The Central Bank of Sri Lanka Releases its inaugural Annual Economic Review and Financial Statements and Operations of the Central Bank for the Year 2023

April 25, 2024

Dr. P Nandalal Weerasinghe, the Governor of the Central Bank of Sri Lanka, presenting the Annual Economic Review 2023 and Financial Statements and Operations of the Central Bank 2023 to the President and Minister of Finance, Economic Stabilization and National Policies Ranil Wickremesinghe in the presence of K M M Siriwardana, Secretary to the Treasury, T M J Y P Fernando, Senior Deputy Governor, K M A N Daulagala, Deputy Governor, Dr. C Amarasekara, Assistant Governor, Dr. S Jegajeevan, Director of Economic Research, W L S W Jayasundera, Director of Policy Review and Monitoring, and Dr. L R C Pathberiya, Additional Director of Economic Research of the Central Bank were also present.

The inaugural publication under Section 80 of the Central Bank of Sri Lanka Act, No. 16 of 2023 (CBA), namely, the Annual Economic Review 2023, and the inaugural publication under Section 99 of the CBA, namely, Financial Statements and Operations of the Central Bank 2023, were presented to Ranil Wickremesinghe, the President and Minister of Finance, Economic Stabilization and National Policies, by Dr. P Nandalal Weerasinghe, the Governor of the Central Bank of Sri Lanka.

The Annual Economic Review (AER) consists of three chapters: Chapter 1 presents an analysis of the macroeconomic developments and conditions of the financial system of the economy; Chapter 2 provides a review of Central Bank policies, covering the monetary policy framework, monetary policy stance and measures, external sector policies, and financial sector policy measures; and Chapter 3 provides a macroeconomic outlook, covering the global economic environment and the domestic economy. Furthermore, the AER contains seven box articles on topical themes and a box article on major economic policy measures implemented by or related to the Central Bank.

The report also contains Statistical Appendix tables with selected annual data for the last 5 to 10 years and Special Statistical Appendix tables with selected annual data from 1970. In addition to the printed version, an online version of the Statistical Appendix (142 tables) and the Special Statistical Appendix (11 tables) is published simultaneously in Microsoft Excel spreadsheet format in all three languages with additional historical data (QR codes and links to access the tables are given in the printed version of the AER).

The Financial Statements and Operations of the Central Bank consists of five sections: Section 1 presents financial statements of the Central Bank including a brief financial review, the report of the Auditor General, statement of financial position, statements of income and cash flows; Section 2 provides details of the operations of Central Bank during 2023, covering the topics of maintaining domestic price stability, ensuring financial system stability, promoting a progressive and inclusive financial system, managing currency operations, international engagements, agency functions, and other entrusted responsibilities of the Central Bank; Section 3 explains the arrangement of internal management functions of the Central Bank including risk management, compliance, internal audit, human capital and general administration; Section 4 provides information on Board members,

Board sub-committees, principal officers, and other committees of the Central Bank; and Section 5 presents information on publications and data dissemination, regional offices, institutions regulated and supervised by the Central Bank and corporate information.

A summary of the performance of the Sri Lankan economy in 2023, as reflected in the Annual Economic Review, is given below:

The Sri Lankan economy witnessed a gradual revival in 2023 from the deepest economic downturn in its post-independence history. Decisive policy adjustments and structural reforms the Government and the Central Bank implemented helped restore macroeconomic stability greatly despite the short-run hardships faced by economic stakeholders. These measures were essential to prevent further deepening of the crisis and to navigate the economy along a sustainable path of recovery. With risks abound, the unwavering commitment of policymakers along with wider public acceptance remains imperative to continue with the economic reform agenda and efforts to regain debt sustainability.

The economic adjustment program has already yielded promising outcomes in 2023. Inflation was contained at single-digit levels by the end of 2023 from its highest level recorded in 2022, enabling the commencement of monetary policy normalization. The economy expanded in the second half of 2023, ending six consecutive quarters' longest streak of economic contraction. The persistent twin deficit of the overall government budget and the external current account, the root cause of the economic downturn, showed signs of correction in 2023. While a surplus was recorded in the primary balance of the Government, the external current account also recorded a surplus in 2023. External buffers, which were almost exhausted during the crisis, were gradually rebuilt during the year. Improved foreign exchange inflows received from tourism and other services exports, as well as workers' remittances, amidst subdued import demand, supported the country in alleviating the severe foreign exchange crunch that prevailed during the crisis.

The Central Bank's net purchases from foreign exchange inflows and receipts from the multilateral partners helped augment the country's international reserves. In light of these developments and enhanced confidence in the market, the Sri Lanka

rupee strengthened in 2023 and early 2024. Concerted efforts to restructure the Government's external debt portfolio would provide the required space for the country to make a sustainable recovery once the process is completed. Meanwhile, domestic market interest rates declined substantially with the easing of monetary policy and reduction of risk premia attached to yields on government securities following the successful finalization of the Domestic Debt Optimization (DDO) operation. This downward adjustment in the market interest rate structure and improved market sentiments reversed the contractionary spell of credit extended to the private sector since June 2023. Meanwhile, the financial sector demonstrated its resilience stemming from the proactive and prudent policies of the Central Bank and the greater crisis preparedness of the financial institutions.

Moving towards international best standards and capitalizing on lessons learned, the Central Bank's mandate was redefined with the enactment of the Central Bank of Sri Lanka Act, No. 16 of 2023 (CBA) in September 2023, marking a significant milestone in enhancing the Central Bank's independence and accountability towards the Parliament and the public.

The Central Bank implemented an array of policies in 2023, initially to bring stability to the economy and then to buttress the economic recovery. This encompassed the shift from a tight monetary policy stance to an accommodative stance since June 2023, allowing greater flexibility in exchange rate determination and progressive removal of administrative restrictions imposed on certain foreign exchange transactions. The Central Bank guided the financial sector with prudential regulatory measures, preserving domestic financial system stability. With the enactment of CBA, in addition to its strengthened role as the supervisory and resolution authority of financial institutions, the Central Bank's role in macroprudential policy formulation was solidified, while its contribution to improving financial inclusion was recognised.

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Meanwhile, several policy measures were introduced to strengthen the safety and

soundness of the banking and nonbank financial sectors. At the same time, the Central Bank continued its efforts to develop digital payment systems in the economy, which would help enhance the efficiency and accessibility of payment methods for the public.

The economic progression witnessed in the latter half of 2023 is expected to continue in the years ahead, supported by the continuation of the reform agenda under the International Monetary Fund's Extended Fund Facility (IMF-EFF) arrangement. While a broad-based economic expansion is envisaged across all sectors, domestic price stability is expected to be preserved with greater independence and accountability of the Central Bank in monetary policymaking and the prohibition of monetary financing of the government budget deficit. The external sector is anticipated to retain its stability, supported by augmenting external buffers, normalization of foreign inflows, and completion of the restructuring of the foreign debt portfolio of the Government.

Reinforced by the legislative amendments and more significant consolidation, the financial sector is expected to remain resilient.

While continuing the implementation of much-needed institutional and policy reforms aimed at enhancing productivity and efficiency, the Government is expected to strive with its fiscal consolidation efforts to ensure the economy's transition towards a sustainable path. However, the formidable recovery of the Sri Lankan economy hinges on the continuity of the reforms implemented thus far. As part of this process, the successful continuation of the IMF-EFF arrangement and completion of the debt restructuring process remains paramount. Since the country has not fully exited the crisis, no space is available for any slippages from the committed path. Recent experiences proved the devastating socioeconomic costs of uncharted policy experiments. Moreover, backtracking from the implemented and planned critical reforms will tip the economy to instability. Thus, continuing with the broader political and social consensus on economic reforms will be essential to avoid recurring policy reversals and resultant economic downturns and to ensure the welfare of the general public is uplifting through sustained growth.