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Communications Department, 30, Janadhipathi Mawatha, Colombo 01, Sri Lanka
+94 11 2477424 / +94 11 2477669 +94 11 2346304
communications@cbsl.lk / dcommunications@cbsl.lk www.cbsl.gov.lk

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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: No. 03 – May 2026

The Central Bank of Sri Lanka increases the Overnight Policy Rate (OPR)

The Monetary Policy Board, at its meeting held yesterday, decided to increase the Overnight Policy Rate (OPR) by 100 bps to 8.75%.[1] The Board arrived at this decision after carefully considering the evolving conditions and outlook on the domestic and global fronts.

The uncertainties arising from the heightened tensions in the Middle East have prompted global commodity prices, particularly petroleum, to remain high, adversely affecting the global as well as the domestic economy. High global oil prices have necessitated sharp upward adjustments to domestic energy prices, largely contributing to the 5.4% (y-o-y) inflation in April 2026. While the recent increase in inflation is largely supply-driven, demand conditions in the economy have also strengthened, as shown by the continued credit expansion, credit-driven imports, and leading indicators of economic activity. Accordingly, headline inflation is likely to remain above the target of 5% in the period ahead, before easing and stabilising around it. Inflation expectations in the short term have also increased somewhat, although they remain well-anchored around the inflation target over the medium term.

While near term pressures on the external sector were expected amid global headwinds stemming from the Middle East conflict, such pressures were seen to have amplified in recent weeks due to speculative activity. Following the robust performance recorded in 2025, the surplus in the external current account remained modest in the first quarter of 2026. This was mainly due to the widening merchandise trade deficit, particularly driven by increased expenditure on fuel imports and slowdown in tourism earnings. However, workers' remittances have remained resilient thus far in 2026. Gross Official Reserves stood at USD 6.8 bn[2] by end April 2026, amid foreign debt servicing. Similar to several regional peer currencies, Sri Lanka rupee experienced notable depreciation pressures in recent weeks, although conditions have since eased to some extent. Going forward, envisaged sizeable multilateral inflows, together with the anticipated easing of geopolitical tensions, and recently announced measures by the

[1] Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR), which are linked to OPR with predetermined margins of ± 50 bps, are increased to 8.25% and 9.25%, respectively.
[2] This includes the swap facility from the People's Bank of China.

Government and the Central Bank, are expected to support the stabilisation of the external sector.

In view of the elevated inflation forecast, the potential second-round effects on headline inflation from energy price adjustments, continued expansion in private sector credit fueling import demand, pressures on the external sector, as well as the risk of de-anchoring inflation expectations, the Board was of the view that a tightening of the monetary policy stance is appropriate at this juncture. This stance reflects the Board's continued commitment to maintaining domestic price stability.

The Central Bank will carefully assess incoming data on the domestic and global fronts and emerging risks, and stand ready to take measures, as appropriate, to ensure that inflation stabilises around the target, while supporting the economy to reach its potential over the medium term.

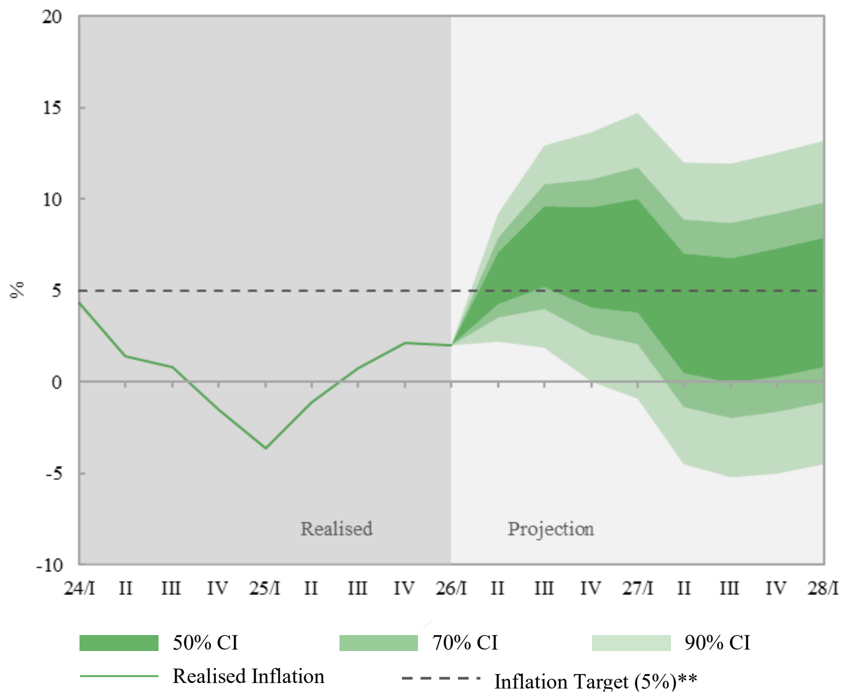
The release of the next regular statement on the monetary policy review will be on 22 July 2026.

Data Annexure is accessible at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/mpr03_2026_e.pdf

Annexure 01:

The projections presented below are based on information available as of 25 May 2026. Amid the fluid nature of the prevailing Middle East war and its wide-ranging spillovers across both global and domestic economic activity, the present inflation outlook remains subject to elevated uncertainty. Accordingly, any significant changes in underlying conditions could lead to notable deviations from these projections.

Baseline Quarterly Headline Inflation Forecast* (CCPI, y-o-y)
Based on the Projections during the May 2026 Monetary Policy Round



Source: Central Bank Staff Projections

*** The inflation target (5%) was agreed under the Monetary Policy Framework Agreement (MPFA) signed between the Central Bank and the Minister of Finance in October 2023.*

* Realised data in the fan chart are based on the CCPI (2021=100, seasonally adjusted). Projections are based on all available data at the forecast round in May 2026.

Note: The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colours. The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. For example, the thick green shaded area represents the 50% confidence interval, implying that there is a 50% probability that the actual inflation outcome will be within this interval. The confidence bands show the increasing uncertainty in forecasting inflation over a longer horizon.

Note: A forecast is neither a promise nor a commitment.

The projections reflect the available data, assumptions, and judgements made at the forecast round in May 2026. They are conditional on the forecasts of global energy and food prices, the expected growth path of Sri Lanka's major trading partners, the anticipated fiscal path of the Government, expected developments in the external sector, including the external current account balance, and global financial conditions implied by the Fed Funds rate. Further, the projections are conditional on the model-consistent interest rate path and the resulting macroeconomic responses. Any notable changes in these assumptions could lead to the realised inflation path deviating from the projected path.

There are upside risks to the realisation of inflation projections stemming from factors such as renewed escalations in geopolitical tensions, which could disrupt global commodity markets, energy supplies, and shipping routes, potentially leading to higher-than-anticipated increases in domestic energy and transport costs, and fertiliser prices; possible depreciation of the Sri Lanka rupee at higher levels arising from adverse market sentiment and external shocks; possible higher-than-anticipated second-round effects from energy price increases; possible higher-than-anticipated demand pressures arising from the lagged impact of strong credit growth; possible broader indirect tax pass-through to consumer prices following the reduction in the VAT registration threshold; and possible repeated adverse weather events affecting the agriculture and energy sectors, thereby exerting upward pressure on food and energy inflation. Meanwhile, downside risks to the realisation of inflation projections include the possibility of unexpected declines in global oil prices, which could reduce domestic energy and transport costs, thereby easing inflationary pressures.