Highlights of the Monetary Policy Report

August 2025

15 August 2025

Economic Research Department
Central Bank of Sri Lanka

Legal Requirement

In keeping with Sections 27 and 80 of the CBA, the Monetary Policy Report is prepared to communicate to the public and other stakeholders the rationale for the monetary policy decisions taken during the relevant period of review, while providing guidance on the inflation and economic growth outlook along with an assessment of risks to the outlook

The Purpose of the Monetary Policy Report is to...

Enhance transparency and communicate monetary policy rationale

Increase accountability and build credibility of monetary policy

Provide an outlook for inflation as well as economic growth

Anchor inflation expectations

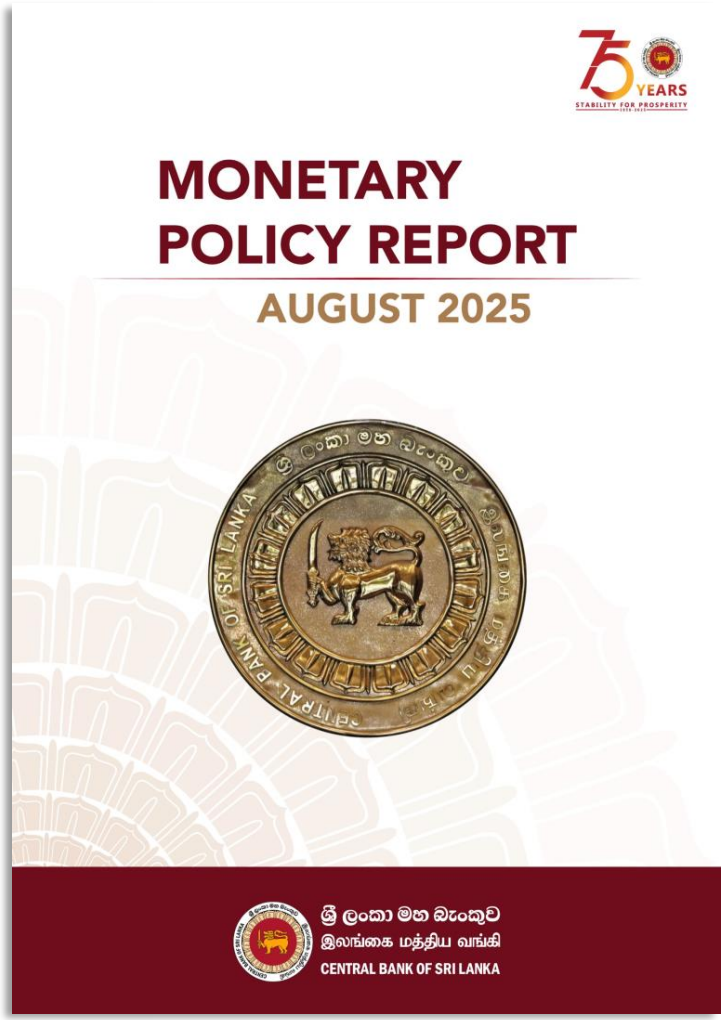
Enhance policy coordination

The Coverage

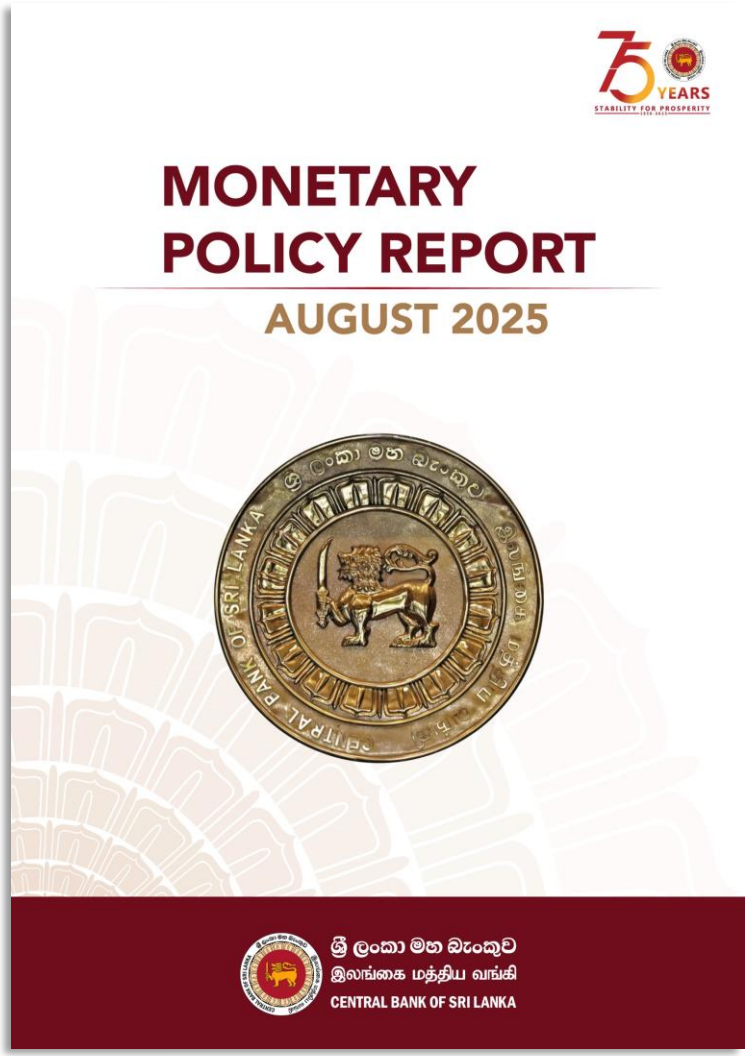
- Monetary Policy Framework of CBSL
- Executive Summary
- Monetary Policy Summary
- Inflation and Economic Outlook
  - Baseline forecast
  - Key assumptions underpinning the forecast
  - Risks to realisation of baseline projections
  - Comparison with the previous forecast
- Current Economic Developments
  - Domestic sectoral and global developments

Box articles : Box A: Understanding Momentum and Base Effect
Box B: Understanding Services Inflation: Why Does It Matter?

The content of the Report is based on the data available as of the July 2025 monetary policy round of the Central Bank, which concluded with the monetary policy announcement on 23 July 2025.



Monetary Policy Framework of the CBSL



Monetary Policy Framework

- CBSL conducts monetary policy under the **Flexible Inflation Targeting (FIT) Framework**
    - The Monetary Policy Board (MPB) is formulating monetary policy and implementing a flexible exchange rate regime that is consistent with FIT
- Inflation target: **5%**, as per the Monetary Policy Framework Agreement (MPFA)
- CBSL steers short-term market interest rates using policy instruments and currently **the Overnight Policy Rate (OPR)** is the primary monetary policy tool
- In the current framework, the **Average Weighted Call Money Rate (AWCMR)** serves as the CBSL's **operating target**

Monetary Policy Decision-making Process in Sri Lanka

Staff-Level Meetings

First Staff Level Meeting

Discussion on macroeconomic developments by sectoral experts

Second Staff Level Meeting

Discussion on preliminary macroeconomic projections and risks to outlook

Pre-MPC Meeting

Chaired by Governor

Tier 1

(Technical Level Open Session)
Issue-based technical level presentation along with risks

Tier 2

(Technical Level Closed Session)
Discussion on medium-term projections and risks to outlook

MPB members join as observers in both sessions of Pre-MPC meeting and clarify issues/ concerns on information presented and suggest improvements.

MPC Meeting

Chaired by Governor

Presentation on medium-term projections, risks to outlook along with scenario analyses

Discussion on the macroeconomic factors determining the appropriate monetary policy stance and technical recommendations

MPC makes policy recommendations on the monetary policy stance

MPB Meeting

Chaired by Governor

Presentation on medium-term projections, risks to outlook along with scenario analyses

Discussion on the macroeconomic factors determining the appropriate monetary policy stance

MPB considers the recommendations by MPC and decides on the monetary policy stance

Release of Monetary Policy Decision

Monetary policy review on the following day of MPB meeting

Monetary policy press conference

Monetary Policy Report

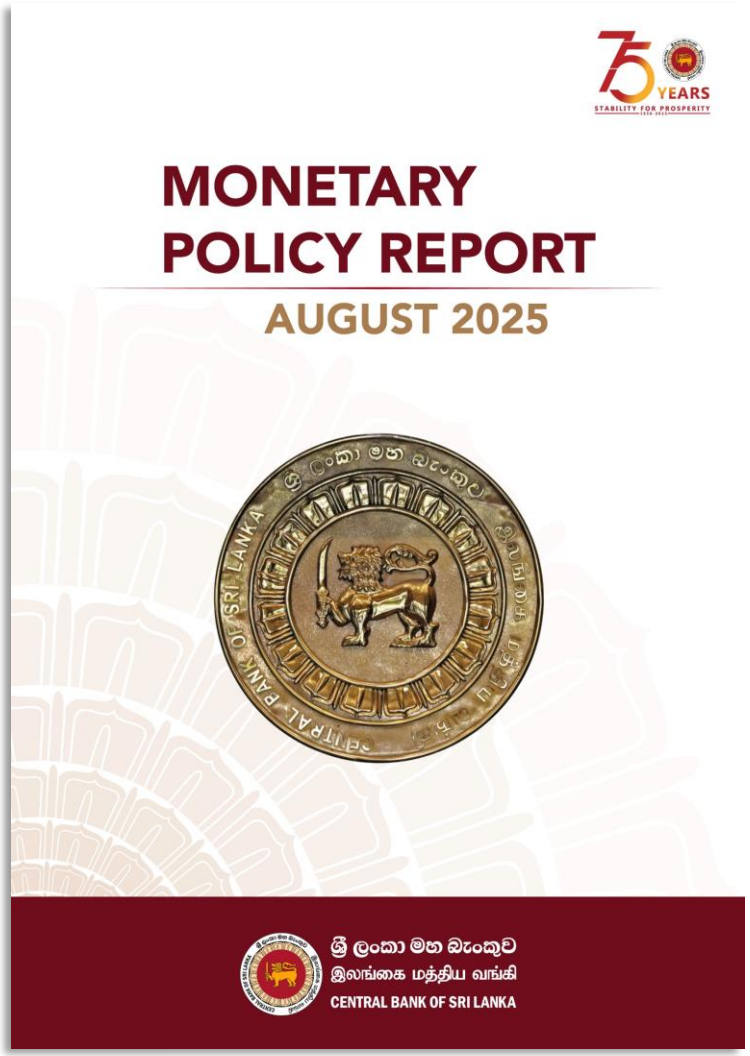
Published biannually

On *15 February* and *15 August*, following the release of January and July monetary policy decisions, respectively

Stakeholder Engagement Committee

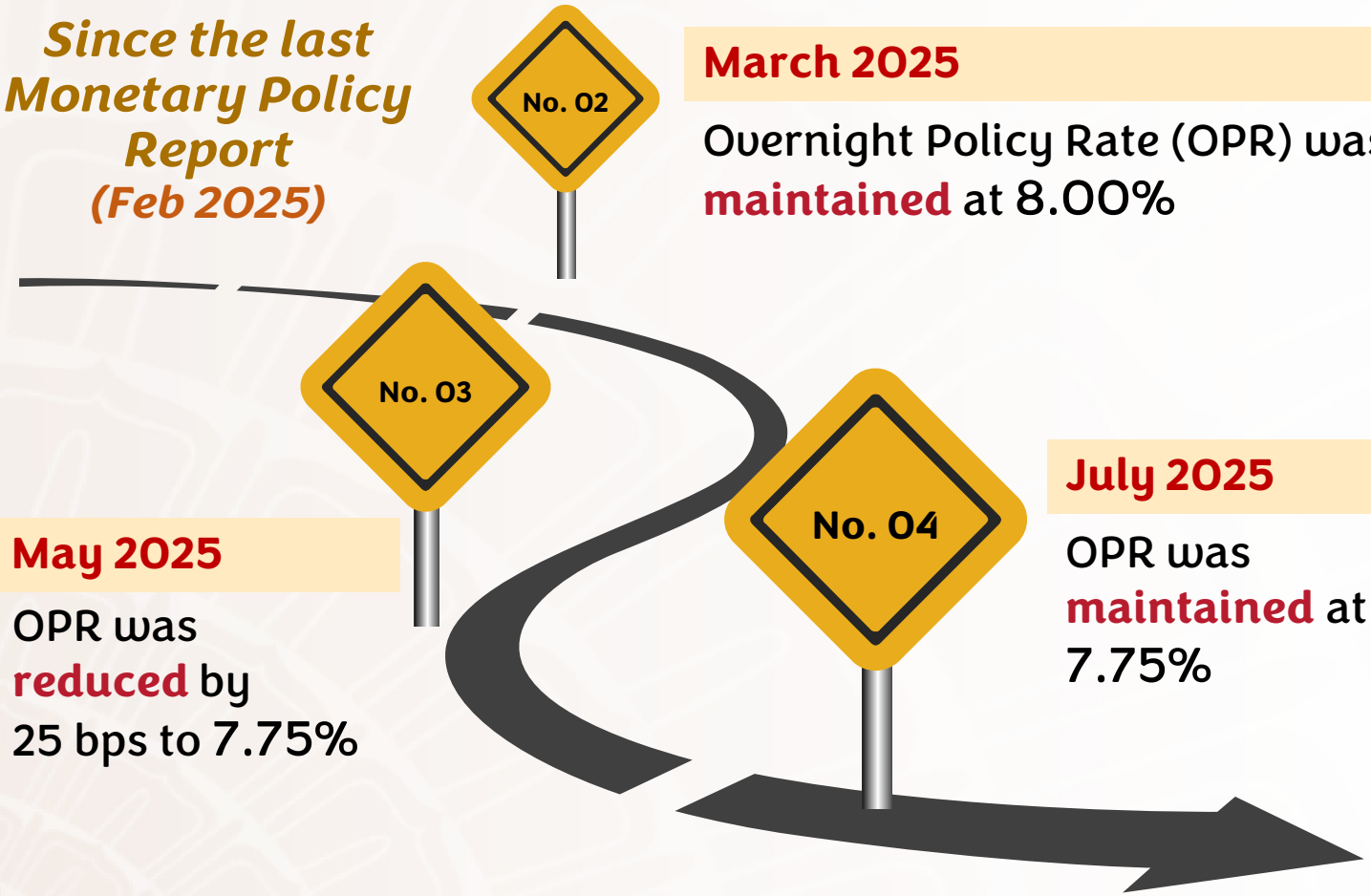
MPC - Monetary Policy Committee
MPB - Monetary Policy Board

Monetary Policy Summary



The Central Bank of Sri Lanka continued to maintain its accommodative monetary policy stance

Since the last Monetary Policy Report (Feb 2025)



March 2025

Overnight Policy Rate (OPR) was **maintained** at 8.00%

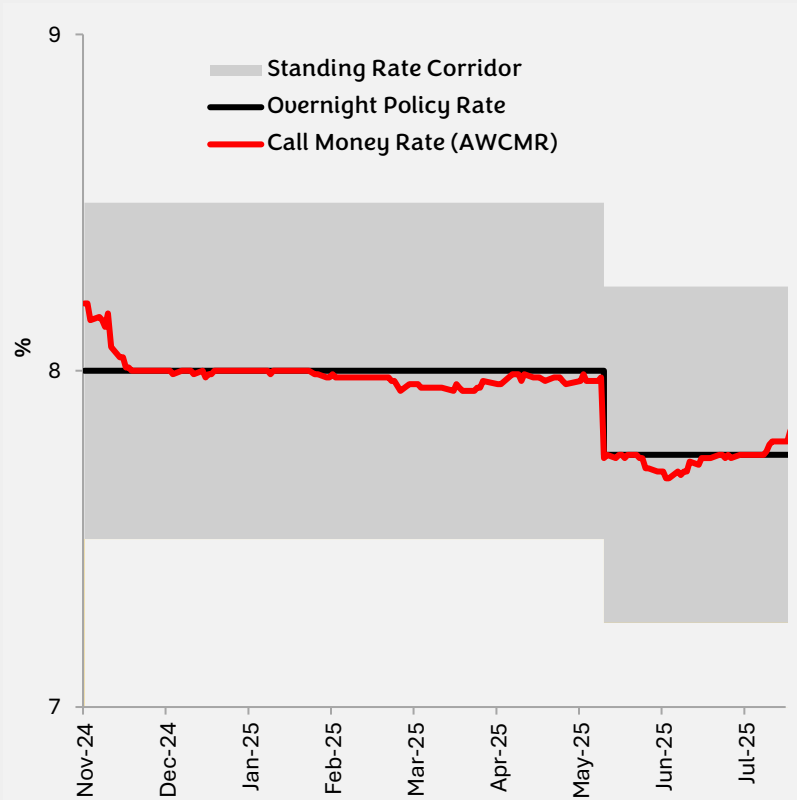
May 2025

OPR was **reduced** by 25 bps to 7.75%

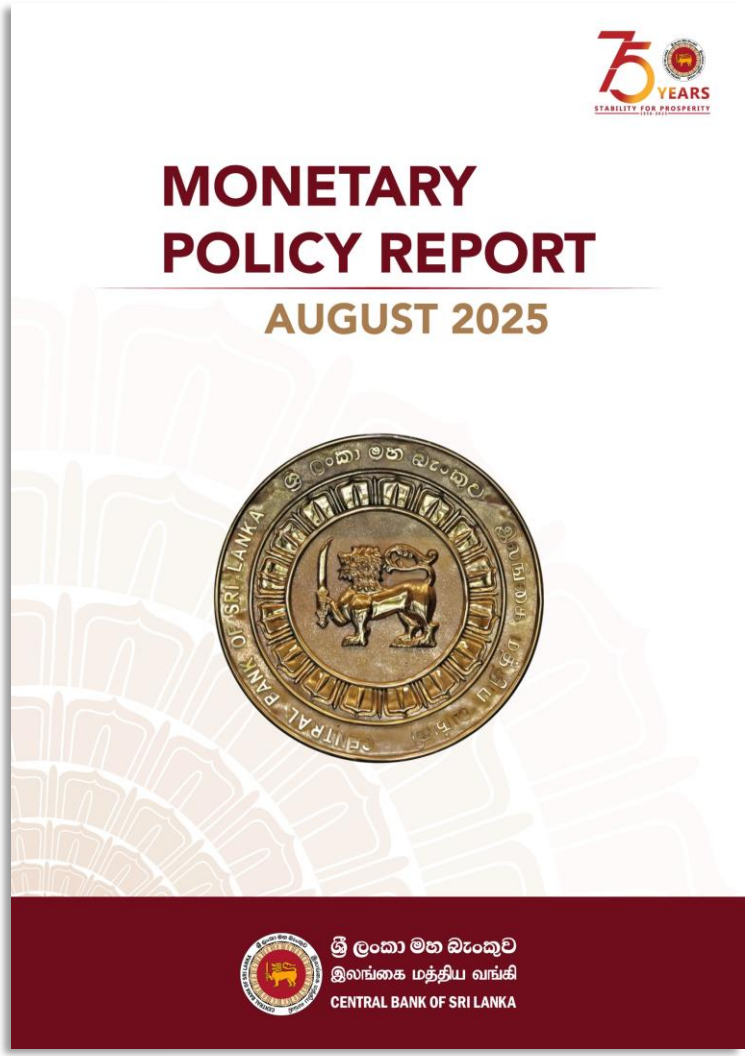
July 2025

OPR was **maintained** at 7.75%

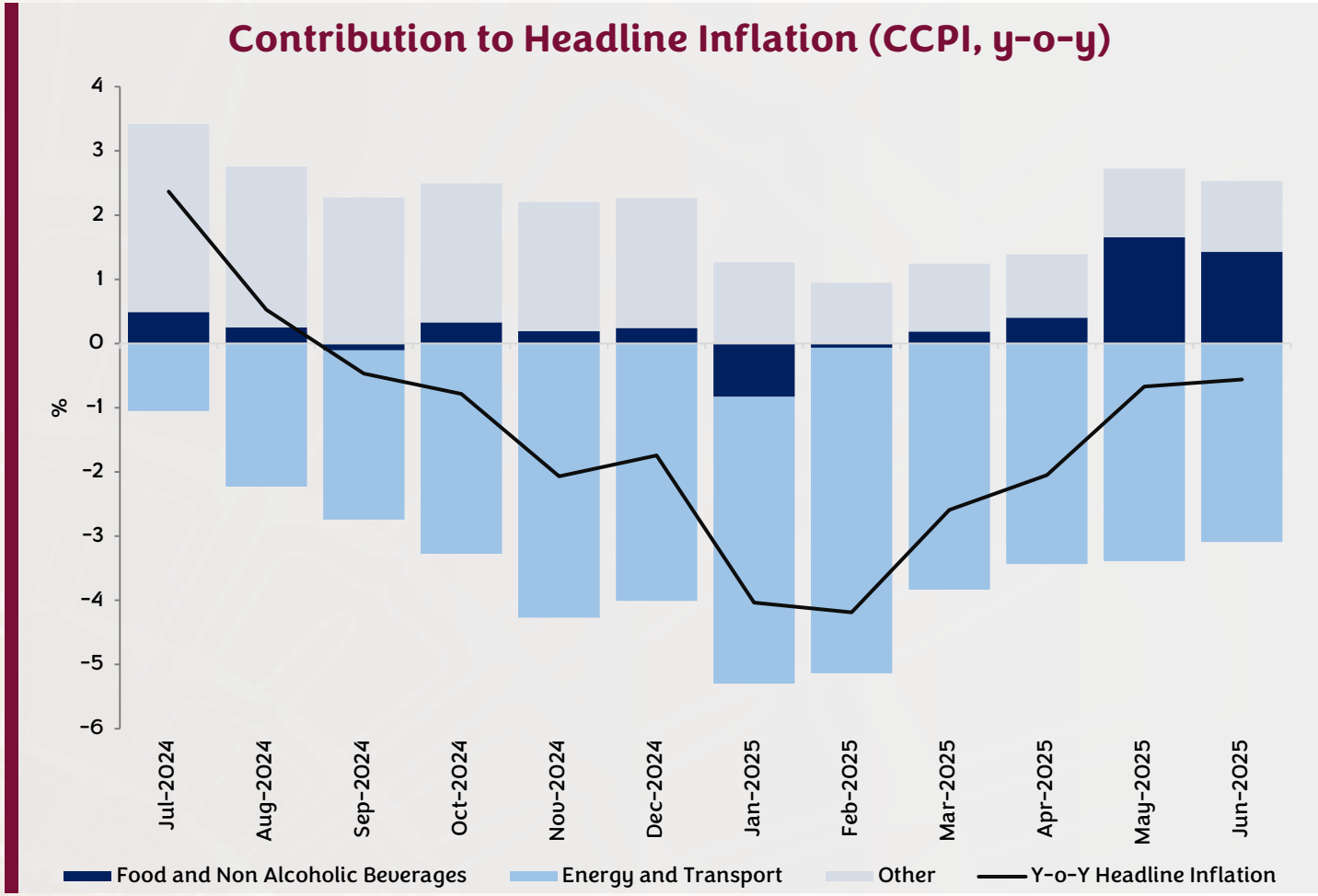
Movements in the Overnight Policy Rate (OPR) and the Average Call Money Rate (AWCMR)



Inflation Development and Outlook



Deflationary conditions began to ease since March 2025

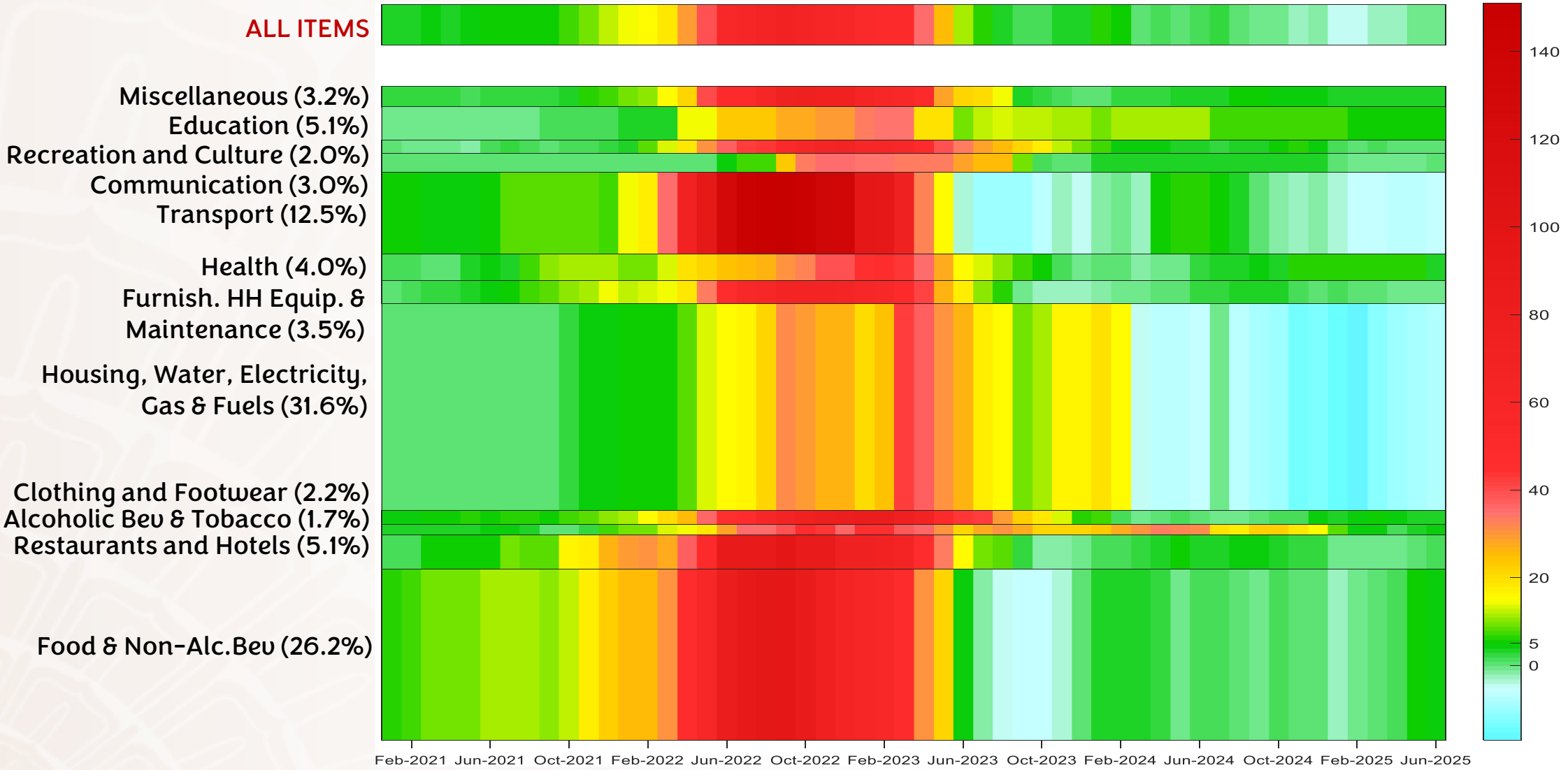


Sources: Department of Census and Statistics, Central Bank Staff Calculations

The easing of the deflationary trend was due to rising food inflation and upward adjustments to administratively determined prices

Upward revision of electricity tariffs in mid-June 2025, along with the positive contribution from the statistical base effect, also helped ease deflation

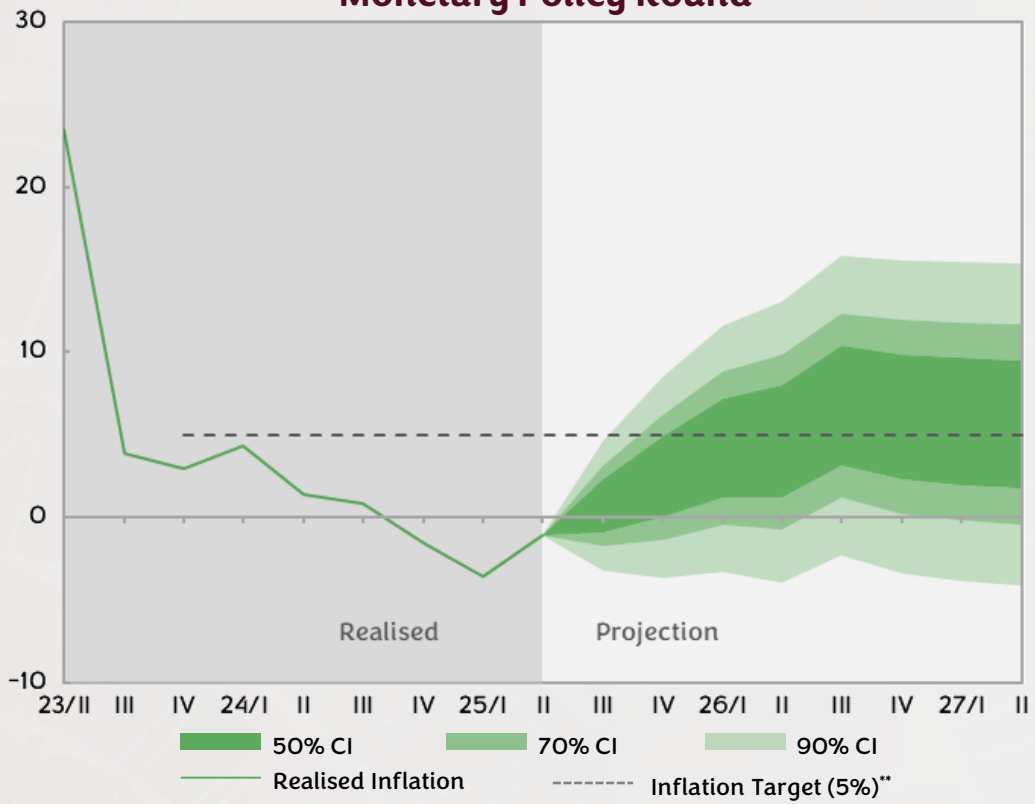
Headline Inflation Heatmap



Note: Data preceding January 2023 are based on the CCPI (2013=100), while data commencing January 2023 are based on the CCPI (2021=100). Base weights are given in parentheses, based on the CCPI (2021=100). The height in each subcategory represents the relative base weight of the category (excluding in the case of All items).

Deflation is expected to end in Q3-2025 and a gradual acceleration of inflation is expected thereafter to reach the 5% target in mid 2026

Projected Headline Inflation: (Quarterly, CCPI, y-o-y, %)
Based on the Projections during the July 2025 Monetary Policy Round



*** 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.*

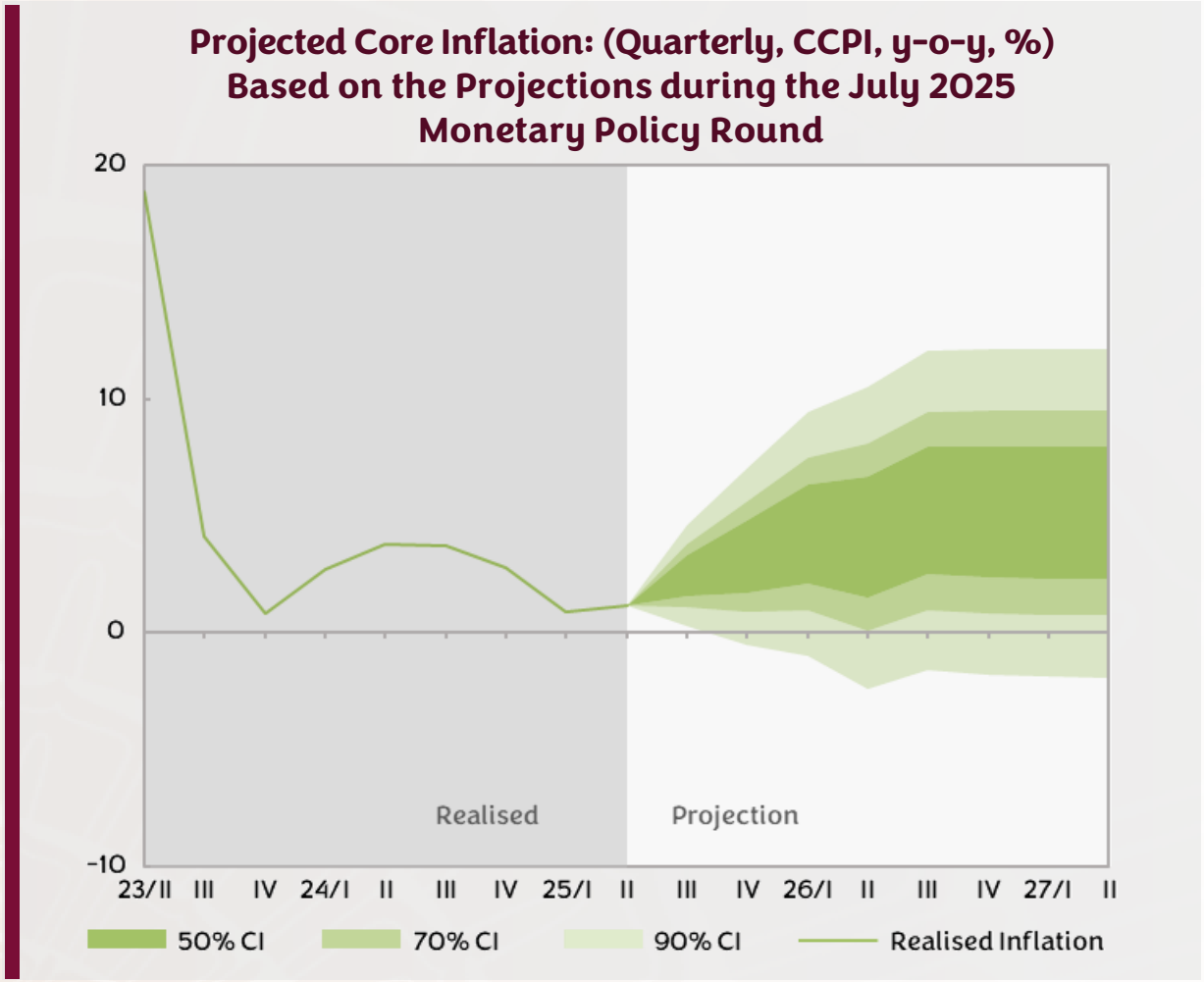
Prevailing deflationary conditions are expected to ease gradually, primarily reflecting the easing of energy-related deflation

Medium-term projections suggest that headline inflation would continue to accelerate and reach the target of 5% in mid-2026, supported by firming demand conditions

Thereafter, following a possible uptick, inflation is projected to stabilise at the target with the implementation of appropriate policy measures

Note: The projections in the fan chart reflect the available data, assumptions and judgements made at the forecast round in July 2025. Realised data shown in the fan chart are based on the CCPI (2021=100, seasonally adjusted). The projections are based on all available data at the forecast round in July 2025.

Core inflation projections reflect a lower degree of volatility



- **Core inflation is expected to record a gradual increase in the near term**
- **Core inflation is projected to stablise at a level consistent with the headline inflation target of 5%, with a lower degree of volatility over the medium term**

Note: The projections in the fan chart reflect the available data, assumptions and judgements made at the forecast round in July 2025. Realised data shown in the fan chart are based on the CCPI (2021=100, seasonally adjusted). The projections are based on all available data at the forecast round in July 2025.

Risks to the Inflation Outlook

Upside risks

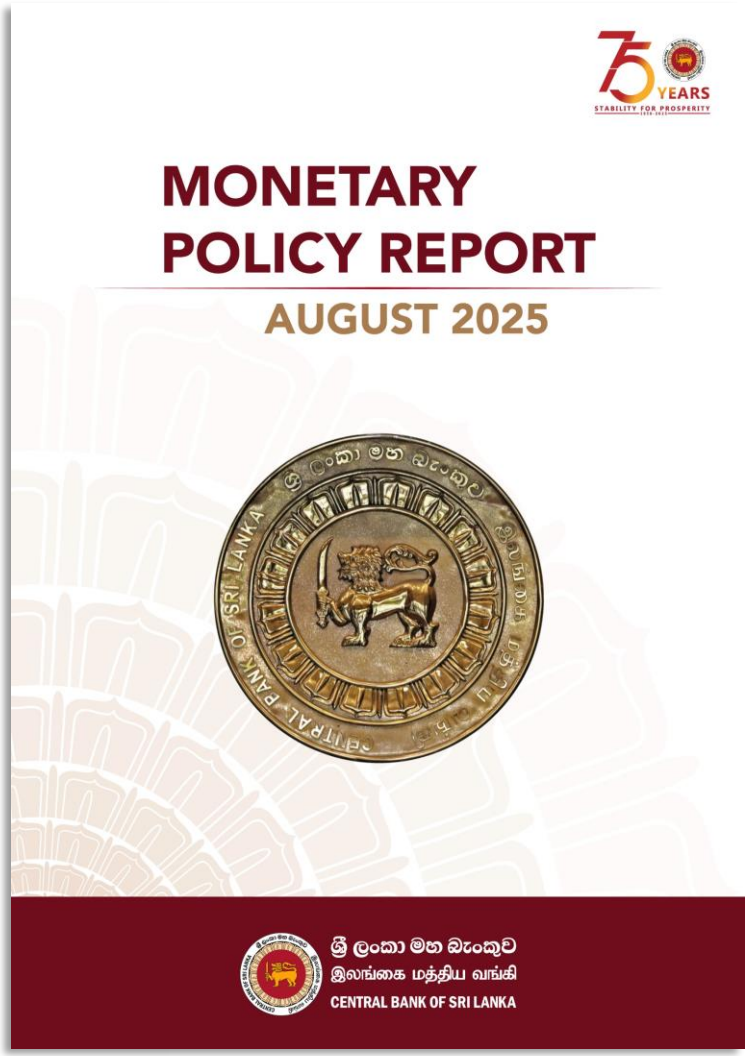
- Possible increases in global commodity prices amidst geopolitical tensions and supply disruptions
- Possible LKR depreciation above assumed levels
- The possibility of higher-than-anticipated demand pressures amid Stronger credit growth
- Possible adverse weather conditions affecting agricultural production

Downside risks

- Possible further reductions in food prices in the near term amid a healthy harvest
- Possible persistent slowdown in global demand leading to a more-than-anticipated reduction in global energy and food prices

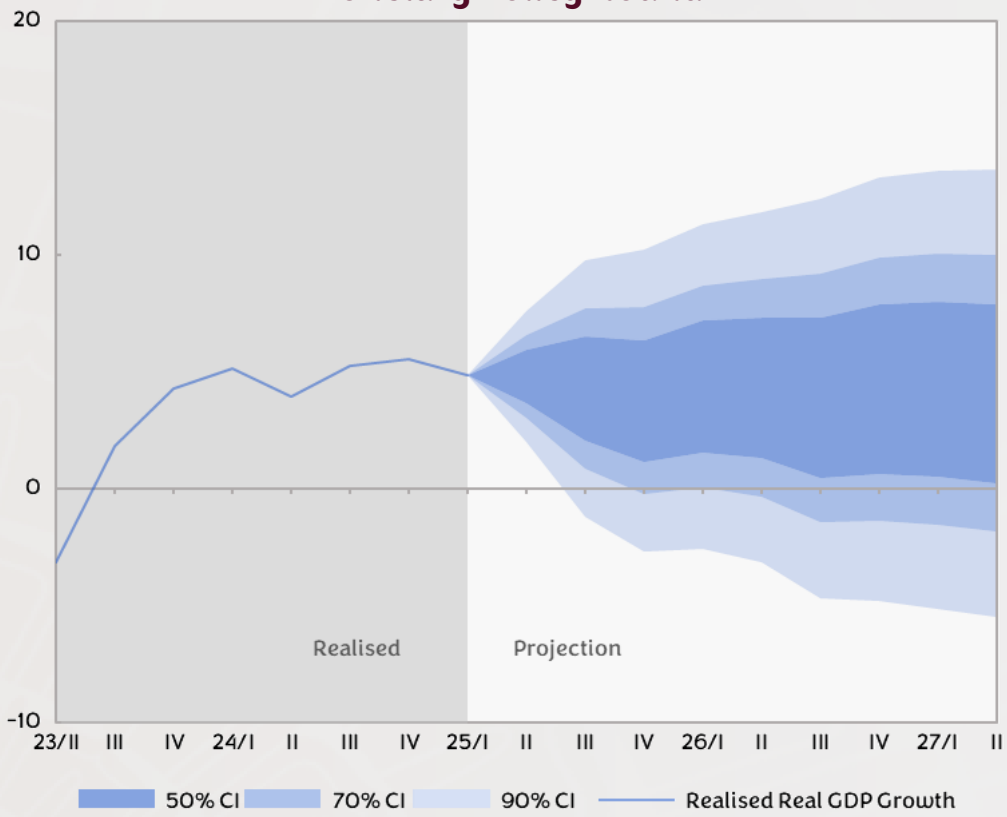
Risks to inflation projections are assessed to be **balanced** in both the near and medium term

Economic Growth Outlook



Economic growth is expected to move along a modest growth trajectory over the medium term

Projected Quarterly Real GDP Growth (y-o-y, %)
Based on the Projections during the July 2025 Monetary Policy Round



Note: The projections in the fan chart reflect the available data, assumptions and judgements made at the forecast round in July 2025.

Continuing the positive momentum, economic growth for 2025 is projected to be around 4.5%

External demand conditions and evolving global geoeconomic landscape increase the level of uncertainty associated with growth prospects

Risks to the Growth Outlook

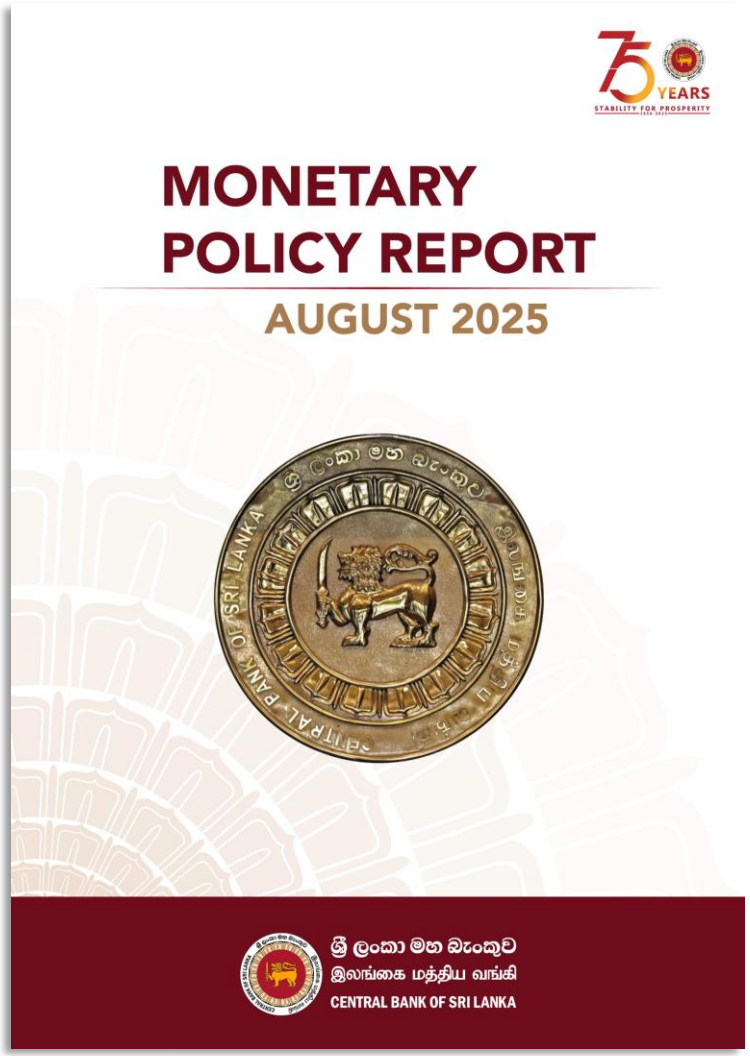
Downside risks

- Negative impact of US tariffs – Both the direct impact on US exports, as well as the impact of the overall global growth slowdown amid high uncertainty
- Possible negative impact on the external demand, foreign employment and tourism due to a potential escalation of geopolitical tensions
- Weather anomalies and climate change could adversely affect domestic economic activity

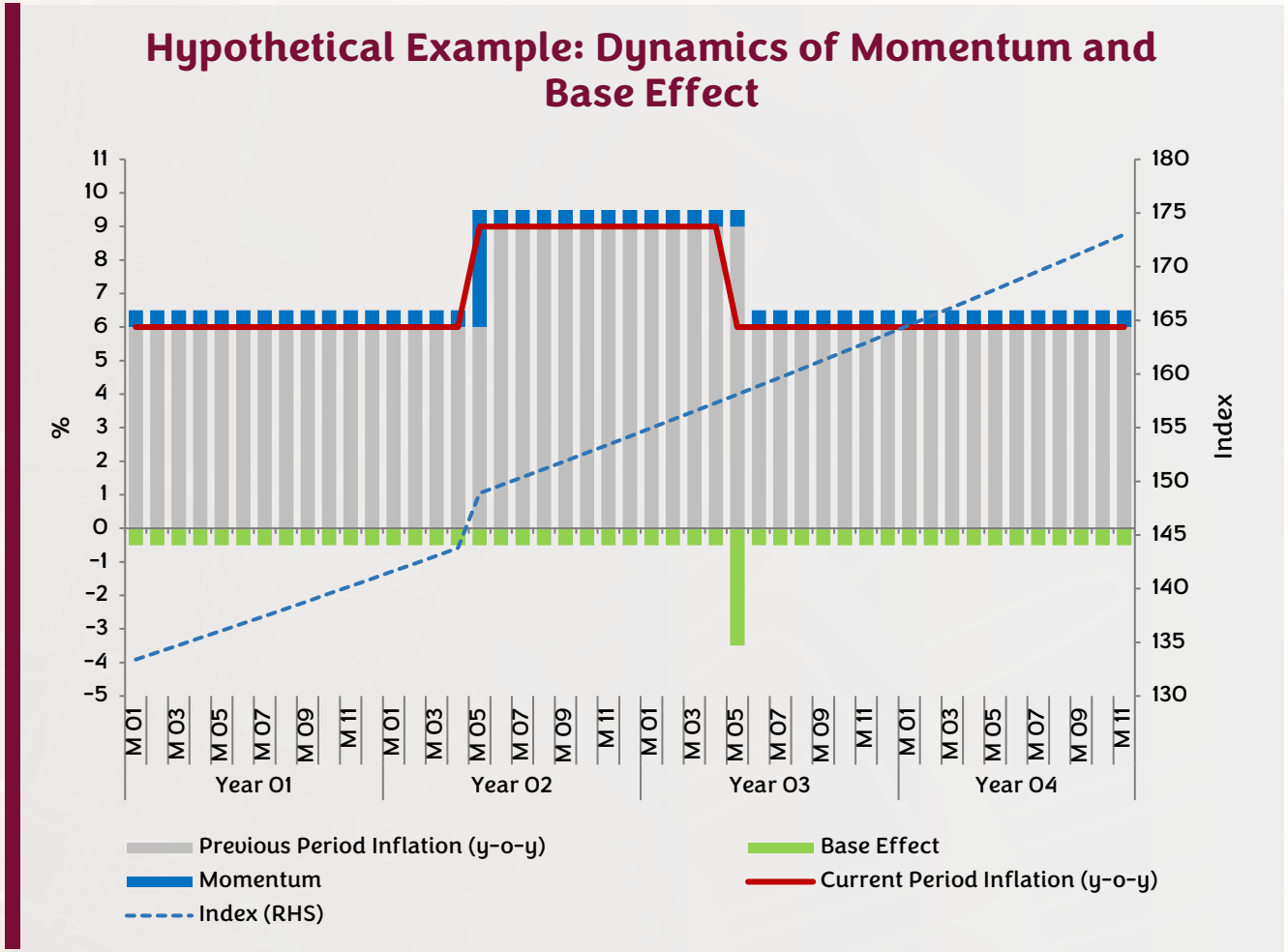
Upside risks

- Better-than-expected recovery in the Agricultural sector in the near term
- Expeditious implementation of growth and export-promoting strategies

Box Articles



Box Article A: Understanding Momentum and Base Effect



Note: Percentage changes are based on log differences

Source: Central Bank Staff Calculations

Momentum: m-o-m inflation in the current month

...represents how **price developments** in the latest month contribute to changing y-o-y inflation...

Base Effect: Negative m-o-m inflation in the same month of the previous year

...represents the statistical component of the change of y-o-y inflation from one month to the next ...

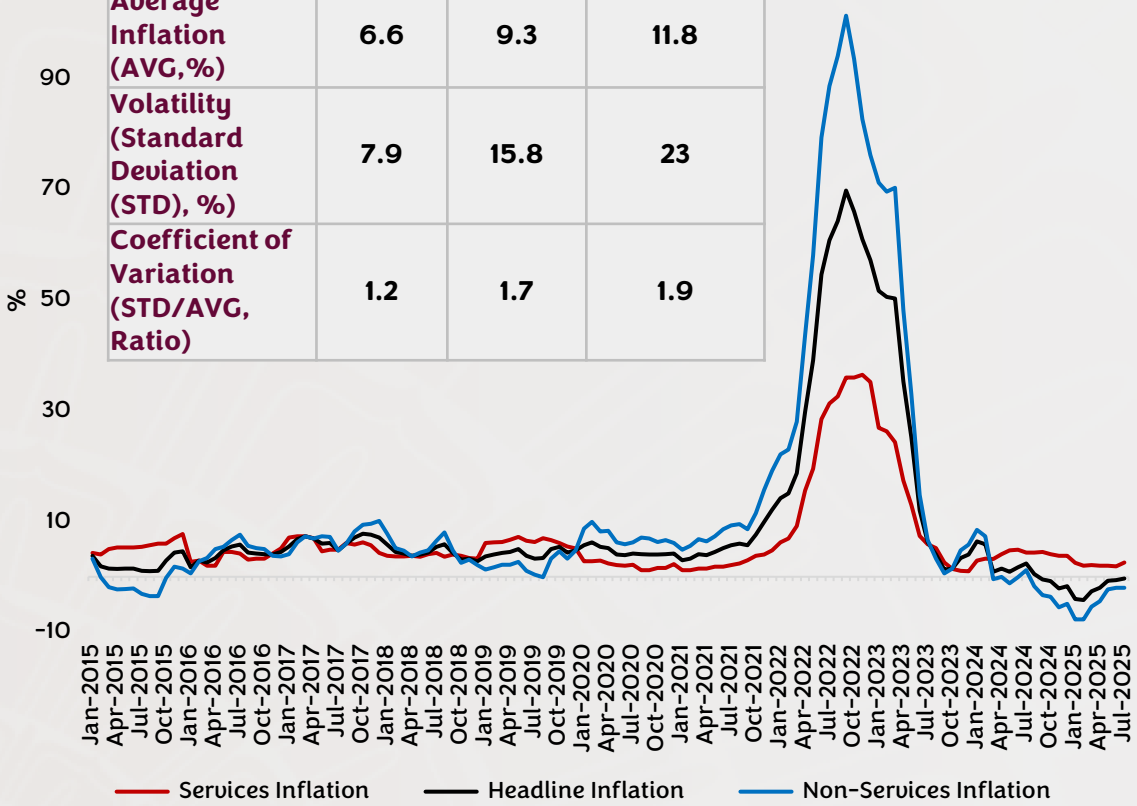
The change of the y-o-y inflation from one month to the next can then be approximated by adding the momentum and the base effect

$$\pi_t^{YoY} \approx \pi_{t-1}^{YoY} + \text{Momentum} + \text{Base Effect}$$

Box Article B: Understanding Services Inflation: Why Does It Matter?

Movement of CCPI (2013=100 and 2021=100) Based Services Inflation (y-o-y)

	Services	Headline	Non-Services
Average Inflation (AVG,%)	6.6	9.3	11.8
Volatility (Standard Deviation (STD), %)	7.9	15.8	23
Coefficient of Variation (STD/AVG, Ratio)	1.2	1.7	1.9



"Services inflation is the rate of increase in services costs, which typically adjust more gradually and show greater persistence than goods prices"

- In Sri Lanka, services make up nearly half of the consumer basket, significantly influencing headline inflation and the cost of living
- Therefore, close monitoring is essential for better inflation analysis, forecasting, and policy action
- Services inflation in Sri Lanka has been relatively stable over time but remained elevated in 2024 and thus far in 2025 compared to non-services inflation

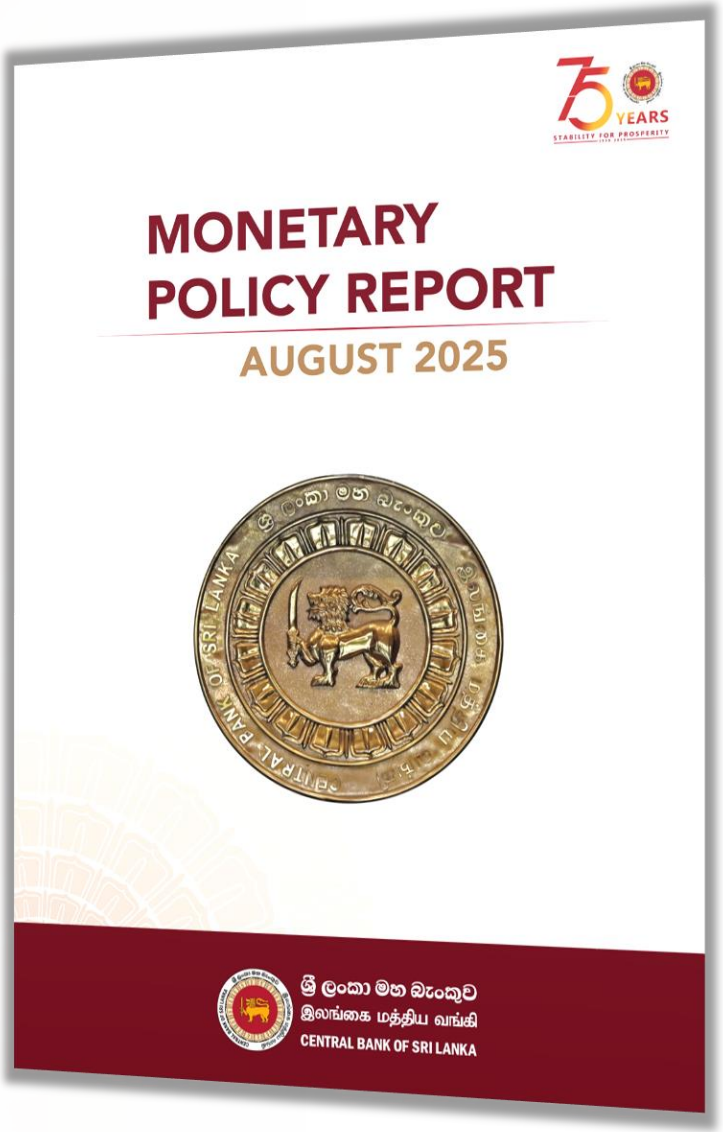
In consideration of the importance of services inflation, it is essential to establish regular and systematic monitoring of prices of services

Central Bank's

Monetary Policy Report

August 2025

Now available at



Thank you