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ECONOMIC AND POLITICAL OVERVIEW

ECONOMIC OVERVIEW

For the latest updates on the key economic responses from governments to address the economic impact of the COVID-19 pandemic, please consult the [IMF's policy tracking platform Policy Responses to COVID-19](#).

Sri Lanka has experienced strong and sustained growth since the end of the conflict between the government and the Tamil Tigers in 2009. Nevertheless, in recent years a catastrophic economic and humanitarian crisis has struck the country, with the economy grappling with significant challenges (a severe recession amid high inflation, depleted reserves, and an unsustainable public debt) that have been exacerbated by a series of external shocks. The crisis can be traced back to pre-existing vulnerabilities and policy missteps that occurred prior to its onset. According to the latest IMF estimates, after growing by 3.3% one year earlier, the country's GDP contracted by 8.7% in 2022 when a shortage of dollars caused a halt in essential imports in the first part of the year. The Census and Statistics Department said that the agriculture sector shrank by 4.6% year-on-year, while industries contracted by 16% and services by 2%. In the July-September quarter, Sri Lanka's economy shrank 11.8% year-on-year, the second-worst quarterly contraction ever recorded. Prospects are not positive for the upcoming future, with the IMF forecasting a GDP contraction of 3% in 2023, followed by a return to growth in 2024 (+1.5%), although risks remain tilted to the downside.

In May 2022, a 30-day grace period to come up with USD 78 million of unpaid debt interest payments expired, resulting in Sri Lanka's first-ever default on its debt. In March 2023, the IMF Board approved a 48-month extended arrangement under the Extended Fund Facility (EFF) of SDR 2.286 billion (about USD 3 billion) in an effort to restore macroeconomic stability and debt sustainability, safeguard financial stability, and step up structural reforms. The central government balance recorded double-digit defaults in recent years (-11.6% and -10.4% of GDP in 2021 and 2022, respectively), and is expected to remain negative this year (-8%) and in 2024 (-6.4%). The historically high debt-to-GDP ratio reached 128.1% in 2022, from 114.3% one year earlier, but is expected to follow a downward trend over the forecast horizon (111.2% in 2023 and 108.5% the following year – IMF). For the fiscal adjustments to be successful, sustained fiscal institutional reforms on tax administration, public financial and expenditure management, and energy pricing are crucial. Meanwhile, inflation skyrocketed to 46.4% in 2022 (from 6% one year earlier) and continued growing in early 2023 (51.7% in January and 50.6% in February). For the year as a whole, the IMF expects the inflation rate to average around 28.5%. Among the recommendations of the IMF to ensure the stability of the financial sector, there are the implementation of a bank recapitalization plan and the strengthening of financial supervision and crisis management frameworks.

The country has been classified as a middle-income economy by the IMF since 2010. According to the latest figures from the Department of Census and Statistics, the estimated labour force participation rate was 48.9% and the unemployment rate was 4.8% for the fourth quarter of 2022. In recent years, Sri Lanka's record of poverty reduction has been encouraging. The poverty headcount rate fell from about 22.7% in 2002 to 6.9% in 2019 (Asia Development Bank, latest data available). However, living standards remain low and pockets of severe poverty persist. Additionally, poverty rates are disproportionately high for vulnerable groups such as youth and ethnic minorities; and unemployment is high for youth and women. Still, the country's 21.9 million inhabitants have achieved some of the best human development results in South Asia. The literacy rate in 2019 was close to 100% and the country's life expectancy is the highest in the region. Low mortality rates and the steadily declining population growth, reflect the country's progress in the sphere of social development. To this extent, the IMF advised strengthening social safety nets, which should be better targeted to the poor. Sri Lanka's GDP per capita (PPP) was estimated at USD 14,223 in 2023 by the IMF. Nevertheless, the World Bank noted that Sri Lanka's ongoing financial crisis may increase poverty from 13.1% in 2021 to 25.6% in 2022, which is equivalent to over 2.5 million people falling into poverty during the period.

Main Indicators	2022	2023 (E)	2024 (E)	2025 (E)	2026 (E)
GDP <i>(billions USD)</i>	74.85	0.00	0.00	0.00	0.00
GDP <i>(Constant Prices, Annual % Change)</i>	-7.8	0.0	0.0	0.0	0.0
GDP per Capita <i>(USD)</i>	3,342	0	0	0	0
General Government Gross Debt <i>(in % of GDP)</i>	115.5	0.0	0.0	0.0	0.0
Inflation Rate <i>(%)</i>	n/a	0.0	0.0	0.0	0.0
Unemployment Rate <i>(% of the Labour Force)</i>	5.3	0.0	0.0	0.0	0.0
Current Account <i>(billions USD)</i>	-0.74	0.00	0.00	0.00	0.00

Main Indicators	2022	2023 (E)	2024 (E)	2025 (E)	2026 (E)
Current Account <i>(in % of GDP)</i>	-1.0	0.0	0.0	0.0	0.0

Source: IMF – World Economic Outlook Database , October 2021

Country Risk

See the country [risk analysis](#) provided by [La Coface](#).

MAIN SECTORS OF INDUSTRY

Breakdown of Economic Activity By Sector	Agriculture	Industry	Services
Employment By Sector <i>(in % of Total Employment)</i>	25.7	27.9	46.4
Value Added <i>(in % of GDP)</i>	8.7	30.3	56.1
Value Added <i>(Annual % Change)</i>	-4.6	-16.0	-2.0

Source: World Bank - Latest available data.

Monetary Indicators	2016	2017	2018	2019	2020
Sri Lanka Rupee (LKR) - Average Annual Exchange Rate For 1 USD	145.58	152.45	162.46	178.70	185.52

Source: World Bank - Latest available data.

FOREIGN TRADE

Sri Lanka is relatively open to international trade, which accounts for 41% of GDP (World Bank, latest data available). Nonetheless, its share in GDP has declined almost continuously in the last 20 years after peaking at 88.6% in 2000. The country mainly exports textiles and garments (almost 40% of total exports in 2021), tea (13.7%), rubber products (8.8%), and electrical machinery (2.7%). Its main imports include mineral fuels (15.8%), machinery (8.5%), electrical machinery (8%), and knitted or crocheted fabrics (5.2% - ITC, 2022).

Sri Lankan exports are directed mainly towards the U.S. (24.7% of all exports), the United Kingdom (7.5%), India (6.7%), Germany (6.1%) and Italy (4.7%); whereas imports come chiefly from China (23.7% of all imports), India (22%), the U.A.E. (6.6%), Malaysia (3.8%) and Singapore (3.6%). The country's trade policy aims to strengthen access to Sri Lankan products on the international market. As such, the Government has signed several bilateral and multilateral trade agreements, especially at the regional level. China and Sri Lanka have been negotiating a free trade agreement. However, while China has been pushing to reach a deal, Sri Lanka stated that they want more time to negotiate the agreement, as the Government is concerned about the economic impact of a rushed deal on its economy (Sri Lanka had demanded a review of the deal after 10 years, to which China did not agree). Therefore, negotiations are currently at a stalemate. For a list of FTAs signed by Sri Lanka, click [here](#). Sri Lankan exports have been traditionally less competitive than those of other countries in the region such as Bangladesh and Vietnam due to higher minimum wage rates. Nevertheless, a rapid fall in the value of the Sri Lankan rupee and a minimum wage hike for the workers of the garment industry in Bangladesh and Vietnam helped to level the playing field.

Sri Lanka has a structural trade deficit. In 2021, merchandise imports reached USD 20.6 billion, while exports totalled USD 12.5 billion, marking an increase of 28.5% and 24.4%, respectively (WTO, 2022). The country is also a net service importer: in 2021, it imported USD 2.4 billion worth of services, against USD 2.9 billion in exports. According to the World Bank, in the same year, the country's trade deficit widened to 7.4% of its GDP, from 6.1% one year earlier. The latest data from the Central Bank show that earnings from exports in 2022 surpassed USD 13 billion for the first time, recording an increase of 4.9% from the previous highest recorded in 2021. Meanwhile, total import expenditure amounted to USD 18.29 billion, recording a year-on-year decline of 11.4%, resulting from measures to restrict non-urgent imports and liquidity constraints that prevailed in the market for most of the year. As a result, the deficit in the trading account in 2022 narrowed to the lowest level since 2010 to USD 5.18 billion.

Foreign Trade Values	2018	2019	2020	2021	2022
Imports of Goods <i>(million USD)</i>	22,233	19,937	16,055	20,637	18,291
Exports of Goods <i>(million USD)</i>	11,890	11,940	10,047	12,499	13,107
Imports of Services <i>(million USD)</i>	6,831	6,619	3,821	2,952	2,782
Exports of Services <i>(million USD)</i>	8,374	7,474	3,035	2,475	3,062

Source: World Trade Organisation (WTO) ; Latest available data

Foreign Trade Indicators	2018	2019	2020	2021	2022
Foreign Trade <i>(in % of GDP)</i>	49.8	49.4	37.0	41.3	46.5
Trade Balance <i>(million USD)</i>	-10,343	-7,997	-6,008	-8,139	-5,185
Trade Balance (Including Service) <i>(million USD)</i>	-6,577	-5,148	-5,189	-6,552	-3,075
Imports of Goods and Services <i>(Annual % Change)</i>	3.3	-3.5	-20.1	4.1	-19.9
Exports of Goods and Services <i>(Annual % Change)</i>	5.4	1.7	-29.6	10.1	10.2
Imports of Goods and Services <i>(in % of GDP)</i>	28.4	27.6	21.6	24.3	25.0

Foreign Trade Indicators	2018	2019	2020	2021	2022
Exports of Goods and Services <i>(in % of GDP)</i>	21.4	21.8	15.4	16.9	21.5

Source: World Bank ; Latest available data

Foreign Trade Forecasts	2023	2024 (e)	2025 (e)	2026 (e)	2027 (e)
Volume of exports of goods and services (Annual % change)	0.0	0.0	0.0	0.0	0.0
Volume of imports of goods and services (Annual % change)	0.0	0.0	0.0	0.0	0.0

Source: IMF, World Economic Outlook ; Latest available data

Note: (e) Estimated Data

International Economic Cooperation

Member of [South Asian Association for Regional Cooperation](#) (SAARC). The country have signed a [trade agreement](#) with 21 other countries in the São Paulo Round of the Global System of Trade Preferences among Developing Countries (GSTP).

Main Partner Countries

Main Customers <i>(% of Exports)</i>	2022
United States	25.5%
United Kingdom	7.4%
India	6.7%
Germany	5.8%
Italy	5.0%
See More Countries	49.6%

Main Suppliers <i>(% of Imports)</i>	2022
India	26.4%
China	20.0%
United Arab Emirates	5.5%
Malaysia	5.2%
Singapore	4.2%
See More Countries	38.7%

Source: Comtrade, Latest Available Data