OFFERING CIRCULAR CONFIDENTIAL

US$1,000,000,000

The Democratic Socialist Republic of Sri Lanka

5.875% Bonds due 2022

The US$1,000,000,000 5.875% Bonds due 2022 (the "Bonds") of the Government of the Democratic Socialist Republic of Sri Lanka (the "Issuer") will be issued in registered form in minimum denominations of US$200,000 and integral multiples of US$1,000 in excess thereof. Interest on the Bonds will be payable semi-annually in arrears on January 25 and July 25 of each year commencing on January 25, 2013. The Bonds are not redeemable prior to maturity. Except as described herein, payments on the Bonds will be made without deduction for or on account of withholding taxes imposed by Sri Lanka. The Bonds will mature at par on July 25, 2022.

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

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

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

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

Price: 100%

Delivery of the Bonds is expected to be made on or about July 25, 2012 through the book-entry facilities of The Depository Trust Company ("DTC").

Joint Lead Managers and Bookrunners

Barclays **BofA Merrill Lynch** **Citigroup** **HSBC**

Co-Manager

People's Bank

The date of this Offering Circular is July 17, 2012.

Sri Lanka
District Boundary
Province Boundary
CENTRAL
Province Name
VAVUNIYA
District Name
A Road
B Road
PALK STRAIT
JAFFNA
Jaffna
Kilinochchi
KILINOCHCHI
Mullaittivu
MULLAITTIVU
NORTHERN
BAY OF BENGAL
Mannar
MANNAR
Gulf of Mannar
VAVUNIYA
Vavuniya
Trincomalee
NORTH CENTRAL
ANURADHAPURA
Anuradhapura
TRINCOMALEE
Kalpitiya
PUTTALAM
POLONNARUWA
NORTH WESTERN
BATTICALOA
Batticaloa
MATALE
CENTRAL
EASTERN
Chilaw
KURUNEGALA
Kurunegala
KANDY
Kandy
Negombo
GAMPAHA
KEGALLE
NUWARA ELIYA
BADULLA
Badulla
AMPARA
WESTERN
Colombo
COLOMBO
Potuvil
UVA
SABARAGAMUWA
MONARAGALA
Kalutara
KALUTARA
Ratnapura
RATNAPURA
Laccadive Sea
GALLE
SOUTHERN
HAMBANTOTA
INDIAN OCEAN
MATARA
Hambantota
Galle
Matara

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

TABLE OF CONTENTS

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

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

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

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

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

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

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

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

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

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

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

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

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT, ANY REPRESENTATION INCONSISTENT WITH PROVISIONS OF THIS PARAGRAPH.

CERTAIN DEFINED TERMS AND CONVENTIONS

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

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

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

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

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

Unless otherwise specified herein, all gross domestic product ("GDP"), gross national product ("GNP") and related data, including growth statistics and sub-sector data are, or are derived from, real data using a base year of 2002.

Unless otherwise specified herein, all 2011 and 2012 full-year and interim statistical and financial data included in this Offering Circular are provisional and subject to revision in accordance with the procedures and practices of the Central Bank or other Government entity responsible for collating and presenting such statistical data.

Prior to 2007, both the Central Bank and the Department of Census and Statistics (the "DCS"), which is the official agency responsible for the compilation and dissemination of national income accounts, compiled and published national income statistics of the country. The methodologies and assumptions used by the Central Bank and the DCS in the compilation of such data were not identical and, as a result, the information published by each of them were different. In 2007, in order to avoid any confusion among the public, the Central Bank decided to use and publish the national income statistics compiled by the DCS going forward. In line with this policy, the Central Bank began using and publishing GDP estimates compiled by the DCS commencing from 2007 in its various statutory reports which incorporated the DCS data series from 2003 onwards. As a result, some macroeconomic information, including per capita income, of the country disclosed herein varies from information published by the Central Bank for the period from 2003 to 2007.

Inflation in Sri Lanka is reported as the annual percentage change in the Colombo Consumers' Price Index ("CCPI"), the compilation of which is based on a Household Income and Expenditure Survey ("HIES") conducted by the DCS. The expenditures data obtained from this survey is reflected in the CCPI, which was originally referred to as the CCPI (1952=100). This index was first revised based on the HIES conducted in 2002, revising the base year (2002=100) in November 2007 to reflect changes in consumption patterns. In June 2011, the base year was changed again (2006/2007=100), based on the HIES of 2006/2007.

Unless otherwise indicated, all references to gross official reserves are to gross official reserves excluding Asian Clearing Union ("ACU") receipts.

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

FORWARD LOOKING STATEMENTS

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

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

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

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

ENFORCEABILITY OF FOREIGN JUDGMENTS

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

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

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

DATA DISSEMINATION

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

EXCHANGE RATE INFORMATION

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

SUMMARY

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

The Democratic Socialist Republic of Sri Lanka

General

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

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

The population of Sri Lanka was estimated to be 20.3 million in 2011. Colombo, located on Sri Lanka's western coast, is the commercial capital and its largest city, with a population of approximately 700,000. Sri Lanka has a diverse ethnic composition: 74.0% of the people are Sinhalese, 18.0% are Tamils, 7.0% are of Arab descent and the remaining 1.0% is of other ethnicities. In 2010, the literacy rate was 91.9%. Sinhalese and Tamil are the official languages of Sri Lanka and, along with English, are taught in schools. 69.3% of the population is Buddhist, mostly Sinhalese, 15.5% is Hindu, 7.6% is Christian and 7.5% is Muslim.

Government and Politics

Sri Lanka's current constitution, which was adopted on September 7, 1978 (the "Constitution"), provides for an Executive President, a unicameral Parliament with legislative power, an independent judiciary and fundamental rights of the people.

The President of Sri Lanka is directly elected for a six-year term and acts as Head of State, Head of the Executive of the Government and Commander-in-Chief of the armed forces. The President is responsible to the Parliament for the exercise and discharge of his powers and duties under the Constitution and the laws of Sri Lanka. The President appoints the Prime Minister and the Cabinet of Ministers, who are responsible to the Parliament.

The fifth presidential election was held on November 17, 2005, and Mahinda Rajapaksa was elected President of Sri Lanka. He was re-elected in the sixth presidential election held on January 26, 2010 receiving 58% of the total votes.

The President has publicly declared the Government's commitment to introduce and support investor friendly economic policies with the participation of the private sector. President Mahinda Rajapaksa's policy priorities include:

- engaging in discussion and dialogue to arrive at a national consensus through an inclusive process culminating in the introduction of reforms to the Constitution;
- carrying out a series of improvements in public services, rule of law and the taxation systems;
- introducing economic policies to boost local and foreign investment and small and medium-scale enterprises;
- developing local and national infrastructure;
- reducing poverty rates and achieving a balanced regional development; and
- strengthening and developing friendly relationships with countries in both Asia and other parts of the world.

The Parliament is a unicameral 225-member legislature elected to a six-year term by universal suffrage on the basis of proportional representation. The President may from time to time summon, suspend or end a legislative session of or dissolve the Parliament under the Constitution. The Parliament reserves the power to make all laws and to repeal or amend any provision of the Constitution. The most recent parliamentary election was held in April 2010, where the ruling party, the United People's Freedom Alliance (the "UPFA"), secured close to a two-thirds majority in Parliament.

On September 8, 2010, the Eighteenth Amendment to the Constitution was passed in the Parliament with a two-thirds majority. This amendment has the effect of introducing, among others, the following changes to the Constitution: removing the limitation on the number of times a person can be elected to the office of President; imposing a requirement for the President to attend Parliament once every three months; conferring on the President the right to address and send messages to Parliament by virtue of his office; vesting in the President the right to appoint the Chairman and members of certain Commissions after seeking the observations of a Parliamentary Council and the right to appoint certain other members of the Judiciary and other officials; vesting power on the Cabinet of Ministers with respect to policy relating to public officers, including the power to appoint, promote, transfer, discipline and dismiss all heads of Departments; and changing certain provisions relating to the National Police Commission.

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

Under the Thirteenth Amendment to the Constitution significant authority was delegated the Provincial Councils. These Provincial Councils are directly elected for five-year terms and possess certain Provincial-level legislative and executive powers over education, health, rural development, tourism, social services, agriculture, public order and local taxation, subject to Government oversight. In 2012, Provincial Council elections will be held for the Eastern, North Central and Sabaragamuwa Provinces. Nominations for the elections are being accepted from July 12 to July 17, 2012.

There are also three categories of local authorities: municipal, urban and rural (Pradeshiya Sabha) councils with limited powers. The most recent local authority election was held on October 8, 2011 where the ruling party, the UPFA secured control of a majority of the local authorities.

Economy

The adoption of market-oriented economic policies in 1977 and the subsequent reforms and liberalization measures undertaken by successive Governments in recent years have enhanced the long-term growth prospects and resilience of the Sri Lankan economy. After four consecutive years of 6.0% or higher growth, the growth of the Sri Lankan economy slowed in 2009 as a result of the global financial and economic crisis. The economy recovered strongly in 2010, underpinned by favorable developments in the domestic and external fronts. The economy grew by 8.3% in 2011, achieving two consecutive years of economic growth of 8.0% or higher for the first time in Sri Lanka's history. Supported by post-conflict optimism and strengthening global demand, the Government believes that the medium term outlook for Sri Lanka's economy is positive.

Economic Growth. The principal sectors of the Sri Lankan economy are services, industry and agriculture. Real GDP grew by 7.9% during the first three months of 2012, compared to 8.0% during the first three months of 2011. Growth in the first three months of 2012 has been driven by a combination of continued investor confidence and favorable macroeconomic conditions partially offset by the fiscal and financial uncertainties in the Euro zone. In 2011, real GDP grew by 8.3% following growth of 8.0% in 2010. Real GNP grew by 8.4% in 2011 from growth of 7.9% in 2010. Per capita GDP rose to US$2,836 in 2011, compared to US$2,400 in 2010, representing an increase of 15.5% in terms of domestic currency. Since independence in 1948, the GDP of Sri Lanka has experienced only one year of negative growth, which was in 2001.

Economic growth has been broad based, with all major sectors contributing to overall economic growth. The services sector has become the key factor driving growth in the economy, as a result of economic liberalization measures and growth of emerging service sectors, such as port services, financial services, information technology and telecommunications. The services sector accounted for 59.5% of GDP in 2011, providing employment to 42.8% of the labor force. In 2011, within the services sector, wholesale and retail trade accounted for 23.6% of GDP, banking, insurance and real estate accounted for 8.8% of GDP and transport and communication accounted for 14.3% of GDP. The industry sector accounted for 29.3% of GDP in 2011, of which 17.3% was from manufacturing. The agriculture sector accounted for 11.2% of GDP in 2011.

Prices, ***Monetary Growth***, ***Wages and Employment.*** Both headline and core inflation have remained in single digits on a year-on-year basis since early 2009. Inflation, as measured by the CCPI, declined to 2.7% on a year-on-year basis in February 2012 from 8.9% in April 2011 due both to the prudent demand management policies of the Central Bank and improvement in supply conditions. With the revision of administratively determined prices, particularly of energy and the decline in food supply due to drought conditions, inflation gradually increased thereafter to 9.3% in June 2012. However, with tighter monetary conditions, inflation is expected to return to the desired mid-single digit levels by mid-2013.

Average growth of broad money was 19.3% in 2011, compared to 15.3% in 2010. Broad money growth has increased on average to 21.7% in the first five months of 2012, primarily due to the increase in credit to both private and public sectors.

Nominal wages of both the public and private sectors increased in 2011 compared to 2010. The nominal wages of public sector employees increased by 6.7% as a result of the special non-pensionable allowance equivalent to 5.0% of basic salary and an increase in monthly COLA by Rs.600 granted to public sector employees from January 2011. In the formal private sector, minimum nominal wages increased by 4.6% in 2011 over 2010. This increase was mainly attributable to the relatively higher increases in nominal wages of employees in the Services sector and the Industry and Commerce sector since August 2010. Accordingly, the minimum wage rate indices in the three major categories of the formal private sector, namely agriculture, industry and commerce, and services increased in nominal terms by 3.0%, 9.2% and 10.7%, respectively, in 2011. Meanwhile, the daily wages of the informal private sector, in nominal terms, increased by an average rate of 11.9% in 2011.

The nominal wage rate indices of the public sector and formal private sector increased by 6.9% and 24.7%, respectively, while average nominal wages of the informal private sector increased by 12.5% in the first four months of 2012, compared to the corresponding period of the previous year. The real wage increase of employees in the formal and informal private sectors in these periods was 19.3% and 15.7%, respectively, while the real wages of public sector employees recorded an increase of 2.3% in the first four months of 2012.

The unemployment rate declined to 4.2% in 2011, compared to 4.9% in 2010. The unemployment rate which had been declining over the past few years increased in 2009, mainly due to the adverse impact of the global recession on several sectors of the economy. The declining trend experienced thereafter has been due to healthy growth experienced in all three sectors of the economy associated with increased economic activity led by the conducive macroeconomic environment, continued reconstruction and infrastructure development programs and increased self-employment opportunities

Balance of Payments ("BOP"). The gradual global economic recovery, the end of Sri Lanka's internal conflict, the SBA Facility from the IMF (see below) and improved investor confidence have fundamentally influenced the performance of the external sector since the second half of 2009. In 2009, BOP recorded a record surplus of US$2,725 million, followed by a surplus of US$921 million in 2010. The external sector, which performed well during the first half of 2011, faced several challenges in the latter part of the year due to adverse global developments and rapid growth in imports demand. This resulted in the BOP recording a deficit of US$1,061 million in 2011. Further, during the first quarter of 2012, the external sector faced several challenges given the adverse global developments including the European debt crisis. Higher import demand led the current account to record a deficit of US$1,053 million. However relatively high inflows to the capital and financial account managed to partially offset the current account deficit, thereby resulting in a deficit of US$251.2 million in the BOP for the first quarter of 2012.

In order to rebuild the country's reserves to comfortable levels and to increase investor confidence in the country, Sri Lanka made a request to, and was approved by, the IMF for a stand by arrangement facility (the "SBA Facility") of US$2.6 billion (SDR1.65 billion) in July 2009. Thus far, the IMF has conducted seven quarterly reviews and released eight tranches under the SBA Facility, totaling US$2,133 million. The eighth and final review was carried out in June 2012 and is expected to be considered by the IMF board in the third week of July.

Foreign Trade. Foreign trade rebounded strongly in 2010, reversing the sharp contraction observed during the global recession of 2009. This trend continued into 2011, as both exports and imports continued to grow despite the withdrawal of EU Generalized System of Preferences Plus ("GSP+") concessions in August 2010. In 2012, however, growth in foreign trade slowed mainly due to the global economic downturn, lower commodity prices, domestic policy measures to reduce the high trade deficit and the base effect. Earnings from exports declined by 3.1% to US$3,314 million during the first four months of 2012, compared to 32.0% growth to US$3,419 million in the first four months of 2011. Expenditure on imports grew by 11.9% to US$6,633 million during the first four months of 2012, compared to the 41.5% growth recorded in the first four months of 2011. As expenditure on imports exceeded earnings from exports, the trade deficit expanded by 32.3% to US$3,319 million in the first four months of 2012, compared to the corresponding period in 2011.

External Reserves. The gross official reserves of the country reached a historically high level of US$8.2 billion in mid-August 2011 and declined thereafter. Absorption of foreign exchange inflows, receipts to the Government, including the proceeds of the Sovereign bond issue, as well as receipts under the SBA Facility helped build up the official reserves during the first eight months of 2011. However, during the latter part of 2011, the widening trade deficit resulting from the sharp increase in import expenditure created a strong demand for foreign exchange in the domestic foreign exchange market. This necessitated the Central Bank to intervene by supplying foreign exchange to the market. Accordingly, gross official reserves at the end of 2011 amounted to US$5,958 million compared to US$6,610 million at the end of 2010.

The increased expenditure in oil imports as a result of high oil prices in the international market in early 2012 created a demand pressure in the market which necessitated the Central Bank to supply foreign exchange to the market in the first two months of the year. This resulted in official reserves declining to US$5,522 million by the end of February 2012. However, since March 2012, with the policy decision taken by the Central Bank to limit supply of foreign exchange to the domestic foreign exchange market, and the absorbing of excess foreign inflows to the Government and the private sector, the official reserves increased to US$6,022 million by the end of June 2012.

Securities Market. Initial Public Offering ("IPO") activity on the Colombo Stock Exchange (the "CSE") increased in 2011. In 2011, there were 13 IPOs through which Rs.19 billion was raised, as well as 22 rights issues, through which Rs.28 billion was raised. In 2012, there have been five IPOs, through which Rs.1.6 billion was raised and five rights issues, through which Rs.4 billion was raised. The number of companies listed on the CSE increased in 2011 by 30 to 272 by the end of December 2011 and 11 to 283 by the end of June 2012. Meanwhile, the cumulative net foreign inflow to the stock market amounted to US$186.5 million from January to June 2012, in comparison to the net outflow of US$171.5 million in 2011. The CSE currently has a membership of 29 institutions, all of which are licensed to operate as stockbrokers. As at June 30, 2012, there were 283 companies listed on the CSE, representing 20 business sectors, with a market capitalization of Rs.1,890.5 billion (US$14.1 billion). Sri Lanka has a large Government securities market consisting of Treasury bills and Treasury bonds. The total outstanding principal amount of Treasury bills and bonds was Rs.770.8 billion (US$5.8 billion) and Rs.2,280.8 billion (US$17.1 billion) as of the end of June 30, 2012.

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

Activities in the inter-bank foreign exchange market expanded in 2011 to US$16,442 million, compared to US$11,065 million during 2010, as a result of expansion in trade, steady inflows into the domestic foreign exchange market from export proceeds and increased workers' remittances inflows. The rupee depreciated by 2.6% to Rs.113.90 per US dollar in 2011 and by a further 14.6% during the first six months of 2012 to Rs.133.30 per US dollar as a consequence of the Central Bank allowing more flexibility in the exchange rate.

Interest Rates. Yields on Treasury bills in the primary market remained broadly stable at Treasury bill auctions since the reduction in policy rates in January 2011 until end September 2011. However, with declining market liquidity, rates began to increase in October 2011. The yields on 91-day, 182-day and 364-day Treasury bills increased by 144 basis points, 136 basis points and 176 basis points, respectively, during 2011. Yields on Treasury bonds in the primary market ranged from 7.77% on 2-year bonds to 9.30% on 15-year bonds.

By the end of 2011, the secondary market yield curve for government securities shifted upwards, although remaining flatter compared to that of the previous year. Similar to other interest rates, yields on both Treasury bills and bonds in the secondary market remained broadly stable during the first nine months, while recording an increase in the last three months. Yields on Treasury bills pertaining to all three maturities were in the range of 6.98-7.55% until September 2011 but increased to a range of 8.60-9.31% by December 2011. The secondary market yields on Treasury bonds with maturities of 2-15 years, which were in a range of 7.33-9.40% during the first nine months of 2011, also increased to a range of 9.45-9.95% by the end of 2011.

In the first six months of 2012, yields in Treasury bills on the primary market have risen by 2.44%, 3.90% and 3.57% for 91-day, 182-day and 364-day maturities from the yields at the end of 2011. At the latest auctions for Treasury bonds held on June 28, 2012, weighted average yields of 14.15-14.75% were recorded for bonds of maturities between 5-9.5 years. In the secondary market, the yield curve shifted further upwards in 2012, particularly for shorter maturities.

Public Finance. Fiscal operations are expected to improve further in 2012, with the overall fiscal deficit declining to 6.2% of GDP from 6.9% of GDP in 2011. The changes introduced to the tax system in the 2011 and 2012 budget to simplify the tax system and to broaden the tax base are expected to have a positive impact on government revenue in the forthcoming period. In addition, the Government is committed to rationalize its current expenditure while directing funds to strategically important infrastructure development activities. According to budget estimates, total revenue and grants for 2012 is estimated to be Rs.1,126.1 billion (US$9.1 billion), total expenditure and net lending is estimated to be Rs.1,594.9 billion (US$12.9 billion) and the overall budget deficit is expected to be Rs.468.9 billion (US$3.8 billion). The budget deficit is expected to be financed through net domestic financing of Rs.271.6 billion (US$2.2 billion) and net foreign financing of Rs.197.3 billion (US$1.6 billion).

In 2011, total revenue including grants was Rs.949.9 billion (US$8.6 billion) and total expenditure and net lending was Rs.1,400.1 billion (US$12.7 billion). The budget deficit was Rs.450.2 billion (US$4.1 billion), which was 6.9% of GDP. Total net domestic financing was Rs.231.2 billion (US$2.1 billion) while net foreign financing was Rs.219.0 billion (US$2.1 billion).

In the first quarter of 2012, total revenue including grants was Rs.228.5 billion (US$1.9 billion) and total expenditure and net lending of the Government was Rs.439.1 billion (US$3.7 billion). The budget deficit was Rs.210.6 billion (US$1.8 billion), which was 2.8% of estimated GDP. Total net domestic financing was Rs.145.9 billion (US$1.2 billion) while net foreign financing was Rs.64.7 billion (US$0.6 billion).

External Indebtedness. The Government has a 60-year history of honoring its external debt service obligations. As of December 31, 2011, Government external debt amounted to Rs.2,329.3 billion (US$20.5 billion), an increase of 15.0% from Rs2,024.6 billion as of December 31, 2010, including the issuance of the US$1 billion fourth international sovereign bond.

As of December 31, 2011, 91% of Government external loans carried fixed rates and the remainder had variable rates. The average cost of fixed rate debt was 2.3% per annum and the average cost of variable rate debt was 3.2% per annum. As of December 31, 2011, 21.9% of Government external debt (including short-term debt) was denominated in US dollars, while 24.1% was denominated in Japanese yen. Multi-currency (SDR) loans from the World Bank and the Asian Development Bank (the “ADB”) accounted for 25.8% of Government external debt.

Social Indicators. In terms of key social indicators such as adult literacy, life expectancy at birth and infant mortality and maternal mortality, Sri Lanka ranks above many developing countries and is on par with many developed countries, mainly due to the free health care and free education services and other welfare programs implemented by successive governments since independence. In 2010, the average adult literacy rate was 91.9%. Based on 2011 data, average life expectancy at birth was 74.9 years, and based on 2007 data, infant mortality was 8.5 per 1,000 live births. According to 2011 data, maternal mortality was 14.6 per 100,000 live births. According to the United Nations Development Program’s Human Development Report 2011, Sri Lanka’s Human Development Index of 0.691 ranked Sri Lanka at 97 among 187 countries.

Sovereign Rating. On February 27, 2009, Fitch Ratings (“Fitch”) revised its credit rating outlook for the country’s long term foreign and local currency Issuer Default Ratings to “negative” from “stable,” citing the “heightened concern regarding the sovereign’s external financial position in light of the marked decline in official foreign exchange reserves.” Fitch revised Sri Lanka’s sovereign rating outlook to “stable” from “negative” to reflect the country’s positive changes in sovereign credit fundamentals on October 9, 2009. The agency has affirmed the long-term foreign and local currency Issuer Default Ratings and the Country Ceiling at “B+” and the short-term Issuer Default Rating at “B,” citing “the positive changes in sovereign credit fundamentals following the end of the 26-year internal conflict, the approval of a 2.6 billion US dollar IMF SBA facility and the return of private capital inflows." On September 21, 2010, Fitch again revised the outlook to "positive" from "stable." On July 18, 2011, Fitch upgraded Sri Lanka's long-term foreign and local currency Issuer Default Rating to "BB-" from "B+", with a stable outlook and affirmed Sri Lanka's short-term Issuer Default Rating at "B." The rating agency has also upgraded the Country Ceiling to "BB-". In Fitch's view, the outlook revision is a reflection of Sri Lanka's economy benefitting from the end of the internal conflict and further benefitting from more disciplined policy framework put in place under the SBA Facility and from the improved external liquidity position bolstered by the IMF program. On May 4, 2012, Fitch re-affirmed its existing rating.

Standard & Poor's Ratings Services ("S&P"), on August 25, 2009, revised its sovereign rating outlook back to "stable" due to Sri Lanka's improved external liquidity position in light of the IMF SBA Facility. On October 15, 2009, S&P further revised its sovereign rating outlook to "positive," citing the "continued strengthening of Sri Lanka's balance of payments position, and Standard & Poor's expectation that the IMF SBA Facility will be pursued to its conclusion, engendering modest improvement in public finances." Accordingly, Standard & Poor's affirmed its "B" long-term foreign currency credit rating and "B+" long term local currency sovereign credit rating on Sri Lanka. They also affirmed the "B" short-term ratings on the sovereign. On September 15, 2010, S&P raised its long-term foreign currency sovereign credit rating on Sri Lanka to "B+" from "B," and the long-term local currency rating to "BB-" from "B+" taking into account the continued strengthening of Sri Lanka's balance of payments position and the expected sustainable decline in fiscal deficits and public debt under the Government's planned revenue reforms. On July 19, 2011, S&P raised its outlook on Sri Lanka's long-term foreign currency sovereign credit rating to "positive" from "stable" based on improved external liquidity, progress in addressing structural fiscal weaknesses and the Government's inflation management efforts. On February 29, 2012, S&P changed its outlook on Sri Lanka's long-term foreign currency sovereign credit rating to "stable" from "positive" while affirming its "B+" rating and lowering its long-term local currency sovereign credit rating to "B+" from "BB-."

In addition, Moody's Investors Service has assigned a "B1" foreign currency issuer rating to the Government of Sri Lanka. The outlook was revised from "stable" to "positive" on July 18, 2011. The agency has considered the end of the internal conflict and the structural improvement in the country's economic prospects and stability in making the rating decision.

Recent Developments

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

For nearly three decades, the Liberation Tigers of Tamil Eelam (the "LTTE"), a terrorist group which sought to create a separate state consisting of the Northern and the Eastern Provinces of Sri Lanka, engaged in a violent struggle against Government forces. Fighting between the Government forces and the LTTE was primarily focused in the North of Sri Lanka after the military evicted the LTTE from its last stronghold in the East in 2007. In May 2009, after a series of successful operations, the military defeated LTTE forces, thereby gaining full control of the Northern Province.

The defeat of the LTTE and conclusion of hostilities is one of the most significant events in the country's history. The peaceful environment that has ensued with the end of the 26-year long conflict has brought stability to the everyday life of the country, enhancing the prospects for future growth. Since regaining control over the Eastern and Northern provinces, the Government has conducted activities to resettle civilians displaced by the conflict ("internally displaced people" — IDPs). From an original 295,136 IDPs at the time of the ending of the internal conflict in May 2009, the Government has resettled 98% of IDPs from the Northern and Eastern provinces by the end of June 2012, providing continuing livelihood support. Approximately 94% of land had been cleared of land mines by the end of 2011 as the demining process targeting public places, farm lands, schools, and hospitals was accelerated with the help of development partners as well as domestic and international non-governmental organizations.

The Government has accelerated development activities in the Eastern and Northern Provinces through its *Neganahira Navodaya* (Eastern Resurgence) and *Uthuru Wasanthaya* (Northern Spring) development programs. These programs are aimed at restoring and developing these regions through the establishment of critical infrastructure for the provision of drinking water, electricity, education and healthcare, as well as by developing the regional economies, especially in the agriculture and services sectors. The Government's investments in the Eastern Province since 2006 have facilitated the resettlement of internally displaced people and contributed to increased economic activity. The contribution to the country's GDP by the Eastern Province increased to 5.9% in 2010, from 5.8%, 5.6% and 5.2% in 2009, 2008 and 2007, respectively. In 2010, the Eastern Province recorded nominal GDP growth of 18.7%, the fourth highest nominal growth rate of all provinces in the country.

With respect to the Northern Province, the Government has spent Rs.145.6 billion (US$1.3 billion) towards rehabilitation and development activities from 2009 to 2011. Furthermore, the Government is planning to spend Rs.63.8 billion in 2012 in the Northern Province, aiming at the development, construction and rehabilitation of roads and other transportation infrastructure and infrastructure for electricity, housing, water supply, agriculture, irrigation, manufacturing and livelihood development. This rehabilitation and reconstruction process is being implemented concurrently with the de-mining and re-settlement activities that are currently being carried out in the region and is expected to yield positive social and economic results in the coming years. The contribution to the country's GDP by the Northern Province increased to 3.4% in 2010, from 3.2%, 3.2% and 2.9% in 2009, 2008 and 2007, respectively. In 2010, the Northern Province recorded nominal GDP growth of 22.9%, the highest nominal growth rate of all provinces in the country.

The end of the 26-year long conflict has had and is expected to continue to have a significant positive impact, not just on the Northern and Eastern provinces, but also on the entire country. The integration of the Northern and Eastern provinces will continue to enhance the growth potential of the country. These two provinces have substantial natural resources, including large stretches of beautiful beaches and ecological conservation areas that can support a vibrant tourism industry. In support of this, restrictions that previously required foreign visitors to obtain permission before visiting certain areas in the Northern Province have been lifted.

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

Recovery from the Global Financial Crisis and Continued Economic Growth

Sri Lanka's economy, which slowed in 2009 due to the global financial and economic crisis, recovered strongly in 2010 and 2011. This growth momentum has continued in the first quarter of 2012, benefitting from favorable domestic and external conditions. With favorable macroeconomic conditions and the recovery in economic activity, the performance and stability of the financial sector strengthened in 2010 and 2011. This improved performance was reflected in the entire economy as credit flows significantly recovered, profitability improved, capital adequacy further increased above the required threshold and the ratio of non-performing loans declined, though provisions for loan losses increased. The performance of finance companies which were previously in distress also improved, while financial markets continued to remain liquid.

The country's foreign exchange reserves, which were adversely affected by the global financial crisis, have improved significantly since May 2009 with the improvements in investor confidence following the end of the conflict and the coordinated policy measures of the Government and the Central Bank. Sri Lanka's graduation to the status of a "middle-income emerging market" by the IMF in January 2010 enabled the country to project itself strongly in international financial markets. The upgrading of the sovereign credit rating of the country by international rating agencies, the successful continuation of the SBA with the IMF, increased long term capital flows to the Government, including the successful issuance of the fourth international sovereign bond in July 2011, as well as increased inflows to the private sector, helped strengthen the performance of the external sector. Further relaxation of restrictions on foreign exchange transactions also helped improve investor confidence and the external sector.

The gross official reserves of the country reached a historically high level of US$8.2 billion in mid-August 2011 and declined thereafter. Absorption of foreign exchange inflows, receipts to the Government including the proceeds of the Sovereign bond issue, as well as receipts under the IMF SBA Facility helped build up official reserves during the first eight months of 2011. However, during the latter part of 2011, the widened trade deficit resulting from the sharp increase in import expenditure created a strong demand for foreign exchange in the domestic foreign exchange market. This necessitated the Central Bank to intervene by supplying foreign exchange to the market. Accordingly, gross official reserves amounted to US$5,958 million at the end of 2011 compared to US$6,610 million at the end of 2010.

The increased expenditure in oil imports as a result of high oil prices in the international market in early 2012 created a demand pressure in the market which necessitated the Central Bank to supply foreign exchange to the market in the first two months of the year. This resulted in official reserves declining to US$5,522 million by the end of February 2012. However, since March 2012, with the policy decision taken by the Central Bank to limit supply of foreign exchange to the domestic foreign exchange market and the absorbing of excess foreign inflows to the Government and the private sector, the official reserves increased to US$6,022 million by the end of June 2012.

The SBA Facility and SDR Allocation and the Government's relationship with the IMF

Due to the sudden withdrawal of investment in Treasury bills and bonds by foreign investors and depreciation of major currencies against the US dollar caused by the intensification of the global economic crisis, there was a substantial decline in the country's international reserves beginning in the fourth quarter of 2008. In order to re-build the country's reserves to comfortable levels and to increase investor confidence in the country, Sri Lanka made a request to, and was approved by, the IMF for the SBA Facility of US$2.6 billion (SDR1.65 billion). The SBA Facility, with a term of 20 months, was finalized in July 2009. The receipt of the first two tranches, i.e., one immediately after the approval of the facility and the second in November 2009, and other foreign inflows such as investment in treasury bonds and bills helped the country's reserves to increase to US$5,097 million by end 2009. In June 2010 two more simultaneous tranches under the SBA Facility amounting to US$407.8 million were disbursed. This disbursement was made following the re-phasing of the program where the tenure was extended by one year. On September 24, 2010, the IMF Executive Board completed its fourth review under the SBA Facility and approved a US$212.5 million disbursement, while the fifth review was conducted in December 2010 and a disbursement of US$216.6 million was approved on February 2, 2011. With the completion of the sixth review, US$218.5 million was received in April 2011. Subsequently, the seventh review was completed and the eighth tranche of US$425.9 million was received on April 2, 2012. The eighth review was conducted in June 2012. As per the provisional data available, the Government has met all of the required targets under the SBA Facility and expects the final tranche to be released following the IMF board meeting in the third week of July 2012, bringing the program to a successful end. The SBA Facility, coupled with several other initiatives by the Government, have contributed towards improving the BOP position, thus, strengthening the country's fiscal position and facilitating greater exchange rate flexibility while acting as a buffer in the event of any external shocks, such as the recent global recession.

In June 2012 the IMF issued a statement following two weeks of meetings with the Central Bank, government officials and representatives of the civil society and the private sector in Sri Lanka in which they expressed their satisfaction with the performance of the Sri Lankan economy and the Government's implementation of economic reforms. The statement indicated that the IMF had a positive outlook for the Sri Lankan economy and that they were considering the continued, close engagement with the Government, including through potential continued financial support. The Government and the Central Bank believe that they have a positive relationship with the IMF and are exploring means by which such relationship can continue following the release of the final tranche of the SBA Facility.

In addition to the SBA Facility, in August 2009, the IMF approved a general allocation of SDRs to countries based on each country's quota with the IMF to strengthen their international reserves in case they may confront any liquidity constraints caused by the global economic crisis. Under the general SDR allocation by the IMF, on August 28, 2009, Sri Lanka received SDR307 million (US$480 million). Further, in accordance with the fourth amendment of the IMF's Articles of Agreement (1997), Sri Lanka received a special allocation of SDR18.1 million (US$28 million) on September 9, 2009.

Recent Policy Measures

In 2012 the Government and the Central Bank have taken a number of policy measures to address what they view as the three key challenges faced by the Sri Lankan economy: the widening current account deficit, high credit growth and monetary expansion and inflationary pressure.

In response to the rapid expansion of the trade deficit in 2011 and 2012, the Government and the Central Bank implemented a number of policy changes with the view to stabilizing external finances. These measures include monetary policy adjustments such as the raising of interest rates and a directive to commercial banks to limit credit growth in 2012 to 18.0% (23.0% if 5.0% is raised externally), in comparison to credit growth in 2011 of 34.5% and allowing more flexibility in the exchange rate. Ceylon Petroleum Corporation has also raised the selling prices of their products and the Ceylon Electricity Board has raised its tariffs in response to increased fuel prices, which is expected to enhance the financial viability of these enterprises.

Diversification of Oil Imports

As a result of the measures taken by Sri Lanka in 2011 and 2012 to reduce imports of crude oil from Iran through the sourcing of additional crude oil from Saudi Arabia and Oman, the United States Secretary of State announced that it had been determined that Sri Lanka had "significantly reduced" its volume of crude oil purchase from Iran and would therefore be one of a number of countries receiving a waiver from the enforcement of these sanctions. This waiver is valid for a renewable period of 180 days.

Derivatives Litigation

Disputes over oil derivative transactions involving the Ceylon Petroleum Corporation ("CPC"), a creature of statute, have led to a court case and two international arbitrations. On July 11, 2011, the Commercial Court in London issued a judgment for US$162 million plus interest against CPC, while dismissing CPC's counterclaims. On the application of the CPC, the Commercial High Court granted unconditional leave to appeal to the Court of Appeal. The hearing in the Court of Appeal has concluded and the result of that appeal is pending. CPC was also party to an oil derivatives arbitration before the London Court of International Arbitration in Singapore in which a decision in favor of CPC was issued where the claim against CPC was dismissed. In addition, CPC was awarded legal costs of US$2.5 million. CPC and the claimant have accepted the decision of the arbitral body. In an arbitration before the International Centre for Settlement of Investment Disputes ("ICSID"), it is alleged that the Government breached the terms of a bilateral investment treaty as a consequence of a dispute involving CPC's oil derivative transactions. The ICSID proceedings have concluded and the award is pending. Any decisions in these legal proceedings may be subject to subsequent legal proceedings. The Government estimates the aggregate amount in dispute across the Court of Appeal and the ICSID cases would be less than US$250 million. The Government was not a party to CPC's oil derivative transactions (as obligor, guarantor or otherwise) and has no obligations under Sri Lankan law to assist the CPC, directly or indirectly, in satisfying any final judgment against CPC that may result from the proceeding before the Court of Appeal.

SUMMARY ECONOMIC DATA

	2007	2008	2009	2010	2011[1]	First three months of 2011[1]	First three months of 2012[1]	% Increase or Decrease
The Economy								
GDP (at current market prices) (Rs. million)	3,578,688	4,410,682	4,835,293	5,604,104	6,542,663	1,572,402	1,779,145	13.1
GDP (at constant 2002 prices) (Rs. million)	2,232,656	2,365,501	2,449,214	2,645,542	2,863,854	695,145	750,405	7.9
GDP per capita (in US dollars at current market prices)	1,617	2,014	2,057	2,400	2,836	N/A	N/A	N/A
GDP growth rate (%)	6.8	6.0	3.5	8.0	8.3	8.0	7.9	—
Inflation rate (year-on-year % change)[2]	18.8	14.4	5.0	6.8	4.9	7.1[3]	9.3[3]	—
Unemployment rate (%)[4]	6.0	5.4	5.8	4.9	4.2	4.3	N/A	—
Government surplus/(deficit) as % of GDP . . .	(6.9)	(7.0)	(9.9)	(8.0)	(6.9)	(2.0)	(2.8)	—

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

Notes:

(1) Provisional

(2) Inflation rate for 2007 and 2008 based on CCPI (2002=100) and from 2009 onwards based on CCPI (2006/07=100)

(3) Rates for June 2011 and June 2012

(4) Unemployment rate for 2007 excluding both the Northern and Eastern provinces and from 2008 excluding the Northern province only

	2007	2008	2009	2010	2011(1)	First three months of 2011(1)	First three months of 2012(1)	% Increase or Decrease
	(in US$ millions, except for percentages)							
External Finance								
Current account (deficit) as % of GDP	(4.3)	(9.5)	(0.5)	(2.2)	(7.8)	N/A	N/A	—
Overall BOP position	531	(1,385)	2,725	921	(1,061)	127	(251)	(279.6%)
Gross international official reserves (as of the end of the period)	3,063	1,753	5,097	6,610	5,958	6,993	5,730	(18.1%)
International total reserves (as of the end of the period)	4,511	2,991	6,770	8,035	7,899	8,249	6,957	(15.7%)

Source: Central Bank of Sri Lanka

Notes:

(1) Provisional

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011(1)	2011(1)	2012(1)	% Increase or Decrease
Domestic and External Debt								
Government domestic debt (Rs. million)	1,715,198	2,140,228	2,400,955	2,565,662	2,804,085	2,729,667	3,142,520	15.1%
Government foreign debt (Rs. million)	1,326,487	1,448,734	1,760,467	2,024,583	2,329,280	2,071,187	2,759,680	33.2%
Government domestic debt as % of GDP	47.9	48.5	49.7	45.8	42.9	—	—	—
Government foreign debt as % of GDP	37.1	32.8	36.5	36.1	35.6	—	—	—

Note:

(1) Provisional

	2007	2008	2009	2010	2011(1)	First three months of 2011(1)	First three months of 2012(1)	% Increase or Decrease
Banking Sector								
Total assets of banking system (as of the end of the period) (Rs. million)(2) . .	2,504,201	2,697,450	3,013,256	3,550,515	4,235,113	3,687,701	4,586,176	8.3
Broad money (as of the end of the period) (Rs. million)(3) . .	1,404,019	1,522,776	1,806,169	2,091,408	2,491,740	2,239,036	2,707,159	20.9
Average Weighted Prime Lending Rate per annum (%) (monthly rate)	17.00	19.17	11.12	9.27	10.49	9.15	12.42	35.7
Fixed capital (medium-term) lending nominal interest rate (%)(4)	18.08	20.13	17.41	14.80	13.44	14.11	14.09	(0.1)

Source: Central Bank of Sri Lanka

Notes:

(1) Provisional

(2) Excludes Central Bank assets

(3) Data for May 2011 and May 2012

(4) Average weighted lending rate (AWLR)

THE OFFERING

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

Issuer	The Government of the Democratic Socialist Republic of Sri Lanka.
Bonds	US$1,000,000,000 aggregate principal amount of 5.875% Bonds due 2022.
Interest Payment Dates	January 25 and July 25 of each year, commencing on January 25, 2013.
Maturity Date	The Bonds will mature on July 25, 2022.
Redemption	The Bonds will not be redeemable prior to maturity.
Status of Bonds	The Bonds will constitute direct, unconditional, unsubordinated and unsecured general obligations of the Issuer. The Bonds will at all times rank *pari passu* among themselves in all respects without any preference of one over the other by reason of priority of date of issue or otherwise. The Bonds will at all times rank at least equally with all other present and future unsecured and unsubordinated External Indebtedness (as defined herein) of the Issuer. The full faith and credit of the Democratic Socialist Republic of Sri Lanka will be pledged for the due and punctual payment of the principal of, and interest on, the Bonds.
Limitation on Liens	With certain exceptions, so long as any Bonds remain Outstanding (as defined herein), the Issuer shall not create, incur, assume or permit to subsist any Lien (as defined herein) upon the whole or any part of its present or future assets or revenues to secure (1) any Public External Indebtedness (as defined herein); (2) any Guarantees (as defined herein) in respect of Public External Indebtedness; or (3) the Public External Indebtedness of any other person; without at the same time or prior thereto securing the Bonds equally and rateably therewith or providing such other arrangement (whether or not comprising a Lien) as shall be approved by not less than 66 2/3% of the aggregate principal amount of Outstanding Bonds which are represented at a meeting of Holders (as defined herein) duly convened in accordance with the Indenture (as defined herein). See "Description of the Bonds — Limitation on Liens."

Taxation . . . . The Issuer will make all payments on the Bonds without withholding or deducting any present or future taxes imposed by Sri Lanka or any of its political subdivisions, unless required by law. If Sri Lankan law requires the Issuer to deduct or withhold taxes, it will pay the holders such additional amounts as are necessary to ensure that they receive the same amount as they would have received without such withholding or deduction. The Issuer will not, however, pay any such additional amounts if the holder is liable for Sri Lankan tax under certain circumstances. See "Description of the Bonds — Additional Amounts." For a description of certain United States tax aspects of the Bonds, see "Taxation — United States Federal Income Taxation."

Cross-Defaults . . . . Events of default with respect to the Bonds include (1) any External Indebtedness shall become (or shall become capable of being declared) due and payable prior to its stated maturity (otherwise than at the option of the Issuer); (2) any default shall occur in the payment of principal of, or premium or prepayment charge (if any) or interest on, any External Indebtedness when and as the same shall become due and payable if such default shall continue for more than the period of grace, if any, originally applicable thereto; or (3) any default shall occur in the payment when due and called upon (after the expiry of any originally applicable grace period) of any Guarantee of the Issuer in respect of any External Indebtedness of any other person, *provided* that the aggregate amount of the relevant External Indebtedness in respect of which one or more of such events have occurred equals or exceeds US$25.0 million (or its equivalent in any other currency or currencies). See "Description of the Bonds — Events of Default."

Collective Action Clause . . . . . The Bonds will contain provisions regarding default and acceleration and approval of amendments, modifications, changes and waivers with the consent of the Holders of specified percentages of the Outstanding Bonds, which are commonly referred to as "collective action clauses." See "Description of the Bonds — Modifications and Amendments; Meetings of Holders."

Listing . . . . Approval in-principle has been received from the SGX-ST for the listing and quotation of the Bonds on the SGX-ST. The Bonds will be traded on the SGX-ST in a minimum board lot size of US$200,000 for so long as the Bonds are listed on the SGX-ST.

Ratings of the Bonds	The Bonds are expected to be rated "B+" by S&P, "B1" by Moody's and "BB-" by Fitch. The ratings assigned by rating agencies are indicative and may go up and down from time to time. A credit rating is not a recommendation to purchase, hold or sell securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.
Form, Denomination and Registration	The Issuer will issue the Bonds in fully registered form in minimum denominations of US$200,000 and integral multiples of US$1,000 in excess thereof. The Bonds will be represented by one or more Global Bonds (as defined herein), registered in the name of Cede & Co., as nominee of DTC. Beneficial interests in the Global Bonds will be shown on, and the transfer thereof will be effected only through, records maintained by DTC and its direct and indirect participants (including Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear") and Clearstream Banking société anonyme, Luxembourg ("Clearstream, Luxembourg")). Settlement of all secondary market trading activity in the Bonds will be made in immediately available funds.
Further Issues	The Issuer may from time to time, without notice to or the consent of the Holders, issue further bonds having terms and conditions the same as the Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single series and class with the Bonds, provided that such further bonds must be fungible with the Bonds for U.S. federal income tax purposes.
Use of Proceeds	The net proceeds from the issuance of the Bonds will be used to finance infrastructure projects and to restructure the existing Government debt portfolio. See "Use of Proceeds."
Trustee; Paying Agent; Transfer Agent	HSBC Bank USA, National Association.
Governing Law	The Bonds and the Indenture will be governed by and interpreted in accordance with the laws of the State of New York.

USE OF PROCEEDS

The Government will use the net proceeds from the issue of the Bonds (estimated to be US$996,300,000 after deduction of underwriting commission and fees as well as estimated expenses) as follows:

- To retire the Government's US$500 million 8.25% Bonds due 2012; and

- To develop infrastructure projects that have been previously approved by the Government and included in the current 2012 budget.

Nevertheless, the Government is subject to budgetary and funding limitations and there is no assurance that all the net proceeds will ultimately be used only for the above purposes.

THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

History, Land and People

History

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

Geography and General Information

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

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

The population of Sri Lanka was estimated to be 20.3 million in 2011. Sri Lanka has a diverse ethnic composition: based on data from the last census that covered the entire country, 74.0% of the people are Sinhalese, 18.0% are Tamils, 7.0% are of Arab descent and the remaining 1.0% is of other ethnicities. As of December 31, 2010, the literacy rate was 91.9%. Sinhalese and Tamil are the official languages of Sri Lanka and, along with English, are taught in all schools. Based on the last census, 69.3% of the population is Buddhist, mostly Sinhalese, 15.5% is Hindu, 7.6% is Christian and 7.5% is Muslim. Sri Lanka's cities with populations of more than 100,000 are Colombo, Dehiwala-Mount Lavinia, Moratuwa, Jaffna, Kandy, Negombo and Sri Jayawardenapura-Kotte. Colombo, located on the western coast of the island, is the commercial capital and the largest city in Sri Lanka, with a population of approximately 700,000. An administrative capital, Sri Jayawardenapura-Kotte, was designated in 1977 and serves as the site of the Parliament.

Government

Constitutions

The first constitution of Ceylon, promulgated at the time of independence on February 4, 1948 and commonly referred to as the Soulbury Constitution, comprised several documents, including The Ceylon Independence Act of 1947 and The Orders in Council of 1946 and 1947. The first republican constitution, which provides for a unicameral Parliament, was drafted by the Members of Parliament functioning as a Constituent Assembly and promulgated on May 22, 1972. On September 7, 1978, the third and current constitution, the Constitution, was promulgated. There have been eighteen amendments to the Constitution, covering various matters relating to the rights and responsibilities of the judiciary, executive and parliamentary branches of the Government. Under the Constitution, the term of office for both the President and Members of Parliament is six years. The Constitution also introduced an electoral process, which provides for a proportional representation system of voting for Members of Parliament. The number of Members of Parliament was increased to 225 by the Fourteenth Amendment to the Constitution.

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

Governmental Structure

President

The President of the Republic is directly elected for a six-year term and functions as Head of State, Head of the Executive and the Government and Commander-in-Chief of the armed forces. The President is responsible to the Parliament for the exercise and discharge of his powers and duties under the Constitution and the laws of Sri Lanka.

The President appoints the Prime Minister and the Cabinet of Ministers, which are responsible and answerable to the Parliament.

The President has the right to attend, address and send messages to Parliament at any time. The President is also entitled to all the privileges, immunities and powers of a Member of Parliament other than the right to vote and shall not be liable for any breach of the privileges of Parliament, or of its Members.

The Constitution also confers upon the President the power to exercise the following rights, among others:

- make the Statement of Government Policy in the Parliament at the commencement of each parliamentary session;
- preside at ceremonial sessions of the Parliament;
- summon, suspend or end a legislative session of and dissolve the Parliament;
- receive, recognize, appoint and accredit Ambassadors, High Commissioners, Plenipotentiaries and other diplomatic agents;
- keep and use the Public Seal of Sri Lanka and to make and execute under the Public Seal the Acts of Appointment of the Prime Minister and other Ministers of the Cabinet of Ministers, the Chief Justice and other Judges of the Supreme Court;
- grant and dispose of lands and immovable property vested in Sri Lanka as the President is by law required or empowered to do;
- declare war and peace;

- perform all such acts and things consistent with the provisions of the Constitution or written law, as by international law, custom or usage the President is required or authorized to do; and

- grant pardons, grant any respite, substitute a less severe form of punishment for any punishment and remit the whole or any part of any punishment imposed.

Under the immunities granted to the President by the Constitution, no legal proceedings may be initiated or continued against the President with regard to any act of the President in his or her official or private capacity while he or she is in office. If the President is unable to perform his or her duties due to illness or absence from the country, the Prime Minister may be appointed to exercise, perform and discharge the powers, duties and functions of the President. A Minister of the Cabinet may then be appointed to act for the Prime Minister. The Elections Department headed by Commissioner General of Elections conducts the presidential elections, where the entire country is considered to be a single constituency.

Prime Minister

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

Parliament

The Parliament is a unicameral 225-member legislature elected by universal suffrage on the basis of proportional representation to a six-year term. The President may from time to time summon, suspend or end a legislative session and dissolve the Parliament under the Constitution. The Parliament reserves the power to make all laws and to repeal or amend any provision of the Constitution. The Parliament is not permitted under the Constitution to abdicate or in any manner alienate its legislative power. The Speaker, the Deputy Speaker and the Deputy Chairman of Committees are elected by the Parliament at its first meeting after a general election. The Speaker is to preside at sessions of the Parliament. In his absence, the Deputy Speaker, or in the absence of both, the Deputy Chairman of Committees shall preside. The privileges, immunities and powers of the Parliament and its Members are determined by the Parliament and regulated by law.

Judiciary

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

Provincial Councils

Under the Thirteenth Amendment to the Constitution significant authority was delegated to the provinces. These Provincial Councils are directly elected for five-year terms. The President appoints a Provincial Governor, who then appoints the Board of Ministers, consisting of the Chief

Minister and four other Ministers from among the elected members. The Provincial Councils possess certain provincial-level legislative and executive powers over education, health, rural development, tourism, social services, agriculture and local taxation, subject to Government oversight. There are also municipal, urban, and rural councils with limited powers.

Principal Government Officials

Name	Principal Positions	Age
Mahinda Rajapaksa	President	67
D.M. Jayarathne	Prime Minister	81
Nimal Siripala de Silva	Leader of the House	68
Dinesh Gunawardena	Chief Government Whip	63
G.L. Peris	Minister of External Affairs	66

National Elections and Recent Political Developments

Sri Lanka has a multi-party democracy. Two major parties, the Sri Lanka Freedom Party (the "SLFP") and the United National Party (the "UNP"), have generally alternated rule since independence in 1948.

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

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

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

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

President Mahinda Rajapaksa dissolved the 13th Parliament on February 9, 2010 and called for a General Election. SLFP, Jathika Hela Urumaya, Jathika Nidahas Peramuna, Lanka Samasamaja Party, the Sri Lanka Communist Party, the National Unity Alliance and the National Muslim Congress contested as an alliance named the United People's Freedom Alliance (the "UPFA").

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

The next parliamentary election is required to be held before April 2016 and the next presidential election is required to be held before November 2016, though the incumbent President can call for a presidential election any time after the completion of four years of his second term of office, which will be on November 17, 2014.

The table below sets out the general election results over the last three elections:

RESULTS OF RECENT PARLIAMENTARY ELECTIONS

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

Source: Sri Lanka Elections Department

Notes:

(1) The SLFP, the Mahajana Eksath Peramuna, the Lanka Samasamaja Party, Jathika Hela Urumaya and the Sri Lanka Communist Party are the main parties of United People's Freedom Alliance

(2) JVP joined together with the Democratic National Alliance and participated in the election in 2010

On September 8, 2010, the Eighteenth Amendment to the Constitution was passed in the Parliament with a two-thirds majority. This amendment has the effect of introducing, among others, the following changes to the Constitution: removing the limitation on the number of times a person can be elected to the office of President; imposing a requirement for the President to attend Parliament once every three months; conferring on the President the right to address and send messages to Parliament by virtue of his office; vesting in the President the right to appoint the Chairmen and members of certain Commissions after seeking the observations of a Parliamentary Council and the right to appoint certain other members of the Judiciary and other officials; vesting power on the Cabinet of Ministers with respect to policy relating to public officers, including the power to appoint, promote, transfer, discipline and dismiss all heads of Departments; and changing certain provisions relating to the National Police Commission.

Administrative Structure

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

The Government is composed of various ministries and ministry-equivalent agencies of the executive branch, which implement the various programs and projects of the Government. There are a total of 55 ministries. Set out below is a list of all of the ministries:

LIST OF MAJOR MINISTRIES

Sector	Ministries
Economic services	Economic Development; Telecommunication and Information Technology; Postal Services; Ports and Highways; Transport; Petroleum Industries; Co-operatives and Internal Trade; Agriculture; Power and Energy; Water Supply and Drainage; Labor and Labor Relations; Fisheries and Aquatic Resources Development; Technology and Research; Livestock and Rural Community Development; Lands and Land Development; Construction, Engineering Services, Housing and Common Amenities; Irrigation and Water Resources Management; Plantation Industries; Traditional Industries and Small Enterprises Development; Industry and Commerce; State Resources and Enterprise Development; Civil Aviation; Coconut Development and Janatha Estate Development; Agrarian Services and Wildlife; Minor Export Crop Promotion; Productivity Promotion; Private Transport Services
Social services	Health; Education; Child Development and Women's Affairs; Social Services; Youth Affairs and Skills Development; Higher Education; Sports; Resettlement; Environment; National Heritage; Culture and Arts; Indigenous Medicine; National Languages and Social Integration; Rehabilitation and Prison Reforms; Foreign Employment Promotion and Welfare
General public services . .	Finance and Planning; Defense and Urban Development; Buddha Sasana and Religious Affairs; Disaster Management; Justice; Local Government and Provincial Councils; Public Administration and Home Affairs; Mass Media and Information; External Affairs; Public Relations and Public Affairs
Constitutional offices	Parliamentary Affairs; Public Management Reforms

Public Corporations

The Government owns or controls a number of corporations that provide essential goods and services and compete with the private sector to encourage economic growth and development. The Government, through the Strategic Enterprise Management Agency ("SEMA"), closely monitors 22 strategic enterprises engaged in various major business activities to ensure that they operate as viable commercial enterprises without depending on state subsidies, and to ensure efficiency of delivering services. These 22 enterprises are: Peoples Bank, Bank of Ceylon, National Savings Bank ("NSB"), State Mortgage & Investment Bank, Lanka Puthra Development Bank, Sri Lanka Transport Board, Sri Lanka Railways ("SLR"), Sri Lanka Ports Authority, Airport and Aviation Services (SL) Ltd., Ceylon Electricity Board, Ceylon Petroleum Corporation ("CPC"), National Water Supply and Drainage Board, State Pharmaceuticals Corporation, Janatha Estates Development Board, Sri Lanka State Plantations Corporation, Elkaduwa Plantations Ltd., Kurunegala Plantations Ltd., Chilaw Plantations Ltd., Sri Lanka Cashew Corporation, National Livestock Development Board, Lanka Salusala Ltd. and Sri Lanka Handicraft Board (Laksala).

The enterprises under SEMA are grouped into four categories or clusters, namely the financial services cluster, the utility cluster, the transport and logistics cluster and the plantation and assets cluster.

Mahinda Rajapaksa Administration Policy

On November 25, 2005, President Mahinda Rajapaksa announced his policy priorities for his term of office to the Parliament, and he continues to have such policy priorities in his second term. They include:

- launching a peace initiative through an inclusive process culminating in the introduction of reforms to the Constitution;

- carrying out a series of improvements in public services, rule of law and the taxation systems;

- introducing economic policies to boost local and foreign investment and small and medium-scale enterprises;

- developing local and national infrastructure;

- launching development and reconstruction schemes to rebuild the lives of those affected by the tsunami in 2004 and taking steps to resettle people internally displaced as a result of the tsunami;

- reducing poverty rates and achieving a balanced regional development; and

- strengthening and developing friendly relationships with countries in both Asia and other parts of the world.

The peace and constitutional reform process has progressed through extensive initiatives and discussions initiated by the All Party Representative Committee ("APRC") and on August 16, 2009, a summary report of the recommendations of the APRC was presented to the President.

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

The Government introduced the Fiscal Management (Responsibility) Act (the "FMRA") in 2003 with a view to improving the management, transparency and accountability of fiscal operations. In order to fulfill the objective of transparency and accountability, the FMRA has specified several reports to be presented to the Parliament and to the general public within a given time frame. Since the enactment of the FMRA, the Government has published these reports, which has improved availability and transparency of information regarding its budgetary operations.

Under the FMRA, the budget deficit was to be reduced to 5.0% of GDP by 2006 and maintained at that level thereafter. The outstanding Government debt, as a percentage of GDP, was also to be reduced to 85.0% by 2006 and to 60.0% by the end of 2013. The targets were not met due to a number of significant unforeseen and adverse events, such as the 2004 tsunami disaster, the escalation of international commodity prices in 2007 and 2008 and the global economic crisis and intensified counterterrorism activities in 2009. In addition to the negative impact that these events had on GDP, the Government had to respond to these events by implementing appropriate measures which had a further negative impact on the performance of its budgetary operations. For example, in 2004, the country was struck by a tsunami, which left more than 35,000 people dead, more than 21,000 people injured and another 500,000 people internally displaced. The tsunami devastated certain economic sectors in the country and left a significant amount of infrastructure damaged or destroyed in its wake. As a result, the Government spent significant amounts of money rebuilding homes and infrastructure and reviving the local economies of the affected areas. The Government also funded certain resettlement, development and reconciliation activities relating to the country's recently resolved internal conflict. In 2009, the Government also prioritized the provision of basic needs for internally displaced people, resettlement of such people and reconstruction and rehabilitation of conflict-affected infrastructure. Although the targets set out in the FMRA relating to budget deficits were not achieved, the outstanding debt to GDP ratio declined from 102.3% in 2003 to 78.5% by the end of 2011. The budget deficit has declined from 9.9% of GDP in 2009 and 8.0% of GDP in 2010 to 6.9% of GDP in 2011.

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

History

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

Resumption of Hostilities in 2006 and Defeat of the LTTE

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

During 2007, Government forces intensified their operations against the LTTE, resulting in the liberation and the restoration of peace in the Eastern Province. Military operations in the Northern Province began in March 2007. In the course of the hostilities, thousands of civilians were held hostage by the LTTE as human shields. The Government carried out a series of military and humanitarian operations to liberate them and provide for the needs of civilians displaced by hostilities. In May 2009, after a series of successful operations, the military defeated LTTE forces, thereby gaining full control of the Northern Province. The LTTE acknowledged their defeat in May 2009, and on May 19, 2009, the President officially notified Parliament that the LTTE had been defeated and that terrorism had been eradicated from the country.

Resettlement, Development and Reconciliation Activities

From the time hostilities resumed in 2006 until the end of the conflict in May 2009, a large number of people were displaced in the Eastern and Northern Provinces. Since defeating the LTTE and obtaining control over the Northern and Eastern Provinces, the Government has re-settled a large number of the internally displaced people as quickly as possible. The Government is currently in the process of completing de-mining activities, rehabilitating key infrastructure and encouraging economic activity for the benefit of people in these two provinces, particularly in the recently liberated Northern Province.

In the Eastern Province, the Government launched the *Neganahira Navodaya* (Eastern Resurgence) Program in 2007 in order to rehabilitate the Eastern Province and accelerate development. During the last five years, the damaged social and economic infrastructure of the Eastern Province was rehabilitated, in part through the removal of all land mines under the *Negenahira Navodaya* program. A number of large bridges in the East including the Kinniya bridge, Sri Lanka's longest bridge, linking Trincomalee with Kinniya, the Irakkandi bridge linking Trincomalee with Pulmodai and the Arugam Bay bridge connecting Pottuvil, Arugam Bay and Panama were constructed at an aggregate cost of more than Rs.7 billion. In addition, various road development projects, water supply schemes, electricity schemes and housing schemes were implemented in the Eastern Province to facilitate reconstruction and development activities. The Government has resettled all internally displaced people from the Eastern Province. In 2012, the Government is planning to spend Rs.25.4 billion (US$205 million) for development activities in the Eastern Province.

Resettlement of the internally displaced people from the Northern Province is one of the Government's top priorities. There were 295,136 IDPs at the time the internal conflict ended in May 2009. At the end of June 2012, 98% of IDPs had been resettled, reflecting the strong effort taken by the Government to resettle IDPs, with the help of development partners and other stakeholders.

In May 2009, President Mahinda Rajapaksa appointed the Presidential Task Force for Resettlement, Development and Security in the Northern Province. The Task Force was mandated to, among other things, prepare and oversee programs to resettle internally displaced persons and rehabilitate and develop the economic and social infrastructure of the Northern Province. The Presidential Directive appointing the Task Force requires it to complete its mandate and report to the President within one year. The Task Force moved quickly to establish the *Uthuru Wasanthaya* (Northern Spring) program in mid-2009. The *Uthuru Wasanthaya* (Northern Spring) Program includes a 180-day accelerated timetable to expedite the resettlement and rehabilitation process, and a parallel long term program for rehabilitation and development activities, including the development, construction and rehabilitation of roads, other transportation, electricity, housing, water supply, agriculture, and irrigation. Money will also be allocated for poverty reduction and the reinforcement of the social safety net. The Government's rehabilitation and reconstruction initiatives are being implemented concurrently with extensive and ongoing de-mining activities in the Northern Province. From 2009 to 2011, the Government spent Rs.145.6 billion (US$1.3 billion) towards rehabilitation and development activities in the Northern Province. In 2012 the Government plans to spend Rs.63.8 billion (US$517 million) for development activities in the Northern Province.

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

The Central Bank opened a Northern provincial office in Jaffna to encourage micro and small entrepreneurs to invest and expand by obtaining financial assistance from the banking sector. The Central Bank also introduced a Credit Guarantee Scheme for the benefit of farmers in the Killinochchi, Mullaitivu and some parts of the Mannar district who have been facing difficulties in obtaining short-term cultivation loans due to their inability to provide title deeds to establish land rights/ownership through which the Central Bank will guarantee up to Rs.200,000 per farmer in case of default arising due to a land ownership dispute. The scheme has encouraged banks to disburse more cultivation loans to farmers. The Central Bank has also arranged credit facilities for and provided entrepreneurship development services to resettled IDPs to restart their livelihood and conducted financial literacy programs to create awareness of the formal sector financial facilities and services. In addition, the Central Bank has also introduced the "Awakening North Loan Scheme Revolving Fund — Phase II " in 2012 which is a special low-interest loan scheme for permanent residents living in the Northern Province.

The Government has also encouraged the expansion of micro-finance activities in the Eastern and Northern Provinces to facilitate grass-roots economic growth. In this regard, since May 2009 111 banking outlets were established in the Northern Province and 117 banking outlets were established in the Eastern Province. As at May 2012 the Northern and Eastern Provinces had 441 bank branches and extension offices, 219 ATMs, 88 licensed finance company branches and 25 specialised and leasing company outlets.

The Government is committed to the restoration of democracy in the two provinces. Local government elections were held in the Batticaloa District in March 2008, and Provincial Council elections were held in the Eastern Province in May 2008. Provincial Council Ministers have been appointed, and a former Tamil child combatant became the Chief Minister of the Eastern Province. The elections for Jaffna Municipal Council and the Vavuniya Urban Council were held in August 2009. Local government elections for most of the remaining local authorities in the Northern and Eastern Provinces were held in March 2011, with the balance held in July 2011.

The Government expects the end of the 26-year internal conflict to have a significant positive economic impact, not just on the Northern and Eastern Provinces, but also on the entire country as these two regions integrate with the national economy. The Northern and Eastern Provinces have substantial natural resources, including long, scenic and unpolluted beaches and ecological conservation areas that can support a vibrant tourism industry. The modernization of existing croplands, livestock farms and fisheries should help boost the regional economies. The contribution to the country's GDP by the Eastern Province increased to 5.9% in 2010, from 5.8% in 2009, 5.6% in 2008 and 5.2% in 2007. The contribution to the country's GDP by the Northern Province increased to 3.4% in 2010, from 3.2% in 2009, 3.2% in 2008 and 2.9% in 2007. The Government expects that the country as well as the Northern and Eastern Provinces will benefit from a peace dividend following the cessation of hostilities in May 2009.

International Relations

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

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

MEMBERSHIP IN INTERNATIONAL FINANCIAL ORGANIZATIONS

Name of Organization	Date of Admission	Subscribed	Capital Paid In	Loans Outstanding (at December 31, 2011)
		(in millions)		
International Monetary Fund	1950	SDR413.4	SDR47.9	SDR1,119.1
International Development Agency	1950	US$463.8	US$56.2	US$2,751.8
Asian Development Bank	1966	US$317.6	US$84.1	US$2,575.2

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

Sri Lanka is now an active member of the Commonwealth, the South Asian Association for Regional Cooperation, the WTO, the World Bank and the IMF. Sri Lanka has also made commitments under the General Agreement of Trade in Services (the "GATS") in relation to insurance, telecommunications, tourism and financial services. With respect to regional and bilateral relationships, Sri Lanka has made considerable progress in furthering its liberalization arrangements in recent years. The tariff concessions offered under the Indo-Sri Lanka Free Trade Agreement (the "ISLFTA"), the Pakistan-Sri Lanka Free Trade Agreement and the Generalized System of Preference Schemes implemented by the EU, the USA and a number of other trading partners have increased trade with these countries.

Sri Lanka promotes its economic interests through membership in the following regional and bilateral trade agreements:

- Bay of Bengal Initiative for Multi-Sectoral, Technical and Economic Co-operation
- Asia Cooperation Dialogue
- Colombo Plan
- Indian Ocean Rim Association for Regional Co-operation
- South Asian Preferential Trading Agreement
- South Asian Free Trade Agreement
- Global System of Trade Preferences
- Generalized System of Preferences
- India-Sri Lanka Free Trade Agreement
- Pakistan-Sri Lanka Free Trade Agreement
- South Asian Association for Regional Cooperation
- Asia Pacific Trade Agreement (Bangkok Agreement)

- United Nations Conference on Trade and Development
- Trade and Investment Framework Agreement between the United States and Sri Lanka
- European Commission — Sri Lanka Joint Commission

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

Recent Economic Indicators

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

PRINCIPAL ECONOMIC INDICATORS

	2007	2008	2009	2010	2011[1]	First three months of 2011	First three months of 2012[1]	% Increase or Decrease
	(in US$ millions, except for percentages)							
GDP growth (%)	6.8	6.0	3.5	8.0	8.3	8.0	7.9	—
GNP growth (%)	7.1	4.6	4.8	7.9	8.4	8.4	8.2	—
Inflation rate (year-on-year % change)[2]	18.8	14.4	5.0	6.8	4.9	7.1[3]	9.3[3]	—
Unemployment rate (%)[4]	6.0	5.4	5.8	4.9	4.2	4.3	N/A	—
91-day T-bill rate (%)	21.3	17.3	7.7	7.2	8.7	7.0	11.0	—
External position								
Balance of payments	531	(1,385)	2,725	921	(1,061)	127	(251)	—
Trade-in-goods balance	(3,657)	(5,981)	(3,122)	(4,825)	(9,710)	(1,767)	(2,559)	44.8
Exports	7,640	8,111	7,085	8,626	10,559	2,671	2,634	(1.4)
Imports	11,296	14,091	10,207	13,451	20,269	4,438	5,193	17.0
Outstanding direct external debt of the issuer	12,201	12,805	15,391	18,247	20,450	18,614	20,665	11.0
International reserves								
Gross official	3,063	1,753	5,097	6,610	5,958	6,993	5,730	18.0
Net official (US$ million)	2,810	1,584	4,150	5,071	4011	5,198	3,760	(28.0)
Merchandised Imports (No. of months)	3	2	6	6	4	6	3	—
Domestic credit growth (%) [3]	16.3	18.0	0.5	18.6	34.3	23.2	40.5	—

Sources: Central Bank of Sri Lanka and Department of Census and Statistics

Note:

(1) Provisional

(2) Inflation rate for 2007 and 2008 based on CCPI (2002=100) and from 2009 based on CCPI (2006/07=100)

(3) Rates for May 2011 and May 2012

(4) The unemployment rate for 2007 excludes both the Northern and Eastern provinces and, from 2008, excludes the Northern province

Overview of the Sri Lankan Economy

Overview

Sri Lanka adopted free market economic policies in 1977. Since then, successive Governments have sought to deregulate and open the economy to international competition by removing many of the financial controls and barriers that previously constrained private sector participation in the economy. Successive Governments have also attempted to establish an economic system under which growth would be driven by the private sector, with the Government serving as a facilitator of economic activities. The internal conflict of 1983 and the subsequent political uncertainty in the late 1980s led to a slowdown in economic diversification and liberalization. In the 1990s, a more market-oriented system was put in place by the Government, in particular with respect to export-oriented growth, which helped boost the economy's performance and increased GDP growth to 6.9% in 1993. Nevertheless, economic growth has been uneven since 1993 as the economy continued to face various economic and political challenges due to both internal and external factors. Average annual GDP growth amounted to 5.2% from 1991 to 2000. In 2001, GDP suffered a negative growth of 1.5%, the first contraction since Sri Lanka's independence in 1948. Since then, GDP has increased by 6.0% on an annual average basis from 2002 to 2008. In 2009, the economy of Sri Lanka demonstrated its resilience by growing 3.5% in the midst of a global economic recession. This was followed by 8.0% growth in 2010 and 8.3% in 2011, leading to two years of economic growth of 8.0% or higher in two consecutive years for the first time in Sri Lanka's history. In 2012, the economy is forecast to grow at 7.2%.

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

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

- high credit growth and trade deficit;
- the now-resolved internal conflict with the LTTE;
- completion of resettlement of internally displaced persons and rehabilitation and reconstruction of conflict affected infrastructure in the newly liberated Northern and Eastern provinces;

- infrastructure deficiencies in electricity, roads and transport, which had become major impediments to investment and balanced regional development;

- high international commodity prices including oil;

- the successive monetization of fiscal deficits, which has resulted in pressure on inflation and high finance costs, which discourage private investment, particularly in small and medium-scaled enterprises; and

- the tax to GDP ratio, which resulted in an increase in the public debt and more restrictive budgets for development expenditures.

In response, the Government has implemented a series of short-term and medium term measures to address these challenges. Further, the Government has shown a deep commitment to the diversification of exports, development of tourism and improvement of information and communication technology. The Government has declared its intention to transform Sri Lanka into a naval, aviation, commercial, energy and knowledge hub and develop the country into a strategically important regional economic center. In so doing, the Government plans to make use of the advantage of Sri Lanka's strategic location on shipping routes, make better use of the Indo-Lanka Free Trade Agreement and enter into more beneficial free trade agreements with other countries to achieve regional trading hub status.

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

Infrastructure Development

Accelerated development in electricity, transport, seaports and airports, highways, irrigation and urban amenities have been identified as key priorities under the infrastructure development strategy of the Government. Sri Lanka works very closely with development partners to complete these projects as scheduled. Some of the major ongoing, planned and recently completed infrastructure projects are set out below:

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

Development Partner	Project	Estimated Project cost (US$ millions)	Loan Amount (US$ millions)[(2)]	Expected Year of Completion
China Exim Bank	Hambantota Sea Port Development Project (Phase I)	361.00	307.00	Completed
ADB	Colombo South Harbor Project	900.00	300.00	2012
China Exim Bank	Puttalam Coal Power Project (Phase I)	455.00	455.00	Completed
China Exim Bank	Puttalam Coal Power Project (Phase II)	891.00	891.00	2014
Japan/JICA	Upper Kotmale Hydro Power Project	446.00	346.00	Completed
Japan	Kerawalapitiya Dual Purpose Fuel Power Plant	309.00	24.00	Completed
Japan	Greater Colombo Transport Development Project	345.00	239.00	2015

Development Partner	Project	Estimated Project cost (US$ millions)	Loan Amount (US$ millions)[(2)]	Expected Year of Completion
Japan/ADB	Southern Expressway Construction Project (Phase I)	695.00	276.00	Completed
China Exim Bank	Southern Expressway Construction Project (Phase II)	142.00	140.00	2013
ADB	National Highways Sector Project	216.00	150.00	2012
Japan	Water Sector Development Project (I)	150.00	112.00	2012
IDA	Road Sector Assistance Project	262.00	102.00	Completed
France	Trincomalee Integrated Infrastructure Project TIIP	61.00	48.00	2012
ADB	Secondary Towns & Rural Community Water/Sanitation	174.65	120.30	2012
China Exim Bank	Southern International Airport	209.00	190.00	2012
China Exim Bank	Colombo — Katunayake Expressway	371.00	248.00	2012
ADB	Jaffna peninsula Water and Sanitation Sector Development Project	166.60	134.70	2017
China Exim Bank	Hambantota Bunkering Project	76.00	65.00	2012
Nordea Bank, Denmark	Oluvil Port Development Project	72.50	72.50	2012
Iran	Uma oya Hydro Electricity and Irrigation	548.00	450.00	2015
Nordea Bank, Denmark	Kelani Right Bank Water Treatment Plant	82.70	70.88	2012
Korea, Exim Bank	Ruhunupura Water Supply Development Project	115.76	76.34	2014
India	Upgrading Colombo-Matara Railway Line	212.40	167.40	2012

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) In addition to loan funds, most of the above projects require counterpart local funds of approximately 20.0% to 30.0% of loan funds

(2) Loan amounts refer to the amounts contemplated in signed agreements

Most of the major infrastructure projects require counterpart funds in addition to committed foreign aid or concessional loans. The Government generally finances these counterpart funds, which typically amount to approximately 20.0% to 30.0% of the total project cost. The counterpart funds, however, may not be immediately available for the project and are usually provided on a reimbursement basis, which generally takes approximately three to six months. Accordingly, the net proceeds from the issue of the Bonds is intended to be used by the Government as counterpart funds and in some cases, as bridging financing on a temporary basis for such infrastructure projects.

The "*Jathika Saviya-Gama Neguma*", the country's rural development initiative, has also been launched within a medium-term development framework aimed at addressing problems in the lagging regions. Under this program, the emphasis has been placed on the development of roads, electricity, irrigation and water supply, housing and livelihood assistance at the village level. The "*Maga Neguma*" program is also being implemented to improve the condition of rural roads. The implementation of these programs is expected to empower the community in the planning and development process and facilitate local ownership in development.

With the liberation of the Eastern and the Northern provinces, the country faces the challenge of quickly developing the necessary infrastructure for people in those areas to be resettled quickly and to facilitate their subsistence and economic activities. In respect of the Eastern Province, the Government has completed the implementation of a three-year comprehensive development plan, the *Neganahira Navodaya* Program, under which the Government improved the economic infrastructure in the Eastern Province. This program entails improving and rebuilding economic infrastructure in the region such as infrastructure for the provision of electricity and water, roads, bridges, and other transport and port development. Similarly, the Government has prepared a development plan for the Northern province, the *Uthuru Wasanthaya* program, which includes the construction of roads and bridges, railroads, transport services, electricity transmission lines, water supply schemes, housing development, telecommunications services and irrigation facilities in the Province. See "— Conclusion of Military Action Against the LTTE and Resettlement, Development and Reconciliation Activities — Resettlement, Development and Reconciliation Activities".

Restructuring Reform

During the past few years, the Government has recognized the importance of improving the management of state-owned enterprises ("SOEs"), which is a core component of its fiscal consolidation plans. In 2005, the SEMA was established. Since its inception, the SEMA has been involved in assisting strategic state enterprises to conceive business development plans to strengthen the management of these enterprises and to improve their performance. The SEMA closely monitors 22 strategic enterprises engaged in various major business activities to ensure that they operate as viable commercial enterprises without depending on state subsidies and to ensure efficiency of delivering services. Initiatives were introduced to speed up the public enterprises reform program aiming at improving fiscal flexibility by reducing budgetary transfers to public enterprises. Initiatives were also undertaken to reduce the Government's contingent liabilities. Accordingly, the Ministry of Public Management Reforms was established to modernize public management.

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

GDP and Major Financial Indicators

Gross Domestic Product

GDP measures the market value of all final goods and services produced within a country during a given period and is an indication of a country's productive output. By comparison, GNP measures the market value of all final goods and services produced by a country's citizens during a given period, whether or not the production occurred within the country.

Economists show GDP and GNP in both current and constant market prices. GDP and GNP at current market prices value a country's output using the actual prices of each year, whereas GDP and GNP at constant market prices (also referred to as real GDP and real GNP) value output using the prices from a base year, thereby eliminating the distorting effects of inflation. Unless otherwise specified, growth figures for GDP and GNP in this Offering Circular are year-on-year comparisons of real GDP and real GNP, respectively.

The domestic economy grew by 7.9% during the first quarter of 2012, compared to growth of 8.0% during the corresponding period in 2011. This growth was broad based with above 5.0% growth rates recorded in all three major sectors in the first quarter of 2012. Agriculture, mining and quarrying and construction grew at a faster pace than in the corresponding period of 2011.

Sri Lanka's GDP grew by 8.3% in 2011 following 8.0% growth in 2010. This was the highest annual growth rate achieved by the country in the past six decades and the first time Sri Lanka recorded an economic growth of 8.0% or higher in two consecutive years.

The services sector, which accounted for 59.5% of GDP in 2011, grew by 8.6% in 2011 compared to 8.0% in 2010. The wholesale and retail trade sub-sector expanded by 10.3%, compared to 7.5% in 2010. This was due to healthy growth in all three sub sectors, i.e., import, export and domestic trade. Import trade sub-sector recorded growth of 14.3% while the export trade sub-sector grew by 10.1% in 2011. The hotels and restaurants sub-sector expanded substantially following the cessation of hostilities in 2009, registering significant growth of 26.4% in 2011, compared to growth of 39.8% recorded in 2010. Meanwhile, the transport and communication sub-sector grew by 11.3% compared to 11.9% in 2010. All three components of this sub-sector, namely, (1) transport, (2) cargo handling-ports and civil aviation and (3) post and telecommunications contributed to this growth. The banking, insurance and real estate sub-sector grew by 7.9% compared to 7.5% in 2010. The government services and private services sub-sectors also contributed to economic expansion with growth rates of 1.2% and 7.2%, respectively, during the year.

The industry sector grew by 10.3% in 2011, compared to 8.4% recorded in 2010. The industry sector's contribution to GDP marginally increased to 29.3% in 2011 from 28.7% in 2010. The factory industry sub-sector, which accounts for more than 90.0% of the manufacturing sector output, grew by 8.3% in 2011, compared to a growth of 7.5% in 2010.

Despite the extreme weather that prevailed during the first quarter of 2011, which negatively affected agriculture production, agriculture sector, which accounted for 11.2% of GDP in 2011 and includes agriculture, forestry and fishing activities, expanded by 1.5% in 2011 from growth of 7.0% in 2010. Main contributory factors to this growth were the bountiful Yala harvest in paddy and other food crops in the second half of the year and expansion in fishing and livestock sectors throughout the year along with the recovery in coconut production.

Economic Effects of Rising Oil Prices

High international oil prices have posed a considerable challenge to Sri Lanka's BOP and had an impact on domestic petroleum prices and inflation. Petroleum imports amounted to US$4,795 million in 2011, US$3,041 million in 2010, US$2,184 million in 2009, US$3,392 million in 2008 and US$2,516 million in 2007. The average crude oil price (Brent) increased by 40% to US$112 per barrel in 2011 compared to US$80 per barrel in 2010. With the high oil prices in the international market in 2011 and first half of 2012, the Government continued short-term as well as medium to long-term measures to mitigate the adverse impact of oil price shocks to the economy, including:

- *encouraging greater energy efficiency and conservation*, including administrative measures to reduce energy inefficiency. The Sustainable Energy Authority carried out an Energy Labeling Programme and annual energy savings were equal to 294 GWh in 2011.

- *encouraging the development of alternative renewable energy sources*, particularly small hydroelectric power plants in the private sector. Currently, there are 87 mini hydroelectric power plants with a capacity of 183 MW already in operation and approvals have been granted for construction of 59 mini hydroelectric power plants with a combined capacity of 117 MW. In addition, there are two biomass-agricultural and industrial waste power plants (11 MW), two solar power plants (0.5 MW) and three wind power plants (30 MW) in operation. Approval has been granted for the construction of eight wind power plants (59 MW), two Biomass-Agricultural and Industrial Waste Power Plants (4 MW), nine Biomass-Dendro power plants (51 MW) and two Solar Power plants (0.86 MW).

- *constructing large-scale hydroelectric projects in Upper Kotmale* (with a capacity of 150 MW), construction of which commenced in 2007. The plant was added to the national grid recently.

- *constructing Phase I of the 900MW Puttalam coal power plant*, comprising installed capacity of 300MW at an estimated cost of US$455 million which has been added to the national grid. The construction work for Phase II (600 MW) has commenced.

- *constructing another coal power plant which will add 500 MW* is scheduled at an estimated cost of US$825 million at Trincomalee and expected to be commissioned for power generation by 2017. The power purchase agreement and the JV agreement have been approved by the Attorney General.

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

GROSS DOMESTIC PRODUCT BY MAJOR SECTORS (AT CURRENT PRICES)

	2007	2008	2009	2010	2011(1)	First Three Months of 2011(1)	First Three Months of 2012(1)	Percentage of GDP: First Three Months of 2011(1)	Percentage of GDP: First Three Months of 2012(1)
	(in Rs millions, except as indicated)								
Agriculture	418,104	590,114	613,694	717,910	791,155	236,161	237,341	15.0	13.3
Agriculture, Livestock and Forestry	363,404	522,180	534,140	624,134	681,951	213,400	210,327	13.6	11.8
Fishing	54,700	67,934	79,554	93,777	109,204	22,762	27,015	1.4	1.5
Industry	1,070,737	1,295,470	1,434,701	1,649,268	1,956,615	470,973	558,180	30.0	31.4
Mining and Quarrying	56,645	71,768	79,204	89,226	112,342	26,999	39,449	1.7	2.2
Manufacturing	661,983	791,898	875,562	1,009,003	1,191,579	302,565	343,951	19.2	19.3
Electricity, Gas and Water	88,005	104,666	113,687	127,625	141,474	33,133	38,124	2.1	2.1
Construction	264,104	327,138	366,248	423,414	511,220	108,276	136,656	6.9	7.7
Services	2,089,847	2,525,099	2,786,897	3,236,926	3,794,893	865,267	983,624	55.0	55.3
Wholesale and Retail Trade	790,628	949,372	948,425	1,096,961	1,357,662	337,280	394,013	21.4	22.1
Hotels and Restaurants	18,367	20,611	24,988	33,213	44,254	9,830	12,682	0.6	0.7
Transport and Communication	423,820	530,980	599,934	709,400	818,386	194,449	214,210	12.4	12.0
Banking, Insurance and Real Estate etc	328,158	413,322	499,304	597,540	709,316	146,241	172,304	9.3	9.7
Ownership of Dwellings	126,212	141,794	161,485	171,871	189,269	48,123	51,748	3.1	2.9
Government Services	333,758	380,765	445,543	500,547	532,455	91,978	98,193	5.8	5.5
Private Services	68,905	88,255	107,219	127,393	143,551	37,365	40,475	2.4	2.3
Gross Domestic Product	3,578,688	4,410,682	4,835,293	5,604,104	6,542,663	1,572,402	1,779,145	100.0	100.0
Gross National Product	3,539,634	4,305,651	4,779,497	5,534,327	6,470,617	1,552,845	1,761,175		
Total GDP (in millions of US dollars)	32,351	40,715	42,068	49,565	59,175	14,223	14,826		
GDP per capita (in US dollars)(2)	1,617	2,014	2,057	2,400	2,836	N/A	N/A		

Source: Department of Census and Statistics

Notes:

(1) Provisional

(2) Calculations based on Department of Census and Statistics Estimates

GROSS DOMESTIC PRODUCT BY MAJOR SECTORS
(AT CONSTANT (2002) PRICES)

	2007	2008	2009	2010	2011(1)	First Three Months of 2011(1)	First Three Months of 2012(1)	Percentage of GDP: First Three Months of 2011(1)	Percentage of GDP: First Three Months of 2012(1)
	(in Rs. millions, except as indicated)								
Agriculture	265,870	285,897	295,097	315,610	320,346	85,371	95,162	12.3	12.7
Agriculture, Livestock and Forestry	241,285	258,881	266,208	283,203	282,916	77,390	86,698	11.1	11.6
Fishing	24,585	27,016	28,888	32,407	37,431	7,981	8,464	1.1	1.1
Industry	635,199	672,791	701,129	760,334	838,932	203,086	225,057	29.2	30.0
Mining and Quarrying .	42,631	48,090	52,030	60,079	71,191	15,952	20,232	2.3	2.7
Manufacturing	394,233	413,681	427,334	458,660	494,990	123,035	131,285	17.7	17.5
Electricity, Gas and Water	55,339	56,847	58,974	63,682	69,547	15,004	15,844	2.2	2.1
Construction	142,996	154,173	162,790	177,912	203,204	49,095	57,697	7.1	7.7
Services	1,331,587	1,406,813	1,452,988	1,569,598	1,704,576	406,689	430,186	58.5	57.3
Wholesale and Retail Trade	546,145	571,911	570,698	613,358	676,565	159,033	170,278	22.9	22.7
Hotels and Restaurants	9,199	8,741	9,901	13,845	17,501	3,321	4,052	0.5	0.5
Transport and Communication . . .	286,764	310,029	329,578	368,643	410,402	100,908	106,665	14.5	14.2
Banking, Insurance and Real Estate etc	193,375	206,048	217,819	234,255	252,677	61,121	65,548	8.8	8.7
Ownership of Dwellings	72,345	73,137	74,051	74,692	75,607	18,911	19,161	2.7	2.6
Government Services .	171,259	181,051	191,778	202,187	204,704	46,554	46,932	6.7	6.3
Private Services . . .	52,500	55,896	59,164	62,617	67,119	16,841	17,551	2.4	2.3
	2,232,656	2,365,501	2,449,214	2,645,542	2,863,854	695,145	750,405	100.0	100.0
Gross National Products	2,208,291	2,309,171	2,420,952	2,612,603	2,832,318	686,499	742,826		
Growth in GDP (%) . .	6.8	6.0	3.5	8.0	8.3	8.0	7.9		
Growth in GNP (%) . .	7.1	4.6	4.8	7.9	8.4	8.4	8.2		

Source: Department of Census and Statistics

Note:

(1) Provisional

The following table shows the percentage distribution of the country's GDP at constant (2002) prices.

PERCENTAGE DISTRIBUTION OF GROSS DOMESTIC PRODUCT BY EXPENDITURE (AT CONSTANT (2002) PRICES)

	2007	2008	2009	2010	2011(1)
Private consumption expenditure	60.8	61.2	59.8	59.7	61.4
Government consumption	13.0	13.4	15.0	13.9	13.2
Investment					
Gross domestic fixed capital formation	24.7	24.3	23.9	23.8	24.5
Changes in stocks	1.5	1.2	1.3	2.5	1.0
Total	100.0	100.0	100.0	100.0	100.0
Exports of goods and services	44.7	43.8	43.1	42.2	40.3
Imports of goods and services	55.3	56.2	56.9	57.8	59.7
Total	100.0	100.0	100.0	100.0	100.0

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

Note:

(1) Provisional

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

GROSS NATIONAL EXPENDITURE AND AVAILABILITY OF RESOURCES (AT CURRENT MARKET PRICES)

	2007		2008		2009		2010		2011(1)	
	Rs. mm	% of GNP	Rs. mm	% of GNP	Rs. mm	% of GNP	Rs. mm	% of GNP	Rs. mm	% of GNP
Consumption Expenditure — Private	2,403,167	67.9	3,085,296	71.7	3,116,221	65.2	3,651,578	66.0	4,568,393	70.6
Consumption Expenditure — Government	546,545	15.4	713,788	16.6	851,549	17.8	872,610	15.8	967,702	15.0
Gross Domestic Capital Formation — Private	807,417	22.8	929,115	21.6	863,485	18.1	1,200,795	21.7	1,549,611	23.9
Gross Domestic Capital Formation — Government	192,903	5.4	286,133	6.6	317,964	6.7	344,704	6.2	409,222	6.3
Gross Domestic Expenditure	3,950,032	111.6	5,014,331	116.5	5,149,219	107.7	6,069,688	109.7	7,494,928	115.8
Gross National Product	3,539,634	100.0	4,305,651	100.0	4,779,497	100.0	5,534,327	100.0	6,470,617	100.0
Excess met by the below	410,398	11.6	708,681	16.5	369,722	7.7	535,360	9.7	1,024,311	15.8
Net Disinvestment Abroad	165,395	4.7	430,970	10.0	33,144	0.7	121,475	2.2	511,095	7.9
Net Receipts of International Gifts and Transfers	245,003	6.9	277,711	6.4	336,578	7.0	413,885	7.5	513,216	7.9

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

Note:

(1) Provisional

Principal Sectors of the Economy

Overview

Services

The services sector comprises the following main sub-sectors: wholesale and retail trade; hotels and restaurants; transport and communication; banking, insurance and real estate; government services; and private services. Over the years, the services sector has grown at a faster rate than the industry and agriculture sectors. Accordingly, the relative importance of the services sector to the economy of Sri Lanka has increased.

During the first quarter of 2012, the sector recorded growth of 5.8%, compared to growth of 9.5% recorded in the corresponding period of 2011. The higher growth momentum witnessed in a number of sub-sectors, which includes wholesale and retail trade, hotels and restaurants and banking, insurance and real estate, contributed towards this expansion. In 2011, the contribution of the services sector to GDP at constant prices was 59.5%. The services sector grew by 8.6% in 2011, compared to growth of 8.0% in 2010. Growth in the services sector in 2011 was attributable to growth in almost all services sub-sectors.

Industry

The industry sector comprises four main sub-sectors: mining and quarrying; manufacturing; electricity, gas and water; and construction. During the first quarter of 2012, the sector, which accounted for 30% of GDP at constant prices, recorded growth of 10.8%. This growth was supported by growth in most sub-sectors.

The industry sector accounted for 28.7% of GDP in 2010 and 29.3% in 2011 at constant prices. The industry sector grew by 10.3% in 2011 compared to 8.4% in 2010, with the manufacturing sub-sector increasing by 7.9% in 2011 compared to a growth of 7.3% in 2010. The growth in the manufacturing sub-sector in 2011 was mainly due to growth in the factory industry category amounting to 8.3% in 2011, which constituted more than 90.0% of the manufacturing sub-sector's output and about 54% of the industry sector's overall output. The major categories of the factory industry are, production of textile, wearing apparel and leather products; food, beverage and tobacco products; chemical, petroleum, rubber and plastic products; non-metallic mineral products and fabricated metal products, machinery and transport equipment.

Agriculture

The agriculture sector comprises two main sub-sectors: agriculture, livestock and forestry; and fishing. The country's principal agricultural products include rice, tea, rubber, and coconuts, produced for both the domestic market and for export. Sri Lanka is the fourth largest tea producer in the world and accounts for around 7.8% of the world's total tea production. The tea sub-sector is also the country's largest employer, providing direct employment to 626,908 people. Sri Lanka's fishing industry contributes to the country's foreign exchange earnings, as a substantial portion of the seafood produced is exported. The contribution of the agriculture sector to GDP at constant prices decreased from 13.0% in 2004 to 11.2% in 2011. The sector grew by 1.5% in 2011, compared to a growth of 7.0% in 2010 and growth of 3.2% in 2009.

Further, the agriculture sector recorded a significant growth of 11.5% in the first quarter of 2012, over the negative growth of 4.3% in the first quarter of 2011.

Services Sector

Wholesale and Retail Trade

Wholesale and retail trade activities grew by 7.1% during first quarter of 2012, compared to the corresponding period in the previous year. This was evidenced by the growth in both domestic trade and import trade activities. Import trade grew by 10.3% while domestic trade grew by 6.8%, following significant expansion in the first quarter of 2012.

In 2011, the wholesale and retail trade sub sector, the largest sector within the Services, grew by 10.3% compared to the 7.5% growth in 2010. This sub sector, which suffered a set back in 2009, mainly due to the global economic downturn, recovered strongly in 2010 and the trend continued in to 2011 with healthy growth in all three sub sectors, i.e., import, export and domestic trade. Value addition in the import trade sub sector increased by 14.3% in 2011 compared to 9.3% in 2010. All three main categories of imports, namely consumer goods, intermediate goods and investment goods reflected sharp increases. The volume of consumer goods imports increased by 25.6% while that of intermediate goods and investment goods increased by 23.3% and 28.2%, respectively. The high growth in investment goods imports was mainly for infrastructure project related items such as building material, machinery and equipment. Growth in the volume of intermediate goods imports was mainly driven by the fertilizer, petroleum products and raw material imports. Growth in consumer goods imports was led by motor vehicles, medical and pharmaceuticals, dairy products and home appliances. The export trade sub sector grew by 10.1% during the year, benefiting mainly from the significant increase in industrial exports, dominated by textiles and garments. Despite the removal of the GSP+ duty concession in August 2010, earnings from textile and garment exports increased around 25% in value terms. The volume of the industrial exports increased by 18.5%. The textile and garment exports, the main export item within the industrial exports category, increased by 13.5%. The volume of agricultural exports dropped by 2.5% due to low export volumes of rubber and other agricultural exports. The domestic trade sub sector, defined as the trading of goods domestically, grew by 7.5%. This growth was largely influenced by improved consumer demand, higher domestic production, and low inflation and interest rates that prevailed during 2011. Expansion of trading activity in the Northern and Eastern provinces also contributed significantly to the growth of the domestic trade.

In 2010, wholesale and retail trade activities expanded, evidenced by growth of 7.5% during the year. The sector, which had a negative contribution to growth in the previous year, rebounded in 2010 with a 23.2% contribution to GDP. This growth was primarily due to the acceleration in export and import activities in connection with the gradual recovery in international markets following the setbacks in the previous year, as well as growth in domestic trade. Import trade recorded growth of 9.3% in value added terms in 2010 compared to the contraction of 8.2% in 2009. This was driven in part by volume growth of 20.6% in the consumer goods category, which includes food items and other consumer goods, such as motor vehicles. The growth rate of intermediate goods category was 13.0%, despite the decline in textile and crude oil imports. The growth in this category was supported in part by the increase in imports of fertilizer and other petroleum products. Meanwhile, investment goods imports grew by 7.3% in volume terms, driven by increased transport and machinery equipment imports during the year. The export sub-sector grew by 3.4% in 2010 over the contraction of 2.2% in the previous year, benefiting from improvements in the global economy. In this sub-sector, agricultural exports grew by 9.7% in volume terms, mainly due to the expansion of exports in tea and other agricultural products, which grew by 11.4% and 20.1%, respectively. Growth in industrial exports was sustained by petroleum and other industrial products while textile and garment exports declined in volume terms during the year. Further, mineral exports expanded by 3.0% in volume terms compared to the contraction of 8.8% in the previous year. Domestic trade activity registered growth of 7.6% in 2010 compared to a growth of 7.3% in the previous year, as domestic demand accelerated.

In 2009, the wholesale and retail trade sub-sector contracted marginally by 0.2%, compared to growth of 4.7% in 2008. This slowdown stemmed from a slowdown in the external trade sector, where the import trade sub-sector contracted by 8.2% and the export trade sub-sector contracted by 2.2%. The slowdown in external trade activities was due mainly to unfavorable demand conditions for exports due to the global recession. However, expansion in the domestic trade sub-sector was sustained. The import trade sub-sector contracted by 8.2% compared to an expansion of 4.7% in the previous year. This contraction was reflected in contraction in imports of consumer goods by 5.0%, intermediate goods by 13.8% and investment goods by 6.4% in volume terms as indicated by Central Bank trade indices. Imports of consumer goods amounted to 19.6% of total imports. Within the intermediate goods category, which registered the sharpest contraction, imports of crude oil and wheat grew at 11.5% and 11.7%, respectively, in volume terms, in contrast to all other sub-categories in intermediate goods which exhibited negative growth during the year. Meanwhile, investment goods amounted to only 22.0% of total imports. Imports of building material and transport equipment contracted by 24.1% and 1.2%, respectively, during the year as per Central Bank trade indices. Due to adverse developments in international markets, the export trade sub-sector contracted by 2.2% compared to growth of 0.9% in 2008. Agricultural exports contracted by 5.9% in volume terms, particularly due to the contraction in tea exports. Industrial exports registered a contraction of 13.9%, due to contraction of textile and garment and other industrial exports volumes by 4.0% and 31.4%, respectively. Mineral export volumes decreased by 8.8%, in particular due to the contraction of 10.1% in gem exports in volume terms as per Central Bank trade indices. The domestic trade sub-sector expanded by 7.3% compared to expansion of 6.4% in 2008. This growth is partly due to robust demand for domestically produced goods along with the increase in economic activities in the Northern and Eastern Provinces, particularly after the end of the internal conflict.

In 2008, the wholesale and retail trade sub-sector grew by 4.7% compared to a growth of 6.1% in 2007. All three segments contributed to this growth, although the export and domestic trade segments expanded at a slower rate in 2008 than in 2007. Within the import trade segment, investment goods imports contracted by 3.3% in volume terms, primarily due to the slower growth of imports in the transport equipment category, machinery and equipment category and other investment goods category. There was a 4.6% growth in intermediate goods imports in volume terms, which was supported by fertilizer imports, which grew by 35.7% in volume terms. Crude oil import volumes decreased by 4.2% while import volumes of other petroleum products increased by 7.9%. The drop in thermal power generation, together with the deceleration in transport activities and relatively high fuel prices, were some of the factors that let to the decline. Imports of consumer goods accounted for 15.5% of total imports and grew by 16.8% in 2008, accompanied by growth of 34.6% in imports of the food and drink categories in volume terms. The export trade segment grew by 0.9% in 2008 compared to growth of 8.8% in 2007. In 2008, industrial exports contracted by 0.4% in volume terms with textile and garment exports recording a growth of 2.5% while exports of other industrial products contracted by 5.4%. These were in sharp contrast to growth rates of 6.8% and 11.8% recorded by exports of textiles and garments, and other industrial products, respectively, in 2007. These declines were primarily due to the intense competition in the international market and slowdown in external trading activities resulting from the global economic crisis, particularly towards the end of 2008. Agricultural exports grew by 3.5% due to the favorable performance of the segment in the first eight months of 2008. Tea exports, which generated foreign earnings of over US$1.3 billion, increased in volume terms to 319.7 million kilograms despite the decrease in market demand faced by the industry, particularly from September 2008. Mineral exports contracted by 0.6% in volume terms in 2008 mainly due to the drop in gem exports. The volume of rubber exports declined as a result of lower global demand. The domestic trade sub-sector grew by 6.4% in 2008 compared to a 7.6% growth rate in 2007. The increased agricultural and industrial output contributed positively to this growth. The significant increase in paddy production, coupled with the higher production of fish, highland crops, vegetables and fruits, made a positive contribution. Trade activities related to domestic market oriented industries such as food, beverages and cottage industry, which expanded by over 4.0% during the year, also contributed to the growth.

Hotels and Restaurants

The hotels and restaurants sub-sector grew by 22.0% in the first quarter of 2012, compared to 34.2% recorded in the corresponding period in 2011, primarily due to growth in tourist arrivals by 21.1% during the first quarter of 2012, when compared to the growth of 34.1% in the corresponding period of 2011.

The value addition in the hotels and restaurants sub sector recorded a growth of 26.4% in 2011 reflecting the continuation of the growth momentum in the industry. Tourist arrivals increased by 30.8% in 2011. However foreign guest nights in graded hotels increased only by 21.4% indicating a higher level of contribution by the unregistered hotels and guest houses to the tourism industry. The majority of the graded hotels were able to sustain a higher occupancy rate of over 70.0% during the year. Further, local guest nights also grew by 9.8% in 2011, following 24.5% growth in the previous year.

The hotels and restaurants sub-sector recorded significant growth of 39.8% in 2010, compared to 13.3% growth in 2009, as a result of increased tourist activity following the cessation of hostilities in 2009. Local and foreign tourist activity accelerated and are reflected in tourism industry indicators such as tourist arrivals, which increased by 46.1% in 2010, compared to 2.1% in 2009. Further, total guest nights, which includes both foreign and local tourists, rose by 42.3% in 2010.

The hotels and restaurants sub-sector showed strong growth following the end of the internal conflict in 2009, registering a growth of 13.3% in 2009, as against a contraction of 5.0% in 2008. Expansion in both local and foreign tourist activities were observed during the year with growth rates of 18.8% and 2.0% in local and foreign guest nights, respectively. Overall, tourist arrivals grew by 2.1% compared to a contraction of 11.2% in 2008.

The hotels and restaurants sub-sector contracted by 5.0% in 2008 compared to a contraction of 2.3% in 2007. This decline was a direct result of a drop in tourist arrivals by 11.2% due to security conditions in the country as well as a worldwide decline in travel and leisure activities beginning in September 2008 as a result of the global economic crisis. Tourist arrivals from Western Europe and the Asian region, which together accounted for 78.0% of total tourist arrivals in 2008, fell by 14.0%. There was also a decline in domestic tourism activities.

Transport and Communication

The transport and communication sub-sector expanded by 5.7% in the first quarter of 2012, compared to growth of 12.9% in the corresponding period in 2011, benefiting from favorable performance in the passenger and goods transport and post and telecommunication subsectors.

In 2011, the transport and communication sub sector grew by 11.3% following an 11.9% increase in the previous year. Transport, cargo handling, ports and civil aviation, and post and telecommunication, contributed significantly to achieve this growth during the year. The transport sub sector, which includes railway, passenger and goods transport, grew by 11.3%. The expansion in transport activities is reflected by the significant growth in transport equipment imports, petrol and sales, registration of new motor vehicles and expansion in air travel during the year. The passenger kilometers operated by the Sri Lanka Railways (SLR) increased by 4% while the passenger kilometers operated by Sri Lanka Transport Board and the private bus operators also improved during the year. The total passenger kilometers flown by the Sri Lankan and Mihin Lanka airlines increased 14.8% in 2011. The cargo handling, ports and civil aviation sub sector expanded by 7.2% in 2011 in comparison to a growth of 16.8% in the previous year. This deceleration in growth was reflected in the marginal expansion in transshipment volumes due to the slow recovery from the 2008 economic downturn in the global economy. During the year, the Port of Colombo handled 4.3 million Twenty Foot Equivalent container Units (TEUs), a 3% increase. Value addition in the post and telecommunications sub sector grew by 13.4% in 2011 following a

13.2% growth in 2010. The total voice line subscriber base, which includes both fixed and mobile connections, grew by 5.4% during the year. As at December 31, 2011, telephone density (telephone connections per 100 people) stood at 105.1, comprising 17.3 in respect of fixed telephone lines and 87.8 in respect of mobile phones. The growth in the telecommunications sub sector was supported by the improvement in the mobile broadband subscriber base with increased affordability and the demand from the Northern and the Eastern provinces. The 3G Broadband subscriber base increased by 142.5% to 0.5 million as at December 31, 2011.

In 2010, the transport and communication sub-sector recorded 11.9% growth, compared to 6.3% growth in the previous year. Healthy growth occurred in all three sub-sectors, namely, transport, cargo handling-ports and civil aviation, and post and telecommunications. Growth in the transport sub-sector was 11.4% in 2010, which is the highest growth rate recorded by the sector during the last three years, partially due to the increase in the year in cluster-bus passenger-kilometers. Fuel consumption grew with increased demand for transport services amidst relatively stable prices during the year, with gasoline sales increasing by 14.3% and diesel sales by 1.2% in 2010. New vehicle registration rose by 76.0% in 2010, as a result of a downward revision in the government tariff on vehicle importation. The air travel sub-sector benefitted from the significant growth in the tourism sector during the year. The cargo handling-ports and civil aviation sub-sector expanded substantially during the year, with growth of 16.8%, compared to growth of 0.4% in 2009. This expansion was driven by the increase in both transshipment and cargo handling, which grew by 18.0% and 26.7%, respectively, during 2010. Further, the Colombo port handled a record volume of 4.1 million Twenty-Foot Equivalent Container Units (TEUs) during the year. The post and telecommunication sector grew by 13.2% in 2010, continuing its favorable contribution towards overall growth. This growth was reflected by the expansion in the telecommunication subscriber-base by 17.6% in 2010. The fixed access subscriber-base, which includes CDMA connections, grew by 3.9%, while the mobile subscriber-base increased by 20.9% to 17.2 million, denoting the improvement of accessibility and affordability resulting from expansion in the sector. Activity in postal services declined during the year, as consumers turned to new technologies for communication services.

In 2009, the transport and communication sub-sector grew by 6.3% compared to 8.1% in 2008. All three sub-sectors, namely, transport, cargo handling-ports and civil aviation and post and telecommunication contributed to this growth, although with lower growth rates than in the previous year. The expansion of the transport sub-sector by 5.9% is comparable to the expansion of 6.3% registered in 2008. This growth stemmed from the expansion of 4.3% and 6.0% in value addition in the railway sub-sector and the passenger and goods transport sub-sector, respectively. The growth in the transport sub-sector was reflected in the increase in fuel consumption as indicated by a growth of 5.4% in petrol sales and 6.0% in auto diesel sales. However, new registrations of motor vehicles contracted further by 23.1% following contractions of 0.9% and 11.0% recorded in 2007 and 2008, respectively. Growth in the rail transport sector also slowed with a contraction of 2.2% in passenger kilometers operated by Sri Lanka Railways, despite the recommencement of operations in certain sectors in the Northern and Eastern Provinces. The cargo handling-ports and civil aviation sub-sector registered a growth of 0.4% amidst slowdown in external trade activities. This was slower than the growth of 8.0% in 2008. The Colombo port handled 3.5 million TEUs, a contraction of 6.0%. Total cargo handled also decreased by 3.6%. However, with expanded operations in the ports during the fourth quarter, the cargo handling sub-sector showed signs of recovery. The post and telecommunication sub-sector posted a growth of 11.7% in 2009 compared to growth of 22.3% in value added terms in 2008. This growth was driven by the initiatives taken by service providers to introduce value added services as well as competitive rates and penetration into liberated areas amidst strong competition. The total number of telephone connections (including mobile and CDMA), increased by 19.6% during the year, while the number of mobile telephone connections grew by 25.9%. The telephone density, (the number of connections per 100 persons) rose to 85 from 72 in 2008.

In 2008, the transport and communication sub-sector grew by 8.1% compared to growth of 10.5% in 2007. This sub-sector achieved the highest growth in the services sector with positive contributions from all three segments. The transport segment grew by 6.3% in 2008 compared to growth of 9.3% in 2007. The slowdown in growth was partly due to the lower growth rate of the railway and passenger and goods transport segments, which recorded growth rates of 4.7% and 6.4%, respectively, in 2008 compared to 5.8% and 9.4%, respectively, in 2007. The slowdown of growth in the transport segment was reflected in the drop in fuel consumption, which was partially caused by high fuel prices and the drop in the registrations of motor vehicles. Although passenger kilometers operated by cluster bus companies increased by 2.3% during 2008, passenger kilometers operated by the SLR declined by 2.1% due to the suspension of services to Vavuniya as a result of unfavorable security conditions. Rail transport activities were expanded in 2008 with the addition of 15 Diesel Multiple Units. The air travel segment declined in 2008 with total passenger kilometers flown by Sri Lankan Airlines decreasing by 6.8%. The cargo handling-ports and civil aviation segment grew by 8.0% compared to growth of 8.8% in 2007. The deceleration was mainly due to the decline in international trade activities. The Port of Colombo, including the South Asia Gateway Terminal, handled 3.7 million TEUs, a 9.1% increase from 2007. The post and telecommunication segment expanded further by 22.3% in value added terms during 2008, sustaining the growth momentum over 20.0% for the sixth consecutive year. In 2008, the fixed access subscriber base, which includes CDMA connections, increased by 25.7% to 3.4 million connections while the mobile subscriber level grew by 38.8% to 11.1 million connections. However, compared to the growth of mobile connections of 47.5% in 2007, a slowdown in mobile connections growth was seen in 2008. Telephone density, the number of connections per 100 persons, was estimated at 71.9 connections in 2008 compared to 53.6 connections in 2007. Meanwhile, the internet and e-mail usage subscriber level base increased 15.6% to 234,000 users in 2008 compared to growth of 55.7% in 2007.

Banking, Insurance and Real Estate

The banking, insurance and real estate subsector experienced growth of 7.2% in the first quarter of 2012, compared to growth of 9.2% recorded in the corresponding period in 2011, primarily due to increased profitability in banking services and the expansion of insurance activities.

In 2011, the banking, insurance and real estate sub-sector grew by 7.9% compared to growth of 7.5% in 2010. The growth in this sub-sector was supported by the expansion of branch networks, services and the favorable macroeconomic environment that led to a high growth in private sector credit. Profits at banking and non-bank financial institutions increased in 2011. The performance of the insurance subsector benefitted from the expansion in general insurance business, including vehicle insurance, along with expansion of economic activities.

In 2010, the banking, insurance and real estate sub-sector expanded by 7.5%, compared to growth of 5.7% in 2009. Growth in the sub-sector was supported by an increase in profitability through income from loans and advances and other investments, owing to moderate interest rates and, consequently, an increase in credit flows to the private sector during the year. This was supported by improved performance in foreign exchange market activities in the banking sector. The widening of financial services through the opening of new branches and service outlets and other services continued. The insurance and leasing sector also grew substantially during the year, in line with the developments in areas such as new vehicle registration. Real estate activity retained its competitive position during the period.

In 2009, the banking, insurance and real estate sub-sector grew by 5.7% compared to growth of 6.6% in 2008. The overall slowdown in the Sri Lankan economy, caused by both the global economic crisis and the volatility in the sector created by the failure of some unauthorized institutions, reduced the demand for financial services. However, the market volatility lessened during the latter part of the year as inflation declined along with a gradual buildup of investor confidence following the end of internal conflict.

In 2008, the banking, insurance and real estate sub-sector grew by 6.6% compared to growth of 8.7% in 2007. This was a challenging year for the global financial industry and a large number of international financial institutions reported significant operating losses. The domestic financial sub-sector also recorded lower growth rates as a result of weaker performance in the banking sector. The growth rate of interest income declined together with the decreasing growth of income from advances and investments in securities. Non-interest income also declined. Further, the growth of other financial services slowed, with the deceleration of insurance and leasing activities. Meanwhile, the real estate segment reported a decline in activities in 2008.

Government Services

The government services sub-sector grew by 0.8% in the first quarter of 2012, compared to growth of 1.5% in the first quarter in 2011, primarily due to a slowdown in public sector recruitment.

In 2011, the government services sub-sector reported only a 1.2% growth. There were no major public sector recruitment programs implemented during the year. Retirements from the government services also contributed to the deceleration in government sector value addition.

In 2010, the government services sub-sector registered moderate growth of 5.4%, compared to growth of 5.9% in 2009. Improvement and expansion of government services mainly contributed to the growth in the sector.

In 2009, the government services sub-sector expanded by 5.9%, compared to 5.7% in 2008. Recruitments into the armed forces, police and education sector were major contributors towards this growth.

In 2008, the government services sub-sector grew by 5.7% compared to growth of 6.0% in 2007. The growth in this sub-sector was primarily due to the expansion of the armed forces.

Private Services

Growth in the private services sub-sector was 4.2% in the first quarter of 2012, compared to growth of 8.9% in the corresponding period in 2011, primarily due to the higher demand for private services with the expansion of the economy.

In 2011, the private services sub-sector recorded a 7.2% growth compared to growth of 5.8% in the previous year. The growth in this sector was largely attributable to expansion of economic activities and the conducive environment for investment in personal services that prevailed during the year.

In 2010, the private services sub-sector recorded 5.8% growth, in line with growth in the previous year. Growth in the sector emanated mainly from areas such as private education and health services, while other private sector services also emerged with the revival of economic activity.

In 2009, the growth in the private services sub-sector was 5.8% compared to 6.5% in 2008. This decline in growth was a consequence of the general slowdown in the Sri Lankan economy.

In 2008, the private services sub-sector grew by 6.5%, compared to growth of 7.8% in the previous year. The growth in this sub-sector was sustained by growth in private health and education services together with other services. However, the growth in the sub-sector slowed during the latter half of the year.

Industry Sector

The industry sector consists of the manufacturing; construction; mining and quarrying; and electricity, gas and water sub-sectors. During the first quarter of 2012, the industry sector expanded by 10.8%, with the mining and quarrying sub-sector recording the highest growth rate of 26.8%, while the construction, electricity, gas and water and manufacturing sub-sectors recording growth rates of 17.5%, 5.6% and 6.7% respectively. The following table presents, at constant market prices, the gross value added, which equals the value of sales minus the cost of raw materials and service inputs, for the manufacturing sub-sector by industry or industry group.

GROSS VALUE ADDED IN MANUFACTURING BY INDUSTRY
Value Added in Industry
(2002 Constant Prices)

Industry/Industry Group	2007	2008	2009	2010	2011(1)	First Three Months of 2011(1)	First Three Months of 2012(1)	% Increase or Decrease
	(in Rs. millions, except as indicated)							
Food	142,146	150,643	160,278	171,841	184,799	43,380	46,437	7.0
Beverages	9,466	9,862	10,594	11,463	12,123	2,786	3,074	10.3
Tobacco products	14,489	14,289	14,270	14,427	14,926	5,946	5,988	0.7
Textile	14,721	15,175	15,332	16,126	16,826	4,123	4,198	1.8
Wearing apparel	67,006	69,074	69,509	73,166	82,221	20,012	21,753	8.7
Leather	2,877	2,965	2,921	3,001	3,216	834	866	3.8
Wood and wood products	1,061	1,085	1,125	1,193	1,246	307	319	3.8
Paper and paper products	624	663	675	731	785	354	367	3.8
Publishing and printing	879	935	960	1,011	1,050	525	571	8.8
Coal and refined petroleum products...	17,403	18,475	18,675	19,675	22,426	5,676	6,028	6.2
Chemicals and chemical products	13,094	13,900	14,155	15,625	16,652	3,848	4,383	13.9
Rubber and plastic based products	24,644	26,275	26,876	31,690	34,125	7,736	8,248	6.6
Non-metallic mineral products	14,547	15,306	14,794	16,328	17,670	4,484	4,829	7.7
Basic metal products	930	958	965	1,028	1,090	130	137	5.6
Fabricated metal products, machinery and transport equipment	30,011	31,702	32,794	35,482	37,733	10,856	11,410	5.1
Other manufactured products	1,715	1,907	2,004	2,138	2,290	313	326	4.3
Total	355,611	373,215	385,927	414,925	449,177	111,310	118,934	6.9

Source: Department of Census and Statistics

Note:

(1) Provisional

Manufacturing

In the first quarter of 2012, the manufacturing sub-sector grew by 6.7%, compared to 8.2% growth in the corresponding period of 2011. The largest contributor within the manufacturing sub-sector, the factory industry, accounted for more than 52.0% of the industry sector output and grew by 6.8% in the first quarter of 2012. The major contributors to this growth in factory industry were improved performance in the categories of textile, wearing apparel and leather products; chemical, petroleum, coal, rubber and plastics and non-metallic mineral products. The textile, wearing apparel leather product category grew by 7.4% in the first quarter of 2012, compared to a growth of 11.5% in the first quarter of 2011. The chemical, petroleum, coal, rubber and plastic products category recorded a growth of 8.1% in the first quarter of 2012, compared to 10.4% in the first quarter of 2011. The factory industry categories of food, beverages and tobacco products, non-metallic mineral products, fabricated metal products, and machinery and equipment, each experienced growth rates of more than 6.5%, 7.7% and 5.1% respectively during the first quarter of 2012.

In 2011, the manufacturing sub-sector grew by 7.9%. Industries focusing on both export and import markets attributed to this growth. The food, beverages and tobacco products category grew by 7.1% in 2011. This growth was attributed to increase in demand from local and foreign tourists, expansion of the supplier chain networks and improved purchasing power parity of domestic consumers. The textile, wearing apparel and leather products category fully recovered during 2011 from the slack global demand in the previous year and recorded a growth of 10.8%. Forward looking marketing strategies adopted by major participants in the category, green and eco-friendly practices, productivity improvement and good labor standards attributed towards this resilience. The chemical, petroleum, coal, rubber and plastic products category grew by 9.3% during 2011. Rubber based products, which is the second largest export oriented industry and the largest within this category continued to grow supplying solid tires and rubber gloves to the export market. Growth in nonmetallic mineral products category grew by 8.2% reinforced by state and private sector construction activities with increase in demand for cement and building materials. Fabricated metal products, machinery and transport equipment category grew at a moderate 6.3% compared to the performance in other categories. Overall growth of the factory industries stood at 8.3% reflecting effective exploitation of new market opportunities arising from a favorable domestic economic climate and conducive economic environment with low inflation, low interest rates and stability in the exchange rate favorable towards the industrial growth.

In 2010, the manufacturing sub-sector grew by 7.3%, compared to growth of 3.3% in 2009, and accounted for 16.0% of overall GDP growth. The factory industry, which is the largest contributor to the industry sector, accounted for approximately 55% of total industry output, and recorded growth of 7.5% during 2010, compared to moderate growth of 3.4% in 2009. This growth was achieved from improved performance in all major categories of factory industry, resulting from enhanced economic conditions in both domestic and international markets in 2010. The export market-oriented industries benefitted from increased demand from major trading partners, the gradual recovery of the global economy, branding and market diversification strategies and expansion in product portfolios. These competitive measures adopted by export market-oriented industries enabled them to retain their existing market share, as well as capture new market segments in international markets. Within the export market-oriented industries, the textile, wearing apparel and leather products category was able to successfully face the cessation of the GSP+ concession from August 2010, by adopting productivity improvement and cost saving strategies. The growth in factory industry output was reflected in both domestic and export market-oriented industries. The high growth in food, beverages and tobacco products category, which accounts for nearly 48% of the total factory industry output, was mainly driven by expansion of markets in post-conflict Northern and Eastern provinces and increased tourism activities during the year. The non-metallic mineral products category was also a main driver of output growth, with high demand for cement and building materials. Several other domestic market oriented industries, comprising glass, ceramic based products, cables, wires, iron, steel sheets and paints also reflected favorable growth rates during 2010. The growth in export market-oriented industries was mainly driven by textile, apparel, petroleum, rubber, machinery and equipment categories. Other major contributors to the increased output in export market oriented industries were tableware, floor and wall tiles, ship building and repairing, transport equipment and machinery.

In 2009, the manufacturing sub-sector grew by 3.3% as compared to growth of 4.9% in 2008, and accounted for 16.3% of overall GDP growth. The factory industry, which accounted for more than 90.0% of the manufacturing sector output, registered a 3.4% growth in 2009 compared with 5.0% in 2008. All major categories of the factory industry, except the food, beverages and tobacco products category, witnessed lower growth rates in 2009 as compared to the previous year. Factory industry growth was affected by reduced international demand following the global financial crisis, as well as decreased domestic demand mainly due to the contraction of disposable income and slowdown in domestic economic activity. The output of the food, beverages and tobacco products category increased by 5.9% and contributed more than 46.0% to the factory industry output in 2009 with the expansion of markets in Northern and Eastern Provinces and the improved performance of the tourism sector. The textile, wearing apparel and leather product category, the second largest category in the factory industry-focused export market, registered low growth of 0.6% in 2009 due to the financial crisis' impact on trading partners' economies. Commencement of gradual recovery of the global economy in the second half of the year was reflected in the output of the textile, wearing apparel and leather products category in the fourth quarter of 2009. Major players in the apparel industry were able to remain competitive in the export markets by maintaining a reputation for high quality products with attractive designs, increasing focus on ethically manufactured ("greener") products and the production of globally-recognized brands. The chemical, petroleum, coal, rubber and plastic products category, the third largest category in the factory industry, registered a lower growth of 1.8% in 2009 due in part to decreased demand and higher costs of production for tires and gloves in the international market. However, the output of rubber-based products also registered improvement in the fourth quarter of 2009 with the improvement of export orders. The output of the non-metallic mineral products category registered negative growth of 3.3% in 2009, mainly due to poor performance in the cement and building materials industries as a result of slowdown in the construction sub-sector. However, non-metallic mineral products registered positive growth in the fourth quarter of 2009 with the expansion of construction activities in the Northern and Eastern Provinces, new and continuing state mega infrastructure development projects, and improvement of private construction activities due to reduced borrowing costs. Growth in the fabricated metal products, machinery and transport equipment category also slowed in 2009, mainly due to decreased domestic and international demand. It registered a recovery in the later part of 2009 with the improvement of both domestic and export markets. Public sector industrial output recorded a deceleration in 2009 compared with 2008, due mainly to low performance by the petroleum refinery of the Ceylon Petroleum Corporation (CPC). The CPC has been the main contributor of public sector output for many years and accounted for more than 95.0% of the total public sector output in 2009.

In 2008, the manufacturing sub-sector grew by 4.9% compared to growth of 6.4% in 2007, and accounted for 14.6% of overall GDP growth. The impact of the global economic crisis and contraction of domestic demand adversely affected the output of the manufacturing sub-sector in 2008. Despite the high cost of inputs and contraction of demand in both the export and domestic markets, factory industry output, which accounted for more than 90.0% of the manufacturing output, grew by 5.0% in 2008, mainly due to the growth in global trade in the early part of 2008 as well as the growth of domestic market demand. The main drivers of growth in the factory industry were the five major sub-categories. These five industrial categories accounted for around 98.5% of the total factory industry output in 2008. Based on value addition, the food, beverages and tobacco products category grew by 5.2% in 2008 and contributed to 46.8% of the factory industry output in 2008. The textile, wearing apparel and leather products category grew by 3.1% and accounted for 23.4% of the overall growth of factory industry in 2008. The growth rate of this industry category decelerated as a result of the lower demand from the international market. The output of chemical, petroleum, coal, rubber and plastic products, the third largest category of factory industry, grew by 6.4% in 2008 as a result of the growth in rubber-based products, chemicals and fertilizer. The output of rubber-based products grew by 6.6%. The non-metallic mineral products category and fabricated metal products, machinery and transport equipment category registered 5.2% and 5.6% growth, respectively in 2008 and together contributed 12.6% to the overall growth in factory industry. The growth momentum of non metallic mineral products category was affected by the slow growth of the construction sub-sector. The output of public sector industries declined by 1.4% in real terms in 2008 compared to a 14.1% decline in 2007. The CPC's output accounted for approximately 96.2% of the public sector industrial output.

Construction

The construction sub-sector grew by 17.5% in the first three months in 2012, compared to 14.3% in the corresponding period in 2011, primarily due to large scale development projects in the country and rehabilitation and resettlement programs, especially in the Northern and Eastern provinces, while disbursement of loans for construction activities such as housing, building premises, other buildings and property development also increased during the quarter.

In 2011, the construction sub-sector grew by 14.2% in value added terms when compared to the 9.3% growth recorded in the previous year. The growth momentum in the construction sub-sector was driven by the enhancement of public sector infrastructure development projects and private sector involvement in construction activities such as commercial and residential building construction projects. The contribution by the private sector to the construction sector was reflected by the growth in credit for construction activities. Mega projects carried out by the government, particularly in the areas of port development, electricity and transportation, are the underpinning factors towards the growth in public sector construction activities. The growth in the construction sector was consistent with the high production and imports of cement and other construction materials. Value of domestic building material production and building material imports including cement increased by 8.6% and 21.2%, respectively, during the period.

In 2010, the construction sub-sector expanded by 9.3% in value added terms compared to lower growth of 5.6% in 2009. This increased construction activity led to the growth in domestic production of building material by 12.0% during the year. Further, cement availability grew by 18.1% in 2010, compared to a contraction of 11.1% in the previous year. The increased involvement of the private sector was reflected in the growth of private sector credit for construction purposes by 19.3% during the year. Meanwhile, Government construction projects related to roads, ports, the power sector, irrigation and water resources and housing, together with other small-scale construction, also contributed favorably to growth in the construction sector. The construction sector expanded with the acceleration of ongoing road development projects such as expressways, interregional national highways and the large scale power projects initiated to meet the rising demand for electricity. Port development projects and construction of houses and reconstruction work in newly-liberated areas also boosted construction activity in 2010.

In 2009, the construction sub-sector grew by 5.6%, lower than growth of 7.8% in 2008. The sub-sector expanded with positive contributions from public sector mega construction projects such as the Norochcholai and Upper Kothmale power plants, road network development projects such as the Colombo — Katunayaka and Southern Expressways, and construction of several flyovers and other rural road development projects under the "*Maga Neguma*" program. However, the deceleration in the sector was reflected in the drop in the volume of building material imports by 24.1% in 2009 as per Central Bank trade indices, due mainly to slower growth in housing construction. The level of bank credit granted for housing purposes also registered a decrease of 1.5%.

In 2008, the construction sub-sector grew by 7.8% compared to growth of 9.0% in 2007. This reduction in growth can be attributed to the reduction in credit availability for the construction industry and the slowdown in economic growth, particularly during the fourth quarter of 2008 as a result of the impact of the global economic crisis. The slowdown in this sub-sector was reflected in the marginal growth in building material imports of 0.1% and the deceleration in domestic building material production to growth of 5.5%. Furthermore, cement consumption declined by 4.8% during 2008. Public sector investment activities, which include expansion of infrastructure development projects, contributed positively to the growth of the construction sub-sector. However, contribution by the private sector to the growth of this sub-sector was relatively low due to the increased input prices of construction. The level of bank credit granted for housing purposes also witnessed a decline of 1.4% in 2008 compared to a 24.7% growth in the previous year. The price indices published by the Institute for Construction Training and Development (the "ICTAD") indicated a 13.8% increase in overall building material price levels during 2008.

Mining and Quarrying

The mining and quarrying sub-sector grew by 26.8% in the first quarter of 2012, compared to growth of 21.9% recorded in the corresponding period in 2011, due to the expansion in gem mining and other mining activities. The growth in other mining activities is mainly driven by the increased demand from the construction sector.

The mining and quarrying sub-sector expanded by 18.5% in real terms with a healthy performance in gem mining and other mining activities in the year 2011. Strong performance in other mining sub-sector, which accounted for more than 75.0% of the mining and quarrying sector in terms of value addition, was supported by the increased phosphate production to meet the higher demand with the extension of the fertilizer subsidy to the plantation sector, expansion in mining of mineral sands and graphite in the Northern and Eastern provinces, and the boom in construction activities during the year. The gem mining sub-sector also grew by 17.4% in 2011. This growth was reflected by the higher growth in export volume of gems during the year.

The mining and quarrying sub-sector grew by 15.5% in 2010, compared to lower growth of 8.2% in the previous year. The mining and quarrying sub-sector consists of gem mining and mining of other resources, both of which grew in 2010. The other mining sub-sector grew by 17.5%, compared to growth of 18.1% in 2009, and was the major contributor to growth in this sector. Demand from increased construction activity contributed to this growth, as well as increased demand for mineral sands, graphite and phosphate. The gem mining sub-sector, which contracted by 17.2% in 2009, grew by 7.9% in 2010. This was supported by the recovery in the demand for gems in the international market, with a 2.6% volume increase in gem exports in 2010.

The mining and quarrying sub-sector grew by 8.2% in 2009 compared to growth of 12.8% in 2008. The gem mining sub-sector contracted by 17.2%, while other mining activities expanded by 18.1% in value added terms. The deceleration in gem mining was reflected in the contraction of 10.1% in gem exports in volume terms, as indicated by the indices compiled by the Central Bank. This contraction was mainly attributable to unfavorable demand conditions which then prevailed in international markets.

The mining and quarrying sub-sector grew by 12.8% in 2008 compared to growth of 19.2% in 2007. The growth of gem mining and other mining slowed in 2008, growing by 8.7% and 14.5%, respectively, and was reflected in a 1.6% contraction in the export volumes of gems in 2008 compared a volume growth rate of 5.3% in 2007. The expansion in other mining activities was supported by the demand from the construction sector. This expansion was also reflected in an increase in exports of other minerals by 5.9% in 2008.

Electricity, Gas and Water

The electricity, gas and water sector grew by 5.6% in the first quarter of 2012, compared to 15.6% in the corresponding period in 2011. The deceleration was primarily due to the slow down in electricity sub-sector with increased in high cost thermal power generation during the quarter.

During 2011, the electricity, gas and water sub-sector performed well recording a 9.2% growth compared to 8.0% growth in 2010. The acceleration of this sector was mainly supported by the better performance in electricity generation. The value added in electricity generation grew by 9.6% with an 18% drop in hydro power generation and a 35.8% increase in thermal power generation. The water subsector expanded by 6.1% with the implementation of new water supply projects during the year. Value added by the gas subsector increased by 5.7%.

During 2010, the electricity, gas and water sub-sector grew by 8.0%, compared to 3.7% growth in 2009. This notable growth was driven by increased activity in each of the three sub-sectors. Electricity, which is the largest contributor in this sub-sector, grew by 8.2%, as increased hydro power generation, made possible by improved weather conditions during the year, lowered demand for thermal power generation. In 2010, hydro power accounted for 52.6% of total electricity output in 2010, compared to 39.3% in the previous year. Demand for electricity from domestic, commercial and industrial sectors increased in line with increased economic activity. The gas sub-sector grew by 7.3% in 2010, compared to 5.4% growth in 2009. The water sub-sector, which grew by 2.9% in 2009, grew a further 4.5% in 2010.

During 2009, the electricity, gas and water sub-sector grew by 3.7%, compared to growth of 2.7% in 2008 as a result of low fuel prices, leading to an increase in value addition in thermal power generation which grew by 3.7%. Electricity, which is the largest segment, grew by 3.7%. High value added hydropower generation contracted by 5.6%, while value added in the gas sub-sector grew by 5.4%. Gas sales increased by 6.4% compared to a contraction of 12.0% in 2008. The water sub-sector grew by 2.9% in 2009 compared to growth of 3.6% in 2008, with water distribution increasing by 2.0% in volume terms in 2009.

During 2008, the electricity, gas and water sub-sector grew by 2.7% compared to growth of 4.6% in 2007 as a result of a deceleration in growth in all three segments. Electricity, which is the largest segment, grew by 3.9% in 2008 compared to growth of 4.6% in the previous year with power generation growth slowing down to 0.9% in 2008 compared to growth of 4.5% in 2007. In 2008, hydropower generation increased by 4.6%, accounting for 41.6% of total generation, while thermal power generation declined by 1.7%. The slowdown of growth in power generation was a result of the deceleration of demand from the domestic and industrial sectors. The commissioning of the Kerawalapitiya power plant during the latter part of 2008 is expected to enhance the future growth prospects of the sub-sector with increased generation capacity. The value added in the gas segment contracted by 10.2% in 2008 compared to growth of 2.9% in 2007. This was due to a decline of 12.0% in total gas sales as a result of a drop in demand from domestic, industrial and auto gas sectors amidst price pressure which subsided to some extent from November 2008. The water segment, which includes the collection, purification and distribution of pipe borne water, grew by 3.6% in 2008 compared to 7.1% in the previous year. The growth was due to the implementation of new water supply projects and improvements to existing projects to provide pipe-borne water to a wider network of consumers. The slowdown in growth during 2008 was due to the increased cost of material inputs and the inability to implement certain projects in the North and East due to the security situation.

Agriculture Sector

The agriculture sector recorded significant growth of 11.5% in the first quarter of 2012, compared to the negative growth of 4.3% in the corresponding period in 2011. This increase in output was mainly attributable to the considerable growth of paddy production by 35.2% to 2.699 million metric tons in the quarter and coconut production increased by 19.3% to 718.8 million nuts. However, tea production and rubber production decreased by 5.3% and 5.0%, respectively, in the first quarter of the year mainly due to the unfavorable weather patterns prevailed in cultivation areas. The overall growth in agriculture in first quarter was also supported by growth of 6.0% in fish production.

The agriculture sector recorded a marginal growth of 1.5% in 2011 compared to a growth of 7.0% in 2010. Rubber production increased by 3.2% to 157.9 million kilograms and coconut production increased by 8.6% to 2,808 million nuts in 2011. Tea production declined marginally by 1.2% to 327.5 million kilograms in 2011 mainly due to the excessive rainfall in the first two months of the year and the dry weather that prevailed in the third quarter of the year. Paddy production decreased by 10% to 3.87 million metric tons in 2011, mainly due to declining production in Maha Season due to floods during the early part of the year. Annual fish production grew by 15.6% to 444.83 million kilograms, supported by favorable weather conditions.

The agriculture sector recorded a growth of 7.0% in 2010 compared to a growth of 3.2% in 2009. Tea production increased by 13.8% to 331.3 million kilograms and rubber production increased by 11.8% to 153 million kilograms in 2010. On the other hand, coconut production declined by 18.8%

to 2,317 million nuts in 2010 mainly due to the lag effect of the low rainfall in 2009 in major coconut growing areas. Paddy production increased by 17.8% to 4.3 million metric tons in 2010, mainly due to an increase in the area under cultivation in the Northern and the Eastern provinces, sufficient rainfall and the Government policy to begin cultivation on fallow lands. Annual fish production grew by 12% to 381.6 million kilograms, largely due to increased fishery activities in the Northern and Eastern areas.

The agriculture sector recorded growth of 3.2% in 2009 compared to growth of 7.5% in 2008. Tea production declined by 8.6% to 291.1 million kilograms and rubber production increased by 5.9% to 136.9 million kilograms in 2009. Coconut production declined by 1.9% to 2,853 million nuts, mainly due to the lagging effect of unfavorable weather conditions in major coconut planting areas in the second half of 2008. Paddy production declined by 5.8% to 3.652 million metric tons in 2009. This was mainly due to the decline in paddy production by 27.6% to 1.267 million metric tons in the *Yala* season of 2009 due to unfavorable weather conditions. Annual fish production grew by 6.5% to 339.7 million kilograms largely due to the relaxation of restrictions on fishing in the Northern and Eastern areas.

The agriculture sector recorded the highest growth of 7.5% in 2008 compared to growth of 3.4% in 2007. Tea production grew by 4.6% to 318.69 million kilograms and rubber production increased by 9.9% to 129 million kilograms in 2008. Coconut production grew by 1.4% to 2,909 million nuts mainly due to the improved performance in the second half of the year as a result of favorable weather conditions. Paddy production increase by 23.6% to 3.87 million metric tons in 2008. This was mainly due to an extraordinary growth of 51.1% yielding 1.75 million tons in the Yala season of 2008. Annual fish production grew by 9.6% to 319 million kilograms.

Prices, Employment and Wages

Inflation

Sri Lanka currently reports inflation as the annual percentage change in the CCPI, the compilation of which is based on the HIES conducted by the DCS in 2006/2007.

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

PRINCIPAL COMPONENTS OF THE CCPI BASKET[(1)]

	Average Index							Annual Average Percentage Change						
Category	2007	2008	2009	2010	2011	End June 2011	End June 2012	2007	2008	2009	2010	2011	End June 2011	End June 2012
All Items	163.1	199.9	133.6	141.9	151.5	147.2	155.8	15.8	22.6	3.5	6.2	6.7	6.9	5.8
Food and Non-Alcoholic Beverages	163.4	213.3	148.5	158.8	172.7	168.4	173.1	20.3	30.5	3.1	6.9	8.8	9.5	2.8
Clothing and Footwear	140.7	154.8	122.0	130.2	147.6	138.1	155.4	10.2	10.0	8.5	6.7	13.4	10.4	12.6
Housing, Water, Electricity, Gas and Other Fuels	206.6	226.8	115.1	119.2	124.4	121.0	130.4	18.6	9.8	1.0	3.5	4.3	3.7	7.8
Furnishing, H/H Equipment and Routine Maintenance of the House	134.4	154.1	122.5	128.0	133.8	130.0	138.1	7.8	14.6	8.4	4.5	4.6	3.6	6.3
Health	115.5	163.2	184.7	233.9	240.3	236.6	244.0	2.1	41.3	22.8	26.6	2.7	9.2	3.1
Transport	178.1	240.3	138.4	139.7	149.6	142.0	166.6	13.6	35.0	(2.3)	0.9	7.1	1.5	17.3
Communication	119.8	100.0	88.2	90.3	90.3	90.3	90.3	(0.6)	(16.5)	6.8	2.4	0.0	(0.1)	0.0
Recreation and Culture	119.5	128.3	122.7	131.8	139.0	135.4	142.5	5.2	7.3	5.7	7.4	5.5	2.3	5.3
Education	133.7	141.0	120.7	135.9	140.6	138.5	140.8	5.9	5.4	9.5	12.6	3.5	7.5	1.6
Miscellaneous Goods and Services	140.5	156.3	122.4	126.3	131.1	128.6	133.8	7.0	11.2	8.1	3.2	3.9	7.5	4.1

Source: Department of Census and Statistics

(1) CCPI details for 2007 and 2008 based on CCPI (2002=100) and from 2009 based on CCPI (2006/07=100)

The following table sets out the consumer price index (data up to 2008 based on the 2002 CCPI basket and data from 2009 onwards based on 2006/07 CCPI basket) and the wholesale price index (based on the 1974 Wholesale Price Index ("WPI") benchmark), as well as the annual percentage changes in each index.

CHANGES IN CONSUMER AND WHOLESALE PRICE INDEX

	2007	2008	2009	2010	2011(1)	End March 2011(1)	End March 2012(1)
Consumer Price Index(2)	163.1	199.9	133.6	141.9	151.5	147.2(3)	155.8(3)
Increase over previous year (%)	15.8	22.6	3.5	6.2	6.7	6.9(3)	5.8(3)
Wholesale Price Index	2,924.4	3,653.6	3,500.9	3,893.0	4,306.5	4,094.5	4,209.4
Increase over previous year (%)	24.4	24.9	(4.2)	11.2	10.6	13.0	2.8

Sources: Central Bank of Sri Lanka and Department of Census and Statistics

Notes:

(1) Provisional

(2) CCPI details for 2007 and 2008 based on CCPI (2002=100) and from 2009 based on CCPI (2006/07=100)

(3) Annual average as at end of June 2011 and end of June 2012

Broad money (M2b), which grew at an average of 19.3% in 2011, continued its expansionary trend in 2012, warranting a tightening of monetary policy to slowdown monetary expansion with a view to addressing the issue of potential demand-driven inflation. Several policy measures were taken in February through April 2012 and subsequent to these measures, the year-on-year growth of broad money decelerated to 20.9% in May 2012, compared to 22.9% in the previous month.

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

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

Following the relaxation of its monetary policy stance in 2009, the Central Bank of Sri Lanka eased its monetary policy stance further in 2010. Broad money expansion continued to moderate during the first three quarters of 2010, indicating subdued demand pressures. Supply-side developments were also favorable, as domestic supplies increased during the year, while commodity prices in international markets, including petroleum prices, moderated towards the middle of 2010. These factors supported a further relaxation of the monetary policy stance to promote economic activity. Accordingly, policy interest rates of the Central Bank were reduced further in July and August 2010. Following these reductions, the Bank's repurchase rate was 7.25% and the reverse repurchase rate was 9.00% by the end of 2010. The targeted annual average growth of broad money in 2010 was also revised upward to 15.0% in July 2010, from the initial target of 14.5%, in order to facilitate growth in economic activity, as it became evident by mid-year that the domestic economy was expanding at a higher rate in 2010 than originally projected. While market interest rates decreased further in 2010 in response to the easing of monetary policy, the decline in market interest rates provided additional impetus to the recovery of economic activity in 2010.

In 2009, in view of declining inflation and the favorable outlook for inflation, the Central Bank relaxed its monetary policy stance in order to support and revive domestic economic activity, which had slowed significantly in tandem with the downturn in global economic activity. The Central Bank reduced its policy interest rates — the Repo rate and the Reverse Repo rate — by a cumulative 300 basis points and 225 basis points, respectively, to 7.50% and 9.75%, respectively, by the end of 2009. These policy measures led to a reduction in other market interest rates. There was therefore a reduction in the cost of borrowing, which in turn eased the adverse credit conditions arising from the global economic crisis. Furthermore, following the easing of conditions in the domestic foreign exchange market, in March and April 2009, the Central Bank removed the margin requirements imposed in October 2008 in relation to the opening of Letters of Credit for certain non-essential items and in respect of imports on Documents Against Acceptance terms.

By December 2008, the annual average growth rate of the CCPI had increased to 22.6%, compared to 15.8% in 2007. The significant rise in international food prices, exacerbated by the spiraling prices of crude oil, exerted significant inflationary pressure beginning in the second half of 2007. Inflation peaked at 28.2% on a year-on-year basis in June 2008 before decelerating to 14.4% by December 2008. In view of the higher than expected levels of inflation in 2007, the Central Bank tightened its monetary policy to prevent increases in prices from becoming more broad-based. The policy stance was tightened by resorting to a downward revision of reserve money targets and allowing market interest rates to adjust upwards in line with the consequent decline in market liquidity. The target for annual average reserve money in 2008 was revised downwards on three occasions with the first and the second revisions being implemented in April and July of 2008. The target for growth in reserve money was further tightened in November 2008 to 9.7% in order to neutralize the expansionary impact of the reduction in the Statutory Reserve Ratio ("SRR") during the last quarter of 2008. In response to the tightening of its monetary policy, growth in monetary aggregates slowed significantly during the year. The expansion in the broad money supply ("M2b") decelerated to 8.5% by the end of 2008 from 16.6% in December 2007. This deceleration in the money supply was largely facilitated by the decline in the growth of credit granted to the private sector, which reached 26.0% during April and May 2007, but decreased to 7.0% by December 2008. However, the direction of monetary policy changed towards the latter part of 2008. On the global front, the bursting of the commodity price bubble and the turmoil in the financial markets which resulted in a decline in economic activities, particularly in the last quarter of 2008, led to a reversal of the monetary policy stance adopted. By December 2008, as a result of the tight monetary policy measures adopted earlier by the Central Bank, the rapid decline in international commodity prices, and the improvements on the supply side, inflationary pressures eased significantly. However, pressures stemming from the domestic foreign exchange market in view of the credit crunch experienced world-wide necessitated foreign exchange sales by the Central Bank to the domestic market as well as the maintenance of policy interest rates at the levels then prevailing, to prevent any further pressure on the exchange rate. However, the Central Bank reduced the SRR applicable to rupee deposit liabilities of commercial banks by a total of 225 basis points to 7.8% by November 2008, thereby releasing rupee liquidity to the market.

Prior to the second half of 2008, Sri Lanka has had to deal with elevated levels of inflation. In order to manage this, the Central Bank had previously taken a tight monetary stance in order to achieve its monetary targets and to reduce inflationary pressures. The measures that the Central Bank has previously taken include:

- Increasing policy interest rates;

- Conducting aggressive open market operations on an overnight and permanent basis to maintain liquidity at desired levels;

- Minimizing purchases of Treasury bills at the primary auctions and special issues;

- Imposing restrictions on excessive usage of reverse repurchase facilities by commercial banks;

- Using moral suasion to discourage excessive lending by banks;

- Implementing prudential measures, such as a general provisioning requirement imposed on all commercial banks to mitigate the potential credit risk of making advances; and

- Imposing a margin requirement on letters of credit for the importation of certain goods and instructing banks not to open letters of credit for the importation of certain luxury items.

Employment and Wages

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

SELECTED EMPLOYMENT INFORMATION

	2007(1)	**2008**(1)	**2008**(2)	**2009**(2)	**2010**(2)	**2011**(2)(3)
			(in thousands, except for percentage)			
Labor force	7,489	7,569	8,082	8,074	8,108	8,236
Unemployment rate (%)	6.0	5.2	5.4	5.8	4.9	4.2
Agriculture, fishery and forestry	2,202	2,344	2,490	2,476	2,520	2,602
Industry sector	1,874	1,888	2,005	1,910	1,867	1,915
Manufacturing	1,331	1,355	1,414	1,348	1,318	1,365
Construction	543	533	590	562	548	550
Services sector	2,966	2,942	3,154	3,216	3,320	3,380
Trade and hotels, etc	1,051	1,028	1,095	1,119	1,196	1,187
Transport, storage and communication	457	426	448	445	484	489
Finance, insurance and real estate	215	236	241	227	264	281
Personal services and other	1,243	1,253	1,370	1,426	1,375	1423
Total employed	7,042	7,175	7,648	7,602	7,707	7894
Percentage of labor force (%)	94.0	94.8	94.6	94.2	95.0	95.8

Sources: Central Bank of Sri Lanka and Department of Census and Statistics

Notes:

(1) Excludes the Northern and the Eastern Provinces

(2) Excludes the Northern Province

(3) Provisional

According to the Quarterly Labor Force Survey (the "QLFS") conducted by the DCS, the rate of unemployment (excluding the Northern Province) dropped to its lowest rate in history of 4.2% in 2011 from 4.9% in 2010. The total number unemployed was estimated at 342,000 in 2011, compared to 401,000 in the previous year. This decline was associated with the healthy growth experienced in all three sectors of the economy, led by the conducive macroeconomic environment that helped create more employment opportunities in 2011. Meanwhile, the employment rate increased to 95.8% in 2011 from 95.1% in 2010. Accordingly, the number of employed persons increased by 2.4% to 7.89 million in 2011, as compared to that of 7.71 million in the previous year.

The unemployment rate (excluding the Northern Province) decreased to 4.9% in 2010 as compared to 5.8% recorded in 2009, in line with the broad based growth in all key sectors of the economy. The total number of unemployed persons was estimated at 401,000 in 2010, compared to 471,000 in the previous year. In 2010, the employment rate increased to 95.1% from 94.2% in 2009. According to the QLFS, the number of employed persons (excluding the Northern Province) increased marginally by 1.4% to 7.71 million in 2010 as compared to 7.60 million in 2009. This was due to the growing demand for labor in line with improved performance in all three major sectors of the economy.

In 2009, the employment rate decreased to 94.2% from 94.6% in 2008. According to the QLFS, the number of employed persons (excluding the Northern Province) decreased by 0.6% to 7.60 million in 2009 compared to 7.65 million in 2008. This decline was due to weaker demand for labor resulting from the general slowdown in economic activity in connection with the global recession. Between these two periods, there was a change in the composition of the employed population among the major industry groups. The share of the services sector in total employment increased to 42.3% in 2009 from 41.2% in the previous year. The services sector also made the largest contribution to total economic growth during this period. The increase in employment in the services sector mainly occurred in the personal services and trade and hotel services categories. Meanwhile, the percentage of people employed in the agriculture sector remained unchanged at 32.6% in 2009. However, the percentage of people employed in the industry sector declined from 26.2% to 25.1% during the year. The unemployment rate increased to 5.8% in 2009 compared to 5.4% in 2008. The steady declining trend in the unemployment rate over the past several years reversed during the first half of 2009. This increase in the rate of unemployment was mainly due to the closures and downsizing of some firms in response to lower demand in connection with the global economic crisis.

In 2008, total employment increased with enhanced job opportunities created by economic growth and investment expansion. According to the QLFS, the employment rate (excluding both Northern and Eastern Provinces) increased to 94.8% as at the end of 2008 from 94.0% as at the end of 2007. The number of employed persons increased by 1.9% to 7.2 million in 2008 compared to 7.0 million in the previous year. The composition of employed population, among the major industry groups recorded a slight change in 2008, with the percentage of people employed in the agriculture sector increasing from 31.3% in 2007 to 32.7% in 2008. Meanwhile, the percentage of people employed in the industry and services sectors declined from 26.6% and 42.1%, respectively, in 2007, to 26.3% and 41.0%, respectively, in 2008. The services sector remained the sector which employed the most people. Meanwhile, the unemployment rate decreased to 5.2% in 2008 compared to 6.0% in 2007, indicating the continuation of the declining trend observed in the past. Youth unemployment, especially among educated females, was higher than the national unemployment rate. The underemployment rate, which is defined as the number of underemployed persons as a percentage of employed persons, was 4.0% in 2008. The underemployment was relatively higher in the agriculture sector, compared to other two major sectors of the economy.

Wages

The employed population comprises paid employees, employers, own account (self-employed) workers and unpaid family workers. Wages in Sri Lanka fall in to two main categories of employment: the public sector and the private sector. The public sector comprises government and semi-government institutions and the private sector comprises formal and informal sectors. Wages in the public sector are largely determined by the Government. For formal private sector employees, the wage-setting mechanism includes several forms: tripartite determination, collective bargaining, remunerative tribunals, unilateral employer decisions and adjustment by Government directives. In the informal private sector, wages are mostly determined based on demand and supply conditions in the market. The nominal wages of both the public and private sector employees increased in 2011 compared to 2010. Within the private sector, employees in both the formal and informal private sectors enjoyed increases in wages in nominal terms. The increase in nominal wages of the employees in the formal private sector, whose wages are governed by the Wages Boards, was due to the substantial increase in the minimum wages of employees in the services sector and the industry and commerce sector since August 2010. The overall real wage rate index for employees in the formal private sector decreased by 2.0% while that of the informal private sector increased by 4.8% in 2011. Nominal wage rate indices of public sector employees recorded a modest increase of 6.7%, and the overall real wage rate index of public sector employees remained unchanged in 2011.

Public Sector Wages. In 2011 the overall nominal wage rate index of the Central Government employees increased by 6.7%, compared to 3.3% in 2010, mainly due to the special non-pensionable allowance equivalent to 5.0% of basic salary and the enhancement of the monthly COLA by Rs.600 granted to the public sector employees from January 2011. This increase resulted in a gain in the nominal wage rate indices of all categories of public sector employees, namely, non-executive officers, minor employees and government school teachers whose wages rose by 6.6%, 6.8% and 7.7%, respectively, in 2011 compared to increases in the range of 3.0-3.5% in 2010. However, the real wages of public sector employees reflected mixed trends in 2011. Minor employees and government school teachers enjoyed real wage increases of 0.1% and 0.9%, respectively, in 2011 while non-executive officers suffered a real wage erosion of 0.1%. The overall real wage rate index of central government employees remained unchanged in 2011 compared to the real wage rate decrease of 2.7% recorded in the previous year.

Formal Private Sector Wages. In nominal terms, the overall minimum wage rate index of the formal private sector, whose wages are administered by regulations under the Wages Boards, increased by 4.6% in 2011 over the previous year. The minimum wage rate indices in the three major categories of the formal private sector, namely agriculture, industry and commerce, and services increased in nominal terms by 3.0%, 9.2% and 10.7%, respectively, in 2011. The relatively higher increases in nominal wage rate indices in the services sector and the industry and commerce sector in 2011 were mainly attributable to the substantial increase in the minimum wages of employees in these two sectors, in August 2010.

The minimum wage rate indices of employees in the industry and commerce and services sectors have enjoyed increases in their real wages while employees in the agriculture sector suffered a real wage loss in 2011. Accordingly, the real wages in the industry and commerce and services sectors increased by 2.4% and 3.8%, respectively, in 2011 while the real wage rate index in the agriculture sector declined by 3.6% in 2011. As a result, the overall real wage rate index for employees in the formal private sector declined by 2.0% in 2011 compared to the previous year.

Informal Private Sector Wages. The daily wages of the informal private sector, in nominal terms, increased by an average rate of 11.9% in 2011 as compared to 8.5% in 2010. The increases in nominal wages of employees in the agriculture and construction sectors were 12.1% and 11.1%, respectively, in 2011. Within the agriculture sector, the average daily wages in the sub-categories of tea and coconut increased by 13.3% each while those in the sub-categories of paddy and rubber increased by 11.2% and 10.9%, respectively, in 2011 compared to those in 2010. The increases were relatively higher in sub-categories in the agriculture sector in 2011 compared to those in the previous year. Real wages in the agriculture and construction sectors increased by approximately 5% and 4%, respectively, in 2011, compared to respective real wage increases of 2.5% and 0.5% in 2010.

Labor Productivity. Overall labor productivity continued to improve in 2011, following the trend observed over the last few years. Labor productivity, measured in terms of GDP per worker (at constant prices of 2002), increased by 5.7% in 2011 over the previous year, to Rs.362,800 per worker. The increase in productivity can be attributed mainly to the growth in productivity of the Industry (by 7.6%) and Services (by 6.7%) sectors while productivity of the agriculture sector suffered a set-back of 1.7% during the year. This labor productivity data excludes the Northern Province, for which data was unavailable for 2011.

Labor Relations

Labor relations have improved noticeably in recent years. The situation in 2011 is particularly positive compared with the environment that prevailed prior to 2009 where prolonged industrial disputes caused extensive damage to the economy. Although the number of strikes and man-days lost increased moderately in 2011, these numbers were significantly lower than those experienced before 2009. Accordingly, the number of strikes in the private sector increased to 27 in 2011 compared to 15 reported during 2010 while total man-days lost increased to 39,186 in 2011 compared to 25,071 in the previous year. Similarly, the number of workers involved in the strikes also increased to 11,039 in 2011 from 5,108 in 2010. The increase in the total number of strikes was mainly due to the increase in industrial disputes in the plantation sector.

Improving the regulatory framework and promoting social dialogue and labor relations were considered important to strike a balance between the flexibility and security of the labor market. As the legal provisions relating to labor and employment are complex and extensive, initiatives were taken in 2011 to review issues related to the existing regulatory framework. Accordingly, the Industrial Disputes Act (Chapter 131) was amended by Industrial Disputes (Amendment) Act, No. 39 of 2011 on 6 October 2011 to suit the modern day requirements. The maximum penalty for unfair labor practices was increased with the goal of serving as a sufficient deterrent.

The number of strikes in the private sector increased to 15 in 2010 compared to only eight strikes reported in the previous year, primarily due to an increase in the number of strikes in the plantation sector. Despite this increase, 2010 experienced the second lowest number of reported strikes since 2000. Total man-days lost increased to 25,071 in 2010, compared to 7,665 in 2009. The number of man-days lost in the plantation sector increased to 23,037 in 2010 compared to 300 in 2009, while the total workers involved in strikes increased to 3,185 in 2010 compared to 300 in 2009. The number of strikes in the rest of the private sector remained at six, similar to that of the previous year. Excluding the plantation sector, the number of workers involved in strikes and the number of man-days lost decreased substantially in 2010 with total workers involved decreasing to 1,923 in 2010 from 4,720 in 2009 and man-days lost decreasing to 2,034 from 7,365. The Government believes that the continuing maintenance of a sound working environment is essential to improving industrial harmony, and thereby increasing investment and productivity in the country.

The number of strikes in the private sector to declined to eight in 2009 compared to 51 in the previous year. Similarly, the total man-days lost in 2009 also declined substantially to 7,665 compared to 65,655 in 2008. The number of strikes in the plantation sector declined to two in 2009 compared with 34 in 2008. The total man-days lost and workers involved also decreased significantly due to improved industrial harmony among the employers, workers and trade unions. The number of strikes in the rest of the private sector declined to six in 2009 compared to 17 in the corresponding period of the previous year. Although the total workers involved in these strikes increased from 3,917 to 4,720 during 2009, loss of man-days declined dramatically by 69% to 7,365 compared to 24,130 in the previous year. This development was a combined result of a number of factors such as better relationships among parties, greater transparency in management practices and maintenance of a better social dialogue at the work place to improve industrial harmony.

Samurdhi Welfare Program

The "Samurdhi Welfare Program" is a program aimed at providing a safety net for the poor to raise their incomes above the poverty line. The percentage of the population living below the national poverty threshold declined to 8.9% in 2010/11 compared to 15.2% based on the 2006/2007 survey. The Samurdhi Authority of Sri Lanka continued with various income generation programs, community development programs as well as capacity building programs during 2011 to help Samurdhi beneficiaries to escape from poverty and improve their standard of living. The number of families who benefited from the Samurdhi Income Supplementary Program in 2011 was 1,541,575 compared to 1,572,129 in 2010. The decline in the number of participating families was largely due to the rising income levels of the beneficiaries, which pushed them above the poverty line. At the same time, cash grants to eligible Samurdhi beneficiaries decreased to Rs.9,043 million (US$81.8 million) in 2011 from Rs. 9,241 million (US$81.7 million) in 2010.

Savings

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

INVESTMENTS AND SAVINGS (AT CURRENT MARKET PRICES)

	2007	2008	2009	2010	2011[(1)]
	(in Rs. millions, except for ratios)				
Gross Domestic Product at Market Prices	3,578,688	4,410,682	4,835293	5,604,104	6,542,663
Private Investment	807,417	929,115	863,485	1,200,795	1,549,611
Government Investment	192,902	286,132	317,964	344,704	409,222
Total Investment	1,000,320	1,215,247	1,181,449	1,545,500	1,958,833
Private Savings	686,683	700,048	1,047,454	1,199,731	1,078,424
Government Savings	(57,707)	(88,450)	(176,931)	(119,815)	(71,856)
Domestic Savings	628,976	611,598	867,523	1,079,916	1,006,568
Net Factor Income from Abroad	(39,054)	(105,032)	(55,795)	(69,776)	(72,046)
Net Private Current Transfers from Abroad	245,006	277,711	336,578	413,885	513,216
National Savings	834,928	784,277	1,148,306	1,424,024	1,447,738
Investment Ratio	28.0	27.6	24.4	27.6	29.9
Domestic Savings Ratio	17.6	13.9	17.9	19.3	15.4
National Savings Ratio	23.3	17.8	23.7	25.4	22.1

Sources: Central Bank of Sri Lanka and Department of Census and Statistics

Note:

(1) Provisional

National savings consist of domestic savings, net factor income from abroad ("NFIA") and net foreign private transfers, which consist partly of worker remittances. NFIA, which is a component of GNP but not GDP, is the net flow of property income to and from the rest of the world, plus the net flow of compensation of employees.

In 2011, national savings were estimated at Rs.1,448 billion, recording an improvement of 1.7% over the previous year. Although both the foreign receipts and payments increased during 2011, the latter recorded a relatively higher growth resulting in the deterioration in NFIA. Net private transfers grew at a significant rate of 24% in 2011. Improvement in net private transfers helped record a positive growth in national savings despite the decline of domestic savings during the year. However, the increase in foreign private transfers was not sufficient to offset the impact of the significant expansion of consumption in 2011. Hence, national savings as a percentage of GDP declined to 22.1% in 2011 from 25.4% in 2010. Accordingly, the resource gap, i.e., the difference between national savings and investment as a ratio of GDP, increased substantially to 7.8% from 2.2% with the drop in the domestic savings ratio and the increase in the investment ratio.

In 2010, national savings grew by 24.0% to Rs.1,424 billion, compared to the high growth of 46.4% in the previous year. This slowdown in growth in national savings is attributed to worsening of NFIA, due to higher growth in factor payments, with the repatriation of profits and dividends exceeding the earnings from investments and trading, while the 23.0% growth in net private current transfers from abroad assisted in securing the growth in national savings during the year. Meanwhile, the national savings ratio increased to 25.4% during 2010 from 23.7% in the previous year.

In 2009, national savings, which is the sum of domestic savings, net foreign private transfers and NFIA, was estimated at Rs.1,148 billion in 2009, an improvement of 46.4% over the previous year. The national savings ratio (national savings divided by GDP) rose by 2.8% to 23.7% in 2009. The improvement in national savings can be attributed to the favorable performance of both NFIA and net private transfers. NFIA remained negative, but improved during the year with a drop in factor payments. Net private current transfers increased by 21.2% to Rs.337 billion in 2009.

In 2008, national savings decreased by 4.0% to Rs.784 billion. In 2008, domestic savings, consisting of private savings and Government savings, contracted by 0.9% and as a percentage of GDP, declined to 13.9% from 17.6% in 2007. This contraction can be attributed to the continued deterioration of net external demand with increased growth in imports and the slowdown in export earnings during 2008. Government savings, which is defined as the current account balance of the Government budget, continued to be negative in 2008. In 2008, net private transfers, which consists of worker remittances, continued to increase by 13.3% compared to 23.8% in 2007, and reached Rs.278 billion (US$2.6 billion). However, NFIA continued to deteriorate during 2008 due to unfavorable developments in the external sector. The combined result of these developments was that the national savings as a percentage of GDP declined to 17.8% in 2008 from 23.3% in the previous year.

Balance of Payments

Overview

BOP figures measure the relative flow of goods, services and capital into and out of the country as represented in the current account and the capital and financial account. The current account tracks the country's trade in goods, services, income and current transfer transactions. The capital and financial account includes the capital account, which covers all transactions involving capital transfers and acquisition or disposition of non-produced, non-financial assets, and the financial account, which covers all transactions associated with changes of ownership in foreign financial assets and liabilities of an economy. A BOP surplus indicates a net inflow of foreign currencies, thereby increasing demand for and strengthening the local currency. A BOP deficit indicates a net outflow of foreign currencies, thereby decreasing demand for and weakening the local currency.

Balance of Payments Performance

The following table sets out the consolidated BOP position for the Issuer for the years from 2007 to 2011 and the first quarter of 2012.

BALANCE OF PAYMENTS

	2007	2008	2009	2010	2011[(1)]	First three months of 2011[(1)]	First three months of 2012[(1)]	% Increase or Decrease
	(in US$ millions, except for percentages)							
Overall BOP position:	531	(1,385)	2,725	921	(1,061)	127	(251)	(298)
Current account:	(1,402)	(3,886)	(214)	(1,075)	(4,615)	(510)	(1,053)	(106)
Trade Balance:	(3,657)	(5,981)	(3,122)	(4,825)	(9,710)	(1,767)	(2,559)	(45)
Exports	7,640	8,111	7,085	8,626	10,559	2,671	2,634	(1)
Imports	11,296	14,091	10,207	13,451	20,269	4,438	5,193	17
Services:	302	401	391	707	1,099	272	401	47
Receipts	1,775	2,004	1,892	2,474	3,084	820	919	12
Payments	1,472	1,603	1,501	1,768	1,985	548	518	(5)
Income (net):	(358)	(972)	(488)	(617)	(647)	(176)	(140)	20
Receipts	449	(32)	116	323	467	109	206	89
Payments	807	940	603	940	1,114	286	346	21
Current transfers:	2,311	2,666	3,005	3,660	4,643	1,161	1,245	7
Private Transfers (net)	2,214	2,565	2,927	3,608	4,583	1,150	1,243	8
Official Transfers (net)	97	101	77	52	60	12	2	(83)
Capital and financial account:	2,097	1,773	2,594	2,877	4,262	907	1,117	23
Capital account:	269	291	233	164	164	38	7	(82)
Capital Transfers (net)	269	291	233	164	164	38	8	(82)
Financial account:	1,828	1,483	2,361	2,713	4,097	869	1,110	28
Long-term:	1,251	1,016	1,304	2,379	3292	456	481	5
Direct investment	548	691	384	435	896	182	210	15
Foreign Direct Investment	548	691	384	435	896	182	210	15
Privatization Proceeds	0	0	0	0	0	0	0	0
Private Long-term (net)	31	74	79	149	153	46	67	46
Inflows	199	265	390	580	364	73	93	27
Outflows	168	191	311	431	211	27	26	(4)
Government, Long-term (net)	672	252	840	1,796	2,244	228	205	(10)
Inflows	1,290	1,059	1,780	2,460	3029	384	386	1
Outflows	618	807	940	665	785	156	182	17
Short-term	577	466	1,058	334	805	413	629	52
Portfolio Investments (net)	101	60	(6)	(230)	(171)	(64)	159	348
Private Short-term (net)	20	594	228	(1,032)	(228)	(49)	(399)	(714)
Commercial Bank (net)	83	25	(533)	1,064	971	447	462	3
Government Short-term (net)	372	(213)	1,369	531	233	79	406	414
Errors and Omissions	(165)	728	346	(881)	(707)	(270)	(316)	(17)

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

During the first quarter of 2012, the external sector faced several challenges in light of adverse global economic developments, including the European debt crisis. The current account recorded a deficit of US$1,053 million in the first quarter of 2012, compared to a deficit of US$510 million in the corresponding period of 2011. However, there has been a deceleration in the current account deficit for the first quarter of 2012 compared to the deficit of US$1.7 billion recorded in the fourth quarter of 2011. An increase in import demand during the festive season mainly contributed to the increase in the deficit in the current account for the first quarter of 2012. As a result of a high deficit in the current account, the overall balance in the BOP recorded of a deficit of US$251 million for the first quarter of 2012. However, the deficit in the BOP was partially offset by the surplus of capital and financial account. During the first quarter of 2012, major inflows to the capital and financial account in the form of FDI was US$238 million. Medium and long-term inflows to the Government amounted to US$386 million, while short term net foreign inflows on account of investments in treasury bills and bonds amounted to US$407 million. Portfolio investments recorded a net inflow of US$159 million during the first quarter of 2012.

The external sector, which performed well during the first half of 2011, faced several challenges during the latter part due to adverse global developments and rapid growth in import demand. Globally, the intensified sovereign debt crisis in the Euro area, sluggish recovery in the global economy, and geopolitical uncertainties in some oil producing Middle Eastern and North African countries exerted pressure on oil prices and financial inflows. Domestically, the expanded aggregate demand resulted in a rapid growth in imports, widening the trade deficit substantially, despite an impressive growth in exports. Exports grew by 22% supported mainly by industrial exports, while imports grew by 51% reflecting a sharp growth in intermediate goods led mainly by oil imports and investment goods for project related imports.

Inflows to the capital and financial account remained strong, though such inflows were insufficient to offset the high current account deficit. Inflows of private long-term investments including foreign direct investments (FDI) and inflows to the Government remained healthy. In 2011, reflecting fast implementation of major on-going infrastructure projects, loan inflows to the Government increased significantly. Medium and long-term loan inflows to the Government excluding the proceeds of the Sovereign bond of US$1 billion, amounted to US$2,029 million during 2011, compared to US$1,460 million in 2010. Meanwhile, the foreign funds utilization rate increased significantly in 2011 to 38.2% from 24.8% in 2010. Foreign loan inflows were mostly directed towards continuation of infrastructure projects such as Colombo Port Expansion Project, Rehabilitation and Improvement of Priority Roads Project, Upper Kotmale Hydro Power Project, Greater Colombo Transport Development Project and Southern Highway Construction Project. However, the higher current account deficit led the overall BOP to record a deficit of US$1.06 billion by the end of 2011.

The gross official reserves of the country reached a historically high level of US$8.2 billion by mid-August 2011 and declined thereafter. Absorption of foreign exchange inflows, receipts to the Government including the proceeds of Sovereign bond issue, as well as receipts under the IMF SBA Facility helped build the official reserves during the first eight months of the year. However, during the latter part of 2011 the widened trade deficit resulting from the sharp increase in import expenditure created a strong demand for foreign exchange in the domestic foreign exchange market. This necessitated the Central Bank to intervene by supplying foreign exchange to the market, thereby reducing the pressure in the domestic foreign exchange market. As a result, the gross official reserves declined to US$6.0 billion by end 2011, equivalent to 3.5 months of imports.

In 2010, the external sector performed well, underpinned by the gradual recovery of the global economy, improved international financial market conditions and enhanced investor confidence brought about by the stable domestic macroeconomic environment. External trade rebounded strongly in 2010, reversing the sharp contraction observed in 2009. Supported by the improved investment climate, attractive prices and the gradual recovery of the global economy, earnings from exports reached a record high, surpassing the previous peak performance in 2008. Despite the withdrawal of the European GSP+ concessions in August 2010, exports to all major destinations increased. Imports also recovered strongly, with significant contributions from consumer and intermediate goods, reflecting tariff reductions, higher commodity prices and strong growth in the domestic economy. As a result, the trade deficit expanded in 2010, following a sharp contraction in 2009 in light of the lower domestic and global demand. Inward workers' remittances increased substantially and continued to be the foremost foreign exchange source in 2010. Sri Lanka's travel and tourism industry, which suffered immensely due to the protracted internal conflict, staged a remarkable recovery during the year. The current account deficit in 2010 was 2.2% of GDP, compared to the 10-year average of 3.5%.

Increased inflows to the financial account supported balance of payments, with a BOP surplus of US$921 million in 2010. Sri Lanka's graduation to 'middle income' economy status by the IMF in January 2010, from the previously listed category of Poverty Reduction and Growth Trust eligible countries, enabled the country to project itself strongly in international financial markets. The continuation of IMF-SBA facility also helped to strengthen positive investor sentiment.

In 2010, the medium and long-term loan inflows to the Government increased. Long-term loan inflows to the Government, excluding the proceeds of the US$1 billion sovereign bond and grants, increased to US$1,460 million in 2010 from US$1,280 million in 2009. The higher foreign loan inflows in 2010 reflect the more rapid disbursement for ongoing projects during the year and, as a result, the foreign aid utilization rate increased marginally in 2010 to 24.8% from 24.1% in 2009.

In 2009, the external sector underwent a strong turnaround and BOP was able to record a surplus of US$2,725 million from a deficit of US$1,385 million in the previous year with the gradual recovery from the global recession and the end of the internal conflict. The economy recovered in the second quarter with remittances flowing in and international investors starting to invest, particularly in the short term. The approval of the SBA Facility by IMF has boosted investor confidence. Though the trade deficit has grown due to a greater increase in imports compared to exports, the deficit was offset by higher remittance inflows. Foreign investments in the government sector have improved with the Government's 2009 bond offering as well as improved short term investments in the Government securities market. The surplus in the capital and financial account was more than sufficient to offset the marginal deficit in the current account and record an unprecedented surplus of US$2,725 million in overall balance in BOP. Consequently, the country's external gross official reserves improved to US$5,097 million and its total external reserves improved to US$6,770 million in 2009.

In 2008, the external sector faced a number of challenges, such as intense competition for Sri Lanka's major industrial exports, such as apparel from lower cost manufacturers in a quota-free trading environment, escalation of hostilities with the LTTE, the escalation during the most part of 2008 of international commodities prices, especially the increase in the price of crude oil, and other unprecedented and unfavorable developments globally and domestically owing to the escalation of the global economic crisis. As a result of these unfavorable developments, the overall BOP, which recorded a surplus of US$390 million by the end of June 2008, turned into a deficit of US$1,385 million by the end of 2008. Consequently, the country's external gross official reserves decreased to US$1,753 million and its total external reserves decreased to US$2,992 million in 2008.

Current Account

During the first quarter of 2012, the current account recorded a deficit of US$1,053 million, compared to a current account deficit of US$510 million recorded during the corresponding period of 2011. The higher current account deficit was mainly driven by the widened trade gap that resulted from increased imports.

In 2011, the current account deficit increased substantially to US$4,615 million from US$1,075 million in 2010 on account of the significantly high trade deficit. In terms of GDP, the current account deficit increased to 7.8% of GDP in 2011 from 2.2% of GDP in 2010. The deficit was mainly due to the widening trade deficit on account of increased import expenditure, particularly, oil and investment goods. However, about two-thirds of the deficit in the trade account was offset by higher inflows of workers' remittances and the surplus in the services account.

In 2010, the current account recorded a deficit of US$1,075 million or 2.2% of GDP. The current account deficit widened due to a larger trade deficit, as a result of increased import demand supported by the recovery of domestic demand and expansion of economic activity, including increased demand for investment goods for infrastructure projects. The current account deficit was partially offset by inflows from services and private transfers. As a percentage of GDP, the current account deficit of 2.2% in 2010 was well below the average deficit of previous years, with the exception of 2009, which recorded a deficit of 0.5% of GDP, reflecting weak global and domestic demand in the context of the global recession.

In 2009, the current account recorded a marginal deficit of US$214 million compared to the substantially larger deficit of US$3,886 million in 2008. In terms of GDP, the current account deficit improved from 9.5% in 2008 to 0.5% in 2009. Because the reduction in expenditure in all major categories of imports was much greater than the reduction in export earnings, the trade deficit as a whole narrowed significantly in 2009. Comparatively low deficits in the trade account and income account were largely offset by the higher inflows of workers' remittances and surplus in the services account, resulting in a marginal deficit in the current account.

In 2008, the current account deficit more than doubled to US$3,886 million from US$1,402 million in 2007 due to increased trade deficit led by unprecedentedly high import expenditure. In terms of GDP, the current account deficit deteriorated to 9.5% of GDP in 2008 from 4.3% of GDP in 2007.

Goods Trade

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

Given the small size of the economy and limited domestic demand, Sri Lanka has had to adopt external trade relations and policies aimed at enhancing the integration of the domestic economy with global markets. This helps the country benefit from increasing global demand, technological developments and the transfer of skills and knowledge. Sri Lanka remains firmly committed to the multilateral trading system, being a founding member of the WTO, and it has made commitments to the WTO on trade in goods and also made commitments under the GATS on insurance, telecommunications, tourism and financial services. As an active member of the WTO Ministerial Meeting, Sri Lanka contributed to the success of countries having similar interests, in designating a number of agricultural products as special products which would be exempt from further tariff cuts to support local farmers. Sri Lanka also made progress in furthering its regional and bilateral trading arrangements in recent years. Sri Lanka is a signatory of many trading arrangements, such as the Indo-Sri Lanka Free Trade Agreement, Pakistan-Sri Lanka Free Trade Agreement, Asia Pacific Trade Agreement and South Asia Free Trade Arrangement. In order to simplify the tax structure, the five-band customs duty structure of 0.0%, 2.5%, 6.0%, 15.0% and 28.0% was changed to a four-band customs duty structure of 0.0%, 5.0% 15.0% and 30.0% in 2010. Although, different duty rates were imposed on different items considering their impact to various stakeholder groups, recent policy direction is to further simplify the tariff bands in operation. Except for a few items, raw materials for local industries were kept at low duty rates, while rates for finished products are higher and intermediate products are in-between. Accordingly, more incentives have been granted to the local manufacturers.

On August 15, 2010, the EU member states decided to withdraw preferential tariff benefits that Sri Lanka had received under the Special Incentive Arrangement for Sustainable Development and Good Governance as part of the GSP+ scheme. The GSP+ scheme, which exempted more than 7,200 products from EU import duties, primarily benefited Sri Lanka's apparel exporters. Following this withdrawal, Sri Lankan exports reverted to the standard EU-GSP, which still provides preferences for key Sri Lankan products such as clothing. The decline in competitiveness that has resulted from the GSP+ withdrawal appears to have been partially offset by Sri Lanka's focus on long-term preparations to adjust to conditions without the GSP+ benefits, the firm level actions taken towards differentiating and diversifying products as well as markets, improvements in the quality and branding of products, negotiations with buyers, enhancements in productivity and reductions in finance and input cost, coupled with an improved macroeconomic environment. The resulting improvements in competitiveness have helped Sri Lankan exports move forward amidst challenges.

Exports of Goods

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

EXPORTS OF GOODS BY COMMODITY GROUP

								Share of Exports (%)		
	2007	**2008**	**2009**	**2010**	**2011(1)**	**First Four Months of 2011(1)**	**First Four Months of 2012(1)**	**2007**	**2011(1)**	**First Four Months of 2012(1)**
	(In US$ millions, except for percentages)									
Agricultural Exports	1,648.2	1,969.3	1,828.5	2,306.4	2,527.8	815.9	719.5	21.6	23.9	21.7
Tea	1,025.2	1,271.5	1,185.3	1,440.6	1,490.9	476.8	421.1	13.4	14.1	12.7
Rubber	109.2	125.0	98.6	173.2	206.4	92.6	64.3	1.4	2.0	1.9
Coconut	128.5	145.1	162.2	165.8	266.0	63.2	71.5	1.7	2.5	2.2
Other agricultural products	385.3	427.6	382.3	526.7	564.5	183.2	162.7	5.0	5.3	4.9
Industrial Exports	5,936.8	6,112.2	5,228.2	6,096.1	7,991.7	2,588.7	2,477.6	77.7	75.7	74.8
Food, beverages and tobacco	323.6	243.0	183.8	244.6	348.2	105.1	89.5	4.2	3.3	2.7
Textiles and Garments	3,336.9	3,477.6	3,261.1	3,356.0	4,191.2	1,361.6	1,323.0	43.7	39.7	39.9
Petroleum products	169.7	254.9	134.4	263.4	552.7	202.3	163.9	2.2	5.2	4.9
Rubber products	483.2	541.9	384.7	557.6	884.8	258.1	289.8	6.3	8.4	8.7
Ceramic products	46.9	49.0	36.5	39.9	38.3	12.4	10.8	0.6	0.4	0.3
Leather, travel goods and footwear	59.5	56.0	47.3	60.2	65.1	19.4	17.0	0.8	0.6	0.5

	2007	2008	2009	2010	2011(1)	First Four Months of 2011(1)	First Four Months of 2012(1)	Share of Exports (%) 2007	2011(1)	First Four Months of 2012(1)
	(In US$ millions, except for percentages)									
Machinery and mechanical appliances	371.1	322.3	186.9	258.8	312.2	99.9	107.5	4.9	3.0	3.2
Gem, diamond and jewelry	474.1	514.5	402.4	409.0	531.5	147.3	187.7	6.2	5.0	5.7
Other industrial exports	671.7	653.0	591.2	906.6	1,067.6	382.7	288.4	8.8	10.1	8.7
Mineral Exports	23.8	21.4	19.8	24.2	32.9	11.9	24.1	0.3	0.3	0.7
Unclassified	31.3	7.7	8.0	199.2	6.5	2.9	92.5	0.4	0.1	2.8
Total Exports	7,640.0	8,110.6	7,084.5	8,625.8	10,558.8	3,419.4	3,313.8	100.0	100.0	100.0

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

Note:

(1) Provisional

EXPORTS OF GOODS BY DESTINATION

	2007	2008	2009	2010	2011	First Four Months of 2011(1)	First Four Months of 2012(1)	Percentage of Total Exports 2007	2011(1)	First Four Months of 2012(1)
	(in US$ millions, except for percentages)									
United States	1,970.0	1,869.3	1,576.0	1,701.2	2,144.8	690.5	725.4	25.8	20.3	21.9
United Kingdom	1,018.0	1,090.4	1,023.6	989.7	1,112.2	369.3	336.5	13.3	10.5	10.2
India	515.3	418.3	321.9	474.0	519.0	166.4	203.6	6.7	4.9	6.1
Belgium-Luxembourg	400.2	425.4	363.6	376.7	565.4	144.3	146.7	5.2	5.4	4.4
Germany	437.9	405.3	346.9	400.2	510.0	166.7	154.2	5.7	4.8	4.7
Japan	159.6	159.0	139.3	171.0	223.0	72.1	73.2	2.1	2.1	2.2
Italy	394.9	445.1	437.5	466.0	610.1	178.9	183.2	5.2	5.8	5.5
Russia	202.6	220.7	192.4	243.3	281.5	92.4	77.9	2.7	2.7	2.4
United Arab Emirates	209.2	252.6	211.3	287.8	298.2	90.2	56.3	2.7	2.8	1.7
Netherlands	151.1	157.3	156.3	200.2	197.7	71.6	51.2	2.0	1.9	1.5
Other	2,181.2	2,667.2	2,315.7	3,315.8	4,096.9	1,377.0	1,305.6	28.6	38.8	39.4
Total	7,640.0	8,110.6	7,084.5	8,625.8	10,558.8	3,419.4	3,313.8	100.0	100.0	100.0

Sources: Sri Lanka Customs, National Gem and Jewellery Authority and the Central Bank of Sri Lanka

Note:

(1) Provisional

Earnings from exports declined by 3.1% to US$3,314 million during the first four months of 2012, compared to the first four months of 2011, due to lower prices in the international market. Textile and garment exports declined by 2.8% to US$1,323 million during the first four months of 2012, compared to the corresponding period in the previous year, reflecting the significantly lower cotton prices. Other key categories of industrial exports, such as petroleum products and food and beverages also declined. However, exports of rubber products and gem, diamond and jewelry performed well. Agricultural exports declined by 11.8%, compared to the corresponding period in 2011, to US$720 million, mainly due to lower earnings from tea, rubber and coconut resulting from lower prices in the international market. Earnings from tea exports and rubber exports declined by 11.7% and 30.6% to US$421 million and US$64 million, respectively in the first four months of 2012, over the first four months of 2011. Earnings from minor agricultural exports also decreased by 13.4% to US$25 million in the first four months of 2012, compared to the corresponding period in 2011.

In 2011, earnings from exports grew by 22.4% to US$10,559 million over the previous year. Industrial exports increased by 31.1% to US$7,992 million mainly driven by higher earnings from textiles and garments, rubber products and petroleum products. Earnings from textiles and garment exports increased by 24.9% to US$4,191 million, surpassing the US dollars 4 billion target set by the apparel industry, mainly driven by the higher cotton prices, concessions to the industry by Budget 2012 (tax exemption on yarn imports and exemption of VAT and customs duty on equipment required to modernize apparel industry) and the market diversification and increased value addition strategies of the apparel industry. Apparel exports to the USA increased by 21.5% while those to the EU increased by 25.1% during the year. Reflecting higher rubber prices in the international market, earnings from rubber product exports also increased by 58.7% to US$885 million. Benefitting from tariff concessions provided for gems, diamonds and jewelry industry, earnings from gem, diamond and jewelry exports which increased by 29.9% to US$532 million in 2011. Earnings from agricultural exports, which accounted for 23.9% of total exports increased by 9.6% to US$2,528 million. Earnings from traditional agricultural crops increased due to the higher prices that prevailed in the international market during the first half of 2011. The extension of the fertilizer subsidy to cover plantations from mid 2011 is expected to help increase tea production and the cess levy on bulk tea and raw rubber exports is expected to increase these exports in value added form.

In 2010, earnings from exports increased by 21.8% to US$8,626 million, compared to 2009, reflecting the improved investment climate, attractive prices, gradual recovery in external demand and the removal of the marine war risk premium on re-insurance. Although earnings from exports were relatively low during the early part of 2010 amidst the slow global recovery, they recovered strongly towards the latter part of the year. The largest contribution to the growth in earnings came from industrial exports (56.3%), followed by agricultural exports (31%). Earnings from industrial exports increased by 16.6% to US$6,096 million in 2010, reflecting growth in all sub-sectors, mainly due to the recovery of global demand. In industrial textiles and apparel garments exports increased by 2.9% to US$3,356 million in 2010, compared to 2009. In view of the impending withdrawal of the GSP+ benefits, many manufacturers improved the quality of products and enhanced productivity, enabling them to face increased competition upon withdrawal. They achieved higher levels of value addition by improving designs, focusing on branded products and catering to the higher-end customers and, as a result, apparel exports to EU decreased only by 0.9% to US$1,616 million in 2010 and constituted 50.8% of total apparel exports in 2010. Apparel exports to the US, Sri Lanka's second largest market, increased by 0.8% to US$1,296 million in 2010. Earnings from exports in the food, beverages and tobacco category increased by 33.1% in 2010 to US$245 million, reflecting substantial growth in exports of fruit and vegetable preparations. Earnings from exports of rubber products and machinery and mechanical appliances increased by 44.9% and 38.5% in 2010 to US$558 million and US$259 million, respectively. Rubber product exports consisted mainly of solid tires and rubber gloves. Machinery and equipment exports consisted of primarily transport equipment, such as boats and bicycles, and electrical equipment, such as transformers, static converters, inductors and insulated cables. Earnings from agricultural exports, which accounted for 26.7% of total exports, increased by 26.1% to US$2,306 million in 2010, due to the higher prices that prevailed in the international market in 2010. Earnings from tea exports increased by 21.5% to US$1,441 million as Ceylon tea continued to obtain high prices in the major tea auction centers of the world during the year 2010. Sri Lanka remained the third largest exporter of tea in the world after Kenya and India. Earnings from rubber, coconut and other agricultural exports also showed healthy growth in 2010. Earnings from rubber exports increased significantly by 75.7% in 2010, compared to 2009. Lower production in major natural rubber producing countries and higher demand for natural rubber emanating from China and India exerted pressure on rubber prices throughout the year, causing average export prices of rubber to rise by 89.6% in 2010.

In 2009, earnings from exports declined by 12.7% to US$7,085 million, largely due to the impact of the global recession. The lower demand for goods and services was the main reason for the decline in exports. The rising costs of production and the uncertainty over the renewal of GSP+ concessions was not conducive to export performance, particularly industrial exports. All major sectors experienced declines in growth, while the largest contribution to the decline in overall exports was from the industrial sector (86.2%) followed by the agricultural sector (13.7%). Earnings from agricultural exports declined by 7.2% to US$1,828 million in 2009. However, there was improvement in the performance of agricultural exports during the last quarter, led by the higher prices of tea, rubber and other minor agricultural commodities in the international market. Tea prices, which were severely affected during the latter part of 2008 with the intensification of the global financial turmoil, stabilized by the end of 2009. However, earnings from tea exports declined by 6.8% to US$1,185 million in 2009 due to a drop in export volumes caused by supply shortages. Earnings from other traditional agricultural products also declined in 2009. Earnings from industrial exports declined by 14.5% to US$5,228 million in 2009 reflecting contractions in all sub sectors. However, textiles and garments exports, which accounted for 46% of total exports, emerged relatively unscathed. Other industrial exports such as food, beverages and tobacco products, rubber products, diamonds and jewelry, and machinery and equipment, which together accounted for another 16.3% of total exports, contracted in 2009, despite improvement in performance towards the latter part of the year. Export earnings from precious and semi precious gems as well as other mineral exports, including graphite, declined. Western countries continued to be the major destination for Sri Lankan exports in 2009, while Asian countries predominated with respect to Sri Lanka's imports. While the US and the UK remained the largest export destination countries, India, followed by Singapore, China and Iran were the foremost import-originating countries.

In 2008, earnings from exports grew by 6.2% to US$8,111 million. Exports, which recorded healthy growth of 12.3% during the first eight months of the year, were adversely affected by the contraction in global demand towards the end of the year, as a result of which, export growth for the year declined to 6.2% by year end. The agricultural sector, which grew by 19.5% to US$1,969 million in 2008, provided the major impetus to growth during the year. Agricultural exports contributed to nearly 70.0% of the growth in earnings from exports, largely due to attractive prices in the international market. In agricultural exports, tea exports recorded earnings of US$1,272 million in 2008, mainly due to higher prices of tea. Sri Lanka's tea prices reached record levels during the first eight months of 2008, in the wake of rising demand from the United Arab Emirates and other Middle Eastern countries, amidst uncertainties of production in Africa. However, tea prices decreased from September 2008, following intensification of the global economic crisis. Minor agricultural products increasingly became an important source of export earnings for the country during 2008. Within the minor agricultural products segment, earnings from exports of fruits, vegetables and certain spices, such as cloves, recorded significant growth in the first nine months of 2008 as a result of both price and volume increases. Earnings from exports of cinnamon and betel leaves, on the other hand, increased mainly due to the higher prices that prevailed in the international markets. Exports of industrial products recorded modest growth of 3% in 2008, partly due to the sluggish demand for apparel in the USA. The reduction in growth was also affected by heightened competition among developing nations, the relatively higher cost of production, and the sharp depreciation of the euro and the sterling pound against the US dollar compared to a relatively stable Rupee/US dollar exchange rate, which eroded the competitiveness of Sri Lanka's exports to some extent. Earnings from most other categories of industrial exports, such as petroleum products, rubber products and diamonds and jewelry, expanded during the year. The country's exports of solid tires and other products made from natural rubber were also adversely affected by the cutbacks in production by the major automakers in the US and Japan towards the latter part of the year.

Imports of Goods

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

IMPORTS OF GOODS BY COMMODITY GROUP

	2007	2008	2009	2010	2011	First Four Months of 2011[(1)]	First Four Months of 2012[(1)]	Percentage of Total Imports 2011[(1)]	Percentage of Total Imports First Four Months of (2012)[(1)]
	(in US$ millions, except for percentages)								
Consumer goods	**1,664.7**	**2,006.3**	**1,564.8**	**2,476.3**	**3,653.6**	**1,179.6**	**1,115.0**	**18.0**	**16.8**
Food and beverages	802.7	1,088.6	933.1	1,321.6	1,566.9	548.7	463.0	7.7	7.0
Rice	38.7	43.8	22.6	59.0	18.4	6.5	10.8	0.1	9.8
Sugar	151.4	203.1	218.1	362.9	426.1	149.3	122.7	2.1	1.8
Other	612.6	841.7	692.4	899.7	1,122.4	392.9	329.5	5.5	5.0
Other consumer goods	862.0	917.7	631.6	1,154.8	2,086.7	630.9	652.0	10.3	9.8
Intermediate goods	**6,983.0**	**9,019.3**	**6,158.4**	**8,054.4**	**12,275.3**	**3,552.1**	**3,848.5**	**60.6**	**58.0**
Petroleum	2,515.8	3,391.9	2,184.4	3,040.8	4,794.9	1,333.6	1,791.5	23.7	27.0
Fertilizer	192.5	576.6	181.7	240.3	407.2	95.1	89.2	2.0	1.3
Chemicals	404.6	507.8	431.5	520.3	702.0	209.3	206.3	3.5	3.1
Wheat and maize	255.0	402.1	269.3	265.1	429.4	153.4	147.3	2.1	2.2
Textiles and clothing	1,724.5	1,788.4	1,528.7	1,811.9	2,320.7	754.1	709.3	11.4	10.7
Other intermediate goods	1,890.7	2,352.6	1,562.8	2,175.8	3,621.0	1,006.6	904.8	17.9	13.6
Investment goods	**2,596.8**	**2,852.3**	**2,093.1**	**2,757.9**	**4,286.1**	**1,179.6**	**1,657.3**	**21.1**	**25.0**
Machinery and equipment	1,428.4	1,467.2	1,077.5	1,339.3	2,141.4	601.3	755.5	10.6	11.4
Transport equipment	410.0	481.2	356.8	593.2	1,064.6	275.8	482.2	5.3	7.3
Building materials	753.2	899.6	655.9	822.1	1,076.1	301.2	418.2	5.3	6.3
Other investment goods	5.1	4.3	2.9	3.3	4.0	1.3	1.4	0.0	0.0
Unclassified imports	**52.0**	**213.3**	**390.3**	**162.3**	**53.9**	**16.8**	**12.1**	**0.3**	**0.2**
Total imports	**11,296.5**	**14,091.2**	**10,206.6**	**13,450.9**	**20,268.8**	**5,928.2**	**6,633.0**	**100.0**	**100.0**

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

Note:

(1) Provisional

IMPORTS OF GOODS BY SOURCE

Country	2007	2008	2009	2010(1)	2011(1)	First Four Months of 2011(1)	First Four Months of 2012(1)	Percentage Total of Total Imports 2011(1)	Percentage Total of Total Imports First Four Months of 2012(1)
	(in US$ millions, except for percentages)								
India	2,610.1	3,447.2	1,819.8	2,569.5	4,430.7	1,428.3	1,341.7	21.9	20.2
Singapore	1,118.5	1,245.7	1,065.6	1,566.7	2,123.9	341.7	373.2	10.5	5.6
Hong Kong	724.8	694.6	517.2	579.7	631.9	193.2	187.4	3.1	2.8
China, People's Republic of	923.8	1,114.5	1,028.9	1,240.1	2,092.1	631.3	771.0	10.3	11.6
Iran	844.2	1,194.3	897.0	906.3	1,602.4	552.9	504.7	7.9	7.6
Japan	413.2	426.0	223.9	584.1	1,024.6	337.6	236.2	5.1	3.6
Malaysia	283.5	358.5	287.8	384.6	684.5	214.8	160.6	3.4	2.4
United Kingdom	229.8	250.0	253.8	266.7	303.5	76.3	106.9	1.5	1.6
Taiwan	263.6	251.3	201.5	264.1	352.2	107.7	114.9	1.7	1.7
South Korea	183.1	211.8	203.2	269.0	321.2	104.9	111.3	1.6	1.7
Other	3,701.8	4,897.3	3,707.8	4,820.1	6,701.8	1,939.6	2,725.0	33.1	41.1
Total	11,296.5	14,091.2	10,206.6	13,450.9	20,268.8	5,928.2	6,633.0	100.0	100.0

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

Note:

(1) Provisional

Since the liberalization of the country in 1977, imports expenditures had increased from US$726 million in 1977 to US$20,269 million by 2011, in line with evolving and expanding economic activities in the country.

In the first four months of 2012, expenditure on investment goods and intermediate goods imports increased by 40.5% and 8.3%, respectively, while consumer goods imports declined by 5.5%. Import expenditure on intermediate goods increased due to significant increases in imports of petroleum products. However, textile and clothing imports, which are used as inputs for apparel exports, decreased by 5.9% during this period. Expenditure on imports of consumer goods also decreased, mainly due to the decline of food and beverages imports. Imports of non-food consumer goods increased by 3.3% primarily due to an increase in imports of medical and pharmaceutical products (to US$123 million) and clothing and accessories (to US$57 million). Imports of motor vehicles decreased by 9.4% to US$245 million. Investment goods imports increased by 40.5% during this period, due to substantially higher import expenditure in machinery and equipment, which grew by 25.6% to US$755 million and transport equipment, which grew by 74.9% to US$482 million.

In 2011, expenditure on imports increased by 50.7% to US$20,269 million compared to US$13,451 million in 2010. Higher demand for all major categories of imports as well as higher international commodity prices contributed to the surge in import expenditure. Expenditure on imports of consumer goods increased by 47.5% to US$3,654 million in 2011. Non-food consumer goods contributed 57.1% to the total consumer goods imports, largely driven by personal motor vehicles and motor cycles, which increased by 93.6% to US$881 million. Medical and pharmaceutical product imports also increased by 60.6% to US$348 million. Expenditure on food and beverages imports increased by 18.6% to US$1,567 million, mainly due to increased international prices of major consumer food varieties. Expenditure on imports of intermediate goods increased by 52.4% to US$12,275 million in 2011, led by higher petroleum and textiles imports, which increased by 57.7% and 28.1%, respectively, accounting for a combined contribution of 35.1% to the total import expenditure. The average import price of crude oil increased by 36.6% to US$108.59 per barrel during the year. Imports of investment goods recorded a significant increase of 55.4% in 2011 to US$4,286 million, led by increases in transport equipment, machinery and building materials imports. Increases in investment goods imports was largely attributed to large scale infrastructure development projects of the government funded by foreign inflows, which increased significantly during the year. Machinery and equipment imports increased by 59.9% to US$2,141 million while imports of transport equipment increased by 79.5% to US$1,065 million. Expenditure on imports of building materials increased by 30.9% to US$1,076 million, reflecting an expansion in construction activities in the country.

In 2010, expenditure on imports grew by 31.8% to US$13,451 million, compared to US$10,207 million in 2009, reflecting higher international commodity prices and increased import volumes due to expanding domestic economic activity. All major categories of imports, consumer, intermediate and investment goods increased during the year. The largest contribution to imports was from intermediate goods, which comprised 59.9% of import expenditure, while the contribution from consumer goods and investment goods was 18.4% and 20.5%, respectively. Expenditure on imports of intermediate goods increased by 30.8% to US$8,054 million in 2010, led by higher petroleum imports. Prices of crude oil imports took on a rising trend towards the end of 2009 in line with the recovery in the global economy. The average import price of crude oil increased by 24.4% to US$79.52 per barrel during 2010, compared to US$63.93 per barrel during 2009, which caused an increase in petroleum import expense by 39.2% to US$3,041 million in 2010. Imports of textiles and clothing, which amounted to US$1,812 million, recorded a 18.5% increase over that of 2009. Meanwhile, expenditure on fertilizer imports increased by 32.3% to US$240 million in 2010, led by higher petroleum prices and increased volumes. Expenditure on imports of consumer goods rose by 58.3% in 2010 to US$2,476 million. The non-food consumer goods category comprised mainly of motor cars and motor cycles, which recorded a significant growth of 388.5% due to improved economic activity and a tax reduction on imports of personal motor vehicles. Food imports increased by 41.6%, owing to higher expenditure on imports of sugar, milk products and other food items. International sugar prices reached historical highs in 2010 amidst supply constraints in major sugar producing countries. The average import price of sugar rose by 41.7% and expenditure on sugar imports increased by 66.4% to US$363 million in 2010. Expenditure on milk product imports increased by 56.6% to US$259 million in 2010, reflecting higher international prices. Imports of investment goods increased by 31.8% to US$2,758 million in 2010, led by higher expenditure on imports of transport equipment and machinery. Expenditure on transport equipment imports grew by 66.2%, mainly due to improved economic activities. Imports of machinery and equipment increased by 24.3% to US$1,339 million mainly due to the numerous large-scale infrastructure development projects across the country. Expenditure incurred on imports of building materials increased by 25.3% to US$822 million during this period reflecting expanding construction activities.

In 2009, expenditure on imports amounted to US$10,207 million, reflecting a 27.6% decline relative to 2008. Expenditure incurred on all three major categories of imports, consumer, intermediate and investment goods, declined due to reductions in international commodity prices, a drop in import volumes and slowing down of domestic economic activity. The relative share of consumer goods to total imports increased to 15.3% during this period, lowering the share of intermediate and investment good imports. This can be attributed to the relatively smaller price reduction in consumer goods compared to intermediate and investment goods and the slow-down of domestic economic activity. The value of imports of consumer goods declined by 22% to US$1,565 million from US$2,006 million in 2008. Expenditure on imports of both food and consumer durables declined largely on account of lower import prices. Lower expenditure on imports of wheat grain was the main contributor to the decline in food imports arising from a significant decline in international market prices. Expenditure on imports of intermediate goods declined by 31.7% to US$6,158 million in 2009, mainly reflected by petroleum product imports. A significant decline in petroleum prices in the international market led to a reduction in petroleum import expenditure of 35.6% to US$2,184 million compared to the previous year. Expenditure on fertilizer, textiles, diamonds and chemicals imported as raw materials for exports also declined in 2009, reflecting world market conditions. Expenditure incurred on imports of investment goods declined by 26.6% to US$2,093 million in 2009, reflecting significant declines in machinery and equipment and building materials by 26.6% and 27.1%, respectively. India continued to be the largest source of imports in 2009 and accounted for nearly 17.8% of imports in 2009. Main imports from India included refined petroleum products, motorcycles and auto-trishaws. Singapore and China followed as the second and third largest import source countries. Main imports from Singapore comprised fertilizer and petroleum products while the major import from China was machinery and mechanical appliances. Iran remained the fourth largest import source country. Main imports from Iran include oil. Hong Kong remained the fifth largest import source country.

In 2008, expenditure on imports grew by 24.7% to US$14,091 million. The sharp increases in international commodity prices had an adverse impact on import expenditure until September 2008. All major categories of imports grew very rapidly, led by substantial increases in commodity prices. The largest contribution to the growth in expenditure on imports came from intermediate goods, primarily due to the higher expenditures incurred on petroleum imports. Import expenditure incurred on intermediate goods increased by 29.2%, accounting for 72.9% of the import growth in 2008. However, towards the end of 2008, the global economic crisis led to a substantial decline in global demand for petroleum and other commodities. The unexpected decline in prices had a favorable impact on import expenditure in the last quarter of 2008. Petroleum imports, which grew by 61.7% during the first three quarters, declined by 25.8% in the fourth quarter due to the significant price drop in the international market. Apart from petroleum, expenditure on fertilizer imports also increased notably, led by higher prices and increased volumes generated by a fertilizer subsidy. Imports of textiles and textile articles in 2008 recorded a marginal increase of 3.7% over those of 2007, reflecting the slow growth of apparel exports during the same period. Within the consumer goods category, expenditure on food and drinks increased significantly due to the high prices of wheat, milk, sugar and rice that prevailed before the commodity price bubble burst. Import expenditure on motor vehicles declined by 2.3 in 2008 compared with 2007. Expenditure on investment goods grew by 9.8% in 2008, led by increases in imports of building materials and transport equipment. This can be attributed to the numerous large-scale infrastructure development projects undertaken across the country during this period.

Services Trade

The following table sets out the Issuer's services trade by sector compiled in accordance with the IMF's Balance of Payments Manual 5 ("BPM5") framework for the periods indicated.

SERVICES TRADE

	2007	2008	2009	2010	2011	First Three Months of 2011(1)	First Three Months of 2012(1)	% Increase of Decrease
	(in US$ millions, except for percentages)							
Transportation	**241**	**298**	**235**	**345**	**439**	**130**	**189**	**45**
Credits	838	1,000	865	1,162	1392	336	402	20
Debits	596	702	631	817	953	205	213	4
Travel	(8)	(86)	(61)	123	329	57	133	133
Credits	385	342	350	576	830	209	268	28
Debits	393	428	411	453	501	152	135	(11)
Telecommunication Services	18	26	26	27	29	15	14	(7)
Credits	72	81	80	83	85	30	27	(10)
Debits	54	55	54	56	57	14	13	(7)
Computer and Information Services	175	230	245	265	355	89	89	0
Credits	175	230	245	265	355	89	89	0
Debits	—	—	—	—	—	—	—	—
Construction services	27	35	34	36	36	14	6	(57)
Credits	33	40	40	42	43	15	8	(47)
Debits	6	6	6	6	7	2	2	0
Insurance services	15	22	28	31	35	13	3	(77)
Credits	55	68	75	80	91	28	15	(46)
Debits	40	47	46	50	55	15	13	(13)
Other business services	(153)	(109)	(100)	(102)	(108)	(39)	(26)	(33)
Credits	196	222	219	245	266	109	105	(4)
Debits	349	330	319	348	373	147	131	(11)
Government Expenditure n.i.e	(14)	(14)	(16)	(17)	(17)	(7)	(7)	0
Credits	20	21	19	21	21	5	5	0
Debits	34	35	35	38	39	12	11	(8)
Total services trade	302	401	391	707	1,099	272	401	47
Credits	1,775	2,004	1,892	2,474	3,084	820	919	12
Debits	1,472	1,603	1,501	1,768	1,985	548	518	(5)

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

During the first quarter of 2012, a surplus of US$401 million was recorded in the services account, compared to a surplus of US$272 million recorded during the corresponding period in 2011. The performance in the services account was mainly driven by improved performance in the transportation and travel subsectors. Earnings from tourism grew at a healthy rate of 28.6% to US$268 million during the first three months of 2012, compared to the corresponding period in 2011. Meanwhile in the first five months of 2012, earnings from tourism increased by 25.5% to US$399 million compared to the same period in 2011.

In 2011, the surplus in the services account of the BOP increased substantially by 55% compared to the previous year. The services account, which consists mainly of transportation, travel, communication, computer and information services registered a surplus of US$1,099 million during 2011, compared to the surplus of US$707 million recorded in 2010, with a higher contribution from transportation and travel sub sectors. Transportation services, the largest category within the services sector, consisting of passenger fares, freight charges and port and air port related activities reported a substantial growth of 20% to US$1,392 million during 2011. Post-conflict growth momentum in the tourism sector continued to improve in 2011. A record level of tourist arrivals, 855,975, was recorded in 2011, an increase of 30.8% compared to 2010. Accordingly, earnings from tourism continued to grow significantly increasing 44.2% compared to the previous year to US$830 million.

In 2010, with the expansion of economic activity and recovery of the global economy, trade in services recorded a significantly higher surplus than in previous years. The services account, mainly consisting of transportation, travel, communications, computer and information, construction and insurance services registered a surplus of US$707 million during 2010. All sub-sectors of the services account performed remarkably well during the year and indicate the country's potential to achieve a steady growth in coming years. Transportation services, the main contributor to the services account, consists of passenger fares, freight charges, port and airport related activities and grew at a rate of 33.6% to US$1,162 million compared to 2009. Sri Lanka's tourism industry rebounded strongly in 2010 following cessation of hostilities in 2009. Tourist arrivals increased to 654,476 in 2010, surpassing the previous record of 566,202 in 2004. Accordingly, earnings from tourism increased by 64.6% to US$576 million in 2010, compared to US$350 million in 2009.

In 2009, with the improvement in the nation's business climate brought about by the end to the internal conflict and the gradual recovery of the global economy, the services account registered a surplus of US$391 million. Although the surplus in the services account contracted rapidly during the first half of 2009 due to slowdown in the transportation, travel, telecommunication and construction services sectors, tapering off in the contraction during the second half resulted in an overall surplus for 2009. Gross inflows on account of transportation services consisting of passenger fares, freight charges and other port-related activities reported a substantial decline of 19% during the first half of 2009 compared to the corresponding period of 2008. However, as all sub-sectors of transportation services performed relatively well during the second half of 2009, the gross inflows on account of transportation services reached US$865 million in 2009. Nevertheless, gross inflows to this sub-sector for the year as a whole declined by 13.5%. Meanwhile, outflows on account of transportation declined by 10.1% in line with decelerated international trade and decreased expenditure by Sri Lankans on foreign travel for leisure, employment and education, and related expenses.

In 2008, the surplus in the services account improved to US$401 million from US$302 million in 2007. This growth was primarily led by transportation services, the largest category within the services trade sector. In spite of the slowdown in global economic activity, the gross inflows on account of transportation services enjoyed significant growth of 22.0% during the first nine months of 2008. However, this growth deteriorated in the last quarter, mainly due to a reduction in passenger traffic, cargo transport, passenger fares and freight charges as a result of the rapid decline in global trade and broadening impact of the global economic crisis. As a result, the overall growth of transportation services moderated to 19.3% and grew to US$1,000 million in 2008.

Meanwhile, outflows on account of transportation increased by 17.8%, which was in line with the higher passenger and freight charges that prevailed in the international markets during the most part of the year. Gross inflows from passenger fares increased mainly due to the increase in air fares led by fuel surcharges. However, towards the latter part of the year, earnings on passenger fares declined due to the contraction in business travel due to the global economic recession. Gross inflows on account of port-related activities increased as a result of increased transshipment attributable to the growing Indian economy and the improved service delivery at the Port of Colombo. Transshipment handling recorded growth of 11.5% during 2008. Tourist arrivals declined by 11.2% to 438,475 in 2008 compared to 494,008 arrivals in 2007. As a result, earnings from tourism declined to US$342 million in 2008 from US$385 million in 2007. The net earnings from telecommunication services increased by 41.7% in 2008 with the increased utilization of email, broad band internet, satellite TV and International Direct Dialing.

Income

The following table sets out the Issuer's income compiled in accordance with the IMF's BPM5 framework for the periods indicated.

INCOME

	2007	2008	2009	2010	2011(1)	First Three Months of 2011(1)	First Three Months of 2012(1)	% Increase or Decrease
	(in US$ millions, except for percentages)							
Compensation of Employees	(11)	(14)	(11)	(11)	(11)	(4)	0	(100)
Credits	6	6	6	7	8	5	0	(100)
Debits	17	20	17	18	19	9	0	(100)
Direct Investment Income	(346)	(464)	(223)	(294)	(375)	(67)	(92)	37
Credits	3	6	7	9	10	3	3	0
Debits	349	470	230	303	385	70	94	34
Interest and other charges	(1)	(495)	(254)	(312)	(261)	(106)	(48)	(55)
Credits	440	(44)	102	307	448	102	203	99
Debits	441	450	357	619	709	207	251	20
Total Income	(358)	(972)	(488)	(617)	(647)	(176)	(140)	(20)
Credits	449	(32)	116	323	467	109	206	89
Debits	807	940	603	940	1,114	286	346	21

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

During the first quarter of 2012, the deficit in the income account contracted to US$140 million from a deficit of US$177 million in the corresponding period of 2011, primarily due to higher increased interest earnings on foreign reserves relative to the increase in interest payments on foreign loans.

In 2011, the income account recorded a deficit of US$647 million, compared to the deficit of US$617 million in 2010. Gross inflows to the income account increased significantly by approximately 45% to US$467 million, mainly due to interest income from the investment of official international reserves and profits earned on the trading of foreign currency and securities. In addition, higher depreciation of the US$ against other major currencies such as the Euro and the Pound sterling in 2011 resulted in a significant gain in values of the official reserves denominated in those currencies when valued on a mark-to-market basis in US$ terms. Meanwhile, outflows in the income account increased by approximately 18% to US$1,114 million as a result of an increase in interest payments on foreign loans obtained by the Government. Of the interest payments on foreign loans of US$709 million, interest paid on long and medium-term loans accounted for approximately 57%. Meanwhile, outflows on account of foreign direct investment increased by 27% to US$385 million, mainly due to the repatriation of profits and dividends by foreign enterprises established in Sri Lanka. However, a considerable portion of profits and dividends has been reinvested, facilitating the expansion of existing operations during 2011.

In 2010, the income account recorded a deficit of US$617 million, compared to the deficit of US$488 million recorded in 2009. Interest earned from the investment of increased reserves and profits earned on trading of foreign currency, foreign securities and gold contributed to the inflows in the income account in 2010. Inflows from interest and other charges increased three fold to US$307 million in 2010. However, these inflows were more than offset by the substantial increase in interest payments on foreign loans of the Government and private sector. Of the interest payments on foreign loans of US$491 million, interest paid on long and medium term loans by the Government, the private sector companies and public corporations accounted for approximately 70%. Given the increase in net foreign liabilities, the net interest payments on foreign financial liabilities of commercial banks increased significantly during the year. Meanwhile, outflows on account of direct investments increased by 67.8% to US$386 million, mainly due to the repatriation of profits and dividends by the foreign enterprises. However, a substantial portion of the repatriated profits and dividends have been reinvested by foreign enterprises for the expansion of existing operations.

In 2009, the income account improved significantly with the deficit contracting to US$488 million from US$972 million recorded in 2008. This was driven mainly by the increase in interest income on foreign exchange reserves, which reached a new high for Sri Lanka in 2009, coupled with the reduction in interest payments on foreign loans due in part to the decline in global interest rates. In addition, appreciation of major reserve holding currencies such as the Euro and Pound Sterling against the US dollar resulted in higher valuation and exchange gains from the mark-to-market valuation of trading securities in US dollar terms. Net interest earnings on foreign financial assets of the private sector, including commercial banks, also showed positive development, as net foreign assets of commercial banks improved during the year. Meanwhile, outflows in the income account decreased by 35.8% to US$603 million, mainly due to significant reduction in repatriation of profits and dividends by foreign enterprises. Although a considerable portion of profits and dividends of these enterprises has been reinvested for the expansion of existing operations during 2009, the amount reinvested was lower than in 2008.

In 2008, the deficit in the income account widened to US$972 million compared to a deficit of US$358 million in 2007. Interest income from investment official reserves decreased by 9.0% to US$96 million in 2008, mainly due to lower global interest rates and the gradual diminution of official reserves during 2008. In addition, the higher appreciation of the US dollar against major currencies such as the euro and sterling pound and the decline in market value of securities resulted in valuation losses in the external reserves valued on a marked-to-market basis in US dollar terms. Similarly, earnings from the foreign financial assets of the private sector, including commercial banks, decreased due to lower global interest rates in 2008. Meanwhile, outflows in the income account increased by 17.0% to US$940 million as a result of increased interest payments on external debt during the year due to higher debt accumulation in the past. Repatriation of profits and dividends of FDI enterprises by foreign investors, which includes offsetting entry for reinvestment of retained earnings by those investors in their existing operations, increased substantially by 35.0% to US$470 million in 2008.

Current Transfers

The following table sets out the Issuer's current transfers compiled in accordance with the IMF's BMP5 framework for the periods indicated.

CURRENT TRANSFERS

	2007	2008	2009	2010	2011(1)	First Three Months of 2011(1)	First Three Months of 2012(1)	% Increase or Decrease
	(in US$ millions, except for percentages)							
Private	2,214	2,565	2,927	3,608	4,583	1,150	1,243	8
Credits	2,502	2,918	3,330	4,116	5,145	1,274	1,493	17
Debits	288	353	403	508	562	124	250	102
General Government	97	101	77	52	60	12	2	(83)
Credits	97	101	77	52	60	12	2	(83)
Debits	—	—	—	—	—	—	—	—
Total Current Transfers	2,311	2,666	3,005	3,660	4,643	1,161	1,245	7
Credits	2,598	3,019	3,408	4,168	5,205	1,285	1,493	16
Debits	288	353	403	508	562	124	250	102

Sources: Central Bank of Sri Lanka

Notes:

(1) Provisional

(2) Entries with "—" indicate either that there were no relevant transactions during the period or that the Issuer had not yet begun to track and record the relevant entry

In the first quarter of 2012, net current transfers increased to US$1,245 million, an increase of 7% over the corresponding period in 2011. Maintaining the positive growth momentum shown in 2011, workers' remittances in the first quarter of 2012 increased by 17.2% to US$1,493 million. Meanwhile, workers' remittances in the first five months of 2012 amounted to US$2,475 million, an increase of 17.7% over the same period in 2011.

In 2011, net current transfers increased significantly to US$4,643 million from US$3,660 million in 2010. Workers' remittances, which constitute the largest share of current transfers, continued to be the foremost foreign exchange earner in 2011, increasing notably by 25% to US$5,145 million, compared to US$4,116 million in 2010. The increase in 2011 was primarily due to increased repatriation of savings by migrant workers owing to uncertainty in the Middle Eastern countries, an increase in average wages of workers, increased migration to high wage paying countries such as Korea, Malaysia and Singapore and increased labor migration of the professional category. Also, entering into collective agreements on labor migration with several countries by the relevant authorities and expansion of the availability of formal channels to remit funds to Sri Lanka, including the increased number of bank branches and service offices in the Northern and Eastern provinces, helped to increase remittances during the year. Meanwhile, the number of workers that have left for foreign employment increased by 6.4% to 262,960 in 2011. To attract migrant workers' remittances, the Government in the 2012 budget provided a tax exemption for five years for migrants' investments on capital goods to commence new businesses.

In 2010, net current transfers increased by 21.8% to US$3,660 million from US$3,005 million in 2009. Inward workers' remittances continued to be the foremost foreign exchange earner in 2010 and increased by 23.6% to US$4,116 million, compared to US$3,330 million in 2009. This increase was driven by Sri Lankan authorities entering into collective agreements with employers for higher wages and salaries, the expansion of the exchange houses network by commercial banks, an increase in skilled labor migration to perform high-earning overseas jobs, the Government's on-going initiative to promote inward remittances through formal channels and financial penetration in the Northern and Eastern Provinces through the opening up of new bank branches. Additionally, remittances inflows for reconstruction and establishment of new livelihoods in the Northern and Eastern provinces contributed to the notable increase in inward workers' remittances. The economic recovery in several key remittance-originating countries, especially in the Middle East, resulted in an increase in the demand for migrant workers in 2010.

In 2009, net inflows to the current transfers account increased by 12.7% to US$3,005 million from US$2,666 million in 2008 on account of improvement in private transfers despite a decline in transfers to the Government. Private transfers, consisting mainly of workers' remittances, became Sri Lanka's foremost foreign exchange earner in 2009. Workers' remittances inflows grew by 14.1% to US$3,330 million in 2009 compared to 2008. These remittances helped to completely offset the deficit in the trade account.

In 2008, net inflows to the current transfers account increased by 15.4% to US$2,666 million from US$2,311 million in 2007. Worker remittances grew by 16.6% to US$2,918 million in the same period. This increase was attributable mainly to a 14.7% increase in the number of migrant workers leaving for foreign employment, the increase in the average wages of migrants in the Middle Eastern region due to the rise in income level of oil producing countries such as Saudi Arabia, United Arab Emirates, Kuwait and Qatar and the increased migration to high wage countries such as Korea, Malaysia and Singapore. Further, the deployment of Sri Lankan troops as UN Peacekeepers contributed to the increase in remittances. The new measures initiated by the commercial banks under the guidance of the Central Bank to promote more remittances among migrants also helped increase the remittances through formal channels in 2008. The net official current transfers increased to US$101 million in 2008 from US$97 million in 2007.

Capital and Financial Account

The capital and financial account is divided into four categories: capital transfers account; portfolio investments; financial derivatives; and other investments.

Sri Lanka continues to maintain a liberal investment regime with a relatively open capital account compared with other countries in the region. In particular, restrictions on FDI over most areas have been lifted. Following the practice of most countries, Sri Lanka also maintains a list of business activities for which foreign investment is restricted and which require approval by certain statutory agencies. The degree of restriction varies across different areas of investment. The Government is committed to reducing this list further to broaden opportunities for foreign investors.

Foreign investment in the following areas is prohibited:

- Money lending other than the business of providing of credits to investors to purchase securities of a listed company by a company registered as a margin provider in terms of sec 19(A) of the Securities and Exchange Commission of Sri Lanka Act no 36 of 1981 as amended;

- Pawn broking;

- Retail trade investment with a capital of less than US$1 million;

- Coastal fishing;

- Provisional of security services including security management, assessment and consulting to individuals or private organizations.

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

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

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

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

During the first quarter of 2012, the capital and financial account recorded a surplus of US$1,117 million. Foreign direct investment increased during this period to US$225 million from US$197 million in the corresponding period in 2011.

In 2011, although the surplus in the capital and financial account increased significantly compared to 2010, the high current account deficit surpassed the surplus in the capital and financial account, resulting in a deficit of US$1,061 million in the BOP by end 2011. Reflecting positive investor confidence, Sri Lanka recorded the highest gross inflows of FDI in 2011 including loans, amounting to US$1,066 million in 2011, compared to US$516 million in 2010. Private sector long-term loan inflows amounted to US$364 million in 2011, compared to US$580 million recorded in 2010, with the receipt of US$451 million from the Export-Import Bank of China to Lanka Coal Company Limited for the Puttalam Coal Power Project. In the meantime, private short-term capital inflows increased substantially during 2011. Private short-term capital inflows recorded a net inflow of US$572 million in 2011 compared to a net outflow of US$198 million in 2010. Further, loan inflows to the Government increased significantly. Medium and long-term loan inflows to the Government excluding the proceeds of the fourth sovereign bond, amounted to US$2,029 million during 2011, compared to US$1,460 million in 2010. In July 2011, Sri Lanka's fourth international sovereign bond in the amount of US$1 billion was successfully issued, with an oversubscription of 7.5 times. Short-term net foreign inflows on account of investments in Treasury bills and bonds to the Government in 2011 amounted to US$233 million compared to US$531 million in 2010, owing to the threshold on foreign investments on treasury bills and bonds.

In 2010, the capital and financial account received higher inflows, which resulted in a BOP surplus. The financial inflows to the Government from the third international sovereign bond issue of US$1 billion in October 2010 and the increase in private long-term investments contributed to the BOP surplus. The gradual recovery of the global economy, improved financial market conditions, and increased investor confidence brought about by the stable macroeconomic environment helped attract higher inflows to the capital and financial account. The medium and long-term loan inflows to the Government increased during 2010 compared to 2009. Realized FDI, including loans, during 2010 decreased to US$516 million from US$601 million in 2009, mainly due to the impact of the global financial crisis on foreign financial flows. Foreign loan inflows to the private sector increased significantly by 48.5% to US$580 million in 2010, mainly due to the inflows from the Export-Import Bank of China to the Lanka Coal Company limited of US$451 million for the Puttalam Coal Power Project. The short-term net capital outflows decreased substantially to US$198 million in 2010, from US$311 million in 2009.

In 2009, inflows to the capital and financial account increased particularly during the second half of 2009. Foreign financial inflows to the Government, which declined considerably during the first half of the year, reversed course during the second half of the year with the end of the internal conflict and the receipt of the SBA Facility from the IMF. Sri Lanka successfully floated the Sovereign Bond Issuance, which was oversubscribed by more than thirteen times. Accordingly, during the year, total long and medium term loan inflows to the Government, excluding the proceeds of the Sovereign Bonds, amounted to US$1,280 million compared to US$1,059 million in 2008. Of these loan receipts, US$673 million (53%) was received on concessional terms while US$607 million (47%) was received on non-concessional terms. FDI including loans, decreased to US$601 million during 2009 after reaching a record high of US$889 million in 2008.

In 2008, inflows to the capital and financial accounts, were more than sufficient to offset the unprecedentedly high current account deficit during the first nine months, however, reversed thereafter as a result of the intensification of the global financial crisis. FDI inflows reached its highest recorded level in 2008, mainly due to increased reinvestment of retained earnings. Foreign inflows to the Government, consisting of both loans and grants, decreased in 2008, mainly due to the lack of counterpart funds for externally funded projects as a result of the global financial crisis. Though some commercial loans did not materialize as a result of the intensifying global financial crisis towards the end of the year, the Government was able to raise US$1.3 billion of loans and grants during 2008 compared to US$1.6 billion in 2007. A larger portion of the loan inflows was on concessional terms and mostly directed towards the implementation of infrastructure projects such as the expansion of the Port of Colombo, construction of the Southern Expressway and the Hambantota Port.

International Reserves

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

GROSS INTERNATIONAL OFFICIAL RESERVES

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011(1)	2011(1)	2012(1)	% Increase or Decrease
	(in US$ millions, except for percentages)							
Gold	129	92	742	487	500	763	412	(46.0)
SDRs	7	2	20	2	4	1	5	400.0
Foreign investments	1,763	826	3,168	4,836	2,890	4,110	2,499	(39.2)
Foreign exchange	1,534	1,567	1,352	1,798	3,280	2,400	3,247	35.3
Reserve position in the IMF	76	74	75	74	73	77	72	(6.5)
ACU Liability	(446)	(807)	(261)	(586)	(790)	(325)	(421)	29.5
Total official reserves	3,063	1,753	5,097	6,610	5,958	7,026	5,815	(17.2)
Total as number of months of imports of goods and services	2.9	1.3	5.2	5.2	3.2	4.8	3.1	N/A
Total as a percent of short-term debt original maturity	275.8	120.1	164.5	252.8	230.6	N/A	N/A	N/A

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

The gross international reserves managed by the Central Bank constitute substantially all of Sri Lanka's official international reserves. The Central Bank occasionally enters into swaps with respect to foreign exchange and foreign securities for purposes of managing yields or market risk.

In 2011, developments in the external sector, including the high oil import bills, have exerted pressure on the exchange rate and foreign reserves, with the Central Bank having to utilize a part of its accumulated reserves to supply foreign exchange to the market. As a result, the gross official reserves decreased to US$5,815 million by the end of May 2012 from US$5,958 million at the end of 2011 though grew marginally to US$6,022 million by the end of June 2012. The receipt of two tranches under the IMF SBA Facility helped strengthen international reserves. Gross official reserves, comprising of international reserves owned by the Central Bank and the Government amounted to US$5,958 million by end 2011, compared to US$6,610 million by end 2010. Due to the Central Bank's move in absorbing excess foreign exchange from the market, the receipt of sovereign bond proceeds and the receipt of the two tranches under the under IMF SBA Facility, gross official reserves of the country reached a record high level of US$8.2 billion in August 2011. However, during the second half of 2011, the widened trade deficit required the Central Bank to supply foreign exchange to meet a part of such increased demand, despite increased receipts on account of workers' remittances, tourism and inflows to capital and financial account. As a result, the gross official reserves declined to US$6 billion by the end of 2011. The reserve position at the end of 2011 was equivalent to 3.5 months of imports, compared to 5.9 months of imports recorded at the end of 2010. Further, total international reserves, which consist of gross official reserves and commercial banks' foreign assets totaled US$7,199 million at the end of 2011, compared to

US$8,035 million by the end of 2010. The decrease in total international reserves by US$836 million was due to the decline in gross official reserves by US$653 million and a decline in commercial banks' foreign reserves by US$183 million.

In 2010, gross official reserves increased substantially to US$6,610 million compared to US$5,097 million at the end of 2009. Disbursements under foreign funded projects, the receipt of three tranches under the IMF-SBA facility in 2010, the proceeds of the third international sovereign bond in October 2010 and inflows to the private sector contributed mainly to the build-up in foreign reserves in 2010. In October 2010, official reserves reached a record high of US$7,173 million, which was equivalent to 6.7 months of imports. However, in the last quarter of 2010, official reserves declined slightly as the Central Bank supplied foreign exchange to the domestic market in order to ensure adequate foreign exchange to cover high petroleum import bills and to prevent any adverse volatility in the exchange rate. Accordingly, gross official reserves at the end of 2010 were equivalent to 5.9 months of imports.

In 2009, gross official reserves continued to improve, supported by the receipt of the first two tranches under the SBA Facility, higher absorption of foreign exchange from the market, and the receipt of special and general allocations of SDRs. At the beginning of 2009, reserves were equivalent to 1.5 months of imports, due to the global financial crisis and a consequent withdrawal of short-term funds by foreign investors. However, with the end of the civil conflict and approval of the SBA Facility, the situation reversed and higher inflows from foreign investors (including the first two tranches of the SBA Facility) were received. By the end of 2009, gross official reserves were equivalent to 6.0 months of imports. Reserve adequacy, as measured by the ratio of gross official reserves to short-term liabilities, also improved to 81% from 33% at the end of 2008. The total external reserves of the country also improved to US$6,770 million.

During the greater part of the first nine months of 2008, the gross official reserves were maintained at a comfortable level equivalent to well over 3.0 months of imports. External official reserves rose to US$3,558 million in July 2008, which was the equivalent of 3.2 months of imports. Thereafter, reserves declined gradually as total outflows were higher than inflows with the intensification of the global financial crisis. By the end of 2008, the gross official reserves declined to US$1,753 million. By the end of 2008, reserves were equivalent to 1.5 months of imports. Reserve adequacy, as measured by the ratio of gross official reserves to short-term liabilities, also declined to 33.0% by the end of 2008 from 79.0% at the end of 2007. The total external reserves of the country also declined to US$2,991 million.

Investments

Foreign Investments to the Government

In the first quarter of 2012, long-term inflows to the Government, in the form of long-term loans and grants, were US$389 million, compared to US$406 million in the corresponding period of 2011. This includes long-term loan inflows of US$386 million and grants of US$3 million. Further, by April 2012, long-term loans and grants to the Government stood at US$486 million compared to US$495 million in the corresponding period of 2011.

In 2011, loan inflows to the Government increased significantly reflecting the implementation of major ongoing infrastructure projects. Medium and long-term loan inflows to the Government, excluding the proceeds of the fourth sovereign bond amounting to US$2,029 million during 2011, compared to US$1,460 million in 2010. Meanwhile, the foreign funds utilization rate increased significantly in 2011 to 38.2% from 24.8% in 2010. Foreign loan inflows were mostly directed towards the continuation of infrastructure projects such as the Colombo Port Expansion Project, the Rehabilitation and Improvement of Priority Roads Project, the Upper Kotmale Hydro Power Project, the Greater Colombo Transport Development Project and the Southern Highway Construction Project. Sri Lanka's fourth international Sovereign bond in the amount of US$1 billion was successfully issued in July 2011, with an oversubscription of 7.5 times. The total receipt of both current and capital grants increased to US$170 million in 2011 from US$150 million in 2010.

In 2010, medium and long-term loan inflows to the Government increased compared to 2009. The long-term loan inflows to the Government, excluding the proceeds of the US$1 billion sovereign bond and grants, increased to US$1,460 million in 2010 from US$1,280 million in 2009. The higher foreign loan inflows in 2010 reflect the faster disbursements for ongoing projects during the year and as a result, the foreign aid utilization rate increased marginally in 2010 to 24.8% from 24.1% in 2009. The loan inflows were mostly directed towards the continuation of infrastructure projects such as the Mahinda Rajapaksa Port in Magampura, the Colombo South Port Project and the Southern Expressway project. Sri Lanka's third international sovereign bond issue of US$1 billion was successfully completed in October 2010. The total receipt of both current and capital grants decreased to US$150 million in 2010 from US$221 million in 2009.

In 2009, although long term foreign inflows to the Government declined considerably during the first half of the year due to the global financial crisis, a strong recovery in long term inflows was observed during the second half. Accordingly, the long-term inflows to the Government, including the Sovereign Bond issuance and grants, increased to US$2,001 million in 2009 from US$1,347 million in 2008. Foreign inflows to the Government increased considerably during the second half of the year principally due to the end of the internal conflict and the approval of the IMF-SBA Facility. The Government's Sovereign Bond issuance was successfully completed in October 2009. The oversubscription of the offering by more than thirteen times suggested that foreign investors placed confidence in the Sri Lankan economy. During the year under review, the total long-and medium-term loan inflows to the Government, excluding the proceeds of the international sovereign bond, amounted to US$1,280 million compared to US$1,059 million in 2008. Of these loan receipts, US$673 million (53%) was received on concessional terms while US$607 million (47%) was received on non-concessional or commercial terms. The concessional loan inflows were mostly directed towards the continuation of already commenced infrastructure projects such as Hambantota Port, the Colombo South Port Project, the Upper-Kotmale Hydro Power plant, the Southern Expressway Project and the Norochcholai Coal Power Plant Project. The total receipt of grants, consisting both of a current and capital nature, decreased to US$221 million in 2009 from US$288 million in 2008. However, the Government continued to receive a fair amount of grants during 2009 for the rebuilding of tsunami-affected areas as well as health and education sector development projects.

In 2008, foreign inflows to the Government decreased, mainly due to the lack of counterpart funds available for externally funded projects due to the global financial crisis. Though some commercial loans did not materialize in the second half of 2008 as a result of the global financial crisis, the Government was able to raise US$1.4 billion worth of loans and grants during 2008 compared to US$1.6 billion in 2007. In 2008, the total long and medium term loan inflows to the Government amounted to US$1,059 million compared to US$1,290 million in 2007. Of the total loan receipts in 2008, 57.0%, or US$604 million, was received on concessional terms and the remaining 43.0%, or US$455 million, was received on non-concessional or commercial terms. The concessional loan inflows were mostly directed towards the implementation of infrastructure projects such as expansion of the Port of Colombo, construction of Southern Expressway and the new Hambantota Port. Despite the faster implementation of major projects, the foreign aid utilization rate decreased marginally in 2008 to 20.5% from 20.6% in 2007 due to an increase in new aid commitments for new projects during the year. Meanwhile, long-term loan repayments by the Government increased by 30.6% to US$807 million in 2008 compared to 2007 mainly due to the repayment of the Government's commercial borrowings and the debts deferred in 2005 as a result of the tsunami by Paris Club members, which had to be settled in seven semiannual installments commencing from 2006. Total grants, consisting of both grants of a current and capital nature, increased to US$289 million in 2008 from US$277 million in 2007. The Government continued to receive a substantial amount of grants for the reconstruction of infrastructure damaged by the tsunami during 2008.

Foreign Direct Investments

During first quarter of 2012, FDI (including loans) increased to US$238 million from US$226 million in the corresponding period of 2011. These inflows included US$86 million received in connection with the development of Colombo International Container Terminals and US$40 million received for oil exploration project of Cairn Lanka Ltd. Further, by the end of May 2012, FDI inflows amounted to US$437 million.

In 2011, Sri Lanka recorded the highest ever gross inflows of FDI, reflecting positive investor confidence. FDI, including loans, increased to US$1,066 million in 2011 compared to US$516 million in 2010. During the year, US$110 million of foreign loans were received by Board of Investment (BOI) approved companies, compared to US$39 million in 2010. A noticeable change was observed in sector-wise composition of FDI inflows. Hotels and restaurant sector (20% of total FDI) attracted the most FDI inflows in 2011, followed by the telecommunication sector (18% of total FDI), which had previously been the dominant sector for FDI in recent years. Inflows to the hotels and restaurant sector were received from several prominent international hotel companies in advance of the anticipated postwar tourism boom. A major investment of approximately US$130 million was received from a leading hotel chain for the construction of luxury hotels in Colombo and Hambantota. FDI inflows in 2011 consisted of equity capital of US$33 million, loans and advances by shareholders of US$513 million, intra-company borrowing of US$192 million, foreign loans of US$110 million and reinvestment of retained earnings of US$218 million. FDI outflows increased to US$60 million in 2011 from US$43 million in 2010, partly due to exchange control relaxations on foreign investments abroad. Accordingly, the net FDI inflows during 2011 increased to US$896 million from US$435 million recorded in 2010.

In 2010, realized FDI, including loans, decreased to US$516 million from US$601 million in 2009, mainly due to the impact of the global financial crisis on the foreign financial flows. As FDI is long-term in nature, the impact of the global financial crisis on foreign equity and debt inflows continue to have an effect on FDI. However, the increase in the reinvestment of retained earnings indicates signs of recovery in FDI. The highest FDI inflows during 2010, amounting to US$110 million, was from India, followed by US$72 million and US$66 million from Malaysia and the United Arab Emirates, respectively. The telecommunication industry has attracted most FDI inflows during 2010, consistent with previous years. FDI inflows in 2010 consisted of equity capital of US$44 million, loans and advances of US$112 million, intra-company borrowing of US$126 million, foreign loans of US$39 million and the reinvestment of retained earnings of US$195 million. FDI outflows increased to US$43 million in 2010 from US$20 million in 2009. Consequently, net FDI inflows during 2010 declined to US$435 million from US$581 million recorded in 2009. Investment commitments of contracted projects and the number of projects contracted have increased in 2010, indicating the future prospects for the realization of new FDI.

In 2009, FDI inflows, including loans, decreased to US$601 million after reaching a record high of US$889 million in 2008. This decrease was mainly due to the global financial crisis' impact on foreign inflows. The global financial crisis resulted in the drying-up of new equity investments and foreign loans channeled to FDI enterprises. The highest FDI inflows, recorded from China, amounted to US$145 million, followed by FDI inflows from the United Kingdom and India amounting to US$80 million and US$78 million, respectively. The telecommunications and power and energy industries attracted most of the FDI inflows from China, United Kingdom and India. FDI inflows in 2009 consisted of equity capital of US$19 million, loans and advances of US$121 million by shareholders, intra-company borrowing of US$110 million, foreign loans of US$197 million and reinvestment of retained earnings of US$154 million by existing companies. Meanwhile, FDI outflows decreased to US$20 million in 2009 from US$62 million in 2008 mainly due to lower realization of FDI projects approved in previous years reflecting the impact of the global financial crisis. Consequently, net FDI inflows during 2009 declined to US$581 million from US$827 million recorded in 2008. Despite the decline in number of projects contracted, investment commitment of contracted projects increased during the year compared to 2008.

FDI inflows reached record levels in 2008, mainly due to increased reinvestment of retained earnings. Gross FDI inflows, including foreign loans obtained by BOI approved companies, reached a record level of US$889 million in 2008 compared to US$734 million in 2007. FDI inflows in 2008 consisted of equity capital of US$131 million, loans and advances by shareholders of US$110 million, intra-company borrowings of US$101 million, foreign loans of US$137 million and reinvestment of retained earnings by existing companies of US$410 million. Meanwhile, FDI outflows increased to US$62 million in 2008 compared with US$55 million in 2007 due to a few local companies investing abroad during the year. Foreign investment commitments approved by the BOI increased during 2008 despite the modest decline in the number of projects approved. Most of the projects approved were large scale projects engaged in the telecommunication and manufacturing sectors. The highest FDI inflows were from Malaysia, amounting to US$150 million, followed by India amounting to US$126 million.

Portfolio Investments

Portfolio investment, which includes foreign investment in the Colombo Stock Exchange (CSE), recorded a net inflow of US$187 million during first half of 2012. During the corresponding period in 2011, portfolio investment recorded a net outflow of US$67 million. A number of new foreign funds entered the market, with foreign investors increasing asset allocations for Asian markets.

Gross foreign inflows to the Colombo Stock Exchange (CSE) during 2011 decreased to US$452 million, compared to US$819 million in 2010, while net outflows recorded in 2011 was US$171 million, compared to net outflows of US$230 million in 2010. The decline in gross inflows was likely partly be due to diversification of investments by investors, with a preference for safe investment opportunities such as commodities, particularly gold, and fixed income government securities amidst a growing global debt crisis.

Despite increased gross foreign inflows to the CSE during 2010 of US$819 million, compared to US$375 million in 2009, net portfolio investment recorded a net outflow of US$230 million in 2010, as compared to US$6 million in 2009. This was mainly due to the higher sales of shares by foreigners to realize profits from rising stock prices and the impact of one-off selling by an international investment fund.

In 2009, despite increased foreign inflows to the CSE during the second half of the year, gross portfolio investment inflows decreased substantially to US$375 million, compared to US$548 million in 2008. This was mainly due to the impact of the global financial crisis, which affected many stock markets around the world. Accordingly, net portfolio investments during 2009 recorded an outflow of US$6 million compared to the net inflow of US$60 million in 2008.

Despite a record level of gross portfolio investment inflows of US$548 million received through the CSE, net portfolio investment inflows declined to US$60 million in 2008 compared to US$101 million in 2007. Companies in the automobile, banking and finance, insurance and telecommunications sectors attracted higher foreign investment. The sale of a major stake by Associated Motorways PLC, the sale by Nippon Telecommunication and Telegraphs Ltd. ("NTT") and certain minority shareholders of their stakes in Sri Lanka Telecom Ltd. ("SLT") to Global Telecommunications Holdings ("GTH") attracted higher inflows to the CSE. Gross outflows also increased to US$488 million, mainly due to the sale of NTT's stake in SLT.

Monetary System

Central Bank

The Central Bank of Sri Lanka (known as the Central Bank of Ceylon prior to 1985) was established by the Monetary Law Act of 1949 (the "MLA") with capital appropriated from the Board of Commissioners of Currency and commenced operations on August 28, 1950. The Central Bank is responsible for safeguarding both the value of the Rupee and the country's banking, financial and payments system.

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

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

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

Monetary Policy

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

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

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

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

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

When inflation is higher or lower than the targeted level, the Central Bank may raise or lower its policy interest rates (the Repo & Reverse Repo rates) to facilitate and maintain a healthy rate of economic development. Given that the effects of monetary policies on the economy normally lag, the Central Bank is required to take appropriate advance policy measures in order to effectively control inflation at the targeted level.

Other key monetary policy tools used by the Central Bank to control inflation are open market operations, which involve the sale or purchase of acceptable securities, namely, Government securities and Central Bank securities, either on a repurchase/reverse repurchase basis or outright basis; the Statutory Reserve Ratio (SRR) in accordance with which, commercial banks are required to maintain a stipulated percentage of their rupee deposits with the Central Bank; and moral suasion.

Monetary Policy in 2009, 2010, 2011 and the First Six Months of 2012

The accommodative policy stance pursued by the Central Bank during the early part of 2011 was gradually reversed in the second half of 2011 and the first six months of 2012. Continuing with the policy easing carried out in the previous year, the Central Bank, enabled by the prevalent healthy outlook for future inflation, reduced its policy rates further in January 2011 with the intent of augmenting private sector investment in the economy. Accordingly, the Repurchase rate was reduced by 25 basis points to 7.00% while the Reverse Repurchase rate was cut by 50 basis points to 8.50%. The continued high level of excess liquidity that prevailed in the market, however, remained a concern given its potential to fuel credit at lower costs leading to eventual inflationary pressures. Therefore, the Central Bank in April 2011 increased the SRR by one percentage point signaling the change in the Bank's policy stance towards a more restrictive approach. The Central Bank also engaged in discussions with the commercial banks to impress upon them the need to curb their lending portfolio to a more desirable size to minimize the expansionary impact on the money supply as well as to mitigate any threats to financial system stability arising from excessive credit growth. However, as growth of credit was yet to moderate as expected during the final quarter of 2011 and market interest rates came under upward pressure, the Central Bank raised its policy rates by 75-125 basis points in February and April 2012. In addition, the Central Bank also issued a direction to licensed banks in March 2012 to limit the growth of credit in 2012 to 18% or Rs.800 million, whichever is higher, while allowing a credit growth of 23% or Rs.1 billion, whichever is higher, for banks that bring in fresh foreign funds.

Following the relaxation of its monetary policy stance in 2009, the Central Bank eased its monetary policy stance further in 2010. Broad money expansion continued to moderate during the first three quarters of 2010, indicating subdued demand pressures. Supply-side developments were also favorable, as domestic supplies increased during the year, while commodity prices in international markets, including petroleum prices, moderated towards the middle of 2010. These factors supported a further relaxation of the monetary policy stance to promote economic activity. Accordingly, policy interest rates of the Central Bank were reduced further in July and August 2010. Following these reductions, the Central Bank's repurchase rate was 7.25% and the reverse repurchase rate was 9.00% by the end of 2010. The targeted annual average growth of broad money in 2010 was also revised upward to 15% in July 2010, from the initial target of 14.5%, in order to facilitate growth in economic activity, as it became evident by mid-year that the domestic economy was expanding at a higher rate in 2010 than originally projected. While market interest rates decreased further in 2010 in response to the easing of monetary policy, the decline in market interest rates provided additional impetus to the recovery of economic activity in 2010.

Monetary policy has continued to be conducted within a monetary targeting framework during 2010. Accordingly, growth in reserve money was used as the operational target, while growth in broad money supply was used as the intermediate target. Policy interest rates and active open market operations were used as the main monetary policy instruments. The policy interest rate corridor is specified in terms of the Repo rate (lower bound) and the Reverse Repo rate (upper bound). The policy interest rates are maintained at a level consistent with the reserve money targets. Reserve money targets are determined on the basis of the level of expected economic activity as reflected by the nominal GDP, while taking into account other factors such as changes in the demand for currency.

A combination of deceleration in inflation at a faster pace than anticipated, the favorable inflation outlook, and the significant slowdown in domestic economic activity in the face of the global financial crisis led the Central Bank to relax its monetary policy stance to support domestic economic activity from early 2009. Further, open market operations were conducted within the policy interest rate corridor beginning in the later part of March 2009, as call money market rates were brought to levels within the policy interest rate corridor since March 2009. In February 2009, the Statutory Reserve Ratio was further reduced to 7.0%, in order to release further liquidity into the market. This was in addition to the actions it took in the last quarter of 2008, which effectively reduced the Statutory Reserve Ratio by 300 basis points from October 2008 to February 2009. The Central Bank gradually lowered and eventually harmonized the penal rate that had been charged on reverse repurchase transactions beginning in November 2007 with the Reverse Repo rate, in May 2009, and the restrictions on access to the reverse repurchase standing facility of the Central Bank were also removed simultaneously. In addition, the policy interest rates of the Central Bank were reduced. In response to these measures, market interest rates decreased gradually in varying degrees. The decrease in real interest rates helped revitalize domestic economic activities.

Monetary Policy during 2006-2008

The monetary policy of the Central Bank from 2006 to 2008 was aimed at curtailing the excess demand arising from monetary expansion, which was higher than the desired level, as well as preventing further increases in prices following the sharp increases in commodity prices internationally becoming more broad-based. Accordingly, the policy interest rates of the Central Bank were increased by 175 basis points during 2006 to 2007 in a bid to stifle demand pressures in the economy. However, from the end of 2007 the Central Bank took a more direct, quantity targeting approach whereby growth in the reserve money supply was targeted on a quarterly basis. This approach was further refined in 2008 by setting the targets based on the quarterly averages of daily reserve money so as to ensure a more disciplined movement in the reserve money supply. These targets were revised downwards on several occasions, as necessary, in line with changes in the underlying macroeconomic factors as well as to contain further inflation. To achieve these targets, the Central Bank maintained market liquidity in a balanced position by conducting aggressive open market operations to siphon off any excess liquidity.

Inflation in Sri Lanka began rising steadily from 2007, led by rising international commodity prices and later underpinned by the unprecedentedly high crude oil prices. It reached its peak in June 2008 before setting on a downward trend supported by the containment of domestic demand and decreases in international commodity prices. Responding to the tight monetary policy stance, growth in monetary aggregates decelerated gradually. Growth in credit flows to the private sector, which grew at high rates of more than 20.0% in the preceding years, dropped to 7.0% by the end of 2008 while growth in the broad money supply declined to 8.5% by the end of 2008.

Given the importance of maintaining transparency of the policy decisions taken by the Central Bank and with a view to enhancing its communication with the general public in order to manage inflation expectations, the Central Bank has continued to communicate its policy decisions to markets, explaining the reasons for the policy decisions made. Communication through press releases as well as the *Road Map*: Monetary and Financial Sector Policies, published at the beginning of each year, which outlines the targets and monetary and financial sector policies expected to be implemented in the forthcoming period, facilitates the general public's understanding of the Central Bank's policies and allows members of the public to align their business decisions and expectations with these policies.

Money Supply

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

MONEY SUPPLY

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011[(1)]	2011[(1)]	2012[(1)]	% Increase or Decrease
	(in Rs. millions, except for percentages)							
Reserve Money	264,419	268,425	303,537	360,511	439,504	400,029	449,479	12.4
(year-on-year change in %)	10.2	1.5	13.1	18.8	21.9	21.0	12.4	
Net Foreign Assets of the Central Bank	292,927	148,157	412,202	505,463	340,090	488,367	327,065	(33.0)
Net Domestic Assets of the Central Bank	(28,506)	120,268	(108,666)	(144,952)	99,414	(88,339)	122,414	238.6
Narrow Money (M1)	266,592	277,323	336,710	407,192	438,707	423,226	434,873	2.8
(year-on-year change in %)	2.7	4.0	21.4	20.9	7.7	19.4	2.8	
Broad Money (M2b)	1,404,019	1,522,776	1,806,169	2,091,408	2,491,740	2,239,036	2,707,159	20.9
(year-on-year change in %)	16.6	8.5	18.6	15.8	19.1	19.4	20.9	
Net Foreign Assets	227,992	77,700	401,880	377,442	98,057	308,868	(27,990)	(109.1)
Central Bank	292,927	148,157	412,202	505,463	340,090	488,367	327,065	(33.0)
Commercial Banks	(64,935)	(70,457)	(10,323)	(128,021)	(242,033)	(179,499)	(355,055)	(97.8)
Net Domestic Assets	1,176,027	1,445,076	1,404,288	1,713,966	2,393,683	1,930,168	2,735,148	41.7
Domestic Credit	1,607,786	1,897,499	1,907,748	2,262,861	3,037,970	2,496,406	3,507,581	40.5
Net Credit to the Govt	374,101	582,907	640,326	627,185	833,610	708,238	1,024,825	44.7
Central Bank	101,079	217,352	109,005	76,894	262,742	95,868	329,465	243.7
Commercial Banks	273,022	365,556	531,321	550,291	570,868	612,370	695,360	13.6
Credit to Public Corps	49,167	46,991	73,233	144,578	198,500	128,467	266,873	107.7
(year-on-year change in %)	55.8	(4.4)	55.8	97.4	37.3	25.0	107.7	
Credit to Private Sector	1,184,519	1,267,601	1,194,189	1,491,099	2,005,860	1,659,701	2,215,883	33.5
(year-on-year change in %)	19.3	7.0	(5.8)	24.9	34.5	32.9	33.5	
Other items (net)	(431,759)	(452,423)	(503,460)	(548,895)	(644,287)	(566,238)	(772,433)	(36.4)
Memorandum Items								
Money Multiplier	5.31	5.67	5.95	5.80	5.67	5.60	6.02	N/A
Velocity (M2b average)	2.73	3.01	2.90	2.92	2.85	N/A	N/A	A/A

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

Responding to the policy measures taken in early 2012, the year-on-year growth of broad money decelerated to 20.9% in May 2012, compared to 22.9% in the previous month. Contributing to this growth was the increase in credit to the private sector. However, the decline in net foreign assets (NFA) of the banking system subdued the high monetary expansion. Credit to the private sector slowed and recorded a year-on-year growth of 33.5% in May 2012, compared to 34% in the previous months and 34.5% at end 2011. Monetary expansion and growth of credit to the private sector is expected to subdue by the end of 2012 owing to the policy action taken earlier this year.

Broad money (M2b) expanded at a higher rate than targeted in 2011. High monetary expansion was largely due to the increase in credit to the private and public sectors above the projected levels. The main reasons for the high demand for credit by the private sector include increased economic activity reflecting the conducive environment for investments, increased domestic demand, higher demand for imports, continued low interest rates and improved access to credit. Meanwhile, public sector borrowings from the banking system also increased, with the decline in non-banking sector funding for government deficit financing. The decline in net foreign assets (NFA) of the banking system partly mitigated the expansionary impact of credit growth on money supply.

At the end of 2010, M2b recorded year-on-year growth of 15.8%. The expansion of broad money was driven mainly by the expansion in credit obtained by the private sector from commercial banks. Credit granted to the private sector, which contracted in 2009 with the downturn in economic activity, expanded at a rapid rate during the second half of 2010, making the largest contribution to the growth of broad money in 2010. The net foreign asset levels of the banking system provided a negative contribution to broad money expansion in the year.

The money supply expanded in 2009, with broad money increasing by 18.6% on a year-on-year basis by December 2009. An expansion in net foreign assets of the banking system since around mid-2009 mostly contributed to this expansion in broad money. Net domestic assets contracted in 2009, along with a contraction in credit obtained by the private sector, the largest component within broad money.

The growth of the broad money supply decelerated steadily during 2008 in response to the Central Bank's tighter monetary policy. Credit obtained by the private sector, which accounted for 83.2% of the money supply in December 2008, led this deceleration in broad money. On a year-on-year basis, M2b grew by 8.5% in December 2008, compared to growth of 16.6% in December 2007. During 2009, however, the growth in broad money gradually increased, driven by increases in net foreign assets of the banking system and an increase in net credit obtained by the Government. The enhanced role of the Government in the domestic economy in the face of the slow-down in private sector economic activity, and the end of hostilities in the North, largely resulted in the steady increase in credit obtained by the Government from the domestic banking system, particularly until around the middle of 2009. Credit constraints in the international markets and the consequent inability of the Government to raise funds from foreign borrowings as planned also led to the Government's increased reliance on domestic financing.

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

DOMESTIC INTEREST AND DEPOSIT RATES

	2007	2008	2009	2010	2011[1]	First Six Months of 2011[1]	First Six Months of 2012[1]
				(percentages)			
Repurchase Rate	10.50	10.50	7.50	7.25	7.00	7.00	7.75
Reverse Repurchase Rate	12.00	12.00	9.75	9.00	8.50	8.50	9.75
Bank Rate	15.00	15.00	15.00	15.00	15.00	15.00	15.00
Average Weighted Prime Lending Rate (AWPR) (weekly rate)	17.95	18.50	10.91	9.29	10.77	9.41	13.39
Average Weighted Deposit Rate (AWDR)	10.31	11.63	8.01	6.23	7.24	6.31	8.38
Weighted Average Call Money Rate	24.99	14.66	9.07	8.03	8.97	8.00	10.39
Treasury Bill Rate							
91-day	21.30	17.33	7.73	7.24	8.68	7.12	11.12
364-day	19.96	19.12	9.33	7.55	9.31	7.35	12.88
Treasury Bond Rate							
2-year	15.50	20.53	9.55	8.27	7.77	7.77	10.61
3-year	15.99	20.34	12.83	8.15	7.99	7.99	13.50
6-year	16.05	—	9.92	8.93	8.85	8.75	12.30
10-year	—	—	13.09	9.30	9.15	9.15	10.25
15-year	—	—	—	—	9.30	9.30	–
Rates on Foreign Currency Deposits							
Savings Deposits — US Dollar	0.5-4.25	0.2-3.931	0.015-2.609	0.2-2.63	0.2-0.3	0.2-2.56	0.2-3.0
Fixed Deposits — US Dollar (1 year)	3.25-5.375	1.125-5.35	0.15-5.5	0.15-5.5	0.15-5.5	0.15-5.5	0.15-6.0
National Savings Bank Rates Savings Deposits	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Fixed Deposits (1 year)	15.00	15.00	9.50	8.50	8.50	8.50	12.00

Source: Central Bank of Sri Lanka

Notes:

(1) Provisional

(2) Bank Rate: Central Bank rate on advances to commercial banks

(3) 8-year Bond

(4) 5-year Bond

Monetary Regulation

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

The Banking Act No. 30 of 1988 (the "Banking Act") introduced a framework for the licensing of commercial banks and specialized banks and the regulation and control of matters relating to banking business. It empowered the Monetary Board of the Central Bank to regulate, through determinations, directions or regulations issued to banks, matters such as share capital to be maintained by banks, reserve funds, liquid assets, carrying on off-shore banking business, payment of dividends, minimum capital ratios, single borrower limits, share capital ownership, provision for bad and doubtful debts and the forms of various accounts and reports. It also conferred upon the Monetary Board and the Director of Bank Supervision their respective powers to call for information, to examine the books and records of banks, to take control of the management of any bank in specified circumstances and to liquidate any bank which is unable to meet the demands of its depositors or other contracting parties or to carry on banking business in Sri Lanka pursuant to the Banking Act.

Following the liberalization policies introduced in 1977 and the subsequent reforms in the financial businesses, the Central Bank gradually moved away from direct controls to a more market-oriented monetary policy. An independently floating exchange rate regime was implemented in January 2001. The Central Bank phased out the use of policy instruments such as quantitative ceilings and refinance facilities while, beginning on March 3, 2003, it increased its reliance on open market operations. To strengthen the institutional arrangement for the determination of the monetary policy decision-making process, the Central Bank established the Monetary Policy Committee in 2001. In order to engage in continuous dialogue with various stakeholders in the economy with a view of strengthening its policy decisions and aligning market expectations with its policies, the Central Bank established the Monetary Policy Consultative Committee in the beginning of 2007, comprising seven stakeholders and economists representing the private sector, to assist in the monetary policy decision making process. Also, a new monitoring mechanism of several key macroeconomic targets was introduced in 2007 enabling the Central Bank to minimize deviations from its monetary targets and take early policy measures to avoid any significant deviations. The Central Bank has also taken steps to enhance the transparency, predictability and credibility of monetary policy. The Central Bank's monetary policy framework, and monetary projections, along with the explanatory notes are regularly posted on the Central Bank's website (*www.cbsl.gov.lk*). Information available on the Central Bank's website is not, directly or indirectly, included or incorporated by reference in this Offering Circular.

Foreign Exchange System

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

The Exchange Control Act provides for the imposition of duties and restrictions in relation to gold, currency, payments, securities, debts, imports, exports and transfer and settlement of properties involving foreign exchange transactions. Foreign exchange transactions relating to goods and services in trade (current transactions) are freely permitted without restrictions through authorized dealers in foreign exchange (i.e. commercial banks) subject to their exercising due diligence to identify transactions that are not bona-fide. Capital transactions (transactions relating to the acquisition of real or financial assets) are partially liberalized, especially in the area of non-resident investments in Rupee-denominated shares issued by Sri Lankan companies, which are permitted subject to certain exclusions and limitations. Capital transactions that are not liberalized require approval of the Central Bank unless they are permitted under a general permission.

During 2010, with the goal of improving investor confidence and stabilizing the foreign exchange market, the Central Bank decided to gradually relax certain restrictions on foreign exchange transactions. Accordingly, the opening and maintaining of bank accounts abroad for certain specific reasons was allowed; provisions for entering into forward contracts in foreign currency to cover foreign exchange transactions were implemented; margin requirements against advance payments on selected imports were removed; suspension of prepayment of import bills was lifted and unification of different investor accounts maintained by non-residents in commercial banks was allowed, effective from March 11, 2010. Additionally, with effect from November 22, 2010, a range of further relaxations were implemented, including permission for foreigners to invest in Rupee denominated debentures issued by local companies, permission for foreign companies to open places of business in Sri Lanka and approval for companies to borrow from foreign sources. Further relaxations were implemented from January 1, 2011, such as permission to Sri Lankan resident individuals, corporate and unincorporated bodies to invest in the equity of overseas companies. Additionally, with effect from November 22, 2011 there was a relaxation of the regulations in relation to foreign investments in debentures by removing the ceiling imposed on the interest rate and the requirement for the maintenance of a sinking fund by the issuing firm and reducing the minimum tenor from five years to two years. Furthermore, the general permission applicable for the foreign investments in shares of local companies was amended to allow foreign investment in the local companies carrying on the business of providing credit to investors having registered under the section 19 (A) of Securities and Exchange Commission of Sri Lanka Act No.36 of 1981. Moreover, the threshold for foreign investments in Treasury bills and Treasury bonds raised from 10.0% of the outstanding Treasury bill and Treasury bond stock to 12.5% with effect from December 6, 2011.

Further relaxations include the granting of a five year tax holiday, followed by a concessionary corporate income tax rate, for new enterprises and a concessionary income tax rate for a period of five years coupled with qualifying payment relief for existing enterprises for investments made in the production of cement, steel, pharmaceuticals, fabric and milk powder with effect from April 1, 2012. Moreover, investments of not less than Rs.50 million by existing enterprises prior to March 31, 2015 for the expansion of their business will be treated as a qualifying payment deductible from the assessable income of the enterprise, subject to a maximum of 25.0% of the investment for each year of assessment falling within the period of four years commencing from the year of investment.

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

EXCHANGE RATES OF RUPEE PER US DOLLAR

Year	Period End	Period Average
2007	108.72	110.62
2008	113.14	108.33
2009	114.38	114.94
2010	110.95	113.06
2011	113.90	110.56
2012		
January	113.90	113.90
February	121.12	117.23
March	128.19	128.91
April	130.77	128.66
May	132.16	129.38
June	130.30	132.04

Sources: Central Bank of Sri Lanka

In February 2012, the Central Bank decided to allow more flexibility in the exchange rate and limit its intervention in the foreign exchange market. During the first six months of 2012, the Rupee depreciated against the majority of the major currencies, including the US dollar 14.6%, the Japanese yen 12.9%, the Indian rupee 8.3%, the Pound sterling 15.3% and the Euro 11.2%.

The effective exchange rate indices are revised regularly to capture new developments once in every 4-5 years. Accordingly, the base year of the 5-currency indices and 24-currency indices which was previously 2006 was recently revised to 2010. The 5-currency Nominal Effective Exchange Rate ("NEER") and Real Effective Exchange Rate ("REER") indices capture the movement of the value of the rupee against five major currencies; the US dollar, Euro, Pound sterling, Japanese yen and Indian rupee. The weights derived from relative importance of trading currencies to Sri Lanka in terms of both exports and imports have been normalized in computing 5-currency NEER and REER indices. Similarly, the 24-currency NEER and REER indices are now being computed with some new trading partners, reflecting recent developments in the external sector. Accordingly, from the 2006 basket of countries, Denmark, the Philippines, South Africa and Sweden have been replaced by Australia, Pakistan, Russia and Turkey in creating the 2010 basket of countries, based on the importance of trade with those countries.

Reflecting these cross currency movements, the 5-currency and 24-currency NEER indices each depreciated by 12.4% and 13.0%, respectively, during the first six months of 2012, mainly due to the depreciation of the Rupee against other major currencies. The REER indices based on both of the 5-currency and 24-currency baskets also depreciated by 15.1% and 11.5%, respectively, during the first six months of 2012. In addition to the 5-currency and 24-currency baskets, a new basket comprising of 10 currencies was introduced in 2010. The 10-currency NEER index depreciated by 12.8% whereas the 10-currency REER index depreciated by approximately 15.1% during the first six months of 2012. During the first six months of 2012, the total volume of spot transactions in the domestic foreign currency market decreased by 0.5% and total volume of forward transactions decreased by 16.0% compared to the corresponding period in 2011. During the first six months of 2012, interest rate differentials have increased marginally while forward premiums remained largely below interest rate differentials, indicating weaker market expectation of an appreciation of the rupee in the short term. The higher interest rate differential was the result of the lower international benchmark interest rates and comparatively high domestic interest rates.

Exchange rate policy in 2011 focused on reducing pressure in the domestic foreign exchange market thereby avoiding undue fluctuations in the exchange rate. The rupee appreciated by 1.2% against the US dollar in the first half of 2011, supported by substantial receipts on account of remittances, tourism and inflows to the capital and financial account, while depreciating by 0.5% during the third quarter of 2011 due to the demand pressure led by the sharp increase in import expenditure. Meanwhile, along with the Government budget proposal to strengthen export competitiveness and curtailing increasing import expenditure, the rupee was depreciated by 3.0% in November 2011. Accordingly, by the end of 2011, the rupee had depreciated against the US dollar by 2.6% to Rs.113.90. Meanwhile, the rupee appreciated significantly against the Indian rupee (15.0%) and moderately against the Euro (0.1%) with the slowdown in activity of Euro Zone. The rupee depreciated against the Pound sterling (2.3%) and the Japanese yen (7.2%).

During 2010, the rupee appreciated at a relatively high rate against certain major currencies such as the US dollar, Pound sterling and Euro. The recovery of commodity prices in the international markets resulted in the US dollar losing value during the second half of 2010. Supported by steady foreign currency inflows from services sector, workers' remittances and financial flows from the third international sovereign bond issue and short-term investments in Treasury bills and bonds, the rupee appreciated gradually by 3.1% to Rs.110.95 per US dollar during 2010. Further, the Rupee appreciated against the Euro (11.0%) and the Pound sterling (6.0%). However, the Rupee depreciated against the Japanese yen (8.8%) and the Indian rupee (0.7%).

During the period from 2007 to 2010, the rupee depreciated from Rs.108.72 to Rs.110.95 per US dollar, representing a decrease of 2.0%. The Rupee appreciated against other major currencies, including the Euro (8.6%), the Pound sterling (26.7%), the Indian Rupee (11.9%) and the SDR (0.4%), while it depreciated against the Japanese yen (28.6%) during the same period.

In 2009, the rupee depreciated by 1.1% against the US dollar to Rs.114.38. The annual average exchange rate in 2009 was Rs.114.94 against the US dollar compared to Rs.108.33 recorded in 2008. The repatriation of foreign investments in Government securities, the settlement of high petroleum bills and the acute drying up of sources of commercial financing during the first four months of 2009 resulted in a heavy demand for foreign exchange in the domestic market. As a result, the rupee depreciated gradually during the first four months of 2009, reaching its lowest level of Rs.120.25 against the US dollar on April 24. During the year, the rupee depreciated against the Euro (2.6%), the Indian rupee (4.1%) and the Pound sterling (10.2%), while it appreciated against the Japanese yen (0.9%).

In 2008, the exchange rate, which gradually appreciated during the first three quarters of the year, depreciated in the fourth quarter primarily due to increased demand for foreign exchange for the settlement of high petroleum import bills and the repatriation of short term investments in the Treasury bill and bond markets. The exchange rate depreciated to Rs.113.14 per US dollar on December 31, 2008 from Rs.108.72 per US dollar on December 31, 2007. For 2008 as a whole, the Rupee depreciated by 3.9% per US dollar compared to a depreciation of 0.9% in 2007.

Sri Lankan Financial Institutions

Total Assets

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

TOTAL ASSETS OF THE FINANCIAL SYSTEM

	2007		2008		2009		2010		2011[1]	
	Rs. billions	%	Rs. billions	%	Rs. billions	%	Rs. billions	%	Rs. billions	%
Banking Sector	3,065.6	71.1	3,294.6	68.0	3,835.2	68.3	4,527.3	68.8	5,367.8	69.7
Central Bank	561.4	13.0	597.1	12.3	821.9	14.6	976.7	14.8	1,123.4	14.6
Licensed Commercial Banks	2,098.3	48.7	2,259.9	46.7	2,506.6	44.7	2,974.6	45.2	3,575.3	46.4
Licensed Specialized Banks	405.9	9.4	437.5	9.0	506.7	9.0	576.0	8.8	669.1	8.7
Non-Bank Deposit Taking Financial Institutions	175.3	4.1	285.9	5.9	315.7	5.6	295.0	4.5	427.0	5.5
Registered Finance Companies	142.0	3.3	175.6	3.6	185.3	3.3	233.6	3.6	352.0	4.6
Co-operative Rural Banks	28.7	0.7	105.4	2.2	124.5	2.2	54.7	0.8	67.6	0.9
Thrift and Credit Co-op. Societies	4.7	0.1	4.9	0.1	5.9	0.1	6.7	0.1	7.4	0.1
Other Specialized Financial Institutions	180.8	4.2	239.7	5.0	257.4	4.6	354.3	5.4	340.8	4.4
Primary Dealers	53.9	1.3	84.4	1.7	99.8	1.8	125.8	1.9	135.3	1.8
Leasing Companies	95.5	2.2	109.9	2.3	111.8	2.0	154.1	2.3	137.7	1.8
Stock Broking Companies	3.6	0.1	3.2	0.1	6.4	0.1	13.2	0.2	11.3	0.1
Unit Trusts	6.3	0.1	6.8	0.1	10.6	0.2	23.0	0.3	23.7	0.3
Venture Capital Companies	1.1	0.0	1.4	0.0	1.5	0.0	1.1	0.0	1.5	0.0
Credit Rating Agencies	0.1	0.0	0.1	0.0	0.2	0.0	0.2	0.0	0.2	0.0
Other	20.2	0.5	33.9	0.7	27.1	0.5	37.0	0.6	31.2	0.4
Contractual Savings Institutions	889.4	20.6	1,019.8	21.1	1,205.5	21.5	1,400.9	21.3	1,569.0	20.4
Employees' Provident Fund	562.4	13.0	655.4	13.5	772.0	13.8	899.7	13.7	1,020.1	13.2
Employees' Trust Fund	78.7	1.8	92.4	1.9	107.3	1.9	125.9	1.9	140.6	1.8
Private Provident Funds	96.2	2.2	97.1	2.0	121.9	2.2	126.2	1.9	115.1	1.5
Insurance Companies	134.9	3.1	155.2	3.2	181.0	3.2	222.2	3.4	263.3	3.4
Public Service Provident Fund	17.3	0.4	19.4	0.4	23.3	0.4	26.9	0.4	29.9	0.4
Total	4,311.2	100.0	4,840.0	100.0	5,613.8	100.0	6,577.5	100.0	7,704.6	100.0

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

According to provisional data, total assets of the financial system increased by 17.1% from the end of 2010 to the end of 2011 and by 78.7% during the five-year period from 2007. The financial assets to GDP ratio stood at 117.8% in 2011. This ratio was 127.0%, 120.4%, 109.7%, 116.1% and 117.4% in 2006, 2007, 2008, 2009 and 2010 respectively. The banking sector, which consists of the Central Bank, Licensed Commercial Banks (LCBs) and Licensed Specialized Banks (LSBs), accounts for 69.7% of total financial assets. Total assets of LCBs grew by 20.2% in 2011 and accounted for 46.4% of total financial assets. LCBs recorded a 70.4% increase in assets since 2007. Total assets of LSBs displayed a growth of 16.2% in 2011 and growth of 64.8% since 2007. The assets of non-bank deposit taking financial institutions, which represent some of the grass-root-level savings institutions, increased by 44.7% in 2011. Their share in the financial system increased from 4.1% in 2007 to 5.5% in 2011. The assets of the other specialized financial institutions sector, which includes specialized leasing companies, primary dealers, unit trusts and unit trust management companies, stock broking companies, venture capital companies, credit rating agencies and market intermediaries declined by 3.8% in 2011. Their share of the financial system increased to 4.4% in 2011 from 4.2% in 2007. The total assets of contractual savings institutions, which include superannuation funds and insurance companies, grew by 12% in 2011, and accounted for 20.4% of total financial assets. Superannuation funds are the biggest category of financial entities in the sector, accounting for 16.9% of total financial assets.

Regulation of Banks and Non-banking Financial Institutions

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

Banks

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

Currently the banking system consists of 33 banks, of which 24 are LCBs and 9 are LSBs. Another distinct market segment within the industry is 21 indigenous banks and 12 branches of foreign banks.

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

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

Other Financial Institutions

As of the end of June 2012, there were 44 licensed finance companies and 72 registered finance leasing establishments, including 13 specialized finance leasing companies under the purview of the Central Bank.

The Central Bank regulates and supervises licensed finance companies under the Finance Business Act. The regulatory and supervisory framework for finance companies is comparable to that of banks. The Central Bank also registers and monitors finance leasing companies under the Finance Leasing Act. To increase public awareness, the Central Bank regularly publishes press notices on "Financial Institutions Legally Permitted to Accept Deposits from the Public" and periodically a "Guide to Interest Rates and Fees".

The Central Bank also regulates and supervises primary dealers under the Local Treasury Bills Ordinance and the Registered Stocks and Securities Ordinance. As at June 30, 2012, there were 12 primary dealers in operation, of which 7 are companies and 5 are units of LCBs.

Financial Sector Developments and Stability

Banking Industry

Banking system has continued to be resilient in the challenging environment of the aftermath of the global financial crisis and emerging world economic downturn. Overall, the key financial soundness indicators in the banking sector, which account for over 55.0% of financial system assets, were maintained at healthy levels. Strong capital and liquidity levels, together with sustained earnings and improved risk management systems, resulted in maintaining system stability.

Capital adequacy, which has remained above 10.0% in the past decade, improved from 14.1% in 2007 to 14.9% in March 2012 due to injection of new capital, retained earnings and improved risk management.

Asset quality of the banking sector continued to improve with the decrease in the gross NPA ratio. The NPA ratio increased from 5.2% in 2007 to 8.5% in December 2009 and reduced to 4.0% in May 2012.

The table below reflects the breakdown of total gross loan and NPLs by type of lenders for the periods indicated:

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

	As of December 31,					As of May 31,	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
	(in Rs. billions, except as indicated)						
State Commercial Banks							
Total Loans(1)	538	543	568	752	1,016	807	1,138
Total Non-performing Loans(1)	26	32	36	31	27	32	33
Ratio of Non-performing Loans to Total Loans (%)	4.9	5.8	6.3	4.2	2.7	4.0	2.9
Domestic Private Banks							
Total Loans(1)	646	705	662	821	1082	909	1,199
Total Non-performing Loans(1)	38	51	64	52	47	53	53
Ratio of Non-performing Loans to Total Loans (%)	5.8	7.2	9.7	6.3	4.3	5.9	4.4
Foreign Banks							
Total Loans(1)	182	209	177	191	226	204	232
Total Non-performing Loans(1)	3.8	5.0	16	7.3	5.6	6.6	6.6
Ratio of Non-performing Loans to Total Loans (%)	2.1	2.4	9.2	3.9	2.5	3.3	2.9
All Licensed Commercial Banks							
Total Loans(1)	1,366	1,457	1,407	1,764	2,324	1,920	2,569
Total Non-performing Loans(1)	68	87	116	90	80	93	93
Ratio of Non-performing Loans to Total Loans (%)	5.0	6.0	8.2	5.1	3.4	4.8	3.6
All Licensed Specialized Banks							
Total Loans(1)	168	178	189	211	269	219	295
Total Non-performing Loans(1)	11	16	20	17	18	19	20
Ratio of Non-performing Loans to Total Loans (%)	6.7	8.9	10.4	7.9	6.8	8.8	6.8
Banking Industry (All LCBs+All LSBs)							
Total Loans(1)	1,534	1,635	1,596	1,975	2,593	2,139	2,864
Total Non-performing Loans(1)	79	103	136	107	98	112	113
Ratio of Non-performing Loans to Total Loans (%)	5.2	6.3	8.5	5.4	3.8	5.2	4.0

Source: Central Bank of Sri Lanka

Note:

(1) Excludes interest in Suspense

Profitability in terms of return on assets, before tax ("ROA") increased from 1.9% in 2007 to 2.6% in March 2012, as a result of increased interest margins, increased exchange gains and high trading gains. The cost efficiency ratio (operating expenses to total income excluding interest expenses) improved from 56% in 2007 to 48% in March 2012.

Liquidity in the banking system measured in terms of Statutory Liquid Assets ratio continued to remain at a comfortable level of over 30.0% throughout the period.

Financial Sector Reforms

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

- **Implementation of the Direction on Corporate Governance:** A direction was issued covering responsibilities of the board of directors of a bank, the board's composition, criteria to assess the fitness and propriety of directors, management functions delegated by the board, the role and responsibilities of the chairman and the chief executive officer of a bank, duties and functions of the board appointed committees, related party transactions and disclosures. The Central Bank strictly monitors the adherence of banks with these directions in an effort to strengthen the corporate governance culture of banks.

  Further, the CBSL has introduced Corporate Governance Directions for Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) to make the board of directors more responsible and accountable for affairs of the respective LFCs and SLCs, with the goal of promoting a healthy and robust risk management framework in these sectors in order to maintain overall soundness.

- **Improving disclosure of the financial condition of banks:** Prescribed formats for publication of quarterly financial statements of banks in the press have been introduced to include selected key performance indicators such as NPLs, capital adequacy, liquidity, interest margin, operational expenses and profitability. Mandatory credit ratings for banks and finance companies have also been required to promote market discipline.

- **Fitness and propriety of bank directors:** The assessment of the fitness and propriety of the banks' directors was further improved to enhance compliance with the provisions of the Directions on Corporate Governance. Further, the "fit and proper" criteria were extended to the senior management performing key executive functions in banks.

- **Strengthening risk management in banks:** With a view to further strengthening risk management in banks, improved directions were issued on (i) classification of advances, provisioning and income recognition for improved credit risk management, (ii) maximum amount of accommodation to improve credit concentration risk management in banks and widen credit delivery (iii) abandoned property in order to safeguard unclaimed deposits of customers (iv) risk management relating to foreign exchange business in LCBs (v) integrated risk management, (vi) outsourcing of business operations of banks, (vii) exposures to stock market and (viii) improving customer confidence and building up a better relationship between banks and customers.

- **Implementing a Mandatory Deposit Insurance Scheme:** A Mandatory Deposit Insurance Scheme to protect small depositors and to strengthen the stability of the banking system was introduced in 2010. In addition, this Scheme will offer liquidity support for banks and financial institutions in imminent liquidity distress.

- **Adoption of International Accounting Standards (IAS) 32 and 39 in 2012:** Commencing January 1, 2012, banks are required to adopt LKAS 32, 39 and SLFRS 7, corresponding to the International Accounting Standards (IAS) 32, 39 and International Financial Reporting Standards (IFRS) 7 respectively. The Central Bank facilitated the adoption of these Standards and formulated guidelines, statutory reporting, and assessed the preparedness of banks.

- **Enhancing the minimum capital requirement of banks:** In July 2010, the Central Bank enhanced the minimum capital requirements of banks on a staggered basis, in the interest of a strong and sound banking system. Accordingly, LCBs and LSBs were required to increase their core capital to Rs.3 billion and Rs.2 billion respectively, by the end of 2011 and subsequently to Rs.5 billion and Rs.3 billion respectively, by the end of 2015.

- **Enhancing the minimum capital requirement of Licensed Finance Companies (LFCs) and Specialized Leasing Companies (SLCs):** With a view to promoting their soundness and resilience to adverse economic and financial shocks, the minimum core capital to be maintained by SLCs was increased from Rs.75 million to Rs.300 million, and LFCs from Rs.200 million to Rs. 400 million, progressively.

- **Implementation of Basel II and Basel III:** The Basel II capital adequacy framework was implemented commencing in January 2008. Banks are currently required to compute their capital adequacy ratio using a standardized approach for credit risk, standardized measurement method for market risk and basic indicator approach for operational risk. The exposure drafts were issued on moving to advanced approaches in operational risk and implementation of Pillar II of Basel II, the Supervisory Review process and the related Directions will be issued during the third quarter of 2012. The banks will be required to move to advanced approaches on Pillar I in 2013 and guidelines on Pillar III will be issued in 2013. Preliminary assessment of the Basel III capital standards reveals that the banks are in a comfortable position in relation to the new capital requirements. Further, the Central Bank intends to issue Guidelines on Basel III compliance in the future.

- **Amendments to the Banking Act:** The Central Bank has initiated amendments to the Banking Act with a view to further strengthening the supervision and regulation of LCBs and LSBs. The proposed amendments will entail changes brought about by the Companies Act No. 7 of 2007 and current developments in the banking sector in relation to consolidation and mergers of banks, strengthening bank resolution measures and facilitating consolidated supervision. The proposed amendments have been discussed with the banking industry and the amendment bill is currently being drafted by the Legal Draftsman Department.

- **Electronic Transactions Act:** Enacted to recognize and facilitate the formation of contacts, the creation and exchange of data messages, communication in electronic form and to provide for the appointment of a certification authority and accreditation of certification for such service providers.

- **Payment Devices Frauds Act:** Enacted to prevent possession and use of unauthorized or counterfeit payment devices and to provide for investigation, prosecution and punishment of such offences.

- **New Finance Business Act:** The Finance Business Act No.42 of 2011 (FBA) was enacted on November 9, 2011 repealing and replacing the Finance Companies Act, No. 78 of 1988 (FCA) for strengthened regulation of LFCs and to curb unauthorized finance businesses. The FCA was enacted over more than two decades ago, and over the years significant developments have taken place in the financial sector. The non-banking financial sector activities also increased tremendously during this period. Moreover, due to unlawful deposit taking activities, several finance companies faced liquidity problems during the last few years. Hence, there has been an immense need for a new legislation to ensure safety and soundness of the financial system. The FBA has addressed the lacunas of the FCA which enabled entities carrying out finance business without authority to thrive as they did in the past few years.

- **Setting up of Separate Authority to Regulate Microfinance Sector:** The Monetary Board in 2009 decided to set up an independent regulatory authority for Micro Finance Institutions (MFIs). This proposal was approved by the Cabinet of Ministers and a draft Micro Finance Act

(MFA) was prepared by the legal draftsman with the input from the Finance Ministry and Central Bank. However, the Monetary Board in March 2012 has decided to consolidate regulation and supervision of Micro Finance sector under the Central Bank considering the expertise and experience available. The Central Bank is currently in the process of formulating the regulatory mechanism for the MFI sector.

- **Service Providers of Payment Cards Regulations:** Pursuant to the Payment and Settlement Systems Act No. 28 of 2005, the Service Providers of Payment Cards Regulation No. 1 of 2009 became effective from July 31, 2009. The main objective of these regulations is to ensure that all service providers involved in card-based payment instruments comply with the best international standards and practices, thereby assuring that operations of service providers of payment cards do not threaten the stability of the financial system. The Central Bank, as the regulator of payment systems, is entrusted with the authority to regulate and direct service providers engaged in the card-based payment industry to accept best standards/practices, and to supervise and monitor to ensure their compliance to the relevant acts, regulations, guidelines and circulars, etc. Under the authority given by the Regulations, the Central Bank issued the Credit Card Guideline No. 01/2010 on March 1, 2010, an operational guideline to streamline the operations of credit card issuers to ensure adherence to best international standards and practices in order to maintain financial system stability.

Further, under the authority given under the same regulations, the Central Bank issued two mobile payment guidelines in March 2011 in order to regularize the emerging payment mechanism.

Sri Lankan Securities Markets

Colombo Stock Exchange

In 1985, Colombo Securities Exchange Ltd. was established by consolidating the Colombo Brokers' Association and the Stock Brokers' Association. Its name was changed to the Colombo Stock Exchange in 1990. The CSE currently has a membership of 29 institutions, all of which are licensed by the Securities and Exchange Commission to operate as stockbrokers.

The CSE All Share Price Index declined by 18.3% from the end of 2011 to June 30, 2012. The CSE currently has a membership of 29 institutions, all of which are licensed to operate as stockbrokers. As of June 30, 2012, there were 284 companies listed on the CSE, representing 20 business sectors, with a market capitalization of Rs.1,894 billion (US$14.2 billion).

The policy making body of the CSE is its board of directors, consisting of nine directors. Five directors are elected by the members and four directors are appointed by the Minister of Finance. Currently, the board of directors has appointed four sub-committees to administer its operations. The Exchange Secretariat, headed by the Chief Executive Officer, is responsible for the operations of the CSE and is accountable to the board of directors.

Government Securities Market

Sri Lanka has a large tradable Government securities market. Total outstanding Treasury bills amounted to Rs.770.8 billion (US$5.8 billion) and Treasury bonds amounted to Rs.2,280.8 billion (US$17.1 billion) as of June 30, 2012. In 2011, the Government issued Treasury bills amounting to Rs.1,164.6 billion (US$10.5 billion) and Treasury bonds totaling Rs.602.9 billion (US$5.5 billion). The Government uses Treasury bonds, Treasury bills and Rupee denominated loans as the primary borrowing instruments, with Treasury bonds accounting for 73.3% of all outstanding Government securities as at June 30, 2012. Over the last ten years, reliance on marketable instruments has expanded rapidly. Since 2003, 10-year, 15-year and 20-year maturing Treasury bonds have been issued. The Government securities market was liberalized partially and foreign investors were permitted to purchase up to 5.0% of outstanding Rupee denominated Treasury bonds from November 1, 2006. This limit was further increased to 10.0% from December 1, 2007. Similarly, from May 6, 2008, foreign investors were permitted to purchase up to 10.0% of outstanding Treasury bills. These liberalization measures were also made applicable to Sri Lanka's migrant work force beginning in January 2009. From December 6, 2011 the Government securities market was further liberalized allowing foreign investors to purchase up to 12.5% of outstanding rupee denominated Treasury bills and Treasury bonds. These measures were introduced to further open the capital account transactions and to develop the capital market by broadening the investor base and increasing the competition in the Government securities market. There are no restrictions on foreign ownership of US dollar denominated Sri Lanka Development Bonds.

Rupee Denominated Debt

The Government continues to raise funds through Rupee denominated instruments, including Treasury bonds and Treasury bills to meet part of its budgetary requirements.

Treasury Bills. Total issues of Treasury bills in the primary market increased by 16.5% in 2011 compared to 2010. In 2011, the Government issued Treasury bills amounting to Rs.1,164.6 billion (US$10.5 billion) in gross terms and Rs.89.3 billion (US$0.81 billion) in net terms through primary market. The Rupee denominated Treasury bill market was opened to foreigners with effect from May 2008 with a view to increasing competition in the Treasury bill market.

Treasury Bonds. A total of Rs.602.9 billion (US$5.5 billion) was issued through the Treasury bond program, of which Rs.26.1 billion (US$0.24 billion) was issued through auctions and Rs.576.8 billion (US$5.2 billion) through direct placements in 2011.

US Dollar Denominated Debt

From January to June 2012, two auctions were conducted to issue Sri Lanka Development bonds, raising US$315.52 million. Interest rates for the three year bonds issued in March and June 2012 were six month LIBOR plus a margin of 385 and 410 basis points, respectively. Interest rates for the four year bond issued in March 2012 was six month LIBOR plus a margin of 415 basis points.

In July 2011, the Government made its fourth issuance of international sovereign bonds, which raised US$1 billion. The interest rate for the ten-year bonds was 6.25%.

In 2011, three auctions were conducted to issue Sri Lanka Development Bonds, raising US$547 million. The interest rates for the three year bonds issued in March, June and August 2011 were six month LIBOR plus a margin of 375, 365 and 365 basis points respectively, while the four year bonds issued in March, June and August 2011 yielded six month LIBOR plus a margin of 385, 375 and 375 basis points respectively. The interest rates for the 5 year bonds issued in June and August 2011 were six month LIBOR plus a margin of 390 basis points.

In October 2010, the Government made its third issuance of international sovereign bonds, which raised US$1 billion. The interest rate for the ten-year bonds was 6.25%.

In 2010, four auctions were conducted to issue Sri Lanka Development Bonds, raising US$628 million. The interest rates for the two year bonds issued in March and June 2010 were six month LIBOR plus a margin of 380 basis points, while the two year bond issued in September 2010 yielded six month LIBOR plus a margin of 350 basis points. The interest rates for the 3 year bonds issued in March, June and July 2010 were six month LIBOR plus a margin of 395 basis points.

In October 2009, the Government made its second issuance of international sovereign bonds, which raised US$500 million. The interest rate for the six-year bonds was 7.4%.

In 2009, four auctions were conducted to issue Sri Lanka Development Bonds, which raised US$541.1 million. The interest rates for the bonds issued in March, June and August 2009, which had a two year maturity, were six month LIBOR plus a margin of 540, 497 and 450 basis points, respectively. The Sri Lanka Development Bonds issued recently in September 2009, which had a three year maturity, had an interest rate of six month LIBOR plus a margin of 425 basis points.

Primary Dealer System

A dedicated primary dealer system was introduced in 2000 to raise resources to fulfill the Government's borrowing requirement at the lowest cost and to develop and diversify the Government securities market. In order to ensure a sound primary dealer system, a regulatory framework was established which is overseen by the Central Bank. The Central Bank has taken some steps to improve the primary dealer system. In 2009, considering the high market risk encountered by primary dealers operating in a single-product market, primary dealers were allowed to diversify their activities within certain limits imposed by the Central Bank. The Central Bank appointed twelve primary dealers with dedicated capital to participate in the primary market of Government securities. The auctions are conducted via an online secured electronic bidding system. Twelve primary dealers and 19 licensed commercial banks deal in the secondary market. Foreign banks also actively participate in the secondary market. The Central Bank provides primary dealers with an intra-day liquidity facility (ILF) and allows them to participate at open market operations (OMO) of the Central Bank, which is in operation for implementing monetary policy. The Central Depository System and Scripless Securities Settlement System have been in operation since February 2004 and have contributed to the improvement of the efficiency in the primary issuances and trading in secondary market of Government securities. These systems are linked to the Real Time Gross Settlement System for Delivery Vs Payment (DvP) mechanism where the transfer of ownership of securities and the underlying transfer of funds are realized simultaneously in real time.

Public Finance

Overview of Government Revenues and Expenditures

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

GOVERNMENT REVENUES AND EXPENDITURES

Summary of Fiscal Operation

	Actual							Budget		
	2007	2008	2009	2010	2011[1]	First Three Months of 2011[1]	First Three Months of 2012[1]	2010-2011 Growth Rate (%)	First Three Months of 2011-2012 Growth Rate (%)	2011 Approved Estimate
	(in Rs. millions, except for percentages)									
Total revenues and grants	**595,559**	**686,482**	**725,566**	**834,188**	**949,917**	**217,088**	**228,536**	**13.9**	**5.3**	**1,126,081**
Total revenues	565,051	655,260	699,644	817,279	934,776	215,905	228,014	14.4	5.6	1,106,081
Tax Revenues	508,947	585,621	618,933	724,747	812,611	183,997	203,020	12.1	10.3	1,000,559
Non-tax Revenues	56,104	69,639	80,711	92,532	122,166	31,908	24,994	32.0	(21.7)	105,522
Grants	30,508	31,222	25,922	16,909	15,141	1,183	522	(10.5)	(55.9)	20,000
Total expenditure	**841,604**	**996,126**	**1,201,927**	**1,280,205**	**1,400,097**	**344,629**	**439,126**	**9.4**	**27.4**	**1,594,946**
Recurrent	622,758	743,710	879,575	937,094	1,006,633	269,504	334,774	7.4	24.2	1,107,902
Capital and net lending	218,846	252,416	322,352	343,111	393,465	75,125	104,353	14.7	38.9	487,044
Current account surplus/(deficit)(-)	(57,707)	(88,450)	(179,931)	(119,815)	(71,856)	(53,599)	(106,760)	(40.0)	99.2	(1,821)
Primary account surplus/(deficit)(-)	(63,364)	(97,170)	(166,686)	(93,425)	(93,481)	(15,310)	(90,937)	0.1	494.0	(98,865)
Overall surplus/(deficit)	(246,045)	(309,644)	(476,361)	(446,017)	(450,180)	(127,541)	(210,590)	0.9	65.1	(468,865)
Total financing	**246,045**	**309,644**	**476,361**	**446,017**	**450,180**	**127,541**	**210,590**	**0.9**	**65.1**	**468,866**
Foreign financing	100,908	(4,645)	230,807	243,788	218,956	18,973	64,675	(10.2)	240.9	197,264
Gross	165,022	116,964	345,523	321,972	317,745	42,674	91,007	(1.3)	113.3	347,264
Repayment	(64,114)	(121,609)	(114,716)	(78,184)	(98,789)	(23,701)	(26,332)	26.4	11.1	(150,000)
Domestic financing	**145,137**	**314,287**	**245,554**	**202,229**	**231,223**	**108,568**	**145,915**	**14.3**	**34.4**	**271,602**
Market borrowings	127,077	309,669	234,275	191,999	236,021	108,568	145,915	22.9	34.4	271,602
Non-bank	111,308	114,437	185,247	193,891	44,171	83,159	22,303	(77.2)	(73.2)	207,602
Bank	15,769	195,233	49,027	(1,892)	191,850	25,408	123,612	(10,240.1)	386.5	64,000
Monetary Authority	(13,098)	118,403	(109,241)	(32,112)	185,848	19,887	64,265	(678.7)	223.1	N/A
Commercial Banks	28,867	76,830	158,268	30,220	6,002	5,521	59,347	(80.1)	974.9	N/A
Non market borrowings	18,060	4,619	11,280	10,230	(4,798)	—	—	(146.9)	—	—
Privatization proceeds	—	—	—	—	—	—	—	—	—	—
	As a percentage of GDP									
Total revenues and grants	**16.6**	**15.6**	**15.0**	**14.9**	**14.5**	**3.4**	**3.0**	—	—	**15.0**
Total revenues	15.8	14.9	14.5	14.6	14.3	3.4	3.0	—	—	14.7
Tax revenues	14.2	13.3	12.8	12.9	12.4	2.9	2.7	—	—	13.3
Non-tax revenues	1.6	1.6	1.7	1.7	1.9	0.5	0.3	—	—	1.4
Grants	0.9	0.7	0.5	0.3	0.2	0.0	0.0	—	—	0.3
Total expenditure	**23.5**	**22.6**	**24.9**	**22.9**	**21.4**	**5.4**	**5.9**	—	—	**21.2**
Recurrent	17.4	16.9	18.2	16.7	15.4	4.2	4.5	—	—	14.8
Capital and net lending	6.1	5.7	6.7	6.1	6.0	1.2	1.4	—	—	6.5
Current account surplus/(deficit)(-)	**(1.6)**	**(2.0)**	**(3.7)**	**(2.1)**	**(1.1)**	**(0.8)**	**(1.4)**	—	—	**(0.0)**
Primary account surplus/(deficit)(-)	**(1.8)**	**(2.2)**	**(3.4)**	**(1.7)**	**(1.4)**	**(0.2)**	**(1.2)**	—	—	**(1.3)**
Overall surplus/(deficit)	**(6.9)**	**(7.0)**	**(9.9)**	**(8.0)**	**(6.9)**	**(2.0)**	**(2.8)**	—	—	**(6.2)**
Total financing	**6.9**	**7.0**	**9.9**	**8.0**	**6.9**	**2.0**	**2.8**	—	—	**6.2**
Foreign financing	**2.8**	**(0.1)**	**4.8**	**4.4**	**3.3**	**0.3**	**0.9**	—	—	**2.6**
Gross	4.6	2.7	7.1	5.7	4.9	0.7	1.2	—	—	4.6
Repayment	(1.8)	(2.8)	(2.4)	(1.4)	(1.5)	(0.4)	(0.4)	—	—	(2.0)
Domestic financing	**4.1**	**7.1**	**5.1**	**3.6**	**3.5**	**1.7**	**1.9**	—	—	**3.6**
Market borrowings	3.6	7.0	4.8	3.4	3.6	1.7	1.9	—	—	3.6
Non-bank	3.1	2.6	3.8	3.5	0.7	1.3	0.3	—	—	2.8
Bank	0.4	4.4	1.0	(0.0)	2.9	0.4	1.6	—	—	0.9
Monetary Authority	(0.4)	2.7	(2.3)	(0.6)	2.8	0.3	0.9	—	—	N/A
Commercial Banks	0.8	1.7	3.3	0.5	0.1	0.1	0.8	—	—	N/A
Non market borrowings	0.5	0.1	0.2	0.2	(0.1)	0.0	0.0	—	—	0.0
Privatization proceeds	—	—	—	—	—	—	—	—	—	—

Source: Ministry of Finance and Planning

Notes:

(1) Provisional

Revenues

The Government derives its revenues from tax and non-tax sources. Tax revenue currently represents approximately 87% of total revenue while non-tax revenue represents the balance. The main sources of the tax revenue are income tax, VAT, excise taxes and customs duties. The main sources of non-tax revenue consists of fees and charges, interest income, profit and dividends and central bank profits transfers.

EXISTING TAX RATES AS OF JUNE 2012

Personal Income Tax

(1)	First Rs.500,000	=	0%	(2)	Next Rs.500,000	=	4%
(3)	Next Rs.500,000	=	8%	(4)	Next Rs.500,000	=	12%
(5)	Next Rs.500,000	=	16%	(6)	Next Rs.1,000,000	=	20%
(7)	Balance	=	24%				

Corporate Income Tax

The general corporate tax rate in Sri Lanka is 28.0%.

Value Added Tax (VAT)

Applicable rate: 12.0%

Zero rate: 0.0% (Exports)

Key Measures

The government continued with further simplification of the tax system in 2011. The chargeability to ESC was simplified by removing the liability to ESC on the turnover of any business of which the profits are subject to Income Tax. Further, the threshold of ESC was expanded from Rs.25 million to Rs.50 million per quarter. Several exemptions were granted to manufacturing industries setup up to replace imports, research and development services, and unit trusts and mutual funds. Further, the existing exemptions were extended to new enterprises engaged in agriculture, fisheries, IT, business or knowledge process outsourcing, health care, education, tourism, and sports and fitness centers, based on the scale of business and size of investment. A five year tax holiday, followed by a concessionary corporate income tax rate, was granted for new enterprises for investments made in strategically import replacement enterprises. Further, investors are permitted to defer taxes on the importation of plant, machinery or equipment by enterprises during the project implementation period. An advance ruling mechanism was introduced for investors eligible for tax exemptions, to ensure consistency in the application of respective provisions of relevant tax laws.

The 2011 budget, presented in November 2010, included far reaching reforms to rationalize and simplify the tax structure while broadening the tax bases for revenue mobilization purposes. Accordingly, marginal tax rates of the personal income tax have been reduced to 4.0% — 24.0%, from 5.0% — 35.0%, while the tax free allowance has been raised to Rs.500,000 from Rs.300,000. The base for income taxation has been widened with the extension of the PAYE tax to government sector employees with effect from April 1, 2011. Corporate income tax rates have been lowered from a range of 10.0% — 35.0%, to a range of 8.0% — 28.0%, except for profits and income arising from the sale and manufacture or import of liquor or tobacco products, which is taxed at 40.0%. The VAT system has been simplified with the elimination of multiple rates and the reduction of the luxury rate of VAT from 20.0% to 12.0%. Banking and financial services are levied a 12.0% VAT rate. The NBT (Nation Building Tax) has been reduced from 3.0% to 2.0%, with coverage extended to include wholesale and retail trade. A composite telecommunication levy of 20.0% has been introduced, replacing the VAT, NBT and Cellular Mobile Subscribers' Levy. Several taxes such as the social responsibility levy, the provincial turnover tax, the regional infrastructure development levy and the debits tax have been removed with a view to simplifying the tax structure. Tax concessions can be offered for strategically important investments under the Strategic Development Projects (Amendment) Act, No. 12 of 2011.

The Government took several measures in 2010 to simplify the tax system and improve revenue generation from taxes. The tariff structure was simplified by abolishing some taxes, such as the import duty surcharge of 15.0% and the Environment Conservation Levy and by reducing the number of customs duty bands from five (0.0%, 2.5%, 6.0%, 15.0% and 28.0%) to four (0.0%, 5.0%, 15.0% and 30.0%). The Government revised several taxes on petrol, diesel, milk powder, certain categories of edible oils, wheat grain, maize, eggs, egg yolk and chicks for breeding and other purposes to mitigate the impact of rising international commodity prices on the domestic market. Several taxes on the importation of certain categories of machinery, equipment and raw materials were also revised during the year to support selected industries. The Presidential Commission on Taxation submitted its report to the President in October 2010, making several recommendations regarding the rationalization of the tax system. The Fiscal Management Efficiency Project, which aims at a comprehensive Fiscal Management Reform Programme to enhance revenue collection and to improve expenditure management, continued in 2010.

In 2009, the Government took steps to broaden the tax base, change tax rates and improve tax administration. Accordingly, measures were taken to rationalize the income tax system. Personal income tax slabs were broadened while tax thresholds for the levy of withholding tax on interest income were revised. Several measures were also introduced to rationalize the VAT system. The standard VAT rate was reduced from 15.0% to 12.0%. With this change, the ability to claim the input tax of VAT paid at the rate of 20.0% on luxury items was reduced from 15.0% to 12.0% and the concessionary VAT rate of 5.0% was abolished. A new tax called Nation Building Tax was introduced and new Harmonized System ("HS") codes were also introduced to broaden excise duty and customs duty bases in order to enhance revenue. Further, the Presidential Commission on Taxation was formed in May 2009 with the objective of studying the existing tax system and to propose suitable measures to enhance tax revenue within the existing system. The main functions of the Commission were to review the existing tax policy and to make recommendations on a comprehensive approach to improve the tax system aimed at the strengthening of tax collection, improving tax auditing and enforcement and the simplification of the tax system.

In 2008, income tax holidays were limited to broaden the tax base. Surcharges applicable on customs duty were increased and certain duty waivers were removed in order to rationalize customs duty. In order to simplify the tax system, a new tax called Special Commodity Levy was imposed on eleven essential goods in place of the various taxes applied on those items. Further steps were taken to increase efficiency and effectiveness of key revenue agencies such as the implementation of the Administration Management Information System ("RAMIS") in the Inland Revenue Department ("IRD"), the introduction of an e-filling system to enable tax payers to access the required VAT forms on-line, the provision of guidance to tax payers and the establishment of databases such as RAMIS within Sri Lanka Customs ("SLC").

Results

Total revenue during the first quarter of 2012 increased by 5.6% to Rs.228 billion (US$1.9 billion) compared to Rs.215.9 billion (US$2.0 billion) recorded in the same period in 2011. As a percentage of GDP, revenue decreased to 3% in the first three months of 2012 from 3.4% in the corresponding period in the previous year. Tax revenue increased by 10.3% to Rs.203 billion (US$1.7 billion), mainly due to an increase in the collection of excise taxes on motor vehicles (27.6%), liquor (16.5%) and cigarettes (12.4%), income taxes (30.2%), the special commodity levy (128.4%), withholding tax (37.3%) and VAT on imports (14.2%). Revenue collection from income tax increased mainly due to the improved performance in the corporate sector profits. The reduced duty rates applicable on motor vehicles, resulted in a significant increase in the collection of excise tax on imports of motor vehicles. However, PAYE tax collection, excise taxes on petroleum, VAT on domestic activities, import duties and non-tax revenue declined during this period

The revenue to GDP ratio declined to 14.3% in 2011 from 14.6% in 2010 as a result of the abolition of several taxes, the lowering of tax rates and the extension of exemptions. In 2011, in normal terms total revenue increased by 14.4% to Rs.934.8 billion from Rs.817.3 billion in 2010 due to higher economic growth and the significant rise in imports. Tax revenue as a percentage of GDP, declined to 12.4% in 2011 from 12.9% in 2010 although in nominal terms it increased by 12.1% to Rs.812.6 billion due to higher revenue from income based taxes, excise duties and import related taxes. Although several major tax reforms were introduced in 2010 and 2011 to simplify the tax system and to improve revenue mobilization, the full impact of these measures will be realized only in the medium term. Consumption based taxes remained the major source of tax revenue in 2011 accounting for 80.6% of the total tax collection. However, the share of income taxes in total taxes increased to 19.4% in 2011 from 18.7% in 2010. Higher corporate tax income due to improved corporate earnings and higher ESC collection contributed to the improvement in income based tax collection. Non-tax revenue recorded a significant growth of 32% to Rs.122.2 billion in 2011 over the previous year. Higher transfer of profits and dividends from public institutions, including the Central Bank and higher revenue from fees and charges mainly due to higher motor vehicle registrations contributed to the increase in non-tax revenue.

In 2010, the total revenue collection of the Government increased by 16.8% to Rs.817.3 billion (US$7.2 billion) from Rs.699.6 billion (US$6.1 billion) in 2009. The declining trend observed in the revenue to GDP ratio during the last three years was reversed in 2010 with a higher mobilization of both tax and non-tax revenue. As a percentage of GDP, total revenue increased to 14.6%, compared to 14.5% in 2009. Tax revenue increased by 17.1% to Rs.724.7 billion (US$6.4 billion) while non-tax revenue increased by 14.7% to Rs.92.5 billion (US$818 million), compared to 2009. As a percentage of GDP, tax revenue increased to 12.9% from 12.8% while non-tax revenue remained at 1.7% compared with 2009. Revenue from income tax decreased by 2.8% compared to 2009, as a result of the sharp decline in withholding taxes on interest income. Revenue from VAT increased by 28.3% compared to 2009, due to the rebound of domestic economic activity and higher imports. Revenue from excise tax increased by 33.1%, mainly due to the higher revenue generated from excise taxes on imports of motor vehicles. Revenue from import duty and SCL (Special Commodity Levy) decreased by 19.5% and 46.4%, respectively, compared to 2009, due to the reduction of import duties and the granting of duty concessions on several items. Revenue from NBT, PAL and Cess levies increased by 69.2%, 36.8% and 10.5%, respectively, compared to 2009. The increase in non-tax revenue was mainly due to an increase in the transfer of profits and dividends from public institutions.

In 2009, total revenue collection by the Government increased by 6.8% to Rs.699.6 billion (US$6.1 billion) from Rs.655.3 billion (US$6.0 billion) in 2008. However, as a percent of GDP, it decreased to 14.5% compared to 14.9% in 2008. Tax revenue increased by 5.7% to Rs.618.9 billion (US$5.4 billion) while non-tax revenue increased by 15.9% to Rs.80.7 billion (US$702.2 million) compared to 2008. As a percentage of GDP, tax revenue decreased from 14.2% to 12.8% while non-tax revenue remained at 1.6% compared with 2008. Revenue from income tax increased by 10% compared to 2008. Continued efforts to enhance the efficiency of the tax collection system through policy and administrative measures contributed to this increase. Revenue from VAT declined by 15.7% compared to 2008, reflecting the decline in import-related VAT due to a substantial reduction in imports and the reduction of the standard VAT rate. Revenue from excise tax declined by 3%, mainly due to the drop in revenue from the excise tax on motor vehicle imports. Despite the sharp decline in volume and value of imports in 2009, revenue from import duty and SCL increased by 25% and 30%, respectively, compared to 2008. The increase in non-tax revenue was mainly attributable to increased level of dividends by public institutions, including the Central Bank, and the increase in social security contributions arising from the higher level of salaries and wages of public servants.

During the first nine months of 2008, total revenue increased at a relatively high rate of 22.0%. However, the global economic crisis had a negative impact on revenue in the last quarter of 2008 and revenue collection for the entire year ended at 14.9% of GDP compared to 15.8% in the previous year. However, in nominal terms, total Government revenue increased by 15.9% to Rs.655.3 billion (US$6 billion) in 2008, from Rs.565 billion (US$5.1 billion) in 2007, as a result of revenue enhancement measures. Tax revenue increased by 15.1% to Rs.586 billion (US$5.4 billion) while non-tax revenue increased by 24.0% to Rs.70 billion (US$642.8 million) compared to 2007. Further, as a percentage of GDP, tax revenue decreased from 14.2% to 13.3% while non-tax revenue remained at 1.6% compared with 2007. Increases in revenue from income tax (18.0%), VAT (8.6%) and import duty (13.9%) were the main contributors to the growth in tax revenue. However, a decline in vehicles and other imports and duty concessions granted to public officers for the import of vehicles had a negative impact on revenue collection. Tax revenue was also adversely affected by a decrease in excise duty, drop in liquor and cigarette sales, and certain tax concessions. The increase in non-tax revenue was mainly due to increases in fees and charges, rental income and transfer of profits earned by the Central Bank.

Expenditures

Total expenditure and net lending is estimated to have increased by 27.4% to Rs439.1 billion (US$3.7 billion) during the first quarter of 2012, from Rs.344.6 billion (US$3.1 billion) in the corresponding period in 2011. As a percentage of GDP, total expenditure and net lending has increased to 5.9% during this period from 5.4% during the same period in 2011. During the first three months of 2012, recurrent expenditure increased by 24.2% to Rs.334.8 billion (US$2.8 billion), mainly due to the increase in expenditure on interest payments, salaries and wages, pensions and the fertilizer subsidy. Interest payments amounted to Rs.119.7 billion (US$1.0 billion), a 6.6% increase over the previous year. Capital expenditure and net lending is estimated to have increased by 38.9% to Rs.104.4 billion (US$0.9 billion). As a percentage of GDP, capital expenditure increased to 1.4% during first quarter of 2012 compared to 1.2% during the corresponding period in 2011.

In 2011, total expenditures and net lending of the Government decreased to 21.4% of GDP, or Rs.1,400.1 billion (US$12.7 billion), from 22.9% of GDP, or Rs.1,280.2 billion (US$11.3 billion), in 2010. Recurrent expenditure as a percentage of GDP declined significantly to 15.4% in 2011 from 16.7% in 2010, reflecting the Government's effort to rationalize recurrent expenditure. In nominal terms, recurrent expenditure increased by 7.4% to Rs.1,006.6 billion (US$9.1 billion) in 2011 due to an increase in salaries and wages and pension payments. Expenditure on salaries and wages for public servants increased by 6.3% to Rs.319.6 billion (US$2.9 billion), amounting to 32% of total recurrent expenditure in 2011. Expenditure on defense, public order and safety declined to 3.1% of GDP in 2011, or Rs.206.0 billion (US$1.9 billion), compared to 3.4% of GDP in 2010. Capital expenditure and net lending increased by 14.7% to Rs.393.5 billion (US$3.5 billion) in 2011, reflecting the Government's commitment to expediting strategic infrastructure development projects. Public investment increased by 14.3% to Rs.407.5 billion (US$3.7 billion) in 2011, although as a percentage of GDP it declined to 6.2% during the year compared to 6.4% in 2010. Public investment in economic services continued to be the main component of the Government's investment program, amounting to Rs.311.6 billion (US$2.8 billion) in 2011, an 11.8% increase compared to that of the previous year. This included investment in roads, ports, power and energy, railways, water supply and irrigation. Public investment in social services increased by 12.0% to Rs.63.0 billion (US$570 million) in 2011, of which Rs.22.3 billion (US$202 million) was on account of education, while Rs.14.8 billion (US$134 million) was in relation to expenditure on health related services. Further, the government continued its commitment towards resolving infrastructure bottlenecks in the country with special emphasis on reconstruction activities in the conflict affected regions.

In 2010, total expenditures and net lending of the Government decreased to 22.9% of GDP, or Rs.1,280.2 billion (US$11.3 billion), from 24.9% of GDP, or Rs.1,202 billion (US$10.5 billion), in 2009. Recurrent expenditure as a percentage of GDP declined significantly to 16.7% in 2010 from

18.2% in 2009, reflecting the Government's effort to rationalize recurrent expenditure. In nominal terms, recurrent expenditure increased by 6.5% to Rs.937.1 billion (US$8.3 billion) in 2010 due to an increase in salaries and wages, pension payments and interest payments. Expenditure on salaries and wages for public servants increased by 10.8% to Rs.300.6 billion (US$2.7 billion), amounting to 32% of total recurrent expenditure in 2010. Expenditure on defense, public order and safety declined to 3.4% of GDP in 2010, or Rs.215.8 billion (US$1.9 billion), compared to 3.9% of GDP in 2009. Capital expenditure and net lending increased by 6.4% to Rs.343.1 billion (US$3.0 billion) in 2010, reflecting the Government's commitment to expediting strategic infrastructure development projects. Public investment increased by 7.9% to Rs.356.5 billion (US$3.2 billion) in 2010, although as a percentage of GDP it declined to 6.4% during the year compared to 6.8% in 2009. Public investment in economic services continued to be the main component of the Government's investment program, amounting to Rs.278.8 billion (US$2.5 billion) in 2010, an 8.7% increase compared to that of the previous year. This included investment in ports, transportation, communication, energy, water supply, agriculture and irrigation. Public investment in social services increased by 4.2% to Rs.56.2 billion (US$497 million) in 2010, of which Rs.19.1 billion (US$169 million) was on account of education, while Rs.13.3 billion (US$118 million) was in relation to expenditure on health related services. Further, the Government continued its commitment towards balanced regional development in 2010 with various development programs conducted under the Ministry of Economic Development.

In 2009, total expenditures and net lending of the Government increased to 24.9% of GDP, or Rs.1,202 billion (US$10.5 billion), from 22.6% of GDP, or Rs.996 billion (US$9.2 billion), in 2008. Current expenditures increased to 18.2% of GDP from 16.9% in 2008. Capital expenditures and net lending increased to 6.7% of GDP from 5.7% in 2008. Expenditure on salaries and wages was the highest single expenditure, accounting for 30.8% of the total recurrent expenditures. It increased by 13.4% in nominal terms from 2008 as well as to 5.6% of GDP compared to 5.4% of GDP in 2008. This was due to new recruitments in the areas of defense and other government services, increase of the cost of living allowance to public sector employees and rectification of salary anomalies. Expenditure on defense, public order and safety in 2009 was Rs.188.6 billion (US$1.6 billion), or 3.9% of GDP, a 7.2% increase in nominal terms. Public investment increased to 6.8% of GDP from 6.0% in 2008. The major public investments continued to be in transport, communication, energy and water supply, demonstrating the Government's focus on major infrastructure development projects as well as provincial and rural infrastructure development projects. Investments in social services were a major priority of the Government, reaching 16.3% of total public investment in 2009. Investment in education was directed towards upgrading educational infrastructure and developing identified schools in selected Divisional Secretariat areas. Public investment in the health sector was mainly directed towards improving access to healthcare, focusing on vulnerable people, while developing health infrastructure and other facilities.

In 2008, total expenditures and net lending of the Government decreased to 22.6% of GDP, or Rs.996 billion (US$9.2 billion), from 23.5% of GDP, or Rs.842 billion (US$7.6 billion), in 2007. Current expenditures decreased to 16.9% of GDP from 17.4% in 2007. Capital expenditures and net lending decreased to 5.7% of GDP from 6.1% in 2007. Expenditure on salaries and wages was the highest single expenditure, accounting for 32.1% of the total recurrent expenditures and 5.4% of GDP. It increased by 11.8% in nominal terms from 2007 and was 6.8% of GDP, compared to 6.0% of GDP in 2007. This was due to new recruitments to the public service, an increase in the cost of living allowance to public servants of lower grades and a revision of allowances for public officers. The expenditure on defense, public order and safety in 2008 was Rs.175.9 billion (US$1.6 billion), or 4.0% of GDP, a 31.0% increase in nominal terms. Public investment decreased to 6.0% of GDP from 6.4% in 2007. The major areas of public investment continued to be in transport, communication, energy and water supply, demonstrating the Government's focus on major infrastructure development projects as well as provincial and rural infrastructure development projects. Investments in social services were a major priority of the Government, reaching 22.8% of total public investment in 2008. Investment in education was directed towards upgrading school infrastructure, eradicating inequality among primary schools and developing IT knowledge among students. Public investment in the health sector was mainly directed towards improving access to healthcare, focusing on vulnerable people, particularly in the lagging regions, through improvement of estate hospitals, while developing health infrastructure and facilities.

Government Budget

The Budget Process

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

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

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

2012 Budget

His Excellency the President, as the Minister of Finance and Planning, presented the Budget for 2012 to the Parliament on November 21, 2011 and it was approved on December 21, 2011. The budget targets five major areas, namely supporting a caring family, ensuring food security, empowering a healthy generation, creating a knowledge society and boosting an enterprise economy. According to the budget for 2012, the fiscal sector was expected to show several positive developments. New proposals were introduced to simplify the tax system, to streamline tax administration and to broaden the tax base. Further, several tax incentives in terms of exemptions and concessionary rates were proposed to increase investments in agriculture, information technology, business/knowledge process outsourcing, healthcare, education, tourism and sports related activities. Considering the fiscal sector, total government revenue and grants in 2012 is expected to be Rs.1,126.1 billion (US$9.1 billion), total expenditure and net lending is estimated to be Rs.1,594.9 billion (US$12.9 billion), and the overall budget deficit is estimated to be Rs.468.9 billion (US$3.8 billion). The budget is expected to be financed through net domestic financing of Rs.293.6 billion (US$2.4 billion) and net foreign financing of Rs.175.3 billion (US$1.4 billion).

2011 Budget

On November 22, 2010, the Minister of Finance presented the 2011 Budget speech to the Parliament, which was approved on December 10, 2011. The overall fiscal policy in 2011 was primarily focused towards developing an efficient and productive economy. The proposals put forward in the budget addressed all the major sectors in the economy with a view to creating an environment conducive to the achievement of a higher economic growth rate and a reduction in poverty. Several sectors were specifically targeted in the budget; the banking sector was encouraged to utilize the savings from the reduced taxes on the financial sector to provide long term loans (and engage in project financing) in new and innovative sectors; small & medium enterprises, which are key drivers of the economy, have been exempted from the economic service charge and foreign exchange controls were eased to facilitate more foreign exchange inflows. Further, incentives were provided to develop the telecommunications sector by amalgamating the multiple taxes imposed on the sector into one tax, to increase tourist spending, to encourage value added exports and to encourage research development in agriculture, new technology and knowledge based industries. The Government focused on creating a low and simplified tax regime to generate more tax revenue from fewer taxes while facilitating easier tax collection and reducing and removing some nuisance taxes. Measures were also introduced to improve tax administration. Total revenue and grants for 2011 was Rs.950.0 billion (US$8.6 billion) compared to Rs.985.9 billion (US$9 billion) expected in the 2011 Budget. Total expenditure and net lending for 2011 was Rs.1,400.1 billion (US$12.7 billion) compared to RS.1,419.7 billion (US$12.9 billion) expected in the 2011 Budget. Accordingly, and the overall budget deficit for 2011 was Rs.450.2 billion (US$4.1 billion). As a percentage of GDP the overall fiscal deficit in 2011 was 6.9%, marginally above the deficit estimated in the 2011 Budget. The overall budget deficit in 2011 was financed through net domestic financing of Rs.231.2 billion (US$2.1 billion) and net foreign financing of Rs.219.0 billion (US$2.0 billion).

2010 Budget

In view of the Presidential and Parliamentary elections held in early 2010, there was a delay in presenting the budget for 2010. During the period January to April 2010 fiscal operations were conducted under a Vote on Account framework. Fiscal operations for the period May to July 2010 were conducted under the provisions of Section 3 of Article 150 of the Constitution by a Presidential decree. The budget for 2010 was presented to Parliament in June 2010 and approved in July 2010. Total revenue and grants of the Government in 2010 amounted to Rs.834.2 billion (US$7.4 billion) compared to Rs.840.7 billion (US$7.4 billion) in the 2010 Budget. Total expenditure and net lending of the Government in 2010 was Rs.1,280.2 billion (US$11.3 billion) compared to Rs.1, 279.6 billion (US$11.2 billion) in the 2010 Budget. The overall budget deficit in 2010 was Rs.446 billion (US$3.9 billion). The 2010 budget deficit was equal to 8% of GDP, in line with the original budget expectations. Improvements in both revenue and expenditure contributed to this noteworthy achievement. The greater availability of relatively low cost external resources to finance the fiscal deficit reduced borrowings from the domestic market. Accordingly, net foreign financing was Rs.243.8 billion (US$2.2 billion) compared with the target of Rs.158 billion (US$1.4 billion) while total net domestic financing was Rs.202.2 billion (US$1.8 billion) compared to the target of Rs.280.8 billion (US$2.5 billion).

2009 Budget

Total revenue and grants of the Government in 2009 was Rs.726 billion (US$6.3 billion) compared to Rs.749 billion (US$6.5 billion) in the 2009 revised budget. Total expenditure and net lending of the Government in 2009 was Rs.1,202 billion (US$10.5 billion) compared to the Rs.1,092 billion (US$9.2 billion) in the 2009 revised budget. The overall budget deficit in 2009 was Rs.476 billion (US$4.1 billion), which was equivalent to 9.9% of GDP. This was higher than the revised 2009 budget-planned deficit of 7.0% of GDP. This was also a reversal of the decreasing trend that prevailed in the past three consecutive years. The significant shortfall in Government revenue, overruns in recurrent expenditures and the increase in public investment over and above the expected level during the year were the main reasons for this increase. The budget deficit was financed through both domestic and foreign sources in 2009. Total NDF was Rs.246 billion (US$2.1 billion) compared to the revised target of Rs.309 billion (US$2.7 billion), while net foreign financing was Rs.231 billion (US$2.0 billion) compared with the revised target of Rs.34 billion (US$299 million).

The following table sets forth the 2011 and 2012 Budgets.

2011 AND 2012 BUDGETS

Item	Budget 2011	Provisional 2011	Provisional First Three Months of 2011	Provisional First Three Months of 2012	Budget 2012
	(in Rs. millions)				
Total revenue and Grants	**985,920**	**949,917**	**217,088**	**228,536**	**1,126,081**
Total revenue	963,320	934,776	215,905	228,014	1,106,081
Tax revenue	861,943	812,611	183,997	203,020	1,000,559
Income taxes	154,883	157,309	34,064	40,501	190,270
VAT	238,390	215,576	51,862	53,516	264,917
Excise taxes	152,250	186,010	39,252	43,322	223,125
Import duties	92,803	75,974	18,660	17,593	93,830
Other taxes	223,617	177,742	40,159	48,088	228,417
Non tax revenue	101,377	122,166	31,908	24,994	105,522
Grants	22,600	15,141	1,183	522	20,000
Total expenditure and net lending	**1,419,664**	**1,400,097**	**344,629**	**439,126**	**1,594,946**
Current expenditure	1,017,155	1,006,633	269,504	334,774	1,107,902
Salaries and wages	344,023	319,601	79,996	83,490	367,980
Interest payments	353,928	356,699	112,230	119,654	370,000
Current transfers and subsidies	207,541	216,602	N/A	N/A	236,400
Other[1]	111,663	113,730	77,278	131,630	133,522
Capital Expenditure and Lending minus Repayments	402,509	393,465	75,125	104,353	487,044
Revenue Surplus/(Deficit)	**(53,835)**	**(71,856)**	**(53,599)**	**(106,760)**	**(1,821)**
Budget Deficit	**(433,744)**	**(450,180)**	**(127,541)**	**(210,590)**	**(468,865)**

Source: Central Bank of Sri Lanka

Note:

(1) In the first three months of 2011 and 2012, expenditure on current transfers and subsidies is included in the other expenditure category

Debt

External Debt

The following table sets forth the external debt of the country.

EXTERNAL DEBT

	As of December 31,				
	2007	**2008**	**2009**	**2010**	**2011[(1)]**
	(in US$ millions, except as indicated)				
Short-term	1,111	1,460	3,098	2,615	2,584
Medium and long-term	12,879	13,646	15,564	18,822	21,882
Total	13,989	15,107	18,662	21,438	24,466
By Debtor:					
Banking system	—	—	—	—	—
Public sector	12,201	12,805	15,391	18,247	20,875
Private sector	1,788	2,302	3,271	3,191	3,591
Total	13,989	15,107	18,662	21,438	24,466
By Creditor Type:					
Multilateral	5,592	5,632	6,533	7,394	8,056
Bilateral	4,935	5,627	5,741	6,569	6,970
Banks and financial					
Institutions	1,673	1,682	2,144	3,023	4,223
Bondholders/noteholders	—	—	—	—	—
Others	1,789	2,166	4,244	4,452	5,217
Total	13,989	15,107	18,662	21,438	24,466
Ratios (%)					
Debt service burden to exports of goods and services.	13.1	15.1	19.0	15.9	12.6
Debt service burden to GNP	3.9	3.8	4.1	3.6	2.9
External debt to GNP	43.7	38.0	44.9	43.8	41.8

Sources: External Resources and Ministry of Finance and Planning

Note:

(1) Provisional

The total external debt of the country as a percentage of GDP decreased to 41.3% in 2011 from 43.3% in 2010. In US dollar terms, total external debt increased by 14.1% to US$24.5 billion in 2011 from US$21.4 billion in 2010, mainly owing to an increase in medium and long-term debt. Of the medium to long-term debt, the government debt accounted for approximately 85%. The higher level of disbursements to the Government, including US$1 billion in sovereign bond proceeds received in July 2011, resulted in government debt stock increasing by 15% in 2011. In 2011, short term debt decreased marginally to US$2.58 billion from US$2.62 billion in 2010. This was mainly due to the drop in outstanding value of trade credits to the CPC, despite the marginal increase in outstanding stock of Treasury bills and bonds. Meanwhile, the ratio of short-term debt to total debt and liabilities declined to 9% at the end of 2011. The banking sector external liabilities increased substantially by 29% to US$4.4 billion by the end of 2011. This was mainly due to the increase of commercial bank liabilities to US$3.4 billion at the end of 2011, compared to US$2.6 billion at the end of 2010, as a result of increased import credits by commercial banks to corporate borrowers, particularly to the CPC. Meanwhile, the ACU liabilities increased to US$790 million at the end of 2011, from US$586 million at the end of 2010, owing to deferred settlement at the year end. The total external debt and liabilities as a percentage of GDP declined marginally to 48.8% by end 2011, from 50.1% in 2010.

The total external debt of the country, which consists of short, medium and long-term debt decreased to 43.3% of GDP in 2010 from 44.4% in 2009. However, in US dollar terms, the total external debt increased by 14.9% to US$21.4 billion in 2010 from US$18.7 billion in 2009. While the increase in medium and long-term debt amounted to approximately US$3.3 billion, the increase in the total debt outstanding moderated due to a decline in short-term debt. The reduction in short-term debt was primarily due to the settlement of trade credits of the Ceylon Petroleum Corporation during the year. Meanwhile, the medium and long-term debt increased mainly due to the US$1 billion sovereign bond and disbursements under IMF-SBA facility, as well as inflows to the private sector, particularly related to the Puttalam Coal Power Project. Banking sector external liabilities increased by 51% to US$3.4 billion at the end of 2010. This was mainly due to an increase in commercial bank liabilities to US$2.6 billion at the end of 2010, compared to US$1.8 billion at the end of 2009, as a result of increased import credits by commercial banks to corporate borrowers, particularly Ceylon Petroleum Corporation. Meanwhile ACU liabilities increased to US$586 million at the end of 2010, from US$261 million at the end of 2009, owing to deferred settlements at the year end. Accordingly, the total external debt and liabilities as a percentage of GDP increased marginally to 50.1% at the end of 2010, from 49.7% in 2009.

The total external debt of the country, consisting of long-term, medium-term and short-term debt, increased to 44.4% of GDP in 2009 from 37.1% in 2008. In US dollar terms, the total external debt increased by around 23.5% to US$18,662 million in 2009. Of the total external debt outstanding, 36.8% was denominated in SDR, 29.4% in Japanese yen and 21.5% in US dollars. Though total banking sector external liabilities have declined, total external debt and liabilities, which consist of total external debt and banking sector external liabilities, increased as a percentage of GDP in 2009 to 49.7% from 43.7% 2008 owing to the higher external debt inflows indicated above. The banking sector external liabilities as a percentage of GDP decreased to 5.4%, which in absolute terms has decreased by 15.7% to US$2,251 million by the end of 2009. Despite the increase in new liabilities due to the currency SWAP facility, the substantial decline in ACU liabilities as at the end of 2009 has resulted in a decline in overall banking sector external liabilities.

In 2009, Government debt continued to account for a major share of external debt. Of the total medium and long-term debt, Government debt accounted for 88.5%, while the remainder represented the borrowings of the private sector and public corporations, and debt obligations to the IMF. Out of the total Government external debt, concessional debt accounted for 81% by the end of 2009 compared to 86% recorded in 2008. The elevation of the country to lower middle income status has reduced the availability of concessional loans from multilateral lending institutions, compelling the Government to seek non-concessional loans to finance various development projects.

In 2008, continuing with the declining trend observed in the past few years except in 2007, the country's total external debt, as a percentage of GDP, declined to 37.1% from 43.2% in 2007. In US dollar terms, total external debt increased by 8.0% to US$15.1 billion in 2008, primarily due to short-term debt of the CPC and other trade credits. Of the total external debt outstanding, 37.2% was denominated in SDR, 31.1% in Japanese Yen and 19.6% in US dollars. Total external debt and liabilities, which consist of total external debt and banking sector external liabilities, as a percentage of GDP decreased in 2008 to 43.7% from 51.0% in 2007. The banking sector external liabilities as a percentage of GDP, decreased to 6.6% though in absolute terms it increased by 7.1% to US$2.7 billion as at December 31, 2008, mainly due to the increase in ACU liabilities.

The Government debt continues to account for a major share of external debt. Of the total medium and long-term debt of Sri Lanka, Government debt accounted for 92.2% as of the end of 2008, while the remaining share represented borrowings of the private sector and public corporations, and debt obligations to the IMF. Of the total Government external debt, concessional debt accounted for 86%. The elevation of the country to the lower middle income status has reduced the availability of concessional loans from multinational financial institutions, compelling the Government to seek non-concessional loans to finance its development projects. However, the Government maintained its non-concessional debt level at a low risk level, thereby reducing the Government's debt burden. As a consequence of the concessional loans decreasing, the finance costs will continually rise due to the higher interest rates, which in turn will cause a higher debt service ratio.

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

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

Debt Service Payments

In 2011, total foreign debt service payments, consisting of amortization and interest payments, declined marginally in nominal terms to US$1,717 million from US$1,761 million in 2010. Further, as a percentage of export of goods and services, total foreign debt service payments decreased to 12.6% in 2011, compared to 15.9% in 2010. The higher debt service ratio in 2010 was due to the settlement of syndicated loans of US$25 million and the full settlement of the debt moratorium, granted in 2005 in the aftermath of tsunami disaster in 2004. Meanwhile, the significant increase in exports of goods and services in 2011 likely had a significant impact on lowering the debt service ratio.

In 2010, the total foreign debt service payments, consisting of amortization and interest payments, declined in nominal terms to US$1,761 million from US$1,702 million in 2009. Further, as a percentage of export of goods and services, total foreign debt service payments decreased to 15.2% in 2010, compared to 19% in 2009. The higher debt service ratio in 2009 was due to the settlement of syndicated loans of US$225 million, whereas in 2010 the syndicated loan settlements were only US$25 million. Also, the full settlement of the rescheduled loan obligation due to moratorium granted after the tsunami in 2004, has resulted in lower debt service ratio, in 2010.

In 2009, the country's debt service ratio (the ratio of principal and interest payments to export of goods and receipts from services and income), which measures the country's capacity to service its external debt, increased to 19.0% from 15.1% in 2008. The debt service ratio remained at a comfortable level mainly due to the high level of concessional loans with longer repayment periods supported by continued growth in earnings from exports of goods and services. At the same time, the country's external debt ratio (the ratio of total external debt to gross national product) increased to 44.4% from 37.1% in 2008. In US dollar terms, Sri Lanka's outstanding external debt was US$18,662 million as at December 31, 2009 and its debt service payments increased by 11.6% to US$1,702 million in 2009. The continuation of scheduled debt repayments since 2006 after a one-off reduction due to the tsunami-based debt moratorium in 2005 (with the final installment paid in 2009), as well as the increasing debt servicing cost of the Government's commercial borrowings, were the main reasons for the increase in the country's external debt service payments.

In 2008, the country's debt service ratio increased to 15.0% from 13.1% in 2007. At the same time, the country's debt ratio improved to 37.1% from 43.2% in 2007. In US dollar terms, Sri Lanka's outstanding external debt was US$15,107 million as at December 31, 2008 and its debt service payments increased by 23.8% to US$1,525 million in 2008. The continuation of scheduled debt repayments since 2006 after a one-off reduction due to the tsunami based debt moratorium in 2005, the increasing debt servicing cost of the Government's commercial borrowings in 2008 were the main reasons for the increase in the country's external debt service payments. The debt service ratio, remained at a comfortable level, mainly due to the high level of concessional loans with longer repayment periods supported by continued growth in earnings from exports of goods and services.

Sri Lanka Credit Ratings

Rating Agencies. On February 27, 2009, Fitch revised its credit rating outlook for the country's long term foreign and local currency Issuer Default Ratings to "negative" from "stable," citing the "heightened concern regarding the sovereign's external financial position in light of the marked decline in official foreign exchange reserves." Fitch Ratings revised Sri Lanka's sovereign rating outlook to "stable" from "negative" to reflect the country's positive changes in sovereign credit fundamentals on October 9, 2009. The agency has affirmed the long-term foreign and local currency Issuer Default Ratings and the Country Ceiling at "B+" and the short-term Issuer Default Rating at "B," citing "the positive changes in sovereign credit fundamentals following the end of the 26-year civil war, the approval of a 2.6 billion dollar IMF agreement and the return of private capital inflows." On September 21, 2010, Fitch again revised the outlook to "positive" from "stable." On July 18, 2011, Fitch upgraded Sri Lanka's long-term foreign and local currency Issuer Default Rating to "BB-" from "B+", with a stable outlook, and affirmed Sri Lanka's short-term Issuer Default Rating at "B." The rating agency has also upgraded the Country Ceiling to "BB-." In Fitch's view, the outlook revision is a reflection of Sri Lanka's economy benefitting from the end of the internal conflict, from the more disciplined policy framework put in place under the SBA Facility and from the improved external liquidity position bolstered by the IMF program. On May 4, 2012, Fitch affirmed its rating.

On December 15, 2008, S&P downgraded Sri Lanka's long-term foreign currency rating to "B" from "B+" and its local currency rating to "B+" from "BB-" with a "stable" outlook. S&P cited the deterioration of the country's external liquidity position as the reason for the change. The rating agency subsequently revised the country's sovereign rating outlook to "negative" from "stable" on May 21, 2009. On August 25, 2009, S&P revised its sovereign rating outlook back to "stable" due to Sri Lanka's improved external liquidity position in light of the SBA Facility. On October 15, 2009, S&P further revised its sovereign rating outlook to "positive," citing the "continued strengthening of Sri Lanka's balance of payments position, and Standard & Poor's expectation that the IMF Standby Loan Program will be pursued to its conclusion, engendering modest improvement in public finances." Accordingly, Standard & Poor's affirmed its "B" long-term foreign currency credit rating and "B+" long term local currency sovereign credit rating on Sri Lanka. They also affirmed the “B” short-term ratings on the sovereign. On September 15, 2010, S&P raised its long-term foreign currency sovereign credit rating on Sri Lanka to “B+” from “B,” and the long-term local currency rating to “BB-” from “B+” taking into account the continued strengthening of Sri Lanka’s balance of payments position and the expected sustainable decline in fiscal deficits and public debt under the Government’s planned revenue reforms. On July 19, 2011, S&P raised its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “positive” from “stable” based on improved external liquidity, progress in addressing structural fiscal weaknesses and the Government’s inflation management efforts. On February 29, 2012, S&P changed its outlook on Sri Lanka’s long-term foreign currency sovereign credit rating to “stable” from “positive” while affirming its “B+” rating and revising its long-term local currency sovereign credit rating to “B+” from “BB-”.

In addition, Moody’s Investors Service has assigned a “B1” foreign currency issuer rating to the Government of Sri Lanka. The outlook was revised from “stable” to “positive” on July 18, 2011. The agency has considered the end of the internal conflict and the structural improvement in the country’s economic prospects and stability in making the rating decision.

Direct Debt of the Issuer

The following table summarizes the Government’s outstanding direct debt as of the dates indicated.

OUTSTANDING DIRECT DEBT OF THE ISSUER

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011[(1)]	2011[(1)]	2012[(1)]	% Increase or Decrease
	(in Rs. millions, except for percentages)							
Medium/long-term debt	2,673,796	3,066,239	3,560,367	3,913,379	4,365,052	4,001,668	4,968,403	24.2
Domestic	1,351,999	1,623,863	1,840,309	1,946,113	2,105,895	1,995,987	2,306,624	15.6
External	1,326,487	1,442,376	1,720,057	1,967,266	2,259,157	2,005,682	2,661,779	32.7
Short-term debt	363,199	522,723	601,055	676,866	768,313	799,185	933,797	16.8
Domestic	363,199	516,364	560,646	619,549	698,190	733,680	835,896	13.9
External[(2)]	0	6,358	40,410	57,317	70,123	65,505	97,901	49.5
Total debt	3,041,684	3,588,962	4,161,422	4,590,245	5,133,365	4,800,853	5,902,200	22.9

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Provisional

(2) Includes foreign investments in Treasury Bills.

OWNERSHIP OF TREASURY BILLS(1)(2)

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011(3)	2011(3)	2012(3)	% Increase or Decrease
	(in Rs. millions, except for percentages)							
Bank Sector	113,782	251,453	197,532	223,351	355,552	244,940	424,577	73.3
Central Bank	44,964	163,584	37,451	2,993	169,797	930	217,639	23,312.1
Commercial Banks	68,818	87,869	160,081	220,358	185,756	244,010	206,938	(15.2)
Non-Bank Sector	193,231	151,146	243,499	291,091	235,333	357,699	269,415	(24.7)
Employees' Provident Fund	5,208	1	420	5,969	—	—	11,544	0.0
Other Provident Funds	166	55	—	15	1,279	N/A	N/A	N/A
Savings Institutions	32,046	20,791	42,677	52,541	58,733	60,499	49,989	(17.4)
Insurance and Finance Companies	8,623	10,988	7,192	12,072	11,010	N/A	N/A	N/A
Departmental and Other Official Funds	29,481	16,431	21,452	20,636	5,968	N/A	N/A	N/A
Private and Other	117,707	102,882	171,757	199,858	158,344	297,201	207,882	(30.1)
Total	307,012	402,600	441,032	514,442	590,885	602,639	693,991	15.2

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Adjusted for secondary market transactions

(2) Excludes outstanding Treasury bill holdings of Rs.6,358 million by foreign investors in 2008, Treasury bill holdings of Rs 40,410 million in 2009 and Rs.57,317 million in 2010 and Rs.70,123 million in 2011 by foreign investors, Sri Lankan diaspora and migrant workers

(3) Provisional

OWNERSHIP OF TREASURY BONDS(1)(2)(3)

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011(4)	2011(4)	2012(4)	% Increase or Decrease
	(in Rs. millions, except for percentages)							
Bank Sector	**58,416**	**90,082**	**188,576**	**162,215**	**206,547**	**179,723**	**240,355**	**33.7**
Central Bank	—	—	—	—	—	—	—	—
Commercial Banks	58,416	90,082	188,576	162,215	206,547	179,723	240,355	33.7
Non-Bank Sector	**960,436**	**1,191,897**	**1,324,936**	**1,481,672**	**1,612,704**	**1,517,702**	**1,745,147**	**15.0**
Employees' Provident Fund	501,331	607,770	718,717	814,451	927,374	860,866	1,008,103	17.1
Other Provident Funds	7,862	9,507	13,766	19,872	7,550	N/A	N/A	N/A
Savings Institutions	134,994	164,457	195,588	221,805	246,418	236,558	253,630	7.2
Insurance and Finance Companies	21,215	26,410	33,194	33,624	34,410	N/A	N/A	N/A
Departmental and Other Official Funds	69,588	90,778	21,949	36,963	37,006	N/A	N/A	N/A
Private and Other	225,446	292,975	341,722	354,957	359,946	420,278	483,414	15.0
Total	**1,018,852**	**1,281,978**	**1,513,512**	**1,643,887**	**1,819,251**	**1,697,425**	**1,985,503**	**17.0**

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Adjusted for secondary market transactions

(2) Excludes Government bonds of Rs.4,397 million issued to Co-operative Wholesale Establishment in November 2003

(3) Excludes outstanding Treasury bonds held by foreign investors in 2007 and 2008 amounting to Rs.49,646 million and Rs.17,647 million respectively and Rs.145,124 million, Rs.183,538 million and Rs.199,531 held by foreign investors, Sri Lankan diaspora and migrant workers in 2009, 2010 and 2011, respectively.

(4) Provisional

OWNERSHIP OF RUPEE LOANS

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011(1)	2011(1)	2012(1)	% Increase or Decrease
	(in Rs. millions, except for percentages)							
Bank Sector	**15,870**	**15,870**	**17,252**	**17,615**	**16,234**	**16,234**	**15,870**	**(2.2)**
Central Bank	—	—	—	—	—	—	—	—
Commercial Banks(2)	15,870	15,870	17,252	17,615	16,234	16,234	15,870	(2.2)
Non-Bank Sector	**115,639**	**114,139**	**95,040**	**70,094**	**45,727**	**64,938**	**42,516**	**(34.5)**
Savings Institutions(3)	19,938	18,820	18,820	12,168	9,168	10,168	6,868	(32.5)
Departmental and Other	—	—	—	—	—	—	—	—
Official Funds	8,410	8,400	6,111	6,103	6,101	6,103	5,190	(15.0)
Employees' Provident Fund	68,921	68,539	56,583	40,921	23,100	40,921	23,100	(43.6)
Other Provident Funds	12,320	12,327	11,417	10,369	7,358	7,736	7,358	(4.9)
Other State Corporations	1,575	1,575	1,575	—	—	—	—	—
Other(4)	4,475	4,477	535	532	—	9	—	(100.0)
Total	**131,509**	**130,009**	**112,292**	**87,709**	**61,961**	**81,171**	**58,386**	**(28.1)**

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Provisional

(2) Includes long term loans issued by the government in connection with the restructuring of two state banks in 1993 and 1996 respectively.

(3) Includes the value of long-term loans of Rs.4,480 million issued by the government to re-capitalize the liabilities of the NSB in 1996, which was matured in 2006.

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

OWNERSHIP OF GOVERNMENT DEBT(1)

	As of December 31,					As of May 31,	
	2007	2008	2009	2010	2011(5)	2011(5)	2012(5)
	(in Rs. millions, except for percentages)						
Domestic Debt	**1,715,198**	**2,140,228**	**2,400,955**	**2,565,662**	**2,804,085**	**2,729,666**	**3,142,520**
Bank Sector	415,318	657,425	705,765	691,716	886,221	764,757	1,061,356
Central Bank	104,817	239,248	109,593	78,376	263,329	96,711	330,052
Commercial Banks	310,501	418,177	596,172	613,340	622,892	668,047	731,305
Non-Bank Sector	1,299,879	1,482,804	1,695,189	1,873,945	1,917,864	1,964,908	2,081,163
Market Borrowings	1,289,688	1,478,553	1,685,638	1,866,267	1,916,930	1,963,974	2,080,230
Savings Institutions	192,413	204,067	257,084	286,514	314,319	307,224	310,487
Insurance Funds	21,012	25,976	34,490	32,839	34,356	N/A	N/A
Provident and Pension Funds(2)	595,807	698,192	835,402	884,279	959,303	901,787	1,042,747
Official Funds(3)	107,480	107,234	132,485	167,374	161,568	N/A	N/A
Private Business and Individuals(4)	372,976	443,084	426,177	495,261	447,385	754,964	726,996
Non-Market Borrowings	10,191	4,251	9,551	7,678	933	933	933
Foreign Debt	**1,326,487**	**1,448,734**	**1,760,467**	**2,024,583**	**2,329,280**	**2,071,187**	**2,759,680**
Total	**3,041,685**	**3,588,962**	**4,161,422**	**4,590,245**	**5,133,365**	**4,800,853**	**5,902,200**

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

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

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

(3) The Central Government, Local Authorities, State Corporations, Departmental and Other Official Funds

(4) Includes the value of Treasury Certificates of Deposits, public debt sinking funds and the National Housing Sinking Fund

(5) Provisional

COMPOSITION OF OUTSTANDING CENTRAL GOVERNMENT DEBT

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011[8]	2011[8]	2012[8]	% Increase or Decrease
	(in Rs. millions, except for percentages)							
Foreign Debt	**1,326,487**	**1,448,734**	**1,760,467**	**2,024,583**	**2,329,280**	**2,071,187**	**2,759,680**	**33.2**
Project Loans[1]	1,087,359	1,261,304	1,362,806	1,461,729	1,640,117	1,514,193	1,936,254	27.9
Non-Project Loans	239,128	187,430	397,661	562,854	689,163	556,993	823,426	47.8
Commodity	68,665	66,499	62,304	54,653	53,460	52,968	61,929	16.9
Other[3]	170,463	120,931	335,357	508,201	635,703	504,025	761,497	51.1
Domestic Debt	**1,715,198**	**2,140,228**	**2,400,955**	**2,565,662**	**2,804,085**	**2,729,666**	**3,142,520**	**15.1**
Rupee Loans	131,509	130,009	112,292	87,709	61,961	81,171	58,386	(28.1)
Treasury Bills[4]	307,012	402,600	441,032	514,442	590,885	602,639	693,991	15.2
Treasury Bonds[5]	1,018,852	1,281,978	1,513,512	1,643,887	1,819,251	1,697,425	1,985,502	17.0
Sri Lanka Development Bonds	86,459	158,805	168,079	173,877	183,845	176,702	218,808	23.8
Central Bank Advances[6]	60,679	76,308	73,881	77,879	94,743	98,662	112,751	14.3
Other[7]	110,687	90,528	92,160	67,868	53,400	73,066	73,081	0.0
Total	**3,041,685**	**3,588,962**	**4,161,422**	**4,590,245**	**5,133,365**	**4,800,853**	**5,902,200**	**22.9**

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Represents the amounts withdrawn and outstanding on the loans contracted with the IBRD, USA, Canada, Denmark, People's Republic of China, Germany, UK, India, IDA, ADB, Netherlands, Kuwait, OPEC, Japan, UAE, IFAD, Skandinaviska Enskilda Benkens — Sweden, Salomon Brother's Incorporated-New York, Bank Indosuez, BFCE-France and Citibank International of USA, Australia, Austria, Saudi Arabian Fund, EIB, Hong Kong and Korea

(2) Represents the amounts withdrawn and outstanding on the loans contracted with the USA, Canada, Germany, Japan, France, India, Italy, Pakistan and Netherlands

(3) Includes cash loans received from the ADB, USA, China, Germany, Japan, OPEC, rupee denominated Treasury bonds from 2007 and Treasury bills from 2008 issued to foreign investors, Treasury bills and Treasury bonds issued to Sri Lankan diaspora and migrant workers from 2009, the international sovereign bonds and outstanding defense loans

(4) Excluding outstanding Treasury bills issued to foreign investors from 2008 and Sri Lankan diaspora and migrant workforce from 2009

(5) Excluding outstanding Treasury bonds issued to foreign investors from 2007 and Sri Lankan diaspora and migrant workforce from 2009

(6) Excludes contributions to international financial organizations

(7) Includes administrative borrowings arising from foreign loans channeled through government or semi-government agencies and outstanding Offshore Banking Units (OBUs).

(8) Provisional

OWNERSHIP OF OUTSTANDING FOREIGN DEBT[1]

Source	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011[1]	2011[1]	2012[1]	% increase or decrease
Multilateral	**580,719**	**618,181**	**665,040**	**674,936**	**721,916**	**699,703**	**839,412**	**20.0**
ADB	292,151	317,763	344,661	358,872	383,461	369,180	442,592	19.9
EIB	15,326	18,010	20,463	18,792	18,054	20,114	23,849	18.6
IBRD	231	240	—	—	—	—	—	—
IDA	258,748	267,475	284,074	281,217	302,244	293,678	351,666	19.7
IFAD	8,719	9,052	10,309	11,032	13,007	11,739	15,188	29.4
OPEC	2,357	2,355	2,173	1,913	2,052	1,797	2,640	46.9
Nordic Development Fund	3,188	3,285	3,360	3,110	3,099	3,195	3,478	8.9
Bi-lateral	**564,500**	**666,533**	**684,750**	**739,213**	**842,804**	**724,991**	**944,402**	**30.3**
Canada	9,852	7,718	8,488	8,134	7,701	8,025	8,583	7.0
France[2]	10,255	12,424	15,021	18,427	19,503	20,267	21,988	8.5
Germany	65,977	61,528	58,279	50,263	47,547	53,824	52,804	(1.9)
India	14,843	15,294	17,902	17,292	41,927	25,243	58,720	132.6
Japan	327,711	426,936	426,767	478,931	529,013	477,844	619,443	29.6
Kuwait	3,855	4,649	5,103	5,237	5,799	5,562	6,759	21.5
Netherlands	1,455	751	291	87	—	94	—	—
People's Republic of China	22,688	29,688	46,641	56,459	59,497	57,181	68,358	19.5
Saudi Arabian Fund	749	1,217	2,328	2,338	2,544	2,255	2,829	25.4
USA	52,797	50,708	46,952	42,414	40,318	41,287	45,958	11.3
Other	54,339	55,619	56,978	59,633	88,957	33,409	58,959	76.5
Financial Markets	**181,268**	**164,020**	**410,677**	**610,433**	**764,560**	**646,493**	**975,866**	**51.0**
Riggs National Bank	3,746	3,674	3,476	3,140	2,984	3,031	3,372	11.3
Indo-Suez Bank (France and Stockholm)	16	—	—	—	—	—	—	—
Bankers' Trust Co	685	634	560	466	399	384	370	(3.7)
France	—	—	—	—	—	—	—	—
Solomon Bros. Inc. — New York	462	374	270	157	54	156	62	(59.9)
Citi Bank/NEXI	24,637	11,314	—	—	—	—	—	—
Other[3]	151,722	148,024	406,370	606,670	761,124	650,456	971,105	49.3
International Sovereign bonds	54,360	56,570	114,384	221,906	341,704	219,524	396,494	80.6
Non-resident investments								
in Treasury bills	—	6,358	40,410	57,317	70,123	65,505	97,901	49.5
in Treasury bonds	49,647	17,647	145,124	183,538	199,531	185,792	233,147	25.5
Other[3]	47,715	67,449	106,452	143,909	149,766	172,101	244,518	42.1
Total	**1,326,487**	**1,448,734**	**1,760,467**	**2,024,583**	**2,329,280**	**2,071,187**	**2,759,680**	**33.2**

Source: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Provisional

(2) Includes loans from Financial Institutions

(3) Includes outstanding defense loans

Direct Domestic Debt of the Issuer

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

OUTSTANDING DIRECT DOMESTIC DEBT OF THE ISSUER

	As of December 31,							As of May 31,			
	2005	2006	2007	2008	2009	2010	2011(1)	2011(1)	2011(1)	2012(1)	% increase or decrease
	(in Rs. millions)							(in US$ millions)	(in Rs. millions)	(in Rs. millions)	
Loans											
Direct	—	—	—	—	—	—	—	—	—	—	—
Assumed(2)	39,746	49,015	60,679	76,308	73,881	77,879	94,743	899	98,662	112,751	12.5
Total loans	39,746	49,015	60,679	76,308	73,881	77,879	94,743	899	98,662	112,751	12.5
Securities											
Treasury bills	234,174	257,732	307,012	402,600	441,032	514,442	590,885	5,490	602,639	693,991	13.2
Treasury notes/bonds	751,569	885,972	1,018,852	1,281,978	1,513,512	1,643,887	1,819,251	15,465	1,697,425	1,985,502	14.5
Total securities	985,743	1,143,704	1,325,864	1,684,578	1,954,543	2,158,328	2,410,136	20,955	2,300,064	2,679,494	14.2
Others	204,233	286,511	328,655	379,342	372,531	329,454	299,206	3,015	330,940	350,275	5.5
Total debt	1,265,722	1,479,230	1,715,198	2,140,228	2,400,955	2,565,662	2,804,085	24,869	2,729,667	3,142,520	13.1

Source: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

(1) Provisional

(2) Central Bank Advances

PROFILE OF COUNTRY'S DOMESTIC DEBT

	As of December 31,					As of May 31,	
	2007	2008	2009	2010	2011(1)	2011(1)	2012(2)
	(in Rs. millions)						
By Domestic Debt	1,715,198	2,140,228	2,400,955	2,565,662	2,804,085	2,729,667	3,142,520
By Maturity							
Short Term	363,199	516,364	560,646	619,549	698,190	733,680	835,896
Medium and Long-term	1,351,999	1,623,863	1,840,309	1,946,113	2,105,895	1,995,987	2,306,624
By Currency							
Domestic Currency	1,534,808	1,949,463	2,207,382	2,371,939	2,603,155	2,533,072	2,903,887
Foreign Currency	180,390	190,765	193,573	193,723	200,930	196,594	238,633
By Ownership							
Bank	415,318	657,424	705,765	691,716	886,221	764,757	1,061,356
Non-Bank	1,299,879	1,482,804	1,695,189	1,873,945	1,917,864	1,964,909	2,081,163

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

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

DIRECT DOMESTIC DEBT SERVICE REQUIREMENTS OF THE ISSUER

Year	Principal Repayments	Interest Payments	Total
		(in Rs. millions)	
2005	203,347	113,164	316,511
2006	247,536	133,787	381,323
2007	251,900	158,701	410,601
2008	258,720	182,198	440,918
2009	403,723	273,977	677,701
2010	389,672	297,127	686,800
2011	439,894	288,134	728,028
2012(1)	446,170	332,187	778,356
2013(2)	570,228	244,059	814,287
2014(3)	307,227	141,963	449,190
2015(3)	363,328	123,738	487,066
2016(3)	173,947	86,035	259,982

Source: Central Bank of Sri Lanka

Notes:

(1) Provisional

(2) Estimates

(3) Current debt obligations as at end May 2012. These figures will increase with future borrowings. Maturing OBU loans have been considered as rollovers.

Direct External Debt of the Issuer

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

OUTSTANDING DIRECT EXTERNAL DEBT OF THE ISSUER

	As of December 31,					As of May 31,		
	2007	2008	2009	2010	2011(1)	2010(1)	2011(1)	% increase or decrease
				(in millions, except for percentages)				
Loans (Rs.)								
Multilateral	580,719	618,106	656,680	711,899	721,916	699,703	839,412	20.0
Bilateral	541,469	636,643	665,040	674,936	796,509	724,991	944,402	30.3
Commercial and Export Credit	204,299	193,984	438,747	637,748	810,856	646,493	975,866	51.0
Total loans	1,326,487	1,448,734	1,760,467	2,024,583	2,329,280	2,071,187	2,759,680	33.2
Exchange Rate	108,7194	113,1398	114,3844	110.9530	113.9013	109.7618	132.1647	20.4
Loans (US$)								
Multilateral	5,341	5,463	5,741	6,416	6,338	6,375	6,351	(0.4)
Bilateral	4,980	5,627	5,814	6,083	6,993	6,605	7,146	8.2
Commercial and Export Credit	1,879	1,715	3,836	5,748	7,119	5,959	7,384	23.9
Total loans	12,201	12,805	15,391	18,247	20,450	18,938	20,881	10.3

Source: Ministry of Finance and Planning

Note:

(1) Provisional

The following table sets out, by designated currency and the equivalent amount in US dollars, the outstanding direct external debt of the Issuer as of May 31, 2012.

SUMMARY OF OUTSTANDING DIRECT EXTERNAL DEBT BY THE ISSUER BY CURRENCY (AS OF MAY 31, 2012)

Currency	in Rupees	in Foreign Currency	in US$	% of Disbursed Outstanding Debt
	(in millions, except for percentages)			
Saudi Riyal	2,829	80	21	0.1
Euro	168,198	1,029	1,273	6.1
Yuan Renminbi	22,560	1,088	171	0.8
Pound Sterling	139	1	1	0.0
Won(000's)	29,534	264	223	1.1
Sri Lanka Rupee	331,049		2,505	12.0
Norwegian Krone	23	1	0	0.0
French Franc	5	0	0	0.0
Kuwaiti Dinar	6,759	14	51	0.2
Yen(000's)	653,607	390	4,945	23.7
Canadian Dollar	8,583	67	65	0.3
Special Drawing Rights	691,623	3,463	5,233	25.1
Swedish Krona	1,047	57	8	0.0
Danish Krone	568	26	4	0.0
US Dollar	843,157	6,380	6,380	30.6
Total	**2,759,680**	**12,859**	**20,881**	**100.0**

Source: Central Bank of Sri Lanka

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

DIRECT EXTERNAL DEBT SERVICE REQUIREMENTS OF THE ISSUER

Year	Average Rate (Rs.)	Principal		Interest		Total	
		(in millions, except for percentages)					
		Rs.	US$	Rs.	US$	Rs.	US$
2005	100.4990	21,360	213	6,995	70	28,355	282
2006	103.9623	45,989	442	16,990	163	62,979	606
2007	110.6232	65,934	596	23,980	217	89,913	813
2008	108.3338	121,609	1,123	30,277	279	151,886	1,402
2009	114.9448	114,716	998	35,698	311	150,413	1,309
2010	113.0647	78,184	691	55,464	491	133,648	1,182
2011(1)	110.5652	98,789	893	68,565	620	167,354	1,514
2012(2)(4)	132.1647	148,184	1,121	61,525	466	209,709	1,587
2013(3)	132.1647	115,261	872	62,270	471	177,531	1,343
2014(3)	132.1647	130,525	988	64,338	487	194,863	1,474
2015(3)(5)	132.1647	218,450	1,653	61,023	462	279,472	2,115
2016(3)	132.1647	154,382	1,168	55,975	424	210,357	1,592

Source: Central Bank of Sri Lanka

Notes:

(1) Provisional

(2) Estimates

(3) Current debt obligations as at end of May 2012. These figures will increase with future borrowings

(4) Includes repayment of US$500 million international sovereign bonds issued in 2007

(5) Includes repayment of US$500 million international sovereign bonds issued in 2009

Government Guaranteed Debt

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

SUMMARY OF OUTSTANDING PUBLIC COOPERATION AND PRIVATE SECTOR WITH GOVERNMENT GUARANTEES

	As of December 31,				
	2007	2008	2009	2010	2011(1)
Domestic	—	—	—	—	—
External (in Rs. millions)	37,501	28,429	12,608	57,398	73,581
(converted in US$ millions)	345	251	110	517	646
Total (in Rs. millions)	37,501	28,429	12,608	57,398	73,581

Source: Central Bank of Sri Lanka

Note:

(1) Provisional

Payment History of Foreign Debt

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

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

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

As of June 30, 2012, the Issuer had US$4,655.6 million in aggregate outstanding principal balance of foreign currency bonds (including the international sovereign bonds issued in 2007, 2009, 2010 and 2011).

DESCRIPTION OF THE BONDS

The Bonds will be issued pursuant to an indenture (the "Indenture") to be dated as of July 25, 2012 between the Issuer and HSBC Bank USA, National Association as trustee for the Holders of the Bonds (the "Trustee") and as registrar, paying and transfer agent. The following is a summary of the material provisions of the Bonds and the Indenture. This summary does not purport to be complete and is qualified in its entirety by reference to all of the provisions of the Indenture and the Bonds. It does not restate those agreements in their entirety. Whenever particular sections or defined terms of the Indenture not otherwise defined herein are referred to, such sections or defined terms are incorporated herein by reference.

General

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

Principal, Interest and Maturity

The Bonds will be issued in an aggregate principal amount of US$1,000,000,000 and will mature on July 25, 2022 (the "Maturity Date"). Interest on the Bonds will be payable semi-annually in arrears on January 25 and July 25 of each year, commencing on January 25, 2013 (each, an "Interest Payment Date") to persons in whose names the Bonds are registered at the close of business on the fifteenth calendar day preceding each Interest Payment Date. The Bonds will bear interest at the rate of 5.875% per annum from and including July 25, 2012 or from the most recent Interest Payment Date to which interest has been paid or provided to, and to and excluding, the Maturity Date. Interest on the Bonds will be calculated on the basis of a 360-day year consisting of twelve 30-day months. Unless previously purchased or cancelled as described herein, the Bonds shall mature on the Maturity Date, and on the Maturity Date, the Holders of the Bonds shall be entitled to a payment equal to the principal amount of the Bonds outstanding on the Maturity Date plus accrued and unpaid interest. The Bonds will not be redeemable prior to maturity and will not be entitled to the benefit of any sinking fund.

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

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

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

Additional Amounts

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

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

- the Holder or beneficial owner is connected with Sri Lanka other than by merely owning the Bonds or receiving income or payments on the Bonds; or

- upon reasonable request by the Issuer or its agent, the Holder or beneficial owner failed to comply with any certification, identification or other reporting requirement concerning the Holder's or beneficial owner's nationality, residence, identity or connection with Sri Lanka, if compliance with such requirement is required by any statute or regulation of Sri Lanka as a precondition to exemption from withholding or deduction of Taxes; or

- the Holder failed to present its Bonds for payment (where presentation is required) within 30 days of when the payment is due or when the Issuer makes available to the Holder or the Trustee a payment of principal or interest, whichever is later. Nevertheless, the Issuer will pay additional amounts to the extent the Holder would have been entitled to such amounts had it presented its Bonds for payment on the last day of the 30 day period; or

- any combination of the above.

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

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

Further Issues

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

Limitation on Liens

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

Certain Definitions

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

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

(a) an obligation to pay or purchase such Indebtedness;

(b) an obligation to lend money, to purchase or subscribe for shares or other securities or to purchase assets or services, in order to provide funds for the payment of such Indebtedness;

(c) any indemnity against the consequences of a default in the payment of such Indebtedness; or

(d) any other agreement to be responsible for such Indebtedness;

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

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

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

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

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

Exceptions

The following exceptions apply to the Issuer's obligations under "— Limitation on Liens":

(a) any Lien upon property to secure Public External Indebtedness incurred for the purpose of financing the acquisition of such property and any renewal and extension of such Lien which is limited to the original property covered thereby and which (in either case) secures any renewal or extension of the original secured financing;

(b) any Lien existing on any property or asset at the time of its acquisition (or arising after its acquisition pursuant to an agreement entered into prior to, and not in contemplation of, such acquisition), and extensions and renewals of such Lien limited to the original property or asset covered thereby and securing any extension or renewal of the original secured financing;

(c) any Lien arising by operation of law, *provided* that any such Lien is not created or permitted to be created by the Issuer to secure any Public External Indebtedness; and

(d) any Lien securing Public External Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction or development of a project; provided that (i) the holders of such Public External Indebtedness expressly agree to limit their recourse to the assets and revenues of such project or the proceeds of insurance thereon as the principal source of repayments of such Public External Indebtedness and (ii) the property over which such Lien is granted consists solely of such assets and revenues.

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

Events of Default

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

(1) Non-payment

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

(2) Breach of other obligations

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

(3) Cross-default

(a) any External Indebtedness shall become (or shall become capable of being declared) due and payable prior to its stated maturity (otherwise than at the option of the Issuer); or

(b) any default shall occur in the payment of principal of, or premium or prepayment charge (if any) or interest on, any External Indebtedness when and as the same shall become due and payable if such default shall continue for more than the period of grace, if any, originally applicable thereto; or

(c) any default shall occur in the payment when due and called upon (after the expiry of any originally applicable grace period) of any Guarantee of the Issuer in respect of any External Indebtedness of any other person, *provided* that the aggregate amount of the relevant External Indebtedness in respect of which one or more of the events mentioned in this paragraph (3) have occurred equals or exceeds US$25.0 million (or its equivalent in any other currency or currencies), or

(4) Moratorium

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

(5) IMF Membership

The Issuer shall cease to be a member of the International Monetary Fund (the "IMF") or shall cease to be eligible to use the general resources of the IMF, or

(6) Validity

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

(7) Revocation of Authority

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

(8) International Monetary Assets

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

If any of the above Events of Default occurs and is continuing, then the Holders of not less than 25.0% in aggregate principal amount of the Bonds then Outstanding by notice in writing to the Trustee at its specified office may declare the principal amount of all such Bonds to be immediately due and payable whereupon they shall become immediately due and payable at their principal amount together with accrued interest without further formality unless such Event of Default shall have been remedied prior to the receipt of such notice by the Trustee.

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

Definition

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

Redemption, Repurchase and Cancellation

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

Modifications and Amendments; Meetings of Holders

A meeting of the Holders may be called by the Trustee at any time. The Issuer or the Holders of at least 10.0% in aggregate principal amount of the Outstanding Bonds may call a meeting if the Issuer or such Holders have requested the Trustee in writing to call such a meeting and the Trustee has not given notice of such a meeting within 20 days of receiving the request. Notices of meetings must include the time and place of the meeting and a general description of the action proposed to be taken at the meeting and must be given not less than 30 days nor more than 60 days before the date of the meeting, except that notices of meetings reconvened after adjournment must be given not less than 10 days nor more than 60 days before the date of the meeting. Any modifications to or waivers in respect of the Indenture or the Bonds will be conclusive and binding on all Holders, whether or not they have given their consent (unless required under the Indenture) or were present at any duly held meeting.

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

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

- add covenants of the Issuer that benefit the Holders;

- surrender any right or power conferred upon the Issuer;

- secure the Bonds;

- cure any ambiguity or correct or supplement any defective provision in the Indenture or the Bonds; or

- amend the Indenture or the Bonds in any other manner which the Issuer and the Trustee may determine and which are not inconsistent with the provisions of the Bonds and will not adversely affect the interests of any Holder in any material respect.

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

The Issuer and the Trustee may modify, amend, supplement or waive the terms of the Bonds or, insofar as respects the Bonds, the Indenture in any way, other than a modification, amendment, supplement or waiver constituting a Reserved Matter, and the Holders may make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided by the Indenture or the Bonds to be made, given or taken by Holders, other than a waiver or other action constituting a Reserved Matter, (1) at any meeting of Holders duly called and held as specified above, upon the affirmative vote, in person or (in the case of registered owners of the Bonds) by proxy thereunto duly authorized in writing, of the Holders of not less than 66 2/3% of the aggregate principal amount of the Bonds then Outstanding represented at such meeting (or of such other percentage as may be set forth in the text of the Bonds with respect to the action being taken) or (2) with the written consent of the Holders of not less than 66 2/3% of the aggregate principal amount of the Bonds then Outstanding (or of such other percentage as may be set forth in the text of the Bonds with respect to the action being taken).

The Issuer and the Trustee may make any modification, amendment, supplement or waiver of the Indenture or the terms and conditions of the Bonds that constitutes a Reserved Matter, (1) at any meeting of Holders duly called and held as specified above, upon the affirmative vote, in person or (in the case of registered owners of the Bonds) by proxy thereunto duly authorized in writing, of the Holders of not less than 75.0% of the aggregate principal amount of the Bonds then Outstanding (for the avoidance of doubt, not of only the Outstanding Bonds represented at such meeting but of all the Bonds Outstanding at that time), or (2) with the written consent of the owners of not less than 75.0% of the aggregate principal amount of the Bonds then Outstanding.

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

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

Waiver of Certain Covenants

The Issuer may omit in any particular instance to comply with any covenant or condition set forth under "Limitation on Liens" if before the time for such compliance the Holders of at least a majority in principal amount of the Outstanding Bonds shall, in accordance with the terms of the Indenture, either waive such compliance in such instance or generally waive compliance with such covenant or condition, but no such waiver shall extend to or affect such covenant or condition except to the extent so expressly waived, and, until such waiver shall become effective, the obligations of the Issuer and the duties of the Trustee in respect of any such covenant or condition shall remain in full force and effect.

The Issuer will not, directly or indirectly, pay or cause to be paid any consideration, whether by way of interest, fee or otherwise, to any Holder for or as an inducement to any consent, waiver or amendment of any of the terms or provisions of the Indenture or of the Bonds unless such consideration is offered to be paid or agreed to be paid to all Holders that consent, waive or agree to amend in the time frame set forth in the solicitation documents relating to such consent, waiver or agreement.

Notices

Where the Indenture provides for notice to Holders of any event, such notice shall be sufficiently given (unless otherwise expressly provided in the Indenture) (a) for so long as the Securities are represented by a Global Security held on behalf of The Depository Trust Company ("DTC"), if sent electronically to DTC (or its representatives) or (b) if the Securities are not represented by a Global Security held on behalf of DTC, if in writing and mailed, first-class postage prepaid, to each Holder affected by such event, at his address as it appears in the Security Register and published once in a leading daily newspaper of general circulation in London and in a leading daily newspaper of general circulation in the United States or, under certain limited circumstances, in other English language newspapers of general circulation in Europe or the United States. Any such Notice shall be deemed to have been given on the later of the date of such publication and the seventh day after being so mailed, as the case may be.

Trustee; Paying Agent; Transfer Agent

The Trustee may resign at any time or may be removed by act of the Holders of a majority in principal amount of the Outstanding Bonds. If the Trustee resigns, is removed or becomes incapable of acting as Trustee or if a vacancy occurs in the office of the Trustee for any reason, a successor Trustee will be appointed in accordance with the provisions of the Indenture.

The corporate trust office of the Trustee as of the date hereof is located at 452 Fifth Avenue, New York, NY 10018-2706, United States.

The Paying Agent and Transfer Agent are appointed in accordance with the Indenture and, as initially appointed, are set forth on the inside back cover hereof.

Governing Law and Jurisdiction

The Bonds and the Indenture will be governed by and construed in accordance with the law of the State of New York. The Issuer will submit to the non-exclusive jurisdiction of any State or Federal Court in the Borough of Manhattan, the City of New York and the courts of Sri Lanka (the "Specified Courts") in any action arising out of or based on the Bonds brought by any Holder of a Bond (a "Related Proceeding"). The Issuer will waive any objection to Related Proceedings in such courts whether on the grounds of venue, residence or domicile or on the ground that the Related Proceedings have been brought in an inconvenient forum. The Issuer will agree that a final non-appealable judgment obtained in any such Related Proceeding (a "Related Judgment") shall be conclusive and binding upon it and, may be enforced in any Specified Court or in any other courts to the jurisdiction of which the Issuer is or may be subject (the "Other Courts"), by a suit upon such judgment or appropriate enforcement proceedings in Sri Lanka.

Waiver of Immunity

To the extent that the Issuer or any of its revenues, assets or properties are entitled, in any jurisdiction in which any Specified Court is located, in which any Related Proceeding may at any time be brought against it or any of its revenues, assets or properties, or in any jurisdiction in which any Specified Court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any Related Judgment, to any immunity from suit, from the jurisdiction of any such court, from attachment prior to judgment, from attachment in aid of execution of a judgment, from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the Issuer will irrevocably agree not to claim and will irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction (and will consent generally for the purposes of the U.S. Foreign Sovereign Immunities Act of 1976, as amended, to the giving of any relief or the issue of any process in connection with any Related Proceeding or Related Judgment). The waiver of immunities given above constitutes only a limited and specific waiver for the purposes of the Bonds and under no circumstances shall it be interpreted as a general waiver by the Issuer or a waiver with respect to proceedings unrelated to the payment under the Bonds. The Issuer will not waive such immunity in respect of property which is (i) used by a diplomatic or consular mission of the Issuer (except as may be necessary to effect service of process), (ii) property of a military character and under the control of a military authority or defense agency or (iii) located in Sri Lanka and dedicated to a public or governmental use (as distinct from patrimonial property or property dedicated to a commercial use).

The Global Bonds

The Bonds sold outside the United States in offshore transactions (the "Regulation S Bonds") in reliance on Regulation S under the Securities Act, subject to certain exceptions, will be represented by one or more global Bonds in fully registered form, without coupons (collectively, the "Regulation S Global Bonds").

The Regulation S Global Bonds will be registered in the name of a nominee of DTC and deposited with a custodian for DTC for the accounts of Euroclear and Clearstream, Luxembourg.

The Bonds sold in reliance on Rule 144A under the Securities Act (the "Rule 144A Bonds"), subject to certain exceptions, will be represented by one or more global certificates in fully registered form, without coupons (collectively, the "Rule 144A Global Bonds," and together with the Regulation S Global Bonds, the "Global Bonds").

The Rule 144A Global Bonds will be registered in the name of a nominee of DTC and deposited with HSBC Bank USA, National Association as custodian for DTC. The Rule 144A Global Bonds will be subject to certain restrictions on transfer as set forth in a legend appearing thereon as described in "Notice to Investors."

Interests in a Rule 144A Global Bond may be transferred to a person who takes delivery in the form of an interest in a Regulation S Global Bond only upon receipt by the Trustee of, among other things, a written certification (in the form provided for in the Indenture) from the transferor.

Any interest in one Global Bond will, upon transfer and delivery in the form of an interest in another Global Bond, cease to be an interest in the first Global Bond and become an interest in the other Global Bond and, accordingly, will thereafter be subject to all of its transfer restrictions and other procedures for as long as it remains such an interest. Interests in the Bonds represented by such Global Bonds will be shown on and transfers thereof will be effected only through, records maintained by DTC, Euroclear and Clearstream, Luxembourg, and their respective direct and indirect participants.

DTC, as registered Holder of such Global Bond, will be considered the sole owner or Holder of the Bonds represented by such Global Bond for all purposes under such Bonds and the Indenture, unless otherwise provided therein.

Payments of principal and interest on any Global Bond will be made in accordance with the settlement and clearing procedures of DTC. None of the Issuer, the Trustee or any Paying Agent or Transfer Agent will have any responsibility or liability for any aspect of any participant's records, policies or procedures relating to, or for payments made on account of, beneficial interests in a Global Bond or for any other aspect of the relationship between DTC, Euroclear or Clearstream, Luxembourg, as the case may be, and their participants, or for maintaining, supervising or reviewing any records relating to such beneficial interests.

All payments on principal and interest on the Global Bonds will be made in immediately available funds.

The Issuer expects that DTC or its nominee, upon receipt of any payment of principal or interest, will credit participants' accounts with payments in amounts proportionate to their respective beneficial interests in the principal amount of such Global Bonds as shown on the records of DTC. The Issuer also expects that the payments by participants to owners of beneficial interests in such Global Bonds held through such participants will be governed by standing instructions and customary practices, as is now the case with securities held for the account of customers registered in "street names," and will be the responsibility of such participants.

Depositary Procedures

The following description of the operations and procedures of DTC, Euroclear and Clearstream, Luxembourg are provided solely as a matter of convenience. These operations and procedures are solely within the control of the respective settlement systems and are subject to change by them from time to time. The Issuer and the Trustee take no responsibility for these operations and procedures and urge investors to contact the system or their participants directly to discuss these matters.

DTC, Euroclear and Clearstream, Luxembourg have advised the Issuer as follows:

DTC. The Issuer understands that DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions among its participants in such securities through electronic book entry changes in accounts of its participants, thereby eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations, some of whom own DTC, and may include the Initial Purchasers. Indirect access to the DTC system is also available to others that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly. Transfers of ownership or other interests in Bonds held by DTC may be made only through DTC participants. In addition, beneficial owners of Bonds held by DTC will receive all distributions of principal of and interest on the Bonds from the Trustee through such DTC participant.

Euroclear. Euroclear advises that it was created in 1968 to hold securities for its participants and to clear and settle transactions between its participants through simultaneous electronic book entry delivery against payment, thereby eliminating the need for physical movement of securities certificates and any risk from lack of simultaneous transfers of securities and cash. Euroclear provides various other services, including securities lending and borrowing, and interfaces with domestic markets in several countries. Euroclear is operated by the Brussels, Belgium office of Morgan Guaranty Trust Company of New York (the "Euroclear Operator"), under contract with Euroclear Clearance Systems, S.C., a Belgian cooperative corporation (the "Cooperative"). All operations are conducted by the Euroclear Operator, and all Euroclear securities clearance accounts and Euroclear cash accounts are accounts with the Euroclear Operator, not the Cooperative. The Cooperative establishes policy for Euroclear on behalf of Euroclear participants. Euroclear participants include banks (including central banks), securities brokers and dealers and other professional financial intermediaries and may include the Initial Purchasers. Indirect access to Euroclear is also available to others that clear through or maintain a custodial relationship with a Euroclear participant, either directly or indirectly.

The Euroclear Operator is the Belgian branch of a New York banking corporation which is a member bank of the United States Federal Reserve System. As such, it is regulated and examined by the Board of Governors of the United States Federal Reserve System and the New York State Banking Department, as well as the Belgian Banking Commission.

Bonds clearance accounts and cash accounts with the Euroclear Operator are governed by the Terms and Conditions Governing Use of Euroclear and the related Operating Procedures of the Euroclear System, and applicable Belgian law (collectively, the "Terms and Conditions"). The Terms and Conditions govern transfers of securities and cash within Euroclear, withdrawals of securities and cash from Euroclear, and receipts of payments with respect to securities in Euroclear. All securities in Euroclear are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts. The Euroclear Operator acts under the Terms and Conditions only on behalf of Euroclear participants and has no record of or relationship with persons holding through Euroclear participants.

Distributions with respect to Bonds held beneficially through Euroclear will be credited to the cash accounts of Euroclear participants in accordance with the Terms and Conditions, to the extent received by Euroclear.

Clearstream, *Luxembourg*. Clearstream, Luxembourg advises that it is incorporated under the laws of The Grand Duchy of Luxembourg as a professional depositary. Clearstream, Luxembourg holds securities for its participants and facilitates the clearance and settlement of securities transactions between its participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of securities certificates. Clearstream, Luxembourg provides to its participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream, Luxembourg interfaces with domestic markets in several countries. As a professional depositary, Clearstream, Luxembourg is subject to regulation by the Luxembourg Monetary Institute. Clearstream, Luxembourg participants are financial institutions around the world, including securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations and may include the Initial Purchasers. Indirect access to Clearstream, Luxembourg is also available to others that clear through or maintain a custodial relationship with a Clearstream, Luxembourg participant either directly or indirectly.

Distributions with respect to Bonds held beneficially through Clearstream, Luxembourg will be credited to cash accounts of Clearstream, Luxembourg participants in accordance with its rules and procedures, to the extent received by Clearstream, Luxembourg.

Settlement and Clearance

Initial settlement for the Bonds will be made in same-day funds. Transfers between participants in DTC will be effected in accordance with DTC's procedures, which currently provide for settlement in same-day funds. Transfers between participants in Euroclear and Clearstream, Luxembourg will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Ownership of beneficial interests in a Global Bond will be limited to persons who have accounts with DTC participants or persons who hold interests through participants. Upon the issuance of a Global Bond, DTC or its custodian will credit, on its internal system, the respective principal amount of the beneficial interests represented by such Global Bond to the accounts of its participants. Such account initially will be designated by or on behalf of the Initial Purchasers. Ownership of beneficial interests in a Global Bond will be shown only on and the transfer of such ownership interests will be effected only through, records maintained by DTC or its nominee (with respect to interests of participants), or by any such participant (with respect to interests of persons held by such participants on their behalf). Payments, transfers, exchanges and other matters relating to beneficial interests in a Global Bond may be subject to various policies and procedures adopted by DTC, Euroclear or Clearstream, Luxembourg, as the case may be, from time to time.

Subject to compliance with the transfer restrictions applicable to the Bonds described above and under "Notice to Investors" below, cross-market transfers of Bonds between DTC, on the one hand, and Euroclear or Clearstream, Luxembourg, on the other hand, will be effected in DTC in accordance with DTC rules on behalf of Euroclear or Clearstream, Luxembourg, as the case may be, by its respective depositary; however, such cross-market transactions will require delivery instructions to Euroclear or Clearstream, Luxembourg, as the case may be, by the counterpart in such system in accordance with its rules and procedures and within its established deadlines (Brussels time). Each of Euroclear or Clearstream, Luxembourg, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to its respective depositary to take action to effect final settlement on its behalf by delivering or receiving interests in the Regulation S Global Bonds in DTC, and making or receiving payment in accordance with normal procedures for same-day funds settlement applicable to DTC. Clearstream, Luxembourg accountholders and Euroclear accountholders may not deliver instructions directly to the depositaries for Clearstream, Luxembourg or Euroclear.

Because of time zone differences, the securities account of a Euroclear or Clearstream, Luxembourg accountholder purchasing an interest in the Bonds from a DTC participant will be credited during the securities settlement processing day (which must be a business day for Euroclear and Clearstream, Luxembourg) immediately following the DTC settlement date, and such credit of any transactions in interests in a Global Bond settlement during such processing day will be reported to the relevant Euroclear or Clearstream, Luxembourg accountholder on such day. Cash received in Euroclear or Clearstream, Luxembourg as a result of sales of interests in a Global Bond by or through a Euroclear or Clearstream, Luxembourg accountholder to a DTC participant will be received with value on the DTC settlement date but will be available in the relevant Euroclear or Clearstream, Luxembourg cash account only as of the business day following settlement in DTC. Settlement between Euroclear or Clearstream, Luxembourg accountholders and DTC participants cannot be made on a delivery versus payment basis. The arrangements for transfer of payments must be established separately from the arrangements for transfer of securities, the latter being effected on a free delivery basis. The customary arrangements for delivery versus payment between Euroclear and Clearstream, Luxembourg accountholders or between DTC participants are not affected.

Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the procedures described above in order to facilitate transfers of interests in the Global Bonds among participants of DTC, Euroclear and Clearstream, Luxembourg, they are under no obligation to perform or continue to perform such procedures and such procedures may be modified or discontinued at any time. None of the Issuer, the Trustee or any of their respective agents will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their respective participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

Definitive Bonds

Beneficial interests in any Global Bond may be exchanged for definitive (i.e., non-global) Bonds in fully registered form, without coupons (collectively, the "Definitive Bonds" and each, a "Definitive Bond") only in the event that (1) DTC notifies the Issuer in writing at any time that DTC is unwilling or unable to continue as depositary or ceases to be a "clearing agency" registered under the Exchange Act, and a successor is not appointed by the Issuer within 90 days after the Issuer is notified by DTC or (2) the Bonds have become immediately due and payable pursuant to the Indenture.

Payment of the principal of any Definitive Bond shall be made, upon presentation and surrender of such Bond, by check drawn on a bank in The City of New York at the option of the Holder, either:

(a) at the corporate trust office of the Trustee, or

(b) subject to any applicable laws or regulations and the right of the Issue to terminate the appointment of any Paying Agent, at the offices of such other paying agents as the Issuer may designate from time to time.

Unless the manner of payment is otherwise agreed by the Issuer and the Trustee, payments of interest on any Definitive Bond shall be made solely in Dollars by check drawn on a bank in The City of New York, mailed to the address of the person entitled thereto as such address shall appear on the Security Register. The Issuer and the Trustee may deem and treat the Holder in whose name a Definitive Bond is registered at the close of business on the fifteenth day preceding such Interest Payment Date as the absolute owner of the Definitive Bond (notwithstanding any notice of ownership or other writing on such Definitive Bond) for the purposes of receiving payment on such Definitive Bond or on account of such Definitive Bond and for all other purposes.

The Holders of Definitive Bonds shall present directly at the corporate trust office of the Trustee or of any other Transfer Agent, all requests for the registration of any transfer of such Definitive Bonds, for the exchange of such Definitive Bonds for one or more new Definitive Bonds in the like aggregate principal amount and in authorized denominations and for the replacement of such Definitive Bonds in cases of mutilation, destruction, loss or theft. Every certificate representing Definitive Bonds presented or surrendered for registration of transfer or for exchange shall be duly endorsed, or be accompanied by a written instrument of transfer in form satisfactory to the Issuer and the Trustee, duly executed by the Holder thereof or his attorney duly authorized in writing. The registration of any transfer of Definitive Bonds in the Security Register is also subject to any reasonable requirements of the Issuer and the Trustee. Except for the expenses of delivery other than by regular mail, no service charge shall be made for any exchange or registration of transfer, but the Issuer may require payment of a sum sufficient to cover any stamp tax or other Governmental charge payable in connection therewith.

The Indenture provides that Definitive Bonds will be issued to replace Definitive Bonds which have been mutilated, destroyed, stolen or lost upon payment of certain costs associated with such replacement and on certain terms as to evidence and indemnity. In the case of destroyed, stolen or lost Definitive Bonds, replacement Definitive Bonds will not be issued if either the Issuer or the Trustee has notice that such Definitive Bonds have been acquired by a bona fide purchaser. Mutilated Definitive Bonds must be surrendered before replacements will be issued. In the event any such mutilated, destroyed, stolen or lost Definitive Bond has become or is about to become due and payable, the issuer in its discretion may, instead of issuing a new Definitive Bond, pay or cause to be paid such Definitive Bond.

All Definitive Bonds issued as a result of any partial or whole transfer, exchange or replacement of Bonds will be delivered to the Holder at the corporate trust office of the Issuer or at the office of any such other Transfer Agent as the Issuer may designate from time to time, or (at the risk of the Holder) sent by mail to such address as is specified by the Holder in the Holder's request for transfer, exchange or replacement.

Restrictions on Transfer

The Bonds may not be sold or otherwise transferred except as described above under "— The Global Bonds" and "— Definitive Bonds."

TAXATION

Sri Lankan Taxation

Income tax

The relevant taxation laws of Sri Lanka are embodied in the Inland Revenue Act No. 10 of 2006 (as amended) ("the Inland Revenue Act").

Under the Inland Revenue Act, income tax is charged in respect of the profits and income of every person. For the purposes of the Act "profits and income" in the current instance means, inter alia, interest and discounts.

Persons *resident in Sri Lanka* are subject to income tax on their worldwide income. A company is considered to be a resident company if its registered or principal office is in Sri Lanka or if the control and management of its business are exercised in Sri Lanka. An individual who is physically present in Sri Lanka for a period of one hundred and eighty three days or more during a year of assessment is deemed to be a resident in Sri Lanka for that year of assessment. Also, an individual who is deemed to be resident for two or more consecutive years of assessment is deemed to be resident until such time as he is absent from Sri Lanka for a continuous period of twelve months.

In the case of persons who are *not resident in Sri Lanka*, any profits and income arising in or derived from Sri Lanka generally are subject to income tax in Sri Lanka. Where interest is payable to a non-resident person on a loan made by such person and the interest on such loan is borne, directly or indirectly, by a person resident in Sri Lanka, such interest is deemed to be profits and income arising in or derived from Sri Lanka.

However, the Inland Revenue Act provides for an exemption from income tax in respect of any interest or discount accrued to or earned by any non-resident person on any sovereign bond issued by the Government of Sri Lanka (the term "person" includes a company or body of persons or any government). In view of the aforesaid exemption any interest or discount arising on the Bonds could be made without any deduction for or on account of withholding tax.

Furthermore, the Inland Revenue Act provides that the profits and income earned by any non-resident person from the sale of any sovereign bond would also be exempt from income tax.

Stamp Duty

The Stamp Duty Act No. 43 of 1982 read with the Stamp Duty (Special Provisions) Act No. 12 of 2006 exempts from the payment of stamp duty any instrument executed by or on behalf of the Government.

United States Federal Income Taxation

The following discussion is a summary based on present law of certain material U.S. federal income tax considerations relevant to the purchase, ownership and disposition of the Bonds. This discussion addresses only U.S. Holders described below who purchase Bonds in the original offering at the issue price (as defined herein), hold the Bonds as capital assets and use the US dollar as their functional currency. This discussion is not a complete description of all U.S. tax considerations relating to the Bonds. It does not address the tax treatment of prospective investors subject to special rules, such as banks, dealers, traders that elect to mark to market, insurance companies, investors liable for the alternative minimum tax, U.S. expatriates, tax-exempt entities or persons holding the Bonds as part of a hedge, straddle, conversion or other integrated financial transaction. The following discussion does not address any U.S. federal taxes (such as the estate tax, the gift tax or the U.S. federal Medicare tax on net investment income) other than U.S. federal income taxes.

TO ENSURE COMPLIANCE WITH INTERNAL REVENUE SERVICE CIRCULAR 230, PROSPECTIVE INVESTORS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF U.S. FEDERAL TAX ISSUES IN THIS OFFERING CIRCULAR IS NOT INTENDED OR WRITTEN BY US TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY INVESTORS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON INVESTORS UNDER THE U.S. INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS WRITTEN IN CONNECTION WITH THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) INVESTORS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

For purposes of this discussion, a "U.S. Holder" is a beneficial owner of Bonds that is, for purposes of U.S. federal income taxation, (1) a citizen or resident of the United States, (2) a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States or its political subdivisions, (3) a trust that (i) is subject to the control of a U.S. person and the primary supervision of a U.S. court or (ii) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person, or (4) an estate the income of which is subject to U.S. federal income taxation regardless of its source.

If a partnership acquires or holds the Bonds, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partnership and partners of a partnership that acquires or holds the Bonds should consult their own tax advisor.

Interest and OID

Stated interest on the Bonds and additional amounts, if any, paid with respect to withholding taxes imposed by Sri Lanka will be included in the gross income of a U.S. Holder in accordance with the U.S. Holder's regular method of tax accounting.

If the Bonds are issued with original issued discount ("OID"), a U.S. Holder must accrue the OID into gross income on a constant yield to maturity basis whether or not it receives cash payments. Generally, the Bonds will have OID to the extent their principal amount exceeds their issue price, unless that excess is less than a specified *de minimis* amount, i.e. the product of 0.25% of the Bonds' principal amount multiplied by the number of complete years from the issue date to maturity. The issue price of a Bond is the initial offering price at which a substantial amount of the Bonds are sold for money (excluding sales to brokers or similar persons). Therefore, the Bonds will be issued with OID only if they have an issue price that is less than par by at least the *de minimis* amount. The interest and any OID accrued on the Bonds will generally be ordinary income from sources outside the United States.

Disposition

A U.S. Holder generally will recognize gain or loss on the sale, redemption or other disposition of a Bond in an amount equal to the difference between the amount realized (less any accrued but unpaid interest, which will be taxable as interest income to the extent not previously included in income) and the U.S. Holder's adjusted tax basis in the Bond. A U.S. Holder's adjusted tax basis in a Bond generally will be the amount the U.S. Holder paid for the Bond increased by any OID previously included in income.

Gain or loss on the disposition of a Bond generally will be U.S. source capital gain or loss. A U.S. Holder will have long-term capital gain or loss if it has held the Bond for more than one year. The long-term capital gains of a non-corporate U.S. Holder may be taxed at lower rates. Deductions for capital losses are subject to limitations.

Information Reporting and Backup Withholding

Payments of interest, accruals of OID and proceeds from the sale, redemption or other disposition of a Bond may be reported to the U.S. Internal Revenue Service unless the U.S. Holder is a corporation or other exempt recipient and, if required establishes a basis for such exemption.

Backup withholding may apply to amounts subject to reporting if the U.S. Holder fails to provide an accurate taxpayer identification number. Backup withholding is not an additional tax. A U.S. Holder can claim a credit against its U.S. federal income tax liability for the amount of any backup withholding and may be entitled to a refund of any excess, provided the required information is furnished to the U.S. Internal Revenue Service in a timely manner.

Certain U.S. Holders may be required to report information with respect to their investment in Bonds to the U.S. Internal Revenue Service unless certain requirements are met. Investors who fail to report required information could become subject to substantial penalties. Prospective investors are encouraged to consult with their own tax advisors regarding the possible implication of this new legislation on their investments in Bonds.

European Union Taxation

The European Union has adopted a Directive regarding the taxation of savings income. Member States are required from July 1, 2005 to provide to the tax authorities of other Member States details of payments of interest and other similar income paid by a person within its jurisdiction to or for an individual resident in another Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period, unless during such period they elect otherwise. A number of third countries have adopted equivalent measures and certain British and Dutch dependent or associated territories have adopted the same measures with effect from the same date. It is expected that a number of third countries and territories will adopt similar measures with effect from the same date.

PLAN OF DISTRIBUTION

Subject to the terms and conditions in the purchase agreement, dated July 17, 2012, between the Issuer and the initial purchasers named below (the "Initial Purchasers") each of the Initial Purchasers has severally agreed with the Issuer to purchase the principal amount of Bonds set forth opposite such Initial Purchaser's name:

Initial Purchaser	Principal Amount of the Bonds	Percentage of Interest of the Bonds
Barclays Bank PLC	US$250,000,000	25%
Merrill Lynch, Pierce, Fenner & Smith Incorporated	US$250,000,000	25%
Citigroup Global Markets, Inc.	US$250,000,000	25%
The Hongkong and Shanghai Banking Corporation Limited	US$250,000,000	25%
Total	US$1,000,000,000	100%

The Issuer will also reimburse the Initial Purchasers in respect of certain of their expenses, and has agreed to indemnify the Initial Purchasers against certain liabilities (including liabilities under the Securities Act), incurred in connection with the issue of the Bonds, or to contribute to payments that the Initial Purchasers may be required to make because of any of these liabilities. The Purchase Agreement may be terminated in certain circumstances prior to payment of the net purchase amounts in respect of the Bonds to the Issuer.

The Initial Purchasers initially propose to offer the Bonds for resale at the issue price that appears on the cover of this Offering Circular. After the initial offering, the Initial Purchasers may change the offering price and any other selling terms. The Initial Purchasers may offer and sell the Bonds through their affiliates.

Other Relationships

Certain affiliates of the Initial Purchasers have performed banking and advisory services for the Issuer from time to time for which they have received customary fees and expenses. The Initial Purchasers and certain of their affiliates may, from time to time, engage in transactions with and perform services for the Issuer in the ordinary course of their business.

The Initial Purchasers or certain of their respective affiliates may purchase the Bonds and be allocated Bonds for asset management and/or proprietary purposes and not with a view to distribution.

United States

The Bonds have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Bonds are being offered and sold only (a) outside the United States as defined in Regulation S in offshore transactions in accordance with Regulation S and (b) in the United States to a limited number of QIBs as defined in Rule 144A in connection with resales by the Initial Purchasers in accordance with Rule 144A.

In addition, until 40 days after the commencement of the Offering, an offer or sale of Bonds within the United States by any dealer (whether or not participating in the Offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A or another exemption from registration under the Securities Act.

The Bonds have not been approved or disapproved by the United States Securities and Exchange Commission, any state securities commission in the United States or any other United States regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering or the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offence in the United States.

Sri Lanka

The Bonds will not directly or indirectly be offered or sold in Sri Lanka. No offering circular, prospectus, form of application or advertisement in relation to the Bonds shall be distributed within Sri Lanka.

United Kingdom

Each Initial Purchaser has agreed that:

- it has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "FSMA")) received by it in connection with the issue or sale of any Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and

- it has complied with, and will comply with, all applicable provisions of the FSMA with respect to anything done by it in relation to the Bonds in, from or otherwise involving the UK.

Hong Kong

No steps have been taken to register this Offering Circular as a prospectus in Hong Kong. Subscriptions will not be accepted from any person other than the person to whom this Offering Circular has been delivered. This Offering Circular is delivered only to the recipient and may not be used, copied, reproduced or distributed, in whole or in part, to any other person.

The Issuer has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Bonds other than (i) to "professional investors" as defined in the Securities and Futures Ordinance (Cap 571) of Hong Kong (the "SFO") and any rules made under the SFO; or (ii) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies Ordinance (Cap 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that ordinance.

No person may issue, or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Bonds, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Bonds which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the SFO and any rules made under that ordinance.

Japan

Each of the Initial Purchasers, on behalf of itself and each of its affiliates that participates in the initial distribution of the Bonds represents and agrees with the Issuer that it has not offered or sold and will not offer or sell any Bonds, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan) or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Law of Japan (Law No. 25 of 1948, as amended) and any other applicable laws, regulations and ministerial guidelines of Japan.

Singapore

This Offering Circular has not been and will not be registered as a prospectus with the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289 of Singapore) (the "Securities and Futures Act"). Accordingly, the Bonds may not be offered or sold or made the subject of an invitation for subscription or purchase nor may this Offering Circular or any other document or material in connection with the offer or sale or invitation for subscription or purchase of any Bonds be circulated or distributed, whether directly or indirectly, to any person in Singapore other than (1) to an institutional investor under Section 274 of the Securities and Futures Act, (2) to a relevant person pursuant to Section 275(1) of the Securities and Futures Act, or any person pursuant to Section 275(1A) of the Securities and Futures Act, and in accordance with the conditions specified in Section 275 of the Securities and Futures Act or (3) otherwise than pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act.

Each of the following relevant persons specified in Section 275 of the Securities and Futures Act which has subscribed or purchased Bonds from and through the Initial Purchasers, namely a person who is:

(1) a corporation (which is not an accredited investor as defined in Section 4A of the Securities and Futures Act) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(2) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an individual who is an accredited investor,

should note that securities (as defined in Section 239(1) of the Securities and Futures Act) of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust shall not be transferable for 6 months after that corporation or that trust has acquired the Bonds under Section 275 of the Securities and Futures Act except:

(a) to an institutional investor under Section 274 of the Securities and Futures Act or to a relevant person (as defined in Section 275(2) of the Securities and Futures Act); or (in the case of such corporation) where the transfer arises from an offer referred to in Section 276(3)(i)(B) of the Securities and Futures Act, or (in the case of such trust) where the transfer arises from an offer referred to in Section 276(4)(i)(B) of the Securities and Futures Act;

(b) where no consideration is or will be given for the transfer;

(c) by operation of law; or

(d) pursuant to Section 276(7) of the Securities and Future Act.

Republic of Italy

Each Initial Purchaser has not offered, sold or delivered, nor distributed and will not offer, sell or deliver, copies of this Offering Circular or any other document relating to the Bonds in the Republic of Italy, except: (i) to qualified investors (*investitori qualificati*), as defined in Article 100 of Legislative Decree No. 58 of February 24, 1998, as amended (the "Financial Services Act") and the relevant implementing CONSOB regulations, as amended from time to time, and in Article 2 of Directive No. 2003/71/EC of November 4, 2003; or (ii) in other circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of the Financial Services Act and Article 33, first paragraph, of CONSOB Regulation No. 11971 of May 14, 1999, as amended ("Regulation No. 11971"); and (iii) any offer, sale or delivery of the Bonds or distribution of copies of this Offering Circular or any other document relating to the Bonds in the Republic of Italy under (i) or (ii) above have been or will be made only (a) by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act, CONSOB Regulation No. 16190 of October 29, 2007 (as amended from time to time) and Legislative Decree No. 385 of September 1, 1993, as amended (the "Banking Act"); and (b) in compliance with Article 129 of the Banking Act, as amended, and the implementing guidelines of the Bank of Italy, as amended from time to time, pursuant to which the Bank of Italy may request information on the issue or the offer of securities in the Republic of Italy; and (c) in compliance with any other applicable laws and regulations or requirement imposed by CONSOB or other Italian authority.

Public Offering Selling Restrictions Under the Prospectus Directive

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a Relevant Member State), each Initial Purchaser has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the Relevant Implementation Date) it has not made and will not make an offer of Bonds which are the subject of the offering contemplated by this Offering Circular to the public in that Relevant Member State other than:

(a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the relevant Initial Purchaser or Initial Purchasers nominated by the Issuer for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Bonds shall require the Issuer or any Initial Purchaser to publish a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an offer of Bonds to the public in relation to any Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe for the Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression Prospectus Directive means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression 2010 PD Amending Directive means Directive 2010/73/EU.

General

No action has been taken by the Issuer or any of the Initial Purchasers that would, or is intended to, permit a public offer of the Bonds or possession or distribution of this Offering Circular or any other offering or publicity material relating to the Bonds in any country or jurisdiction where any such action for that purpose is required. Accordingly, each Initial Purchaser has undertaken that it will not, directly or indirectly, offer or sell any Bonds or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Bonds by it will be made on the same terms.

The Bonds are a new issue of securities with no established trading market. Approval in-principle has been received from the SGX-ST for the listing and quotation of the Bonds on the SGX-ST. However, the Issuer cannot assure you that the prices at which the Bonds will sell in the market after this offering will not be lower than the initial offering price or that an active trading market for the Bonds will develop and continue after this Offering. The Initial Purchasers have advised the Issuer that they currently intend to make a market in the Bonds. However, they are not obligated to do so and they may discontinue any market-making activities with respect to the Bonds at any time without notice. In addition, market-making activity will be subject to the limits imposed by the Securities Act and the Exchange Act. Accordingly, the Issuer cannot assure you as to the liquidity of or the trading market for the Bonds.

In connection with the Offering, The Hongkong and Shanghai Banking Corporation Limited, as the Stabilizing Manager or any person acting for it, on behalf of the Initial Purchasers, may engage in transactions that stabilize or otherwise affect the market price of the Bonds. These transactions consist of bids or purchases for the purpose of pegging, fixing or maintaining the price of the Bonds. If the Stabilizing Manager or its agent creates a short position in the Bonds in connection with the Offering, (i.e., if the Stabilizing Manager or its agent sells more Bonds than are set forth on the cover page of this Offering Circular), the Stabilizing Manager or its agent may reduce that short position by purchasing the Bonds in the open market. In general, purchases of a bond for the purpose of stabilization or to reduce a short position could cause the price of the Bonds to be higher than it might be in the absence of such purchases. These transactions may be effected in the over-the-counter market at any time. If such activities are commenced, they may be discontinued by the Stabilizing Manager or its agent(s) at any time. The Stabilizing Manager or its agent also may impose a penalty bid. This occurs when a particular Initial Purchaser repays to the Stabilizing Manager or its agent a portion of the underwriting discount received by it because the Stabilizing Manager or its agent has repurchased the Bonds sold by or for the account of such Initial Purchaser in stabilizing or short covering transactions.

Neither the Issuer nor the Stabilizing Manager makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the Bonds. In addition, neither the Issuer nor the Stabilizing Manager makes any representation that the Stabilizing Manager or its agent will engage in such transactions or that such transactions, once commenced, will not be discontinued with or without notice.

It is expected that the Bonds will be delivered against payment for the Bonds on or about the date specified in the last paragraph of the cover page of this Offering Circular, which will be the sixth business day following the date of the pricing of the Bonds. Since trades in the secondary market generally settle in three business days pursuant to Rule 15c6-1 of the Exchange Act, purchasers who wish to trade Bonds on the date of pricing or the next succeeding business day will be required, by virtue of the fact that the Bonds initially will settle in T+6 on a delayed basis, to specify alternative settlement arrangements to prevent a failed settlement. Purchasers of Bonds who wish to make such trades should consult their own advisors.

NOTICE TO INVESTORS

Due to the following significant transfer restrictions applicable to the Bonds, investors are advised to consult legal counsel prior to making any reoffer, resale, pledge, transfer or disposal of Bonds.

The Bonds have not been registered and will not be registered under the Securities Act or any other securities laws, and may not be offered or sold in the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Bonds are being offered and sold (1) in the United States only to persons reasonably believed to be QIBs, as defined in Rule 144A under the Securities Act in compliance with Rule 144A and (2) to persons outside the United States ("foreign purchasers") in offshore transactions pursuant to Regulation S.

Each investor of a Bond, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with the Issuer and the Initial Purchasers as follows:

(1) represent that it is purchasing the Bonds for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is (a) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A or (b) a foreign purchaser that is outside the United States;

(2) acknowledge that the Bonds have not been registered under the Securities Act and may not be offered or sold within the United States except as set forth below;

(3) if it is a person other than a foreign purchaser outside the United States after the expiration of the distribution compliance period, agree that if it should resell or otherwise transfer the Bonds within the time period referred to in Rule 144(d) under the Securities Act after the original issuance of the Bonds, it will do so only (a) to the Issuer, (b) to a QIB in compliance with Rule 144A, (c) outside the United States in an offshore transaction in compliance with Rule 903 or 904 of Regulation S under the Securities Act, (d) pursuant to the exemption from registration provided by Rule 144 (if available) but only upon delivery to the Issuer of an opinion of counsel in form and scope satisfactory to the Issuer or (e) pursuant to an effective registration statement under the Securities Act;

(4) agree that it will deliver to each person to whom it transfers Bonds notice of any restriction on transfer of such Bonds;

(5) understand and agree that Bonds initially offered in the United States to QIBs will be represented by one or more Rule 144A Global Bonds and that Bonds offered outside the United States in offshore transactions pursuant to Regulation S will be represented by one or more Regulation S Global Bonds;

(6) understand that unless registered under the Securities Act, the Rule 144A Global Bond and Bond Certificates issued in exchange for a beneficial interest in the Rule 144A Global Bond will bear a legend to the following effect, unless otherwise agreed by the Issuer and the holder thereof:

THE BONDS REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR ANY SECURITIES LAW OF ANY STATE IN THE UNITED STATES OF AMERICA, AND MAY NOT BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT AS PERMITTED BY THE FOLLOWING SENTENCES. THE HOLDER HEREOF, BY PURCHASING THE BONDS IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, ACKNOWLEDGES AND AGREES, FOR THE

BENEFIT OF THE ISSUER, THAT SUCH BONDS MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(I) TO THE ISSUER, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT OR (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY IF AVAILABLE AND UPON DELIVERY TO THE ISSUER OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE ISSUER; AND (B) IN EACH CASE IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES.

(7) acknowledge that the Issuer and the Initial Purchasers will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements, and agree that if any of the acknowledgments, representations or warranties deemed to have been made by it by its purchase of Bonds are no longer accurate, it shall promptly notify the Issuer and the Initial Purchasers; and

(8) if it is acquiring Bonds as a fiduciary or agent for one or more investor accounts, represent that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

LEGAL MATTERS

The validity of the Bonds will be passed upon on behalf of the Issuer by the Attorney General of Sri Lanka and by F. J. & G. de Saram, counsel for the Issuer as to matters of Sri Lankan law and by Milbank, Tweed, Hadley & McCloy, international counsel for the Issuer as to matters of United States and New York State law. Certain legal matters will be passed upon for the Initial Purchasers by Nithya Partners, counsel for the Initial Purchasers as to matters of Sri Lankan law and by Davis Polk & Wardwell, international counsel for the Initial Purchasers as to matters of United States and New York State law.

PUBLIC OFFICIAL STATEMENTS AND DOCUMENTS

Information included herein which is designated as being taken from a publication of Sri Lanka or an agency or instrumentality of the Issuer is included on the authority of the Issuer or such agency or instrumentality.

The information set forth herein relating to Sri Lanka is provided by the Central Bank of the Democratic Socialist Republic of Sri Lanka acting in its official capacity and is included on its authority.

GENERAL INFORMATION

Authorization

The Issuer has obtained all necessary consents, approvals and authorizations under the laws of the Democratic Socialist Republic of Sri Lanka in connection with the issue and performance of the Bonds. The Bonds and the holders of the bonds from time to time have been approved on June 27, 2012 by the Cabinet of Ministers pursuant to the Foreign Loans Act No. 29 of 1957 (as amended). The signing of the Bonds and the relevant agreements have been approved on July 5, 2012 by the President under the Foreign Loans Act No 29 of 1957 (as amended). The Commissioner General of Inland Revenue has confirmed on July 9, 2012 that the interest payments on the Bonds are exempt from income tax in Sri Lanka pursuant to Section 9(b) of the Inland Revenue Act No. 10 of 2006 (as amended). Special permission has been given to the Issuer on July 5, 2012 by the Controller of Exchange for purposes and in terms of the Exchange Control Act No. 24 of 1953 (as amended) in relation to the proposed borrowing through the Bonds and for payments by the Issuer under or in connection with the Bonds. Permission has also been granted to the Issuer by the Controller of Exchange pursuant to Sections 07, 10, 11 and 22(1)(f) of the Exchange Control Act No. 24 of 1953 (as amended).

Listing

Approval in-principle has been received from the SGX-ST for the listing and quotation of the Bonds on the SGX-ST. The Bonds will be traded on the SGX-ST in a minimum board lot size of US$200,000 for so long as the Bonds are listed on the SGX-ST. Listing of the Bonds on the SGX-ST is conditional upon satisfaction of the requirements of the SGX-ST.

So long as the Bonds are listed on the SGX-ST and the rules of the SGX-ST so require, the Issuer shall appoint and maintain a paying agent in Singapore, where the Bonds may be presented or surrendered for payment or redemption, in the event that the Global Bonds are exchanged for Definitive Bonds. In addition, in the event that the Global Bonds are exchanged for Definitive Bonds, announcement of such exchange shall be made through the SGX-ST and such announcement will include all material information with respect to the delivery of the Definitive Bonds, including details of the paying agent in Singapore.

Clearing Systems

The Bonds have been accepted for clearance through DTC, Euroclear and Clearstream, Luxembourg.

The ISIN for the Rule 144A Global Bonds is US85227SAK24 and for the Regulation S Global Bonds is USY2029SAH77. The CUSIP number for the Rule 144A Global Bonds is 85227SAK2 and for the Regulation S Global Bonds is Y2029SAH7.

Application has been made for acceptance of the Bonds into DTC's book-entry settlement system.

Annual Reports

Copies of the 2011 Annual Report and all future monthly bulletins may be obtained at the specified office of the Paying Agent during normal business hours, so long as any of the Bonds are listed on the SGX-ST. The aforementioned 2011 Annual Report contains certain summary information regarding the annual budget of the Government.

Documents

Copies of the Indenture containing the forms of the Bond Certificates will be available for inspection, at the specified offices of each of the Paying Agents during normal business hours, so long as any of the Bonds are outstanding. A copy of the Indenture and the Constitution of Sri Lanka will be available for inspection at the specified office of the Paying Agent during normal business hours so long as the Bonds are listed on the SGX-ST.

Available Information

The Issuer is a foreign government as defined in Rule 405 under the Securities Act and is eligible to register securities on Schedule B of the Securities Act. Therefore, the Issuer is not subject to the information provision requirements of Rule 144A(d)(4)(i) under the Securities Act.

INDEBTEDNESS OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

Page

GOVERNMENT DEBT

	Domestic Debt							Debt as a percent of GDP[4]		
Year[1]	Treasury Bills[2]	Rupee Loans	Treasury Bonds[3]	Other	Total	Foreign Debt[2][3]	Total Debt	Domestic	Foreign	Total
				(in Rs. millions, except for percentages)						
1950 . . .	79	436	—	14	529	125	654	13.7	3.2	16.9
1951 . . .	30	582	—	14	626	125	751	13.6	2.7	16.3
1952 . . .	93	684	—	75	852	192	1,044	18.9	4.3	23.2
1953 . . .	184	731	—	129	1,044	205	1,249	23.2	4.6	27.8
1954 . . .	105	782	—	66	953	211	1,164	20.1	4.4	24.5
1955 . . .	60	829	—	—	889	232	1,121	17.0	4.4	21.4
1956 . . .	68	882	—	—	950	258	1,208	18.6	5.1	23.7
1957 . . .	65	962	—	105	1,132	278	1,410	21.8	5.3	27.1
1958 . . .	140	1,007	—	91	1,238	293	1,531	22.5	5.3	27.9
1959 . . .	320	1,102	—	138	1,560	307	1,867	24.3	4.8	29.1
1960 . . .	550	1,217	—	170	1,937	345	2,282	28.9	5.1	34.0
1961 . . .	750	1,397	—	198	2,345	407	2,752	34.1	5.9	40.0
1962 . . .	1,000	1,515	—	179	2,694	412	3,106	38.7	5.9	44.6
1963 . . .	1,125	1,684	—	222	3,031	489	3,520	41.1	6.6	47.7
1964 . . .	1,250	1,909	—	216	3,375	549	3,924	43.3	7.0	50.4
1965 . . .	1,300	2,150	—	246	3,696	739	4,435	45.7	9.1	54.9
1966 . . .	1,425	2,475	—	295	4,195	1,074	5,269	50.3	12.9	63.2
1967 . . .	1,500	2,785	—	298	4,583	1,376	5,959	50.7	15.2	65.9
1968 . . .	1,750	3,118	—	329	5,197	1,578	6,775	48.5	14.7	63.2
1969 . . .	1,750	3,409	—	354	5,513	1,800	7,313	47.1	15.4	62.5
1970 . . .	1,950	3,925	—	420	6,295	2,394	8,689	46.1	17.5	63.6
1971 . . .	2,025	4,512	—	446	6,983	2,795	9,778	49.7	19.9	69.6
1972 . . .	2,325	5,103	—	498	7,926	2,936	10,862	52.0	19.3	71.2
1973 . . .	2,250	5,812	—	522	8,584	3,705	12,289	46.6	20.1	66.8
1974 . . .	2,250	6,591	—	604	9,445	2,859	12,304	39.7	12.0	51.8
1975 . . .	2,350	7,560	—	949	10,859	3,705	14,564	40.9	13.9	54.8
1976 . . .	2,700	9,001	—	990	12,691	4,968	17,659	42.0	16.4	58.5
1977 . . .	2,500	10,391	—	1,501	14,392	10,593	24,985	39.5	29.1	68.6
1978 . . .	2,635	12,049	—	1,684	16,368	14,583	30,951	38.4	34.2	72.5
1979 . . .	3,000	14,929	—	1,705	19,634	15,840	35,474	37.5	30.2	67.7
1980 . . .	9,800	17,611	—	1,659	29,070	22,276	51,346	43.7	33.5	77.2
1981 . . .	13,920	20,025	—	,573	35,518	29,172	64,690	41.8	34.3	76.1
1982 . . .	17,320	25,800	—	2,147	45,267	35,267	80,534	45.6	35.5	81.2
1983 . . .	17,400	31,953	—	2,416	51,769	46,688	98,457	42.6	38.4	81.0
1984 . . .	14,860	33,228	—	3,564	51,652	53,681	105,333	33.6	34.9	68.5
1985 . . .	22,280	36,570	—	3,761	62,611	67,673	130,284	38.6	41.7	80.2
1986 . . .	26,173	39,130	—	4,196	69,499	86,208	155,707	38.7	48.0	86.8
1987 . . .	29,850	44,957	—	4,190	78,997	111,812	190,809	40.2	56.8	97.0
1988 . . .	43,700	49,797	—	5,099	98,596	125,657	224,253	44.4	56.6	101.0
1989 . . .	57,246	54,217	—	6,099	117,562	156,298	273,860	46.7	62.0	108.7
1990 . . .	67,968	54,677	—	11,251	133,896	176,883	310,779	41.6	55.0	96.6
1991 . . .	72,968	66,823	—	12,328	152,119	214,579	366,698	40.9	57.6	98.5
1992 . . .	87,096	69,180	—	13,744	170,020	235,539	405,559	40.0	55.4	95.4
1993 . . .	97,196	105,707	—	10,782	213,685	270,224	483,909	42.8	54.1	96.9
1994 . . .	98,896	137,554	—	12,669	249,119	301,812	550,931	43.0	52.1	95.1
1995 . . .	113,771	157,928	—	17,711	289,410	346,286	635,696	43.3	51.9	95.2
1996 . . .	124,996	205,975	—	25,731	356,702	359,685	716,388	46.4	46.8	93.3
1997 . . .	114,996	239,475	10,000	23,269	387,740	376,331	764,071	43.6	42.3	85.9
1998 . . .	119,996	250,570	48,915	43,945	463,426	461,273	924,699	45.5	45.3	90.8
1999 . . .	124,996	262,056	104,867	51,546	543,465	507,866	1,051,331	49.1	45.9	95.1
2000 . . .	134,996	263,888	204,124	73,652	676,660	542,040	1,218,700	53.8	43.1	96.9
2001 . . .	170,995	292,813	229,174	122,983	815,965	636,741	1,452,706	58.0	45.3	103.3
2002 . . .	210,995	287,701	347,128	102,562	948,386	721,957	1,670,343	60.0	45.6	105.6
2003 . . .	219,295	248,414	483,107	69,153	1,019,969	843,882	1,863,851	56.0	46.3	102.3
2004 . . .	243,886	164,758	643,349	91,396	1,143,389	996,138	2,139,527	54.7	47.6	102.3
2005 . . .	234,174	140,563	751,569	139,415	1,265,722	956,620	2,222,341	51.6	39.0	90.6
2006 . . .	257,732	116,713	885,972	218,813	1,479,230	1,103,418	2,582,648	50.3	37.5	87.9
2007 . . .	307,012	131,509	1,018,852	257,825	1,715,198	1,326,487	3,041,685	47.9	37.1	85.0
2008 . . .	402,600	130,009	1,281,978	325,641	2,140,228	1,448,734	3,588,962	48.5	32.8	81.4
2009 . . .	441,032	112,292	1,513,512	334,119	2,400,955	1,760,467	4,161,422	49.8	36.5	86.2
2010 . . .	514,442	87,709	1,643,887	319,624	2,565,662	2,024,583	4,590,245	45.8	36.1	81.9
2011[5] . .	590,885	61,961	1,819,251	331,988	2,804,085	2,329,280	5,133,365	42.9	35.6	78.5

Sources: Central Bank of Sri Lanka and Department of Census and Statistics

Notes:

(1) From 1950 to 1973 the outstanding position is given as at end September and since then as at end December

(2) Rupee denominated Treasury bills issued to foreign investors from 2008 and to Sri Lankan diaspora and migrant workforce from 2009 are excluded from domestic debt and included in foreign debt.

(3) Rupee denominated Treasury bonds issued to foreign investors from 2007 and to Sri Lankan diaspora and migrant workforce from 2009 are excluded from domestic debt and included in foreign debt.

(4) From 2003, based on GDP estimates compiled by Department of Census and Statistics

(5) Provisional

OUTSTANDING CENTRAL GOVERNMENT DEBT(1)

Source	December 31, 2007	2008	2009	2010	2011(5)	May 31, 2011(5)	2012(5)	Change as a percent
	(in Rs. millions)							
Total Domestic Debt	**1,715,198**	**2,140,228**	**2,400,955**	**2,565,662**	**2,804,085**	**2,729,666**	**3,142,520**	**15.1**
Short-term	363,199	516,365	560,646	619,549	698,190	733,680	835,896	13.9
Treasury Bills(2)	307,012	402,600	441,032	514,442	590,885	602,639	693,991	15.2
Provisional Advances from the Central Bank	60,679	76,308	73,881	77,879	94,743	98,662	112,751	14.3
Import Bills held by Commercial Banks	376	12,748	11,994	9,154	11,479	12,313	14,245	15.7
Other liabilities to the Banking Sector net of Bank Deposits	(8,747)	20,458	24,188	10,396	150	19,132	13,975	(27.0)
Other	3,879	4,251	9,551	7,678	933	933	933	—
Medium and Long-Term	1,351,999	1,623,863	1,840,309	1,946,113	2,105,895	1,995,987	2,306,624	15.6
Rupee Securities	131,509	130,009	112,292	87,709	61,961	81,171	58,386	(28.1)
Treasury Bonds(3)	1,018,852	1,281,978	1,513,512	1,643,887	1,819,251	1,697,425	1,985,502	17.0
Treasury Certificates of Deposit	—	—	—	—	—	—	—	—
Sri Lanka Development Bonds	86,459	158,805	168,079	173,877	183,845	176,702	218,808	23.8
Other	115,179	53,071	46,427	40,640	40,838	40,688	43,928	8.0
By Debt Instrument	1,715,198	2,140,228	2,400,955	2,565,662	2,804,085	2,729,666	3,142,520	15.1
Rupee Securities	131,509	130,009	112,292	87,709	61,961	81,171	58,386	(28.1)
Treasury Bills(2)	307,012	402,600	441,032	514,442	590,885	602,639	693,991	15.2
Treasury Bonds(3)	1,018,852	1,281,978	1,513,512	1,643,887	1,819,251	1,697,425	1,985,502	17.0
Treasury Certificates of Deposit	—	—	—	—	—	—	—	—
Sri Lanka Development Bonds	86,459	158,805	168,079	173,877	183,845	176,702	218,808	23.8
Provisional Advances	60,679	76,308	73,881	77,879	94,743	98,662	112,751	14.3
Other	110,686	90,528	92,160	67,869	53,400	73,066	73,081	0.0
By Institution	1,715,198	2,140,228	2,400,955	2,565,662	2,804,085	2,729,666	3,142,520	15.1
Banks	415,318	657,424	705,766	691,716	886,221	764,757	1,061,356	38.8
Central Bank								
By Debt Instrument	104,817	239,248	109,593	78,376	263,329	96,711	330,052	241.3
Treasury Bills	44,964	163,584	37,451	2,993	169,797	930	217,639	23,312.0
Treasury Bonds	—	—	—	—	—	—	—	—
Provisional Advances	60,679	76,308	73,881	77,879	94,743	98,662	112,751	14.3
Other	(826)	(644)	(1,739)	(2,496)	(1,210)	(2,881)	(338)	(88.3)
Commercial Banks								
By Debt Instrument	310,502	418,177	596,172	613,340	622,892	668,047	731,305	9.5
Rupee Loans	15,870	15,870	17,251	17,615	16,234	16,234	16,234	—
Treasury Bills	68,818	87,869	160,081	220,358	185,756	244,010	206,938	(15.2)
Treasury Bonds	58,416	90,081	188,576	162,215	206,547	179,723	240,355	33.7
Sri Lanka Development Bonds	86,459	158,805	168,079	173,877	183,845	176,702	218,808	23.8
Other	80,938	65,550	62,186	39,276	30,511	51,377	48,970	(4.7)
By Institution	310,502	418,177	596,172	613,340	622,892	668,047	731,305	9.5
State Banks	130,272	144,641	167,860	138,708	193,698	N/A	N/A	N/A
Other	180,230	273,536	428,313	474,632	429,194	N/A	N/A	N/A
Non-Bank Sector								
By Debt Instrument	1,299,879	1,482,804	1,695,189	1,873,945	1,917,864	1,964,909	2,081,163	5.9
Rupee Loans	115,638	114,139	95,041	70,094	45,727	64,938	42,152	(35.1)
Treasury Bills	193,230	151,146	243,499	291,091	235,333	357,699	269,414	(24.7)
Treasury Bonds	960,436	1,191,897	1,324,936	1,481,672	1,612,704	1,517,702	1,745,147	15.0
Treasury Certificates of Deposit	—	—	—	—	—	—	—	—
Other	146,213	139,761	126,754	101,183	69,827	24,570	24,449	(0.5)
By Institution	1,299,879	1,482,804	1,695,189	1,873,945	1,917,864	1,964,809	2,081,063	5.9
National Savings Bank	192,413	204,067	257,084	286,514	314,319	307,224	310,487	1.1
Savings Institutions & Individuals	366,161	431,562	410,540	482,305	436,221	N/A	N/A	N/A
Employees' Provident Fund	575,460	676,310	806,192	861,341	950,474	901,787	1,042,747	15.6
Insurance Institutions	21,012	25,976	34,490	32,839	34,356	N/A	N/A	N/A
Finance Companies	8,826	11,422	10,756	12,856	11,064	N/A	N/A	N/A
Other	136,007	133,467	176,127	198,090	171,431	755,798	727,829	(3.7)
Administrative Borrowings	3,879	4,251	9,551	7,678	933	933	933	—
Departments, Official Funds and Other	132,128	129,216	166,575	190,412	170,498	754,864	726,896	(3.7)

Source	December 31, 2007	2008	2009	2010	2011(5)	May 31, 2011(5)	2012(5)	Change as a percent
				(in Rs. millions)				
Total Foreign Debt	**1,326,487**	**1,448,734**	**1,760,467**	**2,024,583**	**2,329,280**	**2,071,187**	**2,759,680**	**33.2**
By Type	1,326,487	1,448,734	1,760,467	2,024,583	2,329,280	2,071,187	2,759,680	33.2
Project Loans	1,087,359	1,261,304	1,362,806	1,461,729	1,640,117	1,514,193	1,936,254	27.9
Non-Project Loans	239,128	187,430	397,661	562,854	689,163	556,993	823,426	47.8
Commodity	68,665	66,499	62,304	54,653	53,460	52,968	61,929	16.9
Other	170,463	120,931	335,357	508,201	635,703	504,025	761,496	51.1
By Institution	1,326,487	1,448,734	1,760,467	2,024,583	2,329,280	2,071,187	2,759,680	33.2
Concessional Loans	1,099,911	1,227,222	1,271,142	1,266,910	1,328,797	1,291,682	1,520,941	17.7
Multilateral	565,320	590,776	623,174	601,691	624,634	619,151	719,183	16.2
Bilateral	534,591	636,446	647,967	665,218	704,163	672,531	801,758	19.2
Non-Concessional Loans	226,576	221,511	489,326	757,674	1,000,483	779,505	1,238,739	58.9
Multilateral	15,399	27,405	41,866	73,245	97,282	80,552	120,230	49.3
Bilateral	29,909	30,087	36,783	73,995	138,642	92,047	196,136	113.1
Commercial Loans(4)	181,268	164,020	410,677	610,433	764,560	606,906	922,373	52.0
Total Outstanding Government Debt	**3,041,685**	**3,588,962**	**4,161,422**	**4,590,245**	**5,133,365**	**4,800,853**	**5,902,200**	**22.9**

Sources: Central Bank of Sri Lanka and Ministry of Finance and Planning

Notes:

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

(2) Excludes rupee denominated Treasury bills held by foreign investors from 2008 and to Sri Lankan diaspora and migrant workers from 2009

(3) Excludes Government bonds of Rs.4,397 million issued to CWE in November 2003 and rupee denominated Treasury bonds held by foreign investors from 2007 and Sri Lankan diaspora and migrant workers from 2009

(4) Includes outstanding defense loans

(5) Provisional

EXTERNAL DEBT OUTSTANDING AND BANKING SECTOR EXTERNAL LIABILITIES (DISBURSEMENTS)

Item	As of December 31,									
	2007	2008	2009	2010	2011(1)	2007	2008	2009	2010	2011(1)
	(in US$ millions, except for percentage)					(in Rs. Millions, except for percentage)				
Long and Medium Term	12,879	13,646	15,564	18,823	21,882	1,400,833	1,543,952	1,780,313	2,088,449	2,492,392
Government	11,744	12,593	13,769	16,076	18,508	1,276,846	1,424,729	1,574,933	1,783,728	2,108,084
Multilateral	5,341	5,464	5,814	6,083	6,338	580,719	618,182	665,040	674,937	721,916
of which: ADB	2,687	2,809	3,013	3,234	3,367	292,151	317,763	344,661	358,872	383,461
IDA	2,380	2,364	2,484	2,535	2,654	258,748	267,475	284,074	281,217	302,244
Other	274	291	317	314	318	29,820	32,944	36,305	34,847	36,211
Bilateral	4,935	5,627	5,741	6,569	6,970	536,522	636,643	656,680	728,853	793,908
of which: Japan	3,014	3,774	3,731	4,317	4,644	327,711	426,936	426,767	478,931	529,013
Other	1,921	1,854	2,010	2,253	2,326	208,812	209,708	229,912	249,922	264,895
Financial Markets	789	797	1,068	2,038	3,033	85,814	90,182	122,111	226,090	345,516
Suppliers' Credits	679	705	1,146	1,387	2,166	73,790	79,722	131,103	153,849	246,744
Public Corporations and Private Sector with Government Guarantee	345	251	110	517	646	37,501	28,429	12,608	57,398	73,581
Multilateral	—	—	—	—	—	—	—	—	—	—
Bilateral	—	—	—	—	—	—	—	—	—	—
Financial Markets	345	251	110	66	129	37,501	28,429	12,608	7,358	14,694
Suppliers' Credits	—	—	—	451	517	—	—	—	50,040	58,887
Public Corporations and Private Sector without Government Guarantee	539	634	967	919	1,010	58,553	71,715	110,570	101,913	115,034
Financial Markets	539	634	967	919	1,010	58,553	71,715	110,570	101,913	115,034
Suppliers' Credits	—	—	—	—	—	—	—	—	—	—
Private	—	—	—	—	—	—	—	—	—	—
IMF Drawings	251	169	719	1,311	1,718	27,933	19,079	82,201	145,410	195,693
TOTAL	12,879	13,646	15,564	18,823	21,882	1,400,833	1,543,952	1,780,313	2,088,449	2,492,392
Multilateral	5,592	5,632	6,533	7,394	8,056	608,652	637,260	747,241	820,347	917,609
Bilateral	4,935	5,627	5,741	6,569	6,970	536,522	636,643	656,680	728,853	793,908
Financial Markets	1,673	1,682	2,144	3,023	4,223	181,868	190,327	245,289	335,361	480,967
Suppliers' Credits	679	705	1,146	1,838	2,633	73,790	79,722	131,103	203,888	299,908
Other Private	—	—	—	—	—	—	—	—	—	—
Short-Term and Banking Sector Liabilities	3,604	4,129	5,349	6,008	6,969	391,811	467,157	611,916	666,566	793,817
Short-term	1,111	1,460	3,098	2,615	2,584	120,748	165,207	354,341	290,149	294,311
Central Government	457	212	1,622	2,171	2,367	49,641	24,006	185,534	240,855	269,654
Other(2)	654	1,248	1,476	444	216	71,107	141,201	168,808	49,294	24,657
Banking Sector External Liabilities(3)	2,493	2,669	2,251	3,393	4,385	271,063	301,950	257,575	376,418	499,506
Central Bank Borrowings	2	1	227	229	228	219	64	26,042	25,322	26,047
Commercial Bank Foreign Borrowings	2,046	1,861	1,763	2,578	3,366	222,389	210,531	201,696	286,052	383,427
ACU Liabilities	446	808	261	586	790	48,454	91,355	29,837	65,044	90,032
Total Outstanding Debt	16,483	17,775	20,913	24,830	28,851	1,792,643	2,011,109	2,392,229	2,755,015	3,286,209

Sources: Central Bank of Sri Lanka and External Resources Department

Notes:

(1) Provisional

(2) Includes acceptance credits of Ceylon Petroleum Corporation, and other trade credits

(3) ACU debits and foreign liabilities of commercial banks including those of Foreign Currency Banking Units

This page has been intentionally left blank.

ISSUER

The Government of the Democratic Socialist Republic of Sri Lanka
Ministry of Finance and Planning
The Secretariat
Colombo 1
Sri Lanka

LEGAL ADVISERS TO THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

As to U.S. and New York State law:

Milbank, Tweed, Hadley & McCloy
3007 Alexandra House
16 Chater Road, Central
Hong Kong

As to Sri Lankan law:

Attorney General
Attorney General's Department
Colombo 12
Sri Lanka

F.J. & G. de Saram
216 de Saram Place
Colombo 10
Sri Lanka

LEGAL ADVISERS TO THE INITIAL PURCHASERS

As to U.S. and New York State law:

Davis Polk & Wardwell
c/o 18/F, The Hong Kong Club Building
3A Chater Road, Central
Hong Kong

As to Sri Lankan law:

Nithya Partners
97A Galle Road
Colombo 3
Sri Lanka

TRUSTEE, PAYING AGENT, TRANSFER AGENT, REGISTRAR AND DTC CUSTODIAN

HSBC Bank USA ,National Association
452 Fifth Avenue
New York, NY 10018-2706
United States

LEGAL ADVISERS TO THE TRUSTEE, PAYING AGENT, TRANSFER AGENT, REGISTRAR AND DTC CUSTODIAN

Davis Polk & Wardwell
c/o 18/F, The Hong Kong Club Building
3A Chater Road, Central
Hong Kong

SINGAPORE LISTING AGENT

Shook Lin & Bok LLP
1 Robinson Road
#18-00 AIA Tower
Singapore 048542

US$1,000,000,000

The Democratic Socialist Republic of Sri Lanka

5.875% Bonds due 2022

OFFERING CIRCULAR

July 17, 2012

Joint Lead Managers and Bookrunners

Barclays **BofA Merrill Lynch** **Citigroup** **HSBC**

Co-Manager

People's Bank