

BUFF/11/53

April 5, 2011

**The Acting Chair's Summing Up
Sri Lanka—Sixth Review Under the Stand-By Arrangement and
Requests for Waivers of Applicability, Modification of the Arrangement Period,
and Rephasing of Purchases
Executive Board Meeting 11/33
April 4, 2011**

Executive Directors commended the Sri Lankan authorities for making continued progress under the Fund-supported program and welcomed the favorable economic developments. Growth is strong, imports are recovering, remittances remain high, and reserves are at a comfortable level. Directors called for continued strong program performance to address the challenges facing the economy.

Directors commended the authorities' commitment to handle the fiscal costs from the recent flood damage by reallocating and reprioritizing expenditure within the existing budget envelope, consistent with the program's budget deficit target. Recognizing the challenges posed by rising international oil prices, Directors also welcomed the authorities' intention to raise retail fuel prices as needed to bring the combined budget of the state energy enterprises to balance this year. They stressed the importance of adequate safety nets to limit the impact on the poor.

While there are currently few signs of demand-driven inflationary pressures, Directors highlighted the need for heightened vigilance in the period ahead. They observed that the central bank faces multiple policy challenges arising from second-round effects of rising food and fuel prices, strong credit growth, and excess liquidity in the banking system. Directors advised the central bank to take steps to expand the liquidity management tools at its disposal to maintain its control over monetary conditions. Going forward, monetary policy will need to strike the right balance between supporting economic growth and preventing the excess liquidity from fueling inflationary pressures. Directors generally agreed that two-way exchange rate flexibility will help support the external position and meet the reserve targets.

Directors welcomed the progress made in financial sector reforms. They encouraged the authorities to continue their reform efforts and further focus on strengthening the resilience of this sector and expanding the scope of financing options available to the private sector. Directors welcomed the authorities' decision to undertake a financial system stability assessment, which should help identify future measures for capital market deepening and strengthening of the regulatory and supervisory framework.