



NEW ZEALAND
FOREIGN AFFAIRS & TRADE
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Sri Lanka Economic update

A MARKET INTELLIGENCE REPORT

Summary

- The Sri Lankan economy has stabilised since the worst of the country's economic crisis in mid-2022. Following a year of economic distress and difficult negotiations with creditors, Sri Lanka successfully obtained a US\$3 billion loan from the International Monetary Fund (IMF) in March 2023.
- The approval of the IMF programme is an important milestone in Sri Lanka's road to recovery. It helps to unlock several billion more USD in funding from multilateral development banks, boost investor confidence, and ease foreign exchange constraints on essential imports. With shortages alleviated, civil unrest has significantly reduced.
- The next phase in Sri Lanka's economic recovery will include introducing a series of economic reforms, continuing debt restructuring negotiations, and ensuring fiscal consolidation. Sri Lanka's economy remains constrained by high inflation, high interest payments, reduced tourism numbers, modest foreign exchange reserves and food insecurity.
- As Sri Lanka embarks on a path of reform, recovery and growth, key sectors such as tourism, IT and shared services, marine services, and agri-tech present future market opportunities.

Report

Sri Lanka's economic outlook

In May 2022, Sri Lanka faced its worst economic crisis in 75 years as an independent country; defaulting on its foreign debt obligations for the first time in its history. Sri Lanka's economy shrank by 7.8% last year and is expected to shrink by another 3% in 2023.

Overall, Sri Lanka's economy has bounced back from rock bottom. One year after the crisis, Sri Lanka has secured a US\$3 billion IMF loan, under its Extended Fund Facility (EFF). The loan is critical for the country's economic recovery and unlocks further World Bank and Asian Development Bank funds, totalling up to US\$7 billion.

The IMF EFF programme is expected to help restore macroeconomic stability and debt sustainability, while seeking to protect vulnerable groups and safeguard Sri Lanka's financial system. Analysts are hopeful that economic growth will resume in 2024.

The overall growth outlook will depend on the progress Sri Lanka makes in terms of debt restructuring, fiscal consolidation, and growth-enhancing structural reforms. The Sri Lankan Government is now in the process of restructuring its debt, through discussions with a range of bilateral creditors including China, India, Japan and the United States. It is taking steps to curb inflation, increase local production and exports, reduce reliance on imports, and bolster both foreign investment and foreign exchange reserves. Financial and banking restrictions have eased, particularly in terms of access to Letters of Credit, as more foreign currency becomes available to Sri Lanka.

According to the Colombo Consumer Price Index, headline inflation (year-on-year) for March 2023 eased to 50.3%, having peaked at 70.2% in August 2022. The World Food Programme's latest Household Food Security Survey (February 2023) reports 32% of households as food-insecure. The World Bank projects poverty levels will remain above 25% in the next few years. Nonetheless, despite concerns around price volatility and agricultural productivity last year, shops have largely remained open with a range of products, supply chains have proved resilient, and essential goods are by-and-large available.

The economic crisis has adversely impacted SMEs and other businesses. Challenges faced by business and citizens, such as extended power cuts, long queues for cooking gas and fuel, and fertiliser shortages, have eased. However, the economic crisis has prompted outward labour migration, resulting in shortages of skilled workers, including in the healthcare and engineering sectors. Conversely, this "brain drain" has helped to boost remittance inflows.

Overall, Sri Lanka has effected an impressive economic recovery when one considers the position the country was in a year ago:

- There are no more power or fuel shortages;
 - Tourism numbers and remittances are up;
 - Inflation is still very high (~50%) but trending down;
 - The availability of agricultural produce has started to recover; and
 - An IMF programme has been agreed, meaning Sri Lanka's debt position should become sustainable again in the months ahead.
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Opportunities and Challenges for New Zealand Companies

New Zealand exporters can expect ongoing measures aimed at increasing local production and exports. While this means restrictions on some import items, several exemptions are in place, including for the import of essential commodities and for inputs into Sri Lankan local production. The drive to increase exports includes attracting investment in Sri Lanka's logistics sector, to take advantage of its strategic location. Many businesses are therefore looking to Sri Lanka as a high-skilled processing hub for the export of goods and services to the region.

The country's reform and recovery efforts also present opportunities. Boosting tourism, for example, is a priority for the Sri Lankan government. It hopes to return to pre-COVID tourist arrival numbers of over two million annually. Tourism numbers are rising as the Sri Lankan economy begins to recover, presenting long-term market opportunities for New Zealand's food and beverage industry and marine recreation sector.

Over a quarter of Sri Lankans are employed in the agriculture sector, though it amounts to less than 10 percent of national GDP. Boosting agricultural productivity is therefore another priority reform area for the government. The development of agriculture-related infrastructure and services, including cold-storage facilities, post-harvest management technologies and other agri-tech solutions provide entry points for New Zealand companies.

Sri Lanka aims to become an ICT hub. In particular, the growing pool of young talent and cutting-edge innovation coming out of Sri Lanka lends itself to the growing outsourcing/offshoring market. Many business process outsourcing companies are already providing services to international organisations. The similarity between New Zealand and Sri Lanka's political, legal and administrative systems means these companies are well placed to service New Zealand companies too. As the economy recovers, Sri Lankan government and private sector institutions are also digitising records and processes, while upgrading existing networks and systems, providing opportunities for New Zealand ICT businesses.

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