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The Democratic Socialist Republic of Sri Lanka
US\$1,500,000,000 6.20% Bonds due 2027

The US\$1,500,000,000 6.20% Bonds due 2027 (the “Bonds”) of the Government of the Democratic Socialist Republic of Sri Lanka (the “Issuer”) will be issued in registered form in minimum denominations of US\$200,000 and integral multiples of US\$ 1,000 in excess thereof. Interest on the Bonds will be payable semi-annually in arrears on May 11 and November 11 of each year commencing on November 11, 2017. The Bonds are not redeemable prior to maturity. Except as described herein, payments on the Bonds will be made without deduction for or on account of withholding taxes imposed by Sri Lanka. The Bonds will mature at par on May 11, 2027.

The Bonds will constitute direct, unconditional, unsubordinated and unsecured general obligations of the Issuer. The Bonds will at all times rank *pari passu* among themselves in all respects, without any preference of one over the other by reason of priority of date of issue or otherwise. The Bonds will at all times rank at least equally with all other present and future unsecured and unsubordinated External Indebtedness (as defined herein) of the Issuer. The full faith and credit of the Democratic Socialist Republic of Sri Lanka will be pledged for the due and punctual payment of the principal of, and interest on, the Bonds.

The Bonds are expected to be rated “B+” by Standard & Poor’s Ratings Services, “B1” by Moody’s Investors Service and “B+” by Fitch Ratings. The ratings assigned by rating agencies are indicative and may go up and down from time to time. A credit rating is not a recommendation to purchase, hold or sell securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.

The Bonds are a new issue of securities with no established trading market. Approval in-principle has been received from the Singapore Exchange Securities Trading Limited (the “SGX-ST”) for the listing and quotation of the Bonds on the SGX-ST. For so long as the Bonds are listed on the SGX-ST and the rules of the SGX-ST so require, the Bonds will be traded on the SGX-ST in a minimum board lot size of S\$200,000 (or its equivalent in foreign currencies). The SGX-ST assumes no responsibility for the correctness of any of the statements made, opinions expressed or reports contained in this Offering Circular. Approval in-principle from, admission to the Official List of, and the listing and quotation of any Bonds on, the SGX-ST are not to be taken as an indication of the merits of the Issuer or the Bonds.

The Bonds have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the “Securities Act”), or with any securities regulatory authority of any state or other jurisdiction of the United States. The Bonds may not be offered or sold within the United States except to qualified institutional buyers (“QIBs”) in reliance on the exemption from registration provided by Rule 144A under the Securities Act (“Rule 144A”) and outside the United States in offshore transactions in reliance on Regulation S under the Securities Act (“Regulation S”). Prospective investors are hereby notified that sellers of the Bonds may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of certain restrictions on resale or transfer, see “Plan of Distribution” and “Notice to Investors”.

Bond Price: 100.0%

Delivery of the Bonds is expected to be made on or about May 11, 2017 through the book-entry facilities of The Depository Trust Company (“DTC”).

Joint Lead Managers and Bookrunners

Citigroup	CITIC CLSA Securities	Deutsche Bank	HSBC	ICBC International	J.P. Morgan	Standard Chartered Bank
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The date of this Offering Circular is May 4, 2017.



Prospective investors should rely only on the information contained in this Offering Circular. No person has been authorized to give any information or to make any representation other than those contained in this Offering Circular in connection with the offering of the Bonds (the “Offering”) and, if given or made, such information or representations must not be relied upon as having been authorized by the Issuer or the initial purchasers named in “Plan of Distribution” (the “Initial Purchasers”). Neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Issuer since the date hereof. This Offering Circular does not constitute an offer of, or an invitation by, or on behalf of, the Issuer or the Initial Purchasers to subscribe for, or purchase, any of the Bonds in any jurisdiction in which such offer or invitation is not authorized or unlawful.

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This Offering Circular has been prepared by the Issuer solely for use in connection with the Offering described in this Offering Circular. This Offering Circular is personal to each offeree and does not constitute an offer to any other person or to the public generally to subscribe for or otherwise acquire securities. Distribution of this Offering Circular to any other person other than the prospective investor and any person retained to advise such prospective investor with respect to its purchase is unauthorized, and any disclosure of any of its contents, without our prior written consent, is prohibited. Each prospective investor, by accepting delivery of this Offering Circular, agrees to the foregoing and to make no copies of this Offering Circular.

For a description of some restrictions on the offer and sale of the Bonds and the distribution of this Offering Circular, see “Plan of Distribution” and “Notice to Investors”.

The Initial Purchasers, the Trustee (as defined herein), the Paying Agent, the Transfer Agent and the Registrar make no representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this Offering Circular. Nothing contained in this Offering Circular is, or shall be relied upon as, a promise or representation by the Initial Purchasers as to the past or future. The Issuer has furnished the information contained in this Offering Circular. The Initial Purchasers, the Trustee, the Paying Agent, the Transfer Agent and the Registrar have not independently verified any of the information contained herein (financial, legal or otherwise) and assume no responsibility for the accuracy or completeness of any such information or of any other information provided by the Issuer in connection with the Bonds in their distribution.

The Issuer, having made all reasonable inquiries, confirms that this Offering Circular contains all information which is material in the context of the Offering, that the information contained in this Offering Circular is true and accurate and is not misleading in all material respects, that the opinions and intentions expressed in this Offering Circular are honestly held, and that there are no other facts the omission of which would make this Offering Circular or any of such information or the expression of any such opinions or intentions misleading in any material respect. The Issuer accepts responsibility accordingly.

This Offering Circular is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer, the Initial Purchasers, the Paying Agent, the Transfer Agent and the Registrar that any recipient of this Offering Circular should purchase any of the Bonds. Each prospective investor contemplating purchasing the Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Prospective investors should not construe anything in this Offering Circular as legal, business or tax advice. Each prospective investor should consult its own advisors as needed to make its investment decision and to determine whether it is legally permitted to purchase the securities under applicable legal investment or similar laws or regulations.

IN CONNECTION WITH THIS OFFERING, THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED AS STABILIZING MANAGER (THE “STABILIZING MANAGER”) (OR PERSONS ACTING FOR IT ON BEHALF OF THE INITIAL PURCHASERS) MAY OVER-ALLOT THE BONDS OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE BONDS AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILIZING MANAGER, OR ITS AGENT(S), WILL UNDERTAKE STABILIZATION ACTION. ANY STABILIZING MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE BONDS IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE BONDS AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE BONDS. ANY STABILIZATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE STABILIZING MANAGER, OR ITS AGENT, IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES. SEE “PLAN OF DISTRIBUTION”.

This Offering Circular is being submitted on a confidential basis in the United States to a limited number of QIBs for informational use solely in connection with their consideration of a purchase of the Bonds. It may not be copied or reproduced in whole or in part, nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Each investor or holder of interests in the Bonds will be deemed, by its acceptance or purchase of such Bonds, to have made certain representations and agreements as set out in “Notice to Investors”.

Notwithstanding anything herein to the contrary, from the commencement of discussions with respect to the transaction contemplated by this Offering Circular, all persons may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transaction described herein and all materials of any kind (including opinions and other tax analyses) that are provided to such persons relating to such tax treatment and tax structure, except to the extent that any such disclosure could reasonably be expected to cause this transaction not to be in compliance with securities laws. For purposes of this paragraph, the tax treatment of this transaction is the purported or claimed U.S. federal income tax treatment of this transaction and the tax structure of this transaction is any fact that may be relevant to understanding the purported or claimed U.S. federal income tax treatment of this transaction.

Neither the U.S. Securities and Exchange Commission (the “SEC”), any state securities commission nor any other regulatory authority has approved or disapproved the securities nor have any of the foregoing authorities passed upon or endorsed the merits of the Offering or the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offense. As a prospective investor, you should be aware that you may be required to bear the financial risks of this investment for an indefinite period of time.

This Offering Circular contains summaries believed to be accurate with respect to certain documents, but reference is made to the actual documents for complete information. All such summaries are qualified in their entirety by such reference.

The SGX-ST assumes no responsibility for the correctness of any of the statements made, opinions expressed or reports contained herein. Approval in-principle from, admission to the Official List of, and the listing and quotation of any Bonds on, the SGX-ST are not to be taken as an indication of the merits of the Issuer or the Bonds.

CERTAIN DEFINED TERMS AND CONVENTIONS

Statistical and financial information included in this Offering Circular is the latest official data publicly available at the date of this Offering Circular. Statistical and financial data provided in this Offering Circular may be subsequently revised in accordance with the Issuer's on-going maintenance of its economic data. The Issuer is under no obligation to distribute such revised data to any holder of the Issuer's securities. As used in this Offering Circular, the term "N/A" identifies statistical or financial data that is not available.

All references in this Offering Circular to (a) "the country" or "Sri Lanka" are to the Democratic Socialist Republic of Sri Lanka, (b) the "Issuer" or the "Government" are to the Government of the Democratic Socialist Republic of Sri Lanka and (c) the "Central Bank" are to the Central Bank of Sri Lanka.

Article 170 of the Constitution of Sri Lanka defines a public corporation as any corporation, board or any other body which was or is established by or under any written law other than the Companies Act No. 7 of 2007 of Sri Lanka (the "Companies Act"), with capital wholly or partly provided by the Government by way of grant, loan or otherwise. The Foreign Loans Act No. 29 of 1957, as amended, defines a public enterprise as any company which is registered under the Companies Act and in which the Government of Sri Lanka holds not less than 50% of the paid-up capital.

The fiscal year of the Issuer commences on January 1 of each year and ends on December 31 of such year.

Unless otherwise indicated, all references in this Offering Circular to "Sri Lanka Rupee", "rupee", "rupees", "Rupee", "Rupees" or "Rs." are to the lawful national currency of Sri Lanka, those to "Dollar", "Dollars", "dollars", "US dollar", "US dollars" or "US\$" are to the lawful currency of the United States of America and those to "SDR" are to Special Drawing Rights of the International Monetary Fund (the "IMF").

Unless otherwise specified herein, all gross domestic product ("GDP"), gross national product ("GNP"), gross national income ("GNI") and related data, including growth statistics and sub-sector data are, or are derived from, real data using a base year of 2010.

Unless otherwise specified herein, all 2015 and 2016 full-year and interim statistical and financial data included in this Offering Circular are provisional and subject to revision in accordance with the procedures and practices of the Central Bank or other Government entity responsible for collating and presenting such statistical data. Additional economic data for the first three months of 2017, which may vary from the data presented in this Offering Circular, are expected to be released by the third quarter of 2017.

Prior to 2007, both the Central Bank and the Department of Census and Statistics (the "DCS"), which is the official agency responsible for the compilation and dissemination of national income accounts, compiled and published national income statistics of the country. The methodologies and assumptions used by the Central Bank and the DCS in the compilation of such data were not identical and, as a result, the information published by each of them was different. In 2007, in order to avoid any confusion among the public, the Central Bank decided to use and publish the national income statistics compiled by the DCS going forward. In line with this policy, the Central Bank began using and publishing GDP estimates compiled by the DCS commencing from 2007 in its various statutory reports which incorporated the DCS data series from 2003 onwards. As a result, some macroeconomic information, including per capita income, of the country disclosed herein varies from information published by the Central Bank for the period from 2003 to 2007. Further, the DCS revised the base year relating to national accounts to 2010. As such, economic growth data from 2011 onwards found in this Offering Circular are presented using a base year of 2010. On November 3, 2015, Sri Lanka subscribed to the IMF's Special Data Dissemination Standard ("SDDS").

Inflation in Sri Lanka is currently reported as the year-on-year percentage change in the Colombo Consumer Price Index (“CCPI”), the compilation of which is based on the Household Income and Expenditure Survey (“HIES”) conducted by the Department of Census and Statistics (DCS) in 2012 and 2013. Expenditure information obtained from this survey is reflected in the CCPI (2013=100). DCS released the new series of CCPI in January 2017. Until December 2016, inflation was reported as the year-on-year percentage change in the CCPI (2006/07=100) series. Information on inflation up to 2014 are based on CCPI (2006/07=100) and from 2015 onwards are based on CCPI (2013=100).

Unless otherwise indicated, all references to gross official reserves are to gross official reserves including Asian Clearing Union (“ACU”) receipts.

Any discrepancies in the tables included herein between the amounts listed and the totals thereof are due to rounding.

FORWARD LOOKING STATEMENTS

Some of the statements contained in this Offering Circular under “The Democratic Socialist Republic of Sri Lanka” are forward looking. They include statements concerning, among others:

- Sri Lanka’s economic, business and political conditions and prospects;
- Sri Lanka’s financial stability;
- the ability of the Government to implement economic, political and social reforms;
- governmental, statutory, regulatory or administrative initiatives;
- changes in economic conditions in Sri Lanka;
- official and unofficial expectations and targets for key economic data, including interest rates, domestic and external debt, exchange rates, the fiscal deficit, inflation, foreign reserves, the current account balance, the trade balance and GDP growth;
- the depreciation or appreciation of the Rupee;
- investments;
- natural disasters; and
- the levels of foreign direct and portfolio investment.

Actual results may differ materially from those suggested by these forward looking statements due to various factors. These factors include, but are not limited to:

- Adverse external factors, such as volatile international interest rates, a global recession or economic crisis and recession or low growth in Sri Lanka’s trading partners; high international interest rates could increase Sri Lanka’s current account deficit and budgetary expenditures.
- Adverse domestic factors, such as a decline in foreign direct and portfolio investment, increases in domestic inflation, high domestic interest rates and exchange rate volatility, each of which could lead to lower growth or lower international reserves.
- Changes in the credit ratings of Sri Lanka, the international prices of key commodities and the policies of financial institutions and development partners regarding amounts and terms of financial assistance to Sri Lanka may also adversely affect the economic prospects and investment climate in Sri Lanka.
- Other adverse factors, such as climatic or seismic events and political and civil uncertainty.

ENFORCEABILITY OF FOREIGN JUDGMENTS

The Issuer will irrevocably submit to the non-exclusive jurisdiction of any New York State or Federal court in the Borough of Manhattan, The City of New York and the courts of the Democratic Socialist Republic of Sri Lanka in any action arising out of or based on the Bonds brought by any holder of a Bond (other than any action arising out of or based on U.S. federal or state securities laws). The agreements entered into with respect to the issue of the Bonds are governed by the laws of the State of New York. See “Description of the Bonds — Governing Law and Jurisdiction” and “Description of the Bonds — Waiver of Immunity”.

The Sri Lankan counsels to the Issuer and the Initial Purchasers have advised as follows:

The Democratic Socialist Republic of Sri Lanka is a foreign sovereign state. Consequently, it may be difficult for investors to obtain and enforce judgments of courts in the United States or other jurisdictions against Sri Lanka. The Government will irrevocably waive, to the fullest extent permitted by law, any immunity, including foreign sovereign immunity, from jurisdiction with respect to Sri Lanka and its property to which it may otherwise be entitled in any action arising out of or based on the Bonds brought in any New York State or Federal court in the Borough of Manhattan, The City of New York or in any competent court in Sri Lanka; provided, however, that the Government will not waive its immunity with respect to (1) actions brought against the Government arising out of or based upon U.S. Federal or state securities laws; (2) present or future “premises of the mission” as defined in the Vienna Convention on Diplomatic Relations signed in 1961; (3) “consular premises” as defined in the Vienna Convention on Consular Relations signed in 1963; (4) military property or military assets or property or assets of Sri Lanka related thereto; or (5) properties and assets located in Sri Lanka and used solely or mainly for public or governmental purposes. Because the Government has not waived its sovereign immunity in connection with certain actions arising out of or based on U.S. Federal or state securities laws, it will not be possible to obtain a United States judgment against Sri Lanka based on such laws unless a court were to determine that the Government is not entitled under the U.S. Foreign Sovereign Immunities Act of 1976 (the “Immunities Act”) to sovereign immunity with respect to such an action. Furthermore, under the Immunities Act, execution upon the property of Sri Lanka in the United States to enforce a judgment is limited to an execution upon property used for the commercial activity on which the claim is based. The Government has been advised by its Sri Lankan counsel, the Attorney General of Sri Lanka, that there can be no enforcement of any judgments of the United States courts in Sri Lanka as a general matter, primarily because there is no treaty or other arrangement or basis for reciprocal enforcement of judgments between Sri Lanka and the United States. Thus, any claim arising out of or based on the Bonds, including judgments arising out of or based on the civil liability provisions of U.S. Federal or state securities laws, may be brought as an original action in Sri Lanka, with any judgment of the relevant United States court, if any, being used as evidence in such action. The Government also has been advised by its Sri Lankan counsel that there is doubt as to the enforceability of original actions brought in Sri Lanka courts of the civil liability provisions of U.S. Federal or state securities laws. Moreover, if a judgment is obtained against the Government in the United States or in any other jurisdiction, including Sri Lanka, such judgment may not be enforceable in Sri Lanka. While the Issuer is subject to legal proceedings and suit in the name of the Attorney General in Sri Lanka, under Section 462 of the Civil Procedure Code (Cap 101) of Sri Lanka, no writ against person or property shall be issued against the Attorney General of Sri Lanka in any action brought against the State. In addition, the courts of Sri Lanka have no power to grant enjoining orders or injunctions against, or order specific performance by, the Government.

DATA DISSEMINATION

The Issuer is a subscriber to the IMF's General Data Dissemination Standard ("GDDS"), which is designed to improve the timeliness and quality of information of subscribing member countries. The GDDS requires subscribing member countries to provide schedules indicating, in advance, the date on which data will be released. Summary methodologies of all metadata to enhance transparency of statistical compilation are also provided on the internet under the Dissemination Standards Bulletin Board. The internet website for Sri Lanka's GDDS related information and metadata is located at <http://www.imf.org/external/country/LKA/index.htm>. The information contained on the website does not constitute a part of this Offering Circular.

EXCHANGE RATE INFORMATION

This Offering Circular contains translations of Rupee amounts into US dollar amounts solely for your convenience. Unless otherwise indicated, the translations have been made at the exchange rate between the Rupee and the US dollar on a particular date or calculated at the average of the rates of exchange for a particular period for which data is provided, i.e. the average of the rates of exchange for a given year or a given six-month period. See "The Democratic Socialist Republic of Sri Lanka — Monetary System — Foreign Exchange System" for historical information regarding the exchange rate between the Rupee and the US dollar. You should not construe these translations as representations that the Rupee amounts actually represent such US dollar amounts or could have been or could be converted into US dollar at the indicated or at any other rates.

SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information appearing elsewhere in this Offering Circular.

The Democratic Socialist Republic of Sri Lanka

General

The recorded history of Sri Lanka (formerly known as “Ceylon”) dates back to the sixth century B.C., when an Indian prince named Vijaya together with his followers landed on the island. From the sixteenth century, Ceylon was colonized by the Portuguese, the Dutch and the British until she regained independence on February 4, 1948. In 1972, Ceylon became a republic and changed her name to Sri Lanka. In 1978, a new constitution was promulgated, providing that the country shall be known as the “Democratic Socialist Republic of Sri Lanka.”

Sri Lanka is an island located 29 kilometers from the Southeastern tip of India and 645 kilometers north of the equator. It is located across several major maritime trading routes between Asia and the Middle East, Europe, Africa and the Americas. Sri Lanka extends 438 kilometers from North to South, and 225 kilometers from East to West at its broadest points, occupying a territory of 65,610 square kilometers. Sri Lanka has a marine resource base composed of 21,500 square kilometers of territorial sea and 517,400 square kilometers of Exclusive Economic Zone extending up to 200 nautical miles from the coastline. The geography and topography of Sri Lanka provide the basis for a rich agricultural sector that was for centuries the source of a flourishing trade in coconut, coffee, cinnamon, cardamom, pepper, cloves, nutmeg and other spices, which were replaced by rubber and tea in the mid-19th century. Sri Lanka’s climate is tropical, with high humidity and year-round temperatures averaging 27°C to 28°C.

The population of Sri Lanka was estimated to be 21.203 million in 2016. Colombo, located on Sri Lanka’s western coast, is the commercial capital and its largest city, with a population of approximately 2.395 million. Sri Lanka has a diverse ethnic composition: 74.9% of the people are Sinhalese, 15.3% are Tamils, 9.3% are Sri Lankan Moors and the remaining 0.5% are of other ethnicities. In 2015, the literacy rate was 93.2%. Sinhalese and Tamil are the official languages of Sri Lanka and, along with English, are taught in all schools. 70.1% of the population is Buddhist, 12.6% is Hindu, 9.7% is Muslim and 7.6% is Christian (including Roman Catholic).

Government and Politics

Sri Lanka’s current constitution, which was adopted on September 7, 1978 (the “Constitution”), provides for an Executive President, a unicameral Parliament with legislative power, an independent judiciary and fundamental rights of the people. Under the Constitution, the President of Sri Lanka is directly elected and acts as the Head of State, the Head of the Executive and of the Government and the Commander-in-Chief of the armed forces. The President appoints the Prime Minister and the Cabinet of Ministers, who are responsible to the Parliament.

The sixth presidential election was held on January 8, 2015. The main candidates were Mahinda Rajapaksa, the then-incumbent President contesting under the United People’s Freedom Alliance (“UPFA”), and Maithripala Sirisena, the former Minister of Health in Rajapaksa’s government contesting as a common candidate under New Democratic Front. Sirisena was declared the winner after receiving 51.28% of all votes cast compared to Rajapaksa’s 47.58%, winning 12 of the 22 electoral districts.

The Parliament is currently a unicameral 225-member legislature that was elected to a five-year term by universal suffrage on the basis of proportional representation. The President may from time to time summon, suspend or end a legislative session of or dissolve the Parliament under the Constitution. The Parliament reserves the power to make all laws and to repeal or amend any provision of the Constitution. After the election of President Sirisena in January 2015, the Parliament was dissolved on June 26, 2015. Parliamentary elections were held thereafter on August 17, 2015 (the “2015 Parliamentary General Election”) and the new Parliament convened for the first time on September 1, 2015.

While the United National Party (“UNP”)-led United National Front for Good Governance (“UNFGG”) obtained the most number of seats (106) in the 2015 Parliamentary General Election, it was not able to secure a majority of seats in the Parliament. The UPFA obtained 95 seats while Ilankai Tamil Arasu Kadchi (“ITAK”) and Janatha Vimukthi Peramuna (“JVP”) obtained 16 seats and six seats, respectively. Furthermore, the Eelam People’s Democratic Party and the Sri Lanka Muslim Congress won one seat each. The following table depicts the allocation of seats in the Parliament for each party:

Name of political party	District basis	National basis	Total
	seats	seats	
United National Party	93	13	106
United People’s Freedom Alliance.....	83	12	95
Ilankai Tamil Arasu Kadchi.....	14	2	16
Janatha Vimukthi Peramuna	4	2	6
Eelam People’s Democratic Party.....	1	0	1
Sri Lanka Muslim Congress	1	0	1

Prime Minister Ranil Wickremesinghe, leader of the UNFGG and UNP, formed a national government with the support of certain UPFA members of Parliament. This was the first time since Sri Lanka’s independence that a government was formed with the consensus of the country’s main political parties. President Sirisena addressed the Parliament and presented the “Statement of Government Policy” on September 1, 2015. The policy priorities of the Government highlighted in President Sirisena’s speech include:

- achieving a high level of human development, leading to reconciliation among all communities and rapid socioeconomic development to overcome local and international challenges;
- abolishing the executive presidential system and introducing changes to the Constitution to establish a Presidency that is aligned with the Parliament through the Cabinet;
- establishing a new electoral system;
- prioritizing skills development and enabling the Sri Lankan workforce to meet the needs of local and international employment opportunities;
- forming future economic policies, plans and strategies to maximize benefits from Sri Lanka’s strategic geographic location;
- promoting basic principles of micro credit and financial management among small-scale entrepreneurs and farmers;
- strengthening existing institutional structures to eradicate corruption and protection of state property;
- minimizing income disparity and expanding the middle class while ensuring equitable development across the country;
- focusing foreign policy on Asia-centric “middle path” policy based on the foundation of openness and friendship with all countries;
- introducing a National Food Policy with the aim of producing healthy food locally, promoting the growth of agricultural products to fulfill Sri Lanka’s nutrition needs and prioritizing rice production;
- introducing modern technology to the agricultural and livestock sectors;
- enhancing public services, including free healthcare, free education and public transport;

- formulating a youth policy to address the current needs of Sri Lanka; and
- prioritizing the well-being of women in all development strategies and building a better future for and ensuring the security of children.

On May 15, 2015, the Nineteenth Amendment to the Constitution took effect and repealed the Eighteenth Amendment to the Constitution with the aim of improving consultative and democratic processes in Sri Lanka. The Nineteenth Amendment also removed certain executive powers of the President, limited the Presidency to two terms in office and reduced the length of each term from six years to five years.

The Nineteenth Amendment also established a Constitutional Council and reintroduced many provisions of the Seventeenth Amendment to the Constitution, including allowing the Constitutional Council to set up independent commissions and various other measures to safeguard and promote democratic values in Sri Lanka. The Constitutional Council consists of ten members, including three *ex-officio* members — the Prime Minister, Opposition Leader and Speaker. The other members of the Constitutional Council consist of four members of the Parliament and three non-political persons representing civil society. The first meeting of the Constitutional Council was held on September 10, 2015.

The draft bill on the Twentieth Amendment to the Constitution is currently undergoing review by the Cabinet of Ministers and Parliament. The Twentieth Amendment is expected to propose amendments to the existing preferential voting system for parliamentary elections and also increase the total number of members of Parliament. Under the proposed amendment, members of Parliament will be elected through a first-past-the-post system, ensuring at least one member for each electorate, and a district-based proportional representation system, allowing continued parliamentary representation for minor political parties. In addition, some members of Parliament will be appointed from the National List that will be provided by Sri Lankan political parties. Notwithstanding the progress on the Twentieth Amendment, the current electoral system based on proportional representation for parliamentary elections is expected to remain in place for at least one calendar year due to technical limitations.

Sri Lanka's judiciary consists of a Supreme Court, a Court of Appeal and a number of subordinate courts. The Supreme Court can determine whether a proposed bill is consistent with the Constitution and whether a referendum must be held on a proposed bill. The Supreme Court is also the final court of appeal for all criminal and civil cases.

Under the Thirteenth Amendment to the Constitution, significant authority was delegated to the Provincial Councils. Provincial Councils are directly elected for five-year terms and possess certain Provincial-level legislative and executive powers over education, health, rural development, tourism, social services, agriculture, public order and local taxation, subject to Government oversight. On September 8, 2012, Provincial Council elections were held for the Eastern, North Central and Sabaragamuwa Provinces to elect 114 members of those three Provincial Councils. With 51% of the total votes and 63 seats, the UPFA won all three provinces. The UNP obtained 27.7% of the total votes and secured 29 seats. The Tamil National Alliance (the "TNA") obtained 9.6% of the total votes and won 11 seats while the Sri Lanka Muslim Congress won seven seats by obtaining 6.6% of the total votes.

On September 21, 2013, elections for 148 seats in the Northern, North Western and Central Provincial Councils were held. The UPFA won control over the North Western and Central Provincial Councils by securing 34 and 36 seats, respectively, and the TNA won the Northern Provincial Council (the "NPC") by securing 30 seats.

The establishment of the NPC in 2013 is a historical landmark in Sri Lankan political history. Approximately 20 political parties and independent groups ran for office at the Provincial Council elections held on September 21, 2013. The elections were successfully administrated with 67% voter turnout. The success of the election, despite the Northern Province's history as the center of Sri Lanka's 26-year-long internal conflict, indicates the level of normalcy that has been restored to the region and demonstrates the commitment of the Government to implement post-war reconciliation.

On March 29, 2014, elections were held for the Western and Southern Provincial Councils. The UPFA retained control over both the Western and the Southern Provincial Councils.

On September 20, 2014, elections were held in Uva Province for 34 seats in the Provincial Council. The UPFA retained control and secured 19 seats, followed by the UNP and the JVP, who secured 13 seats and 2 seats, respectively.

There are also three categories of local governments: municipal, urban and rural (*Pradeshiya Sabha*) councils which have duties and responsibilities as conferred by law. The most recent local government elections were held from March to October 2011 for a total of 4,327 seats in 322 of the 335 local councils.

Economy

The adoption of market-oriented economic policies in 1977 and the subsequent reforms and liberalization measures undertaken by successive Governments in recent years have enhanced the long-term growth prospects and resilience of the Sri Lankan economy. After four consecutive years of 6.0% or higher growth, the growth of the Sri Lankan economy slowed in 2009 as a result of the global financial and economic crisis. The economy recovered strongly in 2010, underpinned by favourable developments in the domestic and external fronts. The economy grew by 9.1% in 2012, which was the country's highest historically recorded growth. The economy continued to grow in 2013, 2014, 2015 and 2016 at rates of 3.4%, 5.0%, 4.8% and 4.4%, respectively. Unfavourable weather conditions and sluggish global economic recovery caused the economy to grow at a slower rate in 2016 in real terms. However, the Sri Lankan economy is expected to grow at a moderate rate of around 5.0% amid the adverse impacts of unfavorable weather conditions, and is expected to improve gradually in the medium term.

Economic Growth. The principal economic activities of the Sri Lankan economy are services, industry and agriculture. In 2016, GDP grew by 4.4%, following growth of 4.8% in 2015, 5.0% in 2014 and 3.4% in 2013. GNI grew by 4.1% in 2016 compared with a growth of 4.5% in 2015 and 5.1% in 2014. Per capita GDP declined slightly to US\$3,835 in 2016, compared to US\$3,843 in 2015, representing a marginal decrease of 0.2%, while per capita GDP in 2014 was US\$3,821.

The 4.4% GDP growth rate in 2016 was supported by the services and industry activities while agricultural activities dampened the GDP growth. Services-related activities grew by 4.2% primarily due to significant expansion in financial services activities, supported by developments in the transportation of goods and passengers including warehousing activities. Industry-related economic activities grew by 6.7% primarily due to significant growth in construction and mining and quarrying activities. Agriculture, forestry and fishing activities contracted by 4.2% mainly driven by contraction observed in production of rice, tea, rubber and fruits as a result of adverse weather conditions that prevailed throughout 2016.

Prices, Monetary Growth, Wages and Employment. In January 2017, inflation, as measured by the year-on-year change in CCPI (2013=100), increased to 5.5% from 4.5% in December 2016 due to increase in both food and non-food prices. Thereafter, inflation increased to 6.8% in February mainly due to base effect, while the monthly increase in both food and non-food prices also contributed towards this increase in year-on-year inflation. Inflation continued to increase in March 2017 recording 7.3% amid a monthly decline. This increase in year-on-year inflation was mainly due to the low base that prevailed in March 2016.

Nevertheless, year-on-year inflation remained in low-single digit levels in 2016. Both headline and core inflation have remained at single-digit levels on a year-on-year basis since early 2009. Inflation declined to 4.5% in December 2016 from 4.6% in December 2015 on a year-on-year basis.

Average growth of broad money was 18.1% in 2016, compared to 15.2% in 2015, 13.3% in 2014, 16.5% in 2013 and 20.2% in 2012. The increase from 2015 to 2016 was due to the substantial expansion in credit to both the public and the private sectors.

The nominal wages of public sector employees increased by 1.7% in February 2017 on an annual average basis. Formal private sector wages and minimum nominal wages exhibited negligible increases in February 2017. Wages of informal private sector employees increased in nominal terms by 8.4% in February 2017. Real wages of informal private sector employees increased by 3.1% in February 2017, while real wages of public and formal private sector employees recorded decreases of 3.2% and 4.2%, respectively, in February 2017.

The nominal wages of public sector and informal private sector employees increased by 3.9% and 7.9%, respectively, while average nominal wages of formal private sector employees exhibited a negligible increase in 2016. Meanwhile, real wages of informal private sector employees recorded increases of 3.7%, while real wages in the public sector and formal private sector recorded decreases of 0.1% and 3.6%, respectively, in 2016.

The unemployment rate was 4.4% in 2016, compared to 4.7% in 2015 and 4.3% in 2014. The decrease in the unemployment rate in 2016 was mainly due to the growth in labor force and the decline in the unemployed population, largely attributable to the increase in new employment opportunities in the economy. The labor force participation rate remained unchanged at 53.8% in 2016 and 2015, compared to 53.2% in 2014.

Balance of Payments (“BOP”)

In 2014, the current account deficit narrowed, with higher inflows from trade in services, particularly from tourism, and workers’ remittances offsetting the deficit in the trade account. Despite narrowing substantially during the first half of 2014 as a result of a growth in exports, the current account deficit widened during the second half of 2014 as a result of increased imports. Inflows to the financial account, by way of foreign direct investment (“FDI”) and receipts to the Government, banking and private sectors, helped record a higher surplus in the BOP, resulting in an improvement in gross international reserves of the country.

Sri Lanka’s external sector showed a subdued performance in 2015, with lower than expected inflows to the current and financial accounts of the BOP and higher foreign exchange outflows. Despite the low level of net foreign inflows, the current account deficit in 2015 amounted to US\$ 1.9 billion, and declined marginally to 2.3% of GDP. Although the merchandise trade deficit continued to widen in 2015 due to the increase in non-oil imports and the slowdown in export earnings, a substantial increase was largely avoided by lower expenditure on fuel imports due to the significant reduction in international oil prices and lower import volume due to less reliance on oil-based thermal power. The deficit in the primary income account also widened with increased interest payments during the year. However, the surpluses in the services and secondary income accounts enabled the current account deficit to remain almost unchanged from the previous year’s level. The financial account was adversely affected by the decline in non-debt creating inflows, slowdown in inflows to the Government and gradual reversal of investments in Government securities, due to the expectation of an, and the subsequent, increase in interest rates in the US.

In 2016, Sri Lanka’s external sector performance continued to be suppressed due to factors from abroad and at home. In the global context, monetary policy normalization in the United States, subdued global economic recovery, particularly in advanced economies, together with geopolitical uncertainties in the Middle East all posed challenges for the Sri Lankan economy. Meanwhile, in the domestic front, continued demand on imports, together with subdued level of foreign investments and outflows from the government securities market, also adversely impacted the BOP position in 2016. As a combined result, the external current account deficit in 2016 increased marginally to 2.4% of GDP from 2.3% in 2015. The trade deficit expanded during the year with an increase in import expenditure, particularly with higher domestic demand for investment goods, while earnings from merchandise exports contracted with the drop in both international commodity prices and export volumes. The deficit in the primary income account also widened during 2016 as a result of the decline in earnings from reserve assets and continued interest payments amid outflows on account of reinvested earnings and dividend payments. However, the adverse impact of the trade deficit and the primary income account deficit was mitigated to some extent by surpluses in the services account and the secondary income account. The surplus in the services account continued to increase, particularly with higher earnings from tourism, while the secondary income account benefitted from the moderate expansion

in workers' remittances in 2016. Meanwhile, the financial account continued to experience higher outflows while recording modest inflows by way of non-debt creating sources. In particular, lower levels of FDI and capital outflows arising from disinvestment of Government securities by non-residents, together with continued debt service payments, adversely impacted the financial account in 2016. The lack of non-debt creating inflows to the financial account and the widening of the current account deficit prompted Sri Lanka to seek financing from overseas, in particular through the issuance of an International Sovereign Bond ("ISB") and syndicated loans. In addition, to overcome the economic challenges against the backdrop of an increasingly volatile global economic environment, Sri Lanka sought an Extended Fund Facility ("EFF") from the IMF in 2016. The EFF, which is equivalent to 185.0% of the country's current quota with the IMF, is aimed at supporting the BOP and the Government's reform agenda.

Tourist arrivals grew by 14.0% during 2016, compared to a growth of 17.8% during 2015. As a result of the increase in tourist arrivals, together with higher spending and increased duration of stay by tourists, earnings from tourism grew by 18.0% to US\$ 3,518 million in 2016 in comparison to US\$ 2,981 million in 2015. The top five sources of tourist arrivals were India, China, the UK, Germany and France, which together accounted for around 51% of total tourist arrivals during 2016. Workers' remittances grew at a modest rate of 3.7% to US\$ 7,242 million, as against the decline of 0.5% observed in 2015. Total FDI inflows, inclusive of foreign loans to Board of Investment ("BOI") companies, amounted to US\$ 1,079 million, while direct investments that exclude foreign borrowings of BOI companies amounted to US\$ 898 million in 2016. In comparison, total FDI inflows with foreign loans in 2015 amounted to US\$ 1,160 million while the same excluding foreign loans amounted to US\$ 680 million. Reflecting these developments, the overall balance recorded a deficit of US\$ 500 million in 2016 in comparison to a deficit of US\$ 1,489 million recorded in 2015.

On cumulative terms, tourist earnings are estimated to have increased by 3.4% to US\$ 1,038 million during the first quarter of 2017, compared to US\$ 1,003 million during the corresponding period in 2016. For the first two months of 2017, workers' remittances recorded a growth of 2.0%, with an inflow of US\$ 1,140 million, compared to US\$ 1,118 million during the corresponding period in 2016.

Foreign Trade. In 2016, Sri Lanka's earnings from exports declined by 2.2% to US\$ 10,310 million, while expenditure on imports increased by 2.5% to US\$ 19,400 million, widening the trade deficit by 8.4% to US\$ 9,090 million as compared to US\$8,388 million in 2015. Low commodity prices in the international market and modest recovery of Sri Lanka's major export destinations mainly contributed to the decline in export earnings. Meanwhile, significant increase in expenditure on intermediate and investment goods imports led to the growth in imports.

In 2015, Sri Lanka's earnings from exports declined by 5.2% year-on-year to US\$ 10,546 million while imports declined moderately by 2.5% to US\$ 18,935 million. These results were mainly due to a slowdown in the growth of demand in Sri Lanka's traditional export markets and lower international commodity prices. In 2014, foreign trade recovered strongly, reversing the sharp contraction observed in imports in 2012 and 2013. Accordingly, earnings from exports increased by 7.1% to US\$ 11,130 million in 2014, compared to the 6.4% growth recorded in 2013. Meanwhile, expenditure on imports increased by 7.9% to US\$ 19,417 million in 2014, compared to the 6.2% decline recorded in 2013. As expenditure on imports exceeded earnings from exports, the trade deficit expanded by 8.9% to US\$8,287 million in 2014.

External Reserves. As at 2014 year-end, Sri Lanka's gross official reserves were at US\$ 8.2 billion and total foreign assets amounted to US\$ 9.9 billion. In terms of months of imports, gross official reserves were equivalent to 5.1 months of imports as at 2014 year-end, while total foreign assets were equivalent to 6.1 months of imports. Compared to gross official reserves of US\$ 7.5 billion as at 2013 year-end, an improvement was achieved during 2014 despite outflows due to foreign currency debt service payments totaling US\$ 2.9 billion (including the SBA Facility repayments to the IMF totaling US\$ 719 million) and valuation changes stemming from a decline in the price of gold.

As at 2015 year-end, Sri Lanka's gross official reserve asset position amounted to US\$ 7.3 billion. As at 2014 year-end, the level of gross official reserves stood at US\$ 8.2 billion. During 2015, gross official reserves were drained, mainly due to the scheduled foreign currency debt service payments, the settlement of the matured ISBs, payments to the IMF on account of the Stand-By Arrangement ("SBA") and supply of liquidity to the domestic foreign exchange market. In terms of adequacy of gross official reserves, the level of gross official reserves as at 2015 year-end was equivalent to 4.6 months of imports, which is above the internationally accepted benchmark of 3.0 months of imports.

Sri Lanka's gross official reserve assets position declined as at 2016 year-end to US\$ 6.0 billion from US\$ 7.3 billion recorded at end of 2015. The gross official reserve assets as at 2016 year-end was equivalent to 3.7 months of imports of goods and 3.1 months of imports of goods and services. The decline in gross official reserves was mainly due to the foreign currency debt service payments, settlement of a portion of the foreign currency swap arrangement, repayments of the IMF SBA and the supply of liquidity to the domestic foreign exchange market through the Central Bank's intervention. The total foreign assets, which comprise gross official reserves and foreign assets of deposit taking corporations, declined to US\$ 8.4 billion at end 2016, from US\$ 9.3 billion as at 2015 year-end. Total foreign assets were equivalent to 5.2 months of imports of goods and 4.3 months of imports of goods and services. Gross official reserves as at March 31, 2017 are estimated to be approximately US\$ 5.1 billion.

Securities Market. There were two new listings ("IPOs") on the Colombo Stock Exchange in 2015, through which Rs. 0.3 billion was raised, as well as 15 rights issues, through which Rs. 16.2 billion was raised. During 2016, there were three new IPOs, through which Rs. 1.9 billion was raised and six rights issues, through which Rs. 2.5 billion was raised. The number of companies listed on the CSE increased by five in 2014 to 294 by the end of 2014 and remained unchanged during 2015 and increased by one in 2016 to 295. Meanwhile, the cumulative net foreign inflow to the CSE through the secondary market amounted to US\$ 80.4 million up to April 19, 2017 as compared to US\$ 1.7 million in 2016, the net outflow of US\$ 32.3 million in 2015 and the net secondary inflow of US\$ 169.0 million in 2014. The CSE currently has 12 members who are licensed to operate as stockbrokers and 8 debt trading members. As at April 19, 2017, the companies listed on the CSE represented 20 business sectors and had a total market capitalization of Rs. 2,837.5 billion (US\$ 18.7 billion), compared to Rs. 2,745.4 billion (US\$ 18.3 billion) as at 2016 year-end.

During 2015, there were 25 corporate debentures issued by 23 corporations amounting to Rs. 83.4 billion. During 2016, there were 17 corporate debenture listings by 14 corporations, amounting to Rs. 78.0 billion. During the first three months of 2017, there was one debenture listing amounting to Rs. 8.0 billion.

Foreign Exchange. The Government accepted Article VIII IMF status in 1994 and adopted an independently floating exchange rate system in January 2001.

Sri Lanka's exchange rate policy in 2014 focused on reducing short-term volatility to promote stability in the foreign exchange market. The rupee appreciated against the US dollar by 0.29% during the first three quarters of the year. However, as import demand increased and Government securities market recorded net outflows in the last quarter of 2014, the rupee depreciated by 0.47% against the US dollar, resulting in an overall depreciation of 0.23% in 2014.

The lower than expected foreign exchange inflows, coupled with high levels of outflows, exerted significant pressure on the exchange rate during 2015. This was mainly due to the reversal of foreign investments in the Government rupee securities market, in anticipation of a, and the subsequent, hike in interest rates in the US, and the high level of demand for foreign exchange, due to the increased expenditure in non-oil imports and foreign debt service payments. The resultant persistent depreciation pressure on the rupee against the US dollar necessitated the continuous intervention of the Central Bank in the domestic foreign exchange market, in order to reduce volatility. Supported by the supply of US\$ 1.9 billion by the Central Bank, on a net basis, the rupee recorded a marginal depreciation of 2.42% against the US dollar, during the first eight months of the year. However, on September 3, 2015, the Central Bank decided to limit its intervention in the domestic foreign exchange market and allowed the exchange rate to be largely determined by the demand and supply conditions

of the market. This resulted in the rupee depreciating by 6.64% against the US dollar, during the period from September 4, 2015 to December 31, 2015. Overall, the rupee depreciated against the US dollar by 9.03% to Rs. 144.06 as at December 31, 2015. The annual average exchange rate of the rupee against the US dollar also depreciated to Rs. 135.94 in 2015 from Rs. 130.56 in 2014.

In 2016, the rupee depreciated by 3.83% against the US dollar from Rs. 144.06 as at 2015 year-end to Rs. 149.8 as at 2016 year-end. The relatively low depreciation of the rupee in the first half of 2016 was supported by supply of foreign exchange liquidity by the Central Bank amounting to US\$ 1,093 million on a net basis. Subsequently, the rupee depreciated at a higher rate with the curtailment in intervention by the Central Bank with a net absorption of US\$ 325 million during the second half of the year. A substantial amount of the foreign exchange supplied during the second half was to partially ease the pressure arising due to the disinvestment by non-resident investors in the Government securities market, particularly during the last quarter of 2016. This outflow from the Government securities market was driven by the expectation and the subsequent increase in interest rates by the US Federal Reserve Bank.

In 2016, the rupee depreciated against all major currencies except the pound sterling, which depreciated substantially following the Brexit vote on June 23, 2016. Accordingly, reflecting the movements in the cross currency exchange rates against the US dollar in international markets, the rupee depreciated against the euro by 0.32%, the Indian rupee by 1.72%, the Japanese yen by 7.05%, while appreciating against the pound sterling by 16.04%. Consequently, the rupee also depreciated against the Special Drawing Rights (“SDR”) by 0.87% during 2016.

In its announcement of the “Road Map: Monetary and Financial Sector Policies for 2017 and Beyond”, the Central Bank announced its exchange rate policy to reflect market based movements by aligning the exchange rate with the Real Effective Exchange Rate (“REER”) indices. Accordingly, the exchange rate policy would entail the REER to be maintained at around 100 index points to ensure external competitiveness of the country. Furthermore, Central Bank intervention in the form of supplying of liquidity to the domestic foreign exchange market would be curtailed only to address undue volatilities in the exchange rate. Meanwhile the Central Bank has purchased over US\$ 300 million from the beginning of March up to mid-April 2017. By the end of March 2017, the rupee further depreciated by 1.3% against the US dollar from Rs. 149.8 as at 2016 year-end to Rs.151.7 as at March 31, 2017.

Interest Rates. Yields on Treasury bills in the primary market decreased during 2014, indicating enhanced demand for Government securities and moderating inflation expectation in the country. In 2014, the weighted average yield rates of 91-day, 182-day and 364-day Treasury bills decreased by 180 basis points, 201 basis points and 228 basis points to 5.74%, 5.84% and 6.01%, respectively, compared to the yield rates at the end of 2013. Yield rates on Treasury bonds in the primary market were in the range of 8.65% on 5-year bonds to 11.75% on 30-year bonds. The declining primary market yield rates was reflected across secondary market yield rates for Treasury bills and across the term structure of interest rates, including that of medium to long term Treasury bonds. A substantial foreign demand for Treasury bills and bonds also contributed to this development.

In line with the declining inflation, the Standing Lending Facility Rate (“SLFR” or “Reverse Repo Rate”) was reduced in January 2014 by 50 basis points. Furthermore, improved foreign net inflows, as a result of higher remittances and positive developments in imports and exports, have left the domestic banks with substantial foreign currency liquidity. All of these factors contributed to positive liquidity conditions, resulting in the decline of both Treasury bills and bonds yields in 2014. Other market rates also declined significantly in 2014, particularly during the latter part of the year. This result was supported by the Central Bank’s decision to limit access to the Standing Deposit Facility (“SDF”) by an Open Market Operation (“OMO”) participant, a decision intended to encourage banks to utilize excess liquidity to increase credit flows to the private sector.

Benefiting from relatively relaxed monetary conditions, market interest rates remained low during 2015 although certain upward movements in interest rates were witnessed intermittently. With the removal of restrictions placed on the access to SDF in March 2015, overnight interest rates, which had remained below the standing deposit facility rate (the “SDFR” or “Repo Rate”), moved upwards and settled within the policy rate corridor close to the lower bound. At the same time, a large increase in certain interest rates, particularly yields on Government securities, was observed in the aftermath of the removal of restrictions placed on the SDF. Accordingly, the yields of 91-day and 364-day Treasury bills peaked at 7.10% and 7.37%, respectively, reflecting an increase of 136 basis points and 137 basis points, respectively, for each tenor during the year up to March 11, 2015, while the yield of 182-day Treasury bills also increased by 147 basis points to 7.31%. In April 2015, to address concerns on the movement of market interest rates that was inconsistent with inflation, and to maintain greater stability in interest rates while providing the necessary impetus to economic activity through investments, the Central Bank reduced each of the SDFR and the SLFR by 50 basis points to 6.00% and 7.50%, respectively. The upward trend in interest rates was dampened by the reduction in policy rates of the Central Bank in April 2015. However, with the decline in market liquidity levels, a gradual upward adjustment in overnight interest rates was observed since August 2015. Meanwhile, retail interest rates broadly remained low during 2015, although some increase was witnessed towards the end of the year. With the Central Bank’s decision to raise Statutory Reserve Ratio (“SRR”) with effect from January 2016 and the increase in policy interest rates in February 2016, market interest rates increased further in the first quarter of 2016.

Yield rates on Government securities in the primary market recorded an increase during 2015. Yield rates pertaining to Treasury bills in the primary market, which had remained below the SDFR in the preceding months, increased significantly by March 2015 with the removal of restrictions placed on the SDF by the Central Bank. This increase also reflected the market anticipation of high domestic funding requirement of the Government amid delays in foreign financial inflows as well as the Central Bank’s decision to issue Government securities only through public auctions. However, the yield rates declined to a certain extent during the period between April 2015 to June 2015 in response to the reduction of policy rates of the Central Bank, but moved upwards thereafter. Accordingly, by the end of 2015, the 91-day, 182-day and 364-day Treasury bill yields increased by 71 basis points, 99 basis points and 129 basis points to 6.45%, 6.83% and 7.30%, respectively, compared to the yields that prevailed at the end of 2014. Treasury bonds with maturity periods of 30 years and 20 years were issued in the primary market during February and March 2015 at yield rates of 11.73% and 11.20%, respectively, followed by issuances of Treasury bonds of various tenors throughout 2015. Overall, the yield rates on Treasury bonds in the primary market were in the range of 6.70% on 2-year Treasury bonds to 11.73% on 30-year Treasury bonds in 2015.

The upward pressure on the yield rates on Government securities continued in 2016 although some moderation was observed in the second half of the year. Accordingly, by 2016 year-end, the 91-day, 182-day and 364-day Treasury bill yields were at 8.72%, 9.63% and 10.17%, respectively, compared to the yields that prevailed at 2015 year-end. Following the similar trend, yields on 5-year Treasury bonds increased to 11.76% by year-end 2016, compared to 9.79% at year-end 2015. During the same period, yields on 10-year Treasury bonds increased to 12.11% from 10.94%.

Public Finance. During the year 2016, the Government’s total revenue and grants amounted to Rs. 1,693.6 billion (US\$ 11.3 billion), while total expenditure and net lending amounted to Rs. 2,333.9 billion (US\$ 16.0 billion). The overall fiscal deficit which was Rs. 640.3 billion (US\$ 4.3 billion), which registered to be 5.4% of GDP for the year 2016. Total net domestic financing was Rs. 248.4 billion (US\$ 1.7 billion), while net foreign financing was Rs. 391.9 billion (US\$ 2.7 billion) in 2016.

The Government achieved its key fiscal targets for 2016 by reducing the budget deficit to 5.4% of GDP as a result of enhanced revenue collection combined with reduction in total government expenditure as a percentage of GDP. According to the Budget 2016, which was presented to Parliament in November 2015, the overall budget deficit was expected to be reduced to 5.9% of GDP in 2016 from 7.6% of GDP recorded in 2015. Considering subsequent developments, in March 2016 the Government highlighted its commitment to further reduce the budget deficit to 5.4% of GDP in 2016. The revenue to GDP ratio increased for the second consecutive year in 2016, mainly due to the significant expansion in non-tax revenue, driven by the profit and dividend transfers by the SOBEs, combined

with the increase in tax revenue, which benefited as a result of the measures taken on the taxation front that include: (a) broadening the tax base to ensure a tax revenue of around 15-16% of GDP in the medium term, (b) rationalizing the tax system while minimizing tax exemptions, tax holidays, and special tax rates that are detrimental to fair and effective tax administration, (c) augmenting capacity for revenue administration and (d) strengthening public financial management, particularly commitment control, and financial planning and discipline. These steps are expected to further improve tax compliance and ultimately strengthen fiscal consolidation.

During 2016, a number of measures were implemented by the Government to rationalize expenditures. Accordingly, the Government established the Welfare Benefits Board to develop and implement a coherent system of welfare benefit scheme, as the rationalization of various social welfare programs is essential to achieve the envisaged fiscal targets. In addition, the fertilizer subsidy scheme was also revised with the provision of a cash grant in place of the provision of fertilizer. Further, a commitment recording system has been established at the Ministry of Finance (“MOF”), which helps to track spending commitments for each line ministry on a monthly basis. In addition, in December 2016, Phase I of the Integrated Treasury Management Information System (“ITMIS”), the budget planning module, was rolled out to all ministries. Meanwhile, in March 2017, Statements of Corporate Intents were signed for the five largest SOBEs to enhance oversight and financial discipline of SOBEs, thereby improving their performance.

In 2015, total revenue and grants was Rs. 1,460.9 billion (US\$ 10.7 billion) and total expenditure and net lending was Rs. 2,290.4 billion (US\$ 16.8 billion). The overall fiscal deficit which was Rs. 829.5 billion (US\$ 6.1 billion) recorded 7.6% of GDP in 2015. Total net domestic financing was Rs. 592.7 billion (US\$ 4.4 billion), while net foreign financing was Rs. 236.8 billion (US\$ 1.7 billion) for the year 2015.

In 2014, total revenue and grants was Rs. 1,204.6 billion (US\$ 9.2 billion) and total expenditure and net lending was Rs. 1,795.9 billion (US\$ 13.8 billion). The overall fiscal deficit was 5.7% of GDP in 2014. The budget deficit was Rs. 591.2 billion (US\$ 4.5 billion). Total net domestic financing was Rs. 378.7 billion (US\$ 2.9 billion) while net foreign financing was Rs. 212.5 billion (US\$ 1.6 billion).

External Indebtedness. The Government has a 60-year history of honoring its external debt service obligations. The outstanding position of foreign loans of the Government accounted for approximately 58.4% of total external foreign loan liabilities of Sri Lanka as at 2016 year-end. The total external debt of the Government amounted to US\$ 27.2 billion as at 2016 year-end, compared to US\$ 24.7 billion as at 2015 year-end. This increase was primarily due to the issuance of international sovereign bonds of US\$ 1.5 billion and the net inflow from project loans of US\$ 1.1 billion during 2016. These loan inflows included US\$ 700 million as foreign term financing facilities and US\$ 185 million of development policy loans.

Social Indicators. In terms of key social indicators such as adult literacy, life expectancy at birth and infant mortality and maternal mortality, Sri Lanka ranks above many developing countries and is on par with many developed countries, mainly due to the free health care and free education services and other welfare programs implemented by successive governments since Sri Lanka’s independence. In 2015, the average adult literacy rate was 93.2%. According to United Nations Development Program’s Human Development Report 2016, in 2015, the average life expectancy at birth was 75.0 years, and infant mortality was 8.4 per 1,000 live births in Sri Lanka. Further, maternal mortality was 30 per 100,000 live births, including maternal deaths due to indirect causes. Sri Lanka’s Human Development Index of 0.766 ranked it at 73 among 188 countries.

Sovereign Rating. On February 27, 2009, Fitch Ratings (“Fitch”) revised its credit rating outlook for the country’s long term foreign and local currency Issuer Default Ratings to “negative” from “stable,” citing the “heightened concern regarding the sovereign’s external financial position in light of the marked decline in official foreign exchange reserves.” Fitch revised Sri Lanka’s sovereign rating outlook to “stable” from “negative”, to reflect the country’s positive changes in sovereign credit fundamentals on October 9, 2009. The agency has affirmed the long-term foreign and local currency Issuer Default Ratings and the Country Ceiling at “B+” and the short-term Issuer Default Rating at “B,” citing “the positive changes in sovereign credit fundamentals following the end of the 26-year internal conflict, the approval of the SBA Facility and the return of private capital inflows.” On

September 21, 2010, Fitch again revised the outlook to “positive” from “stable.” On July 18, 2011, Fitch upgraded Sri Lanka’s long-term foreign and local currency Issuer Default Rating to “BB-” from “B+”, with a stable outlook and affirmed Sri Lanka’s short-term Issuer Default Rating at “B.” The rating agency has also upgraded the Country Ceiling to “BB-.” In Fitch’s view, the outlook revision reflects of Sri Lanka’s economic benefits from the end of the internal conflict and further benefits from the disciplined policy framework put in place under the SBA Facility and from the improved external liquidity position bolstered by the IMF program. On May 4, 2012, Fitch affirmed its existing rating. In April 2013, having observed the country’s growth performance, level of human development and payment record against weakness of fiscal and external balance sheet and moderate domestic savings relative to investment needs, Fitch affirmed Sri Lanka at “BB-”, with a stable outlook. On May 12, 2014, Fitch affirmed its existing rating of “BB-” and the stable outlook of the Sri Lankan economy. On April 22, 2015, Fitch reaffirmed its existing rating of “BB-” with a stable outlook, citing Sri Lanka’s smooth political transition following the presidential elections, reinforcing perceptions of a functioning democracy with relatively strong institutions. On February 29, 2016, Fitch revised Sri Lanka’s existing rating of “BB-” to “B+”, and revised Sri Lanka’s sovereign rating outlook to “negative” from “stable”, citing “Sri Lanka’s heightened vulnerabilities, due to deterioration in the external position, continued fiscal slippages, and loss of policy coherence and credibility”. On February 9, 2017, Fitch confirmed Sri Lanka’s rating at “B+” and revised the outlook from “negative” to “stable” considering the continuous improvement in its fiscal performance, improved policy coherence and credibility with the on-going IMF-EFF programme and stable growth in the economy.

Standard & Poor’s Ratings Services (“S&P”), on August 25, 2009, revised its sovereign rating outlook back to “stable” due to Sri Lanka’s improved external liquidity position in light of the SBA Facility. On October 15, 2009, S&P further revised its sovereign rating outlook to “positive,” citing the “continued strengthening of Sri Lanka’s BOP position, and S&P’s expectation that the SBA Facility will be pursued to its conclusion, engendering modest improvement in public finances.” Accordingly, S&P affirmed its “B” long-term foreign currency credit rating and “B+” long-term local currency sovereign credit rating on Sri Lanka. They also affirmed the “B” short-term ratings on the sovereign. On September 15, 2010, S&P raised its long-term foreign currency sovereign credit rating on Sri Lanka to “B+” from “B,” and the long-term local currency rating to “BB-” from “B+” taking into account the continued strengthening of Sri Lanka’s BOP position and the expected sustainable decline in fiscal deficits and public debt under the Government’s planned revenue reforms. On July 19, 2011, S&P raised its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “positive” from “stable” based on improved external liquidity, progress in addressing structural fiscal weaknesses and the Government’s inflation management efforts. On February 29, 2012, S&P changed its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “stable” from “positive” while affirming its “B+” rating and lowering its long-term local currency sovereign credit rating to “B+” from “BB-.” On August 1, 2013, S&P affirmed its “B+” long-term sovereign credit ratings with a stable outlook. S&P expects that Sri Lanka’s gross international reserves will remain at a similar level to that in 2012, at three months’ coverage of current account receipts. The stable outlook reflects S&P’s view that the country has strong prospects for per capita real GDP growth over the next few years and the improvement of the Government’s fiscal profile. On July 8, 2014, S&P again affirmed its “B+” long-term and “B” short-term sovereign credit ratings. On August 6, 2015, S&P affirmed its “B+” long-term and “B” short-term sovereign credit ratings for Sri Lanka with a stable outlook. S&P’s transfer and convertibility risk assessment remained unchanged at “B+”. S&P cited Sri Lanka’s strong economic growth outlook, moderate external imbalances and adequate monetary flexibility dampened by weak fiscal indicators and institutional constraints. On March 26, 2016, S&P affirmed its “B+” long-term and “B” short-term sovereign credit ratings, but changed its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “negative” from “stable”. S&P attributed the latest move to rising pressures on Sri Lanka’s external liquidity position, stemming from a weaker than expected trade balance and falling remittances. On March 7, 2017, S&P affirmed its current ratings and outlook.

In addition, Moody's Investors Service ("Moody's") has assigned a "B1" foreign currency issuer rating to the Government of Sri Lanka. The outlook was revised from "stable" to "positive" on July 18, 2011. The agency has considered the end of the internal conflict and the structural improvement in the country's economic prospects and stability in making the rating decision. In July 2013, Moody's changed its outlook on Sri Lanka's "B1" foreign currency sovereign rating from positive to stable and affirmed its "B1" foreign currency government bond rating citing the stabilization in the external payments position, the sizable loss of foreign reserves in 2011 and the pause in the decline in the Government's high debt burden as large on-going deficits impede a positive credit reduction. On June 20, 2016, Moody's affirmed its "B1" foreign currency issuer and senior unsecured sovereign ratings to the Government of Sri Lanka, while changing its outlook to "negative" from "stable". Moody's latest rating change was underpinned by the expectation of a further weakening in certain of Sri Lanka's fiscal metrics in an environment of subdued GDP growth which could lead to renewed BOP pressure and the possibility that the effectiveness of the fiscal reforms as envisaged by the Government may be lower than currently expected, which could further weaken Sri Lanka's fiscal and economic performance.

Recent Developments

Conclusion of Military Action against the LTTE and Resettlement, Development and Reconciliation Activities

For nearly three decades, the Liberation Tigers of Tamil Eelam (the "LTTE") engaged in a violent struggle against Government forces. In May 2009, after a series of successful operations, the military defeated LTTE forces. The defeat of the LTTE and conclusion of hostilities is one of the most significant events in the country's history. Since regaining control over the Eastern and Northern Provinces, the Government has conducted activities to resettle civilians displaced by the conflict ("internally displaced people" or "IDPs"). The Government's resettlement program successfully concluded in 2013, with the resettlement of approximately 300,000 IDPs from the Northern and Eastern Provinces. The demining process targeted public places, farm lands, schools, and hospitals and was accelerated with the help of development partners as well as domestic and international non-governmental organizations. As at September 30, 2015, the demining process was 99% complete with only 64 square kilometers to be cleared, demonstrating a substantial improvement in comparison to the approximately 6,215 square kilometers of land from the end of the war. As per the Honorary Prime Minister's economic statement presented to the Parliament on October 27, 2016, the Government expects to give high priority for reconstruction of housing and civic infrastructure within the previously war-affected areas around Jaffna, Mullaitivu and Kilinochchi districts. Further, the Government has proposed new development corridors with two key economic zones (the Southwest Economic Zone and the Northeast Economic Zone), which are expected to support an economic resurgence and provide prosperity to across the population. The Southwest Economic zone will cover the Western, Southern, Central, Sabaragamuwa and Wayamba provinces, while the Northeast Economic zone will cover the Northern, North Central and Eastern provinces. The Upcountry Secondary Corridor is expected to serve Nuwara Eliya and Badulla Districts via the Kandy-Colombo Expressway and the Southern Expressway through Mattala, connecting the hill country regions as a secondary economic corridor.

The Government has accelerated development activities in the Eastern and Northern Provinces through its Neganahira Navodaya (Eastern Resurgence) and Uthuru Wasanthaya (Northern Spring) development programs. These programs are aimed at restoring and developing these regions through the establishment of critical infrastructure for the provision of drinking water, electricity, education and healthcare, as well as by developing the regional economies, especially in the agricultural and services sectors. The Government's investments in the Eastern Province have facilitated the resettlement of internally displaced people and contributed to increased economic activity.

With respect to the Northern Province, the Government has spent Rs. 167 billion (US\$ 1.3 billion) towards rehabilitation and development activities from 2009 to 2012. Furthermore, the Government earmarked Rs.49.4 billion (US\$ 383 million) in 2013 for reconstruction, rehabilitation and demining activities in the Northern Province, for continuing the development, construction and rehabilitation of roads and other transportation infrastructure and for electricity, housing, water supply, agriculture,

irrigation, manufacturing and livelihood development. The rehabilitation and reconstruction process was implemented concurrently with the de-mining and re-settlement activities that were being carried out in the region and is expected to yield positive social and economic results in the coming years.

The Government expects the end of the 26-year long internal conflict to have a significant positive economic impact not only on the Northern and Eastern Provinces but also on the entire country as these two regions integrate with the national economy. The Northern and Eastern Provinces possess substantial natural resources such as long, scenic and clean beaches and ecological conservation areas that can support a vibrant tourism industry. The modernization of existing croplands, livestock farms and fisheries is also expected to help boost the regional economy. The contribution to Sri Lanka's GDP by the Eastern Province increased to 6.0% in 2015 from 5.8% in 2009, while the Northern Province's contribution increased to 3.5% in 2015 from 3.2% in 2009.

See "The Democratic Socialist Republic of Sri Lanka — Conclusion of Military Action against the LTTE and Resettlement, Development and Reconciliation Activities".

On March 27, 2014, the UN Human Rights Council ("UNHRC") passed a resolution calling for a probe into the final stages of the LTTE conflict. Subsequently, after pledging to conduct a domestic inquiry into allegations by the UNHRC of war crimes on both sides in the final stages of the conflict, the new Government under President Sirisena achieved a six-month deferral of the UNHRC report against Sri Lanka that had been due on March 25, 2015.

The Government is currently exploring steps to examine alleged incidents of serious violations of human rights that warrant further investigations and criminal justice responses. The Government has initiated discussions regarding mechanisms to be introduced for this purpose. Currently, these are being discussed in Parliament.

Furthermore, based upon recommendations made in the interim report submitted to President Sirisena by the Presidential Commission to Investigate into Complaints regarding Missing Persons ("PCICMP"), four teams will be appointed to investigate complaints recorded by the PCICMP. In the meantime, to expedite the reconciliation process, the Government is also reviewing the list of individuals and entities representing the Tamil diaspora that were banned by the previous government. The Government has also incorporated the right to information into the Constitution as part of the Nineteenth Amendment to safeguard the basic rights of the Sri Lankan people and democracy in Sri Lanka. The Right to information Act No. 12 of 2016 has been passed by the Parliament and a copy of the said Act is publicly available. The said Act has been effective from February 3, 2017.

The Government's Relationship with the IMF

To overcome the economic challenges against the backdrop of an increasingly volatile global economic environment, Sri Lanka sought an EFF from the IMF in 2016. On June 3, 2016, the Executive Board of the IMF approved a three-year EFF of SDR1.1 billion (approximately US\$ 1.5 billion) for Sri Lanka to support its BOP position and in support of the Government's economic reform agenda. This amount is equivalent to 185% of Sri Lanka's current quota with the IMF. The first tranche under the EFF, amounting to SDR 119.894 million (approximately US\$ 169 million), was made available to Sri Lanka in June 2016 and a similar amount was made available as the second tranche in November 2016 upon the successful completion of IMF's review of the first programme. After the IMF staff visit during February-March 2017 and a series of constructive discussions between the Government and the IMF, a staff level agreement was reached on May 3, 2017 for the completion of the second review. Although net international reserves fell short of the target and progress on implementing structural benchmarks was rather uneven with some of the reforms lagging behind intended timelines, the review mission of the IMF commended the authorities for their strong efforts in implementing the IMF-supported economic reform program with all fiscal quantitative targets through end-December having been met. The Net International Reserves ("NIR") target was missed entirely due to the outflows from Government securities market with the improved investor climate

in the United States. The IMF also commended the positive efforts and significant progress made by the Government and the Central Bank in building up NIR during March and April 2017 through market purchases. The third tranche will be available subject to the completion of a prior action by the Government and the approval of the Executive Board of the IMF.

The EFF is subject to semi-annual reviews with performance criteria and indicative targets as set forth below:

Quantitative Performance Criteria (“PC”) and Indicative Targets (“IT”)

	Dec. 2016	Mar. 2017	Jun. 2017	Sep. 2017	Dec. 2017	Dec. 2018
	Actual	Estimated	PC*	IT*	PC*	IT*
Quantitative performance criteria						
Central government primary balance (floor, cumulative from the beginning of the year, in billion rupees)	(29.4)	(5)	(8)	(4)	(3)	N/A
Program net official international reserves (floor, cumulative change from the beginning of the year, in million US\$) ⁽¹⁾	(678)	1,161(*)	1,125(*)	769(*)	958(*)	N/A
Monetary policy consultation clause ⁽²⁾⁽³⁾						
Year-on-year inflation in Colombo Consumers Price Index (in %)						
Outer band (upper limit)	—	—	7.9	8.1	8.1	N/A
Inner band (upper limit)	—	—	6.4	6.6	6.6	N/A
		6.5				
Actual/Center point	4.2	(Actual)	4.9	5.1	5.1	N/A
Inner band (lower limit)	—	—	3.4	3.6	3.6	N/A
Outer band (lower limit)	—	—	1.9	2.1	2.1	N/A
Indicative targets						
Central government tax revenue (floor, cumulative from the beginning of the year, in billion rupees)	1,464	383	793	1,230	1,703	N/A
Reserve money of the CBSL (ceiling, end of period stock, in billion rupees)	856.1	892.2 (Actual)	899	935	948	N/A

* Based on latest TMU (Technical Memorandum of Understanding-December 2016). Targets may be revised after the spring meetings of the IMF in April 2017.

Note:

- (1) The floor on net official international reserves is subject to certain adjustments due to differences as assumed under the EFF and the respective test date with respect to items such as holdings of foreign securities and amortization of external debt, among others.
- (2) Quarterly average of year-on-year inflation
- (3) If the observed year-on-year inflation for the test date of end-December 2016 or end-June 2017 falls outside the outer bands, the Government will be required to complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the fund-supported program remains on track; (ii) the reasons for the deviation; and (iii) on proposed policy response. In addition, if the observed year-on-year inflation falls outside the inner bands for the test date of end-December 2016, end-March 2017, end-June 2017, or end-September 2017, the Government will be required to complete a consultation with IMF staff on the reasons for the deviation and the proposed policy response.

In addition, the following actions have already been taken with respect to certain benchmarks for the EFF:

- The Cabinet issued a Memorandum requiring the Ministry of Finance to complete by the end of October 2016 a definitive strategy to address the issue of outstanding arrears of the central government and obligations of state enterprises. The Memorandum specified that the strategy is to include: (i) completion (by the end of 2016) of a comprehensive database of SOE's financial obligations, including a breakdown of arrears and non-arrears to be certified by the Auditor General, for use in creating a registry of such obligations; and (ii) clarification of the government's responsibility over existing obligations related to subsidies and other non-commercial obligations of the SOEs. Meanwhile, in March 2017, Statements of Corporate Intent ("SCIs") were signed for the five largest SOEs to enhance oversight and financial discipline of these enterprises with the view of improving their performance.
- The Ministry of Finance issued circulars to (i) formally implement tax policy and other revenue measures outlined in the Cabinet Memorandum of March 4, 2016; and (ii) detail revised expenditure ceilings for government ministries and agencies consistent with the overall budget deficit target for 2016.
- The Cabinet issued a resolution to adopt a framework note (which was agreed with IMF staff) for a new Inland Revenue Act, which embodies key tax policy drivers, overarching legal design framework, and the tax law reform roadmap as outlined in the March 2016 IMF Legal Department technical assistance mission Aide Memoire.
- Formally suspended, by Cabinet order the Board of Investment's capacity to grant tax exemptions, tax holidays, and special tax rates until such time as the BOI Act can be formally amended.

Sri Lanka's previous IMF facility was obtained in 2009. In order to rebuild the country's reserves to comfortable levels and to increase investor confidence in the country, Sri Lanka made a request to, and was approved by, the IMF for the SBA Facility of US\$ 2.6 billion (SDR1.65 billion) in July 2009. The SBA Facility successfully completed in July 2012. Sri Lanka achieved the key objectives of this program by rebuilding international reserves to cover more than 3.5 months of imports, containing the budget deficit, maintaining inflation at single-digit levels and ensuring the stability of the financial system. Accordingly, Sri Lanka received the entire amount of SDR1.65 billion (US\$ 2.6 billion), which was approved under the SBA Facility. The completion of the SBA Facility marked the longest engagement that Sri Lanka has had with the IMF and the single largest facility that Sri Lanka has ever obtained from a multilateral institution. Repayment of the SBA Facility commenced in October 2012 and is expected to be completed by July 2017. Outstanding amount of the SBA Facility and EFF Facility as at March 31, 2017 amounted to SDR 103.35 million and SDR 239.79 million, respectively.

In addition to the SBA Facility, in August 2009, the IMF approved a general allocation of SDRs to countries based on each country's quota with the IMF to strengthen their international reserves in case they may confront any liquidity constraints caused by the global economic crisis. Under the general SDR allocation by the IMF, the current outstanding SDR liability position as of end-March 2017 amount to SDR 395.46 million. The previous SDR allocation was received in August 2009 for an amount of SDR 325 million.

Recent Policy Measures

The Central Bank continued to tighten its monetary policy stance in 2016. Accordingly, the SRR applicable on all rupee deposit liabilities of LCBs was raised by 1.50% to 7.50%, to be effective from the reserve period commencing on January 16, 2016. This measure permanently absorbed Rs. 52 billion of excess liquidity from the domestic money market, while short term money market rates were allowed to adjust upwards in response. The Central Bank also raised its policy interest rates, namely

the SDFR and the SLFR, by 50 basis points each, to 6.50% and 8.00%, respectively, effective from the close of business on February 19, 2016, with a view to curb growth of monetary and credit aggregates. Reflecting the pass-through effect of monetary policy measures, market interest rates adjusted upwards, although credit flows to the private sector by commercial banks grew persistently at higher than projected levels due to increased ease of obtaining credit as well as increased demand for long term credit from all major sectors of the economy, as reflected in the Quarterly Survey of Commercial Banks' Loans and Advances to the private sector. Considering these developments, the Central Bank further tightened its monetary policy stance by raising the SDFR and the SLFR by 50 basis points each to 7.00% and 8.50%, respectively, effective from the close of business on July 28, 2016. With the view of limiting monetary expansion to desired levels while curtailing the build-up of adverse inflation expectations, the Central Bank raised the policy interest rates again by 25 basis points with effect from March 24, 2017.

In view of the low inflation environment as well as subdued inflation expectations, the Central Bank continued to pursue a relatively relaxed monetary policy stance during 2015, but initiated a gradual tightening of monetary policy towards the end of 2015. With the revival of the growth in credit to the private sector during the latter part of 2014, the special interest rate of 5% was removed effective March 2, 2015, to stabilize overnight interest rates within the policy rate corridor. In April 2015, considering the interest rate movements that were inconsistent with the low inflation environment and investment needs of the economy, the Central Bank reduced each of the SDFR and the SLFR by 50 basis points to 6.00% and 7.50%, respectively. These measures enabled a significant expansion in domestic credit, particularly credit to the private sector. Given the high exposure of banks and financial institutions to certain lending categories, including loans for motor vehicles, the Central Bank imposed a minimum cash margin requirement of 100% on Letters of Credit ("LCs") opened with commercial banks for the importation of motor vehicles with effect from October 30, 2015 for a period of one month. Thereafter, with effect from December 1, 2015, a maximum loan-to-value ratio of 70% was imposed on loans and advances for the purpose of purchasing or utilizing motor vehicles granted by banks and other financial institutions supervised by the Central Bank. The continued high level of excess liquidity that prevailed in the domestic money market, however, remained a concern given its potential to fuel credit leading to eventual inflationary pressures. Therefore, the Central Bank increased the SRR by 1.50 percentage points in December 2015, to be effective from January 16, 2016, signaling the change in the Central Bank's policy stance towards a more restrictive approach.

The Central Bank maintained its eased monetary policy stance in 2014 and reduced a key policy rate, the SLFR, by 50 basis points on January 2, 2014, thus reducing the policy rate corridor to 150 basis points from the previous 200 basis points. Accordingly, the SDFR and the SLFR were maintained at 6.50% and 8.00%, respectively, throughout the year. The Central Bank also implemented measures to rationalize access to the SDF in view of the continued excess in liquidity in the domestic money market and to encourage commercial banks to increase their credit disbursements to the private sector. Accordingly, on September 23, 2014, the Central Bank placed a limit on the use of SDF by an OMO participant at the SDF rate of 6.50% to three times per calendar month. Further, any deposit by an OMO participant at the SDF window in excess of three times is to be accepted at a reduced interest rate of 5% per annum. The easing of monetary policy since December 2012 continued to affect the market interest rates during 2014, thereby reducing interest rates to historically low levels. In addition, the Central Bank introduced a credit guarantee scheme for pawning advances in June 2014 for licensed banks engaged in pawning businesses in order to mitigate the contraction of pawning advances and its effect on the overall credit growth, which moderated as an indirect result of the decline in international gold prices. Furthermore, considering the improvement in the external sector, on January 2, 2014, the Central Bank removed the minimum cash margin requirement of 100% against LCs opened with commercial banks for the import of certain categories of motor vehicles, which was imposed on August 30, 2013.

A new electricity tariff structure, effective April 20, 2013, was implemented on May 9, 2013 to mitigate the financial losses incurred by the Ceylon Electricity Board ("CEB"). Domestic retail prices of petroleum products were also raised to curb losses incurred by the Ceylon Petroleum Corporation ("CPC"). Effective April 1, 2013, prices of fuel oil used for power generation were increased in a cost-reflective manner to reduce the losses incurred from sale of fuel oil to CEB at below-cost prices. Electricity tariffs have been lowered twice during the last three months of 2014 due to a change in

domestic generation mix with the addition of 900 MW of electricity through the Norochcholai Coal Power Plant. Accordingly, effective September 16, 2014, the electricity tariff for the 'Domestic' category was reduced by 25%. In November 2014, accounts in the 'Industry' and 'General Purposes' categories consuming below 300 units per month were given a tariff reduction of 25% through the introduction of a separate tariff band, while a 15% downward revision was made to the tariff applicable on 'Hotel' and all other 'Industry' and 'General Purposes' categories.

Similarly, petrol, diesel and kerosene prices were lowered on six occasions from September 2014 to January 2016 due to declining global oil prices. Accordingly, kerosene, petrol and diesel prices were reduced by Rs. 20, Rs. 5 and Rs. 3 per liter, respectively, on September 17, 2014 and, effective from December 6, 2014, petrol and diesel prices were reduced again by Rs. 7 per liter and kerosene by Rs. 5 per liter. Furthermore, effective from January 22, 2015, kerosene, petrol and diesel prices were reduced significantly by Rs. 16, Rs. 33 and Rs. 16 per liter, respectively, and, effective from January 30, 2015, kerosene price was further reduced by Rs. 6 per liter. In addition kerosene price was further reduced by Rs. 10 and Rs. 5 effective from November 21, 2015 and January 9, 2017, respectively. The domestic gas price was twice reduced by Rs. 250 per 12.5 kg cylinder, effective from October 10, 2014 and effective from December 7, 2014, respectively, resulting in a cumulative reduction of Rs. 500 per 12.5kg cylinder during 2014. The domestic gas price was again reduced by Rs. 300, Rs. 100 and Rs. 150 per 12.5 kg cylinder, effective from January 30, 2015, July 15, 2015 and November 21, 2015, respectively, due to declining global gas prices. Further, as per the Government's budget for 2017 ("Budget 2017"), domestic gas price was reduced again by Rs. 25 since November 2016.

Diversification of Oil Imports

Since the imposition of sanctions against Iran, Sri Lanka has been proactive in its reduction of crude oil imports from Iran. Since June 2012, Sri Lanka has not imported any crude oil from Iran. Instead, it has initially substituted its crude oil requirements with imports from Saudi Arabia, the U.A.E. and Oman and, since 2013, from only the U.A.E. and Oman. In 2015, crude oil imports from the U.A.E. amounted to 89% of total crude imports. In 2016, crude oil imports were solely from U.A.E. Meanwhile, the end to economic sanctions on Iran by the United States is anticipated to create a positive impact on Sri Lankan oil imports.

Medium Term Macroeconomic Outlook

Sri Lanka's economy expanded at a provisional rate of 4.4% in 2016, and is projected to expect at a rate of 5.0% for 2017 and thereafter expected to strengthen over the medium term to achieve a higher growth trajectory of approximately 6% to 7% per annum. The envisaged growth path is expected to be attained with the improvement in investor sentiment. Further, the new policy initiatives of the Government to spur growth across all major sectors of the economy and increase private sector participation through the creation of an investor-friendly environment are expected to contribute to the growth trajectory of the economy over the medium term. Policy measures to encourage small and large scale entrepreneurs to participate in the global economy and positioning of Sri Lanka in the regional and global value chain are expected to support growth in the industry, agricultural and services sectors.

The monetary policy stance of Sri Lanka is also expected to support growth through the implementation of necessary policy measures to ensure price stability in the country and providing conducive conditions for investors. In the medium term, inflation is estimated to be at a low level of approximately 5.0%.

Positive developments in the domestic and global economies, coupled with recent policy initiatives, are expected to result in a favorable outlook for the external sector over the medium term. The current account deficit, which remained below US\$ 2.0 billion in 2016 and 2015 and which was equivalent to 2.4% and 2.3% of GDP, respectively, is expected to gradually improve as a percentage of GDP during the medium term to a deficit of approximately 1.9% by 2018. The decline in the current account deficit is expected to be driven by the improvement in trade in merchandise goods and services. Improvement in foreign exchange earnings from services, particularly with higher inflows from the tourism sector with increase in both tourist arrivals and higher spending, are expected to contribute favorably towards the improvement of the current account. However, workers' remittances are

expected to slow down due to the decline in migration for foreign employment as a result of economic and geopolitical uncertainties in traditional destinations, such as the Middle East and Europe, the increased availability of domestic employment opportunities, and the implementation of policy measures to discourage migration in semi-skilled and unskilled categories. The overall BOP position is also expected to improve over the medium term, with the expected rise in inflows to the financial account.

Meanwhile, Sri Lanka's external reserve position is expected to improve over the medium term, mainly due to the expected higher inflows from non-debt related sources such as export proceeds and foreign direct investments. Furthermore, projected other inflows to the financial account are expected to comfortably finance the narrowing current account deficit. Overall, the external position is expected to improve over the medium term, yielding a sizable surplus in the overall balance and improving the country's external reserves.

Over the medium term, the monetary policy of the Central Bank will increasingly be aligned towards a flexible inflation targeting framework in place of the existing monetary targeting framework. In this framework, broad money aggregates would continue to serve as key intermediate indicators to guide its monetary policy, while the average weighted call money rate ("AWCMR") would serve as the operating target. Accordingly, in the medium term, the Central Bank's monetary policy will follow a path for monetary expansion consistent with its projections for economic growth and inflation. Although net foreign assets of the banking system contracted in 2016 reflecting the deficit in the overall BOP position, going forward, net foreign assets of the banking sector are projected to increase due to the expected increase in foreign inflows and the resultant BOP surpluses. In the meantime, credit flows to the Government from the banking sector are expected to gradually decline as a result of the projected improvement in the fiscal position of the Government which would lead to a reduction in domestic financing requirements. Similarly, borrowings of public corporations are expected to decline significantly due to the expected improvement in their financial performance, increased operational efficiency and market-based pricing. Accordingly, due to the decreasing reliance of the public sector on funds from the banking sector, the banking sector is expected to provide sufficient credit flows to the private sector which would lead to higher investment levels and improved economic activity.

With the Government's on-going fiscal consolidation efforts, the budget deficit is expected to be around 3.5% of GDP by 2020, while the central Government's debt, which was at 79.3% of GDP as at 2016 year-end, is expected to be reduced to approximately 65% of GDP in the medium term. The revenue-based fiscal consolidation efforts are aimed at increasing Government revenue with a number of policy initiatives, including the automation of revenue collecting agencies, risk-based audits, efficiency enhancing measures and simplification of tax legislation and broadening the tax base. These revenue policies are being complemented by further rationalization of recurrent expenditure to allow the Government to maintain public investment at approximately 5% of GDP in the medium term.

Recognizing the critical role of infrastructure development in sustaining medium term growth, the Government has adopted programs which aim, inter alia, at facilitating growth through well-connected roads and expressway networks, providing irrigation and expanding the water distribution network, building a strong telecommunication network and initiating urban and township development programs that focus on enabling investment inflows, creating jobs and improving living standards of residents. The Government also expects Sri Lanka to continue to benefit from its key strategic location in the Indian Ocean. The development of the Colombo port, including the addition of the new south and east container terminals, are expected to make full use of the country's potential as a maritime hub in the South Asian region. Sri Lanka has also made progress on its two international airports in the Western and Southern parts of the country through its emphasis on training of aviation personnel, development of research facilities, development of a national airline and airports, improvement of facilities to harbor international aviation activities and improvement of passenger services. Plans are underway to construct the second terminal and a multi-level terminal building with two pier passenger terminals at the Bandaranaike International Airport ("BIA"). Upon completion of the construction of the second terminal at the BIA, the current capacity of passenger movements per annum would be doubled. In addition, on-going construction work of the Southern Expressway Extension project is scheduled to be completed in 2019 while land acquisition work is in progress in respect of the 168.7

km long Central Expressway project. Further, the railway line connecting Colombo to Jaffna has provided an alternative route between the Western and Northern parts of Sri Lanka, which is expected to spur economic growth and broader social integration. Initiatives have been taken to conduct a feasibility study for the Colombo Suburban Railway Project which aims at improving railway services in the capital city of Colombo and its suburbs. As a result of these projects, Sri Lanka will be well-positioned to participate in international trade and become a popular tourist destination.

The construction work of the Colombo Financial City, which was earlier named as Colombo Port City Project (“CPCP”), recommenced in March 2016. The Ministry of Megapolis and Western Development has allocated approximately Rs. 94 million in 2017 to develop the infrastructure facilities of the proposed port city development project. Further, construction work for the Uma Oya Hydropower Project (120MW) and Broadlands Hydropower Project (35MW) have been in progress throughout 2016 and these power plants are expected to be connected to the national grid by mid-2018 and mid-2019, respectively.

The Prime Minister appointed a special committee to investigate a certain domestic bond issuance by the Central Bank in early 2015. The special committee presented its finding to the Parliament on May 19, 2015 and the information is currently available in the public domain. The Committee on Public Enterprises (“COPE”) has also investigated this matter. The COPE report is publicly available. A Presidential Commission of Inquiry has also been appointed to investigate and inquire into the issuance of Treasury bonds and such commission is presently conducting its hearings on this matter. Meanwhile, the Government will continue its funding plans via domestic public auctions within the approved limits of the Appropriation Act.

Sri Lanka has recently completed multiple power generation projects that contribute a total of approximately 900MW of coal power, approximately 175MW of hydro power and approximately 275MW of renewable energy including mini hydro. In addition, 120MW of hydro power and 210MW of renewable energy, including mini-hydro and solar power, are in the process of being added to the improved transmission and distribution system. Meanwhile, in education, the Government has introduced initiatives such as the program to establish 1,000 secondary schools in the country. Further, the concept of ‘nearest school is the best school’ has been introduced to promote equal opportunities in education for all students, irrespective of the region or the school type. As a result, education has improved at all levels, creating a greater talent pool to support Sri Lanka’s economic growth.

In January 2017, the European Union (“EU”) has proposed to remove a significant part of the remaining import duties on Sri Lankan products and increase market access, appreciating the new Government’s policies on improving human rights and strengthening democratic institutions. The GSP+ trade status, when regained, is expected to have a positive impact on Sri Lanka’s foreign trade, particularly exports, thereby resulting in a positive economic impact in the medium term. Under the GSP+ scheme, Sri Lanka had obtained duty-free access for exports of over 7,200 products to member countries of the EU. The textiles and garments industry derived substantial benefits from this scheme, as close to half of Sri Lanka’s textiles and garments are exported to EU countries. In mid-January 2015, the EU banned importing fish from Sri Lanka, as it suspected that Sri Lanka was not complying with international rules on illegal fishing and employing inadequate control systems in the Sri Lankan fisheries industry. Discussions were held to negotiate the ban while steps were taken to improve the Sri Lankan fisheries industry’s compliance with international standards and requirements specified by the EU. As a result, in April 2016, the EU recommended lifting the fish import ban of Sri Lanka and such removal of the ban was approved by the EU Parliament in June 2016, who cited the reason that Sri Lanka has successfully reformed its fisheries governance system. With the EU market being one of the major seafood exporting destinations for Sri Lanka, this development contributed significantly towards promoting Sri Lankan seafood exports. Since the removal of the ban, seafood exports to the EU grew by 110.0%, year-on-year, during the second half of 2016.

Appointment of New Governor of the Central Bank

On July 4, 2016, the Central Bank announced that Dr. Indrajit Coomaraswamy had been appointed as the new Governor of the Central Bank by President Sirisena, pursuant to the provisions of the Monetary Law Act No. 58 of 1949. Accordingly, Dr. Coomaraswamy will function as the Chairman of the Monetary Board of the Central Bank. Previously, Dr. Coomaraswamy had held various positions within the Government since 1974 including, but not limited to, as an official in the Central Bank, as Director, Economic Affairs Division and Deputy-Director, Secretary-General's Office of Commonwealth Secretariat and as a member of the Monetary Policy Consultative Committee of the Central Bank. Dr. Indrajit Coomaraswamy replaces the former Governor whose term had expired on June 30, 2016.

The Supreme Court's Interim Order on Value Added Tax

On July 11, 2016, the Supreme Court of Sri Lanka issued an interim order suspending the implementation of recent revisions made to the Value Added Tax and the Nation Building Tax pending the passing of further legislation by Parliament. Subsequently, the Value Added Tax (Amendment) Act No 20 of 2016 has been passed by the Parliament.

SUMMARY ECONOMIC DATA

	2011	2012	2013	2014	2015	2016 ⁽¹⁾	First Three Months of 2016 ⁽¹⁾	First Three Months of 2017 ⁽¹⁾	% Increase or Decrease
The Economy									
GDP (at current market prices) (Rs. million) ⁽²⁾	7,219,106	8,732,463	9,592,125	10,361,151 ⁽⁸⁾	10,951,695 ⁽¹⁾⁽⁸⁾	11,838,975	2,896,030	N/A	N/A
GDP (at constant 2010 prices) (Rs. million) ⁽²⁾	6,952,720	7,588,517	7,846,202	8,235,429 ⁽⁸⁾	8,633,890 ⁽¹⁾⁽⁸⁾	9,012,026	2,082,544	N/A	N/A
GDP per capita (in US dollars at current market prices) ⁽²⁾⁽⁹⁾	3,125	3,351	3,609	3,821 ⁽⁸⁾	3,843 ⁽¹⁾⁽⁸⁾	3,835	N/A	N/A	N/A
GDP growth rate (%) ⁽²⁾	8.4	9.1	3.4	5.0 ⁽⁸⁾	4.8 ⁽¹⁾⁽⁸⁾	4.4	5.1	N/A	N/A
Inflation rate (year-on-year % change) ⁽²⁾⁽⁹⁾	4.9 ⁽³⁾	9.2 ⁽³⁾	4.7 ⁽³⁾	2.1 ⁽³⁾	4.6 ⁽⁴⁾	4.5 ⁽⁴⁾	2.6 ⁽⁴⁾⁽⁵⁾	7.3 ⁽⁴⁾⁽⁵⁾	N/A
Unemployment rate (%) ⁽¹⁾⁽⁶⁾	4.2 ⁽⁷⁾	4.0 ⁽⁷⁾	4.4 ⁽⁷⁾	4.3 ⁽⁷⁾	4.7 ⁽⁸⁾	4.4	4.2	N/A	N/A
Government surplus/(deficit) as % of GDP	(6.2)	(5.6)	(5.4)	(5.7)	(7.6)	(5.4)	(1.8)	NA	NA

Source: The Department of Census and Statistics and Ministry of Finance

Notes:

- (1) Provisional
 - (2) The data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
 - (3) Inflation rates based on Colombo Consumers' Price Index ("CCPI") (2006/07=100)
 - (4) Inflation rates based on Colombo Consumer Price Index ("CCPI") (2013=100)
 - (5) Data as at March 2016.
 - (6) Based on household population aged 15 years and above
 - (7) Revised as per the 2012 Census-based Re-weighting of Labour Force Survey Estimates.
 - (8) Revised
 - (9) Estimates updated with latest population figures.
- N/A Not Available.

	2011	2012	2013 ⁽¹⁾	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	2017 ⁽²⁾	% Increase or Decrease
(in US\$ millions, except for percentages)								
External Finance								
Current account (deficit)								
as % of GDP	(7.1)	(5.8)	(3.4)	(2.5)	(2.3)	(2.4)	(2.1)	12.5
Overall BOP position	(1,059)	151	985	1,369	(1,489)	(500)	1,668	433.6
Gross international								
official reserves (as at								
the end of the period) ..	6,749	7,106	7,495	8,208	7,304	6,019	7,379	22.6
International total								
reserves (as at the end								
of the period)	7,991	8,587	8,573	9,884	9,337	8,433	NA	NA

Source: Central Bank of Sri Lanka

Note:

- (1) Provisional
(2) Projected

As at December 31,								
	2011	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽²⁾		% Increase or Decrease
Domestic and External Debt								
Government domestic debt (Rs.								
million)	2,804,085	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507		7.7
Government foreign debt (Rs. million)	2,329,280	2,767,300	2,960,424	3,113,116	3,544,031	4,045,796		14.2
Government domestic debt as% of								
GDP	38.8	37.0	40.0	41.3	45.3	45.1		
Government foreign debt as% of GDP	32.3	31.7	30.9	30.0	32.4	34.2		

Source: Ministry of Finance and Central Bank of Sri Lanka

Note:

- (1) Revised
(2) Provisional

	2011	2012	2013	2014	2015	2016 ⁽¹⁾	First Three Months of 2016 ⁽¹⁾	First Three Months of 2017 ⁽²⁾	% Increase or Decrease
Banking Sector									
Total assets of banking system									
(as at the end of the period)									
(Rs million) ⁽²⁾	4,252,234	5,098,219	5,941,473	6,971,832	8,077,474	9,046,583	8,354,274	9,492,691	13.6
Broad money (end period) (Rs.									
million)	2,491,740	2,929,070	3,417,853	3,875,853	4,565,917	5,405,596	4,731,636	N/A	N/A
Average Weighted Prime									
Lending Rate per annum									
(%) (monthly rate)	10.49	14.29	9.96	6.35	7.40	11.73	8.87	11.56	N/A
Fixed capital (medium-term)									
lending nominal interest rate									
(%) ⁽³⁾	13.44	15.98	15.18	11.91	11.00	13.20	11.45	N/A	N/A

Source: Central Bank of Sri Lanka

Notes:

- (1) Provisional
(2) Excludes Central Bank assets
(3) Average weighted lending rate
(4) Year-on-year Change

THE OFFERING

The following is a brief summary of certain terms of the Offering. For a more complete description of the terms of the Bonds, see “Description of the Bonds” and “Plan of Distribution.”

Issuer	The Government of the Democratic Socialist Republic of Sri Lanka.
Bonds	US\$1,500,000,000 aggregate principal amount of 6.20% Bonds due 2027.
Interest Payment Dates	May 11 and November 11 of each year, commencing on November 11, 2017.
Maturity Date	The Bonds will mature on May 11, 2027.
Redemption	The Bonds will not be redeemable prior to maturity.
Status of Bonds	The Bonds will constitute direct, unconditional, unsubordinated and unsecured general obligations of the Issuer. The Bonds will at all times rank <i>pari passu</i> among themselves in all respects without any preference of one over the other by reason of priority of date of issue or otherwise. The Bonds will at all times rank at least equally with all other present and future unsecured and unsubordinated External Indebtedness (as defined herein) of the Issuer. The full faith and credit of the Democratic Socialist Republic of Sri Lanka will be pledged for the due and punctual payment of the principal of, and interest on, the Bonds.
Limitation on Liens	With certain exceptions, so long as any Bonds remain Outstanding (as defined herein), the Issuer shall not create, incur, assume or permit to subsist any Lien (as defined herein) upon the whole or any part of its present or future assets or revenues to secure (1) any Public External Indebtedness (as defined herein); (2) any Guarantees (as defined herein) in respect of Public External Indebtedness; or (3) the Public External Indebtedness of any other person; without at the same time or prior thereto securing the Bonds equally and ratably therewith or providing such other arrangement (whether or not comprising a Lien) as shall be approved by not less than 66 2/3% of the aggregate principal amount of Outstanding Bonds which are represented at a meeting of Holders (as defined herein) duly convened in accordance with the Indenture (as defined herein). See “Description of the Bonds — Limitation on Liens.”

Taxation	The Issuer will make all payments on the Bonds without withholding or deducting any present or future taxes imposed by Sri Lanka or any of its political subdivisions, unless required by law. If Sri Lankan law requires the Issuer to deduct or withhold taxes, it will pay the holders, subject to certain exceptions, such additional amounts as are necessary to ensure that they receive the same amount as they would have received without such withholding or deduction. The Issuer will not, however, pay any such additional amounts if the holder or beneficial owner is liable for Sri Lankan tax under certain circumstances. See “Description of the Bonds — Additional Amounts.” For a description of certain United States tax aspects of the Bonds, see “Taxation — United States Federal Income Taxation.”
Cross-Defaults	Events of default with respect to the Bonds include (1) any External Indebtedness shall become (or shall become capable of being declared) due and payable prior to its stated maturity (otherwise than at the option of the Issuer); (2) any default shall occur in the payment of principal of, or premium or prepayment charge (if any) or interest on, any External Indebtedness when and as the same shall become due and payable if such default shall continue for more than the period of grace, if any, originally applicable thereto; or (3) any default shall occur in the payment when due and called upon (after the expiry of any originally applicable grace period) of any Guarantee of the Issuer in respect of any External Indebtedness of any other person, <i>provided</i> that the aggregate amount of the relevant External Indebtedness in respect of which one or more of such events have occurred equals or exceeds US\$25.0 million (or its equivalent in any other currency or currencies). See “Description of the Bonds — Events of Default.”
Collective Action Clause	The Bonds will contain provisions regarding default and acceleration and approval of amendments, modifications, changes and waivers with the consent of the Holders of specified percentages of the Outstanding Bonds, which are commonly referred to as “collective action clauses.” See “Description of the Bonds — Modifications and Amendments; Meetings of Holders.”
Listing	Approval in-principle has been received from the SGX-ST for the listing and quotation of the Bonds on the SGX-ST. For so long as the Bonds are listed on the SGX-ST and the rules of the SGX-ST so require, the Bonds will be traded on the SGX-ST in a minimum board lot size of S\$200,000 (or its equivalent in foreign currencies).
Ratings of the Bonds	The Bonds are expected to be rated “B+” by S&P, “B1” by Moody’s and “B+” by Fitch. The ratings assigned by rating agencies are indicative and may go up and down from time to time. A credit rating is not a recommendation to purchase, hold or sell securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.

Form, Denomination and**Registration**

The Issuer will issue the Bonds in fully registered form in minimum denominations of US\$200,000 and integral multiples of US\$1,000 in excess thereof. The Bonds will be represented by one or more Global Bonds (as defined herein), registered in the name of Cede & Co., as nominee of DTC. Beneficial interests in the Global Bonds will be shown on, and the transfer thereof will be effected only through, records maintained by DTC and its direct and indirect participants (including Euroclear Bank SA/NV (“Euroclear”) and Clearstream Banking S.A. (“Clearstream, Luxembourg”)). Settlement of all secondary market trading activity in the Bonds will be made in immediately available funds.

Further Issues

The Issuer may from time to time, without notice to or the consent of the Holders, issue further bonds having terms and conditions the same as the Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single series and class with the Bonds, provided that such further bonds must be fungible with the Bonds for U.S. federal income tax purposes.

Use of Proceeds

The net proceeds from the issuance of the Bonds will be used to fund ongoing and/or new development projects of the Government. See “Use of Proceeds”.

Trustee; Paying Agent;**Transfer Agent.....**

HSBC Bank USA, National Association.

Governing Law

The Bonds and the Indenture will be governed by and construed in accordance with the laws of the State of New York.

USE OF PROCEEDS

The Government will use the net proceeds from the issue of the Bonds (estimated to be US\$1,497,442,559 after deduction of underwriting commission and fees as well as estimated expenses) to fund on-going and/or new development projects of the Government.

THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

History, Land and People

History

The recorded history of Sri Lanka (formerly known as “Ceylon”) dates back to the sixth century B.C., when an Indian prince named Vijaya together with his followers landed on the island. In the third century B.C., the Buddhist faith was adopted by the majority of the people and the island became a center of Buddhist scholarship and missionary work. From the sixteenth century, Ceylon was successively colonized by the Portuguese, the Dutch and the British until she regained independence on February 4, 1948. In 1972, Ceylon became a republic and changed its name to Sri Lanka. In 1978, the existing Constitution was promulgated, providing that the country shall be known as the “Democratic Socialist Republic of Sri Lanka.”

Geography and General Information

Sri Lanka is an island located 29 kilometers from the Southeastern tip of India and 645 kilometers north of the equator. It is located across several major maritime trading routes between Asia and the Middle East, Europe, Africa and the Americas. Sri Lanka extends 438 kilometers from North to South, and 225 kilometers from East to West at its broadest point, occupying a territory of 65,610 square kilometers. The terrain of Sri Lanka is largely flat, with a cluster of mountain peaks located in the South-central area of the island, the highest of which is the 2,524-meter-high Pidurutalagala Mountain. Numerous rivers originate in the mountains and flow toward the sea, each of which supports agricultural, industrial and transportation activities. Sri Lanka has a marine resource base comprising 21,500 square kilometers of territorial sea and 517,400 square kilometers of Exclusive Economic Zone (“EEZ”) extending up to 200 nautical miles from the coastline.

Sri Lanka’s climate is tropical, with high humidity and year-round temperatures averaging 27°C to 28°C. Two monsoon seasons occur each year, the Southwest monsoon from May to October and the Northeast monsoon from December to March. The North of the island receives an average of approximately 100 centimeters of rain annually, and the Southwest of the island receives an average of approximately 500 centimeters of rain each year. A massive irrigation system comprising large, medium and small-scale tanks and a canal system has been built since ancient times to provide regular water supply for cultivation of paddy and other field crops. Since independence, the Government has implemented extensive programs consisting of numerous irrigation projects, including the Mahaweli Scheme, with a goal to provide the population with electricity, regular water supply for agriculture and new land for cultivation.

The population of Sri Lanka was estimated to be 21.203 million in 2016. Sri Lanka has a diverse ethnic composition: based on data from the previous nation-wide census in 2012, 74.9% of the people is Sinhalese, 15.3% is Tamils, 9.3% is Sri Lankan Moors and the remaining 0.5% is of other ethnicities. In 2015, the literacy rate was 93.2%. Sinhalese and Tamil are the official languages of Sri Lanka and, along with English, are taught in all schools. Based on the census in 2012, 70.1% of the population are Buddhist, 12.6% are Hindu, 9.7% are Muslim and 7.6% are Christian (including Roman Catholic).

More than one fourth of the total population lives in the Western Province (28.4%), while the least populated province is the Northern Province (5.2%). As at 2016 year end, the population in both the Colombo district and the Gampaha district exceeded two million in each district. The five districts of Kurunegala, Kandy, Kalutara, Ratnapura and Galle recorded population of more than one million while the Mullaitivu district recorded the lowest population. An administrative capital, Sri Jayawardenapura-Kotte, was designated in 1977 and serves as the site of the Parliament.

Government

Constitutions

The first constitution of independent Ceylon, promulgated at the time of independence on February 4, 1948 and commonly referred to as the Soulbury Constitution, comprised several documents, including The Ceylon Independence Act of 1947 and The Orders in Council of 1946 and 1947. The first republican constitution, which provides for a unicameral Parliament, was drafted by the Members of Parliament functioning as a Constituent Assembly and promulgated on May 22, 1972. On September 7, 1978, the third and current constitution (the “Constitution”), was promulgated.

The Constitution provides for an independent judiciary and fundamental rights of the people, including the right of any aggrieved person to file a claim with the Supreme Court for redress of any violation of his or her fundamental rights. The Constitution also provides for a Parliamentary Commissioner for Administration (Ombudsman) to investigate and report on public grievances against Government Institutions and State officers and give redress. Furthermore, it provides for a referendum in respect of bills proposed for the amendment of certain Articles of the Constitution and certain other selected bills referred to the people by the President.

Governmental Structure

President

The Nineteenth Amendment to the Constitution curtailed the executive powers of the Presidency. It repealed changes introduced by the Eighteenth Amendment in 2010, which further expanded the executive powers of the Presidency. Accordingly, the Nineteenth Amendment limited the Presidency to two terms in office and reduced the length of each term from six years to five years. The most important change is the limitation on Presidential immunity. In addition, under the Nineteenth Amendment, the exclusive power vested with the President to dissolve the Parliament at any time after one year of its election has been curtailed — the President may not dissolve the Parliament until the expiration of a period of not less than four years and six months from the date of the Parliament’s first meeting unless the President is required to do so through a resolution passed by at least two-thirds of the members of the Parliament.

Under the Nineteenth Amendment, the President’s duties include:

- ensuring that the Constitution is respected and upheld by all organs of the Government;
- promoting national reconciliation and integration;
- facilitating the proper functioning of the Constitutional Council and the institutions whose members are appointed through recommendation of the Constitutional Council; and
- ensuring the creation of proper conditions for the conduct of free and fair elections and referenda on the advice of the Election Commission.

The new constitutional changes also confer upon the President the power to exercise the following rights, among others:

- to make the Statement of Government Policy in Parliament at the commencement of each session of Parliament;
- to preside at ceremonial sittings of Parliament;
- to summon, prorogue and dissolve Parliament;
- to receive and recognize, and to appoint and accredit, Ambassadors, High Commissioners, Plenipotentiaries and other diplomatic agents;

- to appoint as President's Counsel, attorneys-at-law who have reached eminence in the profession and have maintained high standards of conduct and professional rectitude;
- to keep the Public Seal of the Republic, and to make and execute under the Public Seal, the acts of appointment of the Prime Minister and other Ministers of the Cabinet, the Chief Justice and other judges of the Supreme Court, the President of the Court of Appeal and other judges of the Court of Appeal, and such grants and dispositions of lands and other immovable property vested in the Republic as the President is by law required or empowered to do, and to use the Public Seal for sealing all things whatsoever that shall pass that Seal;
- to declare war and peace; and
- to do all such acts and things, not inconsistent with the provisions of the Constitution or written law, as by international law, custom or usage the President is authorized or required to do.

The President shall be responsible and answerable to Parliament for the due exercise, performance and discharge of his or her powers, duties and functions under the Constitution and any written law, including the law for the time being relating to public security. The President remains the Head of State, the Head of the Executive and the Government and the Commander in Chief of the Armed Forces. The President also appoints Ministers to the Cabinet, for which consultation with the Prime Minister for advice is available.

Prime Minister

The President appoints the Member of Parliament who in his opinion is most likely to command the confidence of the Parliament as the Prime Minister. The Prime Minister continues to hold office unless he resigns from his office or ceases to be a Member of Parliament. The Members of Parliament of the ruling party are headed by the Prime Minister during the parliamentary sessions. The President may consult the Prime Minister where he considers such consultation to be necessary when appointing Cabinet Ministers. The President, on the advice of the Prime Minister, may appoint non-Cabinet Ministers and Deputy Ministers and assign ministries, subjects and functions to them. The President may also appoint the Prime Minister to exercise, perform and discharge the powers, duties, and functions of the President during a period when the President is of the opinion that he will be unable to attend to his office due to absence from Sri Lanka or any other reason.

Parliament

The Parliament is currently a unicameral 225-member legislature that was elected by universal suffrage on the basis of proportional representation to a five-year term. The President may from time to time summon, suspend or end a legislative session and dissolve the Parliament under the Constitution. The Parliament reserves the power to make all laws and to repeal or amend any provision of the Constitution. The Parliament is not permitted under the Constitution to abdicate or in any manner alienate its legislative power. The Speaker, the Deputy Speaker and the Deputy Chairman of Committees are elected by the Parliament at its first meeting after a general election. The Speaker is to preside at sessions of the Parliament. In his absence, the Deputy Speaker, or in the absence of both, the Deputy Chairman of Committees shall preside. The privileges, immunities and powers of the Parliament and its Members are determined by the Parliament and regulated by law. The most recent Parliamentary election was held on August 17, 2015. The UNP became the largest group in the Parliament after securing 45.66% of votes and 106 seats while the UPFA secured 42.38% of votes and 95 seats. On August 20, 2015, the central committee of the SLFP, the main party of the UPFA, agreed to form a national government with the UNP for two years. Ranil Wickremesinghe was sworn in as the Prime Minister on August 21, 2015 and R. Sampanthan of ITAK was appointed as the Leader of the Opposition.

The proposed Twentieth Amendment to the Constitution will replace the existing proportional representation system of parliamentary elections with a hybrid proportional representation and first-past-the-post system. Although details remain yet to be confirmed, a draft of the proposed amendment expands the total number of members of Parliament from the present 225 to 255, with each polling division having at least one representative in Parliament. Of those 255 members of Parliament, 196 members are expected to be elected on a first-past-the-post system and a district-based proportional representation system. The remaining 59 members are expected to be from the National List. Meanwhile, a Delimitation Commission will decide on the number of electorates with multi-member electorates, which has been proposed for a number of Districts.

Judiciary

Sri Lanka's judiciary consists of a Supreme Court, a Court of Appeal, and a number of subordinate courts. The Supreme Court consists of a Chief Justice and between six and ten Supreme Court Justices appointed by the President. The Court of Appeal consists of a President of the Court of Appeal and between six and eleven judges appointed by the President. The Supreme Court can determine whether a proposed bill is consistent with the Constitution and whether a referendum must be held on a proposed bill. It also has sole and exclusive jurisdiction to hear and determine any cases relating to the infringement by the executive or administrative action of any fundamental right or language right recognized by the Constitution. The Supreme Court is also the final court of appeal for all criminal and civil cases.

Provincial Councils

Under the Thirteenth Amendment to the Constitution, significant legislative authority was delegated to the Provincial Councils. These Provincial Councils are directly elected for five-year terms. The President appoints the Governor of a province, who then appoints the Board of Ministers, consisting of the Chief Minister and four other Ministers from among the elected members. The Provincial Councils possess certain provincial-level legislative and executive powers over education, health, rural development, tourism, social services, agriculture and local taxation, subject to Government oversight. There are also municipal, urban, and rural councils with limited powers.

Principal Government Officials

Name	Principal Position	Age
Maithripala Sirisena	President	65
Ranil Wickremesinghe	Prime Minister	68
Ravi Karunanayake	Minister of Finance	54
Lakshman Kiriella.....	Leader of the House	69
Gayantha Karunathilaka	Chief Government Whip	54
Mangala Samaraweera.....	Minister of Foreign Affairs	60

National Elections and Recent Political Developments

Sri Lanka has a multi-party democracy. Two major parties, the Sri Lanka Freedom Party (the "SLFP") and the UNP, have generally alternated rule since 1956.

In early 2004, the SLFP, the JVP, the Lanka Sama Samaja Party, the Sri Lanka Communist Party, the National Unity Alliance and the National Muslim Congress formed the UPFA. On February 7, 2004, former President Chandrika Kumaratunga dissolved the Parliament and the parliamentary election was held on April 4, 2004. The election resulted in the UPFA, together with several other parties and Members of Parliament who had agreed to directly support the President, forming a majority in the Parliament. When the Parliament convened on April 23, 2004, Mahinda Rajapaksa was elected as the Prime Minister and the UNP became the main opposition party.

The governing coalition led by the UPFA was supported by 24 Members of the UNP. Further, the Ceylon Workers Congress, which contested the UNP at the general election in 2004, and the Jathika Hela Urumaya supported the Government. Members of the Jathika Nidahas Peramuna who separated from the JVP also supported the Government.

Resolving a protracted debate on the date of expiration of President Kumaratunga's term of office, in August 2005 the Supreme Court ruled that a presidential election must be held in November 2005. Mahinda Rajapaksa was the UPFA candidate and Prime Minister Ranil Wickremesinghe was the UNP candidate in the presidential election. The fifth presidential election was held on November 17, 2005. Mahinda Rajapaksa was elected the fifth Executive President of Sri Lanka in this election and he took the oath as the President on November 19, 2005. President Rajapaksa thereafter appointed Ratnasiri Wickremanayake as the Prime Minister.

Prior to the expiration of his first term, President Mahinda Rajapaksa called for a presidential election one year earlier than what was constitutionally required. Mahinda Rajapaksa was the UPFA candidate while former army commander Sarath Fonseka was the common opposition candidate. The presidential election was held on January 26, 2010 and resulted in the incumbent, Mahinda Rajapaksa, becoming the president-elect. Mahinda Rajapaksa took the oath as President for the second term of office on November 17, 2010 and began a new six-year term as the executive president of Sri Lanka.

President Mahinda Rajapaksa dissolved the 13th Parliament on February 9, 2010 and called for a general election. SLFP, Jathika Hela Urumaya, Jathika Nidahas Peramuna, Lanka Sama Samaja Party, the Sri Lanka Communist Party, the National Unity Alliance and the National Muslim Congress again contested as the UPFA.

The general election was held on April 8, 2010. It was the first general election held in Sri Lanka following the end of the 26-year civil war. The election resulted in the UPFA winning 144 out of 225 seats, securing close to a two-thirds majority in the Parliament. When the Parliament convened on April 22, 2010, D.M. Jayarathne was appointed Prime Minister, and the UNP functioned and continues to function as the main opposition party to this date.

The sixth presidential election was held on January 8, 2015. The incumbent President Mahinda Rajapaksa, seeking a third term in office, was the UPFA's candidate. The UNP-led opposition coalition fielded Maithripala Sirisena, the former Minister of Health in Rajapaksa's government and General Secretary of the SLFP, as its common candidate. Sirisena was declared the winner after receiving 51.28% of total votes cast compared to Rajapaksa's 47.58%, winning 12 of the 22 electoral districts. After a smooth transition of power, Sirisena was sworn in as the sixth executive President of Sri Lanka on January 9, 2015. Immediately after, Ranil Wickremesinghe was sworn in as the new prime minister before President Sirisena.

The most recent Parliamentary election was held on August 17, 2015 after the Parliament was dissolved on June 26, 2015. While the UNFGG obtained the most number of seats (106) in the 2015 Parliamentary General Election, it was not able to secure a majority of seats in the Parliament. The UPFA obtained 95 seats while ITAK and the JVP obtained 16 seats and six seats, respectively. Furthermore, the Eelam People's Democratic Party and the Sri Lanka Muslim Congress won one seat each. Prime Minister Ranil Wickremesinghe, leader of the UNFGG and UNP, was able to form a national government with the support of certain UPFA members of Parliament. This was the first time since Sri Lanka's independence that a government was formed with the consensus of the country's main political parties. The table below sets out the general election results over the last four elections:

RESULTS OF RECENT PARLIAMENTARY ELECTIONS

Party	2001		2004		2010		2015	
	% of Votes Polled	No. of Seats	% of Votes Polled	No. of Seats	% of Votes Polled	No. of Seats	% of Votes Polled	No. of Seats
United National Party	45.6	109	37.8	82	29.3	60	45.7	106
United People's Freedom Alliance ⁽¹⁾ . Janatha Vimukthi Peramuna.....	—	—	45.6	105	60.3	144	42.4	95
Ilankai Tamil Arasu Kadchi	9.1	16	—	—	—	—	4.9	6
Sri Lanka Muslim Congress.....	—	—	6.8	22	2.9	14	4.6	16
People's Alliance	1.2	5	2.0	5	0.4	1	—	—
Democratic National Alliance ⁽²⁾	37.2	77	—	—	—	—	—	—
Tamil United Liberation Front	—	—	—	—	5.5	7	—	—
Jathika Hela Urumaya.....	3.9	15	—	—	—	—	—	—
Others	—	—	5.5	9	—	—	—	—
Total.....	3.0	3	2.2	2	1.9	—	2.1	1
	100.0	225	100.0	225	100.0	225	100.0	225

Source: Sri Lanka Elections Department

Notes:

- (1) The SLFP, the Mahajana Eksath Peramuna, the Lanka Samasamaja Party, Jathika Hela Urumaya and the Sri Lanka Communist Party are the main parties of UPFA
- (2) JVP joined together with the Democratic National Alliance and participated in the election in 2010

Constitutional Amendments

Under the Eighteenth Amendment enacted on September 8, 2010, the Constitutional Council was replaced with a Parliamentary Council, which consisted of the Prime Minister, the Speaker, the Opposition Leader, a member of the Parliament appointed by the President and five persons jointly appointed by the Prime Minister and the Leader of the Opposition. However, the Nineteenth Amendment restored the Constitutional Council. The Constitutional Council is chaired by the Speaker and consists of four members of the Parliament in addition to the Prime Minister, the Speaker and the Opposition Leader (all *ex-officio*) and three non-political persons representing civil society.

The Constitutional Council has powers to appoint members to the independent commissions, including the Election Commission, the Public Service Commission, the National Police Commission, the Audit Service Commission, the Sri Lanka Human Rights Commission, the Commission to Investigate Bribery or Corruption, the Finance Commission, the Delimitation Commission and the National Procurement Commission. The President appoints members to these Commissions, subject to recommendations made by the Constitutional Council. In addition, the Constitutional Council is charged with approving recommendations made by the President with respect to appointments of the Chief Justice and the Judges of the Supreme Court, the President and Judges of the Court of Appeal, the Members of the Judicial Service Commission (other than the Chairman), the Attorney-General, the Auditor-General, the Parliamentary Commissioner for Administration (Ombudsman) and the Secretary-General of Parliament, before such appointments by the President may take effect. However,

in the discharge of its function relating to the appointment of Judges of the Supreme Court and the President and Judges of the Court of Appeal, the Constitutional Council is also required to obtain the views of the Chief Justice. All of the independent commissions, except for the Election Commission, are responsible and answerable to the Parliament.

The Nineteenth Amendment provides that the total number of Ministers of the Cabinet shall not exceed thirty, while the total number of Ministers who are not members of the Cabinet shall not, in the aggregate, exceed forty. The Nineteenth Amendment further provides that if a political party, which obtains the highest number of seats in Parliament, forms a national government together with the other political parties, the number of Ministers of the Cabinet, State Ministers and Deputy Ministers shall be determined by Parliament.

Administrative Structure

Sri Lanka has nine provinces, 25 administrative districts and 335 local authorities. Each province is governed by a directly elected Provincial Council, while each administrative district is administered by a District Secretariat.

The Government is composed of various ministries and ministry-equivalent agencies of the executive branch, which implement the various programs and projects of the Government. Set out below is a list of all ministries:

LIST OF MINISTRIES

Sector	Ministries
Economic services	National Policies & Economic Affairs; Mahaweli Development & Environment; City Planning & Water Supply; Plantation Industries, Power & Renewable Energy; Agriculture; Lands; Ports and Shipping; Industry and Commerce; Transport & Civil Aviation; Fisheries & Aquatic Resources Development; Irrigation & Water Resources Management; Rural Economic Affairs; Public Enterprises Development; Petroleum Resources Development; Primary Industries; Development, Strategies & International Trade; Megapolis & Western Development; Law & Order and Southern Development, Regional Development
Social services	National Integration & Reconciliation; Tourism Development & Christian Religious Affairs; Sustainable Development & Wildlife; Social Empowerment & Welfare; Higher Education & Highways; Science, Technology & Research; Health Nutrition & Indigenous Medicine; Housing & Construction; Sports; Rehabilitation, Resettlement & Hindu Religious Affairs; Education; Foreign Employment; Women & Child Affairs; Post, Postal Services & Muslim Religious Affairs; Disaster Management; Skills Development & Vocational Training; Hill Country New Villages, Infrastructure & Community Development; National Co-Existence, Dialogue and Official Languages
General public services	Finance; Defense; Buddha Sasana; Home Affairs; Foreign Affairs; Public Administration & Management; Provincial Councils & Local Government; Labor & Trade Union Relations; Law & Order and Prison Reforms; Rehabilitation, Resettlement & Hindu Religious Affairs; Internal Affairs, Wayamba Development & Cultural Affairs; Justice; Telecommunication & Digital Infrastructure; National Dialogue; Special Assignment
Constitutional offices	Parliamentary Reforms and Mass Media

Public Corporations

The Ministry of Public Enterprises Development was established in September 2015 for the formulation of policies, programs and projects, and the monitoring and evaluation of public enterprise development. Enterprises within the purview of the Ministry are: Bogala Graphite Lanka Ltd., Ceylon Ceramics Corporation (Brick and Tiles) Division, Kahagolle Engineering Services Company Ltd. (“KESCO”), BCC Company Limited, Public Resources Management Corporation, Hotel Developers (Lanka) PLC, SriLankan Airlines Ltd., Mihin Lanka (Pvt.) Ltd., Insurance Corporation of Sri Lanka and its subsidiaries and associated companies, all state banks and their subsidiaries and associated companies, Lakdiva Engineering Ltd, Werahara Engineering Services Ltd. (WESCO), Janatha Estate Development Board, Sri Lanka State Plantation Corporation, Elkaduwa Plantation Company Ltd, Kurunegala Plantation Company Ltd, Chilaw Plantation Company Ltd and Galoya Plantation (PVT) Ltd.

Policy Priorities of President Sirisena’s Government

The policy priorities of President Sirisena’s Government include:

- achieving a high level of human development, leading to reconciliation among all communities and rapid socioeconomic development to overcome local and international challenges;
- abolishing the executive presidential system and introducing changes to the Constitution to establish a Presidency that is aligned with the Parliament through the Cabinet;
- establishing a new electoral system;
- prioritizing skills development and enabling the Sri Lankan workforce to meet the needs of local and international employment opportunities;
- forming future economic policies, plans and strategies to maximize benefits from Sri Lanka’s strategic geographic location;
- promoting basic principles of micro credit and financial management among small-scale entrepreneurs and farmers;
- strengthening existing institutional structures to eradicate corruption and protection of state property;
- minimizing income disparity and expanding the middle class while ensuring equitable development across the country;
- focusing foreign policy on Asia-centric “middle path” policy based on the foundation of openness and friendship with all countries;
- introducing a National Food Policy with the aim of producing healthy food locally, promoting the growth of agricultural products to fulfill Sri Lanka’s nutrition needs and prioritizing rice production;
- introducing modern technology to the agricultural and livestock sectors;
- enhancing public services, including free healthcare, free education and public transport;
- formulating a youth policy to address the current needs of Sri Lanka; and
- prioritizing the well-being of women in all development strategies and building a better future for and ensuring the security of children.

The Committee Against Corruption and the Urgent Response Committee

The Government has established a special Committee Against Corruption. The Committee Against Corruption is headed by the Prime Minister and includes representatives from the Cabinet, opposition parliamentarians/politicians and legal experts. Cabinet approval has also been granted to establish an Urgent Response Committee, with a member of Parliament as the Coordinator and comprising public officials, police officers, lawyers, financial specialists and officials of the Criminal Investigation Department, to act on the recommendations of the Committee Against Corruption.

The Committee Against Corruption has already taken action on certain matters of public interest. Further, the Committee Against Corruption mainly focuses on the following:

- combating fraudulent financial dealings outside of Sri Lanka;
- introducing an Anti-Bribery or Anti-Corruption Commission with greater powers;
- establishing a National Procurement Commission;
- introducing the National Audit Act; and
- implementing the United Nations Anti-Corruption Covenant, to which Sri Lanka is a signatory.

Furthermore, in February 2015, the Fraud and Corruption Investigation Division, which is also referred to as the Financial Crimes Investigation Division (“FCID”), was established as a functional division of the Police Department. The establishment of FCID was in accordance with Section 55 of the Police Ordinance and was approved by the Cabinet. The FCID operates under the exclusive supervision and direction of the Inspector General of Police.

Right to Information Bill

As part of the Nineteenth Amendment, the Government has incorporated the right to information into the Constitution through the insertion of provisions which ensure the freedom of speech, assembly and movement as a fundamental right. Accordingly, every citizen has the right of access to information required for the exercise or protection of the citizen’s rights where such information is held by the State, a Ministry, a Government Department or any statutory body created under the central Government or provincial councils, any local authority or any other person as provided for by law. The purpose of the Right to Information Act is to provide the public with the right to access official information for purposes of good governance, accountability and anti-corruption. Right to information Act No. 12 of 2016 has been passed by the Parliament and a copy of the said Act is publicly available. The said Act has been effective from February 3, 2017.

Fiscal Management (Responsibility) Act

The Government introduced the Fiscal Management (Responsibility) Act, No.3 of 2003 (the “FMRA”) with a view to improving the management, transparency and accountability of fiscal operations. In order to fulfill the objective of transparency and accountability, the FMRA has specified several reports to be presented to the Parliament and to the general public within a given time frame. Since the enactment of the FMRA, the Government has published these reports, which has improved availability and transparency of information regarding its budgetary operations.

Under the FMRA, the budget deficit was to be reduced to 5.0% of GDP by 2006 and maintained at that level thereafter. The outstanding Government debt, as a percentage of GDP, was also to be reduced to 85.0% by 2006 and to 60.0% by the end of 2013. The targets were not met due to a number of significant unforeseen and adverse events, such as the 2004 tsunami disaster, the escalation of international commodity prices in 2007 and 2008 and the global economic crisis and intensified counter terrorism activities in 2009. In addition to the negative impact that these events had on GDP, the Government had to respond to these events by implementing appropriate measures which had a further negative impact on the performance of its budgetary operations. For example, in 2004, the

country was struck by a tsunami, which in total left more than 35,000 people dead and another 550,000 people internally displaced. The tsunami devastated certain economic sectors in the country and left a significant amount of infrastructure damaged or destroyed in its wake. As a result, the Government spent significant amounts of money rebuilding homes and infrastructure and reviving the local economies of the affected areas. The Government also funded demining resettlement, development and reconciliation activities relating to the country's recently resolved internal conflict. In 2009, the Government also prioritized the provision of basic needs for internally displaced people, resettlement of such people and reconstruction and rehabilitation of conflict-affected infrastructure. Although the targets set out in the FMRA relating to budget deficits were not achieved, the outstanding debt to GDP ratio declined from 102.3% in 2003 to 70.8% by the end of 2013. In 2013, the FMRA was amended and the target outstanding debt to GDP ratios was set at 80% for 2013 and 60% for 2020. The outstanding debt to GDP ratio declined to 71.3% in 2014 and increased to 77.6% in 2015, while the budget deficit increased to 5.7% and 7.6% of GDP in 2014 and 2015, respectively. The outstanding debt to GDP ratio remained at 79.3% in 2016, while the budget deficit declined to 5.4% of GDP in 2016. According to the estimates for 2017, the budget deficit is expected to decline to 4.6% of GDP in 2017. Debt to GDP ratio is also expected to decline to 77.5% in 2017.

Other Reforms

Reforms on taxation and public service have also commenced, resulting in the significant increase of tax revenues as a percentage of the GDP. Investment incentives and related measures such as the removal of administrative bottlenecks and streamlining of investment approval processes are being implemented and are expected to attract further foreign investments into the country in the future.

Reforms towards better Governance Structures:

- The Procurement Commission was appointed in 2015 and is now engaged in formulating new procurement guidelines encompassing modern concepts such as e-procurements.
- The Right to Information Bill was passed by Parliament on June 24, 2016, and certified by the Speaker on August 4, 2017. A copy of the Act is publicly available.
- The Government is in the process of introducing new legislation in the form of a National Audit Act which is expected to be implemented starting in early 2017.

Reforms towards Macroeconomic Stability:

- A modern Inland Revenue Act has been drafted under the advice of the IMF.
- Modernizing revenue administration and public financial management (including implementation of key IT systems such as the Revenue Administration Management Information System ("RAMIS"), the Integrated Treasury Management Information System ("ITMIS"), and the Automated System for Customs Data ("ASYCUDA ++").
- The Ministry of Public Enterprises Development was established in 2015 which is entrusted with the monitoring and supervision of the performance of public enterprises.
- The Finance Act No. 38 of 1971 is being reviewed in order to ascertain the legal reforms necessary in the context of the new reform package, which includes the establishment of a holding company similar to "Temasek Holdings" of Singapore. The operation of this holding company would be based on sound financial principles and market economics. The shares of the state-owned business enterprises ("SOBEs") will thereafter be transferred to a Public Wealth Trust ("PWT"), where the Secretary to the Treasury, Ministry of Finance and the Governor of the Central Bank will be the custodians. The PWT will be managed by a Board comprising of members from civil societies, trade chambers and trade unions, each of whom will be nominated by the Constitutional Council. The PWT will be answerable to Parliament. A new Public Enterprise Act will be enacted to provide the necessary legal framework to this effect.

Reforms in the Business Environment:

- The National Medicines Regulatory Authority Act was passed in the Parliament in March 2015.
- The Ease of Doing Business Unit was established in the MOF in May 2015.
- Introduction of Information and Communication Technology (“ICT”) systems and ITMIS is expected to be completed in 2017 while RAMIS commenced its operations in 2016.
- A new Securities and Exchange Commission Act is being drafted.
- Amendments to the Land (Restriction on Alienation) Act No. 38 of 2014 have been drafted and will be submitted to Parliament.
- The establishment of an Agency for Development has been initiated.
- The establishment of an Agency for Foreign Trade has been initiated.
- The Micro Finance Act was ratified in early 2016 to provide the legislative network for rural micro-finance activities.

Key Legal Reforms identified in the Budget for 2016:

- Payment Guarantee Security Act.
- PWT.
- Colombo International Financial Center.
- Public Private Partnership Act.
- Inclusion of the National Water Supply and Drainage Board and CPC within the regulatory framework of the Public Utilities Commission of Sri Lanka.
- Expanding the scope of the National Transport Commission Act to include regulations of three wheelers, taxis, school vans and cargo transportation vehicles.

Conclusion of Military Action against the LTTE and Resettlement, Development and Reconciliation Activities

History

From 1983 to 2009, there were intermittent armed clashes between the Government and the LTTE. During this period, the LTTE assassinated Sri Lankan President R. Premadasa, former Prime Minister of India Rajiv Gandhi and many other high ranking Sinhalese and Tamil politicians and leaders, including former Minister of Foreign Affairs, Lakshman Kadirgamar. The LTTE also seriously injured President Kumaratunga in an unsuccessful assassination attempt just prior to the presidential election in 1999. As a result, the LTTE has been classified as a terrorist organization by more than 32 nations, including the United States, the United Kingdom, Australia and India.

Resumption of Hostilities in 2006 and Defeat of the LTTE

A series of bombings and assassinations launched by the LTTE beginning in early 2006 resulted in the resumption of hostilities between the LTTE and the Government. The resumption of hostilities led to assassinations of Government officials as well as the deaths of hundreds of LTTE fighters and a significant number of Government soldiers in a series of clashes.

During 2007, Government forces intensified their operations against the LTTE, resulting in the liberation and the restoration of peace in the Eastern Province. Military operations in the Northern Province began in March 2007. In May 2009, after a series of successful operations, the military defeated LTTE forces, thereby gaining full control of the Northern Province.

Resettlement, Development and Reconciliation Activities

From the time hostilities resumed in 2006 until the end of the conflict in May 2009, a large number of people were displaced in the Eastern and Northern Provinces. Since defeating the LTTE and obtaining control over the Northern and Eastern Provinces, the Government has re-settled a large number of the internally displaced people as quickly as possible. The Government has completed the process of resettling IDPs and has almost completed de-mining activities. The rehabilitation of key infrastructure and encouragement of economic activity for the benefit of people in these two provinces continues with substantial public investment, particularly in the Northern Province.

In the Eastern Province, the Government launched the *Neganahira Navodaya* (Eastern Resurgence) Program in 2007 in order to rehabilitate the Eastern Province and accelerate development. The damaged social and economic infrastructure of the Eastern Province was rehabilitated, in part through the removal of all land mines under the *Neganahira Navodaya* program. A number of large bridges in the East including the Kinniya bridge, Sri Lanka's longest bridge, linking Trincomalee with Kinniya, the Irakkandi bridge linking Trincomalee with Pulmodai and the Arugam Bay bridge connecting Pottuvil, Arugam Bay and Panama were constructed at an aggregate cost of more than Rs. 7 billion. In addition, various road development projects, water supply schemes, electricity schemes and housing schemes were implemented in the Eastern Province to facilitate reconstruction and development activities. The Government has resettled all internally displaced persons from the Eastern Province. Further, the bridges are also expected to connect the Eastern Province and the North Central Province to Jaffna linking the Trincomalee Port City to the Rajarata under the second North-Eastern development corridor proposed by the Government.

Resettlement of the internally displaced persons from the Northern Province is one of the Government's top priorities. There were 295,136 IDPs at the time the internal conflict ended in May 2009. All of the IDPs have been resettled by the end of 2013, reflecting the strong effort taken by the Government to resettle IDPs, with the help of development partners and other stakeholders.

In May 2009, President Rajapaksa appointed the Presidential Task Force for Resettlement, Development and Security in the Northern Province. The Task Force was mandated to, among other things, prepare and oversee programs to resettle internally displaced persons and rehabilitate and develop the economic and social infrastructure of the Northern Province. The Presidential Directive appointing the Task Force requires it to complete its mandate and report to the President within one year. The Task Force moved quickly to establish the *Uthuru Wasanthaya* (Northern Spring) program in mid-2009. The *Uthuru Wasanthaya* (Northern Spring) Program included a 180-day accelerated timetable to expedite the resettlement and rehabilitation process, and a parallel long term program for rehabilitation and development activities, including the development, construction and rehabilitation of roads, other transportation, electricity, housing, water supply, agriculture, and irrigation. Money was also expected to be allocated for poverty reduction and the reinforcement of the social safety net. The Government's rehabilitation and reconstruction initiatives were implemented concurrently with extensive and ongoing de-mining activities in the Northern Province. From 2009 to 2014, the Government spent Rs. 325.0 billion (US\$ 2.7 billion) towards rehabilitation and development activities in the Northern Province.

The Government has encouraged the involvement of the private sector in the economic recovery of the Eastern and Northern Provinces through an on-going development program. Major players in the manufacturing sectors have expanded their production capacities. Output from the agricultural sector, especially the fishing sub-sector, has increased as fishing restrictions imposed during the civil war were removed. The expansion of the commercial banking network in the Northern and Eastern Provinces has offered new opportunities to entrepreneurs.

The Central Bank opened its Northern Province regional office in Jaffna to encourage micro, small and medium scale entrepreneurs to invest and expand by providing financial assistance. In addition, the Central Bank commenced operations of its constructed regional office in Kilinochchi on May 6, 2015. The Central Bank also introduced a Credit Guarantee Scheme for the benefit of farmers in the Kilinochchi, Mullaitivu and some parts of the Mannar district who have been facing difficulties in obtaining short-term cultivation loans due to their inability to provide title deeds to establish land rights/ownership through which the Central Bank will guarantee up to Rs.200,000 per farmer in case of default arising due to a land ownership dispute. The scheme has encouraged banks to disburse more cultivation loans to farmers. The Central Bank has also arranged credit facilities for and provided entrepreneurship development services to resettled IDPs to restart their livelihood and conducted financial literacy programs to create awareness of the formal sector financial facilities and services.

In addition, a special low-interest loan scheme, named the “Awakening North Loan Scheme Revolving Fund”, was introduced in 2010 for residents of the Northern Province to develop income generating activities. Another loan scheme that provided financial assistance to repair damaged houses concluded in 2015 after the allocated funds were fully utilized. Similar activities have also been carried out by the Central Bank’s eastern regional office at Trincomalee since 2010.

The Government has also encouraged the expansion of micro-finance activities, especially in the Eastern and Northern Provinces, through the “Poverty Alleviation Microfinance Program”. This program is currently being implemented across Sri Lanka. In this regard, since May 2009, 356 banking outlets were established in the Northern Province and 411 banking outlets were established in the Eastern Province. These banking outlets also include student savings units (“SSUs”). As at the end of 2016, the Northern and Eastern Provinces had 981 banking outlets (including SSUs) and 447 ATMs. Furthermore, as at the end of 2016, there were 1,125 licensed finance companies (“LFCs”) and 88 specialized leasing company (“SLC”) outlets.

The Government is committed to the restoration of democracy in the two provinces. Local government elections were held in the Batticaloa District in March 2008, and Provincial Council elections were held in the Eastern Province in May 2008. Provincial Council Ministers were appointed, and a former Tamil child combatant became the Chief Minister of the Eastern Province.

The elections for Jaffna Municipal Council and the Vavuniya Urban Council were held in August 2009. Local government elections for most of the remaining local authorities in the Northern and Eastern Provinces were held in March 2011, with the balance held in July 2011. The second Eastern Provincial Council election was held in 2012. In September 2013, the Provincial Council elections for the Northern Province were held.

The Government expects the end of the 26-year long internal conflict to have a significant positive economic impact, not just on the Northern and Eastern Provinces, but also on the entire country as these two regions integrate with the national economy. The Northern and Eastern Provinces have substantial natural resources, including long, scenic and unpolluted beaches and ecological conservation areas that can support a vibrant tourism industry. The modernization of existing croplands, livestock farms and fisheries should help boost the regional economies. The contribution to the country’s GDP by the Eastern Province increased to 6.0% in 2014 from 5.8% in 2009 while that of the Northern Province increased to 3.6% in 2014 from 3.2% in 2009.

On March 27, 2014, the UN Human Rights Council (“UNHRC”) passed a resolution calling for a probe into the final stages of the LTTE conflict. Subsequently, after pledging to conduct a domestic inquiry into allegations by the UNHRC of war crimes on both sides in the final stages of the conflict, the new Government under President Sirisena achieved a six-month deferral of the UNHRC report against Sri Lanka that had been due on March 25, 2015.

The Government is currently exploring steps to examine alleged incidents of violations of human rights that warrant further investigations and criminal justice responses. The Government has initiated discussions regarding mechanisms to be introduced for this purpose.

Furthermore, based upon recommendations made in the interim report submitted to President Sirisena by the PCICMP, four teams will be appointed to investigate complaints recorded by the PCICMP. In the meantime, to expedite the reconciliation process, the Government is also reviewing the list of individuals and entities representing the Tamil diaspora that were banned by the previous government. The Government has also incorporated the right to information into the Constitution as part of the Nineteenth Amendment to safeguard the basic rights of the Sri Lankan people and democracy in Sri Lanka.

International Relations

Sri Lanka has been following a non-aligned foreign policy even before its independence. It was also one of the founding members of the Non-Aligned Movement (“NAM”) which hosted the NAM-Colombo summit of 1976. Sri Lanka was a founding member of both the General Agreement on Tariffs and Trade as well as the World Trade Organization (the “WTO”). The trade policy objectives of Sri Lanka are aimed at developing an outward-oriented trade regime following the principles of the WTO, with the goal of increasing overseas market access for Sri Lanka’s products through greater integration into the world economy. These policies have helped the country to benefit from ever increasing global demand and new technological developments. Sri Lanka continues to encourage FDI into the country to expand output and employment and encourage the transfer of skills and knowledge. Sri Lanka is actively engaged in negotiations at the multilateral, regional and bilateral levels to accomplish its policy objectives.

The new administration is determined to continue Sri Lanka’s non-aligned foreign policy and to strengthen its cooperation with all countries and international organizations that extend support to Sri Lanka’s communities. The Government believes that Sri Lanka’s non-aligned foreign policy is pragmatic and results in the most improvement to the livelihoods of the Sri Lankan people. With respect to regional and bilateral relationships, Sri Lanka has made considerable progress in furthering its liberalization arrangements in recent years.

Under the new administration, Sri Lanka has entered into bilateral agreements and has had senior official visits with India, the United Kingdom, China, Pakistan and the United States. Sri Lanka has entered into several bilateral agreements with India, including the agreement between the RBI and the Central Bank to establish a currency swap worth US\$ 1.5 billion to stabilize the Sri Lankan Rupee, a US\$ 318 million credit line to assist development of Sri Lanka Railways and an agreement on nuclear energy. To discuss trade related issues under the Indo-Sri Lanka Free Trade Agreement (“ISFTA”), the third Commerce Secretary Level meeting was held in March 2015. At the meeting, a decision was made to compile a list of non-tariff barriers faced by Sri Lanka in the Indian market to be submitted to the Indian authorities and to review the negative lists under the ISFTA to accommodate various industry concerns. The ISFTA is expected to be reinforced through the inclusion of the services sector and by creating more investment opportunities through the proposed Economic and Technology Cooperation Agreement (“ETCA”). Negotiations on the ETCA are expected to deepen the current ISFTA on goods, technology cooperation, economic cooperation, liberalising services and investments. The preliminary official level discussions started in August 2016, where the two parties had only explored the broader scope of ETCA and the areas that would be considered within the framework. The negotiations continued in September 2016 and January 2017, after which the Government expects to finalize negotiations before the end of 2017. The Memorandum of Understanding (“MOU”) on initiating the negotiations of the China-Sri Lanka Free Trade Agreement (“CSFTA”) was signed in September 2014. The CSFTA covers trade in goods and services, investment, and economic and technical cooperation. The first and the second round of negotiations were held in September 2014 and in November 2014, respectively. The third and fourth rounds of negotiations were held in August 2016 and in November 2016, respectively. The fifth and sixth rounds were held in January 2017 and in March 2017, respectively. Sri Lanka also signed several agreements with China, including agreements on cooperation for special aid in public health, development of water treatment methods and technologies in areas affected by kidney diseases and research and development related to the coconut industry. With Pakistan, Sri Lanka recently signed six agreements, which provide for additional frameworks to cooperate in disaster management, sports, shipping, atomic energy, anti-narcotics and academia. During the US Secretary of State’s recent visit to Sri Lanka in May 2015, the Governments of Sri Lanka and the United States announced an annual partnership dialogue, which

is expected to deepen ties between the two countries. Further, Sri Lanka and Singapore announced in June 2016 that both countries are keen to pursue a comprehensive Free Trade Agreement (“FTA”). This FTA expects to focus on export-led growth, employment generation, expanding market to attract investments with technical know-how and expertise, and the usage of supply chain linkages of both countries. A feasibility study carried out by both parties was followed by a scoping mission from Singapore in July 2016, for initial discussions with relevant institutions on the scope and coverage of the proposed FTA. The first three rounds of negotiations were held in 2016 and another two rounds were held in January and April 2017. FTAs with both China and Singapore are expected to be finalized during 2017. With respect to the EU, the Government is currently working towards regaining its GSP+ trade status. The GSP+ trade status had been withdrawn in August 2010 due to allegations of the previous government not complying with certain eligibility criteria such as implementation of international human rights conventions. More recently, the EU has been evaluating the potential to grant Sri Lanka the GSP+ status under a special monitoring process. The application for regaining the EU-GSP+ facility was submitted to the European Commission (“EC”) in July 2016. After a thorough review process, in January 2017, the EC proposed to reinstate the EU-GSP+ in exchange of Sri Lanka’s commitment to ratify and effectively implement 27 international conventions related to human rights, labor rights, protection of the environment and good governance, while allowing the EU Parliament to raise any potential objections within a period of four months. The Government expects the GSP+ status to be reinstated by the first half of 2017. The GSP offered by the United States, which provides duty free entry into the United States for nearly 5,000 products, from 122 beneficiary countries, including Sri Lanka, was re-authorized in June 2015 and will remain valid until December 31, 2017. Meanwhile, the 12th council meeting of the Trade and Investment Framework Agreement (“TIFA”) between the United States and Sri Lanka was held in April 2016 in Washington DC, United States. During the deliberation, the two governments adopted a US-Sri Lanka Joint Action Plan, which focused on reforming Sri Lanka’s trade and investment regime to match global standards, improving the competitiveness of Sri Lanka’s current exports and developing new markets to boost trade and investment between Sri Lanka and the United States over a period of five years. An inter-sessional TIFA Council meeting was held in September 2016 in Colombo, with the agreement of a wide-ranging implementation plan, mainly to support Sri Lanka’s goal to serve as a regional services hub. Sri Lanka also benefits through GSP schemes granted by several other countries, including Japan and Norway. The tariff concessions offered under the above FTAs and the GSP Schemes implemented by the EU, the US and a number of other trading partners have increased trade with these countries.

The following table shows the Government’s capital participation in, and loans obtained from, major international financial organizations.

MEMBERSHIP IN INTERNATIONAL FINANCIAL ORGANIZATIONS

Name of Organization	Date of Admission	Subscribed	Capital Paid In	Loans Outstanding	Loans Outstanding
				(at December 31, 2016)	(at March 31, 2017)
			(in millions)		
International Monetary Fund	1950	SDR413.4	SDR47.9	SDR412	SDR343
International Development Agency	1950	US\$463.8	US\$56.2	US\$3,803	N/A
Asian Development Bank ⁽¹⁾	1966	US\$317.6	US\$84.1	US\$2,788	N/A

Source: The IMF, the Asian Development Bank and the World Bank

Sri Lanka is now an active member of the Commonwealth, the SAARC, the WTO, the World Bank and the IMF. Sri Lanka has also made commitments under the General Agreement of Trade in Services (the “GATS”) in relation to insurance, telecommunications, tourism and financial services. Sri Lanka promotes its economic interests through its membership in the following regional, bilateral trade agreements and other international arrangements:

- Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Co-operation
- South Asian Preferential Trading Agreement
- South Asian Free Trade Agreement (“SAFTA”)
- Global System of Trade Preferences (“GSTP”)
- Generalized System of Preferences (“GSPs”) offered by the EU, the United States, Australia, Canada, Japan, New Zealand, Russia, Turkey, Norway and Switzerland
- India-Sri Lanka Free Trade Agreement
- Pakistan-Sri Lanka Free Trade Agreement
- Asia Pacific Trade Agreement (“APTA”)
- Trade and Investment Framework Agreement between the United States and Sri Lanka (“TIFA”)
- Joint Commission on Economic Cooperation with EU, Russia, Iran, Belarus, Turkey, Bangladesh, Egypt, Kuwait, Pakistan, Iraq, Kenya, Qatar, China and Vietnam
- World Trade Organization
- Asia Cooperation Dialogue
- Colombo Plan
- Indian Ocean Rim Association for Regional Co-operation
- United Nations Conference on Trade and Development

Sri Lanka was one of the first countries to speak out in global forums on the necessity for a coordinated global effort to combat terrorism. Sri Lanka has also introduced legislation to counter the financing of terrorism and combating money laundering by enacting the Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005 and the Prevention of Money Laundering Act, No. 5 of 2006, respectively. This legislation was subsequently amended as the Prevention of Money Laundering (Amendment) Act No. 40 of 2011 and the Convention on Suppression of Terrorist Financing (Amendment) Act No. 41 of 2011, incorporating recommendations made by the Financial Action Task Force (“FATF”) and the Asia Pacific Group on Money Laundering (“APG”) in their Mutual Evaluation conducted in 2006. The Financial Intelligence Unit was established in 2006 under the Financial Transactions Reporting Act No 6 of 2006 with regulatory powers and a mandate to formulate policies and guidelines in line with international standards and recommendations.

Recent Economic Indicators

The following table sets out the performance of certain principal economic indicators of Sri Lanka for the specified periods.

PRINCIPAL ECONOMIC INDICATORS

	2011	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	First Three Months of 2016 ⁽¹⁾	First Three Months of 2017 ⁽¹⁾	% Increase or Decrease
(in US\$ millions, except for percentages)									
GDP growth (%) ⁽²⁾	8.4 ⁽²⁾	9.1 ⁽²⁾	3.4 ⁽²⁾	5.0 ⁽⁹⁾	4.8 ⁽⁹⁾	4.4	5.1	N/A	N/A
GNI growth (%) ⁽²⁾	8.5 ⁽²⁾	8.3 ⁽²⁾	2.8 ⁽²⁾	5.1 ⁽⁹⁾	4.5 ⁽⁹⁾	4.1	N/A	N/A	N/A
Inflation rate (year-on-year % change).....	4.9 ⁽³⁾	9.2 ⁽³⁾	4.7 ⁽³⁾	2.1 ⁽³⁾	4.6 ⁽⁴⁾	4.5 ⁽⁴⁾	2.6 ⁽⁴⁾⁽⁵⁾	7.3 ⁽⁴⁾⁽⁵⁾	N/A
Unemployment rate (%) ⁽¹⁾⁽⁶⁾	4.2 ⁽⁷⁾	4.0 ⁽⁷⁾	4.4 ⁽⁷⁾	4.3 ⁽⁷⁾	4.7 ⁽⁹⁾	4.4	4.2	N/A	N/A
91-day T-bill rate (%).....	8.7	10.0	7.5	5.7	6.5	8.7	8.9	9.6	N/A
External position Balance of payments	(1,059)	151	985	1,369	(1,489)	(500)	(720)	(173)	76.0
Trade-in-goods balance.....	(9,710)	(9,417)	(7,609)	(8,287)	(8,388) ⁽⁹⁾	(9,090)	(1,855)	N/A	N/A
Exports.....	10,559	9,774	10,394	11,130	10,546 ⁽⁹⁾	10,310	2,739	N/A	N/A
Imports.....	20,269	19,190	18,003	19,417	18,935	19,400	4,594	N/A	N/A
Outstanding direct external debt of the issuer.....	20,450	22,123	22,290	24,132	24,681	27,197	—	—	—
Gross official reserves.....	6,749	7,106	7,495	8,208	7,304	6,019	6,221	5,120	(17.7)
Net official.....	4,012	4,163	5,148	6,517	5,029	4,529	4,309	4,356	1.1
Merchandise Imports (No. of months)	4.0	4.4	5.0	5.1	4.6	3.7	4.0	3.1	(22.5)
Broad Money (M2b) growth (%)	19.1	17.6	16.7	13.4	17.8	18.4	18.9	17.7 ⁽¹⁰⁾	N/A

Source: Central Bank of Sri Lanka and the Department of Census and Statistics

Notes:

- (1) Provisional
- (2) The data is based on the revised GDP estimates (base year = 2010)
- (3) Inflation rates based on CCPI (2006/07=100)
- (4) Inflation rates based on CCPI (2013=100)
- (5) Data as at March
- (6) Based on household population aged 15 years and above
- (7) Revised as per the 2012 Census-based Re-weighted Estimates based on the Labour Force Survey.
- (8) Data as at September 30, 2015
- (9) Revised
- (10) Data as at end January 2017

Overview of the Sri Lankan Economy

Overview

Sri Lanka adopted free market economic policies in 1977. Since then, successive Governments have sought to deregulate and open the economy to international competition by removing many of the financial controls and barriers that previously constrained private sector participation in the economy. Successive Governments have also attempted to establish an economic system under which growth would be driven by the private sector, with the Government serving as a facilitator of economic activities. The internal conflict of 1983 and the subsequent political uncertainty in the late 1980s led to a slowdown in economic diversification and liberalization. In the 1990s, a more market-oriented system was put in place by the Government, in particular with respect to export-oriented growth, which helped boost the economy's performance and increased GDP growth to 6.9% in 1993. Nevertheless, economic growth has been uneven since 1993 as the economy continued to face various economic and political challenges due to both internal and external factors. Average annual GDP growth amounted to 5.2% from 1991 to 2000. In 2001, GDP suffered a negative growth of 1.5%, the

first contraction since 1951, largely due to the unfavorable global economic environment and domestic uncertainties. Since then, GDP has increased by 6.0% on an annual average basis from 2002 to 2008. In 2009, the economy of Sri Lanka demonstrated its resilience by growing 3.5% in the midst of a global economic recession. This was followed by 8.0% growth in 2010, 8.4% growth in 2011 and 9.1% in 2012, the highest level of growth recorded for Sri Lanka, as a result of the increase and improvement in economic activities after the end of the country's internal conflict. Economic growth moderated to 3.4% in 2013, slightly improved to 5.0% in 2014, grew by 4.8% in 2015 and recorded a growth of 4.4% in 2016.

The Government has adopted various measures to achieve a free market environment for international trade, including full current account convertibility, relaxations in the foreign exchange transactions and a freely floating exchange rate regime. Current account convertibility has been maintained pursuant to undertakings given to the IMF since Sri Lanka accepted obligations under IMF Article VIII in 1994. To safeguard the country from large and volatile capital flows, limited capital account restrictions are still in place. With the increased intensity of the global financial crisis and increased import bills including oil, the rupee experienced depreciation and volatility in recent years. However, with prudent policy measures, improved foreign exchange inflows and the end of internal conflict, the rupee has stabilized and foreign exchange reserves have been replenished. External trading relations have been further strengthened in recent years with expansion in multilateral, regional and bilateral trading arrangements. Restrictions on FDI have been lifted for all activities with the exception of money lending, pawn broking, retail trade with capital of less than US\$ 1 million and, coastal fishing and provision of securities services.

In addition, the Government has had to address many challenges in the recent past. These challenges include:

- high credit growth and trade deficit;
- completion of resettlement of internally displaced persons and rehabilitation and reconstruction of conflict affected infrastructure in the newly liberated Northern and Eastern Provinces;
- infrastructure deficiencies in electricity, roads and transport, which had become major impediments to investment and balanced regional development;
- high international commodity prices including oil;
- the successive monetization of fiscal deficits, which has resulted in pressure on inflation and high finance costs, which discourage private investment; and
- the low tax to GDP ratio, which led to an increase in the public debt.

In response, the Government has implemented a series of short term and medium term measures to address these challenges. Further, the Government has shown a deep commitment to the diversification of exports, development of tourism and improvement of information and communication technology. The Government has declared its intention to transform Sri Lanka into a strategically important regional economic center. In doing so, the Government plans to make use of the advantage of Sri Lanka's strategic location on shipping routes, make better use of the Indo-Lanka Free Trade Agreement and enter into more beneficial free trade agreements with other countries to achieve regional trading hub status. Several measures, spearheaded by the Ministry of Development Strategies and International Trade ("MODSIT") and the Export Development Board ("EDB") are currently underway. The National Export Strategy, initiated by the EDB, is a collaborative effort of the Government and the private sector and provides a five-year action-oriented framework for the development of Sri Lankan trade and competitiveness. Simultaneously, a National Trade Policy has been drafted with the objectives of attracting more export-oriented FDI, improving trade logistics, increasing transparency and efficiency of customs procedures, and implementing other measures to boost Sri Lanka's ability to compete in the global market. By recognizing the need for broad-based

institutional support, the Government has already taken steps to create two agencies, the Agency for International Trade (“AfIT”) and the Agency for Development (“AfD”). The AfIT is responsible for rectifying issues in existing trade pacts with the Indian subcontinent while exploring an economic partnership agreement with India and using Sri Lanka’s improved investment climate to attract investment that caters to the entire market of the subcontinent. The AfIT is also in charge of pursuing new bilateral and multilateral trade opportunities beyond the subcontinent, especially with China, Singapore, the EU and the United States, which cater to a market of about 3 billion, complying with the non-aligned foreign policy of the Government. The AfD, on the other hand, is expected to contribute to development efforts by collaborating with the private sector to identify constraints on the development process and by building multi-functional teams that can work across sectors to resolve issues to enable the private sector to enhance capabilities, engage in product development and foster export growth. Further, in order to minimize the disparity in economic development that exists between Colombo’s suburbs and the rest of Sri Lanka, several programs have been planned to spread development through developing economic corridors, such as Kandy, Colombo, Hambantota and Colombo and Trincomalee. For example, progress is being made towards reaching an agreement on the long lease of the Hambantota Port. Consensus has been reached among the leadership of the Government and the terms are being finalized prior to submission to the Cabinet. The Government expects to establish economic zones in Bandaragama, Embilipitiya, Vavuniya, Kuliyaipitiya and Eravur while improving the investment climate and export competitiveness of small and medium enterprises (“SMEs”).

The Government has formulated its policies to ensure the sustainability of high economic growth, while ensuring the inclusion of all segments of the population in Sri Lanka’s growth. In this process, Sri Lanka has given high priority to the construction of a nation-wide infrastructure network to accelerate growth, particularly in the North and the East of Sri Lanka.

Infrastructure Development

The Government launched its flagship project, the Western Region Megapolis Master Plan, in 2016 with an anticipated cost of US\$ 40 billion aimed at transforming the Western Province into a vibrant, livable cosmopolitan region. The Government expects this measure to help resolve issues related to urbanization, such as traffic congestion, poor housing conditions, waste disposal and access to basic utility services, by improving essential infrastructure, such as ICT, transport, power and energy. The Megapolis Project consists of seven city development projects that include the Colombo Financial City (Port City) Development Project, Administrative Capital City in Sri Jayawardenapura Kotte, Science and Technology City in Homagama-Malabe, Industrial City in Horana and Mirigama, Aero City in Katunayake, Plantation City in Avissawella and Forest City in Baduraliya.

Some of the major on-going, planned and recently completed infrastructure projects are set out below:

MAJOR ONGOING, PLANNED AND RECENTLY COMPLETED INFRASTRUCTURE PROJECTS ⁽¹⁾⁽²⁾

Development Partner	Project	Estimated Project		Expected Year of Completion ⁽⁴⁾
		Cost (US\$ millions)	Loan Amount (US\$ millions) ⁽³⁾	
China Exim Bank.....	Hambantota Sea Port Development Project (Phase I)	507.00	307.00	Completed
China Exim Bank.....	Hambantota Sea Port Development Project (Phase II)	808.00	808.00	2017
ADB	Colombo South Harbor Project	900.00	300.00	Completed
China Exim Bank.....	Puttalam/Norochcholai Coal Power Project (Phase I)	455.00	455.00	Completed
China Exim Bank.....	Puttalam/Norochcholai Coal Power Project (Phase II)	891.00	891.00	Completed
Japan/JICA	Upper Kotmale Hydro Power Project	446.00	346.00	Completed
Japan	Kerawalapitiya Dual Purpose Fuel Power Plant	309.00	24.00	Completed
Japan	Greater Colombo Transport Development Project	345.00	239.00	2018
Japan/ADB.....	Southern Expressway Construction Project (Phase I)	695.00	276.00	Completed
China Exim Bank.....	Southern Expressway Construction Project (Phase II)	142.00	140.00	Completed
ADB	National Highways Sector Project	216.00	150.00	Completed
ADB	National Highways Sector Project (Additional Financing)	135.50	85.00	2017

Development Partner	Project	Estimated Project Cost (US\$ millions)	Loan Amount (US\$ millions) ⁽³⁾	Expected Year of Completion ⁽⁴⁾
Japan	Water Sector Development Project (PhaseI)	150.00	112.00	2016
IDA	Road Sector Assistance Project	262.00	102.00	Completed
France.....	Trincomalee Integrated Infrastructure Project TIIP	61.00	48.00	Completed
ADB	Secondary Towns & Rural Community Water / Sanitation	174.65	120.30	Completed
China Exim Bank.....	Southern International Airport	209.00	190.00	Completed
China Exim Bank.....	Colombo — Katunayake Expressway	350.00	248.00	Completed
ADB	Jaffnapeninsula Waterand Sanitation Sector Development Project	166.60	134.70	Completed
China Exim Bank.....	Hambantota Bunkering Project	96.00	65.00	Completed
Nordea Bank, Denmark .	Oluvil Port Development Project	72.50	72.50	Completed
Nordea Bank, Denmark .	Kelani Right Bank Water Treatment Plant	82.70	70.88	Completed
Korea, Exim Bank	Ruhunupura Water Supply Development Project	115.76	76.34	Completed
India	Upgrading Colombo-Matara Railway Line	212.40	167.40	Completed
Japan	Major Bridges Construction Projectof the National Road Network	160.43	129.23	2018
Japan	Landslide Disaster Protection Project of the National Road Network	104.36	79.52	2018
Japan	Anuradhapura North Water Supply Project (PhaseI)	72.83	53.92	2018
US Exim Bank.....	Badulla, Haliela and Ella Integrated Water Supply Project	74.16	64.89	2017
HSBC Bank plc (UK) ...	Regional Bridges Project (PhaseII)	86.00	60.07	2017
China Exim Bank.....	Matara Beliatta Section of Matara Kataragama Railway Extension Project	278.00	278	2017
China Exim Bank.....	Greater Kurunegala Water Supply and Drainage Project	79.60	77.30	2017
Japan/ADB.....	Clean Energy and Network Efficiency Improvement Project — Ordinary Capital Resources	200.00	100.00	2017
Japan/ADB.....	Education Sector Development Program — Ordinary Capital Resources	200.00	100.00	2018
Japan/ADB.....	Greater Colombo Water Wastewater Management Improvement Project (PhaseI) — Ordinary Capital Resources	300.00	70.00	2017
IDA	Second Health Sector Development Project	200.00	196.54 (SDR 129.8 Mn)	2018
OPEC Fund.....	Colombo District National Highways Project	63.00	50.00	2017
ICBC Bank China	Broad lands Hydro power Project	82.00	69.70	2018
China.....	Colombo Port City Development Project	1,337.00	1,337.00	—
Export Development Bank of Iran (Under local financing after imposing sanctions on Iran)	Uma Oya Hydro Electric and Irrigation Project	529.00	450.00	2017
Japan	BIA Expansion Project	711.55	619.47	2020
Japan	Kandy City Waster Water Management Project	162.93	152.38	2017
Japan	Habarana Veyangoda Transmission Line Project	107.72	115.32	2017
Japan	New Bridge Construction Project over the Kelani River	391.26	342.85	2019
Japan	Digitalization of Terrestrial Television Broadcasting Project	154.62	132.10	2018
Japan.....	National Transmission and Distribution Network Development Project	293.97	200.07	2019
Japan.....	Anuradhapura North Water Supply Project Phase 2	250.81	212.16	2020
Korea, Exim Bank	Hatton- Nuwara Eliya Road Improvement Project	69.9	57.1	Completed
Korea, Exim Bank	Improvement of Padeniya-Anuradhapura Road Project	70	66	Completed
Korea, Exim Bank	Construction of Kandy Tunnel Project	252.3	199.3	2022
China Exim Bank.....	Outer Circular Phase III (Kadawatha to Kerawalapitiya)	520.04	494.00	2019
China Exim Bank.....	Construction of Extension of Southern Expressway Section 1 from Matara to Beliatta Project	804.11	683.49	2019
China Exim Bank.....	Construction of Extension of Southern Expressway Section 2 from Beliatta to Watiya Project	423.43	360.29	2021

Development Partner	Project	Estimated Project Cost (US\$ millions)	Loan Amount (US\$ millions) ⁽³⁾	Expected Year of Completion ⁽⁴⁾
China Exim Bank.....	Construction of Extension of Southern Expressway Section 4 from Mattala to Hambantota via andarawewa project	412.43	412.43	2019
China Development Bank.....	Rehabilitation & improvement of Priority Road Projects - 1	169.8	152.80	Completed
China Development Bank.....	Rehabilitation & improvement of Priority Road Projects - 2	556.00	500.00	Completed
China Development Bank.....	Rehabilitation & improvement of Priority Road Projects - 3 (Phase 1)	357.69	300.00	2018
China Development Bank.....	Rehabilitation & improvement of Priority Road Projects - 3 (Phase 2)	117.66	100.00	2018
China Development Bank.....	Moragahakanda Development Project	252.3	214.20	Completed
China Development Bank.....	Gampaha Attanagalla and Miniwangoda Intergrated Water Supply Project	229.49	195.07	2019
IDA	Metro Colombo Urban Development Project	318.0	213.0	2017
IDA	Agriculture Sector Modernization Project	169.84	125	2021
IDA	Dam Safety and Water Resources Planning Project	84.5	83	2018
Australia.....	Importation of 20,000 Cattle	89	74	Ongoing
France.....	Sanitation & Hygiene Initiative for Towns (SHIFT) Project - Phase I	104	87	Ongoing
	Greater Matale Water Supply Project	188	157	Ongoing
	Anuradhapura Integrated Urban Development Project	67	56	Ongoing
	Kelani Right Bank Water Supply Phase II	222	185	Ongoing
Spain	Project for Construction of Flyovers at Rajagiriya, Ganemulla & Polgahwela	70	58	Ongoing
	Anamaduwa Water Supply Project	59	49	Ongoing
Denmark	Relocation of Milco Dairy Processing Plant at Badalgama	89	74	Ongoing
Netherlands.....	Hemmathagama Water Supply Project	92	77	New
European Investment Bank.....	Post Tsunami Line of Credit	87.31	72.76	Completed
Government of Sweden	Ratmalana / Moratuwa & Ja-Ela / Ekala Wastewater Treatment Plant Project	110.30	91.92	Completed
Credit Agricole France..	Rehabilitation of Wimalasurendra and New Laxapana Power Stations	66.32	55.26	Completed
ANZ Bank and EFIC Australia.....	Integrated Water Scheme for the Unnerved area of Ampara District	126.23	105.19	Completed
Nordea Bank Sweden....	Rural Electrification Project 4 — Extension	65.00	54.16	Completed
Robo Bank Netherland and People's Bank...	Development of NuwaraEliya District Hospital	65.31	54.42	Completed
Robo Bank Netherland and People's Bank...	Development of Hambanthota District Hospital	77.15	64.29	Completed
HSBC Bank PLC, UK...	Regional Bridge Project - Phase II	72.09	60.07	Completed
European Investment Bank.....	Sri Lanka SME & Green Energy Global Loan	145.22	121.01	Completed

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

- (1) In addition to loan funds, most of the above projects require counterpart local funds of approximately 20.0% to 30.0% of loan funds
- (2) Projects entirely funded by the Government are not included in this list
- (3) Loan amounts refer to the amounts contemplated in signed agreements
- (4) Expected project completion is based on current progress and estimated project completion time

The importance of improving economic and social infrastructure, which is essential to achieving sustained high economic growth and to raise living standards of its citizens, has been well recognized by the Government and hence, it continues to remain an integral part of the overall development drive. Benefiting from continuous investments, a gradual improvement can be observed over the years in the country's economic infrastructure, which includes, among others, power, transport, roads, highways, ports, water supply and telecommunications. However, the demand for these facilities continues to increase, requiring further investments. Simultaneously, Sri Lanka has achieved significant improvements in human development, due to the efforts made by successive Governments on the provision of social infrastructure, particularly education and health.

The Government undertook several rehabilitation projects of Sri Lanka's railway network, which includes extending the railway lines to Jaffna and Mannar while developing new port and airport facilities as well as rehabilitating existing facilities. The Northern Road Connectivity Project, implemented by the Government to rehabilitate and improve link roads in the Northern region, rehabilitated 169.9 km of national highways consisting of 128.5 kilometers of Class A roads and 41.4 kilometers of Class B roads in the Northern Province and North Central Province. In addition, the i-ROAD programme, which intends to rehabilitate selected rural and national roads in the Southern, Sabaragamuwa, Central, North Central, North Western and Western Provinces, and the Priority Roads Project, which focuses on rehabilitating sections of the national highway network that are selected on a priority basis, were continued. In 2014, the Climate Resilience Improvement Project was commenced in order to improve the climate resilience of road infrastructure, and a substantial amount of work under this project has been completed. Further, several projects on bridge construction and rehabilitation were implemented through bilateral funding arrangements. In addition, 13 new projects were commenced in with financial facilities from both local and foreign funding sources, aimed at providing safe drinking water to public. In the meantime, six new water supply projects are also planned to initiate covering North-Central, Sabaragamuwa, Western, Uva and Southern Provinces. These initiatives are expected to open new opportunities for the country to become a key transport and tourist hub in the region

Restructuring Reform

The Ministry of State Resources and Enterprise Development was established in 2010 to give more attention to under-performing state assets and to address loss-making SOBEs. SOBEs are being re-engineered to generate surpluses by utilizing their resources to the optimum level, thus reducing dependence on the national budget. SOBEs are also being encouraged to explore public private partnerships, while small scale SOBEs that are not viable will be amalgamated to create commercially viable entities. SOBEs will continue to operate in areas of strategic importance and to engage in operations which would not be undertaken by the private sector due to their scale, risk or technological complexity. New strategies were recently introduced for restructuring the non-performing debt of SOBEs while prominent business persons in the private sector were appointed as chairpersons of SOBEs. The Government also appointed professionals as Chief Executive Officers/General Managers of key SOBEs. Oversight Committees of the Parliament were very active and thereby created an environment for better governance.

The Ministry of Public Enterprises Development was established in September 2015 for the formulation of policies, programs and projects, and the monitoring and evaluation of public enterprise development. Enterprises within the purview of the Ministry are: Bogala Graphite Lanka Ltd., Ceylon Ceramics Corporation (Brick and Tiles) Division, KESCO, BCC Limited, Public Resources Management Corporation, Hotel Developers (Lanka) PLC, SriLankan Air Lines Ltd., Insurance Corporation of Sri Lanka and its subsidiaries and associated companies, all State banks and their subsidiaries and associated companies, Lakdiva Engineering Ltd, Werahara Engineering Services Ltd. ("WESCO"), Janatha Estate Development Board, Sri Lanka State Plantation Corporation, Elkaduwa Plantation Company Ltd and Kurunegala Plantation Company Ltd.

GDP and Major Financial Indicators

Gross Domestic Product

The domestic economy grew by 4.4% in 2016, compared to a growth of 4.8% in 2015 and 5.0% in 2014. This growth was mainly attributable to the 4.2% growth in services-related activities, driven by significant expansion in financial services activities, together with developments in the transportation of goods and passengers including warehousing activities. Industry-related activities grew by 6.7%, driven by significant growth in construction and mining and quarrying activities. Meanwhile, agricultural activities contracted by 4.2%, mainly due to the contraction observed in production of rice, tea, rubber and fruits as a result of adverse weather conditions that prevailed throughout 2016.

The domestic economy grew by 4.8% in 2015, compared to a growth of 5.0% in 2014. This growth was mainly attributable to the 5.7% growth in services activities with major contribution from the growth in financial services activities. Industry-related activities grew at a slower pace of 2.1% driven by the 4.9% growth in manufacturing activities, in the midst of the 2.7% contraction in construction activities. Meanwhile, agricultural activities grew by 4.8% mainly due to the 25.0% growth in rice cultivation.

The domestic economy grew by 5.0% in 2014, compared to a growth of 3.4% in 2013. This growth was mainly attributable to the 4.8% growth in services activities as a result of the robust growth in financial services and wholesale and retail trade activities. Industry-related activities grew by 4.7% which was driven by the growth in construction activities. Meanwhile, agricultural activities grew by 4.6%, supported by growth in animal production and production of oleaginous fruits (coconut, king coconut, oil palm) amid adverse weather conditions that prevailed during 2014.

For 2016, the industry activities recorded a growth of 6.7%, compared to a 2.1% increase in 2015, mainly due to the rebound in construction activities, which increased by 14.9% in 2016 compared to a 2.7% contraction in 2015. Correspondingly, the share of industry activities in GDP was 26.8% during 2016. Moreover, all sub-activities within the industry activities contributed positively towards this growth.

The services activities, which accounted for 56.6% of GDP, grew by 5.7% in 2015. Financial services activities grew by 17.2% while real estate activities (including ownership of dwellings) increased by 10.2% in 2015. Wholesale and retail trade activities expanded by 5.1%, other personal services activities grew by 3.6% and public administration-related services grew by 6.9%. Further, transportation and telecommunication-related activities grew by 5.0% and 10.1%, respectively.

The services activities, which accounted for 56.1% of GDP, grew by 4.8% in 2014. Financial services activities grew by 8.9% while real estate activities (including ownership of dwellings) increased by 6.5% in 2014. Further, wholesale and retail trade activities expanded by 2.8%, transportation activities grew by 4.2%, other personal services activities grew by 4.5% and public administration-related services grew by 5.2%.

For 2016, the agricultural activities contracted by 4.2%, compared to the growth of 4.8% in 2015. This contraction in the agricultural sector was mainly driven by a 31.0% contraction in production of rice, 11.2% contraction in production of tea and 10.7% contraction in production of rubber. On the other hand, production of spices, aromatic, drug and pharmaceutical crops, animal production, forestry and logging, and fishing, grew by 6.4%, 6.3%, 5.5%, and 1.6%, respectively, partially offsetting the overall contraction in the agricultural activities to a certain extent.

The agricultural activities grew by 4.8% in 2015, compared to a 4.6% growth recorded in 2014, mainly due to a 25.0% growth in production of rice. Meanwhile, the production of oleaginous fruits (coconut, king coconut, oil palm) recorded a growth rate of 5.2%, while animal produce and production of spices, aromatic, drug and pharmaceutical crops grew by 8.1% and 6.9%, respectively in 2015. However, fishing, rubber and tea production contracted by 2.6%, 10.1% and 2.6%, respectively, in 2015.

The agricultural activities grew by 4.6% in 2014, compared to a 3.2% growth recorded in 2013, mainly due to the 31.0% growth in animal produce and the 20.1% growth in the production of oleaginous fruits (coconut, king coconut, oil palm). However, production of rice, rubber, tea and sugar cane, tobacco and other non-perennial crops contracted by 7.0%, 24.5%, 1.1% and 6.3%, respectively, in 2014.

The industry activities grew by 6.7% and amounted to 26.8% of GDP in 2016. Manufacturing activities grew by 1.7% while construction activities grew by 14.9% in 2016. Meanwhile, mining and quarrying activities grew by 14.4% in 2016.

The industry activities recorded a growth of 2.1% and amounted to 26.2% of GDP in 2015. Manufacturing activities grew by 4.9% while construction activities contracted by 2.7% in 2015. Meanwhile, mining and quarrying activities recorded a decline of 5.2% in 2015.

The industry activities recorded a growth of 4.7% and amounted to 26.9% of GDP in 2014. Manufacturing activities grew by 2.5% while construction activities grew by 10.6% in 2014. Meanwhile, mining and quarrying activities recorded a slower growth of 1.6% in 2014.

Economic Effects of Oil Prices

In 2016, the fuel import bill declined marginally due to the reduction in international oil prices and the increased import volume due to high reliance on oil-based thermal power while the persistent decline in oil prices helped to maintain inflation at a subdued level. Fuel imports amounted to US\$ 2,481 million in 2016, compared to US\$ 2,700 million in 2015, US\$ 4,597 million in 2014, US\$ 4,308 million in 2013, US\$ 5,045 million in 2012 and US\$ 4,795 million in 2011. The average crude oil price (Brent) decreased by 16.2% to US\$ 45.03 per barrel in 2016, as compared to US\$ 53.75 per barrel in 2015 and US\$ 99.68 per barrel in 2014. The CPC's average import price decreased by 15.5% to US\$ 46.30 per barrel in 2016, as compared to US\$ 54.80 per barrel in 2015 and US\$ 104.53 per barrel in 2014. With the international oil price declines in the second half of 2014, which continued to January 2015, the retail prices of kerosene, petrol and diesel in Sri Lanka were reduced on four occasions during the period from September 2014 to January 2015. Kerosene, petrol and diesel prices were reduced by Rs. 20, Rs. 5 and Rs. 3 per liter, respectively, on September 17, 2014. Effective from December 6, 2014, petrol and diesel prices were both reduced again by Rs. 7 per liter and kerosene price was reduced again by Rs. 5 per liter. Subsequently, effective from January 22, 2015, kerosene, petrol and diesel prices were further reduced by Rs. 16, Rs. 33 and Rs. 16 per liter, respectively, and, effective from January 30, 2015, kerosene price was again reduced by Rs. 6 per liter. In November 2015, the price of kerosene was further reduced by Rs. 10 per liter. Effective from January 9, 2017, kerosene price was reduced again by Rs. 5 per litre. Notwithstanding the declining global oil prices in the international market in 2013 to 2016, the Government continued short-term as well as medium to long term measures to reduce any adverse effects of oil prices on the power generation sector, which include the following:

- The Ministry of Power and Renewable Energy launched a new community-based power generation project called 'Soorya Bala Sangramaya' in collaboration with the Sri Lanka Sustainable Energy Authority ("SLSEA"), the CEB and the Lanka Electricity Company (Private) Limited ("LECO") in 2016 to promote self-energy generation by households, religious places, commercial establishments and industries. This program is expected to add 200 MW of solar electricity to the national grid by 2020 and 1,000 MW by 2025.
- The SLSEA implemented several energy conservation programs, focusing on regulatory interventions and strengthening energy efficiency in the services sector. In addition, two major renewable energy projects, namely the solar rooftop power generation project and the estate micro hydro rehabilitation and repowering project, were initiated by the SLSEA with financial assistance from the Asian Development Bank and are currently in progress.
- As an alternative to imported fossil fuel, the Government has targeted to attain 20% of electricity generation of the national grid through new renewable energy sources by 2020. The Government also targeted a reduction of approximately 10% of the total energy consumption by 2020 through various energy conservation measures.

- As at year-end of 2016, 172 mini hydropower projects, 15 wind power plants, nine biomass power plants and five solar power projects have been commissioned, adding approximately 342.2MW, 128.5MW, 24.1MW and 21.4MW, respectively, to the national grid. In addition, by year-end 2016, the CEB has signed agreements for 105 NCRE projects, with a capacity of 288MW.
- Construction work of the Uma Oya Hydropower Project (120MW) and Broadlands Hydropower Project (35MW) was in progress during 2016 and these power plants are expected to be connected to the national grid by mid-2018 and mid-2019, respectively. In addition, preparatory work was in progress to construct the Gin Ganga Hydropower Project (20MW), three hydropower units in the Moragahakanda Hydropower Project (total of 25MW), Moragolla Hydropower Project (30.5MW) and the Mannar Wind Power Project (100MW).
- The construction of Norochcholai Coal Power Plant was completed, which added 900MW of power to the national grid, changing the generation mix of Sri Lanka considerably.

The following tables present the GDP of Sri Lanka by major economic activities at both current and constant factor prices.

GROSS DOMESTIC PRODUCT BY MAJOR ECONOMIC ACTIVITIES (AT CURRENT PRICES) ⁽¹⁾

							Percentage of GDP			
	2011	2012	2013	2014 ⁽²⁾	2015 ⁽²⁾⁽³⁾	2016 ⁽³⁾	First Three Months of 2016 ⁽²⁾⁽³⁾	First Three Months of 2017	First Three Months of 2016 ⁽²⁾⁽³⁾	First Three Months of 2017
	(in Rs. millions, except as is indicated)									
Agriculture, Forestry & Fishing	637,567	650,510	735,382	829,577	894,780	890,659	210,319	N/A	7.3	N/A
Manufacturing, mining and quarrying and other industries	1,569,323	2,009,626	2,081,873	2,118,309	2,162,718	2,276,216	628,885	N/A	21.7	N/A
Of which: Manufacturing activities	1,330,067	1,697,818	1,723,093	1,758,713	1,798,922	1,837,180	528,196	N/A	18.2	N/A
Construction	451,714	621,140	715,455	813,689	828,388	932,260	238,864	N/A	8.2	N/A
Wholesale and retail trade transportation and storage accommodation and food service activities	1,746,884	2,191,057	2,370,519	2,576,789	2,665,003	2,880,777	660,579	N/A	22.8	N/A
Information and communication	37,819	45,560	58,085	61,818	77,175	90,331	22,709	N/A	0.8	N/A
Financial and insurance activities	283,544	361,537	390,522	433,665	448,698	526,546	111,910	N/A	3.9	N/A
Real estate activities (including ownership of dwellings)	350,090	424,415	512,063	562,687	625,521	676,760	165,239	N/A	5.7	N/A
Professional, scientific, technical, administration and support service activities	135,904	178,781	198,873	210,966	197,212	198,198	48616.872	N/A	1.7	N/A
Public administration, defense, education, human health and social work activities ..	740,119	818,584	889,849	985,732	1,144,496	1,201,353	278,702	N/A	9.6	N/A
Other services (excluding own services)	686,140	838,358	986,633	1,063,962	1,111,922	1,169,381	275,899	N/A	9.5	N/A
Equals Gross Value Added (GVA), at basic price	6,639,104	8,139,568	8,939,254	9,657,194	10,155,914	10,842,481	2,641,723	N/A	91.2	N/A
(+) Taxes less subsidies on products	580,002	592,895	652,871	703,957	795,782	996,495	254,307	N/A	8.8	N/A
Equals GDP at market price .	7,219,106	8,732,463	9,592,125	10,361,151	10,951,695	11,838,975	2,896,030	N/A	100.0	N/A
Gross National Income	7,147,065	8,577,574	9,366,039	10,125,078	10,670,358	11,506,217	N/A	N/A	N/A	N/A
Total GDP (in millions of US dollars)	65,293	68,434	74,294	79,359	80,564	81,311	N/A	N/A	N/A	N/A
GDP per capita (in US dollars) ⁽⁴⁾	3,125	3,351	3,609	3,821	3,843	3,835	N/A	N/A	N/A	N/A

Source: The Department of Census and Statistics

Notes:

- (1) Data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
- (2) Revised
- (3) Provisional
- (4) Estimates updated with latest population figures

GROSS DOMESTIC PRODUCT BY MAJOR ECONOMIC ACTIVITIES
(AT CONSTANT (2010) PRICES)⁽¹⁾

								Percentage of GDP		
	2011	2012	2013	2014 ⁽²⁾	2015 ⁽²⁾⁽³⁾	2016 ⁽³⁾	First Three Months of 2016 ⁽²⁾⁽³⁾	First Three Months of 2017	First Three Months of 2016 ⁽²⁾⁽³⁾	First Three Months of 2017
(in Rs. millions, except as is indicated)										
Agriculture, Forestry & Fishing	569,954	592,443	611,676	639,696	670,106	641,943	161,662	N/A	7.8	N/A
Manufacturing, mining and quarrying and other industries	1,442,149	1,520,844	1,565,642	1,606,869	1,669,558	1,732,672	485,259	N/A	23.3	N/A
Of which: Manufacturing activities	1,198,135	1,235,988	1,263,921	1,296,100	1,359,694	1,383,461	402,362	N/A	19.3	N/A
Construction	424,798	514,757	553,438	611,842	595,115	683,604	169,794	N/A	8.2	N/A
Wholesale and retail trade, transportation and storage, accommodation and food service activities	1,643,379	1,792,678	1,840,272	1,905,136	1,997,097	2,064,738	477,156	N/A	22.9	N/A
Information and communication	33,813	36,674	39,510	44,078	48,892	52,802	13,117	N/A	0.6	N/A
Financial and insurance activities	382,274	433,714	456,863	495,201	574,602	642,788	125,576	N/A	6.0	N/A
Real estate activities (including ownership of dwellings)	328,076	369,719	417,024	444,049	489,217	509,993	127,798	N/A	6.1	N/A
Professional, scientific, technical, administration and support service activities	127,358	155,741	161,963	166,486	154,239	149,382	37,606	N/A	1.8	N/A
Public administration, defense, education, human health and social work activities ..	659,260	726,619	686,499	723,918	749,757	786,529	171,923	N/A	8.3	N/A
Other services (excluding own services).....	642,995	730,316	803,514	839,633	869,640	881,221	214,040	N/A	10.3	N/A
Equals Gross Value Added (GVA), at basic price	6,254,056	6,873,506	7,136,401	7,476,908	7,818,224	8,145,671	1,983,930	N/A	95.3	N/A
(+) Taxes less subsidies on products	698,664	715,011	709,801	758,521	815,667	866,355	98,614	N/A	4.7	N/A
Equals GDP at market price	6,952,720	7,588,517	7,846,202	8,235,429	8,633,890	9,012,026	2,082,544	N/A	100.0	N/A
Gross National Income	6,885,232	7,453,571	7,662,004	8,049,085	8,413,897	8,761,221	N/A	N/A	N/A	N/A
Growth in GDP (%).....	8.4	9.1	3.4	5.0	4.8	4.4	N/A	N/A	N/A	N/A
Growth in GNI (%)	8.5	8.3	2.8	5.1	4.5	4.1	N/A	N/A	N/A	N/A
Growth in GDP Deflator (%) ..	3.8	10.8	6.2	2.9	0.8	3.6	N/A	N/A	N/A	N/A

Source: The Department of Census and Statistics

Notes:

- (1) Data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
- (2) Revised
- (3) Provisional

The following table shows the percentage distribution of the country's GDP at constant (2010) prices.

**PERCENTAGE DISTRIBUTION OF GROSS DOMESTIC PRODUCT BY EXPENDITURE
(AT CONSTANT (2010) PRICES)⁽¹⁾**

	2011	2012	2013	2014 ⁽²⁾	2015 ⁽²⁾⁽³⁾	2016 ⁽³⁾
Private consumption expenditure	62.7	59.1	62.7	61.2	62.5	59.3
Government consumption expenditure	6.9	6.7	6.6	6.6	6.9	6.6
Investment	30.4	34.1	30.6	32.2	30.6	34.1
Gross domestic fixed capital formation	23.1	24.7	25.6	23.7	23.0	23.8
Changes in inventories and acquisition less disposals of valuables	7.4	9.5	5.0	8.4	7.6	10.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
Exports of goods and services	39.4	39.2	41.2	40.0	38.6	36.7
Imports of goods and services	60.6	60.8	58.8	60.0	61.4	63.3
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Sri Lanka and the Department of Census and Statistics

Notes:

- (1) Data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
- (2) Revised
- (3) Provisional

The following table shows the percentage distribution of the country's GNI and the availability of resources at current market prices.

**GROSS NATIONAL INCOME AND AVAILABILITY OF RESOURCES
(AT CURRENT MARKET PRICES)⁽¹⁾**

	2011		2012		2013		2014 ⁽²⁾		2015 ⁽²⁾⁽³⁾		2016 ⁽³⁾	
	Rs. mn	% of GNI	Rs. mn	% of GNI	Rs. mn	% of GNI	Rs. mn	% of GNI	Rs. mn	% of GNI	Rs. mn	% of GNI
Consumption Expenditure												
— Private	5,144,879	72.0	5,691,714	66.4	6,483,669	69.2	6,981,947	69.0	7,677,131	71.9	8,003,789	69.6
Consumption Expenditure												
— Government	617,918	8.6	665,831	7.8	745,684	8.0	868,059	8.6	984,755	9.2	1,015,107	8.8
Gross Domestic Capital Formation — Private	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Gross Domestic Capital Formation — Government ...	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Gross Domestic Capital Formation	2,408,573	33.7	3,410,511	39.8	3,189,326	34.1	3,347,638	33.1	3,114,674	29.2	3,723,875	32.4
Gross Domestic Expenditure	8,171,371	114.3	9,768,056	113.9	10,418,678	111.2	11,197,644	110.6	11,776,561	110.4	12,742,771	110.7
Gross National Income	7,147,065	100.0	8,577,574	100.0	9,366,039	100.0	10,125,078	100.0	10,670,358	100.0	11,506,217	100.0
Excess met by the below	1,024,306	14.3	1,190,482	13.9	1,052,639	11.2	1,072,565	10.6	1,106,202	10.4	1,236,554	10.7
Net Disinvestment Abroad	511,090	7.2	501,869	5.9	323,961	3.5	259,437	2.6	264,121	2.5	296,771	2.6
Net Receipts of International Gifts and Transfers	513,216	7.2	688,613	8.0	728,678	7.8	813,128	8.0	842,082	7.9	939,782	8.2

Source: Central Bank of Sri Lanka and the Department of Census and Statistics

Notes:

- (1) Data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
- (2) Revised
- (3) Provisional

Sectors of the Economy

Overview

Services

The services activities, which is the largest contributor to the economy, is comprised of the following main sub-activities: wholesale and retail trade, transportation and storage, accommodation and food service activities, information and communication, financial and insurance activities and real estate activities (including ownership of dwellings), professional, scientific, technical, administration and support service activities and other personal services (excluding own-services), and public administration and defense, education, human health and social work activities.

Services related activities grew by 4.2% in 2016, compared to a growth of 5.7% in 2015. This growth was mainly attributable to growth in financial services activities, together with developments in the transportation of goods and passengers including warehousing activities. Further, the growth in wholesale and retail trade, public administration, real estate activities, education, other personal services, insurance, accommodation services, telecommunication, human health services, and IT related activities contributed positively towards expansion in the services activities. However, professional services recorded a contraction during 2016.

The services activities grew by 5.7% in 2015, compared to a 4.8% growth registered in 2014. This growth was mainly attributable to the drive in financial and auxiliary financial services. Further, transportation of goods and passengers including warehousing, wholesale and retail trade, real estate activities, including the ownership of dwellings, contributed significantly by growing at a higher rate compared to the previous year. However, education, professional services activities, and postal and courier activities contracted in 2015.

The services activities grew by 4.8% in 2014, compared to a 3.8% growth registered in 2013. This growth was mainly attributable to the growth in other personal service activities, transportation of goods and passengers including warehousing and financial and auxiliary financial services. Further, real estate activities, including ownership of dwellings, wholesale and retail trade activities and public administration also contributed positively towards this growth. However, postal and courier activities contracted during 2014.

Industry

The industry activities comprises of three main sub-activities: manufacturing, mining and quarrying and other industries, and construction.

The industry activities grew by 6.7% during 2016 compared to the growth of 2.1% during 2015, mainly driven by 14.9 % growth in construction activities, 14.4% growth in mining and quarrying activities and 1.7% growth in manufacturing activities. The growth in manufacturing activities was mainly supported by manufacturing of rubber and plastic products. Further, electricity, water and waste treatment activities also contributed positively towards this growth.

The industry activities expanded by 2.1% in 2015, compared to a 4.7% growth in 2014, primarily due to manufacturing activities which grew by 4.9% in 2015 compared to the 2.5% growth in 2014. The growth in manufacturing activities in 2015 was mainly due to the 3.7% growth in manufacture of food, beverages and tobacco products. However, the contraction in construction as well as mining and quarrying activities by 2.7% and 5.2%, respectively, dampened the overall growth in industry activities.

The industry activities expanded by 4.7% in 2014, compared to a 4.1% growth in 2013, primarily due to the growth in the construction and manufacturing sub-activities, which grew at rates of 10.6% and 2.5%, respectively, in 2014 compared to rates of 7.5% and 2.3%, respectively, in 2013. The growth in manufacturing activities in 2014 was mainly due to the 22.6% growth in the manufacturing of furniture in 2014.

Agriculture, forestry and fishing

The agricultural activities comprises of three main sub-sectors: agriculture, forestry and fishing. Marine fishing and marine aquaculture, rice production, tea production, production of vegetables, and the production of oleaginous fruits (coconut, king coconut, oil palm) generally represent the highest share in the agriculture, forestry and fishing sector. Sri Lanka is the fourth largest tea producer in the world. Sri Lanka's fishing industry contributes to the country's foreign exchange earnings as a substantial portion of the seafood produced is exported.

The agricultural activities contracted by 4.2% in 2016, compared to an increase of 4.8% in 2015. This contraction in the agricultural activities was mainly driven by a 31.0% contraction in production of rice, 11.2% contraction in production of tea and 10.7% contraction in production of rubber. However, production of spices, aromatic, drug and pharmaceutical crops, animal produce, forestry and logging, and fishing, grew by 6.4%, 6.3%, 5.5%, and 1.6%, respectively, partially offsetting the overall contraction in the agricultural activities.

In 2015, the agricultural activities grew by 4.8%, compared to a 4.6% growth observed in 2014, mainly due to the recovery in the production of rice which grew by 25.0% in 2015 compared to the 7.0% contraction in 2014, and the 17.5% expansion in production of fruits compared to 9.4% growth in 2014. Further, the production of spices, aromatic, drug and pharmaceutical products, oleaginous fruits (coconut, king coconut and oil palm), animal produce, vegetables and other perennial crops also significantly contributed to this growth. However, the contraction in production of rubber, tea, sugar cane, tobacco and other non-perennial crops and other beverage crops (coffee and cocoa) and fishing dampened the growth in 2015.

In 2014, the agricultural activities grew by 4.6%, compared to a 3.2% growth observed in 2013, mainly due to a 31.0% growth in animal produce compared to a 24.0% growth in 2013, and a 20.1% growth in the production of oleaginous fruits (coconut, king coconut and oil palm) recovering from a 14.1% contraction in 2014. However, the production of rice, rubber, tea, and sugar cane, tobacco, and other non-perennial crops contracted during the year.

Services Activities

Wholesale and retail trade, transportation and storage, accommodation and food service activities

Wholesale and retail trade, transportation and storage, accommodation and food service activities, the largest segment of the services sector, grew by 3.4% during 2016 compared to the 4.8% growth recorded in 2015. In particular, wholesale and retail trade activities grew by 2.5% during 2016 compared to a 5.1% growth in 2015. Meanwhile, transportation of goods and passengers including warehousing activities recorded a growth of 4.1% in 2016, compared to a 5.0% growth in 2015. Moreover, accommodation, food and beverage service activities also grew during 2016, recording a 4.0% growth compared to a 1.9% growth posted in 2015. Further, postal and courier activities grew by 5.1% during 2016, compared to a contraction of 0.1% during 2015.

Wholesale and retail trade, transportation and storage, accommodation and food service activities grew by 4.8% during 2015 compared to a 3.5% growth in 2014. In particular, wholesale and retail trade activities grew by 5.1% during 2015 compared to a 2.8% growth in 2014. Meanwhile, transportation of goods and passengers including warehousing activities recorded a growth rate of 5.0% in 2015, as compared to a 4.2% growth rate in 2014. Meantime, accommodation, food and beverage service activities grew by 1.9% during 2015, compared to a 4.0% growth posted in 2014. However, postal and courier activities declined by 0.1% during 2015, compared to a decline of 7.1% during 2014.

Wholesale and retail trade, transportation and storage, accommodation and food service activities grew by 3.5% during 2014 compared to a 2.7% growth in 2013. This growth was mainly driven by the wholesale and retail trade which grew by 2.8% in 2014 compared to a 1.3% growth recorded in 2013. Other activities also contributed to the overall growth, with transportation of goods and passengers

including warehousing activities recording a 4.2% growth in 2014 compared to a 5.5% growth recorded in 2013 and accommodation, food and beverage service activities recording a 4.0% growth in 2014 compared to a decline of 5.8% in 2013. However, postal and courier activities continued to contract, declining by 7.1% in 2014 compared to a decline of 1.7% in 2013.

Information and communication

Information and communication activities grew by 8.0% during 2016 compared to a 10.9% growth recorded in 2015. This growth was mainly due to the 8.3% growth recorded in telecommunication activities during 2016. Further, IT programming consultancy and related activities grew by 7.1% during 2016, compared to a 14.8% growth recorded during the 2015. Moreover, programming and broadcasting activities grew by 7.7% during 2016 compared to the 4.4% growth in 2015.

Information and communication activities grew by 10.9% during 2015 compared to a 11.6% growth recorded in 2014. This growth was mainly due to the continuous expansion in telecommunication activities, which grew by 10.1% during the year, compared to a 13.1% growth in 2014. Further, programming and broadcasting activities and audio, video productions grew by 4.4% during 2015, as compared to a 3.8% growth during 2014 while IT programming consultancy and related activities grew by 14.8% during 2015 compared to a 9.1% growth in 2014.

Information and communication activities grew by 11.6% in 2014 compared to a 7.7% growth in 2013. This growth was mainly attributable to a 13.1% growth in telecommunication activities, increasing from a 3.6% growth recorded in 2013. Programming and broadcasting activities and audio, video productions grew by 3.8%, and IT programming consultancy and related activities grew by 9.1% in 2014, compared to growth rates of 7.6% and 21.6%, respectively, in 2013.

Financial, insurance and real estate activities (including ownership of dwellings)

Financial, insurance and real estate activities (including ownership of dwellings) grew by 8.4% during 2016 compared to a 13.3% growth recorded in the corresponding period of 2015. This growth was mainly due to a 12.4% growth recorded in the financial service activities and auxiliary financial services activities during 2016 compared to a 17.2% growth recorded in 2015. Insurance, reinsurance and pension funding activities also recorded a growth of 8.5% during 2016 compared to a 9.3% growth in 2015. Further, real estate activities, including ownership of dwellings, grew by 4.2% in 2016 compared to a 10.2% growth recorded in 2015.

Financial, insurance and real estate activities (including ownership of dwellings) grew by 13.3% during 2015 compared to a 7.5% growth recorded in 2014. This growth was mainly due to the 17.2% growth in financial service activities and auxiliary financial service activities during 2015 compared to a 8.9% growth recorded in 2014. Real estate activities (including ownership of dwellings) also recorded a higher growth rate of 10.2% during 2015 compared to a 6.5% growth in 2014. Further, activities of insurance, reinsurance and pension funding also posted a growth of 9.3% during 2015 compared to a 5.8% growth in 2014.

Financial, insurance and real estate activities (including ownership of dwellings) grew by 7.5% in 2014 compared to an 8.8% growth in 2013. This growth primarily attributable to financial service activities and auxiliary financial services, which grew by 8.9% in 2014 compared to a 5.8% growth in 2013. Real estate activities (including ownership of dwellings) grew at a slower pace of 6.5% in 2014, compared to a 12.8% growth recorded in 2013. Further, insurance, reinsurance and pension funding activities also grew by 5.8% in 2014 compared to a 2.6% growth recorded in 2013.

Professional, scientific, technical, administration and supporting service activities, and other services (excluding own-services)

Professional, scientific, technical, administration and supporting service activities and other services activities (excluding own-services) grew marginally by 0.7% during 2016, compared to 1.8% growth in 2015. This growth was mainly due to expansion in other personal services activities, which grew by 1.3% in 2016 compared to a 3.6% growth in 2015. However, professional, scientific, technical, administration and contracted further in value added terms by 3.1% in 2016 compared to 7.4% contraction recorded in the previous year.

Professional, scientific, technical, administration and supporting service activities and other personal services activities (excluding own-services) grew by 1.8% during 2015, compared to a 4.2% growth in 2014. This growth was mainly due to the growth in other personal service activities, which grew by 3.6% in 2015 compared to a 4.5% growth in 2014. However, professional, scientific, technical, administration and supporting services activities contracted by 7.4%, compared to the 2.8% growth recorded in 2014.

Professional, scientific, technical, administration and supporting service activities and other services activities (excluding own-services) grew by 4.2% during 2014, compared to a 9.0% growth recorded in 2013. The deceleration in the growth rate was mainly attributable to the slower 4.5% growth in other personal service activities in 2014, compared to a 10.0% growth recorded in 2013. Meanwhile, growth in professional, scientific, technical, administration and supporting services activities also slowed down to 2.8% in 2014, compared to a 4.0% growth in 2013.

Public administration, defense, education, human health, and social work activities

Public administration, defense, education, human health, and social work activities grew by 4.9% during 2016, compared to a growth of 3.6% recorded in 2015. The growth during 2016 was mainly attributable to public administration, defence and compulsory social security activities, which grew by 5.2% compared to a 6.9% growth recorded in 2015. Meanwhile, human health activities, residential care and social work activities grew by 1.5% during 2016, compared to a 8.1% growth posted in 2015. Meanwhile, education services rebounded in 2016 recording a 7.5% growth, compared to an 8.1% contraction posted during 2015.

Public administration, defense, education, human health, and social work activities grew at a slower pace of 3.6% during 2015, compared to a 5.5% growth recorded in 2014. Growth during 2015 was mainly attributable to the public administration and defense; compulsory social security activities, which grew by 6.9%, compared to a 5.2% growth recorded in 2014. Meanwhile, human health activities, residential care and social work activities grew by 8.1% during 2015, compared to a 1.0% growth posted in 2014. However, education services contracted by 8.1% in 2015, compared to a 10.3% growth posted during 2014, dampening the overall growth in the particular segment.

Public administration, defense, education, human health, and social work activities grew by 5.5% in 2014, recovering from a 5.5% contraction in 2013. This recovery was mainly attributable to the public administration and defense; compulsory social security activities and the education activities, which grew by 5.2% and 10.3%, respectively, in 2014, compared to contractions of 0.8% and 5.8%, respectively, in 2013. Further, human health activities, residential care and social work activities grew marginally by 1.0% in 2014, compared to a decline of 15.7% in 2013.

Industry Activities

Sri Lanka's industry activities consist of manufacturing, mining and quarrying and other industries, and construction activities. In 2016, the industry sector grew by 6.7%, primarily due to a significant growth of 14.9% in construction activities, which recovered from the 2.7% contraction recorded in 2015, together with the robust recovery in the mining and quarrying activities, which posted a 14.4% growth in 2016 compared to the 5.2% contraction in 2015.

**GROSS VALUE ADDED IN MANUFACTURING BY
INDUSTRY VALUE ADDED IN INDUSTRY
(2010 CONSTANT PRICES)⁽¹⁾**

Industry/Industry Group	2011	2012	2013	2014 ⁽²⁾	2015 ⁽²⁾⁽³⁾	2016 ⁽³⁾	First Three Months of 2016 ⁽²⁾⁽³⁾	First Three Months of 2017	% Increase or Decrease
(in Rs. millions, except as indicated)									
Food, beverages & tobacco products.....	487,943	507,121	507,127	513,960	532,936	519,815	152,460	N/A	N/A
Textiles, wearing apparel and leather related products.....	238,254	244,496	264,527	276,800	282,070	281,481	97,119	N/A	N/A
Wood and of products of wood and cork, except furniture....	31,521	23,472	25,258	23,139	26,239	30,311	9,023	N/A	N/A
Paper products, printing and reproduction of media products.....	27,605	24,738	24,925	24,968	27,092	29,730	9,831	N/A	N/A
Coal and refined petroleum products.....	35,457	28,858	27,514	28,723	29,075	31,245	13,569	N/A	N/A
Chemical products and basic pharmaceutical products.....	67,644	75,582	81,982	82,243	82,303	85,623	19,355	N/A	N/A
Rubber and plastic products.....	75,656	83,307	82,187	71,909	76,446	90,119	11,608	N/A	N/A
Other non-metallic mineral products.....	86,204	87,090	81,037	78,671	74,269	64,520	16,573	N/A	N/A
Basic metals and fabricated metal products	26,295	24,591	26,589	24,882	28,516	36,711	10,975	N/A	N/A
Machinery and equipment.....	33,650	30,849	30,845	32,064	38,838	44,300	11,485	N/A	N/A
Furniture	53,352	63,922	67,488	82,748	93,529	96,684	29,242	N/A	N/A
Other manufacturing, and Repair and installation of machinery and equipment....	34,555	41,962	44,443	55,993	68,380	72,922	21,120	N/A	N/A
Total manufacturing	1,198,135	1,235,988	1,263,921	1,296,100	1,359,694	1,383,461	402,362	N/A	N/A

Source: The Department of Census and Statistics

Notes:

- (1) Data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
- (2) Revised
- (3) Provisional

Manufacturing

Manufacturing activities grew at a slower pace in 2016 by 1.7%, compared to a 4.9% growth in 2015. This slowdown was mainly attributable to the contraction in the manufacturing of food, beverages and tobacco products, the major manufacturing category, which contracted by 2.5% in 2016 as opposed to a 3.7% growth recorded in 2015. Further, the manufacturing of other non-metallic mineral products and the manufacturing of textiles, wearing apparel and leather related products also contracted by 13.1% and 0.2%, respectively, during the year. However, the manufacturing of rubber and plastic products grew by 17.9% during the year while the manufacturing of basic metals and fabricated metal products and the manufacturing of machinery and equipment grew 28.7% and 14.1%, respectively.

In 2015, manufacturing activities grew by 4.9%, compared to the 2.5% growth rate recorded in 2014. The manufacturing of food, beverages and tobacco products, the largest contributor within manufacturing activities, accounted for 23.5% of the industry segment and registered a growth of 3.7% in 2015, compared to a growth rate of 1.3% in the corresponding period of 2014. The manufacturing of textiles, wearing apparel and leather related products grew by 1.9% in 2015, compared to a growth of 4.6% in 2014. Further, the manufacturing of machinery and equipment recorded a growth of 21.1% in 2015, compared to a 4.0% growth in 2014.

Manufacturing activities grew by 2.5% in 2014, compared to the 2.3% growth in 2013. This growth was mainly due to the substantial growth in the manufacturing of furniture category, which grew by 22.6% in 2014, compared to the 5.6% growth recorded in 2013. Meanwhile, the manufacturing of food, beverages and tobacco products grew marginally by 1.3%, recovering from the stagnant growth recorded in 2013. Further, other manufacturing, and repair and installation of machinery and equipment activities posted a significant growth of 26.0% in 2014, compared to a 5.9% growth in 2013.

Construction

Construction activities recovered during 2016, recording a substantial growth of 14.9% as compared to the 2.7% contraction recorded in 2015. Recommencement of a few large-scale infrastructure development projects, together with private sector involvement in construction activities, contributed towards this growth. Construction activities contracted by 2.7% in 2015 compared to the 10.6% growth recorded in 2014. The comparative slowdown in large-scale infrastructure development projects was a notable dampener of construction activities during 2015. In 2014, construction activities grew at a rate of 10.6% compared to the 7.5% growth in 2013.

Mining and quarrying and other industries

Mining and quarrying and other industries grew together by 12.7% in 2016, compared to a 0.3% contraction in 2015, mainly due to the significant growth of 14.4% in mining and quarrying recorded in 2016, which recovered from the contraction of 5.2% in 2015. All other activities, namely sewerage, waste treatment and disposal activities, electricity, gas, steam and air conditioning supply activities and water collection, treatment and supply activities, also contributed positively towards this growth expanding by 17.8%, 8.4% and 7.9%, respectively, as compared to the 24.9%, 5.9% and 4.4% growth rates observed, respectively, in 2015.

Mining and quarrying and other industries contracted by 0.3% in 2015, compared to a 3.0% growth in 2014, mainly due to the decline in mining and quarrying activities, which contracted by 5.2% during 2015, compared to the 1.6% growth recorded in 2014. Meanwhile, sewerage, waste treatment and disposal activities grew by 24.9% in 2015, compared to an 11.9% growth observed during 2014. Electricity, gas, steam and air conditioning supply activities, and water collection, treatment and supply activities also grew by 5.9%, and 4.4%, respectively, during 2015, compared to growth rates of 4.6% and 4.8%, respectively, during the corresponding period in 2014.

Mining and quarrying and other industries grew by 3.0% in 2014, compared to a 5.9% growth in 2013. This slowdown was mainly due to a slower growth of 1.6% in mining and quarrying activities, compared with the 7.6% growth rate in 2013. However, the other activities within the category recorded relatively higher growth rates in 2014. Electricity, gas, steam and air conditioning supply activities grew by 4.6% in 2014, compared to a 2.0% growth in 2013. Water collection, treatment and supply activities grew by 4.8% in 2014, compared to a 4.0% growth in 2013. Sewerage, waste treatment and disposal activities grew by 11.9% in 2014, compared to the 6.4% growth recorded in 2013.

Agriculture, Forestry and Fishing Activities

The agricultural activities contracted by 4.2% in 2016, compared to the increase of 4.8% in 2015. This contraction in the agricultural sector was mainly driven by a 31.0% contraction in production of rice, a 11.2% contraction in production of tea and a 10.7% contraction in production of rubber. However, production of spices, aromatic, drug and pharmaceutical crops, animal production, forestry and logging, and fishing grew by 6.4%, 6.3%, 5.5%, and 1.6%, respectively, partially offsetting the overall contraction in the agricultural activities.

In 2015, the agricultural sector grew by 4.8%, compared to a 4.6% growth observed in 2014, mainly due to the recovery in the production of rice, which grew by 25.0% in 2015, compared to the 7.0% contraction in 2014, and the 17.5% expansion in production of fruits, compared to 9.4% growth in 2014. Further, the production of spices, aromatic, drug and pharmaceutical products, oleaginous fruits (coconut, king coconut and oil palm), vegetables and other perennial crops also significantly contributed to this growth. However, the contraction in production of rubber, tea, sugar cane, tobacco and other non-perennial crops and other beverage crops (coffee and cocoa) and fishing partially offset the growth in 2015.

Agriculture, forestry and fishing activities grew by 4.6% in 2014, compared to a 3.2% growth recorded in 2013, mainly due to a 31.0% growth in animal produce, compared to a 24.0% growth in 2013 and a 20.1% recovery in production of oleaginous fruits (coconut, king coconut, oil palm) against a 14.1% contraction in 2013. However, production of rubber contracted by 24.5% compared to a 14.2% contraction in 2013 while production of rice, tea, and sugar cane, tobacco and other non-perennial crops contracted by 7.0%, 1.1%, 6.3%, respectively, in 2014 compared to the 5.3%, 3.7% and 8.3% growth recorded, respectively, in 2013.

Prices, Employment and Wages

Inflation

For the period from 2012 to 2014, inflation is reported as the percentage change in the CCPI (2006/07=100), and from 2015 onwards inflation numbers are based on CCPI (2013=100).

The following table sets out the principal components of the CCPI basket.

PRINCIPAL COMPONENTS OF THE CCPI BASKET

Category	Annual Average Index						Period Average Percentage Change				
	2012 ⁽¹⁾	2013 ⁽¹⁾	2014 ⁽¹⁾	2014 ⁽²⁾	2015 ⁽²⁾	2016 ⁽²⁾	2012 ⁽¹⁾	2013 ⁽¹⁾	2014 ⁽¹⁾	2015 ⁽²⁾	2016 ⁽²⁾
All Items	162.9	174.2	179.9	105.1	107.4	111.7	7.6	6.9	3.3	2.2	4.0
Food and Non-Alcoholic											
Beverages	180.9	195.2	202.5	104.3	110.0	116.7	4.7	7.9	3.8	5.5	6.1
Alcoholic Beverages and											
Tobacco	—	—	—	111.1	127.3	153.8	—	—	—	14.6	20.8
Clothing and Footwear	162.1	170.8	171.4	100.9	111.9	119.2	9.8	5.4	0.4	10.9	6.5
Housing, Water, Electricity,											
Gas and Other Fuels	136.4	151	152.7	108.9	110.3	110.1	9.6	10.7	1.1	1.4	-0.2
Furnishing, H/H Equipment											
and Routine Maintenance											
of the House	142.7	148.5	151.9	102.2	107.5	107.8	6.7	4	2.3	5.2	0.3
Health	247.5	251.7	273.1	104.1	111.7	126.0	3	1.7	8.5	7.2	12.9
Transport	181.9	190.2	198.9	101.7	91.1	92.9	21.6	4.6	4.5	-10.4	2.0
Communication	90.3	90.3	93.9	103.5	103.5	110.0	0	0	4	0.0	6.3
Recreation and Culture	144.6	150.4	153.8	101.4	105.3	107.4	4	4.1	2.2	3.8	2.0
Education	141.2	142.6	143.3	103.6	107.4	112.8	0.5	0.9	0.5	3.7	5.0
Restaurants and Hotels	—	—	—	101.2	104.5	107.2	—	—	—	3.3	2.6
Miscellaneous Goods and											
Services	136.5	142.2	146.8	101.5	103.5	118.5	4.1	4.2	3.2	2.0	14.5

Source: The Department of Census and Statistics

Note:

(1) CCPI details based on CCPI (2006/07=100)

(2) CCPI details based on CCPI (2013=100)

The following table sets out the consumer price index and the wholesale price index (based on the 1974 Wholesale Price Index benchmark), as well as the annual percentage changes in each index.

CHANGES IN CONSUMER AND WHOLESALE PRICE INDEX

	2012	2013	2014	2015 ⁽¹⁾	2016 ⁽¹⁾
Consumer Price Index	162.9 ⁽²⁾	174.2 ⁽²⁾	179.9 ⁽²⁾	107.4 ⁽³⁾	111.7 ⁽³⁾
Increase over previous year (%)...	7.6 ⁽²⁾	6.9 ⁽²⁾	3.3 ⁽²⁾	2.2 ⁽³⁾	4.0 ⁽³⁾
Wholesale Price Index	4,457.3	4,867.9	5,022.1	5,072.7	5,284.0
Increase over previous year (%)...	3.5	9.2	3.2	1.0	4.2

Source: Central Bank of Sri Lanka and the Department of Census and Statistics

Notes:

- (1) Provisional
- (2) CCPI details based on CCPI (2006/07=100)
- (3) CCPI details based on CCPI (2013=100)

Inflation, as measured by the year-on-year change in CCPI (2013=100), increased to 5.5% in January 2017, from 4.5% in December 2016 due to increase in both food and non-food prices. Thereafter, inflation increased to 6.8% in February mainly due to base effect, while the monthly increase in both food and non-food prices also contributed towards this increase in year-on-year inflation. Inflation continued to increase in March 2017 recording 7.3% amid a monthly decline. This increase in year-on-year inflation was mainly due to the low base that prevailed in March 2016.

Nevertheless, year-on-year inflation, as measured by the change in the Colombo Consumer Price Index (“CCPI”) (2013=100) as compiled by the DCS, remained at single digit levels on both an annual average and a year-on-year basis during 2016. Inflation on an annual average basis increased gradually through 2016 and reached 4.0% by December 2016. Year-on-year CCPI inflation increased at a comparatively rapid pace in the first half of the year and decelerated during the second half of 2016, leading to an overall increasing trend. As such, year-on-year CCPI inflation was 1.7% in January 2016, peaked to 5.8% in July 2016 and reached 4.5% in December 2016. The year-on-year CCPI inflation increased in May, June and July 2016 due to the impact of the increase in food prices led by adverse weather conditions and the increase in non-food prices resulting from the changes in government taxes. From August 2016 to November 2016, year-on-year CCPI inflation moved on an overall declining trend, supported by some improvements in the supply conditions of food items. The suspension of government tax changes in July also contributed marginally towards this decline. In November, government tax changes were re-introduced, and food prices were also on the rise due partly to the drought conditions. Year-on-year CCPI inflation settled around mid-single digit levels towards the latter part of 2016.

Inflation remained at low single digit levels on both an annual average and a year-on-year basis during 2015. Inflation on an annual average basis declined gradually through 2015. Year-on-year inflation declined until August 2015, continuing the declining trend observed from February 2015. Thereafter it moved on an increasing trend until December 2015. Nevertheless, inflation remained at benign low single digit levels throughout the year. This trend in inflation was partly supported by the downward adjustments of prices of fuel, utility and selected food items effected in several occasions during the latter part of 2014 and during 2015. Favourable price developments in the domestic and international markets, well contained inflation expectations and prudent monetary management also helped maintain inflation at favorable levels.

In order to regain the high growth momentum in the context of well-contained demand-driven inflationary pressures and subdued inflation expectations, the Central Bank eased its monetary policy stance further in 2013. Subsequent to the reduction in policy interest rates by 25 basis points in December 2012, the Central Bank reduced policy interest rates further by 50 basis points in May 2013. The perceived slow adjustment in market interest rates prompted the Central Bank to reduce the SRR by 200 basis points effective July 2013. This was followed by a further reduction in policy interest rates by 50 basis points in October 2013. Responding to these policy measures, market interest rates began to adjust downwards and the average broad money growth for 2013 amounted to 16.5%, compared to the 20.2% recorded by the end of 2012. This was mainly due to a reduction in the net foreign assets (“NFA”) of the banking system and the slower growth in credit granted to the private sector.

Broad money, which grew at an average of 19.3% in 2011, continued its expansionary trend in the early months of 2012, warranting a tightening of monetary policy to slowdown monetary expansion with a view to addressing the issue of potential demand-driven inflation and external sector imbalances. Several policy measures were taken in February through April 2012 and subsequent to these measures, the year-on-year growth of broad money decelerated to 17.6% by end 2012, compared to 22.9% in April 2012. With the expected stabilization outcomes being realized, the Central Bank was able to change its tight monetary policy stance in December 2012 by reducing the Repo Rate and Reverse Repo Rate by 25 basis points to 7.5% and 8.5%, respectively.

Broad money expanded at a higher rate in 2011 recording a year-on-year growth of 19.1% by December 2011, compared to a growth of 15.8% at the end of 2010. Contributing to this accelerated growth of broad money was the increase in credit granted to both the private sector and the public sector. Owing to the domestic credit expansion, Net Domestic Assets (“NDA”) of the banking system increased by 39.7% during the year. Consequently, the contribution of NDA to monetary expansion increased to 170% in 2011, from 109% in the previous year. The contraction in NFA of the banking system dampened the expansion of broad money. Within domestic credit, the growth of credit obtained by the private sector continued unabated with the year-on-year growth increasing to 34.5% by the end of 2011, compared to 24.9% in December 2010. Demand for credit remained high due to increased economic activity, including in the North and East, reflecting the conducive environment for investments as well as increased domestic demand. Additionally, borrowers benefited from the continuously low interest rates and improved access to credit with the expansion in banking facilities throughout the country. Credit to the private sector increased by approximately Rs. 515 billion during the year, compared to Rs. 297 billion in 2010.

Policy interest rates of the Central Bank, which were adjusted downwards in January 2011 considering benign inflation and inflation expectations and with a view to facilitating the private sector to enhance economic activity further, were maintained unchanged since then. However, in April 2011, the Central Bank increased SRR applicable on all rupee deposit liabilities of licensed commercial banks (“LCBs”) by 1 percentage point to permanently absorb a part of excess liquidity from the market and also to signal the policy direction of the Bank. The Central Bank resorted to moral suasion amid signs of credit growth remaining unabated. With excess liquidity declining, daily auctions were recommenced to contain interest rate volatility and maintain short term interest rates at desired levels.

Employment and Wages

The following table presents selected employment information based on the standard of the International Labor Organization for various sectors of the economy.

SELECTED EMPLOYMENT INFORMATION⁽¹⁾⁽²⁾⁽³⁾

	2012 ⁽⁴⁾	2013 ⁽⁴⁾	2014 ⁽⁴⁾	2015 ⁽⁵⁾	2016
Labor force	7,798	8,034	8,049	8,214	8,311
Unemployment rate (%)	4.0	4.4	4.3	4.7	4.4
Agriculture, fishery and forestry	2,333	2,321	2,223	2,245	2,154
Industry sector	1,941	1,997	2,027	2,018	2,098
Manufacturing	—	—	—	—	—
Construction	—	—	—	—	—
Services sector	3,215	3,363	3,450	3,568	3,696
Trade and hotels, etc.....	—	—	—	—	—
Transport, storage and communication ...	—	—	—	—	—
Finance, insurance and real estate	—	—	—	—	—
Personal services and other	—	—	—	—	—
Total employed	7,489	7,681	7,700	7,831	7,948
Percentage of labor force (%)	96.0	95.6	95.7	95.3	95.6

Source: Central Bank of Sri Lanka and the Department of Census and Statistics

Notes:

- (1) Data cover all districts
- (2) Based on household population age 15 and above
- (3) Provisional
- (4) Revised as per the 2012 Census-based Re-weighting of Labour Force Survey Estimates.
- (5) Revised

In 2013, the Department of Census and Statistics modified its system of collecting and reporting data based on International Standard Industrial Classification (“ISIC”) — Revision 4, the international reference classification of productive activities published by the Department of Economic and Social Affairs of the United Nations Secretariat. The following table sets forth the selected employment information for 2014, 2015 and 2016 based on ISIC revision 4.

SELECTED EMPLOYMENT INFORMATION⁽¹⁾⁽²⁾

	2013	2014 ⁽³⁾	2015 ⁽⁴⁾	2016
Labor force	8,034	8,049	8,214	8,311
Unemployment rate (%)	4.4	4.3	4.7	4.4
Agriculture, forestry and fishing	2,321	2,223	2,245	2,154
Industry sector	1,997	2,027	2,018	2,098
Mining and Quarrying	91	75	61	60
Manufacturing	1,366	1,389	1,408	1,421
Construction, Electricity, Gas, Steam and Air Conditioning Supply, Water Supply, Sewerage, Waste Management and Remediation Activities	540	564	550	617
Services sector	3,363	3,450	3,568	3,696
Wholesale and Retail Trade, Repair of Motor Vehicles and Motor Cycles	1,046	1,012	1,060	1,102
Transport and Storage	468	481	480	516
Accommodation and Food Services Activities	171	181	203	203
Information and Communication	55	63	52	62
Financial and Insurance Activities	137	146	145	159
Professional, Scientific and Technical Activities	61	47	65	55
Administrative and Support Service Activities	96	101	120	107
Public Administration and Defense Compulsory Social Security	570	594	600	609
Education	302	314	324	344
Human Health and Social Work Activities	128	127	137	142
Other ⁽⁵⁾	328	382	382	397
Total employed	7,681	7,700	7,831	7,948
Percentage of labor force (%)	95.6	95.7	95.3	95.6

Source: The Department of Census and Statistics

Notes:

- (1) Based on household population age 15 and above and covers all districts
- (2) Provisional
- (3) Revised as per the 2012 Census-based Re-weighting of Labour Force Survey Estimates
- (4) Revised
- (5) Includes domestic employment; real estate; arts, entertainment and recreation; and extraterritorial organizations and bodies

The unemployment rate decreased to 4.4% in 2016, compared to an unemployment rate of 4.7% in 2015. The total number of unemployed persons in 2016 was estimated at 0.363 million, compared to 0.383 million recorded in 2015. The female unemployment rate decreased to 7.0% in 2016 from 7.6% in 2015, while the male unemployment rate also decreased to 2.9% in 2016 from 3.0% in 2015. The number of employed persons increased by 1.5% to 7.948 million in 2016, compared to 7.831 million in 2015. The number of persons employed in the industry and services sectors increased by 3.9% and 3.6%, respectively, in 2016. The number of persons employed in the agriculture sector decreased by 4.0% in 2016. The labor force increased by 1.2% to 8.31 million persons in 2016 from 8.21 million in 2015. While the labor force participation rate (“LFPR”) remained unchanged at 53.8% in 2016, female LFPR remained at 35.9% in both 2015 and 2016 while male LFPR increased marginally to 75.1% in 2016 from 74.7% in 2015.

The unemployment rate increased to 4.7% in 2015, compared to an unemployment rate of 4.3% in 2014. The total number of unemployed persons in 2015 was estimated at 0.383 million, compared to 0.348 million recorded in 2014. The female unemployment rate increased to 7.6% in 2015 from 6.5% in 2014, while the male unemployment rate declined to 3.0% in 2015 from 3.1% in 2014. The number of employed persons increased by 1.5% to 7.831 million in 2015, compared to 7.700 million in 2014. The increase in the number of employed persons was mainly due to the 3.4% increase in number of persons employed in the services sector. Meanwhile, the number of persons employed in the agricultural sector increased by 1.0% while those employed in the industry sector declined by 0.5% in 2015. The labor force increased by 2.1% to 8.214 million persons in 2015 from 8.049 million in 2014, mainly due to the entry of women in to the labor force. The labor force participation rate (“LFPR”) increased to 53.8% in 2015, compared to 53.2% in 2014, primarily due to the increase in female LFPR from 34.6% in 2014 to 35.9% in 2015. Male LFPR improved marginally from 74.6% in 2014 to 74.7% in 2015.

The unemployment rate decreased marginally to 4.3% in 2014 from 4.4% in 2013. This decrease in the unemployment rate was due to a marginal increase in employment generation. The number of employed workers increased by 0.3% while the number of unemployed workers decreased by 1.2% during the period. The female unemployment rate decreased to 6.5% in 2014 from 6.6% in 2013, while the male unemployment rate decreased to 3.1% in 2014 from 3.2% in 2013. This marginal increase in employment was primarily observed in increases in employment in the industry and services sectors. Meanwhile, the number of workers employed in the agricultural sector declined due to adverse weather conditions during most of the year. Accordingly, the share of the number of employed workers in the agricultural sector declined to 28.9% in 2014 from 30.2% in 2013. The share of the number of employed workers in the industry sector increased marginally to 26.3% in 2014 from 26.0% in 2013. The services sector continued to be the foremost sector in terms of employment generation, contributing to 44.8% of total employment in 2014, compared to 43.8% in 2013. The labor force increased marginally to 8.049 million in 2014 from 8.034 million in 2013. The labor force participation rate declined marginally to 53.2% in 2014 from 53.7% in 2013 as the result of a relatively greater increase in the working age population than in the labor force.

Wages

The employed population comprises paid employees, employers, own account (self-employed) workers and unpaid family workers. Wages in Sri Lanka fall into two main categories of employment: the public sector and the private sector. The public sector comprises government and semi-government institutions and the private sector comprises formal and informal sectors. Wages in the public sector are largely determined by the Government. For formal private sector employees, the wage-setting mechanism includes several forms: tripartite determination, collective bargaining, remunerative tribunals, unilateral employer decisions and adjustment by Government directives. In the informal private sector, wages are mostly determined based on demand and supply conditions in the market. Wage movements stated below are analyzed in terms of annual average changes.

Public Sector

The nominal wages of public sector employees increased by 3.9% during 2016 on an annual average basis as measured by the public sector wage rate index compiled by the Central Bank. This increase was a result of the incremental increase in the interim allowance to Rs. 10,000, which came into effect during 2015, and the inclusion of a portion of the interim allowance to the basic salary in 2016, which yielded a higher average wage index in 2016 as compared to 2015. Within the public sector, employees in all categories, namely the senior level, tertiary level, secondary level and primary level received a wage increase of 5.0%, 4.4%, 3.7% and 4.6%, respectively. Real wages of the senior level, tertiary level and primary level public sector employees increased by 1.0%, 0.4% and 0.6%, respectively, while real wages of the secondary level public sector employees decreased by 0.2% in 2016. As a result, real wages of overall public sector decreased by 0.1% in 2016.

The nominal wages of public sector employees increased significantly by 31.7% during 2015 as a result of an interim allowance of Rs.10,000 that was paid to all public sector employees. Out of the total allowance of Rs. 10,000, Rs. 3,000 was granted under the 2015 Budget, with effect from November 2014, and balances of Rs. 5,000 and Rs. 2,000 were granted under the Interim Budget for 2015, with effect from February 2015 and June 2015, respectively. This increase resulted in a gain in the nominal wage rate indices of all categories of public sector employees, namely the senior level, tertiary level, secondary level and primary level, whose wages rose by 21.5%, 28.0%, 32.2% and 36.6%, respectively. Real wages of the same categories of public sector employees increased by 17.1%, 23.4%, 27.4% and 31.8%, respectively, while overall real wages in the public sector recorded an increase of 27.0% in 2015.

The nominal wages of public sector employees increased by 10.5% in 2014. This was primarily due to the increase of the monthly cost of living allowance to Rs. 7,800 from Rs. 6,600 and the interim allowance of Rs. 3,000 paid to all public sector employees from the budget proposal for 2015 effective November 2014. In real terms, public sector employees experienced a 6.7% increase in wages.

Formal Private Sector

Nominal wages of employees in the formal private sector exhibited a negligible increase during 2016, as measured by the annual average change in the minimum wage rate indices of employees whose wages are governed by the Wages Boards Trades. Accordingly, the wage rate index of employees in the agricultural sector exhibited a negligible increase while the indices in the industry and commerce; and services sectors remained unchanged. Real wages of employees in the formal private sector decreased by 3.6% in 2016. Real wages of employees in the agricultural, industry and commerce, and services sectors decreased by 3.5%, 3.6% and 3.6%, respectively, in 2016.

The National Minimum Wages of Workers Act and Budgetary Relief Allowance of Workers Act were passed in the Parliament in March 2016. Accordingly, workers receiving a monthly wage less than Rs. 40,000 will be paid the provisioned allowance of Rs. 1,500 with effect from May 1, 2015 to December 31, 2015, and, an additional allowance of Rs. 1,000 with effect from January 1, 2016. According to the National Minimum Wages of Workers Act, the minimum wage is now set at Rs. 10,000.

Nominal wages of employees in the formal private sector increased by 2.9% during 2015, as measured by the minimum wage rate indices of employees whose wages are governed by the Wages Boards Trades. Accordingly, the wage rate index of employees in the agricultural sector increased by 3.8% while the indices in the industry and commerce and services sectors remained unchanged. Real wages of employees in the formal private sector increased by 1.9% during 2015. Employees in the agricultural sector enjoyed real wage increases of 2.9%, while real wages of employees in both industry and commerce and services sectors declined by 0.9%.

Nominal wages of the employees in the formal private sector recorded an increase of 3.7% in 2014. Accordingly, the wage rate indices of the agriculture, industry and commerce; and services sectors increased by 2.8%, 8.4% and 3.2%, respectively, in 2014. Employees in the industry and commerce sector and services sector received modest increases in nominal wages, following significant increases of 32.9% and 21.0%, respectively, in 2013. Real wages of employees in the formal private sector

showed a marginal increase of 0.4% in 2014. Employees in the industry and commerce sector enjoyed a real wage increase of 5.0%, while those in the agricultural sector experienced a real wage decline of 0.5% in 2014. Meanwhile, the real wage of the employees in the services sector remained unchanged in 2014, compared to a 13.1% increase in 2013.

Informal Private Sector

The nominal wages of informal private sector employees, as measured by the annual average change in Informal Private Sector Wage Rate Index (2012=100), increased by 7.9% in 2016. Accordingly, the nominal wage rate indices of all three sectors, namely, agricultural, industry and services sectors increased by 6.7%, 9.1% and 7.2%, respectively, in 2016. Meanwhile, real wages of informal private sector employees increased by 3.7% in 2016. Real wages of employees in all three sectors, namely, the agricultural, industry and services sectors increased by 2.6%, 4.9% and 3.1%, respectively, in 2016.

Nominal wages of informal private sector employees increased by 7.3% during 2015. Accordingly, the nominal wage rate indices of all three sectors, namely, the agricultural, industry and services sectors increased by 8.5%, 8.4% and 5.9%, respectively, in 2015. Meanwhile, real wages of informal private sector employees increased by 3.5% in 2015. Real wages of employees in all three sectors, namely, agriculture, industry and services increased by 4.6%, 4.5% and 2.0%, respectively, in 2015.

Nominal wages of informal private sector employees increased by 7.6% during 2014. Accordingly, the nominal wage rate indices of the agricultural, industry and services sectors increased by 6.3%, 8.2% and 7.5%, respectively, in 2014. Meanwhile, real wages of informal private sector employees increased by 3.8% in 2014. Real wages of employees in the agricultural, industry and services sectors increased by 2.7%, 4.4% and 3.8%, respectively, in 2014.

Labor Productivity

Labor productivity, as measured by value added (in 2010 prices) per hour worked, increased by 0.2% to reach Rs. 463.20 in the first nine months of 2016, compared to Rs. 462.09 in the corresponding period in 2015. The agricultural sector exhibited the most efficient use of labor resources, with a 6.3% growth in labor productivity amid decreases in the number of persons employed and the number of hours worked. Although both the value added and the number of persons employed in the industry and services sectors increased, both sectors registered labor productivity declines of 2.9% and 2.7%, respectively. Although the agricultural sector exhibited a robust growth in productivity, the level of labor productivity in the agricultural sector continues to remain the lowest of all three sectors in the economy, with Rs. 173.70 per hour worked compared to Rs. 503.27 and Rs. 561.41 in the industry and services sectors, respectively, for the first three quarters of 2016.

Labor productivity, as measured by value added (in 2010 prices) per hour worked, increased by 3.4% to reach Rs. 465.15 per hour in 2015, compared to Rs. 449.76 per hour in 2014. The agriculture sector recorded a 3.6% growth in labor productivity although the level of labor productivity in the sector continues to remain the lowest of all three sectors. Despite the decrease in persons employed and the number of hours worked, the industry sector registered a labor productivity growth of 3.4%. Meanwhile, owing to the increases in the number of persons employed and the number of hours worked in the services sector, labor productivity in the services sector increased by 3.3%.

Labor productivity increased by 3.3% to Rs. 449.76 per hour in 2014, compared to Rs. 435.32 per hour in 2013. Increases were achieved across all three sectors in the economy. The highest labor productivity growth of 8.7% was observed in the agriculture sector. The industry sector recorded a 1.9% growth, while the services sector recorded a productivity growth of 1.5% in 2014.

Labor Relations

The total number of strikes in the private sector decreased while the number of workers involved and the total man-days lost increased during 2016. The number of strikes in the private sector declined from 51 to 41 while the number of workers involved in strikes increased from 14,915 in 2015 to 20,652

in 2016. The decline in the number of strikes was observed in both plantation and other sectors. Nevertheless, on an overall basis, labor relations deteriorated in terms of the number of man-days lost due to strikes, which increased by 26.8% from 82,294 in 2015 to 104,327 in 2016, primarily due to the protracted strikes in the sectors other than plantation sector.

The total number of strikes and the number of workers involved in strikes in the private sector increased during 2015. The number of strikes in the private sector increased from 38 to 51 while the number of workers involved in strikes increased from 6,451 in 2014 to 14,915 in 2015. The increases in workers involved in strikes and total man days lost were observed in both plantation and other sectors. Labor relations worsened in terms of the number of man-days lost due to strikes, which increased by 120.5% from 37,323 in 2014 to 82,294 in 2015, primarily due to the protracted strikes in the plantation sector.

The total number of strikes, the number of employees involved in strikes and the total man days lost in the private sector due to those strikes decreased considerably in 2014 compared to 2013. Although the number of strikes in the plantation sector increased in 2014, the number of strikes recorded in the other sectors declined. As a result, the total number of strikes in the private sector decreased to 38 in 2014 from 42 in 2013. Further, most of these strikes were token strikes, caused by short-term disagreements of the striking workers with their respective managements, with minimal adverse impact. Meanwhile, workers involved in the strikes in the private sector decreased significantly by 42.0% in 2014. This led to a significant decrease in the number of man days lost in the private sector by 53.6% in 2014. However, the man days lost in the plantation sector was higher in 2014 than those of the other sectors in the private sector.

Samurdhi Welfare Program

The “Samurdhi Welfare Program” is a program aimed at providing a safety net for the poor to raise their incomes above the poverty line. The percentage of the population living below the national poverty threshold declined to 6.7% in 2012/13, compared to 8.9% based on the 2009/10 survey and 15.2% based on the 2006/7 survey. The Government continued to channel resources to livelihood development initiatives through Samurdhi/Divineguma in 2016, with the objective of improving socioeconomic conditions of low income households in the country. The Department of Divineguma Development was established in early 2014 by consolidating the Samurdhi Authority of Sri Lanka, the Southern Development Authority and the Udarata Development Authority. The establishment of this department is expected to improve institutional strength to carry out development activities targeted at poverty alleviation, food security and individual empowerment through providing micro-finance facilities, development of physical and social infrastructure and development of human capital to improve the living standard of low income households. The Samurdhi relief was increased by 100% to Rs. 3,000 per month, from Rs. 1,500 per month, commencing from January 2015. This was further increased to Rs. 3,500 per month with effect from April 2015. A total of 1,407,235 families benefited from the Divineguma Subsidy Program in 2016 with the total value of grants reaching Rs.40,740 million (US\$ 279.8 million) compared to 1,453,078 families with the value of grants being Rs. 39,994 million (US\$ 294.2 million) in 2015.

Recognizing the importance of eradicating poverty for inclusive economic growth in Sri Lanka, the Government has declared 2017 as the “Year of Poverty Alleviation”. The Government has created a program to give due recognition and implement a comprehensive poverty alleviation program for Sri Lanka while giving priority to attain the Sustainable Development Goals (“SDGs”) by 2030 through a collaborative approach.

Savings

The following table sets out gross national savings, total investment and the savings-investment gap as a percentage of GDP.

INVESTMENTS AND SAVINGS (AT CURRENT MARKET PRICES)⁽¹⁾

	2012	2013	2014 ⁽²⁾	2015 ⁽²⁾⁽³⁾	2016 ⁽³⁾
	(in Rs. millions, except for ratios)				
Gross Domestic Product at					
Market Prices	8,732,463	9,592,125	10,361,151	10,951,695	11,838,975
Private Investment	N/A	N/A	N/A	N/A	N/A
Government Investment.....	N/A	N/A	N/A	N/A	N/A
Total Investment	3,410,511	3,189,326	3,347,638	3,114,674	3,723,875
Private Savings	2,454,481	2,430,506	2,638,836	2,536,588	2,891,799
Government Savings	(79,563)	(67,733)	(127,692)	(246,779)	(71,719)
Domestic Savings.....	2,374,918	2,362,773	2,511,145	2,289,809	2,820,080
Net Primary Income from Rest of the World	(154,889)	(226,086)	(236,073)	(281,337)	(332,758)
Net Current Transfers from Rest of the World	688,613	728,678	813,128	842,082	939,782
National Savings	2,908,642	2,865,365	3,088,201	2,850,554	3,427,104
Investment Ratio	39.1	33.2	32.3	28.4	31.5
Domestic Savings Ratio	27.2	24.6	24.2	20.9	23.8
National Savings Ratio.....	33.3	29.9	29.8	26.0	28.9

Source: Central Bank of Sri Lanka and the Department of Census and Statistics

Notes:

- (1) The data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
- (2) Revised
- (3) Provisional

National savings consist of domestic savings, net primary income from abroad and net current transfers from abroad. Net primary income from abroad, which is a component of GNI but not GDP, is the net flow of property income to and from the rest of the world, plus the net flow of compensation of employees.

In 2016, national savings grew by 20.2% to Rs. 3,427 billion, compared to a 7.7% contraction in 2015. This recovery was mainly attributable to the significant growth in domestic savings and net current transfers from rest of the world in 2016 by 23.2% and 11.6%, respectively, compared to an 8.8% contraction and 3.6% growth recorded of the same in 2015, respectively. Meanwhile, net primary income from rest of the world contracted by 18.3% in 2016, compared to a 19.2% contraction in 2015. Accordingly, national savings as a percentage of GDP stood at 28.9% in 2016, compared to 26.0% recorded in 2015. However, the resource gap, which is the difference between national savings and investments, increased marginally to 2.5% of GDP in 2016, compared to 2.4% of GDP in 2015, due to higher growth in investments in 2016.

In 2015, national savings contracted by 7.7% to Rs. 2,851 billion, compared to a growth of 7.8% in 2014. This was mainly due to 8.8% contraction in domestic savings, as compared to 6.3% growth in 2014, together with slower growth of 3.6% in net current transfers from rest of the world in 2015, compared to a 11.6% growth recorded in 2014. Meanwhile, net primary income from rest of the world also deteriorated by 19.2% in 2015, compared to a 4.4% contraction in 2014. As a result, national savings decreased to 26.0% of GDP in 2015, compared to a 29.8% of GDP in 2014. However, the resource gap narrowed marginally to 2.4% of GDP from 2.5% of GDP in 2014, due to contraction in investments in 2015.

In 2014, national savings grew by 7.8% to Rs. 3,088 billion, compared to a contraction of 1.5% in 2013. Domestic savings rebounded with a growth of 6.3% compared to a 0.5% decline in 2014 while net current transfers from rest of the world increased to 11.6% compared to a 5.8% growth in 2013. Moreover, the net primary income from rest of the world contracted by 4.4% during the year compared to a 46.0% contraction in 2013. However, the national savings slightly decreased to 29.8% of GDP in 2014, compared to 29.9% of GDP in 2013, due to higher growth in nominal GDP. Meanwhile, the resource gap narrowed to 2.5% of GDP in 2014 from 3.4% of GDP in 2013.

In 2013, national savings contracted by 1.5% to Rs. 2,865 billion, compared to a growth of 53.3% in 2012. This contraction was due to unfavorable developments in domestic savings as well as slow growth in net current transfers. National savings decreased to 29.9% of GDP, compared to 33.3% in 2012. Net current transfers from rest of the world also grew at a slower rate in 2013. The growth in national savings was further dampened by the higher deterioration in net primary income from rest of the world. Meanwhile, the resource gap, which refers to the difference between national savings and investment as a ratio of GDP, narrowed to 3.4% of GDP in 2013 from 5.7% of GDP in 2012.

Balance of Payments

Overview

BOP figures measure the relative flow of goods, services and capital into and out of the country as represented in the current account and the capital and financial account. The current account tracks the country's trade in goods, services, income and current transfer transactions. The capital and financial account includes the capital account, which covers all transactions involving capital transfers and acquisition or disposition of non-produced, non-financial assets, and the financial account, which covers all transactions associated with changes of ownership in foreign financial assets and liabilities of an economy. A BOP surplus indicates a net inflow of foreign currencies, thereby increasing demand for and strengthening the local currency. A BOP deficit indicates a net outflow of foreign currencies, thereby decreasing demand for and weakening the local currency. Prior to 2012, the presentation of BOP was based on the fifth edition of the BOP and International Investment Position manual of the IMF. In 2013, the Central Bank modified its system of collecting and reporting data based on BOP and International Investment Position Compilation Guide ("BPM6"), a set of revised and updated standards for concepts, definitions and classifications for international accounts statistics published by the IMF. As such, from 2012 onwards, all external sector statistics, i.e., BOP, IIP (international investment position) and EDS (external debt statistics) are reported based on BPM6.

Balance of Payments Performance

The following table sets forth the balance of payment information for 2013, 2014, 2015 and 2016 based on BPM6.

BALANCE OF PAYMENTS (2013-2016)

	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	% Increase or Decrease
Exports	10,394	11,130	10,546	10,310	(2.2)
Imports	18,003	19,417	18,935	19,400	2.5
Trade balance	(7,609)	(8,287)	(8,388)	(9,090)	(8.4)
Services (net).....	1,180	1,880	2,325	2,879	23.8
Receipts.....	4,685	5,605	6,397	7,138	11.6
Payments	3,505	3,725	4,072	4,259	4.6
Primary income (net)	(1,751)	(1,808)	(2,013)	(2,184)	(8.5)
Receipts.....	132	155	127	120	(5.4)
Payments	1,883	1,963	2,140	2,304	7.7
Secondary income (net).....	5,639	6,227	6,193	6,453	4.2
Private transfers (net)	5,619	6,199	6,167	6,434	4.3
Receipts	6,407	7,018	6,980	7,242	3.7
Payments.....	788	819	814	807	(0.8)
Official transfers (net)	21	28	27	19	(29.1)
Current account	(2,541)	(1,988)	(1,883)	(1,942)	(3.2)
Capital account	71	58	46	26	(44.9)
Sum of current account and capital account (net)	(2,470)	(1,929)	(1,836)	(1,917)	(4.4)
Financial account					
Net acquisition of assets	986	2,588	911	82	(91.0)
Direct investments	65	67	53	237	347.2
Portfolio investments	—	—	—	—	—
Debt securities.....	—	—	—	—	—
Other investments	(191)	973	503	317	(37.0)
Currency and deposits	(459)	276	143	5	(96.5)
Trade credit and advances.....	225	383	116	-67	(157.8)
Other accounts receivable	42	314	244	379	(55.3)
Reserve assets.....	1,112	1,548	354	-472	(233.3)
Net incurrence of liabilities	4,049	4,124	3,223	2,199	(31.8)
Direct investments	933	894	680	898	(32.1)
Portfolio investments	2,068	2,065	686	993	(44.8)
Equity and investment fund shares.....	226	178	(60)	24	140.0
Debt securities.....	1,843	1,887	747	969	29.7
Other investments	1,048	1,165	1,857	308	(83.4)
Currency and deposits	108	(292)	1,457	-609	(141.8)
Loans	1,118	1,713	759	753	(0.8)
Trade credit and advances.....	(235)	(407)	(401)	109	127.2
Other accounts payable.....	58	151	41	55	34.1
Errors and omissions.....	(572)	393	(476)	(201)	57.8
Overall balance	985	1,369	(1,489)	(500)	66.4

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

The BOP in 2016 reflected the subdued performance of the external sector with a widening of the current account deficit and a moderation in the financial account. The current account deficit in 2016 increased marginally to 2.4% of GDP from 2.3% in 2015. The trade deficit expanded during the year, with an increase in import expenditure, particularly with higher domestic demand for investment goods, while earnings from merchandise exports contracted with the drop in both international commodity prices and export volumes. The deficit in the primary income account also widened during 2016 as a result of the decline in earnings from reserve assets and continued interest payments amid outflows on account of reinvested earnings and dividend payments. However, the adverse impact of the trade deficit and the primary income account deficit was dampened to some extent by surpluses in the services account and the secondary income account. The surplus in the services account continued to increase, particularly with higher earnings from tourism, while the secondary income account benefitted from the moderate expansion in workers' remittances in 2016. Meanwhile, the financial account continued to experience higher outflows amid modest inflows by way of non-debt creating sources. In particular, lower levels of FDI and capital outflows arising from disinvestment of Government securities by non-residents, together with continued debt service payments, adversely impacted the financial account in 2016. The lack of non-debt creating inflows to the financial account and the widening of the current account deficit necessitated financing from the rest of the world. Accordingly, the funding requirement of the BOP was met through the issuance of an ISB and syndicated loans. In addition, to overcome the economic challenges against the backdrop of an increasingly volatile global economic environment, Sri Lanka sought an EFF from the IMF in 2016.

On cumulative terms, tourist earnings are estimated to have increased by 3.4% to US\$ 1,038 million during the first quarter of 2017, compared to US\$ 1,003 million during the corresponding period in 2016. For the first two months of 2017, workers' remittances recorded a growth of 2.0%, with an inflow of US\$ 1,140 million, compared to US\$ 1,118 million during the corresponding period of 2016.

During 2016 Sri Lanka's external sector experienced lower than expected inflows to the current and financial accounts and higher foreign exchange outflows in 2015. The current account deficit in 2015 amounted to US\$ 1.9 billion and declined to 2.3% of GDP. Although the merchandise trade deficit continued to widen in 2015 due to the increase in non-oil imports and the slowdown in export earnings, a substantial increase was largely avoided by the low expenditure on the importation of crude oil. The primary income account also widened with increased interest payments during the year. However, the surpluses in the services and secondary income accounts enabled the current account deficit to remain almost unchanged from the previous year's level. The financial account was adversely affected by the decline in non-debt creating inflows, the slowdown in inflows to the Government and gradual reversal of investments in Government securities, due to the expectation of an, and the subsequent, increase in interest rates in the US. This resulted in the BOP recording an overall deficit of US\$ 1,489 million in 2015. The lackluster performance in the BOP was reflected in the decline in gross official reserves to US\$ 7.3 billion as at the end of 2015, equivalent to 4.6 months of imports. Meanwhile, the rupee, which depreciated by 2.42% against the US dollar during the first eight months, depreciated at a higher rate during the last four months of the year following the Central Bank's decision to allow greater flexibility in the determination of the exchange rate from early September 2015. During the year, the Sri Lankan rupee depreciated by 9.03% against the US dollar. Greater flexibility in the exchange rate helped stabilize trade and current account deficits towards the end of 2015 although short term capital outflows continued into 2016 as well.

The external sector sustained its growth momentum in 2014, with relatively better performance in the first half of the year. Exports grew by 7.1%, with noticeable expansion in industrial exports, especially garment exports and agricultural exports. The expansion in exports was supported by increased demand from the United States and the EU and conducive macroeconomic conditions that prevailed in the domestic economy for the producers. Meanwhile, imports grew by 7.9%, largely due to the increased fuel and motor vehicle imports during the second half of the year. Consequently, the trade deficit widened by 8.9% to US\$ 8.3 billion in 2014, resulting in a negative impact on the external sector current account deficit. However, the receipts from trade in services increased as a result of increases in travel, transport and telecommunication, computer and information services sub-sectors. At the same time, earnings from tourism was supported by both an increase in tourist arrivals, which

surpassed 1.5 million by the end of 2014, and a higher average spending per guest per night. The improvement in the current account, together with inflows to the financial account, resulted in the overall balance recording a surplus of US\$ 1,369 million in 2014, compared to a surplus of US\$ 985 million in 2013.

Reserve assets held by the Central Bank and the Government, which comprise foreign currency reserves, gold balances, reserve position in the IMF, SDR holdings and other reserve assets, amounted to US\$ 8.2 billion in 2014. Proceeds from international sovereign bond issuances in January and April 2014, disbursements under foreign funded projects and net absorption of excess liquidity in the foreign exchange market all helped to improve the reserve asset position, despite outflows on account of foreign debt service payments and SBA Facility payments during 2014. Meanwhile, total foreign assets, which consist of reserve assets as well as foreign financial assets of deposit taking corporations, increased to US\$ 9.9 billion in 2014. The reserve assets position of the Central Bank and the Government in 2014 was equivalent to 5.1 months of import of goods and 4.3 months of import of goods and services, compared to the internationally accepted norm of 3 months of imports. Total foreign assets were equivalent to 6.1 months of imports of goods and 5.1 months of imports of goods and services.

Gross official reserves of the country increased to US\$ 7.5 billion in 2013, compared to US\$ 7.1 billion in 2012. Adequate levels of reserves were maintained throughout 2013 despite outflows relating to foreign debt service payments and SBA Facility payments, among others. The proceeds from the issuances of debt securities by NSB, DFCC and BOC (totaling US\$ 1.35 billion) and other receipts contributed to the maintenance of gross official reserves at a stable level. In 2013, gross official reserves were equivalent to five months of imports, compared to the internationally accepted norm of 3 months. Meanwhile, total foreign assets, which consist of reserve assets managed by the Central Bank as well as foreign financial assets of deposit taking corporations, increased to US\$ 8.6 billion in 2013, equivalent to 5.7 months of imports.

In 2012, Sri Lanka's external sector strengthened further, despite the challenging global economic environment, largely supported by the prudent policy package implemented by the Central Bank and the Government in early 2012. The widening trade deficit, driven by a sharp growth in imports and a slowdown in exports due to weak global demand, was a key policy challenge faced at the beginning of 2012. With a view to ensuring macroeconomic stability, the Central Bank and the Government implemented a strong policy package, which allowed greater flexibility in the exchange rate, increased the policy interest rates, imposed a ceiling on the growth of credit granted by licensed banks and raised customs duties on selected imports. As a result of these policy measures, expenditure on imports declined by 5.4% in 2012 with non-fuel imports decreasing at a higher rate of 8.6%. Although greater flexibility in the exchange rate helped augment export competitiveness, the decline in international commodity prices and subdued global demand, amid faltering economic activity in the US and Europe, resulted in exports declining by 7.4% in 2012. In absolute terms, however, the decline in import expenditure was larger than the decline in earnings from exports, and, as a result, the trade deficit contracted by 3.1% to US\$ 9.4 billion. As a percentage of the GDP, the trade deficit declined from 16.4% in 2011 to 15.8% in 2012.

Current Account

The current account deficit widened during 2016 amid the deterioration of the trade account and the primary income account, despite the surpluses in the services and the secondary income accounts. A significant deterioration of the trade balance was witnessed, particularly during the fourth quarter of 2016, as a result of increased import expenditure on intermediate and investment goods amid a decline in earnings from exports. However, increased inflows to the services account, which was primarily driven by the substantial increase in earnings from tourism and the surplus in the secondary income account, consisting mainly of workers' remittances, helped cushion the deficits in the trade and

primary income accounts of the current account to a certain extent. As a result, the current account deficit widened marginally to US\$ 1,942 million in 2016, compared to US\$ 1,883 million in 2015. Accordingly, the current account deficit as a percentage of GDP increased marginally to 2.4% of GDP in 2016 in comparison to 2.3% of GDP in 2015.

Despite the widening of the deficits in trade and income accounts, the deficit in the external current account was limited to US\$ 1.9 billion in 2015, mainly due to the surpluses in the services and secondary income accounts. The merchandise trade deficit continued to widen in 2015 due to an increase in the expenditure on the importation of consumer goods and the slowdown in export earnings. However, a substantial increase in the trade deficit was largely abated by the low expenditure on the importation of crude oil, driven by the significant decline in oil prices in the international markets, resulting in the merchandise trade deficit recording a marginal increase of 1.7% in 2015 over the previous year. However, the deficits in trade and income accounts were partially offset by the surplus in the services account, which was mainly driven by a substantial increase in earnings from tourism and the surplus in the secondary income account, although the latter experienced a notable setback during the year, due to a marginal decline in workers' remittances. Consequently, the current account deficit amounted to US\$ 1,883 million in 2015, compared to US\$ 1,988 million a year earlier. However, the current account deficit as a percentage of GDP narrowed slightly to 2.3% of GDP in 2015, compared to 2.5% of GDP in 2014, as a result of the moderate growth in the nominal GDP.

In 2014, the current account recorded a lower deficit of US\$ 2,018 million, compared to a current account deficit of US\$ 2,541 million in 2013. This improvement in the current account was supported by the improvement in performance of trade in services and secondary income. The services account recorded higher inflows mainly from the transport, travel and the telecommunication, computer and information services sub-sectors, while workers' remittances also contributed to the reduction of the current account deficit during 2014.

In 2013, the current account recorded a deficit of US\$ 2,541 million, compared to a deficit of US\$ 3,982 million in 2012. The narrowing of the current account deficit was primarily due to the shrinking of the deficit in the trade account as a result of a decline in imports and an increase in exports. A significant increase in inflows to the services account, by way of earnings from tourism, transportation, computer and information services and workers' remittances, helped strengthen the current account deficit during the year, with workers' remittances alone helping to cushion more than 84% of the trade deficit.

Goods Trade

Since liberalization of the economy in 1977, foreign trade policy and trade structure have undergone considerable changes. The external sector was one of the prime drivers of the economy as international trade and finance operated in a free and liberal economic environment. There is full current account convertibility, partial capital account convertibility and a freely floating exchange rate regime. Being a small, open economy, the continuously improving economic environment and the greater freedom in trade, investment and payments have benefited Sri Lanka in maintaining its growth momentum and in strengthening its ability to face external shocks during the last three decades. Current account convertibility has been maintained as defined under the IMF Article VIII since 1994. To safeguard the country from large and volatile capital flows, limited capital account restrictions are still in place. However, the capital account was gradually relaxed in a staggered manner since 2006 by providing opportunities to foreign nationals to invest in rupee denominated Government Treasury bonds and Treasury bills. As announced in the 2011 Budget, the Central Bank has relaxed foreign exchange controls in order to facilitate the foreign exchange transactions in the emerging economic environment. Accordingly, the Central Bank has relaxed foreign exchange regulations relating to investment by Sri Lankans abroad, foreign borrowings by resident companies and investment by non-residents in the domestic market. The continuation of a freely floating exchange rate regime since 2001 has also served the economy well, particularly for the export sector to maintain its external competitiveness, through autonomous adjustments in the exchange rate broadly in line with changes in economic fundamentals of the country.

Given the small size of the economy and limited domestic demand, Sri Lanka has adopted external trade relations and policies aimed at enhancing the integration of the domestic economy with global markets. This helped the country benefit from increasing global demand, technological developments and the transfer of skills and knowledge. Sri Lanka remains firmly committed to the multilateral trading system, being a founding member of the WTO, and it has made commitments to the WTO on trade in goods and also made commitments under the GATS on insurance, telecommunications, tourism and financial services. As an active member of the WTO Ministerial Meeting, Sri Lanka contributed to the success of countries having similar interests, in designating a number of agricultural products as special products which would be exempt from further tariff cuts to support local farmers. Sri Lanka also made progress in furthering its regional and bilateral trading arrangements in recent years. Sri Lanka is a signatory of many trading arrangements, such as the Indo-Sri Lanka Free Trade Agreement, Pakistan-Sri Lanka Free Trade Agreement, Asia Pacific Trade Agreement and South Asia Free Trade Arrangement. Furthermore, Sri Lanka continued its efforts to expand bilateral trade relations with China through the China Sri Lanka Free Trade Agreement (the “CSFTA”). The Memorandum of Understanding (“MOU”) on initiating the negotiations of the CSFTA was signed in September 2014. The CSFTA covers trade in goods and services, investment, and economic and technical cooperation. The first and the second round negotiations were held in September 2014 and in November 2014, respectively, where both nations negotiated the list of ‘highly sensitive products’, ‘general sensitive products’, and ‘normal products’ to be incorporated into the agreement. Further negotiations focused on the rules of origin and product list to be incorporated under the proposed CSFTA. The third and fourth rounds of negotiations were held in August 2016 in Colombo and in November 2016 in Beijing, respectively. The fifth and sixth rounds were held in January 2017 and March 2017, respectively. Further, in June 2016, Sri Lanka and Singapore announced the intent to pursue a comprehensive FTA. This FTA is expected to focus on export-led growth, employment generation, expanding market to attract investments with technical know-how and expertise, and the usage of supply chain linkages of both countries. A feasibility study carried out by both parties was followed by a scoping mission from Singapore in July 2016, for initial discussions with relevant institutions on the scope and coverage of the proposed FTA. The first three rounds of negotiations were held in 2016 and another two rounds were held in January and April 2017. FTAs with both China and Singapore are expected to be finalized during 2017. The FTA with India is expected to be reinforced through the inclusion of the services sector and by creating more investment opportunities through the proposed Economic and Technology Cooperation Agreement (“ETCA”). Negotiations on the ETCA are expected to deepen the current ISFTA on goods, technology cooperation, economic cooperation, liberalising services and investments. The preliminary official level discussions started in August 2016, where the two parties had only explored the broader scope of ETCA and the areas that would be considered within the framework. The negotiations continued in September 2016 and January 2017, post which the Government expects to finalize negotiations before the end of 2017.

In order to simplify the tax structure, the five-band customs duty structure of 0.0%, 2.5%, 6.0%, 15.0% and 28.0%, respectively, was changed to a four-band customs duty structure of 0.0%, 5.0%, 15.0% and 30.0%, respectively, in 2010. Although, different duty rates were imposed on different items considering their impact to various stakeholder groups, recent policy direction is to further simplify the tariff bands in operation. Except for a few items, raw materials for local industries are kept at low duty rates, while rates for finished products are higher. Accordingly, more incentives have been granted to local manufacturers. In the 2014 Budget, the tariff structure was further consolidated to 0.0%, 7.5%, 15.0% and 25.0%, in line with the Government’s policy direction towards further reducing tariff rates. Accordingly, 3,379 tariff lines out of 6,577 were placed at the zero duty band. In line with the policy to further simplify the tax structure and lower the tax rate, the 30% customs duty, which is applicable on end-user products, was reduced to 25%. This policy direction would be simplified further as in the Budget 2016, where a three band customs duty structure of exempt, 15% and 30% was implemented.

On August 15, 2010, the EU member states decided to withdraw preferential tariff benefits that Sri Lanka had received under the Special Incentive Arrangement for Sustainable Development and Good Governance as part of the GSP+ scheme. The GSP+ scheme, which exempted more than 7,200 products from EU import duties, primarily benefited Sri Lanka’s apparel exporters. Following this withdrawal, Sri Lankan exports reverted to the standard EU-GSP, which still provides preferences for key Sri Lankan products such as clothing. The decline in competitiveness that has resulted from the

GSP+ withdrawal appears to have been partially offset by Sri Lanka's focus on long-term preparations to adjust to conditions without the GSP+ benefits, the firm level actions taken towards differentiating and diversifying products as well as markets, improvements in the quality and branding of products, negotiations with buyers, enhancements in productivity and reductions in finance and input cost, coupled with an improved macroeconomic environment. The resulting improvements in competitiveness have helped Sri Lankan exports move forward amid challenges. The present Government has recognised the importance of removing prevailing obstacles for external trade in order to promote exports. In this regard, initiatives were taken to regain the EU-GSP+ and to adhere to the international rules on fisheries, for the lifting of the ban imposed by the European Commission ("EC") on fish exports to the EU. The application for regaining the EU-GSP+ facility was submitted to the EC in July 2016. After a thorough review process, in January 2017, the EC proposed to reinstate the EU-GSP+ in exchange for Sri Lanka's commitment to ratify and effectively implement 27 international conventions related to human rights, labor rights, protection of the environment and good governance, while allowing the EU Parliament to raise any potential objections within a period of four months. The government expects the GSP+ status to be reinstated by the first half of 2017. In mid-January 2015, the EU banned importing fish from Sri Lanka, as it suspected that Sri Lanka was not complying with international rules on illegal fishing and employing inadequate control systems in the Sri Lankan fisheries industry. Discussions were held to negotiate the ban on fish exports, while steps were taken to improve the Sri Lankan fisheries industry's compliance with international standards and requirements specified by the EU. As a result, in April 2016, the EU recommended lifting the fish import ban of Sri Lanka and such removal of the ban was approved by the EU Parliament in June 2016, who cited Sri Lanka's successfully reformation of its fisheries governance system. With the EU market being one of the major seafood exporting destinations for Sri Lanka, this development contributed significantly towards promoting Sri Lankan seafood exports. Since the removal of the ban, seafood exports to the EU grew by 110.0%, year-on-year, during the second half of 2016.

Considering the diverse regulatory issues faced by private actors when importing materials, equipment and other goods, it was proposed in Budget 2016 to establish a "one-stop-shop" concept at the Sri Lanka Customs, which provides all the necessary permissions, clearances and approvals at a single window platform. Accordingly, in January 2016, Sri Lanka Customs initiated operation of the Single Window System, with border regulatory agencies linked to the system to facilitate ease of obtaining approvals. By recognizing the need for broad-based institutional support, the Government took steps to create two agencies, the Agency for International Trade ("AfIT") and the Agency for Development ("AfD"), as purposed by Budget 2016. The AfIT is responsible for rectifying issues in existing trade pacts with the Indian subcontinent while exploring an economic partnership agreement with India and using Sri Lanka's improved investment climate to attract investment that caters to the entire market of the subcontinent. The AfIT is also in charge of pursuing new bilateral and multilateral trade opportunities beyond the subcontinent, especially with China, Singapore, the EU and the United States, which cater to a market of about 3 billion, complying with the non-aligned foreign policy of the government. The AfD, on the other hand, is expected to contribute to development efforts by collaborating with the private sector to identify constraints on the development process and by building multi-functional teams that can work across sectors to resolve issues to enable the private sector to enhance capabilities, engage in product development and foster export growth. Several measures, spearheaded by the Ministry of Development Strategies and International Trade ("MODSIT") and the Export Development Board ("EDB"), are currently underway. The National Export Strategy, initiated by the EDB, is a collaborative effort of the Government and the private sector and provides a five-year action-oriented framework for the development of Sri Lankan trade and competitiveness. Simultaneously, a National Trade Policy has been drafted with the objective of attracting more export-oriented FDI, improving trade logistics, increasing transparency and efficiency of customs procedures, and implementing other measures to boost Sri Lanka's ability to compete in the global market. In addition, a One-Stop-Shop in collaboration with more than 15 stakeholder organisations at the Board of Investment ("BOI") was established, which are among the solutions implemented towards improving the investment climate of Sri Lanka.

The Budget 2017 proposed to appoint a National Trade Prosecutor, who will be entrusted with the responsibility of ensuring proper enactment of trade and the commercial agreements that are expected to be undertaken. Further, the Budget 2017 proposed to abolish the fee on the import and export control on tea, tea packing and logo registration to support the tea industry. Also, action to ease regulations on the import of certain types of tea for re-export was proposed. The Government also expects to gradually phase out the para-tariffs that are applicable in the tax system, with the view of promoting Sri Lanka for foreign investments. In line with this goal, duty rates of 96 tariff lines have been adjusted according to Sri Lanka's bound rate commitments to the WTO. Further, with a view to facilitate industries, the duty on industrial raw materials has been reduced. Moreover, to ease challenges that exporters are expected to face due to the sluggish global demand, the Government has proposed tax benefits for exporters and the establishment of an export-import bank for trade facilitation, establishment of free trade zones, mainly targeting rubber based products, pharmaceuticals, fabric, mineral, chemical and automotive industries, and export villages, mainly targeting information technology (IT), robotics, fashion, high-end apparel and boat manufacturing. Government support for backward integration, especially on textiles and garments industry, were also proposed.

Exports of Goods

The following tables set out the exports of goods by major commodity group and destination, as reported by the Central Bank.

EXPORTS OF GOODS BY COMMODITY GROUP

	2012	2013	2014	2015	2016 ⁽¹⁾	First Three Months of 2015	First Three Months of 2016	Share of Exports (%)		
								2014	2015 ⁽²⁾	2016 ⁽¹⁾
Agricultural Exports	2,331.5	2,581.1	2,793.9	2,481.5	2,326.1	618.9	562.2	25.1	23.5	22.6
Tea	1,411.9	1,542.2	1,628.3	1,340.5	1,269.0	335.3	313.1	14.6	12.7	12.3
Rubber	125.1	71.3	45.3	26.1	32.7	7.4	9.9	0.4	0.2	0.3
Coconut	208.9	204.6	356.4	351.7	366.0	82.1	87.8	3.2	3.3	3.5
Other agricultural products	585.5	762.9	763.9	763.1	658.4	194.1	151.5	6.9	7.2	6.4
Industrial Exports	7,371.2	7,749.4	8,262.0	8,017.1 ⁽²⁾	7,940.1	2,262.9 ⁽²⁾	2,165.6 ⁽²⁾	74.2	76.0	77.0
Food, beverages and tobacco	284.3	235.2	289.3	306.8 ⁽²⁾	323.7	78.3 ⁽²⁾	92.7 ⁽²⁾	2.6	2.9	3.1
Textiles and Garments	3,991.1	4,508.3	4,929.9	4,820.2	4,884.1	1,258.0	1,369.3	44.3	45.7	47.4
Petroleum products	463.0	427.7	338.0	373.9	286.9	127.9	74.2	3.0	3.5	2.8
Rubber products	859.4	887.8	889.8	761.2	767.9	207.8	203.2	8.0	7.2	7.4
Ceramic products	35.8	40.4	41.3	35.2	34.4	9.4	9.5	0.4	0.3	0.3
Leather, travel goods and footwear	55.4	76.8	138.9	135.7	165.6	40.5	39.1	1.2	1.3	1.6
Machinery and mechanical appliances	297.5	312.3	342.9	293.8	317.6	81.7	73.9	3.1	2.8	3.1
Gem, diamond and jewellery	558.9	445.5	393.6	331.7	273.9	109.5	75.0	3.5	3.1	2.7
Other industrial exports	825.9	815.2	898.3	958.7	886.1	349.9	228.8	8.1	9.1	8.6
Mineral Exports	61.3	51.6	59.5	28.4	29.0	10.0	7.6	0.5	0.3	0.3
Unclassified	9.6	12.2	14.7	19.5	14.5	4.0	3.7	0.1	0.2	0.1
Total Exports	<u>9,773.5</u>	<u>10,394.3</u>	<u>11,130.1</u>	<u>10,546.5⁽²⁾</u>	<u>13,309.7</u>	<u>2,895.8⁽²⁾</u>	<u>2,739.2⁽²⁾</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: Sri Lanka Customs, Ceylon Petroleum Corporation and other exporters of petroleum, National Gem and Jewelry Authority and the Central Bank of Sri Lanka

Note:

(1) Provisional

(2) Revised

EXPORTS OF GOODS BY DESTINATION

	2012	2013	2014	2015	2016 ⁽¹⁾	Percentage of Total Exports		
						2014	2015 ⁽²⁾	2016 ⁽¹⁾
United States of America	2,125.7	2,494.3	2,730.7	2,809.9	2,809.9	24.5	26.6	27.3
United Kingdom.....	1,059.4	1,077.9	1,116.1	1,029.2	1,044.0	10.0	9.8	10.1
India	567.5	543.5	624.8	643.3	554.0	5.6	6.1	5.4
Germany	454.6	468.5	498.0	476.0	500.2	4.5	4.5	4.9
Italy.....	508.3	510.5	614.3	434.1	429.6	5.5	4.1	4.2
Belgium-Luxembourg	533.1	449.1	316.0	282.8	338.2	2.8	2.7	3.3
United Arab Emirates.....	222.6	236.8	277.3	276.2	233.8	2.5	2.6	2.3
China, People's Republic of.....	113.0	130.8	188.1	307.9	211.1	1.7	2.9	2.0
Netherlands.....	158.8	190.9	242.7	220.1	207.8	2.2	2.1	2.0
Japan	216.5	224.4	237.5	215.6	201.8	2.1	2.0	2.0
Other	3,814.0	4,067.4	4,284.5	3,851.4	3,779.2	38.5	36.5	36.7
Total.....	9,773.5	10,394.3	11,130.1	10,546.5⁽²⁾	10,309.7	100.0	100.0	100.0

Source: Sri Lanka Customs, National Gem and Jewelry Authority and the Central Bank of Sri Lanka

Note:

(1) Provisional

(2) Revised

Earnings from exports declined by 2.2%, year-on-year, to US\$ 10,310 million in 2016, compared to US\$ 10,546 million recorded in 2015, mainly due to the downward movement in commodity prices in the international market and modest economic recovery in Sri Lanka's major export destinations. Exports earnings of transport equipment, petroleum products, tea and spices primarily contributed for this decline. Export earnings from transport equipment recorded a 46.0% decline to US\$ 131 million in 2016, mainly due to the significantly higher level of exports recorded in 2015, as a result of the export of two dredger vessels that were imported in 2013 and 2014 for the use of the Colombo Port City Development Project. Export earnings from petroleum products, which mainly comprise bunker and aviation fuel, declined by 23.3% to US\$ 287 million in 2016, partly due to higher competition from other regional players, such as Singapore and India. Earnings from tea exports decreased by 5.3% in 2016 to US\$ 1,269 million while the total volume of tea exported declined by 5.9% to 289 million kilograms, due to adverse weather conditions and trade union activities in the plantation sector. Export earnings from spices declined by 16.0% to US\$ 317 million in 2016, due to significant reduction in export volumes of pepper and cloves by 50.8% and 66.6%, respectively. However, both export volumes and prices of cinnamon, nutmeg and mace increased during the year. Earnings from textiles and garments exports, which account for 47.0% of total exports, increased by 1.3% to US\$ 4,884 million in 2016, partially mitigating the impact of lower industrial exports. The United States and the EU continued to be the two largest buyers of Sri Lankan garments, in both volume and value terms. Export earnings from base metals and articles increased significantly by 60.5% in 2016, due to higher earnings from articles of iron and steel, aluminium and copper.

In 2015, earnings from exports declined, largely reflecting the downward movement of international commodity prices and the slower growth in large economies and Sri Lanka's major export destinations. Earnings from exports, which grew at 7.1% in 2014, declined by 5.2%, year-on-year, in 2015, to US\$ 10,546 million, led by the drop in both agricultural as well as industrial exports. Earnings from agricultural exports, declined significantly by 11.2% to US\$ 2,481 million in 2015, led by lower earnings from tea and seafood exports. Export earnings from tea declined significantly by 17.7% to US\$ 1,340 million. Geopolitical developments, currency depreciations in importer countries and the substantial decline in revenue from oil resulted in a significant decline in demand for Ceylon tea from major buyers such as Russia and some countries in the Middle East. Accordingly, the average export price of tea declined significantly by 12.2%, to US\$ 4.37 per kilogram in 2015, from US\$ 4.97 per kilogram recorded in 2014, while the export volume also declined by 6.2% to 307 million kilograms. Meanwhile, earnings from seafood exports declined by 35.5%, year-on-year, in 2015, mainly due to the significant decline recorded in seafood exports by 75.0% to the EU market, with the restrictions on market access, with effect from mid-January 2015. Rubber, non-kernel coconut products, vegetables and unmanufactured tobacco also contributed considerably to the decline in earnings from agricultural exports during the year. However, earnings from coconut kernel products increased by 3.5% due to more than a 100% growth recorded in coconut oil exports. As a result of a bumper harvest in main export crops such as pepper and cloves, earnings from exports of spices increased significantly by 42.7%, to US\$ 377 million in 2015. In line with the decline in commodity prices in the international market and lower global demand, earnings from industrial exports contracted by 3.0% to US\$ 8,017 million in 2015. The lower performance recorded in textiles and garments, rubber products, gems, diamonds and jewellery, and machinery and mechanical appliances, mainly contributed to this decline. Export earnings from textiles and garments, which account for approximately 46% of the total export earnings, declined by 2.2%, mainly due to the 2.7% decline recorded in garment exports, despite the 4.5% and 13.4% growth, respectively, recorded in textiles and other made-up textile articles. Export earnings from garments to the EU market declined significantly by 12.5% in 2015, largely contributing to the decline in earnings from garment exports, despite the 6.0% and 4.6% growth recorded in the earnings from garment exports to the US and other non-traditional markets, respectively. In line with the noticeable drop recorded in international rubber prices, earnings from rubber products exports declined by 14.5%, to US\$ 761 million in 2015, reflecting declines in almost every sub-category in rubber products, such as rubber tires and surgical and other gloves. However, export earnings from transport equipment, petroleum products and animal fodder, under industrial exports, increased during the year.

Earnings from exports increased by 7.1% to US\$ 11,130 million in 2014, supported by increases in all major export categories. The largest contribution came from industrial exports, supplemented by a substantial increase in textile and garments exports. Specifically, earnings from textiles and garments exports, which accounted for 44% of total exports, recorded a significant increase of 9.4% in 2014, evidenced by growth in garment exports to both traditional and non-traditional markets. The garment exports to the EU and the United States increased by 10.6% and 8.8%, respectively, while exports to non-traditional markets increased by 10.5%, compared to the 14.0% recorded in 2013. Among industrial exports, export earnings from leather, travel goods and footwear, food, beverages and tobacco, and machinery and mechanical appliances also increased substantially in 2014. However, export earnings from petroleum products, which primarily comprised bunker and aviation fuel, declined by 21% to US\$ 338 million, and exports of gem, diamond and jewellery declined by 11.7%. Meanwhile, earnings from agricultural exports recorded an increase of 8.2% due to increased exports of coconut products, tea and certain minor agricultural products. Specifically, export of coconut products and tea increased by 74.2% and 5.6%, respectively, primarily due to higher export volumes. However, the export earnings from spices, which experienced a remarkable increase of 38.8% during 2013, declined by 25.6% due to a drop in amount harvested in 2014.

Imports of Goods

The following tables set out the sources of Sri Lanka's imports of goods by commodity group and by country.

IMPORTS OF GOODS BY COMMODITY GROUP

	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	First Three Months of 2015	First Three Months of 2016	Percentage of Total Exports		
								2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾
Consumer goods	2,995.2	3,182.5	3,852.5	4,713.5	4,319.0	1,191.3	1,109.2	19.8	24.9	22.3
Food and beverages	1,304.4	1,368.1	1,633.7	1,627.8	1,627.4	462.8	399.5	8.4	8.6	8.4
Rice	24.4	17.9	281.7	135.1	12.8	80.5	2.7	1.5	0.7	0.1
Sugar	344.9	288.9	255.5	252.5	342.5	75.4	64.3	1.3	1.3	1.8
Other	935.1	1,061.2	1,096.6	1,240.1	1,272.1	306.9	332.5	5.6	6.5	6.6
Other consumer goods	1,690.8	1,814.4	2,218.8	3,085.7	2,691.5	728.5	709.7	11.4	16.3	13.9
Intermediate goods	11,577.6	10,553.7	11,397.7	9,638.2	9,870.0	2,397.0	2,240.3	58.7	50.9	50.9
Fuel	5,044.6	4,308.2	4,597.3	2,699.6	2,481.0	709.1	485.7	23.7	14.3	12.8
Fertilizer	311.0	238.7	272.4	289.6	136.9	54.7	41.1	1.4	1.5	0.7
Chemical Products	669.7	734.3	808.2	870.3	856.3	220.0	209.5	4.2	4.6	4.4
Wheat and maize	363.8	323.2	404.7	357.2	249.2	76.8	54.5	2.1	1.9	1.3
Textiles and textile articles	2,266.4	2,045.8	2,327.6	2,296.2	2,704.9	588.1	698.5	12.0	12.1	13.9
Other intermediate goods	2,922.1	2,903.6	2,987.4	3,125.2	3,441.7	748.2	751.2	15.4	16.5	17.7
Investment goods	4,589.8	4,252.7	4,152.2	4,567.0	5,198.0	1,201.7	1,243.5	21.4	24.1	26.8
Machinery and equipment	2,356.0	2,221.9	2,131.0	2,278.1	2,740.7	586.3	712.4	11.0	12.0	14.1
Transport equipment	991.9	667.8	707.3	930.9	880.2	297.8	157.7	3.6	4.9	4.5
Building materials	1,237.4	1,357.2	1,308.9	1,352.0	1,568.7	316.0	371.6	6.7	7.1	8.1
Other investment goods	4.5	5.8	4.9	5.9	8.5	1.7	1.9	—	—	—
Unclassified imports	27.7	13.9	14.4	15.9	13.1	2.1	1.3	0.1	0.1	0.1
Total imports	19,190.2	18,002.8	19,416.8	18,934.6	19,400.1	4,792.1	4,594.5	100.0	100.0	100.0

Source: Central Bank of Sri Lanka, Sri Lanka Customs, Ceylon Petroleum Corporation, Prima Ceylon Limited, Serendib Flour Mills (Pvt) Ltd and Lanka IOC PLC

Note:

(1) Provisional

IMPORTS OF GOODS BY SOURCE

Country	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016	Percentage of Total Imports		
						2014 ⁽¹⁾	2015 ⁽¹⁾	2016
China, People's Republic of	2,666.7	2,953.1	3,493.6	3,712.1	4,215.1	18.0	19.6	21.7
India	3,639.5	3,170.8	4,023.1	4,268.4	3,815.2	20.7	22.5	19.7
Singapore	1,682.5	1,682.1	1,259.8	1,063.3	1,174.9	6.5	5.6	6.1
United Arab Emirates	1,288.8	1,179.3	1,837.8	1,066.8	1,119.0	9.5	5.6	5.8
Japan	551.8	668.0	941.2	1,389.3	950.4	4.8	7.3	4.9
Malaysia	811.2	570.1	744.5	508.4	637.9	3.8	2.7	3.3
United States of America	233.8	416.4	492.3	470.7	539.5	2.5	2.5	2.8
Thailand	458.4	436.6	442.3	496.6	514.9	2.3	2.6	2.7
Taiwan	365.4	435.4	443.3	459.7	496.1	2.3	2.4	2.6
Hong Kong	605.0	429.8	351.3	365.4	466.3	1.8	1.9	2.4
Other	6,886.9	6,061.2	5,387.4	5,133.9	5,470.7	27.7	27.1	28.2
Total	19,190.2	18,002.8	19,416.8	18,934.6	19,400.1	100.0	100.0	100.0

Source: Central Bank of Sri Lanka, Sri Lanka Customs, Ceylon Petroleum Corporation, Prima Ceylon Limited, Serendib Flour Mills (Pvt) Ltd and Lanka IOC PLC

Note:

(1) Provisional

Since the liberalization of Sri Lanka in 1977, imports expenditures had increased from US\$ 726 million in 1977 to US\$ 19,400 million in 2016, in line with the evolving and expanding economic activities in the country.

Expenditure on imports increased by 2.5% to US\$ 19,400 million in 2016 from US\$ 18,935 million in 2015. Expenditure on imports increased in 2016 mainly due to the increase in the imports of investment goods and non-fuel intermediate goods, partially offset by the favorable impact of the decline in import expenditure on other categories, such as fuel and non-food consumer goods. Higher economic activities in the country led to increased expenditure on overall imports. Machinery and equipment, textiles and textile articles, gold, building material, sugar and confectionery and medical and pharmaceuticals contributed considerably to the increase in import expenditure. Import expenditure on machinery and equipment increased by 20.3% to US\$ 2,741 million in 2016, reflecting significant increases in all subcategories. Electronic equipment, machinery and equipment parts, telecommunication devices and agricultural machinery were the key contributors to the growth of machinery and equipment imports. Import expenditure on building materials increased by 16.0% to US\$ 1,569 million in 2016. Expenditure on textiles and textile articles imports was the largest expenditure category, surpassing fuel imports, and increased by 17.8% to US\$ 2,705 million in 2016, in line with the increase in the export of textiles and garments. Import expenditure on gold increased significantly to US\$ 374 million in 2016 from US\$ 42 million in 2015, as a result of an increase in the volume of gold imported. However, expenditure on personal vehicles, fuel and fertilizer imports declined in 2016 from the level observed in 2015. The increase in import taxes on the importation of motor vehicles by the Government, together with macro prudential measures adopted by the Central Bank, were the main reasons for the decline in personal motor vehicles imports. Expenditure on fuel imports declined by 8.1% to US\$ 2,481 million, due to reduced expenditure on both crude oil and refined petroleum imports, while expenditure on coal imports increased.

In 2015, expenditure on imports declined moderately by 2.5% to US\$ 18,935 million, compared to US\$ 19,417 million in 2014. This decline was largely driven by intermediate goods which decreased by 15.4% to US\$ 9,638 million reflecting the substantial decline in expenditure on fuel imports. In line with the substantial reduction in international oil prices, the average import price of crude oil declined by 47.6% to US\$ 54.80 per barrel in 2015, from US\$ 104.53 per barrel recorded in 2014. Meanwhile, the volume of crude oil and refined petroleum products imports declined by 2.0% and 1.9%, respectively, in 2015, due to the shutting down of the refinery for maintenance purposes during March and April 2015 and the substantial reduction in thermal power generation. Further, the import volume of coal increased by 17.1%, leading to a marginal increase of expenditure on coal imports to US\$ 159 million in 2015, mainly due to the increase recorded in coal power generation. In line with the reduction recorded in garments exports, import expenditure on textiles and textile articles also declined by 1.3% in 2015. However, rubber and articles made of rubber, chemical products, vehicle and machinery parts, fertilizer, and unmanufactured tobacco, classified under intermediate goods, contributed positively towards increased import expenditure in 2015. Expenditure on consumer goods imports increased significantly by 22.3% in 2015 mainly due to the increase in non-food consumer goods as a result of a 51.6% growth recorded in imports of motor vehicles such as motor cars and motor cycles. The continuation of the concessionary motor vehicle permits for government employees, reduction of taxes on the importation of motor vehicles, especially less than 1000 CC engine capacity, and the depreciation of the Japanese Yen, caused the increase in non-food consumer goods imports, especially motor vehicles. Import expenditure on different kinds of non-food consumer goods categories increased significantly in 2015 in part due to the increase in income levels of Government employees. However, import expenditure on food and beverages declined marginally by 0.4% in 2015 mainly due to the drop in expenditure on rice imports to US\$ 135 million in 2015, compared to US\$ 282 million in 2014. Rice imports, which recorded a significant growth since April 2014, started to decline from May 2015, due to the increase in the import tariff, consequent to the ample supply of rice in the local market due to the bumper paddy harvest recorded in both the Yala and Maha seasons in 2015. Further, import expenditure on dairy products declined by 26.1% in 2015, mainly due to the decline recorded in the expenditure on milk powder imports, owing to the significant reduction in the

average imported price of milk powder, despite the large increase in the import volume. Import expenditure on investment goods increased by 10.0%, reflecting increases in all sub-categories. The largest contribution for this increase came from transport equipment, followed by machinery and equipment. Import expenditure on transport equipment increased significantly by 31.6% in 2015, mainly due to higher imports of road vehicles, particularly, auto trishaws, lorries, commercial cabs and agricultural tractors. Import expenditure on machinery and equipment, which mainly comprise engineering equipment, electronic equipment, telecommunication devices and office machinery, increased by 6.9% in 2015.

Expenditure on imports, which decreased in the first half of 2014, increased during the second half of the year, recording an overall average increase of 7.9% in 2014. This increase was largely due to increased expenditure on imports of intermediate goods and consumer goods. Accordingly, the increase in intermediate goods was mainly caused by higher imports of petroleum products and textiles and textile articles. Despite the significant decline in fuel prices in the international market during the second part of 2014, higher import volumes due to increased thermal power generation resulted in an increase in expenditure on fuel imports by 6.7%. Furthermore, in line with the increase in textiles and garments exports, the expenditure on imports of textiles and textile articles increased by 13.8%. At the same time, import expenditure on paper and paper boards, plastic and articles thereof, wheat and maize, chemical products and fertilizer also increased during 2014. Meanwhile, imports of diamonds, precious stones and metals used as inputs for the jewellery industry declined by 63.7% in 2014, following a more moderate decline of 17.8% in 2013. Similarly, import expenditure on cement clinkers also declined by 6.3% in 2014, reflecting lower demand for cement, particularly in the fourth quarter of 2014, due to unfavorable weather conditions for construction activities. However, imports of consumer goods increased in 2014, evidenced by substantial increases in both food and non-food categories. Specifically, an increase in expenditure on imports of personal motor vehicles contributed significantly for the increase in imports in non-food consumer goods, supplemented by an increase in import expenditure on clothing and accessories and telecommunication devices such as mobile phones. The noticeable increase in expenditure on food imports was mainly due to an increase in rice imports, as the domestic rice production in 2014 was negatively affected by the adverse domestic weather conditions. Import expenditure on milk powder, dhal and edible nuts also increased whereas imports of sugar and confectionery products, oil and fats and sea food products declined during the year. Finally, the expenditure on investment good imports declined by 2.4%, largely due to lower imports of machinery and equipment and building material.

Services Trade

The following table sets out the Issuer's services trade by sector compiled in accordance with the BPM6 framework for the periods indicated.

SERVICES TRADE

	2012	2013	2014⁽¹⁾	2015⁽¹⁾	2016⁽¹⁾	% Increase or Decrease
	(in US\$ millions, except for percentages)					
Transportation	462	402	462	526	632	20.1
Credits	1,634	1,784	1,923	2,105	2,250	6.9
Debits	1,172	1,382	1,462	1,579	1,618	2.5
Travel	328	527	1,169	1,561	1,977	26.6
Credits	1,039	1,715	2,431	2,981	3,518	18.0
Debits	710	1,188	1,263	1,420	1,542	8.6
Telecommunication, computer and information services	466	351	350	375	416	10.7
Credits	673	719	748	805	858	6.6
Debits	207	368	398	429	443	3.1
Construction services	41	29	29	30	34	12.2

	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	% Increase or Decrease
	(in US\$ millions, except for percentages)					
Credits	50	55	58	60	63	4.4
Debits	9	26	29	30	29	(3.3)
Insurance services	43	24	26	27	32	16.7
Credits	107	109	115	119	121	1.6
Debits	64	85	90	92	89	(2.8)
Financial services	(46)	(93)	(94)	(126)	(151)	(20.0)
Credits	232	235	256	254	252	(0.8)
Debits	279	328	350	380	403	6.1
Other business services	(8)	(15)	(16)	(21)	(25)	(20.0)
Credits	39	39	43	42	42	(0.8)
Debits	46	55	58	63	67	6.1
Government Expenditure	(24)	(45)	(45)	(48)	(35)	28.6
Credits	27	28	31	31	33	8.2
Debits	51	73	77	79	68	14.3
Total services trade	1,262	1,180	1,880	2,325	2,879	23.8
Credits	3,800	4,685	5,605	6,397	7,138	11.6
Debits	2,538	3,505	3,725	4,072	4,259	4.6

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

The services account recorded a net surplus in 2016, with healthy inflows to the tourism and the transportation sectors. Earnings from exports of services grew by 11.6% to US\$ 7,138 million in 2016, in comparison to US\$ 6,397 million in 2015. The key growth driver within trade in services was earnings from tourism, followed by exports of transport and telecommunications, computer and information services. Meanwhile, outflows on account of services also increased by 4.6% to US\$ 4,259 million during the year, due to the rising demand for services imports, particularly in the travel sector. Overall, the surplus of the services account amounted to US\$ 2,879 million, representing an increase of 23.8% compared to the level recorded in 2015.

With the satisfactory performance in travel, transportation and telecommunications, computer and information services sub-sectors, the services account registered a surplus in 2015. Despite the marginal increase in the services account during the first half of 2015 due to the slowdown in sea-and port-related transportation activities, the accelerated growth in the export of services during the second half of the year resulted in the overall surplus of the services account to increase by 53.2% to US\$ 2,879 million in 2015, compared to that of 2014.

In 2014, a surplus of US\$ 1,880 million was recorded in the services account, compared to a surplus of US\$ 1,180 million recorded in 2013. The performance in the services account was mainly driven by the transport, travel and telecommunication, computer and information services sub-sectors. Arrivals from tourism grew at a substantial rate of 17.7% to 1.79 million in 2015 and 19.8% to 1.53 million in 2014, compared to 1.28 million arrivals in 2013. Arrivals from tourism in the three months ended May 31, 2016 was 0.71 million, which was a 18.3% increase from 0.85 million in the three months ended May 31, 2015. Accordingly, in 2014, earnings from tourism increased by 41.7% to US\$ 2,431 million compared to the US\$ 1,715 million in 2013. Further, gross earnings from transportation services, which comprise of passenger fares, freight charges and port and airport-related activities, recorded a growth of 7.8% to US\$ 1,923 million during 2014, compared to US\$ 1,784 million during 2013. Meanwhile, earnings from telecommunication, computer and information services also grew by 4.1% to US\$ 748 million, contributing to the overall surplus of the services account of the BOP in 2014.

In 2013, a surplus of US\$ 1,180 million was recorded in the services account, compared to a surplus of US\$ 1,262 million in 2012. The performance in the services account was mainly driven by improved performance in the transport, travel and computer and information services sub-sectors. Gross earnings from transportation services, which consist of passenger fares, freight charges, and port-and airport-related activities, showed a growth of 9.2% to US\$ 1,784 million in 2013. Tourist arrivals increased by 26.7% to 1,274,593 in 2013, compared to 1,005,605 arrivals in 2012. As a result, earnings from tourism increased by 65.1% to US\$ 1,715 million in 2013, compared to the US\$ 1,039 million in 2012.

Primary Income

The following table sets out the Issuer's primary income compiled in accordance with the IMF's BPM6 framework for the periods indicated.

PRIMARY INCOME

	2012	2013	2014⁽¹⁾	2015⁽¹⁾	2016⁽¹⁾	% Increase or Decrease
	(in US\$ millions, except for percentages)					
Compensation of Employees.....	(20)	(51)	(50)	(63)	(51)	19.0
Credits	14	15	19	19	16	(18.5)
Debits	34	66	68	83	67	(18.9)
Investment income.....	(1,199)	(1,701)	(1,758)	(1,950)	(2,133)	(9.4)
Credits	128	117	137	108	105	3.1
Debits	1,327	1,817	1,895	2,058	2,238	8.7
Direct investment	(431)	(730)	(653)	(771)	(941)	(22.1)
Credits	15	6	17	17	12	(24.7)
Debits	446	737	670	787	953	21.1
Portfolio and other investment⁽²⁾	(858)	(1,061)	(1,208)	(1,245)	(1,239)	0.5
Credits	23	20	18	25	45	80.0
Debits	881	1,081	1,226	1,331	1,284	(3.5)
Portfolio investment	(408)	(645)	(828)	(844)	(831)	1.5
Credits	—	—	—	—	—	—
Debits	408	645	828	844	831	(1.5)
Other investment	(450)	(416)	(379)	(401)	(408)	(1.8)
Credits	23	20	18	25	45	77.3
Debits	473	436	398	426	453	6.2
Reserve Assets	90	91	102	66	47	(28.3)
Credits	90	91	102	66	47	(28.3)
Debits	—	—	—	—	—	—
Total Income.....	(1,219)	(1,751)	(1,808)	(2,013)	(2,184)	(8.5)
Credits	1,142	132	155	127	120	(5.4)
Debits	1,361	1,883	1,963	2,140	2,304	7.7

Source: Central Bank of Sri Lanka

Notes:

(1) Provisional

(2) Figures correspond to "Interest and Other Charges" from 2009-2011

The deficit in the primary income account increased by 8.5% to US\$ 2,184 million during 2016, in comparison to a deficit of US\$ 2,013 million in 2015. Inflows to the primary income account, which amounted to US\$ 127 million in 2015, declined to US\$ 120 million in 2016. The fall in inflows was primarily due to the reduction in earnings from reserve assets in line with the decline in gross official reserves during the year. Meanwhile, the total outflow from the primary income account amounted to US\$ 2,304 million in 2016, in comparison to US\$ 2,140 million in 2015. Dividend payments and reinvestment of earnings by direct investment enterprises, which stood at US\$ 787 million in 2015, increased to US\$ 953 million in 2016. Meanwhile, interest payments on portfolio investments declined during 2016 due to the reduction in the outstanding stock of Treasury bonds held by non-residents. This resulted in a modest decline of interest payments related to portfolio investments from US\$ 764 million in 2015 to US\$ 756 million in 2016. However, interest payments on ISBs continued to rise as a result of new issuances by the Government. Further, primary income outflows in the form of other investments, which consist of interest payments on foreign loans, increased moderately during 2016.

Outflows on account of dividend and reinvested earnings of direct investment enterprises increased to US\$ 787 million in 2015, compared to US\$ 670 million recorded a year earlier. This comprised US\$ 435 million of dividend payments and US\$ 352 million of reinvested earnings, which are regarded as outflows from the primary income account and inflows to the financial account in the form of direct investments. The dividend payments on inward direct investments were much higher, compared to the previous year, whereas reinvested earnings were lower than a year earlier, indicating the intention of direct investors to repatriate profits back instead of reinvesting. Meanwhile, of the total interest payments on portfolio investments of US\$ 844 million in 2015, US\$ 80 million were dividend payments on equity investments, while US\$ 764 million were coupon and interest payments on debt securities. Further, primary income outflows in the form of other investment, which consist of interest payments on foreign loans, amounted to US\$ 426 million in 2015, compared to US\$ 398 million in 2014. Of the total interest payments on foreign loans in 2015, interest payments on foreign loans obtained by the Government, private sector and SOBEs, deposit taking corporations and the Central Bank, amounted to US\$ 266 million, US\$ 81 million, US\$ 67 million and US\$ 13 million, respectively. During recent years, a structural change in coupon and interest payments was observed, with the Government paying a higher amount as coupon payments on ISBs when compared to interest payments on project loans, despite a relatively lower outstanding amount of ISBs.

The deficit in the primary income account in 2014 widened to US\$ 1,839 million, compared to US\$ 1,817 million in 2013. In 2014, inflows to the primary income account increased primarily due to the increase in income earned on investment in reserve assets and dividends received on direct investment while inflows from employee compensation increased only marginally. As a result, inflows to the primary income account increased to US\$ 153 million in 2014 from US\$ 132 million in 2013. On the other hand, outflows of the primary income account also increased in 2014, primarily due to higher interest payments on debt securities. Primary income account, which recorded an outflow of US\$ 1,883 million in 2013, registered an outflow of US\$ 1,992 million in 2014.

Current Transfers

The following table sets out the Issuer's current transfers compiled in accordance with the IMF's BPM6 framework for the periods indicated.

CURRENT TRANSFERS

	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	% Increase or Decrease
Private	5,339	5,619	6,199	6,167	6,434	4.3
Credits	5,985	6,407	7,018	6,980	7,242	3.7
Debits	646	788	819	814	807	0.8
General Government	53	21	28	27	19	(29.1)
Credits	53	21	28	27	19	(29.1)
Debits	—	—	—	—	—	—
Total Current Transfers	5,392	5,639	6,227	6,193	6,453	4.2
Credits	6,038	6,428	7,046	7,007	7,260	3.6
Debits	646	788	819	814	807	(0.8)

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

The secondary income account recorded a modest growth in 2016, recovering from the marginal decline in 2015. Workers' remittances, which account for the majority of inflows to the secondary income account as the key source of private transfers, grew at a modest rate of 3.7% to US\$ 7,242 million, as against the decline of 0.5% observed in 2015. Meanwhile, receipts in the form of Government transfers declined in 2016. Consequently, inflows to the secondary income account grew by 3.6%, amounting to US\$ 7,260 million in 2016, in comparison to US\$ 7,007 million in 2015. The relatively low growth in workers' remittances can be attributed to the fall in the income levels in countries in the Middle Eastern region as a result of persistently low oil prices and geopolitical uncertainties.

The secondary income account remained subdued in 2015, mainly due to the slowdown in workers' remittances, which account for most of the secondary income inflows. Workers' remittances declined by 0.5% to US\$ 6,980 million, reflecting a sharp moderation from the growth of 9.5% observed in 2014. Government transfers also recorded a decline of 4.3% over 2014. As a result, inflows to the secondary income account amounted to US\$ 7,007 million during the year 2015, a decline of 0.5% as compared to a year earlier. The decline in workers' remittances during 2015 was largely attributable to the fall in the income of oil exporting countries in the Middle East and the resultant stagnating growth in these countries, which have traditionally been the main source of income transfers from migrant workers. Further, the 23.2% decline in labor migration under the semi-skilled and unskilled categories, including house-maids, would also have contributed to the deceleration in workers' remittances during the year. This decline in labor migration is a result of several policy measures taken by the Government to discourage departures of house-maids and unskilled workers, and the prevailing geo-political uncertainty in the Middle Eastern region.

In 2014, net current transfers increased to US\$ 6,227 million, an increase of 10.4% from 2013. Workers' remittances, which account for over 99% of total inflows to the current transfers, increased by 9.5% to US\$ 7,018 million in 2014, compared to US\$ 6,407 million in 2013. The growth in workers' remittances is supported by the continued increase in labor migration under the professional and skilled category, which grew by 5.6% in 2014.

In 2013, net current transfers increased to US\$ 5,639 million, representing an increase of 4.6% over 2012. Maintaining the positive growth momentum shown in 2012, workers' remittances in 2013 amounted to US\$ 6,407 million, representing an increase of 7.1% over 2012. Increased labor migration under the professional and skilled category, additional remittance facilities to facilitate the process of remittance through formal channels as well as the introduction of new internet based money transfer systems were the main factors that contributed to this increase in workers' remittances.

Capital and Financial Account

The capital and financial account is divided into five categories: capital transfers account; direct investment; portfolio investment; financial derivatives; and other investment.

Sri Lanka continues to maintain a liberal investment regime with a relatively open capital account compared with other countries in the region. In particular, restrictions on FDI over most areas have been lifted, and persons outside of Sri Lanka are allowed to invest in the following forms of investments:

- Shares in companies incorporated in Sri Lanka (except for pawn brokering, retail trade with capital of less than US\$ 1 million and coastal fishing businesses as provided under Sri Lanka's exchange control laws);
- Units in unit trusts;
- Treasury bills and Treasury bonds;
- Sri Lanka Development Bonds;
- Debentures;
- Special foreign investment deposit accounts;
- Incorporation of businesses in Sri Lanka;
- Immovable property (subject to the restrictions on transfer of land under the Land (Restriction on Alienation) Act No. 38 of 2014 and the conditions and provisions of the Strategic Development Project Act No. 14 of 2008, and the payment of land lease tax on rental payments of leased lands); and
- Lending under the External Commercial Borrowing Scheme or under special permission granted by the Controller of Exchange.

Foreign investments in the areas listed below are limited to 40.0%. Foreign ownership in excess of 40.0% must be approved on a case-by-case basis by the Board of Investment of Sri Lanka.

- Production of goods where Sri Lanka's exports are subject to internationally determined quota restrictions;
- Production and primary processing of tea, rubber, coconut, cocoa, rice, sugar and spices;
- Mining and primary processing of non-renewable national resources;
- Timber based industries using local timber;
- Deep sea fishing;
- Mass communications;
- Education;
- Freight forwarding;

- Travel agencies; and
- Shipping agencies.

Foreign investments in the areas listed below must be approved by the Government or the relevant legal or administrative authorities:

- Air transportation;
- Coastal shipping;
- Industrial undertaking in the Second Schedule of the Industrial Promotion Act No. 46 of 1990, namely (i) any industry manufacturing arms, ammunitions, explosives, military vehicles and equipment aircraft and other military hardware; (ii) any industry manufacturing poisons, narcotics, alcohols, dangerous drugs and toxic, hazardous or carcinogenic materials; and (iii) any industry producing currency, coins or security documents;
- Large scale mechanized mining of gems; and
- Lotteries.

The capital account recorded a marginal surplus of US\$ 26 million in 2016, in comparison to a surplus of US\$ 46 million in 2015. This was the combined result of a decline in capital transfers received by the Government and the decline in capital outflows from the private sector in 2016. Both net incurrence of liabilities and net acquisition of assets of the financial account of the BOP remained subdued in 2016. Accordingly, net incurrence of liabilities amounted to US\$ 2,199 million in 2016, in comparison to US\$ 3,223 million recorded in 2015. Meanwhile, net acquisition of assets amounted to US\$ 82 million, in comparison to US\$ 911 million in 2015. Lower level of inflows to the financial account reflected the continued moderation of capital inflows, particularly in the form of FDIs and foreign investments to the Colombo Stock Exchange. Furthermore, Sri Lanka experienced significant capital outflows in 2016, especially from the rupee denominated Government securities market, in the backdrop of increasing global interest rates and a stronger growth momentum in the United States economy. Continued capital outflows, high debt repayments and moderate inflows to the financial account during 2016 necessitated increased foreign borrowings in the year. Accordingly, the financial account was supported by the issuance of ISBs amounting to US\$ 1.5 billion, a new international currency swap arrangement of US\$ 400 million following the maturity of international currency swaps amounting to US\$ 1.1 billion and foreign currency term financing facilities amounting to US\$ 700 million. Sri Lanka also entered into an EFF with the IMF in order to support the BOP and to support the Government's reform agenda.

Lower inflow of capital transfers in 2015 resulted in the capital account balance remaining subdued in 2015. Net inflows to the capital account dropped to US\$ 46 million in 2015, from US\$ 58 million in 2014. This was mainly due to an increase in outflows of capital transfers from US\$ 15 million in 2014, to US\$ 24 million in 2015. Meanwhile, capital transfers received by the Government and the private sector also declined marginally from US\$ 73 million in 2014, to US\$ 71 million in 2015. Both the net incurrence of liabilities and the net acquisition of financial assets in the financial account of the BOP were considerably lower in 2015 than in 2014. Net incurrence of liabilities in 2015 recorded an increase of US\$ 3,223 million, compared to an increase of US\$ 4,124 million in 2014, while the net acquisition of assets recorded only a moderate increase of US\$ 911 million in 2015, compared to an increase of US\$ 2,588 million in 2014. These relatively low levels of inflows were partly due to the performance of the global economy in 2015, while subdued investor sentiment amid two major national elections also contributed to the foreign direct investment inflows remaining below expectations during the year. The anticipation of an interest rate hike in the US during the first three quarters of the year and the subsequent increase in interest rates in the fourth quarter resulted in foreign investments in Government securities, namely Treasury bills and bonds, as well as foreign investment in the CSE recording a significant outflow. The major source of inflows to the financial account of the BOP during 2015 were the issuance of two ISBs totaling US\$ 2,150 million following the repayment of the matured ISBs of US\$ 500 million at the beginning of the year. The other major inflow to the financial account was the proceeds of the international swap arrangement of US\$ 1,500

million entered into with the RBI, of which US\$ 400 million was repaid during 2015. During the year, the Government also renewed its focus in foreign financing through the issuance of SLDBs. Further, traditional sources of inflows to the financial account, such as foreign loans to the Government, SOBEs and the private sector, performed moderately during 2015.

Net inflows to the capital account decreased from US\$ 71 million in 2013 to US\$ 58 million in 2014, whereas capital grants received by the Government increased to US\$ 52 million in 2014 from US\$ 39 million in 2013. Meanwhile, capital transfers to corporations and households decreased to US\$ 21 million in 2014 from US\$ 51 million in 2013. The major inflow to the financial account was from the proceeds of the sixth and seventh ISB offerings, which amounted to US\$ 1.0 billion and US\$ 500 million, respectively. In addition, the financial account recorded moderate inflows of foreign loans to the Government and the banking sector, and inflows to the private sector were supported by the issuance of international bonds by SriLankan Airlines and NSB. Specifically, total net incurrence of liabilities was recorded at US\$ 4,239 million in 2014, compared to US\$ 4,049 million in 2013. At the same time, net acquisition of financial assets increased to US\$ 2,303 million in 2014 from US\$ 986 million in 2013, primarily due to an increase in reserve asset transactions and a moderate increase in acquisition of financial assets by the banking sector. Total FDI amounted to US\$ 1,685 million in 2014, compared to US\$ 1,437 million in 2013.

The capital account recorded a net inflow of US\$ 71 million in 2013, compared to US\$ 130 million in 2012. The majority of inflows to the capital account were in the form of capital grants received by the Government. Significant inflows to the financial account were observed during 2013. With the adoption of the BPM6 compilation methodology, the financial account also included reserve asset transactions in addition to direct investments, portfolio investments, financial derivatives and other investments. Total direct investments amounted to US\$ 916 million in 2013, compared to US\$ 941 million in 2012. Total direct investments comprised US\$ 887 million received by BOI companies, US\$ 22 million received by non-BOI companies and US\$ 7 million received by CSE-listed companies not registered with the BOI. In addition to direct investments, BOI companies also received foreign loans amounting to US\$ 505 million, resulting in an increase of FDI received by BOI companies (including loans) to US\$ 1,391 million in 2013 from US\$ 1,279 million in 2012. In 2013, one LCB and two LSBs issued international securities totalling US\$ 1.35 billion, compared to issuances totalling US\$ 500 million in 2012, which strengthened the position of Sri Lanka's banking sector in the international securities market. The issuances in 2013 comprised 5-year international bonds with amounts of US\$ 750 million, US\$ 500 million and US\$ 100 million by NSB, BOC and DFCC, respectively. Total foreign loan inflows to the Government, deposit-taking corporations and the private sector amounted to US\$ 2,992 million in 2013, compared to US\$ 4,234 million in 2012. Total loan inflows to the Government amounted to US\$ 1,677 million in 2013, compared to US\$ 1,854 million in 2012. Net loan inflows of deposit taking corporations, which consist of LCBs, LSBs and LFCs, were US\$ 124 million, significantly less than the US\$ 579 million recorded in 2012. Meanwhile, in 2013, net foreign investments in Treasury bills and Treasury bonds reached the full utilization of the investment threshold for foreign investments in Government securities, resulting in a net inflow of US\$ 493 million.

International Reserves

The following table sets out the gross international reserves of the Central Bank for the periods indicated, compiled in a manner consistent with the revised BOP framework and the treatment of IMF accounts in the monetary survey published in the IMF's International Financial Statistics.

GROSS INTERNATIONAL OFFICIAL RESERVES

	As at December 31,				
	2012	2013	2014 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾
	(in US\$ millions, except for percentages)				
Gold.	727	884	893	760	830
SDRs	4	16	9	7	2
Foreign investments	4,290	3,213	3,442	2,559	2,476
Foreign exchange	2,012	3,308	3,794	3,910	2,645
Reserve position in the IMF.....	74	74	69	66	64
Total official reserves.	7,106	7,495	8,208	7,304	6,019
Total as number of months of imports of goods and services.....	3.9	4.2	4.3	3.8	3.1
Total as a % of short-term debt original maturity	111	110	113	95	82

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

The gross official reserves constitute all foreign assets of the Central Bank and foreign assets of the Government that are managed by the Central Bank. The Central Bank occasionally enters into swaps with respect to foreign exchange and foreign securities for purposes of managing yields or market risk.

Sri Lanka's gross official reserves declined to US\$ 6.0 billion as at 2016 year-end from US\$ 7.3 billion as at 2015 year-end. The gross official reserves as at 2016 year-end was equivalent to 3.7 months of imports of goods and 3.1 months of imports of goods and services. The decline in gross official reserves was mainly due to the foreign currency debt service payments, settlement of a portion of the foreign currency swap arrangement, repayments of the IMF SBA and the supply of liquidity to the domestic foreign exchange market through Central Bank intervention. Total foreign assets, which comprise gross official reserves and foreign assets of deposit taking corporations, declined to US\$ 8.4 billion as at 2016 year-end, from US\$ 9.3 billion as at 2015 year-end. The increase in foreign assets of deposit taking corporations during the year partially mitigated a large depletion of total foreign assets. Total foreign assets was equivalent to 5.2 months of imports of goods and 4.3 months of imports of goods and services.

The gross international reserves held by the Central Bank, which comprise foreign currency reserves, gold balances, reserve position in the IMF, SDR holdings and other reserve assets, amounted to US\$ 7.3 billion as at 2015 year-end. The proceeds from the ISB issuances in January and April 2015, disbursements under foreign funded projects and net absorption of excess liquidity in the foreign exchange market helped improve gross official reserves, despite outflows as a result of foreign debt service payments and SBA Facility payments during 2015. Meanwhile, total reserves, which consist of gross official reserves as well as foreign financial assets of deposit taking corporations, increased to US\$ 9.3 billion as at 2015 year-end. This was equivalent to 5.9 months of import of goods.

The gross international reserves held by the Central Bank, which comprise foreign currency reserves, gold balances, reserve position in the IMF, SDR holdings and other reserve assets, amounted to US\$ 8.2 billion as at December 31, 2014. The proceeds from the ISB issuances in January and April 2014, disbursements under foreign funded projects and net absorption of excess liquidity in the foreign exchange market helped improve the gross official reserves, despite outflows as a result of foreign debt service payments and SBA Facility payments during 2014. Meanwhile, total reserves, which consist of gross official reserves as well as foreign financial assets of deposit taking corporations,

increased to US\$ 9.9 billion as at December 31, 2014. At the same time, the gross official position as at December 31, 2014 was equivalent to 5.1 months of import of goods, substantially higher than the generally accepted requirement of 3 months of imports. Additionally, the total reserves were equivalent to 6.1 months of imports.

Investments

Foreign Investments to the Government

Net inflows to the Government amounted to US\$ 1,287 million in 2016, compared to net inflows of US\$ 470 million in 2015. This comprised total long-term loan inflows of US\$ 2,163 million and repayments amounting to US\$ 876 million during the year. Of the total loan inflows, US\$ 1,278 million was in the form of project loans, US\$ 700 million was from two foreign currency term financing facilities and US\$ 185 million was in the form of program financing. Major project loan inflows to the Government in 2016 included the loans obtained for the construction of extension of Southern expressway section 1 and 2, integrated road investment program — tranche 2, Hambantota hub development project and metro Colombo urban development project. The two loans in the form of programme financing consisted of US\$ 85 million from the Government of Japan as a development policy loan and US\$ 100 million from the International Development Association of the World Bank as development policy financing on competitiveness, transparency and financial stability.

Loan inflows to the Government moderated during the year, whereas higher repayments by the private sector, deposit taking corporations and the Central Bank resulted in the lower net loan inflow in 2015. Accordingly, net inflows from foreign loans amounted to US\$ 759 million, compared to US\$ 1,713 million in 2014. Net foreign loan inflows to the Government were lower in 2015, compared to the previous year. In the backdrop of two major national elections, the initiation of most Government projects stalled during the first three quarters of 2015, resulting in a decrease in project loan inflows. Consequently, loan inflows in the form of Government project loans amounted to US\$ 1,268 million in 2015, compared to US\$ 1,439 million in 2014. Further, repayments of Government loans increased marginally to US\$ 798 million in 2015, compared to US\$ 793 million in 2014. Major loan inflows to Government projects during 2015 included the improvement and rehabilitation of priority roads (Phase I and II), Sri Lanka SME and green energy global loan, Matara Beliatta section of Matara Kataragama railway extension project and Phase II of the Greater Colombo urban transport development project.

In 2014, long-term inflows to the Government, in the form of long-term loans and grants, amounted to US\$ 1,491 million, compared to US\$ 1,716 million in 2013. This includes long-term loan inflows of US\$ 1,439 million and grants of US\$ 52 million. A major source of foreign loan inflow to the Government in 2014 was the US\$ 292 million loan to fund the Priority Roads Project. In addition, foreign loan inflows were recorded to fund the reconstruction of the railway lines connecting Omanthai-Pallai and Madhu-Tallaimannar and Medawachchiya, the Matara-Beliatta section of Matara-Kataragama Railway Extension Project, the Greater Colombo Urban Transport Development Project, the Russian Line of Credit, the Restoration of Northern Railway Services, the Education Sector Development Program and the Greater Kurunegala Water Supply and Sewerage Project.

Total loan inflows to the Government amounted to US\$ 1,677 million in 2013, compared to US\$ 1,854 million in 2012. On a net basis, loan inflows to the Government decreased by 17.2%, recording a net inflow of US\$ 821 million in 2013 compared to US\$ 992 million in 2012. Of the total loan inflows to the Government, US\$ 1,451 million were obtained under concessional terms and conditions, while US\$ 226 million were obtained as non-concessional loans, commercial loans and export credits.

Foreign Direct Investments

Total FDI inflows, inclusive of foreign loans to BOI companies, amounted to US\$ 1,079 million in 2016, while direct investments that exclude foreign borrowings of BOI companies amounted to US\$ 898 million. In comparison, total FDI inflows with foreign loans amounted to US\$ 1,160 million in 2015 while the same excluding foreign loans amounted to US\$ 680 million. While FDI inflows in the Sri Lankan economy have generally been low, FDI inflows during 2016 were specifically affected by the evolving global economic outlook in the backdrop of the interest rate hike by the US Federal Reserve. In addition, the significant increase in wage rates and other costs of production compared to

peer countries in the region were expected to be disadvantageous in attracting foreign investments. Of the total FDI inflows in 2016, US\$ 260 million was in the form of equity, US\$ 450 million was reinvested earnings, US\$ 276 million was shareholder advances and intra company loans, while repayment of shareholder advances and intra company debt amounted to US\$ 87 million in 2016. During the year, BOI companies received US\$ 181 million of foreign loans from non-related lenders.

Total FDI, including foreign loans to BOI companies, recorded an inflow of US\$ 1,685 million in 2014, compared to US\$ 1,437 million in 2013. Total inflows, excluding those to BOI companies, amounted to US\$ 944 million, compared to US\$ 933 million in 2013. Accordingly, BOI companies received direct investment of US\$ 782 million, whereas CSE-listed companies (not registered with the BOI) received US\$ 62 million and non-BOI companies received US\$ 100 million. FDI to BOI companies comprised equity and shareholder advances of US\$ 218 million, intra-company borrowings of US\$ 224 million and reinvestment of retained earnings of US\$ 346 million. A shift towards favoring long-term foreign financing by domestic companies was observed in 2014, primarily due to the relative lower cost at which external borrowing was available to Sri Lankan companies. This shift was evidenced by the direct investment enterprises obtaining an FDI of US\$ 741 million during 2014. The share of FDI inflows to the infrastructure sector and the services sectors were 42.2% and 36.8%, respectively, while the manufacturing sector received 20.7% of the total FDI. A number of key projects continued to attract high foreign investment during 2014. These include SriLankan Airlines (foreign loan of US\$ 150 million and proceeds of US\$ 175 million from its international bond issuance), CEC Port City Colombo (Pvt) Ltd (US\$ 200.4 million), Colombo International Container Terminals (US\$ 113.0 million), Union Bank PLC (US\$ 87.8 million), Waterfront Properties (US\$ 75.0 million) and Hambantota Port Project Phase II (US\$ 64.5 million). Key FDI sources in 2014 were China, the United Kingdom, the United States, Singapore and the Netherlands.

Total direct investments in 2013 were US\$ 916 million, compared to US\$ 941 million in 2012. Total direct investments comprised of US\$ 887 million received by BOI companies, US\$ 24 million received by non-BOI companies and US\$ 7 million received by CSE-listed companies not registered with the BOI. In addition to direct investments, BOI companies also received foreign loans amounting to US\$ 505 million, which increased FDI received by BOI companies (including loans) to US\$ 1,391 million in 2013, compared to US\$ 1,279 million in 2012. For investments in BOI companies by sector in 2013, the infrastructure, manufacturing, services and agricultural sectors received US\$ 787 million, US\$ 360 million, US\$ 236 million and US\$ 8.5 million, respectively. Major sources of FDI inflows were from China (US\$ 240 million), Malaysia (US\$ 176 million), Hong Kong (US\$ 139 million), the Netherlands (US\$ 118 million) and Singapore (US\$ 112 million).

FDI, including loans received by BOI-approved companies, recorded the highest annual inflow in 2012, amounting to US\$ 1,382 million, compared to US\$ 1,066 million in 2011. The FDI inflows consisted of equity capital of US\$ 111 million, loans and advances by shareholders of US\$ 364 million, intra-company borrowings of US\$ 217 million, reinvestment of retained earnings of US\$ 249 million and foreign loans of US\$ 441 million. Considering the sector-wise composition of FDI inflows in 2012, the infrastructure sector received the highest share of FDI (44.6%) with major investments in ports and container terminals, telephone and telecommunication networks, power generation and housing and property development, while the services sector attracted 31.9% of FDI in 2012 including 8.8% from the tourism sector. Meanwhile, the manufacturing sector attracted 23% of FDI in 2012.

Portfolio Investments

Subdued investor sentiments on the capital markets of emerging economies continued to affect equity investments and resulted in a moderate net inflow of US\$ 24 million in 2016. The net inflow of foreign investment to the CSE in 2016 consisted of a net inflow of US\$ 10 million to the secondary market and an inflow of US\$ 14 million to the primary market. Further, Sri Lanka successfully issued a dual tranche ISB of US\$ 1.5 billion, with US\$ 1 billion maturing in 10 years and US\$ 500 million maturing in five and a half years. Foreign investments in Treasury bonds and Sri Lanka Development Bonds (“SLDBs”) continued to record an outflow in 2016. Consequently, net outflows from Treasury bonds and SLDBs amounted to US\$ 361 million and US\$ 207 million, respectively, in 2016. Meanwhile, foreign investments in Treasury bills amounted to a moderate net inflow of US\$ 36 million in 2016. Hence, on a cumulative basis, Government securities other than ISBs recorded a net outflow of US\$ 531 million in 2016 in comparison to a net outflow of US\$ 903 million in 2015.

The subdued global investor sentiment on emerging markets reflected on the passive foreign investment in equity under portfolio investments in 2015. Net incurrence of liabilities as equity under portfolio investments recorded an outflow of US\$ 60 million in 2015, compared to a net inflow of US\$ 178 million in 2014. Equity investments by non-residents in the CSE listed companies comprise foreign investments, other than direct investments in the CSE companies, which are typically more volatile compared to direct investments, recorded a net outflow of US\$ 96 million from the secondary market and a net inflow to the primary market amounting to US\$ 36 million, resulting in an overall net outflow of US\$ 60 million as equity under portfolio investments. This was in sharp contrast to 2014, where foreign inflows amounted to US\$ 174 million in secondary market transactions and US\$ 4 million in primary market transactions of the CSE, totalling an inflow of US\$ 178 million in 2014. As at June 6, 2016, net foreign outflows from the CSE amounted to US\$ 39 million.

Portfolio investments in the form of equity and investment fund in the CSE declined in 2014, reflecting the overall drop in investor enthusiasm in the emerging markets as the Federal Reserve System of the United States ended its quantitative easing stimulus program. Accordingly, net foreign inflows to the CSE were recorded at US\$ 162.6 million in 2014, including US\$ 180 million in the secondary market transactions and US\$ 4.4 million in the primary market transactions, compared to a net inflow of US\$ 226 million in 2013. Foreign investments in the Government securities market recorded a net outflow in 2014 amounting to US\$ 113.1 million with investments in Treasury bonds recording a net inflow of US\$ 59.6 million and investments in Treasury bills recording a net outflow of US\$ 172.7 million.

In 2013, total foreign investment in the CSE amounted to US\$ 270 million, comprising of US\$ 263 million equity and investment fund shares and US\$ 7 million direct investments. Net inflows from equity, as well as the six individual foreign investments (where were for less than 10% of voting shares of Sri Lankan companies), were regarded as 'equity and investment fund shares' and were reported under the portfolio investments category. Investment fund shares to the CSE comprised secondary market transactions of US\$ 172 million and inflows to the primary market of US\$ 91 million. Inflows to the primary market primarily consisted of inflows from rights issues of US\$ 83 million.

Monetary System

Central Bank

The Central Bank of Sri Lanka (known as the Central Bank of Ceylon prior to 1985) was established by the Monetary Law Act No. 58 of 1949 (as amended) (the "MLA") with capital appropriated from the Board of Commissioners of Currency and commenced operations on August 28, 1950. The Central Bank is responsible for safeguarding both the value of the Rupee and the country's banking, financial and payments system.

With the amendments that were introduced to the MLA in December 2002, the Central Bank is responsible for securing the objectives of (a) economic and price stability and (b) financial system stability, with a view to encourage and promote the development of the productive resources of Sri Lanka.

Under the MLA, the Central Bank is governed by the Monetary Board. The Monetary Board is responsible for making all policy decisions and for the management, operation and administration of the Central Bank. The Monetary Board consists of five members, including the Governor, the Secretary to the Ministry of Finance and three other members (the "Appointed Members").

The Governor is the Chairman of the Monetary Board and also functions as the Chief Executive Officer of the Central Bank. The Governor and the Appointed Members are appointed by the President for a six-year term, on the recommendation of the Minister of Finance. The quorum for Monetary Board meetings is three members. The concurrence of three members is required for decisions of the Monetary Board to be valid. However, in cases where a unanimous decision is required, the concurrence of all five members is necessary.

Beginning in 2015, the Central Bank functions under the Ministry of National Policies and Economic Affairs.

Monetary Policy

The Central Bank conducts monetary policy to attain price stability in the domestic economy by influencing the cost and availability of money through the interest rate and credit channels as well as other channels of monetary policy transmission.

The Central Bank sets the policy interest rates for its own dealings with commercial banks to affect the range of interest rates set by commercial banks and other financial institutions for borrowers and savers, and in turn influences spending, investment and output decisions in the economy, and eventually the cost of production and the prices of goods and services.

The Central Bank's monetary policy is primarily conducted through market based policy instruments and open market operations. Under the MLA, the following policy instruments are also available for the Central Bank:

- foreign exchange operations;
- quantitative restrictions on credit;
- ceilings on interest rates; and
- refinance facilities.

The main monetary policy tools used by the Central Bank are the policy interest rates, i.e., the Standing Deposit Facility Rate ("SDFR") and the Standing Lending Facility Rate ("SLFR"). The Central Bank sets these policy rates at a level to ensure that the aggregate demand is in line with the productive capacity of the economy. A change in the Central Bank's standing rates would have an immediate impact on interest rates in the inter-bank call money market (the money market among commercial banks). Within a very short period of time, changes in call rates may lead to changes in other flexible short-term rates, such as the yield on Treasury bills and the lending rates of commercial banks to their prime customers. These changes affect the general lending rates of commercial banks, the yields on medium term Government securities, such as Treasury bonds, and deposit rates offered by banks. The changes in the interest rates may lead to corresponding changes of the demand for credit from firms for investment and consumers for consumption expenditures, thereby affecting the prices and the output of products in various industries.

When inflation is higher or lower than the projected level, the Central Bank may raise or lower its SDFR and SLFR to facilitate and maintain a healthy rate of economic growth. Given that the effects of monetary policies on the economy normally lag, the Central Bank is required to take appropriate advance policy measures in order to effectively control inflation at the targeted level.

Other key monetary policy tools used by the Central Bank to control inflation are open market operations, which involve the sale or purchase of acceptable securities, namely, Government securities and Central Bank securities, either on a repurchase/reverse repurchase basis or outright basis; the SRR in accordance with which, commercial banks are required to maintain a stipulated percentage of their rupee deposits with the Central Bank; and moral suasion. Considering the Central Bank's zero credit risk in rupee transactions, the SDF of the Central Bank was uncollateralized from February 2014, while other transactions under Open Market Operations (OMO) continued to remain collateral based.

Monetary Policy in 2011, 2012, 2013, 2014, 2015, and 2016

The gradual tightening of monetary policy initiated towards the end of 2015 continued into 2016 as well. In spite of the policy measures taken by the Central Bank in December 2015 and some upward adjustments observed in market interest rates, certain risks to macroeconomic stability persisted due to excessive growth of broad money fuelled by domestic credit expansion amid the continued upward trend in underlying inflation. Accordingly, while continuing with precautionary measures such as application of Loan-to-Value ("LTV") ratios as pre-emptive policy measures to contain further build-up of demand driven inflationary pressures in the economy, the Central Bank increased the SDFR and SLFR by 50 basis points each, to 6.50% and 8.00%, respectively, in February 2016. AWCMR and other short term interest rates responded to the increase in policy interest rates, while

excess liquidity in the domestic money market continued to decline further, requiring the Central Bank to actively engage in liquidity management measures. OMOs conducted by the Central Bank helped manage volatility in short term money market rates to a large extent. To preempt the escalation of inflationary pressures and to support the BOP, the Central Bank further tightened the monetary policy stance in July 2016, by increasing the SDFR and the SLFR by 50 basis points each to 7.00% and 8.50%, respectively. Although the growth of credit disbursements to the private sector by commercial banks decelerated to some extent, expansion in money and credit aggregates remained higher than projected while there was a continued supply- and tax-driven rise in inflation, particularly in early 2017. These developments prompted the Central Bank to tighten monetary policy further in March 2017 as a precautionary measure to contain the build-up of adverse inflation expectations and second round effects within its increasingly forward looking approach to the conduct of monetary policy.

In view of the continued low inflation environment as well as subdued inflation expectations, the Central Bank continued to pursue a relatively relaxed monetary policy stance during 2015, although it initiated a gradual tightening of monetary policy towards the end of 2015. Having observed consistent growth in the credit extended to the private sector by commercial banks in the second half of 2014, the special SDF rate of 5% was removed on March 2, 2015. Furthermore, effective April 15, 2015, SDFR and SLFR were reduced by 50 basis points to 6.00% and 7.50%, respectively. With the decline in market liquidity levels during 2015, there has been a gradual upward adjustment in overnight interest rates, and hence the Central Bank occasionally conducted reverse repurchase auctions to maintain interest rate stability.

Given the rapid growth of exposure of banks and financial institutions to certain categories of lending, in particular lending in respect of motor vehicles, several policy measures were introduced towards the end of 2015 to contain credit flows to selected sectors. Accordingly, a minimum cash margin requirement of 100% was imposed on LCs opened for the importation of motor vehicles, which was replaced later by a maximum Loan to Value (“LTV”) ratio of 70% on loans and advances granted for the purpose of purchase or utilization of motor vehicles as a macro-prudential measure. Furthermore, although an immediate threat to price stability is not expected, the Central Bank commenced tightening its monetary policy stance gradually from the end of 2015 in order to forestall excessive demand pressures on inflation arising from high credit and monetary expansion and the relatively high excess rupee liquidity in the domestic money market. Accordingly, the Central Bank raised the SRR by 1.50% in December 2015, to be effective from January 16, 2016.

The Central Bank continued to maintain its eased monetary policy stance throughout 2014. At the beginning of 2014, the Central Bank renamed its Repo Rate and Reverse Repo Rate as the SDFR and the SLFR, respectively. Further, the SDF was uncollateralized starting from February 1, 2014. The Central Bank also lowered the SLFR by 50 basis points to 8% on January 2, 2014, intending to further reduce the volatility of short-term interest rates and facilitate a reduction in the spread between market lending and deposit rates. Such an outcome would, in turn, enhance the efficiency of financial intermediation, thereby enabling the private sector to increase investment to support the expansion in economic activities. However, during the early part of 2014, the Central Bank observed that the growth of credit extended to the private sector by commercial banks remained modest in spite of the continued easing of monetary policy, resulting in the accumulation of a large amount of excess liquidity in the domestic monetary market. As a result, the Central Bank rationalized the access to its SDF in September 2014, aiming to utilize the excess liquidity in the market more effectively to support productive economic activities.

The Central Bank eased its monetary policy stance in 2013 to regain high growth momentum in the context of well-contained demand-driven inflationary pressures and subdued inflation expectations. The Central Bank reduced its key policy interest rates by 50 basis points in May 2013. While market interest rates adjusted downward in line with such policy, deposit rates and general lending rates remained downward rigid in the first few months of the year. To address this rigidity, the Central Bank lowered the SRR by 200 basis points from 8% to 6%, effective July 2013. The Central Bank continued its relaxed monetary policy by further reducing the main policy interest rates by another 50 basis points in October 2013. As a result, the repurchase rate and the reverse repurchase rate were at 6.5% and 8.5%, respectively, at the end of 2013.

The Central Bank followed a tight monetary policy stance in 2012 with the aim of containing monetary expansion, thereby reducing demand driven inflationary pressures. As the high growth of money and credit in 2011 continued unabated into 2012, the Central Bank raised its key policy interest rates by 50 basis points in February 2012. Policy interest rates were increased further by 25 basis points in April 2012. The Central Bank also issued a Direction under Section 101(1) of the MLA in March 2012, informing all banks to restrict their rupee lending portfolio to 18% or 23% with respect to banks that finance the difference through funds mobilized abroad. As a result of these policies, the growth of broad money and credit obtained by the private sector decelerated significantly towards the end of 2012. This decrease, together with favorable inflation environment, enabled the Central Bank to relax monetary policy in December 2012 by reducing the main policy interest rates by 25 basis points. The Central Bank was also able to remove the ceiling on credit expansion in December 2012.

The accommodative policy stance pursued by the Central Bank during the early part of 2011 was gradually reversed in the last six months of 2011. Continuing with the policy easing carried out in the previous year, the Central Bank, enabled by the prevalent healthy outlook for future inflation, reduced its policy rates further in January 2011 with the intent of augmenting private sector investment in the economy. Accordingly, the repurchase rate was reduced by 25 basis points to 7.00% while the reverse repurchase rate was cut by 50 basis points to 8.50%. The continued high level of excess liquidity that prevailed in the market, however, remained a concern given its potential to fuel credit at lower costs leading to eventual inflationary pressures. Therefore, the Central Bank in April 2011 increased the SRR by one percentage point signaling the change in the Bank's policy stance towards a more restrictive approach. The Central Bank also engaged in discussions with the commercial banks to impress upon them the need to curb their lending portfolio to a more desirable size to minimize the expansionary impact on the money supply as well as to mitigate any threats to financial system stability arising from excessive credit growth.

Given the importance of maintaining transparency of the policy decisions taken by the Central Bank and with a view to enhancing its communication with the general public in order to manage inflation expectations, the Central Bank has continued to communicate its policy decisions to markets, explaining the reasons for the policy decisions made. Accordingly, policies and decisions of the Central Bank were communicated to market participants and the general public on a regular basis and in a timely manner through regular and occasional communiqués, press conferences, seminars and lectures as well as speeches by the Governor and the senior officials of the Central Bank. In addition, the Central Bank formally adopted the SDDS of the IMF for disseminating economic, monetary and financial data to the public, while continuing to publish useful economic information on a daily, weekly and monthly basis in the form of economic indicators, bulletins as well as a macroeconomic chart pack on the Central Bank website. The Central Bank is in the process of further improving the quality of data and information used for monetary policy analyses. Accordingly, with the assistance of the IMF, the Central Bank commenced reporting monetary and financial data based on standardized report forms ("SRF") of the IMF. From 2018, the Central Bank is expected to release an improved set of monetary statistics along with relevant explanatory notes and analyses. Further, in January 2017, the Central Bank recommenced the announcement of the Annual Road Map for Monetary and Financial Sector Policies to guide stakeholders of the economy with a medium term focus.

Money Supply

The following table presents certain information regarding Sri Lanka's money supply as at the dates indicated:

MONEY SUPPLY

	As at December 31,					% Increase or Decrease
	2012	2013	2014	2015 ⁽¹⁾	2016 ⁽¹⁾	
	(in Rs. millions, except for percentages)					
Reserve Money.....	484,362	488,586	577,912	673,432	856,147	27.1
(year-on-year change in %)	10.2	0.9	18.3	16.5	27.1	—
Net Foreign Assets of the Central Bank.....	396,468	529,128	688,007	576,187	558,589	(3.1)
Net Domestic Assets of the Central Bank	87,894	(40,543)	(110,095)	97,245	297,557	206.0
Narrow Money (M ₁).....	450,049	484,578	612,155	714,988	776,624	8.6
(year-on-year change in %)	2.6	7.7	26.3	16.8	8.6	—
Broad Money (M _{2b}).....	2,929,070	3,417,853	3,875,853	4,565,917	5,405,596	18.4
(year-on-year change in %)	17.6	16.7	13.4	17.8	18.4	—
Net Foreign Assets	(25,831)	(76,325)	15,126	(298,163)	(231,238)	22.4
Central Bank	396,468	529,128	688,007	576,187	558,589	(3.1)
Commercial Banks	(422,299)	(605,453)	(672,881)	(874,350)	(789,827)	9.7
Net Domestic Assets	2,954,901	3,494,178	3,860,727	4,864,081	5,636,834	15.9
Domestic Credit	3,696,131	4,200,783	4,640,146	5,732,034	6,671,677	16.4
Net Credit to the Government	1,045,232	1,301,342	1,435,900	1,759,492	1,972,133	12.1
Central Bank	278,843	114,007	149,672	229,926	413,016	79.6
Commercial Banks	766,389	1,187,335	1,286,228	1,529,566	1,559,116	1.9
Credit to Public Corps	292,477	365,098	446,047	522,966	495,114	(5.3)
(year-on-year change in %)	47.3	24.8	22.2	17.2	(5.3)	—
Credit to Private Sector.....	2,358,421	2,534,343	2,758,199	3,449,577	4,204,430	21.9
(year-on-year change in %)	17.6	7.5	8.8	25.1	21.9	—
Other items (net)	(741,230)	(706,605)	(779,418)	(867,954)	(1,034,843)	(19.2)
Memorandum Items						
Money Multiplier	6.05	7	6.71	6.78	6.31	—
Velocity (M _{2b} average)	3.17	2.99	2.85	2.62	2.40	—

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

The conduct of monetary policy in 2016 was aimed at addressing the existing and emerging imbalances in the Sri Lankan economy. The Central Bank tightened its monetary policy stance during 2016 to restrain excessive growth of monetary and credit aggregates to contain the possible build-up of demand driven inflationary pressures in the economy. Accordingly, the Central Bank raised the Statutory Reserve Ratio ("SRR") applicable on all rupee deposit liabilities of licensed commercial banks ("LCBs") by 1.50 percentage points to 7.50% effective January 2016. Furthermore, in view of rising inflationary pressures, the Central Bank increased its key policy interest rates by 50 basis points each in February 2016. Despite policy measures taken preemptively, headline inflation indicated an upward movement, particularly in mid-2016 mainly due to supply side disturbances and changes to the government tax structure, while core inflation also increased. Credit to the private sector continued to grow unabated amid the rising trend in inflation. The Central Bank further tightened its monetary policy stance by increasing the SDFR and the SLFR by another 50 basis points each in July 2016 to 7.00% and 8.50%, respectively. Reflecting the impact of monetary tightening amid fiscal tightening measures and the base effect of the high growth in the previous year, the expansion of private sector credit decelerated to 21.9% by 2016 year-end from its peak of 28.5% in July 2016. With the view of bringing down monetary expansion to targeted levels while curtailing the build-up of adverse inflation expectations, the Central Bank raised the policy interest rates again by 25 basis points each with effect from March 24, 2017.

The monetary policy stance remained relatively accommodative throughout 2015 with a view to support economic activity in an environment of continued low inflation and favorable inflation expectations, despite the gradual tightening measures in the latter part of the year. Considering the sustained increase in credit flows to the private sector that was encouraged by the low interest rate environment maintained during the past few years, with effect from March 2, 2015, the Central Bank removed the temporary restrictions that were placed in September 2014 on the access to its SDF by market participants under the OMO. Following this move, the overnight interest rates in the money market increased and displayed some volatility before settling closer to the lower bound of the policy rate corridor. Considering the space created by the sharp decline in inflation as well as the favorable outlook for inflation, the Central Bank reduced its main policy interest rates, namely, the SDFR and the SLFR, by 50 basis points to 6.00% and 7.50%, respectively, in April 2015. However, given the higher than expected domestic credit growth, the Central Bank started to tight the monetary policy by increasing the SRR applicable on all rupee deposit liabilities of licensed commercial banks by 1.50% in December 2015, to be effective from January 16, 2016. This measure was expected to permanently absorb a part of excess liquidity from the market.

Monetary aggregates continued to grow at a high rate in 2016 mainly as a result of the expansion in credit to both the Government and the private sector. The year-on-year growth of broad money, which peaked at 19.8% in February 2016, decelerated to 18.4% by 2016 year-end, compared to 17.8% at 2015 year-end. On average, broad money growth was 18.1% in 2016 in comparison to 15.2% in 2015. The expansion in broad money supply during 2016 was largely driven by the expansion in NDA of the banking system, while NFA of the banking system also increased during the year. Driven by the expansion in credit flows to domestic sectors, NDA of the banking system expanded further in 2016, albeit at a slower pace in comparison to 2015. In absolute terms, NDA recorded an increase of Rs. 772.7 billion in 2016 but remained below the increase of Rs. 1,003.4 billion observed in 2015. Contributing to the increase in NDA, NCG from the banking system increased substantially in 2016. During 2016, NCG increased by Rs. 212.6 billion, compared to the increase of Rs. 323.6 billion recorded in 2015. However, reflecting the improvements in a number of SOBEs, credit extended by the banking system to public corporations declined by Rs. 27.9 billion during 2016, compared to the increase of Rs. 76.9 billion during 2015.

In 2015, responding to relaxed monetary policy conditions in the economy, monetary aggregates increased at a high rate led by the significant expansion in domestic credit. Accordingly, broad money recorded a year-on-year growth of 17.8% by the end of 2015, compared to a 13.4% growth recorded in 2014. The growth of domestic credit, which includes credit flows from the banking sector to the private sector, the Government and public corporations, contributed significantly to the monetary expansion during 2015. As a result, NDA of the banking system increased significantly by Rs.1,003.3 billion while NFA of the banking system recorded a contraction of Rs.313.3 billion by the end of 2015. Within the NDA category credit to the private sector recorded a significant expansion, increasing by 25.1%, year-on-year, by the end of 2015, compared to a 8.8% growth recorded in 2014.

The monetary policy stance has remained relatively eased in 2014, supported by stable inflation levels as a result of well-contained demand pressures as well as improved supply conditions. Several adjustments were introduced to streamline the policy interest rate corridor at the beginning of the year. Specifically, the Central Bank established a Standing Rate Corridor (“SRC”) in place of the policy rate corridor while introducing the SDFR and the SLFR that replaced, respectively, the repurchase rate and the reverse repurchase rate of the Central Bank. Further, in consideration of the Central Bank’s zero credit risk in rupee transactions, the SDF became uncollateralized beginning in February 2014, while all other OMO transactions continued to remain collateral-based. In line with the Central Bank’s strategy to curtail the volatility of interest rates in the short-term money market, in January 2014, the SRC was reduced to 150 basis points from 200 basis points by reducing the SLFR by 50 basis points.

Since then, the SDFR and the SLFR have remained at 6.50% and 8.00%, respectively. In addition to these measures, in light of the improvements in the external sector, commencing on January 2, 2014, the Central Bank decided to remove the minimum cash margin requirement of 100% against LCs opened with commercial banks for the import of certain categories of motor vehicles that was imposed on August 30, 2013. Additionally, to encourage banks to lend more actively to the private sector, access to the SDF was rationalized as a temporary measure, commencing on September 23, 2014. As a result, OMO participants, including commercial banks, would earn a lower special SDF rate of 5% if they access the SDF of the Central Bank more than three times per calendar month. However, having observed consistent growth in the credit extended to the private sector by commercial banks in the second half of 2014, the special SDF rate of 5% was removed on March 2, 2015. Furthermore, effective April 15, 2015, SDFR and SLFR were reduced by 50 basis points to 6.00% and 7.50%, respectively.

Monetary expansion during 2014 was consistent with the continued growth momentum of the economy and the moderation of the inflation. The year-on-year growth of broad money decelerated to 13.4% in December 2014 while the average growth of broad money was 13.3% during 2014. The deceleration in the expansion of monetary aggregates was largely due to the contraction in NDA of the banking system during the first eight months of 2014, led by the decline in credit extended to public corporations and credit to the private sector by commercial banks. However, the substantial increase in NFA of the banking system by Rs.226 billion during the first nine months of 2014 outpaced the decline in NDA of the banking system. Nevertheless, NFA recorded a decline of Rs.134.4 billion in the last quarter of 2014, primarily due to the Central Bank's sale of foreign exchange to the domestic foreign exchange market. In absolute terms, NDA of the banking sector increased by Rs.366.5 billion in 2014, of which Rs.300.6 billion was recorded during the last quarter of 2014. The significant growth in NDA was observed along with increased credits to the private and public sectors.

Due to the lag effect of tight monetary policy measures during 2012, monetary expansion slowed in 2013, with average growth of broad money decelerating to 16.5%, compared to an average annual growth of 20.2% in 2012. The reduction in the NFA of the banking sector, slower growth in private sector credit and the relatively low levels of credit obtained by public corporations contributed to the deceleration in the growth of broad money. However, a significant increase in net credit granted to the Government during this period contributed to the expansion of money supply.

Responding to the policy measures taken in early 2012, the year-on-year growth of broad money decelerated to 17.6% in by the end of 2012, compared to 22.9% in April 2012. Contributing to this growth was the increase in credit to the private sector. However, the decline in NFA of the banking system subdued the high monetary expansion. Credit to the private sector slowed towards the end of the year and recorded a year-on-year growth of 17.6% by the end of December 2012, compared to 35.2% in March 2012 and 34.5% at the end of 2011. Monetary expansion and growth of credit to the private sector decelerated significantly towards end 2012 owing to the policy action taken earlier in 2012.

Broad money expanded at a higher rate than targeted in 2011. High monetary expansion was largely due to the increase in credit to the private and public sectors above the projected levels. The main reasons for the high demand for credit by the private sector include increased economic activity reflecting the conducive environment for investments, increased domestic demand, higher demand for imports, continued low interest rates and improved access to credit. Meanwhile, public sector borrowings from the banking system also increased, with the decline in non-banking sector funding for government deficit financing. The decline in NFA of the banking system partly mitigated the expansionary impact of credit growth on money supply.

The following table presents information regarding domestic interest and deposit rates for the periods indicated:

DOMESTIC INTEREST AND DEPOSIT RATES

	2012	2013	2014 ⁽¹⁾	2015	2016
	(percentage)				
Repurchase Rate	7.50	6.50	6.50	6.00	7.00
Reverse Repurchase Rate	9.50	8.50	8.00	7.50	8.50
Bank Rate	15.00	15.00	15.00	15.00	15.00
Average Weighted Prime Lending Rate (AWPR)(weekly rate)	14.40	10.13	6.26	7.53	11.52
Average Weighted Deposit Rate (AWDR)	10.10	9.37	6.20	6.20	8.17
Weighted Average Call Money Rate.....	9.83	7.66	6.21	6.40	8.42
Treasury Bill Rate					
91-day.....	10.00	7.54	5.74	6.45	8.72
364-day	11.69	8.29	6.01	7.30	10.17
Treasury Bond Rate					
2-year	13.62	—	—	6.70	11.04
3-year	13.50	10.87	—	8.18	11.62
4-year	14.10	—	—	8.91	11.94
5-year	14.15	10.64	8.93	9.79	11.76
6-year	14.25	10.97	—	9.90	12.03
7-year	12.50	—	7.05	9.65	12.18
8-year	14.40	11.55	7.15	10.82	11.98
9-year	—	11.77	—	—	12.08
10-year.....	14.75	11.80	7.88	10.94	12.11
12-year.....	—	12.09	—	—	13.72
15-year.....	—	11.90	8.63	11.00	11.53
20-year.....	11.00	12.13	11.32	10.86	12.09
30-year.....	—	12.50	11.75	11.73	—
Rates on Foreign Currency Deposits					
Savings Deposits — US Dollar.....	0.015-2.737	0.015-2.665	0.01-3.25	0.02-3.00	0.02-3.62
Time Deposits — US Dollar.....	0.15-3.82	0.25-5.00	0.06-4.25	0.14-4.25	0.15-5.00
National Savings Bank Rates Savings Deposits.....	5.00	5.00	5.00	5.00	4.25
Fixed Deposits (1 year)	12.50	9.50	6.50	7.25	11.00

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

Monetary Regulation

The MLA established the monetary system of Sri Lanka and conferred upon the Monetary Board of the Central Bank certain powers and functions necessary for the administration and regulation of the monetary system. The MLA established the Rupee as the unit of monetary value and empowered the Central Bank to issue currency, to set the national monetary policy through regulation of operations in gold and foreign exchange, open market operations and credit operations. The MLA also appointed the Central Bank as fiscal agent, banker and official depository of the Government.

The Banking Act No. 30 of 1988, as amended, (the “Banking Act”) introduced a framework for the licensing of commercial banks and specialized banks and the regulation and control of matters relating to banking business. It empowered the Monetary Board of the Central Bank to regulate, through determinations, directions or regulations issued to banks, matters such as share capital to be maintained by banks, reserve funds, liquid assets, carrying on off-shore banking business, payment of dividends, minimum capital ratios, single borrower limits, share capital ownership, provision for bad

and doubtful debts and the forms of various accounts and reports. It also conferred upon the Monetary Board and the Director of Bank Supervision their respective powers to call for information, to examine the books and records of banks, to take control of the management of any bank in specified circumstances and to liquidate any bank which is unable to meet the demands of its depositors or other contracting parties or to carry on banking business in Sri Lanka pursuant to the Banking Act.

Following the liberalization policies introduced in 1977 and the subsequent reforms in the financial businesses, the Central Bank gradually moved away from direct controls to a more market-oriented monetary policy. An independently floating exchange rate regime was implemented in January 2001. The Central Bank phased out the use of policy instruments such as quantitative ceilings and refinance facilities while, beginning on March 3, 2003, it increased its reliance on open market operations. To strengthen the institutional arrangement for the determination of the monetary policy decision-making process, the Central Bank established the Monetary Policy Committee in 2001. In order to engage in continuous dialogue with various stakeholders in the economy with a view of strengthening its policy decisions and aligning market expectations with its policies, the Central Bank established the Monetary Policy Consultative Committee in the beginning of 2007, comprising stakeholders and economists representing the private sector, to assist in the monetary policy decision making process. Meanwhile, certain measures were taken to upgrade the monetary policy framework to become more in line with international best practice. Going forward, the monetary policy conduct of the Central Bank is expected to be increasingly aligned with a flexible inflation targeting framework focusing on both inflation and growth outcomes while maintaining the flexibility in the exchange rate. To facilitate this goal, the Central Bank expects to continue to strengthen its technical capabilities, particularly in modelling and forecasting. The Central Bank has also taken steps to enhance the transparency, predictability and credibility of monetary policy. The Central Bank's monetary policy framework, and monetary projections, along with the explanatory notes are regularly posted on the Central Bank's website (www.cbsl.gov.lk). Information available on the Central Bank's website is not, directly or indirectly, included or incorporated by reference in this Offering Circular.

Foreign Exchange System

The Government adopted a floating exchange rate system in January 2001, a major step in the liberalization of foreign exchange transactions. The Central Bank intervention in the foreign exchange market is mainly to prevent excessive volatility in exchange rates and to maintain an appropriate level of external reserves. The Central Bank's buying and selling of foreign exchange is conducted at or near market rates.

The Exchange Control Act, No. 24 of 1953, as amended, (the "Exchange Control Act") provides for the imposition of duties and restrictions in relation to gold, currency, payments, securities, debts, imports, exports and transfer and settlement of properties involving foreign exchange transactions. Foreign exchange transactions relating to goods and services in trade (current transactions) are freely permitted without restrictions through authorized dealers in foreign exchange (i.e. commercial banks) subject to their exercising due diligence to identify transactions that are not bona-fide. Capital transactions (transactions relating to the acquisition of real or financial assets) are partially liberalized, especially in the area of non-resident investments in shares issued by Sri Lankan companies, which are permitted subject to certain exclusions and limitations. Capital transactions that are not liberalized require approval of the Central Bank unless they are permitted under a general permission.

During 2010, with the goal of improving investor confidence and stabilizing the foreign exchange market, the Central Bank decided to gradually relax certain restrictions on foreign exchange transactions. Accordingly, the opening and maintaining of bank accounts abroad for certain specific reasons was allowed; provisions for entering into forward contracts in foreign currency to cover foreign exchange transactions were implemented; margin requirements against advance payments on selected imports were removed; suspension of prepayment of import bills was lifted and unification of different investor accounts maintained by non-residents in commercial banks was allowed, effective from March 11, 2010. Additionally, with effect from November 22, 2010, a range of further relaxations were implemented, including permission for foreigners to invest in Rupee denominated debentures issued by local companies, permission for foreign companies to open places of business in Sri Lanka and approval for companies to borrow from foreign sources. Further relaxations were implemented

from January 1, 2011, such as permission to Sri Lankan resident individuals, corporate and unincorporated bodies to invest in the equity of overseas companies. Additionally, with effect from November 22, 2011 there was a relaxation of the regulations in relation to foreign investments in debentures by removing the ceiling imposed on the interest rate and the requirement for the maintenance of a sinking fund by the issuing firm and reducing the minimum tenor from five years to two years. Furthermore, the general permission applicable for foreign investments in shares of local companies was amended to allow foreign investment in the local companies carrying on the business of providing credit to investors having registered under the section 19 (A) of Securities and Exchange Commission of Sri Lanka Act No.36 of 1981. Moreover, the threshold for foreign investments in Treasury bills and Treasury bonds was raised from 10.0% of the outstanding Treasury bill and Treasury bond stock to 12.5% with effect from December 6, 2011.

As a way to conveniently and economically provide for the remittance of earnings of groups of persons employed abroad, a new account named “Inward Remittances Distribution Account” was introduced on December 31, 2012. Pursuant to a recent gazette notice dated June 7, 2016 which was issued under the Exchange Control Act, permission was granted under the Exchange Control Act to certain companies in Sri Lanka to borrow from residents outside Sri Lanka under the External Commercial Borrowing Scheme subject to the following conditions:

- The borrower shall mitigate exchange risk through appropriate hedging instruments with any licensed commercial bank in Sri Lanka, unless the borrower has proven foreign exchange earnings in the same currency.
- The tenure of loans shall be at least 3 years.
- The maximum amount of borrowing shall be based on the financial soundness of the company to repay the loan. This is based on the company’s audited financial statements for at least the most recent three years and its business plan.
- The rate of interest shall be competitive and favorable compared with the prevailing market rates in Sri Lanka.
- All proceeds and repayments of the borrowing shall be routed through an External Commercial Borrowing Account maintained by the borrower in any designated foreign currency in a licensed commercial bank in Sri Lanka.

This permission is applicable to all companies incorporated under the Companies Act, other than the following:

- licensed commercial banks;
- licensed specialized banks;
- licensed finance companies;
- specialized leasing companies;
- companies limited by guarantee; and
- overseas companies.

General permission was also granted on the same date for Sri Lanka residents to accept payments in foreign currency in respect of goods and services supplied by such persons to a non-resident of Sri Lanka, subject to certain conditions. On January 4, 2013, general permission was granted for the issue and transfer of Sri Lanka rupee-denominated redeemable preference shares in a company classified as a specified business enterprise in terms of the Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995 to approved country funds and regional funds, corporate bodies incorporated outside of Sri Lanka and individuals residing outside Sri Lanka (including Sri Lankans residing outside of Sri Lanka), subject to certain conditions. Under general permission issued on January 31, 2013, foreign institutional investors, corporate bodies incorporated outside of Sri Lanka and individuals residing

outside of Sri Lanka (including Sri Lankans residing outside of Sri Lanka) were allowed to invest in unit trusts, subject to certain, conditions. Effective June 12, 2013, general permission was granted to non-residents to repatriate sale proceeds including capital gains, upon sale of immovable property owned and/or developed by the non-resident, provided the property had originally been acquired and/or developed by such owner through funds remitted into Sri Lanka through international banking channels. Authorized dealers were permitted to extend accommodations in foreign currency from the Domestic Banking Unit to persons who maintain Foreign Exchange Earners' Accounts.

The following table sets out exchange rate information between the Rupee and the US dollar.

EXCHANGE RATES OF RUPEE PER US DOLLAR

Period	Period End	Period Average
2010	110.95	113.06
2011	113.90	110.57
2012	127.16	127.60
2013	130.75	129.11
2014	131.05	130.56
2015	144.06	135.94
2016	149.80	145.60
2017 (as at Mar 31, 2017)	151.74	150.78

Source: Central Bank of Sri Lanka

The Sri Lankan rupee, which depreciated by 0.82% in the first half of 2016, depreciated at a higher rate of 3.04% in the second half of the year. The relatively low depreciation of the rupee in the first half of 2016 was supported by supply of foreign exchange liquidity by the Central Bank amounting to US\$ 1,093 million, on a net basis. However, the rupee depreciated at a higher rate with the curtailment in intervention by the Central Bank with a net supply of US\$ 325 million during the second half of 2016. A substantial amount of the foreign exchange supplied during the second half of 2016 was to partially ease the pressure arising due to the disinvestment by non-resident investors in the Government securities market, which was triggered by the expectation and the subsequent increase in interest rates by the Federal Reserve Bank. With these developments throughout 2016, the rupee depreciated by 3.83% against the U.S. dollar from Rs. 144.06 as at 2015 year-end to Rs. 149.80 as at 2016 year-end. In addition, the annual average exchange rate depreciated by 6.64% to Rs. 145.60 against the US dollar in 2016.

Between January 1, 2017 and March 31, 2017, the Sri Lankan rupee depreciated by 1.3% against the US dollar. Based on cross-currency exchange rate movements, the Sri Lankan rupee depreciated against the Australian dollar (6.5%), pound sterling (2.9%), Japanese yen (5.0%), and the euro (2.6%) by March 31, 2017.

The Sri Lankan rupee remained broadly stable during the first eight months of 2015, but depreciated substantially thereafter, as a result of the Central Bank's decision to allow greater flexibility in the determination of the exchange rate. The lower than expected foreign exchange inflows, coupled with high levels of outflows, exerted significant pressure on the exchange rate during the year. This was mainly due to the reversal of foreign investments in the Government rupee securities market, in anticipation of, and the subsequent hike in interest rates in the US, and the high level of demand for foreign exchange, due to increased expenditure non-oil imports and foreign debt service payments. The resultant persistent depreciation pressure on the Sri Lankan rupee against the US dollar necessitated the continuous intervention of the Central Bank in the domestic foreign exchange market, in order to reduce volatility. Supported by the supply of US\$ 1.9 billion by the Central Bank, on a net basis, the rupee recorded a marginal depreciation of 2.42% against the US dollar, during the first eight months of the year. However, on September 3, 2015, the Central Bank decided to limit its intervention in the domestic foreign exchange market and allowed the exchange rate to be largely determined by the demand and supply conditions of the market. This resulted in the Sri Lankan rupee depreciating by 6.64% against the US dollar, during the period from September 4, 2015 to December 31, 2015. Overall, the rupee depreciated against the US dollar by 9.03% to Rs.144.06 as at end 2015.

The Sri Lankan rupee appreciated against the US dollar during the first three quarters of 2014, warranting a certain level of intervention by the Central Bank's in order to avoid undue appreciation. The appreciation pressure was mainly caused by an increase in foreign exchange inflows in the form of export earnings, workers' remittances and other financial inflows such as the proceeds from the ISB offerings, Government securities, foreign loans to the Government and private sector as well as foreign investment in the CSE. Specifically, the rupee had appreciated by 0.29% against the US dollar as at September 30, 2014. However, as import demand increased and Government securities market recorded net outflows in the last quarter of 2014, the Sri Lankan rupee depreciated by 0.47% against the US dollar, resulting in an overall depreciation of 0.23% against the US dollar by the end of 2014. Accordingly, the year-end and annual average exchange rates were at Rs.131.05 and Rs.130.56 against the US dollar, respectively. The Sri Lankan rupee appreciated against the Japanese yen (13.48%), the euro (13.19%), the pound sterling (5.65%) and the Indian rupee (2.13%) in 2014 as a result of international cross-currency exchange rates movements. In addition, the rupee also appreciated against the SDR by 6.05% by the end of 2014.

In February 2012, the Central Bank decided to allow more flexibility in the exchange rate and limit its intervention in the foreign exchange market. Subsequently, the exchange rate policy in 2013 was focused on maintaining flexibility in the determination of the external value of the Sri Lanka rupee. Subsequent to initial fluctuation triggered by the policy change introduced in early 2012, the Sri Lanka rupee gradually stabilized against the US dollar until early June 2013. Accordingly, the rupee appreciated against the US dollar by 0.55% from January 2013 to the first week of June 2013. However, from the second week of June through the end of August, the rupee depreciated by 5.01% against the US dollar, primarily due to increased import demand in June and July and the expectation of unwinding by foreign investors from the Government securities market in anticipation of possible tapering of quantitative easing by the Federal Reserve Bank of the United States. Nonetheless, the Sri Lanka rupee fared better than many regional currencies such as the Japanese yen, the Indian rupee and the Indonesian rupiah, which witnessed heavy depreciations following the announcement of possible tapering of quantitative easing. Since the beginning of September 2013 through the end of October 2013, the Sri Lanka rupee gained value by 1.45% against the US dollar, mainly supported by increased inflows to the banking sector including the NSB Bond issue in September 2013, which strengthened market expectations. In 2013, the rupee appreciated against major international currencies such as the Japanese yen (18.78%), the Australian dollar (13.35%) and the Indian rupee (10.16%), while depreciating against the US dollar (2.75%), the Pound sterling (4.69%) and the Euro (6.83%).

The Central Bank compiles two effective exchange rate indices based on the 5-currency and 24-currency baskets. Accordingly, the 5-currency Nominal Effective Exchange Rate ("NEER") and Real Effective Exchange Rate ("REER") indices capture the movement of the value of the rupee against five major currencies; the US dollar, Euro, Pound sterling, Japanese yen and Indian rupee. The weights derived from relative importance of trading currencies to Sri Lanka in terms of both exports and imports have been normalized in computing 5-currency NEER and REER indices. Similarly, the 24-currency NEER and REER indices are now being computed with some new trading partners, reflecting recent developments in the external sector. Accordingly, from the 2006 basket of countries, Denmark, the Philippines, South Africa and Sweden have been replaced by Australia, Pakistan, Russia and Turkey in creating the 2010 basket of countries, based on the importance of trade with those countries.

The Real Effective Exchange Rate (“REER”) indices, which take the variation in nominal exchange rates in the baskets into account, as well as the inflation differentials among countries, were recalculated from 2010 onwards using the newly rebased Colombo Consumer Price Index (2013=100). Accordingly, both 5-currency and 24-currency REER indices recorded an appreciation of 2.83% and 2.70%, respectively, by the end of 2016. The relatively high level of domestic inflation in Sri Lanka, in comparison to the overall inflation level of its trading partners and competitors, has largely contributed towards the appreciation of the REER indices in 2016. Meanwhile, the Nominal Effective Exchange Rate (“NEER”) index for the 5-currency basket appreciated marginally by 0.23% while the same for the 24-currency basket recorded a marginal depreciation of 0.95% during 2016.

The 5-currency and the 24-currency effective exchange rate indices depreciated during 2015. Reflecting cross currency exchange rate movements and the nominal depreciation of the Sri Lankan rupee against most of the currencies in the currency basket, both the 5-currency and the 24-currency NEER indices depreciated by 4.12% and 3.02%, respectively, during 2015. The REER, which takes into account the inflation differentials amongst countries, in addition to the variation in nominal exchange rates, also depreciated during this period. Accordingly, both the 5-currency and the 24-currency REER indices depreciated by 1.37% and 0.55%, respectively, during the year. This depreciation of the REER indices attributed to the depreciation of the NEER indices and the relatively low levels of domestic inflation, compared to most trading partners and competitors.

In 2014, the NEER and REER indices appreciated, extending the modest appreciation observed in 2013. The NEER, based on the 5-currency and 24-currency baskets, appreciated equally by 6.02%, reflecting the nominal appreciation of the Sri Lankan rupee against the major currencies in both currency baskets. The REER, which takes into account the changes in the inflation differentials, showed appreciation in the 5-currency and 24-currency baskets by 6.01% and 5.52%, respectively. This appreciation of the REER can be attributed to the appreciation of the NEER as well as a relatively high level of domestic inflation compared to that of Sri Lanka’s trading partners and competitors.

Reflecting cross-currency movements, the rupee depreciated against all major currencies in 2012. The rupee depreciated against the US dollar (10.4%), the Pound sterling (14.6%), the Euro (12.3%) and the Indian rupee 7.5%. However, the rupee only depreciated moderately against the Japanese yen (0.9%) with the slowdown in activity in Japan. In 2012, both the NEER and the REER depreciated substantially, compared to the appreciation observed in 2011. The nominal depreciation of the Sri Lanka rupee against all major currencies in the currency basket resulted in a depreciation of the NEER. The NEER based on the 5-currency basket, which includes the US dollar, the Pound sterling, the Euro, the Japanese yen and the Indian rupee, depreciated by 10.5% while the NEER based on the nominal exchange rates of 24 trading partners and competitors depreciated by 11.0%. Meanwhile, the inflation differential was higher due to relatively higher domestic inflation compared to that of trading partners and competitors. However, nominal depreciation of the rupee was larger than the inflation differential, resulting in a depreciation of the REER based on both 5-currency and 24-currency baskets by 4.9% and 5.5%, respectively, in 2012. In 2012, the total volume of spot transactions in the domestic foreign currency market decreased by 25.8% and total volume of forward transactions decreased by 27.7% compared to 2011.

Sri Lankan Financial Institutions

Total Assets

The following table sets out the total assets of the Sri Lankan financial system by category of financial institutions as at the end of the period indicated:

TOTAL ASSETS OF THE FINANCIAL SYSTEM

	2012		2013		2014		2015 ⁽¹⁾		2016 ⁽²⁾	
	Rs. billions	%	Rs. billions	%	Rs. billions	%	Rs. billions	%	Rs. billions	%
Banking Sector	6,377.0	70.4	7,187.5	69.7	8,442.2	70.3	9,503.7	68.8	10,575.8	68.7
Central Bank	1,278.8	14.1	1,246.0	12.1	1,471.3	12.2	1,426.2	10.3	1,529.2	9.9
Licensed Commercial Banks	4,355.7	48.1	5,022.2	48.7	5,884.4	49.0	6,974.3	50.5	7,843.3	51.0
Licensed Specialized Banks.....	742.5	8.2	919.3	8.9	1,087.5	9.1	1,103.2	8.0	1,203.2	7.8
Non-Bank Deposit Taking										
Financial Institutions	621.2	6.9	756.4	7.3	856.8	7.1	1,044.2	7.6	1,246.7	8.1
Licensed Finance Companies	536.1	5.9	653.0	6.3	742.8	6.2	915.3	6.6	1,112.1	7.2
Co-operative Rural Banks.....	77.2	0.9	94.9	0.9	103.0	0.8	117.6	0.9	122.2	0.8
Thrift and Credit Co-op. Societies.....	7.9	0.1	8.5	0.1	10.5	0.1	11.3	0.1	12.4	0.1
Other Specialized Financial										
Institutions	310.4	3.4	378.0	3.7	440.6	3.7	557.8	4.0	522.8	3.4
Primary Dealers.....	160.4	1.8	213.6	2.1	195.3	1.6	282.6	2.0	264.5	1.7
Specialized Leasing Companies ..	60.4	0.7	64.5	0.6	71.7	0.6	80.8	0.6	99.8	0.6
Stock Broking Companies.....	10.8	0.1	10.3	0.1	11.3	0.1	9.8	0.1	10.1	0.1
Unit Trusts/Unit Trust										
Management Companies.....	32.4	0.4	55.8	0.5	126.5	1.1	134.0	1.0	106.7	0.7
Venture Capital Companies.....	2.5	0.0	4.4	0.0	6.7	0.1	8.3	0.1	11.0	0.1
Market Intermediaries ⁽³⁾	43.9	0.5	29.5	0.3	29.1	0.2	42.2	0.3	30.8	0.2
Contractual Savings										
Institutions	1,753.0	19.3	1,998.3	19.4	2,274.9	18.9	2,711.1	19.6	3,040.3	19.8
Employees' Provident Fund	1,144.4	12.6	1,300.0	12.6	1,486.9	12.4	1,664.9	12.0	1,841.5	12.0
Employees' Trust Fund	158.4	1.7	178.5	1.7	199.1	1.7	223.5	1.6	249.4	1.6
Private Provident Funds ⁽⁴⁾	110.3	1.2	123.0	1.2	134.2	1.1	323.0	2.3	398.6	2.6
Insurance Companies	307.0	3.4	360.4	3.5	413.7	3.4	453.6	3.3	503.1	3.3
Public Service Provident Fund....	32.9	0.4	36.4	0.4	41.0	0.3	46.1	0.3	47.7	0.3
Total	<u>9,061.6</u>	<u>100.0</u>	<u>10,320.2</u>	<u>100.0</u>	<u>12,014.5</u>	<u>100.0</u>	<u>13,816.7</u>	<u>100.0</u>	<u>15,385.7</u>	<u>100.0</u>

Source: Central Bank of Sri Lanka

Notes:

- (1) Revised
- (2) Provisional
- (3) Include Underwriters, Investment Managers and Margin Providers
- (4) Estimated numbers from 2012 to 2014

According to provisional data, total assets of the financial system increased by 11.4% from 2015 to 2016 and by 99.5% during the five-year period from the beginning of 2012. Financial sector assets to GDP ratio stood at 130.0 % in 2016. This ratio was 103.8%, 107.6%, 115.0% and 126.2% in 2012, 2013, 2014 and 2015, respectively. The banking sector, which consists of the Central Bank, LCBs and LSBs, accounted for 68.7% of total financial assets in 2016. LCBs accounted for 51.0% of total financial assets in 2016. As at end 2016, LCBs recorded a 119.2% increase in assets since the beginning of 2012. The assets of non-bank deposit taking financial institutions, which represent some of the grass-root-level savings institutions, increased by 19.4% in 2016. Their share in the financial system increased from 6.9% in 2012 to 8.1% in 2016. The assets of the other specialized financial institutions sector, which includes SLCs, primary dealers, unit trusts and unit trust management companies, stock broking companies, venture capital companies and market intermediaries decreased by 6.3% in 2016. The total assets of contractual savings institutions, which include superannuation funds and insurance companies, grew by 12.1% in 2016, and accounted for 19.8% of total financial assets. Superannuation funds are the biggest category of financial entities in this sector, accounting for 16.5% of total financial assets.

Regulation of Banks and Non-banking Financial Institutions

The Central Bank, in discharging its responsibility for financial stability, is the licensing authority and regulator of banking institutions, finance companies, leasing companies and primary dealers. It is responsible for licensing of these financial institutions in Sri Lanka and has statutory responsibility for their safety and soundness to safeguard the interests of depositors and creditors. In ensuring financial system stability, it has established a strong prudential regulation and supervision framework within which all financial institutions licensed by it should operate.

Banks

The regulation and supervision of banks is primarily governed by the Banking Act, the MLA, and the Exchange Control Act. The Central Bank issues banking licenses for two categories of banks, namely, LCBs and LSBs. The main distinction between commercial banks and specialized banks is that only the former are permitted to accept demand deposits (current accounts) from the public and engage in a full range of foreign exchange transactions.

As at March 31, 2017, the banking system consisted of 32 banks, of which 25 are LCBs and seven are LSBs. Another distinct market segment within the industry is 20 local banks and 12 branches of foreign banks.

The regulatory and supervisory framework currently applicable is based on international best practices based on the Basel Core Principles for effective banking-supervision set out by the Basel Committee for Banking Supervision. In keeping with the global trends, the Central Bank has adopted a system of risk-based supervision of banks. This approach focuses on the identification of banking risks, the management of these risks and the assessment of the adequacy of resources to mitigate these risks. As a part of its regulatory and supervisory functions, the Central Bank issues directives and prudential requirements on the licensing, operations and closure of banks, the resolution of weak banks and the enforcement of regulatory actions. The main techniques of supervision are continuous off-site monitoring and surveillance, periodic on-site examinations of banks, meetings with bank management and co-operation with external auditors.

The Central Bank monitors the compliance of banks with a number of prudential requirements and international best practices, such as capital adequacy, liquidity, large exposures, asset quality, provisioning for non-performing loans, related party transactions, income recognition, ownership of shares carrying voting rights in banks, investments, disclosures, audit of banks and standards of corporate governance and integrated risk management. In addition, the internal controls are also assessed.

Other Financial Institutions

As at December 31, 2016, there were 46 LFCs and seven SLCs under the purview of the Central Bank. All LFCs have also been registered as Finance Leasing Establishments. In addition, 17 banks were also registered as Finance Leasing Establishments. As such, as at December 31, 2016, there were 70 establishments involved in the finance leasing business.

The Central Bank regulates and supervises LFCs under the Finance Business Act, No. 42 of 2011 (the “FBA”). The regulatory and supervisory framework for finance companies is comparable to that of banks. The Central Bank also registers and monitors finance leasing companies under the Finance Leasing Act, No. 56 of 2000, as amended. To increase public awareness, the Central Bank regularly publishes press notices on “Financial Institutions Legally Permitted to Accept Deposits from the Public” and periodically a “Guide to Interest Rates and Fees”.

The Central Bank also regulates and supervises primary dealers under the Local Treasury Bills Ordinance and the Registered Stocks and Securities Ordinance. As at March 31, 2017, Sri Lanka had 15 primary dealers. These consisted of seven primary dealer units attached to LCBs, two primary dealer companies owned by licensed banks and six non-bank primary dealer companies.

Financial Sector Developments and Stability

Banking Industry

The banking sector, which comprises LCBs and LSBs, accounts for over 58.8% of assets in the financial system, has continued to be resilient in the challenging environment of the aftermath of the global financial crisis and emerging world economic downturn. Overall, the key financial soundness indicators in the banking sector were maintained at healthy levels. Strong capital and liquidity levels, together with sustained earnings and improved risk management systems, resulted in maintaining system stability.

The capital adequacy ratio, which has remained above 10% in the past decade, slightly decreased from 16.1% in 2009 to 14.3% at the end of 2016 due to an increase in risk-weighted assets.

The quality of assets of the banking sector is well maintained. The gross NPA ratio improved from 8.5% in 2009 to 2.6% in 2016. The growth in credit in 2015 and the first three months of 2016 and recovery of loans, have resulted in improvement of the NPA ratio to 2.6% by 2016 year-end. In addition, several measures taken by the banks have already mitigated the potential credit risk arising from the pawning NPAs. Total loan loss provisions were at Rs. 62,242 million, Rs. 77,233 million, Rs. 83,893 million, Rs. 95,245 million and Rs.102,148 million as at December 31, 2012, 2013, 2014, 2015 and 2016, respectively.

Below is a table summarizing the amount of total loans and non-performing loans in the Sri Lankan banking industry from 2012 to 2016.

TOTAL LOANS (GROSS) AND NON-PERFORMING LOANS IN THE BANKING INDUSTRY

	As at December 31,				
	2012	2013	2014	2015	2016
	(in Rs. billions, except as indicated)				
State Commercial Banks					
Total Loans ⁽¹⁾	1,310	1,345	1,400	1,647	1,938
Total Non-performing Loans ⁽¹⁾	37	65	49	56	50
Ratio of Non-performing Loans to Total Loans (%).....	2.8	4.8	3.5	3.4	2.6
Domestic Private Banks					
Total Loans ⁽¹⁾	1,278	1,471	1,727	2,253	2,679
Total Non-performing Loans ⁽¹⁾	52	85	67	62	64
Ratio of Non-performing Loans to Total Loans (%).....	4.1	5.8	3.9	2.8	2.4
Foreign Banks					
Total Loans ⁽¹⁾	242	263	327	358	391
Total Non-performing Loans ⁽¹⁾	7	9	7	5	8
Ratio of Non-performing Loans to Total Loans (%).....	3.1	3.5	2.1	1.5	2.0
All Licensed Commercial Banks					
Total Loans ⁽¹⁾	2,831	3,079	3,454	4,258	5,008
Total Non-performing Loans ⁽¹⁾	96	159	124	123	122
Ratio of Non-performing Loans to Total Loans (%).....	3.4	5.2	3.6	2.9	2.4
All Licensed Specialized Banks					
Total Loans ⁽¹⁾	319	347	441	457	533
Total Non-performing Loans ⁽¹⁾	20	32	42	29	24
Ratio of Non-performing Loans to Total Loans (%).....	6.4	9.3	9.5	6.4	4.5
Banking Industry (All LCBs + All LSBs)					
Total Loans ⁽¹⁾	3,149	3,427	3,895	4,715	5,541
Total Non-performing Loans ⁽¹⁾	117	191	165	153	146
Ratio of Non-performing Loans to Total Loans (%).....	3.7	5.6	4.2	3.2	2.6

Source: Central Bank of Sri Lanka

Note:

(1) Excludes interest in suspense

Profitability, in terms of return on assets, before tax, deteriorated from 2.4% in 2012 to 1.9% in 2016, due to high interest expenses. Interest margin has also declined from 4.1% in 2012 to 3.6% in 2016.

The cost efficiency ratio (operating expenses to total income excluding interest expenses) marginally declined from 49.4% in 2012 to 49.3% in 2016 due to marginal increase in interest income.

Liquidity in the banking system measured in terms of Statutory Liquid Assets ratio continued to remain at a comfortable level of over 30% throughout the period, substantially above the minimum requirement of 20%.

Financial Sector Reforms

The Central Bank has introduced a number of policy measures intended to improve risk management, corporate governance and the financial health of the banking and non-banking financial institutions sector, as follows:

- **Implementation of the Direction on Corporate Governance:** A Direction that comprehensively covers responsibilities of the board of directors of a bank, the board's composition, criteria to assess the fitness and propriety of directors, management functions delegated by the board, the role and responsibilities of the chairman and the chief executive officer of a bank, duties and functions of the board appointed committees, related party transactions and disclosures, is currently in force. The Central Bank strictly monitors the adherence of banks with these directions in an effort to strengthen the corporate governance culture of banks. With a view to further strengthen good governance in the banking sector, the assessment criteria of fitness and suitability of Board of Directors is currently under review.

Further, the Central Bank has introduced Corporate Governance Directions for LFCs and SLCs to make the board of directors more responsible and accountable for affairs of the respective LFCs and SLCs, with the goal of promoting a healthy and robust risk management framework in these sectors in order to maintain overall soundness.

- **Fitness and propriety of directors and senior management of bank and non-bank financial institution:** The assessment of the fitness and propriety of the banks' directors, CEO and other officers performing executive functions in banks and non-bank financial institutions are carried out to ensure high standards of management.
- **Strengthening risk management in banks and non-bank financial institutions:** With a view to further strengthening risk management in banks and non-bank financial institutions, Directions were issued on (i) classification of advances, provisioning and income recognition for improved credit risk management, (ii) maximum amount of accommodation to improve credit concentration risk management in banks and non-bank financial institutions and widen credit delivery and (iii) risk management relating to foreign exchange business in LCBs and LFCs.

In addition, directions were also issued by banks on (i) abandoned property in order to safeguard unclaimed deposits of customers (ii) integrated risk management, (iii) outsourcing of business operations of banks, (iv) exposures to stock market, (v) improving customer confidence and building up a better relationship between banks and customers, (vi) risk management relating to foreign exchange business and foreign exchange trading activities, (vii) the stress testing framework of the banking sector, (viii) the regulatory framework for valuation of immovable property of licensed banks, (ix) introduction of a loan-to-value ratio on loans and advances granted to purchase or utilize motor vehicles and (x) implementation of the Baseline Security Standard on information security management.

- **Implementing a Mandatory Deposit Insurance Scheme:** A Mandatory Deposit Insurance Scheme to protect small depositors and to strengthen the stability of the financial system was introduced in 2010. In addition, this Scheme will offer liquidity support for banks and LFCs in imminent liquidity distress. According to the decision announced in Budget 2015 to increase deposit insurance cover by 50%, effective from January 1, 2015, the deposit insurance coverage ratio per depositor per institution increased from Rs. 200,000 to Rs. 300,000.
- **Enhancing the minimum capital requirement of banks and Licensed Finance Companies:** Effective January 2015, new LCBs and LSBs have been required to have a minimum core capital of Rs. 10 billion and Rs. 5 billion, respectively. Effective January 2016, existing banks are being subject to the same requirements. The direction for minimum core capital of LFCs was issued in February 2017, which instructed LFCs to improve their core capital level from Rs. 400 million to Rs. 2,500 million on staggered basis.
- **Conduct statutory examinations of all banks annually:** Beginning in 2014, all banks are supervised on an annual basis.
- **Enhancing Bank Examination Methodology:** Measures have been taken to enhance the bank examination methodology to focus on the efficiency, effectiveness and sustainability of individual banks and the banking sector. Further, Bank Sustainability Risk Index (“BSRI”) is being developed to strengthen this process.
- **Implementation of Basel II:** The implementation of the Basel II capital adequacy framework for licensed banks commenced in January 2008. Under Pillar 1 of Basel II, banks are currently required to compute their capital adequacy ratio using a standardized approach for credit risk, standardized measurement method for market risk and operational risk. Starting from July 1, 2014, banks were given the option to move to the Standardized Approach or the Alternative Standardized Approach to compute the capital charge for operational risk. Directions on the implementation of the supervisory review process for banks (Pillar 2 of Basel II) were issued in July 2013. The Internal Capital Adequacy Assessment Process established under these Directions is expected to further strengthen capital planning of banks with the enhancement of their ability to mitigate all inherent risks arising from the banking business. With the adoption of new accounting standards in line with the generally accepted international accounting standards in 2012, significant changes were made to conform to international disclosure requirements by the standards.
- **Minimum Capital Requirements under Basel III:** Commencing on July 1, 2017, licensed banks will be required to maintain a minimum capital ratio in respect of risk weighted assets, according to guidelines based on ‘Basel III: A Global Regulatory Framework For More Resilient Banks and Banking Systems’. The total minimum capital ratio for licensed banks with assets above Rs. 500 billion will be 11.75%, which will be increased further to 14.00% by January 1, 2019. Meanwhile, the requirement for licensed banks with assets below Rs. 500 billion will be 11.25%, which will be increased further to 12.50% by January 1, 2019.
- **Implementation of Basel III Leverage Ratio Framework for licensed banks:** A Consultation Paper on Implementation of Basel III Leverage Ratio was issued to banks and the final standard on the same will be issued in due course for implementation in line with the international timeline. The Central Bank expects to commence monitoring of the leverage ratio during first half of 2017. Amendments to the Banking Act: The Central Bank has initiated amendments to the **Banking Act with a view to further strengthening the supervision and regulation of LCBs and LSBs**. The proposed amendments will entail changes brought about by the Companies Act, and will, among others, facilitate consolidations of banks, strengthen recovery and resolution measures of banks, facilitating consolidated supervision and introduce a deterrent penalty system.

- **Enhancement of disclosure requirements:** To facilitate banks and non-bank financial institutions to successfully adopt the new Sri Lanka Accounting Standards and the Sri Lanka Financial Reporting Standard, the Central Bank issued draft guidelines to banks and non-bank financial institutions on statutory reporting and adoption of these standards. For greater transparency and comparability, forms have also been issued by the Central Bank to banks and non-bank financial institutions for the preparation and publication of interim and annual financial statements. The new reporting forms will facilitate financial institutions to be on par with other financial institutions adopting international accounting standards and to improve disclosure. Uniform and adequate disclosure practices are important for improving market efficiency and promoting healthy competition in the industry. To further enhance transparency of banking operations and market discipline, banks are also required to make annual, bi-annual and quarterly publications of financials on their respective websites.
- **Establishment of stronger communications channels for home-host relationships and other regulators:** Considering the internationalization of the Sri Lankan banking sector and its cross-border presence, the Central Bank has initiated action to enter into memoranda of understandings (“MOUs”) with other supervisory authorities in the Asian region to exchange information and for supervisory cooperation. At present, the Central Bank has entered into MOUs with the State Bank of Pakistan and the Reserve Bank of India on cross border supervisory cooperation and information sharing among regulators.
- **Ceilings on interest rates and penal rates:** To facilitate expansion of economic activities, prompt entrepreneurship and reduce undue burden on borrowers, ceilings have been imposed on interest rates and penal rates on loans and advances.
- **Implementation of Budget 2017 in respect of Banking Services:** Licensed banks have been requested to take appropriate measures to increase distribution of credit to identified sectors (i.e. agriculture, small and medium enterprises (“SMEs”), exports, tourism, youth and women) and to enhance banking services in line with the national policy approved in the Budget 2017.
- **Secondary Market Trading of Government Securities and Reporting:** Licensed banks have been required to use the Bloomberg Trading Platform (FIQ), designed for Sri Lanka, to report yield rates and volumes of all outright trades in excess of Rs. 50 million, with the aim of promoting the secondary market for Government securities.
- **Electronic Transactions Act, No. 19 of 2006:** Enacted to recognize and facilitate the formation of electronic contracts, the creation and exchange of data messages, communication in electronic form and to provide for the appointment of a certification authority and accreditation of certification for such service providers.
- **Payment Devices Frauds Act, No. 30 of 2006:** Enacted to prevent possession and use of unauthorized or counterfeit payment devices and to provide for investigation, prosecution and punishment of such offenses.
- **Finance Business Act, No. 42 of 2011:** The FBA was enacted on November 9, 2011 repealing and replacing the Finance Companies Act, No. 78 of 1988 (the “FCA”) for strengthened regulation of LFCs and to curb unauthorized finance businesses. The FCA was enacted over more than two decades ago, and over the years significant developments have taken place in the financial sector. The non-banking financial sector activities also increased tremendously during this period. Moreover, due to unlawful deposit taking activities, several finance companies faced liquidity problems during the last few years. Hence, there has been an immense need for a new legislation to ensure safety and soundness of the financial system. The FBA has addressed the lacunas of the FCA which enabled entities carrying out finance business without authority to thrive as they did in the past few years. Further, the Central Bank has intervened to resolve distressed LFCs, largely through mergers and recapitalization.

- **Setting up of Separate Authority to Regulate Microfinance Sector:** The Microfinance Act No. 06 of 2016 has been enacted in Parliament to provide a legal basis for the licensing, regulation and supervision of companies carrying on microfinance business, the registration of Non-Government Organizations (“NGOs”) accepting limited savings deposits as Microfinance Non-Government Organizations (“MFNGOs”) and the setting up of standards for the regulation and supervision of MFNGOs and micro credit NGOs. Currently, the Central Bank is preparing licensing criteria, rules and directions for MFCs and standards, principles and guidelines for the Registrar of National Secretariat for NGO. Regulatory process will be commenced before the end of year 2016.
- **Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013:** Pursuant to the Payment and Settlement Systems Act No. 28 of 2005, the Service Providers of Payment Cards Regulation No. 1 of 2009 became effective from July 31, 2009. This was replaced by the Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013, without prejudice to anything done under the 2009 regulations. The main objective of these regulations is to ensure that all service providers involved in card-based payment instruments and mobile payment systems comply with the best international standards and practices, thereby assuring that operations of service providers of payment cards and mobile payment systems do not threaten the stability of the financial system. The Central Bank, as the regulator of payment systems, is entrusted with the authority to regulate and direct service providers engaged in the card-based payment industry and the mobile payment systems industry to accept best standards/practices, and to supervise and monitor to ensure their compliance to the relevant acts, regulations, guidelines and circulars, etc. Under the authority given by the regulations, the Central Bank issued the Credit Card Guideline No. 01/2010 on March 1, an operational guideline to streamline the operations of credit card issuers to ensure adherence to best international standards and practices in order to maintain financial system stability. Furthermore, under the authority given under the same regulations, the Central Bank issued two mobile payment guidelines in March 2011 in order to regularize the emerging payment mechanism.
- **Consolidation of Financial Institutions:** The Central Bank expects to encourage market driven financial sector consolidation with a view of building a stronger and dynamic financial sector. Through this policy, banks and non-bank financial institutions are expected to be in a position to mobilize funds from the international market, leverage on the scale of operations and upgrade technology to strengthen efficiency and thus reduce intermediation cost. The enhanced capital requirements are expected to encourage small and medium sized banks to merge in the medium term, whilst the small state owned banks are expected to merge with larger banks to enable them to contribute to the economy in a more meaningful manner. Concurrently, the regulatory and supervisory framework is expected to be further strengthened.

Sri Lankan Securities Markets

Colombo Stock Exchange

In 1985, Colombo Securities Exchange Ltd. was established by consolidating the Colombo Brokers’ Association and the Stock Brokers’ Association. Its name was changed to the Colombo Stock Exchange in 1990. Currently, there are 28 institutions licensed by the Securities and Exchange Commission of Sri Lanka to operate as stockbrokers (as at April 19, 2017), but only 20 of such institutions possess the CSE membership, out of which 12 members operate as stockbrokers and eight members operate as debt trading members. The CSE All-Share Price Index increased by 3.5% from December 31, 2016 to April 19, 2017. As at April 19, 2017, there were 296 companies listed on the CSE, representing 20 business sectors, with a market capitalization of Rs. 2,837.5 billion (US\$ 18.7 billion).

During the first three months of 2017, there was one debenture listing amounting to Rs. 8.0 billion.

The policy making body of the CSE is its board of directors, consisting of nine directors. Four directors are elected by the members and five directors are appointed by the Ministry of National Policies and Economic Affairs. The Exchange Secretariat, headed by the Chief Executive Officer, is responsible for the operations of the CSE and is accountable to the board of directors.

Government Securities Market

Sri Lanka has a large tradable Government securities market. The Government uses Treasury bonds, Treasury bills, Sri Lanka Development Bonds and rupee-denominated loans as the primary borrowing instruments to finance its budgetary needs. Over the last ten years, reliance on marketable instruments has expanded rapidly. Since 2003, Treasury bonds with 5-year, 10-year, 15-year and 20-year maturities have been issued. With improvements in the Government securities market and to accommodate investors' desire to invest in longer-term securities, the Government issued Treasury bonds with a 30-year maturity in 2013 and continued such issuances thereafter.

Since November 1, 2006, the Government securities market was partially liberalized and foreigners were allowed to purchase up to 5.0% of the outstanding rupee-denominated Treasury bonds. With the aim of further liberalizing capital account transactions and also to develop the capital market, by broadening the investor base and increasing competition in the Government securities market, this limit has gradually been increased to 12.5% of outstanding rupee-denominated Treasury bills and Treasury bonds. Subsequently, this limit has been brought down to 10% of outstanding Treasury bills and Treasury bonds.

Total outstanding Treasury bills amounted to Rs.792.39 billion (US\$ 5.29 billion) and Treasury bonds amounted to Rs. 4,053.57 billion (US\$ 27.06 billion) as at December 31, 2016. The total volume of rupee-denominated Government securities transacted on outright basis in 2016 amounted to Rs. 5,800.02 billion. Similarly, the total volume of Government securities transacted on repurchase and reverse repurchase bases in 2016 amounted to Rs. 50,970.25 billion.

As at March 31, 2017, total outstanding Treasury bills amounted to Rs.793.88 billion (US\$ 5.23 billion) and Treasury bonds amounted to Rs. 4,055.49 billion (US\$ 26.73 billion). The total volume of rupee-denominated Government securities transacted on outright basis for the first three months of 2017 amounted to Rs. 1,211.60 billion, while the total volume of Government securities transacted on repurchase and reverse repurchase bases during the first three months of 2017 amounted to Rs. 12,330.15 billion.

Rupee Denominated Debt

The Government continues to raise funds through rupee-denominated debt instruments, primarily Treasury bonds and Treasury bills to meet part of its budgetary requirements.

Treasury Bills. Issued with maturities of 91 days, 182 days or 364 days, Treasury bills are the primary debt instruments for managing the short-term cash flow needs of the Government. Treasury bills are issued at market yield rates. Such market yield rates are derived through market-based primary auctions conducted via an online secured electronic bidding system. In 2014, the stock of Treasury bills outstanding increased by Rs.11.83 billion (US\$ 0.09 billion) in net terms in the primary market, in line with the Government's strategy to reduce short-term Government securities. In 2015, the stock of Treasury bills outstanding decreased by Rs.73.66 billion (US\$ 0.51 billion) in net terms in the primary market. In 2016 and the first three months of 2017, the stock of Treasury bills outstanding increased by Rs. 105.66 billion (US\$ 0.71 billion) and Rs. 0.31 billion (US\$ 0.002 billion) in net terms in the primary market, respectively.

Treasury Bonds. Treasury bonds are issued with maturities ranging from 2 years to 30 years in the primary market to finance the long-term funding needs of the Government. Treasury bonds are used as the primary domestic debt instrument to finance budgetary needs. In 2014, the Government issued Treasury bonds amounting to Rs.452.86 billion (US\$ 3.46 billion) in net terms in the primary market.

In 2015, the Government-issued Treasury bonds amounting to Rs.399.32 billion (US\$ 2.77 billion) in net terms in the primary market. In 2016 and the first three months of 2017, the Government-issued Treasury bonds amounting to Rs. 305.30 billion (US\$ 2.04 billion) and Rs. 6.09 billion (US\$ 0.04 billion) in net terms in the primary market, respectively.

US Dollar Denominated Debt

Sri Lanka Development Bond. In order to tap the domestically available US dollar resources, the Government issues US-dollar-denominated Sri Lanka Development Bonds. Although the primary investors of the Sri Lanka Development Bonds are local commercial banks, other foreign investors, except for U.S. citizens, can also invest in Sri Lanka Development Bonds. Currently, the Government issues 2-year, 3-year, 4-year and 5-year maturity Sri Lanka Development Bond in the primary market.

In the first three months of 2017, the Government issued Sri Lanka Development Bonds amounting to US\$ 408.01 million in net terms. In 2016, US\$ 820.34 million worth of Sri Lanka Development Bonds were matured in net terms. In 2015, the Government issued Sri Lanka Development Bonds amounting to US\$ 1,655.8 million in net terms in the market. In 2014, the Government issued the Sri Lanka Development Bond, amounting to US\$ 160.5 million in net terms in the market.

In 2013, the Government raised US\$ 1,070.1 million on a net basis through the issuances of Sri Lanka Development Bonds, maturing in 3 years and 5 years, at a rate of six-month LIBOR plus a margin of 400 basis points and 415 basis points, respectively.

In 2012, four auctions were conducted to issue Sri Lanka Development bonds, raising US\$ 140 million on a net basis. Interest rates for the three-year bonds issued in March, July and September 2012 were six-month LIBOR plus a margin of 385,410 and 400 basis points, respectively. The interest rate for the four-year bond issued in March 2012 was six-month LIBOR plus a margin of 415 basis points.

International Sovereign Bonds. In order to fund the on-going infrastructure projects, the Government issued eight ISBs in the international capital markets, once in each of 2007, 2009, 2010, 2011 and 2012, twice in 2014, twice in 2015 and once in dual tranche in 2016. The Government repaid its first ISBs of US\$ 500 million in October 2012 and its second ISBs of US\$ 500 million in October 2015.

In July 2016, the Government issued its tenth and eleventh ISBs of US\$ 500 million and US\$ 1 billion, respectively. The interest rate of the 5.5-year ISBs was 5.750% and the interest rate of the 10-year ISBs was 6.825%.

In November 2015, the Government issued its ninth ISBs of US\$ 1,500 million. The interest rate of for the ten-year bonds was 6.850%.

In June 2015, the Government issued its eighth ISBs of US\$ 650 million. The interest rate of for the ten-year bonds was 6.125%. The Government achieved substantial flexibility for its borrowing program due to the timing of this transaction and also obtained funding at a competitive rate. Sri Lanka's previous seven issuances in 2007 (5-year), 2009 (5-year), 2010 (10-year), 2011 (10-year), 2012 (10-year), January 2014 (5-year) and April 2014 (5-year) were priced at yields of 8.25%, 7.40%, 6.25%, 6.25%, 5.875%, 6.00% and 5.125%, respectively.

In April 2014, the Government issued its seventh ISBs of US\$ 500 million at a rate of 5.125%.

In January 2014, the Government made its sixth issuance of ISBs, which raised US\$ 1 billion. The interest rate for the five-year bonds was 6.00%.

In July 2012, the Government made its fifth issuance of ISBs, which raised US\$ 1 billion. The interest rate for the ten-year bonds was 5.875%.

Primary Dealer System

Primary Dealers (“PD”) are specialized intermediaries in the Government securities market, appointed by the Central Bank under the Local Treasury Bills Ordinance No 8 of 1923 and the Registered Stock and Securities Ordinance No. 7 of 1937. The PD system is expected to strengthen the Government securities market by helping to build a stable and dependable source of demand for securities by effectively participating in the primary auctions conducted by the Central Bank, providing liquidity in the secondary market, building distribution channels (to act as intermediaries) and providing market information, including prices, volumes and spreads between bids and offers. As at March 31, 2017, there were 15 PDs consisting of seven PD units attached to LCBs, two PD companies owned by licensed banks and six non-bank PD companies. PDs continued to be the key players in the Government securities market in 2016 and the first three months of 2017.

The Central Bank provides primary dealers with an intra-day liquidity facility and allows them to participate at the OMO of the Central Bank, which is in operation for implementing monetary policy. The Central Depository System and Scripless Securities Settlement System have been in operation since February 2004 and have contributed to the improvement of the efficiency in the primary issuances and trading in secondary market of Government securities. These systems are linked to the Real Time Gross Settlement System for Delivery vs. Payment mechanism where the transfer of ownership of securities and the underlying transfer of funds are realized simultaneously in real time.

Public Finance

Overview of Government Revenues and Expenditures

The following table sets out Government revenues and expenditures for the periods indicated.

GOVERNMENT REVENUES AND EXPENDITURES

Summary of Fiscal Operation

	Actual					2015-2016 Growth Rate (%)
	2012	2013	2014	2015	2016 ⁽¹⁾	
	Rs. million					
Total revenues and grants..	1,067,532	1,153,306	1,204,621	1,460,892	1,693,558	15.9
Total revenues.....	1,051,460	1,137,447	1,195,206	1,454,878	1,686,062	15.9
Tax Revenues	908,913	1,005,895	1,050,362	1,355,779	1,463,689	8.0
Non-tax Revenues.....	142,547	131,552	144,844	99,099	222,374	124.4
Grants.....	16,071	15,859	9,415	6,014	7,496	24.6
Total expenditure	1,556,499	1,669,396	1,795,865	2,290,394	2,333,883	1.9
Recurrent	1,131,023	1,205,180	1,322,898	1,701,658	1,757,782	3.3
Capital and net lending.....	425,476	464,216	472,967	588,737	576,101	(2.1)
Current account surplus/ (deficit)	(79,563)	(67,733)	(127,692)	(246,779)	(71,719)	(70.9)
Primary account surplus/ (deficit)	(80,469)	(72,083)	(154,849)	(319,827)	(29,430)	(90.8)
Overall surplus/(deficit).	(488,967)	(516,090)	(591,244)	(829,502)	(640,325)	(22.8)
Total financing	488,967	516,090	591,244	829,502	640,325	(22.8)
Foreign financing	286,455	123,700	212,523	236,803	391,914	65.5
Gross.....	463,448	327,693	395,632	521,096	561,020	7.7
Repayment.....	(200,369)	(203,993)	(183,109)	(284,293)	(169,107)	(40.5)
Domestic financing.....	202,511	392,390	378,721	592,699	248,411	(58.1)

	Actual					2015-2016
	2012	2013	2014	2015	2016 ⁽¹⁾	Growth Rate (%)
	Rs. million					
Market borrowings	202,511	379,390	392,084	592,699	248,411	(58.1)
Non-bank	70,985	82,414	265,155	300,858	108,456	(64.0)
Bank	131,527	296,977	126,929	291,841	139,955	(52.0)
Monetary Authority	16,101	(164,836)	35,665	80,254	183,085	128.1
Commercial Banks	115,427	461,813	91,264	211,588	(43,130)	(120.4)
Non market borrowings	—	13,000	(13,363)	—	—	—
Privatization proceeds	—	—	—	—	—	—
As a % of GDP⁽²⁾						
Total revenues and grants ..	12.2	12.0	11.6	13.3	14.3	
Total revenues	12.0	11.9	11.5	13.3	14.2	
Tax revenues	10.4	10.5	10.1	12.4	12.4	
Non-tax revenues	1.6	1.4	1.4	0.9	1.9	
Grants	0.2	0.2	0.1	0.1	0.1	
Total expenditure	17.8	17.4	17.3	20.9	19.7	
Recurrent	13.0	12.6	12.8	15.5	14.8	
Capital and net lending	4.9	4.8	4.6	5.4	4.9	
Current account surplus/ (deficit)	(0.9)	(0.7)	(1.2)	(2.3)	(0.6)	
Primary account surplus/ (deficit)	(0.9)	(0.8)	(1.5)	(2.9)	(0.2)	
Overall surplus/ (deficit)	(5.6)	(5.4)	(5.7)	(7.6)	(5.4)	
Total financing	5.6	5.4	5.7	7.6	5.4	
Foreign financing	3.3	1.3	2.1	2.2	3.3	
Gross	5.3	3.4	3.8	4.8	4.7	
Repayment	(2.3)	(2.1)	(1.8)	(2.6)	(1.4)	
Domestic financing	2.3	4.1	3.7	5.4	2.1	
Market borrowings	2.3	4.0	3.8	5.4	2.1	
Non-bank	0.8	0.9	2.6	2.7	0.9	
Bank	1.5	3.1	1.2	2.7	1.2	
Monetary Authority	0.2	(1.7)	0.3	0.7	1.5	
Commercial Banks	1.3	4.8	0.9	1.9	(0.4)	
Non market borrowings	—	0.1	(0.1)	—	—	
Privatization proceeds	—	—	—	—	—	

Source: Ministry of Finance

Note:

(1) Provisional

(2) Based on revised GDP estimates for 2014 and 2015 made by the Department of Census and Statistics available on March 15, 2017.

Revenues

The Government derives its revenues from tax and non-tax sources. Tax revenue currently represents approximately 90% of total revenue while non-tax revenue represents the balance. The main sources of the tax revenue are income tax, VAT, excise taxes and customs duties. The main sources of non-tax revenue consist of fees and charges, interest income, profit and dividends and central bank profits transfers.

EXISTING TAX RATES

Personal Income Tax

Income tax free allowance is Rs. 500,000

- (1) First Rs. 500,000 = 4%
- (2) Next Rs. 500,000 = 8%
- (3) Next Rs. 500,000 = 12%
- (4) Next Rs. 500,000 = 16%
- (5) Next Rs. 1,000,000 = 20%
- (6) Balance = 24%

Corporate Income Tax

The general corporate tax rate in Sri Lanka is 17.5%. Corporate income tax rate of 28% is applied for banking, financial services, insurance and trading and 40% for liquor, tobacco, lottery, gaming and betting.

Value Added Tax (“VAT”)

Applicable rate: 15.0%

Key Measures

A number of measures were introduced in the Budget 2017 to improve Government revenue. With these measures, the Government expects to continue revenue based fiscal consolidation in the medium term, while increasing the direct tax share to 40% of the total tax revenue from around 20% at present and gradually reduce the indirect taxes to 60% from the present share of around 80%, in the medium term. Accordingly, income tax rate structure of individuals, including PAYE, has been proposed to be revised and the maximum rate is expected to be 24%. The corporate tax rate has been proposed to be revised to create a three tier structure with rates of 14%, 28% and 40%. Further, the PAYE rate structure is expected to be revised in line with the personal income tax rates and all exemptions applicable on various categories have been removed. Withholding Tax (“WHT”) on interest income increased to 5%, while WHT on specified fees where the payment exceeds Rs. 50,000 per month was re-introduced.

Several measures were introduced in the Budget 2016 and some revisions were made to the Budget 2016 to enhance Government revenue through simplifying the tax system and broadening the tax base. Accordingly, the corporate income tax rate of 15% proposed in the Budget 2016 was increased to 17.5%. Further, a share transaction levy of 0.30% was reintroduced. The VAT rate was increased to 15% instead of 8% and 12.5% proposed in the Budget 2016 and the VAT exemption on private healthcare and telecommunication services was proposed to be removed for the Budget 2016. NBT was maintained at 2% instead of increasing to 4% as proposed in the Budget 2016.

Several measures were introduced in the original 2015 Budget and the Interim Budget for 2015 to improve revenue collection. Accordingly, a single, higher excise tax was imposed on motor vehicles, cigarettes and liquor in place of several other taxes. Further, excise taxes on hybrid, petrol and diesel cars with displacements above 1,000 cc were increased while tax on petrol cars with displacements below 1,000 cc was lowered. Effective January 1, 2015, the VAT rate was reduced to 11% from 12%. Further, in order to broaden the VAT base, the quarterly turnover applicable for the imposition of VAT on wholesale and retail trade was further reduced from Rs.250 million to Rs.100 million.

In 2014, the Government took a number of measures to streamline direct tax collection while improving compliance. Accordingly, a lower tax rate of 16% was introduced on employment income of professionals. In addition, the formation of corporate entities by professionals to provide high quality professional services to global customers was also encouraged by reducing applicable corporate income tax by 50% for a period of five years. In order to promote exports, the restriction on time period for the applicability of concessional income tax rate of 12% on qualified export profits was removed. Further, in order to broaden the VAT base, the quarterly turnover applicable for the imposition of VAT on wholesale and retail trade was reduced from Rs.500 million to Rs.250 million while the VAT exempted amount was limited to 25% of total supplies. Additionally, the exemption of NBT on banks and financial institutions was removed to broaden the Nation Building Tax base. In addition to the introduction of a casino entry fee of US\$ 100 per person, the all-inclusive levy for the betting and gaming industry was increased to 10% on gross collections from 5%.

In 2013, the Government took several steps to enhance revenue collection. Steps were taken to broaden the VAT base. Accordingly, the VAT was imposed on wholesale and retail businesses having quarterly turnover/supplies of Rs.500 million or more. Furthermore, amendments to the Simplified Value Added Tax (SVAT) scheme were incorporated to the VAT Act and guidelines were issued to further simplify the scheme. The tax structure of the betting and gaming industry was rationalized with the introduction of an all-inclusive levy of 5% on gross collections in lieu of indirect taxes levied on these activities. In addition, the Excise Duty applicable on tobacco, cigarettes and motor vehicles was increased in order to generate more revenue.

The Government took several measures in 2012 to strengthen the fiscal consolidation process through streamlining the tax policy reforms introduced in recent years to broaden the tax base and simplify the tax structure. The chargeability to Economic Service Charge (“ESC”) was simplified by removing the liability to ESC on the turnover of any business of which the profits are subject to Income Tax. Further, the threshold of ESC was expanded from Rs.25 million to Rs.50 million per quarter. Several exemptions were granted to manufacturing industries setup up to replace imports, research and development services, and unit trusts and mutual funds. Further, the existing exemptions were extended to new enterprises engaged in agriculture, fisheries, IT, business or knowledge process outsourcing, health care, education, tourism, and sports and fitness centers, based on the scale of business and size of investment. A five year tax holiday, followed by a concessionary corporate income tax rate, was granted for new enterprises for investments made in strategically import replacement enterprises. Further, investors are permitted to defer taxes on the importation of plant, machinery or equipment by enterprises during the project implementation period. An advance ruling mechanism was introduced for investors eligible for tax exemptions, to ensure consistency in the application of respective provisions of relevant tax laws.

Results

Total revenue for 2016 increased by 15.9% to Rs.1,693.6 billion (US\$ 11.6 billion) compared to Rs.1,460.9 billion (US\$ 10.7 billion) in 2015. As a percentage of GDP, revenue increased to 14.3% in 2016 from 13.3% in 2015. Tax revenue increased by 8.0% to Rs. 1,463.7 billion (US\$ 10.1 billion), whereas non-tax revenue increased more than two fold to Rs. 222.4 billion (US\$ 1.5 billion) during 2016. Meanwhile, total grants received during 2016 amounted to Rs. 7.5 billion.

Total revenue for 2015 increased by 21.3% to Rs. 1,460.9 billion (US\$ 10.7 billion) compared to Rs. 1,204.6 billion (US\$ 9.2 billion) in 2014. As a percentage of GDP, revenue increased to 13.1% in 2015 from 11.7% 2014. Tax revenue increased by 29.1% to Rs. 1,355.8 billion (US\$ 4.10.4 billion), whereas non-tax revenue declined by 31.6% to Rs. 99.1 billion (US\$ 0.8 billion) during 2015. Meanwhile, total grants received during 2015 amounted to Rs.6.0 billion.

Revenue collection from major sources, including excise taxes on motor vehicles, liquor, cigarettes and tobacco, import duties and SCL (special commodity levy), increased in 2015. However, revenue collection from VAT declined considerably in 2015.

Total revenue in 2014 increased by 5.1% to Rs. 1,195.2 billion (US\$ 9.1 billion) compared to Rs. 1,137.4 billion (US\$ 8.8 billion) in 2013. As a percentage of GDP, revenue decreased to 11.6% in 2014 from 11.9% in 2013. Tax revenue increased by 4.4% to Rs. 1,050.4 billion (US\$ 8.0 billion), whereas non-tax revenue increased by 10.1% to Rs. 144.8 billion (US\$ 1.1 billion) in 2014. Meanwhile, total grants received during 2014 amounted to Rs. 9.4 billion (US\$ 0.1 billion).

Revenue collection from major sources, including value added tax on both domestic transactions and imports, excise tax, especially on liquor, motor vehicles and petroleum products, telecommunication levy and PAL and Cess Levy, all increased during 2014. However, revenue collection from direct taxes, other than PAYE taxes, declined in 2014.

Total revenue in 2013 increased by 8.2% to Rs. 1,137.4 billion (US\$ 8.8 billion) compared to Rs. 1,051.5 billion (US\$ 8.2 billion) in 2012. As a percentage of GDP, revenue decreased to 11.9% in 2013 from 12.0% in 2012. Tax revenue increased by 10.7% to Rs. 1,005.9 billion (US\$ 7.8 billion), mainly due to an increase in the collection of income taxes (19.2%), value added tax on domestic activities (9.2%) the special commodity levy (38.7%), and CESS levy (10.2%). Revenue collection from income tax increased mainly due to the improved performance in the corporate and non-corporate sector, PAYE taxes and withholding tax on interest. However, excise taxes, VAT on imports, import duties and non-tax revenue declined during this period.

Total government revenue as a percentage of GDP declined to 12.0% in 2012 compared to 13.4% recorded in the previous year and 14.7% projected in the budget due to a decline in tax revenue as a percentage of GDP. However, in nominal terms, Government revenue increased by 8.6% to Rs.1,051.5 billion in 2012 from Rs.967.9 billion in the previous year. Tax revenue as a percentage of GDP declined to 10.4% in 2012 from 11.7% in 2011, although in nominal terms it increased by 7.5% to Rs.908.9 billion. The indirect taxes remained the major source of tax revenue in 2012 accounting for 81.0% of the total tax revenue, compared to 81.4% in 2011. Consumption based taxes remained the major source of tax revenue in 2012 accounting for 79.6% of the total tax collection. The share of income tax revenue in total revenue increased to 20.4% in 2012 from 19.4% in 2011. Higher withholding tax revenue reflecting an increase in the volume as well as the maturity structure of new Treasury bond issues, higher borrowings through rupee denominated instruments and relatively high interest rates prevailing in the domestic market, compared to the previous year contributed to the improvement in income based tax collection. Non-tax revenue recorded a growth of 16.7% to Rs.142.5 billion in 2012 over the previous year. Higher transfer of profits and dividends from public institutions, including the Central Bank mainly contributed to the increase in non-tax revenue.

Expenditures

Total expenditure and net lending increased by 1.9% to Rs. 2,333.9 billion (US\$ 16.0 billion) in 2016 from Rs. 2,290.4 billion (US\$ 16.8 billion) in 2015. As a percentage of GDP, total expenditure and net lending decreased to 19.7% in 2016 from 20.9% in 2015. During 2016, recurrent expenditure increased by 3.3% to Rs. 1,757.8 billion (US\$ 12.1 billion). Increase in interest payments mainly contributed to the increase in recurrent expenditure in nominal terms, followed by increase in expenditure on salaries and wages. Interest payments also increased to Rs. 610.9 billion (US\$ 4.2 billion) and capital expenditure and net lending declined by 2.1% to Rs. 576.1 billion (US\$ 4.0 billion). As a percentage of GDP, capital expenditure and net lending declined to 4.9% during 2016, compared to 5.3% in 2015.

Total expenditure and net lending increased by 27.5% to Rs.2,290.4 billion (US\$ 16.8 billion) during 2015 from Rs.1,795.9 billion (US\$ 13.8 billion) in 2014. As a percentage of GDP, total expenditure and net lending has increased to 20.5% in 2015 from 17.2% in 2014. During 2015, recurrent expenditure increased by 28.6% to Rs.1,701.7 billion (US\$ 12.5 billion), mainly due to an increase in expenditure on salaries and wages, pension and Samurdhi payments. Interest payments also increased to Rs.509.7 billion (US\$ 3.7 billion) and capital expenditure and net lending increased by 24.5% to Rs.588.7 billion (US\$ 4.3 billion). As a percentage of GDP, capital expenditure and net lending increased to 5.3% during 2015, compared to 4.5% in 2014.

Total expenditure and net lending increased by 67.6% to Rs.1,795.9 billion (US\$ 13.8 billion) in 2014 from Rs.1,669.4 billion (US\$ 12.9 billion) in 2013. In 2014, as a percentage of GDP, total expenditure and net lending remained unchanged at 17.4% from 2013. In 2014, recurrent expenditure increased by 9.8% to Rs.1,322.9 billion (US\$ 10.1 billion), mainly due to the increase in expenditure on salaries and wages, other goods and services and fertilizer subsidies. Interest payments declined marginally to Rs.443.6 billion (US\$ 3.3 billion) and capital expenditure and net lending increased by 1.9% to Rs.473.0 billion (US\$ 3.6 billion). As a percentage of GDP, capital expenditure and net lending declined to 4.6% in 2014, compared to 4.8% in 2013.

Total expenditure and net lending is estimated to have increased by 7.3% to Rs.1,669.4 billion (US\$ 12.9 billion) in 2013 from Rs.1,556.5 billion (US\$ 12.2 billion) in 2012. As a percentage of GDP, total expenditure and net lending declined to 17.4% in 2013 from 17.8% in 2012. In 2013, recurrent expenditure increased by 60.6% to Rs.1,205.2 billion (US\$ 9.3 billion), mainly due to the increase in expenditure on interest payments, salaries and wages, pensions and the Samurdhi payments. Interest payments amounted to Rs.462.9 billion (US\$ 3.4 billion), an 8.7% increase over 2012 which amounted to Rs.408.5 billion (US\$ 3.0 billion). Capital expenditure and net lending is estimated to have increased by 9.1% to Rs.464.2 billion (US\$ 3.6 billion). As a percentage of GDP, capital expenditure declined to 4.8% in 2013, compared to 4.9% in 2012.

Government Budget

The Budget Process

Each year in May, the Ministry of Finance collects economic data and estimates from all the Ministries and Revenue Departments in order to prepare the budget for the following year. The Minister of Finance presents a budget speech to the Parliament in November every year which has to be subsequently approved by a majority in the Parliament to be passed as an Appropriation Act.

The broad strategies for budget making are to achieve macroeconomic stability and a regionally-balanced economic growth rate of 6.0% to 8.0% per annum over the medium term. The policy envisages prominent roles for both the public and private sectors, and pro-poor, pro-growth strategies, while continuing market-based economic policies pursued by successive Governments over the past 25 years.

As part of the Government's budget process, Government obligations in debt service payments on outstanding foreign debt are included in the expenses to be incurred out of the Consolidated Fund. Such an inclusion is based on the provisions of the Foreign Loans Act No. 29 of 1958 (as amended), which states that the cost of Government foreign debt service payments is to be charged to the Consolidated Fund.

2017 Budget

The Government's budget for 2017 (the "Budget 2017") was presented to the Parliament on November 10, 2016 and approved on December 10, 2016. The broad theme of the Budget 2017 has been set out as "Accelerating Growth with Social Inclusion". Accordingly, the main objective of the Budget 2017 is eradication of poverty by promoting social inclusion. Furthermore, the Budget 2017 placed a greater emphasis on improving Sri Lanka's production capacity, which includes expansion of employment opportunities, recognizing the private sector as the engine of growth, encouraging entrepreneurship development, improving productivity and introducing broad based reforms to achieve a sustainable economic growth while creating a conducive macroeconomic environment. Meanwhile, fiscal operations are expected to improve further in 2017, with the expected overall fiscal deficit being 4.6% of GDP, a decrease from 5.4% of GDP recorded in 2016. According to budget estimates, total revenue and grants for 2017 is estimated to be Rs. 2,020.3 billion (US\$ 13.4 billion), total expenditure and net lending is estimated to be Rs. 2,645.3 billion (US\$ 17.5 billion) and the overall budget deficit is expected to be Rs. 625.0 billion (US\$ 4.1 billion). The budget deficit is expected to be financed through net domestic financing of Rs. 293.0 billion (US\$ 1.9 billion) and net foreign financing of Rs. 332.0 billion (US\$ 2.2 billion).

2016 Budget

The Budget for 2016 was presented to the Parliament on November 20, 2015 and approved on December 19, 2015. The main objectives of the budget were to create an upper middle income economy guaranteeing economic resurgence, thus upgrading Sri Lanka to a higher plateau by further strengthening the fiscal consolidation through rationalizing public expenditure and increasing Government revenue. Furthermore, the budget aims at setting a new dimension in the national economic policy within the framework of good governance and transparency. Fiscal operations were expected to improve further in 2016, with the overall fiscal deficit expected to decline to 5.9% of GDP. On March 8, 2016, the Government announced revisions to certain taxes in the backdrop of the changing global economic climate while highlighting the commitment of the Government to reduce the budget deficit further to 5.4% of GDP in 2016, instead of the originally targeted level of 5.9% of GDP envisaged in the Budget 2016. According to revised estimates, total revenue and grants for 2016 is estimated to be Rs. 1,556.0 billion (US\$ 10.8 billion), total expenditure and net lending is estimated to be Rs. 2,215.0 billion (US\$ 15.4 billion) and the overall budget deficit is expected to be Rs. 659 billion (US\$ 4.6 billion). The budget deficit is expected to be financed through net domestic financing of Rs. 259.0 billion (US\$ 1.8 billion) and net foreign financing of Rs. 400.0 billion (US\$ 2.8 billion).

2015 Interim Budget

The Interim Budget 2015 (Hundred Day Revolution) which was presented to the Parliament on January 29, 2015 and approved on February 7, 2015, proposed changes to the original 2015 Budget that was approved on November 24, 2014. According to revised budget estimates in the 2015 Interim Budget, total revenue and grants for 2015 is estimated to be Rs. 1,535 billion (US\$ 11.6 billion), total expenditure and net lending is estimated to be Rs. 2,034 billion (US\$ 15.3 billion) and the overall budget deficit is expected to be Rs. 499 billion (US\$ 3.8 billion). The budget deficit is expected to be financed through net domestic financing of Rs. 208 billion (US\$ 1.6 billion) and net foreign financing of Rs. 291 billion (US\$ 2.2 billion).

2015 Budget

The Budget for 2015 was presented to the Parliament on October 24, 2014 and approved on November 24, 2014. The main objectives of the budget were to further strengthen the fiscal consolidation through rationalizing public expenditure and increasing Government revenue, continue with infrastructure development in the rural areas, and facilitate human capital development through enhancing education (primary, secondary, university and vocational), supporting research and innovation, and improving health services. Furthermore, the budget aims at promoting export of goods and services, increasing value addition to Sri Lankan products and improving productivity in all sectors of the economy and simultaneously developing the economy in rural areas. In addition, the budget encourages urban development and focuses on strengthening social security and creating support for low income families. Fiscal operations are expected to improve further in 2015, with the overall fiscal deficit expected to decline to 4.6% of GDP from an expected 5.2% in 2014. According to budget estimates, total revenue and grants for 2015 is estimated to be Rs. 1,625 billion (US\$ 12.5 billion), total expenditure and net lending is estimated to be Rs. 2,210 billion (US\$ 17.0 billion) and the overall budget deficit is expected to be Rs. 521 billion (US\$ 4.0 billion). The budget deficit is expected to be financed through net domestic financing of Rs. 230 billion (US\$ 1.8 billion) and net foreign financing of Rs. 291 billion (US\$ 2.2 billion).

2014 Budget

The Budget for 2014 was presented to the Parliament on November 21, 2013 and approved on December 20, 2013. The main objectives of the budget were to sustain economic growth in a non-inflationary environment within a consistent policy framework, to strengthen the fiscal consolidation process, to strengthen the rural economy and to alleviate poverty through inclusive growth. Fiscal operations were expected to improve further in 2014, with the overall fiscal deficit expected to decline to 5.2% of GDP from 5.8% in 2013. According to budget estimates, total revenue and grants for 2014 was estimated to be Rs. 1,469.5 billion (US\$ 11.2 billion), total expenditure and net lending was estimated to be Rs. 1,985.6 billion (US\$ 15.1 billion) and the overall budget deficit was estimated to be Rs. 516.1 billion (US\$ 3.9 billion). The budget deficit was expected to be financed through net domestic financing of Rs. 229.3 billion (US\$ 1.7 billion) and net foreign financing of Rs. 286.8 billion (US\$ 2.2 billion).

2013 Budget

The Budget for 2013 was presented to the Parliament on November 8, 2012 and was approved on December 8, 2012. The 2013 Budget was presented with the objective of transforming the economy into a poverty-free upper-middle income economy over the next three years starting from 2013 while continuing the fiscal consolidation process. Accordingly, several measures were proposed in the fiscal front to increase government revenue and streamline expenditure while encouraging regionally-balanced growth of the country. Measures introduced in the tax system were mainly focused to broaden the tax base and improve tax administration. Total government revenue and grants in 2013 was estimated to be Rs. 1,277.5 billion (US\$ 9.9 billion), total expenditure and net lending was estimated to be Rs. 1,784.9 billion (US\$ 13.8 billion) and the overall budget deficit was estimated to be Rs. 507.4 billion (US\$ 3.9 billion). The budget was expected to be financed through net domestic financing of Rs. 359.4 billion (US\$ 2.8 billion) and net foreign financing of Rs. 148 billion (US\$ 1.1 billion).

2012 Budget

The Budget for 2012 was presented in the Parliament on November 21, 2011 and it was approved on December 21, 2011. The budget targeted five major areas, namely supporting a caring family, ensuring food security, empowering a healthy generation, creating a knowledge society and boosting an enterprise economy. According to the budget for 2012, the fiscal sector was expected to show several positive developments. New proposals were introduced to simplify the tax system, to streamline tax administration and to broaden the tax base. Further, several tax incentives in terms of exemptions and concessionary rates were proposed to increase investments in agriculture, information technology, business/knowledge process outsourcing, healthcare, education, tourism and sports related activities. Considering the fiscal sector, total government revenue and grants in 2012 was Rs. 1,067.5 billion (US\$ 8.4 billion), total expenditure and net lending was to be Rs. 1,556.5 billion (US\$ 12.2 billion), and the overall budget deficit was Rs. 489 billion (US\$ 3.8 billion). The budget was financed through net domestic financing of Rs. 202.5 billion (US\$ 1.6 billion) and net foreign financing of Rs. 286.5 billion (US\$ 2.2 billion).

The following table sets forth the 2017 Budget.

2017 BUDGET

Item	2017 Budget
	(Rs. million)
Total revenue and Grants	2,020,300
Total revenue	2,010,300
Tax revenue	1,827,000
Income taxes	334,550
VAT	380,000
Excise taxes	579,035
Import duties	165,500
Other taxes	367,915
Non tax revenue	183,300
Grants	10,000
Total expenditure and net lending	2,645,300
Current expenditure	1,946,000
Salaries and wages	615,000
Interest payments	680,087
Current transfers and subsidies	427,577
Other	223,336
Capital Expenditure and Lending minus Repayments	699,300
Revenue Surplus/(Deficit)	64,300
Budget Deficit	<u>625,000</u>

Source: Central Bank of Sri Lanka

Debt

External Debt

In 2013, the Central Bank modified its system of collecting and reporting data based on BPM6, a set of revised and updated standards for concepts, definitions and classifications for international accounts statistics published by the IMF. The following table sets forth the external debt of the country for 2012 to 2016 based on BPM6.

EXTERNAL DEBT (2012-2016)

	As at December 31,				
	2012	2013	2014	2015 ⁽¹⁾	2016 ⁽¹⁾
	(in US\$ millions, except as indicated)				
Breakdown by maturity Short-term.....	6,419	6,770	7,263	7,653	7,346
General Government	576	507	399	33	80
Central Bank	232	291	443	483	536
Deposit-taking corporations, except for the Central Bank.....	3,701	3,884	4,747	5,762	5,247
Other sectors	1,910	2,089	1,674	1,375	1,483
Medium and long-term.....	30,679	33,135	35,651	37,186	39,240
General Government	21,547	21,783	23,733	24,647	27,118
Central Bank	3,318	2,665	1,821	2,340	1,486
Deposit-taking corporations, except for the Central Bank.....	1,215	2,875	3,386	3,393	3,543
Other sectors	2,823	3,713	4,167	4,192	4,291
Direct investment and intercompany lending	1,776	2,100	2,544	2,613	2,802
Total.....	37,098	39,905	42,914	44,839	46,586
Breakdown by sector Government	22,123	22,290	24,132	24,681	27,197
Project Loans	15,616	15,814	15,774	16,147	17,295
Multilateral	6,640	6,910	6,776	6,903	7,187
Bilateral	7,155	6,714	6,919	6,414	6,438
Financial Markets.....	30	27	35	40	755
Supplier Credits	1,792	2,163	2,045	2,790	2,915
Debt Securities	6,508	6,476	8,358	8,534	9,903
Treasury bills and bonds	2,643	2,991	2,996	1,844	1,520
International Sovereign bonds	3,864	3,485	5,287	6,425	8,325
Sri Lanka Development Bonds			75	265	58
Central Bank.....	3,550	2,956	2,264	2,823	2,022
Deposit Taking Corporations	4,916	6,758	8,133	9,156	8,790
Other Sectors	4,733	5,801	5,841	5,567	5,774
Inter-company borrowings.....	1,776	2,100	2,544	2,613	2,802
Total	37,098	39,905	42,914	44,839	46,586
Ratios:					
Gross External Debt as a percentage of GDP					
Total Gross External Debt (%)	54.2	53.7	54.1	55.7	57.3
Short-term Debt (%).....	9.4	9.1	9.3	9.5	9.0
Long-term Debt (%).....	44.8	44.6	44.8	46.2	48.3

Source: External Resources and Ministry of Finance

Note:

(1) Provisional

Total external debt increased from US\$ 44.8 billion as at 2015 year-end to US\$ 46.6 billion as at 2016 year-end. The increase in external debt was primarily due to the increase in Government debt by US\$ 2.5 billion in 2016. External borrowings by the Government increased in 2016 due to the issuance of ISBs, two foreign currency term financing facilities and project loans, partially offset by disinvestments by foreign investors in the Government securities market. Meanwhile, the outstanding external debt of the Central Bank was reduced by US\$ 801 million with the repayment of the foreign currency swap liability and the repayment of the IMF SBA. Further, outstanding external debt of deposit taking corporations, private corporations and SOBEs and intra company debt of direct

investment enterprises amounted to US\$ 8,790 million, US\$ 5,774 million and US\$ 2,802 million, respectively, in 2016. Total outstanding external debt as a percentage of GDP increased to 57.3% as at 2016 year-end, compared to 55.7% as at 2015 year-end, primarily due to the increase in Government external debt. Outstanding position of Government external debt amounted to 58.4% of total external debt as at 2016 year-end, compared to 55.0% recorded as at 2015 year-end.

The total external debt of Sri Lanka increased to US\$ 44.8 billion, which accounts for 55.7% of the GDP as at December 31, 2015, compared to US\$ 42.9 billion, which amounts to 54.1% of the GDP as at December 31, 2014. This relatively marginal increase in outstanding external debt was mainly attributable to the moderate inflow of foreign loans, coupled with the repayment of maturing debt securities and other scheduled debt repayments. The outstanding external debt in US dollar terms increased only moderately as a result of the high level of exchange rate valuation differences. Meanwhile, the composition of short-term to long term debt remained at the same level in both the beginning and the end of 2015. Outstanding foreign loans, which accounted for 58% of the total external debt, were the main contributor to the total external debt as at December 31, 2015. Outstanding portfolio investments in the form of debt securities and currency and deposit liabilities amounted to 24% and 7%, respectively, as at December 31, 2015. On a sector wise breakdown, the outstanding external debt of the Government accounted for the largest share of total external debt, with 55% of the total external debt, while deposit taking corporations, private sector corporations and SOBEs and the Central Bank, contributed 20%, 12% and 6%, respectively, to the total outstanding external debt as at December 31, 2015.

As at December 31, 2014, Sri Lanka's total external debt amounted to US\$ 43.0 billion, an increase of 7.7% from the US\$ 39.9 billion as at December 31, 2013. This was mainly attributable to the issuance of the sixth and the seventh international sovereign bonds amounting to US\$ 1.5 billion in total, the international bond issuances of NSB and SriLankan Airlines, net increase in long-term foreign loans of the Government, the SOBEs, the private sector and deposit taking corporations. However, total external debt as a percentage of GDP decreased to 57.5% as at December 31, 2014, from 57.4% as at December 31, 2013, primarily because the real GDP grew at a higher rate than the total external debt.

Higher inflows to the private sector and deposit taking corporations resulted in an increase in the total external debt in 2013. According to the BPM6 guidelines, the external debt includes the outstanding position of SDRs and intra-company lending of DIEs, both of which were not covered in previous statistical publications. With the addition of new categories and reclassification of external debt statistics, the total external debt of the country was recorded at US\$ 39.9 billion at the end of 2013, a 7.5% increase from the US\$ 37.1 billion recorded at the end of 2012. This increase was primarily due to higher inflows to the private sector in the form of foreign borrowings and international debt securities issued by deposit taking corporations. Of the total external debt, 61% was in the form of outstanding loan liabilities at the end of 2013, compared to 64% recorded at the end of 2012. With the inclusion of new data categories in external debt statistics, total external debt as a percentage of GDP amounted to 59% at the end of 2013, compared to 62% at the end of 2012, reflecting a more significant increase in GDP compared to the increase in external debt.

The Government could maintain the non-concessional debt level at a manageable level by encouraging both domestic and foreign investors to undertake major infrastructure projects, perhaps in partnership with the Government. In this regard, it is necessary to encourage the private sector, especially the financially sound private sector enterprises to raise medium and long term external loans from the international markets and multilateral financial institutions to finance such infrastructure projects and their own operations. This would release domestic financial resources to private sector enterprises that are not capable of raising external debt. If the Government is unsuccessful in harnessing private investment and the access to the concession loans decreases, the effect will be an increase in the Government financing costs.

The external debt is expected to remain at current levels in the immediate future. The anticipated direction of capital markets external financing may be offset by the decline in concessional borrowing mainly due to Sri Lanka's advancement into the lower middle income country category.

Debt Service Payments

Capital payments on Sri Lanka's external debt obligations moderated while interest payments increased in 2016. Capital repayments on external debt amounted to US\$ 3,157 million in 2016, compared to US\$ 3,435 million in 2015. The notable decline in capital repayments of Government securities was due to the one-time repayment in 2015 of an ISB of US\$ 500 million. However, repayments of the Central Bank increased with the settlement of foreign currency swaps, amounting to US\$ 1,100 million, along with the repayments for the IMF SBA in 2016. Interest payments on outstanding external debt obligations increased from US\$ 1,190 million in 2015 to US\$ 1,209 million in 2016. The increase in interest payments was mainly due to the expansion in interest payments made by the private sector and deposit taking corporations. Total external debt service payments as a percentage of exports declined in 2016. As a result of the decline in total debt service payments, coupled with an increase in export of merchandise goods and services, debt service payments as a percentage of export of goods and services declined to 25.0% in 2016, compared to 27.3% in 2015.

Debt service payments on Sri Lanka's external debt obligations increased significantly in 2015. Both capital and interest payments increased in 2015 to US\$ 3,435 million and US\$ 1,190 million, respectively, compared to US\$ 2,323 million of capital payments and US\$ 1,156 million of interest payments in 2014. Capital payments increased with the repayment of the Government's foreign loans of US\$ 798 million, matured ISBs of US\$ 500 million, matured Treasury bonds of US\$ 678 million, the SBA Facility repayment of US\$ 507 million, the repayment of foreign loans by SOBEs and deposit taking corporations of US\$ 577 million and the repayment of US\$ 400 million of the RBI swap facility by the Central Bank. Meanwhile, Sri Lanka made US\$ 1,190 million of interest payments during 2015, compared to US\$ 1,156 million in 2014, respectively, an increase of 3% over the previous year. As a result of increased capital and interest payments and lower exports of goods, debt service payments as a percentage of export of goods and services increased significantly to 27.3% in 2015 compared to 20.8% a year earlier.

Total foreign debt service payments, consisting of amortization and interest payments in 2014. In nominal terms, debt service payments declined to US\$ 3,386 million in 2014, from US\$ 3,540 million in 2013, primarily due to a decrease in repayments of Treasury bills and Treasury bonds and a decrease in capital repayments on the long-term loans of the Government. Total capital repayments were comprised of the repayment of long-term borrowings by the Government amounting to US\$ 793 million, the repayment of US\$ 719 million to the IMF, the maturity of Government securities amounting to US\$ 503 million and the repayment of private sector loan liabilities amounting to US\$ 215 million. Meanwhile, debt service payments as a percentage of export of goods and services declined to 20.2% in 2014 compared to 23.5% in 2013, mainly due to decreased capital repayments and increased earnings of exports of goods and services.

Total foreign debt service payments increased in 2013. Total foreign debt service payments, which consisted of both principal and interest payments, increased by 32.0% from US\$ 2,672 million in 2012 to US\$ 3,540 million in 2013. This was primarily due to an increase in capital payments by 50% and an increase in interest payments by 20% in 2013. The capital payments included repayment of the SBA Facility of US\$ 453 million, repayment of Government long-term borrowings of US\$ 836 million, repayment of private sector loans of US\$ 474 million and the maturity of Government securities of US\$ 719 million. The increase in interest payments was primarily due to the increase in interest payments on Government securities. Accordingly, foreign debt service payments as a percentage of exports of goods and services increased to 23.5% in 2013 from 19.7% in 2012.

Sri Lanka Credit Ratings

On February 27, 2009, Fitch revised its credit rating outlook for the country's long term foreign and local currency Issuer Default Ratings to "negative" from "stable," citing the "heightened concern regarding the sovereign's external financial position in light of the marked decline in official foreign exchange reserves." Fitch revised Sri Lanka's sovereign rating outlook to "stable" from "negative" to reflect the country's positive changes in sovereign credit fundamentals on October 9, 2009. The agency has affirmed the long-term foreign and local currency Issuer Default Ratings and the Country Ceiling at "B+" and the short-term Issuer Default Rating at "B," citing "the positive changes in sovereign credit fundamentals following the end of the 26-year internal conflict, the approval of the

US\$ 2.6 billion SBA Facility and the return of private capital inflows.” On September 21, 2010, Fitch again revised the outlook to “positive” from “stable.” On July 18, 2011, Fitch upgraded Sri Lanka’s long-term foreign and local currency Issuer Default Rating to “BB-” from “B+”, with a stable outlook and affirmed Sri Lanka’s short-term Issuer Default Rating at “B.” The rating agency has also upgraded the Country Ceiling to “BB-”. In Fitch’s view, the outlook revision reflects of Sri Lanka’s economic benefits from the end of the internal conflict and further benefits from the disciplined policy framework put in place under the SBA Facility and from the improved external liquidity position bolstered by the IMF program. On May 4, 2012, Fitch affirmed Sri Lanka’s long-term foreign and local currency Issuer Default Rating of “BB-”, with a stable outlook, and affirmed Sri Lanka’s short-term Issuer Default Rating at “B” and a Country Ceiling of “BB-”. In April 2013, having observed the country’s growth performance, level of human development and payment record against weakness of fiscal and external balance sheet and moderate domestic savings relative to investment needs, Fitch affirmed Sri Lanka at “BB-” with a stable outlook. On May 12, 2014, Fitch affirmed again its existing rating of “BB-” and the stable outlook of the Sri Lankan economy. On April 22, 2015, Fitch reaffirmed its existing rating of “BB-” with a stable outlook, citing Sri Lanka’s smooth political transition following the presidential elections, reinforcing perceptions of a functioning democracy with relatively strong institutions. On February 29, 2016, Fitch revised Sri Lanka’s long-term foreign currency risk rating from “BB-” to “B+” with a negative outlook, highlighting an increased vulnerability of the sovereign’s creditworthiness to adverse shocks. On February 9, 2017, Fitch confirmed Sri Lanka’s rating at “B+” and revised the outlook from “negative” to “stable” considering the continuous improvement in fiscal performance, improved policy coherence and credibility with the on-going IMF-EFF programme and stable growth in the economy.

On August 25, 2009, S&P revised its sovereign rating outlook back to “stable” due to Sri Lanka’s improved external liquidity position in light of the SBA Facility. On October 15, 2009, S&P further revised its sovereign rating outlook to “positive,” citing the “continued strengthening of Sri Lanka’s BOP position, and S&P’s expectation that the SBA Facility will be pursued to its conclusion, engendering modest improvement in public finances”. Accordingly, S&P affirmed its “B” long-term foreign currency credit rating and “B+” long term local currency sovereign credit rating on Sri Lanka. They also affirmed the “B” short-term ratings on the sovereign. On September 15, 2010, S&P raised its long-term foreign currency sovereign credit rating on Sri Lanka to “B+” from “B,” and the long-term local currency rating to “BB-” from “B+” taking into account the continued strengthening of Sri Lanka’s BOP position and the expected sustainable decline in fiscal deficits and public debt under the Government’s planned revenue reforms. On July 19, 2011, S&P raised its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “positive” from “stable” based on improved external liquidity, progress in addressing structural fiscal weaknesses and the Government’s inflation management efforts. On February 29, 2012, S&P changed its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “stable” from “positive” while affirming its “B+” rating and lowering its long-term local currency sovereign credit rating to “B+” from “BB-.” On August 1, 2013, S&P affirmed its “B+” long-term sovereign credit ratings, with a stable outlook. S&P expects that Sri Lanka’s gross international reserves will remain at a similar level to that in 2012 at three months’ coverage of current account receipts. The stable outlook reflects S&P’s view that the country has strong prospects for per capita real GDP growth over the next few years and the improvement of the Government’s fiscal profile. On July 8, 2014, S&P again affirmed its “B+” long-term and “B” short-term sovereign credit ratings. On August 6, 2015, S&P affirmed its “B+” long-term and “B” short-term sovereign credit ratings for Sri Lanka, with a stable outlook. S&P’s transfer and convertibility risk assessment remained unchanged at “B+”. S&P cited Sri Lanka’s strong economic growth outlook, moderate external imbalances and adequate monetary flexibility dampened by weak fiscal indicators and institutional constraints. On March 10, 2016, S&P revised its credit rating outlook for the country’s long-term foreign-currency rating from “Stable” to “Negative”, citing “rising pressures on Sri Lanka’s external-liquidity position, stemming from a weaker than expected trade balance and falling remittances”. On March 7, 2017, S&P affirmed its current ratings and outlook.

In addition, Moody's has assigned a "B1" foreign currency issuer rating to the Government of Sri Lanka. The outlook was revised from "stable" to "positive" on July 18, 2011. The agency has considered the end of the internal conflict and the structural improvement in the country's economic prospects and stability in making the rating decision. In July 2013, Moody's changed its outlook on Sri Lanka's "B1" foreign currency sovereign rating from positive to stable and affirmed its "B1" foreign currency government bond rating in consideration of the stabilization in the external payments position, following the sizable loss of foreign reserves in 2011, and the pause in the decline in the Government's high debt burden as large ongoing deficits impede a positive credit reduction. On June 20, 2016, Moody's affirmed its "B1" foreign currency issuer and senior unsecured sovereign ratings to the Government, while changing its outlook to "negative" from "stable". Moody's latest rating change was underpinned by the expectation of a further weakening in certain of Sri Lanka's fiscal metrics in an environment of subdued GDP growth which could lead to renewed BOP pressure and the possibility that the effectiveness of the fiscal reforms as envisaged by the Government may be lower than currently expected, which could further weaken Sri Lanka's fiscal and economic performance.

Direct Debt of the Issuer

The following table summarizes the Government's outstanding direct debt as at the dates indicated.

OUTSTANDING DIRECT DEBT OF THE ISSUER

	As at December 31,					As at December 31,		% Increase or Decrease
	2012	2013	2014	2015 ⁽¹⁾	2016 ⁽¹⁾	2015 ⁽¹⁾	2016 ⁽¹⁾	
	(in Rs. millions, except for percentages)							
Medium/long-term debt	5,106,656	5,810,178	6,394,236	7,584,890	8,405,794	7,584,890	8,405,794	10.82%
Domestic.....	2,419,541	2,923,670	3,339,266	4,045,905	4,372,814	4,045,905	4,372,814	8.08%
External ⁽²⁾	2,687,115	2,886,508	3,057,616	3,538,985	4,032,980	3,538,985	4,032,980	13.96%
Short-term debt.....	893,456	983,072	996,662	918,337	981,509	918,337	981,509	6.88%
Domestic.....	813,272	909,156	938,517	913,291	968,693	913,291	968,693	6.07%
External ⁽³⁾	80,184	73,916	55,500	5,045	12,816	5,045	12,816	154.01%
Total debt	6,000,112	6,793,249	7,390,899	8,503,227	9,387,303	8,503,227	9,387,303	10.40%

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

- (1) Provisional
- (2) Includes foreign investments in Treasury Bonds
- (3) Includes foreign investments in Treasury Bills

The average time to maturity of domestic Government debt was 6.02 years as at March 31, 2017, an increase from 5.98 years as at December 31, 2016 and a decrease from 6.28 years as at December 31, 2015. The average time to maturity of external Government debt was 8.43 years as at December 31, 2016, compared to 9.15 years as at December 31, 2015 and 9.46 years as at December 31, 2014. Meanwhile, the ratio of short-term domestic debt to total domestic debt was 18.17% as at March 31, 2017, compared to 18.14% and 18.42% as at December 31, 2016 and 2015, respectively. The time to maturity of the longest dated Treasury bonds was 30 years for each of 2015 and 2016.

OWNERSHIP OF TREASURY BILLS⁽¹⁾

	As at December 31,					% Increase or Decrease
	2012	2013	2014	2015	2016 ⁽²⁾	
	(in Rs. millions, except for percentages)					
Bank Sector	373,753	447,004	401,792	445,418	575,528	29.2
Central Bank	154,005	3,053	123,496	104,754	331,389	216.3
Commercial Banks	219,748	443,951	278,296	340,664	244,139	(28.3)
Non-Bank Sector	255,317	253,133	292,975	212,822	204,052	(4.1)
Employees' Provident Fund	33,410	13,969	1,000	—	41,057	—
Other Provident Funds	122	45	—	162	77	(52.5)
Savings Institutions	61,972	68,328	47,945	67,766	18,049	(73.4)
Insurance and Finance						
Companies.....	19,097	28,629	47,461	47,375	57,918	22.3
Departmental and Other Official						
Funds	2,566	8,114	10,986	7,570	7,616	0.6
Private and Other	138,149	134,048	185,582	89,949	79,336	(11.8)
Total	629,070	700,137	694,767	658,240	779,581	18.4

Sources: Central Bank of Sri Lanka and Ministry of Finance

Notes:

- (1) Adjusted for secondary market transactions
- (2) Provisional

OWNERSHIP OF TREASURY BONDS ⁽¹⁾⁽²⁾

	As at December 31,					% Increase or Decrease
	2012	2013	2014	2015	2016 ⁽³⁾	
	(in Rs. millions, except for percentages)					
Bank Sector	244,770	386,398	595,067	517,613	731,942	41.4
Central Bank	—	—	—	—	—	—
Commercial Banks	244,770	386,398	595,067	517,613	731,942	41.4
Non-Bank Sector	1,850,284	2,065,962	2,248,987	2,787,635	2,982,845	7.0
Employees' Provident Fund	1,117,360	1,356,389	1,450,144	1,612,461	1,737,219	7.7
Other Provident Funds	30,639	35,031	315	42,713	48,060	12.5
Savings Institutions	261,309	285,915	327,932	358,470	406,722	13.5
Insurance and Finance						
Companies.....	31,711	26,636	42,742	58,808	87,124	48.1
Departmental and Other Official						
Funds	37,596	187,904	210,598	245,045	264,014	7.7
Private and Other	371,669	174,087	217,255	470,138	439,707	(6.5)
Total	2,095,053	2,452,360	3,245,764	3,305,248	3,714,787	12.4

Sources: Central Bank of Sri Lanka and Ministry of Finance

Notes:

- (1) Adjusted for secondary market transactions
- (2) Excludes Treasury bonds of Rs.78,447 million issued to settle dues to CPC in January 2012 and Rs.13,125 million issued to capitalize SriLankan Airlines in March 2013.
- (3) Provisional

OWNERSHIP OF RUPEE LOANS

As at December 31,					
	2012	2013	2014	2015	2016 ⁽¹⁾
	(in Rs. millions, except for percentages)				
Bank Sector	15,870	15,870	15,870	15,870	15,870
Central Bank	—	—	—	—	
Commercial Banks ⁽²⁾	15,870	15,870	15,870	15,870	15,870
Non-Bank Sector	42,516	39,648	39,648	8,218	8,218
Savings Institutions	6,868	4,000	4,000	2,000	2,000
Departmental and Other					
Official Funds	5,190	6,101	6,101	—	—
Employees' Provident Fund	23,100	23,100	23,100	—	—
Other Provident Funds	7,358	6,447	6,447	6,218	6,218
Other ⁽²⁾	—	—	—	—	—
Total	<u>58,386</u>	<u>55,518</u>	<u>55,518</u>	<u>24,088</u>	<u>24,088</u>

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

(1) Provisional

(2) Comprises co-operative banks, other companies, clubs, institutions and individuals

OWNERSHIP OF GOVERNMENT DEBT⁽¹⁾

As at December 31,					
	2012	2013	2014	2015	2016 ⁽⁷⁾
	(in Rs. millions, except for percentages)				
Domestic Debt ⁽²⁾⁽³⁾	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507
Bank Sector	1,060,317	1,433,773	1,669,882	1,924,036	2,114,901
Central Bank	265,198	112,396	267,677	256,050	414,950
Commercial Banks	795,119	1,321,377	1,402,205	1,667,986	1,699,951
Non-Bank Sector	2,172,495	2,399,053	2,607,901	3,035,160	3,226,606
Market Borrowings	2,171,562	2,385,120	2,607,331	3,034,590	3,226,606
Savings Institutions	330,150	358,243	379,877	428,236	426,771
Insurance Funds	33,768	30,849	30,536	50,597	76,944
Provident and Pension					
Funds ⁽⁴⁾	1,204,729	1,428,534	1,474,560	1,655,336	1,826,413
Official Funds ⁽⁵⁾	178,900	202,118	221,584	252,615	271,630
Private Business and					
Individuals ⁽⁶⁾	424,015	365,376	500,773	647,807	624,848
Non-Market Borrowings	933	13,933	570	570	0
Foreign Debt	<u>2,767,299</u>	<u>2,960,424</u>	<u>3,113,116</u>	<u>3,544,031</u>	<u>4,045,796</u>
Total	<u>6,000,112</u>	<u>6,793,249</u>	<u>7,390,899</u>	<u>8,503,227</u>	<u>9,387,303</u>

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

(1) Outstanding Treasury bills and Treasury bonds have been adjusted for secondary market transactions.

(2) Excludes rupee denominated Treasury bills held by foreign investors from 2008

(3) Excludes Treasury bonds amounting to Rs. 78,447 million issued to settle dues to CPC in January 2012, Rs. 13,125 million issued to capitalize SriLankan Airlines in March 2013 and rupee denominated Treasury bonds held by foreign investors from 2007.

(4) Trusts, Benevolent, Pension and Provident Funds and the Employees' Provident Fund

(5) The Central Government, Local Authorities, State Corporations, Departmental and other official funds

(6) Includes the value of Treasury Certificates of Deposits, Public Debt Sinking Funds (the investment fund with effect from September 1971) and the National Housing Sinking Fund

(7) Provisional

COMPOSITION OF OUTSTANDING CENTRAL GOVERNMENT DEBT

	As at December 31,					% Increase or Decrease
	2012	2013	2014	2015	2016 ⁽⁸⁾	
Foreign Debt	2,767,299	2,960,424	3,113,116	3,544,031	4,045,796	14.2
Project Loans ⁽¹⁾	1,846,772	1,938,909	1,904,599	2,180,388	2,361,118	8.3
Non-Project Loans	920,527	1,021,515	1,208,516	1,363,642	1,684,678	23.5
Commodity ⁽²⁾	56,599	61,597	69,993	71,470	69,101	(3.3)
Other ⁽³⁾	863,928	959,918	1,138,523	1,292,173	1,615,577	25.0
Domestic Debt	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507	7.7
Rupee Loans ⁽⁴⁾	58,386	55,518	55,518	24,088	24,088	—
Treasury Bills ⁽⁵⁾	629,070	700,137	694,767	658,240	779,581	18.4
Treasury Bonds ⁽⁶⁾	2,095,054	2,452,360	2,844,054	3,305,248	3,714,787	12.4
Sri Lanka Development Bonds	222,994	369,215	391,083	668,458	572,199	(14.4)
Central Bank Advances	111,292	109,167	143,898	151,132	83,307	(44.9)
Other ⁽⁷⁾	116,017	146,429	148,463	152,031	167,545	10.2
Total	6,000,112	6,793,249	7,390,899	8,503,227	9,387,303	10.4

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

- (1) Represents the amounts withdrawn and outstanding on the loans contracted with the IBRD, US, Canada, Denmark, People's Republic of China, Germany, UK, India, IDA, ADB, Netherlands, Kuwait, OPEC, Japan, UAE, IFAD, Skandinaviska Enskilda Bankens — Sweden, Salomon Brother's Incorporated-New York, Bank Indosuez, BFCE- France, Citibank International of US, Australia, Austria, Saudi Arabian Fund, EIB, Hong Kong and Korea
- (2) Represents the amounts withdrawn and outstanding on the loans contracted with the US, Canada, Germany, Japan, France, India, Italy, Pakistan, and Netherlands
- (3) Includes cash loans received from the ADB, US, China, Germany, Japan, OPEC, rupee denominated Treasury bonds from 2007 and rupee-denominated Treasury bills from 2008 held by foreign investors, the international sovereign bonds and outstanding defense loans
- (4) Includes the market value of investment held by the Joint Investment Fund on behalf of the sinking funds
- (5) Excludes outstanding Treasury bills held by foreign investors from 2008
- (6) Excludes Treasury bonds amounting to Rs.78,447 million issued to settle dues to CPC in January 2012, Rs.13,125 million issued to capitalize SriLankan Airlines in March 2013 and rupee denominated Treasury bonds held by foreign investors from 2007
- (7) Includes administrative borrowings arising from foreign loans channeled through government or semi-government agencies and outstanding borrowings from Offshore Banking Units ("OBUs")
- (8) Provisional

OWNERSHIP OF OUTSTANDING FOREIGN DEBT ⁽¹⁾

Source	As at December 31,					% Increase or decrease
	2012	2013	2014	2015	2016 ⁽¹⁾	
	(in Rs. millions, except for percentages)					
Multilateral	844,292	903,540	887,960	994,430	1,076,549	8.26%
ADB	448,421	478,796	471,762	533,806	569,686	6.72%
EIB	23,438	23,248	21,133	29,728	27,518	(7.43)%
IBRD	322	4,530	6,987	10,382	27,760	167.40%
IDA	349,997	373,085	363,052	391,149	417,636	6.77%
IFAD	16,013	17,419	17,098	18,631	21,520	15.51%
OPEC	2,699	2,998	4,783	7,547	9,309	23.34%
Nordic Development Fund	3,403	3,464	3,145	3,187	3,119	(2.14)%
Bi-lateral	1,035,907	823,180	793,196	888,971	945,754	6.39%
Canada	8,269	7,409	6,339	5,373	5,275	(1.81)%
France ⁽²⁾	24,273	26,861	24,698	25,406	24,448	(3.77)%
Germany	51,164	52,112	43,342	40,726	39,145	(3.88)%
India	78,322	102,843	119,982	137,413	142,277	3.54%
Japan	547,515	468,366	416,408	457,483	486,199	6.28%
Kuwait	6,194	5,749	5,357	6,765	7,774	14.92%
Netherlands	—	—	—	—	—	—
People's Republic of China	67,434	67,154	87,743	117,284	131,604	12.21%
Saudi Arabian Fund	2,648	3,868	4,982	10,724	13,255	23.61%
US	41,386	38,854	35,246	34,594	31,798	(8.08)%
Other	208,702	49,963	49,100	53,205	63,978	20.25%
Financial Markets	887,100	1,233,704	1,431,959	1,660,630	2,023,493	21.85%
Riggs National Bank	3,064	2,922	2,651	2,607	2,336	(10.42)%
Indo-Suez Bank (France and Stockholm)	—	—	—	—	—	—
Bankers' Trust Co.	356	275	184	101	—	(100.00)%
France	—	—	—	—	—	—
Solomon Bros. Inc. — New York	—	—	—	—	—	—
Citi Bank/NEXI	—	—	—	201	—	(100.00)%
Other ⁽³⁾	883,680	1,230,507	1,429,125	1,657,721	2,021,157	21.92%
International Sovereign bonds .	445,063	457,636	655,243	958,014	1,220,870	27.44%
Non-resident investments						
in Treasury bills	80,184	73,916	55,500	5,045	12,816	154.03%
in Treasury bonds	317,604	403,486	401,710	298,734	247,222	(17.24)%
Other ⁽³⁾	40,829	295,469	316,672	395,928	540,250	36.45%
Total	2,767,300	2,960,424	3,113,116	3,544,031	4,045,796	14.16%

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

- (1) Provisional
- (2) Includes loans from Financial Institutions
- (3) Includes outstanding defense loans

Direct Domestic Debt of the Issuer

The following table summarizes the outstanding direct domestic debt of the Issuer as at the dates indicated.

OUTSTANDING DIRECT DOMESTIC DEBT OF THE ISSUER

	As at December 31,					% Increase
	2012	2013	2014	2015	2016 ⁽¹⁾	or decrease
	(in Rs. millions, except for percentages)					
Loans						
Direct	—	—	—	—	—	—
Assumed ⁽²⁾	111,292	109,167	143,898	151,132	83,307	(44.9)
Total loans	111,292	109,167	143,898	151,132	83,307	(44.9)
Securities						
Treasury bills	629,070	700,137	694,767	658,240	779,581	18.4
Treasury notes/bonds	2,095,054	2,452,360	2,844,054	3,305,248	3,714,787	12.4
Total securities.....	2,724,124	3,152,497	3,538,821	3,963,488	4,494,368	13.4
Others.....	397,397	571,161	595,064	844,576	763,832	(9.6)
Total debt	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507	7.7

Source: Central Bank of Sri Lanka and Ministry of Finance

Notes:

(1) Provisional

(2) Central Bank Advances

The following table sets out the direct domestic debt service requirements of the Issuer for the dates indicated.

PROFILE OF COUNTRY'S DOMESTIC DEBT

	As at December 31,				
	2012	2013	2014	2015	2016 ⁽¹⁾
	(in Rs. millions)				
By Domestic Debt.....	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507
By Maturity					
Short Term	813,272	909,156	941,162	913,291	968,396
Medium and Long-term	2,419,541	2,923,670	3,336,620	4,045,905	4,373,111
By Currency					
Domestic Currency	242,068	3,443,997	3,867,042	4,269,129	4,739,348
Foreign Currency	2,990,745	388,828	410,740	690,067	602,159
By Ownership					
Bank.....	1,060,317	1,433,773	1,669,882	1,924,036	2,114,901
Non-Bank	2,172,495	2,399,053	2,607,901	3,035,160	3,226,606

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

DIRECT DOMESTIC DEBT SERVICE REQUIREMENTS OF THE ISSUER

Year	Principal Repayments	Interest Payments	Total
		(in Rs. millions)	
2006	247,536	133,787	381,323
2007	251,900	158,701	410,601
2008	258,720	182,198	440,918
2009	403,723	273,977	677,701
2010	389,672	297,127	686,800
2011	439,894	288,134	728,028
2012	415,441	317,659	733,100
2013	496,042	354,706	850,748
2014	449,554	327,934	777,488
2015 ⁽¹⁾	523,824	394,289	918,112
2016 ⁽²⁾	572,398	484,182	1,056,580
2017 ⁽²⁾	711,232	451,779	1,147,242
2018 ⁽²⁾	861,242	358,109	1,219,351

Source: Central Bank of Sri Lanka

Notes:

- (1) Provisional
- (2) Current debt obligations as at end March 31, 2017. These figures will increase with future borrowings. Maturing OBU loans have been considered as rollovers

Direct External Debt of the Issuer

The following table summarizes the outstanding external direct debt of the Issuer as at the dates indicated.

OUTSTANDING DIRECT EXTERNAL DEBT OF THE ISSUER

	As at December 31,					% Increase or decrease
	2012	2013	2014	2015	2016 ⁽¹⁾	
	(in millions, except for percentages)					
Loans (Rs.)						
Multilateral	844,292	823,180	887,960	994,430	1,076,549	8.26%
Bilateral	855,996	903,540	793,196	888,971	945,754	6.39%
Commercial and Export Credit	1,067,012	1,233,704	1,431,959	1,660,630	2,023,493	21.85%
Total loans	2,767,300	2,960,424	3,113,116	3,544,031	4,045,796	14.16%
Exchange Rate	127.1608	130.7530	131.0486	144.0623	149.8000	3.98%
Loans (US\$)						
Multilateral	6,640	6,296	6,776	6,903	7,187	4.11%
Bilateral	6,732	6,910	6,053	6,171	6,313	2.31%
Commercial and Export Credit	8,391	9,435	10,927	11,527	13,508	17.18%
Total loans	21,762	22,641	23,755	24,601	27,008	9.79%

Source: Ministry of Finance

Note:

- (1) Provisional

The following table sets out, by designated currency and the equivalent amount in US dollars, the outstanding direct external debt of the Issuer as at December 31, 2016.

**SUMMARY OF OUTSTANDING DIRECT EXTERNAL DEBT
BY THE ISSUER BY CURRENCY
(As at December 31, 2016)**

Currency	in Rupees	in Foreign Currency	in US\$	% of Disbursed Outstanding Debt
(in millions, except for percentages)				
Saudi Riyal	13,255	332	88	0.33
Euro	183,561	1,163	1,225	4.54
Yuan Renminbi	53,546	2,483	357	1.32
Pound Sterling	13,072	71	87	0.32
Won ('000s)	48,683	392	325	1.20
Sri Lanka Rupee	260,037	260,037	1,736	6.43
Kuwait Dinar	7,774	16	52	0.19
Yen ('000s)	496,852	386	3,317	12.28
Canadian Dollar	5,275	47	35	0.13
Special Drawing Rights	755,614	3,752	5,044	18.68
Swedish Krona	465	28	3	0.01
Danish Krone	231	11	2	0.01
US Dollar	2,207,431	14,736	14,736	54.56
Total	4,045,796	283,454	27,008	100.0

Source: Central Bank of Sri Lanka

The following table summarizes the direct external debt service requirements of the Issuer for the years indicated.

DIRECT EXTERNAL DEBT SERVICE REQUIREMENTS OF THE ISSUER

	Average						
Year	Rate (Rs.)	Principal		Interest		Total	
(in millions, except for percentages)							
2006	103.9623	45,989	442	16,990	163	62,979	605
2007	110.6232	65,934	596	23,980	217	89,914	813
2008	108.3338	121,609	1,123	30,277	279	151,886	1,402
2009	114.9448	114,716	998	35,698	311	150,414	1,309
2010	113.0647	78,184	691	55,464	491	133,648	1,182
2011	110.5652	98,789	893	68,565	620	167,354	1,513
2012	127.6034	193,529	1,464	90,839	688	284,368	2,152
2013	129.1099	203,993	1,580	108,159	838	312,512	2,418
2014	130.5606	183,109	1,402	115,660	886	298,769	2,288
2015	135.9378	284,293	1,973	115,386	801	399,679	2,774
2016	145.6016	169,107	1,129	126,713	846	295,820	1,975
2017	145.6016	202,541	1,352	126,325	843	328,866	2,195
2018	145.6016	220,745	1,474	128,629	859	349,375	2,333

Source: Central Bank of Sri Lanka

Government Guaranteed Debt

The following table sets out all Government guarantees of indebtedness, including guarantees assumed by the Government, as at the dates indicated.

SUMMARY OF OUTSTANDING PUBLIC CORPORATION AND PRIVATE SECTOR WITH GOVERNMENT GUARANTEES

	As at December 31,				
	2012	2013	2014	2015	2016 ⁽¹⁾
Domestic.....	—	—	—	—	—
External (in Rs. millions).....	256,574	301,087	344,611	349,094	335,915
(converted in US\$ millions).....	2,018	2,303	2,630	2,423	2,242
Total (in Rs. millions).....	256,574	301,087	344,611	349,094	335,915

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

Payment History of Foreign Debt

Sri Lanka has an unblemished sovereign domestic and external debt service record stretching back more than half a century, a claim that, according to Fitch, only a limited number of similarly-rated sovereigns are able to make.

Sri Lanka has received considerable financial assistance and relief from the international community. Sri Lanka received US\$ 278 million of international aid and relief during 2005 to rebuild the areas affected by the tsunami and to house internally-displaced people. In addition, in view of the devastating effects of the tsunami and to allow Sri Lanka to allocate more resources to humanitarian and reconstruction needs, Paris Club creditors, including the United States, Canada, Denmark, Germany, France, Japan, Italy and the Netherlands, offered a debt moratorium to Sri Lanka and other Asian nations affected by the tsunami in March 2005, agreeing to defer debt service payments for 2005. The moratorium was a voluntary, humanitarian gesture by international creditors, and was not requested or declared by the Government. Under the moratorium, the deferred amounts were to be repaid over a period of four years with a one-year grace period. Outstanding debt due to Italy was fully written-off while that of China was partly written-off. The government of the United Kingdom offered to refinance 10.0% of the debt service payments to be made with respect to International Development Agency loans from 2005 to 2015. India voluntarily offered a three-year debt moratorium with respect to the lines of credit from the Government of India, which the Government accepted. The total savings resulting from the debt moratorium, including the written-off debt and the refinancing relief offered by the Government of United Kingdom, amounted to Rs.30 billion (US\$ 287 million). The rescheduled amount under the debt moratorium was repaid in seven installments beginning in 2006 and ending in 2009.

The Government strives to maintain various efforts to manage its debt portfolio to improve yield and maturity profiles. The Government may utilize proceeds from debt issues for the purpose of repurchasing outstanding debt through a variety of methods, including public auctions and repurchases of debt securities in the open markets.

As at December 31, 2016, the Issuer had US\$ 11,969.75 million in aggregate outstanding principal balance of foreign currency bonds (including the international sovereign bonds issued in 2010, 2011, 2012, 2014, 2015 and 2016 and Sri Lanka Development Bonds).

DESCRIPTION OF THE BONDS

The Bonds will be issued pursuant to an indenture (the “Indenture”) to be dated as at May 11, 2017 between the Issuer and HSBC Bank USA, National Association as trustee for the Holders of the Bonds (the “Bonds Trustee”) and as registrar, paying and transfer agent. The following is a summary of the material provisions of the Bonds and the Indenture. This summary does not purport to be complete and is qualified in its entirety by reference to all of the provisions of the Indenture and the Bonds. It does not restate those agreements in their entirety. Whenever particular sections or defined terms of the Indenture not otherwise defined herein are referred to, such sections or defined terms are incorporated herein by reference.

General

The Bonds will constitute direct, unconditional, unsubordinated and unsecured general obligations of the Issuer and will at all times rank *pari passu* among themselves in all respects, without any preference of one over the other by reason of priority of date of issue or otherwise, and will at all times rank at least equally with all other present and future unsecured and unsubordinated External Indebtedness. The full faith and credit of Sri Lanka will be pledged for the due and punctual payment of the principal of, and interest on, the Bonds.

Principal, Interest and Maturity

The Bonds will be issued in an aggregate principal amount of US\$1,500,000,000 and will mature on May 11, 2027 (the “Bonds Maturity Date”). Interest on the Bonds will be payable semi-annually in arrears on May 11 and November 11 of each year, commencing on November 11, 2017 (each, a “Bonds Interest Payment Date”) to persons in whose names the Bonds are registered at the close of business on the fifteenth calendar day preceding each Bonds Interest Payment Date. The Bonds will bear interest at the rate of 6.20% per annum from and including May 11, 2017 or from the most recent Bonds Interest Payment Date to which interest has been paid or provided to, and to and excluding, the Bonds Maturity Date. Interest on the Bonds will be calculated on the basis of a 360-day year consisting of twelve 30-day months. Unless previously purchased or canceled as described herein, the Bonds shall mature on the Bonds Maturity Date, and on the Bonds Maturity Date, the Holders of the Bonds shall be entitled to a payment equal to the principal amount of the Outstanding Bonds on the Bonds Maturity Date plus accrued and unpaid interest. The Bonds will not be redeemable prior to maturity and will not be entitled to the benefit of any sinking fund.

Any payment of principal or interest otherwise required to be made in respect of a Bond on a date that is not a Business Day need not be made on such date, but may be made on the next succeeding Business Day with the same force and effect as if made on such date, and no additional interest shall accrue for the period from and after such date as a result of such delayed payment. “Business Day” means each Monday, Tuesday, Wednesday, Thursday and Friday that is not a day on which banking institutions in London, New York or Singapore are authorized or obligated by law or executive order to close.

Persons in whose name a registered Bond is held are herein referred to as “Bond Holders”.

The Bonds will be issued only in fully registered form, without coupons, in minimum denominations of US\$200,000 and integral multiples of US\$1,000 in excess thereof.

Additional Amounts

The Issuer will make all payments on the Bonds without withholding or deducting any present or future taxes (“Taxes”) imposed by Sri Lanka or any of its political subdivisions, unless such deduction or withholding is required by law. If Sri Lankan law requires the Issuer to deduct or withhold Taxes, it will pay the Bond Holders such additional amounts as are necessary to ensure that they receive the same amount as they would have received without such withholding or deduction.

The Issuer will not pay, however, any additional amounts if the Bond Holder or beneficial owner of the Bonds is liable for Sri Lankan Tax because:

- the Bond Holder or beneficial owner is connected with Sri Lanka other than by merely owning the Bonds or receiving income or payments on the Bonds; or
- upon reasonable request by the Issuer or its agent, the Bond Holder or beneficial owner failed to comply in a timely manner with any certification, identification or other reporting requirement concerning the Bond Holder's or beneficial owner's nationality, residence, identity or connection with Sri Lanka, if compliance with such requirement is required by any statute or regulation of Sri Lanka as a precondition to exemption from withholding or deduction of Taxes; or
- the Bond Holder failed to present its Bonds for payment (where presentation is required) within 30 days of when the payment is due or when the Issuer makes available to the Bond Holder or the Bonds Trustee a payment of principal or interest, whichever is later. Nevertheless, the Issuer will pay additional amounts to the extent the Bond Holder would have been entitled to such amounts had it presented its Bonds for payment on the last day of the 30 day period; or
- any combination of the above.

The obligation to pay such additional amounts shall not apply to (a) any estate, inheritance, gift, sales, transfer, personal property or any similar tax, assessment or other governmental charge or (b) any tax, assessment or other governmental charge which is payable otherwise than by deduction or withholding from payments of principal or interest on the Bonds; *provided* that, except as otherwise set forth in the Bonds and in the Indenture, the Issuer shall pay all stamp and other duties, if any, which may be imposed by Sri Lanka or any political subdivision thereof or any taxing authority of or in the foregoing, with respect to the Indenture or as a consequence of the initial issuance of the Bonds.

Any reference in the Bonds to principal or interest shall be deemed also to refer to any additional amounts which may be payable with respect thereto as described above.

Further Issues

The Issuer may from time to time, without notice to or the consent of the Holders, issue further bonds ("Additional Bonds") having terms and conditions the same as the Bonds or the same in all respects other than with respect to the date of issuance, issue price and first Bonds Interest Payment Date applicable to such Additional Bonds. The Issuer may consolidate such Additional Bonds with the Outstanding Bonds to form a single series and class for all purposes under the Indenture; *provided* that Additional Bonds that are so consolidated with the Outstanding Bonds must be fungible with the Outstanding Bonds for U.S. federal income tax purposes.

Limitation on Liens

So long as any Bonds remain Outstanding, the Issuer shall not create, incur, assume or permit to subsist any Lien upon the whole or any part of its present or future assets or revenues to secure (1) any Public External Indebtedness; (2) any Guarantees in respect of Public External Indebtedness; or (3) the Public External Indebtedness of any other person, without at the same time or prior thereto securing the Bonds equally and ratably therewith or providing such other arrangement (whether or not comprising a Lien) as shall be approved by not less than 66 2/3% of the aggregate principal amount of Outstanding Bonds which are represented at a meeting of Bond Holders duly convened in accordance with the Indenture.

Certain Definitions

"External Indebtedness" means Indebtedness expressed or denominated or payable, or which, at the option of the relevant creditor, may be payable in or by reference to any currency other than the lawful currency of Sri Lanka.

“Guarantee” means any obligation of a person to pay the Indebtedness of another person including (without limitation):

- (a) an obligation to pay or purchase such Indebtedness;
- (b) an obligation to lend money, to purchase or subscribe for shares or other securities or to purchase assets or services, in order to provide funds for the payment of such Indebtedness;
- (c) any indemnity against the consequences of a default in the payment of such Indebtedness; or
- (d) any other agreement to be responsible for such Indebtedness;

“Indebtedness” means all unsecured, unsubordinated obligations of the Issuer or any Public Sector Instrumentality (whether present or future) in respect of money borrowed or raised (including money raised by forward sale or purchase agreements, acceptances and leasing or under any other transaction having the commercial effect of a borrowing) and any guarantee given by the Issuer in respect of money borrowed by others. “Indebtedness” shall not include the borrowings of any Public Sector Instrumentality so long as such Indebtedness does not carry the full faith and credit of Sri Lanka.

“Lien” means any lien, pledge, mortgage, security interest, deed of trust, charge or other encumbrance or preferential arrangement which has the practical effect of constituting a security interest with respect to the payment of any obligations with or from the proceeds of any assets or revenues of any kind, whether in effect on the date the Indenture becomes effective or at any time thereafter.

“Outstanding” means any Bond authenticated and delivered pursuant to the Indenture, as at any date of determination, except: (1) Bonds theretofore canceled by the Bonds Trustee or delivered to the Bonds Trustee for cancellation or held by the Bonds Trustee for reissuance but not reissued by the Bonds Trustee; (2) Bonds which have been called for redemption in accordance with their terms or which have become due and payable at maturity or otherwise and with respect to which monies sufficient to pay the principal thereof (and, premium, if any) and any interest thereon shall have been made available to the Bonds Trustee; or (3) Bonds in lieu of or in substitution for which other Bonds shall have been authenticated and delivered pursuant to the Indenture; provided, however, that in determining whether the Bond Holders of the requisite principal amount of Outstanding Bonds are present at a meeting of Bond Holders for quorum purposes or have consented to or voted in favor of any request, demand, authorization, direction, notice, consent, waiver, amendment, modification or supplement hereunder, Bonds owned, directly or indirectly, by the Issuer or any Public Sector Instrumentality shall be disregarded and deemed not to be Outstanding, except that in determining whether the Bonds Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent, waiver, amendment, modification or supplement, only Bonds which the Bonds Trustee knows to be so owned shall be so disregarded.

“person” means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having a separate legal personality.

“Public External Indebtedness” means any External Indebtedness of, or guaranteed by, Sri Lanka, which (1) is publicly offered or privately placed in securities markets, (2) is in the form of, or is represented by, bonds, notes, debentures or other securities or instruments or any guarantees thereof and (3) is, or was intended at the time of issue to be, or is eligible to be, quoted, listed on any stock exchange, automated trading system or traded on any over-the-counter or other established securities market (including securities eligible for sale pursuant to Rule 144A under the Securities Act (or any successor law or regulation of similar effect)).

“Public Sector Instrumentality” means the Central Bank of Sri Lanka (the “Central Bank”) and any department, ministry or agency of the central government of Sri Lanka or any corporation, trust, financial institution or other entity owned or controlled by the central government of Sri Lanka or any of the foregoing, and “control” means the power, directly or indirectly, through the ownership of voting securities or other ownership interests or otherwise, to direct the management of or elect or appoint a majority of the board of directors or other persons performing similar functions in lieu of, or in addition to, the board of directors of a corporation, trust, financial institution or entity.

Exceptions

The following exceptions apply to the Issuer’s obligations under “— Limitation on Liens”:

- (a) any Lien upon property to secure Public External Indebtedness incurred for the purpose of financing the acquisition of such property and any renewal and extension of such Lien which is limited to the original property covered thereby and which (in either case) secures any renewal or extension of the original secured financing;
- (b) any Lien existing on any property or asset at the time of its acquisition (or arising after its acquisition pursuant to an agreement entered into prior to, and not in contemplation of, such acquisition), and extensions and renewals of such Lien limited to the original property or asset covered thereby and securing any extension or renewal of the original secured financing;
- (c) any Lien arising by operation of law, *provided* that any such Lien is not created or permitted to be created by the Issuer to secure any Public External Indebtedness; and
- (d) any Lien securing Public External Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction or development of a project; provided that (i) the holders of such Public External Indebtedness expressly agree to limit their recourse to the assets and revenues of such project or the proceeds of insurance thereon as the principal source of repayments of such Public External Indebtedness and (ii) the property over which such Lien is granted consists solely of such assets and revenues.

The Central Bank holds International Monetary Assets, including gold and foreign exchange. Because the Central Bank is a judicial entity separate from the Issuer, the Issuer believes that the limitation on liens covenant described herein does not apply to the International Monetary Assets held by the Central Bank. The Central Bank could therefore incur Public External Indebtedness secured by International Monetary Assets without securing amounts payable under the Bonds.

Events of Default

The occurrence and continuance of any of the following will constitute events of default (“Events of Default”) with respect to the Bonds:

(1) Non-payment

The Issuer fails to pay any interest or principal on any of the Bonds when due and payable and such failure continues for a period of 7 days (in the case of principal) or 30 days (in the case of interest), or

(2) Breach of other obligations

The Issuer fails to duly observe or perform any of the other covenants or agreements contained in the Bonds or in the Indenture for a period of 30 days after the date on which written notice specifying such failure and demanding that the Issuer remedy the same shall have been given to the Issuer by the Bonds Trustee or to the Issuer and the Bonds Trustee by the Bond Holders of at least 25.0% of the aggregate principal amount of the Outstanding Bonds, or

(3) *Cross-default*

- (a) any External Indebtedness shall become (or shall become capable of being declared) due and payable prior to its stated maturity (otherwise than at the option of the Issuer); or
- (b) any default shall occur in the payment of principal of, or premium or prepayment charge (if any) or interest on, any External Indebtedness when and as the same shall become due and payable if such default shall continue for more than the period of grace, if any, originally applicable thereto; or
- (c) any default shall occur in the payment when due and called upon (after the expiry of any originally applicable grace period) of any Guarantee of the Issuer in respect of any External Indebtedness of any other person, provided that the aggregate amount of the relevant External Indebtedness in respect of which one or more of the events mentioned in this paragraph (3) have occurred equals or exceeds US\$25.0 million (or its equivalent in any other currency or currencies), or

(4) *Moratorium*

A general moratorium on the payment of principal of or interest on or the performance of the obligation in respect of the External Indebtedness of the Issuer shall be declared by the Issuer, or

(5) *IMF Membership*

The Issuer shall cease to be a member of the IMF or shall cease to be eligible to use the general resources of the IMF, or

(6) *Validity*

The validity of the Bonds shall be contested by the Issuer or any legislative or executive body or official of Sri Lanka which is authorized in each case by law to do so and, acting alone or together with another such body or official, has the legal power and authority to declare the Bonds invalid or unenforceable, or the Issuer shall deny any of its obligations under the Bonds (whether by a general suspension of payments or a moratorium on the payment of debt or otherwise), or any constitutional provision, treaty, convention, law, regulation, official communique, decree, ordinance or policy of Sri Lanka or any final and non-appealable decision by any court in Sri Lanka having jurisdiction, shall purport to render any provision of the Bonds invalid or unenforceable or shall purport to prevent or delay the performance or observance by the Issuer of any of its obligations thereunder, or

(7) *Revocation of Authority*

Any constitutional provision, treaty, convention, law, regulation, ordinance, decree, consent, approval, license or other authority necessary to enable the Issuer to make or perform its obligations under the Bonds or for the validity or enforceability thereof, shall expire, be withheld, revoked, terminated or otherwise cease to remain in full force and effect or remain valid and subsisting, or shall be modified in a manner which adversely affects or will adversely affect any rights or claims of any of the Bond Holders, or

(8) *International Monetary Assets*

The Issuer or the Central Bank shall not at any time exercise full ownership, power and control over any of their International Monetary Assets as they exist from time to time (unless, prior to the occurrence of such an event, a public sector entity has substantially all powers and assets of the Central Bank (including, without limitation, all of its International Monetary Assets) and performs the functions of a central bank and shall assume and acquire such assets, powers and functions).

If any of the above Events of Default occurs and is continuing, then the Bonds Trustee or the Bond Holders of not less than 25.0% in aggregate principal amount of the Bonds then Outstanding by notice in writing to the Issuer (and to the Bonds Trustee if such notice is given by the Bond Holders) may,

and the Bonds Trustee at the written direction of the Bond Holders, subject to being indemnified to its satisfaction, shall, declare the principal amount of all such Bonds to be immediately due and payable whereupon they shall become immediately due and payable at their principal amount together with accrued interest without further formality unless such Event of Default shall have been remedied prior to the receipt of such notice by the Bonds Trustee.

At any time after such a declaration of acceleration has been made and before a judgment or decree for payment of the money due has been obtained by the Bonds Trustee, the Bond Holders of a majority in principal amount of the Outstanding Bonds, by written notice to the Issuer and the Bonds Trustee, may rescind and annul such declaration and its consequences in accordance with the terms and conditions of the Indenture.

Definitions

“International Monetary Assets” means all (1) gold, (2) Special Drawing Rights, (3) Reserve Position in the Fund and (4) Foreign Exchange, and the terms “Special Drawing Rights,” “Reserve Position in the Fund” and “Foreign Exchange” have, as to the type of assets included, the meaning given to them in the IMF’s publication entitled “International Financial Statistics” or such other meanings as shall be formally adopted by the IMF from time to time.

Redemption, Repurchase and Cancellation

Unless previously purchased and canceled, the Bonds will be redeemed at their principal amount on the Bonds Maturity Date. The Issuer may at any time purchase the Bonds by tender (available to all Bond Holders alike) or in the open market or otherwise at any price. If the Issuer shall acquire any Bonds, such acquisition shall not operate as or be deemed for any purpose to be a satisfaction of the indebtedness represented by such Bonds unless and until such Bonds are delivered to the Bonds Trustee for cancellation and are canceled and retired by the Bonds Trustee.

Modifications and Amendments; Meetings of Holders

A meeting of the Bond Holders may be called by the Bonds Trustee at any time. The Issuer or the Bond Holders of at least 10.0% in aggregate principal amount of the Outstanding Bonds may call a meeting if the Issuer or such Bond Holders have requested the Bonds Trustee in writing to call such a meeting and the Bonds Trustee has not given notice of such a meeting within 20 days of receiving the request. Notices of meetings must include (a) the time and place of the meeting, (b) a general description of the action proposed to be taken at the meeting, (c) whether modifications will be proposed under a Single Series Extraordinary Resolution, a Single Series Written Resolution, Multiple Series Single Limb Extraordinary Resolution, a Multiple Series Two Limb Extraordinary Resolution, a Multiple Series Single Limb Written Resolution or a Multiple Series Two Limb Written Resolution and, if relevant, in relation to which other series of debt securities it applies, (d) if the proposed modification or action relates to two or more series of debt securities issued by the Issuer and contemplates such series of debt securities being aggregated in more than one group of debt securities, a description of the proposed treatment of each such group of debt securities, (e) such information that is required to be provided by the Issuer pursuant to “ — *Information*”, (f) the identity of the Aggregation Agent and the Calculation Agent for any proposed modification or action to be voted on at the meeting, and the details of any applicable methodology referred to in “*Aggregation Agent; Aggregation Procedures*”; and (g) any additional procedures which may be necessary and, if applicable, the conditions under which a cross series aggregation will be deemed to have been satisfied if it is approved as to some but not all of the affected series of debt securities. Such notices must be given not less than 30 days nor more than 60 days before the date of the meeting, except that notices of meetings reconvened after adjournment must be given not less than 10 days nor more than 60 days before the date of the meeting. Any modifications to or waivers in respect of the Indenture or the Bonds will be conclusive and

binding on all Bond Holders, whether or not they have given their consent (unless required under the Indenture) or were present at any duly held meeting. To be entitled to vote at any meeting of Bond Holders, a person shall be a Bond Holder of Outstanding Bonds or, in the case of registered Bonds, a person duly appointed by an instrument in writing as proxy for such a Bond Holder.

In addition, the Indenture contains provisions relating to Written Resolutions. All information to be provided in a notice convening any meeting as set forth above shall also be provided, *mutatis mutandis*, in respect of Written Resolutions.

A “record date” in relation to any proposed modification or action means the date fixed by the Issuer for determining the Bond Holders and, in the case of a multiple series aggregation, the holders of debt securities of each other affected series that are entitled to vote on a Multiple Series Single Limb Extraordinary Resolution or a Multiple Series Two Limb Extraordinary Resolution, or to sign a Multiple Series Single Limb Written Resolution or a Multiple Series Two Limb Written Resolution.

An “Extraordinary Resolution” means any of a Single Series Extraordinary Resolution, a Multiple Series Single Limb Extraordinary Resolution and/or a Multiple Series Two Limb Extraordinary Resolution, as the case may be.

A “Written Resolution” means any of a Single Series Written Resolution, a Multiple Series Single Limb Written Resolution and/or a Multiple Series Two Limb Written Resolution, as the case may be.

Any reference to “debt securities” means any notes, bonds (including the Bonds), debentures or other debt securities issued by the Issuer in one or more series with an original stated maturity of more than one year.

“Debt Securities Capable of Aggregation” means those debt securities which include or incorporate by reference the provisions described in “*Modifications and Amendments; Meetings of Holders*” and “*Aggregation Agent; Aggregation Procedures*” or provisions substantially in these terms which provide for the debt securities which include such provisions to be capable of being aggregated for voting purposes with other series of debt securities.

Modification of this Series of Bonds only

At any meeting of Bond Holders, other than a meeting to discuss a Reserved Matter, the persons entitled to vote a majority of the aggregate principal amount of the Outstanding Bonds shall constitute a quorum, and at the reconvening of any such meeting adjourned for a lack of a quorum, the persons entitled to vote 25.0% of the aggregate principal amount of the Outstanding Bonds shall constitute a quorum for the taking of any action set forth in the notice of the original meeting. At any meeting of Bond Holders held to discuss a Reserved Matter, the persons entitled to vote 75.0% of the aggregate principal amount of the Outstanding Bonds shall constitute a quorum, and at the reconvening of any such meeting adjourned for a lack of quorum, the persons entitled to vote 75.0% of the aggregate principal amount of the Outstanding Bonds shall constitute a quorum for the taking of any action set forth in the original meeting. The Bonds Trustee may make such reasonable and customary regulations as it shall deem advisable for any meeting of Bond Holders with respect to the appointment of proxies in respect of Bond Holders of registered Bonds, the record date for determining the registered owners of registered Bonds who are entitled to vote at such meeting (which date shall be set forth in the notice calling such meeting hereinabove referred to and which shall be not less than 15 nor more than 30 days prior to such meeting), the adjournment and chairmanship of such meeting, the appointment and duties of inspectors of votes, the submission and examination of proxies, certificates and other evidence of the right to vote and such other matters concerning the conduct of the meeting as it shall deem appropriate.

Any modification of any provision of, or any action in respect of, the terms of the Bonds or the Indenture in respect of the Bonds may be made or taken if approved by a Single Series Extraordinary Resolution or a Single Series Written Resolution as set out below.

A “Single Series Extraordinary Resolution” means a resolution passed at a meeting of Bond Holders duly convened and held in accordance with the procedures prescribed by the Indenture by a majority of:

- (a) in the case of a Reserved Matter, at least 75.0% of the aggregate principal amount of the Outstanding Bonds; or
- (b) in the case of a matter other than a Reserved Matter, more than 50.0% of the aggregate principal amount of the Outstanding Bonds (unless such meeting is adjourned for a lack of a quorum, in which case a majority of at least 25.0% of the aggregate principal amount of the Outstanding Bonds shall be sufficient).

A “Single Series Written Resolution” means a resolution in writing signed or confirmed in writing by or on behalf of the Bond Holders of:

- (a) in the case of a Reserved Matter, at least 75.0% of the aggregate principal amount of the Outstanding Bonds; or
- (b) in the case of a matter other than a Reserved Matter, more than 50.0% of the aggregate principal amount of the Outstanding Bonds.

Any Single Series Extraordinary Resolution duly passed or Single Series Written Resolution approved shall be binding on all Bond Holders, whether or not they attended any meeting, whether or not they voted in favor thereof and whether or not they signed or confirmed in writing any such Single Series Written Resolution, as the case may be.

Multiple Series Aggregation — Single limb voting

In relation to a proposal that includes a Reserved Matter, any modification to the terms and conditions of, or any action with respect to, two or more series of Debt Securities Capable of Aggregation may be made or taken if approved by a Multiple Series Single Limb Extraordinary Resolution or by a Multiple Series Single Limb Written Resolution as set out below, provided that the Uniformly Applicable condition is satisfied.

A “Multiple Series Single Limb Extraordinary Resolution” means a resolution considered at separate meetings of the holders of each affected series of Debt Securities Capable of Aggregation, duly convened and held in accordance with the procedures prescribed by the Indenture, as supplemented if necessary, which is passed by a majority of at least 75% of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate).

A “Multiple Series Single Limb Written Resolution” means each resolution in writing (with a separate resolution in writing or multiple separate resolutions in writing distributed to the holders of each affected series of Debt Securities Capable of Aggregation, in accordance with the applicable bond documentation) which, when taken together, has been signed or confirmed in writing by or on behalf of the holders of at least 75% of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate). Any Multiple Series Single Limb Written Resolution may be contained in one document or several documents in substantially the same form, each signed or confirmed in writing by or on behalf of one or more Bond Holders or one or more holders of each affected series of debt securities.

Any Multiple Series Single Limb Extraordinary Resolution duly passed or Multiple Series Single Limb Written Resolution approved shall be binding on all Bond Holders and holders of each other affected series of Debt Securities Capable of Aggregation, whether or not they attended any meeting, whether or not they voted in favor thereof, whether or not any other holder or holders of the same series voted in favor thereof and whether or not they signed or confirmed in writing any such Multiple Series Single Limb Written Resolution, as the case may be.

The “Uniformly Applicable” condition will be satisfied if:

- (a) the holders of all affected series of Debt Securities Capable of Aggregation are invited to exchange, convert, or substitute their debt securities, on the same terms, for (x) the same new instrument or other consideration or (y) a new instrument, new instruments or other consideration from an identical menu of instruments or other consideration; or
- (b) the amendments proposed to the terms and conditions of each affected series of Debt Securities Capable of Aggregation would, following implementation of such amendments, result in the amended instruments having identical provisions (other than provisions which are necessarily different, having regard to different currency of issuance).

It is understood that a proposal will not be considered to satisfy the Uniformly Applicable condition if each exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation (or, where a menu of instruments or other consideration is offered, each exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation electing the same option from such menu of instruments).

Any modification or action proposed under a Multiple Series Single Limb Extraordinary Resolution or a Multiple Series Single Limb Written resolution may be made in respect of some series only of the Debt Securities Capable of Aggregation and, for the avoidance of doubt, the provisions described in “ — *Multiple Series Aggregation — Single Limb Voting*” may be used for different groups of two or more series of Debt Securities Capable of Aggregation simultaneously.

Multiple Series Aggregation — Two limb voting

In relation to a proposal that includes a Reserved Matter, any modification to the terms and conditions of, or any action with respect to, two or more series of Debt Securities Capable of Aggregation may be made or taken if approved by a Multiple Series Two Limb Extraordinary Resolution or by a Multiple Series Two Limb Written Resolution as set out below.

A “Multiple Series Two Limb Extraordinary Resolution” means a resolution considered at separate meetings of the holders of each affected series of Debt Securities Capable of Aggregation, duly convened and held in accordance with the procedures prescribed by the Indenture, as supplemented if necessary, which is passed by a majority of:

- (a) at least 66 2/3% of the aggregate principal amount of the outstanding debt securities of all the affected series of Debt Securities Capable of Aggregation (taken in aggregate); and
- (b) more than 50.0% of the aggregate principal amount of the outstanding debt securities in each affected series of Debt Securities Capable of Aggregation (taken individually).

A “Multiple Series Two Limb Written Resolution” means each resolution in writing (with a separate resolution in writing or multiple separate resolutions in writing distributed to the holders of each affected series of Debt Securities Capable of Aggregation, in accordance with the applicable bond documentation) which, when taken together, has been signed or confirmed in writing by or on behalf of the holders of:

- (a) at least 66 2/3% of the aggregate principal amount of the outstanding debt securities of all the affected series of Debt Securities Capable of Aggregation (taken in aggregate); and

- (b) more than 50.0% of the aggregate principal amount of the outstanding debt securities in each affected series of Debt Securities Capable of Aggregation (taken individually).

Any Multiple Series Two Limb Extraordinary Resolution duly passed or Multiple Series Two Limb Written Resolution approved shall be binding on all Bond Holders and holders of each other affected series of Debt Securities Capable of Aggregation, whether or not they attended any meeting, whether or not they voted in favor thereof, whether or not any other holder or holders of the same series voted in favor thereof and whether or not they signed or confirmed in writing any such Multiple Series Two Limb Written Resolution, as the case may be.

Any modification or action proposed under a Multiple Series Two Limb Extraordinary Resolution or a Multiple Series Two Limb Written Resolution may be made in respect of some series only of the Debt Securities Capable of Aggregation and, for the avoidance of doubt, the provisions described in “ — *Multiple Series Aggregation — Two Limb Voting*” may be used for different groups of two or more series of Debt Securities Capable of Aggregation simultaneously.

Reserved Matters

“Reserved Matters” consist of any modification, amendment, supplement or waiver of the Indenture or the terms and conditions of the Bonds that would (a) change the due date for the payment of the principal of, or any installment of interest on, any Bond, (b) reduce the principal amount of, or the portion of such principal amount which is payable upon acceleration of the maturity of, or the interest rate on, any Bond, (c) change the coin or currency in which or the required places at which payment with respect to interest or principal in respect of Bonds is payable, (d) permit the Issuer to redeem the Bonds prior to the Bonds Maturity Date, (e) reduce the proportion of the principal amount of Bonds the vote or consent of the Bond Holders of which is necessary to modify, amend or supplement the Indenture or the terms and conditions of the Bonds or to make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided in the Indenture or the Bonds to be made, taken or given, or change the definition of “Outstanding” with respect to the Bonds, (f) change the obligation of the Issuer to pay additional amounts with respect to the Bonds, (g) change the governing law provision of the Bonds, (h) change the courts to the jurisdiction of which the Issuer has submitted, the Issuer’s obligation to appoint and maintain an Authorized Agent in the Borough of Manhattan, The City of New York, or the Issuer’s waiver of immunity, in respect of actions or proceedings brought by any Bond Holder based upon the Bonds, (i) in connection with an exchange offer for the Bonds, amend any Event of Default (as defined in the Indenture), (j) change the *pari passu* ranking of the Bonds, (k) change this definition, or the definition of “Extraordinary Resolution”, “Single Series Extraordinary Resolution”, “Multiple Series Single Limb Extraordinary Resolution”, “Multiple Series Two Limb Extraordinary Resolution”, “Written Resolution”, “Single Series Written Resolution”, “Multiple Series Single Limb Written Resolution” or “Multiple Series Two Limb Written Resolution”, (l) change the definition of “debt securities” or “Debt Securities Capable of Aggregation”, (m) change the definition of “Uniformly Applicable” and (n) change the definition of “Outstanding” or to modify the provisions set forth in “*Aggregation Agent; Aggregation Procedures*”.

Information

Prior to or on the date that the Issuer proposes any Extraordinary Resolution or Written Resolution as described in “ — *Modification of this Series of Bonds only*”, “ — *Multiple Series Aggregation — Single Limb Voting*” or “ — *Multiple Series Aggregation — Two Limb Voting*”, the Issuer shall publish in accordance with “*Aggregation Agent — Manner of Publication*”, and provide the Bonds Trustee with the following information:

- (a) a description of the Issuer’s economic and financial circumstances which are, in the Issuer’s opinion, relevant to the request for any potential modification or action, a description of the Issuer’s existing debts and a description of its broad policy reform program and provisional macroeconomic outlook;

- (b) if the Issuer shall at the time have entered into an arrangement for financial assistance with multilateral and/ or other major creditors or creditor groups and/or an agreement with any such creditors regarding debt relief, a description of any such arrangement or agreement. Where permitted under the information disclosure policies of the multilateral or such other creditors, as applicable, a copy of the arrangement or agreement shall be provided;
- (c) a description of the Issuer's proposed treatment of external debt securities that fall outside the scope of any multiple series aggregation and its intentions with respect to any other debt securities and its other major creditor groups; and
- (d) if any proposed modification or action contemplates debt securities being aggregated in more than one group of debt securities, a description of the proposed treatment of each such group, as required for a notice convening a meeting of the Bond Holders.

Claims Valuation

For the purpose of calculating the par value of the Bonds and any affected series of debt securities which are to be aggregated with the Bonds as described in “ — *Multiple Series Aggregation — Single Limb Voting*” or “ — *Multiple Series Aggregation — Two Limb Voting*”, the Issuer may appoint a Calculation Agent. The Issuer shall, with the approval of the Aggregation Agent and any appointed Calculation Agent, promulgate the methodology in accordance with which the par value of the Bonds and such affected series of debt securities will be calculated. In any such case where a Calculation Agent is appointed, the same person will be appointed as the Calculation Agent for the Bonds and each other affected series of debt securities for these purposes, and the same methodology will be promulgated for each affected series of debt securities.

Other Modifications

The Indenture and the Bonds may be modified or amended, without the consent of the Bond Holders, to:

- add covenants of the Issuer that benefit the Bond Holders;
- surrender any right or power conferred upon the Issuer;
- secure the Bonds;
- cure any ambiguity or correct or supplement any defective provision in the Indenture or the Bonds; or
- amend the Indenture or the Bonds in any other manner which the Issuer and the Bonds Trustee may determine and which are not inconsistent with the provisions of the Bonds and will not adversely affect the interests of any Bond Holder in any material respect.

It is not necessary for the Bond Holders to approve the particular form of any proposed modification of the Indenture, but it is sufficient if that consent approves the substance of the proposed modification. The Issuer may at any time purchase Bonds in the open market or otherwise at any price. Bonds owned by the Issuer or any Public Sector Instrumentality will not be considered Outstanding for the purpose of determining whether the requisite aggregate principal amount of Bonds has concurred in any request, demand, notice, consent or waiver under the Indenture.

Bonds controlled by the Issuer

For the purposes of (i) determining the right to attend and vote at any meeting of Bond Holders, or the right to sign or confirm in writing, or authorize the signature of, any Written Resolution, (ii) the Indenture and (iii) Events of Default, any Bonds which are for the time being held by or on behalf of the Issuer or by or on behalf of any person which is owned or controlled directly or indirectly by the Issuer or by any Public Sector Instrumentality shall be disregarded and be deemed not to remain Outstanding.

A Bond will also be deemed to be not Outstanding if the Bond has previously been cancelled or delivered for cancellation or held for reissuance but not reissued, or, where relevant, the Bond has previously been called for redemption in accordance with its terms or previously become due and payable at maturity or otherwise and the Issuer has previously satisfied its obligations to make all payments due in respect of the Bond in accordance with its terms.

In advance of any meeting of Bond Holders, or in connection with any Written Resolution, the Issuer shall provide to the Aggregation Agent a copy of the certificate prepared by the Aggregation Agent described in “ — *Aggregation Agent; Aggregation Procedures — Certificate*,” which includes information on the total number of Bonds which are for the time being held by or on behalf of the Issuer or by or on behalf of any person which is owned or controlled directly or indirectly by the Issuer or by any Public Sector Instrumentality of the Issuer and, as such, such Bonds shall be disregarded and deemed not to remain Outstanding for the purposes of ascertaining the right to attend and vote at any meeting of Bond Holders or the right to sign, or authorize the signature of, any Written Resolution in respect of any such meeting. The Aggregation Agent shall make any such certificate available for inspection during normal business hours at its specified office and, upon reasonable request, will allow copies of such certificate to be taken.

Publication

The Issuer shall publish all Extraordinary Resolutions and Written Resolutions which have been determined by the Aggregation Agent to have been duly passed in accordance with the notice provisions described in “*Aggregation Agent; Aggregation Procedures — Manner of Publication*.”

Exchange and Conversion

Any Extraordinary Resolutions or Written Resolutions which have been duly passed and which modify any provision of, or action in respect of, the terms of the Bonds may be implemented at the Issuer’s option by way of a mandatory exchange or conversion of the Bonds and each other affected series of debt securities, as the case may be, into new debt securities containing the modified terms and conditions if the proposed mandatory exchange or conversion of the Bonds is notified to Bond Holders at the time notification is given to the Bond Holders as to the proposed modification or action. Any such exchange or conversion shall be binding on all Bond Holders.

Aggregation Agent; Aggregation Procedures

Appointment

The Issuer will appoint an Aggregation Agent to calculate whether a proposed modification or action has been approved by the required principal amount of the Outstanding Bonds, and, in the case of a multiple series aggregation, by the required principal amount of outstanding debt securities of each affected series of debt securities. In the case of a multiple series aggregation, the same person will be appointed as the Aggregation Agent for the proposed modification of any provision of, or any action in respect of, the terms of the Bonds or the Indenture (including the schedules thereto) in respect of the Bonds and in respect of the terms and conditions or bond documentation in respect of each other affected series of debt securities. The Aggregation Agent shall be independent of the Issuer.

Extraordinary Resolutions

If an Extraordinary Resolution has been proposed at a duly convened meeting of Bond Holders to modify any provision of, or action in respect of, the terms of the Bonds and other affected series of debt securities, as the case may be, the Aggregation Agent will, as soon as practicable after the time the vote is cast, calculate whether holders of a sufficient portion of the aggregate principal amount of the Outstanding Bonds and, where relevant, each other affected series of debt securities, have voted in favor of the Extraordinary Resolution such that the Extraordinary Resolution is passed. If so, the Aggregation Agent will determine that the Extraordinary Resolution has been duly passed.

Written Resolutions

If a Written Resolution has been proposed under the terms of the Bonds to modify any provision of, or action in respect of, the terms of the Bonds and the terms and conditions of other affected series of debt securities, as the case may be, the Aggregation Agent will, as soon as reasonably practicable after the relevant Written Resolution has been signed or confirmed in writing, calculate whether holders of a sufficient portion of the aggregate principal amount of the Outstanding Bonds and, where relevant, each other affected series of debt securities, have signed or confirmed in writing in favor of the Written Resolution such that the Written Resolution is passed. If so, the Aggregation Agent will determine that the Written Resolution has been duly passed.

Certificate

For the purposes of this section “*Aggregation Agent; Aggregation Procedures*”, the Issuer will provide a certificate to the Aggregation Agent up to three days prior to, and in any case no later than, with respect to an Extraordinary Resolution, the date of the meeting referred to, as applicable, and, with respect to a Written Resolution, the date arranged for the signing of the Written Resolution.

The certificate shall:

- (a) list the total principal amount of the Bonds and, in the case of a multiple series aggregation, the total principal amount of each other affected series of debt securities outstanding on the record date; and
- (b) clearly indicate the Bonds which shall be disregarded and deemed not to remain Outstanding and, in the case of a multiple series aggregation, debt securities of each other affected series of debt securities which shall be disregarded and deemed not to remain outstanding on the record date identifying the holders of the Bonds and, in the case of a multiple series aggregation, debt securities of each other affected series of debt securities.

The Aggregation Agent may rely upon the terms of any certificate, notice, communication or other document believed by it to be genuine.

Notification

The Aggregation Agent will cause each determination made by it for the purposes of this section “*Aggregation Agent; Aggregation Procedures*” to be notified to the Bonds Trustee and the Issuer as soon as practicable after such determination. Notice thereof shall also promptly be given to the Bond Holders in accordance with the Indenture.

Binding nature of determinations; no liability

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this section “*Aggregation Agent; Aggregation Procedures*” and any appointed Calculation Agent will (in the absence of manifest error) be binding on the Issuer, the Bonds Trustee, the Bond Holders and (subject as aforesaid) no liability to any such person will attach to the Aggregation Agent or the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.

Manner of publication

The Issuer will publish all notices and other matters required to be published pursuant to the terms of the Bonds and the Indenture including all Extraordinary Resolutions and Written Resolutions which have been determined by the Aggregation Agent to have been duly passed:

- (a) on www.cbsl.gov.lk;
- (b) through DTC, Euroclear, Clearstream, Luxembourg and any other clearing system in which the Bonds are held;
- (c) in such other places and in such other manner as may be required by applicable law or regulation; and
- (d) in such other places and in such other manner as may be customary.

Waiver of Certain Covenants

The Issuer may omit in any particular instance to comply with any covenant or condition set forth under “Limitation on Liens” if before the time for such compliance the Bond Holders of at least a majority in principal amount of the Outstanding Bonds shall, in accordance with the terms of the Indenture, either waive such compliance in such instance or generally waive compliance with such covenant or condition, but no such waiver shall extend to or affect such covenant or condition except to the extent so expressly waived, and, until such waiver shall become effective, the obligations of the Issuer and the duties of the Bonds Trustee in respect of any such covenant or condition shall remain in full force and effect.

The Issuer will not, directly or indirectly, pay or cause to be paid any consideration, whether by way of interest, fee or otherwise, to any Bond Holder for or as an inducement to any consent, waiver or amendment of any of the terms or provisions of the Indenture or of the Bonds unless such consideration is offered to be paid or agreed to be paid to all Bond Holders that consent, waive or agree to amend in the time frame set forth in the solicitation documents relating to such consent, waiver or agreement.

Notices

Where the Indenture provides for notice to Bond Holders of any event, such notice shall be sufficiently given (unless otherwise expressly provided in the Indenture) (a) for so long as the Bonds are represented by a Global Bond held on behalf of DTC, if sent electronically to DTC (or its representatives) or (b) if the Bonds are not represented by a Global Bond held on behalf of DTC, if in writing and mailed, first-class postage prepaid, to each Bond Holder affected by such event, at his address as it appears in the Security Register and published once in a leading daily newspaper of general circulation in London and in a leading daily newspaper of general circulation in the United States or, under certain limited circumstances, in other English language newspapers of general circulation in Europe or the United States. Any such Notice shall be deemed to have been given on the later of the date of such publication and the seventh day after being so mailed, as the case may be.

Trustee; Paying Agent; Transfer Agent

The Bonds Trustee may resign at any time or may be removed by act of the Bond Holders of a majority in principal amount of the Outstanding Bonds. If the Bonds Trustee resigns, is removed or becomes incapable of acting as Bonds Trustee or if a vacancy occurs in the office of the Bonds Trustee for any reason, a successor Bonds Trustee will be appointed in accordance with the provisions of the Indenture.

The corporate trust office of the Bonds Trustee as at the date hereof is located at 452 Fifth Avenue, New York, NY 10018-2706, United States. The Paying Agent and Transfer Agent are appointed in accordance with the Indenture and, as initially appointed, are set forth on the inside back cover hereof.

Governing Law and Jurisdiction

The Bonds and the Indenture will be governed by and construed in accordance with the laws of the State of New York. The Issuer will submit to the non-exclusive jurisdiction of any State or Federal Court in the Borough of Manhattan, the City of New York and the courts of Sri Lanka (the “Specified Courts”) in any action arising out of or based on the Bonds brought by any Bond Holder of a Bond (a “Related Proceeding”). The Issuer will waive any objection to Related Proceedings in such courts whether on the grounds of venue, residence or domicile or on the ground that the Related Proceedings have been brought in an inconvenient forum. The Issuer will agree that a final non-appealable judgment obtained in any such Related Proceeding (a “Related Judgment”) shall be conclusive and binding upon it and, may be enforced in any Specified Court or in any other courts to the jurisdiction of which the Issuer is or may be subject, by a suit upon such judgment or appropriate enforcement proceedings in Sri Lanka.

Waiver of Immunity

To the extent that the Issuer or any of its revenues, assets or properties are entitled, in any jurisdiction in which any Specified Court is located, in which any Related Proceeding may at any time be brought against it or any of its revenues, assets or properties, or in any jurisdiction in which any Specified Court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any Related Judgment, to any immunity from suit, from set-off, from the jurisdiction of any such court, from attachment prior to judgment, from attachment in aid of execution of a judgment, from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the Issuer will irrevocably agree not to claim and will irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction (and will consent generally for the purposes of the U.S. Foreign Sovereign Immunities Act of 1976, as amended, to the giving of any relief or the issue of any process in connection with any Related Proceeding or Related Judgment). The waiver of immunities given above constitutes only a limited and specific waiver for the purposes of the Bonds and under no circumstances shall it be interpreted as a general waiver by the Issuer or a waiver with respect to proceedings unrelated to the payment under the Bonds. The Issuer will not waive such immunity in respect of (i) present or future “premises of the mission” as defined in the Vienna Convention on Diplomatic Relations signed in 1961; (ii) “consular premises” as defined in the Vienna Convention on Consular Relations signed in 1963; (iii) military property or military assets or property or assets of Sri Lanka related thereto; or (iv) properties and assets located in Sri Lanka and used solely or mainly for public or governmental purposes.

The Global Bonds

The Bonds sold outside the United States in offshore transactions in reliance on Regulation S under the Securities Act, subject to certain exceptions, will be represented by one or more global Bonds in fully registered form, without coupons (collectively, the “Regulation S Global Bonds”).

The Regulation S Global Bonds will be registered in the name of a nominee of DTC and deposited with a custodian for DTC for the accounts of Euroclear and Clearstream, Luxembourg.

The Bonds sold in reliance on Rule 144A under the Securities Act, subject to certain exceptions, will be represented by one or more global certificates in fully registered form, without coupons (collectively, the “Rule 144A Global Bonds,” and together with the Regulation S Global Bonds, the “Global Bonds”).

The Rule 144A Global Bonds will be registered in the name of a nominee of DTC and deposited with HSBC Bank USA, National Association as custodian for DTC. The Rule 144A Global Bonds will be subject to certain restrictions on transfer as set forth in a legend appearing thereon as described in “Notice to Investors.”

Interests in a Rule 144A Global Bond may be transferred to a person who takes delivery in the form of an interest in a Regulation S Global Bond only upon receipt by the Bonds Trustee of, among other things, a written certification (in the form provided for in the Indenture) from the transferor.

Any interest in one Global Bond will, upon transfer and delivery in the form of an interest in another Global Bond, cease to be an interest in the first Global Bond and become an interest in the other Global Bond and, accordingly, will thereafter be subject to all of its transfer restrictions and other procedures for as long as it remains such an interest. Interests in the Bonds represented by such Global Bonds will be shown on, and transfers thereof will be effected only through, records maintained by DTC, Euroclear and Clearstream, Luxembourg, and their respective direct and indirect participants.

DTC, as registered Bond Holder of such Global Bond, will be considered the sole owner or Bond Holder of the Bonds represented by such Global Bond for all purposes under such Bonds and the Indenture, unless otherwise provided therein.

Payments of principal and interest on any Global Bond will be made in accordance with the settlement and clearing procedures of DTC. None of the Issuer, the Bonds Trustee or any Paying Agent or Transfer Agent will have any responsibility or liability for any aspect of any participant's records, policies or procedures relating to, or for payments made on account of, beneficial interests in a Global Bond or for any other aspect of the relationship between DTC, Euroclear or Clearstream, Luxembourg, as the case may be, and their participants, or for maintaining, supervising or reviewing any records relating to such beneficial interests.

All payments on principal and interest on the Global Bonds will be made in immediately available funds.

The Issuer expects that DTC or its nominee, upon receipt of any payment of principal or interest, will credit participants' accounts with payments in amounts proportionate to their respective beneficial interests in the principal amount of such Global Bonds as shown on the records of DTC. The Issuer also expects that the payments by participants to owners of beneficial interests in such Global Bonds held through such participants will be governed by standing instructions and customary practices, as is now the case with securities held for the account of customers registered in "street names," and will be the responsibility of such participants.

Depository Procedures

The following description of the operations and procedures of DTC, Euroclear and Clearstream, Luxembourg are provided solely as a matter of convenience. These operations and procedures are solely within the control of the respective settlement systems and are subject to change by them from time to time. The Issuer and the Bonds Trustee take no responsibility for these operations and procedures and urge investors to contact the system or their participants directly to discuss these matters.

DTC, Euroclear and Clearstream, Luxembourg have advised the Issuer as follows:

DTC. The Issuer understands that DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions among its participants in such securities through electronic book entry changes in accounts of its participants, thereby eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations, some of whom own DTC, and may include the Initial Purchasers. Indirect access to the DTC system is also available to others that clear through or maintain a custodial relationship with a

DTC participant, either directly or indirectly. Transfers of ownership or other interests in Bonds held by DTC may be made only through DTC participants. In addition, beneficial owners of Bonds held by DTC will receive all distributions of principal of and interest on the Bonds from the Trustee through such DTC participant.

Euroclear. Euroclear advises that it was created in 1968 to hold securities for its participants and to clear and settle transactions between its participants through simultaneous electronic book entry delivery against payment, thereby eliminating the need for physical movement of securities certificates and any risk from lack of simultaneous transfers of securities and cash. Euroclear provides various other services, including securities lending and borrowing, and interfaces with domestic markets in several countries. Euroclear is operated by the Brussels, Belgium office of Morgan Guaranty Trust Company of New York (the “Euroclear Operator”), under contract with Euroclear Clearance Systems, S.C., a Belgian cooperative corporation (the “Cooperative”). All operations are conducted by the Euroclear Operator, and all Euroclear securities clearance accounts and Euroclear cash accounts are accounts with the Euroclear Operator, not the Cooperative. The Cooperative establishes policy for Euroclear on behalf of Euroclear participants. Euroclear participants include banks (including central banks), securities brokers and dealers and other professional financial intermediaries and may include the Initial Purchasers. Indirect access to Euroclear is also available to others that clear through or maintain a custodial relationship with a Euroclear participant, either directly or indirectly.

The Euroclear Operator is the Belgian branch of a New York banking corporation which is a member bank of the United States Federal Reserve System. As such, it is regulated and examined by the Board of Governors of the United States Federal Reserve System and the New York State Banking Department, as well as the Belgian Banking Commission.

Bonds clearance accounts and cash accounts with the Euroclear Operator are governed by the Terms and Conditions Governing Use of Euroclear and the related Operating Procedures of the Euroclear System, and applicable Belgian law (collectively, the “Terms and Conditions”). The Terms and Conditions govern transfers of securities and cash within Euroclear, withdrawals of securities and cash from Euroclear, and receipts of payments with respect to securities in Euroclear. All securities in Euroclear are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts. The Euroclear Operator acts under the Terms and Conditions only on behalf of Euroclear participants and has no record of or relationship with persons holding through Euroclear participants.

Distributions with respect to Bonds held beneficially through Euroclear will be credited to the cash accounts of Euroclear participants in accordance with the Terms and Conditions, to the extent received by Euroclear.

Clearstream, Luxembourg. Clearstream, Luxembourg advises that it is incorporated under the laws of The Grand Duchy of Luxembourg as a professional depositary. Clearstream, Luxembourg holds securities for its participants and facilitates the clearance and settlement of securities transactions between its participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of securities certificates. Clearstream, Luxembourg provides to its participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream, Luxembourg interfaces with domestic markets in several countries. As a professional depositary, Clearstream, Luxembourg is subject to regulation by the Luxembourg Monetary Institute. Clearstream, Luxembourg participants are financial institutions around the world, including securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations and may include the Initial Purchasers. Indirect access to Clearstream, Luxembourg is also available to others that clear through or maintain a custodial relationship with a Clearstream, Luxembourg participant either directly or indirectly.

Distributions with respect to Bonds held beneficially through Clearstream, Luxembourg will be credited to cash accounts of Clearstream, Luxembourg participants in accordance with its rules and procedures, to the extent received by Clearstream, Luxembourg.

Settlement and Clearance

Initial settlement for the Bonds will be made in same-day funds. Transfers between participants in DTC will be effected in accordance with DTC's procedures, which currently provide for settlement in same-day funds. Transfers between participants in Euroclear and Clearstream, Luxembourg will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Ownership of beneficial interests in a Global Bond will be limited to persons who have accounts with DTC participants or persons who hold interests through participants. Upon the issuance of a Global Bond, DTC or its custodian will credit, on its internal system, the respective principal amount of the beneficial interests represented by such Global Bond to the accounts of its participants. Such account initially will be designated by or on behalf of the Initial Purchasers. Ownership of beneficial interests in a Global Bond will be shown only on, and the transfer of such ownership interests will be effected only through, records maintained by DTC or its nominee (with respect to interests of participants), or by any such participant (with respect to interests of persons held by such participants on their behalf).

Payments, transfers, exchanges and other matters relating to beneficial interests in a Global Bond may be subject to various policies and procedures adopted by DTC, Euroclear or Clearstream, Luxembourg, as the case may be, from time to time.

Subject to compliance with the transfer restrictions applicable to the Bonds described above and under "Notice to Investors" below, cross-market transfers of Bonds between DTC, on the one hand, and Euroclear or Clearstream, Luxembourg, on the other hand, will be effected in DTC in accordance with DTC rules on behalf of Euroclear or Clearstream, Luxembourg, as the case may be, by its respective depository; however, such cross-market transactions will require delivery instructions to Euroclear or Clearstream, Luxembourg, as the case may be, by the counterpart in such system in accordance with its rules and procedures and within its established deadlines (Brussels time). Each of Euroclear or Clearstream, Luxembourg, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to its respective depository to take action to effect final settlement on its behalf by delivering or receiving interests in the Regulation S Global Bonds in DTC, and making or receiving payment in accordance with normal procedures for same-day funds settlement applicable to DTC. Clearstream, Luxembourg accountholders and Euroclear accountholders may not deliver instructions directly to the depositories for Clearstream, Luxembourg or Euroclear.

Because of time zone differences, the securities account of a Euroclear or Clearstream, Luxembourg accountholder purchasing an interest in the Bonds from a DTC participant will be credited during the securities settlement processing day (which must be a business day for Euroclear and Clearstream, Luxembourg) immediately following the DTC settlement date, and such credit of any transactions in interests in a Global Bond settlement during such processing day will be reported to the relevant Euroclear or Clearstream, Luxembourg accountholder on such day. Cash received in Euroclear or Clearstream, Luxembourg as a result of sales of interests in a Global Bond by or through a Euroclear or Clearstream, Luxembourg accountholder to a DTC participant will be received with value on the DTC settlement date but will be available in the relevant Euroclear or Clearstream, Luxembourg cash account only as at the business day following settlement in DTC. Settlement between Euroclear or Clearstream, Luxembourg accountholders and DTC participants cannot be made on a delivery versus payment basis. The arrangements for transfer of payments must be established separately from the arrangements for transfer of securities, the latter being effected on a free delivery basis. The customary arrangements for delivery versus payment between Euroclear and Clearstream, Luxembourg accountholders or between DTC participants are not affected.

Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the procedures described above in order to facilitate transfers of interests in the Global Bonds among participants of DTC, Euroclear and Clearstream, Luxembourg, they are under no obligation to perform or continue to perform such procedures and such procedures may be modified or discontinued at any time. None of the Issuer, the Bonds Trustee or any of their respective agents will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their respective participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

Definitive Bonds

Beneficial interests in any Global Bond may be exchanged for definitive (i.e., non-global) Bonds in fully registered form, without coupons (collectively, the “Definitive Bonds” and each, a “Definitive Bond”) only in the event that (1) DTC notifies the Issuer in writing at any time that DTC is unwilling or unable to continue as depository or ceases to be a “clearing agency” registered under the Exchange Act, and a successor is not appointed by the Issuer within 90 days after the Issuer is notified by DTC or (2) the Bonds have become immediately due and payable pursuant to the Indenture.

Payment of the principal of any Definitive Bond shall be made, upon presentation and surrender of such Bond, by check drawn on a bank in The City of New York at the option of the Bond Holder, either:

(A) AT THE CORPORATE TRUST OFFICE OF THE BONDS TRUSTEE, OR

(B) SUBJECT TO ANY APPLICABLE LAWS OR REGULATIONS AND THE RIGHT OF THE ISSUE TO TERMINATE THE APPOINTMENT OF ANY PAYING AGENT, AT THE OFFICES OF SUCH OTHER PAYING AGENTS AS THE ISSUER MAY DESIGNATE FROM TIME TO TIME.

Unless the manner of payment is otherwise agreed by the Issuer and the Bonds Trustee, payments of interest on any Definitive Bond shall be made solely in Dollars by check drawn on a bank in The City of New York, mailed to the address of the person entitled thereto as such address shall appear on the Security Register. The Issuer and the Bonds Trustee may deem and treat the Bond Holder in whose name a Definitive Bond is registered at the close of business on the fifteenth day preceding such Bonds Interest Payment Date as the absolute owner of the Definitive Bond (notwithstanding any notice of ownership or other writing on such Definitive Bond) for the purposes of receiving payment on such Definitive Bond or on account of such Definitive Bond and for all other purposes.

The Bond Holders of Definitive Bonds shall present directly at the corporate trust office of the Bonds Trustee or of any other Transfer Agent, all requests for the registration of any transfer of such Definitive Bonds, for the exchange of such Definitive Bonds for one or more new Definitive Bonds in the like aggregate principal amount and in authorized denominations and for the replacement of such Definitive Bonds in cases of mutilation, destruction, loss or theft. Every certificate representing Definitive Bonds presented or surrendered for registration of transfer or for exchange shall be duly endorsed, or be accompanied by a written instrument of transfer in form satisfactory to the Issuer and the Bonds Trustee, duly executed by the Bond Holder thereof or his attorney duly authorized in writing. The registration of any transfer of Definitive Bonds in the Security Register is also subject to any reasonable requirements of the Issuer and the Bonds Trustee. Except for the expenses of delivery other than by regular mail, no service charge shall be made for any exchange or registration of transfer, but the Issuer may require payment of a sum sufficient to cover any stamp tax or other Governmental charge payable in connection therewith.

The Indenture provides that Definitive Bonds will be issued to replace Definitive Bonds which have been mutilated, destroyed, stolen or lost upon payment of certain costs associated with such replacement and on certain terms as to evidence and indemnity. In the case of destroyed, stolen or lost Definitive Bonds, replacement Definitive Bonds will not be issued if either the Issuer or the Bonds Trustee has notice that such Definitive Bonds have been acquired by a bona fide purchaser. Mutilated Definitive Bonds must be surrendered before replacements will be issued. In the event any such mutilated, destroyed, stolen or lost Definitive Bond has become or is about to become due and payable, the issuer in its discretion may, instead of issuing a new Definitive Bond, pay or cause to be paid such Definitive Bond.

All Definitive Bonds issued as a result of any partial or whole transfer, exchange or replacement of Bonds will be delivered to the Bond Holder at the corporate trust office of the Issuer or at the office of any such other Transfer Agent as the Issuer may designate from time to time, or (at the risk of the Bond Holder) sent by mail to such address as is specified by the Bond Holder in the Bond Holder's request for transfer, exchange or replacement.

Restrictions on Transfer

The Bonds may not be sold or otherwise transferred except as described above under “— The Global Bonds” and “— Definitive Bonds”.

TAXATION

Sri Lankan Taxation

Income tax

The relevant taxation laws of Sri Lanka are embodied in the Inland Revenue Act No. 10 of 2006 (as amended) (“the Inland Revenue Act”).

Under the Inland Revenue Act, income tax is charged in respect of the profits and income of every person. For the purposes of the Act “profits and income” in the current instance means, inter alia, interest and discounts.

Persons *resident in Sri Lanka* are subject to income tax on their worldwide income. A company is considered to be a resident company if its registered or principal office is in Sri Lanka or if the control and management of its business are exercised in Sri Lanka. An individual who is physically present in Sri Lanka for a period of one hundred and eighty three days or more during a year of assessment is deemed to be a resident in Sri Lanka for that year of assessment. Also, an individual who is deemed to be resident for two or more consecutive years of assessment is deemed to be resident until such time as he is absent from Sri Lanka for a continuous period of three hundred and sixty five days.

In the case of persons who are *not resident in Sri Lanka*, any profits and income arising in or derived from Sri Lanka generally are subject to income tax in Sri Lanka. Where interest is payable to a non-resident person on a loan made by such person and the interest on such loan is borne, directly or indirectly, by a person resident in Sri Lanka, such interest is deemed to be profits and income arising in or derived from Sri Lanka.

However, the Inland Revenue Act provides for an exemption from income tax in respect of any interest or discount paid or allowed to any non-resident person on any sovereign bond issued by the Government of Sri Lanka (the term “person” includes a company or body of persons or any government). In view of the aforesaid exemption, any interest or discount arising on the Bonds will not be subject to Sri Lanka tax and could be made without any deduction for or on account of withholding tax.

Furthermore, the Inland Revenue Act provides that the profits and income earned by any non-resident person from the sale of any sovereign bond issued by the Government of Sri Lanka would also be exempt from income tax. Please see “General Information — Authorization”.

Stamp Duty

The Stamp Duty Act No. 43 of 1982 read with the Stamp Duty (Special Provisions) Act No. 12 of 2006 exempts from the payment of stamp duty any instrument executed by or on behalf of the Government.

United States Federal Income Taxation

The following discussion is a summary based on present law of certain material U.S. federal income tax considerations relevant to the purchase, ownership and disposition of the Bonds. This discussion addresses only U.S. Holders described below who purchase Bonds in the original offering at the issue price (as defined herein), hold the Bonds as capital assets and use the US dollar as their functional currency. This discussion is not a complete description of all U.S. tax considerations relating to the Bonds. It does not address all of the tax consequences to prospective investors subject to special rules, such as banks, dealers, traders that elect to mark to market, insurance companies, partnerships or other pass through entities (or persons that hold Bonds through pass through entities), regulated investment companies, real estate investment trusts, U.S. expatriates and former long term residents of the United States, tax-exempt entities or persons holding the Bonds as part of a hedge, straddle, conversion or other integrated financial transaction. The following discussion does not address any U.S. federal taxes (such as the estate tax or the gift tax) other than U.S. federal income taxes, or any aspect of the U.S. federal Medicare tax on net investment income, the alternative minimum tax or any non-U.S., state or local taxes.

EACH PROSPECTIVE PURCHASER IS URGED TO CONSULT ITS OWN TAX ADVISOR ABOUT THE TAX CONSEQUENCES OF AN INVESTMENT IN THE BONDS UNDER THE STATE AND LOCAL LAWS OF THE UNITED STATES, SRI LANKA AND THE LAWS OF ANY OTHER JURISDICTION WHERE THE PURCHASER MAY BE SUBJECT TO TAXATION.

For purposes of this discussion, a “U.S. Holder” is a beneficial owner of Bonds that is, for purposes of U.S. federal income taxation, (1) a citizen or resident of the United States, (2) a corporation created or organized in or under the laws of the United States or its political subdivisions, (3) a trust that (i) is subject to the control of a U.S. person and the primary supervision of a U.S. court or (ii) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person, or (4) an estate the income of which is subject to U.S. federal income taxation regardless of its source.

If a partnership acquires or holds the Bonds, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partnership and partners of a partnership that acquires or holds the Bonds should consult their own tax advisor.

Interest

Payments of stated interest to a U.S. Holder on a Bond, including any additional amounts paid with respect to withholding tax (if any) on the Bonds, will be includible in such U.S. Holder’s gross income as ordinary interest income at the time such payments are received or accrued in accordance with such U.S. Holder’s regular method of tax accounting for U.S. federal income tax purposes. It is expected, and the remainder of this discussion assumes, that the Bonds will not be issued with original issue discount for U.S. federal income tax purposes.

Interest on the Bonds will be treated as foreign source income for U.S. federal income tax purposes and will constitute “passive category” income, or in certain cases, “general category income” for foreign tax credit purposes, which may be relevant to a U.S. Holder in computing its foreign tax credit limitations.

Disposition

Upon the sale, exchange or other taxable disposition (including redemption) of a Bond, a U.S. Holder generally will recognize taxable gain or loss equal to the difference between the amount realized on the sale, exchange or other taxable disposition (other than accrued but unpaid interest, which will be taxable as such) and the U.S. Holder’s adjusted tax basis in the Bond. A U.S. Holder’s adjusted tax basis in a Bond generally will be equal to the amount that the U.S. Holder paid for the Bond. Any such gain or loss generally will be U.S. source capital gain or loss and will be long-term capital gain or loss if the Bond has been held for more than one year at the time of its sale, exchange or other taxable disposition. Certain non-corporate U.S. Holders (including individuals) may be eligible for preferential rates of U.S. federal income tax in respect of long-term capital gains. The deductibility of capital losses is subject to limitations.

Information Reporting and Backup Withholding

Payments of interest and proceeds from the sale, redemption or other disposition of a Bond may be reported to the U.S. Internal Revenue Service unless the U.S. Holder is a corporation or other exempt recipient and, if required, establishes a basis for such exemption.

Backup withholding may apply to amounts subject to reporting if the U.S. Holder fails to provide an accurate taxpayer identification number. Backup withholding is not an additional tax. A U.S. Holder can claim a credit against its U.S. federal income tax liability for the amount of any backup withholding and may be entitled to a refund of any excess, provided the required information is furnished to the U.S. Internal Revenue Service in a timely manner.

“Specified Foreign Financial Assets” Reporting

Certain owners of “specified foreign financial assets” with an aggregate value in excess of US\$ 50,000 (and in some circumstances, a higher threshold), may be required to file an information statement with respect to such assets with their U.S. federal income tax returns, currently on IRS Form 8938. The Bonds generally are not expected to constitute “specified foreign financial assets” for so long as they are held in accounts maintained by certain financial institutions (but the accounts in which the Bonds are held may be reportable if maintained by foreign financial institutions). U.S. Holders are urged to consult their tax advisors regarding the application of this legislation to their ownership of the Bonds.

PLAN OF DISTRIBUTION

Subject to the terms and conditions in the purchase agreement, dated May 4, 2017, between the Issuer and the initial purchasers named below (the “Initial Purchasers”), each of the Initial Purchasers has severally agreed with the Issuer to purchase the principal amount of Bonds set forth opposite such Initial Purchaser’s name:

Initial Purchaser	Principal Amount of the Bonds	Percentage of Interest of the Bonds
Citigroup Global Capital Markets Inc.....	US\$214,286,000	14.3%
CLSA Limited.....	US\$214,286,000	14.3%
Deutsche Bank AG, Singapore Branch.....	US\$214,286,000	14.3%
The Hongkong and Shanghai Banking Corporation Limited..	US\$214,286,000	14.3%
ICBC International Securities Limited.....	US\$214,286,000	14.3%
J.P. Morgan (S.E.A.) Limited	US\$214,285,000	14.3%
Standard Chartered Bank.....	US\$214,285,000	14.3%
Total	<u>US\$1,500,000,000</u>	<u>100.0%</u>

The Issuer will also reimburse the Initial Purchasers in respect of certain of their expenses, and has agreed to indemnify the Initial Purchasers against certain liabilities (including liabilities under the Securities Act), incurred in connection with the issue of the Bonds, or to contribute to payments that the Initial Purchasers may be required to make because of any of these liabilities. The Purchase Agreement may be terminated in certain circumstances prior to payment of the net purchase amounts in respect of the Bonds to the Issuer.

The Initial Purchasers initially propose to offer the Bonds for resale at the issue price that appears on the cover of this Offering Circular. After the initial offering, the Initial Purchasers may change the offering price and any other selling terms. The Initial Purchasers may offer and sell the Bonds through their affiliates.

Other Relationships

The Initial Purchasers and their affiliates are full service financial institutions engaged in various activities which may include securities trading, commercial and investment banking, financial advice, investment management, principal investment, hedging, financing and brokerage activities. Each of the Initial Purchasers may have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with the Issuer or its controlled or associated entities from time to time. In the ordinary course of their various business activities, the Initial Purchasers and their affiliates may make or hold (on their own account, on behalf of clients or in their capacity of investment advisers) a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments and enter into other transactions, including credit derivatives (such as asset swaps, repackaging and credit default swaps) in relation thereto. Such transactions, investments and securities activities may involve securities and instruments of the Issuer or its controlled or associated entities, may be entered into at the same time or proximate to offers and sales of the Bonds or at other times in the secondary market and be carried out with counterparties that are also purchasers, holders or sellers of Bonds. Bonds may be purchased by or be allocated to any Initial Purchasers or an affiliate for asset management and/or proprietary purposes but not with a view to distribution.

The Initial Purchasers or certain of their respective affiliates may purchase the Bonds and be allocated Bonds for asset management and/or proprietary purposes and not with a view to distribution.

United States

The Bonds have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Bonds are being offered and sold only (a) outside the United States as defined in Regulation S in offshore transactions in accordance with Regulation S and (b) in the United States to a limited number of QIBs as defined in Rule 144A in connection with resales by the Initial Purchasers in accordance with Rule 144A.

In addition, until 40 days after the commencement of the Offering, an offer or sale of Bonds within the United States by any dealer (whether or not participating in the Offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A or another exemption from registration under the Securities Act.

The Bonds have not been approved or disapproved by the United States Securities and Exchange Commission, any state securities commission in the United States or any other United States regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering or the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offense in the United States.

Sri Lanka

The Bonds will not directly or indirectly be offered or sold in Sri Lanka. No offering circular, prospectus, form of application or advertisement in relation to the Bonds shall be distributed within Sri Lanka.

United Kingdom

Each Initial Purchaser has agreed that:

- it has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the “FSMA”)) received by it in connection with the issue or sale of any Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and
- it has complied with, and will comply with, all applicable provisions of the FSMA with respect to anything done by it in relation to the Bonds in, from or otherwise involving the UK.

Hong Kong

Each Initial Purchaser has represented and agreed that:

- (1) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Bonds other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong (the “SFO”) and any rules made under the SFO; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies (Winding Up and Miscellaneous Provisions Ordinance (Cap. 32) of Hong Kong (the “C(WUMP)O”) or which do not constitute an offer to the public within the meaning of the C(WUMP)O; and
- (2) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Bonds, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Bonds which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the SFO and any rules made under the SFO.

Japan

The Bonds have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948), as amended (the “FIEA”). Accordingly, each of the Initial Purchasers has represented and agreed that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Bonds in Japan or to, or for the benefit of, a resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident in Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEA and other relevant laws and regulations of Japan.

Singapore

Each Initial Purchaser has acknowledged that this Offering Circular has not been and will not be registered as a prospectus with the Monetary Authority of Singapore (the “MAS”) under the Securities and Futures Act (Chapter 289 of Singapore) (the “SFA”). Accordingly, each Initial Purchaser has represented, warranted and agreed that it has not offered or sold any Bonds or caused the Bonds to be made the subject of an invitation for subscription or purchase and will not offer or sell any Bonds or cause the Bonds to be made the subject of an invitation for subscription or purchase, and has not circulated or distributed, nor will it circulate or distribute, this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Bonds, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor under Section 274 of the SFA, (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275, of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the Bonds are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

securities (as defined in Section 239(1) of the SFA) of that corporation or the beneficiaries’ rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the Bonds pursuant to an offer made under Section 275 of the SFA except:

- (1) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA;
- (2) where no consideration is or will be given for the transfer;
- (3) where the transfer is by operation of law;
- (4) as specified in Section 276(7) of the SFA; or
- (5) as specified in Regulation 32 of the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005 of Singapore.

Republic of Italy

The offering of the Bonds has not been registered pursuant to Italian securities legislation and, accordingly, no Bonds may be offered, sold or delivered, nor may copies of the Offering Circular or of any other document relating to the Bonds be distributed in the Republic of Italy, except:

- a. to qualified investors (*investitori qualificati*), as defined pursuant to Article 100 of Legislative Decree No. 58 of February 24, 1998, as amended (the “Financial Services Act”) and Article 34-ter, first paragraph, letter b) of CONSOB Regulation No. 11971 of May 14, 1999, as amended from time to time (“Regulation No. 11971”); or
- b. in other circumstances which are exempted from the rules on public offerings pursuant to Article 100 of the Financial Services Act and Article 34-ter of Regulation No. 11971.

Any offer, sale or delivery of the Bonds or distribution of copies of the Offering Circular or any other document relating to the Bonds in the Republic of Italy under a. or b. above must:

- i. be made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act, CONSOB Regulation No. 16190 of October 29, 2007 (as amended from time to time) and Legislative Decree No. 385 of September 1, 1993, as amended (the “Banking Act”); and
- ii. comply with any other applicable laws and regulations or requirement imposed by CONSOB, the Bank of Italy (including the reporting requirements, where applicable, pursuant to Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy, as amended from time to time) and/or any other Italian authority.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “Relevant Member State”), each Initial Purchaser has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “Relevant Implementation Date”) it has not made and will not make an offer of Bonds which are the subject of the offering contemplated by this Offering Circular to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Bonds to the public in that Relevant Member State:

- (a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;
- (b) to fewer than 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive), subject to obtaining the prior consent of the relevant Initial Purchaser or Initial Purchasers nominated by the Issuer for any such offer; or
- (c) in any other circumstances falling within Article 3(2) of the Prospectus Directive, provided that no such offer of Bonds shall require the Issuer or any Initial Purchaser to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Bonds to the public” in relation to any Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression “Prospectus Directive” means Directive 2003/71/EC (as amended, including by Directive 2010/73/EU), and includes any relevant implementing measure in the Relevant Member State.

General

No action has been taken by the Issuer or any of the Initial Purchasers that would, or is intended to, permit a public offer of the Bonds or possession or distribution of this Offering Circular or any other offering or publicity material relating to the Bonds in any country or jurisdiction where any such action for that purpose is required. Accordingly, each Initial Purchaser has undertaken that it will not, directly or indirectly, offer or sell any Bonds or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Bonds by it will be made on the same terms.

The materials relating to the offering of the Bonds do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering of the Bonds be made by a licensed broker or dealer and the Initial Purchasers or any affiliate of the Initial Purchasers is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the Initial Purchasers or such affiliate on behalf of the Government in such jurisdiction.

The Bonds are a new issue of securities with no established trading market. Approval in-principle has been received from the SGX-ST for the listing and quotation of the Bonds on the SGX-ST. However, the Issuer cannot assure you that the prices at which the Bonds will sell in the market after this offering will not be lower than the initial offering price or that an active trading market for the Bonds will develop and continue after this Offering. The Initial Purchasers have advised the Issuer that they currently intend to make a market in the Bonds. However, they are not obligated to do so and they may discontinue any market-making activities with respect to the Bonds at any time without notice. In addition, market-making activity will be subject to the limits imposed by the Securities Act and the Exchange Act. Accordingly, the Issuer cannot assure you as to the liquidity of or the trading market for the Bonds.

In connection with the Offering, The Hongkong and Shanghai Banking Corporation Limited, as the Stabilizing Manager or any person acting for it, on behalf of the Initial Purchasers, may engage in transactions that stabilize or otherwise affect the market price of the Bonds. These transactions consist of bids or purchases for the purpose of pegging, fixing or maintaining the price of the Bonds. If the Stabilizing Manager or its agent creates a short position in the Bonds in connection with the Offering, (i.e., if the Stabilizing Manager or its agent sells more Bonds than are set forth on the cover page of this Offering Circular), the Stabilizing Manager or its agent may reduce that short position by purchasing the Bonds in the open market. In general, purchases of a bond for the purpose of stabilization or to reduce a short position could cause the price of the Bonds to be higher than it might be in the absence of such purchases. These transactions may be effected in the over-the-counter market at any time. If such activities are commenced, they may be discontinued by the Stabilizing Manager or its agent(s) at any time. The Stabilizing Manager or its agent also may impose a penalty bid. This occurs when a particular Initial Purchaser repays to the Stabilizing Manager or its agent a portion of the underwriting discount received by it because the Stabilizing Manager or its agent has repurchased the Bonds sold by or for the account of such Initial Purchaser in stabilizing or short covering transactions.

Neither the Issuer nor the Stabilizing Manager makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the Bonds. In addition, neither the Issuer nor the Stabilizing Manager makes any representation that the Stabilizing Manager or its agent will engage in such transactions or that such transactions, once commenced, will not be discontinued with or without notice.

It is expected that the Bonds will be delivered against payment for the Bonds on or about the date specified in the last paragraph of the cover page of this Offering Circular, which will be the fourth business day following the date of the pricing of the Bonds. Since trades in the secondary market generally settle in three business days pursuant to Rule 15c6-1 of the Exchange Act, purchasers who wish to trade Bonds on the date of pricing will be required, by virtue of the fact that the Bonds initially will settle in T+5 on a delayed basis, to specify alternative settlement arrangements to prevent a failed settlement. Purchasers of Bonds who wish to make such trades should consult their own advisors.

NOTICE TO INVESTORS

Due to the following significant transfer restrictions applicable to the Bonds, investors are advised to consult legal counsel prior to making any reoffer, resale, pledge, transfer or disposal of Bonds.

The Bonds have not been registered and will not be registered under the Securities Act or any other securities laws, and may not be offered or sold in the United States (as defined in Regulation S) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Bonds are being offered and sold (1) in the United States only to persons reasonably believed to be QIBs, as defined in Rule 144A under the Securities Act in compliance with Rule 144A and (2) outside the United States in offshore transactions pursuant to Regulation S.

Each investor of a Bond, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with the Issuer and the Initial Purchasers as follows:

- (1) represent that it is purchasing the Bonds for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is (a) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A or (b) located outside the United States;
- (2) acknowledge that the Bonds have not been registered under the Securities Act and may not be offered or sold within the United States except as set forth below;
- (3) if it is a person other than a purchaser located outside the United States, agree that if it should resell or otherwise transfer the Bonds within the time period referred to in Rule 144(d) under the Securities Act after the original issuance of the Bonds, it will do so only (a) to the Issuer, (b) to a QIB in compliance with Rule 144A, (c) outside the United States in an offshore transaction in compliance with Rule 903 or 904 of Regulation S under the Securities Act, (d) pursuant to the exemption from registration provided by Rule 144 (if available) but only upon delivery to the Issuer of an opinion of counsel in form and scope satisfactory to the Issuer or (e) pursuant to an effective registration statement under the Securities Act;
- (4) agree that it will deliver to each person to whom it transfers Bonds notice of any restriction on transfer of such Bonds;
- (5) understand and agree that Bonds initially offered in the United States to QIBs will be represented by one or more Rule 144A Global Bonds and that Bonds offered outside the United States in offshore transactions pursuant to Regulation S will be represented by one or more Regulation S Global Bonds;
- (6) understand that unless registered under the Securities Act, the Rule 144A Global Bond and Bond Certificates issued in exchange for a beneficial interest in the Rule 144A Global Bond will bear a legend to the following effect, unless otherwise agreed by the Issuer and the holder thereof:

THE SECURITIES EVIDENCED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION AND (A) ACCORDINGLY, THE SECURITIES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION COMPLYING WITH THE REQUIREMENTS OF RULE 144A, (2) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), (4) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT, OR (5) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE

SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES; (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY SUBSEQUENT PURCHASER OF THESE SECURITIES FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE; AND (C) NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALES OF THE SECURITIES.

- (7) acknowledge that the Issuer and the Initial Purchasers will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements, and agree that if any of the acknowledgments, representations or warranties deemed to have been made by it by its purchase of Bonds are no longer accurate, it shall promptly notify the Issuer and the Initial Purchasers; and
- (8) if it is acquiring Bonds as a fiduciary or agent for one or more investor accounts, represent that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

LEGAL MATTERS

The validity of the Bonds will be passed upon on behalf of the Issuer by the Attorney General of Sri Lanka, counsel for the Issuer as to matters of Sri Lankan law, and by Allen & Overy, international counsel for the Issuer as to matters of United States and New York State law. Certain legal matters will be passed upon for the Initial Purchasers by F. J. & G. de Saram, counsel for the Initial Purchasers as to matters of Sri Lankan law, and by Milbank, Tweed, Hadley & McCloy LLP, international counsel for the Initial Purchasers as to matters of United States and New York State law.

PUBLIC OFFICIAL STATEMENTS AND DOCUMENTS

Information included herein which is designated as being taken from a publication of Sri Lanka or an agency or instrumentality of the Issuer is included on the authority of the Issuer or such agency or instrumentality.

The information set forth herein relating to Sri Lanka is provided by the Central Bank of the Democratic Socialist Republic of Sri Lanka acting in its official capacity and is included on its authority.

GENERAL INFORMATION

Authorization

The Issuer has obtained all necessary consents, approvals and authorizations under the laws of the Democratic Socialist Republic of Sri Lanka in connection with the issue and performance of the Bonds. The issue of the Bonds and the bond holders for the time being and from time to time have been approved on April 4, 2017 by the Cabinet of Ministers pursuant to the Foreign Loans Act No. 29 of 1957 (as amended). The signing of the Bonds and the relevant agreements has been approved on April 25, 2017 by the President under the Foreign Loans Act No 29 of 1957 (as amended). The Deputy Commissioner General of Inland Revenue has confirmed on April 21, 2017 that (a) the interest payments on the Bonds are exempt from income tax in Sri Lanka pursuant to Section 9(b) of the Inland Revenue Act No. 10 of 2006 (as amended); (b) the interest earned on the Bonds by any person or partnership located outside Sri Lanka is exempt from income tax in Sri Lanka, under and in terms of Section 9(b) of the Inland Revenue Act No 10 of 2006, (as amended); and (c) the fees derived from the transaction by the Initial Purchasers would not be liable to tax as such fees are not derived from business transacted in Sri Lanka by such institution or through a permanent establishment in Sri Lanka by such institution. Special permission has been given to the Issuer on April 20, 2017 by the Controller of Exchange for purposes and in terms of the Exchange Control Act No. 24 of 1953 (as amended) in relation to the proposed borrowing through the Bonds and for payments by the Issuer under or in connection with the Bonds under Section 7 of the Exchange Control Act No. 24 of 1953 (as amended). Permission has also been granted to the Issuer by the Controller of Exchange pursuant to Sections 10, 11 and 22(1)(f) of the Exchange Control Act No. 24 of 1953 (as amended). The Controller of Exchange has also confirmed on April 20, 2017 that all permissions necessary for the Issuer for purposes and in terms of the Exchange Control Act in relation to the proposed borrowing through the issue of the Bonds have been granted. Approval has been granted by the Monetary Board of the Central Bank of Sri Lanka for the issuance of the Bonds under the Monetary Law Act (Cap 422), as evidenced by an extract of the minutes of the meeting of the Monetary Board No. 40/2016 held on December 30, 2016. Confirmation that the borrowing resulting from the issuance of the Bonds is within the limits authorized by the Parliament of Sri Lanka was given by a letter dated April 24, 2017 issued by the Acting Secretary to the Treasury, Ministry of Finance.

Listing

Approval in-principle has been received from the SGX-ST for the listing and quotation of the Bonds on the SGX-ST. For so long as the Bonds are listed on the SGX-ST and the rules of the SGX-ST so require, the Bonds will be traded on the SGX-ST in a minimum board lot size of S\$200,000 (or its equivalent in foreign currencies). Listing of the Bonds on the SGX-ST is conditional upon satisfaction of the requirements of the SGX-ST.

So long as the Bonds are listed on the SGX-ST and the rules of the SGX-ST so require, in the event that the Global Bonds are exchanged for Definitive Bonds, the Issuer shall appoint and maintain a paying agent in Singapore (the “Singapore Paying Agent”), where the Definitive Bonds may be presented or surrendered for payment or redemption. In addition, in the event that the Global Bonds are exchanged for Definitive Bonds, an announcement of such exchange shall be made through the SGX-ST and such announcement will include all material information with regard to the delivery of the Definitive Bonds, including details of the Singapore Paying Agent.

Clearing Systems

The Bonds have been accepted for clearance through DTC, Euroclear and Clearstream, Luxembourg.

With respect to the Bonds

The ISIN for the Rule 144A Global Bonds is US85227SAT33 and for the Regulation S Global Bonds is USY8137FAH11. The CUSIP number for the Rule 144A Global Bonds is 85227S AT3 and for the Regulation S Global Bonds is Y8137F AH1. The Common Code for the Rule 144A Global Bonds is 161254584 and for the Regulation S Global Bonds is 161142611.

Application will be made for acceptance of the Bonds into DTC's book-entry settlement system.

Annual Reports

Copies of the 2015 Annual Report and all future monthly bulletins may be obtained on the website of the Central Bank of Sri Lanka at http://www.cbsl.gov.lk/pics_n_docs/10_pub/_docs/efr/annual_report/AR2015/English/content.htm, so long as any of the Bonds are listed on the SGX-ST. No information contained on the website of the Central Bank of Sri Lanka is incorporated by reference herein. The aforementioned 2015 Annual Report contains certain summary information regarding the annual budget of the Government.

Documents

Copies of the Indenture containing the forms of the Certificates will be available for inspection, at the specified offices of each of the Paying Agents during normal business hours, so long as any of the Bonds, as applicable, are outstanding. Copies of the Indenture and the Constitution of Sri Lanka will be available for inspection at the specified office of the Paying Agent during normal business hours so long as the Bonds, as applicable, are listed on the SGX-ST.

Available Information

The Issuer is a foreign government as defined in Rule 405 under the Securities Act and is eligible to register securities on Schedule B of the Securities Act. Therefore, the Issuer is not subject to the information provision requirements of Rule 144A(d)(4)(i) under the Securities Act.

INDEBTEDNESS OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

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GOVERNMENT DEBT

Year ⁽¹⁾	Domestic Debt					Debt as a % of GDP ⁽⁵⁾				
	Treasury Bills ⁽²⁾	Rupee Loans	Treasury Bonds ⁽³⁾⁽⁴⁾	Other	Total	Foreign Debt ⁽²⁾⁽³⁾	Total Debt	Domestic	Foreign	Total
(in Rs. millions, except for percentages)										
1950	79	436	—	14	529	125	654	13.7	3.2	16.9
1951	30	582	—	14	626	125	751	13.6	2.7	16.3
1952	93	684	—	75	852	192	1,044	18.9	4.3	23.2
1953	184	731	—	129	1,044	205	1,249	23.2	4.6	27.8
1954	105	782	—	66	953	211	1,164	20.1	4.4	24.5
1955	60	829	—	—	889	232	1,121	17.0	4.4	21.4
1956	68	882	—	—	950	258	1,208	18.6	5.1	23.7
1957	65	962	—	105	1,132	278	1,410	21.8	5.3	27.1
1958	140	1,007	—	91	1,238	293	1,531	22.5	5.3	27.9
1959	320	1,102	—	138	1,560	307	1,867	24.3	4.8	29.1
1960	550	1,217	—	170	1,937	345	2,282	28.9	5.1	34.0
1961	750	1,397	—	198	2,345	407	2,752	34.1	5.9	40.0
1962	1,000	1,515	—	179	2,694	412	3,106	38.7	5.9	44.6
1963	1,125	1,684	—	222	3,031	489	3,520	41.1	6.6	47.7
1964	1,250	1,909	—	216	3,375	549	3,924	43.3	7.0	50.4
1965	1,300	2,150	—	246	3,696	739	4,435	45.7	9.1	54.9
1966	1,425	2,475	—	295	4,195	1,074	5,269	50.3	12.9	63.2
1967	1,500	2,785	—	298	4,583	1,376	5,959	50.7	15.2	65.9
1968	1,750	3,118	—	329	5,197	1,578	6,775	48.5	14.7	63.2
1969	1,750	3,409	—	354	5,513	1,800	7,313	47.1	15.4	62.5
1970	1,950	3,925	—	420	6,295	2,394	8,689	46.1	17.5	63.6
1971	2,025	4,512	—	446	6,983	2,795	9,778	49.7	19.9	69.6
1972	2,325	5,103	—	498	7,926	2,936	10,862	52.0	19.3	71.2
1973	2,250	5,812	—	522	8,584	3,705	12,289	46.6	20.1	66.8
1974	2,250	6,591	—	604	9,445	2,859	12,304	39.7	12.0	51.8
1975	2,350	7,560	—	949	10,859	3,705	14,564	40.9	13.9	54.8
1976	2,700	9,001	—	990	12,691	4,968	17,659	42.0	16.4	58.5
1977	2,500	10,391	—	1,501	14,392	10,593	24,985	39.5	29.1	68.6
1978	2,635	12,049	—	1,684	16,368	14,583	30,951	38.4	34.2	72.5
1979	3,000	14,929	—	1,705	19,634	15,840	35,474	37.5	30.2	67.7
1980	9,800	17,611	—	1,659	29,070	22,276	51,346	43.7	33.5	77.2
1981	13,920	20,025	—	573	35,518	29,172	64,690	41.8	34.3	76.1
1982	17,320	25,800	—	2,147	45,267	35,267	80,534	45.6	35.5	81.2
1983	17,400	31,953	—	2,416	51,769	46,688	98,457	42.6	38.4	81.0
1984	14,860	33,228	—	3,564	51,652	53,681	105,333	33.6	34.9	68.5
1985	22,280	36,570	—	3,761	62,611	67,673	130,284	38.6	41.7	80.2
1986	26,173	39,130	—	4,196	69,499	86,208	155,707	38.7	48.0	86.8
1987	29,850	44,957	—	4,190	78,997	111,812	190,809	40.2	56.8	97.0
1988	43,700	49,797	—	5,099	98,596	125,657	224,253	44.4	56.6	101.0
1989	57,246	54,217	—	6,099	117,562	156,298	273,860	46.7	62.0	108.7
1990	67,968	54,677	—	11,251	133,896	176,883	310,779	41.6	55.0	96.6
1991	72,968	66,823	—	12,328	152,119	214,579	366,698	40.9	57.6	98.5
1992	87,096	69,180	—	13,744	170,020	235,539	405,559	40.0	55.4	95.4
1993	97,196	105,707	—	10,782	213,685	270,224	483,909	42.8	54.1	96.9
1994	98,896	137,554	—	12,669	249,119	301,812	550,931	43.0	52.1	95.1
1995	113,771	157,928	—	17,711	289,410	346,286	635,696	43.3	51.9	95.2
1996	124,996	205,975	—	25,731	356,702	359,685	716,388	46.4	46.8	93.3
1997	114,996	239,475	10,000	23,269	387,740	376,331	764,071	43.6	42.3	85.8
1998	119,996	250,570	48,915	43,945	463,426	461,273	924,699	45.5	45.3	90.8
1999	124,996	262,056	104,867	51,546	543,465	507,866	1,051,331	49.1	45.9	95.1
2000	134,996	263,888	204,124	73,652	676,660	542,040	1,218,700	53.8	43.1	96.9
2001	170,995	292,813	229,174	122,983	815,965	636,741	1,452,706	58.0	45.3	103.3
2002	210,995	287,701	347,128	102,562	948,386	721,957	1,670,343	60.0	45.6	105.6
2003	219,295	248,414	483,107	69,153	1,019,969	843,882	1,863,851	56.0	46.3	102.3
2004	243,886	164,758	643,349	91,396	1,143,389	996,138	2,139,527	54.7	47.6	102.3
2005	234,174	140,563	751,569	139,415	1,265,722	956,620	2,222,341	51.6	39.0	90.6
2006	257,732	116,713	885,972	218,813	1,479,230	1,103,418	2,582,648	50.3	37.5	87.9
2007	307,012	131,509	1,018,852	257,825	1,715,198	1,326,487	3,041,685	47.9	37.1	85.0
2008	402,600	130,009	1,281,978	325,641	2,140,228	1,448,734	3,588,962	48.5	32.8	81.4
2009	441,032	112,292	1,513,512	334,119	2,400,955	1,760,467	4,161,422	49.7	36.5	86.2
2010	514,442	87,709	1,643,887	319,624	2,565,662	2,024,583	4,590,245	40.0	31.6	71.6
2011	590,885	61,961	1,819,251	331,988	2,804,085	2,329,280	5,133,365	38.8	32.3	71.1
2012	629,070	58,386	2,095,054	450,304	3,232,813	2,767,299	6,000,112	37.0	31.7	68.7
2013	700,137	55,518	2,452,360	624,810	3,832,825	2,960,424	6,793,249	40.0	30.9	70.8
2014	694,767	55,518	2,844,054	683,444	4,277,783	3,113,116	7,390,899	41.3 ⁽⁶⁾	30.0 ⁽⁶⁾	71.3 ⁽⁶⁾
2015	658,240	24,088	3,305,248	971,620	4,959,196	3,544,031	8,503,227	45.3 ⁽⁶⁾	32.4 ⁽⁶⁾	77.6 ⁽⁶⁾
2016 ⁽⁷⁾	779,581	24,088	3,714,787	823,051	5,341,507	4,045,796	9,387,303	45.1	34.2	79.3

Sources: Ministry of Finance, Ministry of National Policies and Economic Affairs, Central Bank of Sri Lanka and Department of Census and Statistics

Notes:

- (1) From 1950 to 1973 the outstanding position as at end September and since then as at end December
- (2) Rupee denominated Treasury bills issued to foreign investors from 2008 are excluded from domestic debt and included in foreign debt
- (3) Rupee denominated Treasury bonds issued to foreign investors from 2007 are excluded from domestic debt and included in foreign debt
- (4) Excludes Treasury bonds amounting to Rs. 78,447 million issued to settle dues to CPC in January 2012 and Rs. 13,125 million issued to capitalise Sri Lankan Airlines in March 2013
- (5) From 2003, based on GDP estimates compiled by Department of Census and Statistics and rebased GDP estimates (base year 2010) of the Department of Census and Statistics have been used from 2010 onwards
- (6) Based on revised GDP estimates for 2014 and 2015 made available on 15 March 2017 by the Department of Census and Statistics
- (7) Provisional

OUTSTANDING CENTRAL GOVERNMENT DEBT⁽¹⁾

Source	As at end December 31,					% Change
	2012	2013	2014	2015 ⁽²⁾	2016 ⁽²⁾	
	(in Rs. millions)					
Total Domestic Debt	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507	7.7
Short Term	813,272	909,156	941,162	913,291	968,396	6.0
Treasury Bills ⁽³⁾	629,070	700,137	694,767	658,240	779,581	18.4
Provisional Advances from the Central Bank	111,292	109,167	143,898	151,132	83,307	-44.9
Import Bills held by Commercial Banks.....	18,340	23,960	25,542	4	—	-100.0
Other Liabilities to the Banking Sector Net of Bank Deposits	53,638	61,959	76,386	103,345	105,508	2.1
Other	933	13,933	570	570	—	-100.0
Medium and Long Term.....	2,419,541	2,923,670	3,336,620	4,045,905	4,373,111	8.1
Rupee Securities	58,386	55,518	55,518	24,088	24,088	0.0
Treasury Bonds ⁽⁴⁾	2,095,054	2,452,360	2,844,054	3,305,248	3,714,787	12.4
Sri Lanka Development Bonds.....	222,994	369,215	391,083	668,458	572,199	-14.4
Other	43,107	46,577	45,966	48,111	62,037	28.9
By Debt Instrument	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507	7.7
Rupee Securities	58,386	55,518	55,518	24,088	24,088	0.0
Treasury Bills ⁽³⁾	629,070	700,137	694,767	658,240	779,581	18.4
Treasury Bonds ⁽⁴⁾	2,095,054	2,452,360	2,844,054	3,305,248	3,714,787	12.4
Sri Lanka Development Bonds.....	222,994	369,215	391,083	668,458	572,199	-14.4
Provisional Advances.....	111,292	109,167	143,898	151,132	83,307	-44.9
Other	116,017	146,429	148,463	152,031	167,545	10.2
By Institution	3,232,813	3,832,825	4,277,783	4,959,196	5,341,507	7.7
Banks	1,060,317	1,433,773	1,669,882	1,924,036	2,114,901	9.9
Central Bank						
By Debt Instrument.....	265,198	112,396	267,677	256,050	414,950	62.1
Treasury Bills	154,005	3,053	123,496	104,754	331,389	216.4
Provisional Advances .	111,292	109,167	143,898	151,132	83,307	-44.9
Other	-99	176	282	164	254	54.7
Commercial Banks						
By Debt Instrument.....	795,119	1,321,377	1,402,205	1,667,986	1,699,951	1.9
Rupee Securities	15,870	15,870	15,870	15,870	15,870	0.0
Treasury Bills	219,748	443,951	278,296	340,664	244,139	-28.3
Treasury Bonds	244,770	386,398	595,067	517,613	731,942	41.4
Sri Lanka Development						
Bonds	222,994	369,215	391,083	668,458	572,199	-14.4
Other	91,737	105,943	121,890	125,382	135,802	8.3
By Institution	795,119	1,321,377	1,402,205	1,667,986	1,699,951	1.9
State Banks.....	283,426	435,111	527,641	507,164	506,647	-0.1
Other	511,693	886,266	874,564	1,160,822	1,193,304	2.8

Source	As at end December 31,					
	2012	2013	2014	2015 ⁽²⁾	2016 ⁽²⁾	% Change
	(in Rs. millions)					
Non bank Sector						
By Debt Instrument	2,172,495	2,399,053	2,607,901	3,035,160	3,226,606	6.3
Rupee Securities	42,516	39,648	39,648	8,218	8,218	0.0
Treasury Bills	255,317	253,133	292,975	212,822	204,052	-4.1
Treasury Bonds	1,850,284	2,065,962	2,248,987	2,787,635	2,982,845	7.0
Other ⁽⁵⁾	24,379	40,310	26,291	26,485	31,490	18.9
By Institution	2,172,495	2,399,053	2,607,901	3,035,160	3,226,606	6.3
National Savings						
Bank	330,150	358,243	379,877	428,236	426,771	-0.3
Savings Institutions & Individuals	408,827	350,562	441,106	592,220	556,750	-6.0
Employees' Provident Fund	1,173,870	1,393,458	1,474,244	1,612,461	1,778,276	10.3
Insurance Institutions .	33,768	30,849	30,536	50,597	76,944	52.1
Finance Companies	17,040	27,839	59,667	55,587	68,097	22.5
Other	208,841	238,102	222,470	296,060	319,767	8.0
Administrative						
Borrowings	933	13,933	570	570	—	-100.0
Departments, Official Funds and Other	207,908	224,169	221,900	295,490	319,767	8.2
Total Foreign Debt ⁽⁶⁾	2,767,299	2,960,424	3,113,116	3,544,031	4,045,796	14.2
By Type	2,767,299	2,960,424	3,113,116	3,544,031	4,045,796	14.2
Project Loans	1,846,772	1,938,909	1,904,599	2,180,388	2,361,118	8.3
Non-Project Loans	920,527	1,021,515	1,208,516	1,363,642	1,684,678	23.5
Commodity	56,599	61,597	69,993	71,470	69,101	-3.3
Other	863,928	959,918	1,138,523	1,292,173	1,615,577	25.0
By Institution	2,767,299	2,960,424	3,113,116	3,544,031	4,045,796	14.2
Concessional Loans	1,369,568	1,492,842	1,490,978	1,729,895	1,897,680	9.7
Multilateral	670,692	716,792	704,044	794,485	855,998	7.7
Bilateral	698,876	776,050	786,934	935,410	1,041,682	11.4
Non-Concessional Loans	455,069	460,475	457,668	507,047	538,859	6.3
Multilateral	173,600	186,749	183,917	199,945	220,551	10.3
Bilateral	281,469	273,727	273,751	307,102	318,308	3.6
Commercial Loans	942,662	1,007,107	1,164,470	1,307,089	1,609,257	23.1
International Sovereign						
Bonds	445,063	457,636	655,243	958,014	1,220,870	27.4
Non resident Investments						
in Treasury Bills	80,184	73,916	55,500	5,045	12,816	154.0
Non resident Investments						
in Treasury Bonds	317,604	403,486	401,710	298,734	247,222	-17.2
Other ⁽⁷⁾	99,812	72,070	52,017	45,296	128,350	183.4
Total Outstanding Government Debt	6,000,112	6,793,249	7,390,899	8,503,227	9,387,303	10.4

Source: Ministry of Finance, Ministry of National Policies and Economic Affairs and Central Bank of Sri Lanka

Notes:

- (1) Outstanding Treasury bills and Treasury bonds have been adjusted for secondary market transactions
- (2) Provisional
- (3) Excludes rupee denominated Treasury bills held by foreign investors from 2008
- (4) Excludes rupee denominated Treasury bonds held by foreign investors from 2007 and Treasury bond amounting to Rs. 78,447 million issued to settle dues to CPC in January 2012, Rs. 13,125 million issued to capitalize SriLankan Airlines in March 2013
- (5) Includes sinking fund
- (6) Excludes outstanding loans of projects under state owned business enterprises
- (7) Includes outstanding defense loans

**EXTERNAL DEBT OUTSTANDING AND
BANKING SECTOR EXTERNAL LIABILITIES (DISBURSEMENTS) (2013-2016) ⁽¹⁾**

Item	As at December 31,				As at December 31,			
	2016 ⁽²⁾	2016 ⁽²⁾	2013	2014 ⁽²⁾	2015 ⁽²⁾	2013	2014 ⁽²⁾	2015 ⁽²⁾
	(In US\$ millions, except for percentages)				(In Rs. millions, except for percentages)			
Breakdown by maturity								
Short-term	6,770	7,263	7,653	7,346	884,253	951,795	1,102,524	1,177,140
General Government	507	399	33	80	66,331	52,260	4,813	11,943
Central Bank.....	291	443	483	536	38,029	58,073	69,536	80,315
Deposit-taking corporations, except for the Central Bank.....	3,884	4,747	5,762	5,247	507,795	622,035	830,153	862,694
Other sectors.....	2,089	1,674	1,375	1,483	272,099	219,427	198,022	222,187
Medium and long-term	33,135	35,651	37,186	39,240	4,317,919	4,672,034	5,357,142	5,747,301
General Government.....	21,783	23,733	24,647	27,118	2,850,516	3,110,214	3,550,762	4,010,343
Central Bank.....	2,665	1,821	2,340	1,486	348,424	238,604	337,135	221,335
Deposit-taking corporations, except for the Central Bank ..	2,875	3,386	3,393	3,543	375,872	443,737	488,860	453,102
Other Sectors	3,713	4,167	4,192	4,291	471,459	546,090	603,929	642,809
Direct investment and intercompany lending	2,100	2,544	2,613	2,802	271,648	333,389	376,455	419,712
Total	39,905	42,914	44,839	46,586	5,202,172	5,623,829	6,459,666	6,924,441
Breakdown by sector								
Government	22,290	24,132	24,681	27,197	2,914,484	3,162,465	3,555,576	4,022,286
Project loans	15,814	15,774	16,147	17,295	2,067,766	2,067,208	2,326,106	2,538,833
Multilateral	6,910	6,776	6,903	7,187	903,541	887,961	994,430	1,054,989
ADB	3,662	3,600	3,705	3,803	478,796	471,762	533,806	558,277
IDA	2,853	2,770	2,715	2,788	373,085	363,052	391,149	409,272
Other	395	406	482	596	51,659	53,147	69,475	87,439
Bilateral.....	6,714	6,919	6,414	6,438	877,876	906,708	923,979	945,050
Financial Markets	27	35	40	755	3,530	4,535	5,813	110,883
Supplier Credits	2,163	2,045	2,790	2,915	282,819	268,005	401,885	427,911
Debt Securities	6,476	8,358	8,534	9,903	846,626	1,095,304	1,229,470	1,483,453
Treasury bills and bonds	2,991	2,996	1,844	1,519	390,951	392,622	265,649	227,587
Sovereign bonds.....	3,485	5,287	6,425	8,325	455,674	692,854	925,629	1,247,154
SLDBs	—	75	265	58	—	9829	38,191	8,712
Central Bank	2,956	2,264	2,823	2,022	386,506	296,694	406,671	301,650
Deposit Taking Corporations	6,758	8,133	9,156	8,790	883,629	1,065,818	1,319,013	1,315,796
Other Sectors	5,801	5,841	5,667	5,774	743,558	765,517	801,951	864,996
Private Sector Loans	1,410	1,363	1,604	1,876	157,316	178,673	231,138	281,100
State Owned Enterprises	2,303	2,630	2,423	2,242	314,143	344,611	349,094	335,915
Trade credit and advances	2,089	1,674	1,375	272,099	219,427	198,022	222,187	
Debt Securities.....	—	174	164	172	—	22,806	23,696	25,794
Intercompany Lending	2,100	2,544	2,613	2,802	274,581	333,388	376,455	419,712
Debt service payments								
Total debt service payments	4,040	3,479	4,626	4,366	521,626	454,248	628,641	585,628
Amortization	2,982	2,323	3,435	3,157	384,942	303,347	467,546	410,937
Interest payments	1,059	1,156	1,190	1,209	136,685	150,901	161,095	174,690
Exports of Goods and Services.....	15,079	16,735	16,943	17,448	1,946,848	2,193,098	2,301,065	2,540,049
Ratios:								
Gross external debt as a percentage of GDP								
Gross external debt (%)	59.4	54.1	55.7	57.3				
Short-term debt (%)	10.1	9.3	9.5	9.0				
Long-term debt (%).....	49.3	44.8	46.2	48.3				
Debt service								
Percentage of Earnings from Exports of Goods and Services (%)	26.8	20.8	27.3	25.0				

Source: Central Bank of Sri Lanka and External Resources Department

Notes:

(1) Based on BPM6

(2) Provisional

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The Secretariat

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