped stabilise the external value of the Sri Lanka rupee during the latter part of 2021 and in early 2022. Accordingly, with the engagement of the Central Bank, supported by the LCBs, the weighted average spot exchange rate in the interbank market remained broadly stable during the latter part of 2021 and early 2022 at around Rs. 200-203 per US dollar. However, a significant shortage in liquidity in the domestic foreign exchange market continued to exert pressures on the exchange rate, necessitating a measured adjustment that was allowed in early March 2022. However, the subsequent large overshooting of the exchange rate by market forces led the Sri Lanka rupee to depreciate substantially by 41.4% against the US dollar by end April 2022. To reduce this significant volatility driven by excessive speculation, the Central Bank introduced a new exchange rate arrangement on 13 May 2022 in consultation with the market players. Accordingly, the Central Bank commenced providing daily guidance to all LCBs on the degree of volatility in the spot exchange rate with an allowable two-sided variation margin,

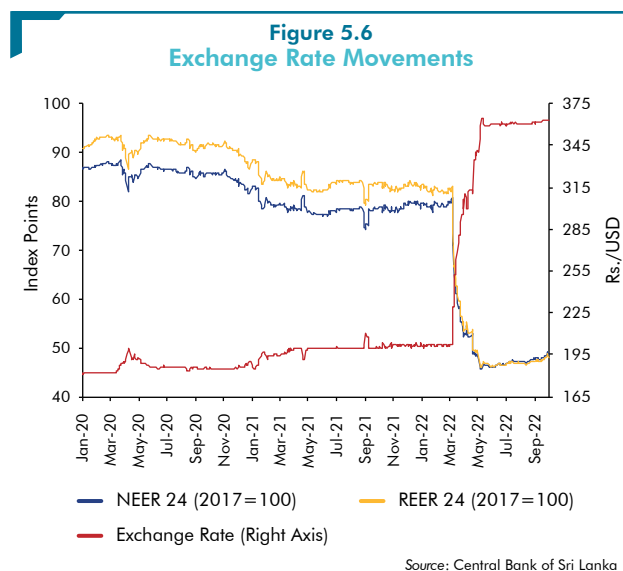


Table 5.5
Exchange Rate Movements

Currency	End Period Rate - In Rupees per unit of Foreign Currency		% Change
	2021	Sep - 2022	
Euro	226.86	355.79	-36.24
Indian rupee	2.69	4.45	-39.51
Japanese yen	1.74	2.51	-30.55
Pound sterling	270.60	402.27	-32.73
USD	200.43	362.90	-44.77
SDR	280.53	464.47	-39.60
Effective Exchange Rate Indices (2017=100)			
NEER 24-currencies	79.65	48.57	-39.02
REER 24-currencies	83.31	48.07	-42.30

Source: Central Bank of Sri Lanka

based on the weighted average spot exchange rate determined in the interbank market on the preceding day. Accordingly, from 13 May 2022 to end September 2022, the Sri Lanka rupee recorded only a marginal depreciation against the US dollar despite recording a depreciation of 44.8% against the US dollar during the year up to end September 2022. Reflecting the cross currency exchange rate movements, the Sri Lanka rupee also depreciated against the pound sterling, the euro, the Japanese yen, and the Indian rupee by end September 2022.

Large overshooting of the exchange rate by market forces led to substantial depreciation of the Sri Lanka rupee by end April 2022 before stabilising thereafter with the commencement of providing daily guidance on the exchange rate...

The NEER and REER indices, which measure the movements of the Sri Lanka rupee against a basket of currencies and thus external competitiveness, declined during the nine months ending September 2022. Overall, the REER indices remained below the threshold of 100 index points, indicating that the exchange rate remained supportive of the country's trade competitiveness.

Abbreviations and Acronyms

ACU	: Asian Clearing Union	NEER	: Nominal Effective Exchange Rate
bn	: Billion	PBOC	: People's Bank of China
BOP	: Balance of Payments	RBI	: Reserve Bank of India
BPM6	: Sixth Edition of the Balance of Payments and International Investment Position Manual	REER	: Real Effective Exchange Rate
CSE	: Colombo Stock Exchange	Rs.	: Sri Lanka Rupee
DIEs	: Direct Investment Enterprises	SAARC	: South Asian Association for Regional Cooperation
EFF	: Extended Fund Facility	SAARCFINANCE	: Network of Central Bank Governors and Finance Secretaries of the SAARC Region
EU	: European Union	SDR	: Special Drawing Rights
FDI	: Foreign Direct Investment	SOBEs	: State Owned Business Enterprises
IIP	: International Investment Position	UAE	: United Arab Emirates
IMF	: International Monetary Fund	UK	: United Kingdom
ISB	: International Sovereign Bond	USD	: United States Dollar
IT/BPO	: Information Technology & Business Process Outsourcing	USA	: United States of America
LCBs	: Licensed Commercial Banks	y-o-y	: Year-on-Year
mn	: Million		