

Sri Lanka: Request for Extension of Repurchase Expectations—Staff Report; and Press Release on the Executive Board Consideration

In the context of the request for extension of repurchase expectations for Sri Lanka, the following documents have been released and are included in this package:

- the staff report for the request for extension of repurchase expectations, prepared by a staff team of the IMF, in response to the authorities' request on January 5, 2005. Based on information available at the time, the staff report was completed on January 7, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the views of the Executive Board of the staff report that completed the request.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

SRI LANKA

Request for Extension of Repurchase Expectations

Prepared by the Asia and Pacific and Policy Development and Review Departments
(In consultation with the Finance and Legal Departments)

Approved by Wanda Tseng and Donal Donovan

January 7, 2005

1. **In the attached letter dated January 5, 2005, the Sri Lankan authorities request an extension of repurchase expectations** arising in the remainder of 2005, in the amount of SDR 74,162,500. The extension would have the effect of moving the repurchase expectations to an obligations basis, with each amount falling due exactly one year after the expectation date. Executive Directors had already approved an extension of four such repurchase expectations arising for one year from the date of approval of the PRGF/EFF supported program on April 18, 2003.¹

2. **The first review of the PRGF/EFF supported program has been delayed now for over a year.** The political environment has been difficult, with the ceasefire holding but the peace process stalled, and amidst parliamentary upheavals, elections, and a change in government. This contributed to a lack of progress on key structural reforms, holding up completion of the review. Moreover, over the past year, macroeconomic conditions have also deteriorated. In the face of a drought and an oil price shock, the government resorted to expansionary fiscal and monetary policies, which helped to maintain GDP growth above 5 percent in 2004, but inflation also increased and the fiscal and external positions deteriorated (Table 1).

3. **The authorities have expressed their desire to resume discussions on the PRGF/EFF supported program.** The Executive Board was briefed about the status of the program during the informal country matters meeting on December 13, 2004. In late December, the staff agreed with the Sri Lanka government to have comprehensive discussions on the authorities' detailed economic strategy and PRSP Progress Report in the context of the 2005 Article IV consultation in March 2005, as well as resume discussions with respect to the reviews of the PRGF/EFF supported program at that time.

¹ See *Sri Lanka—Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Use of Fund Resources—Request for an Extended Arrangement*, IMF Country Report No. 03/107.

4. **The tsunami of December 26 has caused enormous damage to life and property, fundamentally altering the outlook for 2005 and further increasing economic vulnerability.** All government efforts at this time are understandably focused on addressing the extensive humanitarian needs. A needs assessment by multilateral agencies with the participation of the IMF is expected to be finalized by end-January. Initial estimates by the authorities put total physical damage at \$1.3–1.5 billion (about 6½ percent of GDP). The broader macroeconomic impact will clearly be substantial, but the details are difficult to assess at this early stage. The fishing industry has been devastated, agricultural production may be affected, and tourism will suffer, especially in the short term. Preliminary estimates by staff indicate an adverse impact on 2005 GDP growth of about one percentage point. The impact on balance of payments prospects will also be significant. Major export sectors have not been seriously affected, but earnings from tourism are expected to decline by at least 15 percent relative to 2004, and higher imports will be needed for reconstruction (Table 2). While some of the financing needs will be met by increased aid flows (including possible deferment or debt relief by the Paris Club which is a pending issue at this time), preliminary estimates by staff indicate that Sri Lanka will be hard pressed to keep international reserves at the pre-tsunami level (about 2.3 months of imports), even after taking into account the proposed switch in repayments expectations during 2005 to an obligations basis.² Given the need for financial assistance to support recovery efforts, the authorities have also requested, in a letter to the Managing Director dated January 6, financial support under the Fund's Emergency Natural Disaster Assistance special policy. As a PRGF-eligible country, the authorities have expressed their hope that such assistance could be made available on concessional terms.

5. **The policy on repurchase expectations allows for the extension of such repurchases where the member's external position is not sufficiently strong for it to repay early without undue hardship or risk.**³ In arriving at this judgment, elements to be taken into account in assessing the external position are the level of international reserves, the outlook for the balance of payments, access to international capital markets, as well as any relevant special factors.

6. **Staff supports the authorities' request to extend the repurchase expectations arising in the remainder of the year to an obligations basis.** Taking into account the relatively low level of international reserves, limited access to market financing, the difficult balance of payments outlook for 2005, and the substantial financing requirement for economic rehabilitation from the recent natural disaster, repayment on an expectations basis would pose further strains on an already fragile situation. It is important to note in this case Sri Lanka's strong commitment to meet all repayments to the Fund as scheduled. In fact, the

² Estimates of additional aid flows in 2005 (\$300 million in Table 2) are highly provisional and subject to revision.

³ See "Review of Fund Facilities—Decisions," November 28, 2000 (www.imf.org).

authorities have made repurchases to the Fund on the basis of the expectations schedule since April 2004 amounting to SDR 43.96 million. However, meeting these expectations became increasing difficult with the deterioration in the external position to well below what was envisaged in the programs supported by the 2001 SBA and 2003 PRGF/EFF arrangements. Moreover, the situation has been made considerably worse by recent tragic events. Accordingly, staff supports the authorities' request to extend repurchase expectations arising during 2005.

Table 1. Sri Lanka: Selected Economic Indicators, 2001–2005

Nominal GDP (2003): US\$18.2 billion

Population (2003): 19.3 million

GDP per capita (2003): US\$947

Quota: SDR 413 million

	2001	2002	2003	2004 Est.	2005 Projections		
					EBS 03/40	Pre-Tsunami	Post-Tsunami 1/
GDP and inflation (in percent)							
Real GDP growth	-1.5	4.0	5.9	5.2	6.8	5.0	4.0
Inflation (Colombo CPI; average)	14.2	9.6	6.3	7.6	6.0	12.0	14.0
Inflation (Colombo CPI; end-of-period)	10.8	11.3	5.0	13.8	...	8.0	8.5
Public finances (in percent of GDP)							
Revenue	16.6	16.5	15.7	15.6	18.6	16.1	...
Expenditure	27.5	25.4	24.0	24.3	23.7	24.8	...
Savings/revenue measures to be identified	...	...	...	...	...	1.2	...
Primary balance	-4.1	-1.6	-1.2	-2.6	0.8	-1.5	...
Overall balance	-10.8	-8.9	-8.3	-8.7	-5.1	-7.5	...
Government debt (domestic and external)	103.2	105.5	105.9	106.7	89.1	100.8	...
Money and credit (percent change, end of period)							
Reserve money	7.0	12.3	11.9	18.8	...	14.5	...
Broad money	13.6	13.4	15.3	17.5	13.2	14.5	...
Domestic credit	16.2	6.5	7.6	20.1	...	12.3	...
Private sector credit	8.9	12.0	16.9	20.6	...	15.4	...
Public sector credit	30.6	-2.6	-10.0	18.9	...	4.6	...
Balance of payments (in millions of U.S. dollars)							
Exports	4,817	4,699	5,133	5,734	6,280	6,105	6,105
<i>Of which</i> : textiles and garments	2,543	2,424	2,576	2,692	...	2,906	2,906
Imports	5,974	6,105	6,673	8,004	8,302	8,389	8,798
<i>Of which</i> : oil imports	731	789	838	1,145	...	1,187	1,186
Trade balance	-1,157	-1,406	-1,540	-2,271	-2,021	-2,284	-2,693
Current account balance	-179	-236	-76	-801	-876	-690	-1,206
Current account balance (in percent of GDP)	-1.1	-1.4	-0.4	-4.1	-4.2	-3.4	-5.9
Overall balance	229	339	428	-210	384	224	7
Export value growth (percent)	-12.8	-2.4	9.2	11.7	10.6	6.5	6.5
Import value growth (percent)	-18.4	2.2	9.3	19.9	9.2	4.8	9.9
Gross official reserves (end of period)							
In millions of U.S. dollars 2/	1,231	1,566	2,147	1,825	2,818	1,985	1,973
In months of imports	2.1	2.4	2.8	2.2	3.3	2.3	2.3
As a percent of short-term debt 3/	60	80	110	95	...	103	101
External debt (public and private)							
In billions of U.S. dollars	9.5	10.3	11.7	11.9	12.1	12.6	...
As a percent of GDP	60.2	62.5	64.1	61.3	57.3	61.6	...
Memorandum items:							
Nominal GDP (in billions of rupees)	1,407	1,583	1,760	1,972	2,321	2,278	2,297
Nominal GDP (in billions of U.S. dollars)	15.7	16.5	18.2	19.5	21.1	20.6	20.5

Sources: Data provided by the Sri Lanka authorities; and staff estimates and projections.

1/ Fiscal, monetary, and debt projections will be updated when more information is available.

2/ Excluding central bank Asian Clearing Union (ACU) balances.

3/ As reserves exclude ACU balances, they are also excluded from short-term debt to compute this ratio.

Table 2. Sri Lanka: Balance of Payments, 2001–2005
(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004 Est.	2005 Projections		
					EBS/03/40	Pre- Tsunami	Post- Tsunami
Current account	-179	-236	-76	-801	-876	-690	-1,206
Trade balance	-1,157	-1,406	-1,540	-2,271	-2,021	-2,284	-2,693
Exports	4,817	4,699	5,133	5,734	6,280	6,105	6,105
Textiles and garments	2,543	2,424	2,576	2,807	...	2,906	2,906
Other	2,274	2,275	2,557	2,926	...	3,199	3,199
Imports	5,974	6,105	6,673	8,004	8,302	8,389	8,798
Non-oil imports	5,243	5,316	5,835	6,859	...	7,202	7,611
Oil imports	731	789	838	1,145	...	1,187	1,186
Services	241	295	423	406	249	460	300
Receipts	1,373	1,270	1,439	1,558	1,438	1,680	1,520
Of which: from tourism	...	372	532	585	...	655	495
Payments	1,132	975	1,016	1,152	1,189	1,221	1,221
Income	-268	-253	-192	-233	-317	-252	-252
Receipts	106	75	144	153	177	186	186
Payments	374	328	336	386	494	438	438
Transfers	1,005	1,128	1,234	1,296	1,213	1,386	1,438
Private (net)	984	1,097	1,205	1,263	1,189	1,356	1,408
Official (net)	22	31	29	34	24	30	30
Capital and financial account	535	444	603	591	1,260	914	914
Capital transfers (net)	197	65	61	62	67	63	63
Financial account	339	379	542	529	1,193	851	851
Long-term flows	163	327	617	540	1,156	821	821
Direct investment	172	186	201	190	374	220	220
Foreign direct investment	82	181	171	145	324	150	150
Privatization proceeds	90	5	30	45	50	70	70
Private sector borrowing 1/	-257	-21	-33	18	101	108	108
Official sector borrowing	248	162	449	332	681	493	493
Disbursements	575	542	808	660	1,007	877	877
Program		66	242	35	...	189	189
Project		476	566	625	...	688	688
Amortization	327	380	359	328	326	384	384
Short-term flows	175	52	-75	-11	37	30	30
Additional aid flows 2/	...	...	...	...	...	...	300
Errors and omissions	-127	38	-99	0	0	0	0
Valuation adjustments	0	93	0	0	0	0	0
Overall balance	229	339	428	-210	384	224	7
Financing	-229	-339	-428	210	-384	-224	-7
NIR (- = increase)	-229	-339	-428	210	-384	-224	-7
Gross reserves	-320	-335	-581	322	-450	-251	-148
Reserve liabilities 3/	-91	4	-153	112	-66	28	141
Memorandum items:							
Current account (in percent of GDP)	-1.1	-1.4	-0.4	-4.1	-4.2	-3.4	-5.9
Export growth (in percent)	-12.8	-2.4	9.2	11.7	10.6	6.5	6.5
Textiles and garments	-14.7	-4.7	6.3	9.0	...	3.5	3.5
Other	-10.5	0.1	12.4	14.4	...	9.3	9.3
Import growth (in percent)	-18.4	2.2	9.3	19.9	9.2	4.8	9.9
Non-oil	-18.3	1.4	9.8	17.5	...	5.0	11.0
Oil	-18.9	7.9	6.2	36.7	...	3.7	3.6
Gross official reserves 4/ 5/	1,231	1,566	2,147	1,825	2,818	1,985	1,973
(In months of prospective imports of	2.1	2.4	2.8	2.2	3.3	2.3	2.3
(In percent of short term debt)	60	80	110	94	...	103	101
Net international reserves	970	1,278	1,780	1,571	2,215	1,794	1,578
GDP (US\$ millions)	15,746	16,544	18,237	19,459	21,067	20,600	20,511
Oil price (US\$ per barrel)	24.3	25.0	28.9	37.7	22.0	37.0	37.0

Sources: Data provided by the Central Bank of Sri Lanka; and Fund staff estimates and projections.

1/ Includes public corporations.

2/ Preliminary projections.

3/ In 2005, it is assumed that Sri Lanka repays the fund on an expectation and obligation basis under the pre-Tsunami and post-Tsunami scenario, respectively. In addition, two disbursements under the PRGF/EFF arrangement are assumed.

4/ Net of ACU debit balances.

5/ Valued at historical cost through 2002, and at market cost since then.

Table 3. Sri Lanka: Projected Payments to the Fund
(In millions of SDRs, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008
Disbursements 1/	59.1	0.0	118.1	118.1	118.1	0.0
Obligations from existing drawings						
Repayments	22.4	79.4	...	...	...	...
Expectation basis	...	...	100.0	30.2	3.5	10.7
Obligation basis	...	...	25.8	74.2	31.9	7.3
Charges/interest	5.1	5.6	...	...	...	...
Expectation basis	...	...	4.9	2.9	2.4	2.2
Obligation basis	...	...	6.5	4.6	2.9	2.3
Stock of outstanding use of Fund resources						
Obligations basis	264.6	189.2	281.5	325.4	411.6	404.3
Memorandum items: (obligations basis)						
Debt service						
Payments to the Fund/exports GNFS	0.6	1.7	0.6	1.5	0.6	0.2
Payments to the Fund/Quota	6.6	20.6	7.8	19.1	8.4	2.3
Payments to the Fund/GDP	0.2	0.6	0.2	0.5	0.2	0.1
Payments to the Fund/reserves	1.8	6.9	2.5	6.0	2.7	0.7
Outstanding use of Fund resources						
Outstanding UFR/exports GNFS	5.6	3.8	5.6	6.1	7.3	6.8
Outstanding UFR/quota	64.0	45.8	68.1	78.7	99.6	97.8
Outstanding UFR/GDP	2.0	1.4	2.1	2.3	2.6	2.4
Outstanding UFR/reserves	17.3	15.3	21.8	24.9	32.4	27.9

Source: Fund staff estimates.

1/ Assuming two disbursements under the PRGF/EFF arrangements in 2005 and 2006, and the final disbursement in 2007.

Central Bank of Sri Lanka
30, Janadhipathi Mawatha
Colombo 1, Sri Lanka

January 5, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700, 19th Street
Washington D.C. 20431
U.S.A.

Dear Mr. Rato,

Request for an Extension of Repurchase Expectations

On behalf of the Government of Sri Lanka, I wish to make a formal request for an extension of repurchase expectations arising in the balance period of 2005, amounting to an equivalent of SDR 74.163 million.

In 2004, Sri Lanka faced an adverse balance of payments situation, mainly due to the severe drought conditions and high international prices of oil experienced during the year. The balance of payments deficit for 2004 is estimated to be around US\$210 million, with expenditure on oil imports in 2004 estimated to be higher by US\$307 million than in 2003. Gross official foreign reserves net of ACU balances at end 2004 are estimated to be US\$1,825 million, a decline of US\$322 million from the level at end 2003. Notwithstanding these difficulties, we have made every effort to meet our debt service obligations to the Fund according to the expectations schedule.

The recent tragic events have compounded this already difficult situation. The Tsunami disaster that occurred on December 26 has caused enormous damage to life and property and affected key sectors of the economy, compelling the Government to focus all efforts on the extensive humanitarian needs. In this context, we are very grateful for your words of condolence and support expressed in your letter of 28 December 2004.

While financial markets have been stable, the external position is much weaker than projected at the time of approving the PRGF-EFF arrangement in 2003. The loss of life and devastation caused to the tourist facilities in the coastal areas of Sri Lanka, at the height of the tourist season, would materially affected the inflows of foreign exchange from tourism. In addition, the vast amount of reconstruction required to re-establish, even the basic infrastructure facilities in the affected areas would result in a substantial increase in imports. The international community has been greatly concerned by the disaster and has pledged generous assistance. Nevertheless, the magnitude and timing of such assistance is still uncertain. Therefore, meeting the repurchase expectations arising in the coming year would impose an additional undue burden on the Sri Lankan economy.

In view of the developments mentioned above, we earnestly request you to recommend to the Executive Board of the IMF to consider approving this request for an extension of the repurchase expectations. We remain committed to working closely with the IMF in the period ahead, including the resumption of discussions on the PRGF-EFF supported programme at a suitable time.

Yours sincerely,

/s/

Sunil Mendis
Governor of the Central Bank and
Alternate Governor of the Fund

cc: Mr. Jeremy Carter
Senior Resident Representative



INTERNATIONAL MONETARY FUND

EXTERNAL
RELATIONS
DEPARTMENT

Press Release No. 05/5
FOR IMMEDIATE RELEASE
January 13, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves Sri Lanka's Request for Extension of Repayment Expectations

The Executive Board of the International Monetary Fund (IMF) today approved the extension of repayment expectations by Sri Lanka arising in the remainder of 2005, in the amount of SDR 74.2 million (about US\$ 113.5 million).

Sri Lanka requested this extension following the tsunami disaster on December 26 that caused enormous damage to life and property, fundamentally altering the outlook in Sri Lanka for 2005 and further increasing economic vulnerability. The extension of repurchase expectations to the Fund will lower debt service payments to the IMF by about US\$ 113.5 million in 2005.