



Financial Sector Performance and System Stability

The stability of the financial system was challenged amid strained conditions experienced by the sector on the backdrop of adverse macroeconomic conditions during the eight months ending in August 2022. The banking sector recorded a growth in terms of assets particularly due to the impact of depreciation of the local currency along with the rise in investments. However, the asset quality of the banking sector deteriorated during the period under consideration as reflected through the increase in Stage 3 Loans to Total Loans Ratio. Meanwhile, profitability of the sector also fell during the period under consideration with the increase in impairment charges. Performance of Licensed Finance Companies recorded an improvement in terms of total assets and credit portfolio during the eight months ending in August 2022. In terms of development of financial markets, both the domestic money market and the domestic foreign exchange market experienced strained liquidity conditions while primary market yield rates in the government securities market witnessed a significant increase amidst substantive domestic financing requirements and adverse market sentiments. The financial infrastructure continued to support the functioning of the financial sector in this challenging economic environment. Going forward, prudent, and proactive policy measures from all sectors of the economy will be required to ensure stability of the financial sector.

8.1. Financial Institutions

Banking Sector

The banking sector remained resilient during the eight months ending in August 2022 despite the looming threat from the macroeconomic developments. Despite continuous stress faced by the sector in terms of liquidity, the banking sector continued to operate with acceptable levels of capital and impairment coverage ratios during the eight months ending in August 2022, given the challenges in the operating environment. Capital position of banks will be further strained resulting from continuing macroeconomic challenges. Even though, with the retention of profits, a positive impact on capital ratios could be envisaged, due to the impact from the significant policy rate hike, economic contractions and concerns over the possible impact from the sovereign debt restructuring, banks will be faced with escalating challenges in maintaining their capital ratios above regulatory minimum levels and a substantial deterioration in capital buffers are anticipated.

The banking sector sustained its expansion amidst significant level of stress in terms of liquidity, capital, and asset quality...

The growth in assets of the banking sector improved during the eight months ending in August 2022 compared to the corresponding period of the last year mainly due to the reiteration of foreign currency denominated assets in rupee terms with the depreciation of the currency. Total assets of the banking sector expanded by Rs. 2.4 trillion to Rs. 19.2 trillion, recording a growth of 14.1 % in the eight months ending in August 2022, compared to an expansion of Rs. 1.8 trillion which was a growth of 12.1 % recorded in the corresponding period of 2021.

Tightening monetary policy led to a deceleration in year-on-year growth of loans and advances to 6.8 % as at end August 2022, compared to 14.5 % as at end 2021. Total loans and advances increased by Rs. 712.8 billion to reach Rs. 11.5 trillion, recording a 6.6 % growth during the eight months ending in August 2022, compared to

an increase of Rs. 1.4 trillion, which was a 14.5 % growth reported in the same period of 2021, mainly due to the impact of the exchange rate depreciation on foreign currency loans.

An increase in the growth of investments was observed during the period under consideration. Investments in the banking sector increased by Rs. 873.4 billion during the eight months ending in August 2022 and stood at Rs. 5.8 trillion, which was a 17.6 % growth, compared to an increase of Rs. 284.7 billion and a corresponding 6.7 % growth reported at end August 2021.

The banking sector expansion was largely funded by deposits. Deposits expressed as a percentage of total assets stood at 77.1 % as at end August 2022. The deposit base of the banking sector expanded by Rs. 1.9 trillion during the eight months ending in August 2022 and stood at Rs. 14.8 trillion recording a 14.9 % growth, mainly due to growth of rupee deposits, compared to an increase of Rs. 1.3 trillion and a corresponding 11.6 % growth recorded in the same period of 2021.

The growth in borrowings continued to decrease as a result of the decline in foreign currency borrowings. Borrowings of the banking sector moderated, recording a 5.8 % growth with an increase of Rs. 126.5 billion during the eight months ending in August 2022 and reached Rs. 2.3 trillion as at end August 2022, compared to an increase of Rs. 282.1 billion and a corresponding 16.5 % growth recorded in the same period of the previous year.

Asset quality of the sector deteriorated in terms of stage 3 loans to total loans ratio. Stage 3 loans increased by Rs. 475.1 billion, recording a growth of 56.9 % and reached Rs. 1.3 trillion as at end August 2022. Furthermore, stage 3 loans to total loans ratio increased to 10.6 % by end August 2022 from 7.6 % as at end 2021 induced by the increase in stage 3 loans and lower growth in credit.

Despite the liquidity stresses observed in certain domestic banks, the banking sector operated with liquid assets above the minimum regulatory requirement. The Statutory Liquid Asset Ratio of DBUs and OBUs were at 27.3 % and 40.6 %, respectively, as at end August 2022.

The net long position of foreign currency exposure of the banking sector increased to a long position of US dollars 534.6 million as at end August 2022 compared

Table 8.1
Selected Indicators of the Banking Sector

Item	End Aug 2020	End Aug 2021*	End Dec 2021*	End Aug 2022* (a)	y-o-y Change (%)	
					Aug 2021 (b)	Aug 2022 (a)
Total Assets (Rs. tn)	14	16	17	19		17.1
Loans & Advances (Rs. tn)	9	11	11	11		6.8
Investments (Rs. tn)	4	5	5	6		28.4
Deposits (Rs. tn)	10	13	13	15		16.7
Borrowings (Rs. tn)	2	2	2	2		15.4
Capital Funds (Rs. tn)	1	1	1	2		15.0
Tier 1 Capital Adequacy Ratio (%) (c)	13.2	13.0	13.2	12.2		
Total Capital Adequacy Ratio (%) (c)	16.5	16.3	16.5	15.2		
Stage 3 Loans to Total Loans (Net of Stage 3 Impairment & Including Undrawn Credits) (%)		5.0	7.6	10.6		
Stage 3 Loans to Total Loans (Excluding Undrawn Credits) (%)			n/a	11.4		
Return on Assets (Before Tax) (%)	1.3	1.3	1.4	1.1		
Return on Equity (After Tax) (%)	10.6	15.0	13.4	8.9		
Statutory Liquid Assets Ratio (DBU) (%)	38.6	36.1	33.8	27.3		
Liquid Assets to Total Assets (%)	34.6	31.5	29.7	25.4		

(a) Provisional

(b) Since the SLFRS 9 based reporting were not available for end August 2020, y-o-y change could not be reported for August 2021.

(c) As at end of June

n/a - Not Available

* Reported based on SLFRS

Source: Central Bank of Sri Lanka

to a long position of US dollars 132.2 million as at end 2021 due to higher increase in foreign currency assets compared to the increase in foreign currency liabilities. A net gain of Rs. 11.1 billion on foreign currency revaluation was recorded during the eight months ending in August 2022 compared to a net gain of Rs. 21.9 billion during the corresponding period of 2021.

The market interest rates increased amidst the tightening of monetary policy in 2022. FV gains on investment securities in FV through profit and loss and other comprehensive income amounted to Rs. 8.7 billion and Rs. 5.4 billion, respectively, during the eight months ending in August 2022 compared to losses of Rs. 2.7 billion and Rs. 14.3 billion, respectively, during the corresponding period of the previous year. This was largely due to comparatively higher funds being directed to government securities and larger movements in interest rates while the possible losses from interest rate movements were partially negated by the reclassification of investments from FV through other comprehensive income portfolio to amortised cost portfolio as allowed by the Statement of Alternative Treatments issued by the Institute of Chartered Accountants of Sri Lanka.

Profits of the sector decreased during the period under consideration. Profit before tax of the banking sector for the eight months ending in August 2022 was Rs. 126.2 billion, which was a decrease of Rs. 41.3 billion compared to the profits of Rs. 167.5 billion reported during

the corresponding period of 2021. Despite the increase in net interest income by Rs. 154.7 billion and non-interest income by Rs. 88.5 billion, profits decreased during this period mainly due to the increase in impairment charges by Rs. 250.6 billion. ROA and ROE decreased to 1.1 % and 8.9 %, respectively, as at end August 2022 from 1.7 % and 15%, respectively, as at end August 2021.

Despite adverse macroeconomic conditions, the banking sector as a whole maintained the Capital Adequacy Ratio above the minimum statutory requirements during the first half of 2022. As at end June 2022, the banking sector operated with a Tier 1 ratio of 12.2 % and a Total Capital Ratio of 15.2 %, which were well above the Basel III requirements. However, going forward, deteriorating credit quality arising from severe economic contraction, less disposable income of public, and declining revenues of SMEs could result in a capital erosion of the banking sector.

The banking sector's branch network expanded further during the first half of 2022 facilitating financial inclusion in the country. Accordingly, 4 new branches were opened, and 107 SSMs were established while 7 SSMs were closed down during the first half of 2022.

The scope of the statutory examination of banks has been designed to focus on the possible negative implications of current economic downturns and continuously increasing challenges in the operating environment of the banking industry which may lead

to a potential deterioration in assets quality, liquidity positions and capital buffers of banks. Joint supervision has commenced at banks with the involvement of non-regulatory departments of the Central Bank as well in order to strengthen the regulatory supervision mechanism for banks in a comprehensive manner.

The supervisory rating model (BSRI) has been implemented by the Central Bank with a view to facilitating the risk-based supervision framework for banks, whilst enabling early supervisory intervention and prompt corrective actions. Considering the need to protect banks from the contagion risk and to ensure the stability and the soundness of the banking sector and the financial system, consolidated supervision of banking groups has been carried out. Accordingly, a regulatory framework on consolidated supervision is being developed and provisions in this regard will also be brought into the new Banking Act.

Licensed Finance Companies

The total asset base of the sector increased by Rs. 121.1 billion during the eight months ending August 2022 and stood at Rs. 1,573.1 billion, recording a growth of 8.3 %. The Loans and Advances portfolio which represents 73.7 % of the total asset base, increased by Rs. 47 billion, recording a 4.2 % growth, largely contributing to an expansion of the asset base during the eight months ending August 2022. The sector comprised 37 LFCs¹ of which only 35 were in operation as at end August 2022.

The sector expansion was funded by increase in deposits by Rs. 48 billion which grew by 6.1 % and increase in borrowings by Rs. 33.5 billion which grew by 10.9 % during the eight months ending August 2022. The deposits and borrowings of the sector stood at Rs. 831.3 billion and Rs. 340 billion, respectively. Total capital of the sector increased by Rs. 66.9 billion during the eight months ending August 2022 recording a growth of 28.1 % and stood at Rs. 305.3 billion. The liquid assets available in the sector were at a excess of Rs. 70.9 billion by end August 2022 compared to the required level of liquid assets.

The sector recorded a PAT of Rs. 9.6 billion during the five months ending in August 2022 for the financial year 2022/23, compared with a PAT of Rs. 12.5 billion

¹ Assetline Finance Ltd. (previously, Assetline Leasing Co. Ltd., a SLC registered under Finance Leasing Act, No. 56 of 2000) was issued with a license under the Finance Business Act, No. 42 of 2011 on 29.08.2022. Financial figures of Assetline Finance Ltd. are included in SLCs sector from end August 2022.

Table 8.2
Key Performance Indicators of the LFCs Sector

KPIs	%	
	End Dec 2021	End Aug 2022
Gross Stage 3 Loan Ratio	10.8*	18.0
Net Stage 3 Loan Ratio	2.5*	12.8
Tier 1 Capital Adequacy Ratio	15.0	20.3
Total RWCAR	16.6	21.8
Net Interest Margin	8.4	6.8
Return on Assets	4.5	2.4
Return on Equity	17.1	7.4
Cost to Income Ratio	73.0	87.3

* Gross NPL and net NPL ratios prior to implementing Finance Business Act Direction No.01 of 2020.

Source: Central Bank of Sri Lanka

recorded during the corresponding period in the financial year 2021/22. Reduced Net Interest Income by Rs. 3.9 billion, which was a contraction of 7.9 %, and increased Non-Interest Expenses by Rs. 4.3 billion, which was a growth of 13.3 %, largely resulted in the reduction in profitability. 13 LFCs reported net losses during the period under consideration.

The LFCs sector improved in terms of total assets and capital base, although the profitability declined...

The Finance Business Act Direction No. 01 of 2020 on Classification and Measurement of Credit Facilities required LFCs to adopt 120 past due dates for classification of NPLs with effect from 01.04.2022, compared to the earlier requirement of 180 days. Accordingly, the asset quality of the sector deteriorated, as the gross stage 3 loan ratio and net stage 3 loan ratio (net of impairment) stood at 18 % and 12.8 %, respectively, by end August 2022. The impairment coverage ratio for stage 3 loan exposures was at 29.1 % by end August 2022. High stage 3 loans were also due to the possible downgrading of loans and advances after the expiration of the moratorium granted in consideration of the COVID-19 pandemic.

Specialised Leasing Companies

The total asset base of the sector increased by Rs. 2.2 billion, recording an expansion of 6.1 % during the eight months ending August 2022 and stood at Rs. 37.8 billion by end August 2022². Loans and Advances increased by Rs. 1 billion, recording a growth of 3.2 %

² The total asset base of Assetline Finance Ltd. stood at Rs.31.6 billion by end August 2022.

and stood at Rs. 30.8 billion. Total capital of the SLCs sector increased by Rs. 1.3 billion, which grew by 9.7 % compared to end December 2021 and stood at Rs. 14.5 billion by end August 2022. The sector recorded a PAT of Rs. 50 million during the five months period ending August 2022 for the financial year 2022/23, compared to a PAT of Rs. 186 million reported during the corresponding period in financial year 2021/22. Gross and Net stage 3 Loan Ratios stood at 20.8 % and 13.1 %, respectively, by end August 2022. The sector comprised two SLCs by end August 2022.³

Primary Dealer Companies

The sector comprised seven standalone PDCs of which only five were in operations as at end August 2022. The sector showed mixed performance during the eight months ending in August 2022. The total asset base of PDCs increased by 40.3 % and stood at Rs. 110.4 billion as at end August 2022. The government securities portfolio of PDCs increased by 41.3 % and stood at Rs. 108.2 billion by end August 2022. All active PDCs maintained their core capital and RWCAR above the minimum requirements of Rs. 2 billion and 10 %, respectively, by end August 2022. The sector recorded a net loss of Rs. 1.5 billion for the eight months period, compared to a loss of Rs. 0.1 billion recorded in the corresponding period of 2021, mainly due to the mark-to-market losses incurred by the PDCs as a result of the surge in the interest rates.

Licensed Microfinance Companies

The total asset base of the LMFCs sector, which comprised of four companies, stood at Rs. 9.3 billion by end August 2022. Gross loans and advances of LMFCs was at Rs. 6.4 billion indicating a reduction of 4.8 % during the eight months ending in August 2022. The NPL Ratio of LMFCs reduced to 9.4 % by end August 2022, compared to 16.2 % by end 2021. The sector reported a loss of Rs. 50 million during the eight months ending in August 2022.

Insurance Sector

The overall performance of the insurance sector improved with total assets showing healthy growth during the first half of 2022. Total assets and the GWP of the insurance sector grew by 7.9 % and 17.8 % on

year-on-year basis, respectively. Total assets of the long-term Insurance sub sector and General Insurance sub sector increased by 6.8 % and 10.5 %, respectively, while the GWP of both sub sectors registered significant year-on-year growths of 17.9 % and 17.7 %, respectively, as at end June 2022. Profit before tax of the sector accelerated and recorded Rs. 22.5 billion during the first half of 2022 compared to Rs. 16.9 billion recorded during the corresponding period of 2021.

Unit Trusts

A contraction in terms of the NAV of the unit trusts sector was observed during the first half of 2022. The NAV of the industry declined by 40.2 % on year-on-year basis to Rs. 132.7 billion. However, the number of unit holders increased to 62,700 recording a growth of 12.7 % at end June 2022. Investments of the sector recorded a decline of 39.4 % on year-on-year basis to Rs. 134.9 billion. Investments in government securities by the Unit Trusts amounted to 38.7 % of the NAV of the sector at end June 2022 compared to 10.6 % as at end June 2021.

Stockbroker Companies

Stockbroker companies indicated a mixed performance during the first half of 2022 compared to the corresponding period of 2021. Total assets and the net capital of the sector increased by 7 % and 32.4 % on year-on-year basis, respectively, at end June 2022. However, the average turnover of Stockbroker companies decreased by 46 % to Rs. 839 million while the PBT of the sector decreased by 74.9 % to Rs. 228 million during the first half of 2022.

Superannuation Funds

The EPF operated with an asset base of over Rs. 3.3 trillion as at end August 2022. The total number of member accounts of the EPF reached 20.3 million in December 2021.

Total member contributions and refund payments during the eight months ending in August 2022 increased by 21.2 % and 45.9 % to Rs. 123.4 billion and to Rs. 101.1 billion, respectively, in comparison to the corresponding period of the previous year. Accordingly, the net contribution (net of contributions received and refunds paid) during the period under review stood at Rs. 22.3 billion.

³ Assetline Finance Ltd. (previously, Assetline Leasing Co. Ltd., a SLC registered under Finance Leasing Act, No. 56 of 2000) was issued with a license under the Finance Business Act, No. 42 of 2011 on 29.08.2022. Financial figures of Assetline Finance Ltd. are included in SLCs sector from end August 2022.

Table 8.3
Employees' Provident Fund - Selected Indicators

Item	End Aug 2021	End Aug 2022 (a)	Change (%)
Total Contributions (Rs. bn) (b)	101.8	123.4	21.2
Total Refunds (Rs. bn) (b)	69.3	101.1	45.9
Total Assets (Rs. bn)	3,045.9	3,335.0	9.5
Total Investment Portfolio (Rs. bn)	3,037.9	3,330.8	9.6
o/w, Government Securities (%)	93.7	96.2	2.7
Gross Investment Income (Rs. Bn.) (b)	211.2	170.8	-19.1

(a) Provisional

Source: Central Bank of Sri Lanka

(b) First eight months of the respective year

Total investment of EPF also grew by 9.6 % on year-on-year basis, to Rs. 3,330.8 billion as at end August 2022. The investment consists of 96.2 % in government securities, 2.1 % in the equity market, 0.9 % in corporate debt and reverse repo, and 0.8 % in fixed deposits as at end August 2022. The gross investment income of the Fund during the eight months ending in August 2022 amounted to Rs. 170.8 billion, which is a decrease of 19.1 % compared to the corresponding period of 2021. The Rate of Return provided to members on their balances as at the end of 2021 was 9 %.

Total assets of the ETF grew by 10.8 %, on year-on-year basis, and stood at Rs. 441.4 billion as at end June 2022. Total member contributions and refund payments during the first half of 2022 increased by 17.2 % and 10.6 % to Rs. 16.8 billion and Rs. 11.5 billion, respectively, when compared with the corresponding period of the previous year. Investments made by the Fund recorded a healthy growth of 11.1 % on year-on-year basis as at end June 2022 and 93.6 % of the total investments was comprised of government securities.

There were 117 privately managed APFs in operation with 72,633 employees as at end June 2022. The total assets of APFs stood at Rs. 207.4 billion, with investments of Rs. 165 billion as at end June 2022. Total assets of the PSPF increased by 4.7 % on year-on-year basis, to Rs. 84.8 billion as at end June 2022. Total investments

Table 8.4
Employees' Trust Fund - Selected Indicators

Item	End Jun 2021	End Jun 2022 (a)	Change (%)
Total Contributions (Rs. bn) (b)	14.3	16.8	17.2
Total Refunds (Rs. bn) (b)	10.4	11.5	10.6
Total Assets (Rs. bn)	398.2	441.4	10.8
Total Investment Portfolio (Rs. bn)	378.1	419.9	11.1
o/w, Government Securities (%)	84.0	93.6	11.4
Gross Income (Rs. bn) (b)	17.1	20.3	19.0

(a) Provisional

Source: Employees' Trust Fund Board

(b) During the period

made by the PSPF stood at Rs. 84.9 billion as at end June 2022 and the Rate of Return on member balances was 8% for the period under consideration.

8.2 Financial Markets

Domestic Money Market

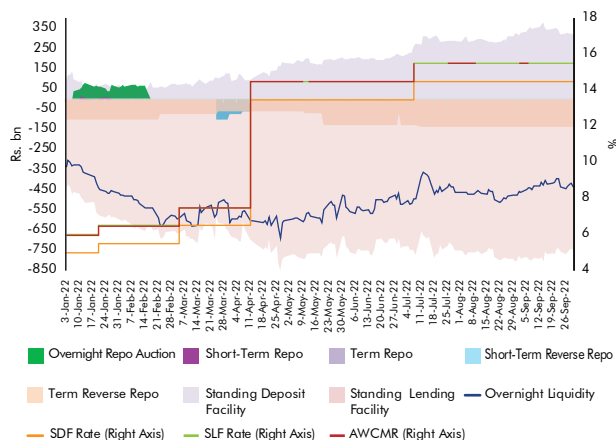
Liquidity in the domestic money market, which was in deficit levels since mid-August 2021, remained in a persistent deficit in 2022. The liquidity deficit, which was at Rs. 366.2 billion by end 2021, increased substantially to a peak of Rs. 688.3 billion towards end April 2022. The liquidity deficit improved gradually and was reported at Rs. 433.5 billion by end September 2022. Subscribing to Treasury bills at the primary auctions and special allocations, as well as granting provisional advances and transferring profits to the Government by the Central Bank caused liquidity improvements in the domestic money market. However, the impact of such injections was negated due to a host of factors, including scheduled foreign loan repayments, currency withdrawals as well as maturities of foreign currency swap transactions and Treasury bills held by the Central Bank.

Rupee liquidity in the domestic money market remained in a persistent deficit during the nine months ending in September of 2022...

During the second half of the year, currency deposits in the banking sector recorded an increase due to high interest rates, thereby improving liquidity in the banking sector. In addition, the Central Bank occasionally infused liquidity through term reverse repo auctions during 2022 with a view to reducing significant liquidity stress among certain LCBs. Further, from mid-June 2022, the Central Bank conducted outright sales of Treasury bills to partially negate the impact of liquidity injections through primary purchases of Treasury bills by the Central Bank and was able to absorb Rs. 23.5 billion by end September 2022. Further, amidst the liquidity deficit in the domestic money market, coupled with increased uncertainty in the markets, particularly on account of the speculation on fiscal sector developments, transactions in the overnight call

Figure 8.1

Standing Rate Corridor, Open Market Operations, Market Liquidity and Average Weighted Call Money Rate



Source: Central Bank of Sri Lanka

money market remained substantially low. Hence PIs mainly relied on the facilities provided by the Central Bank to borrow funds, while PIs with excess liquidity relied on the SDF to park their excess funds with the Central Bank.

In line with the continued tight monetary policy stance, the Central Bank increased its policy interest rates by a cumulative of 950 bps on four occasions during 2022, thereby increasing SDFR and the SLFR to 14.5 % and 15.5 %, respectively. The AWCMR moved towards the upper bound of the SRC and remained stagnant from mid-April to date, amidst the deficit in money market liquidity conditions. Accordingly, the AWCMR remained at 15.5 % by mid-September 2022 and call market remained broadly inactive during the latter part of September 2022. The AWRR also moved broadly in line with the movements of the AWCMR and remained at 15.5 % by end September 2022. Since mid-April 2022, both call and repo markets remained less active. Accordingly, during the third quarter of 2022, average volumes of call and repo markets remained around Rs. 2.9 billion and Rs. 4.4 billion, respectively. Other market interest rates also increased substantially in line with Treasury bill yields rates indicating a substantial deviation of market rates from the policy interest rates.

Domestic Foreign Exchange Market

During the nine months ending in September 2022, the Sri Lankan rupee recorded a significant depreciation of 44.8 % against the US dollar from Rs. 200.43 as at end

2021 to Rs. 362.9 as at 30 September 2022. As per the exchange rate guidance provided by the Central Bank from September 2021 to early March 2022, the US dollar/ Sri Lanka rupee exchange rate ranged between Rs. 200 - Rs. 203. However, considering the sharp depletion of gross official reserves of the country and the significant pressures in the domestic foreign exchange market the Central Bank allowed a measured adjustment in the exchange rate on 07 March 2022, which was subsequently resulted in an overshooting by market forces.

Therefore, as a measure in managing the intraday volatility in the exchange rate at a reasonable level, with effect from 13 May 2022, the Central Bank commenced announcing an exchange rate guidance to licensed banks with a variation margin, on a daily basis. Since then, fluctuations in the exchange rate have started to stabilise gradually, and currently, the weighted average spot exchange rate in the interbank market hovers between Rs. 360 - Rs. 363 per US dollar.

Following the substantial depreciation during March – May 2022, the Sri Lanka rupee remained broadly stable following the commencement of providing daily guidance on the exchange rate in May 2022 ...

During the year up to end September 2022, the Central Bank was a net seller in the domestic foreign exchange market. Although, the Central Bank continued to absorb foreign exchange through non-borrowed sources by mandating licensed banks to sell a certain percentage of converted workers' remittances and mandatorily converted export proceeds of goods and services into Sri Lanka rupees, the acute shortage of liquidity conditions in the domestic foreign exchange market necessitated the Central Bank to supply US dollars to finance essential imports mainly including fuel and coal, on a net basis during the year up to end July 2022. However, with the number of measures taken, including the cessation of the importation of goods via open account payment terms in May 2022 and the discouraging of non-essential imports to a greater extent, the liquidity position in the

domestic foreign exchange market improved gradually by end July 2022, enabling the Central Bank to absorb US dollars on a net basis during the months of August and September 2022. Accordingly, from January to end September 2022, the Central Bank absorbed US dollars 1,383.5 million and supplied US dollars 2,058.6 million, resulting in a net supply of US dollars 675.1 million to the market.

During the nine months that ended in September 2022, trading volumes in the domestic foreign exchange market continued their declining trend. Accordingly, the daily average trading volumes in the domestic inter-bank foreign exchange market declined by 23.4 % to US dollars 39.7 million during the period under consideration, compared to US dollars 51.8 million recorded in the same period in 2021.

Government Securities Market

Primary market yield rates of government securities adjusted upwards significantly to historically high levels due to the substantive domestic financing requirement of the central government and unprecedented market circumstances amidst the tightening monetary policy stance during the first half of the year. The socio-economic unrest that started in April 2022 continued into the following months intertwined with political turmoil, and the ensued volatility created a high degree of uncertainty in the domestic markets, which was factored into the investment decisions causing a substantial increase in the yield rates on government securities. Meanwhile, the

Yield rates on government securities were adjusted upwards to historically high levels due to increased funding requirements of the Government, sharp hike in policy interest rates and market uncertainties...

announcement of the Interim Policy Regarding the Servicing of Sri Lanka's External Public Debt on 12 April 2022, increasing funding requirement of the Government and the sharp hike in policy interest rates also exerted upward pressure on yield rates on government securities, which reached historically high levels during the third quarter of 2022. Accordingly, the secondary market yield rates of Treasury bills increased in the range of 20.77 to 22.98 percentage points while those of benchmark 3, 5, 8 and 10-year Treasury bonds increased in the range of 15.25 to 17.04 percentage points, thus far during the year up to end September 2022.

Stock Market

Price indices recorded a volatile performance in the equity market during the nine months ending in September 2022 amidst adverse macroeconomic conditions. The equity market witnessed a steep fall since early February 2022 as panicked investors started withdrawing their funds amid increased macroeconomic concerns and political instability. However, this declining trend moderated since May 2022, although significant

Figure 8.2
Movements of Secondary Market Yield Curve of Government Securities

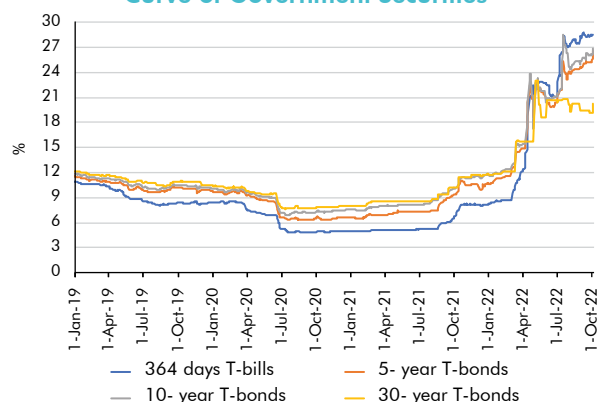


Figure 8.3
Movements of Share Price Indices

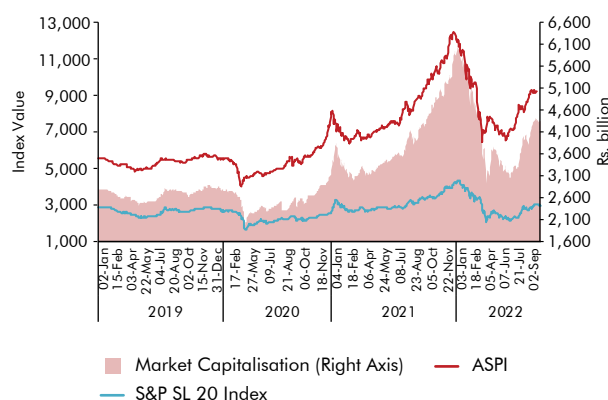


Table 8.5
Equity Market - Selected Indicators

Item	End 2020	2021 Sep	End 2021	2022 Sep
All Share Price Index (1985=100)	6,774.2	9,459.9	12,226.0	9,931.1
Y-t-d change (%)	10.5	39.6	80.5	-18.8
S&P SL 20 Index (2004=1,000)	2,638.1	3,534.8	4,233.3	3,165.3
Y-t-d change (%)	-10.2	34.0	60.5	-25.2
Market Capitalisation (Rs. bn)	2,960.7	4,215.6	5,489.2	4,341.1
As a (%) of GDP (a)	18.7	23.8	31.0	24.5
Market Price Earning Ratio	11.3	11.5	13.6	5.7
Average Daily Turnover (Rs. mn)	1,899.0	4,455.0	4,888.2	3,316.2
Net Cumulative Foreign Purchases (Rs. mn)	-51,275.7	-44,862.0	-52,649.4	13,490.4
Number of Companies Listed	283	287	296	294

(a) Based on GDP for 2021 (Rs. 17,686 bn)

Source: Colombo Stock Exchange

volatilities were observed in several instances, and the market showed signs of improvements since July 2022. Nevertheless, price indices were significantly below the levels observed at end 2021.

Overall, the ASPI and S&P SL 20 index recorded negative growth of 18.8% and 25.2%, respectively, during the year until end September 2022. Market capitalisation stood at Rs. 4,341.1 billion as at end September 2022, recording a year-to-date negative growth of 20.9%. In terms of the sector wise disaggregation of price indices, all sectors except the four sectors Energy (218.2%), Commercial & Professional Services (74.1%), Consumer Services (8.6%), and Food & Staples Retailing (4.1%) have recorded negative year-to-date growth in price indices as at end September 2022. The Diversified Financial sector recorded the highest negative year-to-date growth of 73.6% as at end September 2022, followed by the Transportation (-42%) and Automobile & Components sectors (-31.1%).

A noticeable improvement in terms of net foreign inflows was observed in 2022 until end August. Accordingly, the Colombo Stock Exchange recorded US dollars 97.2 million net foreign inflows during the year until end August 2022 compared to a net outflow of US dollars 181.3 million recorded during the corresponding period of 2021.

Corporate Debt Securities Market

The corporate bond market was relatively less active during the nine months ending in September 2022, mainly due to high interest rates and adverse macroeconomic conditions. Only two institutions issued debentures during the nine months ending

in September 2022, raising Rs. 2.6 billion compared to Rs. 84.4 billion raised by 14 institutions during the corresponding period of 2021. Fixed interest rates were in the range of 15.42% to 15.5% compared to the range of 8% to 12% of the corresponding period in the previous year.

Similar to the corporate bond market, the CP market was also relatively less active in the eight months ending in August 2022. During the year up to August 2022, Rs. 1.7 billion was raised through the CPs issued with the support of licensed banks compared to Rs. 3.6 billion raised through issues in the corresponding period of 2021. Interest rates of CPs varied between the range of 11% to 32% during the eight months ending in August 2022 compared to the range of 6.25% to 11.5% reported in the corresponding period of the previous year.

8.3 Developments in the Financial Infrastructure

Payment and Settlement Systems

In January 2022, the Central Bank granted approval to NSB to become the first LSB to obtain the participant status of the LankaSettle System. With the aim of promoting inward foreign remittances, the Central Bank launched the National Remittance Mobile Application, 'LankaRemit' in February 2022.

The retail payment systems and instruments recorded growth in volumes and values depicting the adoption of digital payment methods. CEFTS and SLIPS exhibited a gradual increase during the period. Further, credit and debit card transactions continued to increase as the public adopted non-cash methods for purchases of goods and services. Meanwhile, registration of LANKAQR merchants increased in the first half of 2022

Table 8.6
Volume of Transactions Through Payment Systems ('000) (a)

Payment system/ Instrument	2017	2021	Growth %	2021 (Jan-Jun)	2022 (Jan-Jun)	Growth %
Large Value Payment Systems						
RTGS System	377	450	19.4	203	283	39.4
Retail Value Payment Systems / Instruments						
Interbank Cheque Clearing System	51,963	33,021	-36.5	16,839	17,227	2.3
SLIPS	30,018	41,868	39.5	19,952	22,492	12.7
Credit Cards	36,964	50,689	37.1	23,349	29,310	25.5
Debit Cards*	46,964	108,040	130.0	48,412	72,258	49.3
CEFTS	3,163	54,675	1,628.6	23,205	39,584	70.6
LANKAQR**	133	849	538.3	429	268	-37.5

(a) During the period

* through Point of Sales (POS) terminals

** Volume of transactions in 2020. LANKAQR introduced in 2018

Source: Central Bank of Sri Lanka

Table 8.7
Value of Transactions Through Payment Systems (Rs. bn) (a)

Payment system/ Instrument	2017	2021	Growth %	2021 (Jan-Jun)	2022 (Jan-Jun)	Growth %
Large Value Payment Systems						
RTGS System	92,302.7	294,602.0	219.2	93,672.4	384,004.9	309.9
Retail Value Payment Systems / Instruments						
Interbank Cheque Clearing System	10,481.9	8,311.5	-20.7	4,015.3	5,007.3	24.7
SLIPS	1,725.0	2,862.2	65.9	1,331.6	1,644.9	23.5
Credit Cards	198.5	282.6	42.4	126.2	191.4	51.7
Debit Cards*	134.5	315.9	134.9	137.8	248.8	80.6
CEFTS	273.7	4,926.6	1,700.0	1,983.5	3,980.9	100.7
LANKAQR**	0.3	1.9	533.3	0.8	0.8	-

(a) During the period

* through Point of Sales (POS) terminals

** Value of transactions in 2020. LANKAQR introduced in 2018

Source: Central Bank of Sri Lanka

owing to merchant awareness campaigns. During the same period, cheque usage, as indicated by the volume of cheques, slightly increased and remained as a popular payment instrument.

The Central Bank took several measures aimed at promoting digital payments and developing the national payment infrastructure in Sri Lanka while efficiently catering to the payments and settlement needs of the country...

Channels of utilising the LankaPay debit card issued under the NCS were extended with the successful launch of a pilot project to issue 2 in 1 LankaPay debit cards with a stored-value facility for transportation purposes. Further, the LSPs of payment cards and mobile phone based e-money systems were continuously supervised

to ensure the safety and efficiency of services provided by them. In addition, the Central Bank continued to educate the public on the usage, security and new developments with regard to digital payment instruments/mechanisms.

Regulation and Supervision of Foreign Exchange

Amendments to the existing Regulations, Directions and Orders issued under the FEA were made as required during the year, largely to improve foreign exchange inflows and curtail foreign exchange outflows from the country. Rules on Repatriation of Export Proceeds into Sri Lanka, issued under the MLA were amended, requiring mandatory conversion of the residual of the export proceeds repatriated into the country within the stipulated period. However, service exporters were subsequently exempted from the conversion requirements under the Rules. Further, Regulations and Directions were issued under the FEA to facilitate foreign exchange transactions/ investments in the Colombo Port City by authorised persons subject

to the permission granted under the provisions of the Colombo Port City Economic Commission Act, No. 11 of 2021.

Additionally, an order was issued under Section 22 of the FEA imposing limitations/ suspensions on remittances in respect of outward capital transactions, to preserve the foreign exchange reserve of the country and avoid abrupt outflows from the market. To encourage inflows and retention of foreign exchange within the country, Regulations and Directions were also issued extending the validity period of opening Special Deposit Accounts by a further 12 months until 08 April 2023.

Moreover, the amount of foreign currency retained in possession by a person in, or resident in, Sri Lanka was reduced from USD 15,000 to USD 10,000 or its equivalent in other foreign currencies. Meanwhile, following the decision of the Central Bank to designate the Thai Baht and Indian rupee for the Offshore Banking Unit transactions, the same were also declared as designated foreign currencies for the purposes/ transactions under the FEA in the Domestic Banking Units of Authorised Dealers.

Anti-Money Laundering and Countering the Financing of Terrorism

During 2022, the FIU performed its key task of receiving, analysing and disseminating information on suspicious transactions relating to ML/TF or any other unlawful activities in terms of the FTRA. Accordingly, as of end September 2022, the FIU referred 303 STRs to Law Enforcement Agencies and Regulators for further investigations/ necessary actions and conducted onsite examinations to ensure AML/CFT compliance by Financial Institutions and proper adaptation of the AML/CFT framework by the DNFBPs sector. With the purpose of further strengthening of the country's AML/CFT framework, the FIU issued 3 Circulars during the nine months ending September 2022 as well.

Moreover, the FIU initiated conducting the second ML/TF NRA in Sri Lanka in 2021, with the participation of 66 public and private stakeholder agencies. The FIU also initiated the introduction of a new transaction reporting system, 'goAML' for reporting institutions and continued to conduct awareness programmes to enhance awareness on AML/CFT among the stakeholders.

Legal Reforms Related to the Financial Sector

In 2022, the Central Bank continued to introduce law reforms to major legislation administered by the Bank, with the objective of strengthening and enhancing the financial regulatory and supervisory regime of the country. As a major step to strengthen decisional and operational independence and accountability of the Central Bank, a new Central Banking Act is being drafted to replace the current Monetary Law Act. A new Banking (Special Provisions) Act will be enacted shortly to strengthen the resolution powers and financial safety net mechanisms exercised by the Central Bank relating to licensed banks. Further, with a view to legally permitting licensed banks and non-bank financial institutions to offload toxic/ hard-to-value assets from their balance sheets, a new law on Financial Asset Management Companies will also be introduced. Meanwhile, the Central Bank has developed new legislation such as the Micro Finance and Credit Regulatory Act and Trading Clearing and Netting Act to address the gaps in the current legal landscape. In addition, the Central Bank is also taking steps to update the existing laws by introducing amendments to the Foreign Exchange Act, Finance Business Act, Finance Leasing Act and Payment and Settlement Systems Act to keep abreast with changes in the financial sector and financial innovations.

Resolution and Enforcement

The Central Bank continued compensation payments to depositors of six license cancelled/ business suspended finance companies under the SLDILSS. However, compensation payments to the depositors of SFSP were suspended during the year due to the revival of the company. Further, the process of accepting new claims in relation to compensation payments from the depositors of CIFL and TSCFL was discontinued due to the expiration of the maximum period as specified in Regulations of SLDILSS.

Moreover, the drafting of relevant provisions pertaining to the establishment of a comprehensive resolution framework for banks and non-bank financial institutions, a deposit insurance scheme and liquidation of banks and non-bank financial institutions were carried out under the proposed Banking (Special Provisions) Act. The Central Bank also took initiatives to develop a depositor-wise data

collection system for all MIs of SLDILSS with the purpose of increasing the quality and the accuracy of the data reporting and minimising the risk associated with data security.

Development Finance and Access to Finance

The Central Bank continued to coordinate, facilitate, and implement various refinance, interest subsidy and credit guarantee schemes, with the intention of granting affordable financial facilities for MSMEs and individuals. During the nine months ending in September 2022, loans amounting to Rs. 7,407.5 million were disbursed among 15,092 beneficiaries through 16 PFIs under 17 loan schemes. Considering the significant increase in market interest rates, the interest rate of the Saubagya (Prosperity) loan scheme was revised upwards, and PFIs were instructed to ensure granting 80 % of new loans to agriculture, livestock, and fisheries sectors, considering probable food shortage in the future. Meanwhile, a debt moratorium was granted for loan schemes operated by the Central Bank to provide

comfort to borrowers who have been severely affected by the current economic situation.

Moreover, the Central Bank continued to monitor the implementation of the NFIS, aligning with its action plan to ensure achieving the set targets. Further, the first ever island wide financial literacy survey was successfully completed with the assistance of the IFC and the key findings of the survey were published.

Financial Consumer Relations

The Central Bank continued to strengthen the financial consumer protection framework. In this context, the Central Bank received 3,208 complaints and grievances during the eight months ending in August 2022.

Moreover, the Central Bank has commenced the process of issuing new regulations/ guidelines for facilitating a comprehensive financial consumer protection framework for entities regulated by the Central Bank and has drafted the Financial Consumer Protection Regulations.

Abbreviations and Acronyms

AML/CFT	: Anti-Money Laundering and Countering the Financing of Terrorism	NRA	: National Risk Assessment
APF	: Approved Provident Fund	NSB	: National Savings Bank
ASPI	: All Share Price Index	OBU	: Off-shore Banking Unit
AWCMR	: Average Weighted Call Money Rate	PAT	: Profit After Tax
AWRR	: Average Weighted Repo Rate	PBT	: Profit Before Tax
BSRI	: Bank Sustainability Rating Indicator	PDC	: Primary Dealer Company
CEFTS	: Common Electronic Fund Transfer Switch	PFI	: Participating Financial Institution
CIFL	: Central Investments and Finance PLC	PI	: Participatory Institution
CP	: Commercial Paper	PSPF	: Public Service Pensions Fund
DBU	: Domestic Banking Unit	ROA	: Return on Assets
DNFBP	: Designated Non-Financial Businesses and Professions	ROE	: Return on Equity
EPF	: Employees' Provident Fund	RWCAR	: Risk Weighted Capital Adequacy Ratio
ETF	: Employees' Trust Fund	SDF	: Standing Deposit Facility
FEA	: Foreign Exchange Act, No. 12 of 2017	SDFR	: Standing Deposit Facility Rate
FIU	: Finance Intelligence Unit	SFSC	: Swarnamahal Financial Services PLC
FTRA	: Financial Transactions Reporting Act, No. 6 of 2006	SLC	: Specialised Leasing Company
FV	: Fair Value	SLDILSS	: Sri Lanka Deposit Insurance and Liquidity Support Scheme
GWP	: Gross Written Premium	SLFR	: Standing Lending Facility Rate
IFC	: International Finance Corporation	SLIPS	: Sri Lanka Interbank Payment System
LCB	: Licensed Commercial Bank	SME	: Small and Medium-sized Enterprise
LFC	: Licensed Finance Company	SRC	: Standing Rate Corridor
LMFC	: Licensed Microfinance Company	SSM	: Self Service Machine
LSP	: Licensed Service Provider	STR	: Suspicious Transaction Report
MI	: Member Institution	S&P SL 20	: Standard and Poor's Sri Lanka 20
ML	: Money Laundering	TF	: Terrorist Financing
MLA	: Monetary Law Act, No. 58 of 1949	TSCFL	: The Standard Credit Finance Ltd
MSME	: Micro, Small and Medium Enterprise		
NAV	: Net Asset Value		
NCS	: National Card Scheme		
NFIS	: National Financial Inclusion Strategy		
NPL	: Non-performing Loan		