

Table 6. Sri Lanka: Financial Soundness Indicators—All Banks, 2008–13

	2010	2011	2012	2012	2013	2013	2013	2013
			Sept.	Q1	Q2	Q3	Q4	
Capital adequacy								
Regulatory capital to risk weighted assets	16.2	16.0	15.0	15.0	16.0	16.1	15.8	16.3
Tier 1 capital/risk weighted assets	14.3	14.4	13.3	13.1	13.9	13.9	13.6	13.7
Capital to assets ratio	8.3	8.7	8.6	8.5	8.4	8.4	8.2	8.2
Asset quality								
Gross nonperforming loans to total gross loans (without interest in suspense)	5.4	3.8	4.0	3.6	4.2	4.7	5.2	5.6
Net nonperforming loans to total gross loans	3.0	2.1	2.4	2.1	2.3	2.7	2.0	3.3
Provision coverage ratio (total) 1/	58.1	57.1	50.9	54.5	45.4	44.9	50.9	40.4
Earnings and profitability								
Return on equity (after tax)	22.2	19.7	20.5	20.2	7.3	24.6	23.2	22.5
Return on assets (after tax)	1.8	1.7	1.7	1.7	0.6	2.1	2.0	1.9
Interest income to gross income	83.1	85.5	85.3	86.3	66.4	69.5	70.5	69.7
Staff expenses to noninterest expenses	45.2	43.7	45.7	45.2	45.9	46.5	46.1	44.9
Personnel expenses to total income	12.0	12.2	10.9	10.7	n.a.	25.5	25.0	25.0
Total cost to total income	71.9	73.9	74.3	75.6	79.1	91.2	n.a.	56.8
Net interest margin	4.6	4.2	4.1	4.1	3.8	6.8	5.8	5.7
Liquidity								
Liquid assets to total assets	31.4	26.8	27.1	26.5	28.0	29.2	30.6	31.9
Assets/funding structure								
Deposits	72.8	72.3	70.5	70.5	70.2	n.a.	n.a.	n.a.
Borrowings	14.3	14.9	16.2	15.8	11.2	11.6	n.a.	n.a.
Capital to external funds	9.5	10.0	9.9	9.9	8.4	8.4	n.a.	8.2
Credit to deposits	76.4	84.7	87.6	87.4	85.7	n.a.	n.a.	n.a.

Source: Central Bank of Sri Lanka.

1/ The drop in the provisioning ratio reflects an increase in NPLs (loans categorized as substandard or below—the denominator), with the bulk of new NPLs at the low end of provisioning requirements. For the given stock of NPLs, this ratio is expected to increase as the stock of new NPLs migrates from substandard to lower categories (doubtful and loss) and provisioning requirements increase.



SRI LANKA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION AND SECOND POST-PROGRAM MONITORING DISCUSSION—INFORMATIONAL ANNEX

July 10, 2014

Prepared By

Asia and Pacific Department

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FUND RELATIONS

(As of May 31, 2014)

Membership Status

Joined 8/29/50; accepted Article VIII, Sections 2, 3, and 4, March 1994.

General Resources Account	SDR Million	% Quota
Quota	413.40	100.00
Fund holdings of currency (Exchange Rate)	1528.25	369.68
Reserve Tranche Position	47.86	11.58

SDR Department	SDR Million	% Allocation
Net cumulative allocation	395.46	100.00
Holdings	5.75	1.45

Outstanding Purchases and Loans	SDR Million	% Quota
Stand-by Arrangements	1162.69	281.25

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	7/24/09	7/24/12	1,653.60	1,653.60
ECF ¹	4/18/03	4/17/06	269.00	38.39
ECF	4/18/03	4/17/06	144.40	20.67

¹ Formerly PRGF.

Projected Payments to Fund²

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2014	2015	2016	2017	2018
Principal	301.44	361.73	327.28	172.25	
Charges/interest	<u>6.16</u>	<u>8.64</u>	<u>4.20</u>	<u>1.16</u>	<u>0.39</u>
Total	307.60	370.36	331.47	173.41	0.39

² When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement

The de jure exchange rate arrangement is free floating since its introduction by the Central Bank of Sri Lanka (CBSL) on January 23, 2001. The CBSL intervenes in the foreign exchange market to limit volatility in the exchange rate. Since October 2013, the Sri Lanka rupee has stabilized within a 2 percent band against the U.S. dollar. Accordingly, the de facto exchange rate arrangement has been reclassified from floating to a stabilized arrangement, effective October 1, 2013. Sri Lanka maintains an exchange system free of exchange restrictions on the making of payments and transfers for current international transactions, except for the exchange restrictions imposed by Sri Lanka solely for the preservation of national or international security.

Safeguards Assessment

Under the Fund's safeguards assessment policy, the Central Bank of Sri Lanka (CBSL) was subject to an update safeguards assessment with respect to a Stand-by Arrangement approved in July 2009. The assessment, completed in July 2009, found that the CBSL continues to have a relatively strong safeguards framework, especially in the external audit, financial reporting and control areas. The assessment recommended measures to improve the process of program data reporting to the Fund and to modernize and strengthen the internal audit function. Also the external audit arrangements were not fully institutionalized. The authorities have implemented majority recommendations of the report. However, staff has not received 2012-2013 Management Letters issued by the CBSL's external auditor. Delivery of this monitoring information by the CBSL is required under the safeguards policy.

Article IV Consultation

It is proposed that the next Article IV consultation take place in 12 months.

FSAP and ROSC Participation

- MFD: Both the FSSA and the FSAP reports were completed in 2002.
- MCM: An FSAP update took place in July 2012.
- STA: A data ROSC was completed and the report published in 2002.
- FAD: A fiscal transparency ROSC was completed and the report published in 2002. A ROSC update was completed and the report published in July 2005.

Resident Representative

Mrs. Eteri Kvintradze has been the resident representative since March 2014.

Technical Assistance

- **FAD.** A number of TA missions in tax policy and administration took place during the 2000s. A series of TA missions in revenue administration were conducted in 2003. Tax policy missions took place in 2001 and 2009, to provide advice on the reform of the tax system. In 2012, a mission visited Sri Lanka to evaluate the state of the Inland Revenue Department, with a particular focus on the effectiveness of the administration of the Value Added Tax (VAT) and

secondarily the Nation Building Tax to identify measures to staunch and reverse the decline in VAT collections and improve the overall performance of the VAT system and taxpayers compliance. In addition, a number of missions took place during 2012–2014 to strengthen Public Financial Management, improving oversight of the State-Owned Enterprises, strengthening budget preparation and improving the commitment control system.

- **MCM.** In August 2001, a TA mission to develop a strategy for strengthening the framework and implementation of monetary and foreign exchange cooperation took place. In May 2002, an IMF/World Bank mission advised the government of Sri Lanka on options for reform of People's Bank. In 2003, TA mission on financial sector issues and financial sector reforms took place, followed by 2005 mission to provide advice on the introduction of new deposit insurance scheme.
- **STA.** In November 2012, a mission visited Sri Lanka to report on data dissemination practices with respect to the requirements of the Special Data Dissemination Standards (SDDS). During 2013–2014, Sri Lanka has received TA provided by the IMF/STA as part of the Asia module of the JSA Project on the Improvement of statistics in the Asia and Pacific Region. This TA focused on improving data collection and compilation of ESS including balance of payments, IIP, EDS, and Reserves Data Template (RDT), and supporting the authorities in their transition to the *BPM6* format. In 2013, TA missions also took place to review work on methodological improvements to the consumer price index and the development of the new producer price index, and to provide guidance on rebasing of GDP estimates and quarterly national accounts. In 2014, a mission took place to review the Government Financial Statistics (GFS) compilation system and make recommendations on the implementation of the GFSM 2001 and its 2014 update (GFSM 2014).

RELATIONS WITH THE WORLD BANK GROUP

(As of May 30, 2014)

As set out in the Country Partnership Strategy (CPS) for FY13–16, the World Bank Group is supporting Sri Lanka in addressing its long-term strategic and structural development challenges as it transitions to middle-income country (MIC) status. Key elements of this transition include boosting investment, including in human capital, realigning public spending and policy with the needs of a middle income country, enhancing the role of the private sector, including the provision of an appropriate environment for increasing productivity and exports, and ensuring inclusive growth. The CPS set out to contribute to achieving these goals through three areas of engagement: (i) facilitating sustained private and public investment; (ii) supporting structural shifts in the economy; and (iii) improving living standards and social inclusion.

A CPS Progress Report prepared this fiscal year provided an opportunity to review the country program and strategy together with the government, taking stock both of progress to date and the government’s evolving development needs and agenda. While the strategic objectives of the CPS remain relevant through FY16, the Progress Report proposed a refocusing of some activities as well as the addition of a fourth strategic area of engagement, namely increasing resilience to disasters and climate change, deemed central to Sri Lanka’s current development agenda and poverty reduction efforts. As the country shifts from reconstruction to addressing the challenges of development on a middle income trajectory greater emphasis has been placed on facilitating and creating the enabling environment for increased foreign and domestic investment. At the same time, continued pockets of poverty highlight the need for renewed efforts to target development to the poor.

The World Bank has been supporting Sri Lanka’s development for close to six decades, having accompanied the country as it has grown to join the ranks of middle-income countries. Sri Lanka re-emerged as a blend IDA-IBRD country in FY12, regaining access to IBRD resources after a 26-year hiatus. It will remain a blend IDA-IBRD country through the IDA17 cycle. The current active World Bank portfolio in Sri Lanka comprises the following 15 projects, with a total net commitment value of \$1.77 billion:

Summary of World Bank IDA Operations

	Board Approval	Revised Closing Date	Net Comm Amount (\$mil)
Dam Safety & Water Resource Planning	03/27/2008	05/15/2018	148.3
Improving Climate Resilience	04/22/2014	05/30/2019	110.0
Catastrophe DDO	04/22/2014	05/31/2017	102.0
Comm Livelihoods in Conflict Areas	06/22/2004	12/31/2014	124.7
2 nd Com Dev & Livelihood improvement	09/10/2009	09/30/2014	75.0
N&E Local Services Improvement	05/13/2010	12/31/2015	50.0
LK – Road Sector Assistance	12/15/2005	09/30/2014	298.1
Provincial Roads Project	12/17/2009	03/31/2015	105.0
Metro Colombo Urban Development	03/15/2012	12/31/2017	213.0
Sri Lanka Strategic Cities Development	05/05/2014	12/31/2019	147.0
SME Development Facility	09/07/2010	03/31/2014	57.4
Warehouse Receipts Financing	06/01/2012	05/31/2015	6.5
Higher Education for 21 st Century	05/13/2010	06/30/2016	40.0
Transforming School Education	11/29/2011	06/30/2017	100.0
Second Health Sector Development	03/27/2013	09/30/2018	200.0

Source: World Bank.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of June 26, 2014)

Country Strategy for Sri Lanka

- **Country Partnership Strategy:** ADB's Country Partnership Strategy (CPS) for Sri Lanka, approved in 2011 identifies three pillars, (i) inclusive and sustainable economic growth, (ii) catalyzing private investment and enhancing the effectiveness of public investment, and (iii) human resource and knowledge development, as the focus of operations over the period 2012–16. ADB continues to focus on transport, energy, water supply and waste water management, and irrigation sectors in infrastructure development, and education sector.
- **Indicative Resources:** The allocation for 2014–2016 consists of \$562 million from ordinary capital resources (OCR) and \$437 million from the Asian Development Fund (ADF).

Indicative Pipeline for 2014–16

- Country Operations Business Plan (COBP) for the period 2014–16 indicates that the indicative project pipeline for 2014–2016 addresses the priority agendas of middle-income countries, such as skills development, integrated transport network development, sustainable energy, and integrated water resource management. To ensure critical mass and continuity, the COBP will take an investment program approach, and financing modalities will include multi-tranche financing facility (MFF), results based lending (RBL) programs, and additional financing. To the extent possible, thematic priorities such as gender, governance, climate change, and regional cooperation will be included in each project. Co-financing and private sector operation opportunities will be explored.

The Skills Sector Enhancement Program (RBL) approved in 2014 develops skills relevant to Sri Lanka's economy by supporting priority sectors where large skills gaps exist. The program focuses on increasing employability of the Sri Lankan workforce, particularly the youth by transforming Sri Lanka's technical and vocational education training (TVET) system into a more market responsive, inclusive, and quality-oriented one. The program will strengthen the engagement of private sector employers and bodies in TVET planning and delivery through (i) industry sector skills councils to validate skills gap analysis, training plans, competency standards, and curricula; and (ii) introduction of an employment-linked training agreement model where employer can deliver training to bridge the skills gaps.

The Integrated Road Operation and Development Investment Program (MFF) is being processed in 2014 to support the Government's program to connect 1,000 villages to city centers. It includes rehabilitation and upgrading of rural, provincial and national roads in 6 provinces. The Expressway Connectivity Investment Program (MFF) for 2015 will optimize the connectivity of highways and expressways. This includes providing the access to the expressway network from Colombo City to limit congestion. The most priority expressways to be constructed under the project will be (i)

elevated expressway from Kelani Bridge to Colombo Port (port access road) and (ii) elevated expressway from Kelani Bridge to Kirulapone (baseline road).

The Green Power Development and Energy Efficiency Improvement Investment Program (MFF) to be approved in 2014 addresses the energy sector focus in four areas: (i) diversifying energy sources by increasing the share of renewable energy, including wind, hydro, and solar; (ii) strengthening transmission infrastructure to absorb additional capacity from renewable energy sources, and expanding access in post-conflict areas and lagging regions; (iii) improving network efficiency through technical loss reduction; and (iv) enhancing regional cooperation.

The Greater Colombo Water and Wastewater Management Improvement Investment Program (MFF) focuses on reducing nonrevenue water (NRW) and improving wastewater management in the greater Colombo area. It targets NRW reduction in Colombo City from 60 percent to about 18 percent in critical areas and to about 20 percent elsewhere after project completion. The Program will be a platform to mobilize co-financing and to introduce public–private partnerships (PPPs). The first two tranches focus on water supply, while the third and fourth tranches (planned in 2015 and 2016) primarily address wastewater management.

The Water Resources Development Investment Program (MFF) will assist the government complete outstanding water conveyance investments under the Mahaweli Development Program (MDP). Completion of MDP is a key priority of the government and will maximize the productivity of Mahaweli River Basin water resources by transferring available water to Sri Lanka’s northern dry zone areas for irrigation, drinking and commercial purposes. This will accelerate local and national economic growth. The first tranche scheduled for 2015.

In the absence of a PPP framework, ADB will adopt a project-based approach to promote PPP in Sri Lanka. Performance-based contracts can be structured as part of regular sovereign projects, such as in water and wastewater management and road maintenance. ADB’s Private Sector Operations supports finance sector development by providing loans, equity investments, or guarantees for banks or nonbank institutions to enable them to expand activities in targeted areas including housing, small and medium-sized enterprise finance, leasing, renewable energy, and infrastructure lending. ADB may also provide transaction advisory services to structure and procure developers for PPP projects as needed.

Ongoing Projects

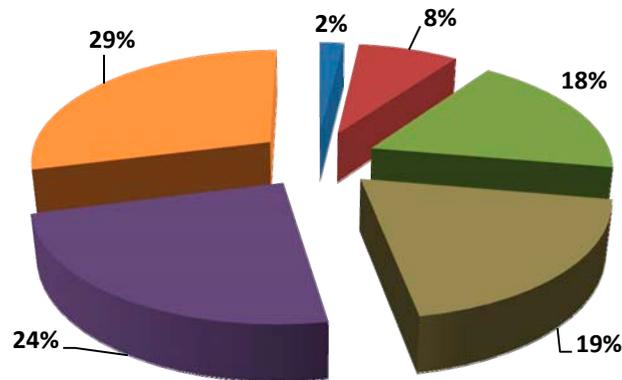
- **Projects approved in 2013:** During 2013, ADB approved 3 new projects for a total of \$363 million as follows:
 - Education Sector Development Program (\$100 million from OCR and \$100 million from ADF)
 - Southern Road Connectivity Project (\$70 million from OCR and \$5 million from ADF)

- Greater Colombo Water And Wastewater Management Improvement Investment Program - Tranche 1 (\$70 million from OCR and \$18 million from ADF)

- **Portfolio Performance:** As of 31 December 2013, ADB has approved a total of 166 loans, with cumulative lending of \$5.8 billion to Sri Lanka. In addition, ADB has provided \$358 million grant assistance (including ADB-administered co-financed grants) for projects and \$123 million through 259 technical assistance grants.

The current portfolio includes 49 ongoing loans and grants for 29 projects with a net loan amount of \$2.1 billion. Cumulative contract awards reaches \$1.0 billion, and disbursements \$0.7 billion. 80% of the ongoing portfolio are in transport, urban and water, and energy sectors. The sector composition of the ongoing loan portfolio is in Figure 1.

Figure 1 : Sectoral Distribution



■ Finance ■ Multisector ■ Education ■ Energy ■ Transport ■ Urban and Water

Source: Asian Development Bank

STATISTICAL ISSUES

Macroeconomic statistics are broadly adequate for surveillance, but weaknesses remain in the timeliness and coverage of certain statistical series. Sri Lanka is a participant in the General Data Dissemination System (GDDS) since July 2000.

Price statistics. The Department of Census and Statistics (DCS) released a new Consumer Price Index for Colombo in 2007, based on the spending pattern reflected in the Household Income and Expenditure Survey. It is based on the spending patterns of all urban households in the Colombo district. A core inflation index is also compiled by the DCS to provide a measure of underlying inflation. The Central Bank of Sri Lanka (CBSL) produces a Wholesale cum-Producer Price Index (WPI/PPI).

National accounts. The national accounts suffer from insufficient data sources and undeveloped statistical techniques. Most of the data used for national accounts are obtained on a timely basis. However, detailed data needed to measure both output and intermediate consumption are mostly unavailable or not collected. As a result, some of the estimates of gross value added are prepared directly relying on fixed ratios, often with outdated studies or ad hoc assumptions. Quarterly indicators are used for compiling quarterly value added estimates. The methodology for deriving GDP at constant prices relies on expenditure estimates which are available only annually and rely mostly on commodity flow techniques. Whenever possible, estimates are validated and checked with other sources.

Government finance. In May 2003, a STA mission followed up on the ROSC recommendation to develop a migration path to compile data in accordance with the *Government Finance Statistics Manual 2001 (GFSM 2001)*. As part of that plan, the authorities agreed to revise (beginning in end–2003) the budgetary classifications and the accounting structure to eventually match the *GFSM 2001* classifications of stocks and flows and to apply that chart of accounts to all general government units. In April 2014, a STA mission took place in the context of the Japan-funded IMF project on implementing GFSM 2001 and its update (GFSM 2014), for compiling, analyzing and reporting fiscal data.

Monetary statistics. Foreign Currency Banking Units (FCBUs) are classified as resident institutions in the monetary survey since 1998. To adjust for the proportion of nonresident foreign currency deposits (NRFC), which are actually held by residents (mainly returning migrant workers), 50 percent of these deposits are reclassified from foreign liabilities to domestic deposits.

In June 2003, a STA mission followed up on issues raised during the 2001 ROSC mission. In particular, the mission clarified the methodology for the treatment of Fund accounts; recommended that repos be treated as collateralized loans (rather than on a change of ownership basis); and resolved discrepancies between the monetary authorities data reported to STA and to APD, which reflected problems in the valuation of Fund accounts and other shortcomings.

External Sector Statistics (ESS). Since April 2014, the CBSL publishes its International Investment Position (IIP) and balance of payments statistics on an annual basis following the sixth edition of the *Balance of Payments Manual* (BPM6). Quarterly data are available three months after the end of the quarter and the CBSL plans to start publishing these data following the BPM6 in June 2014. For Quarterly external debt statistics (QEDS) for GDDS participants, Sri Lanka disseminated data up to 2013 Q1. During 2013 and 2014, Sri Lanka received TA provided by the IMF as part of the Asia module of the JSA Project on the Improvement of ESS in the Asia and Pacific Region. This TA focused on improving data collection and compilation of ESS, including balance of payments, IIP, EDS, and Reserves Data Template (RDT), and supporting the authorities in their transition to the BPM6 format.

Dissemination System/Standards (GDDS/SDDS). Sri Lanka is a participant in the General Data Dissemination System (GDDS) since July 2000. In February 2003, the authorities appointed a coordinator with the objective of subscribing to the Special Data Dissemination Standard (SDDS) and have since made substantial progress. However, additional work is still needed for meeting all SDDS requirements, including quarterly IIP and monthly central government operations.

General

A data ROSC mission visited Sri Lanka in 2001, followed by BCP, CPSS, IOSCO, MFPT, RSSS and Fiscal ROSC missions in 2002. A fiscal ROSC update was conducted in 2005 and reassessments of the BCP in 2007 and 2012 and of CPSS in 2007. [Most of its recommendations have been implemented while others are expected to be implemented in the near future.]

The authorities report key data to the Fund on a timely basis. On government finance, annual cash data were regularly reported for publication in the *GFS Yearbook*. These data cover only the budgetary accounts of central government; and no data on the extrabudgetary funds or the provincial and local governments are reported. At the same time, no sub-annual data are reported for publication in *IFS*. The authorities have been encouraged to reduce the time lag for data reporting. The authorities have not yet begun reporting data in the format of Standardized Report Forms, which were developed by STA for reporting monetary data and reflect principles for classifying positions by economic sector, financial instrument, and currency of denomination recommended in the *Monetary and Financial Statistics Manual*.