

# EXECUTIVE SUMMARY

The Sri Lankan economy continued to recover steadily in 2024, following its deepest economic downturn experienced two years ago. The road to recovery was difficult, but notably faster compared to most debt-distressed countries. Post-crisis reforms have started showing positive outcomes. Signs of improved economic activity, partial recovery in purchasing power, and reduced uncertainty are visible. Election-related uncertainties dissipated towards the latter part of 2024 as signs of the continuation of the reform programme and policy consistency were evident. This, along with the near-completion of external debt restructuring and the country's exit from *restricted default* rating, has enhanced investor and stakeholder confidence.

In terms of economic growth, Sri Lanka performed better than expected in 2024. Inflation eased and the country entered a period of deflation since September 2024 driven largely by energy price reductions. This resulted in a deviation of inflation from the target on the downside. Supported by low interest rates, credit to households and businesses expanded in 2024. Eased monetary conditions contributed to a faster recovery in domestic economic activity, partly regaining lost output during the pandemic and the economic crisis. Meanwhile, external sector performance remained strong during the year. A notable improvement in external buffers was observed along with the increased net foreign exchange inflows to the country. The external current account continued to record a surplus. The Sri Lanka rupee appreciated under the flexible exchange rate policy. The benefit of currency appreciation trickled down to consumers through low import prices, although it had negative implications on foreign exchange earners. Fiscal sector performance improved notably in 2024, with the primary balance recording a surplus for the second consecutive year.

Building on the achievements in 2023, the focus of the Central Bank's policies was to sustain domestic price stability and financial system stability. In keeping with the priorities under the Flexible Inflation Targeting (FIT) framework, the Central Bank continued to maintain an accommodative monetary policy stance given the benign inflation outlook, thereby supporting domestic economic activity. Meanwhile, due to improved external sector performance, remaining restrictions on imports and capital flows were gradually phased out by the Government in consultation with the Central Bank. Financial system stability was reinforced with the enactment of the Banking (Amendment) Act, which strengthened the legal framework for the governance of licensed banks. Overall performance of the financial sector continued to gradually improve during 2024 supported by improved macrofinancial conditions. A range

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of regulatory measures on risk management and corporate governance was also introduced during the year. Special focus was also given to the establishment of business revival units in licensed banks to support micro, small and medium scale enterprises (MSMEs). The Central Bank continued its efforts to enhance financial literacy, promote financial inclusion, and foster digital transformation in the financial sector.

Following the unprecedented crisis in 2022, the country's reform programme aimed to correct deep-rooted structural weaknesses. The need for continued fiscal consolidation was prioritised to achieve debt sustainability while supporting the economic recovery. Special attention was also given by the Government to uplifting the livelihoods of the poor and vulnerable through the implementation of the social safety net programme. Moreover, measures are being taken to address vulnerabilities associated with corruption. A low inflation - low interest rate environment, together with a stable financial sector, has formed a conducive environment for the Sri Lankan economy to achieve its potential. Furthermore, positive market sentiments and stable political conditions along with macroeconomic policy consistencies have set the environment for the country to thrive. That said, the heightening of global geopolitical uncertainties, particularly the imposition of the proposed tariffs by the US and its spillover effects, could weigh on external sector and the broader economic outlook. Hence, there is a compelling need for continued prudence in policymaking and further strengthening of external and fiscal buffers.

The Government and the Central Bank of Sri Lanka have taken bold steps to recover the economy from the crisis. The implementation of the IMF-EFF programme and debt restructuring efforts were important pillars of this journey of recovery. It is noteworthy that most of the major reforms to restore stability were frontloaded and completed in the early phase of the macroeconomic adjustment programme. Although notable progress has been achieved, the journey is far from over. Since macroeconomic stability has now been restored to a greater extent, the commitment to embark on the much-needed structural reforms is crucial for the long-term growth of the country that will ensure the prosperity of all citizens.