2016 ANNUAL MEETINGS
International Monetary Fund
World Bank Group
Washington, D.C.

Governor's Statement No. 16

October 7, 2016

Statement by the Hon. **RAVI KARUNANAYAKE,**
Governor of the Fund and the Bank for **SRI LANKA**

Statement by the Hon. Ravi Karunanayake,
Governor of the Fund and the Bank for Sri Lanka

Mr. Chairman, the world economy has made noteworthy progress since the global financial crisis. However, the recovery is too weak and remains fragile while being more exposed to negative risks. The gradual slowdown and rebalancing of the business model in China, lower energy and commodity prices and US monetary policy tightening as well as Brexit are major challenges ahead in achieving a faster recovery of global growth. Despite the recent slowdown, emerging market and developing economies are still accounting for over 70 per cent of global growth, while a modest recovery is continuing in advanced economies. Since the crisis, monetary policy has been the main policy priority for boosting recoveries in most economies. However, there is much scope for using fiscal policy as well as infrastructure development to strengthen the growth framework in some major economies. There also continues to be an unfinished agenda of financial reforms for addressing current problems in the world economy. Therefore, a combination of these policies and coordinated actions are required to support sustainable high growth in the global economy.

We welcome the completion of the 2010 IMF quota and governance reforms and look forward to completion of the 15th General Review of Quotas and a new formula that further shifts quota shares to emerging market and developing economies. Also, we commend the IMF Executive Board's decision to include the RMB in the SDR basket which is a timely decision and important milestone in the integration of the Chinese economy in to the global financial system.

Mr. Chairman, let me now briefly highlight recent economic developments in my own country. The Sri Lankan economy grew moderately by 3.9 per cent during the first half of 2016 supported by improved manufacturing and services activities. The relatively slow growth was mainly a result of disruptions caused by adverse weather conditions in particular to agricultural activities. Floods which affected 22 of the 24 districts of the country also had an impact on industrial production. However, the economy is expected to grow by 5.5 per cent in 2016 with the recovery in economic activities during the second half of the year supported by favorable base effects in fourth quarter 2016. There have been encouraging trends in the PMI and business confidence.

Sri Lanka entered into a 3-year arrangement under the Extended Fund Facility (EFF) of USD 1.5 billion with the IMF to support its economic program 2016–2019 designed to strengthen the external and fiscal balances of the economy. The anticipated structural adjustments in the external and fiscal sectors, the implementation of sound macro-economic policies, and increased investments with the enhanced investor confidence are expected to support Sri Lanka's economy to expand about 6 per cent in 2017 and to grow thereafter at an annual rate of around 7 per cent.

Inflation, which indicated some upward movements during the second quarter of the year reflecting domestic supply shortages due to adverse weather conditions and the immediate impact of some tax adjustments introduced by the government, declined by August 2016. The year on year headline inflation, as measured by the change in National Consumer Price Index, declined to 4.5 per cent in August 2016 from 5.8 per cent in July 2016. Meanwhile, core inflation, which reflects the underlying inflation in the economy, declined to 6 per cent in August from 6.8 per cent in July. The unemployment rate in Sri Lanka remains around 4.2 per cent.

Mr. Chairman, the relatively higher inflation, along with high monetary and credit expansion, required preemptive monetary policy measures by the Central Bank. Accordingly, the Central Bank tightened monetary policy by raising the Statutory Reserve Ratio (SRR) by 1.5 percentage points to 7.5 per cent and raised policy interest rates twice by 50 basis points each, during 2016.

On the fiscal front, the revenue collection of the government recorded an improvement during the first half of 2016 reflecting increases in both tax and non-tax revenue. This together with the rationalization of expenditure supported the reduction of the budget deficit during the first half of 2016. The strong commitment of the government to increase government revenue through further expanding the tax base and improvement in tax administration, as well as rationalization of expenditure, would help to achieve the targeted budget deficit of 5.4 per cent in 2016 and further reduction of it to 4.7 per cent in 2017.

Mr. Chairman, Sri Lanka's external sector performance was subdued during the first half of 2016 largely due to the impact of a substantial decline in international commodity prices, and lower demand for exports. The deficit in the trade account increased during the period as a result of the considerable decline in exports compared to a marginal decline in imports. However, the current account improved with the increased inflows to the services and secondary income accounts.

Meanwhile, the EFF supported economic program contributed to positive investor sentiments resulting in an improvement in foreign investment in the government securities market. Also, the proceeds from the International Sovereign Bond issuance `amounting to US dollars 1.5 billion, and several other international financial arrangements helped to improve foreign inflows so far during the year. Accordingly, country's gross official reserve level was maintained at a comfortable level of US dollars 6.5 billion by end of July 2016 which was equivalent to over 4.2 months of imports. The Sri Lanka rupee depreciated against the US dollar by 1.2 per cent during the first eight months of 2016.

Meanwhile, the banking sector stability and soundness improved, along with improvements in capital adequacy, liquidity and asset quality.

The Sri Lankan government has planned sweeping reforms centered on private public partnerships to reduce debt and improve public revenue. The government is working with the ADB and the World Bank to create a PPP framework which clearly lays out policy, legal and institutional obligations for contracting PPPs. Also, measures are being taken by the government to improve the financial strength of State Owned Enterprises ensuring their long term viability through the implementation of essential structural reforms.

Mr. Chairman, through the government's policy strategy, we expect to achieve the "Sustainable Development Goals (SDGs) and Targets" and Sri Lanka will continue to work with the UN and other states to achieve global goals by 2030. Since Sri Lanka is a small economy with 21 million people, future growth prospects of the country depend largely on expanding exports through increased market access to the world economy. Therefore, measures are being taken to boost market access through deepening and widening the current FTA with India; invigorating the FTA with Pakistan; signing new partnership agreements with China and Singapore; and the expected restoration of the EU GSP plus. We expect that this will gain preferential access to markets with more than 3 billion people. Meanwhile, trade and investment relationships with many other countries are also being pursued.

Empowering people through education, training and skill development, improving investment climate and the doing business environment, strengthening trade policy and trade facilitation, and financial inclusion are major priorities of the government which would help to enhance private sector participation in economic activities enabling to create new employment opportunities.

Mr. Chairman, Sri Lanka has achieved significant progress in its social development indicators due to the government's continued efforts and the donor support. I take this opportunity to thank the World Bank Group for their continued support to Sri Lanka and I believe that its new Country Partnership Framework for 2017–2020 would help to reinforce Bank's financing arrangements thereby enhancing its role in the country's development. Sri Lanka is among the three countries that are expected to be graduated to "IBRD only" status from "IDA Blend" at the end of Fiscal Year 2017. Therefore, I take this opportunity to highlight the importance of allowing these countries a generous transition support and exempting it from any acceleration clause burden of IDA repayments in order to help their cash flow management.

The vicious civil war that prevailed for 27 years in Sri Lanka caused significant hardships for the population, environment and the economy. Although Sri Lanka demonstrated a satisfactory overall growth performance in the recent years, the brutal war has resulted in significant regional disparities in growth as well as poverty across the country. The government has formulated a well-focused policy strategy to address the regional disparities. However, it is essential that more concessionary financial assistance through innovative financial tools and products from international financial institutions is available to develop infrastructure facilities of such regions and also to provide basic needs such as health, education and sanitary facilities. Also, we look forward to a World Bank shareholding formula that moves towards equitable voting power, enhancing voice and representation of developing countries, while protecting the poorest and smallest countries.

Thank You!