

IMF REACHES STAFF LEVEL AGREEMENT ON THE FIRST REVIEW OF EFF**Key highlights****Report date: 20.10.2023**

International Monetary Fund (IMF) and the Sri Lankan authorities have reached a staff-level agreement on the first review of the 48-month Extended Fund Facility (EFF) program. Once approved, Sri Lanka will gain access to approximately \$330 million in financing from the IMF, marking an important step in addressing the country's economic challenges. This would bring the total IMF financial support disbursed under the arrangement to SDR 508 million (about US\$660 million). The agreement acknowledges that Sri Lanka is making progress in implementing macroeconomic reforms and is showing initial signs of economic stabilization. However, challenges such as a contracting economy, debt restructuring, and governance issues still persist, necessitating further efforts to achieve lasting economic recovery and growth. Given below are the key highlights.

Access to Financing

Sri Lanka will gain access to SDR 254 million (about US\$330 million) in financing once the review is approved by the IMF Management and the Executive Board. This financial injection will provide a much-needed boost to the country's foreign exchange reserves, which have been under pressure due to external debt obligations and dwindling reserves.

Economic Stabilization

The agreement indicates that macroeconomic policy reforms in Sri Lanka are starting to show some results, and the economy is displaying early signs of stabilization. Inflation has significantly decreased, and essential commodity shortages have eased. These developments suggest that the country is taking steps in the right direction.

Reform Commitment

The Sri Lankan government's commitment to an ambitious reform agenda is a positive signal. Rapid disinflation and fiscal adjustments are noteworthy achievements. However, some areas, such as expenditure arrears and tax revenue targets, still need improvement.

Debt Restructuring

The IMF's statement highlights the importance of resolving debt restructuring discussions. Prolonged debt negotiations have weakened Sri Lanka's external position, and reserves accumulation has slowed. To restore confidence and financial stability, a quick resolution of the debt issue is crucial.

External Creditors

The agreement also mentions the need for an agreement with official creditors on a debt treatment consistent with the IMF-approved program parameters. This suggests that negotiations with official creditors, including China's Export-Import Bank, are ongoing. A resolution with official and commercial creditors is vital for Sri Lanka's economic recovery.

Governance and Corruption

The IMF praises Sri Lanka's commitment to implementing recommendations from the Governance Diagnostic Report, emphasizing the importance of addressing corruption risks and strengthening accountability. These actions are seen as essential for economic confidence and inclusive growth.

Challenges Remain

Despite the progress made, there are several challenges. The Sri Lankan economy contracted by 3.1% in the second quarter of the year, and growth remains subdued. High-frequency economic indicators provide mixed signals, indicating that the path to full recovery is uncertain.

Conditions

For the IMF's Executive Board to finalize the review and approve the financial support, two specific conditions must be met.

- 1) First, the Sri Lankan authorities must complete all the actions and measures they were supposed to undertake as part of their agreement with the IMF.
- 2) Second, there needs to be a review of assurances regarding the financing arrangements, ensuring that the conditions for disbursing funds are met.

Overall, the staff-level agreement with the IMF is a positive step for Sri Lanka. It provides financial support and signals that the country is on the right track in terms of economic reforms.

AMBEON SECURITIES (PVT) LIMITED

No: 10, 2nd Floor
 Gothami Road,
 Colombo 08,
 Sri Lanka.
 T : +94 11 532 8 100
 F : +94 11 532 8 177
 E: research@ambeonsecurities.lk

Sales Team

Charith Kamaladasa	Director/CEO	charithk@ambeonsecurities.lk
Niranjan Niles	Executive Director	niles@ambeonsecurities.lk
Romesh Kenny	Senior Manager Institutional Sales	romesh@ambeonsecurities.lk
Chinthaka Weeraratna	Senior Investment Advisor	chinthaka@ambeonsecurities.lk
Pasindu Yatawara	Senior Investment Advisor	pasindu@ambeonsecurities.lk

Research Team

Hansinee Beddage	Manager Investment Research	hansinee@ambeonsecurities.lk
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