5

EXTERNAL SECTOR DEVELOPMENTS AND POLICIES

5.1 Overview

Adjustments in the external trade and current account balance and the buildup of reserves were better than expected in 2013 reflecting the lagged impact of proactive policy measures implemented in 2012. Impressive growth in earnings from exports and decline in expenditure on imports narrowed the deficit in the trade account significantly. In 2013, receipts on account of workers' remittances and earnings from tourism cushioned the trade deficit substantially. This, together with an increase in receipts on account of trade in other services, helped narrow the deficit in the external current account substantially during the year. Meanwhile, inflows to the financial account increased significantly on account of inflows to the government, banking and private sectors. Improved investor sentiment and further relaxation of exchange control regulations encouraged the banking and private sector to mobilise funds abroad. These improvements in the external sector resulted in a sizable surplus in the balance of payments (BOP),[1] thereby increasing the gross international reserves of the country to a healthy level in 2013. Consequently, the Sri Lanka rupee remained relatively stable during the year, despite some volatility witnessed in mid 2013.

External trade performed well benefitting from an increase in demand from major export destinations. With the gradual recovery in advanced economies, global trade rebounded strongly particularly during the fourth quarter of 2013. Sri Lanka's exports responded positively to the favourable developments in the global economy, by recording a growth of 6.4 per cent in 2013. Meanwhile, import expenditure declined by 6.2 per cent mainly due to lower petroleum imports resulting in a significant improvement in the trade balance.

Trade in services and workers' remittances recorded a significant improvement during 2013, contracting the deficit in the external current account substantially. Sri Lanka's potential to emerge as a leading exporter of services in the region was evident from the higher earnings from tourism, transport, information technology, business process outsourcing (BPO)

1 Presentation of the BOP conforms to the latest (sixth) edition of the Balance of Payments and International Investment Position Manual (BPM6) of 2009 published by the International Monetary Fund (IMF).

Chart 5.1 Balance of Payments

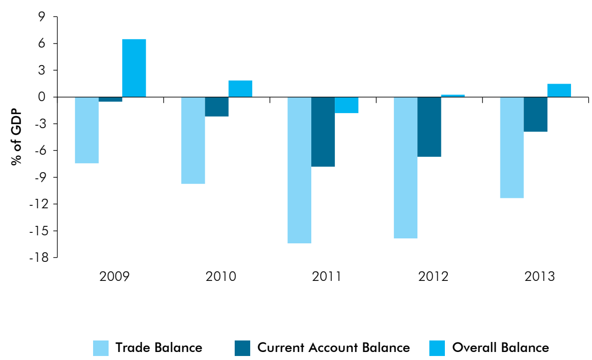


Chart 5.2 Major Sources of Foreign Exchange Earnings

and knowledge process outsourcing (KPO). Accordingly, the five+1 hubs strategy which aims to develop Sri Lanka into a knowledge hub, a maritime hub, an aviation hub, an energy hub, a commercial hub, and a tourism hub provides enormous potential for growth. The travel and tourism sector, which has rapidly grown in recent years, continued to expand in 2013. Meanwhile, the high growth momentum in workers' remittances was maintained with a more diversified migration profile. Despite a widening of the deficit in the primary income account due to interest payments on borrowings and repatriation of profits by foreign investors, the improvement in the trade balance and surpluses in the services and secondary income accounts helped narrow the deficit in the external current account to 3.9 per cent of GDP in 2013, from 6.7 per cent of GDP in 2012.

The overall balance of the BOP and international reserves improved considerably in 2013. With the significant improvement in the current account and increased inflows to the financial account, the overall balance of the BOP recorded a surplus of US dollars 985 million in 2013, compared to a surplus of US dollars 151 million recorded in 2012. The resultant overall surplus led to an increase in gross official reserves to US dollars 7.5 billion at the end of 2013 which was equivalent to 5 months of imports. Reserve adequacy in terms of short term debt and liabilities was 63 per cent, while gross official reserves to short term debt excluding Treasury bonds was 85 per cent at end 2013. An improved BOP position and reserve buildup helped stabilise the domestic foreign exchange market further and improve the country's external sector outlook. Meanwhile, the International Investment Position (IIP), which records Sri Lanka's financial assets and liabilities position vis-à-vis the rest of the world, witnessed an increase in the net liability position at the end of 2013, reflecting the increase in foreign inflows in the form of foreign direct investment (FDI), investment in government securities, long-term debt inflows to the government and private corporates, and international bond issuances by the banking sector.

The Sri Lanka rupee remained relatively stable compared to many other currencies in the region, which suffered sharp depreciation amidst concerns regarding the scaling back of the US quantitative easing programme. Although the rupee came under some pressure in mid 2013 due to high import demand and the expectation of unwinding of positions by foreign investors from the government securities market in anticipation of possible tapering of the US bond buying programme, the Sri Lanka rupee depreciated only at a moderate rate against the US dollar compared to many regional currencies. Accordingly, by end 2013, the Sri Lanka rupee depreciated by 2.75 per cent against the US dollar, while appreciating

Table 5.1 Balance of Payments Analytical Presentation (BPM6 Presentation Format)

Item	US$ million		Rs. million	
	2012 (a)	2013 (b)	2012 (a)	2013 (b)
Current Account	-3,982	-2,607	-501,869	-332,580
Trade Balance	-9,417	-7,609	-1,196,348	-979,074
Exports	9,774	10,394	1,245,531	1,344,054
Imports	19,190	18,003	2,441,879	2,323,128
Services (net)	1,262	1,180	160,755	152,630
Receipts	3,800	4,685	484,936	605,213
Payments	2,538	3,505	324,181	452,583
Primary Income (net)	-1,219	-1,817	-154,889	-234,814
Receipts	142	148	18,137	19,100
Payments	1,361	1,965	173,027	253,914
Secondary Income (net)	5,392	5,639	688,613	728,678
Secondary income: credit	6,038	6,428	770,879	830,407
Workers' remittances	5,985	6,407	763,980	827,689
Government transfers	53	21	6,899	2,718
Secondary income: debit	646	788	82,266	101,728
Capital Account	130	71	16,951	9,188
Capital account: credit	146	90	18,884	11,596
Capital account: debit	15	19	1,933	2,409
Current and Capital Account	-3,851	-2,536	-484,918	-323,392
Financial Account	4,263	3,126	525,889	394,785
Direct Investment: Assets	64	65	8,157	8,399
Direct Investment: Liabilities	941	916	119,813	118,607
Portfolio Investment: Assets	-10	-	-1,295	-29
Debt securities	-10	-	-1,295	-29
Portfolio Investment: Liabilities	2,116	2,106	272,691	273,175
Equity securities	272	263	34,493	36,499
Debt securities	1,844	1,843	238,198	236,676
Financial Derivatives	-	-	-	-
Other Investment: Assets	363	-222	47,384	-28,468
Currency and deposits	162	-459	22,178	-58,839
Trade credit and advances	90	195	11,769	25,190
Other accounts receivable	111	42	13,437	5,181
Other Investment: Liabilities	2,384	1,060	319,695	137,965
Currency and deposits	447	108	61,447	14,960
Loans	3,070	949	389,956	122,747
Central bank	780	-453	100,493	-57,683
Deposit-taking corporations	579	124	69,170	15,940
General government	992	821	127,434	105,707
Other sectors	719	456	92,860	58,783
Trade credit and advances	-571	-54	-70,629	-8,089
Other accounts payable	-563	58	-61,078	8,348
Special Drawing Rights (SDRs)	-	-	-	-
Reserve Assets	760	1,112	132,063	155,060
Monetary gold	178	351	22,679	44,862
Special drawing rights	-0.5	12	-88	2,440
Reserve position in the IMF	-	-	-	-
Other reserve assets	583	749	109,473	107,758
Currency and deposits	-801	1,297	-67,194	179,394
Securities	1,384	-548	176,666	-71,636
Net Errors and Omissions	-412	-590	-40,957	-71,394
Overall Balance	151	985	72,638	229,692
Monetary Movements	-151	-985	-72,638	-229,692
As a percentage of GDP (c)				
Trade Balance	-15.9	-11.3	-15.8	-11.3
Goods and Services	-13.7	-9.6	-13.7	-9.5
Current Account	-6.7	-3.9	-6.6	-3.8
Current and Capital Account	-6.5	-3.8	-6.4	-3.7

(a) Revised

(b) Provisional

(c) Based on GDP at current market prices published by the Department of Census and Statistics. Ratios calculated in rupee values and US dollar values differ due to variations in exchange rates during the year.

Source: Central Bank of Sri Lanka

significantly against other major currencies such as the Indian rupee and the Japanese yen.

Sri Lanka's external sector is expected to strengthen further in 2014 and beyond, enhancing its resilience to external shocks. The positive outlook would be supported by the expected recovery in the global economy and improved growth prospects in the domestic economy. Measures targeted at promoting merchandise goods exports, along with the rationalisation of imports are expected to reduce the trade deficit substantially. As the country's economic hubs gain ground benefitting from the large infrastructure projects especially in the areas of tourism, ports and airports, and the IT/BPO industry, service exports are expected to grow at a faster rate over the medium term. Measures taken to diversify the migration profile would enhance workers' remittances, which would continue to remain a strong source of foreign exchange over the medium term. Meanwhile, the recently introduced exchange control relaxation measures and improved doing business environment are expected to enhance investor confidence in the economy, attracting more investment flows, especially FDI and non-debt creating financial flows.

5.2 External Trade Policies and Institutional Support

External trade policy in 2013 continued to focus on improving Sri Lanka's integration into the world economy through trade negotiations and expanding economic activity through increased openness. Increased integration is expected to help strengthen overseas market access for Sri Lankan products, attract foreign direct investment to Sri Lanka and rationalise import expenditure. Institutional support was extended to improve international competitiveness in the industrial sector through technological innovation, promoting public private partnerships and improving infrastructure facilities and other related services, while ensuring a stable macroeconomic environment is maintained.

The four band custom duty structure, the main trade policy instrument was further simplified to facilitate domestic production and trade. The prevailing tariff bands of 0, 5, 15 and 30 per cent were revised to 0, 7.5, 15 and 25 per cent with effect from November 2013. The 5 per cent custom duty band of the previous tariff structure, which was mostly applied on imported raw materials and machinery was abolished and most of those items were placed at the zero tariff band, while few items were placed at the 7.5 per cent tariff band. Accordingly, 3,379 tariff lines out of 6,577 tariff lines 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 per cent customs duty which is applicable on end use products was revised down to 25 per cent.

Several important policy measures were adopted in 2013 to strengthen export oriented industries. The enactment of Finance Act No.12 of 2013 amending the previous Finance Act further facilitated the establishment of 'Free Ports' and 'Bonded Areas'. Accordingly, the Colombo and Hambantota ports were declared as free ports, while export processing zones in Katunayake, Koggala and Mattala were declared as bonded areas. Industries operating within these bonded areas have been exempted from domestic taxes. Further, exporters who engage in entrepot trade, which involves minor processing of imported items for re-export and logistic services, or the assembling of parts produced in multiple countries, enjoy various benefits by locating in these free zones. Further, through the amendments to the Finance Act, with a view to preventing monopoly pricing in the international shipping trade, the levy on terminal handling and other charges in addition to freight and specified international charges for container cargo were eliminated and made an all-inclusive freight rate. With regard to the apparel sector, the government is seeking to position Sri Lanka's apparel industry among the top ten high quality apparel manufacturers in the world by 2020. In order to achieve this objective, a 300 per cent tax allowance has been proposed for research and development activities carried out within the industry. With the aim of promoting the acquisition of internationally recognised intellectual properties, such as brand names for local products, tax deductions have been provided for expenses incurred in the acquisition of such rights as well as for any income earned in foreign currency on account of these royalties. To reduce the cost of production of textiles and garments, the Cess on the importation of unbleached cotton woven fabrics and other fabrics was reduced to Rs. 75 per kg and Rs. 100 per kg, respectively. Further, to promote the supply of raw materials and other services required for the production of textiles and garments, a concessionary tax rate of 12 per cent that was applied on profits and income derived from the supply of certain services to garment exporters was further extended. High value tea and rubber product exports will be encouraged by maintaining a high level of Cess on primary commodity exports. Further, in the budget for 2014, in order to promote value addition in the tea industry, permission was granted to import specialty teas without restriction for the purpose of blending, to create a well-balanced flavour, as there is a growing demand for blended teas in non-traditional markets.

Several measures were taken to rationalise imports and to encourage domestic production. Higher import taxes were maintained on dried fish and sprats, Maldive fish, canned fish and fish food to promote the local fishery industry, while a Special Commodity Levy (SCL) was introduced in the budget for 2014 on butter, yoghurt and dairy products in addition to the high Cess, to encourage the dairy industry. Further, restrictions were imposed on the importation of coconut oil and palm kernel, while the Nation Building Tax (NBT) on coconut oil milling was removed for three years to strengthen the coconut industry. In order to rationalise vehicle imports, the depreciation schedule for used motor vehicles was revised in November 2013. To encourage the local boat manufacturing industry, it was decided to maintain a high tax on import of fishing boats, while import or supply of parts for the manufacture of fishing boats was exempted from the value added tax (VAT). To encourage the fisheries industry, import or supply of goods such as frozen bait, fish hooks, rods and reels was exempted from VAT. The Cess and SCL which were already applied on several food items were maintained to promote the domestic agricultural and fisheries industries.

Institutional support was provided to enable exporters to withstand the increasing global competition and to access new markets and technologies. With a view to increasing market penetration for textiles and garments, representatives from the Joint Apparel Association Forum (JAAF) visited potential markets like China, Japan, Russia and Brazil to explore the possibility of obtaining preferential access to these markets. The Export Development Board (EDB) established 26 Advisory Committees under the EDB Act No. 40 of 1979, to facilitate external trade. Further, the EDB has taken efforts to expand exports to the BRIC countries (Brazil, Russia, India and China), Africa, the Commonwealth of Independent States (CIS) and untapped EU markets such as Turkey. During the year, several overseas marketing promotional campaigns were conducted by the EDB in the EU, USA, Asia, Middle East, Africa and CIS regions, while several inward buying missions were successfully concluded. The EDB implemented a series of programmes for the development of the agriculture, fisheries and industrial sectors in 2013. Accordingly, 'Pure Ceylon Cinnamon' was established as a global brand in the international market and registration of the trademark was completed in major markets such as USA and the EU. An application has already been submitted to register the brand with the World Intellectual Property Office (WIPO). The EDB together with the National Gem and Jewellery Authority (NGJA) launched a promotional campaign to promote the gem and jewellery industry by highlighting the unique appeal of Ceylon Sapphires. Since Sri Lanka has emerged as a world class rubber products manufacturer supplying to international brands, quality and reliability are of paramount importance. To assist exporters of rubber products, the EDB has initiated a scheme for exporters to obtain quality certification which is currently not available in Sri Lanka. Having identified the importance of raising Sri Lanka's export share in the global market in an increasingly competitive market, the Exporters Association of Sri Lanka facilitated a forum titled 'Whither Exports in the Next 5 Years?'. This forum provided a platform for major exporters to define the strategies required to achieve their targets over the next five years. The Sri Lanka Standards Institution (SLSI) was actively involved with the South Asian Regional Standards Organisation to work towards harmonising standards in the SAARC region. During the year, directions were issued to bring cinnamon exports under the export quality certification scheme of the SLSI. Under the auspices of the Ceylon Chamber of Commerce, a number of seminars, trade shows, meetings and business forums were organised by business councils in many key countries including Britain, Germany, Australia, New Zealand, Poland and Maldives to promote external trade.

In 2013, Sri Lanka was privileged to host the Commonwealth Business Forum (CBF), the largest business event ever held in the country. The theme of the CBF was 'Partnering for Wealth Creation and Social Development: The Commonwealth, Indian Ocean and SAARC'.

The CBF was held in conjunction with the Commonwealth Heads of Government Meeting (CHOGM) bringing together heads of government, ministers, and top business leaders from around the world. Sri Lanka benefitted much from this, as it created a unique opportunity for the local business community to meet foreign delegates, to discuss possibilities of entering into joint ventures and to promote Sri Lanka as a destination for foreign investment. The outcome of these meetings was that several memorandums of understanding were signed with major foreign investors in hotels and mixed development projects. Further, the CBF provided a platform for foreign business leaders and heads of states to meet their counterparts from other countries to discuss and promote investment opportunities.

Sri Lanka continued to engage in bilateral, regional and multilateral negotiations with a view to enhancing market access through preferential and free trade agreements. During the year there was no significant progress in the Doha Round, which was the latest round of trade negotiations within the World Trade Organisation (WTO) aimed at achieving major reforms within the international trading system through the introduction of lower trade barriers and revised trade rules. Hence, to continue the dialogue on selected issues from the broader Doha Round negotiations, the WTO's Bali Ministerial Conference, was held in December 2013. It was concluded with agreements being signed on a range of issues designed to streamline trade, such as allowing developing countries more options for providing food security and boosting trade in least developed countries (LDCs). Trade facilitation is expected to provide better market access because it would reduce restrictions and cumbersome procedures at export destinations, thereby lowering trade transaction costs, and transaction time while improving the clarity, efficiency and transparency of transactions. Under the trade liberalisation programme of the South Asian Free Trade Area (SAFTA) scheduled for completion by 2016, customs duties on products from the region are expected to be progressively reduced. Sri Lanka has agreed to reduce its customs duties to between 0-5 per cent in six equal installments by 2014 for products from other member states. Although Sri Lanka is categorised as a 'non-least developed state', given the size and vulnerability of the economy, it has been able to obtain more concessions and an extended enforcement time period for the graduation of tariffs in all its SAFTA negotiations. In the continuing negotiations on the Asia-Pacific Trade Agreement (APTA), member states have decided to conclude the fourth round of negotiations under APTA in mid 2014 in Thailand. Discussions will focus on areas such as tariff concessions, relaxation of rules of origin and framework agreements on trade facilitation and investment in trade in services. As negotiations between Mongolia and other participating states of APTA have successfully concluded, Mongolia was officially admitted as a member of APTA in 2013.

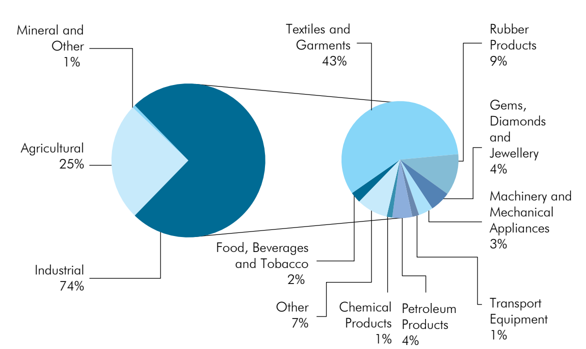
During the year, initiatives were taken to further deepen bilateral trade through the India-Sri Lanka Free Trade Agreement (ISFTA) and the Pakistan-Sri Lanka Free Trade Agreement (PSFTA), which are the trade agreements that have been most utilised by Sri Lanka. Sri Lanka and India set up the India-Sri Lanka Joint Task Force (JTF) to explore avenues for further promotion of bilateral trade and investment between the two countries and the first meeting of the JTF was held in June 2013. Under ISFTA, India has removed the condition relating to the sourcing of fabric on the remaining five million pieces of garments out of a total eight million pieces under the garments export quota, making the total quota under the agreement duty free, with no conditions. The fifth technical level meeting on the PSFTA was held to discuss several outstanding matters. Accordingly, Sri Lanka was able to secure market access for five products, namely mosquito repellent coils, bottle cooling machines, crude coconut oil, betel leaves and herbal cosmetic products. Sri Lanka is seeking the possibility of entering into a Free Trade Agreement (FTA) with China. Currently a joint feasibility study is being carried out to assess the viability of a FTA between China and Sri Lanka. Sri Lanka could make use of the proposed FTA by supplying high quality products like branded textiles and garments, tea, gems and jewellery, to a niche market segment thereby boosting Sri Lanka's exports to China, and helping to reduce the negative trade balance with China. An increase in the overall utilisation of trade agreements has been observed in 2013 compared to the previous year.

5.3 Trade in Goods, Trade Balance, Terms of Trade and Direction of Trade

5.3.1 Export Performance

Exports recovered in 2013, with the moderate recovery in the global economy. Earnings from exports recorded a positive growth from June 2013 following 15 months of contraction. Export earnings grew by 6.4 per cent to US dollars 10,394 million in 2013 in contrast to a decline of

Chart 5.3 Exports by Commodities - 2013



7.4 per cent to US dollars 9,774 million in 2012. Exports recorded an impressive growth from the second half of 2013 with the recovery in Sri Lanka's traditional markets, such as USA and the EU. The expansion in domestic economic activities, a favourable investment climate and conducive external trade policies also supported the growth in exports in 2013.

The largest contribution to the growth in export earnings came from industrial exports, which accounts for around three fourths of total export earnings. Earnings from industrial exports increased by 5.1 per cent to US dollars 7,749 million in 2013 mainly due to the better performance in textiles and garments, which contributed 43.4 per cent to total export earnings in 2013. Earnings from textile and garment exports increased by 13 per cent to US dollars 4.5 billion in 2013, surpassing the US dollars 4 billion target set by the apparel industry. Garment exports to the EU and USA, which are major export destinations, recorded a significant growth of 6.8 per cent and 21 per cent, respectively in 2013, benefiting from the recovery in those economies. Market diversification, acquisition of expert knowledge, vertical and backward integration and greater emphasis on activities at the higher end of the value chain contributed to the robust performance in the textiles and garments industry. The increase in value addition has reduced import dependence in the industry as reflected in the decline in import of textiles and textile articles in 2013. Accordingly, the average import dependency ratio for the entire garments industry declined to 45 per cent in 2013 from 57 per cent in 2012.

Earnings from export of other industrial products recorded varied performance in 2013. Earnings from export of rubber products increased by 3.3 per cent to US dollars 888 million in 2013, making it the second largest contributor to the growth in industrial exports. An increase in export of surgical and other gloves and tyres, as a result of

Table 5.2 Composition of Exports

Category	2012 Value US$ million	2012 Share %	2013 (a) Value US$ million	2013 (a) Share %	Change in Value US$ million	Y-o-Y Change %	Contribution to Change %
Agricultural Exports	**2,331.5**	**23.9**	**2,581.1**	**24.8**	**249.6**	**10.7**	**40.2**
Tea	1,411.9	14.4	1,542.2	14.8	130.3	9.2	21.0
Rubber	125.1	1.3	71.3	0.7	-53.8	-43.0	-8.7
Coconut	208.9	2.1	204.6	2.0	-4.3	-2.0	-0.7
Spices	256.1	2.6	355.4	3.4	99.3	38.8	16.0
Vegetables	13.3	0.1	24.9	0.2	11.6	86.8	1.9
Unmanufactured Tobacco	42.2	0.4	47.6	0.5	5.4	12.9	0.9
Minor Agricultural Products	76.0	0.8	101.3	1.0	25.3	33.3	4.1
Seafood	198.0	2.0	233.7	2.2	35.7	18.1	5.8
Industrial Exports	**7,371.2**	**75.4**	**7,749.4**	**74.6**	**378.3**	**5.1**	**60.9**
Textiles and Garments	3,991.1	40.8	4,508.3	43.4	517.2	13.0	83.3
Rubber Products	859.4	8.8	887.8	8.5	28.4	3.3	4.6
Petroleum Products	463.0	4.7	427.7	4.1	-35.2	-7.6	-5.7
Gems, Diamonds and Jewellery	558.9	5.7	445.5	4.3	-113.4	-20.3	-18.3
Food, Beverages and Tobacco	284.3	2.9	235.2	2.3	-49.1	-17.3	-7.9
Machinery and Mechanical Appliances	297.5	3.0	312.3	3.0	14.8	5.0	2.4
Printing Industry Products	41.8	0.4	36.3	0.3	-5.5	-13.1	-0.9
Transport Equipment	164.9	1.7	146.3	1.4	-18.6	-11.3	-3.0
Leather, Travel Goods and Footwear	55.4	0.6	76.8	0.7	21.5	38.7	3.5
Ceramic Products	35.8	0.4	40.4	0.4	4.6	13.0	0.7
Other Industrial Exports	619.2	6.3	632.7	6.1	13.5	2.2	2.2
Mineral Exports	**61.3**	**0.6**	**51.6**	**0.5**	**-9.7**	**-15.9**	**-1.6**
Unclassified Exports	**9.6**	**0.1**	**12.2**	**0.1**	**2.6**	**26.6**	**0.4**
Total Exports (b)(c)	**9,773.5**	**100.0**	**10,394.3**	**100.0**	**620.7**	**6.4**	**100.0**
Annual Average Exchange Rate (d)	**127.60**		**129.11**				

(a) Provisional
(b) Adjusted
(c) Excludes re-exports
(d) Rupee/US dollar exchange rate

Sources: Ceylon Petroleum Corporation and Other Exporters of Petroleum
National Gem and Jewellery Authority
Sri Lanka Customs
Central Bank of Sri Lanka

the decline in natural rubber prices and increasing external demand from advanced economies such as USA and EU, mainly contributed to the growth in export of rubber products. Export of leather products increased by 38.7 per cent to US dollars 77 million in 2013, mainly due to a more than two fold increase in footwear exports. The industry was supported by the government through duty free import access to leather machinery in addition to the continuous support provided by the EDB, the Industrial Development Board and the Ministry of Industry and Commerce. Export of machinery and mechanical appliances including transformers, static converters, accumulators, weighing machines and other home appliances increased in 2013. However, export earnings from gems, diamonds and jewellery declined significantly by 20.3 per cent to US dollars 446 million in 2013 mainly due to declining global demand and a sharp fall in gold prices in the international market. Export earnings from petroleum products declined by 7.6 per cent to US dollars 428 million, as a result of rising competition from regional ports and a decline in international bunkering prices. Earnings from food, beverages and tobacco exports declined by 17.3 per cent to US dollars 235 million, mainly due to a reduction in wheat flour exports as a result of restrictions imposed on import of wheat flour by a major trading partner. Export of transport equipment, declined by 11.3 per cent to US dollars 146 million in 2013 due to a reduction in export of road vehicles such as bicycles and cars, although the export of rowing boats and other floating structures increased significantly during the year.

Agricultural exports which account for nearly one fourth of total export earnings contributed around 40 per cent to the overall increase in export earnings in 2013. Earnings from agricultural exports increased by 10.7 per cent, year-on-year to US dollars 2,581 million in 2013. Earnings from tea exports increased by 9.2 per cent to reach the highest-ever annual earnings of US dollars 1,542 million in 2013, mainly due to the high price obtained for Ceylon tea owing to its superior quality and the rise in international demand for orthodox teas. The average export price of tea rose by 9.3 per cent to US dollars 4.82 per kg in 2013 from US dollars 4.41 per kg in 2012. Export volumes of tea, however, remained at 320 million kilograms in 2013 as in 2012. Earnings from raw rubber exports declined by 43 per cent in 2013, largely due to increased usage of rubber in the domestic market to produce value added rubber products. However, higher production in major natural rubber producing countries exerted downward pressure on rubber prices throughout the year. The average export price of rubber declined by 9.7 per cent to US dollars 3.02 per kg in 2013 from US dollars 3.35 per kg in 2012. Total earnings from coconut exports declined by 2 per cent to US dollars 205 million in 2013, despite earnings from coconut kernel exports increasing by 7.6 per cent to US dollars 86 million as export earnings from non-kernel products such as yarn and coconut shells declined.

Export earnings from other agricultural products such as spices, vegetables, unmanufactured tobacco, minor agricultural products and seafood increased substantially in 2013, contributing to the overall growth in agricultural exports. Earnings from the export of spices increased by 38.8 per cent to US dollars 355 million in 2013. This was mainly on account of an increase in earnings from export of pepper by 82.9 per cent to US dollars 128 million and an increase in earnings from export of cloves by 169.4 per cent to US dollars 50 million. An increase in planting due to favourable prices and incentives given through the 'Gama Neguma' programme as well as improved extension services provided by the Department of Export Agriculture contributed to the significant growth in export of spices during the year. Meanwhile, earnings from export of unmanufactured tobacco and minor agricultural products increased by 12.9 per cent and 33.3 per cent, respectively in 2013, mainly due to favourable weather conditions. Export earnings from seafood increased by 18.1 per cent during the year to US dollars 234 million, with increased earnings from processed fish, frozen fish as well as molluscs.

5.3.2 Import Performance

Expenditure on imports, which declined continuously from April 2012, on a year-on-year basis continued to contract during most of 2013. Expenditure on imports in 2013 declined by 6.2 per cent to US dollars 18,003 million, from the previous year, reflecting the impact of policy measures adopted in 2012 to rationalise imports, lower expenditure on fuel imports as well as subdued commodity prices in international markets. All major categories of imports except

Chart 5.4 Imports by Commodities - 2013

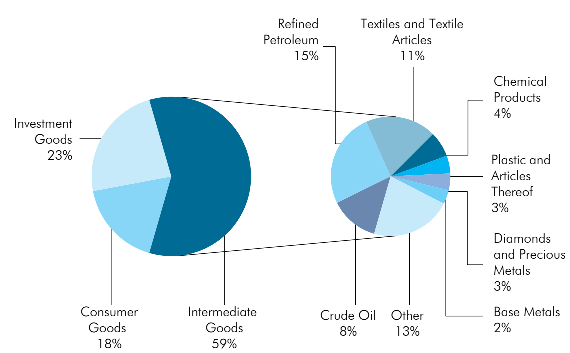


Table 5.3 Composition of Imports

Category	2012 (a) Value US$ million	2012 (a) Share %	2013 (b) Value US$ million	2013 (b) Share %	Change in Value US$ million	Y-o-Y Change %	Contribution to Change %
Consumer Goods	**2,995.2**	**15.6**	**3,182.5**	**17.7**	**187.3**	**6.3**	**-15.8**
Food and Beverages	1,304.4	6.8	1,368.1	7.6	63.7	4.9	-5.4
Rice	24.4	0.1	17.9	0.1	-6.5	-26.6	0.5
Sugar and Sugar Confectionery	346.7	1.8	290.6	1.6	-56.0	-16.2	4.7
Dairy Products	307.3	1.6	291.0	1.6	-16.4	-5.3	1.4
Lentils	69.0	0.4	104.1	0.6	35.1	51.0	-3.0
Other	557.0	2.9	664.4	3.7	107.4	19.3	-9.0
Other Consumer Goods	1,690.8	8.8	1,814.4	10.1	123.6	7.3	-10.4
Vehicles	495.1	2.6	582.2	3.2	87.1	17.6	-7.3
Medical and Pharmaceuticals	372.2	1.9	378.3	2.1	6.1	1.6	-0.5
Home Appliances	218.5	1.1	192.2	1.1	-26.2	-12.0	2.2
Clothing and Accessories	174.5	0.9	201.7	1.1	27.2	15.6	-2.3
Other	430.5	2.2	460.0	2.6	29.5	6.9	-2.5
Intermediate Goods	**11,577.6**	**60.3**	**10,553.7**	**58.6**	**-1,023.8**	**-8.8**	**86.2**
Fuel	5,044.6	26.3	4,308.2	23.9	-736.4	-14.6	62.0
Textiles and Textile Articles	2,266.4	11.8	2,045.8	11.4	-220.5	-9.7	18.6
Diamonds and Precious Metals	587.7	3.1	482.9	2.7	-104.9	-17.8	8.8
Chemical Products	669.7	3.5	734.3	4.1	64.6	9.6	-5.4
Wheat and Maize	363.8	1.9	323.2	1.8	-40.6	-11.2	3.4
Fertilizer	311.0	1.6	238.7	1.3	-72.3	-23.3	6.1
Other Intermediate Goods	2,334.4	12.2	2,420.8	13.4	86.4	3.7	-7.3
Investment Goods	**4,589.8**	**23.9**	**4,252.7**	**23.6**	**-337.1**	**-7.3**	**28.4**
Building Materials	1,237.4	6.4	1,357.2	7.5	119.8	9.7	-10.1
Transport Equipment	991.9	5.2	667.8	3.7	-324.1	-32.7	27.3
Machinery and Equipment	2,356.0	12.3	2,221.9	12.3	-134.1	-5.7	11.3
Other Investment Goods	4.5	...	5.8	...	1.3	28.5	-0.1
Unclassified Imports	**27.7**	**0.1**	**13.9**	**0.1**	**-13.8**	**-50.0**	**1.2**
Total Imports (c) (d)	**19,190.2**	**100.0**	**18,002.8**	**100.0**	**-1,187.4**	**-6.2**	**100.0**
Annual Average Exchange Rate (e)	**127.60**		**129.11**				

(a) Revised
(b) Provisional
(c) Adjusted
(d) Excludes re-imports
(e) Rupee/US dollar exchange rate

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

consumer goods, declined significantly. The anaemic recovery in major economies around the world moderated international commodity prices, including petroleum prices leading to an overall decline in import expenditure. Expenditure on non-fuel imports in 2013 declined by 3.2 per cent to US dollars 13,695 million.

The largest contribution to the decline in overall import expenditure came from the reduction in expenditure on intermediate goods, mainly due to lower expenditure on fuel, textiles and textile articles, fertilizer, and diamonds and precious stones. In value terms, expenditure on intermediate goods imports, which accounts for around 59 per cent of total imports, declined by 8.8 per cent to US dollars 10,554 million in 2013. Expenditure on fuel imports, which accounts for around one fourth of total import expenditure, declined by 14.6 per cent to US dollars 4,308 million, mainly due to lower usage of thermal power for electricity generation during the year and a decline in petroleum prices in international markets. The average import price of crude oil declined to US dollars 109.84 per barrel in 2013 from US dollars 114.00 per barrel in 2012. As a result of the increase in local production, imports of textiles and textile articles declined by 9.7 per cent to US dollars 2,046 million in 2013, raising the value addition in the garment industry. Expenditure on fertilizer imports declined substantially by 23.3 per cent to US dollars 239 million. The decline in the volume of fertilizer imports was partly

Table 5.4 Volume of Major Imports

MT '000

Item	2009	2010	2011	2012	2013 (a)
Rice	**52**	**126**	**28**	**36**	**23**
1st Quarter	3	121	8	15	9
2nd Quarter	3	2	2	7	6
3rd Quarter	2	2	9	10	4
4th Quarter	44	1	9	4	4
Wheat (b)	**1,026**	**1,051**	**1,242**	**1,084**	**895**
1st Quarter	288	352	322	353	197
2nd Quarter	229	171	455	235	326
3rd Quarter	220	292	254	291	170
4th Quarter	289	236	211	205	201
Sugar	**466**	**548**	**606**	**569**	**548**
1st Quarter	123	145	163	158	126
2nd Quarter	110	145	170	135	175
3rd Quarter	142	154	124	114	118
4th Quarter	92	104	149	162	129
Crude Oil (b)	**2,066**	**1,819**	**2,070**	**1,486**	**1,743**
1st Quarter	559	332	557	558	482
2nd Quarter	417	541	555	413	545
3rd Quarter	416	541	410	137	315
4th Quarter	673	405	547	379	401
Refined Petroleum (b)	**2,162**	**2,882**	**3,501**	**3,961**	**3,201**
1st Quarter	411	789	702	1,036	673
2nd Quarter	607	881	807	903	756
3rd Quarter	567	507	1,022	997	791
4th Quarter	577	705	970	1,025	981
Fertilizer	**462**	**649**	**801**	**640**	**600**
1st Quarter	46	88	131	129	61
2nd Quarter	83	238	207	176	139
3rd Quarter	110	165	266	226	187
4th Quarter	223	158	197	108	214

(a) Provisional
(b) Adjusted

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

due to the utilisation of existing stocks and the government's efforts to rationalise the usage of fertilizer while encouraging the use of organic fertilizer in agricultural production. Meanwhile, import expenditure on diamonds, precious stones and metals declined significantly by 17.8 per cent in line with the decline in export of gems, diamonds and jewellery. However, import of gold, which is the main sub-category within diamonds, precious stones and metals, increased by 17.5 per cent to US dollars 200 million in 2013, mainly due to the 47.1 per cent increase in gold imports during the first half of the year. In June 2013, a 5 per cent customs duty and a 100 per cent surcharge on customs duties were imposed on the importation of gold to contain imports. However, the surcharge was removed with effect from November 2013 and the customs duty was increased to 7.5 per cent. Import expenditure on other categories of intermediate goods, such as chemical products, plastics, paper and paperboard, agricultural inputs, food preparations and mineral products increased during the year.

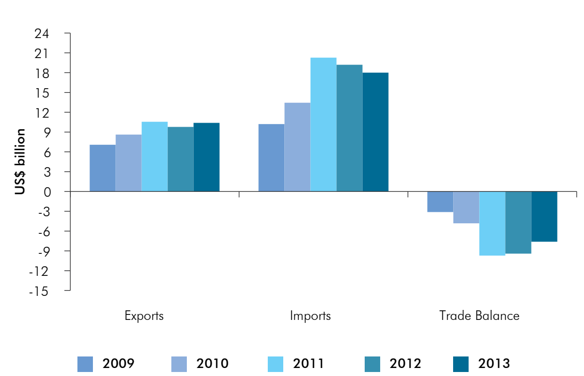
Expenditure on import of investment goods declined by 7.3 per cent to US dollars 4,253 million in 2013, led by a decline in importation of transport equipment as well as machinery and equipment. Responding to policy measures taken in 2012 to rationalise imports, expenditure on transport equipment declined by 32.7 per cent to US dollars 668 million in 2013. Import expenditure on all categories of transport equipment, except ships and boats and aircraft, declined during this period. Import expenditure on machinery and equipment, which comprise mainly engineering equipment, electronic equipment, telecommunication devices, office machinery, medical and laboratory equipment and machinery and equipment parts declined by 5.7 per cent to US dollars 2,222 million in 2013. However, the import of building materials which comprise mainly cement, iron and steel, aluminium articles and mineral products, increased by 9.7 per cent to US dollars 1,357 million, to meet the increasing demand from the mega infrastructure development projects being undertaken by the government and the private sector.

With respect to consumer goods imports, expenditure on food and beverages as well as non-food items increased considerably in 2013. Overall import expenditure on consumer goods, which accounts for around 18 per cent of total imports, increased by 6.3 per cent to US dollars 3,182 million in 2013 from US dollars 2,995 million in 2012. Import expenditure on food and beverages increased by 4.9 per cent to US dollars 1,368 million due to higher expenditure on the importation of vegetables, seafood as well as oils and fats. However, expenditure on the importation of sugar and confectionery products, dairy products, beverages and cereals and milling industry products declined during the period under review. An increase in the Cess imposed on the importation of butter, yoghurt and dairy products, with a view to encouraging domestic dairy production, mainly contributed to the 5.3 per cent reduction in import expenditure on dairy products. Meanwhile, expenditure on import of non-food consumer goods increased by 7.3 per cent to US dollars 1,814 million, largely due to the increase in the importation of motor vehicles by 17.6 per cent. Import of other categories of non-food consumer goods, such as medical and pharmaceutical products, clothing and accessories, telecommunication devices and rubber products also increased during the year.

5.3.3 Trade Balance

The trade deficit contracted sharply in 2013 with the pickup in export earnings and decline in import expenditure. Accordingly, the trade deficit narrowed by 19.2 per cent to US dollars 7,609 million in 2013 from US dollars 9,417 million in 2012. As a percentage of GDP, the deficit in the trade account declined to 11.3 per cent in 2013 from 15.9 per cent in 2012.

Chart 5.5 Exports, Imports and Trade Balance



5.3.4 Terms of Trade

The significant reduction in import prices and a marginal increase in export prices resulted in an improvement in the terms of trade in 2013. The export price index increased marginally by 0.4 per cent to 103.5 index points, while the import price index declined significantly by 5.9 per cent to 108.4 index points. Accordingly, the terms of trade improved by 6.7 per cent to 95.5 index points in 2013 from 89.5 index points in 2012.

Despite the significant price reduction in key commodities in the international market, the overall export price index increased marginally. The increase in the average price of textiles and garments and tea, the two major export items which account for more than 58 per cent of total exports, raised the export price index. The export price of textiles and garments, increased by 2.4 per cent, while the average export price of tea increased by 7.5 per cent. Higher value addition in the garment industry with the acquisition of modern technology and innovation and increasing shift to supplying niche markets resulted in an increase in the unit price of textiles and garments. Although tea prices in Kolkata and Mombasa auctions declined considerably in 2013, the average export price of Ceylon tea increased significantly as a result of an increase in demand for high quality Ceylon tea. However, the price of petroleum products, gems, diamonds and jewellery and base metals categorised under industrial exports and the price of rubber, coconut, seafood and vegetables categorised under agricultural products, recorded a decline in 2013. Accordingly, while the average export price index of agricultural and mineral exports increased by 4.6 per cent and 10.8 per cent, respectively, the export price index of industrial exports declined by 0.8 per cent.

The import price of all major import categories remained lower than in the previous year, reflecting the moderation in

Table 5.5 Trade Indices (a)

2010 = 100

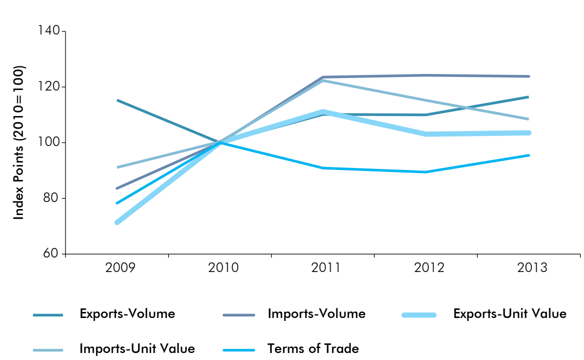
Category	Value Index			Volume Index			Unit Value Index		
	2012	2013 (b)	Y-o-Y Change %	2012(c)	2013(b)	Y-o-Y Change %	2012 (c)	2013 (b)	Y-o-Y Change %
EXPORTS									
Agricultural Exports	**101.1**	**112.0**	**10.7**	**92.0**	**97.4**	**5.9**	**109.9**	**115.0**	**4.6**
Tea	98.1	107.1	9.2	93.5	95.0	1.6	104.9	112.8	7.5
Rubber	72.2	41.2	-43.0	69.6	45.5	-34.6	103.9	90.5	-12.9
Coconut	126.1	123.5	-2.0	110.0	112.7	2.4	114.6	109.6	-4.3
Spices	123.6	171.5	38.8	84.1	115.2	37.0	147.0	148.9	1.3
Minor Agricultural Products	106.4	141.8	33.3	132.9	162.6	22.3	80.0	87.2	9.0
Industrial Exports	**121.0**	**127.2**	**5.1**	**120.2**	**127.4**	**6.0**	**100.7**	**99.8**	**-0.8**
Textiles and Garments	119.0	134.4	13.0	109.8	121.1	10.3	108.4	111.0	2.4
Petroleum Products	175.9	162.5	-7.6	115.3	116.9	1.4	152.6	139.0	-8.9
Rubber Products	154.4	159.5	3.3	112.6	109.0	-3.2	137.1	146.3	6.7
Mineral Exports	**252.9**	**212.8**	**-15.9**	**106.7**	**81.0**	**-24.0**	**237.0**	**262.6**	**10.8**
Total Exports	**113.4**	**120.6**	**6.4**	**110.0**	**116.4**	**5.9**	**103.1**	**103.5**	**0.4**
IMPORTS									
Consumer Goods	**121.0**	**128.6**	**6.3**	**111.9**	**119.2**	**6.6**	**108.2**	**107.9**	**-0.3**
Food and Beverages	98.6	103.4	4.9	100.1	105.4	5.3	98.5	98.1	-0.4
Other Consumer Goods	146.8	157.6	7.3	125.3	135.1	7.8	117.2	116.7	-0.4
Intermediate Goods	**143.8**	**130.8**	**-9.1**	**118.3**	**113.6**	**-4.0**	**121.6**	**115.1**	**-5.3**
Fertilizer	129.5	99.4	-23.3	97.0	88.4	-8.8	133.5	112.3	-15.9
Fuel	165.9	140.8	-15.1	120.8	110.0	-8.9	137.4	128.0	-6.8
Chemical Products	128.8	141.2	9.6	116.9	128.1	9.6	110.2	110.3	0.1
Wheat and Maize	137.1	121.8	-11.2	102.0	84.8	-16.9	134.4	143.6	6.9
Textiles and Textile Articles	125.3	113.1	-9.7	114.3	104.7	-8.4	109.6	108.0	-1.5
Plastics and Articles	114.7	121.8	6.2	116.9	116.9	0.1	98.1	104.2	6.2
Diamonds and Precious Metals	155.7	127.9	-17.8	134.4	131.7	-2.0	115.8	97.1	-16.2
Investment Goods	**166.6**	**154.4**	**-7.3**	**156.1**	**157.6**	**1.0**	**106.7**	**97.9**	**-8.2**
Building Materials	150.6	165.2	9.7	137.6	153.9	11.9	109.5	107.3	-1.9
Transport Equipment	167.4	112.7	-32.7	147.6	103.5	-29.9	113.4	108.9	-4.0
Machinery and Equipment	176.2	166.1	-5.7	171.4	183.9	7.3	102.8	90.3	-12.1
Other Investment Goods	135.4	174.0	28.5	131.0	161.8	23.5	103.3	107.5	4.1
Total Imports	**143.1**	**134.3**	**-6.2**	**124.2**	**123.8**	**-0.3**	**115.2**	**108.4**	**-5.9**
Terms of Trade							**89.5**	**95.5**	**6.7**

(a) In terms of US dollars
(b) Provisional
(c) Revised

Sources: Sri Lanka Customs
Central Bank of Sri Lanka

global commodity prices due to a slower than expected recovery in advanced economies and a slowing down of emerging market economies. The significant reduction in petroleum and fertilizer import prices, mainly contributed to the decline in the overall import price index. On average, petroleum and fertilizer prices declined by 6.8 per cent and 15.9 per cent, respectively during 2013. The rapid expansion of unconventional oil production as well as lower demand from USA and Europe contributed to the decline in oil prices. In the food and beverages category, the price of sugar declined by 12.3 per cent due to the weakening of the Brazilian Real and excess production. The price of investment goods imports declined, due to a fall in the price of almost all sub categories. Accordingly, the average import price index of consumer, intermediate and investment good categories declined by 0.3 per cent, 5.3 per cent and 8.2 per cent, respectively in 2013.

Chart 5.6 Terms of Trade and Trade Indices



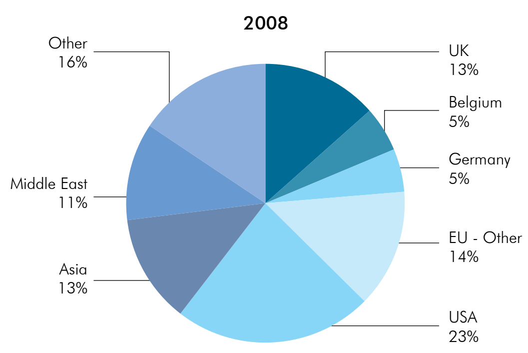
5.3.5 Direction of Trade

Industrialised countries continued to be the major destination for Sri Lankan exports in 2013, while Asian countries accounted for a major share of imports into the country. USA remained the largest export destination in 2013 followed by the UK and India, while India remained the largest source of imports followed by China and Singapore. India remains the leading trading partner of Sri Lanka with bilateral trade in 2013 exceeding US dollars 3.7 billion.

USA which is the major export market for Sri Lanka accounted for around 24 per cent of total exports, followed by the UK (10.4 per cent) and India (5.2 per cent). Textiles and garments remained the largest export to USA and UK. With the recovery of these economies total exports to USA and UK increased by 17.3 per cent and 1.8 per cent, respectively. The major exports to India were spices, transport equipment, machinery and mechanical appliances and animal fodder. In 2013, apart from UK, the other leading export destinations in Europe were Italy, Germany and Belgium-Luxemburg, representing 4.9 per cent, 4.5 per cent and 4.3 per cent of total exports, respectively. Exports to Italy and Germany comprised mainly garments, accounting for 14 per cent of total garment exports. Almost 42 per cent of Sri Lanka's gems, diamonds and jewellery were exported to Belgium, one of the world's leading trading centres for diamonds. Tea exports to the Middle East and CIS countries accounted for nearly 46.3 per cent and 24.1 per cent, respectively, of total tea exports in 2013, making them the main destinations for Ceylon tea.

India continued to be the largest source of imports in 2013, accounting for nearly 17.6 per cent of Sri Lanka's imports. However,

Chart 5.7 Exports by Destination



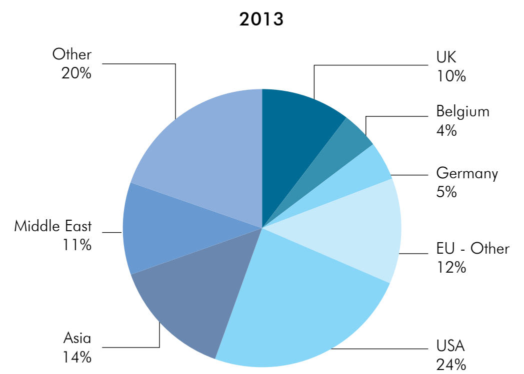
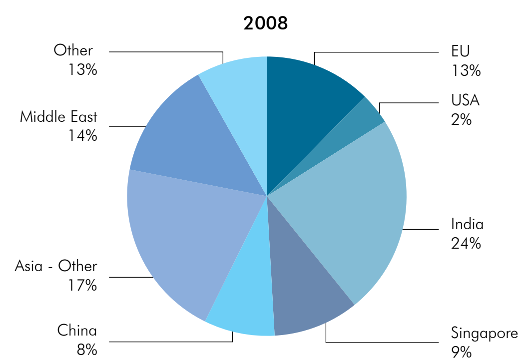
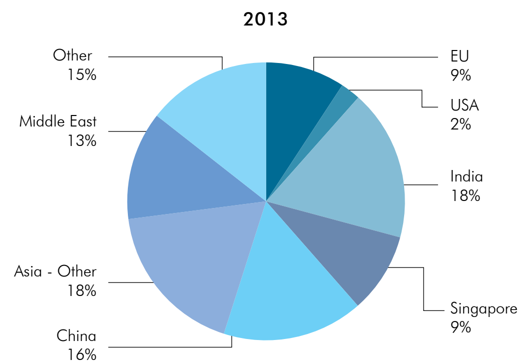


Chart 5.8 Imports by Origin





imports from India declined by 12.9 per cent to US dollars 3,171 million in 2013. The main imports from India were petroleum products, textiles and textile articles and building materials. Price competitiveness has enabled India to secure a significant market share for these items, although most of these items do not have duty free access under the ISFTA. China and Singapore followed as the second and third largest import sourcing countries, accounting for 16.4 per cent and 9.3 per cent of total imports, respectively. Imports from China grew by 10.7 per cent to US dollars 2,953 million, while imports from Singapore amounted to US dollars 1,682 million. The main imports from China comprised machinery and equipment, textiles and textile articles and building materials. The major imports from Singapore consisted of petroleum products and machinery and equipment. United Arab Emirates remained the fourth largest import source accounting for a share of 6.6 per cent of total imports. Imports from Oman increased by more than six fold, year-on-year, in 2013, making it the fifth largest import sourcing country, due to a shift of crude oil imports from Iran to Oman.

5.4 Current and Capital Account

5.4.1 Trade in Services

With improved performance in global economic activity, trade in services recorded higher inflows during 2013. The services account registered gross inflows of US dollars 4,685 million in 2013, a 23.3 per cent increase over the previous year. The improved performance in the services account was mainly due to higher receipts from travel, transport, telecommunications, computer and information services sub sectors. Reflecting Sri Lanka's potential to emerge as a key services export economy in the region, other services also received substantial amount of foreign inflows during the year.

Transport Services

Transport services, the key sector within the services account, grew rapidly during the year. Gross inflows on account of transport services, which consist of passenger fares, freight, port and airport related activities, increased by 9.2 per cent to US dollars 1,784 million in 2013, from US dollars 1,634 million in 2012. In the meantime, outflows on account of transport services increased by 17.9 per

Table 5.6 Current and Capital Account (BPM6 Presentation Format)

US$ million

Item	2012 (a)			2013 (b)		
	Credit	Debit	Net	Credit	Debit	Net
Goods and Services	**13,573**	**21,729**	**-8,155**	**15,079**	**21,508**	**-6,429**
Goods	**9,774**	**19,190**	**-9,417**	**10,394**	**18,003**	**-7,609**
General merchandise	9,759	19,020	-9,261	10,392	17,802	-7,410
Non-monetary gold	14	170	-156	2	201	-199
Services	**3,800**	**2,538**	**1,262**	**4,685**	**3,505**	**1,180**
Transport	1,634	1,172	462	1,784	1,382	402
Sea transport	825	597	229	893	686	208
Freight	825	597	229	893	686	208
Air transport	808	576	233	890	696	194
Passenger	717	509	207	791	620	171
Freight	92	66	25	99	76	23
Travel (c)	1,039	710	328	1,715	1,188	527
Construction	50	9	41	55	26	29
Insurance and pension services	107	64	43	109	85	24
Financial services	232	279	-46	235	328	-93
Telecommunications, computer and information services	673	207	466	719	368	351
Telecommunications	109	68	41	114	87	27
Computer services	564	139	425	604	281	324
Other business services	39	46	-8	39	55	-15
Government goods and services n.i.e.	27	51	-24	28	73	-45
Primary Income	**142**	**1,361**	**-1,219**	**148**	**1,965**	**-1,817**
Compensation of employees	14	34	-20	15	66	-51
Investment income	128	1,327	-1,199	133	1,899	-1,767
Direct investment	15	446	-431	22	774	-751
Dividends	15	200	-185	22	422	-400
Reinvested earnings		246	-246		352	-352
Portfolio investment	-	408	-408	-	576	-576
Interest	-	408	-408	-	576	-576
Short term	-	46	-46	-	48	-48
Long term	-	362	-362	-	528	-528
Other investment	23	473	-450	20	550	-530
Reserve assets	90	-	90	91	-	91
Secondary Income	**6,038**	**646**	**5,392**	**6,428**	**788**	**5,639**
General government	53	-	53	21	-	21
Workers' remittances	5,985	646	5,339	6,407	788	5,619
Current Account	**19,754**	**23,736**	**-3,982**	**21,655**	**24,262**	**-2,607**
Capital Account	**146**	**15**	**130**	**90**	**19**	**71**
Capital transfers	146	15	130	90	19	71
General government	98	-	98	39	-	39
Corporations and households	47	15	32	51	19	32
Current and Capital Account	**19,900**	**23,751**	**-3,851**	**21,745**	**24,281**	**-2,536**

(a) Revised
(b) Provisional
(c) Passenger services provided to non-residents are included in transport services.

Source: Central Bank of Sri Lanka

cent to US dollars 1,382 million during 2013 compared to the previous year, due to external trade activity and an increase in travel abroad by Sri Lankans.

Gross inflows on account of passenger fares increased by 10.3 per cent to US dollars 791 million in 2013, over the previous year, mainly due to higher tourist arrivals. This was supported by the increase in the number of passengers and upward revisions to airfares by SriLankan Airlines during the year. At present, SriLankan Airlines operates to 65 destinations in 35 countries across the world. Meanwhile, Mihin Lanka started operating direct flights to Seychelles as the eleventh destination in November 2013 creating additional space to carry more passengers in the region.

Earnings from freight, port and airport related activities increased by 8.3 per cent to US dollars 993 million in 2013. The growth was mainly due to an increase in the volume of cargo and container handling during the year. The new container terminal at the Colombo South Port was completed in August 2013, expanding the existing capacity by 2.4 million Twenty-foot Equivalent Container Units (TEUs). In addition, the government declared the Colombo and Hambantota ports as free ports and the Mattala Rajapaksa International Airport (MRIA) as a bonded area with a view to expanding port and airport related activities further. More inflows are expected in the coming years with the completion of ongoing port and airport development projects.

Travel and Tourism

The peaceful environment in the country together with the ongoing strategic investments in the tourism sector, new tourist attractions and mega promotional campaigns attracted a significant number of tourists to Sri Lanka in 2013. Tourist arrivals in 2013 surpassed the initial target of 1.2 million to record 1.27 million arrivals, a growth of 26.7 per cent over the previous year. Although Western Europe continued to be the prime source market for tourists to Sri Lanka, tourist arrivals from emerging market economies increased significantly in 2013. Consequently, tourist arrivals from Western Europe as a share of total arrivals fell to 33 per cent in 2013 from 37.1 per cent in 2012, albeit the number of tourist arrivals from this region increased by 12.9 per cent, year-on-year in 2013. On the other hand, the share of tourist arrivals from East Asia, South Asia, Eastern Europe and Middle East increased due to effective and strategic promotional campaigns executed during the year focusing on emerging markets. The South Asian region which was the second major market accounted for 25.6 per cent of arrivals in 2013 compared to 24.6 per cent in 2012. It is noteworthy that tourist arrivals from all regions recorded a significant growth in 2013 compared to the previous year. Meanwhile, India remained the leading tourist origin country followed by the UK, Germany, Maldives and France. These five countries together accounted for 45.2 per cent of tourist arrivals to Sri Lanka in 2013. In terms of purpose of visit, a majority of tourists (76.9 per cent) visited the country for pleasure, while 7.4 per cent came for business.

Earnings from tourism continued to grow considerably in 2013. The continuous increase in tourist arrivals and an increase in average spending

Chart 5.9 Tourist Arrivals by Country - 2013

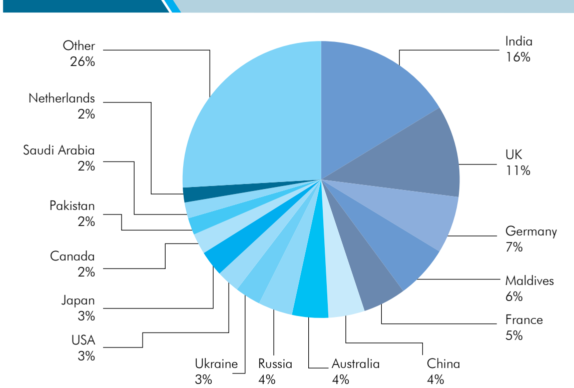


Chart 5.10 Tourist Arrivals and Earnings from Tourism

per tourist resulted in earnings from tourism recording US dollars 1,715 million in 2013, compared to US dollars 1,039 million in 2012. According to the Sri Lanka Tourism Development Authority (SLTDA), the average spending per tourist per day increased to US dollars 156.5 in 2013 from US dollars 103 in 2012, while the average duration of stay per tourist decreased to 8.6 days in 2013 from 10 days in 2012. Further, improved hotel and related infrastructure facilities and an increase in arrivals of high end tourists contributed to the growth in tourist earnings in 2013. Meanwhile, outflows on account of travel also increased substantially in 2013 due to an increase in travel by Sri Lankans for education, leisure, business and health purposes.

The SLTDA and other relevant authorities stepped up efforts to reach the target of 2.5 million tourists by 2016. Tourism Development Zones in Kalpitiya, Kuchchaveli and Yala were being promoted for investment with a view to developing tourism on different themes. Ippantive, Vellai and Uchchamuni islands were leased to three investors and approval was granted by the Coast Conservation Department to construct four water bungalows in Vellai island as a pilot project. Shangri-La Asia Limited, one of Asia Pacific's luxury hotel chains as well as several other international hotel chains such as the Hyatt, Movenpick, Marriott and Sheraton were under construction during the year and are expected to commence operations in Sri Lanka in the near future. Further, approval was granted for 36 new hotel projects consisting of 2,547 rooms with an investment of US dollars 372 million during the year. Lesser known sites were identified in Ampara, Gampaha and Puttalam districts and are expected to be promoted in order to attract more tourists to the country, encourage more investment and generate direct and indirect employment opportunities. New initiatives like visits to communities, and activities relating

Table 5.7 Tourism Performance

Item	2009	2010	2011	2012	2013 (a)	Y-o-Y Change % 2013 (a)
Tourist Arrivals (No.)	447,890	654,476	855,975	1,005,605	1,274,593	26.7
Pleasure	358,188	516,538	663,343	748,436	980,162	31.0
Business	38,473	83,270	68,097	90,040	94,320	4.8
Other	51,229	54,668	124,535	167,129	200,111	19.7
Tourist Guest Nights ('000)	4,076	6,548	8,559	10,056	10,961	9.0
Room Occupancy Rate (%)	48.4	70.2	77.1	71.2	71.7	0.7
Gross Tourist Receipts (Rs. million)	40,133	65,018	91,926	132,427	221,720	67.4
Per Capita Tourist Receipts (Rs.)	89,605	99,344	107,393	131,688	173,954	32.1
Total Employment (No.)	124,970	132,055	138,685	162,869	270,150	65.9
Direct Employment	52,071	55,023	57,786	67,862	112,550	65.9
Estimated Indirect Employment	72,899	77,032	80,899	95,007	157,600	65.9

(a) Provisional

Sources: Sri Lanka Tourism Development Authority
Central Bank of Sri Lanka

to farming, fishing, festivals, religious and cultural programmes, sports, bird watching and wildlife were also actively promoted. In addition, developments in infrastructure facilities such as 'Pura Neguma' and the Katunayake expressway have helped improve the first impression of tourists who arrive into the country.

Considering the importance of promotional activities to attract tourists, several campaigns were conducted in 2013. Sri Lanka's first ever mega joint promotional campaign, with the involvement of public and private sectors named 'Get SriLankan'ed', was launched in India followed by a high profile media conference as well as Business to Business meetings in travel and trade. The main aim of this campaign was to position Sri Lanka as the most preferred travel destination in emerging markets. In addition, promotion campaigns were held in Russia and other CIS countries as well as in emerging high potential markets such as China. The Sri Lanka Tourism Promotion Bureau participated in 35 travel fairs and exhibitions abroad during the year together with representatives from the travel and tourism industry. Further, 72 media familiarisation tours were organised for journalists from 30 countries under the 'Visiting Journalists Programme' which has proved successful in promoting the country. In addition, the private sector continued its promotional activities by participating in international tourism fairs and hosting 33 finalists of the Miss France 2014 contest. Further, an exhibition titled 'Reflection of Sri Lanka' and several organised tours were arranged for visitors to the CHOGM, enabling them to get an exposure of locations, attractions and Sri Lankan traditions and culture. This is expected to generate interest among conference organisers to consider Sri Lanka as a venue for hosting international events and promote the country as a tourist destination among commonwealth countries. The way forward in the tourism sector is to diversify the range of products to cater to different segments of the market.

Telecommunications, Computer and Information Services

Gross inflows on account of telecommunications, computer and information services recorded US dollars 719 million in 2013, compared to US dollars 673 million in 2012. The telecommunications services sub sector grew moderately in 2013 with gross inflows amounting to US dollars 114 million in 2013. Although the high competition in the telecommunications sector has led to a significant decline in the domestic price of international voice call charges in recent years, greater utilisation of internet services resulted in a marginal reduction in both International Direct Dialing (IDD) incoming and outgoing voice call minutes in 2013 compared to 2012. Sri Lanka's telecommunications industry is broadening compared to its regional peers, with two Sri Lankan operators already launching Fourth Generation Long Term Evolution (4G LTE) services, while more entrants to the market are expected in the near future.

Performance in computer and information services improved during 2013. Gross inflows to the computer and information services sub sector increased by 7.2 per cent to US dollars 604 million in 2013. Software and Information Technology Enabled Services (ITES) such as BPO and KPO have emerged as a sector with high growth potential in Sri Lanka, generating significant inflows in 2013 compared to the previous year. As a result, Sri Lanka has been awarded the 'Outsourcing Destination of the Year' by the National Outsourcing Association (NOA), UK in October 2013. As Sri Lanka has the ability to produce skilled human resources needed for Information Technology (IT), BPO and KPO sectors, the government has put forward a proposal to facilitate corporate entities engaged in BPO services while offering a 5-year half tax holiday for the commencement of new entities. Further, a proposal was made to develop an Information and Communication Technology (ICT) Zone at Hambantota as the emerging ICT Hub of South Asia.

BOX 6 Sri Lanka's Transition to the Latest Balance of Payments Manual in Compilation of External Accounts

The Balance of Payments Manuals (BPMs) published by the International Monetary Fund (IMF) specify international standards and norms applicable to the compilation of external sector statistics. Since 1948, the IMF has issued six editions of BPMs and each new edition has been introduced in line with global economic and financial developments, changes in analytical frameworks and experience gained by the compilers over the years.

The balance of payments (BOP), the international investment position (IIP) and the other changes in financial assets and liabilities account are the key components of international account statements. Chart B 6.1 depicts the manner in which these three sets of statistics in international accounts are inter-connected.

Chart B 6.1 International Accounts

	BOP (During the Year)		
	Current Account		
	Capital Account		
IIP Beginning of the Year	**Financial Account** Transactions	**Other Changes in Financial Assets and Liabilities Account (During the Year)** 1. Other Changes in Volume 2. Revaluations (Exchange Rate Changes and Other Price Changes)	**IIP End of the Year**
	Errors & Omissions		

The sixth edition of the Balance of Payments and International Investment Position Manual (BPM6), the latest edition of BPMs, focuses on key new areas. The BPM6 aims at strengthening the integration of external sector statistics with other macroeconomic statistics, takes account of specialised manuals and classification systems (e.g., System of National Accounts 2008) and highlights the IIP and related development of the balance sheet approach. Further, the BPM6 accommodates global financial and technological innovations, clarifies selected areas (e.g., residence, economic ownership and scope of direct investment) and deals with special topics. The BPM6 also gives more prominence to the IIP (refer to Box Article No. 7). However, the basic framework of the fifth edition of the Balance of Payments Manual (BPM5) has not been changed in the BPM6 and the presentation of the Current, Capital, and Financial accounts is maintained.

Although the BPM6 was introduced in 2009, many countries are still in the transition stage to its adoption. With the publishing of the BOP and IIP statistics based on the BPM6, Sri Lanka joins the first few countries in the region to adopt the BPM6. Sri Lanka adopts a progressive approach towards implementing the BPM6 recommendations by conforming as far as possible, depending on the applicability to Sri Lankan context and availability of data for certain items. With the adoption of the BPM6, the analytical presentation of the BOP has the following key changes compared to the previous format:

Goods and Services Account

The Goods and Services Account shows transactions between residents and non-residents in goods and services that are outcomes of production activities. The Goods Account includes general merchandise and non-monetary gold, while the Services Account includes transport, travel, construction, insurance and pension services, financial services, telecommunications, computer and information services, other business services and government goods and services (not included elsewhere).

- **Goods :** Migrants' personal effects are not included in general merchandise or anywhere else in the international accounts as there is no change in economic ownership.
- **Services :** In addition to the sub-categories of the Services Account under the previous presentation, **financial services appear as a separate sub-category under the new presentation, e.g. bank fees and commission.**

Primary Income Account

The primary income represents the returns that accrue to residents for their contribution to the production process or provision of financial assets and renting natural resources to non-residents. Accordingly, the Primary Income Account includes compensation of employees and investment income. The **Income Account in the previous format is now referred to as the Primary Income Account in the BPM6.**

Secondary Income Account

The Secondary Income Account shows current transfers between residents and non-residents. Current transfers may be in cash or kind. **The Secondary Income Account in the BPM6 replaces the 'current transfers' in the previous format.**

Capital Account

The Capital Account includes (a) capital transfers receivable and payable between residents and non-residents and (b) the acquisition and disposal of non-produced, non-financial assets between residents and non-residents.

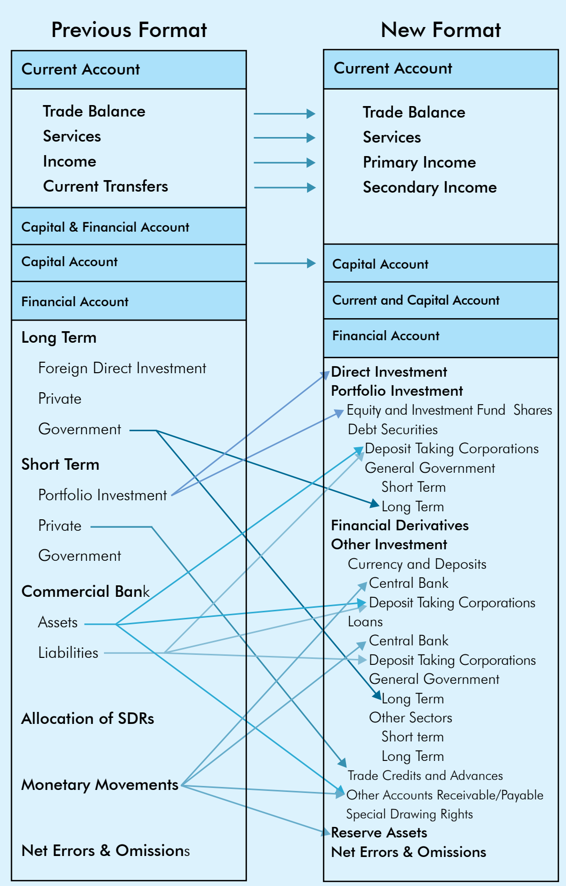
- **The personal effects, financial assets, and liabilities of persons changing residence are no longer covered by capital transfers.**
- **The Capital Account is not grouped with the Financial Account anymore.** Instead it is coupled with the Current Account. The balance of the Current and Capital Accounts represents the net lending or borrowing of the economy.

Financial Account

The Financial Account records transactions that involve financial assets and liabilities that take place between residents and non-residents.

- The balance of the Current and Capital Accounts is conceptually equal to the balance of the Financial Account, which measures how the net lending to or borrowing from non-residents is financed.

Chart B 6.2 Major Changes in the Analytical Presentation of the BOP



- The Financial Account uses the headings **'net acquisition of financial assets'** and **'net incurrence of liabilities'** instead of **'debits'** and **'credits'**.
- The Financial Account shows transactions in net terms, which are shown separately for financial assets and liabilities (i.e., net transactions in financial assets show acquisition of assets less reduction of assets, not assets net of liabilities).
- The fundamental change in the Financial Account in the previous and new formats is that the former was based on **'institutional sectors'** with some categories further divided based on maturity as 'long term' and 'short term', whereas the latter is based on **'financial instruments'**, namely, **direct investment, portfolio investment, financial derivatives, other investment and reserve assets.** Under each instrument category, **'institutional sectors'** appear as sub categories which are further broken down based on maturity, i.e., 'long term' or 'short term'. Therefore, most of the data items in the previous format is segregated and presented under different sub categories in the new format. Some of the key changes as illustrated in Chart B 6.2 are as follows:

a) **'Long term: government'** transactions under the previous format included financial flows relating to long term debt securities and project loans to the government. With the new format, **long term debt securities transactions** appear under long term 'debt securities' of the 'general government' under 'portfolio investment' while **project loans to the government** are classified under long term 'loans' of the 'general government' under the 'other investment' category.

b) **Portfolio investment** which was classified under 'short term - portfolio investment' in the previous format included foreign investments related transactions to companies listed in the Colombo Stock Exchange (CSE). With the new format, **portfolio investment** is reclassified as either 'direct investment' or 'equity and investment fund shares' under 'portfolio investment' on the basis that if the investor owns 10 per cent or more of the equity with voting power in the domestic enterprise, then such investment is considered as 'direct investment'. If it is less than 10 per cent, the investment is recorded as 'equity and investment fund shares' under the 'portfolio investment' category.

c) **'Private – short term'** transactions in the previous format included trade credits and advances obtained by the private sector. Now they are recorded as 'trade credits and advances' under the 'other investment' category.

d) **Commercial bank assets and liabilities** were not segregated based on the 'financial instruments' in the previous format. In the new format, all foreign assets and liabilities not only of 'commercial banks' but also of 'licensed specialised banks' and 'licensed finance companies' are included as 'deposit-taking corporations', under the appropriate financial instrument. Consequently, net transactions in foreign financial assets and liabilities of 'deposit taking corporations' are classified as 'loans', 'debt securities', 'currency and deposits' or 'other accounts receivable/ payable' based on the appropriate financial instrument classification.

e) **'Monetary movements'** which are classified as a separate category under the previous format included transactions of 'reserve assets' and 'reserve related liabilities' managed by the Central Bank. In the new format **'monetary movements'** are incorporated into the Financial Account, with foreign financial assets managed by the Central Bank being included separately as 'reserve assets', while foreign financial liabilities of the Central Bank are recorded under the appropriate financial instrument, namely, deposit liabilities with international organisations under 'currency and deposits', credit and loans with the IMF under 'loans' and other receivables and payables under 'other accounts receivable/payable' (e.g., Asian Clearing Union liabilities under 'other accounts payable').

Changes derived from the BPM6 to each component of the Financial Account are described in detail in Box Article No. 7 on 'International Investment Position of Sri Lanka' of this Annual Report.

5.4.2 Primary Income

The higher interest payments on outstanding loans of the banking and private sector and government securities resulted in a significant increase in the primary income account deficit.[2] The deficit in the primary income account increased from US dollars 1,219 million in 2012 to US dollars 1,817 million in 2013. Income earned on the investment of reserves of the Central Bank (excluding trading profits) remained largely unchanged at US dollars 91 million in 2013 compared to US dollars 90 million in 2012. Income earned on commercial bank assets classified under other investments in the primary income account, marginally declined to US dollars 20 million in 2013 from US dollars 23 million in 2012. Interest earned on the assets of the Central Bank and commercial banks remained at relatively low levels during both 2012 and 2013 due to the low interest rates that prevailed in the global financial markets.

Outflows in the primary income account recorded a significant increase primarily due to higher interest payments on outstanding debt. Interest payments on long term borrowings by the government, banking sector, private sector, state owned enterprises and the Central Bank (interest payments to the IMF on account of the Stand-by Arrangement (SBA) programme), which are classified under 'other investment' in the primary income account recorded an increase of 16.2 per cent from US dollars 473 million in 2012 to US dollars 550 million in 2013. Further, interest expenses in terms of coupon payments for outstanding government securities, classified under 'portfolio investment' increased from US dollars 408 million in 2012 to US dollars 576 million in 2013, primarily due to higher interest payments on government Treasury bonds and international sovereign bonds. Meanwhile, dividend payments to direct investors by Sri Lankan companies and reinvested earnings[3] which represent outflows relating to direct investment were US dollars 422 million and US dollars 352 million, respectively, in 2013. Higher level of dividend payments as well as a higher portion of reinvested earnings compared to 2012 reflect increased profits in Direct Investment Enterprises (DIEs). A higher proportion of reinvested earnings is also an indication of the positive outlook that prevailed in the economy.

2 With the adoption of the BPM6 presentation format, the 'Income Account' of the previous format is replaced by the 'Primary Income Account'. The Primary Income Account now excludes all valuation changes (e.g. trading profits of Central Bank reserves) that were included in the previous format.

3 Considered as an outflow in the primary income account and as an inflow in the foreign direct investment in the financial account.

5.4.3 Secondary Income

Inflows to the secondary income account,[4] which consist of workers' remittances and general government transfers, increased by 6.5 per cent to US dollars 6,428 million in 2013, compared to US dollars 6,038 million in 2012. Workers' remittances, which account for over 99 per cent of total inflows to the secondary income account mainly contributed to the improvement in 2013. Accordingly, workers' remittances which increased by 7.0 per cent to US dollars 6,407 million in 2013 from US dollars 5,985 million in 2012, has become a steady source of foreign exchange to the country. Increased labour migration under professional and skilled categories, more facilities and awareness on remitting money through formal channels as well as the introduction of new web based money transferring systems were the main factors that contributed to the increase in workers' remittances. The number of migrant workers leaving for foreign employment increased by 3.8 per cent to 293,105 in 2013, from 282,447 in 2012, while workers leaving for foreign employment under skilled and professional categories increased by 24.6 per cent in 2013.

5.5 Current Account Balance

The current account deficit decreased substantially to US dollars 2,607 million in 2013 from US dollars 3,982 million in 2012, mainly due to the contraction in the trade deficit, a substantial increase in workers' remittances and enhanced earnings from tourism. Although the trade deficit widened during the first half of 2013 compared to the corresponding period of 2012, an increase in global demand due to the gradual recovery in the main export destinations and a sharp decline in expenditure on imports particularly due to reduced petroleum imports resulted in a significant improvement in the trade balance during the second half of the year. Workers' remittances together with earnings from tourism cushioned the trade deficit substantially, thereby narrowing the deficit in the external current account in 2013. Accordingly, the current account deficit declined to 3.9 per cent of GDP in 2013 from 6.7 per cent of GDP in 2012, reducing the savings-investment gap as a percentage of GDP by 42 per cent.

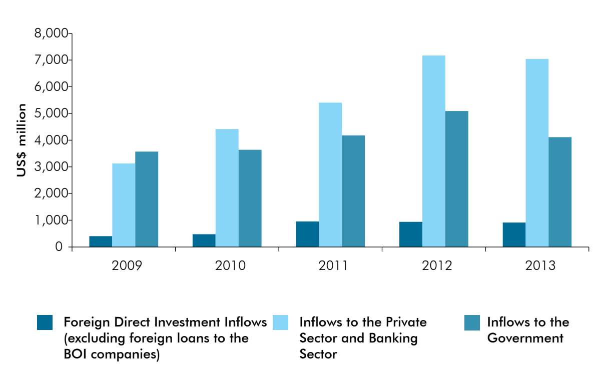
5.6 Capital Account Balance

Lower inflows of capital transfers reduced the balance in the capital account. The capital account recorded a net inflow of US dollars 71 million in 2013 compared to US dollars 130 million in 2012. A large part of inflows to the capital account was in the form of capital grants received by the government. As Sri Lanka graduated to a lower middle income country the level of capital grants has declined. With the significant reduction in the current account deficit, the balance in the current and capital account recorded a lower deficit of US dollars 2,536 million in 2013 compared to US dollars 3,851 million in 2012.

5.7 Financial Account

Significant inflows to the financial account were observed during 2013. With the adoption of the BPM6 compilation methodology, the financial account also captures reserve asset transactions in addition to direct investment, portfolio investment, financial derivatives and other

Chart 5.11 Inflows to the Financial Account



4 Secondary Income is a new terminology introduced in the BPM6 format which replaces the 'Current Transfers Account' in the previous format.

investment. Significant foreign currency inflows to the government, banking and private sectors in the form of foreign loans, proceeds from issuance of debt securities and direct investment sustained the inflows to the financial account resulting in a net incurrence of liabilities of US dollars 4,081 million in 2013, which was however lower than US dollars 5,440 million recorded in 2012. Meanwhile, the net acquisition of financial assets declined by 18.8 per cent to US dollars 955 million in 2013 from US dollars 1,177 million in 2012, primarily due to a decrease in currency and deposits held by the banking sector, despite a significant increase in reserve asset transactions.

5.7.1 Direct Investment

Foreign direct investment (FDI) remained strong in 2013 with the gradual recovery in the global economy and improved investor sentiment underpinned by a stable macroeconomic environment. Total direct investment[5] during 2013 amounted to US dollars 916 million, compared to US dollars 941 million in 2012. Total direct investment comprised US dollars 887 million received by BOI companies, US dollars 22 million received by non-BOI companies and US dollars 7 million received by CSE listed companies not registered with the BOI. In addition to the direct investment amounting to US dollars 887 million in 2013, the BOI companies also received foreign loans amounting to US dollars 505 million, thereby increasing the FDI received by BOI companies including loans, from US dollars 1,279 million in 2012 to US dollars 1,391 million in 2013. These inflows contained equity capital of US dollars 16 million, loans and advances by shareholders of US dollars 370 million, inter-company borrowings of US dollars 150 million, reinvestment of retained earnings of US dollars 350 million and foreign loans of US dollars 505 million. Consequently, total

5 If a foreign investor owns over 10 per cent or more voting shares in a Sri Lankan company, any such foreign investment is categorised as direct investment as per the BPM6. Further, foreign loans received by Direct Investment Enterprises (DIEs) from any non-related source are excluded from FDI and recorded under loans.

Table 5.8.A Financial Account (BPM6 Presentation Format)

US$ million

Item	2012 (a)		2013 (b)	
	Net acquisition of financial assets	Net incurrence of financial liabilities	Net acquisition of financial assets	Net incurrence of liabilities
Financial Account	1,177	5,440	955	4,081
Direct Investment	64	941	65	916
Equity and investment fund shares	64	360	65	373
Equity other than reinvestment of earnings	64	111	65	23
Direct investor in direct investment enterprise	64	111	65	23
BOI companies	-	12	-	16
CSE companies (not registered with the BOI)	-	33	-	7
Other companies	-	67	-	-
Reinvestment of earnings	-	249	-	350
Debt instruments	-	581	-	542
Direct investor in direct investment enterprise	-	581	-	542
BOI companies	-	581	-	518
Shareholder advances	-	364	-	370
Inter-company borrowings	-	217	-	150
CSE Companies (not registered with the BOI)	-	-	-	22
Portfolio Investment	-10	2,116	...	2,106
Equity and investment fund shares	-	272	-	263
CSE companies (not registered with BOI)	-	272	-	263
Debt securities	-10	1,844	...	1,843
Deposit-taking corporations	-10	500	...	1,350
Long term	-10	500	...	1,350
General government	-	1,343	-	493
Short term (Treasury bills)	-	38	-	-80
Long term	-	1,306	-	572
Treasury bonds	-	806	-	572
Sovereign bonds	-	500	-	-
Financial Derivatives	-	-	-	-
Other Investment	363	2,384	-222	1,060
Currency and deposits	162	447	-459	108
Central bank	-	-24	-	-199
Short term	-	-	-	-200
Long term	-	-24	-	1
Deposit-taking corporations	162	471	-459	307
Short term	52	471	-221	307
Long term	110	-	-238	-

Continued on page 147

Memorandum items				
Total net inflows to the CSE		**305**		**270**
Direct investment		33		7
Portfolio investment		272		263
Net investments in Treasury bills and bonds (excluding sovereign bonds)		**843**		**493**
Foreign purchases		2,236		2,434
Foreign sales		1,393		1,941

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

FDI including foreign loans amounted to US dollars 1,421 million in 2013, compared to US dollars 1,382 million in 2012. As a percentage of GDP, total direct investment including foreign loans to BOI companies stood at 2.1 per cent in 2013.

Infrastructure and manufacturing sectors attracted the highest FDI inflows in 2013. The share of FDI inflows into infrastructure amounted to 56.5 per cent of total FDIs with major investments in telephone and telecommunication networks, housing and property development and ports and container terminals. The manufacturing sector attracted 25.9 per cent of the total FDI, with major investments in textiles, wearing apparels and leather products, rubber products and chemical, coal and petroleum industries. Meanwhile, the services sector attracted 17.0 per cent of the total FDI in 2013, with the continuous expansion of the tourism industry and increased emphasis on foreign investment in education, communication and information technology sectors. FDI outflows were US dollars 65 million in 2013 compared to US dollars 64 million in 2012. Reflecting the significant potential for realising new FDI, the investment commitment of contracted projects increased by 15.3 per cent in 2013 compared to 2012. Further, the projects in the pipeline for 2014 too increased compared to projects that were in the pipeline for 2013.

5.7.2 Portfolio Investment

Equity and Investment Fund Shares

Inflows in the form of 'equity and investment fund shares' showed greater resilience in 2013. Total foreign investments in the CSE were US dollars 270 million, of which US dollars 263 million were in the form of equity and investment fund shares,[6] while US dollars 7 million were in the form of direct investment. Net inflows from equity and investment fund shares to the CSE comprised secondary market transactions amounting to US dollars 172 million and inflows to the primary market of US dollars 91 million. Inflows to the primary market mainly consisted of inflows from rights issues amounting to US dollars 83 million.

Debt Securities

Substantial inflows were received to the financial account from the issuance of debt securities by the government and the banking sector. Strengthening the position of the Sri Lankan banking sector in the international securities market, a licensed commercial bank (LCB) and two licensed specialised banks (LSBs) issued US dollars 1.35 billion worth of international securities in 2013 compared to US dollars 500 million issued in 2012. This included issuance of 5 year international bonds amounting to US dollars 750 million by National Savings Bank (NSB), US dollars 500 million by Bank of Ceylon (BOC) and US dollars 100 million by the Development Finance Corporation of Ceylon (DFCC). Meanwhile, net foreign investments in Treasury bills and bonds reached the full utilisatiion of the investment threshold for foreign investments in government securities in 2013 resulting in a net inflow of US dollars 493 million.

5.7.3 Other Investment

Currency and Deposits

Transactions of currency and deposits related assets decreased while liabilities increased in 2013. Currency and deposits recorded a net decrease in assets of US dollars 459 million compared to a net increase of US dollars 162 million in 2012, due to a significant decrease in the currency and deposits asset position of deposit taking corporations. Further, currency and deposit liabilities recorded a net increase of US dollars 108 million in 2013 as a result of a reduction in the liabilities of the Central Bank by US dollars 199 million (primarily due to a repayment of an international currency swap arrangement), and an increase in the liabilities of commercial banks by US dollars 307 million (primarily non-resident foreign currency account liabilities).

Loans

Foreign loan inflows continued to take place during 2013. Foreign loan inflows to the government, Central Bank, deposit taking corporations and the private sector amounted to US dollars 2,922 million in 2013 compared to US

6 Individual foreign investment of less than 10 per cent of voting shares of a Sri Lankan company is regarded as 'equity and investment fund shares' and reported under the portfolio investment category.

Table 5.8.B **Financial Account (BPM6 Presentation Format)**

US$ million

Item	2012 (a) Net acquisition of financial assets	2012 (a) Net incurrence of liabilities	2013 (b) Net acquisition of financial assets	2013 (b) Net incurrence of liabilities
Other investment (continued from page -145)				
Loans	-	3,070	-	949
Central bank	-	780	-	-453
Credit and loans with the IMF	-	780	-	-453
Deposit-taking corporations	-	579	-	124
Short term	-	-	-	-124
Long term	-	579	-	248
General government	-	992	-	821
Long term	-	992	-	821
Other sectors (c)	-	719	-	456
Long term	-	719	-	456
Trade credit and advances	90	-571	195	-54
Deposit-taking corporations	-24	-	15	-
Short term	-24	-	15	-
Other sectors (d)	114	-571	180	-54
Short term	114	-571	180	-54
Other accounts receivable/payable	111	-563	42	58
Central bank	-	-563	-	58
Short term (e)	-	-563	-	58
Deposit-taking corporations	111	-	42	-
Short term	111	-	42	-
Special Drawing Rights (SDRs)	-	-	-	-
Reserve Assets	**760**		**1,112**	
Monetary gold	178		351	
Special Drawing Rights	-0.5		12	
Reserve position in the IMF	-		-	
Other reserve assets	583		749	
Currency and deposits	-801		1,297	
Claims on monetary authorities	-817		1,462	
Claims on other entities	15		-165	
Securities	1,384		-548	
Debt securities	1,384		-548	
Long term	1,384		-548	
Financial Account (net)	**4,263**		**3,126**	
Memorandum items				
Long term loans to the government (net)		**992**		**821**
Inflows (disbursements)		1,854		1,677
Repayments		862		856

(a) Revised
(b) Provisional
(c) Include State Owned Enterprises (SOEs) and private sector companies.
(d) Include trade credit of the Ceylon Petroleum Corporation and other private companies.
(e) Net transactions of ACU liabilities

Source: Central Bank of Sri Lanka

dollars 4,234 million in 2012. As a result of higher debt repayments due to IMF-SBA payments and private sector loan repayments, net increase of total loans in the financial account amounted to US dollars 949 million in 2013, which was significantly less compared to the net increase of US dollars 3,070 million in 2012. Of the total foreign loans received, 90 per cent were in the form of long term borrowings. Total loan inflows to the government amounted to US dollars 1,677 million in 2013, compared to US dollars 1,854 million in 2012. On a net basis, loan inflows to the government declined by 17.2 per cent to US dollars 821 million in 2013 compared to US dollars 992 million in 2012. Of the total loan inflows to the government, US dollars 1,451 million were obtained under concessional terms and conditions while US dollars 226 million were obtained as non-concessional loans, commercial loans and export credits. In term of receipts to the Central Bank, a net outflow of US dollars 453 million was recorded in 2013 compared to a net inflow of US dollars 780 million in 2012, which was mainly due to repayments of the IMF-SBA programme in 2013.

Foreign borrowings of deposit taking corporations recorded a net inflow during the year. Net loan inflows of deposit taking corporations, which consist of LCBs, LSBs and licensed finance companies (LFCs) were US dollars 124 million, which were notably less than US dollars 579 million recorded in 2012. The reduction in borrowings in 2013 was mainly a result of more deposit taking corporations opting for long term financing by issuing debt securities. Of the net borrowings of deposit taking corporations, US dollars 225 million and US dollars 23 million were long term borrowings by LCBs and LSBs, respectively, while short term borrowings of LCBs and LSBs decreased by US dollars 124 million in total in 2013. Loan inflows to the private sector and state owned enterprises (SOEs) were US dollars 1,120 million in 2013 compared to US dollars 964 million in 2012. This consisted of US dollars 425 million received by SOEs and US dollars 695 million received by the private sector. Of the total loans received by the private sector, US dollars 505 million were to companies registered with the BOI. Major loan inflows to the private sector were to companies in port related services, telecommunications services, finance and leasing services and the manufacturing sector. Inflows to SOEs in 2013 included US dollars 125 million to Lanka Coal Company Limited for the Puttalam Coal Power project, US dollars 26 million to Airport and Aviation Services (Sri Lanka) Limited for the Mattala Rajapaksa International Airport project and US dollars 275 million to the Sri Lanka Ports Authority for Phase II of the Magam Ruhunupura Mahinda Rajapaksa Port. Further, 8 private sector companies were granted approval by the Central Bank to raise long term debt during 2013. Despite higher inflows in 2013, a significant increase in repayments resulted in a decrease in net long term borrowings of the private sector and SOEs. Consequently, net loan inflows to the private sector and SOEs were US dollars 456 million in 2013, compared to US dollars 719 million in 2012.

Trade Credit and Other Accounts Receivable/Payable

Trade credit receivable increased while trade credit payable decreased during 2013. Net trade credit given to non-resident enterprises recorded an increase of US dollars 195 million, while net trade credit received by Sri Lankan companies decreased by US dollars 54 million in 2013. The decrease in net trade credit received was primarily due to higher settlement of petroleum importation bills by the Ceylon Petroleum Corporation (CPC). Further, other accounts payable, which are primarily Asian Clearing Union (ACU) liabilities managed by the Central Bank recorded a net increase of US dollars 58 million in 2013, while other accounts receivable, which are receivables to LCB's offshore banking units (OBUs) recorded an increase of US dollars 42 million, in 2013.

5.7.4 Reserve Assets

Transactions in reserve assets registered a net increase in 2013. Increase in reserve assets included increases in currency and deposits, monetary gold, special drawing rights amounting to US dollars 1,297 million, US dollars 351 million and US dollars 12 million, respectively. Meanwhile, the fixed income securities held by the Central Bank recorded a net sale of US dollars 548 million in 2013 compared to a net purchases of US dollars 1,384 million in 2012. Higher levels of net sales of fixed income securities primarily resulted in a significant increase in currency and deposits held by the Central Bank recording an increase of US dollars 1,297 million in 2013, compared to a decrease of US dollars 801 million in 2012.

Table 5.9 Major Projects Financed with Foreign Borrowings during 2013

Lender and Project	Amount Disbursed US$ million
The Export-Import Bank of China	**810**
of which;	
Hambantota Port Development Project - Phase II	236
Puttalam Coal Power Project - Phase II	110
Matara Kataragama Railway Extension Project	85
Supply of 13 Nos. Diesel Multiple Units to Sri Lanka Railway Project	43
Asian Development Bank	**279**
of which;	
Conflict-Affected Region Emergency Project	41
Northern Road Connectivity Project	35
Clean Energy and Access Improvement Project	25
National Highways Sector Project (Additional Finance)	24
Education Sector Development Program	20
Government of Japan	**265**
of which;	
Greater Colombo Urban Transport Development Project-Phase II	93
Greater Colombo Transport Development Project	26
Provincial/Rural Road Development Project (Central Province and Sabaragamuwa Province)	22
Water Sector Development Project-Phase II	17
Emergency Natural Disaster Rehabilitation Project	17
Government of India	**189**
of which;	
Railway Line Omanthai-Pallai, Madhu-Tallaimannar and Medawachchiya	130
Restoration of Northern Railway Services	50
International Development Association	**171**
of which;	
Second Additional Financing for Road Sector Assistance Project	35
Provincial Roads Project	27
China Development Bank Corporation	**129**
Rehabilitation and Improvement of Priority Roads Project	105
Moragahakanda Development Project	24
Government of the Russian Federation	**65**
Russian Line of Credit	65
Rabobank of Netherlands	**55**
of which;	
Upgrading of the National Blood Transfusion Services of Sri Lanka	18
Development of Hambantota District General Hospital	16
Government of the Republic of Korea	**36**
of which;	
Ruhunupura Water Supply Development Project	15
International Bank for Reconstruction and Development	**32**
Metro Colombo Urban Development Project	32

Source: External Resources Department of Ministry of Finance and Planning

5.8 Balance of Payments

The external sector strengthened in 2013 resulting in a higher BOP surplus. Significant improvement in the current account and substantial inflows to the financial account contributed to a larger surplus in the overall balance. Accordingly, the BOP recorded a surplus of US dollars 985 million in 2013 compared to a surplus of US dollars 151 million in 2012.

5.9 International Investment Position (IIP)

The IIP shows the value and the composition of external financial assets and liabilities of a country vis-à-vis the rest of the world at the end of a particular period. As at end 2013, Sri Lanka's total foreign assets recorded an outstanding value of US dollars 9.4 billion, an increase of 2.5 per cent compared to US dollars 9.2 billion at end 2012. Almost 80 per cent of Sri Lanka's assets with non-residents were in the form of reserve assets held by the Central Bank, while other deposit taking corporations held around 11 per cent of total assets. Meanwhile, significant increases in inflows of foreign investments, which are liabilities in the context of the IIP, resulted in an increase in foreign liabilities to an outstanding position of US dollars 48.7 billion, a 6.8 per cent increase from the previous year. In terms of the total liability position of Sri Lanka, around 50 per cent was in the form of loan liabilities, while 22 per cent and 18 per cent were on account of portfolio investment and direct investment, respectively. Consequently, the net IIP of Sri Lanka as at end 2013 recorded a net liability position of US dollars 39.3 billion, compared to a net liability position of US dollars 36.4 billion in 2012.

5.9.1 Direct Investment Position

Significant inflows of direct investment resulted in an increase in the FDI stock position as at end 2013. Continuous foreign exchange inflows from direct investment by non-resident

Table 5.10 International Investment Position (BPM6 Presentation Format)

US$ million (end period position)

Item	2012 (a)		2013 (b)	
	Assets	Liabilities	Assets	Liabilities
Direct Investment (c)	**475**	**8,087**	**540**	**8,987**
Equity and investment fund shares	472	6,311	537	6,670
Debt Instruments	3	1,776	3	2,318
Portfolio Investment	**0.3**	**9,242**	**...**	**10,725**
Equity and investment fund shares	-	2,188	-	2,293
Other sectors	-	2,188	-	2,293
Debt securities (d)	0.3	7,055	...	8,432
Deposit-taking corporations	0.3	542	...	1,954
Long term	-	542	-	1,954
General government	-	6,508	-	6,479
Short term	-	576	-	507
Long term	-	5,932	-	5,971
Financial Derivatives	-	-	-	-
Other Investment	**1,611**	**28,273**	**1,390**	**28,991**
Currency and Deposits	**741**	**1,778**	**283**	**1,886**
Central bank	-	205	-	6
Short term	-	5	-	6
Long term	-	200	-	-
Deposit-taking corporations	741	1,574	283	1,880
Short term	467	1,574	246	1,880
Long term	274	-	37	-
Loans	**-**	**23,749**	**-**	**24,355**
Central bank	-	2,510	-	2,056
Credit and loans with the IMF	-	2,510	-	2,056
Deposit-taking corporations	-	2,800	-	2,924
Short term	-	2,127	-	2,003
Long term	-	673	-	921
General government	-	15,616	-	15,806
Long term	-	15,616	-	15,806
Other sectors (e)	-	2,823	-	3,570
Long term	-	2,823	-	3,570
Trade Credit and Advances	**234**	**1,910**	**429**	**1,856**
Deposit-taking corporations	103	-	118	-
Short term	103	-	118	-
Other sectors (f)	132	1,910	312	1,856
Short term	132	1,910	312	1,856
Other Accounts Receivable/Payable	**635**	**228**	**678**	**285**
Central bank (g)	-	228	-	285
Short term	-	228	-	285
Deposit-taking corporations	635	-	678	-
Short term	635	-	678	-
Special Drawing Rights (SDRs)	**-**	**608**	**-**	**609**
Reserve Assets	**7,106**	**-**	**7,495**	**-**
Monetary gold	727	-	884	-
Special Drawing Rights	4	-	16	-
Reserve position in the IMF	74	-	74	-
Other reserve assets	6,301	-	6,522	-
Currency and deposits	2,012	-	3,309	-
Claims on monetary authorities	1,381	-	2,843	-
Claims on other entities	631	-	465	-
Securities	4,290	-	3,213	-
Debit Securities	4,290	-	3,213	-
Total Assets / Liabilities	**9,193**	**45,602**	**9,425**	**48,704**
Net International Investment Position		**-36,409**		**-39,279**
Memorandum Items				
IIP- Maturity-wise breakdown				
Short term	4,149	5,843	5,619	6,030
Long term	5,039	29,073	3,802	31,321

(a) Revised
(b) Provisional
(c) Include direct investment position of BOI, CSE and other private companies
(d) Foreign currency debt issuances are based on market value while domestic currency issuances are based on book value.
(e) Include loans outstanding position of project loans obtained by State Owned Enterprises (SOEs) .
(f) Include outstanding trade credit position of the Ceylon Petroleum Corporation and the private sector companies.
(g) Outstanding position of ACU liabilities managed by the Central Bank

Source: Central Bank of Sri Lanka

BOX 7 International Investment Position of Sri Lanka

Introduction

The International Investment Position (IIP) is a statistical statement that shows the value and the composition of financial assets of residents of Sri Lanka that are claims on non-residents, and liabilities of Sri Lankan residents to non-residents at a particular point in time. Sri Lanka's IIP is compiled and presented according to the guidelines of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6), published by the International Monetary Fund (IMF). With the publication of the IIP, Sri Lanka fulfills another requirement of Special Data Dissemination Standard (SDDS), which is an improved data dissemination methodology introduced by the IMF and adopted by many countries that seek more access to international capital markets.

Composition of International Investment Position

Sri Lanka's IIP is mainly published on a functional category basis, following the standard presentation format. The main functional categories include direct investment, portfolio investment, financial derivatives, other investment and reserve assets. Each functional category, in turn, consists of one or more financial instruments in the form of equity and investments fund shares, debt instruments and other financial assets and liabilities. Each financial instrument is further categorised based on the resident institutional sector, comprising the Central Bank, general government, deposit-taking corporations except the Central Bank (which include, in the Sri Lankan context, licensed commercial banks (LCBs), licensed specialised banks (LSBs) and licensed finance companies (LFCs)) and other sectors (comprising households, financial and non-financial corporations and non-profit institutions).

Further, all assets and liabilities are classified based on the maturity of the financial instrument, where assets and liabilities with the original maturity less than one year being classified as short term, and those with original maturity more than one year being classified as long term. Sri Lanka's IIP position as it stands at end 2013 and 2012 in the standard functional category basis is given in Table 5.10.

Main Functional Categories of the IIP

Direct Investment: As per the BPM6 standard definition, a direct investor is a non-resident investor who has invested in more than 10 per cent of the voting equity shareholding in a Sri Lankan enterprise. The international benchmark of 10 per cent has been adopted, as an investment above 10 per cent can be considered to give the non-resident direct investor a significant degree of influence in the management of the local enterprise. With the initiation of the BPM6 format, a standard benchmark definition is used to demarcate between direct investment and portfolio investment, whereby inflows to the Colombo Stock Exchange (CSE) is reclassified based on the equity shareholding percentage of each individual foreign investor in a company listed in the CSE. Furthermore, total inflows to BOI companies, which include foreign loans received in addition to direct investment, are recorded as a memorandum item due to their importance as a specific foreign exchange inflow in the Sri Lankan context.

Portfolio Investment: Portfolio investment consist of foreign investments in equity and investment fund shares and foreign investment in debt securities issued by Sri Lankan residents. The stock position of portfolio investment is obtained after deducting direct investment flows to CSE companies from the total foreign investment stock position as published by the CSE. Portfolio transactions include secondary market transactions in the CSE, foreign investment in initial public offerings (IPOs), rights issues and other non-voting shares. Liabilities in the form of debt securities are securities issued by the government and securities issued by deposit taking corporations except the Central Bank. All debt securities are accounted based on market price, as per the recommendation of the BPM6 and the face value of which are separately provided under memorandum items. The short and long term nature of debt securities is based on the original maturity and consequently only Treasury bills issued by the government to non-resident investors are considered short term.

Other Investment: Other Investment is a broad category which includes other equity, currency and deposits, loans, trade credits and advances, other accounts receivable and payable and Special Drawing Rights (SDRs). Assets and liabilities in the form of currency and deposits are assets and liabilities of the Central Bank and other deposit taking corporations. Outstanding foreign asset and liability positions of LCBs is obtained from the Monetary Survey while outstanding foreign asset and liability position of LSBs and LFCs are obtained from the Financial Survey conducted by the Central Bank of Sri Lanka (CBSL).

Loans outstanding, which form more than 50 per cent of Sri Lanka's total liability position, consist of loan liabilities of the CBSL, deposit-taking corporations, the government as well as the private sector. All outstanding loan liabilities of the Central Bank are in the form of outstanding liabilities to the IMF, while government loans comprise concessional and non-concessional project loans received by the government from foreign sources. Outstanding loans classified under 'other sectors' include corporate borrowings from the private sector and state owned enterprises (SOEs).

Trade credits given to non-residents by Sri Lankan companies and export bills discounted by LCBs, fall under assets in the form of trade credits, while trade credits received by Sri Lankan residents, the major portion of which is outstanding trade credit position of the Ceylon Petroleum Corporation (CPC), are classified under liabilities in the form of trade credits. Trade credit positions of private sector corporations are obtained from the Annual International Investment Survey (AIIS) conducted by the CBSL, while the CPC data are obtained on a quarterly basis.

The asset position of other accounts receivable is primarily short term assets of commercial banks on international trade transactions, while the liability position of the same is outstanding payables on account of Asian Clearing Union (ACU) settlements, transactions of which are managed by the CBSL.

SDRs are reserve assets introduced by the IMF and allocated to member countries to supplement existing official reserves. According to the BPM6, allocation of SDRs is recorded as an incurrence of a liability of the member country receiving them (due to the remote possibility of repaying the allocation in certain circumstances). All countries were allocated SDRs in 2009, and consequently, Sri Lanka's outstanding SDR allocation stood at US dollars 609 million as at end 2013.

Reserve Assets

The reserve asset position of a country represents external assets that are readily available and controlled by the monetary authority for meeting balance of payments requirements, for intervention in the foreign exchange market to prevent excessive volatility in the exchange rate, for maintaining the confidence in the currency and the economy, and serving as a basis for foreign borrowing. With the introduction of the BPM6 reporting format, the CBSL's previous practice of reporting reserve assets 'with' and 'without' ACU liabilities has been discontinued from January 2014 onwards and all financial instruments that fall within the IMF definition of reserve assets are included. Further, the term 'Total International Reserves' which consisted of reserve assets managed by the Central Bank as well as foreign financial assets of deposit-taking corporations will be replaced with the term 'Total Foreign Assets'.

Reference: Balance of Payments and International Investment Position Manual – Sixth Edition (BPM6), International Monetary Fund, 2009.

investors, particularly from 2009 onwards, resulted in the increase in outstanding liability position of direct investment to US dollars 8,987 million as at end 2013 from US dollars 8,087 million as at end 2012. Of the total direct investment liability position, 74 per cent was in the form of equity, while 26 per cent was in the form of debt as intra company borrowings and shareholders' advances. The outstanding stock of direct investors listed in the CSE witnessed a significant market price gain, resulting in an increase in the direct investment stock position of equity held by non-residents to US dollars 6.7 billion as at end 2013. Meanwhile, direct investments abroad by Sri Lankan residents recorded an outstanding asset position of US dollars 540 million by end 2013, an increase of 13.7 per cent from the previous year. The majority of these investments were by listed Sri Lankan companies investing primarily in South East Asian countries, particularly in private listed companies in Singapore and Malaysia.

5.9.2 Portfolio Investment Position

Stock position of portfolio investment increased at the end of 2013. Outstanding position of portfolio investment, which was in the form of equity and investment fund shares and debt securities, recorded a significant increase of 16 per cent to reach US dollars 10.7 billion as at end 2013. Equity investments, which are primarily foreign investments of less than 10 per cent in a Sri Lankan company listed in the CSE by any individual non-resident shareholder amounted to US dollars 2.3 billion, compared to US dollars 2.2 billion by end 2012. This increase was primarily due to valuation gains from the increase in the market price of shares and the increase in net transactions, reflecting enhanced investor confidence. Foreign investments in debt securities issued by the government and the banking sector recorded an outstanding of US dollars 8.4 billion as at end 2013, compared to US dollars 7.1 billion in 2012. Of the total debt securities issued by the government, 92 per cent were long term Treasury bonds and international sovereign bonds, while 8 per cent were Treasury bills. Meanwhile, the issuance of international debt securities by deposit taking co-operations amounted to US dollars 1.35 billion (face value) in 2013 resulting in an outstanding position of long term debt securities of US dollars 1.95 billion (based on market price) as at end 2013.

5.9.3 Other Investment Position

Currency and Deposits

Currency and deposits asset position declined compared to end 2012 while liability position recorded a net increase as at end 2013. Currency and deposits held by LCBs increased during 2013 to record an external asset position of US dollars 283 million as at end 2013. External liabilities outstanding in the form of currency and deposits increased from US dollars 1.8 billion in 2012 to US dollars 1.9 billion by end 2013, primarily due to an increase in currency and deposit liabilities of the banking sector, as liabilities of the Central Bank remained unchanged.

Loans

Net increase in foreign loan inflows to the government, deposit-taking corporations and the private sector resulted in the increase in outstanding foreign loan liability position as at end 2013. Foreign loan liabilities which account for more than 50 per cent of the total international liability position, increased by 2.6 per cent to reach US dollars 24.4 billion as at end 2013 compared to US dollars 23.7 billion as at end 2012. Out of this, US dollars 15.8 billion were outstanding long term loans of the government, which recorded a marginal increase of 1.2 per cent from 2012. Meanwhile, outstanding loan liabilities of the Central Bank, deposit taking corporations except the Central Bank and the private sector (classified under other sectors) amounted to US dollars 2.1 billion, US dollars 2.9 billion and US dollars 3.6 billion, respectively, as at end 2013. All outstanding loan liabilities of the Central Bank were on account of outstanding liabilities to the IMF, primarily the outstanding liability position of the IMF-SBA programme, which is due to be repaid by 2016. Gradual relaxation of exchange control regulations effected by the Central Bank encouraged a number of private sector corporations to seek foreign financing in 2013, partly contributing to the increase in foreign borrowings by the corporate sector and SOEs which are classified under other sectors.

Trade Credit and Advances

Outstanding position of trade credit and advances granted increased while trade credit and advances received position declined as at end 2013. Trade credit and advances given by Sri Lankan companies recorded an outstanding position of US dollars 429 million as at end 2013. Meanwhile, the position of trade credit and advances received by Sri Lankan companies declined by 2.8 per cent to US dollars 1.9 billion as at end 2013. This was primarily due to the settlement of petroleum bills by the CPC, which accounted for a considerable portion of the total outstanding trade credit and advances.

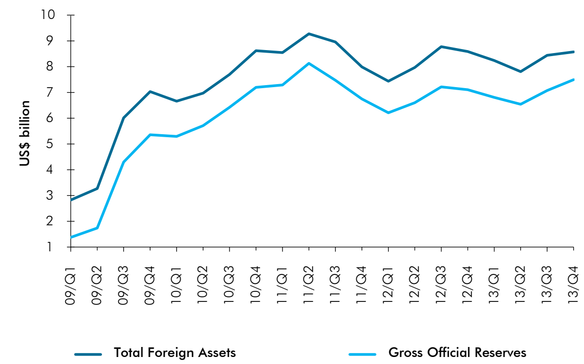
Other Accounts Receivable/Payable

Assets and liability positions of other accounts receivable and payable increased as at end 2013. The other accounts receivable which mainly included short term assets positions of commercial banks on international trade transactions, recorded an outstanding value of US dollars 678 million as at end 2013. With regard to the other accounts payable, the recorded value of US dollars 285 million as at end 2013 referred to the outstanding payables of ACU related liabilities of the Central Bank.

Special Drawing Rights

Outstanding liability position of special drawing rights (SDRs) changed slightly due to exchange rate variations at end 2013. According to the BPM6, allocation of SDRs is recorded as an incurrence of liability of the member country of the IMF (because of a requirement to repay the allocation in certain circumstances). Sri Lanka's outstanding SDR allocation was US dollars 609 million as at end 2013.

Chart 5.12 Quarterly Gross Official Reserves and Total Foreign Assets



5.9.4 Reserve Asset Position

The reserve asset position of the country, which represents external assets that are readily available to the monetary authority, stood at US dollars 7.5 billion as at end 2013. With the introduction of the BPM6 reporting format, the Central Bank's previous practice of reporting reserve assets 'with' and 'without' ACU liabilities was discontinued and reserve assets now include all financial instruments that fall within the IMF's definition of reserve assets. 'Total foreign assets' which consisted of reserve assets managed by the Central Bank as well as foreign financial assets of deposit taking corporations increased to US dollars 8.6 billion at the end of 2013. The improved reserve assets position as at end 2013 was equivalent to 5.0 months of import of goods and 4.2 months of import of goods and services, compared to the internationally accepted norm of 3 months of imports. Total foreign assets were equivalent to 5.7 months of import of goods and 4.8 months of import of goods and services. Reserve adequacy in terms of short term debt and liabilities was 63 per cent by end 2013, declining from 64 per cent in 2012 mainly due to an increase in short-term liabilities in the banking sector. Meanwhile, gross official reserves to short term debt excluding Treasury bonds increased to 85 per cent by end 2013 from 83 per cent at end 2012.

Table 5.11 Gross Official Reserves and Total Foreign Assets of Sri Lanka

(End period position)

	US$ million					Rs. million				
	2009	2010	2011	2012	2013 (a)	2009	2010	2011	2012	2013 (a)
1. Government	113	88	615	631	465	12,920	9,747	70,088	80,209	60,857
2. Central Bank	5,244	7,109	6,134	6,475	7,030	599,880	788,722	698,666	823,375	919,171
3. Gross Official Reserves (1+2)	5,357	7,196	6,749	7,106	7,495	612,799	798,469	768,754	903,584	980,028
4. Deposit-taking Corporations	1,673	1,424	1,241	1,480	1,078	191,373	158,031	141,394	188,195	141,008
5. Total Foreign Assets (3+4) (b)	7,030	8,621	7,991	8,586	8,574	804,173	956,500	910,148	1,091,779	1,121,036
6. Gross Official Reserves in Months of										
6.1 Import of Goods	6.3	6.4	4.0	4.4	5.0					
6.2 Import of Goods and Services	5.5	5.7	3.6	3.9	4.2					
7. Total Foreign Assets in Months of										
7.1 Import of Goods	8.3	7.7	4.7	5.4	5.7					
7.2 Import of Goods and Services	7.2	6.8	4.3	4.7	4.8					

(a) Provisional

Source: Central Bank of Sri Lanka

(b) Excludes foreign assets in the form of 'Direct investment abroad' and 'Trade credit and advances granted'.

5.10 External Debt and Debt Servicing

5.10.1 External Debt

Higher inflows to the private sector and deposit taking corporations resulted in an increase in the total external debt position as at 2013. According to BPM6 guidelines, external debt includes the outstanding position of SDRs and intercompany lending of Direct Investment Enterprises (DIEs), both of which were not reported under external debt previously. With the addition of new categories and reclassification of external debt statistics, the total external debt position of the country recorded an outstanding of US dollars 39.7 billion at end 2013, a 7.1 per cent increase from US dollars 37.1 billion recorded at end 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 per cent was in the form of outstanding loan liabilities as at end 2013, compared to 64 per cent as at end 2012. With the inclusion of new data categories in external debt statistics, total external debt as a percentage of GDP amounted to 59.2 per cent at end 2013 compared to 62.5 per cent at end 2012, reflecting the higher increase in GDP compared to the increase in external debt.

Chart 5.13 External Debt

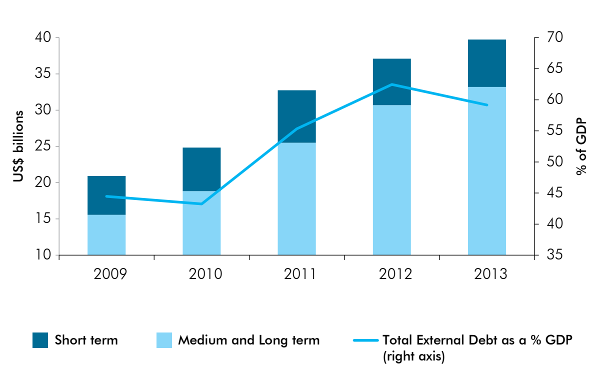


Table 5.12 Outstanding External Debt Position (BPM6 Presentation Format)

US$ million (end period position)

Item	2012(a)	2013(b)
General Government	**22,123**	**22,284**
Short term	**576**	**507**
Debt securities	576	507
Treasury bills (c)	576	507
Long term	**21,547**	**21,777**
Debt securities	5,932	5,971
Treasury bonds (c)	2,067	2,486
International sovereign bonds (d)	3,864	3,485
Loans	15,616	15,806
Central Bank	**3,550**	**2,956**
Short term	**232**	**291**
Other accounts payable	228	285
Asian Clearing Union liabilities	228	285
Currency and deposits	5	6
Long term	**3,318**	**2,665**
Special Drawing Rights (SDRs) allocation	608	609
Loans	2,510	2,056
Credit and loans with the IMF	2,510	2,056
Stand-By Arrangement (IMF-SBA Facility)	2,502	2,056
PRGF loan No. 2	6	-
Extended Fund Facility & Emergency Assistance	3	-
Currency and deposits	200	-
International currency swap arrangements (c)	200	-
Deposit-taking Corporations	**4,916**	**6,758**
Short term	**3,701**	**3,884**
Currency and deposits (e)	1,574	1,880
Commercial banks	1,574	1,880
Loans	2,127	2,003
Commercial banks	2,127	2,003
Long term	**1,215**	**2,875**
Debt securities (d)	542	1,954
Commercial banks	542	990
Other deposit-taking corporations	-	964
Loans	673	921
Commercial banks	600	825
Other deposit-taking corporations	73	96
Other Sectors (f)	**4,733**	**5,425**
Short term	**1,910**	**1,856**
Trade credit and advances (g)	1,910	1,856
Long term	**2,823**	**3,570**
Loans	2,823	3,570
Private sector corporations	806	1,194
State owned enterprises and public corporations	2,018	2,376
Direct Investment: Intercompany Lending (h)	**1,776**	**2,318**
Gross External Debt Position	**37,098**	**39,741**
As a percentage of GDP		
Gross external debt	62.5	59.2
Short term debt	10.8	9.7
Long term debt	51.7	49.4
As a percentage of gross external debt		
Short term debt	17.3	16.4
Long term debt	82.7	83.6
Memorandum items		
Debt securities-sectorwise breakdown at face value	**7,131**	**9,001**
General government	6,631	7,151
Treasury bills	631	565
Treasury bonds	2,500	3,086
International sovereign bonds	3,500	3,500
Deposit-taking corporations, except the central bank	500	1,850
Commercial banks	500	1,000
Licensed specialised banks	-	850

(a) Revised
(b) Provisional
(c) Based on book value
(d) Based on market price
(e) Include deposits of non-resident foreign currency holders
(f) Include private sector and state owned enterprises
(g) Include trade credits outstanding of the Ceylon Petroleum Corporation and private sector companies
(h) Include inter-company borrowings and shareholder advances on BOI registered companies

Source: Central Bank of Sri Lanka

Majority of Sri Lanka's total external debt was in the form of long term debt. According to the debt maturity profile, 84 per cent of external debt was categorised as long term, with a maturity of more than one year based on original maturity of debt instruments. In terms of sector-wise distribution of external debt, government debt amounted to 56 per cent of total external debt, while the outstanding debt of deposit taking corporations, other sectors (private sector and SOEs), the Central Bank and direct investment enterprises were 17 per cent, 14 per cent, 7 per cent and 6 per cent, respectively. The relaxation of exchange control regulations and more opportunities given to banks and private enterprises to raise funds abroad through issuance of corporate debt securities and long term borrowings, resulted in a significant increase in the external debt position in the banking and private sectors.

5.10.2 Foreign Debt Service Payments

Total foreign debt service payments increased in 2013. Total foreign debt service payments which consist of principal and interest payments increased by 42.8 per cent from US dollars 2,673 million in 2012 to US dollars 3,818 million in 2013. This was primarily due to an increase in capital payments by 50.2 per cent and an increase in interest payments by 27.8 per cent in 2013. Capital payments included repayment to the IMF of US dollars 453 million, repayment of government long term borrowings of US dollars of 856 million, repayment of private sector loan liabilities of US dollars 665 million and maturity of government securities of US dollars 719 million. The increase in interest payments was primarily due to the increase in interest payments on government securities. Accordingly, foreign debt

Table 5.13 External Debt Service Payments

Item	US$ million					Rs. million				
	2009	2010	2011	2012 (a)	2013 (b)	2009	2010	2011	2012 (a)	2013 (b)
1. Debt Service Payments	**2,009**	**1,853**	**1,799**	**2,673**	**3,818**	**230,616**	**208,984**	**199,305**	**334,733**	**491,888**
1.1 Amortisation	**1,652**	**1,234**	**1,092**	**1,792**	**2,692**	**189,621**	**138,941**	**121,246**	**223,061**	**346,710**
(i) To IMF	95	46	11	57	453	10,941	5,238	1,238	7,413	57,683
(ii) To others	1,557	1,188	1,081	1,735	2,239	178,680	133,703	120,008	222,973	289,026
Government, medium and long term	940	665	789	862	856	107,880	74,932	87,754	110,412	110,437
Government securities	307	92	95	628	719	35,109	10,406	10,406	80,991	92,610
Public corporations and private sector	311	431	197	245	665	35,691	48,365	21,848	31,570	85,978
1.2 Interest Payments	**357**	**619**	**707**	**881**	**1,126**	**40,995**	**70,043**	**78,059**	**111,671**	**145,178**
(i) To IMF	6	7	10	36	33	644	803	1,081	4,639	4,298
(ii) To others	351	612	697	845	1,092	40,351	69,240	76,978	107,032	140,880
Equity				437	516				55,528	66,670
Debt securities				408	576				51,415	74,210
2. Earnings from export of goods and services	**8,977**	**11,100**	**13,643**	**13,573**	**15,079**	**1,031,289**	**1,254,021**	**1,508,565**	**1,730,467**	**1,949,267**
3. Receipts from export of goods, services, income and current transfers	**12,500**	**15,592**	**19,314**	**19,754**	**21,655**	**1,436,578**	**1,761,613**	**2,135,356**	**2,519,483**	**2,798,774**
4. Debt service ratio (c)										
4.1 As a percentage of 2 above										
(i) Overall ratio	22.4	16.7	13.2	19.7	25.3	22.4	16.7	13.2	19.3	25.2
(ii) Excluding IMF transactions	21.3	16.2	13.0	19.0	22.1	21.2	16.2	13.1	19.1	22.1
4.2 As a percentage of 3 above										
(i) Overall ratio	16.1	11.9	9.3	13.5	17.6	16.1	11.9	9.3	13.3	17.6
(ii) Excluding IMF transactions	15.3	11.5	9.2	13.1	15.4	15.2	11.5	9.2	13.1	15.4
5. Government debt service payments										
5.1 Government debt service payments (d)	1,497	1,219	1,474	2,191	2,443	171,834	136,411	162,507	280,215	315,016
5.2 As a percentage of 1 above	74.5	65.8	82.0	82.0	64.0	74.5	65.3	81.5	83.7	64.0

(a) Revised
(b) Provisional
(c) Debt service ratios calculated in rupee values and US dollar values differ due to variations in exchange rates during the year.
(d) Exclude transactions with the IMF

Sources : External Resources Department
Central Bank of Sri Lanka

service payments as a percentage of export of goods and services increased to 25.3 per cent in 2013 from 19.7 per cent in 2012.

5.11 Exchange Rate Movements

Exchange rate policy in 2013 continued to maintain flexibility in the determination of the exchange rate. Since January 2013 through early June 2013, the rupee appreciated marginally by 0.55 per cent against the US dollar, while it depreciated by 5.01 per cent against the US dollar during the second week of June through end August mainly due to an increase in import demand and the expectation of unwinding by foreign investors from the government securities market in anticipation of possible tapering of the US bond buying programme. It is noteworthy that the Sri Lanka rupee was less volatile compared to other emerging market currencies such as the Indian rupee and the Indonesian rupiah and major currencies such as the Japanese yen which experienced a sharp depreciation following the US Federal Reserve Bank's announcement that it would begin scaling-down its quantitative easing programme in the near future. However, from early September, the Sri Lanka rupee began to appreciate against the US dollar supported by an increase in inflows to the banking sector, and bond issuances by NSB and DFCC, strengthening market expectations further. Overall, by end 2013, the rupee depreciated against the US dollar by 2.75 per cent to Rs. 130.75, while the annual average exchange rate against the US dollar in 2013 stood at Rs. 129.11 compared to Rs. 127.60 in 2012.

Reflecting cross currency exchange rate movements, the Sri Lanka rupee showed mixed performance against major currencies during 2013. The rupee depreciated against the pound sterling (4.69 per cent), the euro (6.83 per cent), while appreciating significantly against the Indian rupee (10.16 per cent) and the Japanese yen (18.78 per cent). The rupee depreciated against the SDR by 3.00 per cent during 2013 reflecting the movement of major currencies such as the euro, the Japanese yen and the pound sterling against the US dollar in international markets.

Table 5.14 Exchange Rate Movements

Currency	In Rupees per unit of Foreign Currency						Percentage Change over Previous Year(a)			
	End Year Rate			Annual Average Rate			End Year		Annual Average	
	2011	2012	2013	2011	2012	2013	2012	2013	2012	2013
Euro	147.42	168.13	180.45	153.86	164.01	171.51	-12.31	-6.83	-6.18	-4.37
Indian rupee	2.15	2.33	2.11	2.39	2.39	2.21	-7.45	10.16	-0.34	8.22
Japanese yen	1.47	1.48	1.25	1.39	1.60	1.32	-0.88	18.78	-13.26	20.74
Pound sterling	175.45	205.47	215.58	177.23	202.28	202.08	-14.61	-4.69	-12.38	0.10
US dollar	113.90	127.16	130.75	110.57	127.60	129.11	-10.43	-2.75	-13.35	-1.17
SDR	174.87	195.31	201.36	174.54	195.38	196.19	-10.47	-3.00	-10.67	-0.42
Effective Exchange Rate Indices(b) (c) (2010=100)	End Year Index			Annual Average Index			Percentage Change over Previous Year			
							End Year Index		Annual Average Index	
	2011	2012	2013	2011	2012	2013	2012	2013	2012	2013
NEER 24-currencies	101.44	90.33	90.97	99.84	90.44	91.39	-10.95	0.71	-9.41	1.05
REER 24-currencies	103.83	97.85	100.31	101.84	95.80	100.61	-5.76	2.51	-5.93	5.02

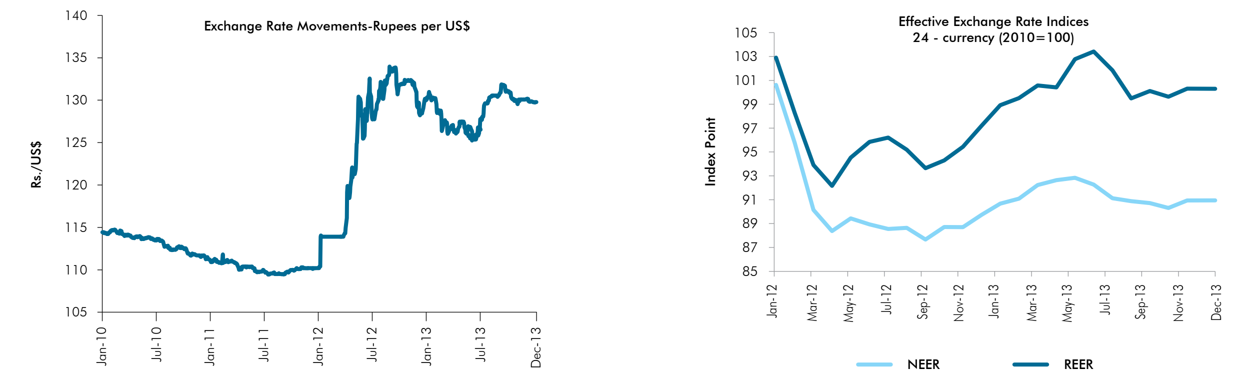
(a) Changes computed on the basis of foreign currency equivalent of Sri Lanka rupees. The sign +/- indicates appreciation/depreciation of Sri Lanka rupee against each currency, respectively.

(b) The Nominal Effective Exchange Rate (NEER) is a weighted average of nominal exchange rates of 24 trading partner and competitor countries. Weights are based on the trade shares reflecting the relative importance of each currency in each of the currency baskets. The Real Effective Exchange Rate (REER) is computed by adjusting the NEER for inflation differentials with respect to each currency in the basket. A minus sign indicates depreciation. CCPI was used for REER computation.

(c) The exchange rates have been defined in terms of indices so that the appreciation/depreciation of the rupee relative to other currencies is directly reflected by a rise/fall in the values of the effective exchange rate indices, respectively.

Source: Central Bank of Sri Lanka

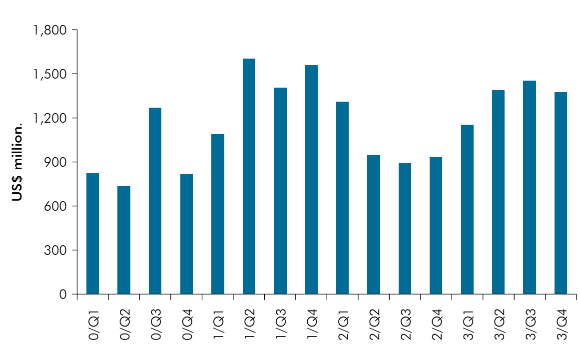
Chart 5.14 Exchange Rate Movements



5.11.1 Nominal and Real Effective Exchange Rates

During 2013, effective exchange rate indices witnessed a modest appreciation compared to the depreciation observed in 2012. Except for the Nominal Effective Exchange Rate (NEER) based on the 5-currency basket, all other indices namely, the NEER based on the 24-currency basket and the Real Effective Exchange Rates (REER) based on the 5-currency basket and the 24-currency basket, appreciated at a moderate rate. Despite the substantial nominal appreciation of the Sri Lanka rupee against the Japanese yen and the Indian rupee, the depreciation of the Sri Lanka rupee against other currencies in the basket, namely, the US dollar, the pound sterling and the euro, resulted in a marginal depreciation of the NEER based on the 5-currency basket by 0.07 per cent. However, the NEER based on the nominal exchange rates of 24 trading partners and competitors appreciated by 0.71 per cent. As a result of the higher nominal appreciation of the Sri Lanka rupee against some international currencies and the relatively higher domestic inflation compared to that of trading partners and competitors, the REER based on both the 5-currency and the 24-currency baskets appreciated by 1.88 per cent and 2.51 per cent, respectively, during 2013.

Chart 5.15 Quarterly Inter- Bank Forward Transaction Volumes



5.11.2 Developments in the Domestic Foreign Exchange Market

In 2013, the domestic foreign exchange market recorded mixed performance compared to the contraction observed in 2012. The total volume of spot transactions declined to around US dollars 8,332 million in 2013 (61 per cent of total transactions) compared to US dollars 9,331 million recorded in 2012, primarily due to the slowdown in external trade activity as a result of weak global demand, especially in the early part of the year. However, total volume of forward transactions increased to US dollars 5,373 million in 2013 from US dollars 4,089 million in 2012. Overall, the volume of total inter-bank foreign exchange transactions increased, albeit marginally, to US dollars 13,706 million during 2013 from US dollars 13,420 million during 2012. The Central Bank intervention in the domestic foreign exchange market was limited only to the extent needed to address significant volatility in the exchange rate. During the year 2013, Central Bank intervention recorded a net absorption of US dollars 436 million compared to the net supply of US dollars 1,166 million recorded in 2012. This was the combined outcome of the Central Bank absorbing US dollars 1,139 million from the domestic foreign exchange market, while supplying US dollars 703 million to the market during 2013.

The forward premia for three month and six month contracts remained lower than the interest rate differential, on average, in 2013. From mid-June, the forward premia started to increase in response to the depreciation of the Sri Lanka rupee against the US dollar. However, from end August 2013, the forward premia for three month and six month contracts decreased with the expectation of future inflows to the domestic foreign exchange market. Further, the forward premia remained lower than the interest rate differential reflecting the market's expectation of an appreciation of the rupee in the near-term. Meanwhile, commercial banks have maintained the net open positions (NOP) at minimum but positive levels, on average, during 2013. However, since end September towards end 2013, the NOP turned negative, on average, indicating market expectations of a further appreciation of the rupee in the near-term.