1. The Government of Ceylon has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. The increase in gross national product slowed down from 5 per cent in 1960 to 3 per cent in 1961 chiefly because rice production in 1961 did not increase further from the high level attained in 1960. Per capita output was practically unchanged in 1961. The authorities estimate that gross national product in 1962 increased somewhat more than in 1961.

3. The Government has incurred large deficits in the last six years financed by borrowing from the banking system, and another large deficit is anticipated in the current year. These deficits and a worsening of the terms of trade have resulted in a deterioration in the external payments position. Although the pace of reduction in foreign exchange reserves has slowed down since 1961 because of a tightening of restrictions and an increase in foreign liabilities, these reserves are now at a low level. The Fund notes that the authorities have recently decided to take measures to reduce the government deficit but believes that much stronger measures are urgently necessary if serious inflation is to be avoided and the development program is not to be jeopardized. The present policy of credit restraint should be continued and, if necessary, strengthened.

4. In view of the rapid deterioration of the balance-of-payments position during the first nine months of 1962, Ceylon increases still further its restrictions on imports and import payments and on payments for invisibles. The Fund recognizes that these restrictions and the temporary increases in customs duties are no more than may be considered necessary to cope with the balance-of-payments difficulties. However, the Fund again emphasizes that the pursuit of appropriate fiscal and monetary policies is vital for strengthening the payments position and for early relaxation of the intensified restrictive measures. The Fund notes that Ceylon has extended its bilateral payments arrangements and urges their elimination, particularly those with Fund members.

5. In concluding the 1962 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Ceylon.