

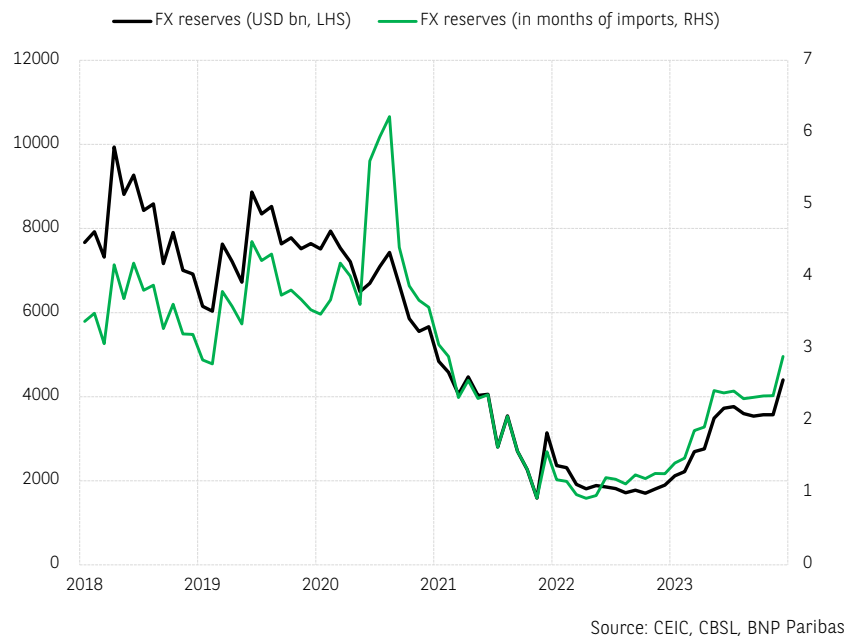
CHART OF THE WEEK



31 January 2024

SRI LANKA: FX RESERVES HAVE INCREASED BUT THE SITUATION REMAINS FRAGILE

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More than 18 months after defaulting on its external debt payments, Sri Lanka's macroeconomic position has improved, but remains very fragile. Economic activity bounced back in the third quarter, after eight consecutive quarters of contraction. Growth is likely to be negative for 2023 as a whole (-3.6%), but is likely to reach nearly 3% in 2024, boosted in particular by a reduction in inflationary pressures (2.6% y/y in H2 2023 vs 37.1% in H1 2023) and the easing of monetary policy.

Meanwhile, external accounts have consolidated. Officially, FX reserves reached USD4.4 billion in December 2023, the equivalent of 2.9 months of imports of goods and services, from just USD1.9 billion a year earlier.

But this improvement is fragile. First, excluding currency swaps, "usable" reserves cover only 1.3 months of imports according to the IMF. Secondly, the recovery in external accounts results mainly from international financial aid, the suspension of payments of debt principal on the government's external debts, the reduction in imports (a consequence of the economic crisis) and restrictions the central bank has imposed on imports, capital outflows and foreign exchange. These restrictions remain in force, even though they have been significantly relaxed since the summer. With the return to growth, we would expect an increase in the current account deficit.

In addition, the restructuring of the government's external debt has still not been finalised. The government must rapidly reach an agreement with private creditors to respond to the IMF's requirements and cover its financing needs. So far, however, although it reached an agreement in principle with public creditors in November 2023, discussions with private creditors (who hold 61% of the government's external debt) are ongoing.

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