

SRI LANKA

Table 1 **2023**

Population, million	22.2
GDP, current US\$ billion	84.4
GDP per capita, current US\$	3792.8
International poverty rate (\$2.15) ^a	1.0
Lower middle-income poverty rate (\$3.65) ^a	11.3
Upper middle-income poverty rate (\$6.85) ^a	49.3
Gini index ^a	37.7
School enrollment, primary (% gross) ^b	96.9
Life expectancy at birth, years ^b	76.6
Total GHG emissions (mtCO2e)	34.3

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2019), 2017 PPPs.
b/ Most recent WDI value (2022).

The economy has stabilized with positive growth, low inflation, a steady exchange rate, and improved fiscal and external balances amid the debt service suspension. However, poverty and inequality remain high. Continued macro stability hinges on policy consistency and the successful completion of the external debt restructuring. Prospects for medium-term growth and poverty reduction depend on the design and sustained implementation of key structural reforms.

Key conditions and challenges

The economy has stabilized since late 2023 following the deep economic crisis. Sri Lanka defaulted in 2022 amid unsustainable debt and depleted reserves, driven by macroeconomic mismanagement and long-standing structural weaknesses, and exacerbated by exogenous shocks. However, reforms implemented since 2022, including cost-reflective utility pricing, new revenue measures, a return to prudent monetary policy, and domestic debt restructuring, have helped regain macroeconomic stability.

After contracting by 7.3 percent (year-on-year, y-o-y) in 2022, the economy grew in the last two quarters of 2023, limiting the annual contraction to 2.3 percent. Inflation moderated to single digits in mid-2023, down from a peak of 69.8 percent (y-o-y) in September 2022. The rupee appreciated by 10.8 percent (y-o-y) in 2023 after sharply depreciating by 81.2 percent the year before. Due to the recovery of tourism receipts and remittances and increased inflows from development partners, usable official reserves increased to US\$3.0 billion (equivalent to 2.1 months of imports) by end-2023, compared to US\$500 million at end-2022. In June 2024, the International Monetary Fund successfully completed the second review of the Extended Fund Facility program.

Despite progress, external debt servicing remains suspended while negotiations

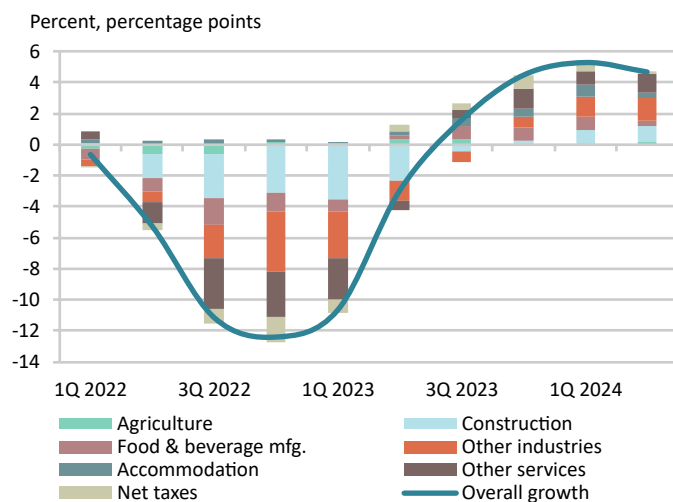
with external creditors continue. Household budgets remain stretched due to tax and price increases, as well as jobs and income losses. Real wages contracted by 16.9 and 22 percent between 2021 and 2024, in the private and public sectors, respectively. Food insecurity remains high, and poverty has nearly doubled to 23.4 percent in 2024. Sustained implementation of key structural reforms—related to fiscal and debt management, the financial sector, social assistance, state-owned enterprises, and trade and investment—will determine the prospects for medium-term growth and poverty reduction.

Recent developments

The economy grew by 5 percent (y-o-y) in H1 2024, driven by a rebound in the industrial sector—particularly in construction and food and beverage manufacturing—as well as strong performance in tourism-related services. Private consumption remained weak as household disposable incomes continued to be depressed. Labor force participation continued to decline (from 49.9 percent in Q1 2023 to 47.1 percent in Q1 2024). Food insecurity was widespread, with 23.7 percent of households being food insecure and 26 percent of households consuming an inadequate diet in 2023.

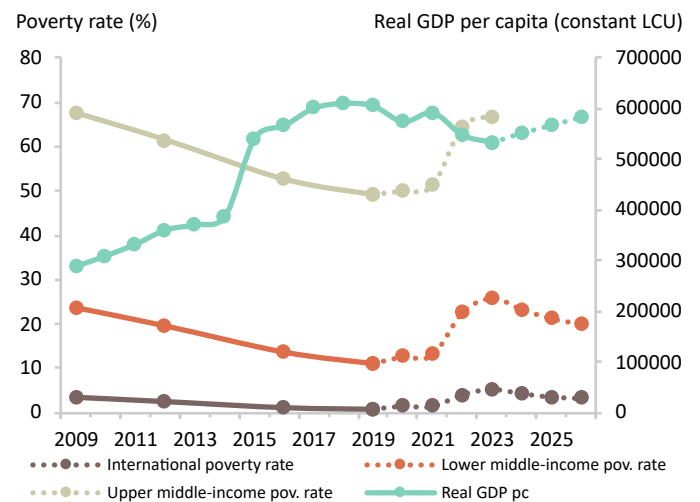
Headline inflation, measured by the Colombo Consumer Price Index, remained in the low single digits throughout 2024 (0.5 percent, y-o-y, in August 2024), supported by downward adjustments in administered

FIGURE 1 Sri Lanka / Real GDP growth and contributions to real GDP growth (production side)



Sources: Department of Census and Statistics and World Bank calculations.
Note: Food and beverage manufacturing includes production of tobacco products and accommodation includes food and beverage services.

FIGURE 2 Sri Lanka / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

prices, currency appreciation, and improved supply conditions, whilst demand remained subdued. With inflation well below target, the central bank maintained an accommodative stance, cutting policy rates by 75 basis points (bps) between March and July 2024 (a cumulative 725 bps reduction since May 2023), pushing commercial bank lending and deposit rates downwards. Despite this, growth in credit to the private sector remained sluggish at 6.9 percent in July 2024 (y-o-y).

The merchandise trade deficit increased by 18.3 percent (y-o-y) in the first seven months of 2024 as import demand gradually recovered. However, increased tourism receipts (66.1 percent, y-o-y) and remittances (11 percent, y-o-y) in the first eight months, the continued suspension of debt servicing, and inflows from development partners contributed to a balance of payment surplus during this period. As a result, usable official reserves increased to US\$4.5 billion (equivalent to 3 months of imports) by the end of August 2024, and net foreign assets of the banking system turned positive in May 2024 for the first time in four years. With improved foreign exchange liquidity, the rupee appreciated by 7.3 percent between January and August 2024.

The primary surplus, achieved in 2023, strengthened further in the first six months of 2024, as new measures, including an increase in the VAT rate and removal of VAT exemptions, led to a 42.6 percent increase in tax revenues, while expenditures remained tightly controlled. The overall fiscal deficit declined as the interest bill fell, driven by lower borrowing costs.

Outlook

Faster-than-expected macroeconomic stabilization has improved the short-term growth outlook to 4.4 percent (y-o-y) in 2024. Continued implementation of structural reforms will, however, be key to raising the medium to long-term growth potential. Poverty (below \$3.65 per person per day, 2017 PPP) is expected to decline gradually but remain above 20 percent until 2026. Inflation is likely to remain below the central bank's target of 5 percent in 2024, and gradually increase towards the medium-term target as demand picks up. The current account is projected to remain in surplus in 2024, driven by tourism and remittances, and with the restriction on importing personal vehicles only being phased out from 2025. Debt restructuring

and continued fiscal consolidation are expected to reduce the overall fiscal balance in the medium term.

While recent economic performance has been sound, macroeconomic stability remains fragile and is predicated on the consistent implementation of key fiscal, financial, and monetary policies. Given limited fiscal and external buffers, however, downside risks remain high. These include a protracted or insufficiently deep debt restructuring, policy uncertainty (including direction and pace of policy reform and the potential fiscal impact of electoral promises), and medium-term scarring effects of the crisis. Financial sector risks need to be carefully monitored as elevated non-performing loans and high exposure to the sovereign hinder financial sector stability. Poverty outcomes will hinge on reform design and sequencing, as well as the adequacy and targeting of compensating transfers. Inequality is estimated to remain high and increases in stunting and malnutrition are expected to increase spatial and intergenerational inequalities in the absence of compensating mechanisms and sustained growth. On the upside, a strong and sustained implementation of the structural reform program could boost confidence and attract fresh capital inflows.

TABLE 2 Sri Lanka / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2021	2022	2023	2024e	2025f	2026f
Real GDP growth, at constant market prices	4.2	-7.3	-2.3	4.4	3.5	3.1
Private consumption	2.7	-0.5	-1.6	2.2	2.6	2.9
Government consumption	-2.8	1.4	-5.4	-0.1	2.4	1.8
Gross fixed capital investment	6.5	-24.5	-8.4	14.0	7.0	4.6
Exports, goods and services	10.1	10.2	12.0	4.3	3.6	3.4
Imports, goods and services	4.1	-19.9	6.5	4.7	3.9	3.7
Real GDP growth, at constant factor prices	3.9	-7.0	-2.6	4.4	3.5	3.1
Agriculture	1.0	-4.2	2.6	1.5	1.5	1.5
Industry	5.7	-16.0	-9.2	10.4	6.4	4.1
Services	3.4	-2.6	-0.2	2.3	2.5	2.9
Inflation (consumer price index)	6.0	46.4	17.4	3.0	4.5	5.1
Current account balance (% of GDP)	-3.7	-2.0	1.8
Net foreign direct investment inflow (% of GDP)	0.7	1.2	0.8	-0.9	-1.0	-1.0
International poverty rate (\$2.15 in 2017 PPP)^a	1.5	4.1	5.2	4.3	3.5	3.3
Lower middle-income poverty rate (\$3.65 in 2017 PPP)^a	13.1	22.7	25.9	23.4	21.3	20.1
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^a	51.2	64.4	66.6	64.3	63.3	62.0
GHG emissions growth (mtCO₂e)	1.2	-5.8	-2.4	6.2	6.1	5.9
Energy related GHG emissions (% of total)	59.7	57.8	56.2	58.5	60.7	62.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast.

a/ Calculations based on SAR-POV harmonization, using 2019-HIES. Actual data: 2019. Nowcast: 2020-2023. Forecasts are from 2024 to 2026.