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SRI LANKA

March 2025

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, FINANCING ASSURANCES REVIEW, AND MONETARY POLICY CONSULTATION CLAUSE—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SRI LANKA

In the context of the Third Review Under the Extended Arrangement Under the Extended Fund Facility, Financing Assurances Review, and Monetary Policy Consultation Clause, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 28, 2025, following discussions that ended on November 23, 2024, with the officials of Sri Lanka on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on February 11, 2025.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Sri Lanka.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Completes the Third Review Under the Extended Fund Facility with Sri Lanka

FOR IMMEDIATE RELEASE

- The IMF Executive Board completed the Third Review under the 48-month Extended Fund Facility with Sri Lanka, providing the country with immediate access to SDR 254 million (about US $334 million) to support its economic policies and reforms.
- Performance under the program has been strong. All quantitative targets for end-December 2024 were met, except the indicative target on social spending. Most structural benchmarks due by end-January 2025 were either met or implemented with delay. The recent successful completion of the bond exchange is a major milestone towards restoring debt sustainability.
- Reform efforts are bearing fruit with the recovery gaining momentum. As the economy is still vulnerable, sustaining the reform agenda is critical to put the economy on a path towards lasting recovery and debt sustainability.

Washington, DC – **February 28, 2025:** The Executive Board of the International Monetary Fund (IMF) completed the third review under the 48-month Extended Fund Facility (EFF) Arrangement, allowing the authorities to draw SDR 254 million (about US$334 million). This brings the total IMF financial support disbursed so far to SDR 1.02 billion (about US$1.34 billion).[1]

The EFF arrangement for Sri Lanka was approved by the Executive Board on March 20, 2023 (see Press Release No. 23/79) in an amount of SDR 2.286 billion (395 percent of quota or about US$3 billion. The program supports Sri Lanka's efforts to restore and maintain macroeconomic stability and debt sustainability while protecting the poor and vulnerable, rebuild external buffers, and enhance growth-oriented structural reforms including by strengthening governance.

Following the Executive Board discussion on Sri Lanka, Mr. Kenji Okamura, Deputy Managing Director, issued the following statement:

"Reforms in Sri Lanka are bearing fruit and the economic recovery has been remarkable. Inflation remains low, revenue collection is improving, and reserves continue to accumulate. Economic growth averaged 4.3 percent since growth resumed in the third quarter of 2023. By end-2024, Sri Lanka's real GDP is estimated to have recovered 40 percent of its loss incurred between 2018 and 2023. The recovery is expected to continue in 2025. As the economy is still

[1] SDR figures are converted at the market rate of U.S. dollar per SDR on the day of the Board approval.

vulnerable, it is critical to sustain the reform momentum to ensure macroeconomic stability and debt sustainability, and promote long-term inclusive growth. There is no room for policy errors.

“Program performance has been strong with all quantitative targets met, except for the indicative target on social spending. Most structural benchmarks due by end-January 2025 were either met or implemented with delay.

“Sustained revenue mobilization is crucial to restoring fiscal sustainability and ensuring that the government can continue to provide essential services. Boosting tax compliance and refraining from tax exemptions are key to maintaining support for economic reforms. To ease economic hardship and ensure the poor and vulnerable can participate in Sri Lanka’s recovery it is important to meet social spending targets and continue with reforms of the social safety net. Going forward, social support needs to be well-targeted towards the most disadvantaged so as to promote inclusive growth with limited fiscal space. Restoring cost-recovery electricity pricing without delay is needed to contain fiscal risks from state-owned enterprises. A smoother execution of capital spending within the fiscal envelope would foster medium-term growth.

“The progress to advance the debt restructuring to restore Sri Lanka’s debt sustainability is noteworthy. The recent successful completion of the bond exchange is a major milestone towards restoring debt sustainability. Timely finalization of bilateral agreements with creditors in the Official Creditor Committee and with remaining creditors is a priority now.

“Monetary policy should prioritize maintaining price stability, supported by sustained commitment to prohibit monetary financing and safeguard Central Bank independence. Continued exchange rate flexibility and gradually phasing out the balance of payments measures remain critical to rebuild external buffers and facilitate rebalancing.

“Resolving non-performing loans, strengthening governance and oversight of state-owned banks, and improving the insolvency and resolution frameworks are important priorities to revive credit growth and support the economic recovery.

“Prolonged structural challenges need to be addressed to unlock Sri Lanka’s long-term potential, including steadfast implementation of the governance reforms.”

Sri Lanka: Selected Economic Indicators 2022-2030

	2022	2023	2024	2025	2026	2027	2028	2029	2030
		Act.	Proj.			Projections			
GDP and inflation (in percent)									
Real GDP	-7.3	-2.3	4.5	3.0	3.0	3.1	3.1	3.1	3.1
Inflation (average) 1/	45.2	17.4	1.2	3.8	5.4	5.2	5.0	5.0	5.0
Inflation (end-of-period) 1/	58.6	3.0	-1.5	7.8	5.4	5.2	5.0	5.0	5.0
GDP Deflator growth	47.5	17.5	3.5	4.9	5.5	5.3	5.2	5.1	5.0
Nominal GDP growth	36.6	14.8	8.2	8.1	8.7	8.5	8.5	8.4	8.3
Savings and investment (in percent of GDP)									
National savings	27.6	33.8	34.0	31.7	31.9	32.1	31.9	31.7	31.7
Government	-6.4	-6.0	-3.2	-1.8	-0.7	0.0	0.1	0.3	0.5
Private	34.0	39.8	37.2	33.5	32.6	32.1	31.7	31.4	31.2
National investment	28.6	30.8	32.1	32.2	32.5	32.9	32.7	32.6	32.5
Government	5.5	3.7	3.6	4.4	4.6	4.7	4.6	4.6	4.6
Private	23.1	27.1	28.5	27.7	27.9	28.2	28.1	28.0	28.0
Savings-Investment balance	-1.0	3.1	1.8	-0.4	-0.6	-0.8	-0.9	-0.9	-0.8
Government	-11.9	-9.6	-6.8	-6.2	-5.3	-4.7	-4.5	-4.3	-4.1
Private	10.9	12.7	8.6	5.8	4.7	3.9	3.6	3.4	3.2
Public finance (in percent of GDP)									
Revenue and grants	8.4	11.1	13.7	15.1	15.3	15.3	15.2	15.3	15.3
Expenditure	18.6	19.4	19.3	20.4	19.8	19.2	19.1	19.0	18.8
Primary balance	-3.7	0.6	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Central government balance	-10.2	-8.3	-5.6	-5.4	-4.6	-4.0	-3.8	-3.7	-3.5
Central government gross financing needs	34.1	27.6	22.1	22.8	19.7	15.7	13.2	11.8	11.6
Central government debt	115.9	109.5	99.5	105.7	106.4	103.5	100.2	97.0	93.9
Public debt 2/	126.3	115.8	104.6	110.7	110.9	107.4	103.7	100.1	96.8
Money and credit (percent change, end of period)									
Reserve money	3.3	-1.5	10.3	9.7	8.7	8.5	8.5	8.4	8.3
Broad money	15.5	7.3	10.0	9.7	8.7	8.5	8.5	8.4	8.3
Domestic credit	18.8	-1.2	6.1	3.3	2.8	3.3	4.0	4.3	4.9
Credit to private sector	6.4	-0.8	7.9	7.5	9.5	9.5	9.4	9.4	9.4
Credit to private sector (adjusted for inflation)	-38.8	-18.2	6.6	3.7	4.1	4.3	4.3	4.3	4.3
Credit to central government and public corporations	31.1	-1.6	4.7	-0.1	-3.1	-2.9	-2.2	-2.2	-1.5
Balance of Payments (in millions of U.S. dollars)									
Exports	13,107	11,911	12,772	13,446	14,090	14,795	15,638	16,397	17,192
Imports	-18,291	-16,811	-18,841	-21,718	-22,668	-23,410	-24,105	-25,109	-26,026
Current account balance	-737	2,582	1,824	-409	-538	-751	-864	-952	-922
Current account balance (in percent of GDP)	-1.0	3.1	1.8	-0.4	-0.6	-0.8	-0.9	-0.9	-0.8
Current account balance net of interest (in percent of GDP)	0.1	4.2	3.8	1.7	1.6	1.5	1.5	1.3	1.3
Export value growth (percent)	4.9	-9.1	7.2	5.3	4.8	5.0	5.7	4.9	4.9
Import value growth (percent)	-11.4	-8.1	12.1	15.3	4.4	3.3	3.0	4.2	3.7
Gross official reserves (end of period)									
In millions of U.S. dollars	1,898	4,392	6,122	7,056	9,303	13,118	14,710	14,875	15,175
In months of prospective imports of goods & services	1.2	2.4	2.9	3.2	4.1	5.5	5.9	5.8	5.7
In percent of ARA composite metric	16.6	37.5	50.3	58.3	75.4	100.1	108.8	108.5	108.7
Usable Gross official reserves (end of period) 3/									
In millions of U.S. dollars	462	2,956	4,686	7,056	9,303	13,118	14,710	14,875	15,175
In months of prospective imports of goods & services	0.3	1.6	2.2	3.2	4.1	5.5	5.9	5.8	5.7
In percent of ARA composite metric	4.0	25.3	38.5	58.3	75.4	100.1	108.8	108.5	108.7
External debt (public and private)									
In billions of U.S. dollars	57.4	54.1	53.9	54.9	57.2	61.2	62.9	63.3	65.6
As a percent of GDP	77.0	64.1	54.4	56.1	62.9	65.9	64.0	60.4	58.9
Memorandum items:									
Nominal GDP (in billions of rupees)	24,064	27,630	29,893	32,309	35,123	38,113	41,343	44,819	48,551
Exchange Rate (period average)	322.6	327.5	302.0	…	…	…	…	…	…
Exchange Rate (end of period)	363.1	323.9	293.0	…	…	…	…	…	…

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

1/ Colombo CPI.

2/ Comprising central government debt, publicly guaranteed debt, and CBSL external liabilities (i.e., Fund credit outstanding and international currency swap arrangements). The debt statistics currently assume the external debt restructuring to have been completed at end 2023.

3/ Excluding PBOC swap ($1.4bn in 2022) which becomes usable once GIR rise above 3 months of previous year's import cover.

INTERNATIONAL MONETARY FUND

SRI LANKA

February 11, 2025

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, FINANCING ASSURANCES REVIEW, AND MONETARY POLICY CONSULTATION CLAUSE

EXECUTIVE SUMMARY

Context. Sri Lanka underwent a political transition with presidential and parliamentary elections in late 2024. The new authorities expressed commitment to the program. Reform efforts are bearing fruit with growth recovering, low inflation, increased revenue collection, and reserves accumulation. By end-2024, Sri Lanka's real GDP is projected to have recovered about 40 percent of its loss incurred between 2018 and 2023. Nevertheless, the economy is still vulnerable, and restoration of debt and external sustainability depends on continued implementation of reforms.

Program Status. On completion of the third review, Sri Lanka would have access to an additional SDR 254 million, bringing total disbursements to SDR 1.016 billion under the Extended Fund Facility (EFF) Arrangement.

Program Performance. Program performance was strong with all end-December Quantitative Performance Criteria (QPCs) and standard continuous Performance Criteria met except the Monetary Policy Consultation Clause (MPCC) and Indicative Target (IT) on social spending. By end-January 2025, most continuous Structural Benchmarks (SBs) and other SBs were either met or implemented with a delay. The prior action (PA) on lifting import restrictions is met and two more PAs on the 2025 draft budget and underlying revenue measures are on track.

Program Risks. Risks to program financing have declined with the improved external outlook, but risks to implementation remain high given the possibility of reform fatigue. Contingency plans are important, and policies should remain agile to adjust to evolving circumstances.

Program Modalities. New and modified quantitative targets and SBs until December 2025 are proposed. Staff recommends that the Board completes the required MPCC consultation and the financing assurances review.

Approved By
Sanjaya Panth (APD) and Martin Čihák (SPR)

Technical meetings took place during October 16-25, 2024, in Washington DC and discussions were held in Colombo during November 17-23, 2024. The mission met with President and Finance Minister Dissanayake, Central Bank of Sri Lanka Governor Weerasinghe; Secretary to the Treasury Siriwardana; other senior officials; P. Harischandra (OED); and representatives of the Parliamentary Opposition, the business community, civil society, and international partners. The staff team comprised P. Breuer (Mission Chief) and K. Svirydzenka (Deputy Mission Chief), S. Dhungana, H. Selim, U. Wiriadinata, (all APD), S. Kwalingana (SPR), D. Rozhkov (FAD), D. Palermo (MCM), J. Turkewitz (LEG), M. Woldemichael (resident representative), and M. Abeyawickrama (local economist). R. Yang, P. Mahmud, and S. Abebe (APD) assisted in the preparation of this report.

CONTENTS

TABLES

ANNEXES

APPENDIX

Acronyms

ADB	Asian Development Bank
AIP	Agreement in Principle
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ARA	Assessing Reserve Adequacy
BOI	Board of Investments
BOP	Balance of Payments
BSTA	Bulk Supply Transaction Account
CBSL	Central Bank of Sri Lanka
CDB	China Development Bank
CEB	Ceylon Electricity Board
CFM	Capital Flow Measures
CIABOC	Commission to Investigate Allegations of Bribery or Corruption
CIT	Corporate Income Tax
COT	Comparability of Treatment
CPC	Ceylon Petroleum Corporation
CPI	Consumer Price Index
DSA	Debt Sustainability Analysis
EFF	Extended Fund Facility
FAD	Fiscal Affairs Department
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FSSR	Financial Sector Stability Reviews
FX	Foreign Exchange
GDP	Gross Domestic Product
GFN	Gross Financing Needs
GFSM	Government Finance Statistics Manual
IFI	International Financial Institution
IRD	Inland Revenue Department
IRIT	Imputed Rental Income Tax
ISB	International Sovereign Bond
IT	Indicative Target
ITMIS	Integrated Treasury Management Information System
KPI	Key Performance Indicator
LEG	Legal Department
LIOA	Lending into Official Arrears
MCM	Monetary and Capital Markets Department
MCP	Multiple Currency Practices
MEFP	Memorandum of Economic and Financial Policies
MOF	Ministry of Finance, Planning, and Economic Development
MPCC	Monetary Policy Consultation Clause
NCG	Net Credit to Government

NIR	Net International Reserves
NPLs	Non-Performing Loans
NPP	National People's Power
NPV	Net Present Value
OCC	Official Creditor Committee
PA	Prior Action
PBoC	People's Bank of China
PDM	Public Debt Management
PDMO	Public Debt Management Office
PIT	Personal Income Tax
PFM	Public Financial Management
PPP	Public-Private Partnership
PSSA	Payment Settlement and Systems Act
QPC	Quantitative Performance Criterion
RAMIS	Revenue Administration Management Information System
RDA	Road Development Authority
REER	Real Effective Exchange Rate
SARTTAC	South Asia Regional Training and Technical Assistance Center
SB	Structural Benchmark
SCL	Special Commodity Levy
SDP	Strategic Development Projects
SEZ	Special Economic Zone
SOB	State-Owned Banks
SOE	State-Owned Enterprises
SPR	Strategy, Policy, and Review Department
SPRR	Sales Price and Rents Register
SSCL	Social Security Contribution Levy
SSN	Social Safety Net
SVAT	Simplified Value-Added Tax
TA	Technical Assistance
TADAT	Tax Administration Diagnostic Tool
UNCAC	United Nations Convention against Corruption
VAT	Value Added Tax
WB	World Bank

CONTEXT

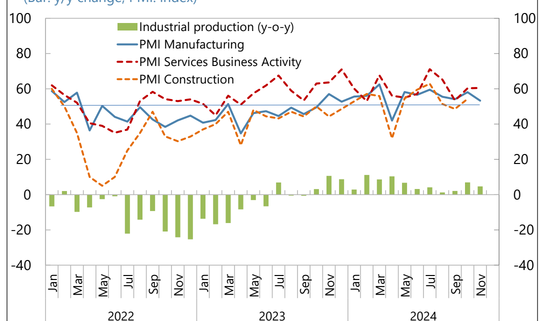
1. **In late 2024, Sri Lanka underwent a political transition with elections ushering in a new presidential administration and parliament.** Anura Kumara Dissanayake, leader of the National People's Power (NPP) party, won in the September 21 presidential elections. He assumed the Finance Minister responsibility, dissolved parliament, and called for legislative elections on November 14, in which his party (NPP) gained a two-third majority. The new authorities expressed commitment to the program objectives and targets, while seeking some adjustments of fiscal measures in line with their priorities (¶9).

RECENT MACROECONOMIC DEVELOPMENTS

2. **The recovery has put the Sri Lankan economy on a stronger footing**.

- *The economic recovery gathered momentum*. Real annual GDP growth reached 5.5 percent in 2024Q3 and averaged 4.3 percent since growth resumed in 2023Q3. By end-2024, Sri Lanka's real GDP is projected to have recovered about 40 percent of its loss incurred between 2018 and 2023. High frequency indicators point to continued expansion across all sectors.

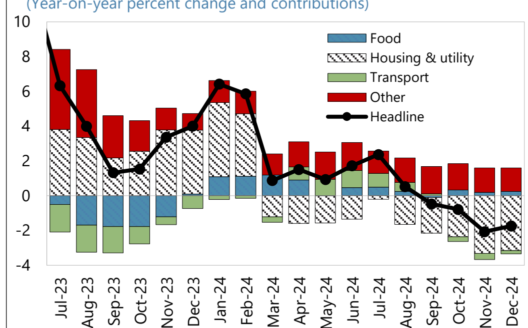
High Frequency Indicators
(Bar: y/y change; PMI: index)



Sources: Haver Analytics; and CBSL.

- *Inflation fell below target*. Year-on-year headline inflation entered temporary deflation territory starting September 2024, as a result of large cuts in electricity tariffs (39 percent cumulatively in March and July) and favorable fuel prices leading to drops in utility and transport costs, exchange rate appreciation, and improved domestic supply conditions, amidst muted demand pressures. In December 2024 year-on-year headline inflation fell to -1.7 percent while core inflation remained positive at 2.7 percent.

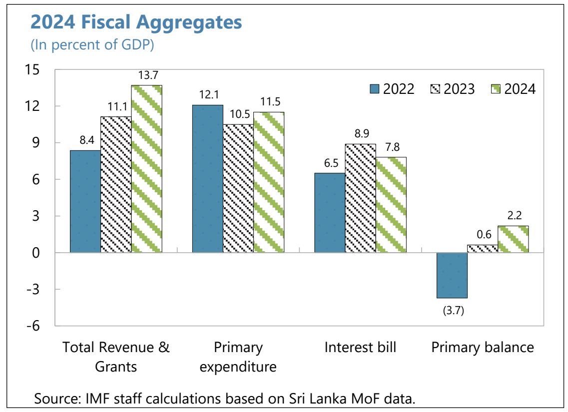
Colombo Consumer Price Index
(Year-on-year percent change and contributions)



Sources: CBSL; and Haver Analytics.

- *Reserve accumulation continued amidst ample FX liquidity*. The current account improved with buoyant tourism, strong remittances, and narrower-than-projected trade deficit due to weaker imports. Following net foreign exchange (FX) purchases of US$2.8 billion, gross official reserves reached US$6.1 billion (50.3 percent of the ARA metric) by end-December 2024. The nominal exchange rate appreciated by 10.6 percent through end-December 2024, and the REER appreciated by 4.6 percent through October 2024 supported by strong external sector performance, successful completion of the international sovereign bond exchange, and reform continuity.

- *The primary balance overperformed despite the election cycle*. A surplus of Rs. 653.5 billion (2.2 percent of GDP) at end-2024 reflected subdued spending and sustained revenue mobilization (text chart).[1]



- *Credit growth is picking up, albeit slowly due to legacy non-performing loans (NPLs).* Nominal credit growth accelerated to 9.3 percent y/y by end-October 2024 thanks to stronger bank capital positions. As of 2024Q3, the system-wide capital adequacy ratio was 18.5 percent.[2] NPLs have started to come down, but remain high at 12.6 percent, mainly due to inefficient mechanisms for collecting debt in arrears, constraining banks' ability to provide new credit.

- *Domestic financing conditions have broadly eased and the sovereign risk premium on international bonds has fallen significantly.* T-bill yields declined from 14 percent in early 2024 to 9 percent in December, and authorities were able to issue longer-term domestic bonds (DSA, ¶2). Spreads on Eurobonds have fallen sharply from a weighted average of 1,900 bps prior to the restructuring to around 520 bps in mid-January on the non-macro-linked bond (2035 maturity with governance-linked features).[3]

OUTLOOK AND RISKS

3. **The outlook is for continued recovery with contained inflation and an improving external position**. 2024 growth is revised up from 2.0 to 4.5 percent to reflect the stronger outturn. The recovery is expected to continue as uncertainties from elections and debt restructuring dissipate. Average inflation is expected to gradually return to the 5 percent target. A small uptick in year-on-year inflation is expected towards end-2025 given base effects, relaxation of import restrictions, and stronger demand. Stronger current account balances for 2024-26 reflect continued improvement in tourism and remittances.

[1] Lower collections from VAT and external trade taxes (partly due to price effects following lower inflation and the exchange rate appreciation) were offset by higher fuel excise collections. Relatedly, an expected gain of 0.2 percent of GDP from lifting import restrictions on motor vehicles in 2024 is partly shifted to 2025 due to the delay in relaxing the import ban.

[2] CBSL data indicates that at the end of 2024, all banks complied with Sri Lanka's regulatory minimum of 10 percent Tier 1 capital and of 14 percent total capital ratio.

[3] The latter spread overstates sovereign risks slightly as coupon rates could be reduced by 75 basis points if authorities meet conditions linked to governance reforms.

4. While upfront reform implementation has reduced program risks, it remains important to continue monitoring them carefully. Fiscal reform momentum could slow after the completion of the debt restructuring. Fiscal risks could materialize if cost-recovery energy pricing is not restored. This, in turn, would have significant negative implications on confidence and financing conditions. While the risks of social unrest have receded with macroeconomic stabilization, potential perceptions of unmet campaign promises and reform fatigue could reignite social tensions. External risks from intensifying geopolitical tensions, commodity price volatility, and a global slowdown remain. Risks are managed through policy adjustment and contingency measures, including locking in overperformance. Upside risks include program overperformance and larger-than-expected inflows following the debt restructuring.

PROGRAM PERFORMANCE

5. Performance of quantitative conditionality was strong (Table 1).

- **Fiscal**. The end-December (end-June) primary surplus was Rs. 653 (543) billion, surpassing the QPC of Rs. 300 (140) billion by a wide margin. End-December (end-June) tax revenues of Rs. 3,705 (1,709) billion surpassed the QPC floor of Rs. 3,700 (1,500) billion. The end-June and end-December QPC on arrears were met while ITs on social spending were missed for both June (Rs. 128 billion vs. the IT of 150 billion) and December (Rs. 186 billion vs. the IT of Rs. 205 billion).[4]

- **Monetary and Reserves**. Headline inflation in the second and fourth quarter, at 1.4 and -1.5 percent respectively, fell below the outer lower band (2 percent) of the Monetary Policy Consultation Clause (MPCC), triggering a consultation with the IMF Executive Board. The end-June and end-December QPCs on CBSL's primary market purchases of government securities and Net Credit to Government (NCG) were met with no new monetary financing and continued T-bill offloading. The end-June and end-December Net International Reserves (NIR) targets were exceeded by US$1.3 billion and US$1.5 billion, respectively.

6. Most SBs due by end-January 2025 were met or implemented with delay. Those missed—often due to the electoral cycle—are either remedied through corrective actions or proposed to be reset.

- **Fiscal**. While the continuous SB on ensuring cost-recovery fuel prices is met, the one on electricity prices was breached in January, and is expected to be remedied within the existing regulatory framework (¶16). Most fiscal SBs were either met or implemented with delay. The two SBs on revenue measures (end-June and end-July) were missed due to the timing of the elections, with remedial measures taken or underway. Similarly, given the delays to the 2025 budget calendar, the end-October SB on budget submission was

[4] Due to technical challenges in opening bank accounts for new beneficiaries and delays in the completion of the second-round applications given the election cycle.

implemented with delay, but the end-December SB on budget approval was missed and remedial measures are proposed (¶8, 9 and 10). Parliament approved a "Vote on Accounts" for January-April 2025, with new Budget approval expected by March 2025.[5] The reporting of end-September KPIs was missed due to difficulties in extracting the required data.

- **Financial**. The Banking (Amendment) Act was enacted on June 15, and implementation rules were published. The recapitalization plans for private banks were implemented, with all meeting minimum capital requirements by end-2024. The authorities reached agreements with State-Owned Banks (SOBs) on the CPC FX loan restructuring, but election-related delays in reclassification of the agreed cash payment in the budget led to the SB on bank recapitalization being met with delay.[6]

- **Governance and Anti-corruption**. SBs on public procurement contract publication, asset declaration, and revenue agencies' anti-corruption plans were met. Due to the elections and recent appointment of a new Director General for CIABOC, the SB on publication of CIABOC's new strategic plan and corresponding budget will be implemented with a delay by mid-March, and the SB on enacting a comprehensive Asset Recovery Law was missed and reset to end-April 2025.

POLICY DISCUSSIONS

A. Maintaining Revenue-Based Fiscal Consolidation and Fiscal Structural Reforms

7. A lower spending execution implies a tighter fiscal stance in 2024 than envisaged at the second review. Sustained revenue mobilization efforts have brought tax revenue up from 9.8 percent of GDP in 2023 to the target of 12.4 percent of GDP this year. Due to a sizeable capital spending under-execution, the primary balance (**QPC**) registered a larger surplus (2.2 percent of GDP) than envisaged during the second review (1.0 percent) (text table).[7] The

[5] A procedure under which the Government can use funds for existing projects to ensure that essential public services are maintained.

[6] This end-August SB was met on December 13, 2024. To ensure capital adequacy of the two state-owned banks after the restructuring of the CPC FX loans, the Ministry of Finance (MOF) provided them with a cash injection as advance interest payment. Given improving macroeconomic conditions and robust banking profits, capital shortfalls identified in the 2022 asset quality review were revised downward, and the cash injection was sufficient to close the capital gap.

[7] Primary current spending is higher than expected at the second review (by 0.4 ppt of GDP) because the authorities adopted temporary subsidy schemes as of October 2024, targeting farmers and fishing boat owners. Capital spending is lower (by 1.4 ppt of GDP) due to slower-than-warranted execution.

interest bill significantly declined on the back of a declining sovereign risk premium (¶2) and monetary policy normalization (¶20).[8]

Sri Lanka: Fiscal Projections 2024–2025 1/

(In percent of GDP)

	2024		2025	
	Second review	Baseline	Second review	Baseline
Total Revenue and Grants	13.6	13.7	15.1	15.1
Total Revenue	13.5	13.5	15.0	15.0
Tax Revenue	12.4	12.4	13.9	13.9
Income Taxes	3.3	3.4	3.6	3.5
Tax on goods & services	7.2	7.4	8.1	8.2
VAT	4.4	4.4	5.0	4.9
Excises	1.8	2.0	2.0	2.3
Other taxes	1.1	1.0	1.1	1.0
Taxes on external trade	1.6	1.6	2.2	2.2
Non-Tax Revenue	1.1	1.1	1.1	1.1
Grants	0.1	0.2	0.1	0.1
Total Expenditure and net lending	20.9	19.3	20.3	20.4
Primary spending	12.5	11.5	12.8	12.8
Current Expenditure	8.5	8.9	8.3	9.0
Salaries & wages	3.6	3.5	3.7	3.8
Goods & services	1.1	1.2	1.0	1.2
Subsidies & transfers	3.7	4.1	3.6	4.1
Interest payments	8.4	7.8	7.5	7.7
Capital Expenditure and Net Lending	4.0	2.6	4.4	3.7
Overall balance (program definition)	**(7.3)**	**(5.6)**	**(5.2)**	**(5.4)**
Primary balance (program definition)	**1.0**	**2.2**	**2.3**	**2.3**
Memo items				
Nominal GDP	30,917	29,893	33,958	32,309
Total revenue gains	2.6	2.5	1.5	1.5

1/ The spending figures exclude the banks' recapitalization amounts which are reported in tables 2a and 2b.

8. The draft 2025 Budget is consistent with program parameters (SB), targeting a primary surplus of 2.3 percent of GDP (**QPC** and text table). Total revenue is forecasted at about 15 percent of GDP in 2025 after implementing tax relief and compensating measures (¶9 and 10), and targeted social protection (¶13). Primary spending is forecasted at 12.8 percent of GDP, in line with the 13 percent ceiling instituted in the new Public Financial Management (PFM) law. The upcoming presentation to parliament by the Minister of Finance of the 2025 annual budget document, the Appropriation Bill and the Budget Speech (second reading) in line with program parameters **(PA)** together with the authorities' commitment to execute the budget

[8] The overall balance is different from that reported by the authorities due to the reliance on different accounting approaches to compute the interest bill and differences in the debt perimeter.

within the approved 2025 spending envelope provide appropriate assurances that the draft budget and its planned execution are adequate. The Appropriation Act is expected to be approved by parliament by end-March 2025 **(reset SB)**. Going forward, annual **SBs** on national budgets and revenue measures consistent with program parameters will remain as program safeguards.

9. Tax relief will be introduced in 2025 to account for the cumulative impact of inflation and will be compensated by revenue measures to achieve the revenue target. Measures include amending the PIT structure (Annex III) and introducing VAT exemptions on milk and yoghurt, both of which should compensate for real income erosion and broadly ease social pressures. To reach the 13.9 percent-of-GDP tax revenue target for 2025 **(QPC)**, gross revenue gains of 1.6 percent of GDP (text table) are needed to accommodate: (i) the tax relief, (ii) absence of gains from the imputed rental income tax (IRIT) (¶12) and (iii) lower yield from VAT compliance (¶14).

10. The revenue target for 2025 will be achieved with the adoption of a revenue package (PA), which retains most measures agreed during the second review:[9] (i) introduce VAT on the supply of digital services, (ii) introduce a Corporate Income Tax (CIT) rate of 15 percent on services exports, (iii) increase the CIT rate on betting and gaming, tobacco, and liquor industries from 40 percent to 45 percent and (iv) increase the withholding tax rate on interest income from 5 to 10 percent. The revenue package includes a gazette notification to introduce an import duty on motor vehicles and relevant regulations eliminating import restrictions on all motor vehicles (**PA** and ¶23).[10] These measures would be complemented by gains from improved VAT compliance (¶11). Should the cost of relief proposals turn out higher than staff estimates, the authorities will adopt appropriate high-quality compensating measures.

[9] Plans to remove the SCL will not be considered this year and the removal of the CIT exemption on exports of IT services will be implemented in a phased manner.

[10] Measures requiring legislative action account for 0.4 percent of GDP while measures requiring a gazette notification account for 1.2 percent of GDP. Relatedly, the gains from lifting import restrictions are estimated at 1.2 percent of GDP broken down as follows: (i) increase in VAT on imports (0.3 percent of GDP), (ii) increase in excises on motor vehicles (0.3 percent), (iii) increase in external trade taxes from pent-up demand (0.4 percent) and (iv) introducing an import duty of 30 percent on motor vehicles (0.2 percent).

Sri Lanka: Proposed Measures for 2025
(in percent of GDP)

	Second review	Third review baseline
a. Net tax revenue gains 1/ (a=b+e)	**1.5**	**1.5**
b. Total tax revenue gains (b=c+d)	**1.5**	**1.6**
c. Previously agreed measures during the second review	**1.5**	**1.3**
Imputed rental income tax	0.15	0.00
Introduce CIT of 15 percent on export of services	0.04	0.02
Increase CIT rate from 40 to 45 percent on betting and gaming, tobacco and	0.08	0.08
Replace the SCL with VAT at a rate of 18 percent	0.04	0.00
Introduce VAT on supply of digital services	0.04	0.04
Lifting import ban on motor vehicles	0.84	1.0
Improving the VAT compliance gap	0.30	0.1
Increase of stamp duty on leases of land from 1 percent to 2 percent 2/	-0.03	-0.03
d. New measures		**0.3**
Import duty of 30 percent on motor vehicles		0.2
Increase in final withholding tax rate on interest income from 5 to 10 percent		0.1
e. Cost of raising the PIT tax-free threshold 3/		**-0.15**
Memo items		
Tax revenue in 2024	12.4	12.4
Tax revenue in 2025	13.9	13.9

1/ Gross gains from new measures are 1.6 percent of GDP but because some measures are resulting in revenue losses, the net gains are only 1.5 percent of GDP.

2/ The increase in the stamp duty will result in lower transfers to provincial councils and thus lower total spending.

3/ The loss is computed only for 3/4 of the foregone revenue since the measures is expected to be implemented as of April 1, 2025. The remaining 1/4 foregone revenue is incorporated in 2026.

11. **The adoption of a VAT compliance improvement program and a revamped VAT refund system to enable the Simplified VAT (SVAT) repeal are key priorities under the program**. Projected compliance gains are lowered relative to the second review (0.1 vs. 0.3 percent of GDP) reflecting slow reforms.[11] Compliance gains would accrue from enhanced efforts towards large CIT taxpayers and from the adoption of a VAT compliance improvement program to be prepared by the tax authority. The program will identify, assess, and prioritize compliance risks for key taxpayer segments and formulate and publish a detailed plan to respond to those risks by May 2025 **(new SB)**. Expedited efforts are needed to fix the refund system as a pre-requisite to abolishing the SVAT by end-September 2025 **(reset SB)**, an essential step to boost VAT compliance.[12] The IRD will

[11] The VAT compliance gap was estimated to be at least 1 percent of GDP. Implied gains hinge on a fully operational IT system, sufficient resources for IRD and a well-functioning VAT refund system. An additional 0.1 percent of GDP in compliance gains is incorporated in 2026.

[12] Refunds of excess input tax are restricted under the VAT Act. The SVAT system was introduced to reduce the VAT input tax claims and ameliorate the burden on cashflows of registered exporters, who can purchase otherwise taxable

(continued)

report before end-June 2025 the results of a simulation exercise to test the new refund arrangements, which will replace the SVAT **(new SB)**. Some KPIs have been revised and new quarterly KPIs (Annex V) until December 2025 are proposed **(SB)**.

12. Building an adequate database on properties and related transactions is a needed step to introduce the property tax and help sustain the medium-term revenue path.[13] While a provisional Sales Price and Rents Register (SPRR) is in place, work by the MoF's valuation department on building the data infrastructure should continue with the goal of having a fully operational nationwide digital SPRR by end-June 2025 **(revised and reset SB)**. This would be the key resource for assessing property values and eventually the property tax.

13. The increase in primary spending from 12 to 12.8 percent of GDP in 2025 accommodates some relief measures. The measures include increases in capital spending, public wages (0.3 percent of GDP), and an interest rate subsidy of 3 percent from July 2025 for six months for senior citizens above 60 years of age with one-year term deposit account balances below Rs. 1 million.[14] The additional half-year cost from this measure is estimated at 0.1 percent of GDP in 2025 and is slightly higher than the Budget's allocation of 0.05 percent of GDP. Given the uncertainty of the cost estimate, the authorities have reaffirmed their commitment to execute total spending in line with program parameters. They have also committed to limit the potential for abuse by commencing the scheme only after an appropriate identity verification system is in place and to ensure timely refunds to commercial banks of valid subsidy payments so as to not incur arrears. While the authorities consider this measure as necessary to ease economic hardship from the crisis and to maintain social cohesion, it is regressive with benefits increasing with term deposits balances up to a level close to Sri Lanka's per capita GDP. Alternative and less regressive ways of supporting the vulnerable elderly would have been preferable as the scheme only benefits those with sufficient wealth to maintain considerable bank balances.

14. Social safety net (SSN) reforms should continue to effectively protect the poor and vulnerable. The authorities took steps to address the Aswesuma program challenges that led to IT underperformance: they (i) expedited the opening of outstanding bank accounts of first-round applicants and settled associated arrears and (ii) resumed the second round of applications, which they expect to complete by mid-2025 following election-related delays. To maintain adequate SSN

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goods and services from registered suppliers without paying tax if at least 50 percent of their sales are zero-rated. As the remainder could be sold domestically, the SVAT introduces a break in the VAT chain and places all the responsibility for accurate reporting and remitting of VAT on exporters and their suppliers. The coverage of SVAT not only extended to exporters but also their suppliers (if at least 50 percent of their sales is to supply exporters) and in some cases, even the suppliers of suppliers. This set-up creates compliance risks and possibly revenue losses.

[13] The incremental gains are incorporated as 0.2 and 0.1 percent of GDP for 2027 and 2028, respectively.

[14] The wage increase is the first since 2016 involving a basic salary adjustment notwithstanding considerable inflation.

coverage amid high poverty rates and meet the IT, payments to various groups will be increased and extended.[15] Accordingly, the end-2025 SSN spending floor was raised to Rs. 237 billion.

15. The PFM framework requires further reforms to better manage fiscal risks. Building on the 2024 PFM law, key future reforms supported by IMF technical assistance (TA) include (i) developing and publishing a medium-term PFM reform strategy and action plan by June 2025; (ii) developing and publishing the fiscal risk statement by June 2025; and (iii) adopting the implementing regulations of the new PFM law by December 2025. Any future PFM-related bill (e.g., Public-Private Partnerships (PPP), SOE, procurement, investment) should be consistent with the PFM law.

16. Cost-recovery electricity pricing is no longer maintained and needs to be restored without delay (continuous SB). Lower electricity costs from favorable international oil and coal prices and strong rainfall allowed for electricity tariffs reduction in March and July (39 percent cumulatively), while allowing CEB to make profits and repay some legacy debts. Losses incurred in October 2024 were offset by profits in November and December, and CEB remained profitable in the second half of 2024. However, the downward tariff revision by 20 percent implemented by the regulator on January 17 resulted in the SB not being met, as the CEB is expected to start making losses in the coming months. To start restoring the cost recovery pricing, the authorities have committed to ensure the Bulk Supply Transaction Account (BSTA) operates as envisaged by triggering an automatic adjustment once the CEB's cash balances reach the lower threshold. In addition, the April tariff revision will be used to adjust the tariffs to the cost recovery level if the BSTA-triggered adjustment is not sufficient.

B. Restoring Debt Sustainability

17. The recent successful completion of the bond exchange is a major milestone in Sri Lanka's efforts to restore debt sustainability (Annex I-II). The authorities successfully completed the Eurobond exchange in December, with 98 percent participation following the activation of collective action mechanisms, in line with the Agreements in Principle (AIPs) reached with the external bondholder committee and local bondholder consortium on September 18. These agreements were assessed by staff as consistent with debt sustainability, and by the Official Creditor Committee (OCC) as consistent with comparability of treatment (COT). The authorities also completed their debt treatment with China Development Bank (CDB) in line with program parameters and with COT as assessed by the OCC.

18. Based on the progress in restructuring Sri Lanka's debt, staff recommends completing the financing assurances review. Staff assesses that progress made in restructuring Sri Lanka's

[15] Payments to transitional and vulnerable groups will be extended through end-March and end-December 2025 respectively. Payments were also increased for the poor and extremely poor groups effective January 2025, and will be raised for the elderly, disabled and chronic kidney patients from April 2025. The empowerment program, financed by the World Bank (WB) and ADB, has started providing livelihood support to help beneficiaries graduate from the Aswesuma program.

debt is consistent with restoring medium-term external viability and safeguarding its capacity to repay the Fund. In line with expectations, the authorities fully completed their debt restructuring with China EXIM Bank in July and are finalizing individual agreements with OCC creditors. In addition to having reached agreements with major private creditors in line with debt sustainability, the authorities are engaged in good faith negotiations with the remaining commercial creditors. The outstanding steps are to finalize the bilateral OCC agreements, and to reach agreements with the remaining commercial and official creditors.[16] Staff remains confident these processes will conclude in 2025.

19. Full implementation of the Public Debt Management (PDM) Act will establish prudent debt management practices. While domestic financing conditions eased recently, efforts towards a more holistic debt management strategy are necessary. Following the approval of the PDM Act (July 2024) and the establishment of the Public Debt Management Office (PDMO) (December 2024) **(SB)**, the authorities will adopt the PDM Act implementing regulations (March 2025) and parliament will repeal the Foreign Loans Act by April 2025 **(new SB)** to ensure debt management activities are consolidated under the PDMO. Authorities will formulate a medium-term debt strategy and annual borrowing plan, to be published together with the 2026 Budget, as envisaged in the PFM law.

C. Maintaining Price Stability and Restoring External Sustainability

20. Monetary policy normalization continued. The CBSL cut the policy rate by 50 basis points in March, 25 basis points in July, and another 50 basis points in November.[17] Inflation declined faster than expected, with headline inflation dropping below the outer band of the MPCC starting in 2024Q2 and turning negative starting in September. The deflation was caused by temporary factors, which are expected to dissipate in early 2025 as the effects from energy price reductions run their course, import restrictions are removed, and demand continues to recover. With both core inflation and inflation expectations declining to 3 percent since October, the loosening was warranted to prevent second round effects from higher-than-expected declines in inflation.

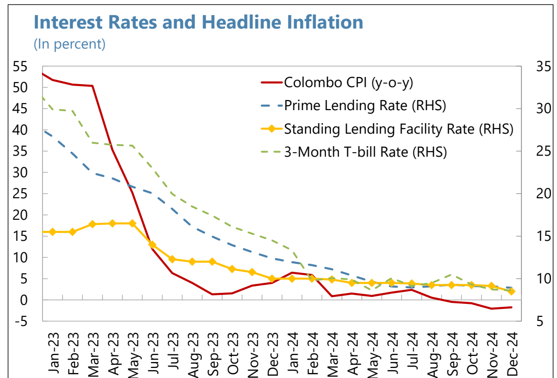
21. The CBSL stands ready to tighten the monetary stance as needed. With inflation projected to gradually return to the 5 percent target in 2025, forward-looking real rates are close to the neutral rate estimate (2.5 percent). Taylor rule models imply little room for further rate cuts unless inflation continues to surprise on the downside. The CBSL will monitor inflationary

[16] The remaining official creditors comprise of Saudi Arabia, Kuwait, Iran, and Pakistan. In the absence of an adequately representative standing forum, a sufficient set of creditors have provided direct commitments to the Fund on their restructuring intentions by having finalized MOUs (OCC) or final treatment (China EXIM) so that the Enhanced Safeguards under Strand 4 of the lending into official arrears (LIOA) policy are met. Accordingly, consent for LIOA is no longer required, as these assurances allow all official arrears to be deemed resolved (IMF 2024/17, ¶20). Small amounts of commercial debt (below USD 50 million) remain to be restructured.

[17] The CBSL also moved from a dual rate system to a single policy rate in November to strengthen monetary policy signaling, in line with IMF TA recommendations. The new single rate policy is close to the mid-corridor rate. The width of the corridor remains unchanged.

pressures that could arise from wage increases, demand recovery, relaxation of import restrictions, and exchange-rate passthrough, and carefully set the monetary stance to achieve the price stability objective.

22. The CBSL continues to refrain from monetary financing (continuous QPC). The CBSL has reduced holdings of government securities by fully offloading CBSL holdings of T-Bills (**QPC**). The NCG ceiling is maintained at the same level until December 2025 **(QPC)** given the uncertainty over market liquidity and marketability of the restructured domestic bonds. However, this should not prevent effective monetary policy operations given other available instruments.



Sources: CBSL; and Haver Analytics.

23. External adjustment is supported by continued reserve accumulation, exchange rate flexibility and relaxation of remaining exchange restrictions, multiple currency practices (MCPs), and capital flow measures (CFMs).[18]

- Amidst strong external sector developments, the authorities plan to continue building up reserves through outright purchases, targeting a positive NIR by end-2025 **(QPC).** They have continued to allow exchange rate flexibility.

- The authorities issued gazettes to relax vehicle import restrictions, starting with public transport vehicles in December 2024, commercial and special purpose vehicles on January 27, 2025, followed by personal vehicles on January 31, 2025, except for a few categories for environmental and safety reasons (**PA**).[19] The introduction of an import duty will help moderate the impact on the exchange rate. With these relaxations, they have removed all import restrictions put in place over 2020-22. They have made progress on phasing out remaining exchange restrictions and CFMs.[20]

[18] Sri Lanka maintains two MCPs arising from the following official actions which create impermissible spreads: (i) the levy of a 2.5 percent stamp duty on credit card transactions abroad; and (ii) the levy of a 14 percent remittance tax on nonresidents' profits. As these are so closely connected with exchange transactions, the additional cost is considered a part of the effective exchange rate ("imputed" exchange rate) and imposes an additional burden (increased cost) on payments for current international transactions that is directly tied to payments abroad.

[19] Sri Lanka had been restricting vehicle imports since 2020. Therefore, these import restrictions were not introduced during this EFF-supported program and did not implicate the standard PC on non-introduction of import restrictions for BOP purposes.

[20] In March 2024, the authorities removed the exchange restrictions on the prohibitions on converting Sri Lankan Rupees into FX for certain current international transactions (e.g. servicing certain external loans, payment of income on certain nonresident investments). In June 2024, some outflow CFMs were eased, including by increasing the limit for the initial migration allowance claimed by an emigrant to $100,000, from $50,000 in December 2023, and from $30,000 in June 2022; and increasing the limit on capital transactions via the Business Foreign Currency Account to $200,000 from $100,000 in June 2023.

D. Ensuring Financial Sector Stability

24. Credit intermediation needs to be improved to underpin the economic recovery. The initial phase of the EFF program focused on restoring banks' capital and liquidity levels and enhancing the supervisory and regulatory standards. With these objectives achieved, efforts should now focus on resolving NPLs to promote healthy credit growth and create the right conditions for banks to lend to the private sector.[21] Reinstating Parate executions (**new SB**, June 2025),[22] especially for large borrowers who have been in default for more than five years, combined with the reform of corporate and personal bankruptcy regimes by enacting the Rescue, Rehabilitation, and Insolvency Act will support NPL recovery and allow banks to allocate their capital efficiently to new credit in support of the growing economy.[23]

25. Sri Lanka should continue to strengthen supervision, the resolution framework, and governance of SOBs. A modern financial sector with adequate bank supervision, an effective resolution framework and better governance of SOBs will support financial intermediation and growth.[24] The resolution framework, equipping Sri Lanka to manage bank failures more effectively, was introduced in September 2023 through the Banking (Special Provisions) Act, but CBSL is yet to adopt the necessary policy, manuals, and regulations, and to prepare resolution plans. The amendments to the Banking Act enacted on June 15, 2024, brought improvements to the regulatory, supervisory and governance standards of banks, and especially of SOBs. CBSL published the associated regulations, which impose fit-and-proper requirements including for key managers of SOBs. It is important to monitor implementation to ensure that SOBs are operated at arms' length from the government.

E. Strengthening Governance and Reducing Corruption Vulnerabilities

26. Continuing comprehensive anti-corruption and governance reforms remains critical for Sri Lanka's long-term growth prospects. The new government has demonstrated strong commitment to advancing this agenda. The authorities' action plan on governance reforms, based on recommendations in the Governance Diagnostics Report, will be updated with detailed progress and new reform initiatives, and published annually **(new SB)**. The authorities will

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[21] Provisions set aside for NPLs absorb capital that precludes deployment to more productive purposes in new loans.

[22] Parate executions, an out of court procedure which allows banks to auction collateral on defaulted loans, were suspended during the Covid-19 pandemic, with an additional suspension until March 2025 approved by Cabinet, to offer relief to distressed borrowers.

[23] The Rescue, Rehabilitation, and Insolvency (Corporate and Personal) Act will reform the corporate and personal bankruptcy regime in Sri Lanka, facilitating out-of-court credit workouts and streamlining the procedures for credit recovery, in line with the WB's "Principles for Effective Insolvency and Creditor/Debtor Regimes". The Act, which was developed by the Sri Lankan authorities with the assistance of the WB, was approved by the Cabinet of Ministers but is yet to be voted by parliament.

[24] In September 2024, the CBSL issued the Banking Act Directions on Corporate Governance for Licensed Banks strengthening the responsibilities of the Board and Board sub-committees, risk governance structure, and the Board oversight of senior management. In December, the authorities changed the SOB Board compositions such that independent directors comprise a majority.

continue prioritizing reforms to improve fiscal governance and strengthen the operational capacity and independence of the anti-corruption commission (CIABOC) (Annex IV).

- **Anti-corruption Legal Frameworks and Institutions, and Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)**. The CIABOC appointed a new Director-General and will publish its new strategic plan in March. The key next steps will be for the CIABOC to strengthen the asset declaration system by (i) allowing public access to published asset declarations through foreign and local phone numbers or email accounts and posted forms to be downloadable, (ii) publishing the remaining asset declarations of senior officials along with the list of non-filers, (iii) revising the existing form to include beneficial ownership information, and (iv) modifying current rules on redactions so that information on the value of bank accounts and other assets is disclosed to public (**new SB**) and enact a comprehensive Asset Recovery Law to harmonize it with the UNCAC (**reset SB**). The authorities remain committed to strengthening the AML/CFT regime, including through amending the Companies Act to ensure the beneficial ownership framework is consistent with FATF standards.

- **Tax Policy and Revenue Administration**. In August, each revenue department developed an implementation plan to launch a program of anti-corruption measures (**SB**). The new government is committed to continue refraining from new exemptions or incentives and approving new projects under the SDP Act. They will submit amendments to the SDP Act introducing transparent, rules-based eligibility criteria for time-bound incentives by end-August (**reset SB**) and similar amendments under Port City Act (MEFP ¶35). They will also strengthen coverage of exemptions in their semi-annual publication to include incentives under the Port City Act (**revised SB**).

- **PFM**. The authorities will (i) enact a Public Procurement law and implement procurement system reforms including by increasing the share of competitive procurement and rolling-out an e-procurement system, (ii) strengthen the regulatory framework to oversee and manage public assets, and (iii) ensure regular and timely publication of audited financial statements of the 52 major SOEs (MEFP ¶19).

F. Raising Potential Growth

27. The new government started developing a structural reform agenda to unlock Sri Lanka's growth potential (MEFP ¶41). Key structural reforms targeting trade liberalization, the labor market, SOE governance and productivity, and climate resilience will need to advance (MEFP ¶42).

- **Trade**: The authorities adopted regulations to rationalize para-tariffs and will implement a National Export Strategy while expediting negotiations of Free Trade Agreements and entry into regional trade blocs.

- **Labor market**: The authorities are working on streamlining and modernizing existing labor laws into a unified Employment Law in line with international standards. The Women's Empowerment Act was enacted in July 2024.[25]

- **SOEs**: The government is pressing ahead with structural reforms to improve the financial viability of SOEs (including electricity and airline sectors) and to strengthen their governance, including through regular and timely publication of audited financial statements (MEFP ¶19).

- **Climate**: The government aims to enhance electricity generation from renewable sources and to engage with multilateral partners on capacity development for climate mitigation and adaption efforts.

PROGRAM MODALITIES AND MONITORING

28. Proposed modifications and new program conditionality are aligned with macroeconomic developments and the budget calendar. Staff proposes a modification of the primary balance, tax revenue, and social spending ITs for March 2025, and new QPCs and ITs until December 2025. The PAs ensure the implementation of measures critical for the program, including passage by parliament of necessary legislation on the revenue side and presentation to parliament of the draft 2025 budget for the second reading.

29. Program financing. Program financing gaps in 2024-27 are expected to be filled through debt restructuring (¶18) and new financing. Sri Lanka's program is fully financed, with firm commitments of financing from international financial institutions (IFIs) for the next twelve months and good prospects for adequate financing for the rest of the program period. The People's Bank of China (PBoC) has renewed its swap arrangement with CBSL for another three years up to December 2027.

30. The Fund continues to face important enterprise risks. Financial risks stemming from the authorities' capacity to repay pose credit risks to the Fund (¶29, 31). Business and reputational risks could arise if the new government's reform agenda would deviate significantly from program objectives. With good recent progress, risks from a protracted debt restructuring process have now declined significantly. Key mitigation measures include the authorities' commitment to upfront implementation of reform measures, adjusting program conditionality to evolving circumstances and steadfast implementation of structural reforms, supported by extensive Capacity Development (Annex VI).

[25] The Act establishes a National Commission on Women to enforce Sri Lanka's obligations under relevant United Nations Conventions.

Sri Lanka: External Financing Gap and Program Financing, 2022-2027

(In millions of US dollars)

	2022	2023	2024	2025	2026	2027	Total 2022-27
Financing Gap (A)	-2,834	-5,670	-4,372	-5,007	-3,423	-4,356	-25,661
Program Financing (B)	2,834	5,670	4,372	5,007	3,423	4,356	25,661
IMF EFF	0	678	338	1012	673	337	3,037
IFI program financing support	0	1,220	650	783	758	480	3,891
World Bank*	0	570	250	388	258	250	1,716
ADB	0	650	400	395	500	230	2,175
Other	0	0	0	0	0	0	0
Debt moratorium: external arrears accumulation	2,834	3,772	644	0	0	0	7,250
Debt relief	0	0	2,740	3,211	1,992	2,040	9,983
Sovereign bonds (market access)	0	0	0	0	0	1,500	1,500
Shortfall (A+B)	0	0	0	0	0	0	0
Memorandum:							
Gross International Reserves	*1,898*	*4,392*	*6,122*	*7,056*	*9,303*	*13,118*	
Project loans	*1,473*	*680*	*850*	*1,250*	*1,603*	*1,651*	

Source: CBSL and IMF Staff Projections

** World Bank CY 25-27 figures are indicative as WB CPF will be reviewed in FY 2025, and the size of IDA 21 is unknown. An additional $135 million disbursment from the WB on deposit insurance is not included in program financing, as it will be ringfenced.*

31. Capacity to repay the Fund. Capacity to repay the Fund (Table 8), while assessed to be adequate under the program scenario, is subject to significant risks and contingent on the successful implementation of program measures and the debt restructuring. Under the program, Fund credit outstanding would peak at 3.4 percent of GDP in 2027, or 13.8 percent of exports of goods and services, and 23.8 percent of gross reserves. EFF repurchases and charges would peak in 2031, at 2.2 percent of goods and services exports, and 3.8 percent of gross reserves.

32. Safeguards Assessment. CBSL equity has returned to positive levels and is expected to continue recovering gradually thanks to earnings on the holdings of government bonds. The CBSL will continue to monitor its financial position to ensure it is at an adequate level to conduct effective monetary policy (MEFP ¶27). The CBSL is working on implementing the remaining recommendations from the February 2023 updated safeguards assessment.

33. Article VIII. Since program approval, Sri Lanka has not (i) introduced additional measures giving rise to new MCPs or exchange restrictions or (ii) modified/intensified existing exchange restrictions and MCPs subject to Fund Approval under Article VIII; or (iii) concluded bilateral payment agreements that are inconsistent with Article VIII of IMF Articles of Agreement; or (iv) imposed or intensified import restrictions for BOP purposes.[26]

STAFF APPRAISAL

34. Reforms and policy adjustment are aiding the economic recovery, and program performance remains strong. The economy is recovering, including contained inflation, reserve accumulation, improved fiscal performance, and progress in restoring debt sustainability. All end-June and end-December quantitative targets were met, except for the IT on social spending. All end-December continuous SBs and most other SBs were either met or implemented with a delay. The review includes three PAs.

35. Maintaining macroeconomic stability and restoring debt sustainability are key to securing Sri Lanka's prosperity and require persevering with responsible fiscal policy. The new government has committed to continuing the reforms under the program. With a narrow path to maintain sustainable growth and debt sustainability, there is no room for policy errors. Strong communication of these realities will be required to foster broad political acceptance that will allow continuing with the reform momentum and pre-empt reform fatigue. Going forward, social support needs to be well-targeted towards the most disadvantaged so as to promote inclusive growth with limited fiscal space. In this respect, the authorities are encouraged to explore alternatives that are less regressive than the interest subsidy scheme to support the vulnerable elderly.

36. Restoring fiscal sustainability requires sustained revenue-based consolidation and reinstating cost-recovery electricity prices. Effective and timely implementation of revenue measures supported by reinvigorated efforts to boost tax compliance are key to sustaining revenue mobilization. To comply with the new fiscal rules framework and maintain fiscal discipline prioritized spending is important. A smoother execution of capital spending throughout the year in line with approved budget allocations would ensure needed investment takes place to foster medium-term growth. The authorities' commitment to closely monitor spending related to the interest subsidy scheme (¶15) is important to ensure the fiscal path remains on track and that there are no negative spillovers to banks. Restoring cost-recovery electricity pricing without delay is essential to curb fiscal risks from SOEs. The recent breach of the continuous SB on cost-recovery electricity pricing is a concern, and the remedial action should be taken without delay. Preserving revenue and primary balance program targets will ensure medium-term debt sustainability.

37. The authorities should continue to reinforce monetary, exchange rate and financial sector policies. Maintaining price stability as a priority requires prudent and agile monetary policy and continued commitment to refrain from monetary financing. Gradually phasing out BOP restrictions and allowing continued exchange rate flexibility would facilitate rebalancing external

[26] As at end-December 2024, the authorities had also eliminated the exchange restriction arising from the prohibition on converting LKR into FX for certain current international transactions (e.g., servicing certain external loans, payment of any income on certain nonresident investments).

positions and rebuilding external buffers. The authorities should continue to work on creating favorable conditions for private sector credit and foreign direct investment (FDI) to expand.

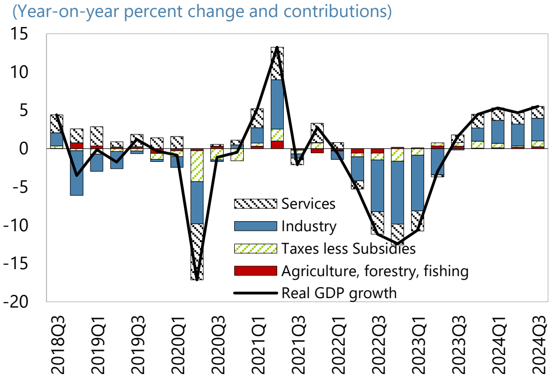
38. Although improving, structural challenges need to be addressed to unlock Sri Lanka's long-term potential. Despite ongoing efforts, comprehensive yet strategic reform plans are needed to achieve higher and more-inclusive sustained growth. Considerable progress to address corruption vulnerabilities has been made and the new government's mandate to reduce and eliminate acts of corruption would support revenue-based fiscal consolidation and economic recovery. Prioritization should be given to further liberalize trade, improve the investment climate, reduce the gender gap, improve SOE efficiency, and mitigate climate vulnerabilities.

39. Based on Sri Lanka's overall performance and commitments under the program (detailed in the MEFP), staff supports the completion of the Third Review. Staff supports the requests to the Board for modification of quantitative conditionality, and completion of the MPCC consultation (MEFP), and of the financing assurances review.

Figure 1. Sri Lanka: Real Sector

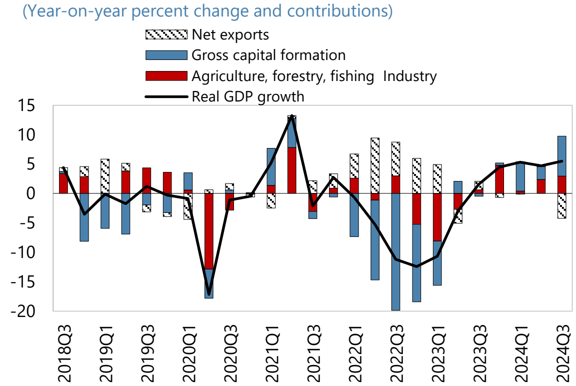
The economy showed a strong recovery in 2024, driven by expansions across all sectors…

Real GDP Growth by Sector
(Year-on-year percent change and contributions)



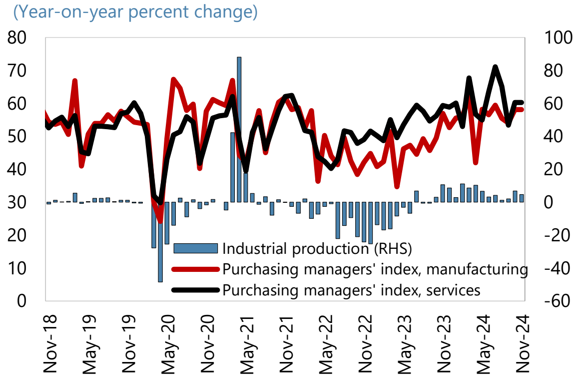
…with strong capital investment and robust consumption recovery.

Real GDP Growth by Type of Expenditure
(Year-on-year percent change and contributions)



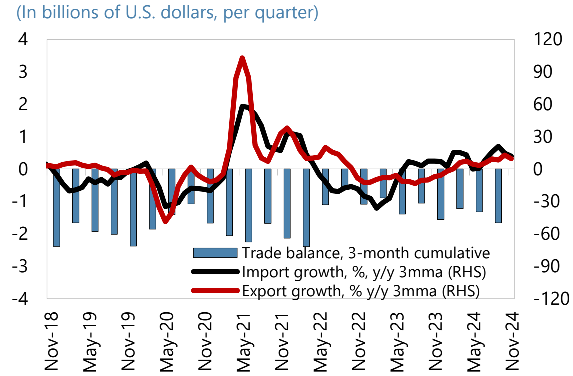
High frequency indicators suggest a positive outlook.

Economic Activity
(Year-on-year percent change)



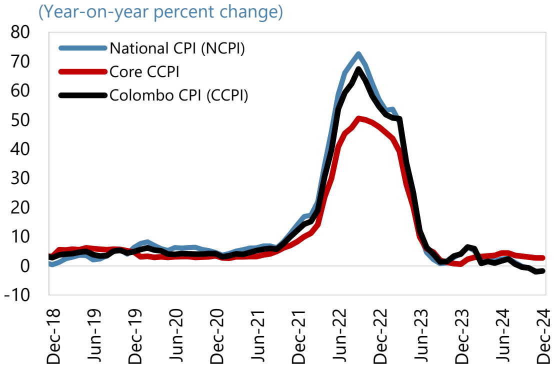
Trade shows signs of improvements with exports growth and imports recovery, although deficit remains substantial.

Trade
(In billions of U.S. dollars, per quarter)



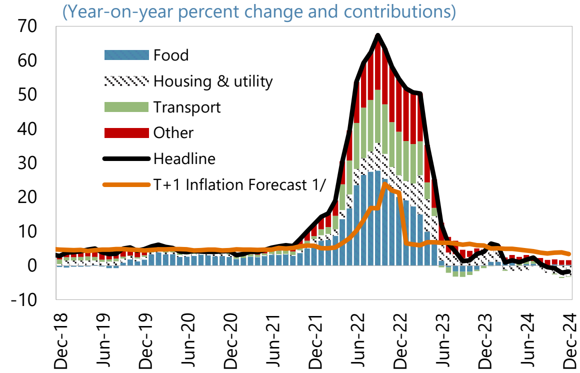
Inflation dropped sharply, shifting to deflation in recent months …

Consumer Price Index
(Year-on-year percent change)



… mainly due to the decline in energy prices and real exchange rate appreciation.

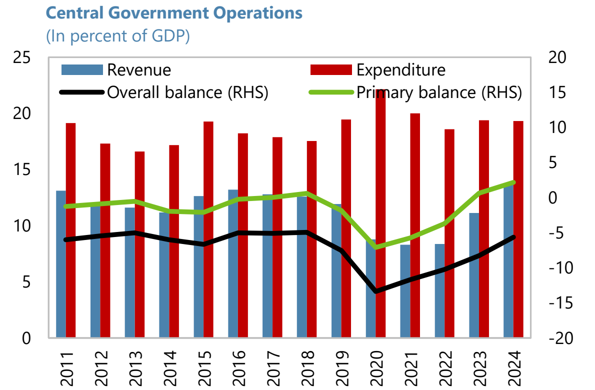
Colombo Consumer Price Index
(Year-on-year percent change and contributions)



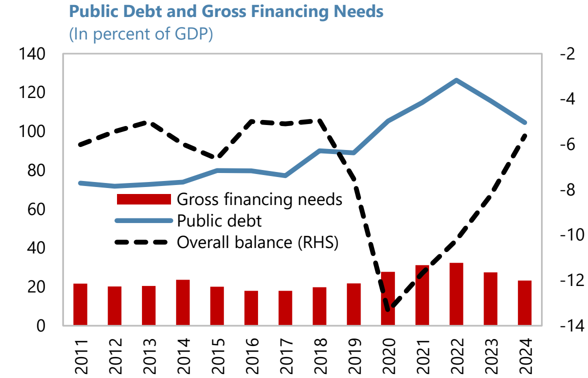
Sources: CBSL; and IMF staff calculations.
1/ T+1 Inflation Forecast is sources from the IMF Consensus Forecast Database.

Figure 2. Sri Lanka: Fiscal Sector

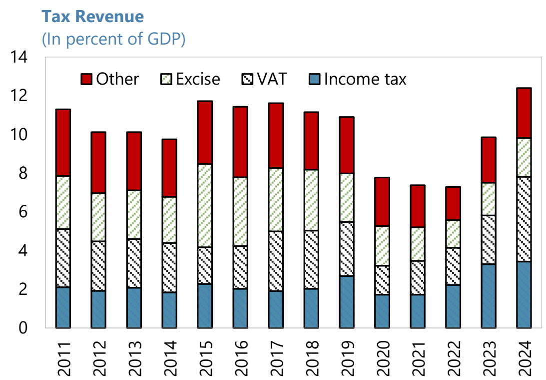
Fiscal policy has tightened despite the elections...



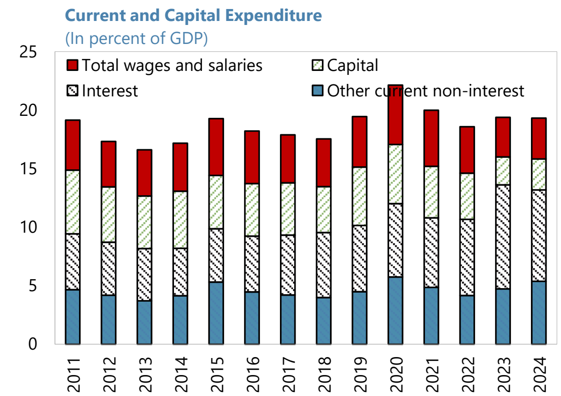
... resulting in lower GFNs though public debt remains high.



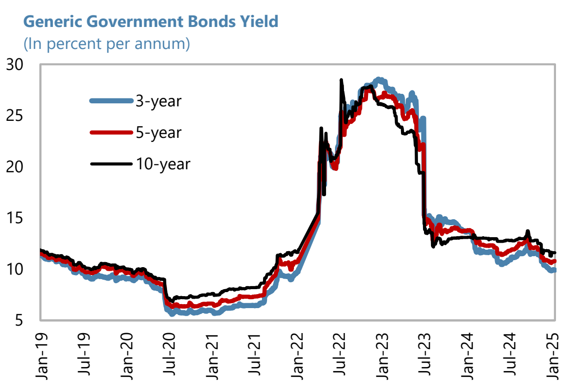
Tax collections were driven by VAT reforms and higher fuel excises...



... while interest payments started declining.



Domestic government bond yields declined to pre-crisis levels ...



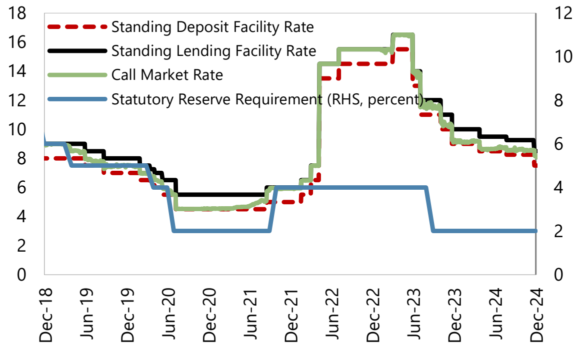
... and Sri Lanka's Emerging Markets Bond Index (EMBI) spreads dropped following the successful completion of international bond exchange.

Sources: CBSL; Ministry of Finance; Bloomberg Data L.P.; and IMF staff calculations.
1/ Following the bond exchange (December 19), spreads on the 2035 governance linked bond are used to calculate sovereign spreads. They overstate sovereign debt risks slightly as the coupons could be reduced by up to 75 basis points.

Figure 3. Sri Lanka: Financial Markets

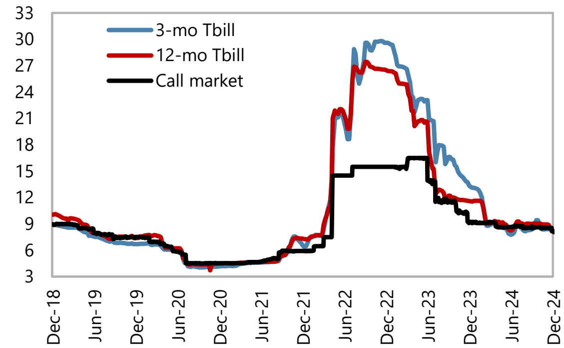
CBSL lowered the policy rate through successive rate cuts in 2024…

Policy and Interbank Rates
(In percent per annum)



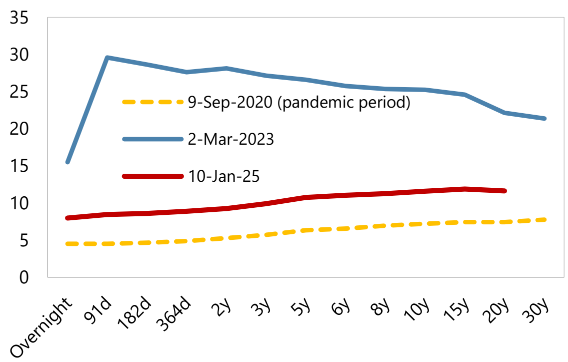
… while T-bill rates moved towards the policy rate with a compression of the sovereign risk premium…

Short-Term Interest Rates
(In percent per annum)



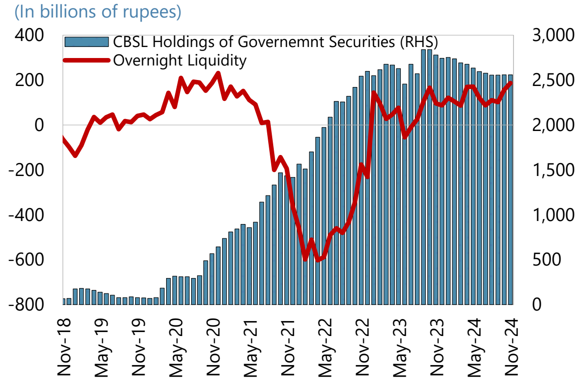
.. and resurfacing of the upward sloping yield curve.

Yield Curve Evolution
(In percent)



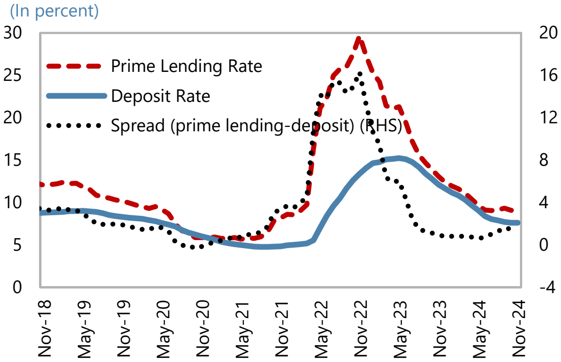
Markets normalized with higher levels of liquidity and CBSL offloaded its government security holdings …

Overnight Liquidity
(In billions of rupees)



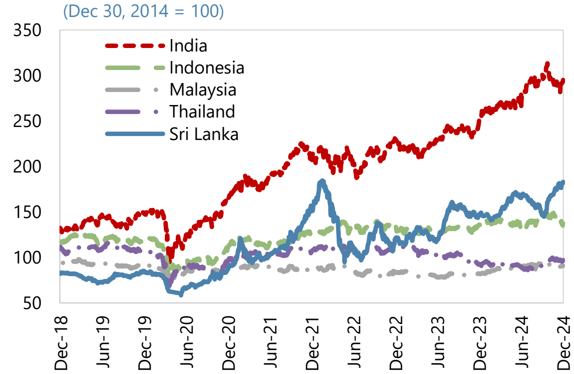
…while the spread between lending and deposit rates returned to its longer-term average.

Deposit Rate and Spread
(In percent)



Through fluctuations, the equity market has experienced growth in 2024.

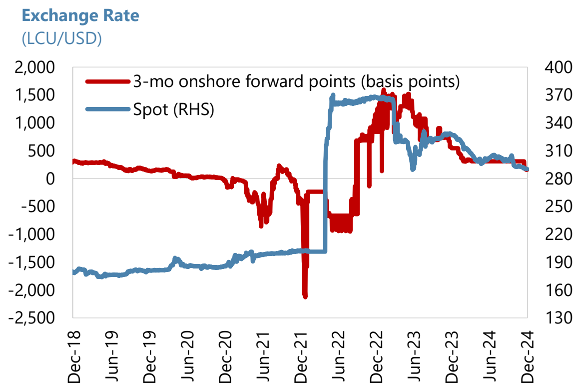
Stock Market Index
(Dec 30, 2014 = 100)



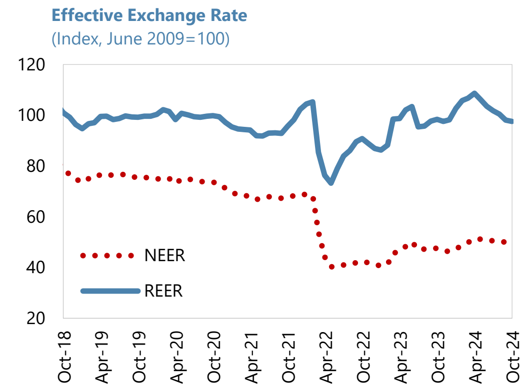
Sources: CBSL; Bloomberg Data L.P.; Haver Analytics; and IMF staff calculations.

Figure 4. Sri Lanka: Foreign Exchange and Reserves

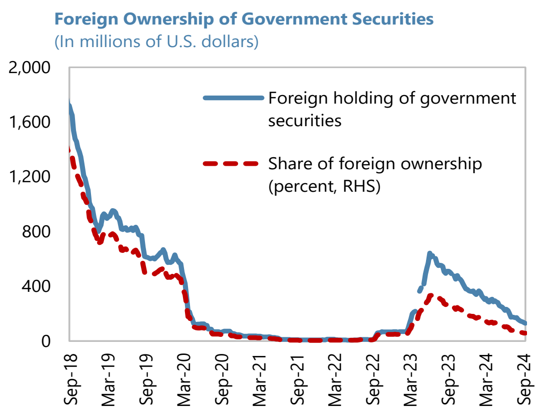
The rupee has appreciated by over 10 percent in 2024 supported by tight monetary stance and improved BOP outlook ...



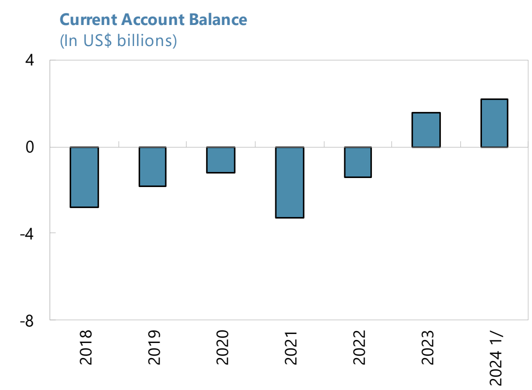
... and REER has appreciated substantially.



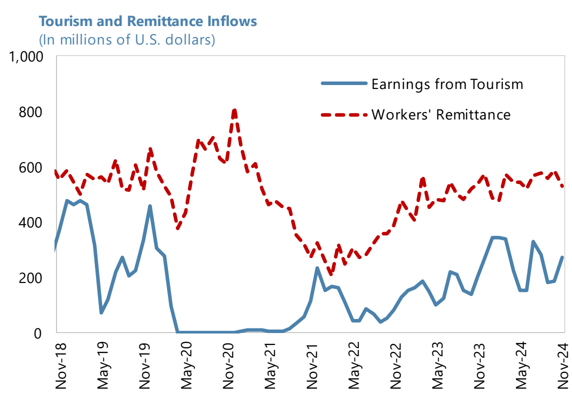
With the interest rate differential shrinking, foreign holdings of government securities have been shrinking.



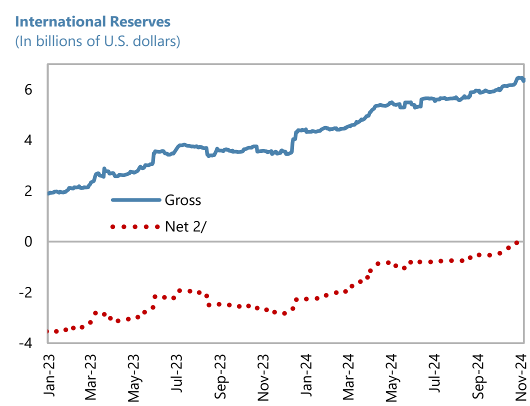
The underlying current account balance has remained strong for the second consecutive year ...



...buoyed by a strong recovery in remittance and tourism inflows...



...leading gross and net reserves to rise further.



Sources: CBSL; Bloomberg Data L.P.; Haver Analytics; and IMF staff calculations.

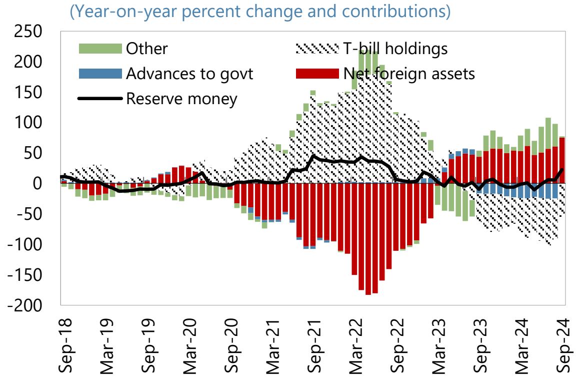
1/ 2024 data is a projection.

2/ NIR numbers as per IMF definition.

Figure 5. Sri Lanka: Monetary and Financial Sector

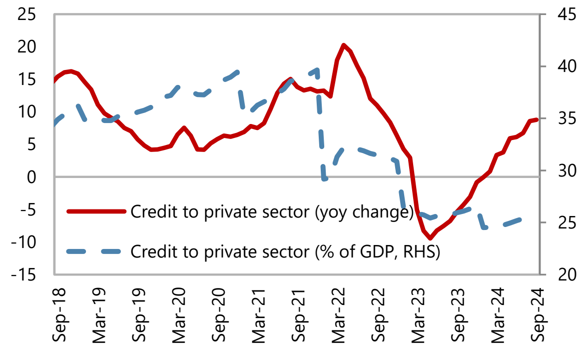
Money growth remains contained with the offloading of T-bills roughly offsetting FX reserve accumulation.

Reserve Money
(Year-on-year percent change and contributions)



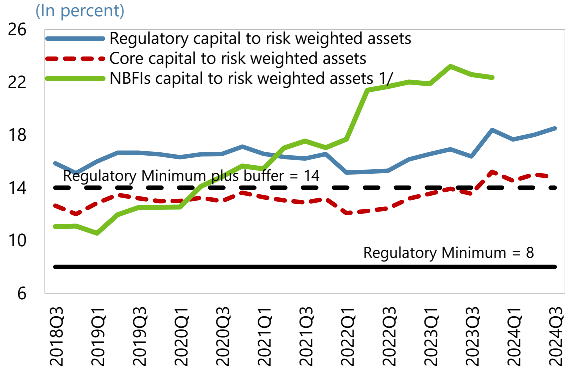
Credit to private sector started to pick-up supporting economic recovery.

Credit to Private Sector
(In percent)



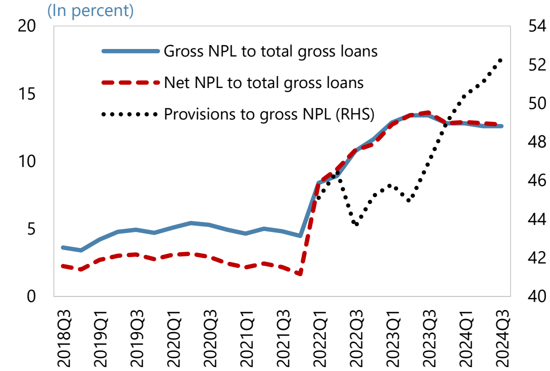
Reported capital levels remain high after accounting for the full impact of debt restructuring.

Capital Adequacy of Banking Sector
(In percent)



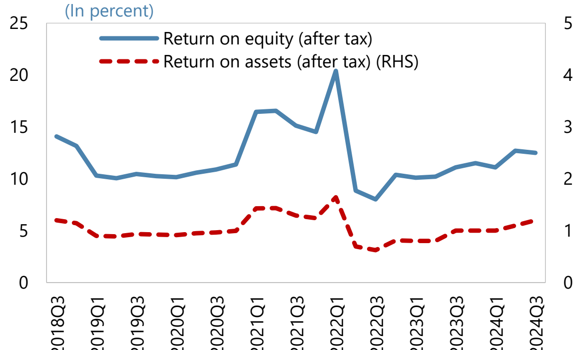
NPLs remained high, and provisions increased in 2024.

Non-performing Loans of Banking Sector
(In percent)



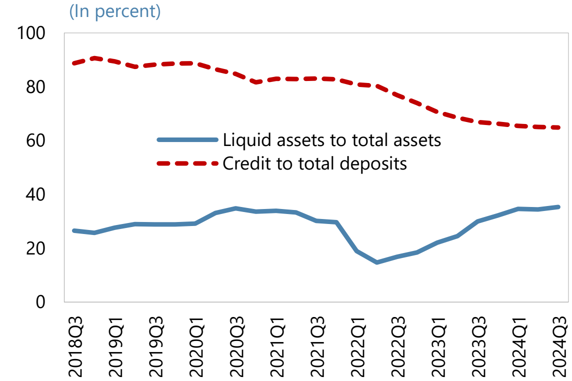
Banking sector profits have been gradually improving.

Profitability of Banking Sector
(In percent)



Banking sector liquidity remains abundant given the still lagging credit to private sector.

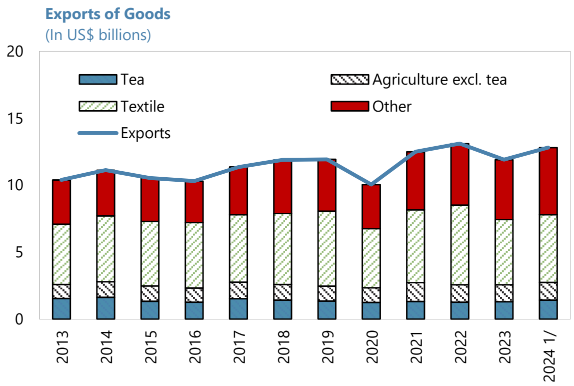
Liquidity of Banking Sector
(In percent)



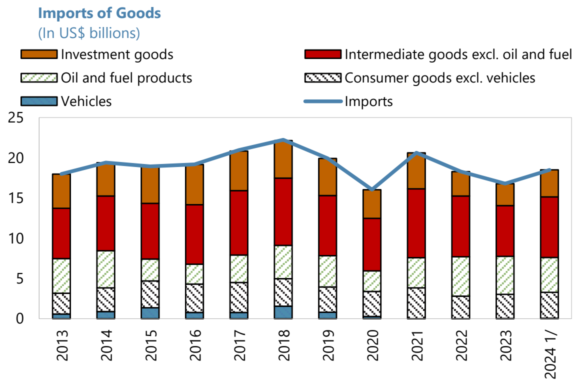
Sources: CBSL; and IMF staff calculations.
1/ NBFI stands for Licensed Finance Companies and Specialized Leasing Companies.

Figure 6. Sri Lanka: Balance of Payments

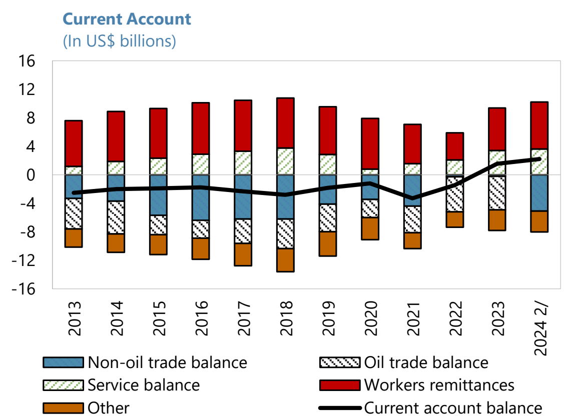
Sri Lanka's goods exports picked up in 2024...



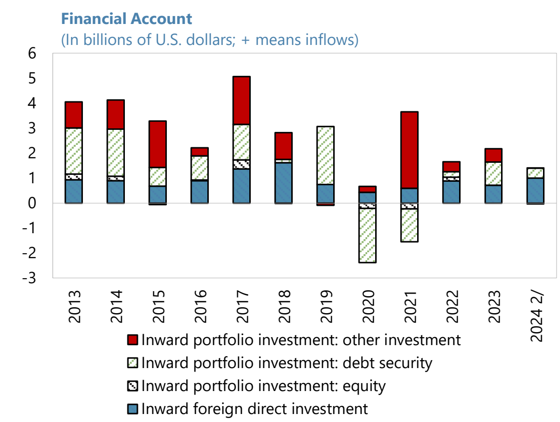
... with imports picking up slowly ...



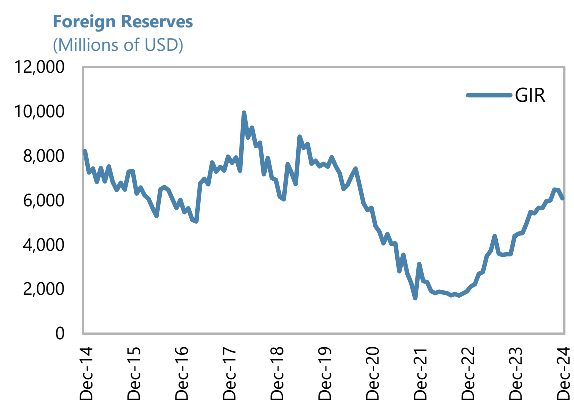
... leading to a positive current account balance.



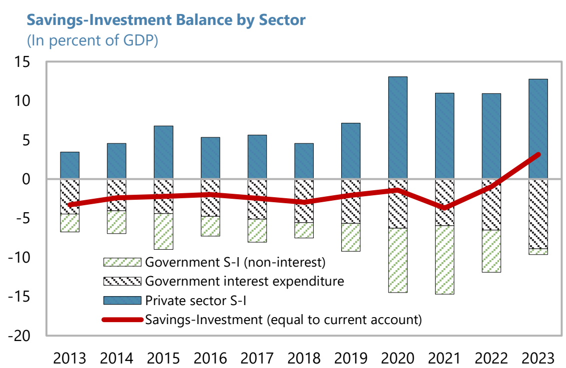
Investment flows have dried up apart from FDI and portfolio debt flows...



... and Gross International Reserves have been on the rising trend.



The improved current account balance in 2023 was supported by increased net savings by the private sector and fiscal consolidation by the public sector.



Sources: CBSL; and IMF staff calculations.
1/ 2024 data is annualized based on the first 10 months of data.
2/ 2024 data is annualized based on data from the first half of the year.

Table 1. Sri Lanka: Selected Economic Indicators 2022-2030

	2022	2023	2024		2025		2026		2027		2028	2029	2030
	Act.		Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Proj.		
GDP and inflation (in percent)													
Real GDP growth	-7.3	-2.3	2.0	4.5	2.7	3.0	3.0	3.0	3.1	3.1	3.1	3.1	3.1
Inflation (average) 1/	45.2	17.4	7.0	1.2	5.8	3.8	5.4	5.4	5.2	5.2	5.0	5.0	5.0
Inflation (end-of-period) 1/	58.6	3.0	6.9	-1.5	5.5	7.8	5.4	5.4	5.2	5.2	5.0	5.0	5.0
GDP Deflator growth	47.5	17.5	9.8	3.5	6.9	4.9	5.4	5.5	5.2	5.3	5.2	5.1	5.0
Nominal GDP growth	36.6	14.8	11.9	8.2	9.8	8.1	8.5	8.7	8.5	8.5	8.5	8.4	8.3
Savings and investment (in percent of GDP)													
National savings	27.6	33.8	32.5	34.0	31.0	31.7	31.3	31.9	31.9	32.1	31.9	31.7	31.7
Government	-6.4	-6.0	-3.4	-3.2	-1.0	-1.8	-0.1	-0.7	0.3	0.0	0.1	0.3	0.5
Private	34.0	39.8	35.9	37.2	31.9	33.5	31.4	32.6	31.6	32.1	31.7	31.4	31.2
National Investment	28.6	30.8	32.1	32.1	32.1	32.2	32.4	32.5	32.8	32.9	32.7	32.6	32.5
Government	5.5	3.7	5.0	3.6	5.1	4.4	5.2	4.6	5.1	4.7	4.6	4.6	4.6
Private	23.1	27.1	27.1	28.5	27.0	27.7	27.3	27.9	27.7	28.2	28.1	28.0	28.0
Savings-Investment balance	-1.0	3.1	0.5	1.8	-1.1	-0.4	-1.2	-0.6	-0.9	-0.8	-0.9	-0.9	-0.8
Government	-11.9	-9.6	-8.4	-6.8	-6.0	-6.2	-5.3	-5.3	-4.8	-4.7	-4.5	-4.3	-4.1
Private	10.9	12.7	8.8	8.6	4.9	5.8	4.1	4.7	3.9	3.9	3.6	3.4	3.2
Public finances (in percent of GDP)													
Revenue and grants	8.4	11.1	13.6	13.7	15.1	15.1	15.3	15.3	15.4	15.3	15.2	15.3	15.3
Expenditure	18.6	19.4	20.9	19.3	20.3	20.4	19.9	19.8	19.5	19.2	19.1	19.0	18.8
Primary balance	-3.7	0.6	1.0	2.2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Central government balance	-10.2	-8.3	-7.3	-5.6	-5.2	-5.4	-4.6	-4.6	-4.1	-4.0	-3.8	-3.7	-3.5
Central government gross financing needs	34.1	27.6	24.9	22.1	23.7	22.8	20.5	19.7	16.6	15.7	13.2	11.8	11.6
Central government debt	115.9	109.5	108.8	99.5	108.4	105.7	108.3	106.4	106.6	103.5	100.2	97.0	93.9
Public debt 2/	126.3	115.8	114.2	104.6	113.1	110.7	112.5	110.9	110.2	107.4	103.7	100.1	96.8
Money and credit (percent change, end of period)													
Reserve money	3.3	-1.5	18.8	10.3	11.0	9.7	8.5	8.7	8.5	8.5	8.5	8.4	8.3
Broad money	15.5	7.3	14.9	10.0	10.4	9.7	8.5	8.7	8.5	8.5	8.5	8.4	8.3
Domestic credit	18.8	-1.2	9.3	6.1	3.6	3.3	2.5	2.8	2.3	3.3	4.0	4.3	4.9
Credit to private sector	6.4	-0.8	7.2	7.9	9.2	7.5	9.3	9.5	9.5	9.5	9.4	9.4	9.4
Credit to private sector (adjusted for inflation)	-38.8	-18.2	0.2	6.6	3.4	3.7	4.0	4.1	4.3	4.3	4.3	4.3	4.3
Credit to central government and public corporations	31.1	-1.6	11.0	4.7	-0.9	-0.1	-3.4	-3.1	-4.7	-2.9	-2.2	-2.2	-1.5
Balance of payments (in millions of U.S. dollars)													
Exports	13,107	11,911	12,913	12,772	13,624	13,446	14,261	14,090	14,903	14,795	15,638	16,397	17,192
Imports	-18,291	-16,811	-20,059	-18,841	-22,565	-21,718	-23,706	-22,668	-24,362	-23,410	-24,105	-25,109	-26,026
Current account balance	-737	2,582	412	1,824	-926	-409	-1,031	-538	-804	-751	-864	-952	-922
Current account balance (in percent of GDP)	-1.0	3.1	0.5	1.8	-1.1	-0.4	-1.2	-0.6	-0.9	-0.8	-0.9	-0.9	-0.8
Current account balance net of interest (in percent of GDP)	0.1	4.2	2.8	3.8	1.3	1.7	1.1	1.6	1.5	1.5	1.5	1.3	1.3
Export value growth (percent)	4.9	-9.1	8.4	7.2	5.5	5.3	4.7	4.8	4.5	5.0	5.7	4.9	4.9
Import value growth (percent)	-11.4	-8.1	19.3	12.1	12.5	15.3	5.1	4.4	2.8	3.3	3.0	4.2	3.7
Gross official reserves (end of period)													
In millions of U.S. dollars	1,898	4,392	5,605	6,122	7,174	7,056	9,262	9,303	13,466	13,118	14,710	14,875	15,175
In months of prospective imports of goods & services	1.2	2.4	2.7	2.9	3.3	3.2	4.1	4.1	5.8	5.5	5.9	5.8	5.7
In percent of ARA composite metric	16.6	37.5	47.9	50.3	58.6	58.3	73.1	75.4	100.2	100.1	108.8	108.5	108.7
Usable Gross official reserves (end of period) 3/													
In millions of U.S. dollars	462	2,956	4,169	4,686	7,174	7,056	9,262	9,303	13,466	13,118	14,710	14,875	15,175
In months of prospective imports of goods & services	0.3	1.6	2.0	2.2	3.3	3.2	4.1	4.1	5.8	5.5	5.9	5.8	5.7
In percent of ARA composite metric	4.0	25.3	35.6	38.5	58.6	58.3	73.1	75.4	100.2	100.1	108.8	108.5	108.7
External debt (public and private)													
In billions of U.S. dollars	57.4	54.1	53.6	53.9	55.6	54.9	58.0	57.2	62.3	61.2	62.9	63.3	65.6
As a percent of GDP	77.0	64.1	61.1	54.4	64.4	56.1	65.7	62.9	68.5	65.9	64.0	60.4	58.9
Memorandum items:													
Nominal GDP (in billions of rupees)	24,064	27,630	30,917	29,893	33,958	32,309	36,839	35,123	39,959	38,113	41,343	44,819	48,551
Exchange Rate (period average)	322.6	327.5	...	302.0	...	...	...	...	...	...	...	...	...
Exchange Rate (end of period)	363.1	323.9	...	293.0	...	...	...	...	...	...	...	...	...

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.
1/ Colombo CPI.
2/ Comprising central government debt, publicly guaranteed debt, and CBSL external liabilities (i.e., Fund credit outstanding and international currency swap arrangements). The debt statistics currently assume the external debt restructuring to have been completed at end 2023.
3/ Excluding PBOC swap ($1.4bn in 2022) which becomes usable once GIR rise above 3 months of previous year's import cover.

Table 2a. Sri Lanka: Summary of Central Government Operations, 2022-30

(In billions of rupees)

	2022	2023	2024		2025			2026		2027		2028	2029	2030
	Act.		Second Review	Proj.	Draft budget	Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Proj.		
Total revenue and grants	2,013	3,074	4,194	4,094	4,990	5,117	4,865	5,634	5,360	6,147	5,822	6,298	6,845	7,424
Total revenue	1,979	3,049	4,165	4,034	4,960	5,086	4,834	5,600	5,326	6,110	5,785	6,259	6,803	7,378
Tax revenue	1,751	2,721	3,837	3,705	4,590	4,725	4,485	5,219	4,985	5,694	5,420	5,878	6,390	6,931
Income taxes	534	911	1,023	1,026	1,157	1,221	1,129	1,425	1,211	1,590	1,389	1,534	1,674	1,824
VAT	463	694	1,354	1,310	1,615	1,704	1,568	1,857	1,775	2,018	1,889	2,039	2,218	2,410
Excise taxes	343	470	550	597	839	688	756	740	846	807	922	1,008	1,104	1,205
Other taxes on goods and services	70	256	333	294	318	366	311	389	330	413	350	381	417	453
Taxes on international trade	341	389	577	477	661	746	721	808	823	867	871	917	978	1,040
Nontax revenue	228	328	328	329	370	361	349	381	341	416	365	380	412	446
Grants	33	26	29	60	30	31	31	34	34	37	36	39	43	46
Total expenditure and net lending [1/]	4,473	5,357	6,855	5,776	7,190	6,898	6,607	7,328	6,959	7,781	7,332	7,881	8,495	9,117
Primary spending	2,907	2,901	4,267	3,440	4,240	4,336	4,122	4,787	4,545	5,212	4,928	5,339	5,806	6,298
Current expenditure [2/]	3,520	4,700	5,208	4,986	5,886	5,409	5,405	5,654	5,572	5,952	5,783	6,207	6,666	7,123
Wages and salaries	956	939	1,127	1,047	1,230	1,273	1,222	1,381	1,335	1,498	1,464	1,588	1,721	1,864
Goods and services	183	300	340	370	416	340	375	368	400	400	434	471	511	553
Subsidies and transfers	815	1,005	1,154	1,233	1,290	1,234	1,323	1,363	1,423	1,485	1,481	1,606	1,744	1,885
of which: social safety net transfers	142	187	205	205	237	221	237	240	240	260	260	282	306	331
Other current transfers [1/ 2/]			395	130										
Interest payments	1,565	2,456	2,587	2,336	2,950	2,562	2,485	2,542	2,414	2,569	2,404	2,542	2,690	2,819
Capital expenditure and net lending	953	657	1,646	777	1,304	1,489	1,202	1,674	1,387	1,829	1,549	1,674	1,829	1,995
Capital expenditure	715	914	1,251	777	1,315	1,489	1,187	1,674	1,370	1,829	1,531	1,654	1,808	1,971
Net lending	237	-257	0	0	-11	0	15	0	17	0	18	20	21	23
Overall balance [1/ 3/]	-2,460	-2,282	-2,661	-1,812	-2,200	-1,781	-1,742	-1,694	-1,599	-1,634	-1,510	-1,583	-1,650	-1,693
Overall balance (program definition) [1/3/]	-2,460	-2,282	-2,266	-1,682	-2,200	-1,781	-1,742	-1,694	-1,599	-1,634	-1,510	-1,583	-1,650	-1,693
Financing	2,460	2,282	2,661	1,812	2,200	1,781	1,742	1,694	1,599	1,634	1,510	1,583	1,650	1,693
Privatization	0	0	0	0		0	0	0	0	0	0	0	0	0
Net external financing	425	495	484	283		560	471	584	669	1,156	1,056	509	521	444
Net domestic financing	2,035	1,788	2,176	1,529		1,221	1,271	1,111	931	478	454	1,074	1,130	1,248
Memorandum items:														
Central government primary balance	-895	173	-73	523	750	781	743	847	815	935	894	959	1,040	1,126
Central government primary balance (program definition) [1/3/]	-895	173	322	653	750	781	743	847	815	935	894	959	1,040	1,126
Central government debt 1/	27,899	30,265	33,632	29,743		36,809	34,164	39,893	37,358	42,587	39,433	41,412	43,469	45,599
Nominal GDP (in billion of rupees)	24,064	27,630	30,917	29,893	33,000	33,958	32,309	36,839	35,123	39,959	38,113	41,343	44,819	48,551

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

1/ For 2024, total spending includes current transfer to account for the cash injection for banks' recapitalization. Overall and primary balances of fiscal accounts include this amount but they are excluded from program targets. See Note 3.

2/ Relative to the second review, the bank recap amount has been reclassified to current instead of capital expenditure. This amount is only presented for information and is not included in total spending aggregates. The table show the fiscal baalnces with and without this amount for transparency purposes only.

3/ As per the EFF TMU and for the purpose of program monitoring, the government's equity injections into banks for recapitalization purposes will not be recorded as central government expenditure.

Table 2b. Sri Lanka: Summary of Central Government Operations, 2022-30

(In percent of GDP)

	2022	2023	2024		2025			2026		2027		2028	2029	2030
	Act.		Second Review	Proj.	Draft budget	Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Proj.		
Total revenue and grants	8.4	11.1	13.6	13.7	15.1	15.1	15.1	15.3	15.3	15.4	15.3	15.2	15.3	15.3
Total revenue	8.2	11.0	13.5	13.5	15.0	15.0	15.0	15.2	15.2	15.3	15.2	15.1	15.2	15.2
Tax revenue	7.3	9.8	12.4	12.4	13.9	13.9	13.9	14.2	14.2	14.2	14.2	14.2	14.3	14.3
Income taxes	2.2	3.3	3.3	3.4	3.5	3.6	3.5	3.9	3.4	4.0	3.6	3.7	3.7	3.8
VAT	1.9	2.5	4.4	4.4	4.9	5.0	4.9	5.0	5.1	5.0	5.0	4.9	4.9	5.0
Excise taxes	1.4	1.7	1.8	2.0	2.5	2.0	2.3	2.0	2.4	2.0	2.4	2.4	2.5	2.5
Other taxes on goods and services	0.3	0.9	1.1	1.0	1.0	1.1	1.0	1.1	0.9	1.0	0.9	0.9	0.9	0.9
Taxes on international trade	1.4	1.4	1.9	1.6	2.0	2.2	2.2	2.2	2.3	2.2	2.3	2.2	2.2	2.1
Nontax revenue	0.9	1.2	1.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.9	0.9	0.9
Grants	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total expenditure and net lending 1/	18.6	19.4	22.2	19.3	21.8	20.3	20.4	19.9	19.8	19.5	19.2	19.1	19.0	18.8
Primary spending	12.1	10.5	13.8	11.5	12.8	12.8	12.8	13.0	12.9	13.0	12.9	12.9	13.0	13.0
Current expenditure 2/	14.6	17.0	23.4	19.7	17.8	15.9	16.7	15.3	15.9	14.9	15.2	15.0	14.9	14.7
Wages and salaries	4.0	3.4	3.6	3.5	3.7	3.7	3.8	3.8	3.8	3.7	3.8	3.8	3.8	3.8
Goods and services	0.8	1.1	1.1	1.2	1.3	1.0	1.2	1.0	1.1	1.0	1.1	1.1	1.1	1.1
Subsidies and transfers	3.4	3.6	3.7	4.1	3.9	3.6	4.1	3.7	4.1	3.7	3.9	3.9	3.9	3.9
of which: social safety net transfers	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Other current transfers 1/ 2/			1.3	0.4										
Interest payments	6.5	8.9	8.4	7.8	8.9	7.5	7.7	6.9	6.9	6.4	6.3	6.1	6.0	5.8
Capital expenditure and net lending	4.0	2.4	5.3	2.6	4.0	4.4	3.7	4.5	3.9	4.6	4.1	4.0	4.1	4.1
Capital expenditure	3.0	3.3	4.0	2.6	4.0	4.4	3.7	4.5	3.9	4.6	4.0	4.0	4.0	4.1
Net lending	1.0	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance 1/ 3/	-10.2	-8.3	-8.6	-6.1	-6.7	-5.2	-5.4	-4.6	-4.6	-4.1	-4.0	-3.8	-3.7	-3.5
Overall balance (program definition) 1/3/	-10.2	-8.3	-7.3	-5.6	-6.7	-5.2	-5.4	-4.6	-4.6	-4.1	-4.0	-3.8	-3.7	-3.5
Financing	10.2	8.3	8.6	6.1	6.7	5.2	5.4	4.6	4.6	4.1	4.0	3.8	3.7	3.5
Privatization	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	1.8	1.8	1.6	0.9		1.6	1.5	1.6	1.9	2.9	2.8	1.2	1.2	0.9
Net domestic financing	8.5	6.5	7.0	5.1		3.6	3.9	3.0	2.7	1.2	1.2	2.6	2.5	2.6
Memorandum items:														
Central government primary balance	-3.7	0.6	-0.2	1.8	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Central government primary balance (program definition) 1/3/	-3.7	0.6	1.0	2.2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Central government debt 1/	115.9	109.5	108.8	99.5		108.4	105.7	108.3	106.4	106.6	103.5	100.2	97.0	93.9
Nominal GDP (in billion of rupees)	24,064	27,630	30,917	29,893	33,000	33,958	32,309	36,839	35,123	39,959	38,113	41,343	44,819	48,551

Sources: Data provided by the Sri Lankan authorities; and IMF staff estimates.

1/ For 2024, total spending includes current transfer to account for the cash injection for banks' recapitalization. Overall and primary balances of fiscal accounts include this amount but they are excluded from program targets. See Note 3.

2/ Relative to the second review, the bank recap amount has been reclassified to current instead of capital expenditure. This amount is only presented for information and is not included in total spending aggregates. The table show the fiscal baalnces with and without this amount for transparency purposes only.

3/ As per the EFF TMU and for the purpose of program monitoring, the government's equity injections into banks for recapitalization purposes will not be recorded as central government expenditure.

Table 3. Sri Lanka: Monetary Accounts, 2022-30 1/

(In billions of rupees, unless otherwise indicated, end of period)

	2022	2023	2024	2025	2026	2027	2028	2029	2030
	Act.		Proj.						
Central Bank of Sri Lanka									
Net foreign assets	-1,606	-837	22	407	1,421	2,845	3,446	3,402	3,386
Net domestic assets	2,956	2,166	1,444	1,201	327	-949	-1,389	-1,172	-970
Net claims on central government	3,432	2,376	2,137	1,617	1,097	627	307	187	67
o.w. Holdings of government securities for monetary operations 2/	599	262	262	242	222	202	182	162	142
Other items, net	-465	-229	-712	-435	-789	-1,595	-1,715	-1,378	-1,056
Reserve Money	1,349	1,329	1,466	1,608	1,748	1,896	2,057	2,230	2,416
Currency in circulation	1,027	1,187	1,278	1,367	1,453	1,548	1,704	1,872	2,053
Commercial banks' deposits	323	142	188	241	295	349	353	358	363
Monetary survey									
Net foreign assets	-1,753	-456	405	851	1,739	2,995	3,598	3,557	3,543
Monetary authorities	-1,606	-837	22	407	1,421	2,845	3,446	3,402	3,386
Deposit money banks	-146	381	384	444	318	149	152	155	158
Net domestic assets	14,049	13,645	14,106	15,065	15,564	15,780	16,767	18,521	20,373
Net claims on central government	7,466	8,285	8,511	8,498	8,201	7,934	7,738	7,545	7,415
Credit to corporations	9,161	8,136	8,919	9,513	10,321	11,208	12,165	13,215	14,362
Public corporations	1,735	770	973	975	975	975	975	975	975
Private corporations	7,427	7,366	7,946	8,538	9,347	10,233	11,191	12,240	13,388
Other items (net)	-2,579	-2,776	-3,323	-2,945	-2,959	-3,361	-3,136	-2,238	-1,404
Broad money	12,296	13,189	14,511	15,916	17,302	18,775	20,366	22,078	23,917
Memorandum Items									
Gross international reserves (in millions of U.S. dollars)	1,898	4,392	6,122	7,056	9,303	13,118	14,710	14,875	15,175
Net international reserves (in millions of U.S. dollars)	-3,196	-1,085	1,574	2,606	5,007	8,670	10,475	10,904	11,570
Net Foreign Assets of commercial banks (in millions of U.S. dollars)	-403	1,177	1,309	1,209	784	359	359	359	359
Reserve money (in percent of GDP)	5.6	4.8	4.9	5.0	5.0	5.0	5.0	5.0	5.0
Private credit (in percent of GDP)	30.9	26.7	26.6	26.4	26.6	26.8	27.1	27.3	27.6
Money multiplier	9.1	9.9	9.9	9.9	9.9	9.9	9.9	9.9	9.9
Broad money velocity	2.0	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0
				(Annual percentage change)					
Nominal GDP	36.6	14.8	8.2	8.1	8.7	8.5	8.5	8.4	8.3
Broad money	15.5	7.3	10.0	9.7	8.7	8.5	8.5	8.4	8.3
Reserve money	3.3	-1.5	10.3	9.7	8.7	8.5	8.5	8.4	8.3
Credit to private sector	6.4	-0.8	7.9	7.5	9.5	9.5	9.4	9.4	9.4
Credit to private sector (adjusted for inflation)	-38.8	-18.2	6.6	3.7	4.1	4.3	4.3	4.3	4.3

Sources: Central Bank of Sri Lanka; and IMF staff estimates.

1/ Covers the monetary authorities and commercial banks. Excludes deposit-taking finance companies

2/ Arise from purchases of government securities, for monetary policy purposes, on temporary basis with an agreement to reverse the transaction after an agreed number of days.

Table 4a. Sri Lanka: Balance of Payments, 2022-30

(In millions of dollars, unless otherwise indicated)

	2022	2023	2024		2025		2026		2027		2028	2029	2030
	Act.		Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Proj.		
Current account	**-737**	**2,582**	**412**	**1,824**	**-926**	**-409**	**-1,031**	**-538**	**-804**	**-751**	**-864**	**-952**	**-923**
Balance on goods	-5,184	-4,900	-7,146	-6,069	-8,942	-8,271	-9,444	-8,578	-9,459	-8,615	-8,467	-8,712	-8,834
Credit (exports)	13,107	11,911	12,913	12,772	13,624	13,446	14,261	14,090	14,903	14,795	15,638	16,397	17,192
Debit (imports)	-18,291	-16,811	-20,059	-18,841	-22,565	-21,718	-23,706	-22,668	-24,362	-23,410	-24,105	-25,109	-26,026
Non-oil imports	-13,394	-12,108	-14,987	-13,747	-17,596	-16,531	-18,792	-17,441	-19,409	-18,099	-18,656	-19,499	-20,577
Oil imports	-4,897	-4,703	-5,072	-5,094	-4,969	-5,187	-4,914	-5,227	-4,953	-5,311	-5,449	-5,610	-5,449
Balance on services	2,110	3,403	4,031	3,639	4,273	3,844	4,412	3,801	4,644	3,689	3,458	3,512	3,559
Credit (exports)	3,063	5,415	6,324	6,790	6,718	7,233	6,965	7,433	7,312	7,745	7,757	8,072	8,402
Debit (imports)	-952	-2,012	-2,294	-3,151	-2,444	-3,390	-2,553	-3,632	-2,668	-4,056	-4,299	-4,561	-4,843
Primary income, net	-1,161	-1,523	-2,241	-2,178	-2,129	-2,526	-2,114	-2,418	-2,244	-2,596	-2,739	-2,748	-2,757
Secondary income, net	3,497	5,603	5,768	6,431	5,871	6,544	6,115	6,657	6,255	6,771	6,884	6,997	7,109
General government (net)	4	4	0	4	-1	4	-1	4	-1	4	4	4	5
Of which: workers' remittances (net)	3,493	5,599	5,768	6,427	5,872	6,540	6,116	6,654	6,255	6,767	6,880	6,993	7,104
Capital account (+ surplus / - deficit)	**19**	**36**	**12**	**12**	**12**	**12**	**12**	**12**	**12**	**12**	**12**	**12**	**12**
Balance from current account and capital account	**-719**	**2,618**	**424**	**1,836**	**-914**	**-397**	**-1,019**	**-526**	**-792**	**-739**	**-852**	**-940**	**-911**
Financial account (+ net lending / - net borrowing) 1/	**222**	**-1,023**	**-327**	**227**	**-2,015**	**-529**	**-2,624**	**-2,297**	**-4,842**	**-4,403**	**-2,657**	**-1,369**	**-1,578**
Direct investments	-869	-678	-800	-672	-1,120	-800	-1,400	-1,000	-1,500	-1,200	-1,400	-1,500	-1,500
Portfolio investments	189	-236	90	579	-13	276	-20	-20	-1,520	-1,520	-726	833	897
Equity and investment Fund shares	-151	-8	0	15	0	0	0	0	0	0	0	0	0
Debt instruments	340	-228	90	564	-13	276	-20	-20	-1,520	-1,520	-726	833	897
Of which: deposit taking corporations	0	0	0	0	0	0	0	0	0	0	0	0	0
Of which: general government	340	-228	90	564	-13	276	-20	-20	-1,520	-1,520	-726	833	897
T-bills, T-bonds, and SLDBs	-52	-228	90	444	-13	-13	-20	-20	-20	-20	-20	-20	0
Sovereign bonds	392	0	0	120	0	289	0	0	-1,500	-1,500	-706	853	897
Other investments 2/	903	-109	383	320	-882	-5	-1,204	-1,277	-1,822	-1,683	-531	-702	-974
Of which:													
Currency and deposits	1,101	-1,843	1,250	1,032	680	800	380	430	-250	-200	0	0	0
Central bank	-398	-1,750	900	900	900	900	630	630	0	0	0	0	0
Deposit taking corporations	1,499	-93	350	132	-220	-100	-250	-200	-250	-200	0	0	0
Loans 2/	-392	-606	-607	-452	-1,673	-916	-1,503	-1,625	-1,475	-1,385	-546	-716	-989
Deposit taking corporations	1,163	561	0	0	-390	0	-389	-225	-331	-225	225	225	0
General government	-1,546	-1,140	-907	-810	-1,143	-916	-964	-1,200	-994	-960	-971	-1,141	-1,189
Disbursements	-2,316	-2,150	-1,768	-1,500	-2,433	-2,170	-2,298	-2,498	-2,201	-2,131	-2,101	-2,152	-2,204
Amortizations	1,153	1,010	861	690	1,290	1,254	1,334	1,298	1,207	1,171	1,130	1,010	1,015
Other sectors	-9	-27	300	358	-140	0	-150	-200	-150	-200	200	200	200
SDR allocation	0	0	0	0	0	0	0	0	0	0	0	1	2
Other accounts receivable/payable (incl. ACU balance)	-1,491	1,994	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	-139	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance (- = need of inflow) 1/	**-1,080**	**3,641**	**751**	**1,609**	**1,101**	**132**	**1,605**	**1,771**	**4,050**	**3,663**	**1,805**	**429**	**667**
Financing (- = inflow)	**-1,080**	**4,319**	**1,430**	**1,946**	**1,781**	**1,143**	**2,286**	**2,442**	**4,389**	**3,997**	**1,801**	**423**	**659**
Change in reserve assets	-1,220	4,146	1,218	1,736	1,569	934	2,088	2,247	4,203	3,815	1,592	165	301
Use of Fund credit, net	140	172	212	211	212	209	198	195	185	182	208	259	359
Financing gap (- = inflow) 4/	**0**	**-678**	**-679**	**-338**	**-682**	**-1,012**	**-683**	**-673**	**-342**	**-337**	**0**	**0**	**0**
IMF	0	-678	-679	-338	-682	-1,012	-683	-673	-342	-337	0	0	0
Other IFIs	0	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:													
Current account (in percent of GDP)	-1.0	3.1	0.5	1.8	-1.1	-0.4	-1.2	-0.6	-0.9	-0.8	-0.9	-0.9	-0.8
Gross official reserves	1,898	4,392	5,605	6,122	7,174	7,056	9,262	9,303	13,466	13,118	14,710	14,875	15,175
In months of prospective imports of goods and services	1.2	2.4	2.7	2.9	3.3	3.2	4.1	4.1	5.8	5.5	5.9	5.8	5.7
In percent of ARA composite metric	16.6	37.5	47.9	50.3	58.6	58.3	73.1	75.4	100.2	100.1	108.8	108.5	108.7
Usable Gross official reserves 3/	462	2,956	4,169	4,686	7,174	7,056	9,262	9,303	13,466	13,118	14,710	14,875	15,175
In months of prospective imports of goods and services	0.3	1.6	2.0	2.2	3.3	3.2	4.1	4.1	5.8	5.5	5.9	5.8	5.7
In percent of ARA composite metric	4.0	25.3	35.6	38.5	58.6	58.3	73.1	75.4	100.2	100.1	108.8	108.5	108.7
Net international reserves	-3,196	-1,085	716	1,574	2,716	2,606	4,951	5,007	9,001	8,670	10,475	10,904	11,570
In percent of ARA composite metric	...	...	6.1	12.9	22.2	21.5	39.1	40.6	67.0	66.1	77.5	79.6	82.9

Sources: Data provided by the CBSL; and IMF staff estimates.

1/ Excluding changes in reserves assets and credit and loans with the IMF.

2/ Excluding credits and loans with the IMF, other than reserves (net purchases and repurchases), and other international institutions' loan disbursement.

3/ Excluding PBOC swap ($1.4bn in 2022) which becomes usable once GIR rise above 3 months of previous year's import cover.

4/ In this table, all program financing in 2022-2027 (IFI budget support, debt relief, external arrears) except the IMF financing is included above the line.

Table 4b. Sri Lanka: Balance of Payments, 2022-30

(In percent of GDP, unless otherwise indicated)

	2022	2023	2024		2025		2026		2027		2028	2029	2030
	Act.		Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Second Review	Proj.	Proj.		
Current account	**-1.0**	**3.1**	**0.5**	**1.8**	**-1.1**	**-0.4**	**-1.2**	**-0.6**	**-0.9**	**-0.8**	**-0.9**	**-0.9**	**-0.8**
Balance on goods	-6.9	-5.8	-8.1	-6.1	-10.4	-8.5	-10.7	-9.4	-10.4	-9.3	-8.6	-8.3	-7.9
Credit (exports)	17.6	14.1	14.7	12.9	15.8	13.7	16.1	15.5	16.4	15.9	15.9	15.6	15.4
Debit (imports)	-24.5	-19.9	-22.9	-19.0	-26.1	-22.2	-26.8	-24.9	-26.8	-25.2	-24.5	-24.0	-23.3
Non-oil imports	-18.0	-14.4	-17.1	-13.9	-20.4	-16.9	-21.3	-19.2	-21.3	-19.5	-19.0	-18.6	-18.5
Oil imports	-6.6	-5.6	-5.8	-5.1	-5.8	-5.3	-5.6	-5.8	-5.4	-5.7	-5.5	-5.4	-4.9
Balance on services	2.8	4.0	4.6	3.7	4.9	3.9	5.0	4.2	5.1	4.0	3.5	3.4	3.2
Credit (exports)	4.1	6.4	7.2	6.9	7.8	7.4	7.9	8.2	8.0	8.3	7.9	7.7	7.5
Debit (imports)	-1.3	-2.4	-2.6	-3.2	-2.8	-3.5	-2.9	-4.0	-2.9	-4.4	-4.4	-4.4	-4.3
Primary income, net	-1.6	-1.8	-2.6	-2.2	-2.5	-2.6	-2.4	-2.7	-2.5	-2.8	-2.8	-2.6	-2.5
Secondary income, net	4.7	6.6	6.6	6.5	6.8	6.7	6.9	7.3	6.9	7.3	7.0	6.7	6.4
Of which: workers' remittances (net)	4.7	6.6	6.6	6.5	6.8	6.7	6.9	7.3	6.9	7.3	7.0	6.7	6.4
Capital account (+ surplus / - deficit)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Balance from current account and capital account	**-1.0**	**3.1**	**0.5**	**1.9**	**-1.1**	**-0.4**	**-1.2**	**-0.6**	**-0.9**	**-0.8**	**-0.9**	**-0.9**	**-0.8**
Financial account (+ net lending / - net borrowing) 1/	**0.3**	**-1.2**	**-0.4**	**0.2**	**-2.3**	**-0.5**	**-3.0**	**-2.5**	**-5.3**	**-4.7**	**-2.7**	**-1.3**	**-1.4**
Direct investments	-1.2	-0.8	-0.9	-0.7	-1.3	-0.8	-1.6	-1.1	-1.6	-1.3	-1.4	-1.4	-1.3
Portfolio investments	0.3	-0.3	0.1	0.6	0.0	0.3	0.0	0.0	-1.7	-1.6	-0.7	0.8	0.8
Equity and investment Fund shares	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt instruments	0.5	-0.3	0.1	0.6	0.0	0.3	0.0	0.0	-1.7	-1.6	-0.7	0.8	0.8
Of which: deposit taking corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: general government	0.5	-0.3	0.1	0.6	0.0	0.3	0.0	0.0	-1.7	-1.6	-0.7	0.8	0.8
T-bills, T-bonds, and SLDBs	-0.1	-0.3	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sovereign bonds	0.5	0.0	0.0	0.1	0.0	0.3	0.0	0.0	-1.6	-1.6	-0.7	0.8	0.8
Other investments 2/	1.2	-0.1	0.4	0.3	-1.0	0.0	-1.4	-1.4	-2.0	-1.8	-0.5	-0.7	-0.9
Of which:	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	1.5	-2.2	1.4	1.0	0.8	0.8	0.4	0.5	-0.3	-0.2	0.0	0.0	0.0
Central bank	-0.5	-2.1	1.0	0.9	1.0	0.9	0.7	0.7	0.0	0.0	0.0	0.0	0.0
Deposit taking corporations	2.0	-0.1	0.4	0.1	-0.3	-0.1	-0.3	-0.2	-0.3	-0.2	0.0	0.0	0.0
Loans 2/	-0.5	-0.7	-0.7	-0.5	-1.9	-0.9	-1.7	-1.8	-1.6	-1.5	-0.6	-0.7	-0.9
Deposit taking corporations	1.6	0.7	0.0	0.0	-0.5	0.0	-0.4	-0.2	-0.4	-0.2	0.2	0.2	0.0
General government	-2.1	-1.4	-1.0	-0.8	-1.3	-0.9	-1.1	-1.3	-1.1	-1.0	-1.0	-1.1	-1.1
Disbursements	-3.1	-2.5	-2.0	-1.5	-2.8	-2.2	-2.6	-2.7	-2.4	-2.3	-2.1	-2.1	-2.0
Amortizations	1.5	1.2	1.0	0.7	1.5	1.3	1.5	1.4	1.3	1.3	1.1	1.0	0.9
Other sectors	0.0	0.0	0.3	0.4	-0.2	0.0	-0.2	-0.2	-0.2	-0.2	0.2	0.2	0.2
SDR allocation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts receivable/payable (incl. ACU balance)	-2.0	2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (- = need of inflow) 1/	**-1.4**	**4.3**	**0.9**	**1.6**	**1.3**	**0.1**	**1.8**	**1.9**	**4.5**	**3.9**	**1.8**	**0.4**	**0.6**
Financing (- = inflow)	**-1.4**	**5.1**	**1.6**	**2.0**	**2.1**	**1.2**	**2.6**	**2.7**	**4.8**	**4.3**	**1.8**	**0.4**	**0.6**
Change in reserve assets	-1.6	4.9	1.4	1.8	1.8	1.0	2.4	2.5	4.6	4.1	1.6	0.2	0.3
Use of Fund credit, net	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3
Financing gap (- = inflow) 4/	**0.0**	**-0.8**	**-0.8**	**-0.3**	**-0.8**	**-1.0**	**-0.8**	**-0.7**	**-0.4**	**-0.4**	**0.0**	**0.0**	**0.0**
IMF	**0.0**	**-0.8**	**-0.8**	**-0.3**	**-0.8**	**-1.0**	**-0.8**	**-0.7**	**-0.4**	**-0.4**	**0.0**	**0.0**	**0.0**
Other IFIs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:													
Current account (in percent of GDP)	-1.0	3.1	0.5	1.8	-1.1	-0.4	-1.2	-0.6	-0.9	-0.8	-0.9	-0.9	-0.8
Gross official reserves	1,898	4,392	5,605	6,122	7,174	7,056	9,262	9,303	13,466	13,118	14,710	14,875	15,175
In months of prospective imports of goods and services	1.2	2.4	2.7	2.9	3.3	3.2	4.1	4.1	5.8	5.5	5.9	5.8	5.7
In percent of ARA composite metric	16.6	37.5	47.9	50.3	58.6	58.3	73.1	75.4	100.2	100.1	108.8	108.5	108.7
Usable Gross official reserves 3/	462	2,956	4,169	4,686	7,174	7,056	9,262	9,303	13,466	13,118	14,710	14,875	15,175
In months of prospective imports of goods and services	0.3	1.6	2.0	2.2	3.3	3.2	4.1	4.1	5.8	5.5	5.9	5.8	5.7
In percent of ARA composite metric	4.0	25.3	35.6	38.5	58.6	58.3	73.1	75.4	100.2	100.1	108.8	108.5	108.7
Net international reserves	-3,196	-1,085	716	1,574	2,716	2,606	4,951	5,007	9,001	8,670	10,475	10,904	11,570
In percent of ARA composite metric	...	...	6.1	12.9	22.2	21.5	39.1	40.6	67.0	66.1	77.5	79.6	82.9

Sources: Data provided by the CBSL; and IMF staff estimates.

1/ Excluding changes in reserves assets and credit and loans with the IMF.

2/ Excluding credits and loans with the IMF, other than reserves (net purchases and repurchases), and other international institutions' loan disbursement.

3/ Excluding PBOC swap ($1.4bn in 2022) which becomes usable once GIR rise above 3 months of previous year's import cover.

4/ In this table, all program financing in 2022-2027 (IFI budget support, debt relief, external arrears) except the IMF financing is included above the line.

Table 5. Sri Lanka: Composition of Public Debt 1/ (Including Arrears)

	Debt Stock (end of period, incl. arrears and past due interest) 2023			Debt Service on end-2023 debt stock (on contractual terms)					
				2024	2025	2026	2024	2025	2026
	(In US$mn)	*(Percent total debt)*	*(Percent GDP)*	*(In US$mn)*			*(Percent GDP)*		
Total public debt	**98,758**	**100.0**	**115.8**	**28,272**	**14,213**	**10,376**	**30.4**	**14.9**	**11.3**
External (foreign law)	**43,323**	**43.9**	**50.8**	**6,577**	**7,416**	**5,055**	**7.1**	**7.8**	**5.5**
Multilateral creditors[2]	13,175	13.3	15.4	1,543	1,575	1,528	1.7	1.6	1.7
IMF	1,579	1.6	1.9	328	323	278	0.4	0.3	0.3
World Bank	4,388	4.4	5.1	368	393	372	0.4	0.4	0.4
ADB	6,583	6.7	7.7	716	728	758	0.8	0.8	0.8
Other Multilaterals	625	0.6	0.7	132	131	121	0.1	0.1	0.1
Bilateral Creditors	11,100	11.2	13.0	1,222	1,575	1,059	1.3	1.6	1.2
Paris Club	4,834	4.9	5.7	351	336	298	0.4	0.4	0.3
o/w: Japan	2,676	2.7	3.1	215	205	190	0.2	0.2	0.2
Non-Paris Club	6,266	6.3	7.3	872	1,239	761	0.9	1.3	0.8
o/w: China	4,349	4.4	5.1	654	576	479	0.7	0.6	0.5
India	1,575	1.6	1.8	131	603	262	0.1	0.6	0.3
Bonds	14,130	14.3	16.6	2,799	3,309	1,664	3.0	3.5	1.8
Commercial creditors	3,498	3.5	4.1	1,013	957	803	1.1	1.0	0.9
o/w: China Development Bank	3,241	3.3	3.8	780	749	634	0.8	0.8	0.7
Central bank bilateral currency swaps	1,420	1.4	1.7	-	-	-	0.0	-	-
Domestic (local law)	**55,436**	**56.1**	**65.0**	**21,695**	**6,797**	**5,321**	**23.3**	**7.1**	**5.8**
T-Bills	12,634	12.8	14.8	13,552	-	-	14.6	-	-
Bonds	37,423	37.9	43.9	7,912	6,539	5,164	8.5	6.8	5.6
Others	5,379	5.4	6.3	231	258	157	0.2	0.3	0.2
Memo items:									
Collateralized debt[3]	0	0	0						
o/w: Related	0	0	0						
o/w: Unrelated	0	0	0						
Contingent liabilities									
o/w: Public guarantees	(included in public debt)								
o/w: Other explicit contingent liabilities									
Exchange rate (eop., Rupees/$)	324								
Nominal GDP (billions of Rupees)	27,630								

1/As reported by the Sri Lankan authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA.
2/Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies
3/Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

Table 6. Sri Lanka: Gross External Financing, 2021-30 (Restructuring Scenario)

(In millions of U.S. dollars, unless otherwise indicated)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
		Act.				Proj.				
Current account	-3,285	-737	2,582	1,824	-409	-538	-751	-864	-952	-923
Balance on goods	-8,139	-5,184	-4,900	-6,069	-8,271	-8,578	-8,615	-8,467	-8,712	-8,834
Credit (exports)	12,499	13,107	11,911	12,772	13,446	14,090	14,795	15,638	16,397	17,192
Debit (imports)	-20,638	-18,291	-16,811	-18,841	-21,718	-22,668	-23,410	-24,105	-25,109	-26,026
Balance on services	1,587	2,110	3,403	3,639	3,844	3,801	3,689	3,458	3,512	3,559
Credit (exports)	2,476	3,063	5,415	6,790	7,233	7,433	7,745	7,757	8,072	8,402
Debit (imports)	-889	-952	-2,012	-3,151	-3,390	-3,632	-4,056	-4,299	-4,561	-4,843
Primary and secondary income, net	3,268	2,336	4,080	4,253	4,018	4,239	4,174	4,145	4,248	4,352
Amortization	-1851	-1733	478	-2279	-3453	-2945	-2236	-3016	-3007	-3158
General government	-2,815	-1,653	-1,010	-810	-1,543	-1,298	-1,171	-1,924	-1,863	-1,912
Sovereign bonds	-1000	-500	0	-120	-289	0	0	-794	-853	-897
Syndicated loans	-92	0	0	0	0	0	0	0	0	0
Bilateral and multilateral	-1,723	-1,153	-1,010	-690	-1,254	-1,298	-1,171	-1,130	-1,010	-1,015
Central bank	1318	258	1578	-1111	-1110	-827	-185	-213	-264	-366
IMF repurchases/repayments	-57	-140	-172	-211	-210	-197	-185	-213	-264	-366
Other central bank liabilities, net	1375	398	1750	-900	-900	-630	0	0	0	0
Private sector loans	-354	-339	-90	-358	-800	-820	-880	-880	-880	-880
Debt service on treated CG and guaranteed debt on pre-restructuring terms	...	-2,834	-3,772	-4,038	-4,341	-2,928	-2,961	-2,503	-2,493	-2,314
Principal	...	-2,107	-2,628	-3,073	-3,508	-2,267	-2,457	-2,122	-2,232	-2,190
Interest	...	-727	-1,144	-965	-833	-660	-505	-381	-261	-124
Debt service on treated CG and guaranteed debt debt post-restructuring	...	0	0	654	1,129	936	922	1,562	1,659	1,659
Principal	...	0	0	153	377	377	377	968	1,064	1,093
Interest	...	0	0	501	753	559	545	594	594	565
Gross external financing needs	-5,136	-5,304	-712	-3,839	-7,074	-5,475	-5,027	-4,822	-4,794	-4,736
Sources of financing	5,136	5,304	712	3,839	7,074	5,475	5,027	4,822	4,794	4,736
Borrowing	1834	1,390	-811	1,203	3,001	4,299	5986	5073	3724	4348
General government	2080	2,374	1,158	406	1,400	1,760	3171	3221	1772	1804
T-bills, Tbonds, and SLDBs, net	-30	52	228	-444	13	20	20	20	20	0
Sovereign bonds	0	0	0	0	0	0	1500	1500	0	0
Syndicated loans	800	0	0	0	0	0	0	0	0	0
Bilateral and multilateral	1300	2,316	930	850	1,387	1,740	1651	1701	1752	1804
Official capital transfers	10	6	0	0	0	0	0	0	0	0
Other capital inflows, net	-247	-984	-1,969	797	1,601	2,539	2,815	1,853	1,953	2,543
Deposit-taking corporations, excl. central bank, net	364	-3,142	-468	-144	77	411	411	-240	-240	-15
FDI inflows, net	573	869	678	672	800	1,000	1,200	1,400	1,500	1,500
Private sector loans	187	332	117	0	800	1,020	1,080	880	880	880
Other capital inflows, net	-1371	956	-2,296	269	-76	108	124	-188	-188	178
Change in reserve assets	3,302	1,081	-4,146	-1,736	-934	-2,247	-3,815	-1,592	-165	-667
External financing gap	0	2,834	5,670	4,372	5,007	3,423	2,856	1,341	1,235	1,055
Exceptional Financing	...	2,834	5,670	4,372	5,007	3,423	2,856	1,341	1,235	1,055
IMF EFF	...	0	678	338	1,012	673	337	0	0	0
IFI budget support	...	0	1,220	650	783	758	480	400	400	400
Debt moratorium: external arrears accumulation	...	2,834	3,772	644	0	0	0	0	0	0
Debt relief	...	0	0	2,740	3,211	1,992	2,040	941	835	655

Sources: Central Bank of Sri Lanka; and IMF staff estimates and projections.

Table 7. Sri Lanka: Financial Soundness Indicators – All Banks, 2022-24Q2

	2022				2023				2024	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Capital adequacy										
Regulatory capital to risk weighted assets	15.1	15.2	15.3	16.2	16.5	16.9	16.4	18.4	17.7	17.9
Tier 1 capital/risk weighted assets	12.1	12.2	12.4	13.2	13.5	13.9	13.5	15.2	14.5	14.8
Equity capital and reserves to assets ratio	7.8	7.6	7.8	8.2	8.5	8.6	8.7	8.7	8.8	8.8
Asset quality										
Gross nonperforming loans to total gross loans (without interest in suspense)	8.4	8.9	10.8	11.6	12.9	13.4	13.4	12.8	12.8	12.6
Net nonperforming loans to total gross loans	8.4	9.4	10.8	11.3	12.7	13.4	13.6	12.8	12.9	12.9
Provision coverage ratio (total)	45.1	46.5	43.6	45.2	45.8	44.9	46.9	49.0	50.4	51.1
Earnings and profitability										
Return on equity (after tax)	20.4	8.8	8.0	10.4	10.2	10.2	11.1	11.5	11.1	12.7
Return on assets (after tax)	1.6	0.7	0.6	0.8	0.8	0.8	1.0	1.0	1.0	1.1
Net Interest income to gross income	4.2	4.3	4.1	4.0	3.7	3.5	3.5	3.7	3.8	3.9
Staff expenses to noninterest expenses	53.9	53.3	53.7	53.5	50.9	50.7	51.3	50.8	52.8	52.9
Total cost to total income	53.7	59.7	66.0	70.0	81.5	83.1	81.6	80.5	79.5	76.7
Net interest margin	4.2	4.3	4.1	4.0	3.7	3.5	3.5	3.7	3.8	3.9
Liquidity										
Liquid assets to total assets	19.0	14.7	16.8	18.5	22.1	24.5	30.0	32.2	34.6	34.4
Assets/funding structure										
Deposits to total assets	75.9	75.6	77.4	78.8	80.5	80.4	81.0	81.5	81.8	82.1
Borrowings to total assets	13.0	13.1	11.2	9.6	7.8	7.8	6.9	6.9	6.1	6.1

Source: CBSL.

Table 8. Sri Lanka: Projected Payments to the Fund, 2023-36 1/

(In millions of SDRs, unless otherwise indicated)

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
Fund repurchases and charges														
In millions of SDR	208.2	260.5	254.4	264.5	275.7	291.2	320.2	383.9	452.3	459.1	423.3	325.7	252.0	139.7
In millions of U.S. dollars	277.7	346.2	336.9	350.4	365.4	385.9	424.4	508.8	599.5	608.5	561.1	431.7	334.0	185.2
In percent of exports of goods and services	1.6	1.8	1.6	1.6	1.6	1.6	1.7	2.0	2.2	2.2	1.9	1.4	1.0	0.6
In percent of government fiscal revenue	3.0	2.6	2.3	2.5	2.6	2.6	2.7	3.1	3.4	3.3	2.9	2.1	1.5	0.8
In percent of quota	36.0	45.0	44.0	45.7	47.6	50.3	55.3	66.3	78.1	79.3	73.1	56.3	43.5	24.1
In percent of gross official reserves	6.3	5.7	4.8	3.8	2.8	2.6	2.9	3.3	3.8	3.7	3.3	2.5	1.9	1.0
Fund credit outstanding 2/														
In millions of SDR	1,176.8	1,272.1	1,875.4	2,234.7	2,348.8	2,188.6	1,989.7	1,714.5	1,354.7	973.7	613.8	338.7	127.0	21.2
In millions of U.S. dollars	1,570	1,684	2,485	2,960	3,116	2,903	2,639.3	2,274.3	1,796.9	1,291.6	814.2	449.2	168.5	28.1
In percent of exports of goods and services	9.1	8.6	12.0	13.8	13.8	12.4	10.8	8.9	6.7	4.6	2.8	1.5	0.5	0.1
In percent of government fiscal revenue	16.9	12.6	17.0	21.5	22.1	19.5	16.8	13.7	10.3	7.0	4.2	2.2	0.8	0.1
In percent of quota	203.3	219.8	324.0	386.1	405.8	378.1	343.8	296.2	234.0	168.2	106.1	58.5	21.9	3.7
In percent of GDP	1.9	1.7	2.5	3.3	3.4	3.0	2.5	2.1	1.6	1.1	0.6	0.3	0.1	0.0
In percent of gross official reserves	35.7	27.5	35.2	31.8	23.8	19.7	17.7	14.8	11.3	7.9	4.8	2.6	0.9	0.2
Memorandum items:														
Exports of goods and services (in millions of U.S. dollars)	17,326	19,562	20,680	21,522	22,540	23,395	24,447	25,547	26,697	27,898	29,154	30,466	31,837	33,269
Central government fiscal revenue (billion of Rupees)	3,049	4,034	4,834	5,324	5,780	6,245	6,748	7,292	7,880	8,514	9,200	9,941	10,742	11,608
Quota 2/	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8	578.8
Quota (in millions of U.S. dollars) 2/	772	766	767	767	768	768	768	768	768	768	768	768	768	768
Gross official reserves (in millions of U.S. dollars) 2/	4,392	6,122	7,056	9,303	13,118	14,710	14,875	15,375	15,875	16,375	16,875	17,375	17,875	18,375

Source: IMF staff estimates.
1/ Projections as of January 16, 2025.
2/ As of the end of the year.

Table 9. Sri Lanka: Reviews and Disbursements Under the Four-Year Extended Arrangement

Availability Date	Amount (millions of SDR)	Percent of Quota (%)	Conditions
At arrangement approv	254	43.9	Board Approval of the Extended Arrangement
September 1, 2023	254	43.9	Completion of the 1st review based on end-June 2023 and continuous perfomance criteria
April 1, 2024	254	43.9	Completion of the 2nd review based on end-December 2023 and continuous perfomance criteria
October 1, 2024	254	43.9	Completion of the 3rd review based on end-June 2024 and continuous perfomance criteria
April 1, 2025	254	43.9	Completion of the 4th review based on end-December 2024 and continuous perfomance criteria
October 1, 2025	254	43.9	Completion of the 5th review based on end-June 2025 and continuous perfomance criteria
April 1, 2026	254	43.9	Completion of the 6th review based on end-December 2025 and continuous perfomance criteria
October 1, 2026	254	43.9	Completion of the 7th review based on end-June 2026 and continuous perfomance criteria
March 1, 2027	254	43.9	Completion of the 8th review based on end-December 2026 and continuous perfomance criteria
Total	2,286.0	395.0	

Source: IMF staff.

Annex I. Sri Lanka's Debt Restructuring Process

Following the recent agreements with major commercial creditors, the Sri Lankan authorities are close to completing their debt restructuring process. In light of the developments, this annex summarizes the debt restructuring process.

1. Official sector involvement (OSI) includes negotiations with (i) the Official Creditor Committee (OCC), and (ii) China EXIM bank as the major official bilateral creditors, along with (iii) smaller exposure to other official creditors.

External Official Restructuring Perimeter Claims – End 2023 Stock (USD billions)	
Official Creditor Committee	5.9
China Exim Bank	4.2
Others	0.5
Total	**10.6**

- **The restructuring of the bulk of the bilateral official debt was negotiated with the Official Creditors Committee (OCC).** France, India, and Japan (as co-chairs) jointly announced the formation of the OCC—which they made open to all bilateral creditors—on the sidelines of the 2023 IMF-World Bank Spring Meetings. An AIP between Sri Lanka and the OCC, in line with the program parameters, was reached in November 2023. In June 2024, Sri Lanka reached agreement with the OCC on codifying the agreement in the form of a Memorandum of Understanding. Authorities are currently working on finalizing bilateral agreements with individual OCC creditors.

- **Discussions with China EXIM Bank progressed in parallel.** The China EXIM Bank did not formally join the OCC but participated in many of the OCC meetings as an observer. After providing financing assurances in early 2023, the China EXIM Bank continued its engagement with Sri Lanka's debt advisors. After several rounds of discussions, an AIP between Sri Lanka, and the China EXIM Bank, in line with the program parameters, was reached in October 2023. In June 2024, Sri Lanka finalized its amendment agreements with China EXIM, and started debt service on the restructured facilities in July 2024.

- **The authorities continue to have discussions with remaining bilateral creditors.** Sri Lanka remains in arrears to Saudi Arabia, Kuwait, Iran, and Pakistan. Until an agreement to restructure is reached, these arrears would remain outstanding. Until the second review, Fund policies required consent by creditors to move ahead with continued disbursements of the EFF arrangement. Starting at the third review, based on the enhanced safeguards approach under the LIOA policy Strand 4, commitment provided towards restructuring by a sufficient set of official creditors implies that arrears are considered eliminated for the purposes of the LIOA policy. The authorities continue to discuss restructuring terms with the creditors.

2. Private Sector Involvement (PSI) includes discussions with the holders of International Sovereign Bonds (ISBs), the China Development Bank (CDB) as the two major creditor groups, and other commercial creditors.

External Commercial Restructuring Perimeter Claims – End 2023 Stock (USD billions)	
International Sovereign Bonds	14.2
China Development Bank	3.3
Others	0.2
Total	**17.8**

- **International Sovereign Bonds**: Almost immediately after the EFF arrangement approval, the Sri Lankan authorities organized an Investor Presentation to engage their commercial creditors. Soon after, the authorities received an initial restructuring proposal from the foreign bondholders' advisors on April 11, 2023. Discussions continued with the foreign bondholders' committee, where both parties shared proposals with state-contingent features. Discussions with bondholders slowed down in late 2023, as authorities were engaging with official creditors to finalize their agreements and guide the assessment of comparability of treatment. Sri Lanka underwent an initial restricted round of discussions with the bondholders' committee in April 2024. Authorities entered a second round of restricted negotiations with the committee and reached an agreement on a Joint Working Framework (JWF) in early July 2024. The framework included the use of macro-linked bonds (MLBs), a type of state contingent instrument (SCDI) where both coupon rates and principal payments would go up if Sri Lanka's dollar GDP and economic growth stay above certain levels by 2027. IMF staff assessed the JWF as not meeting the debt sustainability requirements under the IMF program (DSA), and the OCC also assessed the JWF as not meeting comparability of treatment principles. Authorities entered a third restricted period with external bondholders on September 12 and reached Agreement in Principle with the committee on September 18. This scenario was assessed by IMF staff as consistent with the program's debt sustainability targets (DSA). The OCC also assessed the AIP as consistent with comparability principles.

  The bondholder agreement featured an innovation in the form of a governance-linked bond. Creditors agreed to provide more coupon relief for one of the restructured bonds if Sri Lanka met two transparent criteria related to fiscal governance (meeting targets on revenue to GDP by 2027 and publishing fiscal strategy statements).

  Finally, the committee representing local ISB holders, who hold 12 percent of ISBs, had requested a non-contingent option with some portion of the bonds being exchanged to local currency bonds. Authorities also reached AIPs with the committee on September 18, with a treatment that remains compatible with the program's objectives. This treatment does not include state contingent features unlike the agreement with external bondholders.

  In line with these agreements, the authorities launched their bond debt exchange on November 25, 2024, with a consent solicitation deadline of December 12, 2024. Overall, 98 percent of ISBs were exchanged through the bond exchange after enforcement of the collective action mechanisms. An aggregate minimum participation threshold of 80/90 was used by authorities to ensure sufficient participation.[1] By the deadline, 96 percent of investors had initially accepted to enter the bond exchange. The bond portfolio featured seven bonds with aggregate CAC features and four without. Participation in ten of the eleven bonds went from 98 percent to 100 percent after enforcement of the collective action mechanisms. On the remaining bond with the holdout creditor (Hamilton Reserve Bank (HRB)), the participation was lower at 73 percent. After the bond exchange was completed, JP Morgan announced that the MLB instruments satisfied index eligibility criteria and would be included in the emerging market bond indices. Index inclusion will improve marketability and liquidity of Sri Lanka's external bonded debt. Yields on restructured Eurobonds have fallen sharply, with spreads for the non-macro-linked bond (2035 maturity with governance linked features) at around 520 bps.[2]

- **China Development Bank**: The authorities started with technical exchanges with the CDB, including in person in Colombo in May 2023 and in Beijing in October 2023, to reconcile their DSA modeling and advance technical discussions. The authorities reached agreement on an AIP with CDB in November 2024, assessed by IMF staff as consistent with debt sustainability. The OCC assessed this AIP as consistent with COT. Authorities completed their debt treatment with CDB and started paying on restructured debt in December 2024.

- **Other Commercial Creditors**. Authorities reached an AIP with HSBC in October 2024 on a Sinosure backed facility in line with program parameters. Commercial debt yet to be restructured stands at less than USD 50 million.

- **HRB Litigation**: Hamilton Reserve Bank (HRB) filed a motion for summary judgment in US courts in 2023 on its exposure for the 2022 bond. The US court denied Sri Lankan government's motion to dismiss the complaint from Hamilton Reserve Bank. There has been no judgment on the merits of the claim. The US court held a status conference on April 20 and the judge agreed to allow Sri Lanka another month to complete its discovery process against HRB before reconvening in late-May to decide on whether a stay can be granted to allow the country more time to finish its negotiations with bondholders. The Court then provided multiple stays on the matter first till August 2024, then till November 30, 2024. Sri Lanka has filed a motion to extend the stay further in the court. HRB did not participate in the debt exchange offer in December 2024.

3. Domestic Debt Operation (DDO) was mostly concluded in 2023, with three portions, (i) maturity extension of T-bonds held by superannuation funds, (ii) exchange of dollar-denominated SLDBs held by domestic banks and other small FX-denominated bank loans into local currency bonds with longer maturities, and (iii) exchange of T-bills held by CBSL into long term T-bonds. The

[1] With authorities not accepting the exchange below 80 percent participation and required to accept the exchange above 90 percent participation, but with a choice to accept or not between 80 and 90 percent.

[2] This spread overstates sovereign risks slightly as coupon rates could be reduced by 75 basis points if authorities meet conditions linked to governance reforms.

operation helped manage financing needs during the program period and lowered gross financing needs to meet the 2027-32 program debt targets. Authorities agreed in late 2024 with two state banks on the terms of the restructuring of large FX loans from CPC (the state petroleum company) held by two state banks. These dollar instruments were renegotiated into a long-term loan, with authorities making a lumpsum payment to compensate banks for their day-one losses, which helped restore the banks' capital position, as reflected in the context of the holistic bank recapitalization plan.

Annex II. Sovereign Risk and Debt Sustainability Analysis (SRDSA)

This SRDSA focuses on changes in assumptions relative to the second program review staff report and includes all the restructuring agreements so far, which make up a large majority of the restructuring perimeter.

DSA Assumptions

1. **The macroeconomic framework has been updated to reflect recent developments since June 2024**. This update includes (i) higher growth and primary balance, and lower inflation in 2024, (ii) smaller interest bill for 2024, and (ii) lower depreciation by end 2024. The medium-term projections of macro variables remain anchored at (i) Sri Lanka's medium-term growth potential, (ii) the central bank's inflation target, and (iii) the External Balance Assessment (EBA)-based misalignment and external adjustment needs, respectively.

Text Table 1. DSA Macroeconomic Assumptions – Differences with Second Review

	2023	2024	2025	2026	2027	2028	2029
Real growth (%)							
2nd Review	-2.3	2.0	2.7	3.0	3.1	3.1	3.1
Current	-2.3	4.5	3.0	3.0	3.1	3.1	3.1
GDP deflator inflation (yoy, %)							
2nd Review	17.5	9.8	6.9	5.4	5.2	5.1	5.0
Current	17.5	3.5	4.9	5.5	5.3	5.2	5.1
Primary balance (% of GDP)							
2nd Review	0.6	1.0	2.3	2.3	2.3	2.3	2.3
Current	0.6	2.2	2.3	2.3	2.3	2.3	2.3
Nominal GDP (Rs bln)							
2nd Review	27,630	30,917	33,958	36,839	39,959	43,287	46,869
Current	27,630	29,893	32,309	35,123	38,113	41,343	44,819

Source: IMF staff estimates and projections.

2. **Financing assumptions are updated to reflect recent developments and the challenging outlook for lengthening domestic issuance maturities**. Domestic T-bill rates declined in 2024 from 14 percent in January to 9 percent in December, slightly faster than projected during the second review. The authorities issued around one third of their T-bond issuances in the form of long-term domestic debt (above 5-year maturity) in 2024, at rates between 12 and 13 percent.[1] The outlook on long term issuances remains challenging. The institutional agenda on public debt management has also progressed slowly. In line with these developments, the 2025 projections assume a smaller share of long-term bonds relative to the second review. These factors partially offset the improvement in the Gross Financing Needs (GFN) path due to the changes in the macro assumptions. This DSA also includes an updated

[1] T-bond rates fell from around 14 percent in January to around 11 percent by December 2024.

estimate for banking sector recapitalization costs consistent with the finalization of the remaining SOE local law FX-denominated debt restructuring (CPC FX loans).[2] Banking sector absorption of government debt as of end-2023 was at around 39 percent of banking system assets and is expected to rise to around 42 percent by end-2024. A majority of gross domestic issuances in 2024 is expected to be absorbed by banks and pension funds, within their respective absorptive capacity.

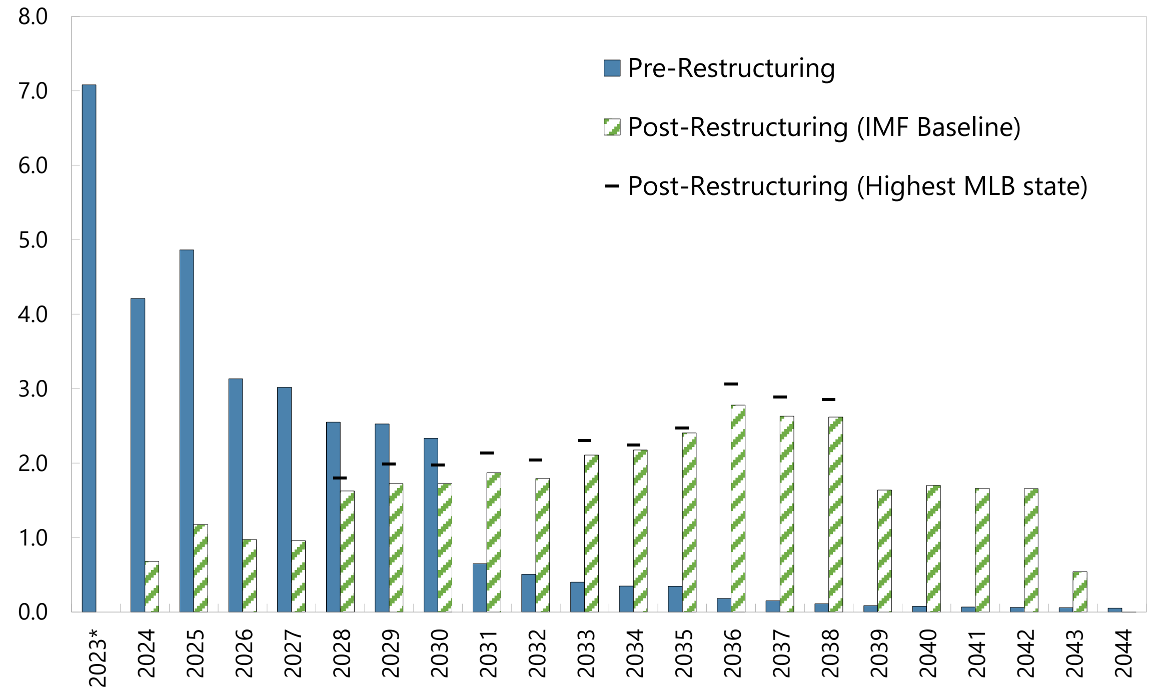
3. The debt restructuring scenario reflects agreements with all major external official and commercial creditors. The authorities have now completed their debt restructuring with China EXIM Bank and resumed debt service payments. They reached final agreements with the OCC, with only small official creditor agreements remaining. They have also restructured their international sovereign bonds and completed their debt restructuring agreement with the CDB, with only small commercial creditors remaining. With these developments, the authorities have reached agreements in principle on around 97 percent of the restructuring debt perimeter as defined under their strategy.[3] The terms for bondholders feature a principal haircut and step-up coupon in the ISB treatment in the September 18 AIP (amended Joint Working Framework Scenario), and include state contingent debt instruments (SCDI) linked to macro-economic outcomes (macro-linked bonds (MLBs). The bilateral debt treatment features a maturity extension with lower interest rates and a progressive amortization profile. The proposed debt treatments for external creditors lead to significant reduction in debt service for the next decade (Text Chart) and imply a meaningful Net Present Value (NPV) reduction.[4]

[2] The authorities have agreed with the state-owned banks on a treatment in line with the assumptions at the Second Review. However, the recapitalization of the state-owned banks, which was originally planned through issuance of a long-term bond, is now being executed through the provision of cash. This change lowers the debt stock in 2024 but does not materially affect gross financing needs.

[3] The size of remaining holdouts from the commercial bond restructuring is small and hence not material to debt sustainability.

[4] 41 percent NPV/NPV relief for total restructured external debt (at 9 percent discount rate corresponding approximately to the bond restructuring exit yields) in the baseline case of the MLBs, and 37 percent NPV/NPV relief in the highest growth state under the MLB.

Sri Lanka: Pre and Post Restructuring External Debt Service on Restructured Debt: 2023-2044
(In billions of USD)



* 2023 pre-restructuring debt service includes arrears for 2022-23.

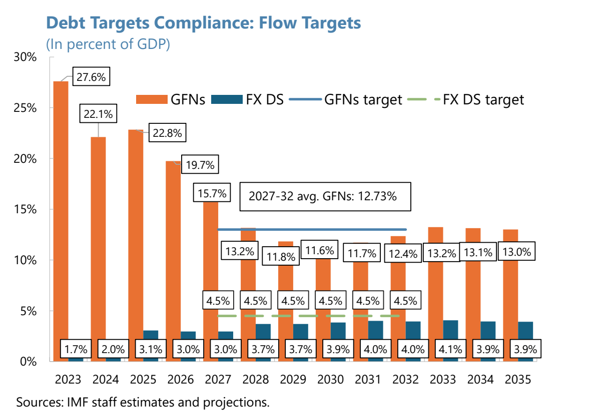
4. Given the inclusion of the SCDI, staff's assessment of debt sustainability includes a baseline assessment and an additional assessment of risks due to the contingent element. While the higher state contingent payments are not triggered in the baseline forecast, with the improvements to growth projections, the probability of such payments has increased relative to the second review macro-framework.[5] Such increased probabilities required commensurately larger buffers to the debt targets in the baseline, analyzed under the additional assessment.

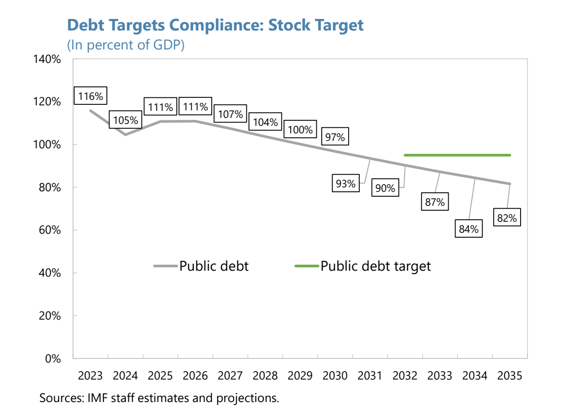
Baseline Compliance with Debt Targets

5. All four debt targets are respected in the baseline in the authorities' abovementioned restructuring agreement scenario (text chart). This DSA update assumes a full execution of the authorities' announced debt treatments and treatments in line with authorities' strategy for remaining creditors based on end-2023 outstanding debt stock—the same approach adopted by the authorities and their major creditor groups. The four debt targets (on program period external debt service relief, post-program GFNs and FX debt service, and debt stock) are met. The total relief

[5] Projected average dollar GDP in 2025-27 is below, but close to the first trigger for state contingent payments.

provided in the baseline allows for appropriate buffers to the debt targets to compensate against the extra risks from the macro-linked bonds and ensure debt sustainability.





State Contingent Instruments Analysis

6. Staff developed a new methodology to assess debt sustainability risks from state contingent instruments. This method checks if adding SCDIs in the restructuring increases the likelihood of exceeding debt sustainability targets.[6] It also examines if SCDI triggers are linked to real improvements in debt carrying capacity, ensuring that increased payments are only triggered if debt carrying capacity improves. Additionally, the method assesses the risk of making extra payments in downside scenarios where debt targets are already exceeded without SCDIs.[7] Finally, staff analyzed tail risks by i) checking that the SCDI design includes maximum payment ceilings, their size and effects on additional payments, and ii) separately assessing the largest possible SCDI contributions to debt indicators in scenarios where debt indicators are already high.

7. The methodology is implemented using the SRDSF's debt fan chart module. This computes a range of debt and gross financing needs outcomes around the baseline scenario for a range of probabilities.[8] To analyze their impact, payments from SCDIs are added to this range. Two scenarios are compared: one with SCDIs and one without. This comparison checks (i) whether SCDIs increase the chance of exceeding debt targets,[9] (ii) whether positive SCDI contributions are

[6] Assuming a baseline with debt indicators exactly at their target, the probability of exceeding the target in a distribution around the baseline is close to 50 percent. The methodology thus tests whether the probability of exceeding the debt burden targets increased relative to such a baseline (exactly at target) after introducing the SCDI.

[7] To test this, the methodology looks at the probability of making additional payments in downside scenarios where debt targets are already breached without the SCDI.

[8] This is in the form of a debt and GFN fan chart.

[9] If a SCDI implies a higher probability of debt burden indicators (debt to GDP and average GFN to GDP) exceeding targets than noncontingent DSAs with zero buffers to the targets.

compensated by baseline buffers,[10] and (iii) whether the extreme/high risks from SCDIs are acceptable.

8. Using this methodology staff assessed the September 18's AIP to be in line with the debt sustainability targets. The chances of breaching debt and financing needs targets were below acceptable thresholds. In scenarios where targets were already exceeded, SCDI contributions were smaller than the baseline buffers with a large probability. Additionally, the SCDIs feature a cap on payments, and the contribution from SCDI in extreme scenarios was also limited.

[10] Whether contributions of the SCDI to the debt burden are offset by any baseline buffers to the debt targets with high probability

Figure 1. Sri Lanka: Risk of Sovereign Stress and Sustainability (Restructuring Scenario)

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	High	Sri Lanka is in debt distress. The fiscal adjustment, combined with debt restructuring will eventually restore debt sustainability. However, downside risks remain high under a restructuring scenario.
Near term 1/	n.a.	n.a.	Not applicable
Medium term	High	High	Risks remain high under a restructuring scenario due to relatively high levels of debt and GFNs, a strong sovereign-bank nexus, and the economy's vulnerability to large shocks.
Fanchart	High	...	
GFN	High	...	
Stress test	...	...	
Long term	...	High	Long-term risks include slowing growth due to a declining labor force and climate vulnerabilities.
Sustainability assessment 2/		Sustainable	The debt operation will put Sri Lanka on a firm downward path. But the reduction of debt vulnerabilities to safe levels will take time. Meanwhile, external shocks or domestic policy reversals could lead to renewed debt increase.
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Sri Lanka is in a deep crisis. Debt sustainability is restored, conditional on the succesful completion of its debt restructuring plan. Deep fiscal reforms are necessary but not sufficient to address the situation in a durable manner. The authorities are seeking contributions from creditors, along with new concessional financing, to restore debt sustainability. Even after the implementation of a successful program and debt restructuring, debt sustainability risks will remain high for many years.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Sri Lanka: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					Yes	
2. Subsectors included in the chosen coverage in (1) above:						

Sector		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected	2	Extra budgetary funds (EBFs)	No	
CPS / NFPS / GG: expected	3	Social security funds (SSFs)	No	
CPS / NFPS / GG: expected	4	State governments	No	
CPS / NFPS / GG: expected	5	Local governments	No	
CPS / NFPS	6	Public nonfinancial corporations	Yes	Guaranteed debt
CPS	7	Central bank	Yes	Fund credit and bilateral swaps
CPS	8	Other public financial corporations	Yes	Guaranteed debt

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-Government Debt Holdings

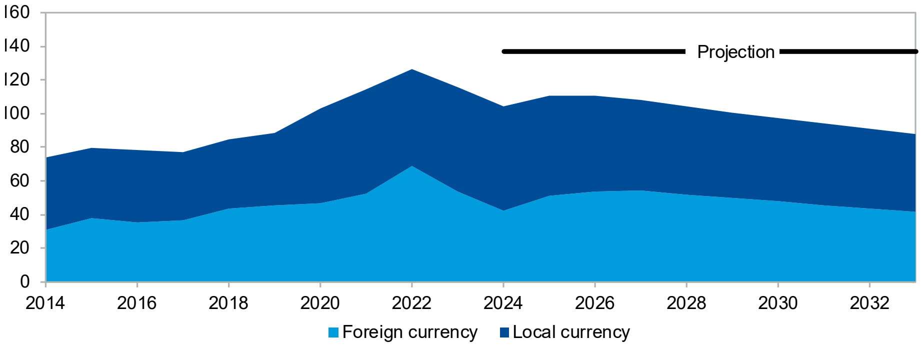
Issuer \ Holder			Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt							2742	3687	6429
CPS / NFPS / GG: expected	2	Extra-budget. funds									0
CPS / NFPS / GG: expected	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.								702	702
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	2742	4389	7131

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The DSA perimeter includes (i) central government debt; (ii) SOE debt guaranteed by the central government; and (iii) liabilities of the central bank arising from the 2016-20 EFF and bilateral swap arrangements. Note: Oth. pub. fin. corp. holdings of CG debt includes holdings by state-owned banks, but excludes retirement funds. Provincial and local governments do not carry debt as they are not authorized to borrow.

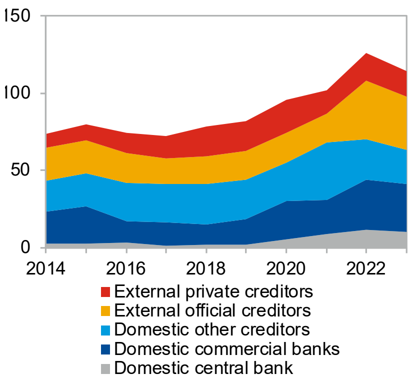
Figure 3. Sri Lanka: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



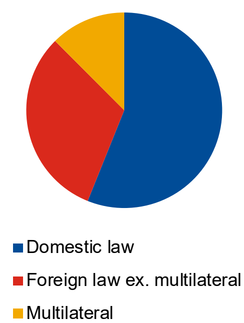
Note: The perimeter shown is central government.

Public Debt by Holder (Percent of GDP)



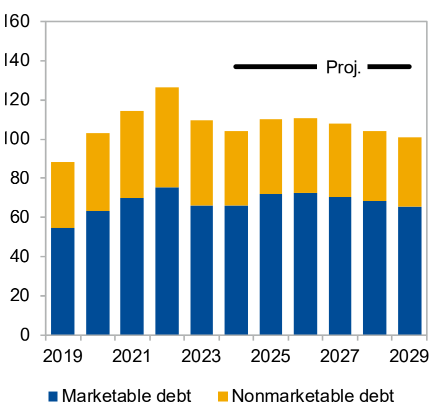
Note: The perimeter shown is central government.

Public Debt by Governing Law, 2023 (Percent)



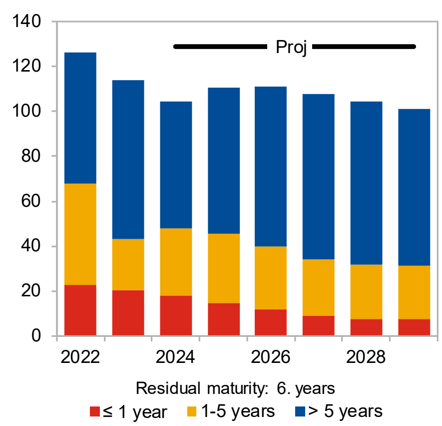
Note: The perimeter shown is central government.

Debt by instruments (Percent of GDP)



Note: The perimeter shown is central government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is central government.

Commentary: Accelerating inflation reduced the real value of domestic debt in 2022, while exchange rate depreciation led to a large increase in external and foreign-currency debt. These dynamics reversed partially in 2023, as the exchange rate appreciated, and inflation slowed down. Foreign-law and multilateral law debt account for close to half of Sri Lanka's debt. The debt operation is assumed to rebalance the maturity profile, increasing the residual maturity.

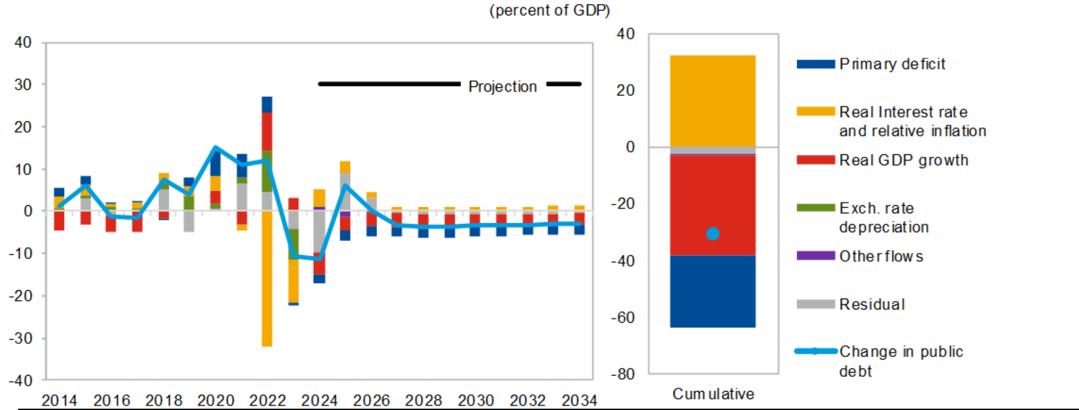
Figure 4. Sri Lanka: Baseline Scenario

(percent of GDP unless indicated otherwise)

	Prel.	Medium-term projection						Extended projection				
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Public debt	115.8	104.6	110.7	110.9	107.4	103.7	100.1	96.8	93.5	90.3	87.2	84.4
Change in public debt	-10.5	-11.2	6.2	0.1	-3.5	-3.7	-3.5	-3.4	-3.3	-3.2	-3.1	-2.8
Contribution of identified flows	-6.2	-1.4	-2.8	-3.0	-3.1	-3.0	-2.9	-2.8	-2.7	-2.7	-2.4	-2.3
Primary deficit	-0.6	-2.2	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3
Noninterest revenues	11.0	13.5	15.0	15.2	15.2	15.1	15.1	15.1	15.1	15.1	15.1	15.1
Noninterest expenditures	10.4	11.3	12.7	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8
Automatic debt dynamics	-5.6	-0.4	0.9	-0.4	-0.7	-0.6	-0.5	-0.5	-0.4	-0.4	-0.1	0.0
Real interest rate and relative inflation	-1.4	4.7	4.0	2.9	2.5	2.6	2.6	2.6	2.5	2.5	2.6	2.6
Real interest rate	-10.2	4.1	2.9	1.3	0.9	1.0	1.1	1.1	1.2	1.2	1.4	1.4
Relative inflation	8.9	0.6	1.1	1.6	1.7	1.6	1.5	1.4	1.4	1.3	1.2	1.2
Real growth rate	3.0	-5.0	-3.1	-3.3	-3.3	-3.2	-3.1	-3.0	-2.9	-2.8	-2.7	-2.6
Real exchange rate	-7.2	…	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.0	1.2	-1.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	1.2	-1.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	-4.2	-9.8	9.0	3.1	-0.4	-0.8	-0.7	-0.6	-0.6	-0.5	-0.7	-0.5
Gross financing needs	27.6	22.1	22.8	19.7	15.7	13.2	11.8	11.6	11.7	12.4	13.2	13.1
of which: debt service	28.2	24.3	25.1	22.1	18.0	15.5	14.2	13.9	14.0	14.7	15.5	15.4
Local currency	26.5	22.2	22.0	19.1	15.0	11.8	10.4	10.0	10.0	10.7	11.4	11.5
Foreign currency	1.7	2.1	3.1	3.0	3.0	3.7	3.7	3.9	4.0	4.0	4.1	4.0
Memo:												
Real GDP growth (percent)	-2.3	4.5	3.0	3.0	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Inflation (GDP deflator; percent)	17.5	3.5	4.9	5.5	5.3	5.2	5.1	5.0	5.0	5.0	5.0	5.0
Nominal GDP growth (percent)	14.8	8.2	8.1	8.7	8.5	8.5	8.4	8.3	8.3	8.3	8.3	8.3
Effective interest rate (percent)	8.2	7.3	7.9	6.7	6.2	6.2	6.3	6.3	6.3	6.4	6.7	6.8

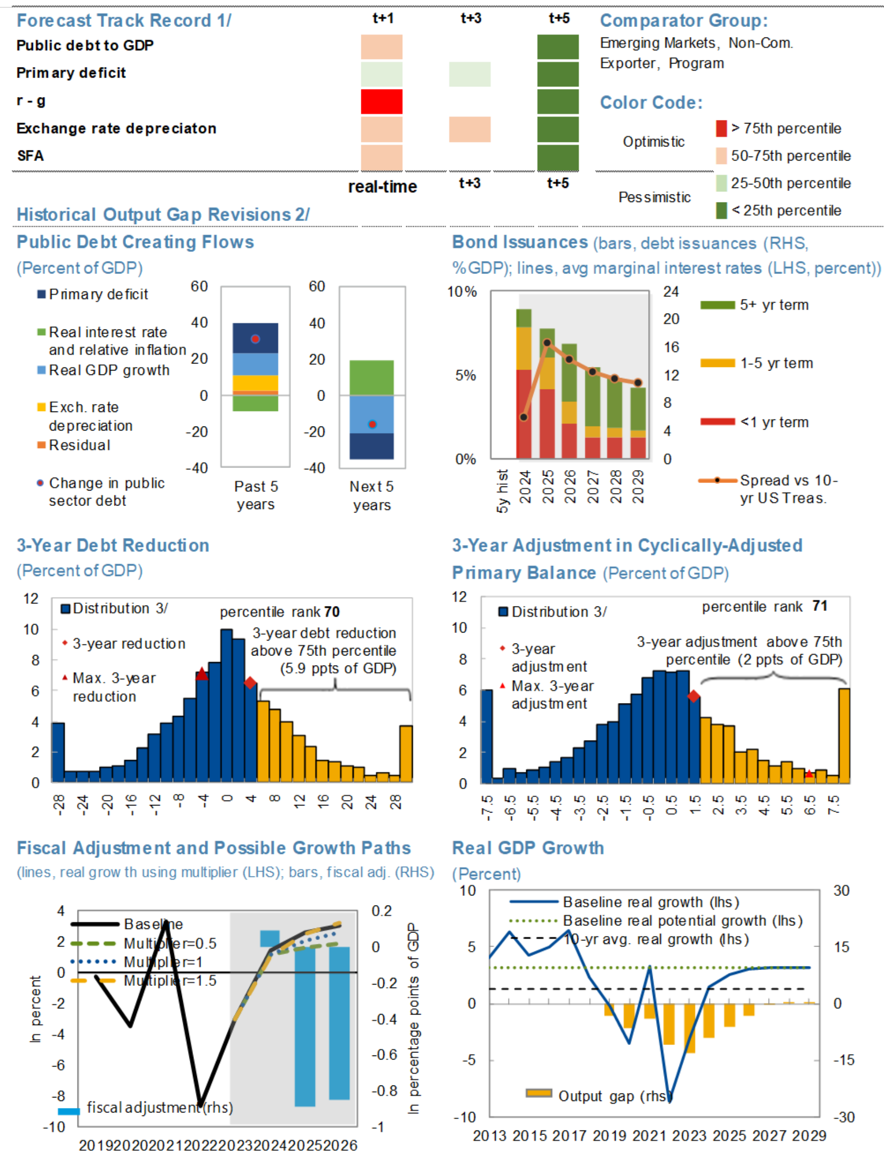
Contribution to Change in Public Debt

(percent of GDP)



Staff commentary: Public debt increased drastically in 2020-22, due to exchange rate depreciation, large fiscal deficits, SOE borrowing, and external borrowing by the Central Bank. In 2023, automatic debt dynamics (exchange rate appreciation, primary surplus, low real interest rate) all contributed to the decline of debt to GDP. In the near term, inflation and contribution from creditors will lead to a drop in public debt. The nominal haircut from the restructuring is included in the 2024 residuals. The restructuring contributes to debt reduction in the long term additionally through reduction in interest rate. The debt reduction over the longer term rests on continued fiscal discipline and adherence to the macroeconomic adjustment program.

Figure 5. Sri Lanka: Realism of Baseline Assumptions



Commentary: Sri Lanka's forecasts in the past have shown optimism for most debt drivers. Domestic yields are presently high but expected to normalize under the program. The fiscal adjustment efforts are ambitious but backed by identified measures that are needed to restore fiscal sustainability.The 3-year debt reduction is driven by the debt restructuring and fiscal prudence. Growth recovery will be slow due to sovereign default and economic crisis, as well as the associated balance sheet impact.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

Figure 6. Sri Lanka: Medium-Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

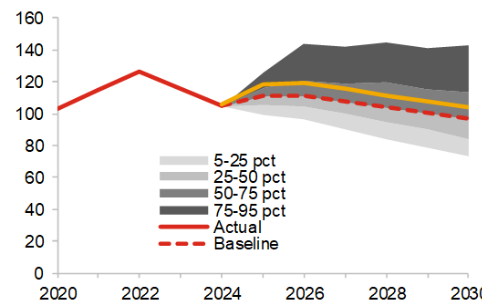
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	69.7	1.0	…
	Probability of debt not stabilizing (pct)	8.3	0.1	…
	Terminal debt level x institutions index	63.3	1.4	…
	Debt fanchart index	**…**	**2.5**	**High**
GFN finance-ability module	Average GFN in baseline	15.8	5.4	…
	Bank claims on government (pct bank assets)	41.4	13.4	…
	Chg. in claims on govt. in stress (pct bank assets)	3.6	1.2	…
	GFN financeability index	**…**	**20.0**	**High**

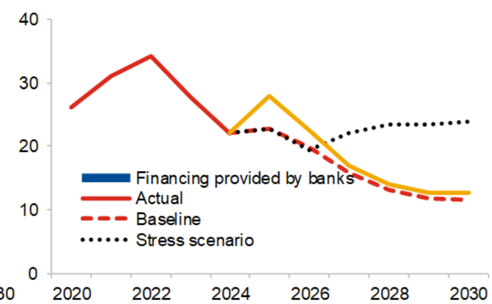
Emerging Markets, Non-Com. Exporter, Program: 0 25 50 75 100

Legend: Interquartile range; Sri Lanka

Final Fanchart (Pct of GDP)



Gross Financing Needs (Pct of GDP)

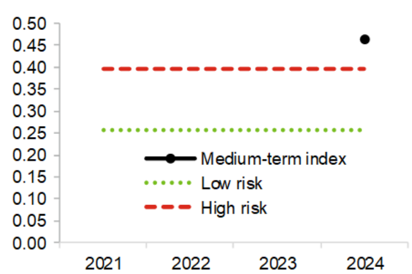


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index

(index number)



Medium-term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.5
GFN finaceability index	7.6	17.9	0.5	0.4
Medium-term index (MTI)	0.3	0.4	…	0.5, High

Prob. of missed crisis, 2024-2029 (if stress not predicted): 54.5 pct.

Prob. of false alarm, 2024-2029 (if stress predicted): 3.4 pct.

Commentary: Both MT tools (which are now run for 2025-30) point to high level of risks, associated with relatively high levels of debt and GFNs, a strong sovereign-bank nexus, and the economy's vulnerability to large shocks. The banking sector is expected to absorb higher amounts of government debt as a proportion of its assets (now estimated at 40.2% in end-2024) compared to the first review. Sri Lanka is prone to natural disasters such as typhoons and such natural disasters could take both debt and gross financing needs to very high levels, threatening sustainability further. Debt drivers from 2023 are excluded from the historical draws of the debt fanchart in line with the SRDSF guidance note.

Figure 7. Sri Lanka: Long Term Amortization Module

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

Overall, the triggers for the amortization module are not met. However, if Sri Lanka's public finances (primary balance and macroeconomic policies) revert to historical averages, long term financing risks remain high (as shown by the historical average assumptions). The authorities' reform efforts, supported by the extended arrangement, ameliorate these risks.

Annex III. Revisions to Personal Income Tax

1. **Following the collapse of tax revenues, a progressive reform of the personal income tax (PIT) was designed in May 2022 and went into effect from January 1, 2023.** It entailed raising the marginal PIT rate schedule, reducing the PIT tax-free allowance, and introducing mandatory withholding. The reform resulted in increasing PIT revenue by about 0.5 percent of GDP in 2023 compared to 2022.[1]

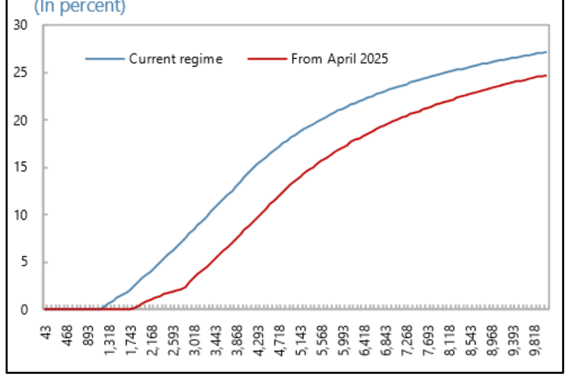
2. **Since the design of the reform until end-December 2024, cumulative CPI inflation amounted to over 40 percent,** significantly eroding the purchasing power of nominal incomes and resulting in a "bracket creep", with various income tax brackets affecting lower percentiles of income distribution than initially intended. In such cases, an adjustment of income thresholds is generally appropriate to restore the tax structure.

3. **In December 2024, the cabinet approved amendments to the PIT structure,** which will go into effect in April 2025 (Text Table). The tax-free threshold has been increased from Rs 1.2 mln to Rs 1.8 mln per year, the width of the 6 percent marginal tax rate band has been increased from Rs 500,000 to Rs 1,000,000 per year, and the 12 percent marginal tax rate has been eliminated. The highest marginal tax rate of 36 percent will now be reached at the annual income of Rs 4.3 mln, instead of Rs 3.7 mln.

Marginal Tax Rate	Annual Taxable Income (Rs)	
	Current Regime	From April 2025
0	Up to 1.2 mln	Up to 1.8 mln
6	1.2-1.7 mln	1.8-2.8 mln
12	1.7-2.2 mln	-
18	2.2-2.7 mln	2.8-3.3 mln
24	2.7-3.2 mln	3.3-3.8 mln
30	3.2-3.7 mln	3.8-4.3 mln
36	Over 3.7 mln	Over 4.3 mln

4. **The amendments result in the reduction of average tax rates for most income levels (Text Figure).** In percentage terms, the reduction in the tax payments is the highest for individuals with annual income between Rs 1.2 and 1.8 million, and then declines gradually with income. Individuals earning between Rs 1.8 million and 4 million per year will see a reduction in their tax bill by at least 40 percent. This reflects the intention of the authorities to provide relief to low-income households and skilled professionals, who are most prone to emigrate, thus limiting the potentially damaging brain drain.

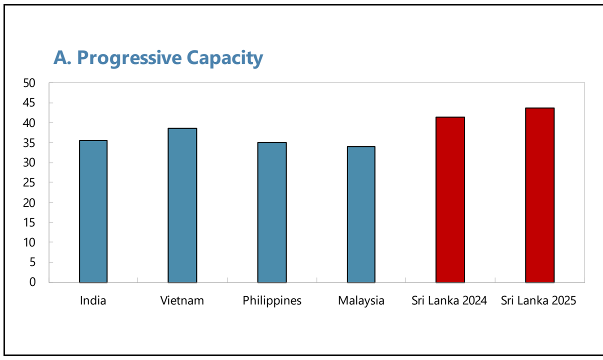
Average Tax Rates
(In percent)

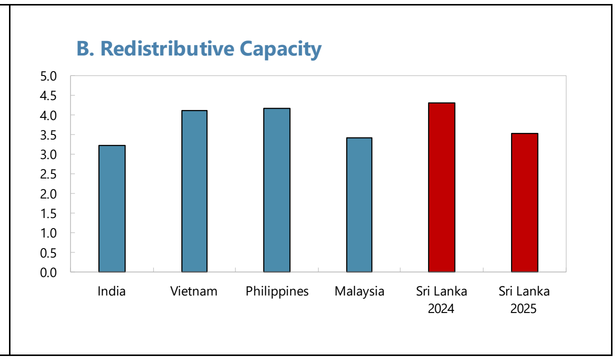


[1] In addition, reinstating the interest income taxation and removing corporate income tax exemptions raised revenue by 0.5 and 0.1 percent of GDP respectively, bringing the total income taxes increase in 2023 to 1.1 percent of GDP.

5. Staff estimates the revenue loss from the amendments at just under 0.2 percent of GDP in annual terms. With the amendments going into effect on April 1, the revenue loss in 2025 would be limited to three quarters of that amount.

6. Staff calculations show that the amendment diminishes redistributive capacity but has no tangible impact on the progressivity of the PIT structure. With the tax-free threshold relatively high compared to the income distribution, the PIT in Sri Lanka remains focused on the highest income earners. Estimates based on extrapolating the income distribution data from 2019 suggest that only the top 17 percent of individuals will be subject to PIT under the new regime. The amendments to the PIT structure increase slightly the measure of the PIT progressive capacity developed by Gerber et al (2018) from 41.3 to 43.6.[2] However, with average tax rates decreasing, the redistributive capacity (which is measured as a reduction in the Gini coefficient due to the imposition of the PIT and depends on both the progressive capacity and the average tax rate) falls from 4.32 to 3.54. Nevertheless, Sri Lanka's PIT continues to be comparable in both progressivity and redistributive capacity to regional peers (Text Figure).





[2] The methodology is described in IMF Working Paper WP/18/246.

Annex IV. Status of Governance Reforms in Sri Lanka

As one of the key pillars of the IMF-supported program, the government continues to implement comprehensive governance reforms to reduce corruption vulnerabilities, durably restore fiscal sustainability, and unlock growth potential. The annual governance action plan for 2025 will be published in February. This annex describes the main recent developments and next steps.

1. Anti-corruption legal framework and institutions. Key first steps have been completed to operationalize CIABOC to carry its broadened mandate: (i) 200 senior officials, including from CIABOC commission have published asset declarations in line with Anti-corruption Act in July (**SB**), (ii) a new Director General was appointed on January 10, and (iii) a new strategic plan providing priorities and timelines is currently under review and will be published by mid-March and the corresponding budget consistent with the new strategic plan was submitted to the MOF (**SB**) and was then incorporated into the 2025 Budget submitted to the parliament. For the next steps:

- As an essential tool to enhance transparency, promote accountability, and mitigate corruption vulnerabilities, CIABOC will strengthen the asset declaration system by June-2025 (**new SB**) to progress towards fully operationalizing an e-asset declaration system. Specifically, the authorities will: (i) allow public access to published declarations through foreign and local phone numbers or email accounts and posted forms to be downloadable; (ii) publish the remaining asset declarations of senior officials along with the list of non-filers; (iii) revise the existing form to include beneficial ownership information; and (iv) modify current rules on redactions so that information on the value of bank accounts and other assets is disclosed to the public.

- The government has made significant progress on enacting a comprehensive Asset Recovery Law. A draft amendment to harmonize it with the United Nations Convention Against Corruption will be gazetted in February after public consultation and the law is on track to be enacted by end-April 2025 (**reset SB**).

2. Tax policy. Ad-hoc, non-transparent, and large tax exemptions are a source of corruption incentives and of foregone tax revenue. The government will continue to refrain from approving new projects under the SDP Act and from providing new exemptions or incentives. Despite a delay due to the change in the administration, the government will submit amendments to the SDP Act introducing transparent, rules-based eligibility criteria for granting time-bound incentives by end-July 2025 (**reset SB**). Similar amendments for tax incentives under the Port City Act will also be introduced (MEFP ¶35).

3. Revenue administration. Having developed implementation plans for anti-corruption measures in August (**SB**), revenue departments will begin regularly reporting the quarterly implementation progress. The authorities will also start implementing reforms to enhance customs' governance based on recent IMF TA recommendations (MEFP ¶36).

4. PFM. The government remains committed to the semi-annual publication of procurement contracts, list of firms receiving tax exemption and the associated tax expenditure estimates under the SDP Act. To strengthen transparency and monitoring, beginning in June 2025, the reporting coverage will include the exemptions under the Port City (**revised SB**) and the tax expenditure report will be improved based on IMF TA recommendations. For the next steps:

- On procurement, to curb revenue leakages and reduce corruption vulnerabilities the government will: (i) enact a Public Procurement Law reflecting international good practice by end-June 2025, (ii) strengthen the e-procurement system, and (iii) reduce the share of non-competitive procurement (MEFP ¶37). To this end, a pilot on a competitive tender under the e-procurement system will begin in March 2025.

- On SOE governance, the government will continue improving oversight and transparency of SOE operations by implementing the SOE policy. Further efforts are needed to ensure regular and timely publication of audited financial statements of the 52 major SOEs (MEFP ¶19).

5. Financial Sector Oversight. The CBSL began the implementation of the amendments to the Banking Act in June 2024 (**SB**) to enhance banking-sector corporate governance and supervision in line with international best practices. To this end, CBSL had recently issued Directions to banks and will monitor their compliance. The government issued in May a framework to strengthen governance of public banks (**SB**) and will monitor the implementation of the framework.

6. Public Asset Oversight and Management. Despite delays due to change in administration, the government remains committed to strengthening the regulatory framework to oversee and manage public assets. The authorities will (i) submit to Cabinet proposed criteria for allocating rights to public assets with clear requirements for transparency, competition, and information provision to the public and a timeline to bring existing laws and regulations including the new Bill in compliance with the policy, and (ii) amend the National Audit Act to facilitate the effective levying of fines on officials who fail to fulfill their responsibilities in overseeing and managing public assets by June 2025 (MEFP ¶39).

7. AML/CFT. Following the AML/CFT National Policy for 2023-2028 developed based on the National ML/TF Risk Assessment result, the government will continue strengthening the AML/CFT regime. To this end, the government will (i) enact amendments to the Companies Act to make the beneficial ownership framework consistent with FATF standards by end-April 2025; (ii) conduct risk-based supervision; (iii) strengthen the use of financial intelligence to identify potential corruption activities, and (iv) strengthen the cooperation between Financial Intelligent Unit, law enforcement, and CIABOC to facilitate parallel investigations (MEFP ¶40).

Annex V. Capacity Development

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Tax Policy		
Tax Policy Reform	FAD	Jun 6-17, 2022
VAT and Excise Tax	FAD/LEG	Jan 12-25, 2023
Property and Wealth Tax	FAD	Jun 30 - Jul 13, 2023
Property Taxation in Sri Lanka	FAD	Feb 7-21, 2024
Tax Expenditure Quantification and Reporting	FAD	Jul 11-22, 2024
Revenue Administration		
Strengthening the Large Taxpayer Office	FAD/SARTTAC/STX/LTX	Feb 15 - Mar 8, 2022
Implement Large Taxpayer Office	FAD/STX	Apr 4-18, 2022
Tax Administration Diagnostic Tool (TADAT) training	FAD	Dec 5-9, 2022
TADAT Assessment	SARTTAC (with ADB and WB)	Jan 9-26, 2023
RAMIS	SARTTAC	Mar 7 -20, 2023
Guiding the Development of Tax Administration Reform	FAD (with WB)	Jul 3-11, 2023
Medium-term Revenue Administration Reform Plan	FAD	Aug 21-Sep 3, 2023
Compliance for High-Wealth Individuals (Peripatetic)	FAD/STX	Sep 5-Dec 5, 2023
Strengthened Revenue Administration Management and Governance Arrangements	FAD/SARTTAC	Oct 24-26, 2023
Guiding the Development of a Revenue Authority	FAD (duty station based)	Nov 6, 2023-Jan 19, 2024
Diagnostic Assessment on the Customs and Excise Departments	FAD/SARTTAC	Feb 26 - Mar 7, 2024
Implementation of VAT Refund Model	FAD	Feb 28-Mar 7, 2024
Compliance for High-Wealth Individuals	FAD	Jan 29-Feb 2; Jul 1-Sep 13, 2024
Support to Develop a Strategic Plan to Deliver RAMIS 3.0	FAD/LTX/STX (with WB)	Apr 23-30, 2024
Revenue Administration	FAD/STX	Jul 3-12, 2024
Tax Incentive Reform and Improving Tax Expenditure Reporting	FAD/STX	Jul 11-22, 2024
Compliance Management of High-Wealth Individuals and Criminal Investigations Program Progress Report (Peripatetic)	FAD	Jul 15-Oct 11, 2024
Support for the Development of an Information Technology Strategic Plan (ITSP)	FAD	Aug 8-Sep 9, 2024
Customs Tax Cooperation and Customs Modernization	FAD	Aug 14-17, 2024
Status of Key Tax Reform Measures - Transition of Resident Tax Advisors	FAD/STX	Aug 26-Sep 17, 2024

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Implementing Anti-Corruption Measures at the Sri Lanka Customs Department	FAD/STX	Oct 21-29, 2024
Compliance Management of High-Wealth Individuals and Criminal Investigations Program (Peripatetic)	FAD	Nov 11-Dec 31, 2024
SVAT Repeal and VAT Refund	FAD/STX	Nov 27-Dec 10, 2024
Revenue Administration	FAD	Dec 3-6, 2024
High-Wealth Individual and Tax Crime Investigations	FAD	Jan 2-10, 2025
Public Financial Management		
Strengthening Macro-Fiscal Unit: Fiscal Analysis and Forecasting	SARTTAC	Mar 15-26, 2021
Strengthening the Macro-Fiscal Unit	FAD/SARTTAC/STX/LTX	Jan 20-Feb 9, 2022
Macro-Fiscal Unit and MTFF	FAD/SARTTAC/LTX	Sep 19-23, 2022
Fiscal Risks Management	FAD/SARTTAC/LTX	Oct 3-7, 2022
PFM Diagnostic Scoping Mission/ PFM Reform Agenda	FAD/SARTTAC/STX/LTX	Dec 8-10, 2022
Debt Management Reform Plan	MCM/LEG (with WB)	Feb 20-Mar 3, 2023
PFM Law (including fiscal rules)	FAD/LEG	Mar 13-24, 2023
Developing a Fiscal Strategy Statement	FAD	Jun 12-16, 2023
Debt Management Law	LEG/MCM/WB	Jun 26-Jul 7, 2023
Drafting the PFM Bill: Strengthening the PFM Legal Framework	FAD/LEG	Aug 10-21, 2023
Develop Rules/Regulations for the Provision of Sovereign Guarantees and On-lending	FAD/SARTTAC/WB	Oct 10-16, 2023
Debt Management Reform Plan Implementation	MCM/FAD/STX/WB	Oct 16-25, 2023
Strengthening Cash Management Practice	FAD	Feb 13-23, 2024
Improving Fiscal Reporting	SARTTAC	Apr 2024
Review of Chart of Accounts	FAD/SARTTAC	Apr 15-18, 2024
Strengthening Accounting and Financial Reporting	FAD/SARTTAC	May 2-16, 2024
Review of Fiscal Strategy Statement	FAD/STX	May 14-Jun 28, 2024
Implementing a Medium-Term Budget Framework	FAD	Jun 3-14, 2024
Scoping Mission to Establish a Public Debt Management Office	MCM	Aug 29-30, 2024
Reviewing ITMIS Implementation for Supporting Enhanced Budget Execution and Commitment Controls	FAD/SARTTAC	Sep 3-16, 2024
Revising Financial Regulations	FAD/LTX	Nov 20-29, 2024
Fiscal Risk Statement	FAD/STX (with WB)	Jan 15-18, 2025
Enhancing the Primary Debt Market and Support to the Establishment of the Public Debt Management Office	FAD/SARTTAC/LTX (with WB)	Jan 20-29, 2025

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Monetary and Foreign Exchange Operations		
Monetary Policy Operations	MCM/SARTTAC	Jun 1-Jul 2, 2021
Monetary Policy Frameworks and Implementation	MCM/SARTTAC	Jun 6-17, 2022
Forecasting and Policy Analysis System	ICD/SARTTAC	Nov 28-Dec 9, 2022; and Apr 29-May 10, 2024
Monetary Policy Implementation (training)	CDOT/SARTTAC	Jan 29-Feb 4, 2024
FX Market Development	SARTTAC/MCM	Mar 18-24, 2024
FX Market Follow-up	SARTTAC/MCM	Jun 24-28, 2024
Central Bank Operations, Financial Stability, and Debt Management		
Strengthening Technology Risk Management of NBFIs & Building Supervisory Capacity	MCM	May 11-Nov 12, 2021
Financial Sector Stability Reviews (FSSR) Follow-up and Stress Testing	MCM	May 1-12, 2021
FSSR Macroprudential TA/ Resident Advisor	MCM	Aug 1, 2021 - Jul 31, 2023
Sri Lanka Interconnectedness TA	MCM	Feb 28-Mar 31, 2022
Liquidity Monitoring	MCM/SARTTAC	Sep 1-9, 2022
Policy Discussion on Revision of PSSA (First Phase)	MCM	Oct 24-Nov 4, 2022
Central Bank Balance Sheet	MCM	Dec 1-12, 2022
Macroprudential Policy Tools Follow-up	MCM	May 9-16, 2023
Operationalizing Macroprudential Policy Framework	MCM	June 13-20, 2023
Central Bank Liquidity Monitoring and Monetary Operations	MCM/SARTTAC	Jul 4-17, 2023
Policy Discussion on Revision of PSSA (Second Phase)	MCM	Aug 2-8, 2023
Borrower-Based Tools and Sectoral Capital Requirements	MCM	Oct 3-17, 2023
Strengthening the Risk Assessment of Central Bank of Sri Lanka	MCM	Nov 6-17, 2023
Central Bank Operations Risk Appetite Framework	MCM	Nov 27-Dec 4, 2023
Strengthening Debt Management	MCM (with WB)	Apr 23-May 3, 2024
Strengthening Central Bank of Sri Lanka Capacity in Supervision	MCM/SARTTAC/LTX/STX	Apr 29-May 10, 2024
Domestic Systemically Important Banks (D-SIB) Framework Model Validation Follow-up	MCM	Aug 19-21, 2024
Modernizing CBSL's Strategic Communication Framework	SARTTAC	Jan 13-22, 2025
Governance and Anti-corruption		
Governance Diagnostic Scoping Mission	LEG	Mar 9-14, 2023

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Governance Diagnostic Mission	LEG/FAD/MCM/FIN	Mar 20-31, 2023
Support the Development of a Strategic Plan for the CIABOC	LEG/STX	Sep 19 - Oct 11, 2024
Implementation of the Governance Diagnostic Recommendations	LEG	Nov 15-22, 2024
Support the Development of a Strategic Plan for the CIABOC (follow-up)	LEG/STX	Jan 13-31, 2025
Government Finance Statistics		
Implementing a Strategy for Broadening the Coverage and Scope of GFS to General Government	SARTTAC	Jan 24 - Feb 3, 2022
Expanding Compilation for Consolidated Central Government (CG)	SARTTAC	Jan 23-27, 2023
Real Sector Statistics		
National Accounts - GDP Rebasing	SARTTAC	Mar 29-Apr 23, 2021
National Accounts - GDP Rebasing	SARTTAC	Aug 16-20, 2021
PPI Update	SARTTAC	Nov 1-12, 2021
National Accounts - GDP Rebasing	SARTTAC	Feb 7-8, 2022
Institutional Sector Accounts - Sequence of Accounts	SARTTAC	Nov 21-25, 2022
CPI Update	STA	Dec 19-23, 2022
Expanding the PPI	STA	Apr 17-28, 2023
Institutional Sector Accounts - Sequence of Accounts	SARTTAC	Apr 24-28, 2023
Developing Institutional Sector Accounts	SARTTAC	Nov 20-24, 2023
CPI Update	STA	Mar 11-15, 2024
National Accounts: Input-Output Tables	SARTTAC	Jul 1-5, 2024
Monetary and Financial Sector Statistics		
Monetary and Financial Statistics	STA	Feb 20-Mar 8, 2024
Others		
Scoping Mission: Model-Based Financial Programming and Policies (FPP)	ICD/SARTTAC	Jan 30-Feb 3, 2023
Developing a Model-Based FPP Framework	ICD/SARTTAC	Jun 5-9, 2023
Macroeconomic Framework	ICD/SARTTAC	Sep 4-5, 2023
Customized Macroeconomic Foundation Course for CBSL staff	SARTTAC	May 27-31, 2024
Macroeconomic Framework	ICD/SARTTAC	Oct 7-11, 2024
Regional Training		
Macroeconometric Forecasting and Analysis	SARTTAC	Jan 15-29, 2021

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Compliance Risk Management	SARTTAC	Feb 1-5, 2021
Supply and Use Tables, Input-Output Tables and Extensions	SARTTAC	Feb 8-12, 2021
Public Investment Management Assessment	SARTTAC	Feb 8-12, 2021
Fiscal Policy Analysis	SARTTAC	Mar 1-12, 2021
Taxpayer Registration	SARTTAC	Apr 12-16, 2021
Fiscal Sustainability	SARTTAC	Apr 26-May 6, 2021
Government Finance Statistics: GFS Special Topics	SARTTAC	Apr 26-28, 2021
Financial Programming and Policies	SARTTAC	Jul 5-16, 2021
Collections and Arrears Management	SARTTAC	Jul 12-16, 2021
High Frequency Indicators and Monthly Index of Economic Growth	SARTTAC	Jul 12-16, 2021
Fiscal Frameworks	SARTTAC	Aug 2-13, 2021
Effective Cash Management under Fiscal Stress	SARTTAC	Aug 2-6, 2021
Public Sector Debt Statistics – Special Topics	SARTTAC	Aug 23-27, 2021
Monetary policy implementation - Interest Rate Corridor	SARTTAC/CDOT	Aug 24-26, 2021
Risk-Based Audit and Investigation Techniques - Income Tax	SARTTAC	Sep 6-10, 2021
Macroeconometric Forecasting and Analysis	SARTTAC	Sep 13-24, 2021
Selected Topics in Managing Capital Flows	SARTTAC/SEACEN	Sep 13-17, 2021
Digitalization and Public Financial Management	SARTTAC/CDOT	Sep 20-24, 2021
Macroeconomic Diagnostics	SARTTAC	Sep 27-Oct 7, 2021
National Accounts Statistics	SARTTAC	Oct 25-29, 2021
Monetary Operations- Part 2. Liquidity Monitoring and Forecasting	SARTTAC/CDOT	Oct 26-29, 2021
Fiscal Sustainability	SARTTAC	Nov 8-19, 2021
Fiscal Reporting and Transparency	SARTTAC	Jan 17-21, 2022
Monetary Policy Implementation: Central Bank Collateral Framework (with CDOT)	SARTTAC	Jan 17-19, 2022
External Debt Statistics	SARTTAC/STI	Feb 7-11, 2022
Compliance Risk Management	SARTTAC	Feb 7-11, 2022
Gender and Macroeconomics	SARTTAC	Feb 7-11, 2022
Monetary Policy	SARTTAC	Mar 14-25, 2022
Sector Classification of Public Sector Units: A Practical Workshop	SARTTAC	Mar 21-25, 2022
Nowcasting	SARTTAC	Mar 28-Apr 1, 2022
Fiscal Risks Analysis and Management	SARTTAC	Apr 4-7, 2022
Taxpayer Registration	SARTTAC	Apr 4-8, 2022
Emergency Liquidity Assistance	SARTTAC	Apr 4-6, 2022

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Consumer Price Index	SARTTAC	Apr 25-29, 2022
Insurance Supervision	SARTTAC	Apr 25-29, 2022
Macro-Fiscal Analysis and Quantitative Methods	SARTTAC	Jun 13-17, 2022
Compiling Public Sector Balance Sheets	SARTTAC	Jun 27-Jul 1, 2022
Fiscal Policy Analysis	SARTTAC	Jul 11-22, 2022
Monetary Policy Implementation - Reserve Requirements	SARTTAC	Jul 11-14, 2022
Developing a Medium-Term Fiscal Framework Tool	SARTTAC	Jul 25-29, 2022
Sectoral Accounts and Balance Sheets	SARTTAC	Aug 29-Sep 2, 2022
eGovernment and Digitalization of PFM - The Changing Topography	SARTTAC	Sep 5-9, 2022
Macroeconometric Forecasting and Analysis	SARTTAC	Sep 19-30, 2022
Taking on Green PFM and Climate Change	SARTTAC/CDOT	Oct 17-20, 2022
Risk-Based Audit Techniques	SARTTAC	Oct 17-21, 2022
Monetary Policy Implementation: Reference Exchange Rate	SARTTAC	Oct 18-20, 2022
Introduction to Climate Change Indicators for Economic Analysis and Policy Formulation	SARTTAC	Oct 31-Nov 3, 2022
Strategic Budgeting: Integrating Fiscal Strategy with Budget Formulation	SARTTAC	Nov 22-25, 2022
Central Bank Digital Currencies	SARTTAC	Dec 5-9, 2022
TADAT	SARTTAC	Dec 12-16, 2022
Monetary Policy Implementation: Foreign Exchange Operations	SARTTAC	Jan 10-12, 2023
National Accounts	SARTTAC	Jan 16-20, 2023
Classification of Functions of Government	SARTTAC	Feb 6-10, 2023
Effective Management of Accelerated Investment in Public Infrastructure	SARTTAC	Feb 13-17, 2023
Collections and Arrears Management	SARTTAC	Feb 27-Mar 3, 2023
Financial Development and Financial Inclusion	SARTTAC	Apr 10-20, 2023
Macroeconomic Diagnostics	SARTTAC	Apr 10-21, 2023
Macroeconomics of Climate Change	SARTTAC	Apr 24-May 4, 2023
Taxpayer Registration	SARTTAC	Apr 24-28, 2023
Fintech Market Development and Policy Implications	SARTTAC	Jul 17-21, 2023
International Trade in Goods and Services	SARTTAC	Jul 24-28, 2023
International Survey on Revenue Administration	SARTTAC	Aug 21-25, 2023
Implementing Modern Cash Management	SARTTAC	Aug 28-Sep 1, 2023
Introduction to Government Finance Statistics	SARTTAC	Aug 28-Sep 1, 2023
Core Elements of Banking Supervision: An Overview and Regional Perspectives	SARTTAC	Sep 11-15, 2023

IMF Capacity Development Missions January 2021 – January 2025		
TA/Training Missions	**Provider**	**Date**
Nowcasting	SARTTAC	Sep 18-29, 2023
Advanced Government Finance Statistics	SARTTAC	Oct 16-20, 2023
Exchange Rate Policy	SARTTAC	Oct 30-Nov 9, 2023
Quarterly National Accounts and Seasonal Adjustment	SARTTAC	Dec 11-15, 2023
Enhancing Effectiveness of AML/CFT Frameworks: Evolution of the FATF Standard	SARTTAC	Jan 8-12, 2024
Public Sector Debt Statistics	SARTTAC	Jan 15-19, 2024
Navigating Banking Supervision: Unpacking the Latest Supervisory Issues with a Regional Perspective	SARTTAC	Jan 22-25, 2024
Macroeconomics of Climate Change	SARTTAC	Jan 29-Feb 8, 2024
Monetary Policy Implementation	SARTTAC/CDOT	Jan 29-Feb 2, 2024
Fiscal Sustainability	SARTTAC	Feb 5-15, 2024
Effective Leadership for Revenue Administration	SARTTAC	Feb 19-23, 2024
Financial Sector Policies	SARTTAC	Feb 19-29, 2024
Monetary Policy	SARTTAC	Feb 26-Mar 7, 2024
Liquidity Forecasting	SARTTAC/CDOT	Mar 4-8, 2024
High-Frequency Indicators and Monthly Indicators of Economic Growth	SARTTAC	Mar 18-22, 2024
Integrated Risk Management in Customs	SARTTAC	Apr 22-26, 2024
Gender Inequality and Macroeconomics	SARTTAC	Apr 22-26, 2024
Compiling Supply Use Tables/Input Output Tables	SARTTAC	Apr 29-May 3, 2024
Navigating Banking Supervision: Unpacking the Latest Issues with a Regional Perspective	SARTTAC	Jun 24-28, 2024
IFRS9 and Expected Credit Loss Supervision	SARTTAC/MCM	Aug 26-30, 2024
Developing a Medium-Term Debt Management Strategy	SARTTAC	Sep 23-27, 2024
Annual National Accounts	SARTTAC	Sep 30-Oct 4, 2024
Cash Management and Treasury Single Account	SARTTAC	Oct 14-18, 2024
Collections and Arrears Management	SARTTAC	Nov 18-22, 2024
Fiscal Policy Analysis	SARTTAC	Dec 2-12, 2024
Monetary Policy Implementation	SARTTAC/CDOT	Dec 2-6, 2024
Strengthening Revenue Administration for Gender Equality	SARTTAC	Dec 9-11, 2024
Central Bank Communications and Transparency	SARTTAC/CDOT	Dec 9-11, 2024
Institutional Sector Accounts	SARTTAC	Dec 9-13, 2024
Consumer Price Index	SARTTAC	Jan 13-17, 2025
Cyber Risk Supervision	SARTTAC	Jan 20-24, 2025
Implementing Effective Regulation and Supervision of Climate-related Financial Risks	SARTTAC	Jan 27-31, 2025

Source: IMF Staff

Annex VI. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Expected Impact	Policy Response
Domestic Risks			
Program financing risks arising from lower reserve accumulation, financing shortfalls from external partners, high interest burden, and lower tax revenue collection	High	**H**: Program becomes underfinanced	Depending on the triggers, a combination of actions including (i) higher IFI financing (ii) deeper debt restructuring, (iii) broader and more frontloaded revenue mobilization measures could be considered.
Waning reform momentum especially on revenue mobilization measures.	High	**H**: Can result in fiscal slippages and weaken confidence and delay access to external financing, slowing economic stabilization.	Enforce program slippages through corrective actions. Streamline and prioritize reforms in line with the program objectives. Continue to engage frequently on program performance through weekly meetings with the authorities.
Social unrest, fueled by falling real incomes including from tax hikes and cost recovery pricing in the energy sector, insufficient anti-corruption efforts, and unmet election promises.	Medium	**M**: Can delay or reverse progress of important reforms	Proactively implement inclusive reforms including social security and anti-corruption reforms. Strengthen communication to increase public understanding of the program design and objectives.
Upside inflation risks from stronger economic rebound and second round effects from new tax measures, or exchange rate depreciation pressure.	Medium	**M**: can de-anchor inflation expectations and reduce real income	Monitor inflation development closely and tighten monetary policy if needed to keep inflation anchored around the target level.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Source of Risks	Likelihood	Expected Impact	Policy Response
		External Risks	
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism.	High	**H**: Disrupts trade, remittances, and capital inflows, worsening balance of payments. Can slow recovery.	Support the economy with easing monetary policy and targeted fiscal support. Address the BOP pressure by allowing the exchange rate to adjust and seeking higher access to external financing support.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	High	**H**: Increase volatility in inflation dynamics and uncertainties in economic activity	Closely monitor implications to inflation and maintain agility of monetary policies.
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs.	High	**M:** Slow growth in trade and FDI, increase input costs and inflationary pressure.	Develop corresponding export and FDI promotion strategies in response to the structural change, promote domestic suppliers and improve labor skills. Closely monitor implications to inflation and maintain agility of monetary policies.
Global growth surprises (Slowdown). Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs.	Medium	**M**: Slow trade and capital inflows, with negative spillovers to growth.	Support the economy with easing monetary policy and targeted fiscal support. Address the BOP pressure by allowing the exchange rate to adjust and seeking higher access to external financing support.

Appendix I. Letter of Intent

February 11, 2025
Colombo

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Georgieva:

As part of our IMF-supported program under the 48-month Extended Fund Facility (EFF) arrangement, we have undertaken significant reforms to pave our way out of a deep economic and debt crisis. Robust economic recovery is underway. Growth is expected to have reached 4.5 percent last year, a significant reserves build-up continues, and inflation has remained low. Our ambitious multi-year revenue-based fiscal adjustments have been on track. Tax revenues have improved significantly. We continue to advance on our wide-raging governance and other structural reforms.

We successfully completed the international bond exchange in December. We have completed our restructuring agreements with China EXIM Bank and China Development Bank and are finalizing bilateral agreements with members of the Official Creditor Committee (OCC). All of these treatments are consistent with program parameters and comparability of treatment principles. Efforts are underway to finalize and implement remaining bilateral agreements and agree on debt treatment with remaining official creditors. We continue good faith negotiations with our other external private creditors.

Implementation of our program has been strong. We have completed the prior actions on relaxing import restrictions and are on track to completing the prior actions on the 2025 draft budget and underlying revenue measures. For end-June 2024, all quantitative performance criteria (QPCs) and indicative targets (ITs) were met, except the IT on social spending. All end-December QPCs were also met, while the IT on social spending was missed. Most structural benchmarks due by end-January 2025 were met or implemented with delay. Those missed were in multiple cases due to the electoral cycle. End-June and end-December headline inflation fell below the monetary policy consultation clause (MPCC) outer lower band primarily due to administrative price adjustments and real exchange rate rebound in 2024.

Going forward, we remain committed to our reform agenda under the EFF. Our objectives remain: (i) an ambitious revenue-based fiscal consolidation, accompanied by strong social safety nets, fiscal institutional reforms, and cost-recovery based energy pricing; (ii) restoration of public debt sustainability; (iii) restoring price stability and rebuilding reserves under greater exchange rate flexibility; (iv) safeguarding financial sector stability; and (v) structural reforms to address corruption vulnerabilities and enhance growth.

The policies we will be implementing over the coming months are presented in the attached Memorandum of Economic and Financial Policies (MEFP), which updates the MEFP of June 2024. We believe that the economic and financial policies set forth in the MEFP are sufficient to ensure that the objectives of the program will be met. We stand ready to take additional measures that may prove necessary to meet our objectives. We will consult in advance with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. We will refrain from policies that would be inconsistent with program objectives. We will provide Fund staff with timely and accurate data for program monitoring.

With regards to program conditionality, we request (i) approval of the modification of ITs on primary balance, tax revenue, net international reserves, and social spending for end-March 2025 and the new proposed quantitative targets for June-December 2025, (ii) approval of the reformulation or resetting of existing SBs and the setting of new SBs, (iii) completion of the Board consultation triggered by the end-June and end-December 2024 MPCC breaches, (iv) completion of the financing assurances review.

The program will continue to be monitored through semi-annual reviews, quantitative performance criteria, indicative targets, and structural benchmarks as described in the attached MEFP and Technical Memorandum of Understanding.

Based on our performance and the strength of policies outlined in the MEFP, we are requesting the IMF Executive Board approve the completion of the third review under the EFF and the disbursement of SDR 254 million (43.9 percent of quota) upon approval.

Consistent with our commitment to transparency policy, we consent to the IMF's publication of this letter and its attachments, as well as the associated staff report.

Sincerely yours,

/s/	/s/
Anil Jayantha Fernando Acting Minister of Finance, Planning, and Economic Development	Nandalal Weerasinghe Governor Central Bank of Sri Lanka

Attachments:

Memorandum of Economic and Financial Policies

Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

I. Context and Macroeconomic Developments

1. We remain fully committed to the economic reform program supported by the Extended Fund Facility (EFF). The IMF Executive Board approved the second review of Sri Lanka's four-year EFF program on June 12, 2024. The program continues to prioritize restoring macroeconomic stability and debt sustainability, mitigating the economic impact on the poor and vulnerable, safeguarding financial sector stability, and strengthening governance and medium-term growth potential.

2. Policy adjustments and reforms are bearing fruit. The economy has stabilized, and a robust recovery is underway, with a strong rebound across sectors. Following our decisive monetary policy actions, inflation has declined rapidly since 2022. Financial sector stability is maintained, with increased banking sector capital buffers. Tax revenues further improved in 2024 following the implementation of new measures. We will continue revenue mobilization efforts to enable us to continue providing essential services in a sustainable manner. Our debt restructuring process has now largely concluded, providing a substantial contribution towards restoring debt sustainability. Deep-rooted governance issues and structural impediments are being addressed with a comprehensive anti-corruption and growth-enhancing reform agenda. Our commitments under this economic program will help restore confidence, which would in turn help stabilize the economy and foster higher and more inclusive growth.

- Real Gross Domestic Product (GDP) growth reached 5.5 percent in 2024Q3 and averaged 4.3 percent since growth resumed in 2023Q3. A strong rebound is projected throughout 2024 after 2 years of recession.

- Inflation has decelerated rapidly from the peak of nearly 70 percent in September 2022 to about 2 percent on average since August 2023. Inflation declined to -1.7 percent in December 2024 due to one-off factors, including declines in electricity tariffs and stronger real exchange rate, while core inflation remained at around 3 percent. Inflation expectations remain well anchored.

- Gross international reserves reached US$6.1 billion at end-2024, covering about 3.3 months of imports, up from just a few weeks of imports during the peak of the crisis. Net international reserves accumulation has outperformed the program target significantly, supported by large FX purchases by the CBSL. The current account is projected to reach a surplus of 1.8 percent of GDP in 2024, supported by buoyant tourism, strong remittances, and weak imports.

- We have achieved our fiscal targets for 2024. The primary surplus has significantly improved to 2.2 percent of GDP in 2024 **(QPC)**, well above the program target of 1 percent and almost reaching our medium-term fiscal target (2.3 percent of GDP), a year earlier than planned. This improvement is due to the implementation of revenue measures – bringing the tax revenue to the target of 12.4 percent of GDP **(QPC)** – and contained spending despite the election cycle. A decline in the interest bill is also expected to help improve the overall deficit (excluding bank recapitalization costs) to about 6.8 percent of GDP (program definition).

II. Economic Program

3. To restore macroeconomic stability and public debt sustainability in Sri Lanka, our comprehensive economic reform program rests on the following key pillars: (i) an ambitious primarily revenue-based fiscal consolidation, accompanied by fiscal institutional reforms and cost-recovery energy pricing, aimed at restoring fiscal sustainability and strengthening fiscal discipline; (ii) a stronger social safety net to protect the most vulnerable; (iii) a sovereign debt restructuring strategy aimed at restoring public debt sustainability, (iv) strengthened central bank independence to restore price stability and rebuild international reserves under continued exchange rate flexibility; (v) policies to safeguard financial system stability; (vi) focused reforms to address governance and corruption vulnerabilities; and (vii) broader structural reforms to unlock Sri Lanka's growth potential.

4. We continue to implement the ambitious reform agenda under the EFF. We have already implemented many policy changes, including tax reforms, cost recovery energy pricing, and targeted social safety nets. All end-June and end-September 2024 quantitative performance criteria (QPCs) and indicative targets (ITs) were met, except the IT on social spending. End-June and end-September headline inflation fell below the MPCC outer lower band. All end-December quantitative criteria are expected to be met, except for the SSN IT. Some structural benchmarks (SBs) due by January-2025 were missed because of the timing of the election cycle. We are committed to addressing the remaining gaps and delivering on program objectives. To this end, we will ensure the implementation of the prior actions (PAs) and SBs (Tables 2), and the achievement of the quantitative targets (Table 1).

III. Advancing Revenue-Based Fiscal Consolidation and Reforms to Fiscal Institutions and SOEs

5. We have prepared a draft Budget for 2025 consistent with program parameters. The draft budget will target a primary surplus of 2.3 percent of GDP starting 2025 (**QPC**). The dissolution of parliament has delayed the approval of the 2025 Budget until 2025Q1. Parliament approved a "Vote on Account" procedure for January-April 2025 under which the Government can use funds for existing projects and to ensure that essential public services are maintained. We have submitted the 2025 Appropriation Bill to parliament in line with program parameters **(SB)**. Our Minister of Finance will present to parliament on February 17 the 2025 annual budget document, the Appropriation Bill and the Budget Speech (second reading) in line with program parameters **(PA)** and we will execute total spending so as to not exceed the approved budget. We will ensure that the 2025 Budget in line with program parameters is approved by parliament by end-March 2025 **(reset SB).**

6. We will implement revenue measures to reach the 2025 program target. We will adopt revenue measures with an expected yield of 1.6 percent of GDP in 2025 to raise tax revenues to 13.9 percent of GDP in 2025 **(QPC)**. These measures would also compensate for (i) the absence of gains from the imputed rental income tax in 2025 and 2026 (¶13), (ii) the lower expected yield from improved VAT compliance (¶9), and (iii) the adjustment of the personal income tax (PIT) threshold. If the yield from any of the revenue measures does not fully materialize, we commit to adopt additional high-quality measures to compensate for the shortfall. Any overperformance of tax revenue will be locked-in to reduce the needed revenue adjustment in 2026.

7. **We are adopting a revised revenue package consistent with program parameters that reflects the new administration's policy priorities.** Our package will require that we submit legislation proposals to parliament (**PA**) to: (i) increase the withholding tax rate on interest income from 5 to 10 percent, (ii) introduce a Corporate Income Tax (CIT) of 15 percent on services export, (iii) increase the CIT rate on betting and gaming, tobacco and liquor industries from 40 to 45 percent, and (iv) introduce VAT on supply of digital services. We have issued gazette notifications to introduce a 30 percent import duty on motor vehicles and relevant regulations eliminating remaining import restrictions on them (**PA**). These measures would be complemented by gains from improved VAT compliance (¶9).

8. **We intend to provide an adjustment of the tax-free threshold of PIT, with the ensuing revenue loss being fully compensated by high-quality revenue measures.** To provide tax relief for middle-income families and compensate the erosion of incomes during the past two years due to inflation, we will adjust the PIT schedule effective April 1, 2025. In addition, to assist low-income families, we will introduce VAT exemptions on locally manufactured liquid milk and yoghurt. Both measures are estimated to result in a revenue loss of 0.2 percent of GDP that is fully compensated by progressive measures described in ¶7. We view these measures as essential to ease social pressures, including to ease pressures stemming from the emigration of skilled professionals that have led to labor shortages.

Text Table 1. Adjusted PIT Schedule

Marginal Tax Rate	Annual Taxable Income (Rs)	
	Current Regime	From April 2025
0	Up to 1.2 mln	Up to 1.8 mln
6	1.2-1.7 mln	1.8-2.8 mln
12	1.7-2.2 mln	-
18	2.2-2.7 mln	2.8-3.3 mln
24	2.7-3.2 mln	3.3-3.8 mln
30	3.2-3.7 mln	3.8-4.3 mln
36	Over 3.7 mln	Over 4.3 mln

9. **We will prioritize the implementation of a VAT compliance improvement program**. The low efficiency and weak compliance of the VAT system continue to undermine tax collection. Our work in this area has progressed slowly and the expected yield for 2025 is slightly lower than initially envisaged (0.1 percent of GDP in 2025 and a further 0.1 percent in 2026). To ensure these gains materialize, we will formulate and publish a VAT compliance improvement program identifying, assessing, and prioritizing compliance risks for key taxpayer segments (focusing on large and medium businesses) and determining a detailed plan to address those risks by end-May 2025 **(new SB)**. This program will involve proactive strategies in all aspects of compliance management from taxpayers' education, registration, filing, payment, and risk-based verifications including by taxpayer field visits. To this end, we will provide Inland Revenue Department (IRD) with sufficient additional resources to conduct core operations including field inspections. Relatedly, we will also work with

IRD and customs to validate the veracity of temporary VAT numbers to ensure they are used for their intended purpose.

10. We will expedite efforts to fix the VAT refund system to ensure the full repeal of the simplified VAT (SVAT) system by end-September 2025 (reset SB). Abolishing the SVAT requires efforts to put in place a fully functional VAT refund system, which is an essential step to boost VAT compliance. IRD has already initiated efforts to ensure that the transition to VAT cash refunds issued to exporters is smooth and timely. It has prepared with IMF support a project plan covering all activities required to ensure the SVAT is repealed by the deadline, and plans to implement a robust refund process for the remaining VAT system. The implementation of the plan is effective from January 1, 2025. IRD will report before end-June 2025 the results of a simulation exercise to test the new refund arrangements which will come into place once SVAT is repealed **(new SB)**. We will ensure that the number of exporters eligible for VAT refunds under the revamped system is manageable given IRD capacity limitations. We will also ensure IRD has the human, IT, and financial resources required to support this improved level of VAT refund performance.

11. We will continue to improve revenue administration through better tax compliance. These efforts should improve the perception that the tax system is equitable, predictable, and transparent. We will continue tracking and reporting Key Performance Indicators (KPIs) related to: (i) payment, (ii) filing, (iii) reporting, and (iv) registration – including the revised and new targets for all KPIs up to December 2025 **(SB and annex I)**. To improve tax collections from large taxpayers, the IRD has completed risk profiling of the largest 100 High Wealth Individual (HWI) taxpayers and solicited required information. The IRD is following up on the cases where responses were insufficient. High-risk HWIs will be subject to more intensive checks and audits.

12. We are advancing the modernization of the IRD. We are working on a medium-term IRD Modernization Strategy and Implementation Plan with IMF CD assistance. We have (i) obtained cabinet approval of a prioritized, time-bound, and costed information Technology Strategic Plan to deliver RAMIS 3.0 with the needed functionality enhancements and design improvements; (ii) streamlined the online portal for simplified individual income tax filing; and (iii) enhanced RAMIS to support the assessment of 2022/23 corporate income tax returns with a view to reducing interactions between taxpayers and tax officials. We are in the testing stage to enhance RAMIS in a similar way for individual income tax returns and to administer and assess the Social Security Contribution Levy. We are also ensuring that processing tax collections is only carried out through RAMIS. In the coming months, we will accelerate outreach to re-register VAT taxpayers who dropped out in 2020-22.

13. We have made some progress in building an adequate database on properties and related transactions. The introduction of the property tax and the gift and inheritance tax has been hindered by the constitutional restrictions on sharing revenues between the central and local authorities and the lack of adequate information on property values. In the meantime, we have collected information from a representative sample of 5,000 standard properties that includes information on annual values, latest assessment date, and property type **(SB)** which is the first step to establish a database on estimated current market values by end-December 2024. We will immediately begin to digitize the valuation records held by the government valuation department, starting with municipal councils, finalizing this effort by end-2025. We have also put in place a provisional digital nationwide Sales Price and Rents Register (SPRR) and will establish the final SPRR by end-June 2025 (**revised and reset SB**). We will ensure that the IRD, the valuation department, the land registry, and the general public have access to the SPRR by end-September 2025. The SPRR would be the key resource for the assessment of property values and hence the basis for several taxes, including property taxation, capital gains taxation, and stamp duties. Finally, we will amend the Notaries Act by April 2025 to ensure comprehensive information on each notarized real property contract (which will include the valuation roll, the cadastral number, and a unique tax ID) is automatically fed into the digital SPRR.

14. While we remain bound by the expenditure ceiling set in the PFM law, our primary spending is projected to increase in 2025. Primary spending would increase to 12.8 percent of GDP (from about 12 percent last year) but remain below the 13 percent ceiling instituted in the new PFM law. This draft budget envelope increase will accommodate an adjustment of the wage bill (0.3 percent of GDP) and an interest rate subsidy of 3 percent for senior citizens above 60 years of age from July 2025 for 6 months with term deposit account balances below Rs 1 million. We estimate the additional half-year cost from this measure at 0.05 percent of GDP in 2025. We consider this measure as necessary to ease economic hardship from the crisis and maintain social cohesion. So as to reduce uncertainty about the cost of this measure relating to the potential for abuse we will commence this scheme only after an appropriate identity verification system is in place. We will ensure timely refunds to commercial banks of valid subsidy payments so as to not incur arrears to them. In case the costs of this scheme exceed the initial estimate, we will execute total spending in line with program parameters by finding savings elsewhere.

15. To mitigate fiscal risks arising from the energy SOEs, we will restore cost reflective energy pricing by allowing the existing automatic adjustment mechanism to function unimpeded. In 2024, favorable international energy prices, exchange rate, interest rates, as well as strong rainfall have improved CEB's ability to finance its capital expenditure (primarily to build new generation capacity) from domestic banks and allowed us to reduce electricity tariffs in March and July, while still providing cost recovery for the CEB. However, the decision of the regulator to reduce the electricity tariffs further by 20 percent on average as of January 17, 2025 resulted in the continuous SB on the cost recovery electricity pricing not being met. We will ensure that the Bulk Supply Transaction Account (BSTA), that was fully operationalized in June 2024, will be used to trigger an automatic 10 percent increase of the tariff each time the CEB's buffers reach the lower threshold. CEB will not run arrears and its short-term debt will not be allowed to increase to avoid triggering this automatic tariff increase. Since this adjustment is likely to be insufficient, we will also ensure that the tariffs are increased to the cost recovery level at the next tariff revision in April. We have introduced legislative reforms to give the Minister of Power and Energy the responsibility to implement cost-recovery based electricity price adjustments. Going forward:

- We will continue to set retail fuel prices to their cost-recovery levels on a monthly basis using the agreed formula and will compensate the CPC for providing any residual fuel subsidies with on-budget transfers (**continuous SB**).

- We will maintain the electricity tariff at its cost-recovery level (overall across different types of final consumers) with quarterly formula-based adjustments on a forward-looking basis (effective from January 1, April 1, July 1, and October 1). We will compensate the electricity sector for providing any residual electricity subsidies with on-budget transfers and we will use tariff surcharges in the periods between revisions to restore cost recovery in case CEB is making losses (**continuous SB**). We will monitor CEB's financial performance on a continuous basis and stand ready to increase the tariff as soon as losses emerge. We plan to finalize the dispatch audit of CEB's operational costs, which would assess the scope for efficiency gains in electricity generation and transmission by end-March 2025.

- To ensure that the CPC and CEB are fully compensated for the residual fuel and electricity subsidies with on-budget transfers, a zero ceiling on the cost of non-commercial obligations for fuel and electricity (net of government transfers) is set under the program (**IT**).

16. We will further improve the timeliness, accuracy, and coverage of fiscal data. With the expected completion of ITMIS in May 2025, the MOF's Department of State Accounts will report monthly cash flows from revenues, expenditures, and financing by the third business day of the subsequent month. We have taken preliminary steps to update our fiscal reporting framework to the GFSM 2014 standard by end-May 2025. Finally, we will form a committee that will hold bi-weekly meetings to address any issues regarding the timeliness, accuracy, and coverage of fiscal data.

17. We will continue revamping our public financial management (PFM) procedures in line with the new PFM law. We will fully implement the new law by end-December 2025. We will ensure that future Budget submissions starting from the 2026 Budget will include all documentation required by the PFM law. To this end, we already adopted, in June 2024, the fiscal strategy statement (FSS) that includes the medium-term fiscal framework (MTFF). We will update and publish the FSS and enhance it with a Fiscal Risks Statement, identifying and discussing the main sources of fiscal risks, by end-June 2025. We will ensure that any future PFM-related bill (including PPP, SOE, procurement, and investment bills) is consistent with the PFM law. We will fully integrate PPPs with the public investment management process and ensure that the MOF has a strong gatekeeper role for evaluating the viability and affordability of all projects, including PPPs.

18. We will continue to enhance the PFM functions to ensure fiscal transparency and improve budget processes. This will further enhance the transparency and accountability of our new fiscal rule framework. We are committed to the following PFM measures:

- Prepare and publish a medium-term PFM Reform Strategy and Action Plan by end-June 2025. This strategy will help prioritize and sequence PFM reforms.

- Continue integrating the MOF's recently established Macro-Fiscal Unit into fiscal policy decision making by clearly defining its roles and responsibilities, and strengthening its macro-fiscal analytical, forecasting, and reporting capacity.

- Continue strengthening commitment-based spending controls by introducing a rigorous IT-based commitment control framework. The expansion of ITMIS, a full-fledged IT-based PFM platform, to include all budget heads, has been delayed due to the lack of sufficient licenses, protracted contract discussions with the vendor, and the longer- than-expected time needed for the finalization of the annual accounts. The 3-year extension of the contract with the vendor has now been approved, and we expect to include the remaining 8 budget heads into ITMIS by end-May 2025. The completion of the roll-out will enable us to improve the analytical content of in-year budget execution reports. It is envisaged that ITMIS will be integrated with the e-procurement (e-GP) system.

19. We will press ahead with structural reforms to improve financial viability of SOEs and strengthen their governance.

- Three foreign companies have entered the fuel retail sector so far and have started operating 340 fuel stations, allowing for a more dynamic and competitive environment. In addition, a small margin in the fuel pricing formula is utilized by CPC to repay US$251 million of the old financial obligations. Of this amount, US$161 million remains to be repaid as of end-October 2024, and we expect repayments to continue.

- To improve CEB's efficiency, we have adopted new legislation separating the generation, transmission, and distribution businesses. In addition, we plan to settle CEB's remaining legacy debt (incurred prior to 2023), estimated at about Rs. 301 billion as of end-September 2024. We have obtained cabinet approval of the repayment schedule of CEB's legacy debt on February 10, 2025 **(SB)**. The repayments will start in April 2025 and will be included in the electricity tariff calculation starting from the next tariff revision, thus ensuring that the repayment of old CEB debt does not create an additional burden for the central government budget or higher exposure of the banking sector to SOE debt.

- We will finalize a medium-term strategic plan for Sri Lankan Airlines (SLA) by February 2025, which will include plans to restore operational viability and resolve legacy debts incurred by SLA.

- To strengthen SOE governance and enhance their financial transparency, we will: (i) clarify the mandates of key SOEs through Statements of Corporate Intent and hold their management accountable for delivering satisfactory results informed by key performance indicators, (ii) review the framework for selecting SOE board members to ensure that they are qualified and independent, and (iii) ensure that all 52 major SOEs publish their audited financial statements by end-June of the following year. In 2024, we have published 2023 audited statements of 43 SOEs. The remaining nine SOEs are encountering delays given the required auditing, in some cases going back to 2018. We plan to eliminate the backlog and publish audited 2024 financial statements of all 52 major SOEs by end-June 2025. We are drafting the SOE law with assistance from the World Bank, which will incorporate many of these transparency and governance requirements. We will ensure that this new law is consistent with the PFM Act and that the government has full authority to exercise financial oversight of SOEs. We will consult with the IMF before submitting the SOE law to parliament.

20. We will continue strengthening the framework for SOE borrowing. We will ensure that new SOE borrowing is limited to the financing of commercially viable activities, and subsidies and other quasi-fiscal activities will be remunerated through government transfers. We will also ensure that, except for project loans on-lent by the Treasury and short-term trade financing, there will be no new borrowing in foreign currency for non-financial SOEs with less than 20 percent of revenues denominated in foreign currency. Our new PDM Act lays out the principles and processes for government borrowing and debt management while enhancing the transparency and accountability and institutional arrangements of the borrowing framework. It establishes the requirement of credit risk assessment and the collection of risk-based fees for the issuance and management of loan guarantees and on-lending. We introduced implementing regulations of the law further defining guidelines for clear processes and prudent measures for risk mitigation and regular disclosure of guarantees and on-lending including strict eligibility criteria for SOEs. Guarantees on FX borrowing remain allowed on exceptional basis to facilitate IFI financing to SOEs under very strict conditions. Overall, we will ensure that SOEs effectively comply with all reporting requirements to the MOF under the PFM and PDM laws. In the meantime, we will continue to comply with the program **ITs** on the total and FX outstanding stock of treasury guarantees and the limit set under the PFM Act or related regulations. We have also strengthened the governance and oversight of state-owned banks to ensure that their lending to SOEs is guided solely by commercial considerations.

IV. Social Safety Net Reforms

21. We remain committed to strengthening social safety nets (SSN), including by addressing structural challenges in the Aswesuma cash transfer program.

- **2024.** We missed the end-June, end-September, and end-December 2024 social spending ITs due to technical challenges in opening bank accounts for new beneficiaries and delays in the completion of the second-round applications given the election cycle. Nevertheless, we worked towards resolving structural issues. Specifically, we mobilized village-level administrative officers to support beneficiaries in the issuance of national identity cards and to expedite the opening of bank accounts. This allowed swift payment of arrears to affected first-round beneficiaries by end-December 2024. We also provided a one-off cash transfer of about Rs. 6.6 billion to Aswesuma households with children for purchasing school stationery. As a result, the number of households under the Aswesuma program increased to 1.7 million at end-2024, representing a coverage of 25.6 percent of the Sri Lankan population, against an estimated poverty rate of 23.4 percent.

- **2025.** Given persistent vulnerabilities, we are resolved to maintaining Aswesuma coverage above the poverty rate. To this end, we extended the second-round application deadline and resumed enumeration for second-round applicants, with the aim of allowing for full on-boarding of second-round beneficiaries by June 2025 and swift payment of associated arrears. We concurrently improved the adequacy of cash transfers by obtaining parliamentary approval to increase the monthly cash transfer amounts for the poor and extremely poor categories by Rs. 1,500 and Rs 2,500, respectively, starting from January 2025. Payments will also be increased by Rs 2,000 for the elderly, and by Rs 2,500 for the disabled and chronic kidney disease patients, starting from April 2025. At the same time, we passed legislation to extend the period of payments of benefits for the transitional and vulnerable groups through end-March 2025 and end-December 2025, respectively. As a result, we expect the number of households under Aswesuma to be at 1.6 million by end-2025, representing a coverage of 24.4 percent of the population, against an estimated poverty rate of 21.3 percent. With these developments, we expect cumulative social spending to increase to Rs. 237 billion in 2025. Additionally, to improve targeting under Aswesuma, a dedicated committee will review the existing eligibility criteria, informed by the findings of nationally representative surveys, including the 2025 HIES survey. The full transition of the three categorical programs (elderly, disabled, and chronic kidney disease) to Aswesuma will be completed by end-June 2025 to centralize SSN cash transfers. Going forward, we plan to review the design of SSN programs to further alleviate child poverty and malnutrition, and support pregnant women and the disabled.

- **Empowerment program.** With Rs. 3.5 billion in financial support from the World Bank and ADB, we will start providing livelihood support to about 24,000 beneficiaries from 2025 through skills training and seed capital to help beneficiaries graduate from the Aswesuma program.

V. Restoring Public Debt Sustainability

22. We remain committed to restoring debt sustainability. Debt negotiations are anchored by the debt sustainability targets established under the EFF program, which include (i) reducing the ratio of public debt to GDP to below 95 percent by 2032, (ii) reducing the central government's annual gross financing needs below 13 percent of GDP, on average, in 2027-32, (iii) reducing the central government's annual debt service in foreign currency below 4.5 percent of GDP in every year in 2027-32, and (iv) closing the balance of payments financing gaps of US$17.1 billion over the EFF program period. The debt negotiations have progressed as follows:

- We have now concluded all components of the Domestic Debt Optimization, including the completion of the restructuring of FX local law debt originally contracted by CPC to the state banks.

- In June 2024, we reached final agreements with our largest official creditors: the Official Creditor Committee (OCC) and China EXIM Bank. We have resumed payments to China EXIM Bank. We are now translating the OCC agreements into bilateral agreements.

- In September 2024, we reached an agreement in principle (AIP) with the bondholders' steering committee and the local banking consortium. The AIP is in line with the program's debt sustainability objectives and the OCC's comparability of treatment (COT) principles. We successfully executed these agreements through the bond exchange in December 2024, with 98 percent total participation. We also completed the restructuring process with China Development Bank and resumed payments in December 2024. We are working on the restructuring of the small remaining external commercial and official creditors.

- We reiterate our commitment, as communicated in our open letter to official bilateral creditors on March 14, 2023, to refrain from resuming debt service payments to any external commercial or bilateral creditor unless it agrees to a comprehensive debt treatment in line with the IMF program parameters, debt sustainability targets, and the comparability of treatment principle. We are also committed to communicating transparently with all our creditors on debt treatments agreed with any creditor or group of creditors and to report regularly our debt statistics to ensure full transparency.

- It is our utmost priority to resolve our arrears to external creditors as soon as possible. Consistent with the IMF's arrears policies, we have continued our engagement with the remaining official and commercial creditors in good faith through early dialogue, timely information sharing, and opportunities for them to provide input on the design of restructuring strategies. We will keep IMF staff informed, with the consent of parties involved, of any tentative debt treatment agreements, to facilitate their timely analysis with respect to consistency with the debt targets.

23. We are committed to improving debt management and debt transparency.

- To improve debt management, the parliament approved the Public Debt Management Act in June 2024, which, among other provisions, establishes a Public Debt Management Office (PDMO) in line with international best practices. The PDMO was effectively established by end-December 2024 **(SB)**, with the Director General assuming duties on December 2 and staffing completed for key functions. The PDMO will be fully operationalized by end-December 2025. To this end, we will publish guidelines for PDMO operation and submit to parliament regulations on on-lending and guarantee activities by March 2025. The PDMO will centralize the management of Sri Lanka's public debt in a holistic manner, fully absorbing the relevant functions of CBSL's Public Debt Department, the MOF's External Resources Department, and Treasury Operations Department. The PDMO will: (i) report to and be accountable to the MOF but have significant operational autonomy; (ii) assume overall policy responsibility for debt management by formulating medium-term debt strategies (MTDS) and annual borrowing plans (ABP); and (iii) direct the implementation of ABPs, including taking decisions on auction cut-offs. The PDMO will oversee all domestic and international market-based financing decisions and participate in the evaluation of all debt, derivatives, and guarantees. To ensure debt management functions are consolidated in the PDMO, we will fully repeal the Foreign Loans Act by April 2025 **(new SB)**.

- To improve our strategic debt management function, we will formulate and publish a MTDS and an ABP together with the 2026 Budget, as envisaged in the PFM law.

- We are committed to improving debt transparency. The MOF is publishing a quarterly bulletin of public debt and debt service since February 2023. We are committed to gradually broaden the quarterly bulletin's coverage to stock and debt service flows of all liabilities and contingent liabilities of the budgetary central government and of extra-budgetary central government units. In line with international best practice, we will issue guidelines regarding the statistical treatment of guaranteed debt of distressed corporations and the transfer of government liabilities to SOEs, to be approved by Cabinet.

VI. Restoring Price Stability and Rebuilding External Buffers

24. We are committed to our price stability mandate of 5 percent inflation target. This will be monitored through the Monetary Policy Consultation Clause (**MPCC),** with a mid-point at 5 percent and inner and outer bands of ±1.5 and 3 percentage points in March 2024 and onwards (**QPC**). A policy consultation will be held with the IMF staff ahead of each Monetary Policy Board meeting. A non-observance of the inner and outer bands would require completion of a policy consultation with the IMF staff and the IMF Board, respectively (see Technical Memorandum of Understanding). The CBSL will remain prudent and carefully assess and calibrate its policy stance to maintain inflation around the target. We will maintain the forward-looking real policy rates close to the neutral rate level.

25. We have strengthened the institutional framework to support our price stability mandate. The new Central Bank Act (CBA) has strengthened the CBSL's independence and modernized its policy framework to enable credible inflation targeting. In particular, the CBA (i) establishes price stability as the CBSL's primary objective and financial system stability as the other objective, and (ii) buttresses the CBSL's operational autonomy by removing government representation from the Governing Board and Monetary Policy Board. To address the potential fiscal liquidity shortfall, the new CBA included an 18-month transitory period to allow monetary financing as a last resort, which will expire in March 2025. However, our commitment is governed by the program conditionality below. In November 2024, the CBSL transitioned from a dual policy rate system to a single policy interest rate mechanism as part of its efforts to modernize and streamline its monetary policy framework and signaling.

26. We will continue to refrain from monetary financing. The fiscal adjustment, debt relief, and new external financing envisaged under the program allow budget deficits to be financed in a more sustainable way, without relying on direct credit to government to finance budget deficits which has jeopardized price stability in the past. The discontinuation of monetary financing is monitored by a **QPC** on the ceiling of the CBSL's net credit to the government and a **continuous QPC** to ensure no purchases of Treasury securities from the primary market.

27. The CBSL will continue to regularly assess its balance sheet and ensure an adequate level of capital to conduct an effective monetary policy. The CBSL has followed best practice, consistent with the IFRS, to record the impact of Domestic Debt Optimization on its balance sheet.

CBSL equity has returned to positive levels and is expected to gradually recover. The CBA contains the necessary provisions to recapitalize the CBSL if necessary.

28. We are firmly committed to exchange rate flexibility and rebuilding international reserves.

- Since March 2023, we have allowed the rupee to move in line with fundamentals. A flexible exchange rate will serve as a buffer against external shocks. We limit FX interventions on the sale side to truly disorderly market conditions that could lead to destabilizing inflation and/or significant balance sheet effects and we transparently disclose our intervention to guide market expectations. We also ensure that our FX intervention is consistent with meeting the Net Official International Reserves (NIR) targets. We continue encouraging financial market deepening, including by implementing appropriate recommendations of IMF technical assistance (TA).

- We commit to meeting the program targets on net international reserves (NIR) (**QPC**). We are gradually rebuilding gross international reserves including through outright FX purchases in the market, supported by a non-interest current account surplus, new external financing and other non-debt creating inflows, and sovereign debt relief. We stand ready to undertake outright FX purchases on a net basis of US$2.65 billion between November 2024 and end-2025 to meet reserves target. We strive to save any overperformance in NIR accumulation. As a signal of our proactive approach to reserves accumulation, we have a cap on the adjustor for NIR target in cases of shortfall in project financing.

29. We continue to phase out the administrative measures imposed to support the balance of payments, including those introduced on an emergency basis as conditions allow. These measures include import restrictions, exchange restrictions, multiple currency practices (MCPs), and capital flow management (CFM) measures.

- Over 2020-22 we suspended the import of many non-priority non-critical goods, which helped contain the import bill and relieved BOP pressures but also hurt economic activity. Starting in September 2022, we gradually lifted the temporary restrictions, and by October 2023, restrictions on all items except motor vehicles have been lifted. On September 13, 2024, cabinet approved the phased removal of restrictions on motor vehicles by February 2025. Subsequently, the Minister of Finance issued gazettes and other relevant regulations removing import restrictions on public passenger vehicles and special purpose vehicles on December 18, 2024; commercial vehicles on January 27, 2025; and all vehicles including personal vehicles on January 31, 2025, except a few categories specified in the gazette for environmental and safety reasons (**PA**).

- We currently have the following exchange restrictions: (i) the levy of a 2.5 percent stamp duty on credit card transactions abroad; (ii) the levy of a 14 percent remittance tax on nonresidents' profits; (iii) limits on repatriation by nonresidents of proceeds derived from current transactions; and (iv) the requirement to provide a tax clearance certificate prior to permitting transfers for certain current transactions. We plan to eliminate these restrictions when conditions allow.

- Based on the IMF's new MCP policy, we have in place two MCPs, (i) the levy of a 2.5 percent stamp duty on credit card transactions abroad; and (ii) the levy of a 14 percent remittance tax on nonresidents' profits. We plan to eliminate these when conditions allow.

- Since 2020 we introduced new CFMs and tightened existing CFMs, including on payments made by residents relating to capital transactions outside of Sri Lanka from foreign currency deposit accounts during the pandemic and recent crisis.[1] Out of these, we have removed the surrender requirement for banks on purchases of proceeds from both goods and service exports and inward worker remittances and, since program approval, relaxed the CFMs related to outward remittances on capital transactions made by residents and outward transfers of funds by emigrants.

- While the above import restrictions, exchange restrictions, MCPs and CFMs could help mitigate FX shortages in the near term, we believe they should not be a substitute for the comprehensive policy package and ongoing macroeconomic adjustment. We are committed to phasing these measures out as macroeconomic situation stabilizes. To this end, we have already revoked some of these restrictions, and have developed and shared with IMF Staff, for consultation, a plan for the phased removal of these measures during the program period, as we make progress with achieving macroeconomic stability.

- During the program period, we will not: (i) introduce or intensify exchange restrictions or multiple currency practices (MCPs); (ii) impose or intensify import restrictions for balance of payments purposes, or (iii) conclude any bilateral payment agreements inconsistent with Article VIII (**continuous PC**).

VII. Ensuring Financial Stability

30. We are committed to ensuring a healthy and adequately capitalized banking system. Banks faced elevated credit risk in their credit to both the private and public sectors. Against this background:

- The restructuring of the CPC FX loans held by the two largest state-owned banks was concluded in December 2024, when parliament approved the reclassification of the agreed cash injection amount in the 2024 budget from a capital expenditure allocation to a current expenditure allocation (**SB**).

[1] CFMs introduced or tightened since 2020 include: (i) a repatriation requirement for exports of goods and services; (ii) a surrender requirement for exporters on proceeds from exports of goods; (iii) a surrender requirement for banks on purchases of export proceeds; (iv) a surrender requirement for banks on purchases of inward worker remittances; (v) suspension/limitation of outward remittances on capital transactions made by residents; (vi) restrictions on purchases of Sri Lankan ISBs by local banks; (vii) limitations on outward transfers of funds by emigrants.

- The CBSL completed the assessment of the recapitalization plans of seven largest domestic banks in December 2023 and monitored their implementation, which was concluded, without the need for capital injections from the government, by end-December 2024 (**SB**).
- Going forward, the CBSL will continue to monitor the capital position of banks through forward-looking stress tests and stands ready to impose capital requirements under Pillar 2 of the Basel capital standards, if needed.
- The suspension of Parate executions (non-court procedure to help banks recover collateral from non-performing loans) will not be renewed beyond June 2025 (**new SB**), as it negatively affects banks' ability to recover value from non-performing loans and their capacity to provide credit at lower rates which is needed for economic growth.

31. The frameworks for financial sector supervision and crisis management are being strengthened. The implementation of the amendments to the Banking Act to enhance supervision was completed in June 2024, with the introduction of the necessary regulations[2] by CBSL **(SB).** Following the enactment of the Banking (Special Provisions) Bill in September 2023 to strengthen CBSL's crisis management powers, the CBSL will continue working on its implementation with respect to resolution of licensed banks and enhancing the mandate of the Sri Lanka Deposit Insurance Scheme with the support of the ADB and the World Bank. The CBSL is reviewing the Finance Business Act to enhance the supervision, regulation, and resolution framework of finance companies and Finance Leasing Act to address the irregularities in the finance leasing business. Amended bill on Finance Business Act will be submitted parliament by end-September 2025.

32. We will strengthen the resilience and governance of state-owned banks (SOBs). The amendments of the Banking Act ensure SOBs meet the same regulatory requirements as private banks, including on large exposures, related party lending, and appointment of directors and key management personnel and governance. In May 2024, the Cabinet adopted and published a framework for SOBs to have a majority of independent directors, and nominations for board and senior management to be made by the banks' nomination committees following open search procedures with clear requirements for independence and professional experience **(SB)**. In line with the framework, we will, by March 2025 (i) ensure that the SOB boards of directors have not less than nine and not more than 13 members; and (ii) nominate several independent directors such that independent directors comprise the majority of the total number of directors of each SOB board, one of whom shall be Chair of the Board of each of the banks. In March 2024, the CBSL issued the Banking Act Directions on Large Exposures for Licensed Banks with provisions aimed at ensuring the state-owned banks are run at arm's length from the government and lending to SOEs on a commercial basis and within standard prudential limits on concentration. In September 2024, the

[2]Banking Act Determination no. 1 of 2024, on Statutory Liquidity Ratios of Licensed Banks; Banking Act Directions no. 2 of 2024, on offshore banking business; Banking Act Directions no. 1 of 2024, on large exposures of licensed banks, Banking Act Directions no. 05 of 2024 on Corporate Governance, Banking Act Determination no.04 of 2024 on Approved Securities for accommodation granted to related parties and Gazette No. 2404/33 on limits for accommodation granted to related parties, among others.

CBSL issued the Banking Act Directions on Corporate Governance for Licensed Banks strengthening the responsibilities of the Board and Board sub-committees, risk governance structure, and the Board oversight of senior management.

VIII. Reducing Corruption Vulnerabilities

33. We remain committed to advancing governance and anti-corruption reforms as a central pillar of our program. Based on our Government Action Plan published in February 2024, we will continue implementing key measures, with special attention to the areas below to set the stage for broader reform agenda. The Action Plan will be updated and published in February 2025 to reflect the progress and introduce new initiatives (**new SB**). The implementation performance will also be reviewed on a quarterly basis.

34. Anticorruption (AC) Legal Frameworks and Institutions. The new AC Act enacted in August 2023 significantly strengthens CIABOC's (Commission to Investigate Allegations of Bribery or Corruption) investigative power, as well as the asset and income declaration frameworks. Notably, asset declarations of 200 senior officials were published in 2024 in line with the AC Act (**SB**). Rapid operationalization of the AC Act will be critical to address current corruption vulnerabilities associated with the lack of an effective mechanism to investigate and prosecute corruption cases and to review and publish asset declarations by public officials. CIABOC Commissioners have established an open and transparent process to ensure selected candidates, including for the new Director-General, meet the highest levels of professionalism, ethical conduct, and integrity. The CIABOC have published asset declarations for senior officials in line with the AC Act. Going forward:

- We will publish a strategic plan for the CIABOC and submit CIABOC's annual budget consistent with the new strategic plan to the MOF to be incorporated in the 2025 Budget by mid-March 2025 (**SB**).

- We will enact a comprehensive Asset Recovery Law to harmonize it with the United Nations Convention Against Corruption by end-April 2025 **(reset SB)**.

- We will strengthen the asset declaration system by June 2025 (**new SB**). Specifically, we will (i) allow public access to published declarations through foreign and local phone numbers or email accounts and posted forms to be downloadable; (ii) publish the remaining asset declarations of senior officials along with the list of non-filers; (iii) revise the existing form to include beneficial ownership information; and (iv) modify current rules on redactions so that information on the value of bank accounts and other assets is disclosed to the public. We will also produce a report on the compliance and adoption rate of the enhanced asset declaration.

- The government will review the process for selection of CIABOC Commissioners and Director General to identify any reforms needed to improve transparency and the merit-based and participatory nature of the process.

35. Tax Policy. To minimize revenue losses and curb corruption risks, we are no longer providing any tax exemptions or incentives, and we are also no longer approving new projects under the Strategic Development Projects (SDP), Act since December 2023. We have published our first tax expenditure statement in 2024, assessing the value of all tax exemptions. Should we consider new tax proposals to attract investments, we will consult with IMF staff prior to their implementation. Going forward:

- We will continue to publish, on the designated websites (Promise and MOF) on a semi-annual basis: (i) all public procurement contracts above Rs. 1 billion, (ii) the list of firms receiving tax exemptions through BOI, SDP, and the Port City Acts (for Port City Act, the publication will start in June 2025) and estimated values of the exemptions, and (iii) the list of firms receiving tax exemptions on luxury vehicle imports (**revised SB**). We will also improve the annual tax expenditure statement incorporating recommendations from IMF TA by June 2025.

- We will submit to parliament by end-August 2025 amendments to the SDP Act, consistent with IMF TA, that will introduce transparent, rules-based eligibility criteria to increase the effectiveness of granted tax incentives and to limit the duration for which incentives can be granted (**reset SB**). We will introduce transparent, rules-based eligibility criteria and duration limits on the incentives granted under the Port City Act to strengthen the net economic benefit by end-September 2025.

36. Revenue Administration. We aim to reduce corruption vulnerabilities in revenue collection that arise from: (i) decentralized and discretionary tax policies favoring certain prioritized sectors and commodities, and (ii) lack of effective system for information sharing and performance monitoring to detect and sanction corrupt behaviors in revenue administration. Limited progress has been made in digitizing processes in tax and customs. This has reduced the ability to identify integrity issues through data analytics and tackling the issue requires high levels of direct interaction with officials. To this end, each revenue department has developed an implementation plan to launch a program of anti-corruption measures to strengthen the Code of Conduct, Internal Affairs department, risk management and automation in August 2024 (**SB**). Moreover, the IRD has strengthened information sharing with CIABOC, and introduced a simplified PIT return that can be filed via mobile phone technology. Going forward:

- Each revenue department will provide quarterly updates to Ministry of Finance on the implementation progress of the anti-corruption measures including the digitization and automation beginning from March 2025.

- We will establish a new Tax Crimes Investigation (TCI) unit within IRD, separate from standard audit functions, by end-February 2025.

- To curb revenue leakages from customs, we will approve necessary legislation by end-June 2025 to mandate the Customs Department of Sri Lanka (CDSL) with clear and unfettered responsibility for the clearance, movement, and control of goods to and from the special economic zones (SEZ).

- We will enhance customs compliance by (i) implementing more robust risk assessment so that percentage of shipments assigned to the green channel approaches 80 percent; and (ii) closing the long rooms and eliminating face-to-face document review of customs declarations prior to their formal submission.

37. **PFM**. We intend to tackle corruption associated with political engagement in public procurement selection and limited oversight and transparency around the management of SOE operations. We have operationalized the National Procurement Commission and adopted an action plan. Going forward:

- We will enact a Public Procurement Law by end-June 2025 that reflects international good practice and will coordinate with the ADB and WB to provide needed technical support.

- We will further strengthen the e-procurement system and will work to eliminate the procurement contracts awarded through a non-competitive process. The pilot of national and international competitive bidding for the procurement of goods and works under the digital platform will begin in March 2025 and the full roll-out is planned to take place by end-June 2025.

- To address governance weaknesses in the management of SOEs, we continue to implement the SOE Policy, including an explicit policy on the management of state financial assets, and ensure that all officers and directors of SOEs are appointed in a rigorous, transparent, and merit-based process.

38. **Financial Sector Oversight**. With the amendments to the Banking Act, we enhanced the regulation and supervision of licensed banks' corporate governance, especially the assessment of board and senior management fitness, propriety, and effectiveness in line with international standards and best practices. In September 2024, the CBSL published and adopted regulations to strengthen the governance of all banks, including the public-owned ones, requiring their boards to have a majority of independent directors, and establishing clear requirements for independence and professional experience for managers and board members of licensed banks. Other regulations introduced by the CBSL established criteria for related party transactions, statutory liquidity requirements, regulations on offshore banking business, and establishment of limits for large exposures. CBSL continues to monitor the compliance with these regulations.

39. **Public Asset Oversight and Management.** We are committed to strengthening the regulatory framework to oversee and manage public assets. We will (i) study options and submit to Cabinet proposed criteria for allocating rights to public assets, with clear requirements for transparency, competition, and information provision to the public and a timeline to bring existing laws and regulations in compliance with the policy by March 2025; and (ii) make adjustments to regulations implementing the National Audit Act to facilitate the effective levying of fines on officials, including Chief Accounting Officers, who fail to fulfill their responsibilities in overseeing and managing the public assets by June 2025.

40. AML/CFT. Following the AML/CFT National Policy for 2023-2028 developed based on the National ML/TF Risk Assessment (NRA) result, we are strengthening the AML/CFT regime to address the illicit finance risks and to prepare for the comprehensive AML/CFT assessment by the Asia Pacific Group on Money Laundering in 2026. We are working towards improving the AML/CFT legal framework, as part of the AML/CFT National Policy, focusing on enhancing the transparency of legal persons and arrangements and beneficial ownership requirements to ensure its compliance with the international standards. Going forward:

- We are in the final stages of introducing amendments to the Companies Act to bring the beneficial ownership framework in line with the FATF standards, for adoption by end-April 2025.
- We will implement measures to improve the effectiveness of ML investigations, prosecutions, and asset recovery, including increasing the number of investigations related to the threats identified in the NRA, developing the confiscation policy guidelines and relevant capacity of the prosecutors, investigators, and judiciary.
- We will strengthen the use of financial intelligence to identify potential corruption activities and the cooperation between FIU, law enforcement, and CIABOC to facilitate parallel investigations.
- We will also improve the risk-based AML/CFT supervision of financial institutions through strengthened supervisory capacity and regular supervisory engagements focused on compliance with beneficial ownership requirements and enhanced due diligence measures for politically exposed persons.

IX. Advancing Growth-Enhancing Structural Reforms

41. Our growth-enhancing reform agenda will focus on key areas critical for unlocking Sri Lanka's growth potential. Our near-term focus has been on stabilizing the macro economy and restoring debt sustainability. Going forward, we will start developing structural reforms agenda to build a stronger and more inclusive growth.

- We are fully committed to trade liberalization, critical for attracting investment and boosting productivity growth. We have adopted regulations to rationalize the para-tariffs and will carefully implement the plan with due consideration given to its revenue implications and complement the implementation with measures to support local businesses enhancing their competitiveness. We will pursue further trade reforms with technical assistance from development partners.
- To improve the resilience of the external sector, we will implement a National Export Strategy while expediting negotiations of Free Trade Agreements and entry into regional trade blocs. Initiatives are also planned to improve the competitiveness of Sri Lanka's exports while enabling the positioning in Global Value Chains. Initiatives to develop the industry sector to cater to both domestic and global markets are in train. We will also implement comprehensive strategies to

transform the information technology, business process outsourcing, and Tourism sectors to key service exports.

- To boost labor productivity stemming from a relatively low human capital, labor market rigidities, and a large gender gap in employment, labor market reforms under the program will be geared towards improving the quality and quantity of labor, including promoting female labor force participation. This will also serve as an effective counterforce to the negative impact of population aging. In this regard, we will develop a comprehensive and actionable strategy, which can include reforms to: (i) labor laws to improve labor market flexibility (for example the proposed Employment Act which aims to unify existing labor laws and introduce new measures to improve labor force participation), (ii) the education sector to improve labor productivity and to close gender gaps, (iii) promote financial inclusion including through credit guarantee schemes supporting female entrepreneurs, and (iv) increase quantity, quality, and affordability of child and elderly care facilities.

- We are also committed to addressing climate-related vulnerabilities considering its far-reaching implications on the agriculture sector, especially the direct impacts on the livelihoods and overall food security. Recently, the severity and frequency of climate-related disasters has intensified, underscoring the pressing need to find immediate solutions. Efforts are underway to enhance electricity generation from renewable energy, led by annual additions of solar and wind capacity. Private sector financing and multilateral financing are expected to help meet the envisaged annual investment in this regard. Sri Lanka will also proactively engage with multilateral partners to build the technical capacity to catalyze the rapid implementation of climate mitigation and adaptation efforts.

- With the support of development partners, we will embark on broader reforms to address growth impediments, including impediments to private investment; the large role of the public sector in the economy; an inefficient electricity sector; and climate change. Reforms could be targeted to facilitate investment by (i) reducing red tape and modernizing the regulatory and doing business environment; (ii) reducing electricity cost by improving the generation mix and electricity distribution efficiency; (iii) reducing the government's and SOEs' role in the economy to enable a more efficient allocation of resources, foster competition, and boost productivity, and (iv) strengthening climate change adaptation, including through contingency budget and insurance scheme for natural disasters. We will enact the Rescue, Rehabilitation and Insolvency Bill which provides for orderly insolvency processes that will support NPL recovery and allow banks to allocate their capital efficiently to new credit in support of the growing economy.

X. Program Risks and Contingency Planning

42. We stand ready to deploy contingency measures should downside risks materialize. Risks to program implementation remain high, given adverse initial conditions and a complex debt restructuring:

- Any program underperformance will be corrected by remedial measures. We will ensure that risks of revenue shortfalls are mitigated by prioritizing revenue administration reforms to improve compliance. Targeted spending cuts will be the last line of defense instead of depending solely on capital expenditure reductions.

- We stand ready to tighten monetary policy on a data-driven basis should inflation upside risks materialize.

- Slippages in the reserves buildup would require the introduction of explicit FX intervention rules to avoid hindering necessary exchange rate adjustment.

- Finally, program overperformance resulting from better-than-expected outturns should be locked-in to the extent possible, to help achieve program objectives.

- To ensure program performance, we are conducting monitoring meetings on weekly basis with the IMF to report progress and discuss strategies to meet our commitments.

XI. Program Monitoring and Safeguards

43. Our program will be subject to semiannual reviews with performance criteria, MPCC bands, and indicative targets set out in Table 1 and structural benchmarks in Table 2 attached to this MEFP and TMU. We continue to request the use of IMF financing for budget support, and, in this respect, the Memorandum of Understanding between the CBSL and the Ministry of Finance on responsibilities for servicing financial obligations to the IMF continues to apply. We also recognize the importance of the safeguards assessment of the Central Bank which was finalized in February 2023. The CBA would serve to address some of the identified safeguard issues, and the CBSL has initiated steps to implement other safeguards recommendations.

44. We request that the Executive Board approves the modification of existing and introduction of new quantitative targets and SBs listed in Tables 1 and 2.

45. We request that the Board completes the required MPCC Consultation as inflation breached the end-June and end-December 2024 lower outer MPCC band.

Table 1. Sri Lanka: Proposed Quantitative Performance Criteria (PC) and Indicative Targets

(Cumulative from the beginning of the year to the end of the period, unless otherwise noted)

	2024															2025				
	end-Mar			end-June				end-Sep			end-Dec (preliminary)				end-Mar		end-June	end-Sep	end-Dec
	IT	Actual	Status	PC	Adj. PC	Outturn	Status	IT	Outturn	Status	PC	Adj. PC	Outturn	Status	Second Review IT	Proposed IT	Proposed PC	Proposed IT	Proposed PC
Quantitative performance criteria																			
Central government primary balance (floor, in billion rupees)	70	316	**Met**	140	140	543	**Met**	220	785	**Met**	300	300	653.5	**Met**	130	80	130	300	730
Program net official international reserves (Program NIR, floor, end of period stock, in million US$) 1/ 2/	-2,035	-1,368	**Met**	-1,710	-1,951	-650	**Met**	-1,524	-474	**Met**	-1,338	-1,212	322	**Met**	-1,088	-675	-595	-233	3
Net credit to the government of the CBSL (ceiling, end of period stock, in billion rupees) 3/	2,800	2,691	**Met**	2,720	2,720	2,593	**Met**	2,560	2,515	**Met**	2,560	2,560	2,514	**Met**	2,560	2,560	2,560	2,560	2560
Stock of expenditure arrears of the central government (ceiling, in billion rupees)	0	0	**Met**	0	0	0	**Met**	0	0	**Met**	0	0	0	**Met**	0	0	0	0	0
Central government tax revenue (floor, in billion rupees)	750	837	**Met**	1,500	1,500	1,709	**Met**	2,400	2,689	**Met**	3,700	3,700	3,705	**Met**	850	800	1,650	2,750	4,350
Continuous performance criteria (cumulative from beginning of the program)																			
New external payment arrears by the nonfinancial public sector and the CBSL (ceiling, in million US$)	0	0	**Met**	0	0	0	**Met**	0	0	**Met**	0	0	0	**Met**	0	0	0	0	0
CBSL purchases of government securities in the primary market	0	0	**Met**	0	0	0	**Met**	0	0	**Met**	0	0	0	**Met**	0	0	0	0	0
Monetary policy consultation clause																			
Year-on-year inflation in Colombo Consumers Price Index (in percent) 4/																			
Outer band (upper limit)	8.0			8.0	8.0			8.0			8.0	8.0			8.0	8.0	8.0	8.0	8.0
Inner band (upper limit)	6.5			6.5	6.5			6.5			6.5	6.5			6.5	6.5	6.5	6.5	6.5
Actual / Center point	5.0	4.3	**Met**	5.0	5.0	1.4	**Not Met**	5.0	0.8	**Not Met**	5.0	5.0	-1.5	**Not Met**	5.0	5.0	5.0	5.0	5.0
Inner band (lower limit)	3.5			3.5	3.5			3.5			3.5	3.5			3.5	3.5	3.5	3.5	3.5
Outer band (lower limit)	2.0			2.0	2.0			2.0			2.0	2.0			2.0	2.0	2.0	2.0	2.0
Indicative targets																			
Social spending by the central government (floor, in billion rupees)	50	31	**Not met**	100	100	85	**Not Met**	150	128	**Not Met**	205	205	186	**Not Met**	56	53	114	181	237
Cost of non-commercial obligations (NCOs) for fuel and electricity (net of government transfers) (ceiling, in billion rupees) 5/	0	0	**Met**	0	0	0	**Met**	0	0	**Met**	0	0	0	**Met**	0	0	0	0	0
Treasury guarantees (ceiling, in billion rupees)	2,100	1,692	**Met**	2,100	2,100	1,646	**Met**	2,100	1,565	**Met**	2,100	2,100			2,100	2,100	2,100	2,100	2,100
Treasury FX guarantees (ceiling, in billion rupees)								1,275	1,008	**Met**	1,275	1,275			1,275	1,275	1,275	1,275	1,275

1/ The CBSL's conventional definition of net official international reserves (NIR) includes outstanding liabilities in foreign exchange swaps with domestic commercial banks. The Program NIR excludes the outstanding liabilities in foreign exchange swaps with domestic commercial banks from the CBSL's conventional NIR definition. See TMU for details.

2/ Program NIR will be adjusted upward/downward by the cumulative amounts of (i) foreign program financing by the central government, (ii) net borrowings from SLDBs and FCBUs by the central government in FX terms, (iii) external commercial loans (including Eurobonds and syndicated loans) by the central government, (iv) the amount of project loans and grants FX cash flows disbursed to the central government, and (v) proceeds from commercialization of public assets to non-residents, that are higher/lower than assumed under the program; and by the cumulative amounts of (vi) amortization of total external debt owed by the central government (excl.IMF), (vii) interest payments on total external debt owed by the central government, (viii) interest payments on SLDBs and FCBUs by the central government in US dollar terms, and (ix) amortization and interest payments in FX for restructured CPC loans, that are lower/higher than assumed under the program. See TMU for details.

3/ Excludes holdings of treasury securities for monetary policy purposes and Rupee-denoimated government deposits. See TMU for details on the calculation for the test date.

4/ See the TMU for how to measure year-on-year inflation.

5/ NCOs refer to the obligation of CPC and CEB to supply fuel and electricity at administered prices. See TMU for how to measure the cost of NCOs.

Sources: Authorities; and IMF Staff.

Table 2. Sri Lanka: Structural Benchmarks and Prior Actions

	Date	Status
Prior Action		
Submit to parliament amendments to the VAT Act and Inland Revenue Act and issue relevant gazette notifications to introduce revenue measures (detailed in ¶7) to underpin revenue mobilization in 2025		Gazette on import duties for motor vehicles issued. Others expected prior to the Board meeting
Presentation by the Minister of Finance to parliament of the 2025 annual budget document, the Appropriation Bill and the Budget Speech (second reading) in line with program parameters (¶5)		Expected prior to the Board meeting
Issue relevant gazettes eliminating all remaining import restrictions.		Met
Fiscal, SOE, and Social Safety Net Reforms		
Set retail fuel prices to their cost-recovery levels with monthly formula-based adjustments, and compensate the CPC for providing any fuel subsidies with on-budget transfers	Continuous	Met
Maintain cost-recovery level of the end-user electricity tariff schedule (overall across different types of final consumers) with quarterly formula-based adjustments, on a forward-looking basis in January, April, July and October each year (effective from January 1, April 1, July 1, and October 1 respectively); the CEB submits tariff revision requests to the Public Utility Commission of Sri Lanka by end-October (for January tariff revisions), end-January (for April tariff revisions), end-April (for July tariff revisions) and end-July (for October tariff revisions); compensate the electricity sector for providing any residual subsidies with on-budget transfers; and use tariff surcharges in the interim, in case CEB is making losses	Continuous	Not Met as of January 17, 2025.
Obtain Cabinet approval of the fiscal strategy statement (FSS) containing a medium-term fiscal framework (MTFF).	End-June 2024	Met
Fully operationalize the BSTA by adopting the rule requiring the regulator to use it to determine the cost-recovery based electricity tariff and government transfer requirement.	End-June 2024	Met
Submission to parliament of revenue measures to support fiscal consolidation during 2025, in line with program parameters	End-June 2024	Not Met

Table 2. Sri Lanka: Structural Benchmarks and Prior Actions (continued)

	Date	Status
Parliamentary approval of revenue measures to support fiscal consolidation during 2025, in line with program parameters	End-July 2024	Not Met
Collect information from a representative sample of 5,000 standard properties that includes key variables, including annual values, latest assessment date, and property type, of all properties in all municipal councils	End-August 2024	Met
Obtain cabinet approval of a prioritized, time-bound, and costed Information Technology (IT) Strategic Plan to deliver RAMIS version 3.0 with the needed functionality enhancements and design improvements	End-August 2024	Not Met. Implemented with Delay on September 9.
Track and report the updated quarterly KPIs of tax compliance (Annex IV)	End-August 2024/End November 2024	Met/Not Met
Submission to parliament for the first reading of the 2025 Appropriation Bill that is in line with program parameters	End-October 2024	Not Met. Implemented with delay on December 27, 2024
Parliamentary approval of the 2025 Appropriation Act and the spending allocations in line with program parameters	End-December 2024	Not Met. Reset to end-March 2025.
Obtain a cabinet approval of the repayment schedule of CEB's legacy debts, starting in April 2025	End-December 2024	Not Met. Implemented with delay on February 10, 2025.
Establish a digital SPRR	End-June 2025	
Newly Proposed and Reformulated		
SBs		
Track and report the updated quarterly KPIs of tax compliance (Annex I)	End-February 2025, end-May 2025, end-August 2025 and end-November 2025	

Table 2. Sri Lanka: Structural Benchmarks and Prior Actions (continued)

	Date	Status
Parliamentary approval of the 2025 Appropriation Act and the spending allocations in line with program parameters	End-March 2025	
Formulation and publication of a VAT compliance improvement program identifying, assessing, and prioritizing compliance risks for key taxpayer segments and determining a detailed plan to address those risks	End-May 2025	
IRD will report the results of a simulation exercise to test the new refund arrangements which will come into place once SVAT is repealed	End-June 2025	
Abolish the SVAT system	End-September 2025	
Cabinet approval of revenue measures requiring legislative amendments to support fiscal consolidation during 2026, in line with program parameters	End-September 2025	
Submission to parliament for the first reading of the 2026 Appropriation Bill that is in line with program parameters	End-October 2025	
Parliamentary approval of the 2026 Appropriation Act and the spending allocations in line with program parameters	End-December 2025	
Financial Sector		
SBs		
Implementation of the amendments to the Banking Act.	End-May 2024	Not Met. Implemented with delay on June 15, 2024.
Completion of the recapitalization for two largest State-owned banks including the completion of restructuring of CPC FX loans.	End-August 2024	Not Met. Implemented with delay on December 13, 2024.
Completion of the recapitalization for private sector banks	End-December 2024	Met
Establish Public Debt Management Office (PDMO) in consultation with IMF staff.	End-December 2024	Met

Table 2. Sri Lanka: Structural Benchmarks and Prior Actions (continued)		
	Date	**Status**
Newly Proposed and Reformulated		
Parliament to repeal the Foreign Loans Act in full.	End-April 2025	
Parliament to lift the moratorium on enforcement of collateral, which was introduced during the pandemic, to permit foreclosures by creditors under the Parate Law	End-June 2025	
Governance		
SBs		
Cabinet approval and publication of a framework prepared in consultation with IMF and WB staff to strengthen the governance of public banks, requiring their boards to have a majority of independent members, and nominations for board and senior management to be made by the banks' nomination committees following open search procedures with clear requirements for independence and professional experience.	End-June 2024	Met
Publish on a semi-annual basis on a designated website (i) all public procurement contracts above Rs. 1 billion, along with comprehensive information in a searchable format on contract award winners; (ii) a list of all firms receiving tax exemptions through the Board of Investment and the SDP, and an estimation of the value of the tax exemption; and (iii) a list of firms receiving tax exemptions on luxury vehicle import.	End-June 2024	Met
The operationalized Anticorruption commission shall publish asset declarations for senior officials in line with Anticorruption Act.	End-July 2024	Met
Develop in each revenue department an implementation plan to launch a program of anti-corruption measures to strengthen the Code of Conduct, Internal Affairs department, risk management and automation	End-August 2024	Met
Publish a strategic plan for the CIABOC, in consultation with IMF staff, describing its mission, objectives, timebound actions for operations, and a monitoring framework, together with submission of CIABOC's annual budget based on the new strategic plan.	End-October 2024	Not Met.
Enact a comprehensive Asset Recovery Law to harmonize it with the United Nations Convention Against Corruption, in consultation with IMF staff.	End-November 2024	Not Met. Reset to end-April 2025

Table 2. Sri Lanka: Structural Benchmarks and Prior Actions (concluded)

	Date	Status
Publish on a semi-annual basis on a designated website (i) all public procurement contract above Rs. 1 billion, along with comprehensive information in a searchable format on contract award winners; (ii) a list of all firms receiving tax exemptions through the Board of Investments, the SDP, and an estimation of the value of these tax exemptions; and (iii) a list of firms receiving tax exemptions on luxury vehicle import.	End-December 2024	Met
Submission to parliament of revisions of the SDP Act, with IMF technical assistance, that introduce transparent, rules-based eligibility criteria, to increase the effectiveness of granted tax expenditures, and to limit the duration for which incentives can be granted	End-February 2025	Proposed to be postponed to end-August 2025
Newly Proposed and Reformulated		
Publish updated action plan on governance reforms with detailed progress and new reform initiatives on an annual basis	End-February 2025	
Enact a comprehensive Asset Recovery Law to harmonize it with the United Nations Convention Against Corruption, in consultation with IMF staff.	End-April 2025	
Strengthen the existing asset declaration system by (i) allowing public access to published declarations through foreign and local phone numbers or email accounts and posted forms to be downloadable, (ii) publishing the remaining asset declarations of senior officials along with the list of non-filers, (iii) revising the existing form to include beneficial ownership information, and (iv) modifying current rules on redactions so that information on the value of bank accounts and other assets is disclosed to the public.	End-June 2025	
Publish on a semi-annual basis on a designated website (i) all public procurement contract above Rs. 1 billion, along with comprehensive information in a searchable format on contract award winners; (ii) a list of all firms receiving tax exemptions through the Board of Investments, the SDP and Port City, and an estimation of the value of these tax exemptions; and (iii) a list of firms receiving tax exemptions on luxury vehicle import.	End-June 2025, end-December 2025	
Submission to parliament of revisions of the SDP Act, with IMF technical assistance, that introduce transparent, rules-based eligibility criteria, to increase the effectiveness of granted tax expenditures, and to limit the duration for which incentives can be granted	End-August 2025	

Annex I. KPIs for Inland Revenue Department – Quarterly Targets Under EFF

KPI	Baseline	March 2024 Target & Outcomes	June 2024 Target & Outcomes	September 2024 Target	December 2024 Target	March 2025 Target	Proposed June 2025 Target	Proposed Sept 2025 Target	Proposed December 2025 Target
KPI-1.1: Risk Based Audit Shift to data-driven, risk-based audit case selection and assignment, away from discretion-based selection by auditor and/or supervisor.	No cases are currently selected on a systematic, data-driven, risk basis.	Target: 10 LTO cases selected Outcome: 25 cases selected	Target: 20 new LTO cases selected Outcome: 21 cases selected	Target: 30 new LTO cases selected, & 2 percent of new non-LTO cases selected Outcome: 38 LTO cases & 2 percent of non-LTO cases (18)	40 new LTO cases selected in Q4, & 5 percent of new non-LTO cases in Q4	50 new LTO cases selected in Q1, & 10 percent of new non-LTO cases in Q1	50 new LTO cases selected in Q2, & 10 percent of new non-LTO cases in Q2	50 new LTO cases selected in Q3, & 10 percent of new non-LTO cases in Q3	50 new LTO cases selected in Q4, & 10 percent of new non-LTO cases in Q4
KPI-1.2: Audit Effectiveness for LTOs. The strike rate is the percent of completed audit cases that resulted in an adjustment that increased the tax liability by 5 percent or	Baselines currently unknown and must be determined using historic data for different taxpayer segments: large, upper corporate, medium corporate.	No Target	No Target	No Target	The strike rate is the percent of completed audit cases that resulted in an adjustment that increased the tax liability by 5 percent or more than the taxpayer's	The strike rate is the percent of completed audit cases that resulted in an adjustment that increased the tax liability by 5 percent or more than the taxpayer's	The strike rate is the percent of completed audit cases that resulted in an adjustment that increased the tax liability by 5 percent or more than the taxpayer's	The strike rate is the percent of completed audit cases that resulted in an adjustment that increased the tax liability by 5 percent or more than the taxpayer's	The strike rate is the percent of completed audit cases that resulted in an adjustment that increased the tax liability by 5 percent or more than the taxpayer's

KPI	Baseline	March 2024 Target & Outcomes	June 2024 Target & Outcomes	September 2024 Target	December 2024 Target	March 2025 Target	Proposed June 2025 Target	Proposed Sept 2025 Target	Proposed December 2025 Target
more than the taxpayer's self-declared.					self-declared.	self-declared.	self-declared.	self-declared.	self-declared.
KPI-2.1: Tax Return Filing Compliance of Large Taxpayers This is the percentage of expected tax returns from large taxpayers by the due date: (1) VAT – one-month after monthly or quarterly deadline; (2) PAYE by April 30; (3) CIT by November 30	From 2023 TADAT Assessment (P4.12): On-Time CIT Filing: 93.4 percent On-Time VAT Filing: 82.6 percent Only baseline for PAYE is 23.6 percent but covers all employers not just under LTO control.	Target: 85 % of VAT returns on-time Outcome: 95 % of VAT returns on-time	Target: 87 % of VAT returns on-time Outcome: 88% achieved & Target: 90 % of PAYE returns on-time Outcome: 56% achieved	Target: 89 % of VAT returns on-time Outcome: 89.6 % of VAT returns on-time	91 % of VAT returns on-time & 95 % of CIT returns on-time	95 % of VAT returns on-time	95 % of VAT returns on-time & 90 % of PAYE returns on-time	95 % of VAT returns on-time	95 % of VAT returns on-time & 95 % of CIT returns on-time
KPI-2.2: Tax Return Filing Compliance of Non-Large Taxpayers This is the percentage of	From 2023 TADAT Assessment (P4.12): On-Time CIT Filing: 32 percent	Target: 48 % of VAT returns on-time Outcome: 66% achieved	Target: 52 % of VAT returns on-time Outcome: 54% achieved	Target: 56 % of VAT returns on-time Outcome: 55.8 % of	60 % of VAT returns on-time & 50 % of CIT returns on-time	65 % of VAT returns on-time	67 % of VAT returns on-time & 60 % of PAYE returns on-time	69 % of VAT returns on-time	70 % of VAT returns on-time & 60 % of CIT returns on-time

KPI	Baseline	March 2024 Target & Outcomes	June 2024 Target & Outcomes	September 2024 Target	December 2024 Target	March 2025 Target	Proposed June 2025 Target	Proposed Sept 2025 Target	Proposed December 2025 Target
expected tax returns from non- large taxpayers by the due date.	On-Time VAT Filing: 45.5 percent PAYE Filing: 23.6 percent.		& Target: 60 % of PAYE returns on-time Outcome: 12% achieved	VAT returns on-time					
KPI-2.3: Electronic Filing of Individual Income Tax (IIT) Returns First three quarters will reflect 2022/23 IIT returns, Q4 will reflect 2023/24 IIT return.	From 2023 TADAT assessment (P4.14): 23 percent of IIT returns filed electronically in 2021	Target: 30 % filed electronically Outcome: 33% achieved	Target: 35 % filed electronically Outcome: 34% achieved	Target: 40 % filed electronically Outcome: 34.2% achieved	50 % filed electronically	60 % filed electronically	60 % filed electronically	60 % filed electronically	80 % filed electronically
KPI-3.1: Management of Collectible debt Collectible debt is that portion of arrears owed	From 2023 TADAT assessment (P5.18): At end of 2021, ratio of collectible debt to	Target: Collectible debt is not above 15 % of 2024 revenue target	Target: Collectible debt is not above 14 % of 2024 revenue target	Target: Collectible debt is not above 13 % of 2024 revenue target	Collectible debt is not above 12 % of 2024 revenue target	Collectible debt is not above 11 % of 2025 revenue target	Collectible debt is not above 10 % of 2025 revenue target	Collectible debt is not above 10 % of 2025 revenue target	Collectible debt is not above 10 % of 2025 revenue target

KPI	Baseline	March 2024 Target & Outcomes	June 2024 Target & Outcomes	September 2024 Target	December 2024 Target	March 2025 Target	Proposed June 2025 Target	Proposed Sept 2025 Target	Proposed December 2025 Target
to IRD that is not subject to dispute and where there is no legal impediment to collection action.	annual collections was 13.75 percent, but deteriorated to 15.4 percent by end-2022.	Outcome: 9.2% achieved	Outcome: 8.3% achieved	Outcome: 8.3% achieved					
KPI-4.1: VAT Registration	The registered VAT population was nearly 29,000 before the 2019 changes and has fallen to 12,000. IRD seeks to rebuild VAT and SSCL taxpayer base to 20,000 by end-2024	Target: 14,000 active VAT and SSCL registered taxpayers Outcome: VAT – 17,209 SSCL – 8,190	Target: 16,000 active VAT and SSCL registered taxpayers VAT – 18,902 SSCL – 10,241	Target: 18,000 active VAT & 11,000 SSCL registered taxpayers VAT – 20, 214 SSCL – 11,269	20,000 active VAT & 12,000 SSCL registered taxpayers	22,000 active VAT & 13,000 SSCL registered taxpayers	23,000 active VAT & 14,000 SSCL registered taxpayers	24,000 active VAT & 15,000 SSCL registered taxpayers	25,000 active VAT & 16,000 SSCL registered taxpayers

Annex II. Consultation with the IMF Executive Board on Missed Inflation Target Under the MPCC

Inflation[1] decelerated to 1.4 percent and -1.5 percent in the second and fourth quarters of 2024, respectively, which were below the outer bound of the MPCC band of 2.0 percent as agreed under the EFF. In fulfillment of our obligation to consult with the IMF's Executive Board this annex explains: (1) the reasons why inflation fell below the lower outer limit of the MPCC band in the second and fourth quarters of 2024; and discusses (2) the policy response and (3) the inflation outlook.

I. Inflation Deviation from the Consultation Band

The lower-than-expected inflation in the second, third, and fourth quarters of 2024 was driven primarily by favorable energy prices, exchange rate dynamics, and improved domestic supply conditions, amidst muted demand pressures.

- **Energy and Transport Price Reductions.** A significant decline in energy and transport-related inflation was observed in 2024. The electricity tariff was reduced significantly in March and July 2024 by 22 percent and 22.5 percent, respectively, and multiple domestic fuel and LP gas price reductions were implemented. These reductions were larger than anticipated.

- **Exchange Rate Appreciation.** The projected Sri Lankan rupee depreciation – in line with the external sector rebalancing needs, planned relaxation of import restrictions, and the authorities' commitment to build up reserves – did not materialize in spite of substantial forex purchases from the market by the Central Bank. Instead, the rupee appreciated by 6.0 percent against the US dollar during the first six months of 2024 and by 10.7 percent cumulatively in 2024, reflecting a further strengthening of the external sector, delay in the relaxation of import restrictions, and improved market sentiment following agreement in principle with international bondholders and elections. The appreciation of the rupee, along with the absence of larger increases in key international commodity prices, helped reduce inflationary pressures through lower import costs.

- **Improved Domestic Supply Conditions.** Following a brief temporary increase of food inflation in early 2024, a notable moderation in food prices was observed in the remainder of the year, supported by a strong harvest and the easing of supply chain bottlenecks.

- **Limited Second-Round Effects of Tax Adjustments.** Value Added Tax rate was increased, and several tax exemptions were removed in January 2024. Although these had led to a rise in headline inflation in early 2024, the second-round effects were muted, due to subdued demand conditions.

[1] As defined in the TMU.

II. Policy Response

During 2024, the CBSL further eased monetary policy stance, implementing a total reduction of 125 basis points in the policy rate. Accordingly, the CBSL cut the policy rate by 50 basis points in March, 25 basis points in July, and another 50 basis points in November. These decisions took into consideration the deeper-than-expected deflation conditions in the near term, further moderation of underlying inflationary pressures and inflation expectations, better-than-expected developments on the external front, and the lack of further space available for a reduction in market lending rates.

While transitioning to a single policy interest rate framework effective on November 27, the CBSL actively engaged in open market operations to ensure that short-term money market interest rates are aligned with the monetary policy stance. Market deposit and lending interest rates adjusted downwards in line with the eased monetary policy stance of the CBSL and credit extended to the private sector by the banking system showed clear signs of expansion.

Given the nature of the recent inflation drivers, the CBSL will remain vigilant of upside inflation risks that may emerge. The upside risks could emerge from the external sector, particularly due to global commodity price volatility and the relaxation of the import restrictions, wage increases, continued demand recovery and possible domestic supply disruptions including weather disturbances. The CBSL remains committed to its price stability mandate.

III. Inflation Outlook

In the near-term, CBSL forecasts suggest the deflation will continue in the first quarter of 2025, driven by the base effects. Headline inflation is projected to turn positive towards mid-2025 and gradually converge to 5 percent target thereafter, supported by appropriate monetary policy adjustments, demand recovery, and exchange rate adjustment.

The CBSL will continue to closely monitor the impact of the policy measures, as well as developments in the global and domestic economy and stands ready to take additional measures as necessary to achieve the price stability objective.

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) sets out a framework for monitoring the performance of Sri Lanka under the program supported by the Extended Arrangement under the Extended Fund Facility (EFF). It specifies the performance criteria and indicative targets (including adjustors) under which Sri Lanka's performance will be assessed through semiannual reviews. Monitoring procedures and reporting requirements are also specified.

2. The quantitative performance criteria and indicative targets specified in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP) are listed as follows.

a) a quantitative performance criterion on central government primary balance (floor);

b) a quantitative performance criterion on central government tax revenue (floor);

c) a quantitative performance criterion on the stock of expenditure arrears of the central government (ceiling);

d) a quantitative performance criterion on net official international reserves (floor);

e) a quantitative performance criterion on the CBSL's net credit to the government (ceiling);

f) a continuous quantitative performance criterion on new external payment arrears of the nonfinancial public sector and the CBSL (ceiling);

g) performance criterion on new CBSL's purchases of government securities in the primary market;

h) a monetary policy consultation clause;

i) an indicative target on social safety net spending (floor);

j) an indicative target on cost of non-commercial obligations for fuel and electricity (net of government transfers) (ceiling); and

k) an indicative target on treasury guarantees (ceiling).

l) an indicative target on foreign exchange treasury guarantees (ceiling).

3. Throughout this TMU, the central government is defined to include line ministries, departments, and other public institutions. The Central Bank of Sri Lanka (CBSL), state-owned enterprises, parastatals and other agencies that do not receive subventions from the central government are excluded from the definition of central government. Debt is defined in accordance with paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 16919-(20/103), adopted October 28, 2020.

I. PERFORMANCE CRITERIA

A. Performance Criterion on Central Government Primary Balance

4. Unless otherwise specified, all definitions follow the GFSM1986. The primary balance of the central government on cash basis is defined as central government revenues and grants minus expenditures and net lending, plus interest payments. The proceeds from privatization or commercialization of public assets to residents or non-residents (as defined in paragraph 10) will not be recorded as part of central government revenues. Spending will be recorded in the period during which cash disbursements are made.

5. For the purpose of program monitoring, the primary balance of the central government on cash basis will be measured as the overall balance of the central government plus the interest payment of the central government. The overall balance of the central government is measured from the financing side, as the negative of the sum of the items listed below. Here, net borrowings refer to gross disbursements minus principal repayments. For 2023, the primary balance of the central government on cash basis measured in this manner was Rs 173 billion (the overall balance was Rs. minus 2,282 billion and the interest payment was Rs 2,456billion).

a) Net borrowings from issuances of Treasury Bills, Treasury Bonds, and loans in local currency.

b) Net decreases in the balances (deposits minus overdrafts) of the central government in the banking system.

c) Net increases in CBSL advances, net of changes in central government deposits at the CBSL.

d) Net borrowings from Sri Lankan Development Bonds (SLDBs) and domestic loans in foreign currency. In 2023, the total amount was Rs minus 393 billion.

e) Commercial borrowings issued under foreign law, including international sovereign bonds and syndicated loans.

f) Net borrowings from official project and program loans and trade credit lines.

g) Net borrowings from all other bonds, loans, and advances contracted by the central government.

h) Proceeds from privatization or commercialization of public asset to residents and nonresidents.

6. For the purpose of program monitoring, the government's equity injections into banks for recapitalization purposes will not be recorded as central government expenditure. Accordingly, the primary balance as defined in paragraph 5 will be reduced by the amounts transferred to banks. By contrast, the government's equity injections into other corporations (both private and state-owned) will be recorded as central government expenditure, consistent with GFSM 1986. Accordingly, the

primary balance as defined in paragraph 5 will not be reduced by the amounts transferred to other corporations. Net lending by the government is recorded as a government expenditure, in line with GFSM1986. For example, funds lent by the government to CPC in 2022 related to fuel credit lines from India are recorded above the line (increasing the deficit). A repayment will similarly be recorded above the line (reducing the deficit).

B. Performance Criterion on the Stock of Expenditure Arrears of the Central Government

7. Expenditure arrears of the central government are defined as: (i) any invoice that has been received by a spending agency of the central government from a supplier of goods, services, and capital goods delivered and verified, and for which payment has not been made within the contractually agreed period (taking into account any applicable contractual grace period), or in the absence of a grace period, within 3 months after the due date; and (ii) wages, pensions, or transfers expensed by the central government, for which payment has been pending for longer than 3 months to domestic or foreign residents.

C. Performance Criterion on Central Government Tax Revenue

8. Central government tax revenue refers to revenues from taxes collected by the central government. It excludes all revenues from asset sales, grants, and non-tax revenues. The revenue target is calculated as the cumulative flow from the beginning of the year.

D. Performance Criterion on Net Official International Reserves

9. For the purpose of program monitoring, the stock of net official international reserves (NIR) will be measured as the difference between (a) and (b) below, and will be called the "Program NIR." The Program NIR at the test dates will be evaluated at the program exchange rates and gold price specified in paragraph 9.

a) The CBSL's conventional definition of the NIR, which is the sum of (i) the difference between the gross foreign assets and liabilities of the CBSL and (ii) the balance of State Treasury's (DSTs) Special Dollar, Japanese Yen, and Chinese Yuan Revolving accounts, both expressed in terms of market values. Gross foreign assets of the CBSL consists of monetary gold; foreign exchange balances held outside Sri Lanka; foreign securities (valued in market prices); foreign bills purchased and discounted; the reserve position at the IMF and SDR holdings; and the Crown Agent's credit balance. Foreign exchange balances, securities, and bills denominated in Chinese Yuan, including the assets held under the People's Bank of China (PBoC) swap arrangement, are part of the gross foreign assets of the CBSL. Excluded from gross foreign assets will be participation in international financial institutions; holdings of nonconvertible currencies;[1]

[1] Convertible currencies include the currencies of the SDR basket (U.S dollar, U.K pound, Japanese yen, Chinese yuan, Euro) as well as Canadian dollar, Australian dollar, and Swiss franc.

holdings of precious metals other than monetary gold; claims on residents (e.g., statutory reserves on foreign currency deposits of commercial banks and central bank foreign currency deposits with resident commercial banks); pledged, non-liquid, collateralized or otherwise encumbered foreign assets (such as the ringfenced assets of the Sri Lanka Deposit Insurance Scheme and the government's war risk insurance deposit with Lloyds during 2001/02; except for assets held under the PBoC swap arrangement); claims on overseas subsidiaries of domestic commercial banks and claims in foreign exchange arising from derivative transactions (such as futures, forwards, swaps and options). Gross foreign liabilities are all foreign currency denominated liabilities of the CBSL to non-residents (including currency swap arrangements with foreign central banks); the use of Fund credit (including for budget support purposes); and Asian Clearing Union debit balance. Commitments to sell foreign exchange to residents arising from derivatives such as futures, forwards, swaps, and options, such as commitments arising from currency swaps with domestic commercial banks, are not included in the gross foreign liabilities. DST accounts are foreign currency accounts held by the Treasury and managed by the CBSL as an agent of the government.

b) The CBSL's outstanding liabilities (i.e., net short positions) in foreign exchange swaps with domestic commercial banks.

10. For the purpose of measuring the Program NIR, all foreign-currency related assets and liabilities will be converted into U.S. dollar terms at the exchange rates prevailing on January 3, 2023, as specified in Table 1. Monetary gold will be valued at US$1,831.615 per troy ounce, which was the price prevailing on January 3, 2023 as per CBSL.

Table 1. Sri Lanka: Program Exchange Rates

(Rates as of January 3, 2023)

Currency	Units of Currency per 1 US dollar
Sri Lanka rupee	363.11
British pound	0.838012
Japanese yen	132.650000
Canadian dollar	1.365800
Euro	0.948317
Chinese yuan	6.892800
Australian dollar	1.497006
Swiss franc	0.939650
SDR	0.752014
Memorandum:	
Gold price, US$/oz	1831.62

Source: IMF, CBSL

Note: JPY and AUD rates as of December 23, 2022

The Following Adjustment Will Apply:

11. If (i) the amount of foreign program financing (exclusive of EFF disbursements) by the central government, (ii) the amount of net borrowings from SLDBs and FCBUs by the central government in FX terms, (iii) the amount of external commercial loans (including international sovereign bonds and syndicated loans) borrowed by the central government, (iv) the amount of project loans and grants disbursed as FX cash flows to the central government, and (v) proceeds from commercialization of public assets to non-residents—as set out in Table 2a. or 2b.—are higher/lower in U.S. dollar terms than assumed under the program, the floor on the program NIR will be adjusted upward/downward by the maximum of the cumulative differences on the test date and the caps on the adjustors as specified. The proceeds from commercialization of public assets are defined as cash receipts from the sale or lease of publicly held assets. Such assets will include, but not be limited to, publicly held land, public holdings of infrastructure or commercial real estate, and public or quasi-public enterprises. These adjustors will apply to the NIR floor for end-December 2022 and thereafter.

12. If the sum of amortization of total external debt and interest payments on total external debt owed by the central government (excluding IMF) in U.S. dollar terms, as well as the sum of interest payments on SLDBs and FCBUs by the central government in U.S. dollar terms—as set out in Table 2a. or 2b.—is higher/lower than assumed under the program, the floor on the Program NIR will be adjusted downward/upward by the cumulative differences on the test date. Total external debt refers to external debt owed by the central government to all foreign creditors (excluding IMF), as defined in the *2013 External Debt Statistics: Guide for Compilers and Users*. These adjustors will apply to the NIR floor for end-December 2022 and thereafter.

Table 2a. Sri Lanka: Program Assumptions (2024)

(Cumulative from the beginning of each calendar year, in million US$)

	Mar. 2024	Jun. 2024	Sep. 2024	Dec. 2024
Foreign program financing of the central government	425	650	800	800
Net borrowings from SLDBs and FCBUs by the central government in FX terms	0	0	0	0
External commercial loans (including Eurobonds and syndicated loans) by the central government	0	0	0	0
Proceeds from commercialization of public assets to non-residents	0	0	0	0
Amortization of total external debt owed by the central government (excl. IMF)	187	374	561	748
Interest and Amortization payments on FX restructured CPC loans by central government	25	50	75	100
Interest payments on total external debt owed by the central government and central bank (excl. IMF)	308	615	919	1,226
Interest payments on SLDBs and FCBUs by the central government in US dollar terms	0	0	0	0
Project loans and grant FX cash amounts disbursed to the central government	105	210	315	420

13. The adjustor on the amount of project loans and grants disbursed as FX cash flows to the central government will be capped at US$250 million in 2024 and 2025. The other adjustors will be uncapped.

Table 2b. Sri Lanka: Program Assumptions (2025)

(Cumulative from the beginning of each calendar year, in million US$)

	Mar. 2025	Jun. 2025	Sep. 2025	Dec. 2025
Foreign program financing of the central government	188	288	573	783
Net borrowings from SLDBs and FCBUs by the central government	0	0	0	0
External commercial loans (including Eurobonds and syndicated loans) by the central government	0	0	0	0
Proceeds from commercialization of public assets to non-residents	0	0	0	0
Amortization of total external debt owed by the central government (excl. IMF)	370	741	1,111	1,481
Interest and Amortization payments on FX restructured CPC loans by central government	58	116	174	232
Interest payments on total external debt owed by the central government (excl. IMF)	290	580	870	1,159
Interest payments on SLDBs and FCBUs by the central government in US dollar terms	0	0	0	0
Project loans and grants disbursed to the central government	175	350	525	700

14. In the event NIR outcome outperforms its program target(s), the CBSL will consult with IMF staff on raising the targets for subsequent test dates accordingly to safeguard such overperformance.

E. Performance Criterion on the CBSL's Net Credit to the Government (NCG)

15. **The CBSL's net credit to the Government (NCG)** will be measured as the difference between a) and b) below.

(a) The CBSL's claims on the central government, which include provisional advances, government securities acquired by the CBSL through primary market purchases, the central government's special direct issuances to the CBSL, and long-term or outright open market operations. For the program monitoring purpose, government securities acquired through purchases of government securities, solely for monetary policy purposes (e.g., standing lending facility and short-term open market operations) and emergency liquidity assistance (ELA) operations, on a temporary basis with an agreement to reverse the transaction in less than 90 days, will be excluded from the CBSL's claims on the central government. For the program monitoring purpose, the stock of government securities held by the CBSL will be measured in the face value.

(b) The central government's Rupee-denominated deposits at the CBSL. The deposits related to foreign program financing (including IMF disbursements) placed at the government's account at the CBSL are not part of the central government's Rupee-denominated deposits at the CBSL.

The Following Adjustment Will Apply:

16. The ceiling on the CBSL's NCG will be adjusted upward by the amount of shortfalls in foreign program financing of the central government (measured against programmed amounts as set out in Table 2). This adjustor will only apply to the NCG ceiling during six months after the Board date of the First review. The foreign currency amounts will be converted to Sri Lankan rupees using the program exchange rates defined in paragraph 9.

II. CONTINUOUS PERFORMANCE CRITERIA

F. Performance Criterion on New External Payment Arrears of the Nonfinancial Public Sector and the CBSL

17. A continuous performance criterion applies to the non-accumulation of new external payments arrears on external debt contracted or guaranteed by the nonfinancial public sector and the CBSL. The nonfinancial public sector is defined following the 2001 Government Finance Statistics Manual and the 1993 System of National Accounts. It includes (but is not limited to) the central government as defined in paragraph 3 and nonfinancial public enterprises, i.e., boards, enterprises, and agencies in which the government holds a controlling stake. External payments arrears consist of debt-service obligations (principal and interest) to nonresidents that have not been paid at the time they are due, as specified in the contractual agreements, subject to any applicable grace period. However, overdue debt and debt service obligations that are in dispute will not be considered as external payments arrears for the purposes of program monitoring. Arrears resulting from the nonpayment of debt service, for which a rescheduling or restructuring agreement is being sought, are excluded from this definition. This continuous performance criterion will be monitored continuously by the authorities and any non-observance will be immediately report to the Fund.

G. Performance Criterion on New CBSL's Purchases of Government Securities in the Primary Market

18. A continuous performance criterion applies a ceiling of zero on new purchases of government securities by the CBSL in the primary market on the continuous basis.

The Following Adjustment Will Apply:

19. The ceiling (¶17) will be adjusted upward by the amount of shortfalls in foreign program financing of the central government (measured against programmed amounts as set out in Table 2). This adjustor will only apply to the ceiling ((¶17) during six months after the Board date of the First

review. The foreign currency amounts will be converted to Sri Lankan rupees using the program exchange rates defined in paragraph 9.

H. Other Continuous Performance Criteria

20. During the program period, Sri Lanka will not:

a) impose or intensify **restrictions on the making of payments and transfers** for current international transactions;

b) introduce or modify **multiple currency practices** (MCPs);

c) conclude **bilateral payment agreements** that are inconsistent with Article VIII of IMF Articles of Agreement; and

d) impose or intensify **import restrictions** for balance of payments purposes.

III. MONETARY POLICY CONSULTATION CLAUSE

21. The inflation target bands around the projected 12-month rate of inflation in consumer prices, as measured by the headline Colombo Consumer Price Index (CCPI) published by the Department of Census and Statistics of Sri Lanka, are specified in Table 1 attached to the MEFP. The CCPI index (2021=100) will be used to measure actual inflation. For this purpose, the year-on-year inflation for each test date is measured as follows:

$$\{ CCPI^*(t) - CCPI^*(t-12) \} / CCPI^*(t-12)$$

where

t = the month within which the test date is included

$CCPI(t)$ = CCPI index (all items) for month t

$CCPI(t-k)$ = CCPI index (all items) as of k months before t

$CCPI^*(t) = \{ CCPI(t-2) + CCPI(t-1) + CCPI(t) \} / 3$

$CCPI^*(t-12) = \{ CCPI(t-14) + CCPI(t-13) + CCPI(t-12) \} / 3$

If the observed year-on-year inflation for the test date falls outside the outer bands specified in Table 1 attached to the MEFP, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) on proposed policy response. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. In addition, if the observed year-on-year inflation falls outside the inner bands specified in Table 1 attached to the MEFP for the test date, the authorities will complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

IV. INDICATIVE TARGETS

I. Indicative Target on Social Safety Net Spending

22. The Social Safety Net (SSN) spending is the central government's spending on SSN programs comprising of: (1) Aswesuma cash transfers; (2) assistance to the elderly (over 70 years of age); (3) allowance for disabled people; (4) financial support for kidney patients; and (5) support under the empowerment program. These classifications are in line with the reporting in the Ministry of Finance Annual Report as in Table 9).

J. Indicative Target on Cost of Non-Commercial Obligations for Fuel and Electricity (Net of Government Transfers)

23. The non-commercial obligations (NCOs) for fuel and electricity refer to the obligations of Ceylon Petroleum Corporation (CPC) and Ceylon Electricity Board (CEB) to supply fuel and electricity at prices below cost-recovery levels. The indicative target is set on the cost of fuel and electricity NCOs net of government transfers, which corresponds to the cost of the NCOs that are not compensated by the central government budget.

24. The cost of NCOs for fuel during each quarter is measured as the cost of sales (including fuel cost, terminal charges, transport charges, personnel cost, other operational expenses, exchange rate variation, and finance cost; excluding sales taxes) minus revenues (net of sales taxes) with regard to fuel supplies by CPC for transport, power generation, aviation, industries, kerosene and LPG, and agrochemicals. If the revenues (net of taxes) exceed the cost of sales, the cost of NCOs for fuel is zero. The government transfers to cover the cost of fuel NCOs are measured as central government current transfers disbursed to CPC.

25. Starting on January 1, 2024, the cost of NCOs for electricity during each quarter will be measured as total expenditures (including energy purchases and allowed revenue for transmission) minus total sales revenues from 5 distribution licensees under CEB, as shown in the statement of the Bulk Supply Transaction Account managed by CEB. Until January 1, 2024, the cost of NCOs for electricity during each quarter will be measured by total losses as reported on the CEB's financial statement. If the total sales revenues exceed the total expenditures, the cost of NCOs for electricity is zero. The government transfers to cover the cost of electricity NCOs are measured as central government transfers disbursed (including capital injection as specified in paragraph 6) to CEB.

26. For the purpose of program monitoring, the cost of fuel and electricity NCOs net of government transfers is calculated as follows. This takes account of a time lag in estimating the cost of fuel and electricity NCOs.

For the test date of end-March 2025:

NCO(2024Q4) – G(2025Q1)

For the test date of end-June 2025:

{ NCO(2024Q4) + NCO(2025Q1) } – { G(2025Q1) + G(2025Q2) }

For the test date of end-September 2025:

{ NCO(2024Q4) + NCO(2025Q1) + NCO(2025Q2) }

– { G(2025Q1) + G(2025Q2) + G(2025Q3) }

For the test date of end-December 2025:

{ NCO(2024Q4) + NCO(2025Q1) + NCO(2025Q2)) + NCO(2025Q3) }

– { G(2025Q1) + G(2025Q2) + G(2025Q3) + G(2025Q4) }

where

NCO(q) = cost of NCOs for fuel and electricity during quarter "q"

NCO_fuel(q) = cost of NCOs for fuel during quarter "q"

NCO_electricity(q) = cost of NCOs for electricity during quarter "q"

NCO(q) = NCO_fuel(q) + NCO_electricity(q)

G(q) = central government transfers to CPC and CEB disbursed during quarter "q"

G_fuel(q) = central government transfers to CPC disbursed during quarter "q"

G_electricity(q) = central government transfers to CEB disbursed during quarter "q"

G(q) = G_fuel(q) + G_electricity(q).

K. Indicative Target on Treasury Guarantees

27. Treasury guarantees are defined as outstanding debt guarantees issued by the central government. A guarantee of a debt refers to any explicit legal obligation of the central government to service such a debt in the event of nonpayment by the recipient. Treasury guarantees exclude letters of comfort. Outstanding guarantees are defined as the drawn amounts of guaranteed debts. They differ from issued guarantees, which are defined as the total amount of guaranteed debts

(including for debts that are not disbursed yet). Treasury guarantees include outstanding treasury guarantees published in the Statement of Contingent Liabilities contained in the Annual Report of the Ministry of Finance. Rupee values for guarantees issued in other currencies will be calculated using the exchange rate for the last day of the calendar year as it appears in the Statement of Contingent Liabilities in the Annual Report of the Ministry of Finance.

L. Indicative Target on Foreign Exchange Treasury Guarantees

28. Foreign exchange treasury guarantees are defined as outstanding debt guarantees issued in foreign currency by the central government. A guarantee of a debt refers to any explicit legal obligation of the central government to service such a debt in the event of nonpayment by the recipient. Treasury guarantees exclude letters of comfort. Outstanding guarantees are defined as the drawn amounts of guaranteed debts. They differ from issued guarantees, which are defined as the total amount of guaranteed debts (including for debts that are not disbursed yet). Treasury guarantees include outstanding treasury guarantees published in the Statement of Contingent Liabilities contained in the Annual Report of the Ministry of Finance. Rupee values for the FC guarantees will be calculated using the exchange rate for the last day of the calendar year as it appears in the Statement of Contingent Liabilities in the Annual Report of the Ministry of Finance.

V. DATA REPORTING REQUIREMENTS

29. Sri Lanka shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Sri Lanka in achieving the objectives and policies set forth in the Memorandum of Economic and Financial Policies and Letters of Intent. All the program monitoring data will be provided by the Ministry of Finance and the CBSL. For the purpose of monitoring the fiscal performance and expenditure arrears under the program, data will be provided in the format as shown in Tables 3, 4, and 5. For the purpose of monitoring the NCG targets under the program, data will be provided in the format shown in Table 6. For the purpose of monitoring the external sector performance under the program, data will be provided in the format shown in Tables 7 and 8. For the purpose of monitoring the performance against the indicative target on social safety net spending, data will be provided in the format shown in Table 9 on a quarterly basis. For the purpose of monitoring the financial performance of three state-owned enterprises—CEB, CPC, and Sri Lankan Airlines—data will be provided in the format shown in Tables 10, 11, and 12, respectively, on a quarterly basis. In addition, BSTA weekly operation statements of the CEB will be provided no later than eight days after the end of each week. For the purpose of monitoring the performance against the indicative target on the cost of fuel NCO (net of government transfers), data will be provided in the format shown in Table 13 on a quarterly basis. For the purpose of monitoring the performance against the indicative target on treasury guarantees, data will be provided in the format shown in Table 14 on a quarterly basis. For the purposes of the assessment of Multiple Currency Practices, data and information on official exchange rate action and impact on rates will be provided, as requested by IMF staff.

30. Data relating to the fiscal targets (Table 3, Table 4, and Table 5) will be furnished within no more than five weeks after the end of each month, except for the data on salaries and wages, goods and services, subsidies and transfers (and its subcomponents) that will be furnished within no more than seven weeks after the end of each month (the data on total recurrent expenditure and interest payments will be furnished within no more than five weeks after the end of each month). Data relating to the monetary targets (Table 6) will be furnished within no more than four weeks after the end of each month. Data relating to the external targets (Table 7 and Table 8) will be furnished within no more than 25 days after the end of each month. Data relating to the indicative target on social safety net spending (Table 9) will be furnished within no more than two months after the end of each quarter. Data relating to the three state-owned enterprises (Tables 10-12) will be furnished within no more than 2 months after the end of each quarter. Data relating to the indicative target on the cost of fuel NCO (net of government transfers) (Table 13) will be furnished within no more than 5 weeks after the end of each quarter. Data relating to the indicative target on treasury guarantees (Table 14) will be furnished within no more than two months after the end of each quarter.

31. For the purpose of monitoring the financial sector, the authorities will provide a quarterly written update and the following information on a bank-by-bank basis:

- Liquidity monitoring template, with breakdown by currency (daily)
- LCR template, with breakdown by currency (monthly)
- Net open foreign currency positions (weekly)
- Exposures to the central government and large SOEs (CEB, CPC, SLA, RDA), with breakdown by entity, currency, and instrument (monthly)
- Maturities of exposures to the central government and large SOEs (CEB, CPC, SLA, RDA), (monthly)
- Arrears of state-owned banks (monthly)
- Impairment schedule including breakdown of impairments on public sector exposures (monthly)
- Monthly supervisory returns to CBSL including statements of financial position and comprehensive income (monthly)
- Top 10 largest depositors (quarterly)
- Large exposures exceeding 15 percent of capital (quarterly)
- Capital adequacy template (quarterly)
- Financial soundness indicators (quarterly)

- Daily financial sector data will be provided within one week of the end of the reporting period; weekly data within two weeks; monthly data within four weeks; quarterly data within six weeks.

Table 3. Sri Lanka: Central Government Operations

(In millions of rupees)

Total Revenue and Grants
Total Revenue
Tax Revenue
Income Taxes
Personal & corporate
Corporate & non-corporate
Personal
Corporate
Personal Income Tax (PAYE)
Economic Service Charge
Interest Income tax
Tax on goods & services
VAT
Domestic
Imports
Excise Taxes
Liquor
Cigarettes
Motor vehicles
Petroleum
Other
Other taxes & levies incl. SSCL
Social Security Contribution L
Domestic
Imports
Other Taxes and Levies
Tax on external trade
Import Duties
Cess Levy
Special Commodity Levy
Ports & Airporst Development Levy
Non Tax Revenue
Property Income
Fines, Fees and Charges
Other
Grants
Total Expenditure
Current Expenditure
Salaries & wages
Goods & services
Interest payments
Subsidies & transfers
Public Corporations
Public Institutions
Households
Capital Expenditure
Net Lending
Primary balance
Overall balance
Total Financing
Total Foreign Financing (Net)
Total Domestic Financing (Net)
Privatization

Table 4. Sri Lanka: Central Government Financing [1]

(In millions of rupees)

	(i) Borrowing/ Cash inflow	(ii) Repayment/ Cash outflow	(iii) Net
1. Domestic financing in local currency			
T-bills 1/			
T-bonds 1/			
Loans			
Deposits and overdrafts at banks			
CBSL advances and deposits			
Other (specify)			
2. Domestic financing in foreign currency			
Sri Lanka Development Bond (SLDB) 1/			
Loans			
Other (specify)			
3. Net foreign financing			
International Sovereign Bonds 2/			
Official project loans			
Official program loans			
Official trade credit			
Syndicated loans			
Other (specify)			
4. Change in Treasury Single Account 3/			
5. Privatization receipts			
Total financing (1+2+3+4+5)			

1/ including net purchases by non-residents
2/ including net purchases by residents
3/ A negative sign means an increase in the TSA and vice versa.

1/ The template has been modified to include the change in the Treasury Single Account as a financing item.

Table 5. Sri Lanka: Unpaid Bills and Arrears 1/

(In millions of rupees)

Recurrent
Capital
Total
o.w. more than 3 months:
Recurrent
Capital
Total

1/ as agreed for the purpose of monitoring the program

Table 6. Sri Lanka: CBSL's Balance Sheet 1/

(In millions of rupees)

Net foreign assets
Foreign assets
Foreign liabilities
o.w. Reserve liabilities
Net dometic assets
Net credit to government
Claims on government
Provisional advances
Treasury bills, o.w.,
Acquired through primary market purchases 1/
Acquired through standing lending facility operations
Acquired through ST OMOs
Acquired through LT OMOs
Acquired through outright OMOs
Acquired through emergency liquidity assistance
Treasury bonds, o.w.,
Acquired through standing lending facility operations
Acquired through ST OMOs
Acquired through LT OMOs
Acquired through outright OMOs
Government deposits 2/
Claims on commercial banks
Other items (net)
Reserve money
Currency in circulation
Commercial bank deposits
Memo: Net worth of the CBSL

1/ includes direct issuances of treasury securities by the government to the CBSL.

2/ Rupee-denominated deposits, excluding those converted from foreign program financing.

Table 7. Sri Lanka: Foreign Exchange Cashflows of the Central Bank and the Government 1/

(In millions of U.S. dollars)

1. Total inflows, without swaps
Loans (public sector)
Program loans (budget support)
Project loans and grants
SLDBs
FCBUs
Commerical loans
Syndicated loans
Sovereign bonds
Other inflows
Interest receipts, forex trading profits, capital gains
Change in balances in DST account
o/w proceeds from public assets
2. Total outflows, without swaps
Public sector debt service
Public sector amortization (excl. to IMF)
Official loans
multilateral creditors
India credit lines
other loans
SLDBs
FCBU loans
Syndicated loans
Settlement of ISBs
Public sector interest payment (incl. to IMF)
Interest to IMF
Interest to external creditors
Interest on domestic FX debt (SLDB, FCBU, etc)
3. Net FX purchases from market
Outright purchases of FX from commercial banks
Outright sales of FX to commercial banks
4. Swaps with domestic commercial banks
OMO FX swap transactions-inflows
OMO FX swap transactions-outflows
Net inflows (incl. swaps = 1-2+3+4) at current rates
Net inflows (excl. swaps = 1-2+3) at current rates
Net International Reserves (at market rates)
Net International Reserves (at program rates)
Gross International Reserves (at market rates)
Changes in Reserve Related Liabilities
Change in ACU liabilities
Change in liabilities to IMF
existing debt service (amortization)
new purchases
International swaps with foreign CBs
inflows
outflows
Valuation changes
Changes in CBSL other liabilities

1/ As agreed for the purpose of monitroing the program.

Table 8. Sri Lanka: Gross Official Reserve Position 1/

(In millions of U.S. dollars)

Date	Central Bank				Government				Gross Official Reserves				Liabilities					Net International Reserves	IMF-EFF liability of the Government	Outstanding domestic swaps liabilities	IMF-EFF Programme NIR at market exchange rate
	Reserves managed by IOD		Reserves Position at IMF & SDR holdings	Total	Crown Agent's Credit Balance	DST's Special Dollar Revolving Credit Balance	DST's Yen Accounts	Total	(without ACU & DA & with swap)	(with ACU & swap & without DA)	Outstanding assets of BOC London branch deposit, NZD assets and SEK assets*	(with ACU & swap & without DA & excluding outstanding assets of BOC London branch deposit, NZD assets and SEK assets)	Other Deposits	Asian Clearing Union	Drawings from the IMF	International currency swap	Total				
	Foreign Assets (FA) (with ACU & without DA)	Domestic Assets (DA) (BOC & PB)																			
				(1+2)				(4+5+6)	(8-10)	(3+7)		(9-8)						(10-11)			(12-13-14)
	1		2	3	4	5	6	7		8	9	10					11	12	13	14	15

1/ As agreed for the purpose of monitoring the program.

Table 9. Social Safety Net Spending (by Month) 1/

(In millions of rupees)

Budget Code		Total	Of which, externally financed
	Total Social Safety Net Spending = (1)+(2)		
	Cash transfers to empower the vulnerable and needy		
102-1-2-040-1501	(1) Aswesuma cash transfers		
102-1-2-040-1501 -033	Cash grant for low income families		
102-1-2-040-1501 -034	Financial support for low income disabled persons		
102-1-2-040-1501 -035	Financial support for elderly (over 70 years of age)		
102-1-2-040-1501 -036	Financial support for elderly (over 100 years of age)		
102-1-2-040-1501 -037	Financial support for kidney patients		
237-1-01-020-2202 and 331-2-02-003-2202	(2) Empowerment Program		

1/ In line with the reporting of the Ministry of Finance Annual Report

Table 10. Sri Lanka: Financial Outturn of Ceylon Electricity Board 1/
(In millions of rupees)

Total revenue
Sale of electricity
Other income
Total expenditure
Direct generation cost
Generation, transmission, and distribution O&M cost
Corporate expenses
Interest on borrowings and delayed payments
Depreciation
Other cost
Operating profit/loss
Liquidity position
Borrowings from banks
Payments to banks
Outstanding debt to banks
Purchases from CPC and IPP
Payments to CPC and IPP
Outstanding to CPC and IPP

1/ As agreed for the purpose of monitoring the program.

Table 11. Sri Lanka: Financial Outturn of Ceylon Petroleum Corporation 1/
(In millions of rupees)

Total revenue	
Octane 90	
Diesel	
Other products	
Other income	
Total expenditure	
Cost of sales	
Sales and distribution	
Administration	
Finance cost	
Depreciation	
Other cost	
Operating profit/loss	
Outstanding dues to state banks	

1/ As agreed for the purpose of monitoring the program.

Table 12. Sri Lanka: Financial Outturn of Sri Lankan Airlines 1/
(In millions of rupees)

Total revenue
Passenger
Cargo
Other income
Total expenditure
Aircraft fuel cost
Employee cost
Other operating expenses
Financial cost
Operating profit/loss
Capital contribution

1/ As agreed for the purpose of monitoring the program.

Table 13. Sri Lanka: Cost of Non-Commercial Obligations for Fuel 1/

(In millions of rupees, unless otherwise noted)

	a=e-b	b=c-d	c	d	e=f+g+h+i +j+k+l	f	g	h	i	j	k	l	m
	Cost of NCOs	**revenue (net of sales**	Sales revenue	Sales taxes	**(net of sales taxes)**	Cost of sales	Terminal charge	Transport charge	Personnel cost	Other expenses	Exchange rate variation	Finance cost	Sales quantity
Product	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Rs millions	Million liters
A.TRANSPORT													
Super petrol (92 octane)													
Unladed petrol (95 octane)													
Auto diesel													
Super diesel													
B.POWER GENERATION													
Auto diesel													
Fuel oil 800'													
Fuel oil 1500'													
Fuel oil 1500' low sulphur													
Fuel oil 200'													
Naphtha													
C.AVIATION													
Jet A-1 (Foreign)													
Jet A-1 (Sri Lankan Airline)													
Jet A-1 (Local)													
Avgas													
D.INDUSTRIES													
Ind Kero													
Fuel oil 800'													
S.B.P.													
Bitumen													
Lubricant													
E.DOMESTIC													
Kerosene													
LPG													
F.AGRO													
Agro chemicals													
Total (A-F)													
Memorandum item:													
Central government current transfers to CP	[x]												

1/ As agreed for the purpose of monitoring the program.

Table 14. Sri Lanka: Treasury Guarantees 1/
(In millions of rupees)

	Treasury Guarantees Issued	Treasury Guarantees Outstanding
Total Treasury Guarantees		
Ceylon Electricty Board		
Ceylon Petroleum Corporation		
National Water Supply and Drainage Board		
Road Development Authority		
SriLankan Airlines		
Other		

1/ As agreed for the purpose of monitoring the indicative target under the program.

INTERNATIONAL MONETARY FUND

SRI LANKA

February 24, 2025

THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, FINANCING ASSURANCES REVIEW, AND MONETARY POLICY CONSULTATION CLAUSE—SUPPLEMENTARY INFORMATION

Prepared By Asia and Pacific Department

This supplement provides an update on recent developments since the issuance of the report on February 12, 2025. The update does not alter the thrust of the staff appraisal.

1. All three prior actions (PAs) have now been met.

- The PA on eliminating all remaining import restrictions was met on January 31, 2025, as detailed in the staff report (¶23).
- The PA on submitting to parliament amendments to the Value Added Tax (VAT) Act and Inland Revenue Act and issuing relevant gazette notifications to introduce revenue measures to underpin revenue mobilization in 2025 was met on February 21, 2025.
- The PA on the presentation by the Minister of Finance to parliament of the 2025 annual budget document, the Appropriation Bill and the Budget Speech (second reading) in line with program parameters was met on February 17, 2025. The budget speech presented to parliament during the second reading included a proposal for a VAT exemption for imported packaging materials for local pharmaceuticals and ayurvedic medicines that was not taken into account in the determination of needed revenue measures. The authorities have indicated that the potential cost of this exemption is minimal and the budget would still be in line with program parameters. Nevertheless, they have committed not to proceed with the proposed exemption and did not include it in the draft VAT Act amendments.

2. The authorities have informed staff of a technical deviation from their MEFP commitment not to provide any tax exemptions or incentives. Since December 2023 the authorities have committed to not provide tax exemptions or incentives and no longer approve new projects under the Strategic Development

Projects (SDP) Act ahead of introducing transparent, rules-based eligibility criteria (IMF/23/408, p.99; IMF/24/161, p. 103). They also committed to consult with IMF staff in case they consider new tax proposals to attract investments. This commitment is a key plank of the program given the history of tax exemptions leading to sizeable tax revenue loss in Sri Lanka in the past. Meanwhile, the parliament approved in January 2025 a tax exemption to a private investor who had signed an agreement with the government in June 2022 to set up a project in a dedicated textile manufacturing zone that had previously been authorized to offer tax concessions. The zone is located in a poor part of the country and the eligibility of investments benefiting from tax relief are determined based on specific rules-based criteria. The authorities consider that the jobs created justify this exemption and that reversing their earlier commitment to the investor would hurt their reputation and their ability to attract more foreign investors in the future. The forgone tax revenue appears de minimis and the authorities have reaffirmed their intention to uphold their MEFP commitments and not approve any new projects under the SDP Act until a proper evaluation mechanism is established. SDP Act amendments are currently being considered, in consultation with Fund staff, with a view to introducing transparent, rules-based eligibility criteria, to increase the effectiveness of granted tax expenditures, and to limit the duration for which incentives can be granted (Structural Benchmark (SB) for end-August 2025).

3. The authorities are continuing to make progress on SBs, including those overdue or due in the near-term. The 2025 Government Action Plan on governance reforms (end-February 2025 SB) is on track. The draft shared with staff contains comprehensive reforms identified in the Governance Diagnostic Assessment. The strategic plan of the anti-corruption commission (CIABOC) (end-October 2024 SB) is on track to be published in March 2025 following the appointment of a new director general in January 2025. In line with the SB, the government has submitted CIABOC’s annual budget based on the new strategic plan, which would allocate almost double the previous year’s resources to CIABOC.

Statement by Krishnamurthy V. Subramanian, Executive Director for Sri Lanka and PKG Harischandra, Alternate Executive Director
February 28, 2025

Sri Lanka has reached the halfway mark of its 48-month Extended Fund Facility (EFF) arrangement. Since the onset of the economic and debt crisis in 2022, Sri Lanka has faced significant socio-economic disruptions and unprecedented political tensions. Despite these challenges, the program has continued successfully, thanks to the unwavering support from all stakeholders, including the Fund management and staff, other international financial institutions, creditor community, and the perseverance of Sri Lankan authorities and the people.

On behalf of the Sri Lankan authorities, we extend our gratitude to the Fund management and staff for their invaluable support during this critical period. We deeply appreciate the tireless efforts of the mission team, led by Mr. Peter Breuer, and their constructive engagement with authorities and stakeholders. The exceptional quality of work delivered by the staff amidst the complexities of Sri Lanka's program is commendable, and we broadly agree with the assessment in the Staff Report. Our authorities thank all creditor nations, represented by the Official Creditor Committee (OCC) co-chaired by France, India, and Japan, as well as China and other non-OCC creditor nations, for their unwavering support. The authorities also appreciate the collaboration of private creditors, which facilitated the successful conclusion of debt restructuring negotiations and the bond exchange in late 2024. Additionally, our authorities are grateful for the strong financing assurances provided by the World Bank and the Asian Development Bank (ADB), whose support has been crucial in meeting their financing requirements. This collective support from all stakeholders has enabled this Third Review under the 48-month EFF arrangement.

RESTORING ECONOMIC, SOCIAL AND POLITICAL STABILITY

The IMF-supported program has driven significant reforms, aiding Sri Lanka's recovery from a severe economic and debt crisis. Economic growth surpassed expectations in 2024, reaching an estimated 4.5%, compared to the 2% growth projected during the Second Review. The revival of the industrial sector and the remarkable rebound of the tourism sector fueled this faster recovery. Authorities project a growth of 5% this year, a phenomenal recovery compared to the real contraction of 7.3% in 2022. International reserves increased to US$6.1 billion by the end of January 2025, providing about four months of import coverage, compared to the virtually nonexistent usable reserves in mid-April 2022. Inflation remains low and turned negative in late 2024 due to temporary factors, with expectations to return to target by late 2025. Sri Lanka's disinflation episode was a notable achievement, dropping from 70% in September 2022 to 4% by August 2023 in less than a year. Fiscal adjustments and improved tax revenues are on track, with the recent government budget targeting total revenue of 15% of GDP in 2025, the highest in 15 years, up from an estimated 13.4% of GDP in 2024. The primary balance surplus is projected at 2.3% of GDP in 2025, an all-time high, and a notable improvement from 0.6% in 2023 and an estimated 2.2% of GDP in 2024. These sharp adjustments in fiscal indicators reflect the authorities' unwavering commitment to the program objectives. Sri Lanka's sovereign credit rating was upgraded from 'restricted default' in late 2024 as the debt restructuring process neared completion, with agreements finalized with major creditors.

Political stability has been restored, and the electoral cycle did not hinder the fulfillment of program commitments, despite concerns raised during the Second Review under the EFF. The current administration, in power since September 2024, remains dedicated to meeting these commitments. The authorities' pragmatic approach, evidenced by their adherence to the original program agreements and the ongoing debt restructuring process, has successfully restored market confidence and ensured macroeconomic stability. Reflecting this commitment, program implementation has been strong, meeting all end-December Quantitative Performance Criteria (QPCs) and standard Continuous Performance Criteria, except for the Monetary Policy Consultation Clause (MPCC) due to a lower-end breach, and the Indicative Target (IT) on social spending due to technical onboarding difficulties. By the end of January 2025, most Structural Benchmarks (SBs) were met, with a few implemented with delays, mainly due to the revised timeline for submitting the budget to Parliament following the change in administration. The governance and structural reforms to unlock growth potential are progressing.

ADVANCING REVENUE BASED FISCAL CONSOLIDATION AND FISCAL STRUCTURAL REFORMS

The steadfast commitment of authorities to fiscal consolidation has been demonstrated by enhancing resource mobilization, increasing the efficiency of government expenditure, and improving public financial management. Government revenue is estimated to improve significantly from 8.2% of GDP in 2022 to 15% of GDP in 2025. The primary balance showed a remarkable adjustment, shifting from a deficit of 3.7% of GDP in 2022 to an estimated surplus of 1.8% of GDP in 2024 (2.2% of GDP for program purposes, as the government's equity injections to banks for recapitalization are not recorded as central government expenditure). A higher primary surplus of 2.3% of GDP is projected from 2025 onwards. The overall fiscal deficit improved from 10.2% of GDP in 2022 to an estimated 6.8% of GDP in 2024 (6.1% for program purpose). These achievements reflect the authorities' commitment to fiscal consolidation and program objectives. Revenue measures aim to raise tax revenues to 13.9% of GDP in 2025 through increased withholding taxes on interest income, taxes on service exports, higher taxes on certain industries, and VAT on digital services. These measures will offset the revenue impact of the tax relief provided for personal income taxation, aimed at alleviating the burden on low and middle-income groups and addressing brain drain. Additionally, VAT exemptions on locally manufactured liquid milk and yoghurt will help vulnerable populations access affordable nutrition.

Authorities plan to implement several measures to improve tax administration and compliance, including a VAT compliance improvement program by May 2025 and the repeal of the simplified VAT system by September 2025. Enhancing tax compliance remains a priority, with risk profiling of the largest 100 High Wealth Individual (HWI) taxpayers already completed. Efforts are underway to modernize the Inland Revenue Department (IRD) with a medium-term strategy, including an IT Strategic Plan and a property database for more efficient property tax collection. Authorities are committed to fiscal discipline as guided by the Public Finance Management (PFM) Law enacted in June 2024. Primary spending (*i.e.,* non-interest government expenditure) will remain below 13% of GDP, projected at 12.8% of GDP in 2025. This will accommodate a wage bill adjustment, including a basic salary increase for the first time since 2016, to account for significant price level increases, and an interest rate subsidy for senior citizens. Many senior citizens rely on interest income from lifelong savings deposited in banks to cope with the elevated prices of essential goods and services.

Cost-reflective energy pricing will be maintained, despite a temporary breach caused by the recent revision of electricity tariffs by the independent regulatory commission. This demonstrates authorities' commitment to respecting independence of institutions, thereby strengthening institutional quality and upholding the rule of law. To mitigate fiscal risks from energy SOEs, authorities will restore cost-reflective energy pricing and use the Bulk Supply Transaction Account (BSTA) to trigger automatic tariff increases. Legislative reforms will enable cost-recovery-based adjustments for electricity and fuel prices. Authorities will strengthen the framework for SOE borrowing, limiting it to commercially viable activities and ensuring subsidies are covered by government transfers. The new PFM law will enhance transparency and accountability in borrowing, debt management, and treasury guarantees. Authorities will clarify SOE mandates, review board member selection, and ensure all major SOEs publish audited financial statements by June 2025. They are drafting an SOE law with the World Bank's assistance, ensuring alignment with the PFM Act. Governance and oversight of state-owned banks have been improved to ensure their lending to SOEs is based on commercial considerations. Authorities remain committed to fully implementing the new PFM law by the end of 2025, ensuring future Budget submissions include all required documentation. They will update and publish the fiscal strategy statement (FSS) with a Fiscal Risks Statement and a medium-term PFM Reform Strategy and Action Plan by June 2025.

STRENGTHENING SUPPORT FOR VULNERABLE AND SOCIAL SAFETY NET (SSN) REFORMS

A major priority of authorities remains assisting the vulnerable through SSN reforms. Despite technical challenges delaying social spending targets in 2024, authorities resolved structural issues by mobilizing village-level officers to support beneficiaries and expedite bank account openings. The second-round of applications under the SSN program (*Aswesuma*) is expected to complete by mid-2025. In 2025, authorities aim to maintain *Aswesuma* coverage above the poverty rate, extend application deadlines, and increase cash transfer amounts. To maintain SSN coverage amid high poverty rates, payments to various groups will be increased and extended through 2025. Payments for the poor, extremely poor, elderly, disabled, and chronic kidney patients are set to increase starting January and April 2025, raising the SSN spending floor by end-2025. Legislation was passed to extend benefit payments for transitional and vulnerable groups. The number of households under *Aswesuma* is expected to be 1.6 million by end-2025. The empowerment program, financed by the World Bank and ADB, provides livelihood support to help beneficiaries graduate from the *Aswesuma* program.

RESTORING PUBLIC DEBT SUSTAINABILITY AND DEBT MANAGEMENT REFORMS

Efforts to restore debt sustainability have progressed significantly with the support of bilateral and private creditors, anchored by the targets under the Debt Sustainability Analysis (DSA) of the EFF program. Authorities have completed all components of Domestic Debt Optimization and reached agreements with major creditors, including the OCC and China EXIM

Bank. The bond exchange with private creditors in December 2024 achieved 98% participation, aligning with the Agreements in Principle (AIPs) and assessed as consistent with the DSA and comparability of treatment (COT). Debt treatment with China Development Bank (CDB) was also completed in line with program parameters and COT. Authorities are finalizing agreements with OCC creditors and negotiating with remaining creditors, maintaining a commitment to transparent communication. They established a Public Debt Management Office (PDMO) under the PDM Act to enhance debt management, set to be fully operational by December 2025. The PDMO will centralize debt management functions and operate with significant autonomy, with guidelines and regulations to be issued by March 2025. Additionally, a medium-term debt strategy (MTDS) and an annual borrowing plan (ABP) will be developed and published alongside the 2026 Budget. To improve debt transparency, the Ministry of Finance (MOF) has been publishing a quarterly report on public debt and debt service since February 2023, with the scope gradually broadening to encompass all liabilities and contingent liabilities of both the budgetary central government and extra-budgetary units.

RESTORING PRICE STABILITY AND EXTERNAL STABILITY

Authorities effectively managed the high inflation episode of 2022/23 through proactive, data-driven monetary policy and the elimination of monetary financing. Inflation declined faster than expected, turning negative in September 2024 due to temporary factors, such as reductions in electricity tariffs, fuel prices, transport costs, and declining food prices. This decline alleviated the burden on businesses and households, which had faced a significant cumulative rise in prices from the crisis. The effects of these deflationary factors are expected to dissipate in early 2025, with inflation projected to rise as demand strengthens. The Central Bank of Sri Lanka (CBSL) maintained an accommodative monetary policy stance throughout 2024, supporting economic activity amidst subdued inflation. The CBSL will monitor inflationary pressures from wage increases, demand recovery, relaxation of import restrictions, and exchange-rate passthrough to achieve price stability. The CBSL is prepared to take measures if inflation deviates from the target, with inflation projected to return to 5% in late 2025. The CBSL is committed to a 5% inflation target, monitored through the Monetary Policy Consultation Clause (MPCC), with consultations held with IMF staff ahead of each Monetary Policy Board meeting. In November 2024, the CBSL introduced a single policy interest rate to improve the transmission and effectiveness of monetary policy.

The new Central Bank Act (CBA), enacted in 2023, has strengthened the CBSL's independence and its policy framework for credible inflation targeting. Authorities will continue to avoid monetary financing, ensuring budget deficits are sustainably financed through fiscal adjustments, debt relief, and new external financing. This approach prevents reliance on direct credit to the government, which previously jeopardized price stability. The CBSL will regularly assess its balance sheet to maintain adequate capital levels for effective monetary policy. Following best practices consistent with International Financial Reporting Standards (IFRS), the impact of Domestic Debt Optimization has been recorded on its balance sheet. The CBSL's equity has returned to positive levels and is expected to strengthen further.

STRENGTHENING FINANCIAL SECTOR RESILIENCE

Significant efforts have been made to create a more resilient and well-governed financial sector, supporting overall economic growth by carefully managing the potential risks related to domestic debt restructuring. These efforts focused on restoring banks' capital and liquidity and enhancing regulatory standards. In 2024, banking sector capital funds grew by 15.7% while the regulatory capital (capital base) grew by 6.9%, enhancing their ability to absorb potential losses, while total banking sector assets grew by 8.7%, driven by increased investments and loans. Gross loans and receivables grew by 4.1%, supported by an easing monetary policy. Liquidity conditions also improved by the end of 2024. The CBSL will continue monitoring banks' capital and may impose additional requirements if needed. Efforts are underway to resolve non-performing loans (NPLs) and improve banks' ability to recover value from NPLs by ending the suspension of *Parate* executions (an out-of-court procedure allowing banks to auction collateral on defaulted loans). The CBSL is also enhancing financial sector supervision and crisis management with support from the ADB and World Bank and plans to submit the amended Finance Business Act by September 2025. State-owned banks (SOBs) are being strengthened to meet the same regulatory standards as private banks. A framework was adopted in May 2024 for SOBs to have a majority of independent directors and transparent nomination processes. The CBSL issued directions to ensure SOBs operate independently from the government and adhere to prudential limits and issued corporate governance directions in September 2024 to enhance board responsibilities and oversight.

GOVERNANCE AND ANTI-CORRUPTION REFORMS

Authorities remain committed to anti-corruption and governance reforms, updating and publishing an annual action plan. Key areas include strengthening the AML/CFT regime, publishing asset declarations, enacting a comprehensive Asset Recovery Law, aligning the Companies Act with the Financial Action Task Force (FATF) standards, and implementing anti-corruption measures in tax policy. Public financial management reforms focus on enacting a Public Procurement law, increasing competitive procurement, and ensuring timely publication of SOE financial statements. The new Anti-Corruption Act enhances powers of the Commission to Investigate Allegations of Bribery or Corruption (CIABOC), with plans for a strategic plan and budget by mid-March 2025, and an Asset Recovery Law by end-April 2025. No new tax exemptions or incentives are being provided, and amendments to the Strategic Development Projects (SDP) and Port City Acts will introduce transparent criteria for tax incentives. Authorities remain committed to a consultative process with staff on these matters. Efforts to reduce corruption in revenue administration include digitizing processes and establishing a Tax Crimes Investigation unit by end-February 2025. Public Financial Management reforms include a Public Procurement law by end-June 2025 and improving SOE governance. Financial sector oversight has been enhanced with amendments to the Banking Act. The authorities are also strengthening the regulatory framework for managing public assets and enhancing the AML/CFT regime, while measures are underway to improve the Risk-based AML/CFT supervision of financial institutions.

ENHANCING THE GROWTH POTENTIAL

The medium-term growth agenda, as outlined in the recent Budget, aims to enhance macroeconomic resilience, restore debt sustainability, and promote inclusive growth. Key strategies include enhancing the social safety net, diversifying the economy, promoting exports, improving the investment climate, modernizing agriculture, adopting green economy policies, fostering innovation and digitalization, supporting entrepreneurship and startups, and encouraging Public-Private Partnerships (PPPs). The authorities' efforts to enhance digital public infrastructure aim to boost productivity in economic activities. Strengthening anti-corruption measures remains a major priority, thereby improving governance and promoting transparency. Additional reforms are expected to unlock Sri Lanka's growth potential through trade liberalization, labor market reforms, SOE governance, and climate resilience. The Rescue, Rehabilitation, and Insolvency Bill will *inter-alia* support efficient capital allocation by banks, through improved credit risk management. The authorities are committed to rationalizing para- tariffs, implementing a National Export Strategy, and expediting Free Trade Agreements. They also plan to address climate-related vulnerabilities by enhancing renewable energy generation with solar and wind capacity, supported by private and multilateral financing, and engaging with multilateral partners to build technical capacity for climate mitigation and adaptation.

CONCLUSION

The Sri Lankan authorities remain steadfast in their commitment to achieving long-term macroeconomic stability and sustainable public debt levels, aiming to avoid repeated Fund assistance. They view the 2022 economic and debt crisis as an opportunity to implement long-awaited reforms. Authorities express gratitude to the creditor community and appreciate the support from the Fund and other partners. They monitor the progress of deliverables under the EFF on a weekly basis, alongside staff, allowing for timely corrective measures and contingency planning when needed. In light of their unwavering dedication to achieving satisfactory program performance, the authorities appreciate the support of Executive Directors for the completion of the Third Review under the EFF arrangement.