



EXECUTIVE SUMMARY

In 2025, the Sri Lankan economy continued to build on the recovery achieved in previous years, underpinned by sustained macroeconomic stabilisation and the continued implementation of policy and structural reforms. Notwithstanding heightened global uncertainties, especially related to trade and geopolitical developments, as well as the impact of adverse weather conditions and devastating natural disasters towards late 2025, domestic economic activity remained resilient. Improved macroeconomic conditions and continued policy consistency strengthened overall investor confidence, paving the way for sustained economic growth, while enhancing the ability of the economy to build buffers to weather shocks more effectively.

Economic activity remained robust in 2025, with real GDP growth estimated at 5%, marking the second consecutive year of expansion. Labour market conditions improved alongside the recovery, and inflation turned positive from August 2025 following a period of deflation, largely driven by easing energy-related price declines and higher food prices, with demand remaining firm. Lower interest rates, reflecting relaxed monetary conditions, led to a notable expansion in credit to the private sector. The removal of restrictions on vehicle imports contributed to higher imports and credit demand during the year. External sector performance strengthened further, with the current account recording a surplus for the third consecutive year, particularly supported by the historically high levels of workers' remittances, along with improved services exports, despite a widening trade deficit. These foreign exchange inflows enabled the continued build-up of reserves amid external debt service payments, while the Sri Lanka rupee recorded a modest depreciation under the flexible exchange rate regime. Fiscal performance remained strong, with the primary balance recording a surplus for the third consecutive year, underpinned by revenue-based fiscal consolidation measures, alongside continued efforts to support vulnerable groups. Financial sector performance also improved amid strengthened macroeconomic conditions. The profitability of both bank and non-bank financial institutions improved in 2025, alongside notable enhancements in asset quality, largely supported by robust credit expansion. Liquidity and capital buffers of banks and finance companies remained well above regulatory minimum requirements, reflecting the strengthened resilience of the financial sector.

Building on improved macroeconomic conditions, the Central Bank's policy focus in 2025 remained on maintaining price stability and financial system stability. Monetary policy was kept accommodative in an environment of subdued inflation and heightened global

uncertainty. This helped sustain low interest rates and supported credit expansion. Conscious efforts were made to build foreign reserves through foreign exchange purchases, thereby strengthening buffers and enhancing external sector resilience. Moreover, improved external sector performance allowed for the gradual easing of capital flow management measures and the complete removal of vehicle import restrictions. In 2025, the Central Bank pursued a comprehensive set of regulatory, supervisory, and financial system development initiatives to align the financial system with evolving economic and technological dynamics while ensuring system stability. Financial system resilience was further reinforced through enhanced macroprudential measures and strengthened supervisory and regulatory frameworks. Efforts to enhance crisis preparedness were advanced through the introduction of recovery planning requirements and improvements to the resolution and deposit insurance framework. Financial system modernisation efforts progressed further with the promotion of digital payments, enhanced cybersecurity, and technology risk management. Progress continued in anti-money laundering, countering the financing of terrorism, and countering proliferation financing initiatives, supported by legislative reforms. Meanwhile, the Central Bank facilitated the smooth transfer of public debt management functions to the Public Debt Management Office by end 2025.

Stability-conducive policies and reforms implemented by the authorities have helped Sri Lanka build buffers and maintain a stable macroeconomic footing. However, persistently elevated global uncertainties, including geopolitical tensions, trade disruptions, and climate-related risks, pose continued challenges to the economic outlook, which remains contingent on the duration and magnitude of the ongoing war in the Middle East and its potential spillovers to global energy markets, trade flows, and financial conditions. Inflation, which has remained low thus far, is expected to return to target sooner than previously anticipated, reflecting the impact of the war in the Middle East. Monetary policy under the Flexible Inflation Targeting framework will continue to be forward-looking and data-driven supporting the anchoring of inflation expectations and maintaining price stability. Credit growth is expected to continue, albeit at a more moderate pace, while external sector conditions are expected to remain manageable amid potential pressures on trade, tourism, and financial flows stemming from the war in the Middle East. Revenue-based fiscal consolidation measures, critical to safeguarding medium-term debt sustainability, are expected to remain a key policy priority.

Significant progress under the IMF-EFF programme and debt restructuring, together with political stability, has reinforced Sri Lanka's position as an economy with renewed potential. Overall, the progress made in restoring macroeconomic stability, together with continued policy consistency and reforms, is expected to support sustainable and inclusive growth, going forward. Nonetheless, in an environment of heightened global uncertainty and unabated consequences of climate change, sustaining policy buffers, accelerating structural reforms and remaining steadfast in implementation will be vital to strengthening resilience and safeguarding macroeconomic and financial stability.