

# IMF: 1<sup>ST</sup> REVIEW

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# IMF PROGRAM STATUS

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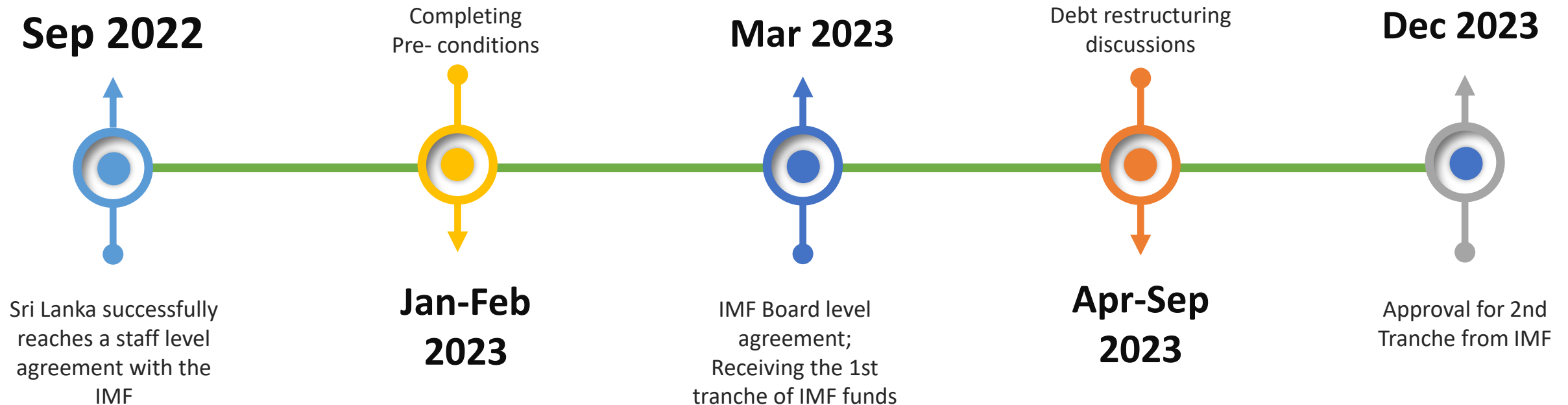


The background of the slide features a blurred image of the Sri Lankan national flag, which consists of horizontal stripes of green, yellow, and red, with a white border containing a lion holding a sword. Below the flag, the heads and shoulders of a crowd of people are visible, suggesting a public gathering or protest.

## IMF PROGRAM STATUS

- IMF completed the 1<sup>st</sup> review of the 48-month Extended Fund Facility (EFF) for Sri Lanka on Dec 12, 2023
- About USD 337.0Mn will be disbursed under the 2<sup>nd</sup> tranche, bringing the total disbursed to around USD 670.0Mn, to date
- Total amount of Sri Lanka's EFF is about USD 3.0Bn as of the IMF approval on Mar 20, 2023

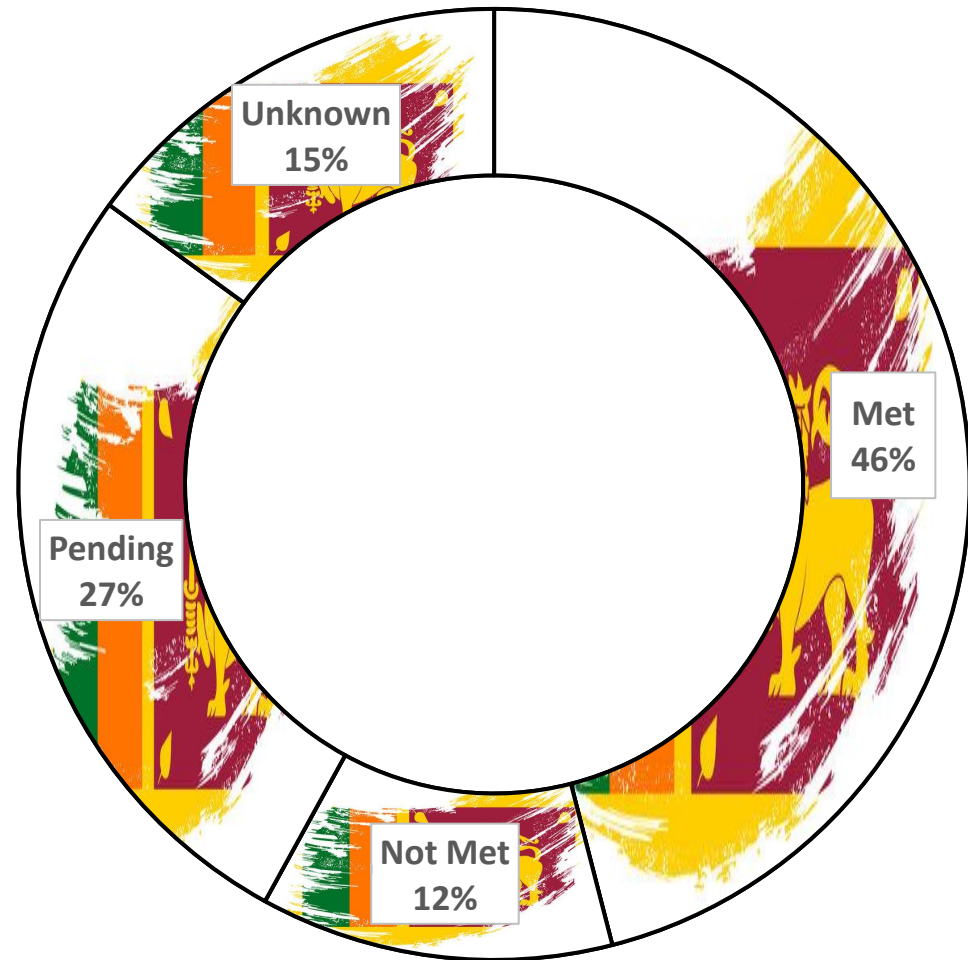
# IMF Timeline



*Note: The IMF timeline has consistently aligned with the projections made by First Capital Research, and as expected, the approval for the 2<sup>nd</sup> tranche occurred in early Dec 2023*

## IMF Tracker

- As of Nov 2023, Sri Lanka has met 46 out of 100 IMF commitments and has failed to meet 12 IMF commitments



Source: Manthri

# Key Takeaways – 1<sup>st</sup> Review

1

## Debt Treatments and Sustainability

- Called for swift completion of the MoU with official creditors
- Emphasized the need to reach agreements with commercial creditors before the completion of the 2<sup>nd</sup> review, slated by end of 1H2024

2

## Reform Priorities for Swift Recovery

- Emphasized on key priorities including:
  - i. Advancing revenue mobilization
  - ii. Aligning energy pricing with costs
  - iii. Strengthening social safety nets
  - iv. Rebuilding external buffers
  - v. Protecting financial stability
  - vi. Eradicating corruption
  - vii. Enhancing governance

3

## Revenue-Based Fiscal Consolidation

- Called to reinforce revenue-based fiscal consolidation to recover from program slippages & past policy shortcomings

4

## Central Bank and Disinflation Strategy

- Called for CBSL to focus on the disinflation strategy to uphold the credibility of its inflation targeting regime
- Accumulating reserves, supported by exchange rate flexibility, remains a key priority under the EFF

5

## Financial Sector Stability

- Called to implement a bank recapitalization plan & strengthen financial supervision & crisis management framework to protect financial stability

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## Social Safety Net (SSN) and Social Spending Protection

- Called to strengthen the SSN & protect social spending to safeguard the poor & vulnerable

# IMF PROGRAM PERFORMANCE

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# IMF PROGRAM PERFORMANCE

- Program performance at end-June was satisfactory
- All end-June quantitative performance criteria (QPCs) and continuous QPCs were met, except for expenditure arrears
- All end-June indicative targets were met, with the exception of tax revenues which fell short by nearly 8%

	Targets	Actual	Status
<b>Primary Balance (floor):</b>			
End-Jun 2023	LKR 113.0Bn	LKR 31.0Bn	Met
End-Sep 2023	LKR 160.0Bn	LKR 123.7Bn	Met
<b>Expenditure Arrears (ceiling):</b>			
End-Jun 2023	0	LKR 34.5Bn	Not Met
End-Sep 2023	0	0	Met
<b>Tax Revenue (floor):</b>			
End-Jun 2023	LKR 1,300.0Bn	LKR 1,199.0Bn	Not Met
End-Sep 2023	LKR 2,100.0Bn	LKR 1,934.0Bn	Not Met
<b>Net credit to the government (ceiling):</b>			
End-Jun 2023	LKR 2,890.0Bn	LKR 2,800.0Bn	Met
End-Sep 2023	LKR 2,840.0Bn	LKR 2,838.0Bn	Met
<b>Net International Reserves (floor):</b>			
End-Jun 2023	USD -2.9Bn	USD -1.9Bn	Met
End-Sep 2023	USD -2.8Bn	USD -2.5Bn	Met

# IMF PROGRAM PERFORMANCE

Most structural benchmarks due by end-Oct 2023 were either met or implemented with slight delays

CBSL's unwinding of net credit to the government (NCG) should persist in line with program targets and Treasury should maintain a cash buffer to prevent the necessity for monetary financing

Due to the planned repayment of LKR 4.3Tn of T-bills and T-bonds by Treasury by end-2023, the proposed NCG ceiling for end-2023 is LKR 2.8Tn

CBSL is expected to continue selling government securities as domestic borrowing markets normalize and external financing resumes in 2024

As the new Central Bank Act allows a longer transition period for monetary financing of 18 months, CBSL has committed to refrain from additional primary market purchases of government securities

Exceptions will be made to address external financing shortfalls within six months of the 1<sup>st</sup> review

# IMF TARGETS

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# IMF Targets (2023/2024)

	DATE	STATUS
<b>Newly Proposed and Reformulated</b>		
Implement a High-Net-Worth Individuals and design and monitoring units within the Large Taxpayers Unit	End-Dec 2023	Pending
Cabinet approval of a reduction in the limit on government guarantees to 7.5% of GDP	End-Dec 2023	Pending
Cabinet approval of a strategy to build a VAT refund system and achieve a full repeal of SVAT	End-Dec 2023	Pending
Constitutional Council will develop rules for appointing CIABOC Commissioners	End-Dec 2023	Pending
Publish on a semi-annual basis on a designated website (firms receiving tax exemptions, etc.)	End-Dec 2023	Pending
Parliamentary approval for the amendments to the Banking Act	End-Jan 2024	Pending
Submission to Parliament of a new Public Financial Management (PFM) law	End Feb 2024	Pending
Government and CBSL to develop a detailed recapitalization plan for the remaining 4 banks	End-Feb 2024	Pending
Publication of a government action plan	End-Feb 2024	Pending
Introduction, tracking and reporting quarterly KPIs of tax compliance	End-Mar 2024	Pending
Implementation of the amendments to the Banking Act	End-Mar 2024	Pending
Enact a comprehensive Asset Recovery Law	End-Apr 2024	Pending
Cabinet approval of the fiscal strategy statement	End-Jun 2024	Pending
Cabinet approval and publication of a framework to strengthen the governance of public banks	End-Jun 2024	Pending
Anticorruption commission shall publish asset declarations for senior officials in line with Anticorruption Act	End-Jul 2024	Pending
Cabinet approval of revenue measures to support fiscal consolidation in 2025	End-Sep 2024	Pending

# IMF Targets (2023/2024)

	DATE	STATUS
<b>Fiscal, SOE, and Social Safety Net Reforms</b>		
Cabinet approval of revenue measures to support fiscal consolidation in 2024	End-Jul 2023	Not met (To be adopted as a prior action)
Completion of the rollout of the ITMIS	End-Sep 2023	Not met (Expected to be met by end-Mar 2024)
Parliamentary approval of the 2024 Appropriation Act	End-Dec 2023	Pending
Improve the Bulk Supply Transaction Account to accurately measure electricity subsidy	End-Dec 2023	Pending
<b>Financial sector</b>		
Cabinet approval of a full revision of the Banking Act	End-Jun 2023	Not met (in progress)
Parliament approval of a full revision of the Banking Act	End-Dec 2023	Not met



# IMF Targets (2023/2024)

EFFECTIVE ON OR BEFORE	
<b>Income Tax</b>	
Remove CIT exemptions on exports of IT services	April 1, 2025
Start estimating and publishing the direct costs imposed by tax incentives	January 1, 2024
<b>Excise Duties</b>	
Introduce automatic indexation of all excises to inflation	January 1, 2024
<b>Property, Wealth, and Wealth Transfer Taxes</b>	
Introduce a nationwide real property tax	January 1, 2025
Introduce a gift and inheritance tax with a tax-free allowance and minimal exemptions	January 1, 2025

# IMF PROPOSED CONDITIONS

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# Proposed Conditions To Strengthen IMF Program

1. To revise targets for end-Dec 2023—Quantitative performance criteria (QPC) on the Net Credit to Government, Monetary Policy Consultation Clause bands, and Indicative Targets (IT) on tax revenue and limit on treasury guarantees
2. New quantitative targets for end-Mar (ITs), end-Jun (QPCs), and end-Sep 2024 (ITs)
3. New continuous QPC on new CBSL purchases of government securities in the primary market as of Dec 2023
4. Upgrade the existing IT on tax revenue to a QPC as of Jun 2024

Sri Lanka: External Financing Gap and Program Financing, 2022-2027  
(In millions of USD)

	2022	2023	2024	2025	2026	2027	Total 2022-27
<b>Financing Gap (A)</b>	-2,834	-5,674	-4,654	-4,708	-3,291	-3,949	-25,110
<b>Program Financing (B)</b>	<u>2,834</u>	<u>5,674</u>	<u>4,654</u>	<u>4,708</u>	<u>3,291</u>	<u>3,949</u>	<u>25,110</u>
IMF EFF	0	682	682	685	689	346	3084
IFI program financing support	0	<u>1,220</u>	<u>780</u>	<u>524</u>	<u>524</u>	<u>524</u>	<u>3,572</u>
World Bank*	0	570	330	0	0	0	900
ADB	0	650	450	300	300	300	2,000
Other Financing**	0	0	0	224	224	224	672
Debt moratorium: external arrears accumulation	2,834	0	0	0	0	0	2,834
Debt relief	0	3,772	3,192	3,499	2,078	1,579	14,120
Sovereign bonds (market access)	0	0	0	0	0	1500	1,500
<b>Shortfall (A+B)</b>	0	0	0	0	0	0	0
<b>Memorandum:</b>							
Gross International Reserves	1,898	3,806	5,346	7,477	9,894	13,525	
Project loans	1,473	680	1,200	1,556	1,603	1,651	

Sources: CBSL; and IMF staff projections.

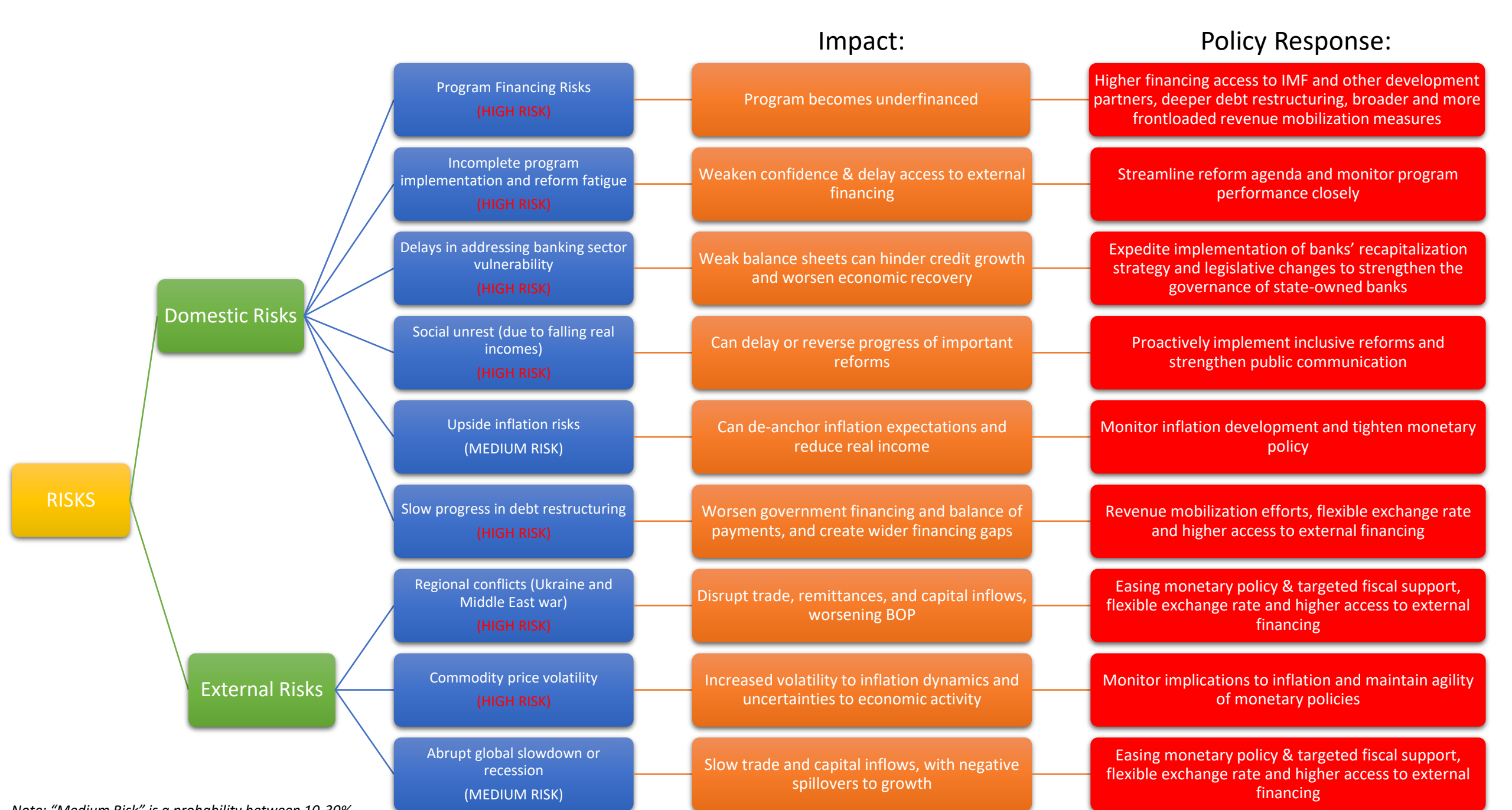
\* An additional US\$135 million disbursement from the WB on deposit insurance is not included in program financing, as it will be ringfenced.

\*\* This includes WB financing based on expectations of IDA21 allocation, and historical net disbursement trends from the range of WB instruments.

	Dec-2023 (O)	Dec-2023 (R)	Reason
Net credit to the government ceiling	LKR 2,740.0Bn	LKR 2,800.0Bn	To address structural liquidity shortages
Inflation (YoY)	15.0%	5.0%	For faster disinflation
Tax revenue floor	LKR 2,940.0Bn	LKR 2,550.0Bn	For slower than expected revenue mobilization
Treasury guarantees ceiling	LKR 1,700.0Bn	LKR 2,100.0Bn	For the new guarantee of the special swap between CBSL and Reserve Bank of India

# IMF PROGRAM RISKS & POLICY RESPONSE

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Note: "Medium Risk" is a probability between 10-30% and "High Risk" is a probability between 30-50%



# Capacity to Repay the Fund

- There is a financial risk arising from:
  - i. Lower reserve accumulation
  - ii. Financing shortfall from external partners
  - iii. High domestic interest burden
  - iv. Higher than expected bank and CBSL recapitalization needs (buffer of 0.5% of GDP reserved for recapitalization of CBSL in 2024, which would enable CBSL to reach positive equity from 2025)
  - v. Lower tax revenue collection
- Fund outstanding credit would peak at 3.7% of GDP in 2027, corresponding to 14.4% of exports of goods and services and 24.0% of gross reserves
- EFF repurchases and charges would peak in 2031, at 2.5% of exports of goods and services and 4.0% of gross reserves



# IMF OUTLOOK

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# Economy Outlook

- Projected Growth: To rebound from -3.6% in 2023 to 1.8% in 2024, supported by monetary conditions and eased import restrictions, but constrained by limited bank credit and fiscal consolidation
- Inflation Forecast: To increase to 4.8% by end-2023 due to Oct-2023 electricity tariff hike and further rise to 6.6% by end-2024 following the introduction of VAT measures
- Current Account Balance: Expected to post a deficit 0.8% of GDP, driven by strong import growth despite increased tourism earnings and remittances
- Gross International Reserves: Projected to reach USD 5.4Bn by end-2024, driven by new program & project financing and Foreign Direct Investment



# Sri Lanka: Economic Indicators (2022-2024)

	2022	2023 (Est)	2024 (Proj.)
Nominal GDP (%)	37.2%	16.1%	12.1%
Real GDP (%)	-7.8%	-3.6%	1.8%
Inflation (end of period %)	54.5%	4.8%	6.6%
Public Debt (% of GDP)	125.8%	114.1%	115.9%
Credit to Private Sector (%)	6.4%	0.3%	7.7%
Credit to central government and public corporations	31.1%	9.8%	12.8%
Gross Official Reserves (USD Mn)	1,898	3,806	5,346
External Debt (USD Bn)	57.4	53.8	55.5
Current Account Balance (USD Mn)	-744	1,232	-634
Primary Balance (% of GDP)	-3.7%	-0.7%	0.8%
Expenditure (% of GDP)	18.5%	19.0%	20.3%



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