DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

("Sri Lanka" or the "Republic")

Q&As FOLLOWING THE AUTHORITIES' INVESTOR PRESENTATION

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The Investor Presentation gathered 637 registered attendees and enabled the Sri Lankan Authorities (the "Authorities" or "we") to provide an update on the ongoing process and the next steps related to the engagement with the IMF and the Republic's creditors. Following the presentation by the Governor of the Central Bank of Sri Lanka ("CBSL") and the Secretary to the Treasury and Ministry of Finance, attendees were invited to raise questions.

In line with the commitment for transparency undertaken by the Authorities, this Q&A documents intends to provide responses to all relevant questions raised by participants during the virtual Investor Presentation held by the Authorities on Friday 23 September 2022, including those which could not be addressed live by the Authorities and their advisors.

Questions raised during the interactive session have been organized and summarized by topics so as to facilitate the provision of answers.

The presentation itself can be found here.

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CONTENTS

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Answers provided by topic

1. IMF Program and timeline
a. IMF Program
Fiscal
The fiscal targets included in the macro-framework underpinning the IMF Staff Level Agreement ("SLA") are reflective of a set of policies that will aim at restoring public finance sustainability. The foreseen fiscal adjustment should allow the country to bring the primary surplus at 2.3% by 2025 from a primary deficit of 5.7% in 2021, which corresponds to an 8pp fiscal consolidation effort in 4 years. To achieve such fiscal adjustment path, the Authorities will implement an ambitious and progressive tax reform package and several revenue administration measures that should strengthen tax compliance, tax base, and reinforce the progressivity of the tax system. On the expenditure side, the Government will seek to contain recurrent expenditure and to boost public investment efficiency. With regard to its SOEs, the Government will reform their governance, enhance their financial viability and will introduce automatic fuel and electricity pricing mechanisms to mitigate fiscal risks arising from energy SOEs. The Authorities are committed to implementing all these reforms in a sequenced manner and to ensuring that the poor and vulnerable are protected from the economic crisis and policy adjustments through enhanced Social Safety Nets.
Growth
Sri Lanka's growth trajectory should benefit from a base effect, from the country's restored macroeconomic stability and from the country's ambitious growth enhancing reform agenda, as foreseen by the IMF-supported program. The structural reforms agenda should boost the country's potential notably through greater foreign investments, improved productivity growth, and a greater female labour force participation.

The economic growth is expected to gather pace from 2024 onwards with the commissioning of long overdue structural and policy reforms along with the IMF program leading to a conducive environment for the economy to grow in the medium term. The success of the agreement with IMF is expected to stimulate other foreign exchange inflows to the country, particularly financing from various parties including the World Bank and ADB. The envisaged debt restructuring is also expected to ease the burden on the external sector and restore the sustainability of public debt in the medium term. Proactive monetary policy measures that are implemented by the Central Bank are aimed at stabilising the inflation and inflation-expectations while facilitating greater macroeconomic stability, thus enabling an investor conducive environment over the medium term. Furthermore, the tourism sector is set to be one of the key drivers of economic growth in the years to come with the gradual normalization of economic conditions. Promoting the domestic industry sector to reach untapped potentials in the export markets will also be an additional focus of measures to come. While these measures would be instrumental in attracting more foreign income flows, a market-based exchange rate system is expected to have a positive impact on foreign exchange inflows, particularly in relation to supporting exports while rationalizing imports, thereby supporting agricultural and industrial production as well as support services. Colombo Port City is also expected to be a catalyst in attracting foreign direct investments over the medium term, while emerging as a destination for portfolio investments in the region.

With regard to exports to the European region, Sri Lanka benefits from the EU Generalised Scheme of Preferences Plus (GSP+) scheme and the UK GSP scheme. The exports to the European region including the UK amounted to 30% of export flows in the last three consecutive years. Most of these exports were garments. Sri Lanka is set to benefit from the UK – Developing Countries Trading Scheme from January 2023 and the entire EU GSP + scheme is set for review in 2023. Most of Sri Lanka’s exports benefit from these schemes, especially agricultural exports with high domestic value addition. Industrial exports as well as agricultural exports performed well in 2021 amidst lockdowns, global logistics issues, and other difficulties. Both industrial exports and agricultural exports have performed well thus far in 2022, particularly garment exports. The depreciation of the exchange rate and targeted support from the Government have so far provided good results for the export sector. According to information gathered from the garment sector, continued growth in 2023 and 2024 is expected. The industry representatives foresee a change in demand patterns mainly from Europe, shifting more to generic product types, but not a complete reduction in demand. The Government, under the new political leadership is making renewed efforts to increase export-oriented production in the country, including services exports with a view to restore the pace of economic growth in the medium term.

Reform program

As part of its IMF-supported program, Sri Lanka is committed to an ambitious reform agenda that it intends to implement in full, as it should enable the country to restore macroeconomic stability and public finance sustainability, and to rebuild its growth engine.

The Authorities will also implement a series of institutional reforms included in the IMF program. These reforms notably include governance and anti-corruption reforms, that will align the country's legislation with international standards and reinforce its anti-corruption institutional capacity.

In addition, the Authorities are committed to adopting a new Central Bank Act that will further strengthen the autonomy of the CBSL and to refrain from any monetary financing.

On primary deficit targets:

As per the original Budget submitted to the Parliament on 12 November 2021, the primary deficit for 2022 was 2.8% of GDP.

However, there was no target indicated for the year 2023 in the Budget.

As per the Interim Budget presented on 30 August 2022, the primary deficit target for 2023 has not been published.

The following table details primary deficit targets for 2022 and 2023.

Estimate	**Primary Deficit as a % of GDP**
Original Estimate 2022	2.8
Revised Estimate 2022	4.0
Target for 2023	0.7

b. Prior actions, expected timeline, financing assurances
Since the IMF Staff Level Agreement ("SLA"), the Authorities have intensified their efforts to complete the prior actions agreed with IMF staff and to obtain bilateral creditors' financing assurances, to ensure that Sri Lanka's IMF program can be formally adopted by the IMF Board in the targeted timeframe (i.e., before mid-December 2022). Regarding prior actions, the Authorities are working hand in hand with IMF staff to ensure that all prior actions are satisfied as soon as possible. Sri Lanka is currently on track to complete all prior actions before yearend. Prior actions include (i) parliament approval of a revised 2022 budget that is in line with the program (completed), (ii) revenue measures to support fiscal consolidation and annual budget for 2023 in line with the program, (iii) the introduction of formula-based price adjustments for fuel and electricity, (iv) the introduction of a new Central Bank Act and amendments to the Banking Act to enhance Central Bank powers, and (v) measures to support prices and financial sector stability. Sri Lanka has engaged with all its official bilateral creditors (see next section) as well as International Financing Institutions (IFIs) with a view to obtain financing assurances. In practice, financing assurances from official bilateral creditors are obtained once each bilateral creditor (or all official bilateral creditors collectively) officially confirms its (or their) commitment to grant Sri Lanka a debt treatment compatible with the macroeconomic and debt sustainability frameworks underpinning the IMF program. It is critical that these assurances be obtained as soon as possible so that Sri Lanka can start benefiting from the multilateral support and external foreign assistance it urgently needs. As detailed on slide 20 of the Investor Presentation, with regards to private creditors, the financing assurances necessary for the IMF Board approval are considered as obtained once IMF staff has assessed that Sri Lanka is making a "good faith" effort to reach a collaborative agreement with its private creditors, defined as: (i) engaging in early dialogue, (ii) sharing relevant information on a timely basis, and (iii) giving creditors the early opportunity to provide input in the framework underpinning the debt restructuring. Finally, the financing assurances from IFIs materialise in the form of commitments for new financings intended to contribute to the closing of the financing gap of the program.

2. General update on creditor engagement
The Authorities have engaged with all their bilateral creditors, including China, Japan and India (which are the country's largest creditors), to provide an update on the ongoing process and to underline the benefits of creating an ad hoc coordination platform or forum that would gather all bilateral creditors, placing both members and non-members of the Paris Club on an equal footing. Sri Lanka believes that such a platform / forum would enable progress to be made expeditiously towards obtaining financing assurances from all bilateral creditors while ensuring greater transparency, enabling all official bilateral creditors to receive the same information in a timely manner and on a coordinated basis. Notwithstanding the aforementioned suggested platform, bilateral creditors, including Chinese, Japanese and Indian Authorities have demonstrated their willingness to help the country in its efforts to find a way out of the crisis.

3. Debt Sustainability Analysis

General considerations:

As customary in this kind of situation, the IMF is considering both liquidity and solvency indicators to assess Sri Lanka's debt situation. In this instance, the nature of these indicators / debt sustainability targets is standard for Market Access Countries: these targets will be dealing with our overall debt-to-GDP trajectory and levels, our yearly Gross Financing Needs, and FX-denominated debt service expressed as a percentage of GDP. The indicative targets assigned to Sri Lanka were determined by the IMF staff team in accordance with the new Sovereign Risk and Debt Sustainability Framework for Market Access Countries. They are country specific and set to ensure that debt sustainability is restored with appropriate space to absorb shocks. These targets cannot be publicly disclosed at this stage but will become public once approved by the IMF Board.

As underlined in the Investor Presentation, Sri Lanka's debt situation has been deemed unsustainable by the IMF and will need to be addressed by a comprehensive debt treatment. It is however premature to prejudge debt treatment parameters necessary to achieve these targets.

On the Central Bank of Sri Lanka's swap arrangements:

As of end June 2022, the total swap lines held by the CBSL amounted to USD 2.1 billion. Out of these USD 2.0 billion, People's Bank Of China and Bangladesh Bank's swap lines accounted respectively for USD 1.5 billion and USD 0.2 billion. Reserve Bank of India's swap line represented the remaining share (USD 0.4bn).

On the return to international bond markets:

Sri Lanka's medium-term framework assumes a progressive return on the international bond markets, beyond the IMF program period.

4. Debt restructuring process

a. Contemplated perimeter

The perimeter that will be considered for debt treatment will depend on the nature of the vulnerabilities identified in the IMF DSA, which we have also been performing on our own with the assistance of our debt advisors. It also depends on the nature and level of the debt sustainability targets that the IMF is asking Sri Lanka to reach in the context of the program supported by the EFF.

Debt sustainability targets discussed in section 3 herein mean that in the case of Sri Lanka the perimeter of the IMF DSA includes all public and publicly guaranteed ("PPG") debt, i.e., external debt (including USD denominated instruments issued under local law), domestic debt (the service of which represents a significant share of our Gross Financing Needs) and SOEs' debt.

For this reason, we shall not a priori exclude any particular category of debt from our debt treatment strategy, except as would be seen customary in such exercise. However, each category of debt should be looked at from different angles, bearing in mind the potential impact a specific treatment may have on our overall macroeconomic and fiscal framework, and without jeopardizing the capacity of the economy to rebound from the current social and economic crisis. Indeed, a deterioration of the overall framework would further deteriorate the debt dynamics, thus requiring a deeper relief to restore long term debt sustainability.

We are still assessing precisely, with the assistance of our debt advisors and the IMF team, the impact certain reforms of the domestic financial sector may have on our fiscal accounts and growth estimates. Yet, we want to reassure our external partners that this topic is being looked at with an open mind, and by reference to the principle of fair and equitable treatment of all creditors. This does not mean however that strict comparability of treatment will necessarily apply between external and domestic creditors (even more so given that certain domestic creditors are to be ringfenced for financial stability or social reasons).

Regarding SOEs, there are also different dimensions to consider, in particular for SOEs that could return to profitability and servicing their debt going forward without capital injections from the Government. Again, this issue is being analysed on a case-by-case basis. For those SOEs that are able to come up with a credible restructuring plan from an operational and financial point of view, debt treatments may differ and creditors may be asked to contribute differently from other external creditors.

Other criteria to be considered include for instance how much an SOE contributes to the economic and/or social stability of the country (in the energy/utility sectors in particular) and how much it contributes to generating FX inflows (for transport/tourism related companies for example). In this area as well, it is premature to discuss details, but we commit to transparency and fairness towards our external creditors.

As for General Government external debt, standard rules of engagement and debt restructuring principles will be pursued, which include (i) the exclusion of debt towards preferred creditors (in line with international convention) from the perimeter of the debt treatment, (ii) comparability of treatment between our official bilateral or plurilateral creditors and external commercial creditors, and (iii) the establishment, in coordination with our creditors, of a cut-off date after which date all debts contracted or disbursed will be safeguarded. Moreover, the Authorities are proposing to exclude from the perimeter of debt treatment all emergency assistance credit lines provided since the beginning of the year as well as all swap lines.

b. Contemplated debt treatment

It is too early in the process to determine precisely what kind of debt treatment will be required and justified to restore public debt sustainability within the program parameters. There are mainly three reasons for that:

1. We have not yet precisely determined the perimeter that will be subject to debt treatment (refer to section 3.a for more details).

2. Debt treatment parameters should be the result of an interactive process involving Sri Lanka and the community of creditors, in communication with the IMF. It is not up to Sri Lanka on its own to determine what parameters should be applied. The creditor engagement strategy that is currently pursued by Sri Lanka with the assistance of debt advisors aims at factoring in creditors' concerns, constraints, and preferences to be able to arrive at a mutually acceptable solution.

3. The issue of inter-creditor equity is also key, and this is why discussions around debt treatment parameters have to be considered comprehensively rather that with a piece-meal approach. Inter-creditor dialogue is also key in that regard.

The overall quantum of debt relief to be sought by Sri Lanka is the result of the IMF debt sustainability assessment, including the debt sustainability targets that are contemplated as part of the program. Sri Lanka will comment publicly on the expected debt relief as and when appropriate.

What can be said at this stage, is that debt treatments will likely include a combination of debt service relief (through maturity extension and/or coupon reduction) – condition sine qua non for the program to be financed and therefore approved – and debt reduction relief in order for Sri Lanka to return to a sustainable indebtedness in the medium term. Depending on the nature, constraints and preferences of participating creditors, they may be asked to contribute with one, the other, or a combination of both types of debt relief. The careful design and implementation of the Comparability of treatment principle will allow to ensure fair and equitable burden sharing between all participating creditors.

c. Contemplated process, principles and timeline

Sri Lanka is not classified as a Low-Income Country and is therefore not eligible for the Common Framework. The principles of comparability of treatment, inter-creditor equity, and more broadly transparency and fairness have nevertheless become standard principles and best practices in sovereign debt restructurings. The Authorities have committed to abide by these principles.

Likewise, to our knowledge and understanding, these principles are commonly agreed by all our creditors, be they official or commercial.

Although clear as a concept, inter-creditor equity is not straightforward to implement. As already mentioned in this document, creditors' contributions to restoring our public debt sustainability can come in several forms, including maturity extension, interest rate reduction, or nominal debt reduction. Comparing the various contributions requires a consensus on which criteria and metrics should be used. Historically, Paris Club creditors had determined a set of criteria, which included the net present value of post treatment debt, its average maturity, as well as how the debt treatment contributes to filling the financing gap during the program period. In the case of Sri Lanka, which criteria should be used to ensure inter-creditor equity and how they should be applied is not a straightforward topic. Moreover, this is not a Sri Lankan decision to make. This should be discussed with our creditors and among creditors themselves. Hence the importance of having an efficient coordination forum among official bilateral creditors and a channel of communication between commercial and official creditors.

In terms of sequencing, timing and sharing of information, our strategy is clear. Our priority now is to secure the approval of our program by the Board of the IMF. This notably requires financing assurances from our official bilateral creditors. This is why we are currently focusing our efforts on engaging with our official bilateral creditors. We are notably promoting communications amongst our official bilateral creditors gathered in an ad hoc forum to enable us and the IMF to share all necessary information, hopefully allowing for an expedite delivery of financing assurances.

In parallel, and in order to lay the ground for efficient negotiations at the appropriate time, we have started to share information on our program parameters and debt sustainability assessment both publicly, through this webinar, and in more details with the advisors to bondholders on a confidential basis under Non-Disclosure Agreements (NDA).

Once the IMF Board approves the program, all information will become publicly available with the publication the Staff Report shortly after the Board. We are working to secure board approval by the end of the year. At that point only will we start actual negotiations with our creditors on debt treatment parameters consistent with the program parameters and the IMF Sovereign Risk and Debt Sustainability Framework. Such discussions should span over the first half of 2023.

5. Interim Debt Policy and short-term financing

a. Interim Debt Policy

As described in the Interim Policy, the Authorities have suspended normal debt servicing of all Affected Debts (as defined in the Interim Policy, whose perimeter covers most of the debts denominated in foreign currency) on account of an extremely severe reduction in available FX reserves and PPG debt becoming unsustainable as a result of various events, including some past policy mistakes, the effect of the COVID-19 pandemic, the fallout of the current energy and food crisis.

In the Interim Debt Policy, the Ministry of Finance of Sri Lanka advised any holders of the Affected Debts (including ISBs), who wished to receive the Sri Lankan Rupee (LKR) equivalent of any payments on such debts, to contact the Ministry of Finance to express such willingness. The Interim Debt Policy goes on to state that the Ministry of Finance shall attempt to accommodate such requests but would only be able to do so to the extent this is consistent with CBSL's monetary policy and feasible under the relevant credit documentation. The Authorities ultimately took the view that it was too difficult to pursue this option due to the limitations in the relevant documentation of some debts (notably the ISBs) and the current economic conditions in Sri Lanka. As a result, Sri Lanka is currently not making any payments on the Affected Debts in Sri Lankan Rupees. The Authorities took note, however, of all requests received, and will advise investors if the situation in relation to payments on the ISBs or other Affected Debts in Sri Lankan Rupees changes.

Certain amounts on SLDBs (USD equiv. 96 million of principal and interest) were settled in LKR shortly after the implementation of the Interim Debt Policy, as these limited amounts were still consistent with CBSL's monetary objectives at that time. Investors will note in slide 8 of the Investor Presentation that the majority of SLDBs debt service from mid-April to End-June has either been refinanced or suspended. The same applies to SLDBs debt service onwards, notably in Q3 and Q4 2022.

Regarding Sri Lankan Airlines, the Authorities (and their advisors) are currently defining a strategy to address the company's operational and financial issues, in consultation with the company. Further information and update on this matter will be shared on a regular basis and with full transparency with all relevant stakeholders. As already mentioned, (i) SOE government guaranteed debt (either through an explicit guarantee arrangement or through implicit government support) is included in the DSA perimeter and hence is considered for the debt treatment perimeter; however (ii) tailored debt treatments may be applied on a case-by-case basis depending on the specificities of each SOEs' situation. Please note that Sri Lanka Airlines' decision to pay in July 2022 the June 2022 coupon on its 2024 bonds does not prejudge of any decision regarding the inclusion or not of these series of bonds in the perimeter of debt considered for treatment. Sri Lanka Airlines took the decision to make this coupon payment from its own resources during the governmental crisis of July 2022 as the grace period on this payment was ending.

Overall, the Interim Debt Policy has resulted in a significant reduction in foreign currency debt service, as shown on Slide 8: approximately US$759 million have been saved as a result of the implementation of the Interim Debt Policy, representing approximately 41.8% of foreign exchange reserves at the end of December 2021.
b. Short-term financing
Given the current debt situation, Sri Lanka currently relies on domestic financing and a few limited external sources of financing such as some emergency credit lines from key international partners for essential imports. Given the current scarcity of external sources of financing and the necessity to ensure a swift economic recovery, the Authorities are doing their utmost efforts to have the envisaged IMF program approved as soon as possible, which in turn will enable Sri Lanka to access much needed new financings from the IMF, other IFIs and some official bilateral partners.

6. Litigations and other legal aspects
a. Litigations
On 21 June 2022, Hamilton Reserve Bank ("HRB") filed a suit against Sri Lanka in the New York federal court. HRB alleges that it has accelerated a series of bonds that were due in July 2022 (the "July 2022 Bonds") and that it holds more than 25% of the aggregate principal amount of the July 2022 Bonds. HRB is seeking full payment of the principal and interest on the July 2022 Bonds and an order barring Sri Lanka from paying other debts in the meantime. Sri Lanka is vigorously defending itself in this action. We cannot comment further on the litigation at this time.
b. Other legal aspects
We confirm the July 2022 Bonds, which were issued in July 2012 (prior to the publication of template aggregated CACs by ICMA), do not contain aggregated CACs.

7. Current social / political / economic outlook in Sri Lanka and miscellaneous
On the government's financing strategy: In April 2022, Sri Lanka called upon the IMF to seek of an IMF-supported program that would help the country restore macroeconomic stability. The program seeks to address the country's debt situation that has been deemed unsustainable by IMF staff, through the implementation of a comprehensive debt treatment and comprehensive and fundamental economic and fiscal reforms. The IMF program also foresees the unlocking of disbursements from the IMF and from other development partners, which will address the Government's liquidity needs over the coming years. ***On the government's stake in Port City Colombo:*** Colombo Port City is governed under the Colombo Port City Economic Commission Act, No. 11 of 2021 As per the provisions of the Act, the Colombo Port City Economic Commission is vested with the authority of leasing Government Marketable Land situated in the area. Land vested with the Government of Sri Lanka can be offered for other investments once the land vested with the China Harbour Engineering Company (CHEC) is sold out to investors. ***On the role of the Monetary Authority in the issuance of public debt:*** Initial arrangements are being made to set up an independent debt office at the Ministry of Finance. Organising a clear segregation of functions in each agency should facilitate the prevention of conflicts of interest.

On Sri Lanka's tourism industry outlook and social situation on the ground:

Although Sri Lanka's tourism industry had to face some unprecedented challenges over the past couple of years primarily attributable to the COVID-19 pandemic, the industry is now back on track for recovery. As per the Sri Lanka Tourism Development Authority, tourist arrivals from January to August 2022 were recorded at 490,430, compared to 24,377 in the same period of the previous year. Several countries, including Belgium, Canada, New Zealand, the Netherlands, Sweden, Norway and the UK, have recently relaxed travel warnings issued for Sri Lanka. Meanwhile, the Government has already stepped up its efforts to boost promotions by allocating Rs. 300 million for developments related to the tourism sector, working for instance on the draft National Tourism Policy, while also expediting processes to resolve certain disruptions such as the interruptions to fuel availability and intermittent power cuts that are critical to attracting visitors. The social situation in Sri Lanka has improved notably in recent weeks creating a conducive atmosphere for revival of the tourism activities. In terms of fuel shortages, the fuel issue is being addressed with the introduction of QR-code based fuel sales system. Even though, there are some temporary restrictions imposed on certain imports such as non-essential consumer goods, such measures are expected to have only a moderate impact on the tourism industry given the availability of local alternatives and the temporary nature of the said restrictions.

On workers' remittances:

Numerous measures have been taken by the Government and the CBSL to boost workers' remittances through official channels:

- An additional Incentive Scheme on Inward Workers' Remittances in the National Budget has been introduced whereby Sri Lankan migrant workers are paid an additional Rs. 2 per USD remitted and converted to Sri Lankan Rupees from December 2020.
- An incentive scheme has been introduced to reimburse the transaction costs borne by migrant workers up to Rs. 1,000 per each transaction over Rs. 20,000 when remitting money to Sri Lanka and converting to Sri Lankan rupees with effect from 1 February 2022.
- The CBSL launched the National Remittance Mobile Application, "Lanka Remit" in February 2022 to increase the inflows of foreign remittances to Sri Lanka as well as to encourage the use of formal remittance channels when sending remittances to the country.
- The Cabinet of Ministers has granted approval to provide an electric vehicle import allowance to migrant workers based on the amount they remit to the country through official channels while enhancing duty-free scheme for migrant workers who remit foreign exchange above USD 2,400 per annum.
- There has been active enforcement of foreign exchange regulations to curb grey market activities with a view to reducing the difference between official exchange rate and rates offered in the grey market.
- In order to control any large volatility in the intraday exchange rate, the CBSL started providing guidance by publishing a middle rate and a variation margin of the interbank weighted average spot exchange rate from 13 May 2022, subsequent to which a greater stability in the exchange rate was observed.

Although, workers' remittances declined to US 2,215 million during the period from January to August 2022 in comparison to USD 4,224 million in the corresponding period in the previous year, measures implemented by the Government and the CBSL are gradually paving the way for an increase in worker remittances. Accordingly, workers' remittances increased to USD 325 million during August 2022, in comparison to USD 279 million in the previous month. Furthermore, as per provisional data, workers' remittances are expected to have reached about USD 360 million in September 2022, an increase of about 10% on month-on-month basis.

Workers' remittances are expected to improve further in the period ahead with (i) the expected gradual stability in the macroeconomic situation in Sri Lanka supported by the measures implemented by the Government and the CBSL, (ii) gradual improvement in departures for foreign employment, (iii) the improvement of global travel, (iv) increased demand for migrant labour and (v) expected continued recovery in the flow of remittances through official channels backed by incentive schemes.

Additionally, following measures/developments should also increase the confidence of all the stakeholders in the foreign exchange market, including the remitters.

- Sri Lanka reached staff-level agreement with the IMF for an economic adjustment program under the EFF of about US dollars 2.9 billion. The EFF is expected to support the economy to transit to a sustainable recovery path in the period ahead. Entering into an IMF program would not only provide access to additional financing but would also enhance the confidence of potential foreign investors, including multilateral and bilateral counterparts which may result in some improvement in forex inflows in the period ahead.
- Meanwhile, the CBSL has implemented a new comprehensive data gathering system on cross border transactions and domestic foreign currency transactions known as the International Transactions Reporting System (ITRS) in June 2022 with the participation of Licensed Banks. The ITRS is expected to help policy formulation in many aspects by providing valuable inputs for both statistical and regulatory purposes.

The following measures are expected to improve the foreign exchange liquidity in the domestic market.

- In view of the continuous pressure on the external sector, the Government imposed several restrictions on selected non-urgent and non-essential imports.
- The Government has also sought assistance from bilateral and multilateral sources to mobilise funds to bridge the gap in essential forex financing need.
- The implementation of the new exchange rate arrangement is expected to reduce the gap between the official exchange rate and the grey market exchange rate, thereby discouraging the remitters from resorting to informal markets to send money.

On envisaged privatizations:

As per budget proposal, a SOE restructuring unit has recently been established. The unit is yet to announce the strategies on restructurings and privatizations.

On the possibility of Sri Lanka benefiting from SDR reallocation initiatives:

From the outset of the crisis, Sri Lanka requested an IMF-supported program that would help the country restore macroeconomic stability. The program notably seeks to address the country's debt situation that has been deemed unsustainable by IMF staff, through the implementation of comprehensive debt treatment and certain economic and fiscal reforms. The IMF program also foresees the unlocking of disbursements from the IMF and from other development partners, which will address the Government's liquidity needs over the coming years.

On the possibility of long-term leases of the Colombo Port and divestment of the Bandaranaike International Airport:

No decision has yet been taken on these matters.

On FX rate policy:

As part of the IMF program, the Authorities are fully committed to restoring a market determined and flexible exchange rate.

On projects capital expenditures:

As part of its Interim Debt Policy, the Government suspended the servicing of affected external public debt obligations, with a view to safeguarding the country's FX reserves. However, the Government may decide in line with its Interim Debt Policy to resume some debt service payments on certain facilities should they be tied to projects identified as high priority for the country and its population. Such a classification will rely on a list of pre-defined criteria and will concern only a limited number of capital expenditure projects.

On the on-ground situation and shortages of basic goods:

Though fuel procurement still remains vulnerable in the short-term amidst foreign exchange shortages, the situation should stabilise following board approval of the IMF program and the related disbursements under the EFF, which together with the implementation of the debt restructuring, will open up foreign financing avenues. To ensure the provisioning of fuel distribution across the country to some degree, thereby facilitating the economic activity and mobility during this interim period, several measures have been undertaken in the recent months. The CBSL's active facilitation to prioritize foreign exchange payments pertaining to the procurement of fuel and other energy commodities has been accompanied by several measures undertaken by the Ministry of Power and Energy to smoothen domestic supply, especially through the implementation of the National Fuel Pass QR and fuel quotas. The measures, such as allowing bunker license holders to provide selected sectors with fuel upon receipt of US dollars payments or Ceylon Petroleum Corporation's (CPC) call for registration of Sri Lankan export businesses who wish to avail a guaranteed fuel quota upon payment in US dollars, are expected to provide marginal foreign exchange cushioning to CPC in fuel importation. Meanwhile, the implementation of regular fuel price revisions, as observed in recent months, can help provide some financial leeway for CPC. Nevertheless, going forward, there will be continued rationing of fuel to facilitate both transportation and power generation activities until the foreign exchange shortage is mitigated.

Meanwhile, the Ceylon Electricity Board has also been compelled to continue with load shedding for several hours on a daily basis due to continued fuel shortages that are stemming from foreign exchange liquidity shortages and frequent closures of coal plants. However, with the increase in reservoir levels through rainfalls and hydropower generation, the duration of load shedding has recently been reduced as compared to the situation that prevailed in the first half of 2022 where load shedding was adopted for long hours on a daily basis. However, load shedding has seen a slight increase during the end of September and could increase further going forward due to vulnerabilities stemming from delays in the coal procurement process.

Agriculture sector performance weakened in the second quarter of 2022 mainly attributed to the limited availability of required chemical fertilisers and other inputs in a timely manner mainly due to the temporary chemical fertiliser ban and foreign liquidity issues. The weak performance during the Maha 2021/22 season and subpar performance in the Yala 2022 season that is nearing conclusion have led to sizable declines in both availability and affordability of food, culminating in consistently high food inflation in recent months. Furthermore, the poor agriculture sector performance, alongside fuel shortages, has had spill-over impacts on other industries, such as poultry and fisheries which are registering exorbitantly high prices amid low production. However, with the importation of agriculture inputs, i.e., fertilizer and agrochemicals, the major harvesting season of Maha 2022/23 is expected to be more successful, compared to the 2021/2022 Maha season and the 2022 Yala season. Agricultural supply chain linkages have improved to some extent and agricultural produce has begun to arrive in markets with some availability of fuel for transportation activities. Yet, the disrupted agricultural production and resulting increase in food inflation are likely to have negative implications on household food security and overall socioeconomic well-being of vulnerable segments of the population, especially, young children, elderly, and those in financially vulnerable households.

The CBSL continues to prioritize the provision of foreign exchange liquidity for the importation of fuel, medicines, and other essential commodities, including food, fertilizer, and agrochemicals. Accordingly, the Government of Sri Lanka and the CBSL, despite much difficulty, are trying to actively facilitate the smooth provisioning of all essential commodities to all stakeholders. However, import restrictions and rationing of commodities are expected to continue in the near term to facilitate equitable distribution of essentials, primarily focusing on safeguarding the well-being of households while facilitating continuity of economic activity.

On the situation and prospects of Sri Lanka's export sector:

Sri Lanka has always welcomed tourism and workers' remittances as important sources of foreign exchange. However, the earnings from exports in Sri Lanka is higher than collective earnings from tourism and workers' remittances. Export earnings as a share of GDP is more than 10% whereas the other two sectors are comparatively low, indicating the vital role of exports in the Sri Lankan economy.

However, Sri Lanka has lost its competitiveness in the international trade which is reflected in the falling share of Sri Lankan exports in total global exports. Sri Lankan exports declined from about 0.37% of global exports on average in 1950's to about 0.06% on average since 2000. Also, exports as a share of

GDP have declined significantly from the 33.3% peak in 2000 to about 14.8% in 2021. The protracted civil war that spanned for about three decades, political instability, and lack of export related FDI were the main reasons that led to this outcome.

Diversification of exports, in terms of both products and markets, and exploring new export opportunities to upgrade Sri Lanka's export base towards high value added technologically intensive exports, have been identified as policy priorities. Accordingly, a new trade policy was developed in 2017 along with a National Export Strategy (2018-2022), which suggested broad changes to the trade sector, some of which are still on going. Meanwhile, comprehensive FTA (covering both goods and services) negotiations have been initiated with China, India, and Thailand and a comprehensive FTA was signed with Singapore in 2018. Also, Sri Lanka enjoys preferential access to some of the advanced economies through schemes such as the EU GSP+. These initiatives continue although there were several drawbacks due to the Easter Sunday attacks, COVID 19, and most recently due to the foreign exchange and debt crisis faced by Sri Lanka. Also, efforts have been taken to maintain a conducive business environment in the country to ensure consistent economic policies, stable macroeconomic conditions, a competitive exchange rate, while measures regarding for instance the improvement of doing business conditions and the proper management of foreign relations (, which are necessary to attract FDI flows) were taken. Hence, Sri Lanka is making steps in the right direction to improve export driven manufacturing and to attract the support of foreign investors through increased FDI in the manufacturing sector. However, completing the debt restructuring process and securing financial assistance from the IMF and other multinational agencies are imperative to boost investor confidence and attract new export oriented FDIs to the country.

On outstanding balances to the Asian Clearing Union:

The Asian Clearing Union’s balance amounted to USD 1,917 million as of end June 2022.

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