

Financial Stability Review 2026



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CENTRAL BANK OF SRI LANKA

Financial Stability Review 2026



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In terms of Section 70(1) of the Central Bank of Sri Lanka Act, No. 16 of 2023, the Central Bank is required to prepare and publish the Financial Stability Review (FSR) on or before the thirty-first day in the month of October of each year. Fulfilling this obligation, FSR of 2026 encapsulates the developments in the financial system, the risks and vulnerabilities identified thereof, and the policy measures taken by the Central Bank and other regulatory institutions in addressing such risks during the review period, which primarily covers data up to end June 2026. However, more updated selected developments are also reported in the publication. Data may include calculations made specially for this publication based on information obtained from various sources.

For inquiries, comments and feedback please contact:

Macroprudential Surveillance Department
Central Bank of Sri Lanka
30, Janadhipathi Mawatha
Colombo 01
Email: msd@cbsl.lk

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Abbreviations

AWLR	Average Weighted Lending Rate	CRIB	Credit Information Bureau
AFI	Alliance for Financial Inclusion	CSE	Colombo Stock Exchange
AI	Artificial Intelligence	CSTFA	Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005
AML	Anti-Money Laundering	DTFIs	Deposit Taking Financial Institutions
APG	Asia Pacific Group	D-SIBs	Domestic Systemically Important Banks
ASPI	All Share Price Index	DY	Dividend Yield
ASTRI	All Share Total Return Index	EBIT	Earnings before Interest and Tax
AWCMR	Average Weighted Call Money Rate	EBITDA	Earnings before Interest, Taxes, Depreciation, and Amortisation
AWNDR	Average Weighted New Deposit Rate	EDD	Enhanced Due Diligence
AWNLR	Average Weighted New Lending Rate	EMDEs	Emerging Markets and Developing Economies
AWPR	Average Weighted Prime Lending Rate	EOT	End of Term
AWRR	Average Weighted Repo Rate	ERP	Equity Risk Premium
BCBS	Basel Committee on Banking Supervision	ESG	Environmental, Social, and Governance
BFCAs	Business Foreign Currency Accounts	EUR	Euro
BSI	Banking Soundness Index	FATF	Financial Action Task Force
BSPA	Banking (Special Provisions) Act, No. 17 of 2023	FBA	Finance Business Act, No.42 of 2011
CAR	Capital Adequacy Ratio	FCRD	Financial Consumer Relations Department
CAS	Common ATM Switch	FCs	Finance Companies
CBA	Central Bank of Sri Lanka Act, No. 16 of 2023	FCY	Foreign Currency
CCPI	Colombo Consumer Price Index	FEA	Foreign Exchange Act No. 12 of 2017
CDR	Credit to Deposit Ratio	FIU	Financial Intelligence Unit
CEFTS	Common Electronic Fund Transfer Switch	FSF	Financial Stability Fund
CET 1	Common Equity Tier 1	FSI	Financial Stress Index
CFT	Countering the Financing of Terrorism	FSOC	Financial System Oversight Committee
CMS	Complaint Management System	FSSNP	Financial Sector Safety Net Strengthening Project
CPCIA-Investee	Colombo Port City Investment Account – Investee	FTRA	Financial Transactions Reporting Act, No. 06 of 2006
CPF	Countering Proliferation Financing	FVTOCI	Fair Value Through Other Comprehensive Income
CPI	Consumer Price Index		

FVTPL	Fair Value Through Profit or Loss	LPPL	LankaPay (Pvt) Ltd
GBP	Great British Pound/ Pound Sterling	LP 92	Lanka Petrol 92 Octane
GDP	Gross Domestic Product	LTBO	Local Treasury Bills Ordinance
GSS+	Green, Social, Sustainability and Sustainability Linked	LTV	Loan to Value
GWP	Gross Written Premium	MBUs	Mobile Banking Units
H1	First Half	MDR	Merchant Discount Rate
H2	Second Half	ME	Mutual Evaluation
HQLA	High-Quality Liquid Assets	MIIs	Member Institutions
IADI	International Association of Deposit Insurers	ML	Money Laundering
ICAAPs	Internal Capital Adequacy Assessment Processes	MoDE	Ministry of Digital Economy
ICR	Interest Coverage Ratio	MoU	Memorandum of Understanding
IFC	International Finance Corporation	MSCI	Morgan Stanley Capital International
IMF	International Monetary Fund	MSMEs	Micro, Small, and Medium Enterprises
INR	Indian Rupee	MVTS	Money or Value Transfer Service
IPSF	International Platform for Sustainable Finance	NBFIs	Non-Bank Financial Institutions
IRCSL	Insurance Regulatory Commission of Sri Lanka	NBER	National Bureau of Economic Research
JPY	Japanese Yen	NCC	National Coordinating Committee
KRI	Key Risk Indicator	NDC	Net Debit Cap
LAD	Lanka Auto Diesel	NFC	Non-Financial Corporates
LBs	Licensed Banks	NFIS	National Financial Inclusion Strategy
LCBs	Licensed Commercial Banks	NGFS	Network for Greening the Financial System
LCR	Liquidity Coverage Ratio	NII	Net Interest Income
LCs	Letters of Credit	NIM	Net Interest Margin
LFC	Licensed Finance Company	NKY	Nikkei 225 Volatility Index (Japan)
LFIs	Licensed Financial Institutions	Volatility Index	
LKR	Sri Lanka Rupee	NLFP	Nation Lanka Finance PLC
LM	Liability Manager	NPL	Non – Performing Loan
LMFCs	Licensed Microfinance Companies	NRA	National Risk Assessment
		NSFR	Net Stable Funding Ratio
		OMOs	Open Market Operations

OPR	Overnight Policy Rate	SEC	Securities and Exchange Commission of Sri Lanka
P2P	peer-to-peer	SFCA-DA	Special Foreign Currency Account – Designated Agent
PAT	Profit After Tax	SGA	Settlement Guarantee Amount
PBV	Price to Book Value	SGFA	Settlement Guarantee Fund Account
PDCs	Primary Dealer Companies	SLDIS	Sri Lanka Deposit Insurance Scheme
PER	Price to Earnings Ratio	SLFRS	Sri Lanka Financial Reporting Standard
PF	Proliferation Financing	SMEs	Small and Medium – sized Enterprises
PFCA	Personal Foreign Currency Account	SOBEs	State Owned Business Enterprises
PIs	Participating Institutions	SOEs	State-Owned Enterprises
PMI	Purchasing Managers’ Index	SRCC	Strikes, Riots and Civil Commotion
PMLA	Prevention of Money Laundering Act, No. 05 of 2006	SRCC & T	Strike, Riot, Civil Commotion and Terrorism
PSE	Payout Simulation Exercise	SRS	Systemic Risk Survey
PTL	Perpetual Treasuries Limited	SSCL	Social Security Contribution Levy
RCP	Recovery Plans	SWIFT	Society for Worldwide Interbank Financial Telecommunications
RE	Real Estate	T-bills	Treasury Bills
RHS	Right Hand Side	T-bonds	Treasury Bonds
RII Act	Regulation of Insurance Industry Act, No. 43 of 2000	TF	Terrorist Financing
ROA	Return on Assets	USD	United States Dollar
ROE	Return on Equity	VAs	Virtual Assets
ROO	Regional Offices	VAT	Value Added Tax
RSSO	Registered Stock and Securities Ordinance	VIX	Volatility Index (U.S. S&P 500)
RTGS	Real Time Gross Settlements	VSTOXX	Euro STOXX 50 Volatility Index
RWA	Risk Weighted Assets	WEO	World Economic Outlook
S&P SL20	Standard & Poor's Sri Lanka 20	WUI	World Uncertainty Index
SBFN	Sustainable Banking and Finance Network	XBRL	eXtensible Business Reporting Language
SDGs	Sustainable Development Goals	Y-o-Y	Year-on-Year

Executive Summary

Amidst multiple shocks, Sri Lanka's financial system remained stable during the first half of 2026, supported by the continued economic recovery, sustained adequacy of capital and liquidity buffers across banks and Finance Companies (FCs), and improved fiscal performance. While domestic macrofinancial conditions remained stable, intensifying uncertainties in the global environment increased the risk of adverse spillovers to the domestic economy. Stability during the review period was supported by the continued recovery in economic activity, improved fiscal conditions and stronger financial sector performance. These developments provided an important cushion against heightened external uncertainties and supported the overall stability of the financial system. Nevertheless, the external environment remained challenging. Heightened geopolitical tensions, resurgent global inflationary pressures, elevated energy and commodity prices, tighter global financial conditions, growing trade fragmentation and increasing climate related risks continued to pose potential spillovers to the domestic economy. Sri Lanka remained particularly exposed to adverse external developments, given its significant exposure through trade, tourism receipts, workers' remittances, capital flows, external financing conditions and exchange rate dynamics. On the domestic front, credit growth, particularly in household lending including vehicle financing and gold backed lending, continued to widen the private sector Credit Gap, signaling a potential build-up of systemic vulnerabilities. Moreover, although financial sector exposure to the public sector reduced, it remained significant, underscoring the considerable sovereign-financial sector nexus. Rising household indebtedness, volatility in collateral values with increased exposure to collateral backed lending, the continued rise in real estate prices and inflationary pressures further highlighted emerging risks. In response to these developments, the Central Bank increased the overnight policy interest rate in May 2026 and introduced macroprudential measures, including Loan-to-Value (LTV) limits on vehicle and gold backed lending, aimed at containing the build-up of vulnerabilities within the economy.

Domestic financial markets remained largely stable during the period, with the Financial Stress Index remaining at relatively low levels. Financial market conditions were shaped by heightened global uncertainty, domestic inflation concerns, and tighter monetary conditions. Equity market performance moderated amid subdued investor sentiment, while market liquidity weakened and volatility increased. Yields of Government securities increased across maturities during the review period with evolving market expectations and subsequently due to monetary policy tightening. Secondary market liquidity remained relatively subdued pointing to limited depth and trading activity in the domestic debt market. Meanwhile, foreign investor participation continued to be low despite a modest recovery towards the latter part of the reference period. The domestic foreign exchange market experienced periods of heightened pressure particularly with the escalation of tensions in the Middle East, reflecting increased demand for foreign currency arising from higher import expenditure, rising energy prices, and shifts in investor sentiment. These developments contributed to the depreciation of the Sri Lanka rupee against the US dollar. Market conditions subsequently improved, supported by policy measures and continued inflows from workers' remittances, tourism, exports and intermittent fall in oil prices. Money market activity strengthened during the period, while overall liquidity remained in surplus and interest rates remained broadly aligned with the monetary policy stance. Payment and settlement systems continued to demonstrate operational resilience, supported by further digitalisation and improvements in settlement infrastructure. The continued expansion of digital financial services enhanced efficiency and financial inclusion, albeit increasing the financial system's exposure to cyber, operational, and third party risks. As digital connectivity deepens and technology evolves rapidly, ensuring adequate cyber resilience and operational preparedness remains critical to safeguarding financial stability.

Financial institutions continued to demonstrate overall resilience during the period under review, supported by the recovery in economic activity, stronger profitability and adequate capital and liquidity buffers. The banking sector credit expanded significantly amid robust private sector demand, with notable growth in consumption, trade, financial services, construction, and offshore-related lending. The decline in the Stage 3 loans ratio along with the improvement in the Stage 3 impairment coverage ratio depicted improved resilience of the banking sector. However, Stage 2 loans increased during Q2 of 2026, indicating a potential build-up of credit risk among borrowers amid elevated credit expansion. While liquidity ratios in the banking sector moderated during the review period, they remained well above regulatory thresholds. This decline primarily reflected a shift in asset allocation from high quality liquid assets, particularly Government securities, to private sector lending. Meanwhile, short term maturity mismatches widened, increasing potential refinancing and liquidity risks within the sector under unexpected stress conditions. Further, banking sector profitability continued to improve, although the pace of growth moderated somewhat from the levels recorded during the first half of 2025. Despite continued buildup of capital, driven by stronger profitability, the banking sector's capital adequacy ratios declined as the growth of risk weighted assets exceeded the pace of capital accumulation. Notwithstanding this moderation, capital buffers remained well above regulatory thresholds, providing adequate capacity to absorb potential shocks.

FCs sector witnessed a significant credit expansion driven by heightened demand for vehicle financing and gold backed lending. Despite the improvement in the Stage 3 loans ratio, the sharp increase in Stage 2 loans indicated rising credit risks within the FCs sector. This was partly attributable to the adverse effects of Cyclone Ditwah and the Middle East conflict on affected borrowers and underscored the need for continuous monitoring of asset quality developments and the potential buildup of sectoral vulnerabilities. Moreover, the impairment coverage ratio declined, indicating a deterioration in loss absorption capacity within the sector. While liquidity buffers in the FCs sector remained adequate and well above regulatory thresholds, liquidity ratios declined amid strong credit expansion. Meanwhile, faster growth in borrowings compared to deposits highlighted the increasing interconnectedness between FCs and banks. Profits in the FCs sector continued to increase, supported by net interest income, although the rate of profit growth moderated during the first quarter of the financial year 2026/27. Capital buffers of the sector declined alongside the increase in risk weighted assets driven by the expansion in credit. The insurance sector remained adequately capitalised, although profitability moderated. Significant claims arising from Cyclone Ditwah increased reinsurance receivables and heightened underwriting, liquidity, and counterparty risks.

Lending to both the Household and Institutional sectors¹ increased during the first half of 2026. Although household credit growth remained elevated, a marginal moderation was observed towards the latter part of the period. The share of credit extended by Non-Bank Financial Institutions to the Household sector increased further during the first half of 2026, although the banking sector remained the primary source of formal financing for households. Moreover, risk profiles of Household borrowers, as reflected by overall credit scores, remained broadly stable during the first half of 2026. Credit to the Institutional sector also expanded at a rapid pace, with the banking sector accounting for the vast majority of lending to the sector. Meanwhile, the listed Non-Financial Corporate (NFC) sector² recorded stronger revenue growth during the first half of 2026, although aggregate profitability weakened. The decline in aggregate profits was largely attributable to higher costs of sales and operating expenses. Against this backdrop, creditworthiness of the listed NFC sector showed some signs of moderation, reflecting a slowdown in aggregate profitability and debt servicing capacity.

¹ Based on aggregate credit data obtained from the Credit Information Bureau (CRIB).

² Based on the financial performance of 204 companies listed on the Colombo Stock Exchange (CSE).

In response to developments and emerging risks within the financial sector, a range of policy measures were implemented during the review period. Against the backdrop of rapid credit expansion in vehicle financing and gold backed lending, borrower based macroprudential measures were tightened to contain excessive leverage and mitigate emerging risks. These measures included simplification and tightening of maximum LTV limits on motor vehicle financing and the introduction of maximum LTV limits on gold backed lending, aimed at promoting prudent lending practices and containing the buildup of systemic vulnerabilities. In addition to the LTV limits on gold backed lending, applicable risk weights were also tightened during the review period. In response to the adverse effects of Cyclone Ditwah, the Central Bank issued circulars to both banks and FCs, requiring relief measures to be provided to affected individuals and businesses. The Directions on recovery planning for both banks and FCs were issued, alongside consolidation initiatives aimed at strengthening the resilience of the banking and FCs sectors. Amid the increasing prevalence of financial frauds and scams involving digital payment channels, the Central Bank introduced policy initiatives aimed at strengthening the security of digital payment methods and improving public awareness of related risks. Measures were also taken to strengthen the resolution framework, financial consumer protection, and Anti-Money Laundering, Countering the Financing of Terrorism and Countering Proliferation Financing (AML/CFT/CPF) framework, alongside preparations for Sri Lanka's third Mutual Evaluation of its AML/CFT/CPF framework by the Asia Pacific Group on Money Laundering (APG), as well as initiatives aimed at improving financial inclusion.

Outlook

The outlook for financial stability remains broadly positive, provided that the ongoing economic recovery remains sustained, fiscal consolidation progresses, and prudent policy implementation continues. However, the outlook is contingent on external developments, including geopolitical and financial market uncertainties, as well as domestic vulnerabilities arising from any excessive expansion and sectoral concentration of credit, along with evolving cyber risks. Continued monitoring and timely policy intervention will therefore remain important in preserving financial stability. Prolonged geopolitical tensions and energy price shocks could weaken external balances and increase inflationary pressures, thereby impacting the repayment capacity of borrowers. These effects could amplify existing domestic vulnerabilities, including higher growth in collateral backed lending to households, rising Stage 2 exposures and declining liquidity and capital buffers. Financial market resilience will increasingly be shaped by the ability to strengthen investor confidence, improve market liquidity, deepen domestic capital markets, and attract a broader and more stable foreign investor base, thereby enhancing the market's capacity to absorb shocks and support efficient price discovery. Overall, maintaining financial stability will require a well calibrated combination of prudent monetary, macroprudential and regulatory policies, supported by sustained progress in structural reforms. Priorities of the financial sector should therefore focus on preserving strong capital and liquidity buffers across financial institutions, strengthening the management of climate related and cyber risks, enhancing resolution and crisis-preparedness frameworks, and ensuring that credit expansion remains commensurate with underlying economic activity and risk conditions. These efforts will be essential in mitigating the buildup of systemic vulnerabilities, strengthening the financial system's shock absorbing capacity, and safeguarding financial stability over the medium term.

MACROFINANCIAL CONDITIONS

CHALLENGING GLOBAL CONDITIONS



- Geopolitical tensions and Middle East conflict intensified
- Global growth projected to moderate
- Global inflation projected to rise
- Global financial conditions tightened

DOMESTIC ECONOMIC ENVIRONMENT



- GDP Growth at 4.2% (Q2 2026)
- Inflation rose to 7.3% (July 2026)
- External sector trade deficit widened
- Fiscal performance improved
- Emerging climate related risks

CREDIT INTERMEDIATION



- Significant expansion in total credit granted by banks and FCs
- Private sector credit improved amid declining sovereign exposure
- Improved financial intermediation
- Private sector credit cycle remained in the expansionary phase

SRI LANKA'S
MACROFINANCIAL
ENVIRONMENT
REMAINED
STABLEDEVELOPMENTS IN ASSET
BACKED LENDING

- Real estate prices increased
- Elevated gold price volatility
- Strong growth in gold and vehicle backed lending
- Macroprudential measures were introduced

OVERALL ASSESSMENT



Amid intensified
global uncertainty



Domestic macrofinancial
conditions remained stable



Supported by improved
economic growth and
fiscal consolidation



Although rapid credit growth,
inflationary pressures and
elevated external risks remain



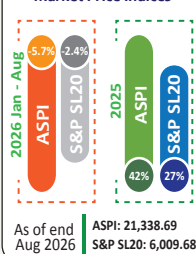
Requiring continued
vigilance to safeguard
financial stability

FINANCIAL MARKETS



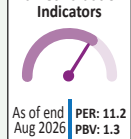
STOCK MARKET

Market Price Indices

Net Foreign Outflow
(Jan – Aug 2026)

USD 171.8 mn

Net foreign outflows from the secondary market persisted

Market Valuation
Indicators

As of end August 2026

Market Capitalisation Rs. 7,730.8 bn

During January - August 2026

Average Daily Turnover Rs. 4,000.3 mn



GOVERNMENT SECURITIES MARKET

Net Foreign Inflow (Jan – Aug 2026)

USD 207.7 mn

Foreign capital inflows maintained net positive cumulative value

As of end August 2026

91-Day T-Bill 9.01% (+140bps)

364-Day T-Bill 9.80% (+174bps)

05-Year T-Bond 10.80% (+101bps)

Yields Shifted Upward

Liquidity Remained Constrained

Foreign Participation Moderated



DOMESTIC FOREIGN EXCHANGE MARKET



Net Foreign
Purchases of
Central Bank

USD 1,517.4 mn

Central Bank net purchases from domestic forex market rose, supporting build up of foreign reserves.

As of end August 2026

USD/ LKR **Rs. 328.01**
(-5.5%)

1-Month Forward Premium **4.56%**
(+102 bps)

Interbank Foreign Exchange Transaction Volume **\$1,355.9 mn**
Monthly Average



DOMESTIC MONEY MARKET

Overnight Money Market Liquidity

Rs. 132.33 bn

Remained positive throughout the review period.



TRADING VOLUME

Increased Activity

As of end August 2026

AWCMR (Call Money) 8.85% (+81 bps)

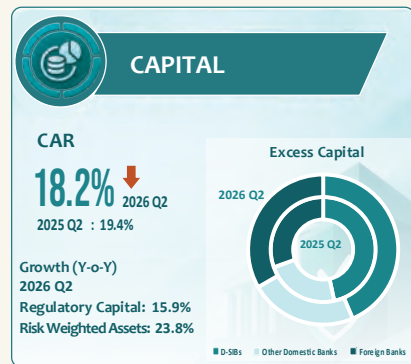
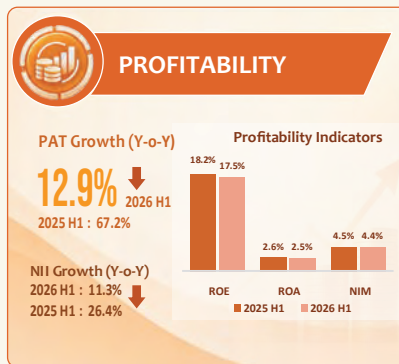
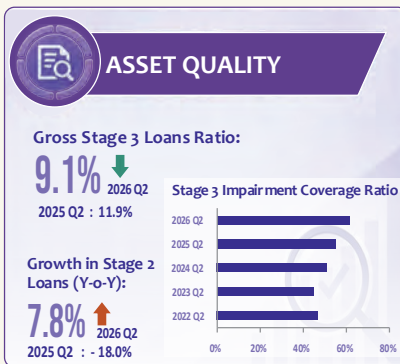
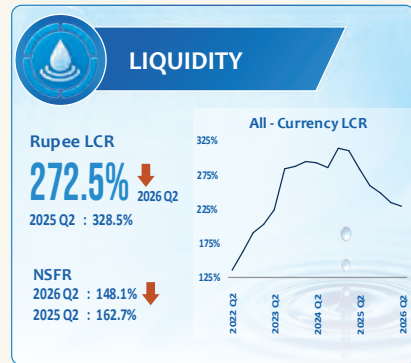
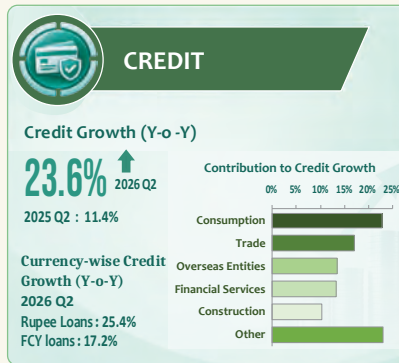
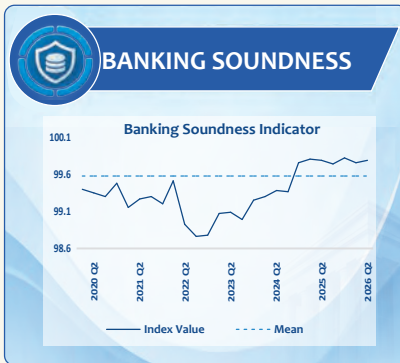


LIQUIDITY DISTRIBUTION

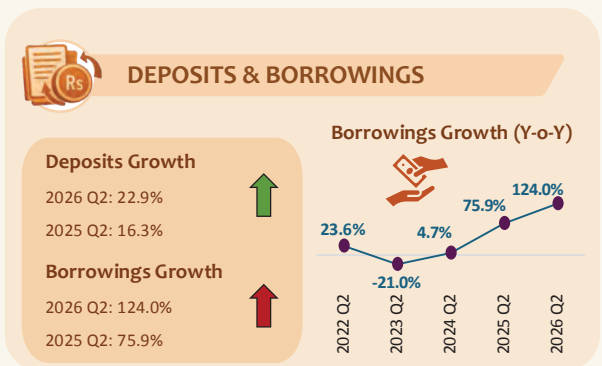
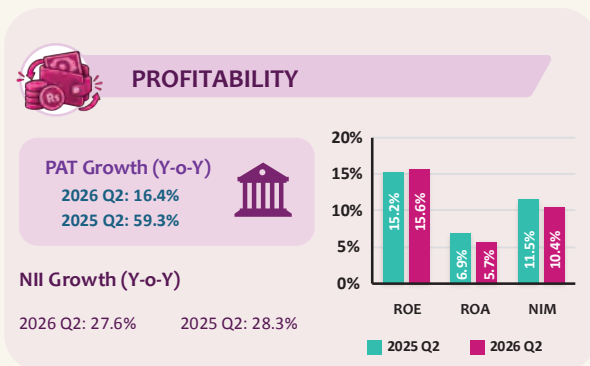
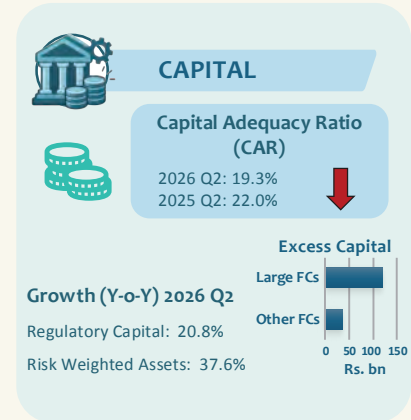
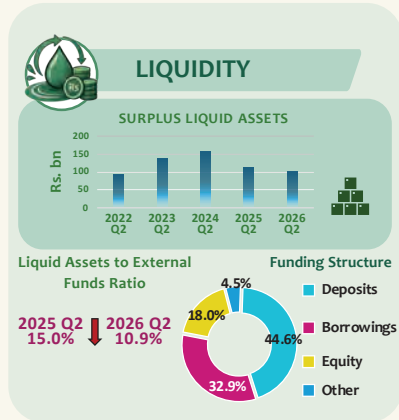
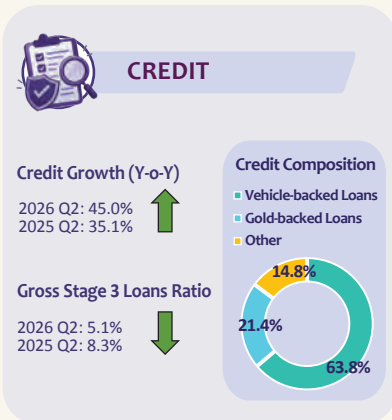
Asymmetric Positions

AWRR (Repo Rate) 8.91% (+85 bps)

BANKING SECTOR



FINANCE COMPANIES SECTOR



INSURANCE SECTOR

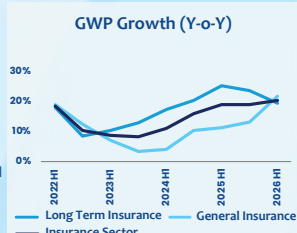


GWP GROWTH

20.3% 2026 H1 (Y-o-Y) ↑

Long Term ↓ 19.3% 2026 H1 (Y-o-Y)

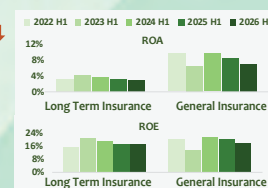
General ↑ 21.8% 2026 H1 (Y-o-Y)



PROFITABILITY

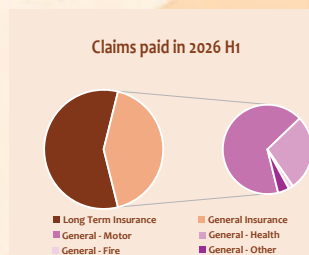
General Insurance 2026 H1 ROE: 17.4% ↓ ROA: 7.1% ↓

Long Term Insurance 2026 H1 ROE: 16.8% ↓ ROA: 3.0% ↓



CLAIM PAID

General insurance claims increased by **21.4% y-o-y** in H1 of 2026, driven by a **40.8% increase in motor claims**

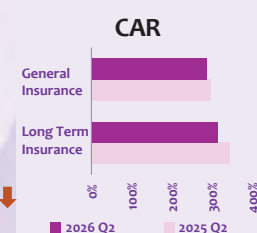


CAPITAL

✓ CAR exceeded minimum requirement at end 2026 Q2

Long term 313.1% ↓

General 286.2% ↓



HOUSEHOLD AND CORPORATE SECTORS

CREDIT GROWTH

25.4%

at Q2 2026

14.8% at Q2 2025



Household Sector

REVENUE GROWTH

22.0%

in H1 2026

7.6% in H1 2025



Listed Non-Financial Corporate Sector

HOUSEHOLD SNAPSHOT

CREDIT PROVIDERS

Banks remained the principal source

Banks 62.5% NBFIs 37.5%

BORROWER CREDIT SCORE

538.2

Weighted average at Q2 2026

Improved from 511.6 at Q2 2025

CREDIT-TO-GDP RATIO

Continued its upward trend



WESTERN PROVINCE

48.9%

of total household credit

CORPORATE SNAPSHOT

Median net profit growth H1 2026

7.7%

+7.3% in H1 2025

Majority of companies recorded an increase in net profit

KEY PROFITABILITY INDICATORS

RETURN ON ASSETS

10.2% 9.0%

H1 2025 H1 2026

RETURN ON EQUITY

14.5% 11.9%

H1 2025 H1 2026

DEBT SERVICING CAPACITY

INTEREST COVERAGE RATIO

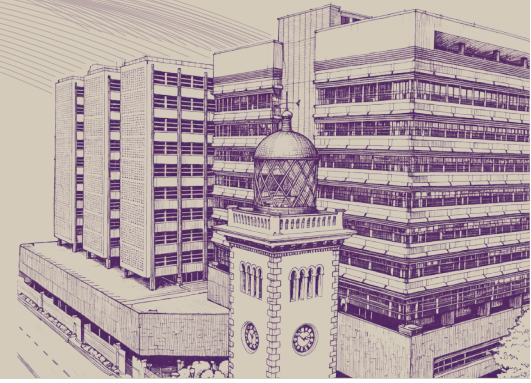
4.2 3.7

H1 2025 H1 2026

*Household sector analysis based on CRIB data

Chapter 1

Macrofinancial Conditions



Sri Lanka's macrofinancial environment remained stable, supporting financial stability during H1 of 2026 while external headwinds intensified. Global macrofinancial conditions became more challenging, exerting negative spillovers on the domestic economy. Heightened geopolitical tensions, including the escalation of the conflict in the Middle East, elevated global uncertainty, renewed inflationary pressures, tightened global financial conditions, increasing trade fragmentation, policy uncertainty, climate related risks such as the El Niño phenomenon and elevated volatility in financial markets created a challenging external environment, with potential implications for domestic macroeconomic and financial stability. Rising energy and commodity prices, disruptions to key trade routes, and heightened uncertainty contributed to a resurgence of inflationary pressures and increased downside risks to the global outlook. These developments heightened the exposure of emerging markets and developing economies including Sri Lanka to adverse spillovers through trade, capital flow, financing, and exchange rate channels, as well as climate related shocks.

Against this backdrop, domestic macrofinancial conditions remained broadly conducive to financial stability, underpinned by continued economic growth, improved fiscal performance and conducive financial sector developments. However, the rapid expansion of credit and emerging pressure from global macrofinancial conditions warranted close monitoring of the financial system. Credit to the private sector expanded significantly amid the recovery in economic activity and relatively accommodative monetary conditions that prevailed during much of the review period, with particularly strong expansions observed in household lending, vehicle financing, and gold backed lending. Consequently, financial intermediation strengthened, as credit growth continued to outpace deposit growth. Moreover, the private sector credit cycle remained in an expansionary phase, with the widening private sector credit gap indicating the potential buildup of systemic vulnerabilities. Meanwhile, renewed inflationary pressures, stemming mainly from higher global energy and commodity prices and strengthening domestic demand, along with significant growth in credit to the private sector prompted a tightening of domestic monetary policy in May 2026. Consequently, this contributed towards further upward adjustments in market interest rates and Government securities yields. In addition, macroprudential measures in the form of Loan to Value (LTV) limits on vehicle and gold backed lending, were introduced amid significant credit growth to mitigate the buildup of systemic risks within the financial sector.

Fiscal performance strengthened further, reducing reliance on domestic financing and supporting the reallocation of financial sector resources towards private sector activities. Nevertheless, the external sector remained vulnerable to adverse global developments, particularly through commodity prices, with potential spillovers through trade, tourism, workers' remittances, and exchange rate channels. At the same time, growing interconnectedness among financial institutions, increasing digitalisation of financial services and rapid developments in financial technologies, together with rising cyber security threats, have emerged as important considerations for financial sector resilience. Further, the increasing frequency and severity of climate related events added to the macrofinancial risk landscape, posing challenges to stability.

Looking ahead, Sri Lanka's macrofinancial outlook remains broadly stable despite potential headwinds on several fronts. Continued economic growth, stronger fiscal performance, and improved financial sector resilience would provide important safeguards against potential shocks. Nevertheless, heightened geopolitical tensions, renewed inflationary pressures, tighter global financial conditions, climate related risks, and rapid credit expansion could pose challenges to financial stability going forward. Accordingly, preserving macroeconomic stability, maintaining adequate capital and liquidity buffers, strengthening risk management practices and ensuring that credit expansion remains consistent with underlying economic fundamentals will be important for safeguarding the stability of the financial system. Thus, the Central Bank will continue to closely monitor and assess emerging risks and vulnerabilities to the financial system and take proactive and timely macroprudential measures, where necessary.

1.1 International Economic Environment and Financial Conditions

Global Macrofinancial Developments and Outlook

Global macrofinancial conditions became more challenging during the review period with heightened geopolitical tensions, conflict in the Middle East, renewed inflationary pressures, increasing trade fragmentation, policy uncertainty and volatile financial markets. The escalation of tensions in the Middle East during early 2026 significantly altered the global risk landscape, heightening concerns over energy security, disruptions to international trade routes and renewed supply-side pressures. Against this backdrop, global uncertainty indicators remained above historical norms despite easing from the peaks recorded in 2025. However, the tightening in global financial conditions following the escalation of geopolitical tensions remained less pronounced than during previous major global shocks, while international credit markets continued to function broadly in an orderly manner. At the same time, the increasing frequency and severity of climate related events could amplify global supply disruptions, commodity price pressures and economic losses, adding to existing macrofinancial vulnerabilities and potentially affecting domestic macrofinancial conditions through spillover effects. Meanwhile, the interaction between

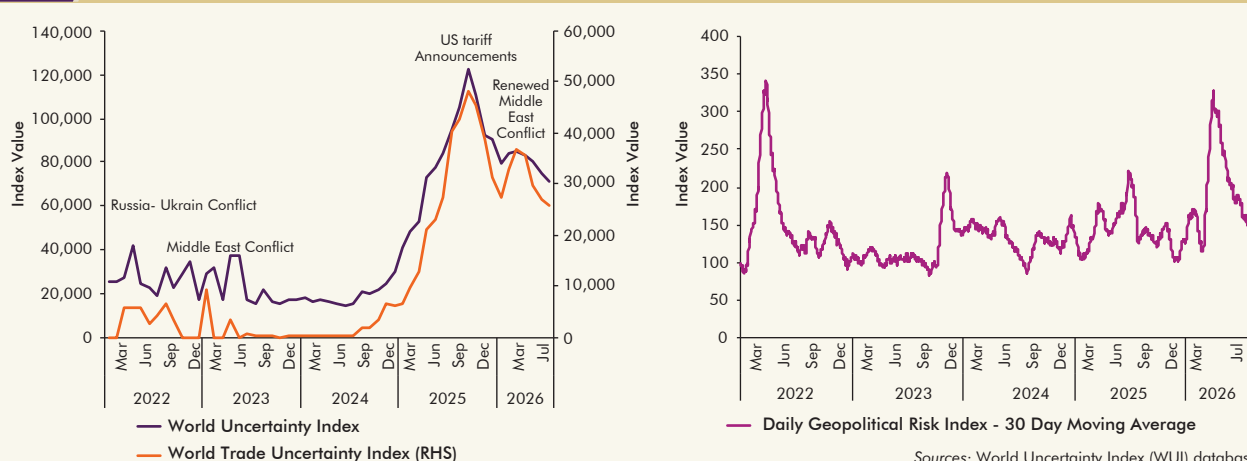
geopolitical risks, persistent inflationary pressures, elevated sovereign indebtedness and uncertainty surrounding the global monetary policy outlook could give rise to mutually reinforcing pressures. Domestic macrofinancial conditions are exposed to these developments mainly through commodity imports, trade, tourism, remittances, exchange rates and global investor sentiments. However, stronger fiscal space, sustained remittance inflow and improved foreign reserve buffers provide some cushion to face these challenges. Meanwhile, a prolonged deterioration in global conditions could continue to strain domestic macrofinancial conditions, with potential adverse implications for financial institutions and broader financial stability.

Global Growth and Merchandise Trade

Uneven global growth and subdued global trade amid persistent geopolitical and policy uncertainties heighten external vulnerabilities for small open economies such as Sri Lanka. Global economic growth remained positive but increasingly uneven across countries and regions, particularly energy importing economies which are adversely affected by the conflict in the Middle East. The International Monetary Fund (IMF) World Economic Outlook (WEO) Update of July 2026 has projected global growth to moderate to 3.0% in 2026 from 3.5% in 2025. Although global economic activity demonstrated a degree of resilience,

Figure 1.1

Global Uncertainty

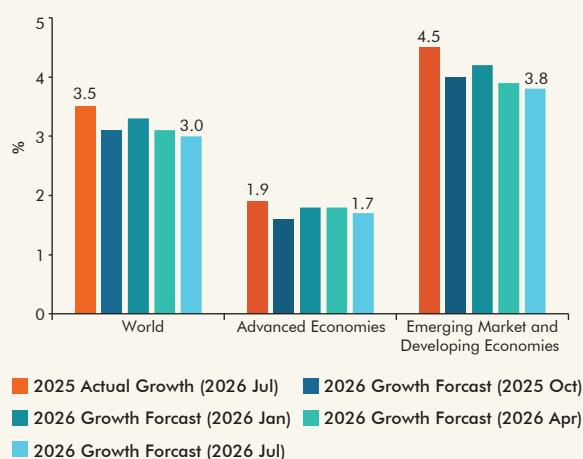


Sources: World Uncertainty Index (WUI) database*
www.matteoiacoviello.com

* The WUI database is constructed based on methodology in H. Ahir, N. Bloom, D. Furceri. 2022. "The World Uncertainty Index." NBER Working Paper 29763.

Figure 1.2

Global Real GDP Growth



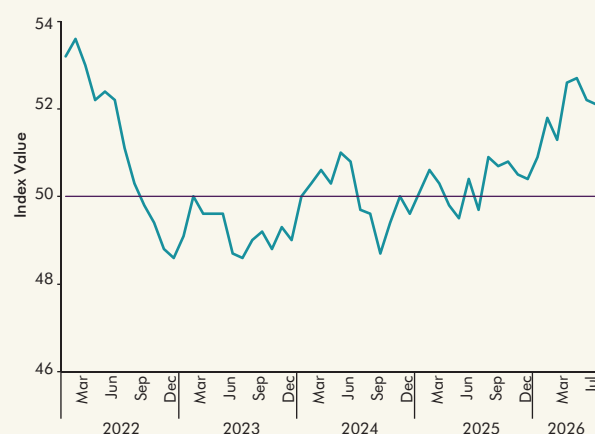
Source: IMF - World Economic Outlook

growth performance diverged considerably across economies. Continued strength in technology related investments and advances in Artificial Intelligence (AI) supported economic activity in countries more integrated into AI related technology value chains. In contrast, several Emerging Markets and Developing Economies (EMDEs) faced weaker external demand and heightened vulnerabilities.

Global manufacturing activity remained resilient, with the Global Manufacturing Purchasing Manager Index (PMI) staying in the expansionary territory since June 2025. Manufacturing output and new orders continued to increase, supported partly by earlier precautionary stock building and

Figure 1.3

Global Manufacturing PMI



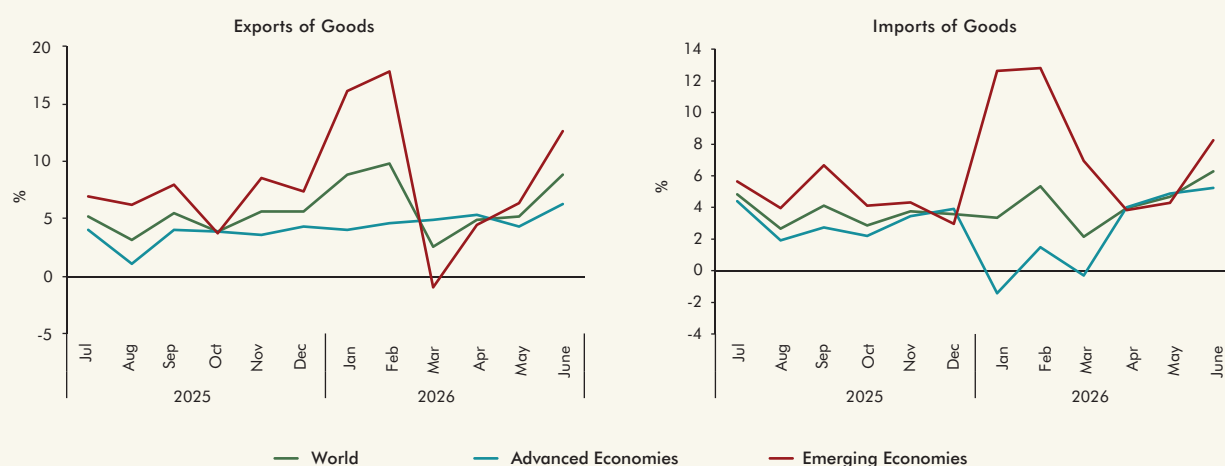
Source: S&P Global

resilient activity in major economies. Nevertheless, the pace of expansion softened gradually from the peaks observed during the second quarter, as growth in output and new orders eased, while business sentiment remained subdued despite some moderation in supply chain pressures and cost increases. Further, new export orders stabilised in July 2026 following recent contractions while geopolitical tensions, trade policy uncertainty, and concerns over energy prices continued to weigh on the outlook and pose downside risks to global manufacturing activity.

Global merchandise trade remained subdued during the review period as geopolitical tensions, elevated policy uncertainty and the continued

Figure 1.4

Global Merchandise Trade Growth



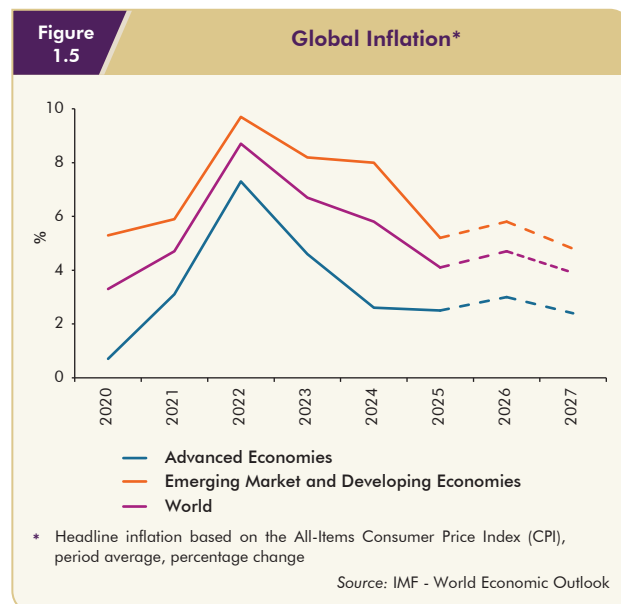
Source: CPB World Trade Monitor

proliferation of trade restrictions weighed on cross-border trade. Thus, trade growth weakened across both advanced and emerging economies in March 2026 following the escalation of tensions in the Middle East, with the slowdown being most pronounced among emerging economies. Although large scale disruptions to global trade routes were largely avoided, supply chain vulnerabilities remained elevated, particularly amid disruptions to key maritime routes in the Middle East. Meanwhile, higher transportation and logistics costs, increased maritime insurance premiums and longer delivery times, further intensified trade related uncertainties. Moreover, increasing trade fragmentation through industrial policies, export controls, trade restrictions and strategic competition among major economies continued to reshape global trade and investment patterns, adding to the fragility of the global outlook.

Consequently, the domestic financial sector remains vulnerable to adverse spillovers from current global developments, which could pose risks to financial stability. Weaker global growth and trade have hampered Sri Lanka's export earnings, while elevated energy and commodity prices and higher transportation costs increased the import bill resulting in an external sector current account deficit while impacting the accumulation of foreign exchange reserves. Such developments increase pressures in the domestic foreign exchange market and contribute to exchange rate volatility, with potential second-round effects through imported inflation, higher production costs, weaker household and corporate repayment capacity and tighter domestic financial conditions. Accordingly, further deterioration in global trade and growth conditions could weaken Sri Lanka's external sector buffers and amplify the transmission of external shocks to domestic economic activity and the financial system, thereby posing downside risks to macrofinancial conditions and financial system stability.

Global Inflation and Commodity Prices

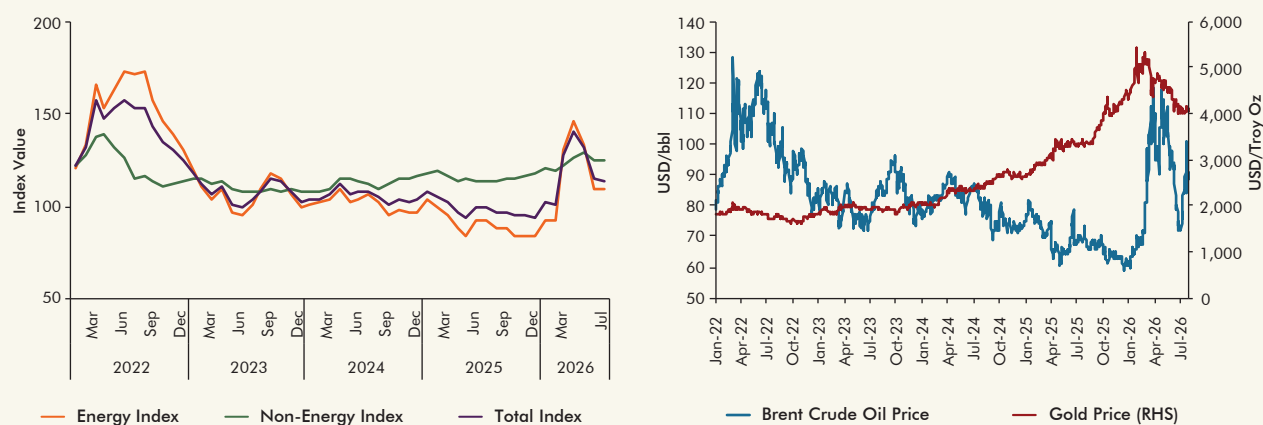
Global inflationary pressures intensified during 2026 with elevated and volatile commodity prices. According to the IMF WEO Update of July 2026,



global headline inflation is projected to increase to 4.7% in 2026 from 4.1% in 2025, before moderating to 3.9% in 2027. Concerns over energy supply disruptions, transportation bottlenecks and risks to critical shipping routes in the Middle East contributed to heightened volatility in crude oil prices, while higher energy costs generated broader inflationary pressures through increased fuel, electricity, manufacturing, transportation and logistics costs. Food prices also remained vulnerable to higher energy and fertiliser costs, climate related shocks and disruptions to agricultural supply chains, disproportionately affecting EMDEs where food and energy account for a relatively larger share of household expenditure. For Sri Lanka, as a net energy importing economy, sustained increases in global energy and food prices raises the merchandise import bill, exerting pressure on the external current account and domestic inflation while reducing household purchasing power and increasing operating costs for businesses, with consequent effects on debt servicing capacity, asset quality and overall financial system stability. Meanwhile, global gold prices reached their historical high in January 2026 amid heightened geopolitical uncertainty and increased safe haven demand, and subsequently prices recorded downward adjustment by nearly 25%. These significant fluctuations in gold prices also warrant attention in jurisdictions such as Sri Lanka where financial institutions have material exposures to gold backed lending.

Figure 1.6

Global Commodity Price Indices



Sources: World Bank
Bloomberg

Global Financial Conditions

Global financial conditions tightened during 2026 amid heightened geopolitical tensions, renewed inflationary pressures and increased uncertainty surrounding the global monetary policy outlook.

The escalation of the Middle East conflict prompted broad repricing across global financial markets as investors reassessed the outlook for inflation, interest rates and economic growth. Sovereign bond yields increased, equity markets experienced temporary corrections and financing conditions tightened across several market segments. Nevertheless, the tightening remained less pronounced than during previous major episodes of global market

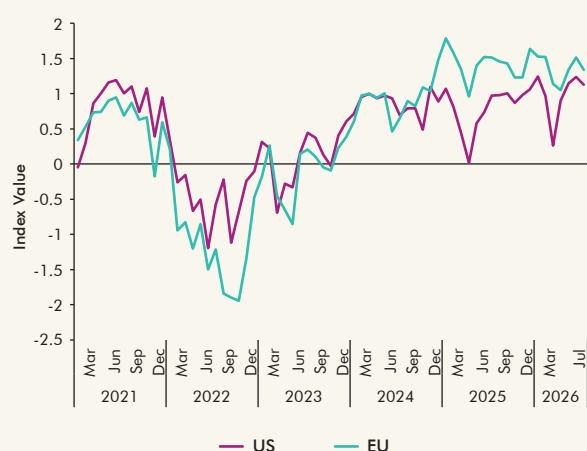
stress, while overall financial conditions remained broadly accommodative by historical standards. Financial markets continued to function in a broadly orderly manner, supported by resilient economic activity, relatively favourable liquidity conditions and expectations of eventual monetary policy easing in several major economies. Financing conditions remained uneven across economies. Advanced economies generally continued to benefit from deeper and more liquid financial markets, while several EMDEs faced more challenging financing environments due to elevated external vulnerabilities, weaker fiscal positions and relatively high borrowing costs. Moreover, a stronger US dollar, the potential unwinding of carry trades and the growing participation of relatively risk sensitive non-bank financial investors could increase the likelihood of capital outflows and exchange rate pressures.

These developments could tighten financial conditions particularly for vulnerable economies.

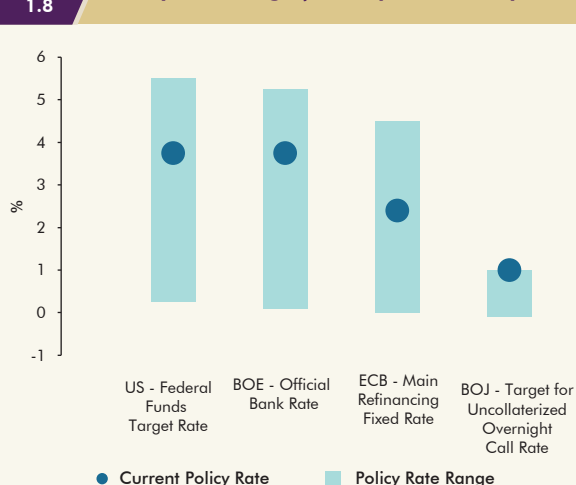
Increasing refinancing costs amid tightening financial conditions could adversely impact economies with substantial foreign currency liabilities or significant external financing requirements. Meanwhile, a prolonged geopolitical conflict, persistent energy driven inflation or an abrupt reassessment of the global monetary policy outlook could lead to further tightening in financial conditions. These developments would lead to an increase in external financing costs

Figure 1.7

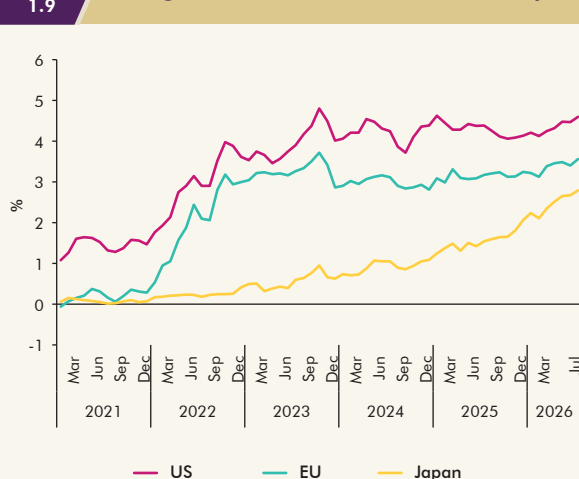
Financial Condition Index



Source: Bloomberg

Figure 1.8 Policy Rate Range (January 2021 to July 2026)

Sources: Bank of England, The Federal Reserve, European Central Bank and Bank of Japan

Figure 1.9 Long Term Government Bond Yields:10-year

Source: Federal Reserve Bank of St. Louis - Economic Data

in Sri Lanka, influence capital flows and exchange rate dynamics and constrain access to international financing by domestic entities. Thus, tightening financial conditions can amplify refinancing pressures and weaken the balance sheets of highly leveraged borrowers and financial intermediaries. Accordingly, preserving macroeconomic stability and adequate fiscal, external and financial sector buffers remain important in mitigating potential adverse spillovers from global financial conditions.

Global Financial Markets

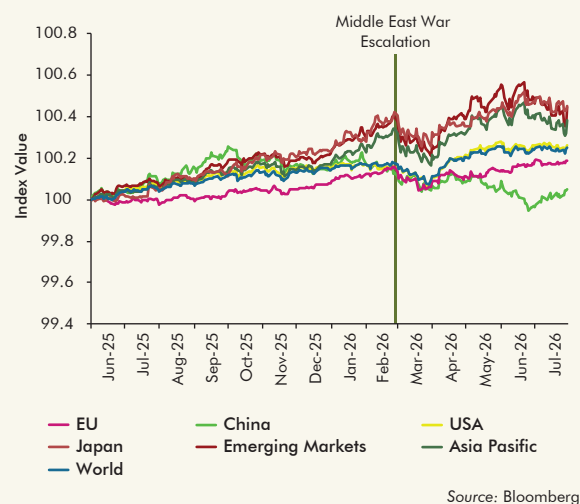
Financial market volatility increased during the review period as the escalation of the Middle East tensions heightened geopolitical uncertainty and weakened investor confidence. Concerns over energy security, renewed inflationary pressures and disruptions to global trade prompted investors to reassess financial market risks, resulting in heightened price fluctuations across equity, sovereign bond, foreign exchange and commodity markets. Reflecting these developments, key measures of implied volatility recorded notable increases during early 2026¹. The simultaneous increase in volatility across different asset classes highlighted the

interconnected nature of global financial markets and the potential for geopolitical shocks to be transmitted rapidly through investor portfolios and financial intermediaries. This increased volatility can raise risk premia, reduce market liquidity and encourage investors to reduce exposures to relatively risky assets, potentially generating capital outflows from emerging markets like Sri Lanka. Although financial market volatility moderated following signs of easing geopolitical tensions and improving investor sentiment, global markets remained susceptible to renewed episodes of stress. Further, high public debt and greater reliance on short term issuances increased the rollover and market liquidity risks in major sovereign markets. Persistent geopolitical risks, stretched asset valuations, elevated sovereign debt and uncertainty surrounding the outlook for inflation and monetary policy continued to create conditions for abrupt changes in global risk sentiment. A prolonged deterioration in global risk sentiment could therefore generate mutually reinforcing pressures through sovereign bond markets, capital flows, exchange rates and funding conditions, with potential adverse implications for financial institutions' balance sheets and global financial stability. Hence, such episodes could increase exchange rate and capital flow volatility, affect foreign investor participation and contribute to tighter domestic financial conditions through adverse external financial market spillovers.

¹ The VIX, which measures expected volatility in the U.S. S&P 500 Index, the VSTOXX, which captures anticipated volatility in the Eurozone's EURO STOXX 50 Index, and the NKY Volatility Index, which tracks expected fluctuations in Japan's Nikkei 225, increased markedly during periods of heightened geopolitical tensions.

Figure 1.10

MSCI Share Price Indices



Implications for Domestic Financial Stability

Global macrofinancial developments are expected to increase external risks to the domestic financial sector. Emerging and developing economies remain vulnerable to adverse external spillovers, particularly through trade, capital flow, exchange rate and commodity price transmission channels. Higher energy and commodity prices, together with potential disruptions to global trade and supply chains, could adversely affect domestic inflation dynamics, external balances, and economic activity going forward as well. Further, it could reduce the profitability and debt servicing capacity of exporters, tourism related businesses, and importers. These developments may also weaken the repayment capacity of households if higher food, fuel and utility costs reduce their disposable income. In addition, these could result in increasing non-performing loans and impairment charges of financial institutions, particularly if global uncertainty persists. Nevertheless, the tightening of monetary policy in May 2026, together with the introduction of LTV² related measures is expected to contribute to a gradual moderation in credit expansion and help contain the buildup of financial vulnerabilities. At the same time, the persistence of relatively restrictive monetary policy in major advanced economies and shifting global investor sentiments may contribute to continued exchange rate pressures, tighter external financing conditions,

and increased volatility in capital flows, thereby posing challenges to macroeconomic and financial stability. Thus, the continued strengthening of risk management practices, maintaining adequate capital and liquidity buffers and continued monitoring of emerging risks, will remain important in supporting the resilience of the domestic financial sector and its ability to withstand potential external shocks.

1.2 Domestic Macrofinancial Conditions

Developments in Credit

Total domestic credit³ expanded at a rapid pace during the review period, supported by the continued recovery in economic activity and the relatively accommodative monetary conditions that prevailed during much of the period. However, the operating environment became increasingly challenging following the escalation of the conflict in the Middle East, which contributed to heightened global uncertainty and renewed inflationary pressures through higher energy and commodity prices, with consequential spillovers to the domestic economy. The subsequent tightening of domestic monetary conditions in May 2026 along with macroprudential measures in relation to LTV ratios, is expected to moderate credit growth going forward. Credit extended by regulated Deposit Taking Financial Institutions (DTFIs), comprising banks and Finance Companies (FCs), recorded strong growth, with y-o-y growth in total credit accelerating from 14.0% in June 2025 to a peak of 27.9% in March 2026, before moderating marginally to 26.4% by June 2026 reflecting the gradual tightening of domestic monetary conditions. Moreover, this credit expansion was particularly observed in gold backed lending and vehicle related financing. Although the banking sector continued to account for the largest share of lending, the FCs sector recorded a substantially higher growth rate, contributing to the expansion in credit across the financial system.

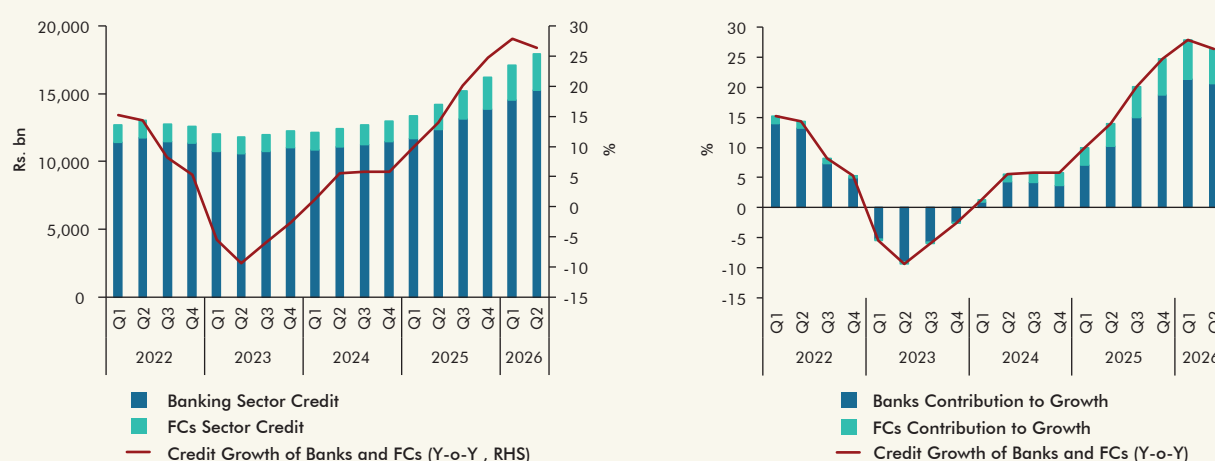
Although rapid credit expansion supported financial intermediation, the sustained high pace of credit growth and the composition of

2 Further details on LTV are available in Chapter 5.

3 Includes total credit granted by banks and FCs to both the private sector and the public sector.

Figure 1.11

Total Credit Growth of the Banks and FCs



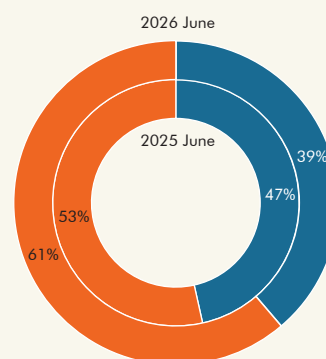
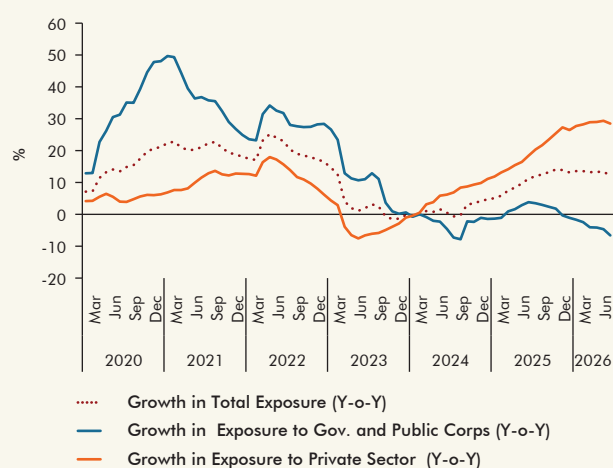
Source: Central Bank of Sri Lanka

credit warrant close monitoring. While the strong momentum in credit growth supported financial intermediation amid the ongoing economic recovery, the sustained high pace of expansion in credit highlights the potential buildup of systemic risk within the financial sector. In particular, a prolonged period of rapid credit growth would contribute to a buildup of vulnerabilities if accompanied by increased borrower leverage, concentration of lending in relatively riskier segments, weakening credit underwriting standards or increased risk taking by Financial Institutions. At the same time, rising domestic inflation levels which necessitated tightening of monetary conditions could increase debt servicing burdens for households and businesses. Going forward continued uncertainty surrounding the global economic outlook, geopolitical developments, commodity price fluctuations, and shifts in global financial conditions, and climate related risk could, if materialised, adversely affect domestic economic activity and borrower repayment capacity. Climate related events could disrupt economic activity, damage productive assets and adversely affect household and corporate incomes, potentially weakening debt servicing capacity and increasing credit risks, particularly in climate sensitive sectors. These developments could amplify credit risk and potentially affect asset quality, particularly in sectors that have experienced rapid credit expansion, underscoring the need for continued monitoring of the pace, composition and quality of credit across the financial system.

Financial Institutions' exposures continued to rebalance towards the private sector during the review period, reflecting stronger private sector credit demand and the gradual normalization of financial intermediation. According to Financial Survey (M4) data, this reorientation of credit gained further momentum, with the share of private sector exposure in total financial sector exposure increasing to 61.3% by end June 2026, while the share of exposure to the Government and public corporations declined to 38.7%. This shift was primarily driven by the strong growth in private sector credit exposure particularly to personal loans and advances, including gold backed lending, as well as increased lending to the services sector and selected industrial subsectors. In contrast, credit exposure to the Government and public corporations declined gradually over the review period. Nevertheless, the overall exposures to the Government and public corporations including investments in government securities remain sizeable, underscoring the continued interconnectedness between the sovereign and the financial sector. Looking ahead, heightened geopolitical uncertainty and associated pressures on fiscal sector revenue and expenditure could increase government financing requirements and reverse the trend observed in falling domestic financial sector's exposure towards the public sector. From a financial stability perspective, although the continued rebalancing of credit towards the private

Figure 1.12

Exposure of Banks and FCs



Source: Central Bank of Sri Lanka, Financial Survey (M4)

sector could support economic activity, the rapid pace of private sector credit growth warrants close monitoring to ensure that the reallocation of credit does not contribute to excessive borrower leverage, weakening underwriting standards or a buildup of sectoral credit concentrations.

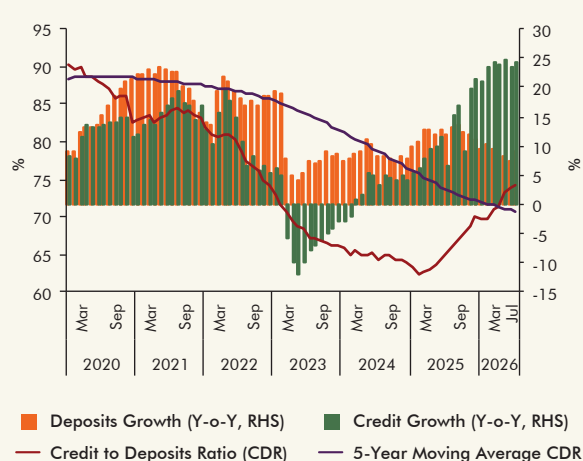
Financial Intermediation and Credit Cycle

Financial intermediation strengthened during the review period with the continued expansion in credit. The banking sector Credit-to-Deposit Ratio (CDR) maintained the upward momentum that emerged in early 2025, exceeding 70% by early 2026 for the first time in three years and surpassing its

long term average by end Q2 of 2026. Notably, the increase in the CDR occurred alongside broadly stable GDP growth, suggesting that the recovery in financial intermediation and credit demand outpaced changes in overall economic activity. This increase reflected the widening differential between credit and deposit growth, as credit growth accelerated markedly amid the continued recovery in economic activity and the accommodative monetary conditions that prevailed during much of the period, while deposit growth remained comparatively moderate. Nevertheless, the CDR remained below the levels observed prior to the recent economic crisis, indicating that the current increase partly reflects the normalisation

Figure 1.13

Credit to Deposit Ratio of the Banking Sector



Source: Central Bank of Sri Lanka

Figure 1.14

Banking Sector CDR Vs. GDP Growth

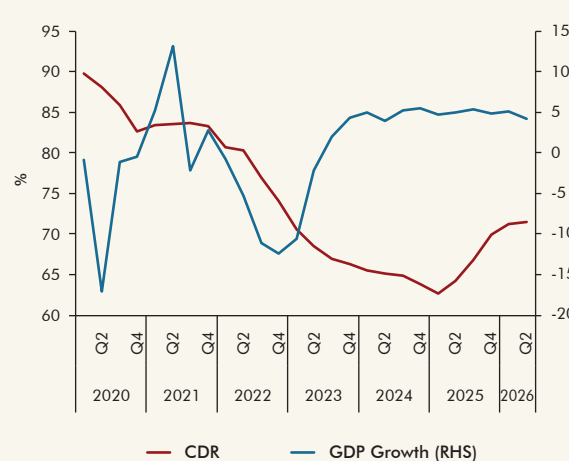
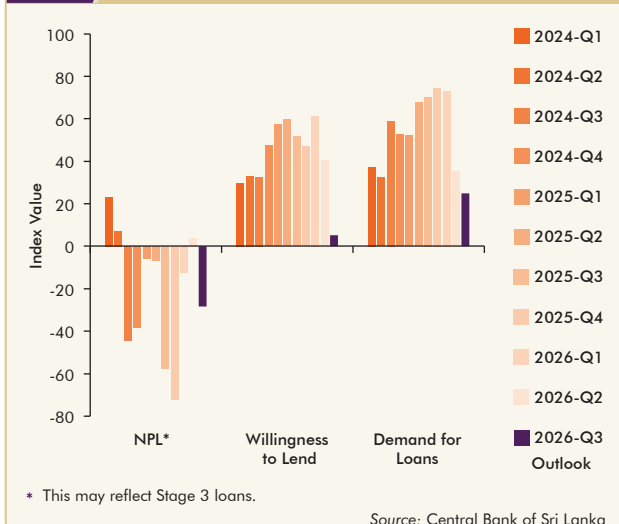
Sources: Central Bank of Sri Lanka
Department of Census and Statistics

Figure 1.1 **Movement of Credit Supply Survey Indices**



of financial intermediation from the exceptionally subdued levels recorded during 2023 and 2024. Moreover, results of the Credit Supply Survey indicated that loan demand continued to strengthen in Q2 of 2026, with increases observed across the retail, corporate, SME and SOE sectors, although at a more moderate pace compared to Q1 of 2026. The expansion in credit demand was largely supported by higher working capital requirements, demand for short term loans, and revival of investment activity. However, banks expected both lending activity and credit demand to remain positive in Q3 of 2026, although banks' willingness to lend is expected to increase at a slower pace, reflecting a more cautious outlook amid anticipated inflationary pressures, rising operating costs, exchange rate volatility and geopolitical uncertainties. While the recovery in financial intermediation supports the financing needs of the economy, a sustained widening of the gap between credit and deposit growth could increase funding pressures and contribute to a gradual erosion of liquidity buffers if credit expansion continues to significantly outpace growth in stable deposit funding.

The private sector credit cycle continued to progress within the expansionary phase with widening gap highlighting the potential buildup up of systemic risk. The private sector credit-to-GDP ratio continued to increase throughout the period, supported by the strong expansion in

credit mainly driven by personal loans receivables, including vehicle financing and gold-backed lending, alongside higher lending to the services sector and selected industrial subsectors. At the same time, the Credit Gap remained in positive territory and widened further, indicating that private sector credit growth continued to outpace its long term trend. While the emergence of a positive credit gap is consistent with the recovery of credit expansion following the prolonged contraction observed during 2022–2024, its continued widening particularly alongside rapid private sector credit growth, warrants close monitoring from a financial stability perspective. A sustained expansion in credit significantly above its long-term trend could contribute to a buildup of borrower leverage, increased risk taking and sectoral credit concentrations if not accompanied by commensurate growth in borrowers' income and repayment capacity. Nevertheless, the tightening of monetary policy in May 2026, together with the introduction of LTV related measures, is expected to contribute to a gradual moderation in credit expansion and contain the further buildup of credit related vulnerabilities. As the effects of these measures are expected to transmit with a lag, their impact on the pace and composition of credit growth would warrant continued monitoring. Accordingly, close monitoring of credit dynamics remains important to assess whether the ongoing expansion in the credit cycle is giving rise to emerging systemic vulnerabilities.

Figure 1.16 Private Sector Credit Cycle*

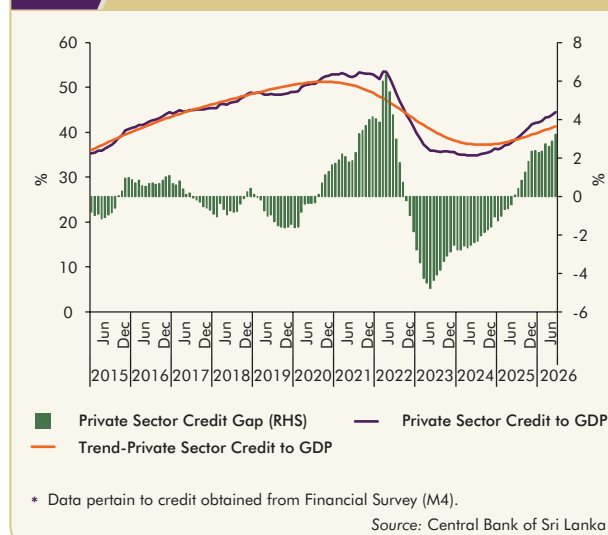
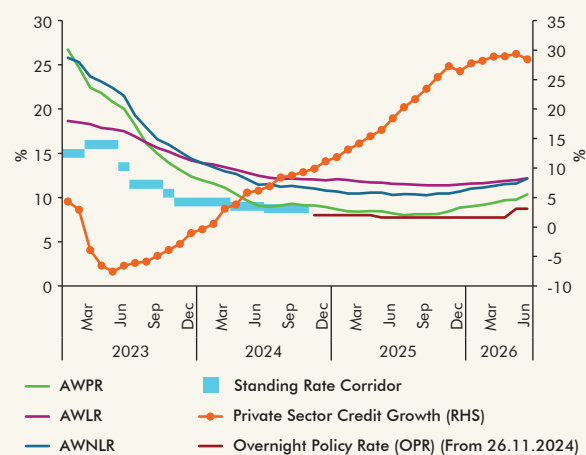
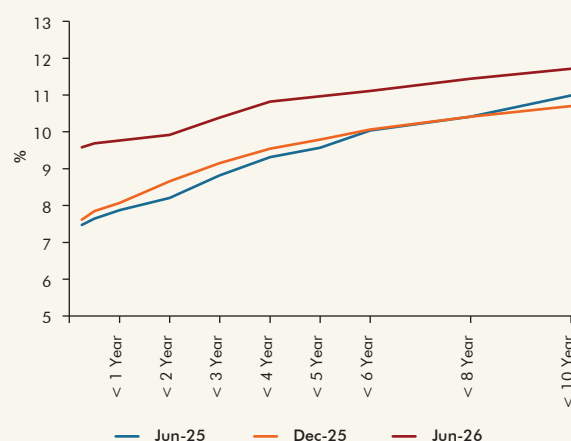


Figure 1.17 Policy Rate and Selected Market Interest Rates

Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

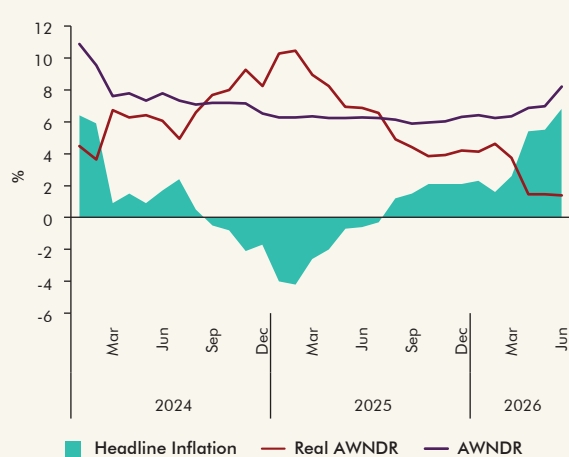
Figure 1.19 Secondary Market Yield Curve of Government Securities

Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

Market Interest Rates and Yield Rates

Following the broad-based easing observed during 2025, market interest rates and Government securities yields adjusted upwards during the first half of 2026. Market interest rates remained under upward pressure mainly driven by heightened uncertainty emanating from geopolitical tensions, market expectations on inflation and tightening of policy interest rates. Short term money market rates increased in response to the monetary policy tightening, while lending rates also further adjusted upwards as the change in the policy stance was transmitted through the financial system. Despite

these upward adjustments, market interest rates remained well below the elevated levels observed during the post-crisis period, suggesting that financing conditions remained comparatively supportive of financial intermediation during the period under review. Meanwhile, Government securities yields increased across maturities, contributing to an upward shift in the yield curve amid evolving market expectations and investor sentiments along with heightened uncertainty. Further real interest rates moderated during the period as inflation gradually increased. Against this backdrop, private sector credit growth, which had strengthened markedly during 2025 and early 2026, showed some moderation towards the latter part of the period amid the tightening of financing conditions and evolving macrofinancial landscape. Overall, financial markets and institutions continued to adjust to the changing interest rate environment in an orderly manner without signs of significant stress.

Figure 1.18 AWNDR and Real AWNDR

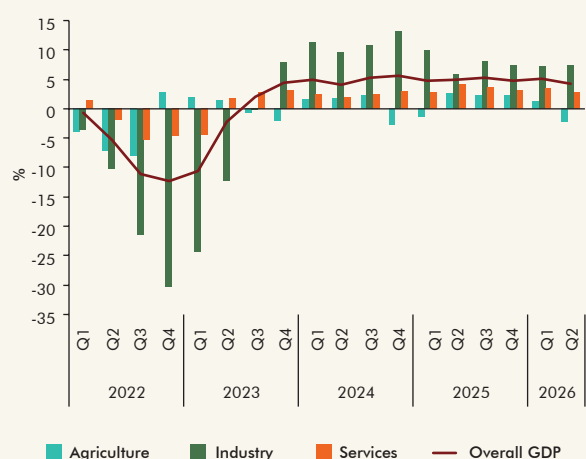
Sources: Central Bank of Sri Lanka
Department of Census and Statistics

Economic Growth and Inflation

The continued expansion of economic activity supported macroeconomic stability and eased financial pressures on households and businesses. The Sri Lankan economy sustained its recovery momentum in Q2 of 2026, recording y-o-y growth of 4.2%, compared to 5% in Q2 of 2025. This growth was supported by positive contributions from the industry and services sectors, despite a contraction in agriculture sector. The sustained

Figure 1.20

Quarterly GDP Growth



Source: Department of Census and Statistics

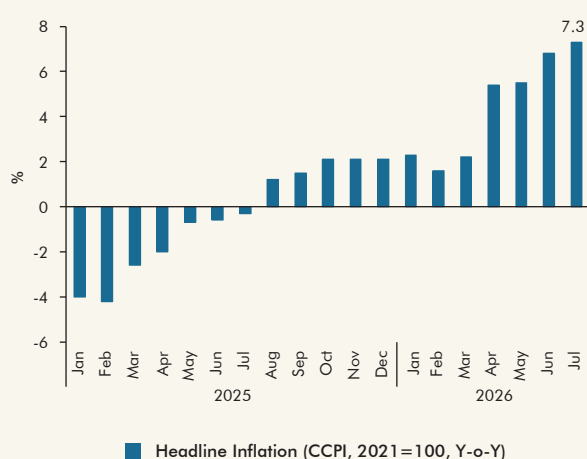
recovery has supported business confidence and income generation, thereby contributing to the gradual strengthening of household and corporate balance sheets and supporting the easing of default risk faced by financial institutions. Nevertheless, the growth outlook remains subject to downside risks arising from escalating geopolitical tensions, particularly in the Middle East, which could adversely affect economic activity through higher oil prices, increased shipping costs, weaker external demand, and heightened uncertainty. Adverse weather conditions, including the heat waves experienced in early 2026 and the potential emergence of El Niño conditions, could

also weigh on agricultural production, energy supply, and broader economic activity. However, continued expansion in private sector credit and resilient domestic demand could provide support to economic growth going forward.

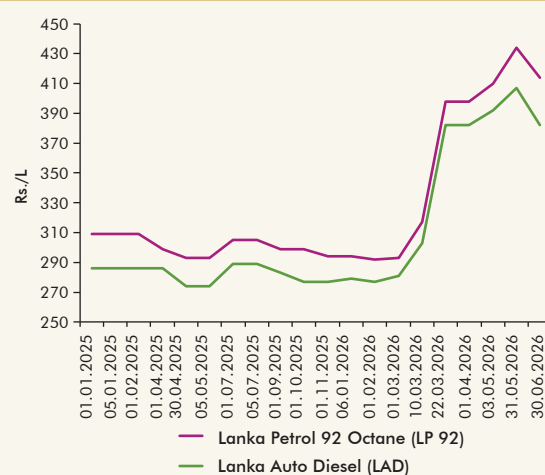
The recent escalation in inflationary pressures could increase financial strain on households and firms, thereby exerting negative repercussions towards the financial sector. Following eleven consecutive months of deflation, inflation returned to positive territory in August 2025 and accelerated thereafter, exceeding the Central Bank's target of 5% from April 2026 onwards. Headline inflation increased from 2.1% at end 2025 to 7.3% by July 2026, rising above the upper limit of the target, reflecting the pass-through of higher domestic energy and fuel prices amid the conflict in the Middle East, alongside other price adjustments. While the continued recovery in economic activity has supported income generation and repayment capacity, rising price levels could erode real incomes and place pressure on household and corporate balance sheets, particularly in the context of rapid credit growth. Despite the gradual recovery in real wage indices since mid 2025, a slight decline observed in Q2 of 2026 indicates emerging pressures on household purchasing power amid renewed inflationary pressures. Further, inflation is projected to remain above the target in the near

Figure 1.21

Headline Inflation and Domestic Oil Prices



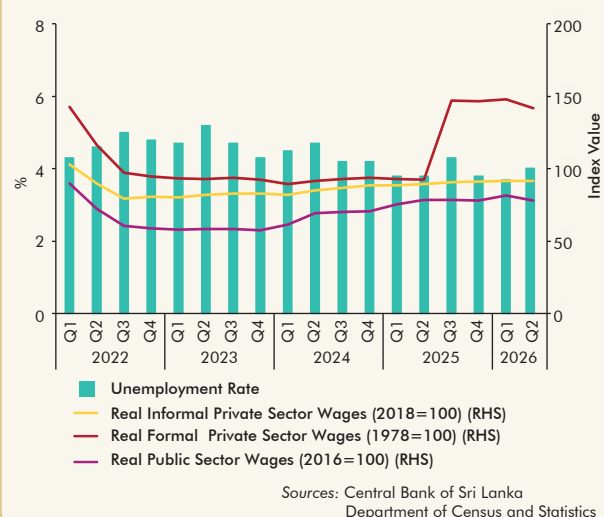
■ Headline Inflation (CCPI, 2021=100, Y-o-Y)



— Lanka Petrol 92 Octane (LP 92)
— Lanka Auto Diesel (LAD)

Sources: Department of Census and Statistics
Ceylon Petroleum Corporation

Figure 1.22 Unemployment Rate and Wage Rate Indices

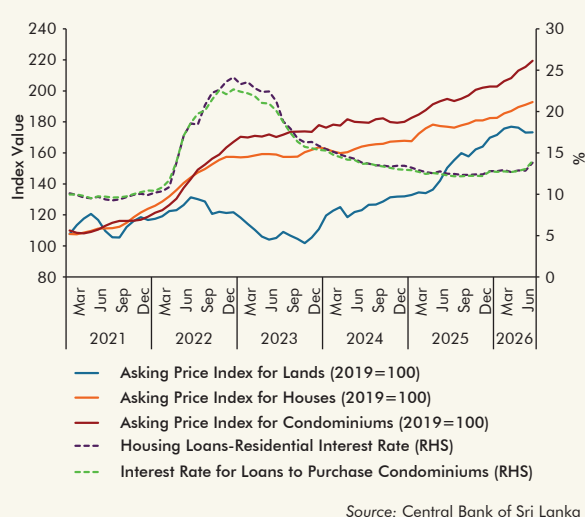


term before gradually stabilising around 5% over the medium term. Moreover, the inflation outlook remains subject to elevated uncertainty, with upside risks stemming from geopolitical tensions, higher energy and shipping costs, strong domestic demand, exchange rate pressures, and adverse weather conditions, particularly due to the impact of El Niño. Hence, a prolonged period of elevated inflation could further weaken debt servicing capacity of both households and firms and thereby pose challenges to asset quality within the financial sector.

Real Estate Sector

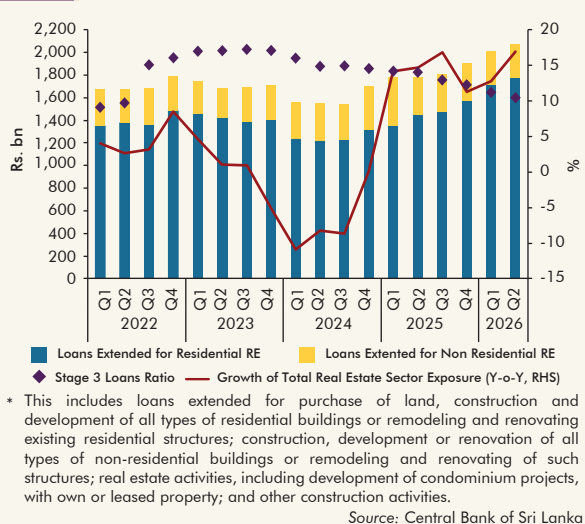
Continued upward trend in real estate prices, together with the banking sector's increasing exposure to real estate activities, warrant continued monitoring. Asking Price Indices for land, houses and condominiums in the Colombo District continued to increase during most of the period, with all three indices reaching their highest levels since 2019. The upward movement in prices reflect improving economic activity, elevated construction costs and sustained demand for real estate assets supported by lower borrowing costs amid relatively accommodative monetary policy conditions. However, the persistent increase in property valuations highlights the need for continued attention given the risk of potential market imbalances. Meanwhile, the banking sector's exposure to real estate related activities

Figure 1.23 Real Estate Prices and Lending Rates



remained elevated, with loans extended to the sector accounting for 13.7% of total loans and advances by end June 2026. The expansion in real estate sector lending was primarily driven by residential real estate activities, while lending to non-residential real estate activities recorded a contraction. However, the stage 3 loans ratio of the sector declined to 10.4% by end June 2026 from 14.0% a year earlier, indicating an improvement in asset quality amid credit expansion. Given the linkages between the real estate market and the banking sector, a sharp correction in property prices could adversely affect collateral values and borrower repayment capacity, creating negative spillover risks to financial stability.

Figure 1.24 Banking Sector Exposure to Real Estate Sector*



* This includes loans extended for purchase of land, construction and development of all types of residential buildings or remodeling and renovating existing residential structures; construction, development or renovation of all types of non-residential buildings or remodeling and renovating of such structures; real estate activities, including development of condominium projects, with own or leased property; and other construction activities.

Source: Central Bank of Sri Lanka

Collateral Asset Prices

Volatility in gold market, alongside geopolitical tensions, continued to pose challenges for financial stability. Gold prices⁴ increased steadily during the second half of 2025 and early 2026, reaching a peak of around USD 1,393 per sovereign at end January 2026 amid heightened market activity. Subsequently, following significant fluctuations, gold prices corrected and remained volatile, falling to around USD 1,141 per sovereign by end August 2026, underscoring the potential risks to institutions with sizeable gold backed lending exposures from further price adjustments. Further corrections in gold prices could weaken collateral values and increase asset quality risks, particularly given the strong growth in gold backed lending. In addition, ongoing geopolitical tensions may lead to higher energy prices and supply chain disruptions, placing pressure on household and business incomes, thereby affecting debt servicing capacity. In recognition of these risks, the Central Bank has implemented targeted macroprudential measures, including LTV restrictions on gold backed lending, aimed at containing excessive risk taking and mitigating vulnerabilities arising from asset price volatility.

⁴ Gold sovereign prices are derived from the Bloomberg gold price (USD/troy ounce), converted to grams and adjusted for the standard sovereign weight of 8g.

Figure 1.25 Fluctuations in Gold Prices*



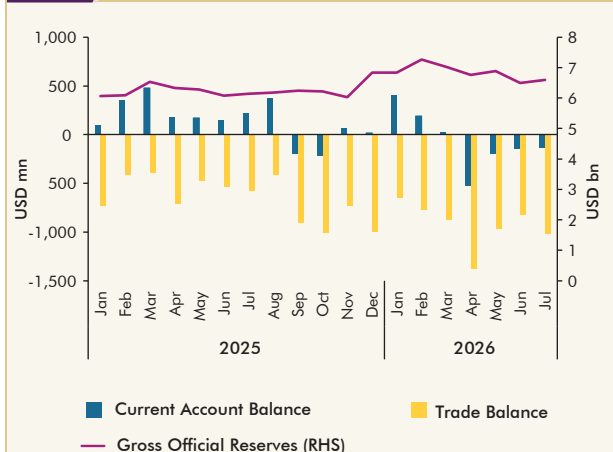
* Gold sovereign prices are derived from the Bloomberg gold price (USD/troy ounce), converted to grams and adjusted for the standard sovereign weight of 8g.

Source: Bloomberg

External Sector

Sri Lanka's external sector remained vulnerable to adverse global developments resulting in spillovers to the financial sector. As a net energy importing economy, Sri Lanka remained particularly exposed to rise in global oil and other commodity prices, which contributed towards the widening of the merchandise trade deficit through a higher import bill along with higher vehicle imports. Nevertheless, the LTV limits introduced on vehicle related lending are expected to help moderate credit demand for vehicle imports and thereby contain associated pressures on import expenditure and foreign exchange demand, providing some support in mitigating external sector vulnerabilities. At the same time, weaker global growth and trade fragmentation constrained merchandise export earnings and other foreign exchange inflows, while heightened geopolitical uncertainty affected tourism receipts and investor flows. Nevertheless, continued inflows from tourism and workers' remittances provided an important buffer against external pressures and helped support foreign exchange liquidity. Thus, amid the deterioration of the external current account, foreign exchange reserve accumulation moderated with gross official reserves stabilizing at around USD 6.6 bn by end July 2026, while the pressures in the domestic foreign exchange market increased as reflected through the depreciation of the Sri Lankan rupee against the US

Figure 1.26 External Balances



Source: Central Bank of Sri Lanka

dollar. Accordingly, the rising import cost along with depreciation of the domestic currency increased imported inflation and foreign currency funding costs, while raising debt servicing burdens of unhedged foreign currency borrowers.

Fiscal Sector

Continued improvements in fiscal performance have supported broader economic and financial stability. Government revenue remained buoyant during the first half of 2026, primarily driven by strong tax revenue collections from Value Added Tax (VAT), excise duties, import related taxes, and income taxes. The increase reflected the effects of tax policy measures, improved tax administration, strengthening economic activity, and robust vehicle imports. Meanwhile, growth in government expenditure remained comparatively moderate despite increases in subsidies, transfers, salaries and wages, and capital spending. As a result, key fiscal balances improved further, with sizeable primary and current account surpluses recorded during the period. The continued strengthening of fiscal performance has reduced the Government's reliance on domestic financing and eased potential pressures on domestic financial sector. Accordingly, the Government recorded a net repayment of domestic financing during first half of 2026, underscoring the reduced need for domestic borrowing. This has supported the availability of financial resources for private sector lending, thereby

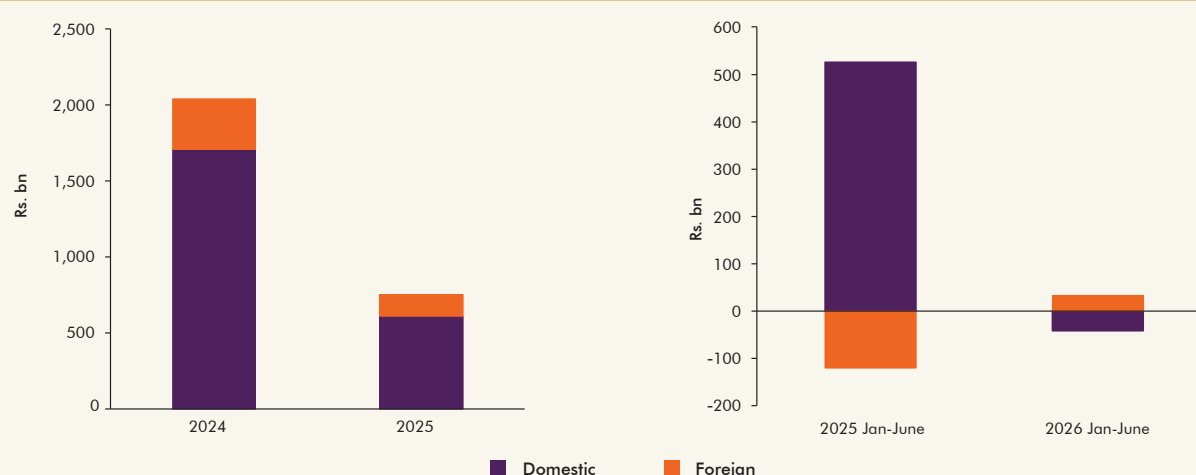
facilitating improved financial intermediation within the private sector. Nevertheless, maintaining fiscal discipline remains important amid evolving external uncertainties and potential expenditure pressures arising from adverse weather events and geopolitical developments.

Climate Related Risks to Financial Stability

The increasing frequency and severity of climate related events could pose risks to financial stability through their adverse effects on asset values, borrower repayment capacity, credit quality, insurance losses and broader macroeconomic conditions. Cyclone Ditwah, which affected all 25 districts, caused significant damage to physical infrastructure leading to erosion of asset values affecting collateral of financial institutions. Meanwhile, the disruptions to economic activity hampered borrower repayment capacity necessitating the implementation of relief measures including debt moratoria and concessionary arrangements for affected borrowers, potentially distorting the impact on the financial sector through impaired loans. Further, the current El Niño related weather conditions would exert pressure on financial institutions through a deterioration in credit quality with a potential increase in Stage 2 and Stage 3 loans due to hampered debt repayment capacities of affected households, SMEs, and businesses operating in climate sensitive sectors. The insurance sector could also face higher

Figure 1.27

Government Financing



Source: Ministry of Finance, Planning and Economic Development

Special Note 1

Rising Climate Risks: A Growing Concern for Financial System Stability

Introduction

Contemporary climatic events battering the island has brought up the discussion on the economic impact of repeating such events in the future. While any climate catastrophe could disrupt production and impact the general price level triggering price stability concerns, it could also take a toll on financial system stability. Recent experiences in the Sri Lankan context provides a more tangible illustration of the magnitude of any potential shocks. Cyclone Ditwah, which struck Sri Lanka in November 2025, caused estimated physical damages of USD 4.1 bn, equivalent to approximately 4% of the GDP, according to the World Bank's Global Rapid Post-Disaster Damage Estimation (GRADE) assessment.¹ These figures only represent direct physical damages and excludes wider income, production and recovery losses.

In the present context, the Meteorology Department of Sri Lanka has made an official announcement forecasting a 90% probability of a very strong El Niño event developing during September - November 2026 through November 2026 - January 2027.² At the outset this may result in more severe outcomes in comparison to the spells of El Niño experienced during 2015-16 or 2023-24 periods, especially impacting rice cultivation and other agriculture and Small and Medium Sized Enterprises (SMEs) sectors' output.

These climatic events pose a growing financial stability risks particularly through physical risks with possible transition risks. Physical risks arise from climate related events and long term changes, such as floods, cyclones, droughts, extreme temperatures and rising sea levels, while transition risks result from changes in climate policies, technologies, markets and consumer preferences during the shift towards

a low-carbon economy on the backdrop of climate change. Both can adversely affect economic activity, financial institutions and financial markets.

Accordingly, climate risk should increasingly be considered as a cross-cutting source of traditional financial risks, including credit, market, liquidity, operational, as well as insurance and sovereign risks. The Basel Committee on Banking Supervision (BCBS) similarly recognises that climate risk drivers can affect the safety and soundness of individual banks and have broader financial stability implications.³

How a climate event is transmitted to a financial stability concern

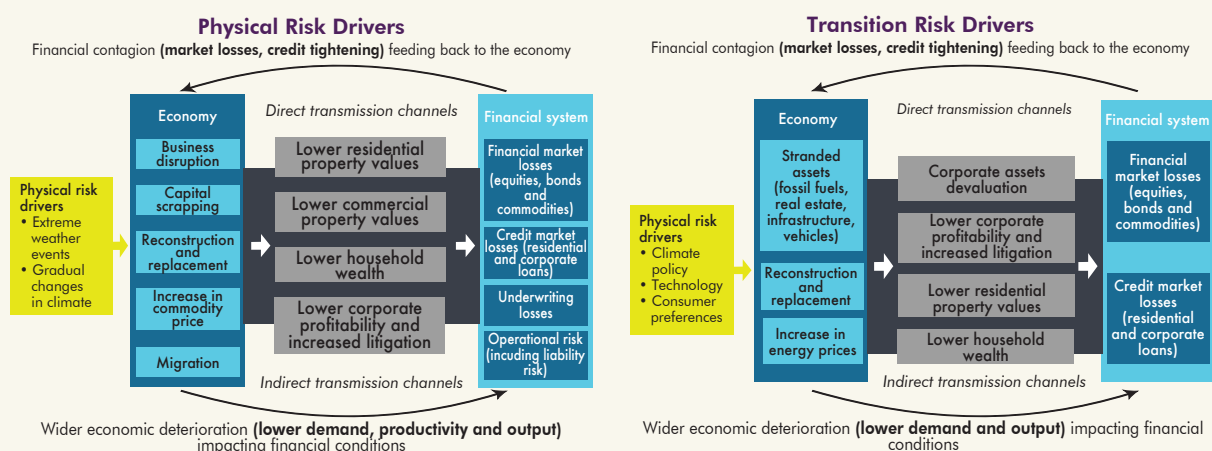
Climate related risks can be transmitted to the financial system through several interconnected channels covering multiple sectors of an economy.

In the Sri Lankan context, climate shocks can reduce the income and repayment capacity of climate sensitive borrowers, particularly agricultural households, SMEs and businesses in hazard prone areas. Limited financial buffers may lead to higher arrears, restructuring and defaults, while damage to pledged assets can further intensify potential credit losses. For example, repeated flooding or coastal hazards may reduce the marketability and value of properties located in such areas. Consequently, even where a borrower initially remains current on a loan, a deterioration in collateral quality could exacerbate the bank's potential loss in the event of a default.

Increasing frequency and severity of natural catastrophes on the other hand can result in higher insurance claims, higher premiums and reduced availability of insurance coverage as well. A widening insurance protection gap would also increase the portion of losses ultimately borne by

Figure 1

Transmission Channels of Climate Risks to Financial Stability



Source: Network for Greening the Financial System (NGFS)

households, firms, governments and financial institutions. Swiss Re Institute estimates that in emerging economies, typically 80% - 90% of catastrophe losses remain uninsured, highlighting the potential importance of this channel for countries with relatively low insurance penetration.⁴

Climate shocks would also increase fiscal and external-sector pressures through higher disaster related expenditure, weaker government revenues and increased imports during a recovery phase. They can also generate inflationary pressures by disrupting agriculture, energy, transport and food supplies, thereby reducing household purchasing power, compressing corporate profitability and complicating monetary policy implementation leading to high cost of borrowing.

Early diagnosis of stability implications

Climate shocks are likely to first appear through migration of loan arrears of banks and Finance Companies (FCs) from Stage 1 to Stage 2 exposures. As borrower repayment capacity deteriorates, expected credit loss provisions rise. If conditions persist, a portion of these exposures may migrate to Stage 3. Institutions with concentrations in agriculture, rural lending, leasing and SMEs are expected to experience greater sensitivity. The share of SME sector loans of the banking sector amounts to about 11% of the total loan portfolio. Climate shocks could therefore generate system-wide consequences even if individual institutions remain resilient.

By the end of first half of 2026, bank lending to Agriculture sector was 8.7% of the total loan portfolio with a gross Stage 3 loans ratio of 9.2%. Similarly, Consumption loans accounted for 19.5% of total bank lending, with a gross Stage 3 loans ratio of 3.3%. As forecasted by the Department of Meteorology, if an El Niño event with 90% probability occurs, it could be among other sectors, transmitted into agriculture and consumption sectors with a higher magnitude through the aforementioned transmission channels.

Hence, the increasing magnitude and economic significance of climate related shocks suggest that climate risk warrants greater attention within the macroprudential surveillance framework. In this regard, the following measures could strengthen the resilience of Sri Lanka's financial system.

- **Strengthening climate risk surveillance** by monitoring sectoral and geographical exposures to climate sensitive hazards and identifying concentrations in vulnerable sectors and locations.
- **Developing a climate risk data architecture** - A major constraint internationally is the non-availability of sufficiently granular, forward looking data. The BCBS notes that climate

risk measurement requires granular data and forward looking methodologies, while the Reserve Bank of India (RBI) has similarly identified geographical information on borrowers and collateral as a major challenge.⁵

- **Developing climate scenario analysis and stress testing** within the existing financial stability framework, initially focusing on Sri Lanka's key physical hazards and subsequently incorporating transition risks.
- **Integrating climate risks into credit risk management**, including borrower assessment, collateral valuation, portfolio monitoring and provisioning, particularly for climate sensitive sectors and hazard-prone areas.
- **Integrating climate considerations into capital and liquidity planning** - As climate risk measurement improves, material climate related vulnerabilities should increasingly inform banks' Internal Capital Adequacy Assessment Processes (ICAAPs), recovery planning and liquidity risk management. International experience suggests that climate stress testing can identify vulnerabilities that may not be visible through conventional stress tests.⁶
- **Strengthening international cooperation and technical capacity** - Sri Lanka could benefit from continued engagement with international initiatives and from adopting internationally recognised climate scenarios and methodologies, while calibrating them to Sri Lanka specific physical hazards, economic structure and financial sector exposures.

Way forward

Financial system participants should make individual and collaborative efforts in integrating climate risk into the existing risk management frameworks through enhanced surveillance, climate scenario analysis, stress testing, granular data, insurance and risk-transfer mechanisms, and facilitate more sustainable finance. Promoting climate resilient infrastructure, climate smart agriculture, renewable energy and other sustainable investments can simultaneously support long term economic development and strengthen financial system resilience.

1. World Bank Group – Press Release
<https://www.worldbank.org/en/news/press-release/2025/12/22/damage-from-cyclone-ditwah-in-sri-lanka-estimated-at-4-1-billion>
2. Department of Meteorology- Current condition and forecasts of ENSO and IOD for SON 2026 (10 September 2026)
3. BCBS – Climate Related Financial Risks -
<https://www.bis.org/publications/202206-guidelines-principles-effective-management-and-supervision-climate-related-financial-risks>
4. Swiss Re Institute - <https://www.swissre.com/press-release/Wildfires-storms-floods-contribute-to-record-92-of-global-insured-losses-in-2025-says-Swiss-Re-Institute/7b39b1a5-b878-4a55-a5ff-bf5aa561a675>
5. Climate related financial risks - measurement methodologies - <https://www.bis.org/bcb/publ/d518.htm>
6. Banks have made good progress in managing climate and nature risks – and must continue
<https://www.ecb.europa.eu/press/blog/date/2025/html/ecb.blog20250711~f5c6a0259f.en.html>

claims and underwriting losses from an increase in the frequency or severity of climate related events. Meanwhile, damages to agricultural production and disruptions to transportation, infrastructure and supply chains could constrain domestic production and exports, raise food and other commodity prices, increase public sector spending on relief measures and thereby impact overall macroeconomic conditions as well. Moreover, government policy changes, technological developments, and changing investor and market expectations could adversely affect the financial sector and borrowers with limited transition preparedness to climate change as well. Thus, these conditions could place additional pressure on profitability, liquidity, and capital buffers of financial institutions going forward with continued incidence of climate events. Meanwhile, sustainable lending remains relatively limited, accounting for around 2 % of the banking sector loan portfolio and around 1 % of the FCs sector loan portfolio, indicating scope for further financing of climate resilient and transition supportive activities.

Overall, domestic macrofinancial conditions broadly remained supportive of financial sector stability despite emerging risks and external uncertainties. Continued economic growth, improving financial intermediation, stronger fiscal performance, and resilient credit quality indicators underpinned this favourable backdrop. The recovery in economic activity and accommodative financial conditions supported a strong expansion in private sector credit, while improved income generation and easing financial stress strengthened household and corporate balance sheets. Continued fiscal

consolidation strengthened public sector finances and reduced reliance on domestic financing, facilitating the reallocation of financial resources towards productive private sector activities. Nevertheless, credit growth accelerated notably, resulting in a widening divergence between credit expansion and underlying economic activity in certain segments. At the same time, inflationary pressures re-emerged and market interest rates adjusted upwards. Although asset quality indicators continued to improve, the rapid pace of credit growth, rising private sector leverage, elevated real estate valuations, and heightened uncertainty surrounding the global economic and financial outlook, and increasing exposure to climate related risks continue to pose potential vulnerabilities to the domestic financial system. At the same time, growing interconnectedness between banks and FCs, increasing digitalisation of financial services, rising cyber security threats, evolving payment technologies, developments in AI-driven financial services, and the emergence of digital currencies have emerged as important considerations for financial sector resilience. Sustaining prudent lending standards, maintaining adequate liquidity and capital buffers, and ensuring that credit growth remains aligned with productive economic activities will be important to preserve macrofinancial stability and strengthen the resilience of the financial system going forward. The potential buildup of vulnerabilities from rapid credit expansion, together with external, inflationary and climate related risks, warrants continued vigilance. Accordingly, close monitoring of emerging risks and timely policy responses, where necessary, will remain important in safeguarding financial system stability.

Chapter 2

Financial Markets and Payment Infrastructure



Stress in domestic financial markets, as measured by the Financial Stress Index (FSI)¹, remained subdued during the first eight months of 2026, despite a temporary increase in March 2026 amid heightened geopolitical uncertainty. The FSI remained contained at low level, as relatively stable conditions in the Government securities market and money market offset intermittent increases in stock and domestic foreign exchange market stress.

Stock market performance moderated during the first eight months of 2026, amid heightened geopolitical tensions, global financial market uncertainty, rising energy prices, the domestic inflation outlook and tighter monetary conditions. Stock price indices remained subdued, while market liquidity moderated and volatility increased. Market valuation indicators increased modestly but remained broadly in line with their long term averages and below those of most regional peers. Persistent net foreign outflows underscored the importance of attracting stable, long term capital inflows to strengthen market liquidity and resilience.

Conditions in the Government securities market tightened, with yields increasing across maturities. Evolving market expectations, geopolitical uncertainty and tighter monetary conditions were reflected in the upward adjustment in yields. Despite strong fiscal performance and robust demand for Government securities, secondary market liquidity remained constrained, with trading concentrated within a limited range of maturities. Foreign investment recorded a modest recovery towards the latter part of the review period as yields adjusted upwards and exchange rate conditions improved, although overall foreign participation remained low.

The domestic foreign exchange market experienced some pressure, with conditions improving in the latter part of review period. Heightened geopolitical tensions, rising energy prices, increased import demand and changing investor sentiment caused to the depreciation of the Sri Lanka rupee against the US dollar and several other major currencies. Nevertheless, conditions subsequently improved, supported by policy measures and continued foreign exchange inflows from workers' remittances, export proceeds and tourism earnings, while exchange rate volatility moderated and interbank transaction volumes exhibited a gradual recovery.

Domestic money market activity strengthened further, with increased repo and call money market transactions. State-owned banks remained key net lenders, while domestic private banks continued to be net borrowers, reflecting the asymmetric distribution of liquidity. The Average Weighted Call Money Rate (AWCMR) and Average Weighted Repo Rate (AWRR) exhibited some intermittent upward pressure during the review period and subsequently returned to broad alignment with the Overnight Policy Rate (OPR), while overall money market liquidity remained in surplus.

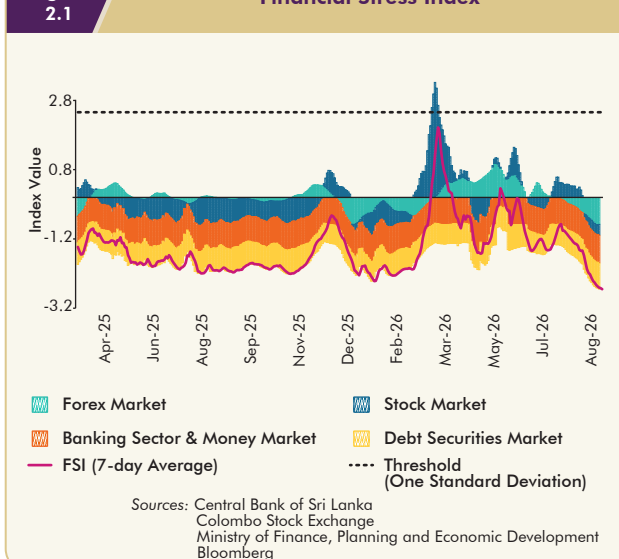
Payment and settlement infrastructure remained operationally resilient during the review period, while continued growth in digital payments and measures to strengthen settlement risk management, interoperability and accessibility supported payment system resilience. Nevertheless, the increasing reliance on digital channels continued to warrant close monitoring of cyber, operational and third-party risks.

Overall, domestic financial markets and payment infrastructures remained resilient during the review period despite heightened global uncertainty, tighter domestic monetary conditions and moderate pressure on foreign exchange and stock markets. Maintaining macroeconomic stability, strengthening investor confidence, broadening foreign investment base and deepening domestic financial markets and payment infrastructures would enhance resilience against external and domestic shocks.

¹ This index captures the combined stress emanating from stock, domestic foreign exchange, Government securities and domestic money markets.

Figure 2.1

Financial Stress Index



2.1 Stock Market

Stock market performance moderated during the review period, following the strong gains recorded in 2025, amid heightened external uncertainty. Stock market price indices exhibited a decline in March 2026 with the escalation of tension in the Middle East and remained relatively subdued up to end August 2026. As of end August 2026, All Share Price Index (ASPI) and S&P SL 20 index declined by 5.7% and 2.4%, respectively, compared to the notable annual growth of 41.9% and 26.6%, respectively, recorded by end 2025. The subdued performance of the stock market reflected heightened geopolitical

tensions in the Middle East and increased uncertainty in global financial markets, which adversely affected investor sentiment. The associated increase in global energy prices also raised concerns over the domestic inflation outlook, adding to market uncertainty. The subsequent tightening of domestic monetary conditions, together with higher market interest rates, further weighed on stock market sentiment by increasing the relative attractiveness of fixed income investments and raising financing costs and discount rates applicable to corporate earnings. Consequently, market capitalisation declined by 4.2% from end 2025 to Rs. 7,730.8 bn by end August 2026. The orderly nature of the adjustment thus far suggests limited immediate implications for financial system, although developments in investor leverage, foreign portfolio flows and market liquidity warrant continued monitoring.

Real return² in the stock market as reflected by the inflation adjusted All Share Total Return Index (ASTRI) continued to decline during the review period. Following peak in August 2025, the real return of the stock market declined as the moderation in nominal stock market performance coincided with rising domestic inflation, resulting in weaker real returns to investors. Market liquidity also weakened during the review period, as evidenced by a decline

2 Real return for All Share Price Index is calculated as

$$\text{Real Return} = \frac{1 + \text{Monthly ASTRI Return}}{1 + \text{Monthly CCPI inflation rate (2021=100)}} - 1$$

Figure 2.2

Share Price Indices

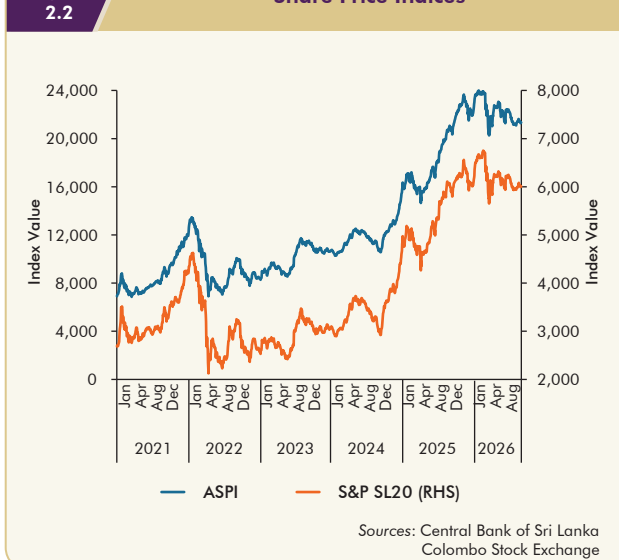


Figure 2.3

Monthly Stock Market Turnover and Real Returns

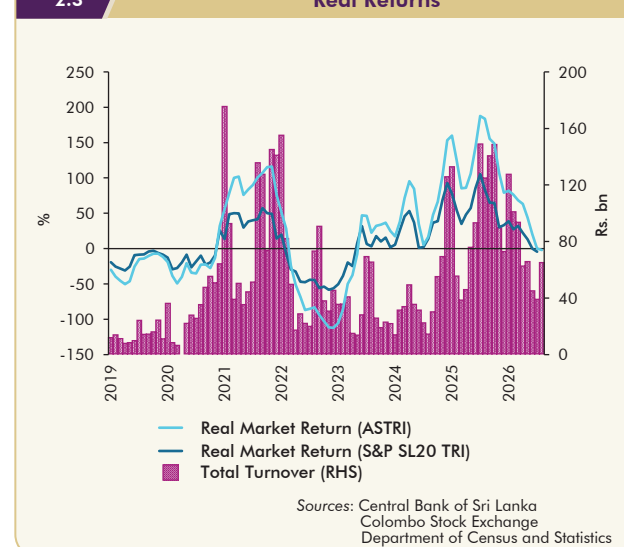
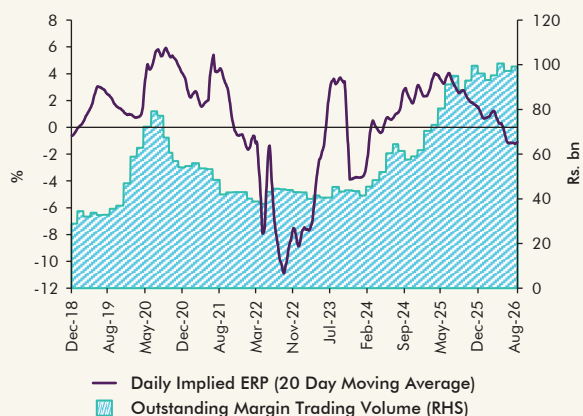


Figure 2.4

Implied Equity Risk Premium and Credit Exposure of CSE



Sources: Central Bank of Sri Lanka
Colombo Stock Exchange
Securities and Exchange Commission

in average daily turnover to Rs. 4,000.3 mn during the first eight months of 2026, compared with the average of Rs. 5,179.2 mn recorded in 2025. The implied equity risk premium³ continued its downward trajectory moved into negative territory since May 2026. The negative implied equity risk premium indicated that the aggregate earnings yield on equities fell below the 364-day Treasury bill yield, reducing the relative return compensation for holding equities and potentially lowering their attractiveness relative to risk-free Government securities. Further, total credit exposure⁴ to the stock market which exhibited an increasing trend until early 2026, started to decelerate subsequently, indicating a lagged response that closely followed the moderation in market earnings. As of end August 2026, the total credit position of Colombo Stock Exchange (CSE) stood at Rs. 99.0 bn recording an increase of 12.0% compared to end 2025 and an increase of 91.0% compared to end 2024. However, it remained at a low level as a percentage of market capitalisation and total loan portfolio of the banking and finance company sectors.

- 3 Implied Equity Risk Premium (ERP) is calculated as the spread between the aggregate market earnings yield; the reciprocal of the market Price-to-Earnings Ratio (PER) and the secondary market yield on 364-day T-bills which reflects the risk-free rate:

$$\text{Implied ERP}_t = \left(\frac{1}{\text{PER}_t} \times 100 \right) - Y_{t,\text{RF}}$$

Where PER_t is the market PER and $Y_{t,\text{RF}}$ is the prevailing secondary market yield on 364-day T-bills.

- 4 Total credit exposure to the stock market includes all outstanding margin loans from licensed margin providers and credit extended by licensed stockbrokers to the investors for trading securities on the CSE.

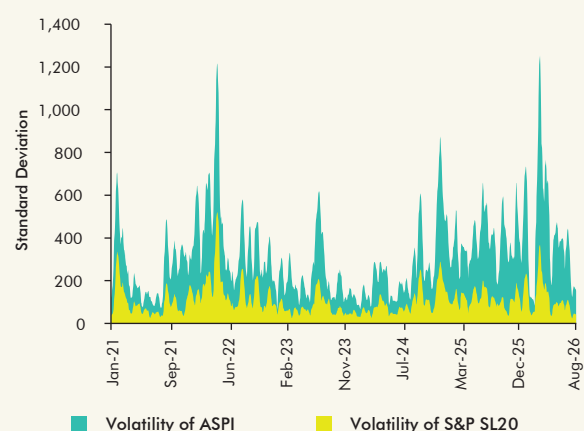
While the subsequent moderation in credit exposure reduced the potential for leverage to amplify stock market adjustments, developments in margin related and other credit exposures warranted continued monitoring, particularly during periods of elevated market volatility. However, the orderly adjustment in market prices and the subsequent moderation in credit exposure suggested that the direct implications for financial system stability remained contained, although the interaction between market volatility, investor leverage and liquidity conditions warranted continued monitoring.

Stock market volatility⁵ increased significantly during the first eight months of 2026 amid heightened geopolitical uncertainty and changing investor sentiment. Volatility in both the ASPI and the S&P SL20 indices as measured by 20 day moving standard deviation exceeded the average levels recorded in 2024 and 2025 and surged sharply in March 2026 to its highest level since January 2021, reflecting increased market uncertainty and changes in investor sentiment amid escalating geopolitical tensions, particularly in the Middle East. Although stock market volatility subsequently moderated from its peak in March 2026, it remained relatively elevated during parts of the review period. Persistent or renewed episodes of heightened volatility could weaken investor confidence, reduce market liquidity and amplify valuation losses, particularly where

- 5 Stock market volatility is measured by the standard deviation of ASPI and S&P SL 20 for preceding 20 days of active trading at CSE.

Figure 2.5

Volatility of Share Price Indices



Sources: Central Bank of Sri Lanka
Colombo Stock Exchange

investors are exposed through leveraged positions. Nevertheless, the direct implications for financial system stability remained contained, given the relatively limited interconnectedness of the stock market with the broader financial system, while developments in market liquidity, investor leverage and financial institutions' stock related exposures warrant continued monitoring.

The Price to Book Value (PBV) ratio and Price to Earnings Ratio (PER) of the stock market remained close to their long term averages. PBV stood at 1.30 at the end of August 2026 remaining unchanged from the level recorded at end 2025. Further, PER also increased during the period under review, reaching 11.20 at the end of August 2026 compared to 10.70 at the end of 2025 while remaining slightly below its long term average of 12.00 since 2000. This increase is attributable to the decline in corporate earnings, which outweighed the moderation in stock market prices. The slowdown and short term fluctuations in PBV indicate that prevailing factors including geopolitical uncertainties have constrained market growth to a certain extent. Nevertheless, the PBV and PER of CSE remained at lower levels compared to most of the other stock exchanges in the region.

Stock market performance across major sectors remained uneven during the review period. Five major sectors, which accounted for around 74% of market capitalisation as at end August 2026,

recorded a mixed performance during the period under review as per the sectoral standardised price indices rebased to 2020. While all major sectors experienced downward pressure in March 2026, the subsequent recovery was uneven across sectors. The Telecommunication Services sector recorded a strong recovery and outpaced the other major sectors, standing around 48.3% above its early January level by end August 2026. In contrast, Diversified Financials, Capital Goods, Banks, and Food, Beverage and Tobacco remained below the levels at beginning of the year. This divergence indicates that the sectoral performance was not broad based, with overall market performance being supported mainly by the Telecommunication Services sector, while other key sectors continued to reflect subdued performance following the market correction in March 2026. This suggests that the subsequent improvements in the stock market was concentrated in selected sectors rather than being supported by a broad-based improvement across listed companies. Such concentration could increase the sensitivity of aggregate market performance to developments affecting a relatively narrow set of sectors and firms. Nevertheless, the differentiated performance across sectors also reflects variations in sector specific earnings prospects, balance sheet conditions and sensitivity to changes in domestic and external macrofinancial conditions.

Sectoral valuation indicators remained highly heterogeneous, while market capitalisation continued to concentrate into five major sectors.

Figure 2.6 Market Valuation Indicators

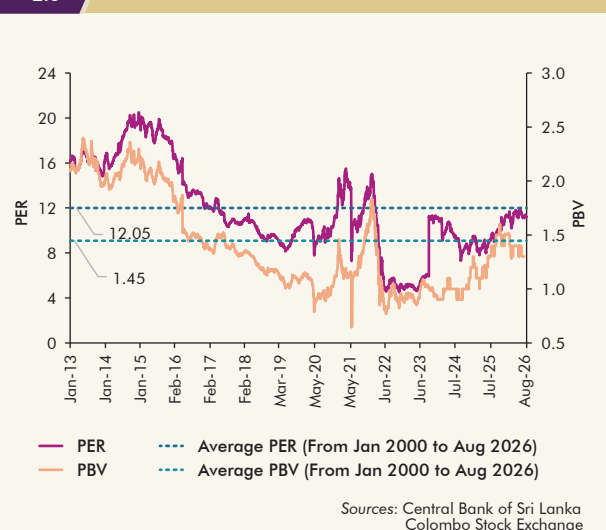


Figure 2.7 Sectoral Dynamics of the Stock Market*

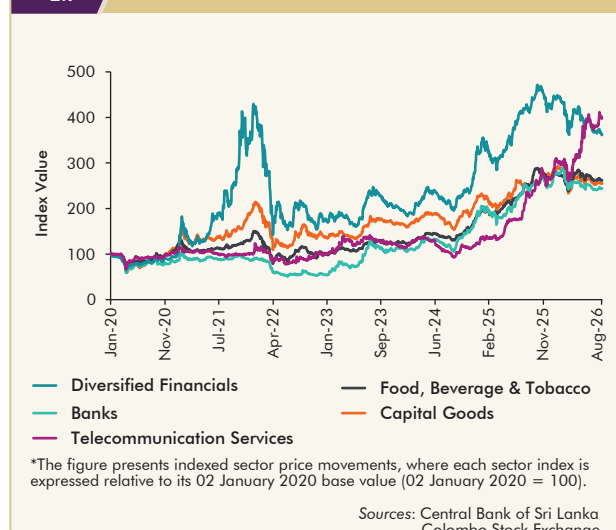
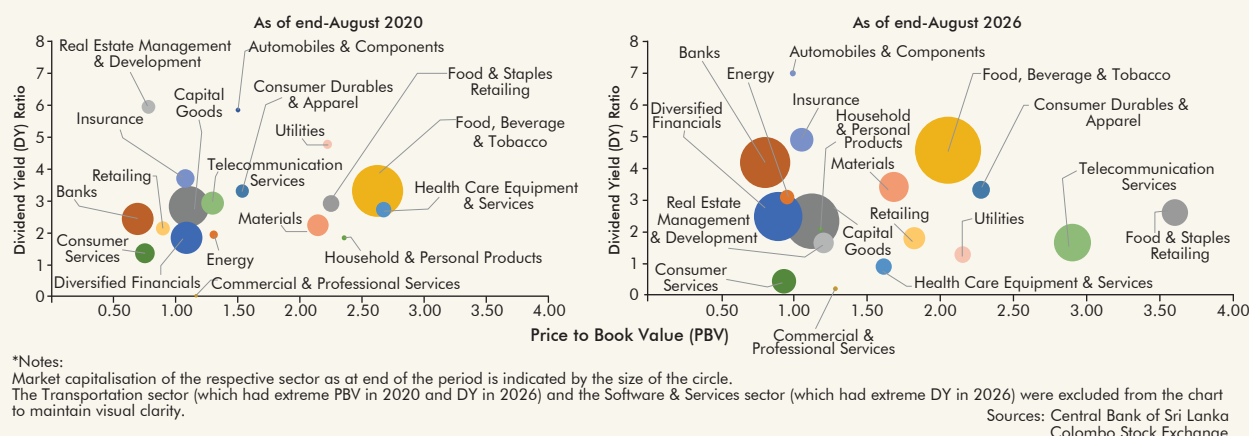


Figure 2.8

Sector-wise Positioning (January 2020 to August 2026)*



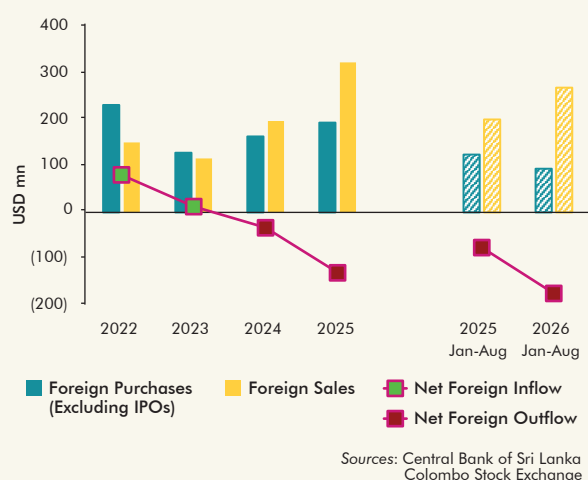
Secondary market data from January 2020 to August 2026 indicates that the PBV ratios of several sectors converged towards the reference level of one, though certain sectors exhibiting notable increase in PBV ratios. During the review period, the Software and Services sector recorded the largest percentage increase in its PBV ratio, rising from 5.0 at end 2025 to 6.90 by end August 2026. This was followed by the Commercial and Professional Services sector and the Telecommunication Services sector. In contrast, the Consumer Services sector recorded the largest decline in its PBV ratio, decreasing from 1.3 at end 2025 to 0.9 by end August 2026, followed by the Food & Staples Retailing, Retailing and Diversified Financial sectors. In terms of long term dividend yield and PBV, Automobile & Components, Real Estate Management & Development, Banks and Insurance

sectors are mostly characterised by modest PBV ratios with relatively high dividend yields.

The CSE recorded net foreign outflows during the first eight months of 2026. The secondary share market recorded a cumulative net foreign outflow of USD 171.8 mn as of end August 2026 following net foreign outflows of USD 127.7 mn in 2025 and USD 32.6 mn in 2024. Foreign participation in the primary market also remained subdued, with foreign inflows amounting to only USD 2.9 mn during the review period, compared to USD 5.4 mn in 2025 and USD 65.5 mn in 2024. The proportion of shares held by foreign investors in CSE stood at 19.0% as of end July 2026 compared to 17.8% at the end of 2025, 17.6% at end 2024 and 24.9% at end 2023. Attracting long term inflows into the market will remain a key requirement to sustain growth in the stock market. Greater participation by stable, long term investors could support market depth, liquidity and diversification of the investor base, thereby strengthening the resilience and development of the domestic stock market.

Figure 2.9

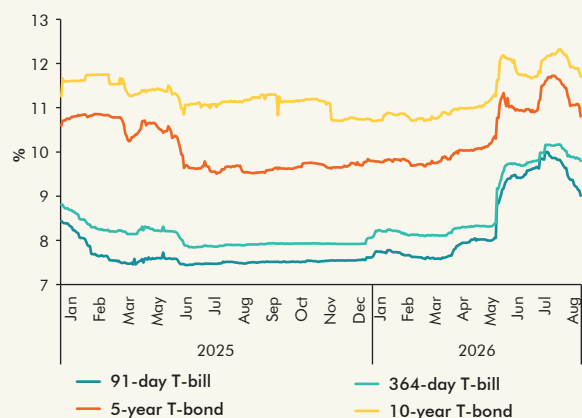
Foreign Participation in the Secondary Stock Market



2.2 Government Securities Market

Yields on Government securities increased during the review period, driven by changing market sentiment and the tightening of monetary conditions. The impact of Cyclone Ditwah on Government securities yields remained limited, although expectations of fiscal pressures and the utilisation of fiscal buffer funds resulted in an uptick of yields towards the end of 2025. Subsequently, the escalation of geopolitical tensions in the Middle

Figure 2.10 Secondary Market Yields of Government Securities

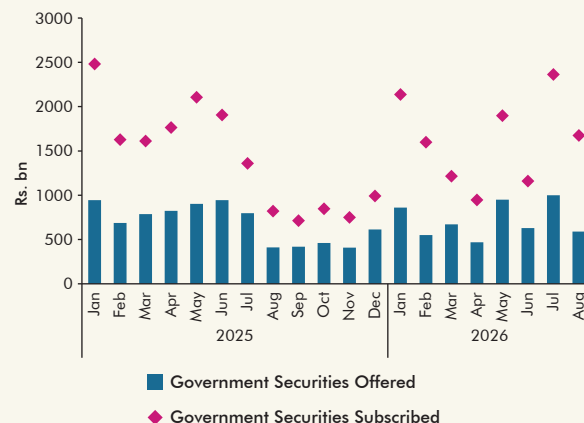


Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

East altered the domestic inflation outlook, resulting in a gradual increase in yields from March 2026. Further, yields rose sharply towards the end of May 2026, following the 100-basis point increase in Overnight Policy Rate (OPR), which marked the first policy rate increase since June 2023. Despite strong fiscal performance and maintenance of the buffer fund, upward pressure on yields across maturities remained elevated as investors continued to price in heightened inflationary pressures.

Demand for Government securities in the primary market remained robust during the review period, despite stronger private sector credit growth and larger offering amounts at primary auctions.

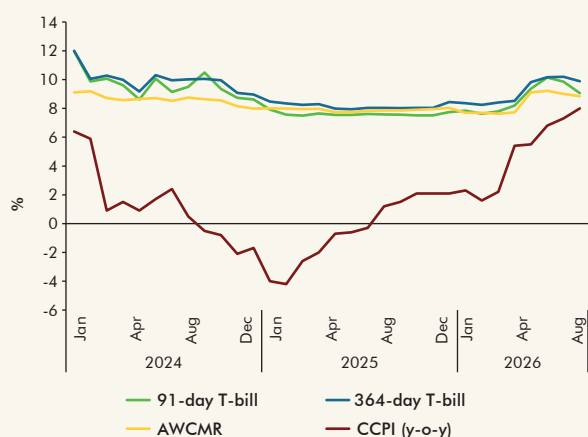
Figure 2.12 Primary Market Demand for Government Securities



Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

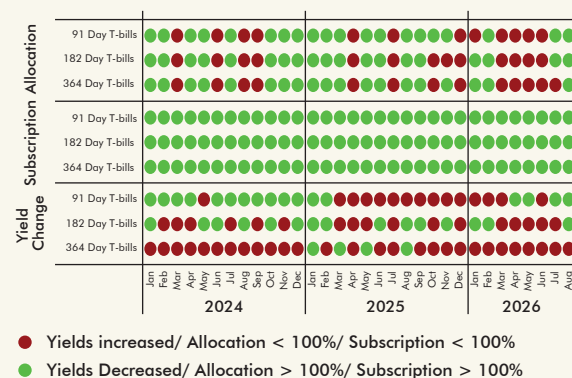
Although private sector credit continued to expand at a relatively higher pace during 2026, following the strong growth recorded in 2025, investor demand for Treasury bills and Treasury bonds remained strong. However, changing global conditions and the resulting shift in domestic market sentiment from March 2026 onwards led investors to demand higher yields at primary market auctions. Nevertheless, bid-to-offer ratio for both Treasury bills and Treasury bonds recorded an average of 221% during the first eight months of 2026, reflecting sustained investor interest for Government securities. However, as upward pressure on yields emerged, some auctions were under allocated, particularly those for 182-day and 364-day Treasury bills. Meanwhile, the amounts

Figure 2.11 Primary Market Yields, AWCMR and CCPI



Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development
Department of Census and Statistics

Figure 2.13 Dynamics in Treasury Bill Auctions



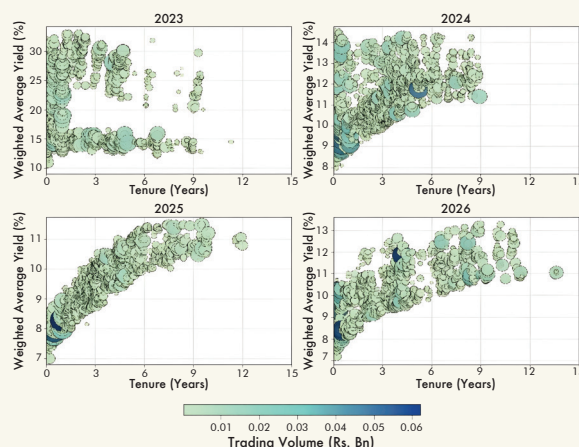
Note: Maroon colour dots indicate periods in which end-of-month auction yields increased, auction allocations were below 100% of the amounts offered, or auction subscriptions were below 100% of the amounts offered. Green indicates the opposite conditions.

Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

offered at auctions, which had declined during the second half of 2025, increased during the first eight months of 2026. Despite the higher issuance, Government securities were generally well subscribed by the market, as evidenced by the continued strong subscription levels.

Secondary market activity in Government securities remained relatively subdued, with liquidity conditions continuing to be constrained despite a recent recovery in trading activity. In the months following September 2025, the turnover ratio declined further, reaching a low of 16.4% by November 2025. Thereafter, trading activity recovered gradually, particularly in Treasury bonds, contributing to an increase in the turnover ratio. Nevertheless, the volatility observed in the turnover ratio since 2023 highlighted the intermittent nature of secondary market activity rather than a sustained improvement in liquidity conditions. Trading activity remained concentrated in shorter-tenure securities throughout recent years. However, the relatively higher turnover observed in Treasury bonds during 2026 suggests some increased activity in longer-tenure securities, although overall market liquidity remained limited. This indicates that changes in the yield curve, including the decline in yields during 2023 and 2024 and the subsequent upward movement in 2026, have not materially altered investor trading preferences or the overall liquidity profile of the market. Persistently limited liquidity has constrained effective yield curve

Figure 2.15 Government Securities
Secondary Market Trades - Yields vs Tenure

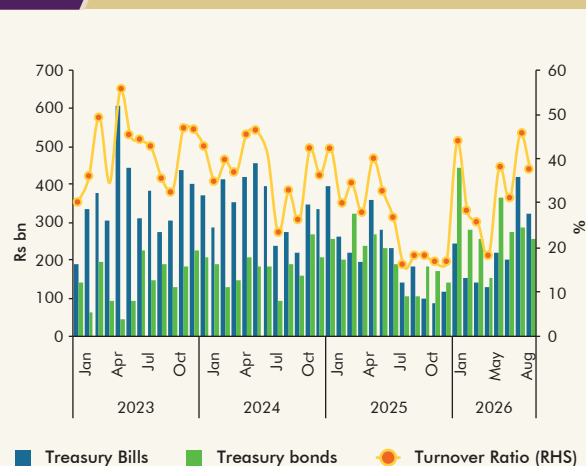


Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

formation and price discovery, as the actively traded maturity spectrum remained narrow. Further, reliance on quoted prices for less actively traded maturities could underestimate market volatility. While the overall turnover ratio of both Treasury bills and bonds increased to 45.6% in July 2026 before moderating to 37.3% in August 2026, the continued variability in trading activity and its concentration across a limited range of maturities suggest that the recent increase in turnover does not yet indicate a sustained improvement in secondary market liquidity.

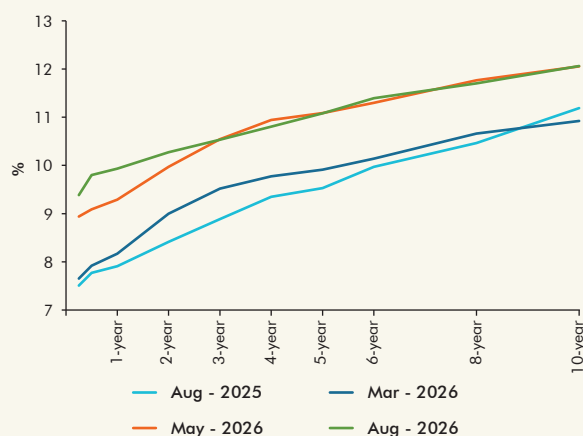
Government securities yields shifted upward across the maturity spectrum during the review period, accompanied by increases in yield volatility. After remaining broadly stable throughout 2025, yield gradually witnessed upward pressure during 2026. The initial adjustment occurred in March 2026, when the yield curve exhibited bearish flattening, with comparatively larger increases in short term yields, resulting in a temporary narrowing term spread. Subsequently, the inherently illiquid structure of the market, together with evolving market expectations, exerted upward pressure on the longer end of the yield curve, which further materialised following the monetary policy rate adjustment. Consistent with these developments, yield volatility across both short and long term securities increased during 2026 compared to the relatively subdued levels observed in the latter half of 2025. Elevated yield volatility may increase uncertainty in the valuation of

Figure 2.14 Secondary Market Trades



Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

Figure 2.16 Government Securities Secondary Market Yield Curve

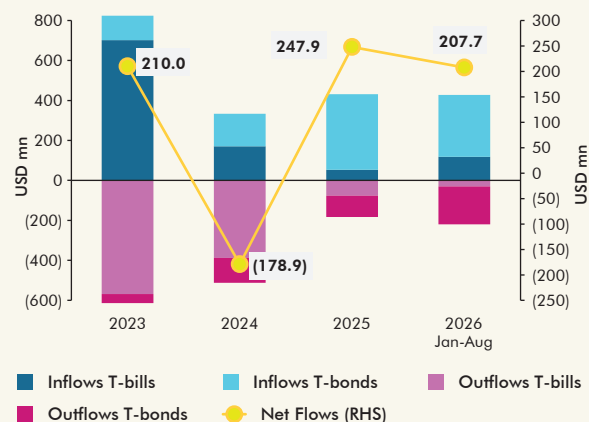


Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

fixed income securities and discourage secondary market participation, potentially reinforcing existing liquidity constraints. The broad-based upward shift in the yield curve also heightened interest rate risk for financial institutions with sizable holdings of Government securities, particularly through valuation losses on securities measured at fair value.

Reflecting the increased yield for Government securities, foreign portfolio investments into Treasury bills and bonds recorded a modest recovery during the review period, although foreign participation remained low and was subject to intermittent outflows. Following the return of net inflows observed in 2025, foreign investments

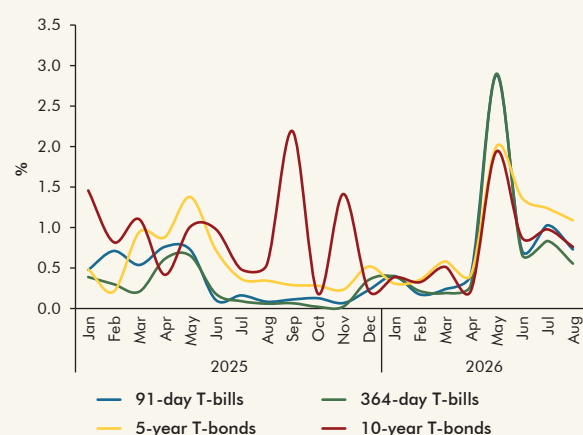
Figure 2.18 Government Securities Market Foreign Flows



Source: Central Bank of Sri Lanka

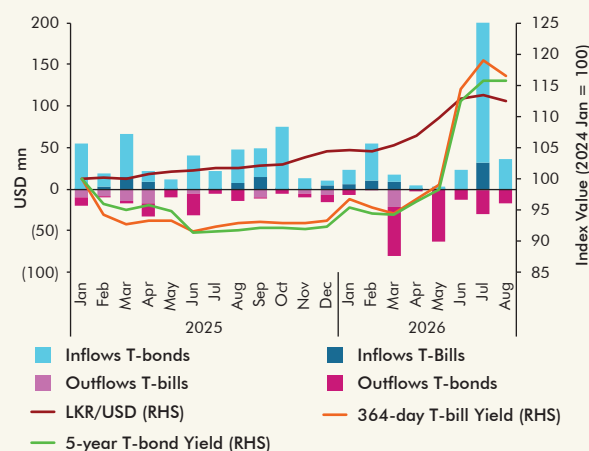
in Government securities recorded net inflows during January and February 2026. However, significant outflows were observed from March to May 2026, reflecting heightened geopolitical uncertainty and weaker investor sentiment towards emerging market assets. These outflows coincided with increased pressures on the Sri Lankan rupee, alongside higher import expenditure arising from increased energy prices. Subsequently, as Government securities yields adjusted upward and domestic foreign exchange market conditions stabilised, foreign investor sentiment improved, resulting in renewed net inflows during June, July and August 2026. Consequently, foreign holdings of Government securities increased

Figure 2.17 Secondary Market Yield Volatilities



Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

Figure 2.19 Monthly Foreign Flows, Exchange Rate and Monthly Yields

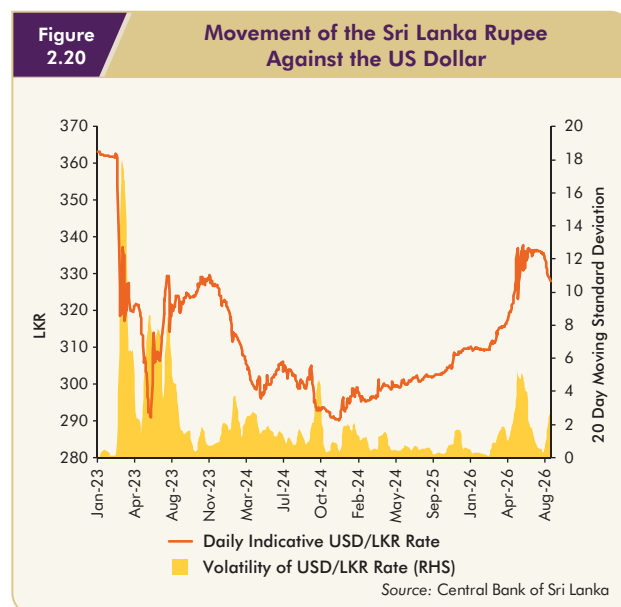


Sources: Central Bank of Sri Lanka
Ministry of Finance, Planning and Economic Development

to around 1.1% of total outstanding securities by end August 2026, compared to 0.6% in August 2025. The outflows observed from March to May 2026 and the subsequent inflows during June to August 2026 were largely concentrated in Treasury bonds, suggesting that foreign investments were primarily influenced by evolving yield expectations and broader market conditions. Nevertheless, the overall share of foreign investor participation and holdings of Government securities remain minimal, limiting the direct exposure of the Government securities market to potential volatility arising from foreign portfolio flow reversals.

2.3 Domestic Foreign Exchange Market

The Sri Lanka rupee depreciated by 5.5% against the USD during the first eight months of 2026 extending the depreciation recorded in 2025, after two consecutive years of appreciation in 2023 and 2024. Following marginal appreciation during the first two months of 2026, the rupee came under renewed pressures from late February amidst a sharp increase in global energy prices and heightened uncertainty in international financial markets mainly due to escalating geopolitical tensions in the Middle East. These developments, combined with increased import-related demand for foreign exchange particularly on fuel and other speculative market activity together with stock market outflows, intermittent Government securities market outflows and subdued conversion of export proceeds in several months have exerted pressure on the domestic foreign exchange market. Depreciation and volatility intensified during the second quarter of 2026 as elevated energy import costs, growing demand for foreign exchange associated with expanding economic activity and imports, and adverse market sentiment weighed on the exchange rate. However, market conditions started to improve from the latter part of May 2026 following the policy measures and interventions by the Central Bank to ease pressures in the domestic foreign exchange market and contain excessive volatility and recorded an appreciation of 2.4% during August 2026. Meanwhile, the surcharge imposed by the Government on motor vehicle imports,



together with the tightening of Loan to Value (LTV)⁶ restrictions by the Central Bank on vehicle related lending, is expected to moderate demand for vehicle imports and thereby help contain associated foreign exchange demand and pressures in the domestic foreign exchange market. The domestic foreign exchange market continued to benefit from resilient inflows from worker remittances, export proceeds and tourism earnings, which helped cushion the impact of heightened foreign exchange demand to a certain level. Further, exchange rate volatility⁷ eased towards August 2026 compared to the sharp increases observed during the peak of market pressures at the beginning of the second quarter, indicating a gradual improvement in market conditions. During the first eight months of the year 2026, the Central Bank intervened in the domestic foreign exchange market, where necessary, to rebuild foreign reserves in line with the IMF-supported EFF programme, to strengthen external buffers, to mitigate excessive exchange rate volatility, and to facilitate the financing of essential energy related imports. Nevertheless, the exchange rate remained exposed to external developments, particularly geopolitical uncertainties, fluctuations in global energy prices, disruptions in maritime transport, changes in investor sentiment and capital flows. Continued growth in foreign exchange demand, particularly for fuel imports, external debt

⁶ For further details on the LTV requirements, refer to Chapter 05.

⁷ Exchange rate volatility is measured using the 20-day moving standard deviation of the daily indicative USD/LKR rate.

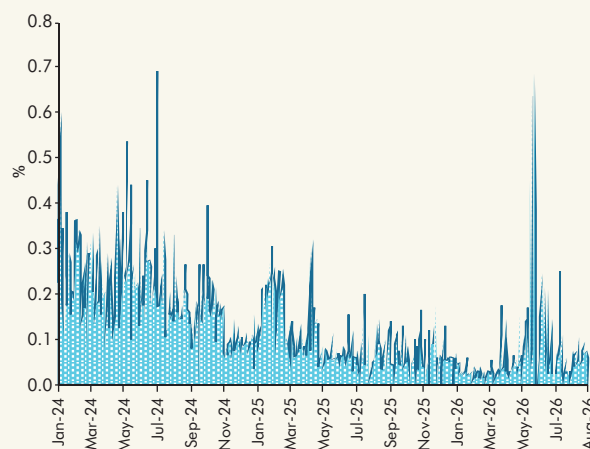
servicing obligations amidst possible adverse global developments could exert further pressure on the rupee. Therefore, containing excessive exchange rate volatility depends on maintaining strong non-debt creating foreign exchange inflows, improving investor confidence, and ensuring adequate reserve accumulation.

The Sri Lanka rupee depreciated against other major trading partner currencies as well. By end August 2026, the rupee depreciated by 4.3% against the Euro (EUR), 6.1% against the Pound Sterling (GBP), and 3.5% against the Japanese Yen (JPY), although appreciated by 0.4% against the Indian Rupee (INR). Depreciation of the Sri Lanka rupee highlights the significant influence of other factors in addition to the slight appreciation of the base currency. Exchange rate movements against major trading currencies will continue to depend not only on bilateral movements of the domestic foreign exchange market but also on cross rate movements in the global currency markets, geopolitical risks, monetary policy actions of major central banks, and shifts in international investor sentiment.

The bid-ask spread of USD/LKR rate exhibited significant spikes between May to July 2026 reflecting the foreign exchange pressure persisted, subsequently remained relatively low towards the latter part of the review period. The

Figure 2.22

Bid-Ask Spread (USD/LKR)

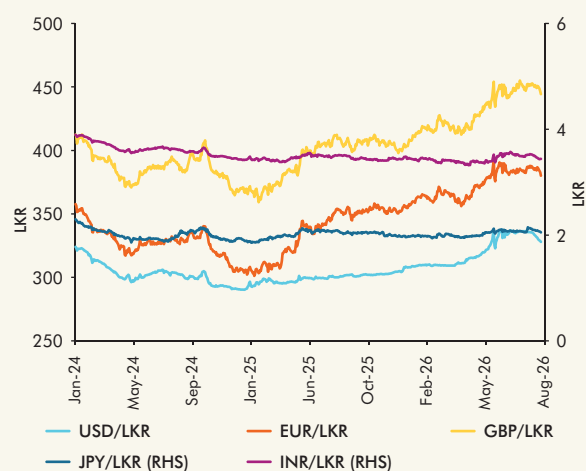


Source: Central Bank of Sri Lanka

occasional spikes observed in the bid-ask spread primarily reflected demand-supply mismatches in the domestic foreign exchange market, driven by heightened uncertainty surrounding global developments, including geopolitical tensions, their repercussions on energy prices and the resulting spillovers to domestic market conditions. Maintaining a low and stable bid-ask spread in the long term requires policy measures which promote foreign exchange inflows including increased exports earnings, tourism and worker remittances and capital market inflows to keep the transaction costs low while improving the confidence among market participants.

Figure 2.21

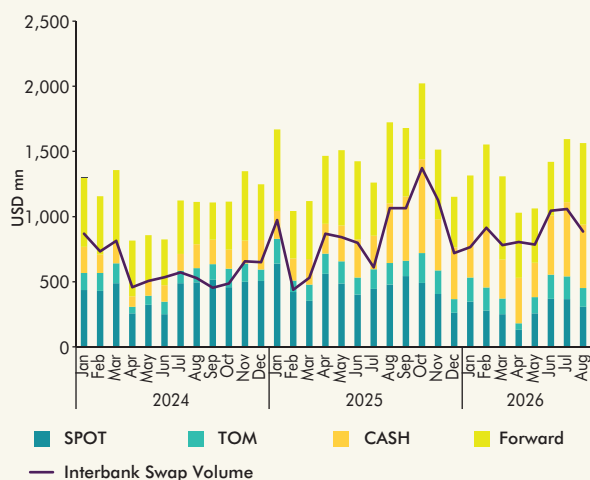
Key Exchange Rates Against the Sri Lanka Rupee



Source: Central Bank of Sri Lanka

Figure 2.23

Interbank Forex Transactions



Source: Central Bank of Sri Lanka

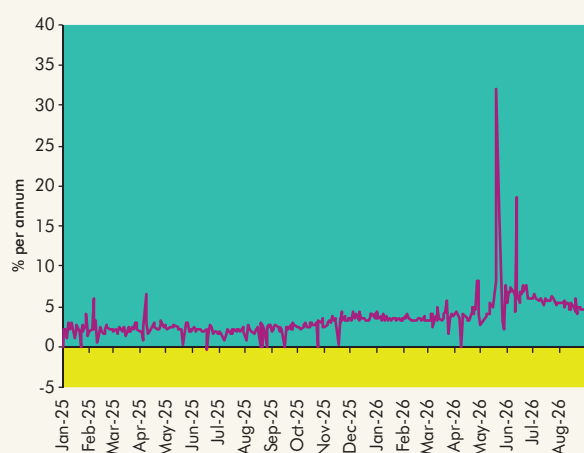
Moreover, it will be crucial in facilitating smooth foreign exchange operations and potentially attracting foreign investments, which ultimately contribute to overall financial stability.

Total interbank forex transaction volume declined slightly during the first eight months of 2026, compared to the corresponding period of last year. Total interbank foreign exchange market transactions declined between March and May 2026, reflecting subdued market activity amidst prevailing uncertainties. However, transaction volumes recovered thereafter, reaching USD 1,594.5 mn in July 2026, the highest monthly foreign exchange transaction volume recorded thus far in 2026 before moderating slightly to USD 1,563.4 million in August 2026. Monthly average of interbank foreign exchange transaction volume was USD 1,355.9 mn during the first eight months of 2026 compared to USD 1,465.0 mn recorded during year 2025. Forward transactions accounted for the largest share of total transaction volume during the review period, contributing 38% of overall transactions, followed by cash transactions and spot transactions, which accounted for 30% and 21% respectively. In the forward market, the majority of the transactions entered into were more than one week up to a one-month period indicating a strong preference for short term hedging. Although forward contract activity helps businesses and financial institutions manage their risk, the concentration of forward contract at short term maturities may create liquidity pressure if market conditions further tighten.

The one-month forward premium exhibited a temporary surge during the review period amid increased uncertainties related to global tensions and domestic market conditions. The sharp rise in the forward premium indicated market expectations of near term depreciation pressures on the rupee and a greater preference among market participants to hedge against exchange rate risk. These developments were likely influenced by heightened geopolitical tensions, volatility in global energy prices, and the resulting uncertainty in domestic foreign exchange market conditions. However, the subsequent moderation of the one-month forward premium suggests an improvement in market sentiment and foreign exchange liquidity conditions, supported by the easing of uncertainties and measures taken by the Central Bank.

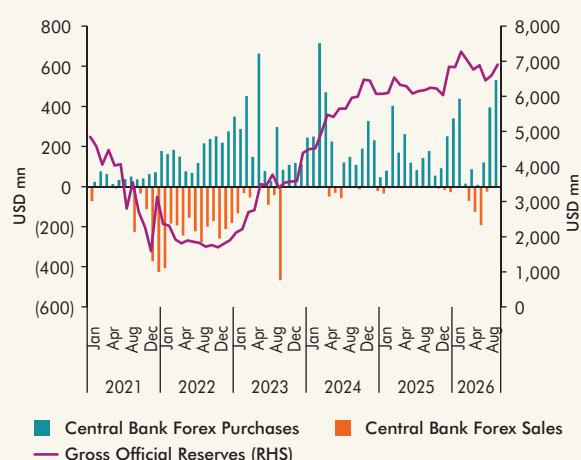
The Central Bank remained a net purchaser during the review period. However, amid heightened pressures in the domestic foreign exchange market, the Central Bank supplied foreign exchange to the market from March 2026 onwards to curb excessive exchange rate volatility and facilitate essential energy related imports, thereby becoming a net seller during the months of April and May 2026, on value date basis. As market conditions improved from the latter part of May 2026, the Central Bank recorded net purchases of foreign exchange. Over the first eight months of 2026, the Central Bank recorded net purchases of approximately USD 1,517.4 mn on trade date basis.

Figure 2.24 One-month Forward Premium



Source: Central Bank of Sri Lanka

Figure 2.25 Central Bank Interventions in the Domestic Forex Market and Gross Official Reserves



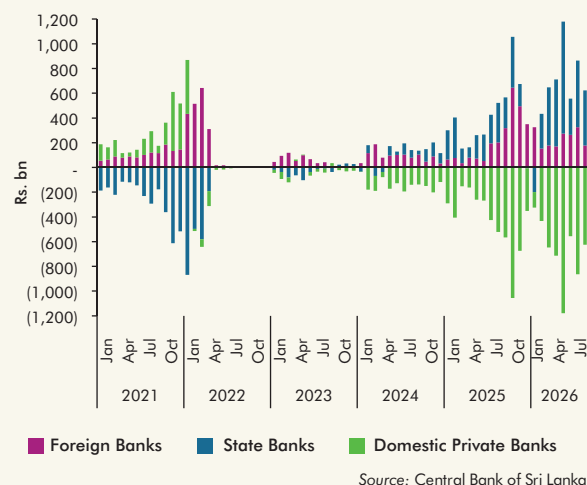
Source: Central Bank of Sri Lanka

2.4 Domestic Money Market

Domestic money market activity remained robust during the first eight months of 2026. Total monthly transaction volume reached an all-time high level in May 2026, driven by increased activities in both the repo and the call money markets. The repo market continued to account for the larger share of money market activity, with average monthly transaction volumes increased to Rs. 1,468.5 bn during the period from January to August 2026, from monthly average of Rs. 923.4 bn in 2025. Similarly, average monthly call money market turnover during the first eight months of 2026 notably increased to Rs. 805.2 bn from monthly average of Rs. 480.2 bn recorded in 2025. Monthly repo market volumes remained consistently higher than the monthly call money market volumes, reflecting more active involvement by market participants in securitised lending compared to clean lending. Participant level activity indicates differences in liquidity positions across financial institutions. On a net basis, domestic private banks and standalone primary dealers were net borrowers in the repo market during the first eight months of 2026, while state-owned banks continued to be net lenders. In the call money market, state-owned banks and foreign banks continued to be the net lenders during the same period, while domestic private banks remained net borrowers. The role of state-owned banks as suppliers of liquidity helped for

Figure 2.27

Participants in the Call Market



improved money market activities during the review period. However, the concentration of system liquidity intermediation among state-owned banks could give rise to vulnerabilities, given the linkages between their liquidity positions and Government financing operations. Accordingly, unexpected increases in the Government's financing requirements could affect the liquidity positions of state-owned banks and, in turn, influence overall money market liquidity conditions.

Overnight money market rates remained aligned with the Overnight Policy Rate (OPR), notwithstanding some temporary deviations amid changing liquidity conditions. The Average Weighted Call Money Rate (AWCMR) and Average

Figure 2.26

Domestic Money Market Volume

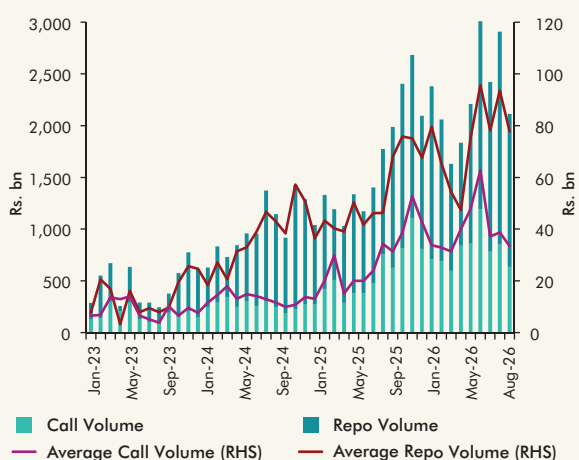


Figure 2.28

Participants in the Repo Market

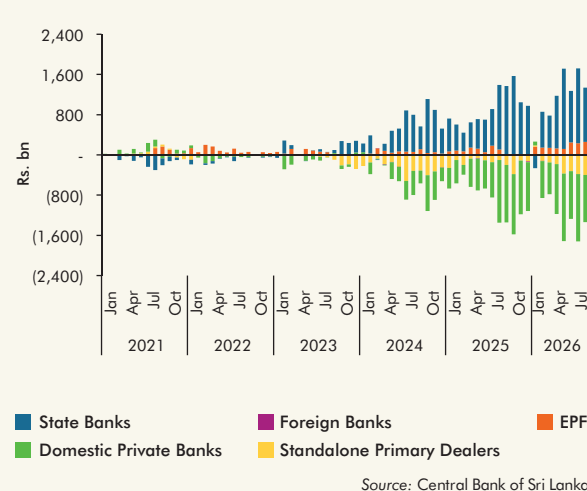
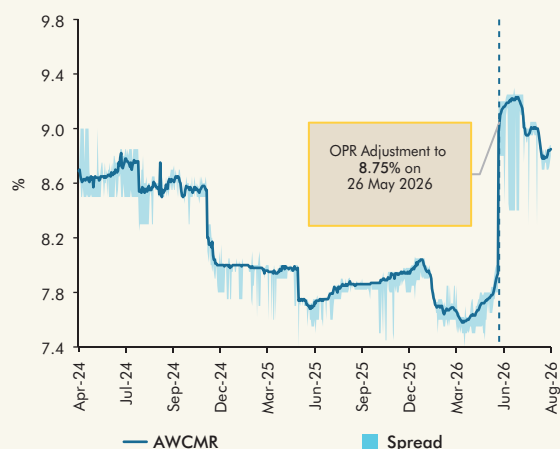


Figure 2.29

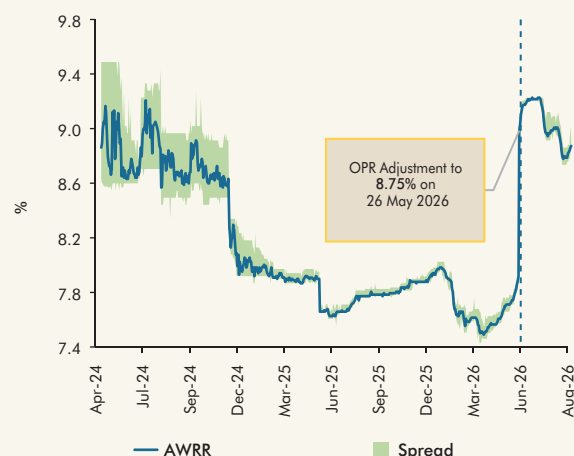
AWCMR



Source: Central Bank of Sri Lanka

Figure 2.30

AWRR



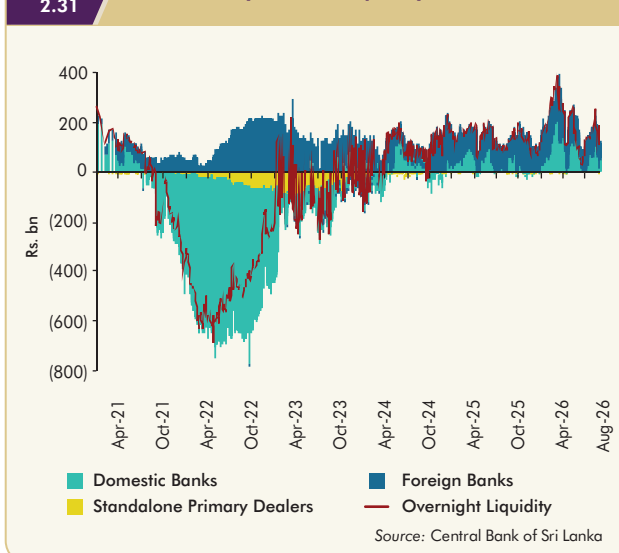
Source: Central Bank of Sri Lanka

Weighted Repo Rate (AWRR) remained broadly aligned with the OPR during the first eight months of 2026. However, both rates experienced upward pressure, particularly from June to August 2026, following the policy rate increase at end May 2026. Significant liquidity surplus in the domestic money market exerted downward pressure in AWCMR to move below the OPR during the early part of the year. In this context, the Central Bank resumed Open Market Operations (OMOs) from mid-February 2026 to absorb excess liquidity and facilitate the alignment of short term market interest rates with the OPR. OMOs were temporarily discontinued in April 2026 as excess liquidity declined. This was largely due to sizeable foreign loan repayments and increased currency withdrawals during the festive season, following which AWCMR gradually returned towards the OPR. However, in view of renewed pressures in the domestic foreign exchange market, OMOs were recommenced since latter part of April 2026. The subsequent moderation in domestic money market liquidity, together with the tightening of the monetary policy stance, exerted upward pressure on short term market interest rates. The moderation in liquidity conditions continued during the second quarter of 2026, exerting upward pressure on short term interest rates, thereby causing the AWCMR to move above the OPR from mid-May 2026. As of end August 2026, following 100 basis points increase in OPR in May 2026, AWCMR and AWRR stood at 8.85% and 8.91%, respectively, remaining slightly above the

prevailing OPR of 8.75%. The upward adjustment in money market rates following the policy rate increase indicates effective monetary policy transmission, while the rates remained closely aligned with the OPR during the review period, spread between daily minimum and maximum rates of the call money market and the repo market mostly remained narrow reflecting effective trading activities in the market. Owing to these improvements, AWCMR and AWRR continued to remain less volatile during the first eight months of 2026.

Domestic money market liquidity remained in a surplus throughout first eight months of 2026 although the magnitude of the surplus varied considerably during the period. The liquidity surplus reached a recent peak of Rs. 403.8 bn in early March 2026, mainly supported by the Central Bank purchases of foreign exchange in the domestic foreign exchange market, foreign exchange swap transactions and the transfer of Central Bank profits to the Government. Thereafter, a notable decline in surplus liquidity was observed between April to June 2026, primarily attributable to net foreign loan repayments of the Government using reserves, sales of foreign exchange in the domestic foreign exchange market and coupon payments to the Central Bank on its holdings of Treasury bonds. As of end August 2026, liquidity surplus stood at Rs. 132.3 bn compared to Rs. 175.2 bn by end 2025. The significant fluctuations in money market liquidity during the period primarily

Figure 2.31 Money Market Liquidity Distribution



reflected the effects of Central Bank foreign exchange operations and Government related cash flows on domestic liquidity conditions.

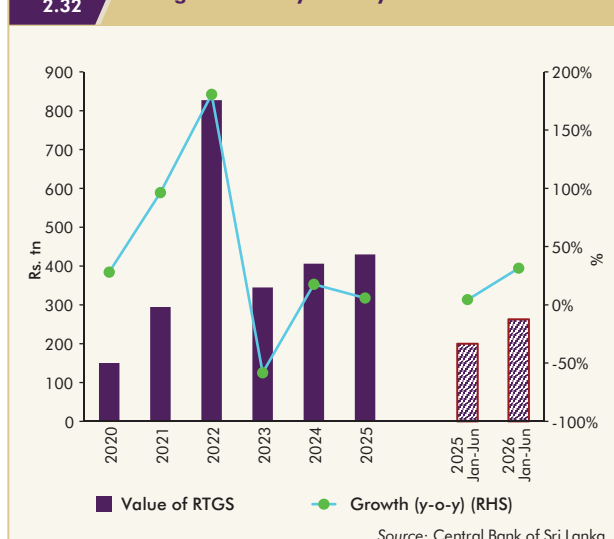
Despite some improvements, the asymmetric distribution of liquidity among Participating Institutions (PIs) persisted during 2026 as well.

Foreign banks continued to maintain surplus liquidity, while surplus liquidity position of state banks declined recently partly reflecting Government related transactions. Meanwhile, domestic private banks experienced relatively tighter liquidity conditions, primarily driven by the expansion in private sector credit. The persistence of uneven liquidity distribution across PIs could give rise to market frictions and constrain the efficient redistribution of liquidity within the interbank market, potentially affecting the alignment of short term market interest rates with the policy rate and, thereby, the effective transmission of the monetary policy.

2.5 Payment and Settlement Infrastructure

Payment and settlement systems continued to remain operationally resilient during the first half of 2026. Real Time Gross Settlement (RTGS) system, which facilitates the smooth, secure and timely settlement of large value and time critical transactions among participating institutions, settled 318,231 transactions with a total value of Rs. 263 tn, reflecting 10.4% and 31.5% increases in the volume

Figure 2.32 Large Value Payment System - Value of RTGS



and value of transactions, respectively, during the first half of 2026 compared to the corresponding period of 2025. Retail payment systems also demonstrated sustained growth throughout the first half of 2026. In particular, the fast payment system of the country, the Common Electronic Fund Transfer Switch (CEFTS), continued to facilitate instant interbank fund transfers and remained a key channel for digital payments. The value of transactions processed through CEFTS increased by 31.9% during the first half of 2026 compared to the corresponding period of 2025, reflecting the growing preference for instant account to account transfers. From a financial system stability perspective, the increasing reliance on digital payment channels and the growing volume and value of transactions processed through systemically important payment infrastructure heighten the potential impact of operational disruptions, cyber incidents and technology failures, underscoring the importance of maintaining robust operational resilience, cybersecurity safeguards and contingency arrangements.

During the period under review, the resilience of the retail payment infrastructure was strengthened with the introduction of a mechanism to better manage credit risk relating to CEFTS and the Common ATM Switch (CAS). Accordingly, participants of CEFTS and CAS are required to comply with the applicable Net Debit Cap (NDC) for both CEFTS and CAS as well as the applicable

Special Note 2

Systemic Risk Survey

The Central Bank of Sri Lanka has been conducting the Systemic Risk Survey (SRS) on a semi-annual basis since 2017, to assess the risks to the Sri Lankan financial system based on the perceptions of executives responsible for risk management in financial institutions.¹ SRS is a forward looking survey, and this special note summarises the key findings² for year 2026 with a particular focus on the results of the latest survey³ conducted for the second half (H2) of the year.

Confidence in the Financial System

Respondents' overall confidence⁴ in the financial system, as measured by the net percentage balance, declined in H1 of 2026 before recording a slight improvement in H2 2026. Overall, short term confidence remained lower in 2026 compared to 2025, although it remained in positive territory. Medium term confidence exhibited a broadly similar pattern across the two survey rounds. A substantial proportion of respondents expressed a 'Fairly Confident' outlook, indicating that confidence in financial system stability remained moderate.

Perceived Probability of a High Impact Negative Event

The survey requested respondents to assess the likelihood of a high impact negative event occurring within the financial

system over the short to medium term. The perceived probability of such an event materialising in the short term increased, as reflected by the net percentage balance,⁵ reversing the declining trend observed in previous years. In contrast, the perceived probability of a high impact negative event occurring in the medium term moderated slightly in H2 of 2026, following a marginal increase in H1 of 2026, indicating a slightly more favourable assessment of medium term risks.

Sources of Risks to the Financial System

According to the survey responses, '*Global Macroeconomic Risks*' emerged as the most critical risk category in H2 of 2026 in terms of its potential impact on the financial system, largely reflecting uncertainties related to geopolitical tensions and associated spillovers. This was followed by '*General Domestic Macroeconomic Risks*'. Meanwhile, the perceived impact of '*Risks Related to Financial Infrastructure*' increased slightly in H2 of 2026 compared to H1 of 2026 indicating a rising trend in recent surveys, while the perceived impact of other risk categories declined.

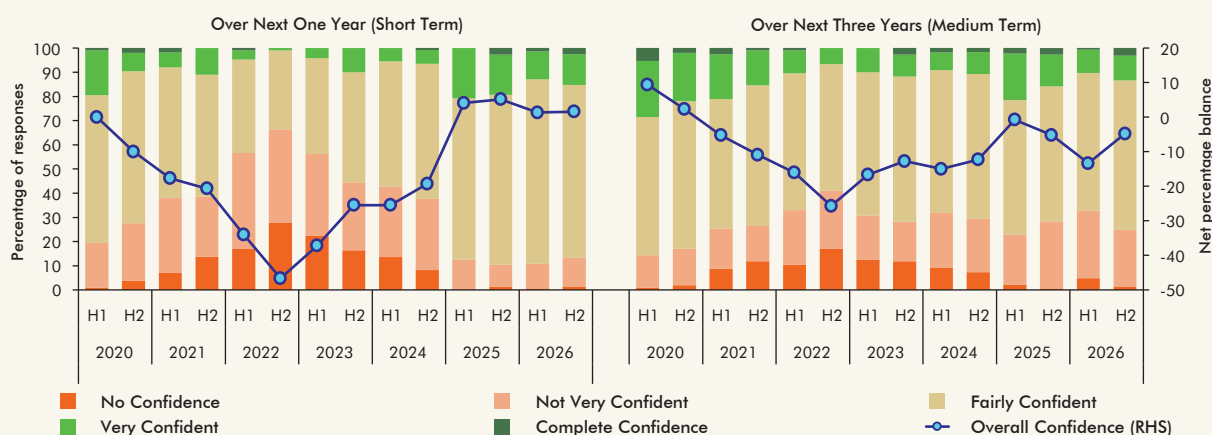
Respondents identified '*Geopolitical Tensions and Risk Spillovers from Other Countries*' as the most critical sub risk⁶, with the potential to exert the greatest impact to the financial system in H2 of 2026. This was followed by '*Cyber-attacks and Phishing*' and '*Inflation*'. The prominence of geopolitical and inflation related risks likely reflected heightened geopolitical tensions, particularly developments in the Middle East, and concerns over their potential spillovers to the domestic economy during the survey

1. The participants of the survey represent a diverse range of financial institutions including licensed banks, finance companies, primary dealers, insurance companies, unit-trust managing companies, stock brokerage firms, licensed microfinance companies, rating agencies, financial infrastructure providers and mobile based e-money service providers.
2. Findings discussed in this note are derived from survey responses and do not necessarily convey the views of the Central Bank of Sri Lanka.
3. Beginning in H2 of 2026, the survey was migrated to a fully online platform, enhancing the efficiency of the survey process and supporting the reliability and consistency of responses.
4. The overall level of confidence is measured by the net percentage balance. It is calculated by weighing 1 for 'Complete Confidence', 0.5 for 'Very Confident', 0 for 'Fairly Confident', -0.5 for 'Not Very Confident' and -1 for 'No Confidence' responses.

5. In this context, the net percentage balance is calculated by weighing 1 for 'Very High', 0.5 for 'High', 0 for 'Medium', -0.5 for 'Low' and -1 for 'Very Low' likelihood.
6. The classification of risks used in the survey included 7 major risk categories with 46 sub-risks.

Figure 1

Confidence in the Financial System



Source: Central Bank of Sri Lanka

Figure 2

Perceived Probability of Materialising a High Impact Event in the Financial System

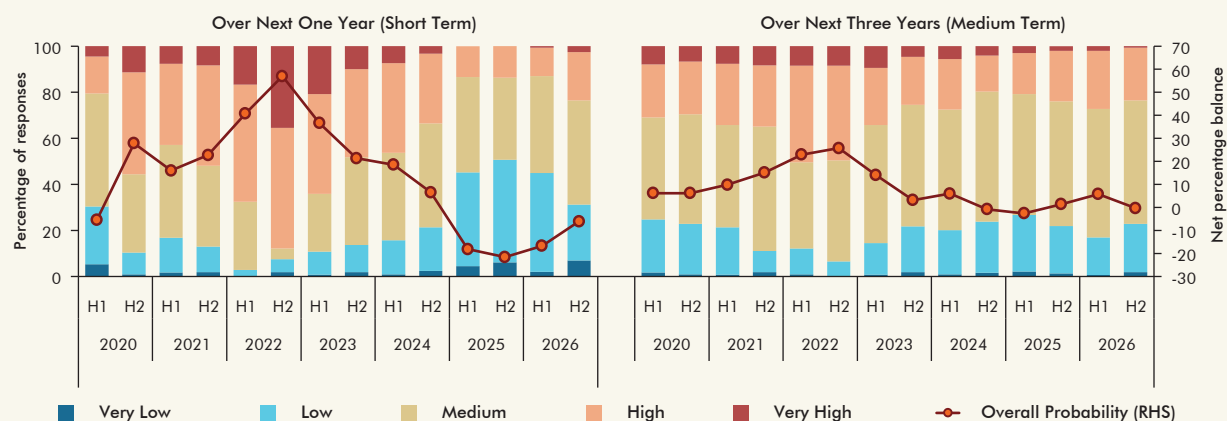
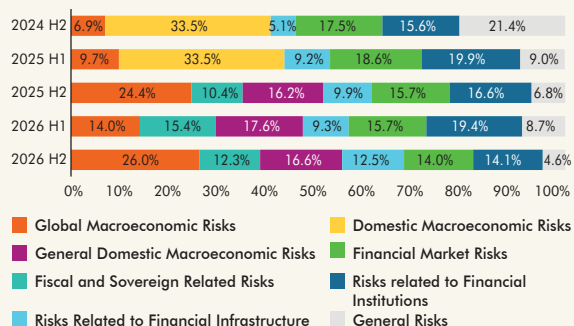
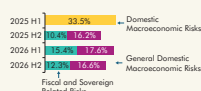


Figure 3

Dynamics of Major Risk Categories



Notes: All five sub risks identified by each respondent were considered in calculating the total for each main risk category. 'Domestic Macroeconomic Risks' risk category in the previous surveys was split into two separate categories, i.e., 'Fiscal and Sovereign Related Risks' and 'General Domestic Macroeconomic Risks', since the survey conducted in H2 of 2025.



Source: Central Bank of Sri Lanka

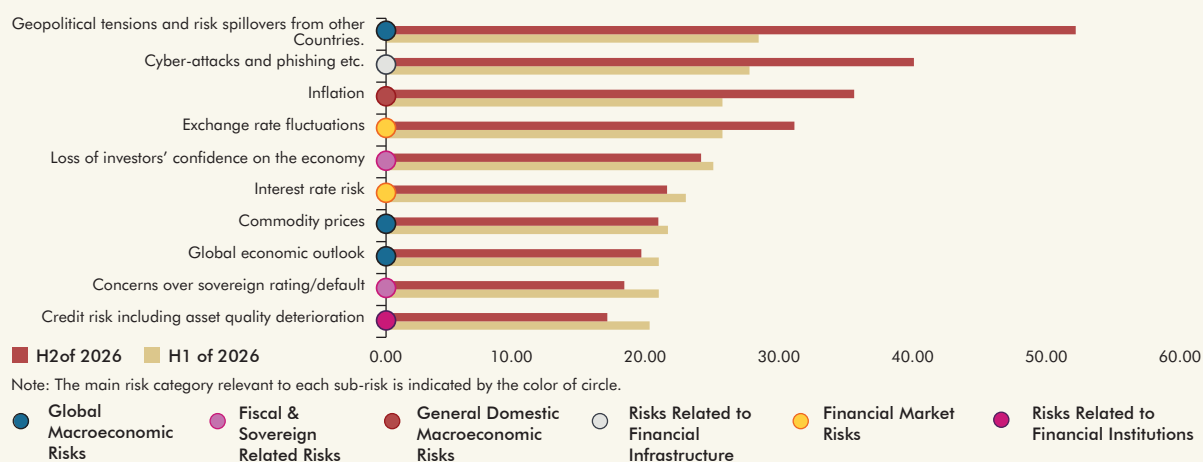
period. Risk perceptions associated with 'Cyber-attacks and Phishing' remained among the most cited sub risks in all the surveys conducted since 2025. Moreover, respondents across all sectors of the financial system, including banks, finance companies, and insurance companies, consistently highlighted 'Geopolitical Tensions and Risk Spillovers from Other Countries' as the most challenging risks to manage at the firm level.

Conclusion

Findings of the recent SRS indicate that respondents' overall confidence in the financial system exhibited some fluctuations during 2026 mainly due to external developments. Compared to H1 of 2026, overall confidence recorded a slight improvement in H2 of 2026, reflecting a generally stable outlook towards the financial system. Perceptions regarding the likelihood of a high impact adverse event in the short term increased, reversing the declining trend observed in recent years. In contrast, medium term

Figure 4

Most Cited Sub Risks

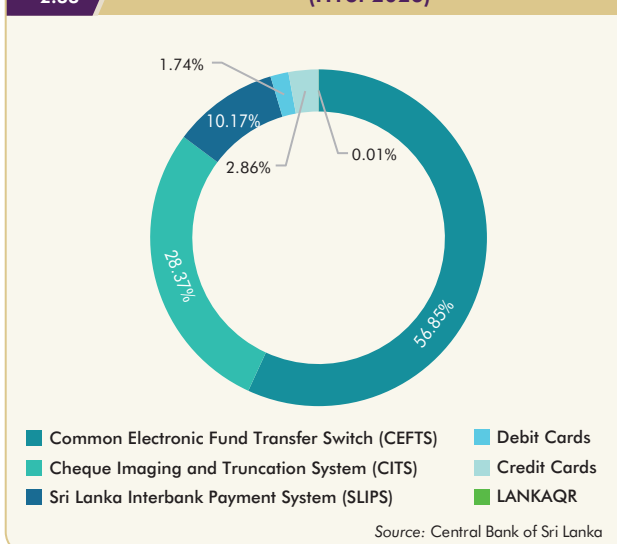


risk perceptions eased slightly in H2 of 2026, suggesting a more favourable assessment of risks over the medium term. Respondents identified '*Global Macroeconomic Risks*' as the most significant source of risk to the financial system, with '*Geopolitical Tensions and Risk Spillovers from Other Countries*' emerging as the most critical sub risk category. Risks related to financial infrastructure, particularly '*cyber-attacks and phishing*', also continued to feature prominently among respondents' concerns. Furthermore, institutions across the financial sector identified '*geopolitical tensions and external risk spillovers*' as the most challenging risks

to manage at the firm level. These findings underscore the importance of continued vigilance, strengthening risk management frameworks, enhancing cyber resilience, and closely monitoring global developments to safeguard the stability of the financial system.

The semi-annual publications presenting the key findings of the 2026 systemic risk surveys are available on the official website of the Central Bank of Sri Lanka and can be accessed through: <https://www.cbsl.gov.lk/en/publications/other-publications/systemic-risk-survey/>

Figure 2.33 Retail Payment Systems/ Instruments (H1 of 2026)



Settlement Guarantee Amount (SGA) in the RTGS system,⁸ with effect from 1 June 2026. While the value of the SGA that a participant of the RTGS system maintains in the Settlement Guarantee Fund Account (SGFA) in the RTGS system determines the participant's Net Debit Cap, the Net Debit Cap limits the maximum credit exposure an RTGS participant may incur between two settlement cycles, to the value of the NDC. This mechanism strengthens the management of settlement-related credit exposures and helps contain the potential transmission of losses arising from a participant's inability to meet

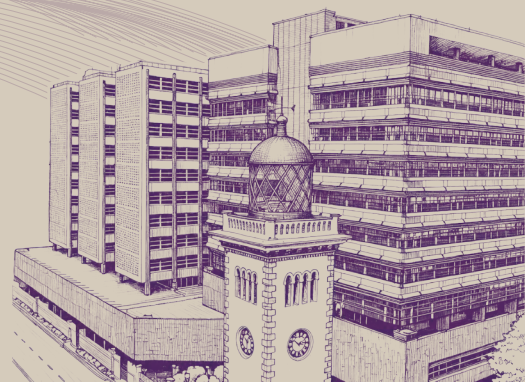
its settlement obligations, thereby reducing the risk of disruptions spreading across the payment system and the broader financial system.

Several measures were taken by the Central Bank to broaden the access and use of digital payments during the first half of 2026. The maximum limit for JustPay enabled transactions was increased to Rs. 150,000 with effect from February 2026; peer-to-peer (P2P) fund transfers through LANKAQR were enabled with effect from April 2026 and the Merchant Discount Rate (MDR) on merchant-presented LANKAQR transactions of Rs. 5,000 or below were waived with effect from April 2026. The interoperability and international reach of Sri Lanka's QR payment infrastructure expanded further with the integration of two more international payment networks, namely, WeChat Pay and Nepal's ConnectIPS, with LankaPay (Pvt) Ltd (LPPL). Regional promotional and public awareness campaigns were also conducted to promote the wider adoption of digital payment methods and educate the public about the benefits and safe use of digital payment products. These measures support payment efficiency, accessibility and financial inclusion while deepening the role of interoperability digital channels in economic activity. However, the increasing reliance on digital payment channels could heighten the financial system's exposure to cyber threats, operational disruptions, fraud and third-party dependencies, warranting continued strengthening of cybersecurity, operational resilience and contingency arrangements.

⁸ Participants of CEFTS and CAS are participants of the RTGS system,

Chapter 3

Financial Institutions



Financial institutions remained resilient during the twelve month period that ended in June 2026, supported by continued recovery in economic activity, increased earnings, and adequate capital buffers, despite the adverse impacts from natural disasters and heightened geopolitical uncertainty. Financial intermediation improved across the banking and finance companies (FCs) sectors, supporting the overall economic recovery during the period. Credit demand was particularly high for certain sectors, including vehicle and gold backed facilities. However, elevated credit expansion contributed to some moderation in liquidity and capital positions, although the sectors continued to maintain adequate buffers above the respective regulatory minimum requirements. Nevertheless, rapid and concentrated credit growth, increases in Stage 2 loans, cross-border lending, and interconnectedness between banks and FCs arising from excessive lending to FCs warrant close monitoring. Considering the potential build-up of systemic risks from excessive credit growth, the Central Bank introduced several macroprudential policy measures, including tightened loan-to-value (LTV) limits for vehicle loans and introduced LTV limits and higher risk weights for gold backed facilities.¹ These measures, together with the policy rate adjustment in May 2026 and the extension of the temporary surcharge on motor vehicle imports, are expected to moderate credit growth over the coming quarters.

The Banking Soundness Index, an indicator to assess the overall soundness of the banking sector, declined marginally during the first half of 2026. The banking sector credit expanded significantly amid robust private sector demand, with notable growth in consumption, trade, financial services, construction, and offshore lending. Asset quality indicators continued to improve, supported by the expansion of the credit base and a reduction in outstanding Stage 3 loans, while the improvement in the Stage 3 impairment coverage ratio provided an additional cushion against unexpected credit losses. However, increasing Stage 2 loans during Q2 of 2026 highlights the potential risk of future downward migration of loans. The sector's exposure to the Government and state owned enterprises declined amid strong private sector credit demand during the period, although it remained sizeable. Liquidity coverage ratios and net stable funding ratio remained well above the regulatory minimums, though moderated slightly as banks reallocated liquid assets towards lending. Capital ratios also declined, as risk weighted assets expanded faster than capital due to strong credit expansion, narrowing the sector's capacity to absorb unexpected losses.

The FCs sector also demonstrated robust growth during the period, with lending accelerating sharply amid increased demand for motor vehicle financing, following the relaxation of vehicle import restrictions, and the continued expansion of gold backed lending, supported by the elevated gold prices. The concentration of credit in vehicle and gold backed lending increased the sector's vulnerability to adverse movements in the underlying collateral values. To contain these risks, the Central Bank proactively introduced several macroprudential policy measures. Asset quality indicators improved, supported by the significant expansion of the credit portfolio and a reduction in outstanding Stage 3 loans. However, increase in Stage 2 exposures and the moderation in impairment coverage warranted continued vigilance on asset quality. The sector's liquidity buffers declined amid the rapid balance sheet expansion. Meanwhile, borrowings remained elevated at end June 2026, underpinned by the sector's growing reliance on funding from banks. The aggregate capital ratio of the sector remained well above the regulatory requirements, despite a decline in capital buffers resulting from the growth in lending.

The insurance sector continued to expand with an improvement in insurance penetration during the period, supported by strong growth in gross written premiums and assets. Profitability in both the long term and general insurance subsectors moderated, although their capital adequacy ratios remained well above the respective regulatory minimum requirements. Cyclone Ditwah generated substantial insurance claims, and the settlement of these claims could exert certain pressure on the underwriting performance, liquidity, and capital positions of general insurers.

¹ Further details on LTV and risk weights are available in Chapter 5.

3.1 Banking Sector

Banking Soundness Index (BSI)²

The overall soundness of the banking sector, as measured by the BSI, declined marginally at end of Q2 of 2026 compared with the corresponding period in 2025, primarily reflecting the effects of strong credit growth on liquidity and capital adequacy. Accordingly, the liquidity sub index weakened as rapid credit expansion outpaced funding growth, while high quality liquid assets declined, partly due to the reallocation of funds from government securities to lending activities. The capital adequacy sub index also deteriorated, reflecting declined capital adequacy ratios amid an increase in risk weighted assets associated with credit expansion. Meanwhile, the profitability sub index moderated, contributed by the declines recorded in return on equity, return on assets, and the net interest margin. However, the asset quality sub index recorded a notable improvement, supported by a decline in the Stage 3 loans ratio, while the efficiency and resilience to market risk sub indices also improved during the period.

- 2 The BSI is a composite indicator which reflects the overall stability of the banking sector based on developments in Asset Quality, Liquidity, Capital Adequacy, Resilience to Market Risk, Profitability, and Efficiency. The index is weighted based on the market share of each bank. The BSI has been compiled using SLFRS-9 based data from Q1 of 2021 onwards.

Figure 3.1 Banking Soundness Index*

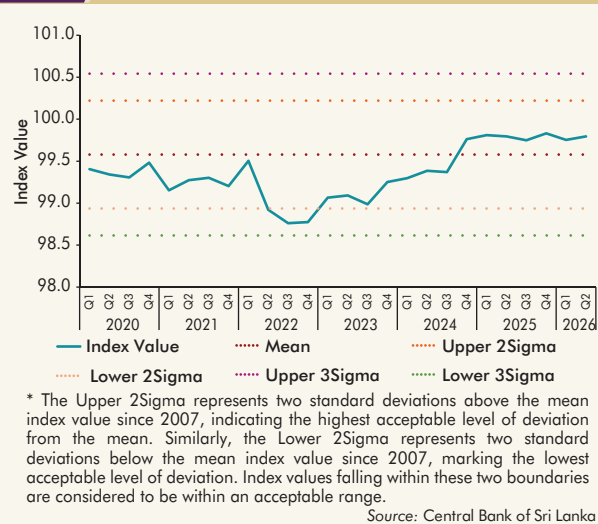
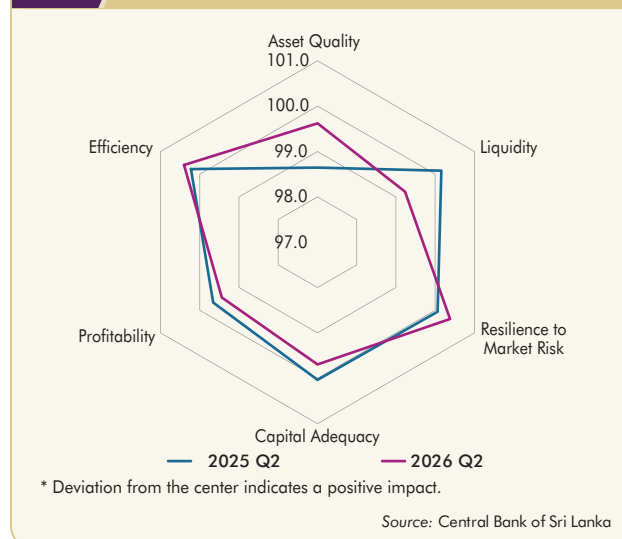


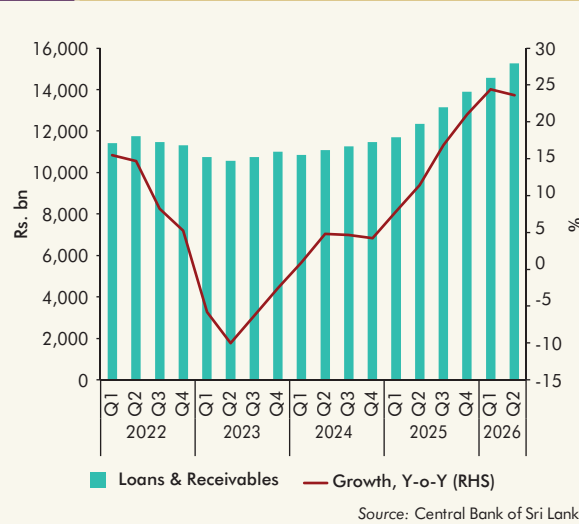
Figure 3.2 Banking Soundness Map*



Credit Risk

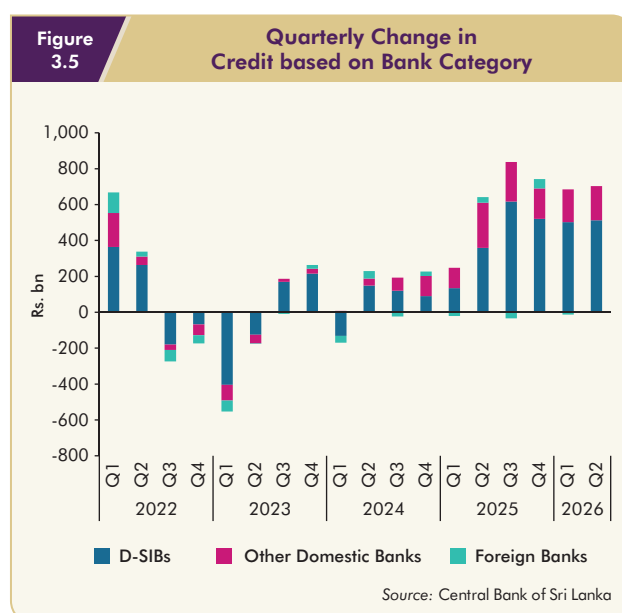
The banking sector credit significantly grew during the period under review, supported by conducive macroeconomic conditions, despite the recent unfavourable global uncertainties. The credit growth momentum observed since latter half of 2023 continued during the first half of 2026, recording a year-on-year (y-o-y) credit growth of 23.6% at end Q2 of 2026 compared to 11.4% at end Q2 of 2025. The sector's credit accelerated significantly amid the recovery in economic activity and relatively accommodative monetary conditions that prevailed during much of the review period, with particularly strong expansions observed in vehicle

Figure 3.3 Loans and Receivables



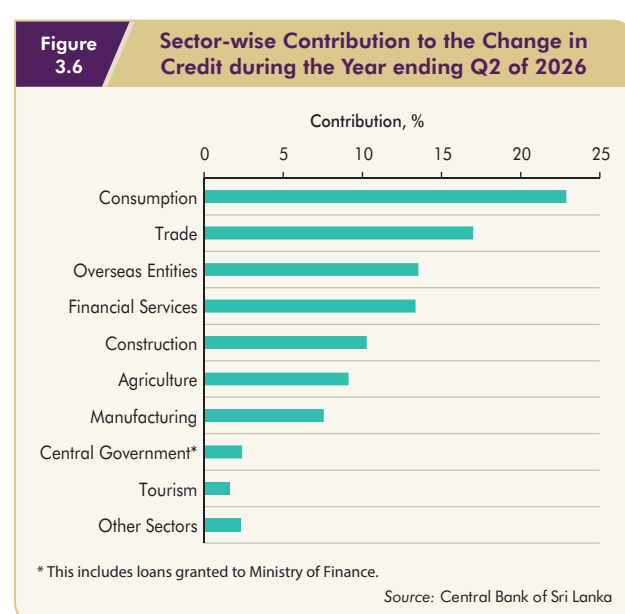
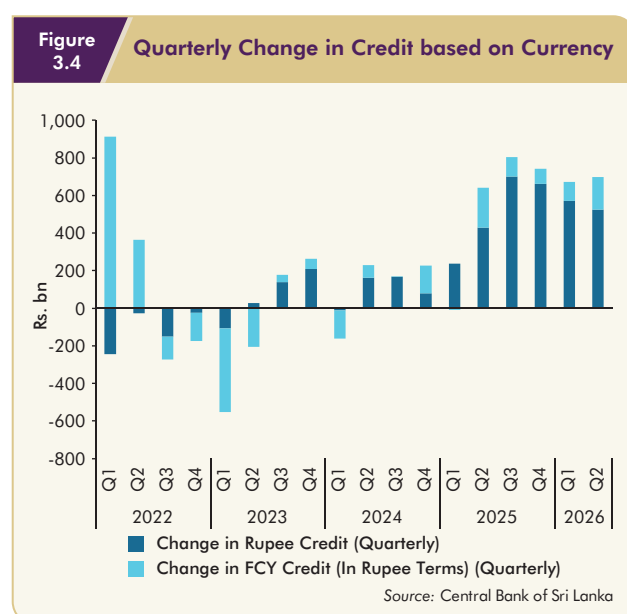
and gold backed household lending. This sustained acceleration in lending also indicates a notable revival in credit demand and improved willingness to lend of the banking sector. However, credit expansion could moderate amid renewed inflationary pressures, upward adjustment in market interest rates, tightened macroprudential policy measures, higher energy cost, and geopolitical uncertainties. Nevertheless, the rapid credit expansion also underscores the need for continued monitoring of the pace, composition, and quality of credit.

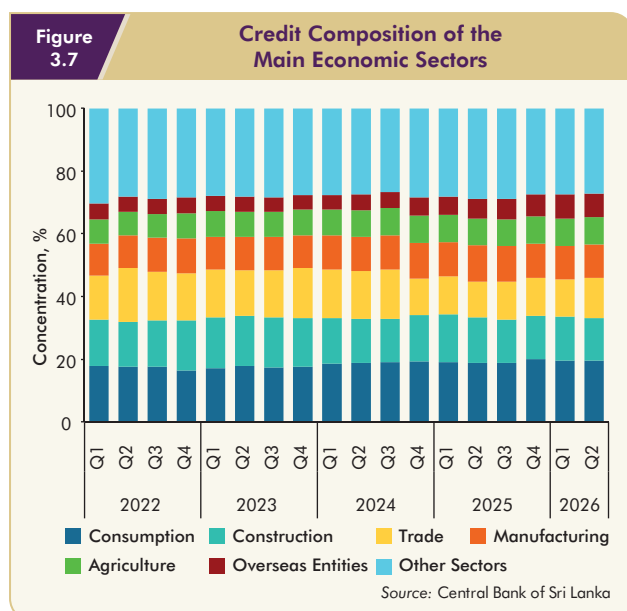
The credit expansion during the period under review was predominantly supported by the increase in Rupee credit. Rupee denominated credit of the banking sector increased by 25.4% y-o-y at end Q2 of 2026 and accounted for 84.3% of the credit expansion during the review period. Meanwhile, foreign currency (FCY) denominated credit in Rupee terms also notably grew by 17.2% y-o-y at end of the review period, accounting for 15.7% of the credit expansion in the sector. In USD terms, FCY credit growth was only 4.4% y-o-y at end Q2 of 2026, while 37.1% of outstanding FCY lending was granted to overseas entities. Furthermore, credit expansion was almost entirely driven by domestic banks, out of which Domestic Systemically Important Banks (D-SIBs) accounted for 73.8% of the banking sector's credit expansion at end Q2 of 2026, while other domestic banks accounted for the remaining 26.2%. However, foreign banks recorded only a marginal y-o-y credit growth and experienced quarterly



contraction during certain periods over the past year. This partially exhibited the transfer of retail banking operations from a foreign bank to another domestic bank, which shifted the accompanying credit portfolio between the two bank categories. A further transfer of retail banking operations from a foreign bank to a domestic bank, completed in July 2026, is expected to moderate the reported credit position of foreign banks in Q3 of 2026, while correspondingly increasing that of domestic banks.

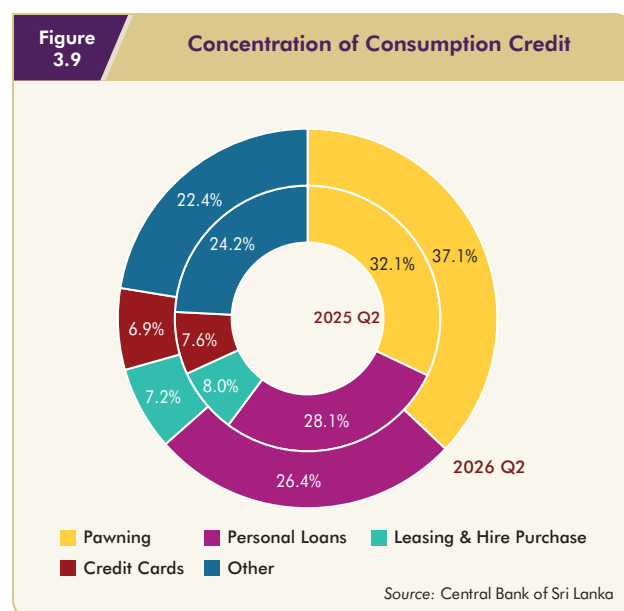
Credit expansion was mainly concentrated to consumption, trade, lending to overseas entities, financial services, and construction sectors during the period. Accordingly, each of these



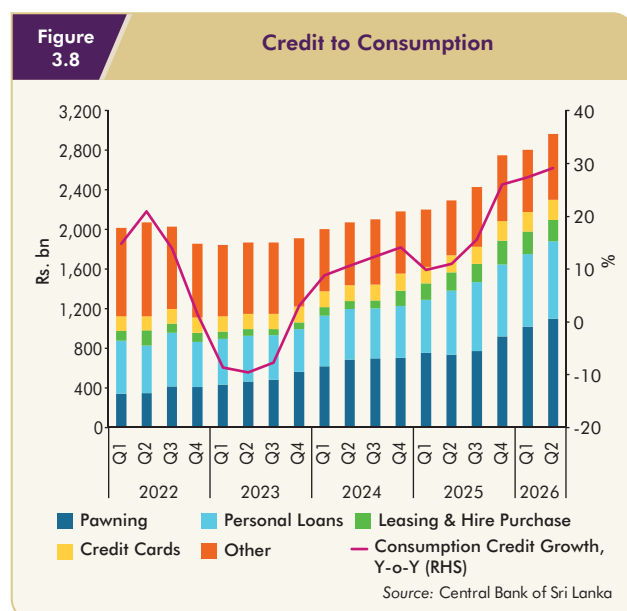


sectors accounted for more than 10% of the credit expansion of the banking sector during the period under consideration, indicating continued expansion in lending alongside the recovery in economic activity. Furthermore, 72.9% of the total credit of the sector was concentrated among six sectors at end Q2 of 2026, namely, consumption, construction, trade, manufacturing, agriculture, and lending to overseas entities, compared to 71.1% at end Q2 of 2025, showing a marginal increase in credit concentration.

Consumption loans, which remained the largest credit segment, expanded rapidly, primarily driven by pawning and personal loans, including personal loans granted for the purchase of vehicles. Consumption loans recorded a significant

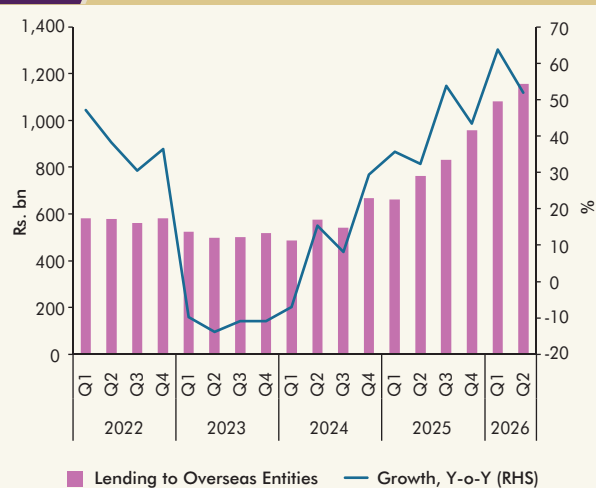


growth of 29.1% y-o-y at end Q2 of 2026 compared to a growth of 11.0% reported at end Q2 of 2025. Pawning facilities and personal loans significantly grew by 49.2% and 21.3%, respectively. This notable increase in pawning facilities could be attributed to the rise in gold prices, which may increase the exposure to market risk in the event of significant downward adjustments in global gold prices and possible collateral risks arising from non-repayment. However, the Central Bank introduced a maximum loan-to-value (LTV) ratio of 70% on credit facilities secured by gold collateral, with effect from May 2026 to mitigate the risks highlighted above. This requirement provides a collateral buffer against fluctuations in gold prices and reinforces prudent lending practices.



The significant increase in credit to overseas entities, and financial services signed potential risk build-up in terms of FCY liquidity, heightened vulnerability to external shocks, as well as the increased interconnectedness with the FCs sector. Lending to overseas entities, which includes both lending through overseas branches as well as domestic banking branches, accelerated to 51.9% growth y-o-y at end Q2 of 2026 from 32.3% a year ago, which could expose banks to country specific, foreign exchange, and cross border risks. Credit to financial services also strongly increased by 52.9% y-o-y at end Q2 of 2026, predominantly reflecting significant lending to FCs, increasing the interconnectedness between the banking sector and

Figure 3.10 Credit to Overseas Entities

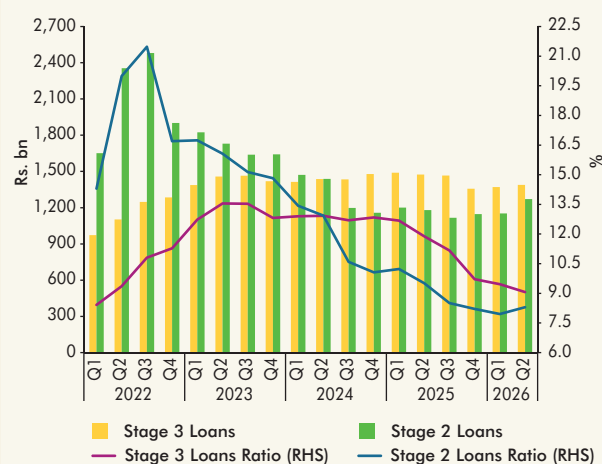


Source: Central Bank of Sri Lanka

the FCs sector. However, the y-o-y credit growth of lending to overseas entities and financial services slightly moderated at end Q2 of 2026 compared to the growth recorded at end Q1 of 2026.

The Stage 3 loans ratio (including undrawn amounts) of the banking sector declined to a single digit level since end 2025 amid significant credit expansion. The Stage 3 loans ratio of the sector declined to 9.1% at end Q2 of 2026 compared to 11.9% at end Q2 of 2025. This improvement during the period emanated primarily from the significant credit expansion, along with a decline in Stage 3 loans of the sector by 5.8% y-o-y. However, following the impact from Ditwah, together with heightened fuel

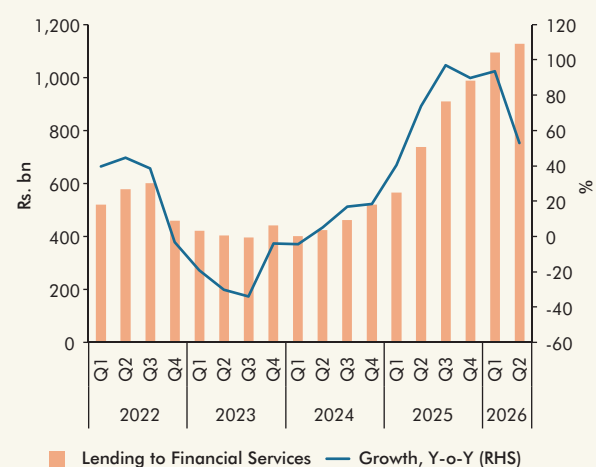
Figure 3.12 Stage 3 and Stage 2 Loans Ratios



Source: Central Bank of Sri Lanka

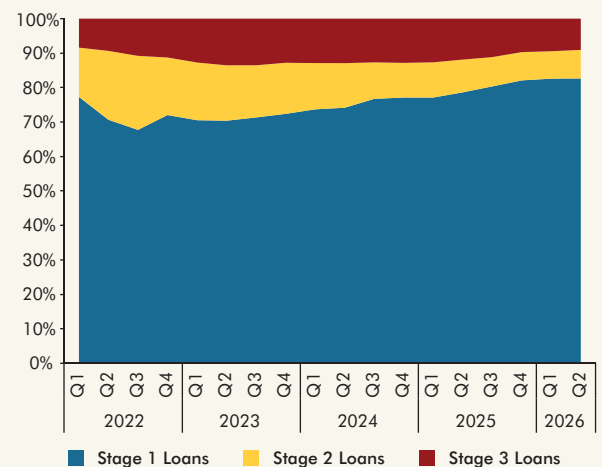
prices and geopolitical uncertainties arising from the Middle East war, Stage 3 loans of the sector recorded slight increases at end Q1 and Q2 of 2026. Moreover, Stage 2 loans of the sector increased by 10.4% at end Q2 of 2026 compared to end Q1 of 2026. This increase in Stage 2 loans was concentrated in lending to overseas entities, trade, and tourism sectors, reflecting the adverse economic spillovers arising from the conflict in the Middle East and the increase in cross border vulnerabilities. Further, it indicates that a considerable volume of loans experienced a significant increase in credit risk during the quarter, highlighting the possibility of future migration into Stage 3, if borrowers' repayment capacity weakens.

Figure 3.11 Credit to Financial Services Sector



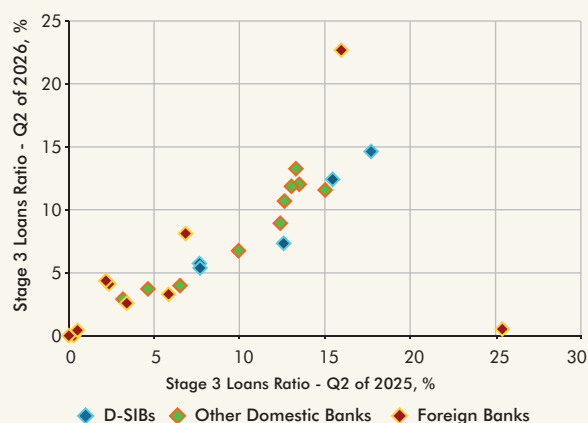
Source: Central Bank of Sri Lanka

Figure 3.13 Stage-wise Composition of Credit



Source: Central Bank of Sri Lanka

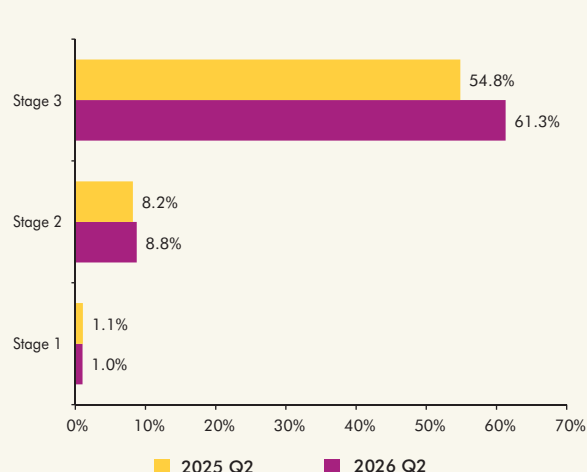
Figure 3.14 Bank-wise Stage 3 Loans Ratio*



Source: Central Bank of Sri Lanka

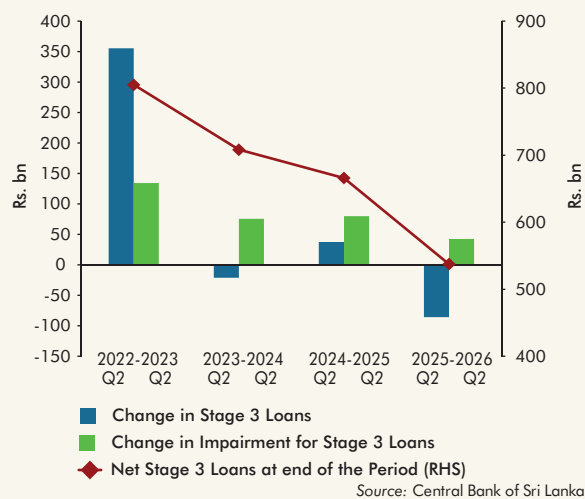
The Stage 3 impairment coverage ratio recorded an improvement at end Q2 of 2026 compared to end Q2 of 2025, driven by the decline in Stage 3 loans with a growth in impairment. The Stage 3 impairment coverage ratio of the sector notably improved to 61.3% at end Q2 of 2026 compared to 54.8% recorded at end of the corresponding period of the previous year, mainly due to a growth of Stage 3 impairment by 5.2% y-o-y, along with the contraction of Stage 3 loans by 5.8% at end Q2 of 2026. The increase in impairment offers an additional buffer for banks to absorb any future credit losses, thereby strengthening their resilience against potential asset quality deterioration. Moreover, a higher impairment coverage ratio reflects a prudent and proactive risk management approach by banks.

Figure 3.15 Impairment Coverage Ratios



Source: Central Bank of Sri Lanka

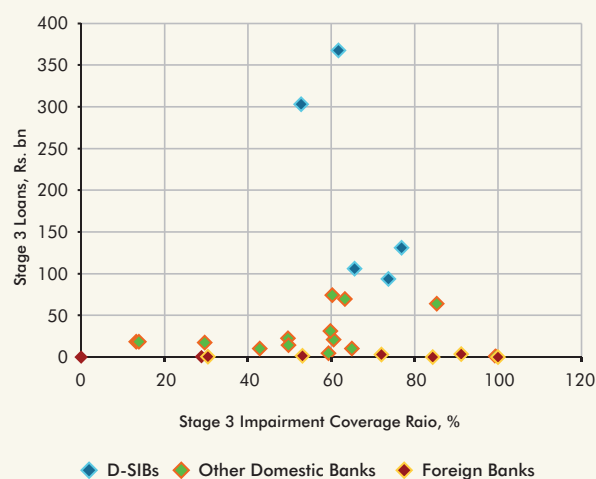
Figure 3.16 Change in Stage 3 Loans & Stage 3 Impairment



Source: Central Bank of Sri Lanka

The net Stage 3 loans to common equity Tier 1 (CET 1) capital ratio notably declined at end Q2 of 2026 compared to a year ago, due to a growth in CET 1 capital, while net Stage 3 loans notably contracted. The net Stage 3 loans to CET 1 capital ratio, which measures the capacity of quality capital to absorb potential losses from defaults that have not been covered by impairment, notably declined to 28.3% at end Q2 of 2026 compared to 40.2% at end Q2 of 2025. The growth of CET 1 capital by 14.5% y-o-y amidst the contraction of net Stage 3 loans by 19.3% at the end of the period contributed to the decline in the ratio, indicating enhanced resilience against potential credit losses not covered by impairment.

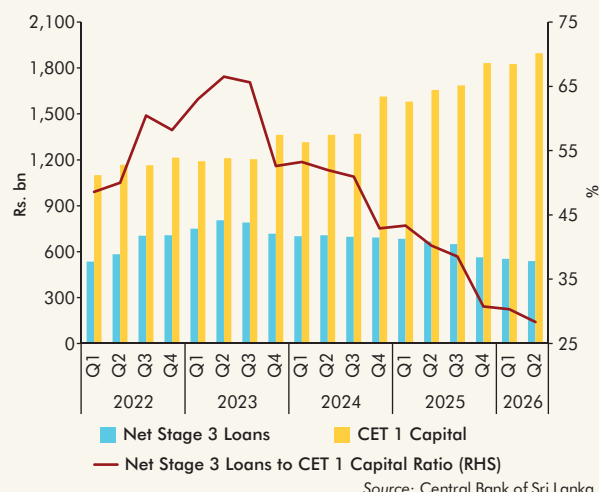
Figure 3.17 Bank-wise Stage 3 Loans & Stage 3 Impairment Coverage



Source: Central Bank of Sri Lanka

Figure 3.18

Net Stage 3 Loans to CET 1 Capital



Despite the decline in the overall Stage 3 loans ratio of the banking sector, asset quality vulnerabilities persisted across certain economic sectors at end Q2 of 2026. Manufacturing, trade, and construction, each accounting for more than 10% of total credit of the banking sector, continued to record relatively high Stage 3 loans ratios, indicating that credit risk remained elevated across several sectors important to the overall economy. Nevertheless, downward trends in Stage 3 loans ratios were observed in these sectors at end Q2 of 2026 compared to end Q2 of 2025. Although Stage 3 loans ratio of the transportation sector also declined, it remained notably high at 45.2% at end Q2 of 2026, particularly due to overdue facilities of a key state owned enterprise (SOE). Furthermore, the default

risk of lending to the tourism sector was persistently high since the latter part of 2022; however, Stage 3 loans ratio of the tourism related loans declined to 28.4% at end Q2 of 2026 from 38.3% at end Q2 of 2025. Nevertheless, the loans of the transportation and tourism sectors represented only 2.2% and 3.1%, respectively, of the total credit portfolio of the banking sector, indicating a comparatively lower system-wide impact.

The banking sector's credit exposure to the Government and SOEs³ declined to a single digit level at end Q2 of 2026, while the associated default risk moderated. Share of credit granted to all the private sector institutions out of the total banking sector credit slightly increased to 52.1% at end Q2 of 2026 from 51.2% at end Q2 of 2025, mainly due to increased lending to non-financial corporates. In contrast, credit granted to the Government and SOEs declined, reducing its share of the total banking sector credit to 9.6% at end Q2 of 2026 from 12.2% at end Q2 of 2025. Meanwhile, the Stage 3 loans ratio of the private sector entities stood higher than that of the overall banking sector at 11.2% at end Q2 of 2026, exhibiting that default risk remained relatively concentrated in these entities. Nevertheless, this marked a decline compared to the Stage 3 loans ratio of 15.2%, recorded a year ago. Further, default risk of the Government and SOEs slightly declined to 10.2%

³ The Government and SOEs represent the banking sector loans to the Central Government, SOEs, and any other Government-related entities.

Figure 3.19

Economic Sectors with High Stage 3 Loans Ratios

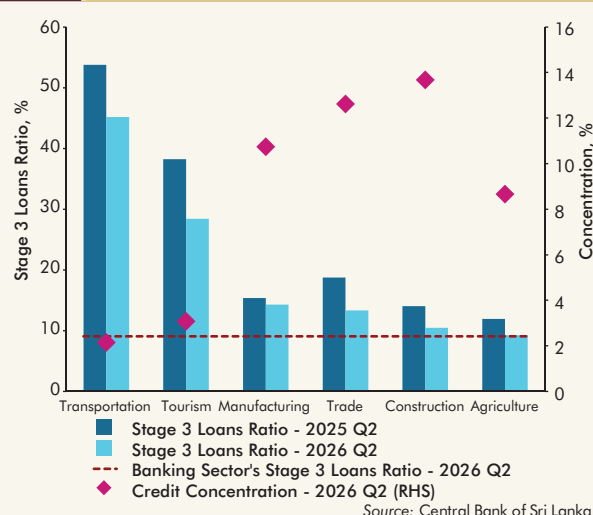


Figure 3.20

Credit Composition by Borrower Category

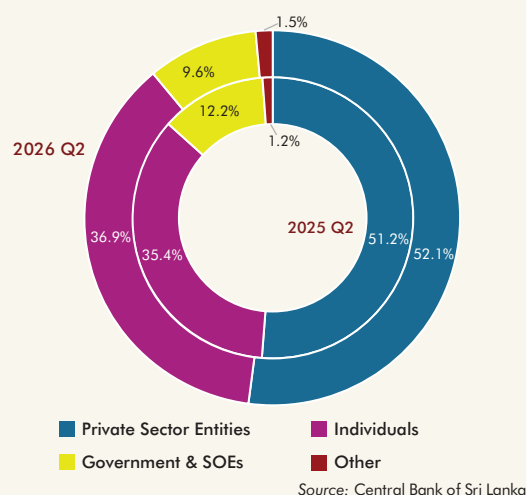
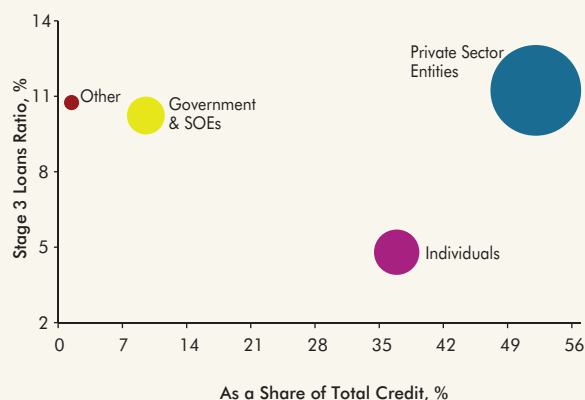


Figure 3.21 Default Risk by Borrower Category at end Q2 of 2026*



* Bubble size represents the volume of Stage 3 Loans.

Source: Central Bank of Sri Lanka

at end of the review period compared to 11.1% at end of the corresponding period of the previous year, yet remained at an elevated level.

The banking sector lending to agriculture and trade related micro, small, and medium enterprises (MSMEs)⁴ primarily contributed to the credit expansion of the MSME sector during the period under review. Accordingly, these two sectors accounted for 60.8% of the increase in banking sector credit to MSMEs during the period

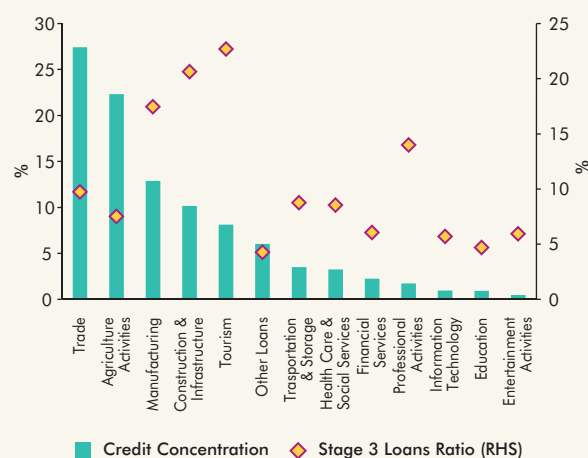
4 MSMEs are classified as follows: Micro - annual turnover is less than or equals to Rs. 15 mn; Small - annual turnover is greater than Rs. 15 mn or less than or equals to Rs. 250 mn; and Medium - annual turnover is greater than Rs. 250 mn or less than or equals to Rs. 1 bn.

concerned. Furthermore, 72.8% of the credit granted was concentrated to MSMEs in four sectors, namely, trade, agriculture, manufacturing, and construction and infrastructure at end Q2 of 2026, indicating a high degree of sectoral concentration risk. In addition, although most of the MSME sectors continued to display elevated Stage 3 loans ratios, a notable decline was recorded at end Q2 of 2026 compared to the corresponding period of the previous year. Nevertheless, tourism and construction related MSMEs continued to register Stage 3 loans ratio above 20.0% at end Q2 of 2026, reflecting persistent repayment challenges in these sectors.

Sovereign exposure⁵ declined during the year ended in Q2 of 2026, though it remained a sizable share of the banking sector assets. Sovereign exposure declined by 8.1% y-o-y at end Q2 of 2026, compared with a growth of 13.2% recorded a year earlier. Accordingly, sovereign exposure as a share of the banking sector's total assets fell to 37.9% from 45.0% a year earlier, indicating some easing of concentration risk to the sovereign, although the exposure remained sizeable. The contraction was primarily attributable to a 38.7% y-o-y decline in banks' holdings of Treasury bills, suggesting a reallocation of funds from relatively low yielding short term

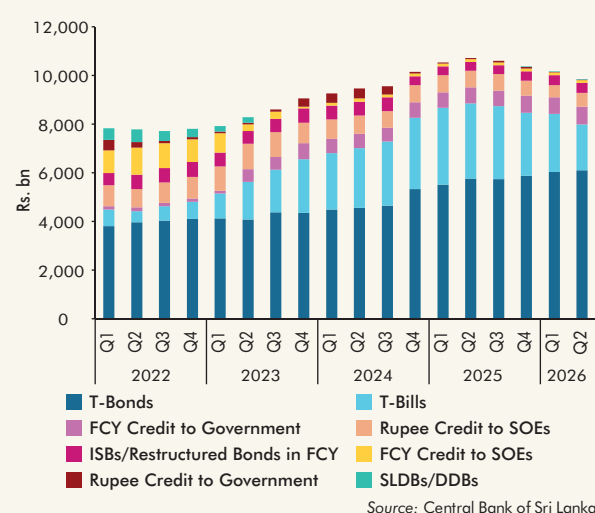
5 At end Q2 of 2026, the sovereign exposure of the banking sector consisted of the investments made by licensed banks in restructured bonds denominated in FCY (formerly International Sovereign Bonds), Treasury bonds, Treasury bills, Domestic Dollar Bonds, and loans and advances granted by licensed banks to the Government and SOEs in both Rupees and FCY.

Figure 3.22 Credit Concentration and Default Risk of Sector-wise Credit to MSMEs



Source: Central Bank of Sri Lanka

Figure 3.23 Exposure to the Government and SOEs

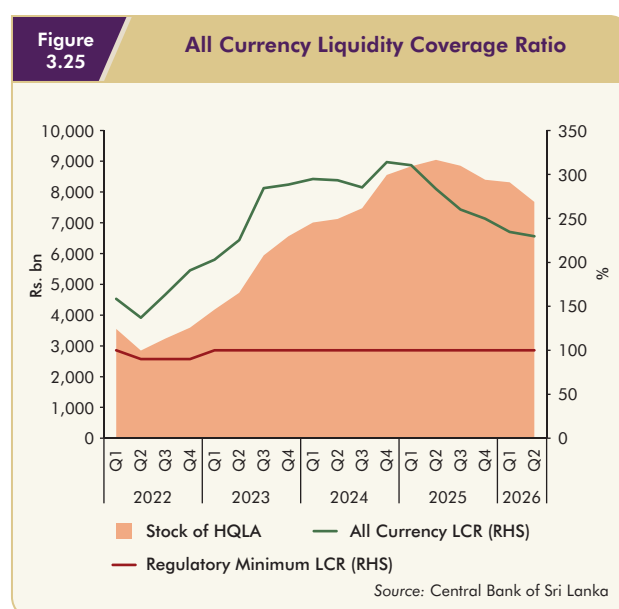


Source: Central Bank of Sri Lanka

government securities towards lending to the private sector, as well as the reduced stock of outstanding Treasury bills amid the Government's adequate fiscal buffers. Rupee denominated credit facilities granted to the Government and SOEs also contracted notably during the period. In contrast, investments in Treasury bonds increased as banks shifted towards longer term government securities offering higher yields than short term instruments. Meanwhile, the Rupee value of FCY denominated credit facilities extended to the Government increased, primarily reflecting the impact of exchange rate depreciation during the period.

Liquidity Risk

Reflecting the rapid credit expansion, liquidity ratios of the banking sector continued to decline since the beginning of 2025 yet remained well above the minimum regulatory requirements. The rupee liquidity coverage ratio (LCR) decreased to 272.5% by end Q2 of 2026 from 328.5% by end Q2 of 2025. A similar trend was observed in all-currency LCR, which decreased to 229.7% by end Q2 of 2026 from 283.7% by end Q2 of 2025. Nevertheless, both ratios remained well above the minimum regulatory requirement of 100%, indicating that banking sector maintained sufficient liquidity buffers to withstand short term liquidity stress scenarios. Further, the prevailing liquidity buffers provide a cushion for banks to continue the balance sheet expansion and financial intermediation. Moreover, the net stable



funding ratio (NSFR) also declined to 148.1% at end Q2 of 2026 from 162.7% a year ago, yet remained above the minimum regulatory requirement of 100%, manifesting that banks maintained sufficient stable funding relative to their asset profile and remained better positioned to withstand longer term funding pressures.

The moderation in LCRs was primarily driven by the contraction in high quality liquid assets (HQLA), as banks reallocated funds for the credit expansion. The HQLA contracted by 15.1% y-o-y by end Q2 of 2026, compared to a growth of 27.0% recorded at end Q2 of 2025. This contraction largely reflected a shift in banks' asset allocation from

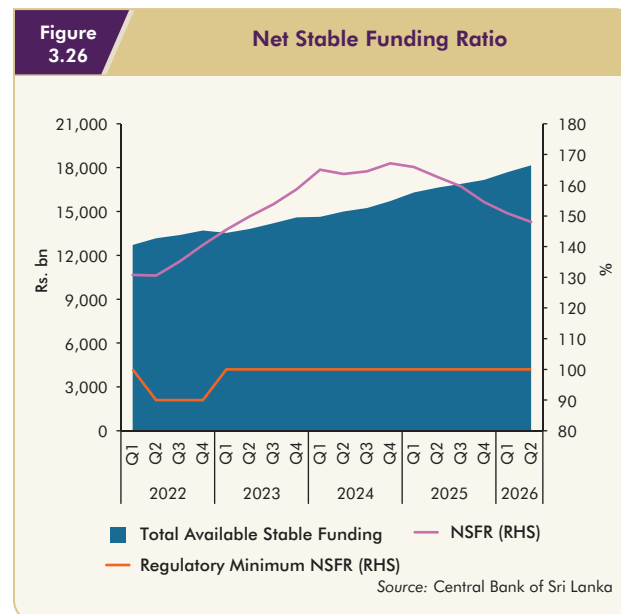
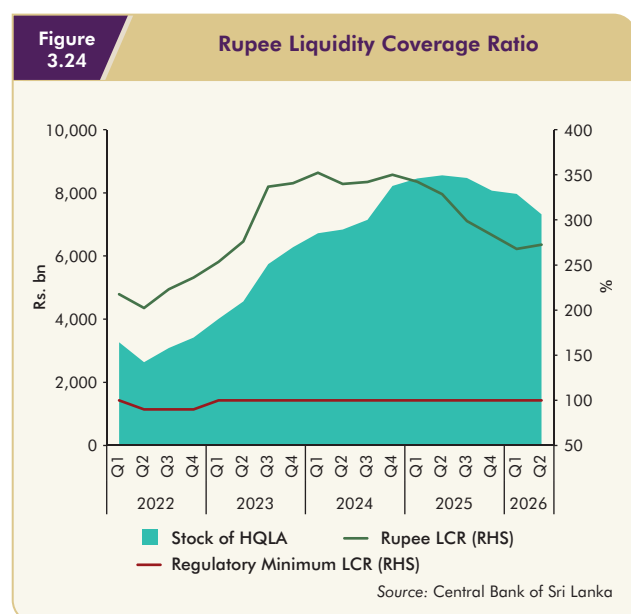
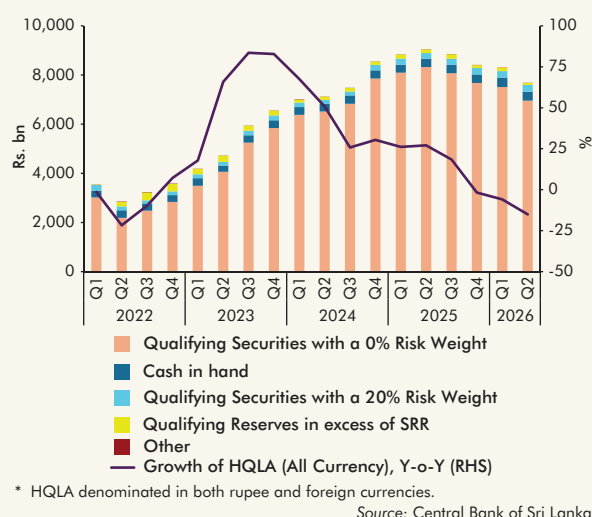


Figure 3.27 Composition of High Quality Liquid Assets*



government securities towards lending, supported by the accommodative monetary policy since mid-2023, the lifting of restrictions on motor vehicle imports from the beginning of 2025, and the rapid rise in gold prices since the second half of 2025, which contributed to a significant acceleration in credit growth. In addition, the outstanding stock of Treasury bills declined during the year, as the Government maintained adequate fiscal buffers, thereby reducing the availability of Treasury bills for investment.

Growth in FCY assets of the banking sector slowed notably by end Q2 of 2026, mainly due to a contraction in FCY investments, amid forex sales to facilitate the surge in imports as well as

Figure 3.28 Composition of FCY Assets

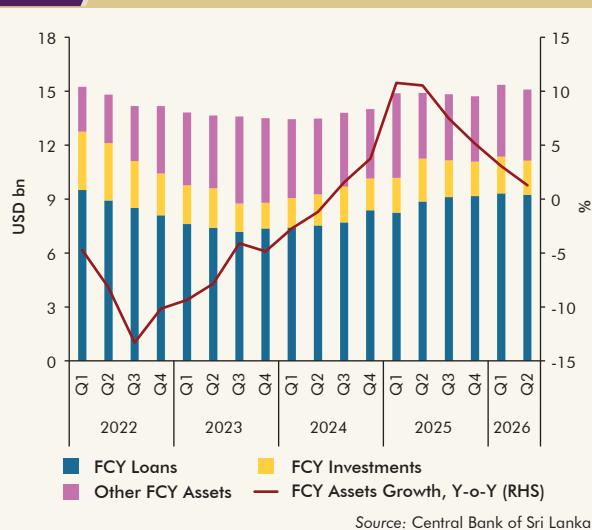
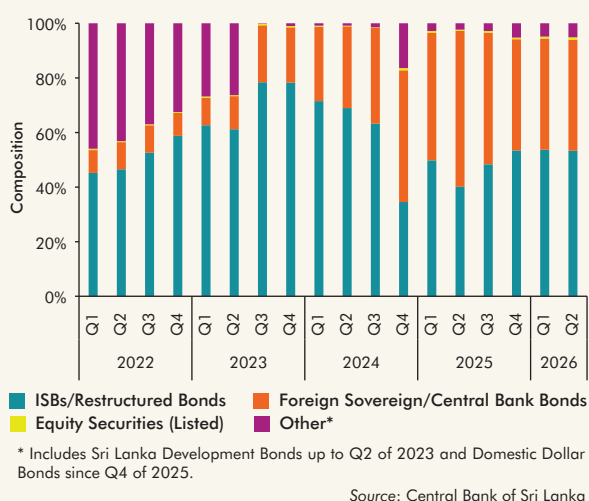


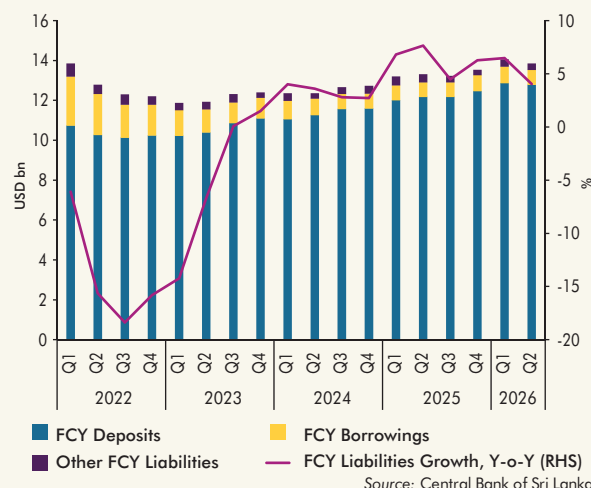
Figure 3.29 Composition of FCY Investments



forex purchases by the Central Bank. FCY assets growth of the sector decelerated to 1.3% y-o-y at end Q2 of 2026 compared to 10.5% at end Q2 of 2025. The increase in FCY assets was mainly supported by FCY credit, which recorded a growth of 4.4% y-o-y, while balances with foreign financial institutions also expanded by 13.2%. However, FCY investments of banks declined notably by 20.7% y-o-y at end Q2 of 2026, primarily due to a reduction in holdings of foreign sovereign securities by several banks. This reduction in FCY investments may partly reflect a reallocation of FCY funds towards lending, including significant cross border lending. However, this aggressive expansion of cross border lending by the banking sector may also expose the sector to cross border credit risk and FCY liquidity risk.

FCY liabilities grew faster than FCY assets, contributing to a contraction in net FCY assets and highlighting the banking sector's high reliance on FCY deposits for FCY funding. FCY liabilities grew by 4.0% y-o-y at end Q2 of 2026, decelerating from a growth of 7.6% recorded at end Q2 of 2025. This growth was mainly driven by FCY deposits, which recorded a growth of 5.1% y-o-y, partly supported by the elevated level of workers' remittances during the period. Meanwhile, FCY borrowings started to expand on a y-o-y basis since end 2025, after recording significant contraction in previous years. Accordingly, it increased by 2.2% y-o-y at end Q2 of 2026. Moreover, with the significantly decelerated growth in total FCY assets, net FCY assets of

Figure 3.30 Composition of FCY Liabilities



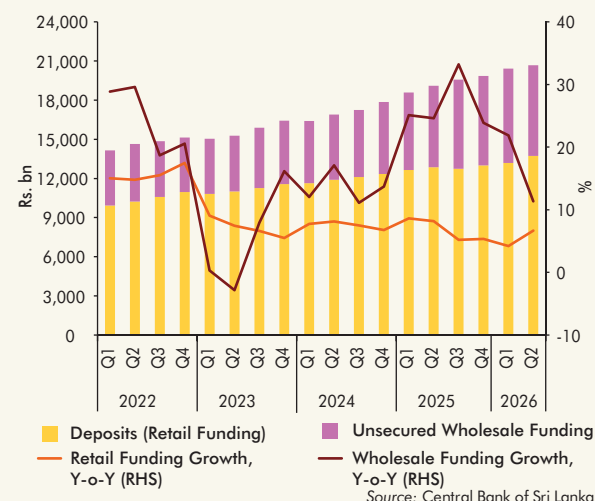
the banking sector considerably contracted by 22.6% y-o-y at end Q2 of 2026 compared to a growth of 43.3% a year ago.

The banking sector continued to rely predominantly on retail funding⁶, although unsecured wholesale funding⁷ grew at a faster pace and remained particularly significant among foreign banks. Retail funding increased by

6 Includes demand, savings and term deposits (less than 30 days maturity), and term deposits with residual maturity greater than 30 days.

7 Includes operational deposits generated by clearing, custody, and cash management activities; cooperative banks in an institutional network (qualifying deposits with the centralised institution); non-financial corporates, sovereigns, central banks, Multilateral Development Banks, and Public Sector Enterprises; and other legal entity customers.

Figure 3.32 Retail and Wholesale Funds



6.7% y-o-y at end Q2 of 2026, while unsecured wholesale funding grew by 11.4%. Retail funding represented 66.9% and 73.2% of the total funding⁸ for D-SIBs and other domestic banks, whereas foreign banks relied predominantly on unsecured wholesale funding, which accounted for 91.6% at end Q2 of 2026, a notable increase from 74.8% a year ago, largely reflecting the transfer of retail banking operations from a foreign bank to a domestic bank during the period. While the dominance of retail deposits supports funding stability, the continued reliance of foreign banks on wholesale funding was consistent with their business model of limited domestic retail deposit mobilisation. Nevertheless,

8 Sum of retail funding and unsecured wholesale funding.

Figure 3.31 Net FCY Assets

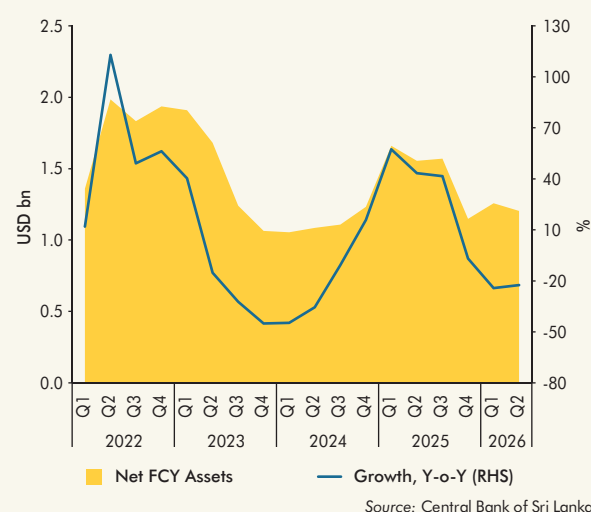
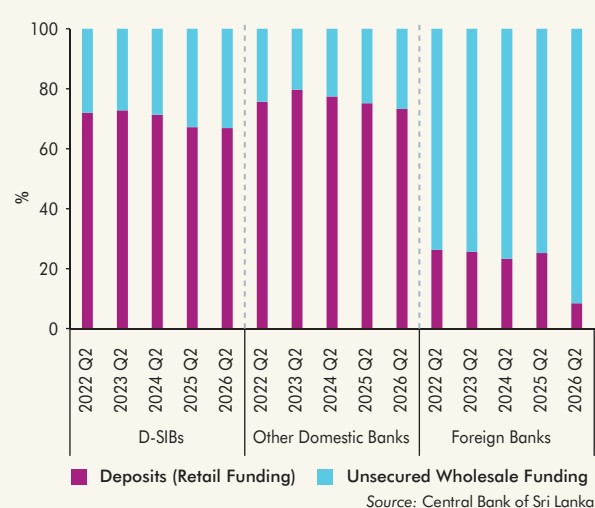


Figure 3.33 Retail and Wholesale Funds by Bank Category



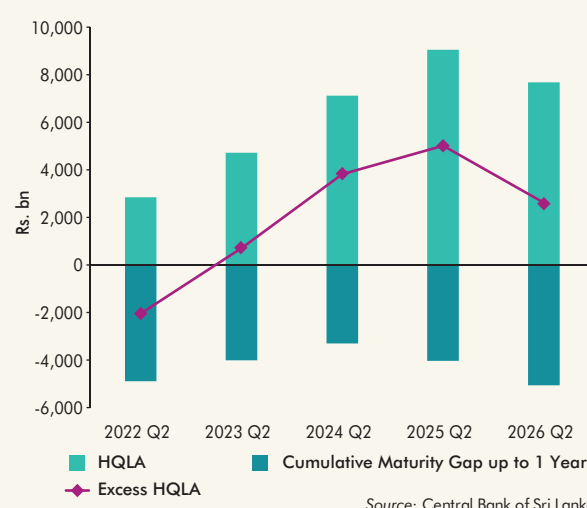
such funding sources warrant close monitoring, as it could expose these banks to funding concentration and rollover risks, particularly during periods of market stress. However, a significant deceleration in wholesale funding of the sector was observed at end Q2 of 2026.

Short term maturity mismatches widened in 2026, increasing potential refinancing and liquidity pressures under unexpected stress conditions.

The banking sector's cumulative negative maturity gaps in the short term buckets, including up to 7 days, 28 days, 3 months, 6 months, and 12 months, generally widened, both in absolute terms and relative to total assets, indicating a growing imbalance between expected cash inflows and outflows within one year horizon. The widening of cumulative gaps in the longer term buckets also point to a more persistent structural mismatch between the maturity profiles of assets and liabilities, which could elevate refinancing and funding costs if maintained over time. In addition, HQLA in excess of the cumulative negative gap up to one year declined to Rs. 2.6 tn at end Q2 of 2026 from Rs. 5.0 tn at end Q2 of 2025, indicating that short term contractual mismatches increased amid a decline in available liquid asset buffers. A continuation of this behaviour could point to heightening of rollover and refinancing risks in the short term, particularly if banks face deposit withdrawals, reduced market access, or pressure to liquidate HQLA during stressed liquidity conditions.

Figure 3.35

Short Term Maturity Gap vs. High Quality Liquid Assets



Off-balance sheet exposures expanded notably by end Q2 of 2026, highlighting potential contingent liquidity and credit risks under stressed conditions.

Total off-balance sheet exposures increased by 19.3% y-o-y at end Q2 of 2026, while off-balance sheet items as a share of on-balance sheet liabilities rose to 33.5% from 30.5% a year earlier. Commitments relating to undrawn credit lines remained the largest component, accounting for 35.4% of total off-balance sheet exposures, and increased by 10.1% y-o-y in line with the credit expansion. Forex contracts also remained sizeable, increasing by 15.7% y-o-y. Contingencies increased by 25.3% y-o-y, driven mainly by documentary credits and guarantees/bonds, indicating increased

Figure 3.34

Maturity Gap

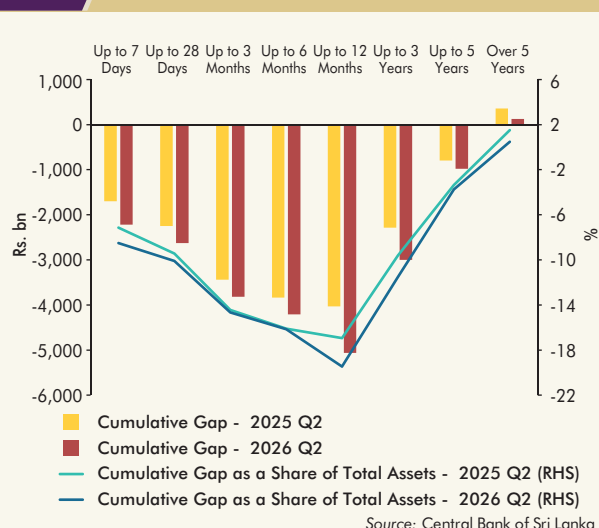
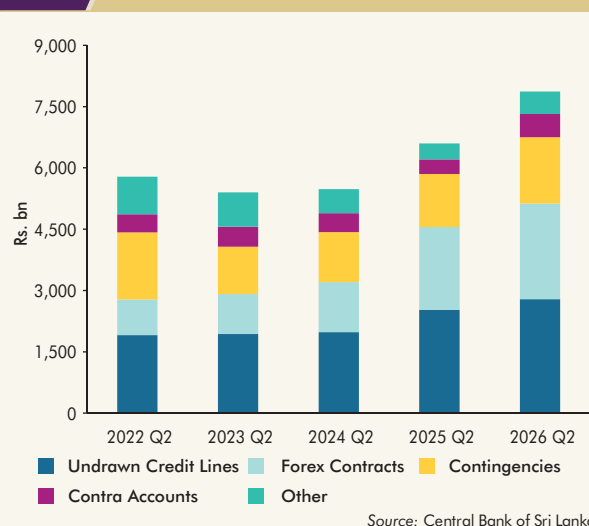


Figure 3.36

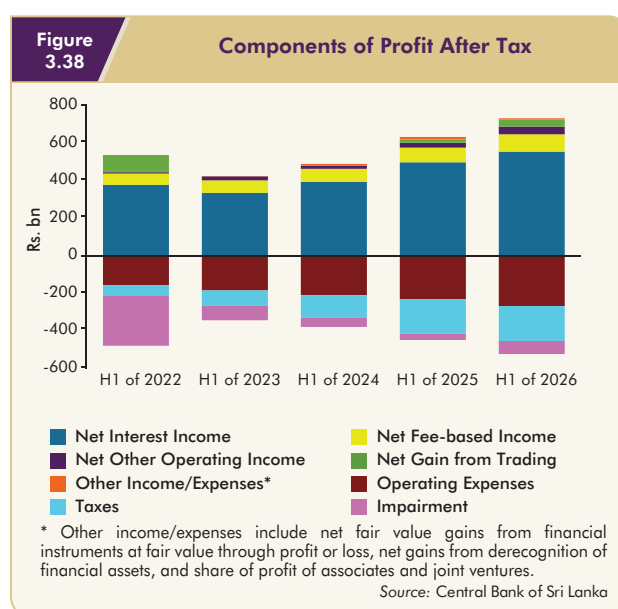
Off-Balance Sheet Operations



trade-related and guarantee exposures. The expansion in undrawn credit lines could expose banks to higher liquidity demands if customers draw down committed facilities during periods of stress, while the increase in forex contracts could heighten counterparty, settlement, and exchange rate related risks, particularly under volatile market conditions. Further, the increase in contingencies may raise the possibility of credit conversion into on-balance sheet exposures if guarantees or documentary credits are called. Therefore, the continued expansion of off-balance sheet activities warrants close monitoring, particularly in relation to banks' liquidity buffers, counterparty risk management, and capital adequacy for credit conversion risks.

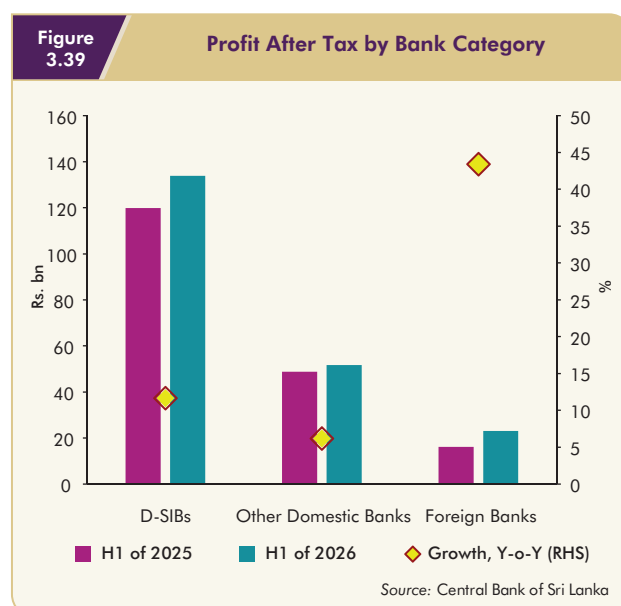
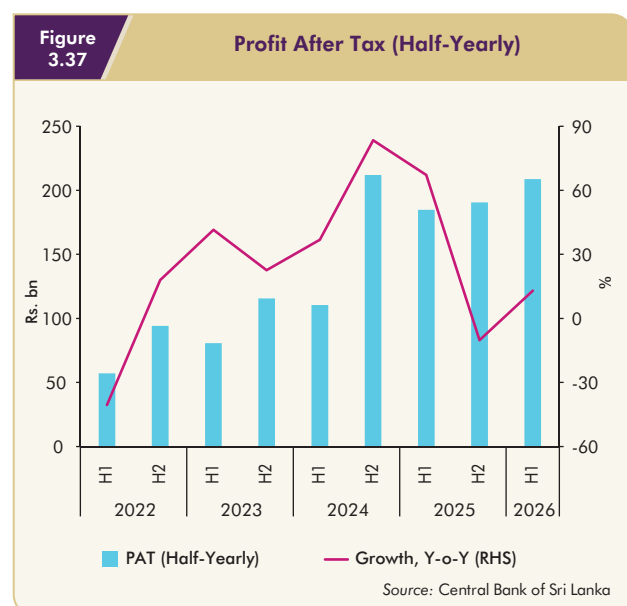
Profitability

The banking sector's profitability improved in the first half (H1) of 2026, though the pace of the growth moderated compared to the corresponding period of 2025. The sector reported a profit after tax (PAT) of Rs. 208.7 bn in H1 of 2026, recording a y-o-y growth of 12.9%. However, this was significantly lower than the growth of 67.2% recorded in H1 of 2025, which was supported by a sharp increase in net interest income (NII), mainly due to the rapid decline in interest expenses amid the accommodative monetary policy phase. In H1 of 2026, NII increased by 11.3% y-o-y and remained the key contributor to the increase in sector profitability. Net gains from trading and net fee



based income also recorded notable y-o-y growths of 105.7% and 19.2%, respectively. However, operating expenses and impairment charges substantially increased, partly offsetting these gains.

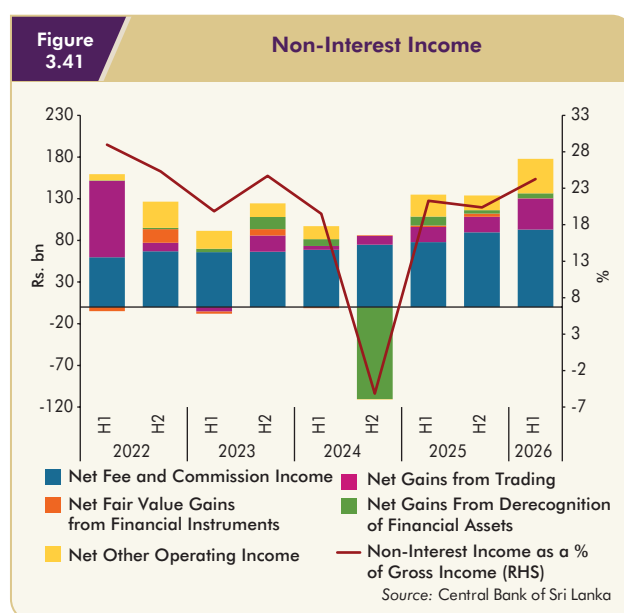
Higher profits among D-SIBs primarily supported the improvement in the banking sector's profitability in H1 of 2026. The PAT of D-SIBs increased by 11.7% y-o-y in H1 of 2026, driven by a substantial increase in NII, and accounted for 58.6% of the overall increase in sectoral profits. Meanwhile, PAT of foreign banks also recorded a significant growth of 43.4 % y-o-y, largely due to an increase in other operating income of a foreign bank, arising from the sale of its retail banking business to a domestic



bank during the period. Further, other domestic banks recorded a PAT increase of 6.2% y-o-y, supported by increased NII, net gains from trading, net fee based income, and a downward revision to the corporate income tax of the bank which acquired the retail banking business of the said foreign bank. However, a notable increase in operating expenses and a decline in other operating income, along with increased impairment charges, moderated the profit growth of the other domestic banks category.

The growth in NII was mainly driven by D-SIBs, while foreign banks continued to record subdued earnings from lending activities. The NII of D-SIBs grew by 13.4% y-o-y in H1 of 2026 and accounted for 66.0% of sector's NII. Other domestic banks also recorded NII growth of 9.2% y-o-y, while NII of foreign banks declined by 1.3%, continuing with the downward trend observed in recent years. The NII divergence across bank categories highlights the concentration of interest income generation within domestic banks.

Non-interest income as a share of gross income increased in H1 of 2026 compared to H1 of 2025, supported by a higher net gain from trading activities, increased fee-based income, and other operating income. Accordingly, non-interest income to gross income ratio increased to 24.3% in H1 of 2026 compared to 21.3% in the corresponding period of the previous year. Net gains from trading



recorded a significant increase of 105.7% y-o-y, while net fee and commission income and net other operating income increased by 19.2% and 56.9%, respectively.

New impairment charges negatively weighed on profitability of the banking sector during H1 of 2026. New impairment charges during the period, which include new impairment provisions on loans and receivables, investments and off-balance sheet exposures, increased by 104.7% y-o-y in H1 of 2026 compared to a 29.5% contraction in H1 of 2025. This was primarily driven by impairment charges on loans and receivables, amid the accelerated credit expansion by the sector.

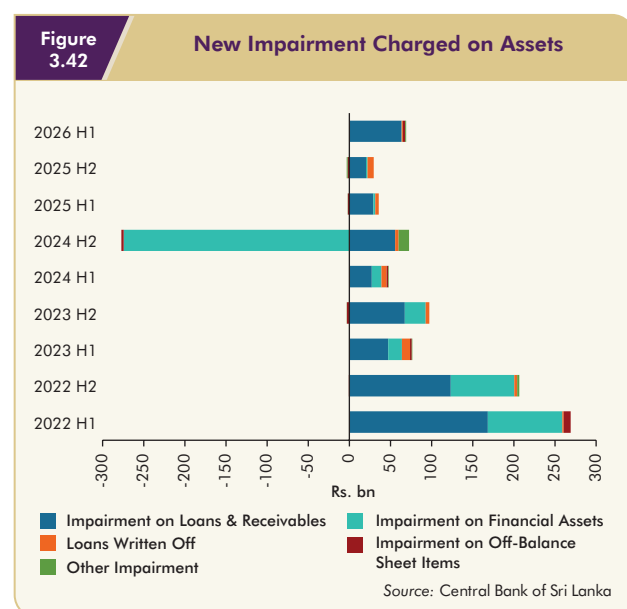
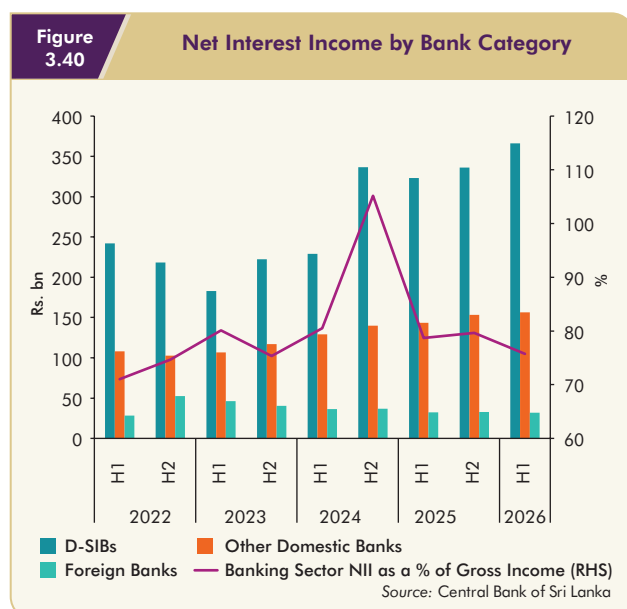
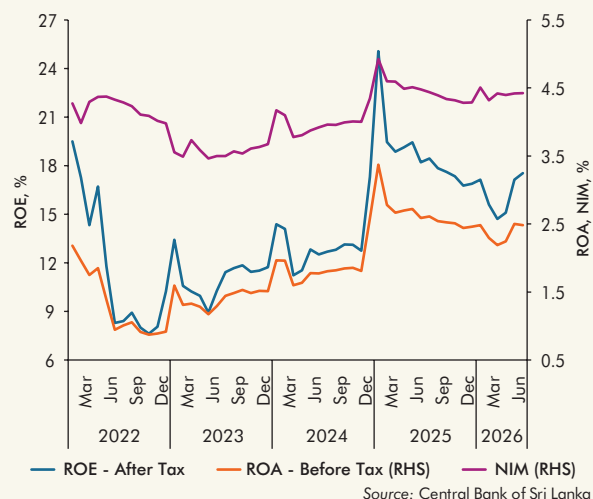


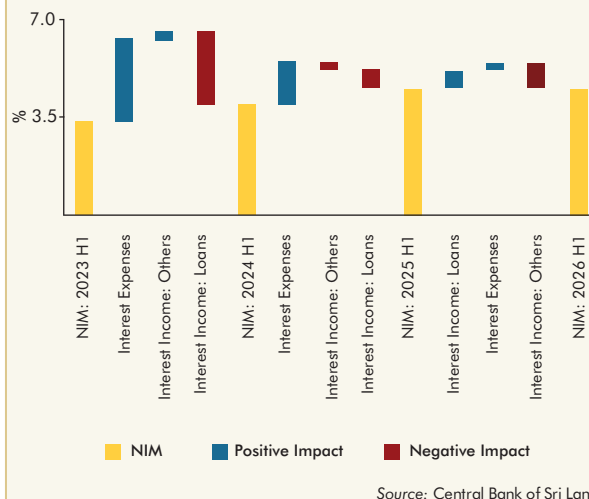
Figure 3.43 Profitability Ratios



Key profitability ratios declined modestly in H1 of 2026 compared to the corresponding period of the previous year. The return on equity (ROE), return on assets (ROA) and net interest margin (NIM) of the sector declined to 17.5%, 2.5% and 4.4%, respectively, in H1 of 2026, compared to 18.2%, 2.6% and 4.5% reported, respectively, in H1 of 2025.

The NIM of the banking sector remained elevated, with increased interest income from loans, though declined interest income from other financial assets exerted downward pressure to the ratio. The NIM of the banking sector marginally declined from 4.5% in H1 of 2025 to 4.4% in H1 of 2026 yet remained above its 10-year average of 3.8%. The

Figure 3.45 Decomposition of Net Interest Margin



NIM of the sector recorded a surge in 2022, partly supported by the significant investments of banks in government securities due to high yields prevailed during the economic crisis. Further, during the accommodative monetary policy phase commenced in mid-2023, the sector sustained NIM by faster and asymmetric adjustment in deposit rates compared to lending rates. The subsequent expansion of the lending portfolio also strengthened interest income from lending. However, a decline in income from other financial assets, predominantly government securities, was observed since the second half of 2025, possibly reflecting the lower yields for government securities, together with the reallocation of funds from government securities towards lending to support the

Figure 3.44 Distribution of Bank-wise Net Interest Margin and Return on Equity*

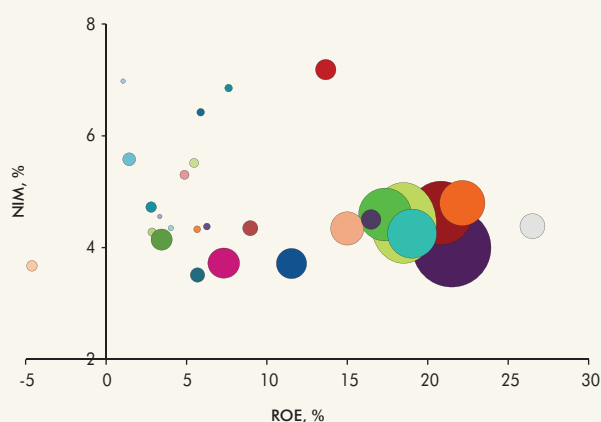
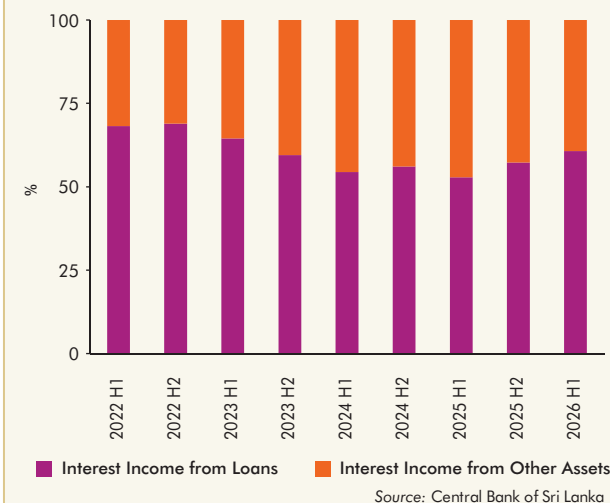


Figure 3.46 Composition of Interest Income



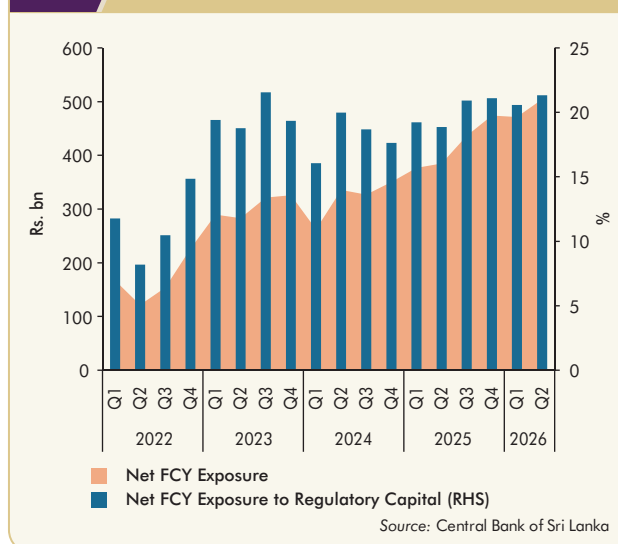
accelerated credit demand. Although, this drop in interest income from other financial assets exerted some pressure on NIM in H1 of 2026, the expansion in lending portfolio supported to sustain NIM relatively high compared to the historical average.

Market Risk

Near term repricing portfolio of the banking sector improved at end Q2 of 2026, as interest-bearing assets were higher than the interest-bearing liabilities up to one month bucket amid increasing market interest rate conditions. However, material negative gaps persisted beyond one month horizon. The cumulative position within 1 month shifted from a negative Rs. 111.2 bn at end Q2 of 2025 to a positive Rs. 457.3 bn at end Q2 of 2026, while the negative positions within 3 and 6 months narrowed substantially to Rs. 277.7 bn and Rs. 709.0 bn, respectively. The cumulative negative position within the 12 month horizon also narrowed from Rs. 2.7 tn to Rs. 2.5 tn. This indicates that, beyond the 1 month horizon, a greater volume of interest-sensitive liabilities remained subject to repricing compared to assets. Following the 100 bps increase in the Overnight Policy Rate (OPR) in May 2026, the remaining negative repricing gaps could result in liabilities repricing faster than assets, leading to some moderation in NIM. However, given that NIM remains elevated, such moderation may not be an immediate concern for sector's profitability.

Figure 3.48

Net FCY Exposure to Regulatory Capital



The banking sector's net FCY exposure increased at end Q2 of 2026, indicating increased sensitivity to exchange rate movements. The net FCY exposure, which includes both on and off-balance sheet positions, increased by 31.0% y-o-y, to a long position of Rs. 504.3 bn (USD 1,499.9 mn) at end Q2 of 2026. Accordingly, the net FCY exposure to regulatory capital ratio increased from 18.9% at end Q2 of 2025 to 21.3% at end Q2 of 2026. Although the on-balance sheet position shifted from a net asset position of Rs. 51.5 bn at end Q2 of 2025 to a net liability position of Rs. 106.8 bn at end Q2 of 2026, this was offset by a significant increase in the off-balance sheet net long position. In currency terms, although USD exposure continued to dominate

Figure 3.47

Cumulative Interest-bearing Assets and Liabilities

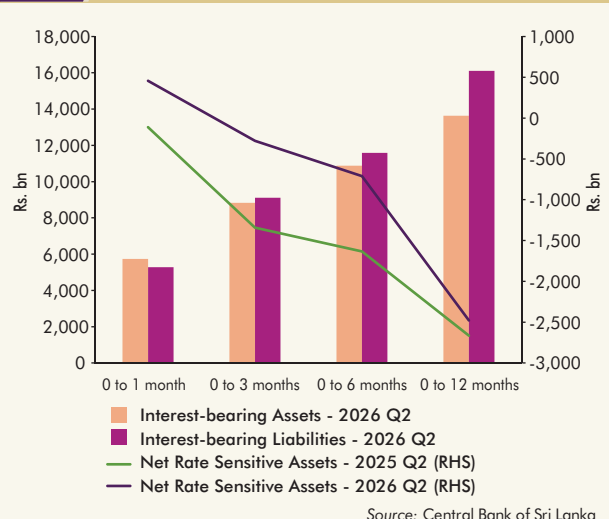


Figure 3.49

Currency-wise Net FCY Exposure

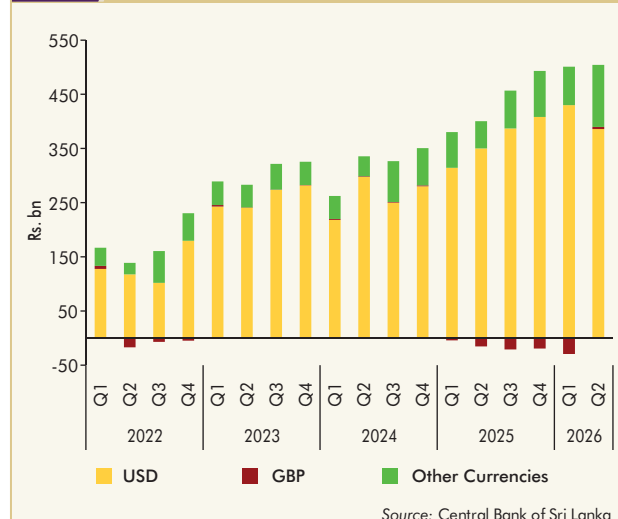
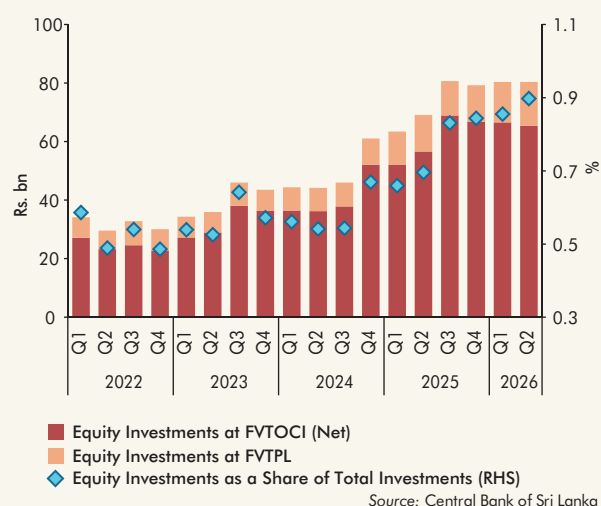


Figure 3.50

Equity Investments



the overall position, exposures to other currencies reported a notable increase. The larger overall long position could increase valuation gains in the event of further Rupee depreciation but would expose banks to losses if the Rupee appreciates.

The banking sector's exposure to equity risk increased moderately at end Q2 of 2026, although equity investments remained relatively small.

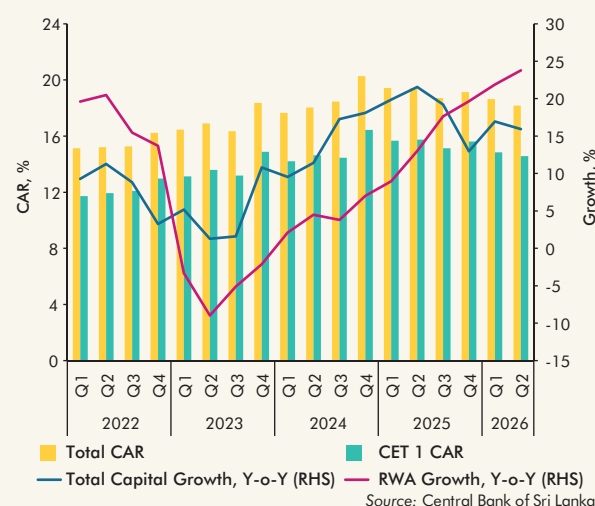
Listed equity investments increased by 16.3% y-o-y to Rs. 80.4 bn at end Q2 of 2026. Meanwhile, total investments of the sector contracted by 9.8% y-o-y to Rs. 8,955.0 bn at end Q2 of 2026, increasing the share of equity investments out of total investments from 0.7% at end Q2 of 2025 to 0.9% at end Q2 of 2026. Nevertheless, the limited share of equity investments in the overall investment portfolio contained the banking sector's direct exposure to stock market fluctuations.

Capital Adequacy

The banking sector maintained capital adequacy ratios (CARs) above the regulatory requirements, although the ratios declined due to the higher credit expansion witnessed during the period. The banking sector recorded a total CAR of 18.2% at end Q2 of 2026 compared to 19.4% at end Q2 of 2025. This was mainly due to increase in risk weighted assets (RWA) by 23.8% y-o-y, largely reflecting the significant credit expansion during this period, against a relatively lower growth in regulatory

Figure 3.51

Capital Adequacy Ratios



capital by 15.9% y-o-y at end Q2 of 2026. Moreover, common equity Tier 1 (CET 1) CAR of the sector also deteriorated to 14.6% at end Q2 of 2026 compared to 15.7% a year ago, indicating a moderation in the sector's high quality capital buffer relative to its RWA, increasing the sector's vulnerability to unexpected losses.

The decline in CAR was broad based across all bank categories, reflecting a sector-wide increase of RWA compared to regulatory capital.

Total CAR of D-SIBs and other domestic banks declined to 17.2% and 16.4%, respectively, at end Q2 of 2026 compared to 18.3% and 17.4%, respectively, recorded at end Q2 of 2025. Total regulatory capital of D-SIBs increased by 19.6% y-o-y at end Q2 of

Figure 3.52

Capital Adequacy Ratios by Bank Category

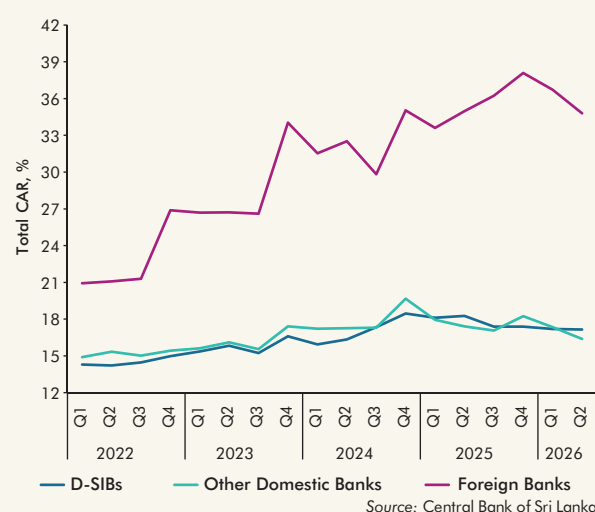
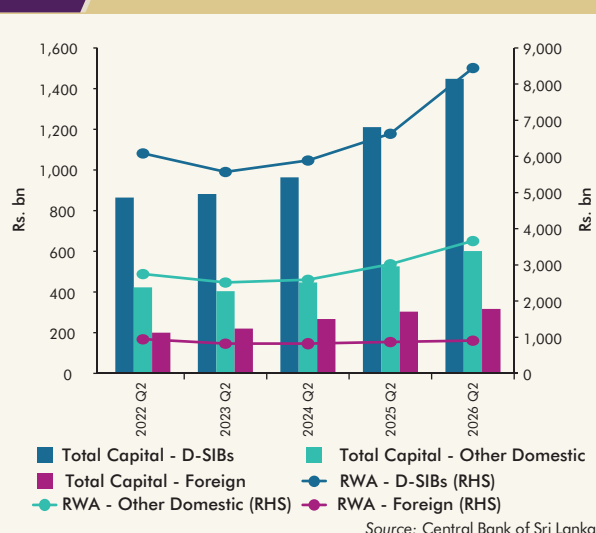
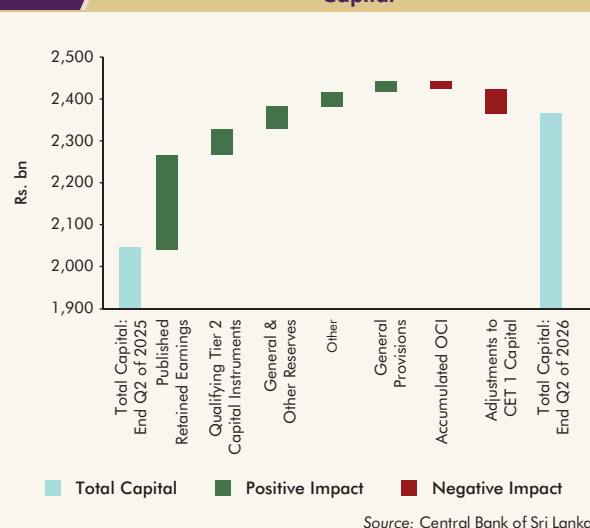


Figure 3.53 Total Capital and RWA by Bank Category

2026, while their RWA expanded considerably faster by 27.4%. Similarly, the total regulatory capital of other domestic banks increased by 14.2% y-o-y at end Q2 of 2026 compared with a 21.3% increase in RWA. With regards to foreign banks, total CAR marginally declined to 34.8% at end Q2 of 2026 from 35.0% a year ago, with total regulatory capital and RWA recorded relatively moderate growths of 4.3% and 4.8% y-o-y, respectively. The transfer of retail banking operations from a foreign bank to a domestic bank partly influenced the higher increase in RWA of the other domestic bank category, while the corresponding reduction in the transferring bank's RWA moderated the RWA growth among foreign banks. Nevertheless, the significant gap between regulatory capital and RWA growth among domestic banks indicates that capital accumulation did not keep pace with the expansion in risk weighted exposures.

The growth in total regulatory capital was primarily supported by retained earnings, indicating greater reliance on internal capital generation for capital augmentation. Total capital increased by 15.9% y-o-y at end Q2 of 2026 compared to 21.6% increase at end Q2 of 2025. Published retained earnings recorded a growth of 28.2% y-o-y and contributed to 69.6% of the increase in regulatory capital at end Q2 of 2026. Further, Tier 2 capital instruments and general and other reserves, which increased y-o-y by 30.5% and 14.5%, respectively, also notably contributed to the increase in regulatory

Figure 3.54 Factors impacted on the Change in Regulatory Capital

capital during the period. Particularly, Tier 2 capital continued to increase primarily due to issuance of subordinated debentures by banks.

The RWA for credit risk exposures expanded due to a substantial increase in corporate claims⁹ and retail claims.¹⁰ The RWA related to the credit risk exposures, which represents 88.1% of total RWA, increased by 25.6% y-o-y at end Q2 of 2026, mainly

⁹ Corporate claims include exposures to corporates, including exposures (loans, bonds, receivables, etc.) to incorporated entities, associations, partnerships, proprietorships, trusts, funds, and other entities with similar characteristics (Basel Committee on Banking Supervision (BCBS) Calculation of RWA for credit risk - CRE20.41).

¹⁰ Retail claims include exposures to an individual person or persons; and exposures to SMEs (BCBS Calculation of RWA for credit risk - CRE20.63).

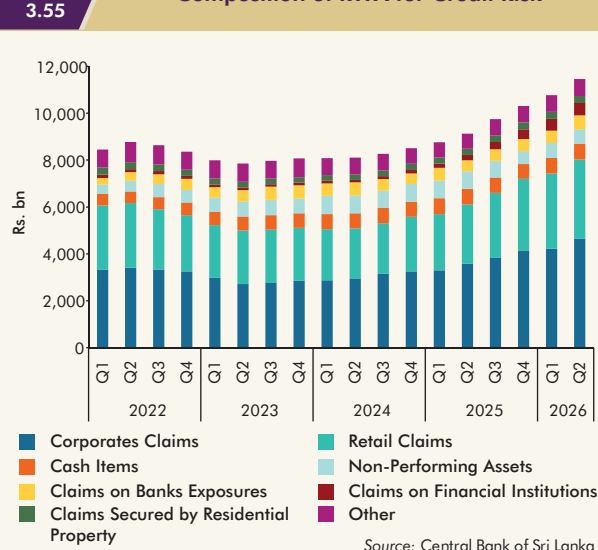
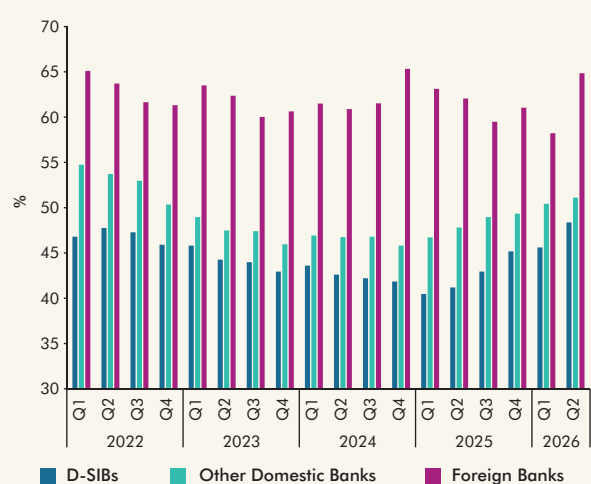
Figure 3.55 Composition of RWA for Credit Risk

Figure 3.56

Bank Category-wise RWA Density



Source: Central Bank of Sri Lanka

due to substantial increase in corporate claims and retail claims. Claims on corporates constituted 40.5% of the total RWA for credit risk and increased by 29.7% y-o-y at end Q2 of 2026. The increase in RWA was further prompted by the increase in retail claims, which represented 29.5% of the total RWA for credit risk and increased by 33.6% y-o-y. However, RWA for non-performing assets declined during the period, indicating the improved asset quality of the sector.

Reflecting the differences in business models, the RWA density¹¹ of foreign banks was higher at end Q2 of 2026 compared to domestic banks.

11 The RWA Density is computed as the percentage of risk weighted assets to total assets.

The RWA density of foreign banks stood at 64.9% at end Q2 of 2026 and remained notably higher than that of domestic banks. This was due to their lower investments in the government securities with 0% risk weights compared to domestic banks. However, this high RWA density did not translate into stronger income generations of foreign banks from lending due to their lack of credit growth, which was also reflected by their weak NII performance during the period under concern.

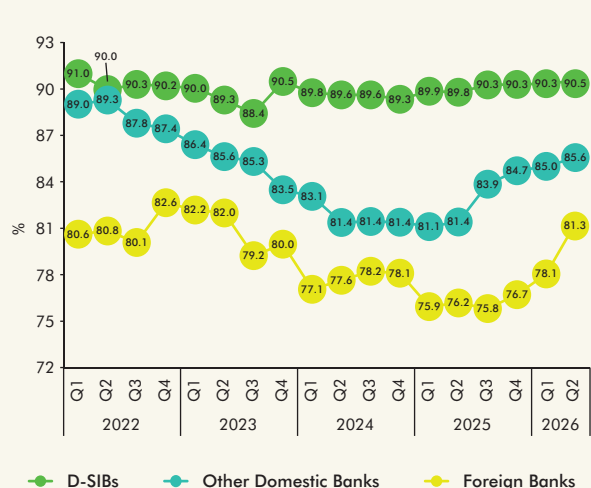
Excess capital of the banking sector, calculated based on the minimum regulatory requirements, recorded a marginal decline at end Q2 of 2026. Excess capital of the sector contracted by 4.9% y-o-y at end Q2 of 2026. Particularly, excess capital of D-SIBs and other domestic banks marginally contracted by 11.1% and 4.2%, respectively, reflecting the credit expansion during the period under review.

The banking sector continued to record a high leverage ratio¹² at end Q2 of 2026. The leverage ratio of the banking sector stood at 7.2% at end Q2 of 2026, which was well above the minimum regulatory requirement of 3%. The D-SIBs reported the lowest

12 The leverage ratio, calculated as Tier 1 capital to total exposures, indicates the extent to which assets are funded by other than own funds. The numerator is Tier 1 capital, as defined under Basel III, while the denominator includes all balance sheet assets, derivative exposures, securities financing transaction exposures and off-balance sheet items (Financial Soundness Indicators Compilation Guide, 2019).

Figure 3.57

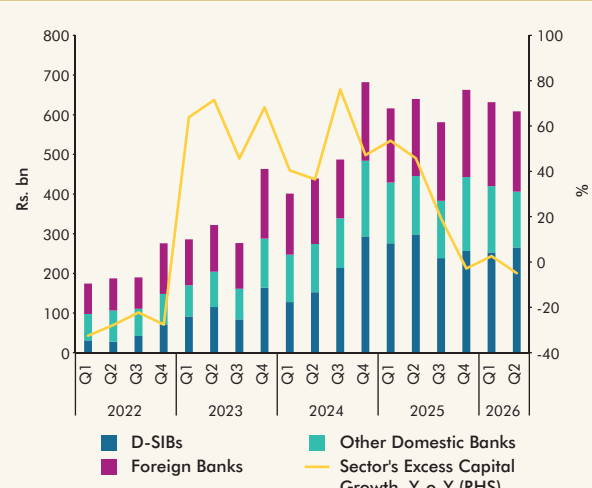
RWA for Credit Risk as a share of Total RWA



Source: Central Bank of Sri Lanka

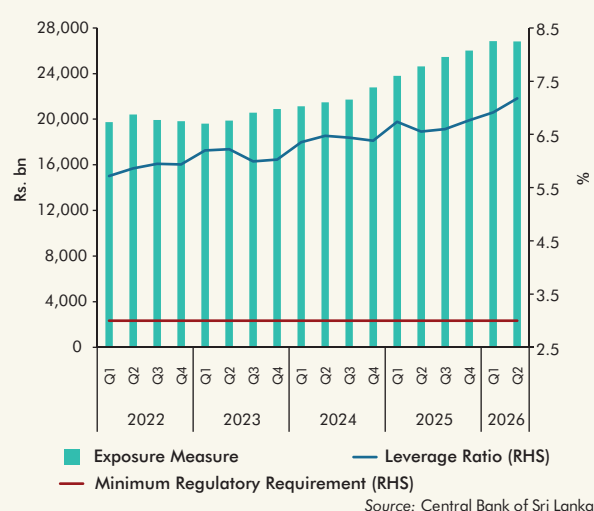
Figure 3.58

Capital in Excess of the Minimum Regulatory Requirement under Pillar 1



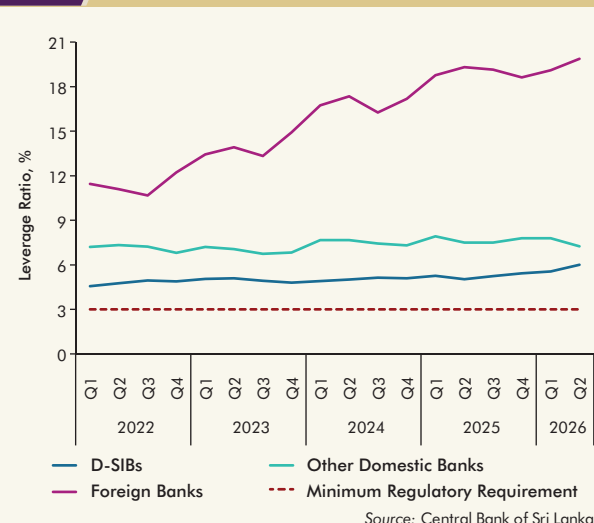
Source: Central Bank of Sri Lanka

Figure 3.59
Leverage Ratio



leverage ratio of 6.0% at end Q2 of 2026, which was a slight increase compared to Q2 of 2025. Other domestic Banks' leverage ratio stood at 7.2% at end Q2 of 2026, which was a decline compared to 7.5% recorded at end Q2 of 2025, primarily due to a notable growth in the exposure measure against stagnant Tier 1 capital. Foreign banks maintained a relatively stronger leverage ratio of 19.9% at end Q2 of 2026, driven by a higher growth in Tier 1 capital compared to the growth in exposure measure, which remained considerably low due to low growth in credit. A higher leverage ratio indicates a higher level of quality capital buffers relative to on and off-balance sheet exposures, which increases the sector's resilience to financial shocks.

Figure 3.60
Leverage Ratio by Bank Category



3.2 Finance Companies (FCs) Sector

The FCs sector remained resilient, although its overall soundness index marginally declined at end Q2 of 2026 amid rapid expansion of the balance sheet. The decline in overall soundness index was largely reflected in liquidity, profitability, capital adequacy, and market risk. Although the liquidity and capital adequacy of the sector marginally deteriorated relative to the corresponding period of the previous year, they remained well above the minimum regulatory requirement at end Q2 of 2026. Nevertheless, asset quality of the sector improved notably during the period under consideration, while efficiency also recorded a marginal improvement.

Credit Risk

The FCs sector lending activities continued to expand significantly by mid-2026. Gross loans and advances of the sector significantly grew by 45.0% y-o-y at end Q2 of 2026 compared to a growth of 35.1% reported at end of the corresponding period of the previous year. However, credit growth recorded at end Q2 of 2026 moderated from the previous quarter's growth of 52.4%. This moderation reflected slower expansion in vehicle backed lending following the Central Bank's tightening of the maximum loan-to-value (LTV) ratio on motor vehicle financing in May 2026, together with the easing of pent up demand for importation of motor vehicles and an upward

Figure 3.61
Finance Companies Soundness Map*

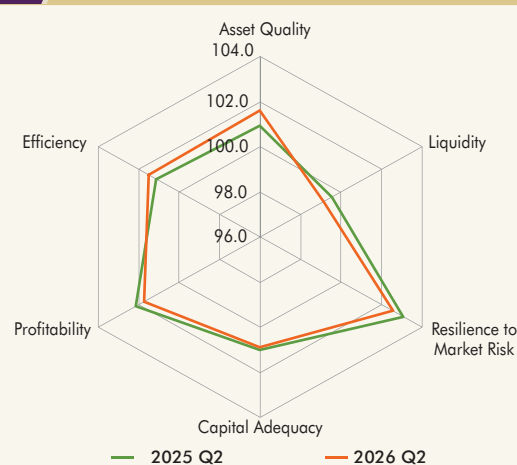
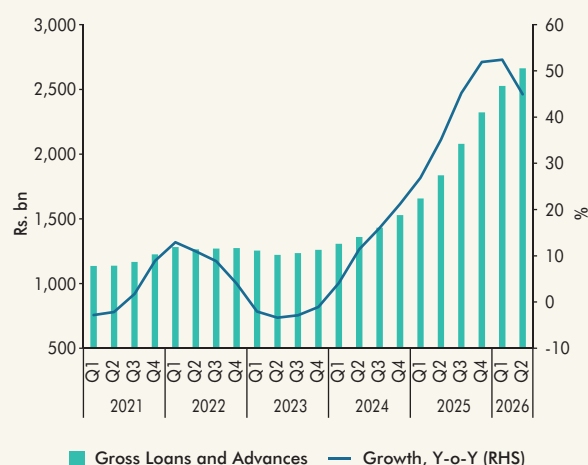


Figure 3.62

Gross Loans and Advances



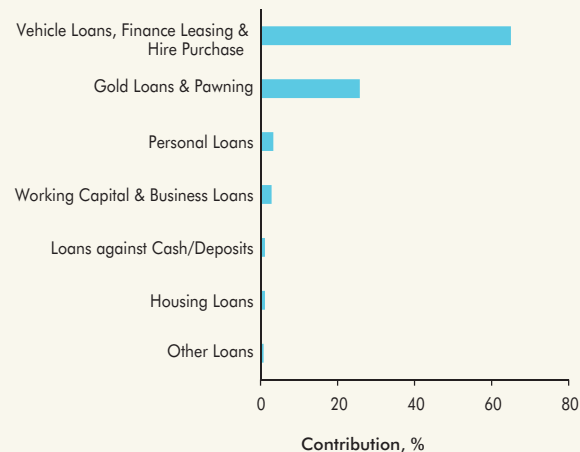
Source: Central Bank of Sri Lanka

adjustment in vehicle prices arising from the shift in point of taxation of the Social Security Contribution Levy (SSCL), exchange rate depreciation during the first half of 2026, and the implementation of a temporary surcharge on customs import duty for the importation of motor vehicles. The expansion in gold backed lending also slowed following the introduction of LTV limits on credit facilities secured by gold in May 2026. Moreover, the growth in credit facilities granted on vehicles is expected to further decelerate in the coming quarters, along with the increase in lending rates following the policy rate adjustment in May 2026 and the extension of the temporary surcharge on importation of motor vehicles until end of 2026. Further, in addition to the introduction of the maximum LTV ratio on gold backed loans, the Central Bank increased risk weights on such facilities for the purpose of determining capital adequacy requirements, implemented with effect from September 2026, which may lead to a further moderation in the growth of gold backed lending in the coming quarters, thereby slowing the overall credit growth of the sector.

The credit growth of the FCs sector by end Q2 of 2026 was mainly driven by the expansion in vehicle and gold backed lending. Vehicle backed loans of the sector grew by 46.3% y-o-y at end Q2 of 2026, accelerating from a growth of 33.4% reported in the corresponding period of the previous year. Consequently, vehicle backed lending contributed

Figure 3.63

Product-wise Contribution to the Credit Expansion during the Year ended Q2 of 2026



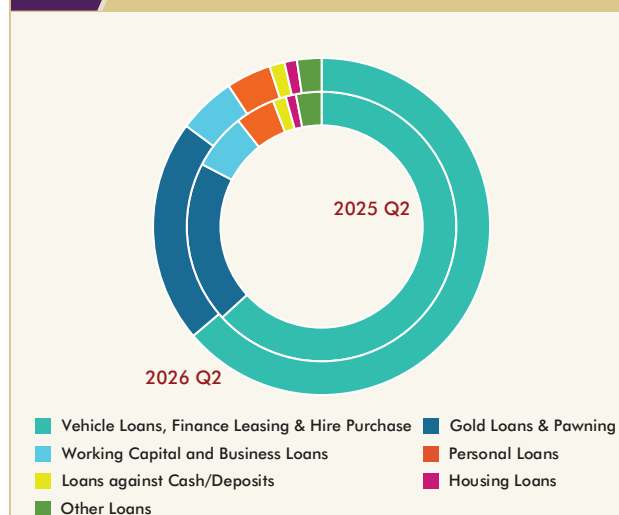
Source: Central Bank of Sri Lanka

to 65.0% of the increase in total credit of the sector during the year ended Q2 of 2026. Moreover, gold backed loans recorded a significant y-o-y growth of 59.8% at end Q2 of 2026 compared to 43.8% recorded a year ago and represented 25.8% of the FCs sector's credit expansion during the reference period. This substantial increase in gold backed lending was supported by the elevated gold prices prevailed in the global market.

Following the considerable expansion in vehicle and gold backed lending during the period under consideration, credit concentration of the FCs sector on collateralised lending further increased, heightening its vulnerability to

Figure 3.64

Composition of Gross Loans and Advances

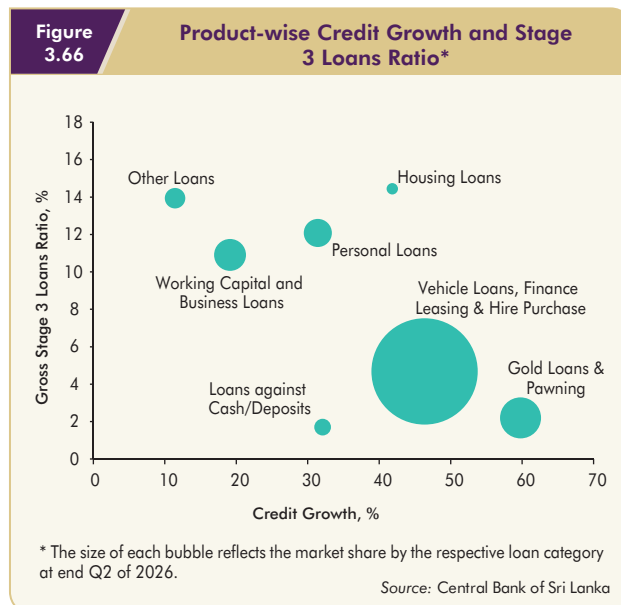


Source: Central Bank of Sri Lanka

adverse movements in collateral values. As at end Q2 of 2026, vehicle and gold backed lending together accounted for 85.2% of total credit of the FCs sector, further increasing from 82.6% recorded a year ago. Meanwhile, gold backed loans accounted for 21.4% of total credit, increasing from 19.4% recorded at end Q2 of 2025. This heavy reliance on limited collateral types creates a significant collateral concentration risk, particularly in the event of a decline in collateral values amid prevailing geopolitical uncertainties. However, with the tightening of the maximum LTV on vehicle backed loans and the implementation of a maximum LTV on gold backed loans, possible risks emanating from adverse movement in collateral values remained subdued.

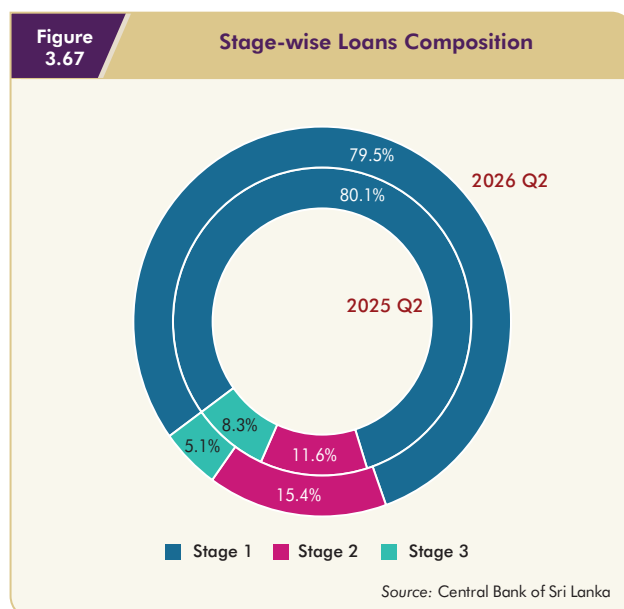
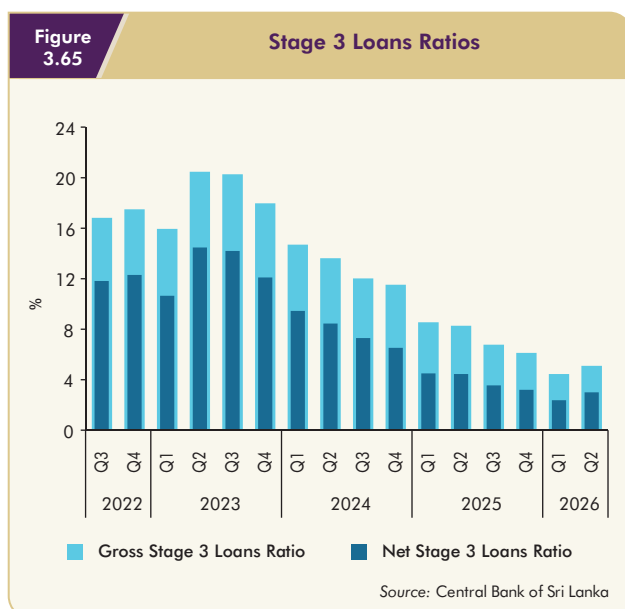
The Stage 3 loans ratio¹³ of the FCs sector recorded an overall decline during the period under review, mainly due to the significant expansion in credit coupled with a decline in volume of outstanding Stage 3 loans. The Stage 3 loans ratio of the sector decreased to 5.1% at end Q2 of 2026 compared to 8.3% recorded a year ago, due to the high credit growth of 45.0% y-o-y and a contraction in outstanding Stage 3 loans by 10.5% at end Q2 of 2026. Although, Stage 3 loans of the sector reported an overall decline during the period considered, an uptick in Stage 3 loans of Rs. 23.6 bn was observed at end Q2 of 2026 compared to end Q1 of 2026, driven by

13 Stage 3 loans ratio refers to the gross Stage 3 loans ratio.



vehicle and gold backed Stage 3 loans, reflecting the broad impacts of geopolitical uncertainties on the sector.

Despite the decline in total Stage 3 loans of the sector during the period reflecting an improvement in asset quality, the significant increase in Stage 2 loans of the sector warrants close monitoring, as it signals a potential build-up of credit risk in the FCs sector. Gross Stage 2 loans of the sector surged substantially by 92.1% y-o-y at end Q2 of 2026 compared to a contraction of 0.9% recorded in the corresponding period of the previous year. Consequently, the Stage 2 loans ratio of the sector also increased to 15.4% at end Q2 of 2026 from 11.6% reported a year ago. This increase may partly



reflect the weakening repayment capacity of certain borrowers following the impact of the Cyclone Ditwah and the Middle East conflict, particularly through disruptions to income generation, and higher cost pressures. Moreover, the Stage 2 loans for vehicle backed loans increased by 75.5% y-o-y and became the primary contributor to the increase in total Stage 2 loans of the sector, whilst Stage 2 loans for gold backed loans grew significantly by 279.2% y-o-y at end Q2 of 2026. Accordingly, the current uptick in Stage 2 loans reflects a potential buildup of credit risk within the sector and requires continuous monitoring and proactive risk mitigation by FCs, as a further deterioration in borrower repayment capacity could result in the migration of these exposures into Stage 3 in the coming periods.

The Stage 3 impairment coverage ratio of the sector declined at end Q2 of 2026 compared to a year ago, largely due to the decline in impairment for Stage 3 loans. The Stage 3 impairment coverage ratio decreased to 41.0% at end Q2 of 2026 compared to 46.1% recorded at end of the corresponding period of the previous year. Moreover, the Stage 2 impairment coverage ratio of the sector also declined to 2.9% at end Q2 of 2026 from 3.9% recorded a year ago, mainly due to the significant increase in Stage 2 loans during the period. Given the comparatively elevated risk associated with Stage 2 exposures, FCs need to remain vigilant and strengthen recoveries while maintaining adequate impairment coverage for Stage 2 loans as well, to absorb potential losses in the event of further deterioration in credit quality.

Figure 3.68 Impairment Coverage Ratios

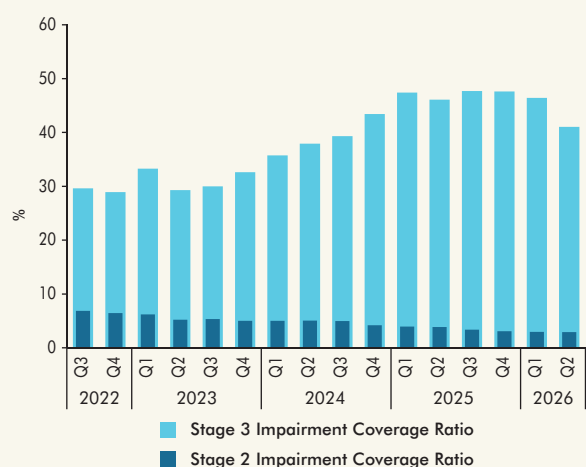
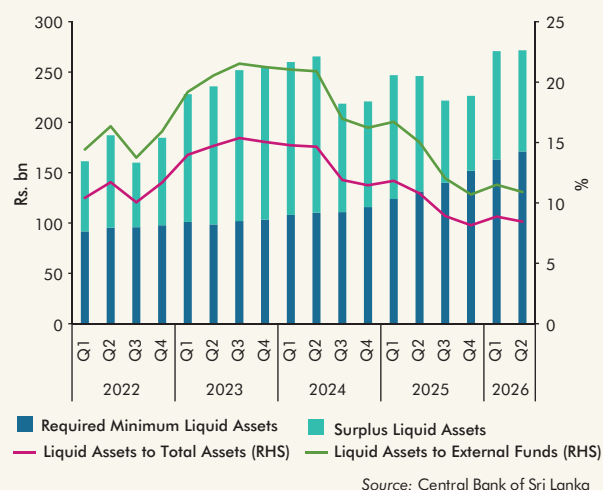


Figure 3.69 Regulatory Liquid Assets to External Funds and Total Assets



Liquidity Risk

The liquidity position of the FCs sector remained well above the regulatory minimum requirement although liquidity ratios and surplus liquid assets declined as the balance sheet expanded. Both the liquid assets to total assets ratio and the liquid assets to external funds¹⁴ ratio of the sector declined to 8.5% and 10.9%, respectively, at end Q2 of 2026 compared to 10.8% and 15.0% respectively, recorded at end Q2 of 2025, primarily reflecting a denominator effect, as total assets and external funds expanded at a faster pace than liquid assets. Moreover, although the

¹⁴ External funds of the FCs sector consist of deposits and borrowings.

Figure 3.70 Composition of Liquid Assets

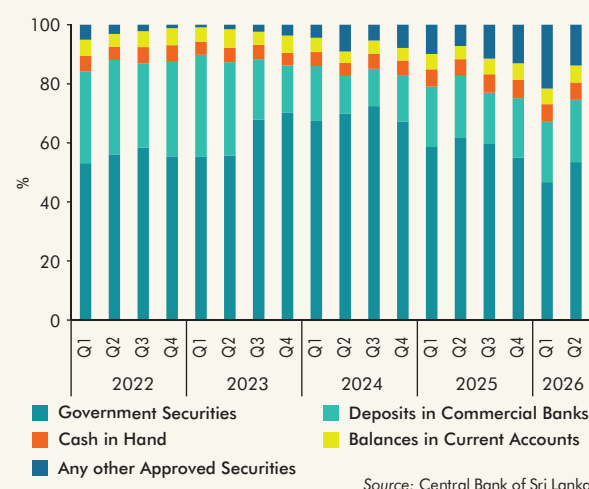
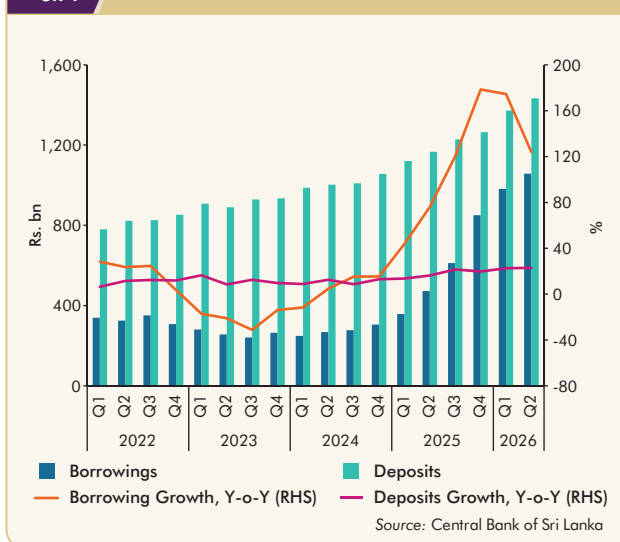


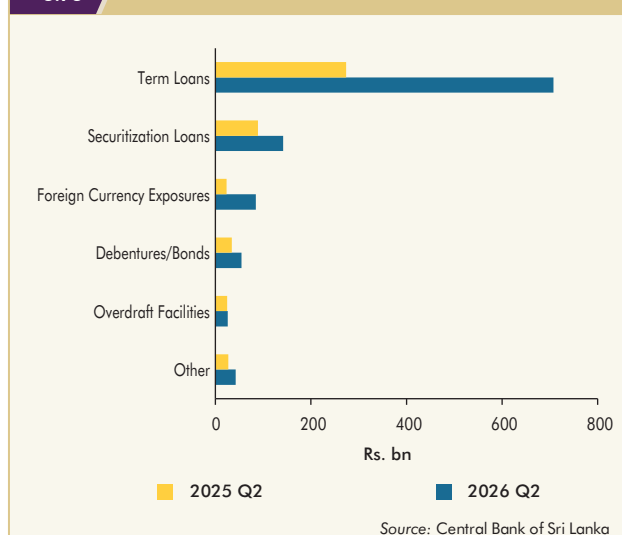
Figure 3.71 Deposits and Borrowings



sector recorded a liquidity surplus of Rs.100.5 bn by end Q2 of 2026, it was a decline of 12.3% compared to the corresponding period of 2025. Nevertheless, total liquid assets of the sector increased by 10.4% y-o-y at end Q2 of 2026. This increase was mainly due to the growth in investments in repos, deposits and current account balances with banks.

The borrowings of the FCs sector continued to remain elevated, as the sector increasingly relied on borrowings from the banking sector as an alternative source of funding to support the expansion in credit. The borrowings of the FCs sector increased significantly by 124.0% y-o-y at end Q2 of 2026, compared to a growth of 75.9% recorded at end Q2 of 2025, however, the pace of growth has

Figure 3.73 Composition of Borrowings

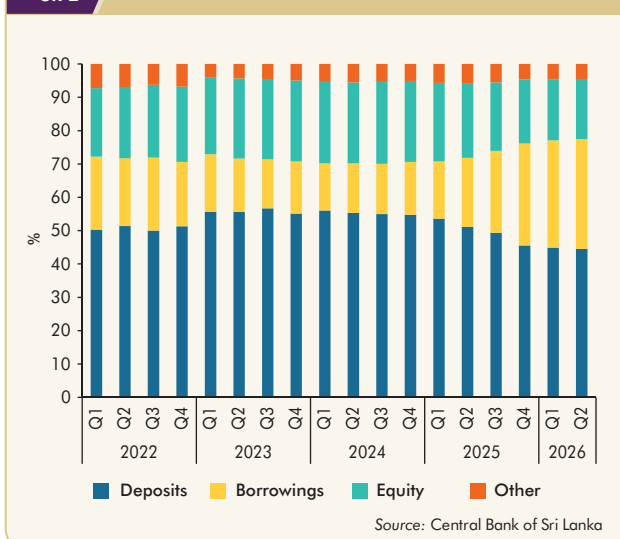


gradually moderated in recent quarters. Moreover, deposits, as a relatively more stable source of funding, increased by 22.9% y-o-y, at end Q2 of 2026 compared to a growth of 16.3% reported a year ago. Subsequent to those improvements, borrowing as a share of total funding increased to 32.9% at end Q2 of 2026 from 20.7% recorded a year ago, while deposits as a share of total funding substantially decreased to 44.6% from 51.1% during the same reference period. This growing reliance on borrowings compared to deposits could increase the sector's exposure to refinancing risk, particularly if funding needs to rise during a period of tightened market liquidity or higher funding cost. Moreover, the reliance on bank funding indicates an increased degree of interconnectedness of the FCs sector with the banking sector. Meanwhile, the sector's borrowings were predominantly funded through term loans, which accounted for 66.9% of the total borrowings at end Q2 of 2026. Nevertheless, the borrowing growth of the FCs sector is expected to decelerate further in the coming quarters, in line with the anticipated moderation in credit.

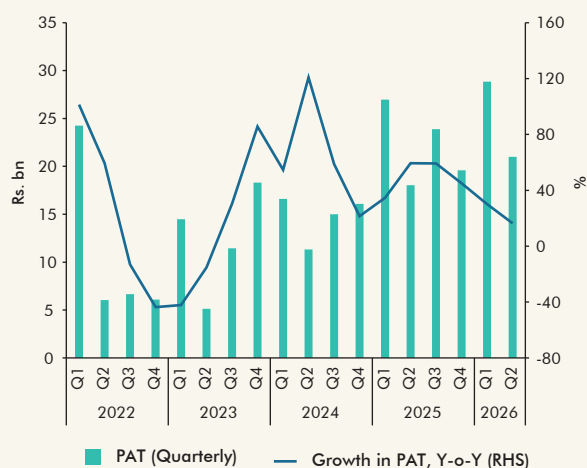
Profitability

Profit After Tax (PAT) of the FCs sector continued to improve during the first three months of the financial year 2026/27¹⁵ (Q2 of 2026), with a noticeable moderation in profit growth.

Figure 3.72 Funding Structure

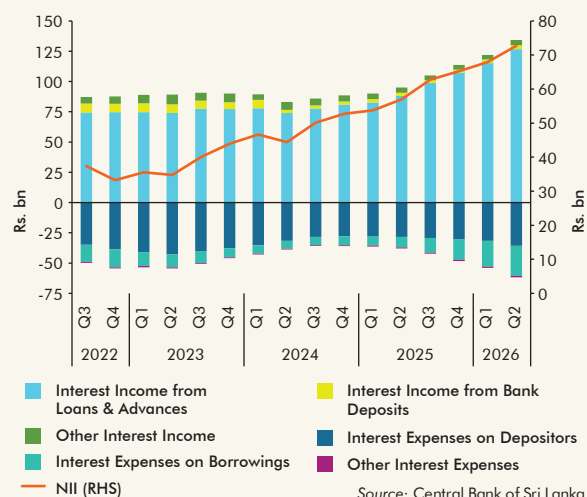


¹⁵ Financial year of the majority of the FCs spans between 01 April of a given year and 31 March of the following year.

Figure 3.74 Profit After Tax (Quarterly)

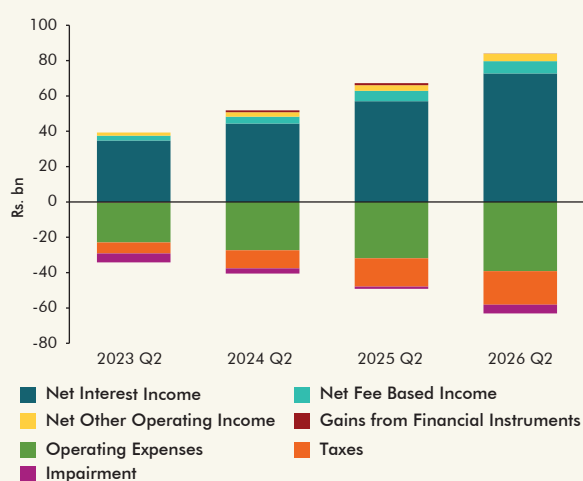
Source: Central Bank of Sri Lanka

The sector reported a PAT of Rs. 21.0 bn during Q2 of 2026, recording a y-o-y growth of 16.4%, declining from a significant growth of 59.3% recorded in the corresponding period of the previous year. Net interest income (NII) of the sector recorded a y-o-y growth of 27.6% during Q2 of 2026, mainly contributing to the improvement in the sector's profitability. Meantime, increase in impairment charges along with higher operating expenses, primarily stemming from employee remunerations, exerted a downward pressure on PAT during the period considered. Accordingly, operating expenses increased by 22.7% y-o-y, whilst impairment charges grew substantially by 282.3% y-o-y during Q2 of 2026.

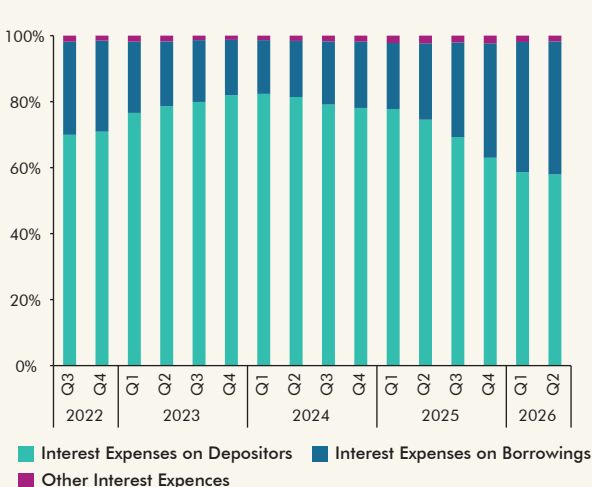
Figure 3.76 Composition of Net Interest Income

Source: Central Bank of Sri Lanka

Interest expenses of the FCs sector grew at a significantly higher pace than the interest income during Q2 of 2026. The growth in interest income of the sector significantly accelerated to 41.5% y-o-y in Q2 of 2026 from 14.2% in Q2 of 2025, mainly driven by the higher interest income generated from loans and advances with the expansion in credit portfolio. However, this upward trend was largely offset by the notable increase in interest expenses of 62.3% y-o-y in Q2 of 2026 compared to a 2.0% contraction recorded in the corresponding period of the previous year. The increase in interest expenses of the sector was primarily driven by the increase in

Figure 3.75 Components of Profit After Tax

Source: Central Bank of Sri Lanka

Figure 3.77 Composition of Interest Expenses

Source: Central Bank of Sri Lanka

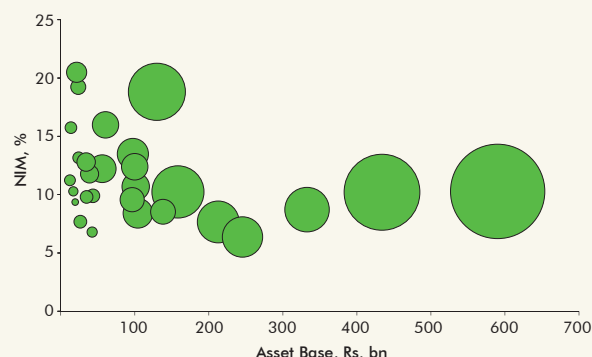
borrowing costs, which grew by 181.7% y-o-y, whilst interest expenses for deposits also increased by 26.2% during the period considered.

Although the return on equity (ROE) of the FCs sector slightly improved in Q2 of 2026 compared to a year before, the net interest margin (NIM) and return on assets (ROA) moderated, partly due to the rapid expansion in the asset base that outpaced the profit growth. The ROE of the sector marginally increased to 15.6% in Q2 of 2026 from 15.2% recorded in Q2 of 2025. However, the sector's ROA decreased to 5.7% in Q2 of 2026 compared to 6.9% recorded a year ago. Following a similar trend, NIM of the sector also decreased to 10.4% from 11.5% during the same reference period. Accordingly, the sector's profitability indicators underscored a mixed performance during Q2 of 2026, as rapid expansion in assets funded by borrowings exerted pressure on interest margin.

Based on the interest rate sensitivity profile at end Q2 of 2026, the FCs sector appears well positioned to remain profitable in the near term. Rate-sensitive assets exceeded rate-sensitive liabilities across all repricing buckets up to one year, resulting in a peak positive cumulative net rate-sensitive asset position of Rs. 298.7 bn within six months before moderating to Rs. 128.7 bn within one year. The positive repricing gap indicates that a larger

Figure 3.79

Net Interest Margin Vs. Asset Base*



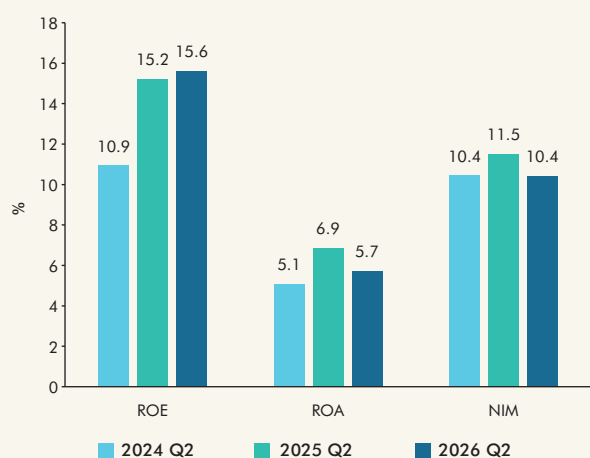
* The size of each bubble reflects the PAT reported by the respective FC in Q2 of 2026. Three FCs that recorded losses during the same reference period are excluded from this chart.

Source: Central Bank of Sri Lanka

proportion of interest-earning assets than interest bearing liabilities are due for repricing in the coming months. Accordingly, an increase in market interest rates could support net interest income as assets reprice more quickly than liabilities, while a decline in interest rates could exert pressure on net interest income through the same channel. Given the sizeable positive gap and the sector's strong concentration of rate-sensitive earning assets such as vehicle and gold backed loans, profitability is expected to remain resilient over the near term, although margin dynamics will continue to depend on the future path of interest rates and competitive funding conditions.

Figure 3.78

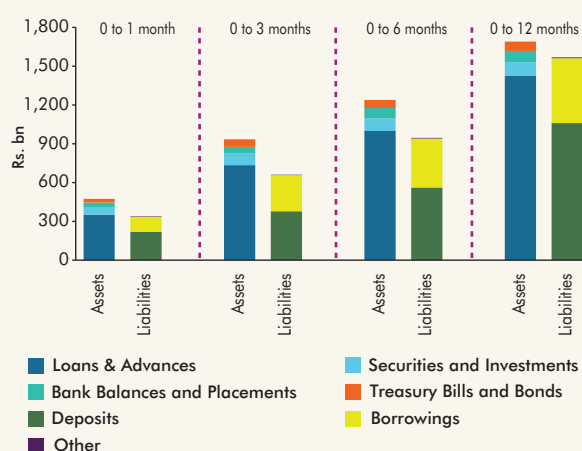
Profitability Indicators



Source: Central Bank of Sri Lanka

Figure 3.80

Rate Sensitive Assets and Liabilities



Source: Central Bank of Sri Lanka

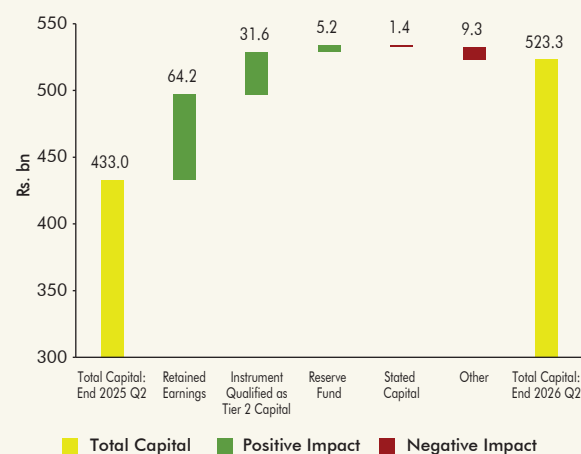
Capital Adequacy

The capital position of the FCs sector remained resilient at end Q2 of 2026, in terms of both regulatory minimum capital adequacy requirement and minimum core capital requirement. Except for three companies which represented a market share of 3.0%, all other FCs remained compliant with the regulatory minimum total capital adequacy requirement as at end Q2 of 2026. Moreover, except for one FC, all other FCs were compliant with minimum core capital requirement of Rs. 2.5 bn during the same reference period.

The capital adequacy ratios (CARs) of the FCs sector declined at end Q2 of 2026 compared to the corresponding period of the previous year, mainly due to increase in risk weighted assets (RWA) driven by the significant credit expansion. Accordingly, total CAR and Tier 1 CAR of the sector declined to 19.3% and 17.3%, respectively, at end Q2 of 2026 compared to 22.0% and 20.8%, respectively, reported at end Q2 of 2025. However, as a sector, these ratios remained above the regulatory minimum requirement during the period considered. The RWA grew substantially by 37.6% y-o-y at end Q2 of 2026 against a relatively slower capital growth of 20.8%, exerting downward pressure on CAR.

Total capital of the sector further strengthened during the period, supported by increase in retained earnings and Tier 2 capital. Total capital

Figure 3.82 Change in Total Regulatory Capital

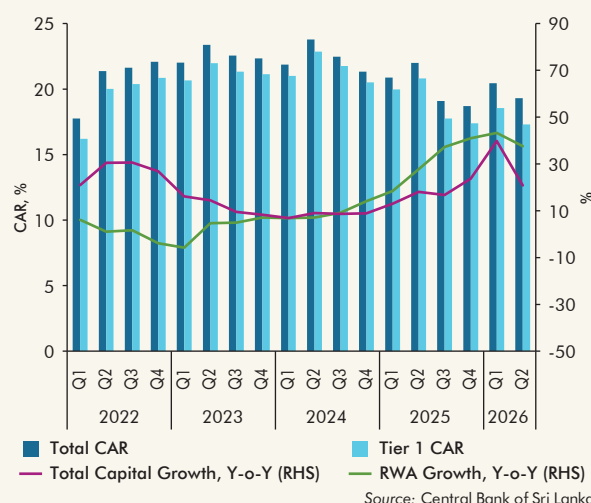


Source: Central Bank of Sri Lanka

recorded a y-o-y growth of 20.8% at end Q2 of 2026 compared to 18.0% y-o-y growth recorded a year ago. The increase in the total capital of the sector was primarily driven by the increased retained earnings, with the inclusion of the audited profits for the financial year 2025/26, and infusion of Tier 2 capital through approved unsecured subordinate debt instruments.

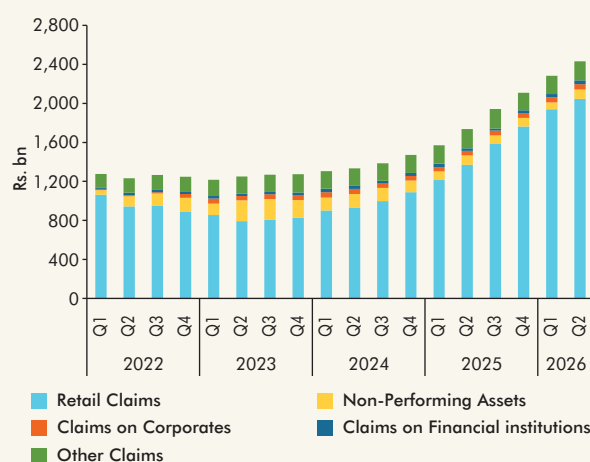
Reflecting the robust expansion in the credit portfolio, the FCs sector's RWA under the credit risk category recorded a significant growth by end Q2 of 2026. Accordingly, RWA for credit risk, which accounted for 89.5% of the sector's total RWA, increased by 39.7% y-o-y at end Q2 of 2026 compared to 30.2% at end Q2 of 2025. The increase

Figure 3.81 Capital Adequacy Ratios



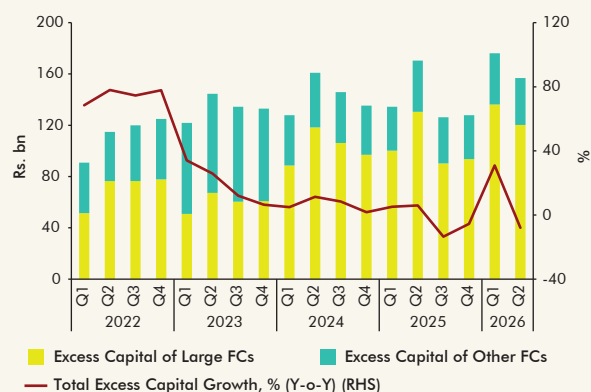
Source: Central Bank of Sri Lanka

Figure 3.83 RWA for Credit Risk



Source: Central Bank of Sri Lanka

Figure 3.84 Excess Capital*



* The analysis covers the 31 FCs (excluding Nation Lanka Finance PLC) that prevailed at end Q2 2026. Further, for each quarter, FCs with total assets exceeding Rs. 100 bn, based on their latest available audited financial statements, as at the respective quarter are classified as Large FCs, while the remaining FCs are classified as Other FCs. Accordingly, as at end Q2 of 2026, 08 FCs were classified as Large FCs.

Source: Central Bank of Sri Lanka

was primarily driven by the growth in performing retail claims, particularly attributed to vehicle and gold backed loans, which accelerated to 49.3% y-o-y at end Q2 of 2026 from 47.5% a year ago. Accordingly, the growing concentration of RWA in retail exposures underscores the increasing capital requirements associated with the sector's lending activities.

Total excess capital of the FCs sector recorded a y-o-y contraction at end Q2 of 2026, reflecting a narrowing of capital buffers despite an increase in regulatory capital. Accordingly, excess capital of the sector decreased by 8.0% y-o-y at end Q2 of 2026, compared to 5.9% expansion recorded at end of the corresponding period of the previous year. Moreover, the narrowing of capital buffers underscores the need to closely monitor the sector's capital position amidst sustained credit growth. Nevertheless, the sector possessed an excess capital of Rs. 156.8 bn at end Q2 of 2026, indicating that the sector has further capacity to support the elevated credit demand.

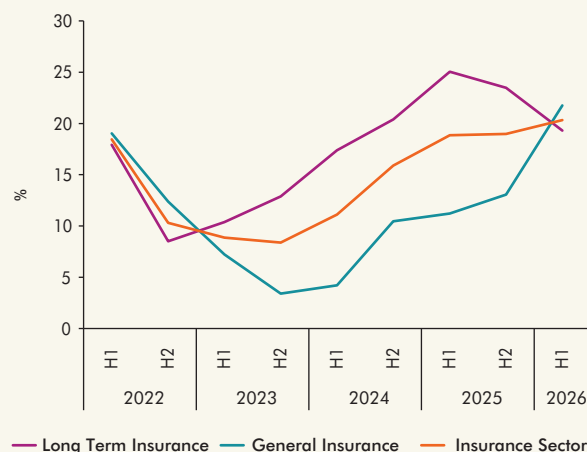
3.3 Insurance Sector

Insurance penetration in the country improved during H1 of 2026 compared to H1 of 2025 amid the continued recovery in the economic activity.

Insurance penetration, as measured by annualised Gross Written Premium (GWP)¹⁶ as a percentage of

16 Gross Written Premium is the total revenue from a contract expected to be received by an insurer before deductions for reinsurance or ceding commissions.

Figure 3.85 Growth in GWP (Y-o-Y)



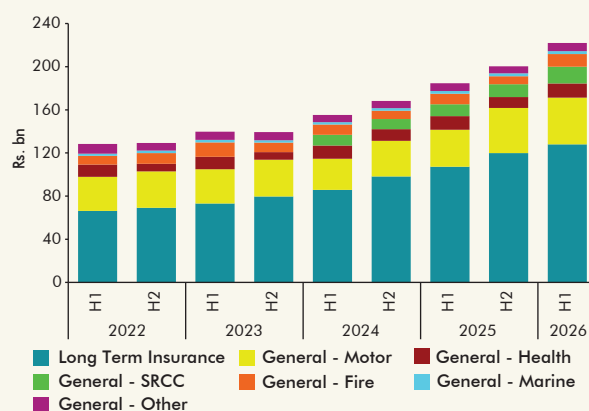
Source: Insurance Regulatory Commission of Sri Lanka

Gross Domestic Product (GDP)¹⁷, improved to 1.5% at end H1 of 2026 compared to 1.3% at end H1 of 2025.

The insurance sector demonstrated a notable growth in terms of GWP during H1 of 2026 compared to the corresponding period of 2025. The GWP of the insurance sector increased by 20.3% y-o-y during H1 of 2026. The GWP in the long term insurance subsector grew by 19.3% y-o-y during H1 of 2026, though the pace of growth moderated from 25.0% during the corresponding period of 2025. The GWP of the general insurance subsector

17 Gross Domestic Product for 2025 was used in the computation.

Figure 3.86 Subsector-wise GWP*



* From Q2 of 2024, SRCC (Strikes, Riots and Civil Commotion) under General Insurance sub sector has been presented separately according to the Cabinet Approval Memorandum Number MF/PE/007/CM/2024/098.

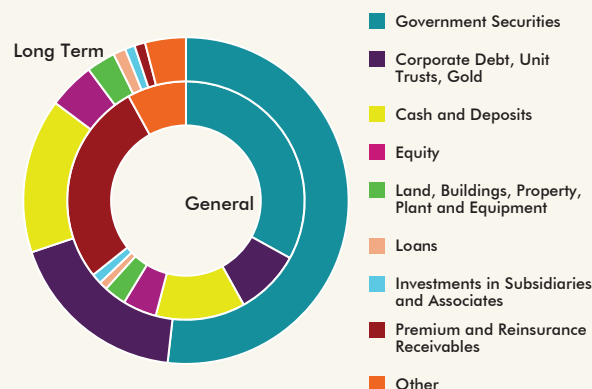
Source: Insurance Regulatory Commission of Sri Lanka

also recorded a significant increase to 21.8% y-o-y during H1 of 2026 compared to a growth of 11.2% recorded during H1 of 2025. With the continued revival of economic activities, GWP expanded across all categories in the general insurance subsector, particularly with increased GWP from motor insurance and Strikes, Riots and Civil Commotion (SRCC). The relaxation of vehicle imports restrictions in early 2025 also contributed to the expansion in GWP in the general insurance subsector.

Insurance sector recorded a strong asset growth during the period under review, supported by a notable business expansion. Out of the total assets of the insurance sector, long term insurance accounted for 74.2%, while general and reinsurance subsectors represented 25.1% and 0.7%, respectively, at end H1 of 2026. Total assets of the insurance sector grew by 15.4% y-o-y at end H1 of 2026 compared to 15.7% a year ago. Although general insurance assets recorded a higher growth rate of 24.1% y-o-y compared to 13.1% for long term insurance, the long term insurance segment contributed 64.3% of the overall growth in the insurance sector's asset base. Meanwhile, assets of the insurance sector were concentrated to debt securities, out of which government securities accounted for 47.0% of total assets at end H1 of 2026. Further, the combined share of government and corporate debt securities as a share of total assets declined from 63.6% at end H1 of 2025 to 60.9% at end H1 of 2026 due to an

Figure 3.88

Composition of Assets of Long Term and General Insurance at end H1 of 2026



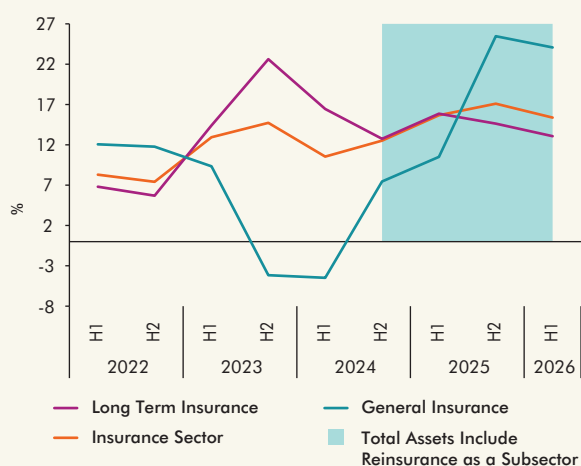
Source: Insurance Regulatory Commission of Sri Lanka

increase in the reinsurance receivables, particularly in the general insurance subsector, indicating some moderation in the insurance sector's concentration in fixed income securities.

Claims pressures in the general insurance sector increased during H1 of 2026, amid significant claims arising from Cyclone Ditwah. General insurance claims increased by 21.4% y-o-y during H1 of 2026, largely driven by a 40.8% increase in motor claims. Health insurance claims also increased by 3.7%, while fire insurance claims declined significantly. Meanwhile, long term insurance claims increased marginally by 1.5% y-o-y. Claims related to Cyclone Ditwah amounting to Rs. 57.0 bn were received as

Figure 3.87

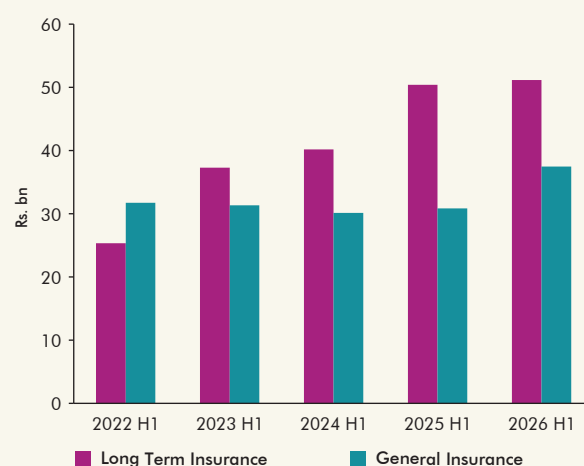
Growth in Assets (Y-o-Y)



Source: Insurance Regulatory Commission of Sri Lanka

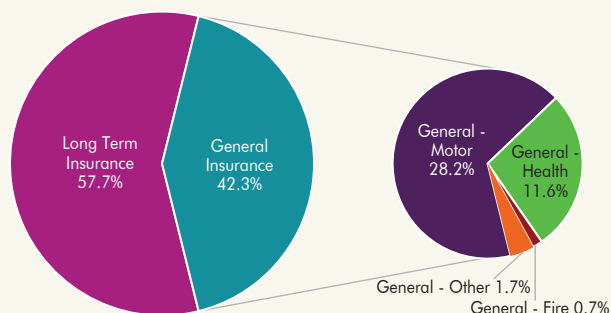
Figure 3.89

Claims Paid by Subsector



Source: Insurance Regulatory Commission of Sri Lanka

Figure 3.90 Claims Paid in H1 of 2026

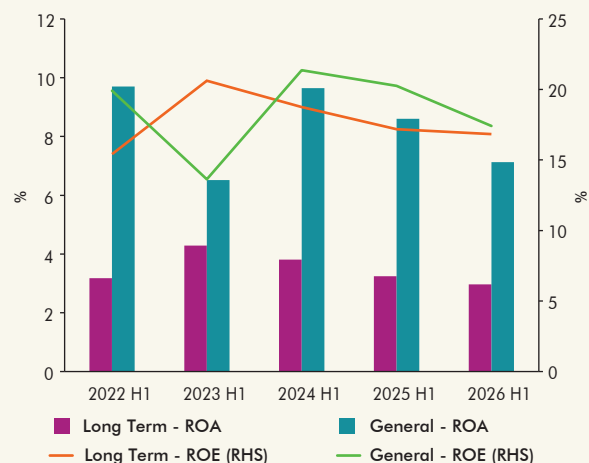


Source: Insurance Regulatory Commission of Sri Lanka

at end H1 of 2026, equivalent to 152.9% of total general insurance claims paid during H1 of 2026. Of these, 44.5% had been paid, while 49.5% remained outstanding, where non-motor claims accounted for 97.2% of outstanding claims by value. Accordingly, the settlement of these claims could exert certain pressure on the underwriting performance, liquidity, and capital positions of general insurers.

The profitability of the sector moderated during H1 of 2026, with general insurance subsector recording a comparatively sharper decline. The return on assets (ROA) of general insurance subsector declined to 7.1% in H1 of 2026 from 8.6% in H1 of 2025, while its return on equity (ROE)

Figure 3.92 Return on Assets and Return on Equity

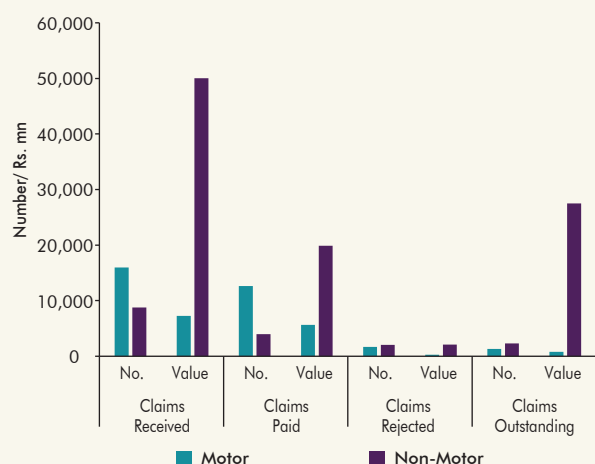


Source: Insurance Regulatory Commission of Sri Lanka

decreased to 17.4% from 20.2% during the same period. Nevertheless, general insurers continued to report higher profitability than long term insurers. Meanwhile, ROA and ROE of long term insurance subsector declined marginally to 3.0% and 16.8%, respectively, in H1 of 2026 from 3.2% and 17.2%, respectively, in H1 of 2025. The continued moderation in profitability, particularly among general insurers, raises concerns amid the potential pressure on underwriting performance arising from Cyclone Ditwah related claims.

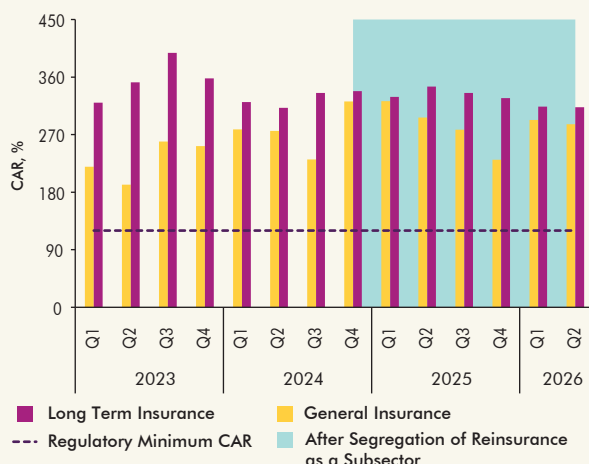
The capital adequacy ratios (CAR) of both insurance subsectors continued to remain well above the regulatory thresholds, despite

Figure 3.91 Claims related to Cyclone Ditwah by Category and Status at end H1 of 2026



Source: Insurance Regulatory Commission of Sri Lanka

Figure 3.93 Capital Adequacy Ratio



Source: Insurance Regulatory Commission of Sri Lanka

Special Note 3

Artificial Intelligence Adoption in Sri Lanka's Banking Sector

Artificial Intelligence (AI) is being adopted across the global financial services industry at a pace that has drawn sustained supervisory attention. AI is elevating cyber risk from an operational concern to a core financial stability issue, principally through the scale effects it unleashes across shared technologies.¹ Against this background, the Central Bank surveyed all Licensed Banks (LBs) in Sri Lanka in November 2025 on AI adoption, governance, risk management, data readiness and strategic priorities.² However, as AI is rapidly evolving, current status could be slightly different. This Special Note summarizes the key findings³ and examines the emerging risks with potential systemic implications with particular emphasis on cyber security resilience of LBs.

Current State of AI Adoption in LBs

In total, 69% of LBs have commenced some form of AI activity, although the depth of adoption remains shallow. No AI usage and no immediate plans were reported by 31% of LBs, while 21% were at exploratory or feasibility stage and 17% had pilot projects under development. Further, 31% have moved to live deployment, 10% in limited areas, 17% across multiple functions and 4% with extensive integration. No bank reported an AI-first operational model.

Prevailing use cases cluster around fraud and anti-money laundering monitoring, credit scoring, customer facing chatbots, document processing and internal productivity applications. Faster service delivery, round-the-clock availability and lower service costs were identified as the principal customer benefits, while clear disclosure of AI usage was the most cited trust building measure. Generative AI applications are emerging in customer service and internal knowledge management.

Governance and Risk Management Practices

AI governance structures are still in the early stages of forming. 23% of LBs manage AI through integration with existing risk committees and an equal share through cross functional working groups, while 8% have established a board level AI oversight committee and 15% a senior management AI steering committee. AI governance arrangements are yet to be formed in 17% of LBs.

Risk assessment practices display a comparable skew. Banks concentrate on technology, operational, compliance and model risk, while credit, market and liquidity risk receive less attention. AI is presently treated as a technological deployment matter rather than a driver of financial risk.

Third Party Dependence and Concentration

62% of LBs reported partnerships with a small group of international technology companies. Engagement with local technology firms (24%), regional fintech companies and open source solutions (21% each) and system integrators and AI consultancies (17% each) is substantially lower.

Due diligence on AI service providers and data security requirements in contracts stand at 17%, service level agreements at 16%, exit strategies and data portability clauses at 14%, board approval for AI outsourcing and vendor business continuity arrangements at 13%, and the right to audit vendor operations at only 10%. Narrow provider concentration combined with contractual controls that need strengthening is the most consequential finding of the survey.

Implications for Cyber Security Resilience and Financial Stability

Cyber security and risk concerns ranked among the three most cited adoption challenges (15% of responses), alongside limited local AI talent (17%) and high implementation costs (15%). The concern is well founded.

Figure 1 Current AI Implementation Status

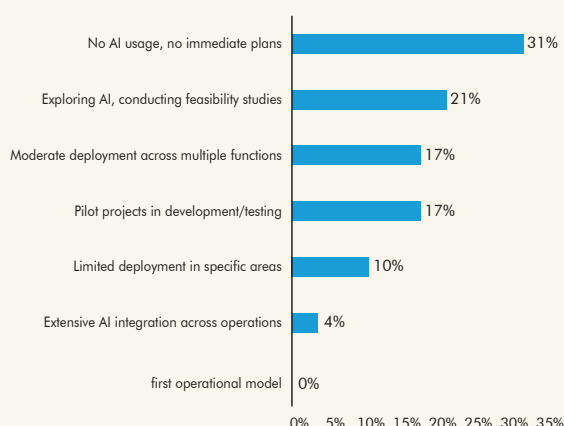


Figure 2 AI Governance Framework

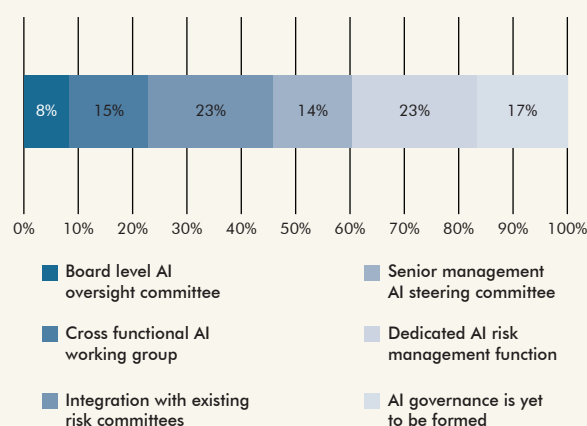
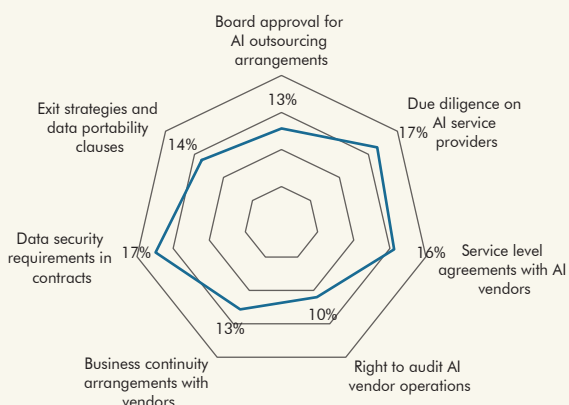


Figure 3 Outsourcing and Third Party Risk Management



The principal systemic risk arises not from novel attack techniques but from the speed, frequency and breadth with which AI allows vulnerabilities to be discovered and exploited across widely used technologies. Industry data indicate that activity by AI enabled adversaries rose by 89% between 2024 and 2025, while the average time taken by attackers to move laterally within a compromised network fell by 65% to 29 minutes.⁴ The window for detection and containment is narrowing towards machine speed.

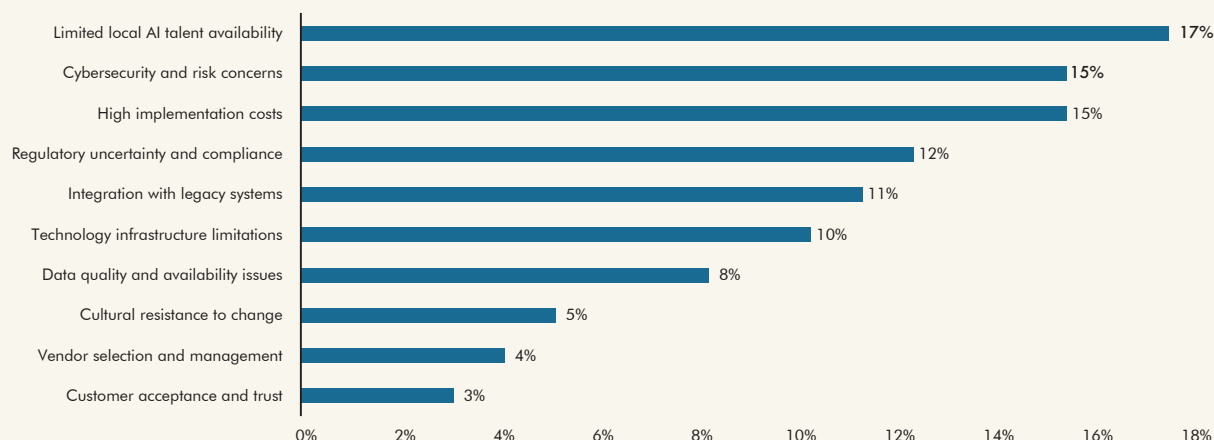
These dynamics bear directly on LBs. AI lowers the cost and raises the impact of attacks on banks and their customers. Generative models enable phishing and business email compromise in fluent Sinhala, Tamil and English at scale, while synthetic voice and video permit impersonation of customers and senior officers, threatening remote onboarding, video based customer identification and payment authorization controls. In this context, an emerging risk can be observed in relation to fraud typologies in domestic retail payment channels.

Adoption also expands the attack surface. Model endpoints, application programming interfaces, training data repositories and vector databases sit outside conventional perimeter controls, and attack vectors specific to AI systems, such as prompt injections, training data poisoning and model inversion are not addressed by existing control baselines. Unsanctioned staff use of public generative AI tools creates a further channel for confidential data to leave the bank's control boundary.

Most consequentially for financial stability, AI concentrates exposure. Where banks rely on the same limited set of cloud and model providers, a compromise or outage at a single provider ceases to be idiosyncratic and becomes a common mode failure across institutions. Emerging markets and developing economies are disproportionately exposed, sharing the same global digital infrastructure as advanced economies, but with fewer defensive resources, more limited supervisory capacity and greater reliance on smaller vendors whose patching cycles are longer, extending the window during which known vulnerabilities remain open. For Sri Lanka, this is the operative warning.

Offsetting these exposures, AI strengthens defensive capability through anomaly detection, behavioral analytics and automated triage. The supervisory expectation is therefore symmetrical that banks investing in AI for revenue generating functions are expected to invest commensurately in machine speed defense. Prevention alone is no longer sufficient. Segmentation, zero trust architecture, disciplined access control and secure by design practices that limit the blast radius of a breach and constrain lateral movement are now central to resilience.

Figure 4 Major Challenges Faced in AI Adoption



Supervisory Approach and Way Forward

The existing regulatory framework provides substantial coverage.

- Banking Act Directions No. 16 of 2021 on Technology Risk Management and Resilience set requirements for governance, information security, third party risk and business continuity.
- Banking Act Directions No. 01 of 2026 on Outsourcing of Business Operations of LBs effective 01 January 2027, strengthen board accountability, due diligence, audit rights and exit planning for outsourced and cloud based arrangements.
- Circular No. 02 of 2025 requires reporting of information technology and cyber security incidents.
- Personal Data Protection Act, No. 09 of 2022, governs personal data used in model development.

Banks identified regulatory certainty, cloud and infrastructure support and capacity building as their principal requirements. The Central Bank is in the process of issuing guidance on the safe and responsible adoption of AI, covering board accountability, model inventories and lifecycle validation, human oversight of consequential decisions and explainability. Consistent with international recommendations, supervisory work will extend to identifying critical AI and cloud dependencies and assessing their

substitutability, incorporating AI enabled threat scenarios into cyber simulation exercises and extending examinations to the AI control environment.

Conclusion

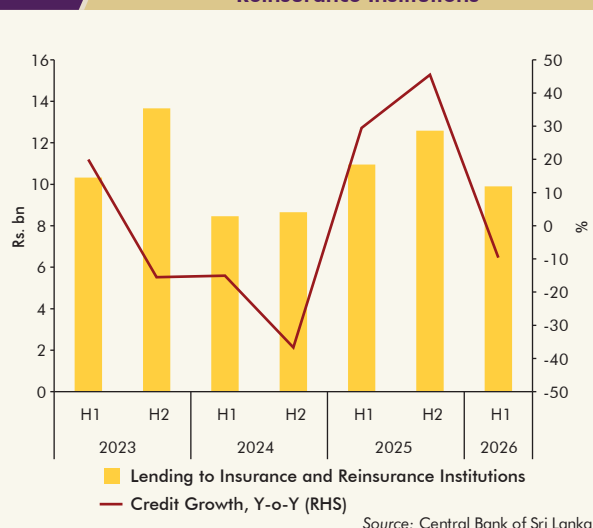
AI adoption in the Sri Lankan banking sector is broad in intent, and more work is required on execution and governance and third party controls. The window in which supervisory expectations can be set ahead of scale therefore remains open. Cyber security resilience is the binding constraint that the same technology that improves detection also equips adversaries and concentrates dependence upon a small number of external providers. Strengthening board oversight, contractual control over AI service providers, investments in infrastructure, incident reporting discipline and resilience testing calibrated to AI specific threats will be essential to ensure that AI adoption enhances financial system stability.

- 1 Adrian, T., T. Gaidosch, M. Moretti, M. Qureshi and R. Ravikumar (2026), Artificial Intelligence and Cybersecurity in the Financial Sector, IMF Note 2026/005, June; Financial Stability Board, The Financial Stability Implications of Artificial Intelligence (November 2024); Monetary Authority of Singapore, Artificial Intelligence Model Risk Management: Observations from a Thematic Review (December 2024); and Reserve Bank of India, FREE-AI Committee Report (August 2025).
- 2 The survey was circulated to the Chief Executive Officers of all LBs and covered implementation status, use cases, governance, risk management, data readiness, vendor arrangements, customer impact and future strategic priorities. Percentages are expressed as a share of the 29 LBs unless otherwise stated.
- 3 Findings discussed in this note are derived from survey responses and do not necessarily convey the views of the Central Bank.
- 4 CrowdStrike (2026), Global Threat Report, as cited in IMF Note 2026/005. Breakout time measures the interval between initial compromise and lateral movement within the network.

recording slight declines during the period under review. The CAR of the general insurance subsector slightly declined to 286.2% at end Q2 of 2026 from 296.6% at end Q2 of 2025, whilst CAR of the long

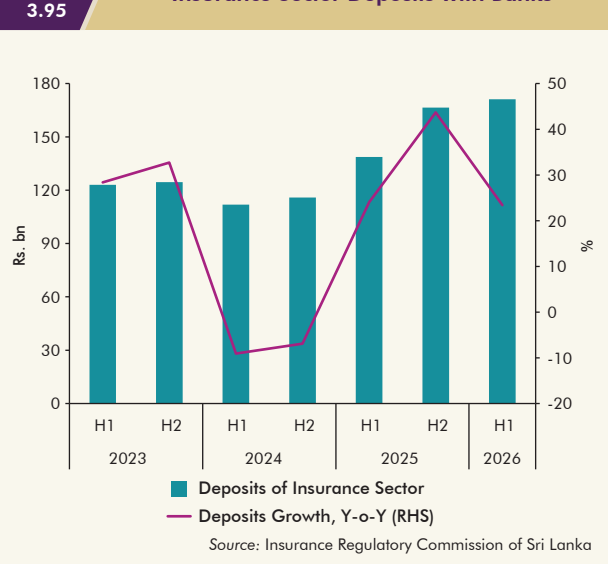
term insurance sub sector also declined to 313.1% at end Q2 of 2026 from 344.9% at end Q2 of 2025. However, CARs of both sectors continued to surpass the regulatory minimum CAR requirement of 120.0%.

Figure 3.94 Banking Sector Lending to Insurance and Reinsurance Institutions



Interconnectedness between the banking and insurance sectors remained primarily driven by insurers' placements with banks at end H1 of 2026. Deposits maintained by the insurance sector with banks increased by 23.4% y-o-y to Rs. 171.2 bn at end H1 of 2026. In contrast, bank lending to insurance and reinsurance institutions declined by 9.6% y-o-y to Rs. 9.9bn. Accordingly, insurers remained net providers of funds to the banking sector, while banks' direct credit exposure to insurers remained comparatively limited. However, during the period under review, Cyclone Ditwah demonstrated how climate risk could interact with cross sector interconnectedness. Large claims related to catastrophes may require insurers

Figure 3.95 Insurance Sector Deposits with Banks



to utilise cash and bank deposits, while awaiting for reinsurance recoveries. The decline in insurance sector's deposits growth at end H1 of 2026 could be partly attributable to this higher liquidity utilisation by insurance companies.

3.4 Cyber Risks and Operational Resilience of Financial Institutions

As digitalisation continues to accelerate across Sri Lanka's financial system, strengthening operational and cybersecurity resilience remains important for safeguarding the overall financial system stability. Financial institutions have continued to expand digital financial services and payment channels, improving accessibility, efficiency and convenience of financial services. However, increased digitalisation, greater interconnectedness and growing reliance on technology and third party service providers may also broaden the financial system's exposure to cyber and operational risks. A significant cyber incident affecting a systemically important institution or critical financial market infrastructure could disrupt the provision of essential financial services, impair payment and settlement activities, and potentially undermine confidence in the financial system.

In response to the evolving cyber threat landscape, including cyberattacks, ransomware, phishing, social engineering, and third party

Figure 3.96 Overview of Cyber Risks in Sri Lankan Financial System Stability



vulnerabilities, the Central Bank strengthened its cyber resilience oversight framework across the financial sector. Regulatory and supervisory initiatives focused on strengthening cyber risk governance, enhancing incident reporting, modernising critical systems, strengthening oversight of third party service providers, and promoting regular cyber resilience and business continuity and disaster recovery arrangements. These measures aim to improve the preparedness and operational resilience of the financial system, mitigate emerging digitalisation related risks, and support the stability of the financial system.

Incidents reported to the regulator indicate that digital scams and phishing accounted for the majority. While most incidents did not result in a direct business impact, potential reputational consequences, particularly the erosion of customer trust and confidence, remain key concerns. Meanwhile, reported system outages and interruptions also underscore the importance of maintaining the availability and operational resilience of critical digital financial services.

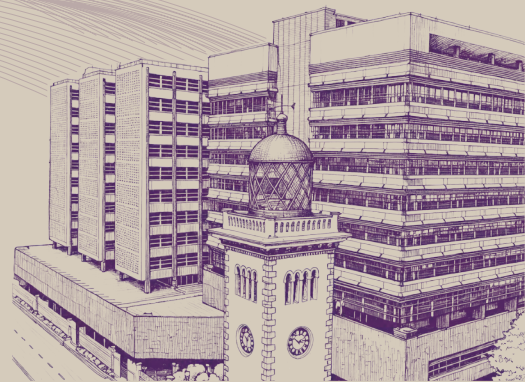
Amid the rising prevalence of online banking fraud, phishing attacks, social engineering schemes, and fraudulent investment activities, authorities and industry stakeholders strengthened fraud prevention and consumer protection measures.

Efforts focused on enhancing transaction security through advanced authentication mechanisms, fostering collaboration with telecommunications providers to detect and prevent emerging fraud risks, improving customer safeguards through rapid fraud response mechanisms, and promoting secure access to digital financial services. These initiatives aim to strengthen public trust in digital financial services and support the safe adoption of digital payment channels.

Going forward, the increasing interconnectedness of financial institutions, payment systems, technology providers and other critical service providers warrants continued vigilance. Strengthening system-wide cyber resilience, information sharing arrangements, third party risk management and coordinated incident response will remain important to contain potential contagion from operational disruptions and safeguard the continuity of critical financial services.

Chapter 4

Household and Corporate Sectors



The Household and Corporate sectors¹ play a central role in the financial system through their close linkages with financial institutions and their contribution to economic activity. Households support consumption and savings, while corporates drive production, investment and employment. As major borrowers from the financial system, their financial positions and capacity to service debt directly influence the asset quality and profitability of financial institutions. Adverse developments in household income and corporate earnings can increase credit losses and constrain lending, with broader implications for economic activity. Accordingly, assessing vulnerabilities in these sectors is important for the early identification of risks to financial system stability.

Credit extended to the Household² and Institutional³ sectors continued to expand strongly during H1 of 2026, reflecting robust credit demand supported by improving economic activity. Household sector credit growth remained elevated, although the pace of expansion moderated slightly during Q2 of 2026 following a sustained acceleration over the previous two years. Institutional sector credit also recorded robust growth, supported primarily by bank lending. Although the expansion in credit strengthens financial intermediation, it underscores the need for continued monitoring of the pace, composition and quality of credit. Meanwhile, the risk profile of Household sector borrowers improved further in H1 of 2026, with the majority of borrowers remaining within lower risk categories. Institutional sector borrowers also exhibited a broadly sound credit risk profile, with exposures remaining largely concentrated in lower risk categories. Nevertheless, borrower risk profiles in the Non-Bank Financial Institution (NBFI) sector continued to be relatively weaker compared to the banking sector, warranting continued monitoring from a financial stability perspective. Looking ahead, tighter monetary conditions and the recently introduced Loan to Value (LTV)⁴ measures are expected to moderate credit growth gradually, particularly in the Household sector. Nonetheless, recent improvements recorded in repayment performance and borrower credit quality may provide some support to the resilience of both sectors.

Listed Non-Financial Corporates (NFCs), recorded stronger business activity during H1 of 2026, supported by broad based revenue growth across most sectors. The improvement in revenue was driven mainly by the Automobile, Power and Energy, and Manufacturing sectors, reflecting favourable sector specific developments and improved business conditions. Despite the increase in revenue, overall net profit recorded a decline during H1 of 2026 compared to previous year. However, underlying profitability conditions among NFCs showed signs of improvement, as reflected in increased median net profit and profit growth among a majority of firms. The decline in overall profitability has been driven primarily by few corporates. Consequently, key profitability indicators weakened, and the overall debt servicing capacity of listed NFCs moderated, with the aggregate Interest Coverage Ratio (ICR) declining during the period. However, leverage conditions improved modestly and the aggregate ICR remained comfortably above one, indicating that listed NFCs continued to generate sufficient profits to meet their interest obligations on average. Overall, the listed NFC sector remained resilient despite mixed profitability trends. Most firms maintained healthy debt servicing capacity, limiting overall credit risk to the financial institutions.

¹ Data presented in this chapter is based on information obtained from the Credit Information Bureau (CRIB) and the Colombo Stock Exchange (CSE). Thus, the data reported in this chapter is not directly comparable with Chapter 3, which is based on FinNet data, a system through which financial institutions report financial information to the Central Bank.

² The Household sector debt presented in this analysis, based on aggregate credit data obtained from CRIB, comprises loans and advances obtained by individuals identified through their National Identity Card or Passport number, and may also include borrowings by individuals for business activities undertaken through household-owned unincorporated enterprises, including certain Micro, Small, and Medium Enterprises (MSMEs).

³ The Institutional sector debt includes loans and advances obtained by institutions which are registered as business entities and accommodations to State Owned Business Enterprises (SOBEs) and the Government.

⁴ Further details on LTV are available in Chapter 5.

4.1. Risk Assessment of Household and Institutional Sectors

This section assesses potential financial vulnerabilities in the Household and Institutional sectors, based on aggregate credit data⁵ obtained from the Credit Information Bureau (CRIB).

Risk Assessment of Household Sector Credit

Credit extended to the Household sector continued to record a notable growth during H1 of 2026, although the pace of growth moderated slightly during Q2 of 2026. Household sector credit, which accounted for 41.8% of total formal financial sector lending⁶, recorded a growth of 25.4% y-o-y at end Q2 of 2026, considerably higher than the growth of 14.8% y-o-y recorded at end Q2 of 2025. Following a sustained acceleration in Household sector credit growth over the past two years, the y-o-y growth rate eased from 28.0% at end Q1 of 2026 to 25.4% at end Q2 of 2026. Nevertheless, credit growth remained elevated. The continued expansion in household credit was supported by lending from both banks and Non-Bank Financial Institutions (NBFIs).⁷ The

Banking sector remained the principal source of household credit, accounting for 62.5% of the total outstanding amount at end Q2 of 2026. The share of credit provided by NBFIs increased relative to the previous year, reflecting their growing contribution to Household sector lending. Looking ahead, tighter monetary conditions and macroprudential policy through the implementation of more stringent Loan to Value (LTV) requirements on motor vehicle financing and gold backed lending⁸ are expected to contribute to a gradual moderation in Household sector credit growth. Nevertheless, given the high expansion in household credit, with y-o-y growth exceeding 20% in each of the past four quarters, close monitoring of household indebtedness and debt servicing capacity remains important from a financial stability perspective.

Household sector indebtedness increased alongside the sustained expansion in household credit, although it remained below its historical average.⁹ The Household sector credit-to-GDP¹⁰ ratio, a broad indication of household indebtedness, continued its upward trend observed since mid-2024.

5 For comparability purposes, pawning advances/gold-backed loans and off-balance-sheet exposures, including bank guarantees and letters of credit, were excluded from the analysis. However, CRIB data includes unearned interest associated with leasing portfolios and may also contain written-off loans of individual customers.

6 Formal financial sector lending includes lending by licensed banks, finance companies, and a specialised leasing company.

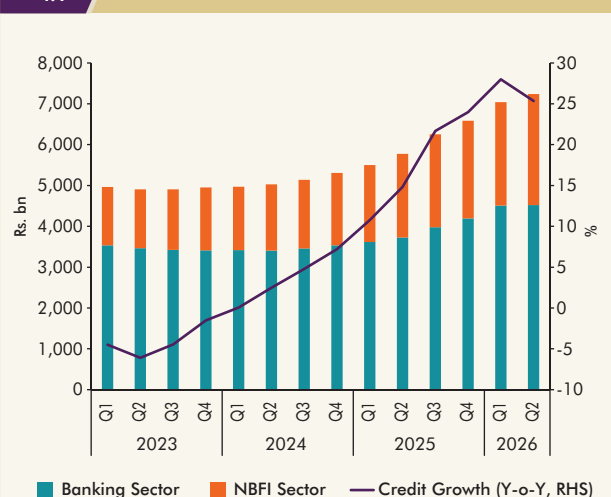
7 NBFIs include finance companies and a specialised leasing company. The registration of this leasing company was cancelled in June 2026.

8 Although tighter LTV requirements on gold-backed lending are expected to contribute to a moderation in household credit growth, gold-backed loans are not covered in the present analysis, as CRIB is still in the process of incorporating pawning data into its database and such data are not yet consistently reported by all financial institutions.

9 The arithmetic average since Q1 of 2021 is used as the historical average of the Credit-to-GDP.

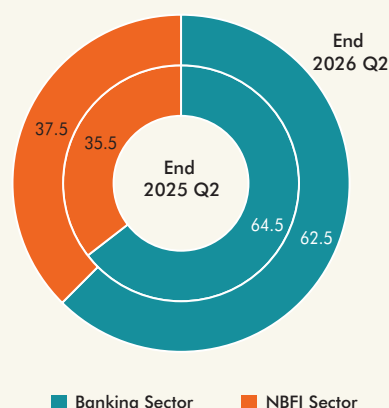
10 The Household sector Credit-to-GDP ratio is computed by dividing outstanding loans to households by the sum of nominal GDP over the last four consecutive quarters.

Figure 4.1 Household Sector Credit



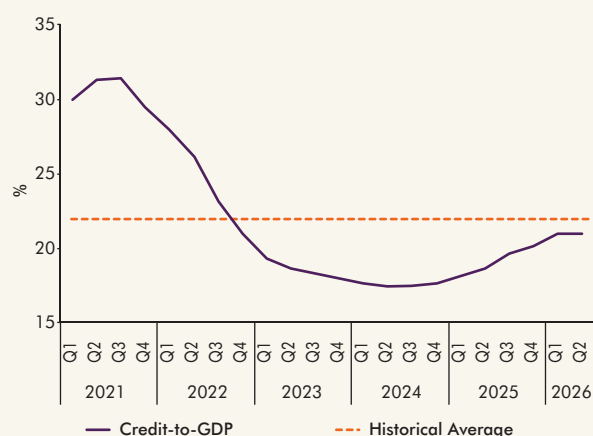
Source: Credit Information Bureau of Sri Lanka

Figure 4.2 Composition of Household Sector Credit (%)



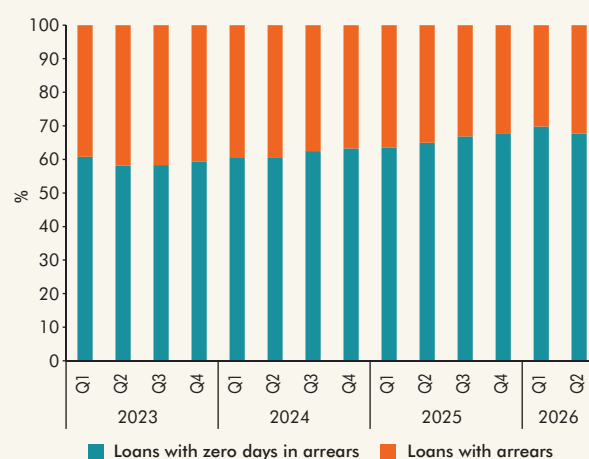
Source: Credit Information Bureau of Sri Lanka

Figure 4.3 Household Sector Credit-to-GDP



Sources: Credit Information Bureau of Sri Lanka
Department of Census and Statistics

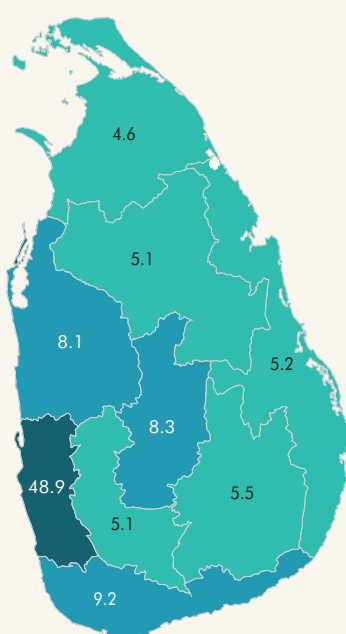
Figure 4.5 Household Sector Credit Quality



Source: Credit Information Bureau of Sri Lanka

Household credit remained geographically concentrated in the Western Province. The Western Province continued to account for nearly half of total Household sector credit and recorded the highest household credit per capita among all provinces. The remaining credit was distributed across the other provinces, with the Northern Province accounting for the lowest share. This geographical pattern has remained broadly unchanged over the years.

Figure 4.4 Geographical Distribution of Household Sector Loans by end June 2026 (%)



Source: Credit Information Bureau of Sri Lanka

Therefore, a continuous geographical concentration may affect the financial inclusion and income level of households in other provinces.

Loan Repayment of the Household sector improved further during H1 of 2026, amidst continued expansion in household lending. Loans with zero days in arrears continued to account for the majority of total Household sector credit exposures, with the share increasing to 67.7% at end Q2 of 2026 from 65.0% a year earlier. In correspondence, the share of loans with arrears declined, reflecting improved repayment performance across both the banking and NBFIs sectors. These developments in repayment behaviour indicate that the continued expansion in Household sector credit has not, thus far, resulted in a broad based deterioration in overall borrower repayment capacity.

Borrower creditworthiness in the Household sector, as measured by the weighted average CRIB score¹¹ of borrowers, improved further during H1 of 2026, although overall borrower profile remained in the high risk category.

¹¹ CRIB score is credit rating computed by the CRIB which is used to score borrowers based on different parameters such as credit history. The score ranges from 250 to 900. Borrowers with credit scores in the range of 250-500 are considered as very high risk, 500-550 are considered high risk, 550-580 are considered average risk, 580-610 are considered low risk and 610-900 are considered very low risk. A weighted average CRIB score is computed by CBSL based on the number of borrowers in each risk category and average credit score of each risk category received from CRIB.

Figure 4.6 Average Credit Score of the Household Sector Borrowers

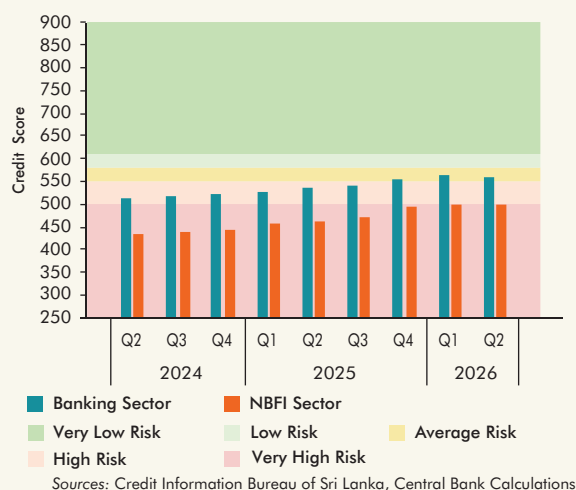
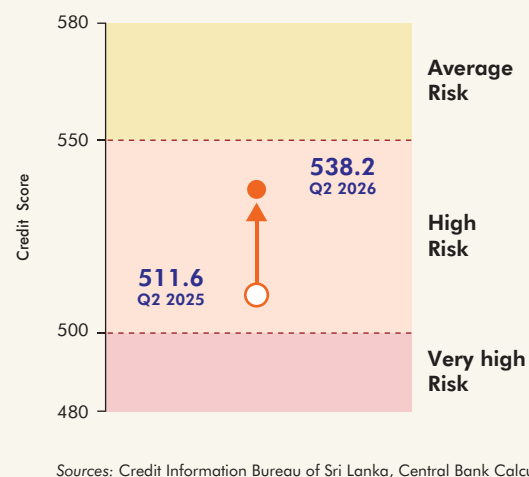


Figure 4.7 Overall Weighted Average CRIB Score



The weighted average CRIB score increased to 538.2 during Q2 of 2026 from 511.6 recorded in the corresponding quarter of the previous year. The increase in average scores indicates a gradual improvement in the creditworthiness of Household sector borrowers. Borrowers within the Banking sector continued to exhibit comparatively stronger credit profiles, with the average CRIB score increasing to 557.2 by end Q2 of 2026, placing the sector within the average risk category. In contrast, borrowers of the NBF sector recorded a lower average score of 497.4, remaining within the very high risk category despite the continued improvement during recent quarters. Moreover, the average credit scores across

the risk segments generally improved, indicating a broad based improvement in household borrower creditworthiness. Weighted average CRIB scores increased across all risk categories except the average risk category between Q2 of 2025 and Q2 of 2026. Overall, these movements indicate a general improvement in borrower credit profiles across the risk spectrum.

The distribution of Household sector borrowers across credit risk categories continued to reveal distinct differences between banking and NBF sectors. The majority of Household sector borrowers within the banking sector were concentrated in the

Figure 4.8 Credit Score Movement – Q2 of 2025 Vs Q2 of 2026

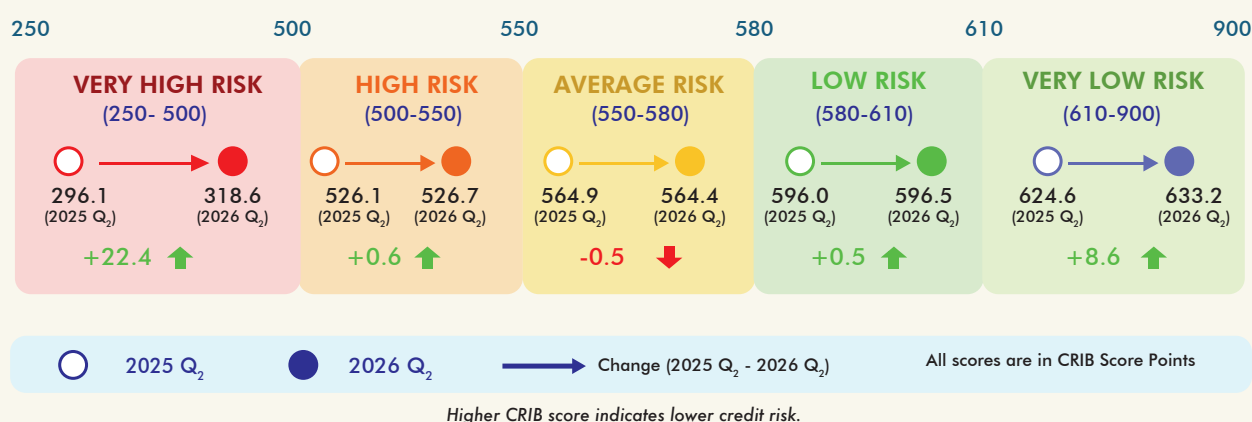
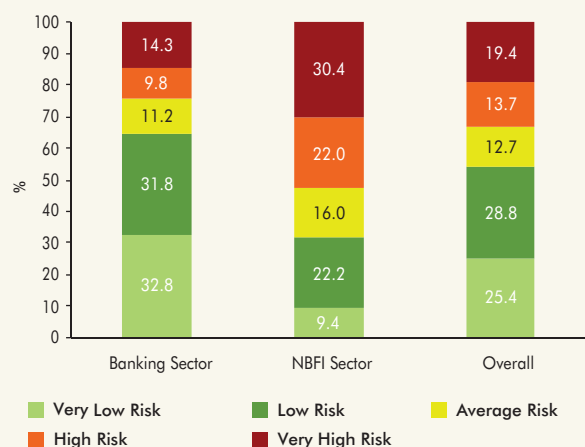


Figure 4.9 Credit Risk Distribution of Household Borrowers by end June 2026



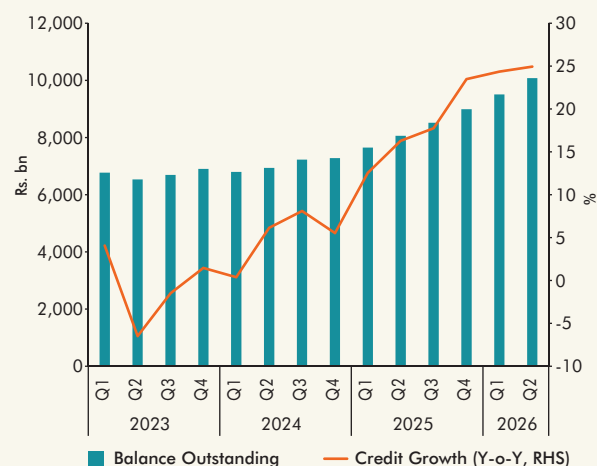
Source: Credit Information Bureau of Sri Lanka

low and very low risk categories based on their CRIB scores, indicating a comparatively stronger borrower credit profile. However, 24.1% of borrowers within the banking sector remained within the high and very high risk categories, highlighting the presence of a notable segment with relatively weaker credit scores. In contrast, the NBFI sector continued to exhibit a comparatively riskier borrower profile, where 52.4% of the borrowers concentrated within the high and very high risk categories, while only 31.6% of borrowers were classified within the low and very low risk categories. Overall, observed distribution of Household sector borrowers across risk categories remained broadly stable. Nevertheless, the relatively larger share of higher risk in the NBFI sector remains an area warranting continued attention from a financial stability perspective.

Risk Assessment of Institutional Sector Credit

Credit extended to the Institutional sector continued to expand at a notable pace during H1 of 2026. Institutional sector credit, which accounted for 58.2% of total financial sector lending, grew by 24.9% y-o-y at end Q2 of 2026, compared to the growth of 16.3% y-o-y recorded in the corresponding period of the previous year. Banks continued to dominate Institutional sector lending, accounting

Figure 4.10 Institutional Sector Credit

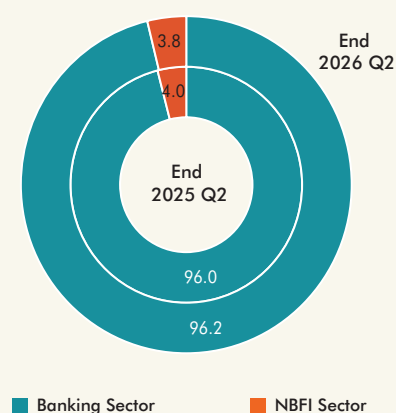


Source: Credit Information Bureau of Sri Lanka

for 96.2% of total outstanding credit at end Q2 of 2026, while NBFIs accounted for only a marginal share.

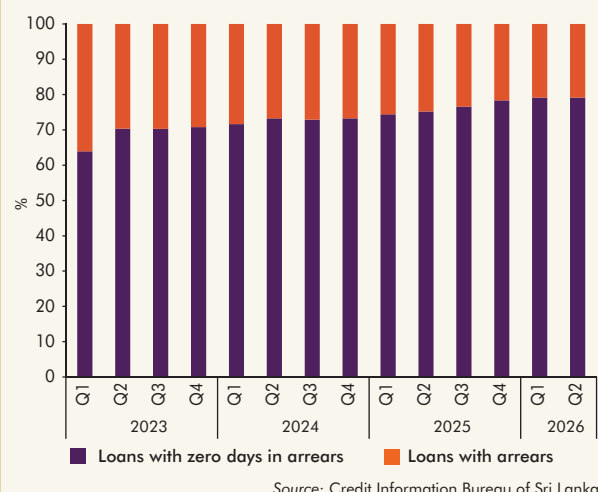
Loan repayment within the Institutional sector improved further during H1 of 2026, despite the continued expansion in lending. The share of loans classified as zero days in arrears increasing to 79.2% at end Q2 of 2026 from 75.2% a year earlier while the share of loans with arrears declined during the corresponding period. These developments suggest that the continued expansion in Institutional sector credit has not been associated with a broad based weakening in borrower credit quality.

Figure 4.11 Composition of Institutional Sector Credit (%)



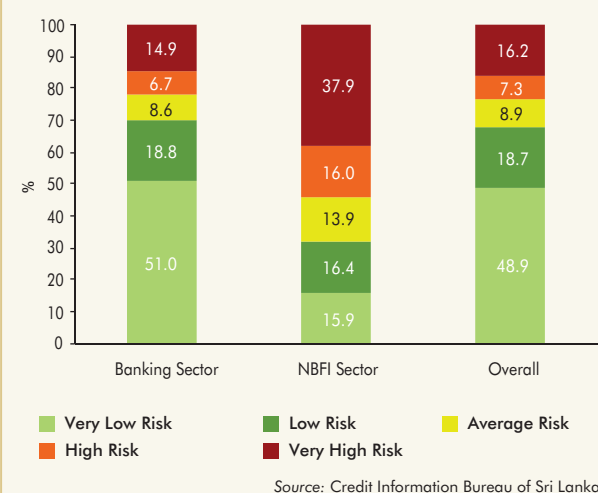
Source: Credit Information Bureau of Sri Lanka

Figure 4.12 Institutional Sector Credit Quality



Institutional sector borrowers in the banking sector had a better credit risk profile compared to the NBFi sector. Institutional borrowers in the banking sector were primarily classified under the low and very low risk categories, while 21.6% were classified under the high and very high risk categories. In contrast, 53.9% of NBFi sector borrowers were concentrated in the high and very high risk categories, with only 32.3% falling within the low and very low risk categories. Overall, 67.6% of Institutional sector borrowers were classified under the low and very low risk categories, indicating a generally sound borrower risk profile.

Figure 4.13 Credit Risk Distribution of Institutional Borrowers by end June 2026



4.2. Risk Assessment of Listed Non-Financial Corporates

This section assesses the risks and potential vulnerabilities arising from the Non-Financial Corporate (NFC) sector and their implications for financial stability. The assessment is based on the financial performance of 204 companies listed in the Colombo Stock Exchange (CSE) as at end June 2026. Listed companies are used as a proxy for the broader NFC sector, providing insights into emerging risks and vulnerabilities of the sector and their potential transmission to the financial system.

Financial Performance of Listed NFCs during H1 of 2026

The listed NFC sector recorded a notable improvement in revenue during H1 of 2026, indicating stronger business activity. Revenue of listed NFCs expanded by 22.0% y-o-y during H1 of 2026, compared with 7.6% y-o-y growth recorded in the corresponding period of the previous year. Further, the proportion of NFCs reporting a growth in revenue also increased to 67.2% during H1 of 2026 from 59.8% recorded in the corresponding period of the previous year, indicating that the improvement in revenue remained relatively broad based across the sector supported by continued expansion of business activities.

Figure 4.14 Revenue and Growth in Revenue in NFCs

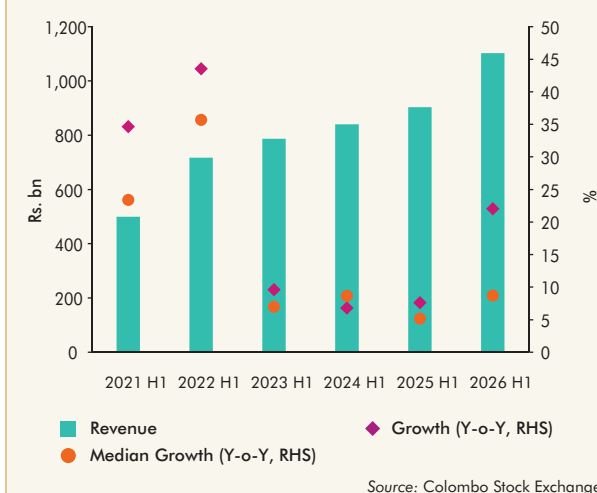
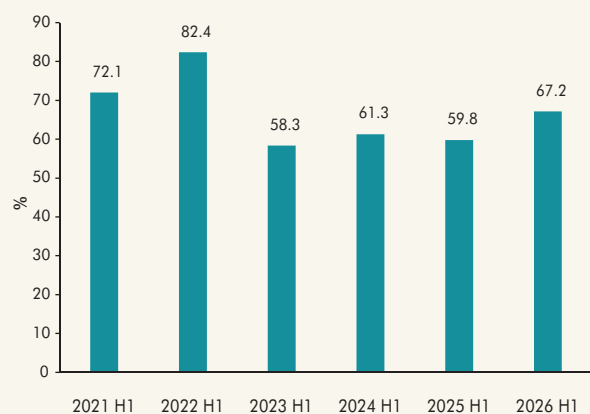


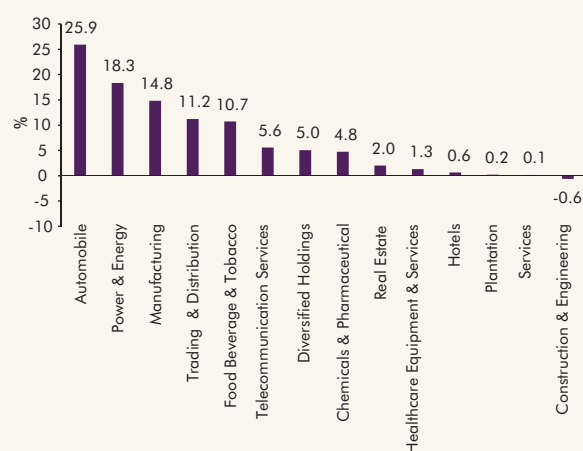
Figure 4.15 Share of NFCs that Reported an Increase in Revenue



Source: Colombo Stock Exchange

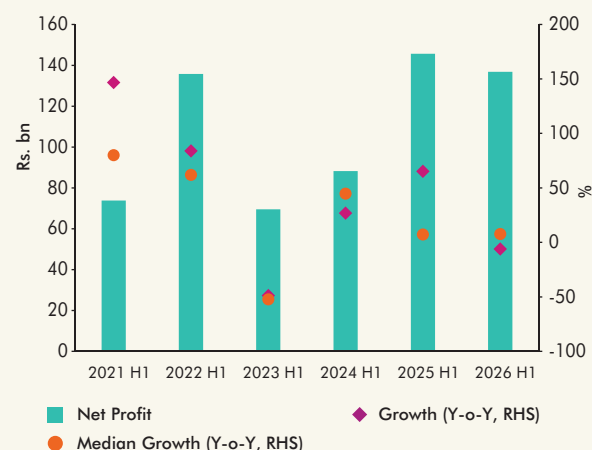
Revenue growth during H1 of 2026 was primarily driven by the Automobile, Power and Energy and Manufacturing sectors. The Automobile sector made the largest contribution to overall revenue growth, recording the highest y-o-y growth of 138.9%, supported by the expansion in vehicle related business activity following the relaxation of import restrictions. The Power and Energy sector also significantly contributed to the revenue, reflecting the increased energy prices amid heightened geopolitical tensions. Meanwhile, all other sectors excluding Construction and Engineering, contributed positively to overall revenue growth during the period under review, thereby supporting the notable increase in revenue recorded by the listed NFC sector.

Figure 4.16 Sectoral Contribution to Growth in Revenue



Source: Colombo Stock Exchange

Figure 4.17 Net Profit and Growth in Net Profit in NFCs

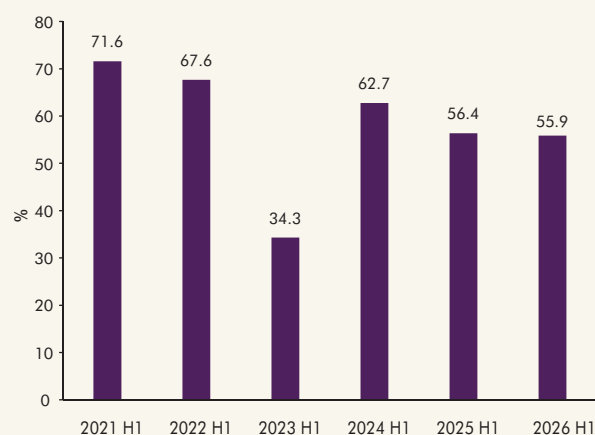


Source: Colombo Stock Exchange

While aggregate profitability weakened during H1 of 2026, median net profit growth improved modestly, highlighting a favourable shift in profit performance among listed NFCs. Aggregate net profit declined by 6.1% y-o-y during H1 of 2026 as against the 65.2%¹² y-o-y growth recorded in the corresponding period of 2025. The share of NFCs reporting an increase in net profit declined marginally to 55.9% from 56.4% a year earlier. Nevertheless, majority of the NFCs recorded a growth in net profit. However, the overall decline in aggregate net

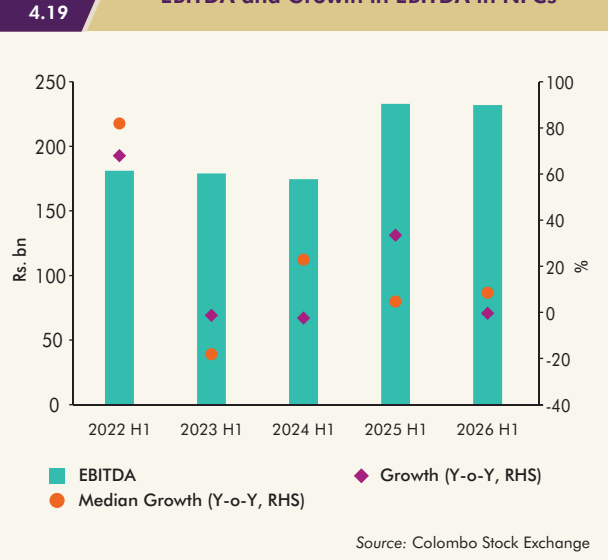
¹² During H1 of 2025, the notable increase in net profit was primarily driven by a one-off gain recorded by a large corporate in the Diversified Holdings sector.

Figure 4.18 Share of NFCs that Reported an Increase in Net Profit



Source: Colombo Stock Exchange

Figure 4.19 EBITDA and Growth in EBITDA in NFCs

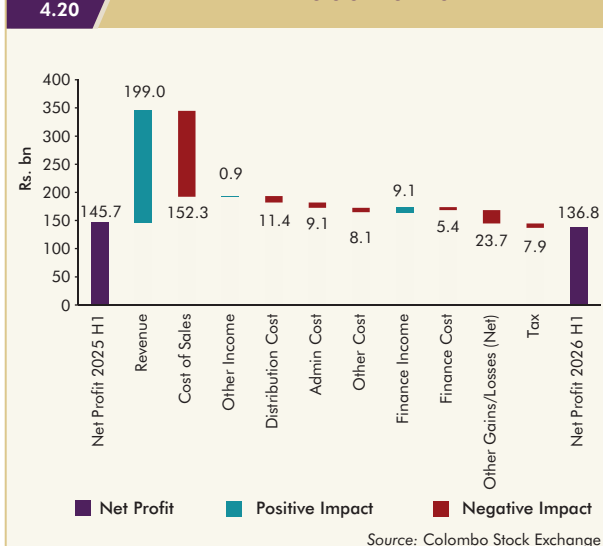


profit suggests that the profit contractions recorded by several large corporates outweighed the profit improvements observed among many other NFCs.

Operating profitability declined marginally in H1 of 2026. Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) declined marginally by 0.4% y-o-y during H1 of 2026, reversing the 33.4% y-o-y growth recorded in the corresponding period of the previous year. Despite this marginal decline, median EBITDA growth remained positive during H1 of 2026, indicating that the decline in aggregate operating profitability was not broad based across listed NFCs. Although the moderation in operating profitability was not widespread across NFCs, persistent earnings pressures among vulnerable corporates could weaken their debt servicing capacity and contribute to higher credit risk in the financial sector.

Higher cost of sales and operating expenses were the main contributors to the decline in net profit during H1 of 2026. Although revenue growth had a positive impact of Rs. 199.0 billion on profitability, this was largely offset by a Rs. 152.3 billion increase in the cost of sales. Higher distribution, administrative and other operating costs further reduced net profit by a combined Rs. 52.3 billion. Meanwhile, the positive contributions from finance income and other income were insufficient to offset the adverse effects of higher operating expenses, finance costs and

Figure 4.20 Drivers of Net Profit



taxes. Consequently, aggregate net profit declined to Rs. 136.8 billion in H1 of 2026 from Rs. 145.7 billion in H1 of 2025.

Profitability remained uneven across NFCs with aggregate profitability indicators somewhat weakening during H1 of 2026. Net profit margin and return on equity declined notably during H1 of 2026, while gross profit margin and return on assets also moderated. Meanwhile, finance costs as a share of average debt increased slightly in both aggregate and median terms, amid the rise in market interest rates. The simultaneous weakening of profitability and increase in borrowing costs could further constrain the debt servicing capacity of financially vulnerable NFCs.

Figure 4.21 Profitability Indicators

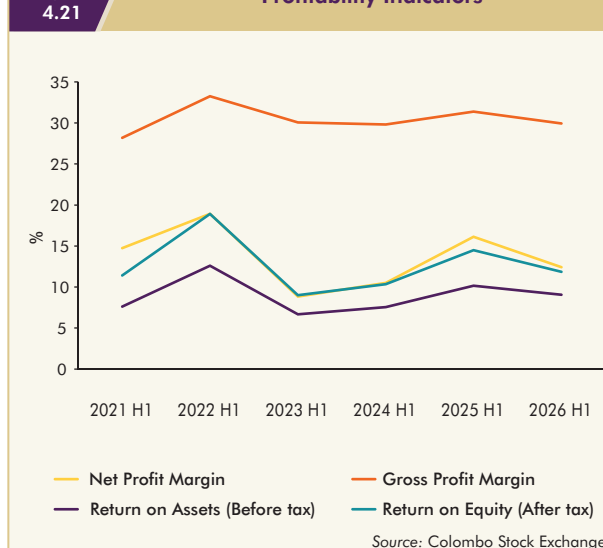


Figure 4.22 Interest Expenses as a Percentage of Average Debt

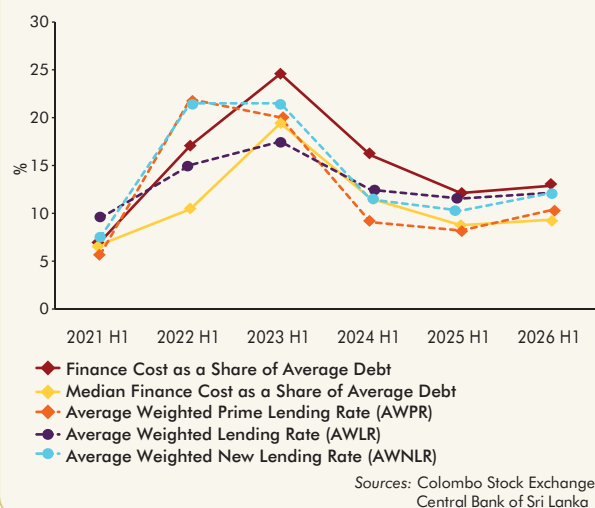
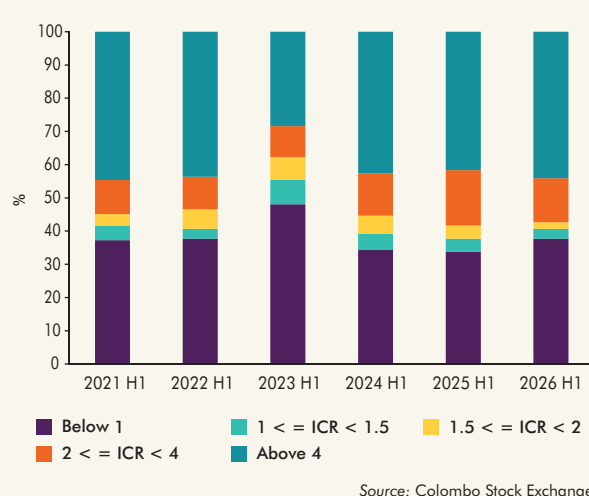


Figure 4.24 Distribution of Companies according to ICR



Corporate Sector Creditworthiness

In line with the moderation in aggregate profitability, the debt servicing capacity of listed NFCs moderated during H1 of 2026, despite a modest improvement in leverage conditions. The Interest Coverage Ratio (ICR) declined to 3.7 times from 4.2 times in H1 of 2025, indicating a moderation in the ability of listed NFCs to meet interest obligations from operating earnings. Net profit as a share of debt obligations also decreased, reflecting decline in earnings relative to debt obligations. In contrast, the debt-to-equity ratio declined, indicating a modest improvement in leverage conditions across the listed NFC sector. Nevertheless, the aggregate

ICR remained comfortably above one, indicating that listed NFCs, on average, continued to generate sufficient operating earnings to meet their interest obligations.

At the firm level, approximately one-third of listed NFCs recorded an ICR below one during H1 of 2026. In line with the moderation in the aggregate ICR, the share of firms with an ICR below one increased to 37.7% from 33.8% in H1 of 2025. Accordingly, more than one third of listed NFCs did not generate sufficient Earnings before Interest and Tax (EBIT) to fully cover their interest expenses. The share of firms with an ICR of one or above declined to 62.3% from 66.2%, however such companies continued to account for the majority. Although interest servicing pressures intensified among a segment of financially vulnerable NFCs, the majority of firms continued to generate sufficient EBIT to meet their interest obligations.

Sectoral ICRs further highlighted considerable differences in debt servicing conditions across the listed NFC sector. Food, Beverage and Tobacco and Real Estate recorded the highest ICRs, reflecting strong earnings relative to interest obligations. In contrast, Trading and Distribution recorded the lowest ICR and was the only sector with an ICR below one, indicating that aggregate EBIT was insufficient to fully cover interest expenses. Relatively weak interest

Figure 4.23 Key Financial Performance Indicators

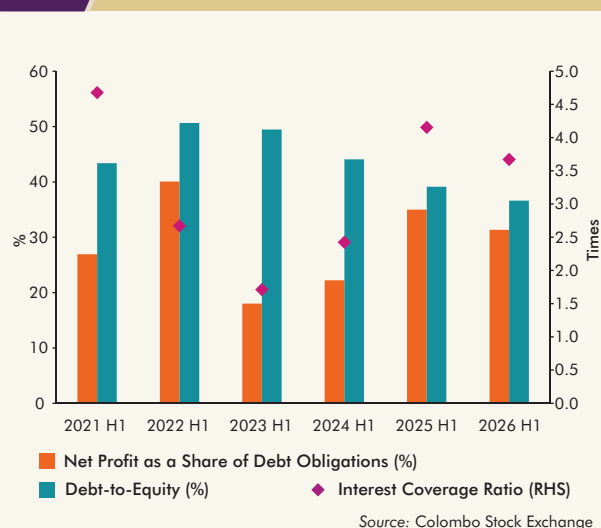
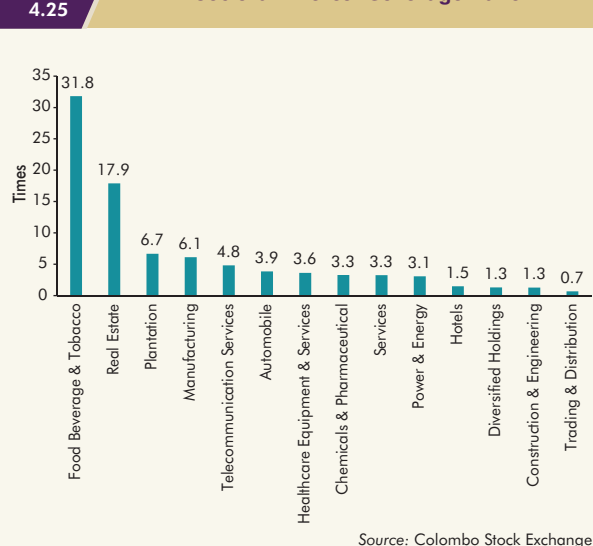


Figure 4.25 Sectoral Interest Coverage Ratio

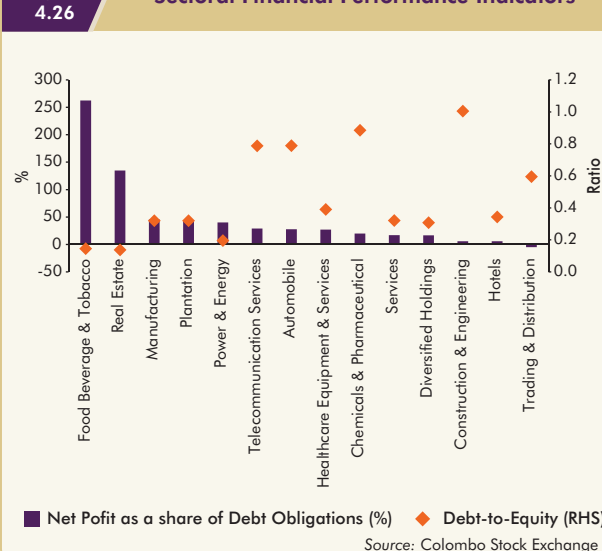


coverage was also observed in a few other sectors, suggesting elevated debt servicing pressures in certain segments of the listed NFC sector.

Sectoral profitability and leverage indicators broadly supported the differences observed in interest coverage across the listed NFC sector.

Food, Beverage and Tobacco and Real Estate recorded the highest net profit relative to debt obligations, together with relatively low debt-to-equity ratios, reinforcing their strong interest coverage

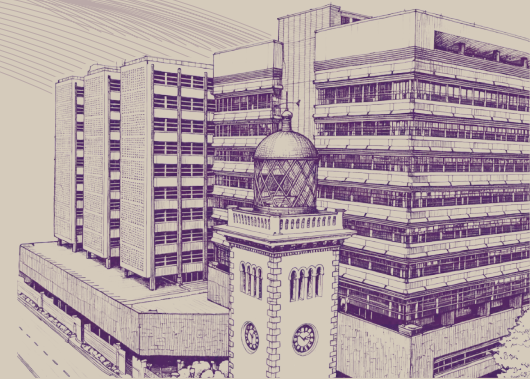
Figure 4.26 Sectoral Financial Performance Indicators



positions. In contrast, Trading and Distribution recorded a negative net profit as a share of debt obligations, consistent with its ICR remaining below one. Construction and Engineering recorded the highest debt-to-equity ratio, together with a low level of net profit relative to debt obligations, indicating comparatively higher financial vulnerability. Overall, these indicators suggest that debt servicing pressures remained concentrated within a few relatively weaker sectors.

Chapter 5

Policies for Financial Stability



The Central Bank deployed macroprudential tools along with other prudential measures during the period under review against the backdrop of rapid credit expansion in the economy in its capacity as the designated macroprudential authority under the Central Bank of Sri Lanka Act, No. 16 of 2023. The increasing exposures of Licensed Banks (LBs) and Finance Companies (FCs) towards motor vehicle related credit and gold backed lending coupled with price volatility of underlying collaterals warranted strengthening of borrower based macroprudential policies. In response, the Central Bank issued forward guidance in March 2026 on managing risk in gold backed lending to LBs and FCs, with a view of promoting greater prudence in such lending activities. Subsequently, in response to the continued rapid growth in motor vehicle related lending and gold backed lending, the Central Bank implemented macroprudential measures aimed at containing excessive leverage, enhancing borrower resilience, and mitigating systemic risks. Accordingly, the Central Bank introduced a Loan to Value (LTV) limit of 70% for credit facilities backed by gold collateral during May 2026. Further, the Central Bank reduced the maximum permissible LTV ratio for motor vehicle related credit in November 2025 and May 2026. These revisions not only reinforced prudential safeguards but also simplified the LTV framework applicable for motor vehicles related credit facilities, enhancing its operational effectiveness.

In addition to macroprudential policies, the Central Bank introduced several prudential regulations and policy measures to strengthen the overall financial system stability. Accordingly, in conjunction with broader macroprudential tightening measures, the Central Bank tightened the risk weights applicable to gold backed lending by LBs and FCs, including the removal of the zero risk weights previously applicable for certain gold backed credit facilities for the purpose of determining Capital Adequacy Requirements. The Central Bank introduced the Framework for Banking Sector Consolidation to promote a stronger, more resilient, and sustainable banking sector through the consolidation of small sized banks. Further, the regulatory framework for FCs sector was further enhanced through the introduction of several directions while extending the continued supervisory efforts to strengthen compliance of FCs sector with Anti Money Laundering, Countering the Financing of Terrorism and Countering Proliferation Financing (AML/CFT/CPF) requirements. Moreover, various regulatory initiatives were implemented during the period under consideration to strengthen risk management, enhance institutional resilience, operational soundness, and smooth functioning of the LBs and FCs sectors.

Moreover, the Central Bank continued to strengthen the resilience, efficiency, and inclusiveness of the financial system through a range of policy, supervisory, and consumer-focused initiatives. The Central Bank took further policy initiatives to safeguard consumers by strengthening the security of digital payment methods and enhancing public awareness of scam related risks. As part of the Central Bank's efforts to strengthen the resolution regime of the country, the resolution plans are being progressively developed for Licensed Financial Institutions (LFIs) to support the effective management of institutional distress. The Central Bank continued to strengthen the financial consumer protection framework via enhanced market conduct supervision, regulatory oversight, complaint management, and financial consumer awareness initiatives. The financial literacy and public awareness of sound financial management practices continued to be promoted as part of the Central Bank's efforts to advance financial inclusion. Moreover, the Financial Intelligence Unit (FIU) of the Central Bank continued to strengthen Sri Lanka's AML/CFT/CPF framework through a range of regulatory, supervisory, and policy initiatives during the period under review.

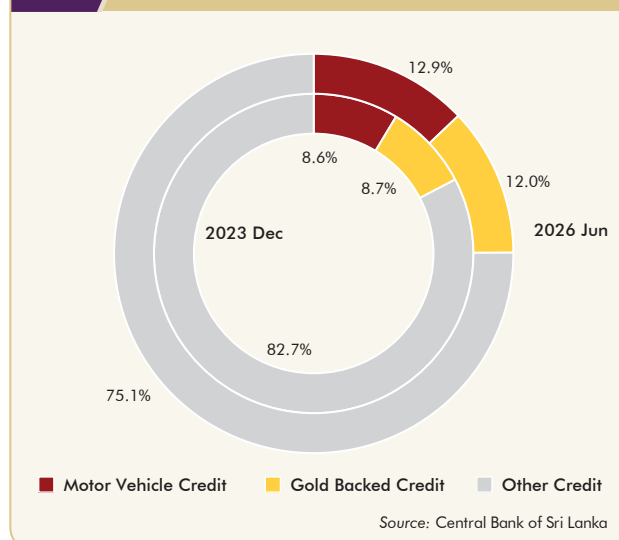
Amid heightened global uncertainties, evolving geopolitical and macrofinancial risks and the build-up of vulnerabilities within the domestic financial system, the Central Bank remains committed to safeguarding the stability and resilience of the financial system. Accordingly, the Central Bank will continue to closely monitor market developments, global and domestic macroeconomic and financial conditions, and calibrate its macroprudential stance and implement appropriate prudential policy actions, to mitigate emerging vulnerabilities and preserve financial system stability.

5.1 Macroprudential Policies for Stability

The Central Bank tightened its macroprudential stance during the review period by reducing the maximum LTV ratios applicable to motor vehicle financing and introducing a maximum LTV ratio for credit facilities backed by gold collateral. These measures were implemented against the backdrop of rapid credit expansion across LBs and FCs, accompanied by a notable increase in lending backed by vehicle and gold. Overall credit growth in the LBs and FCs sectors rose significantly above its historical average during the period under review, highlighting the need for timely macroprudential measures to mitigate the build-up of systemic risks and safeguard financial stability. The combined share of motor vehicle related credit¹ and gold backed lending, which were the main contributors to the growth in collateral backed lending, in the financial sector² credit increased from 19.6% at end 2024 to 24.9% by end June 2026, implying that nearly one quarter of financial sector lending was concentrated in these two collateral backed lending segments. The increasing concentration of such exposures within the credit portfolios of regulated financial

- 1 Motor vehicle related credit comprises finance leases, hire purchase facilities, and motor vehicle loans extended by FCs, together with the leasing portfolio of LBs, which is used as a proxy for motor vehicle financing due to data limitations. Accordingly, banking sector leasing data may include a small proportion of leases granted for non-motor vehicle purposes.
- 2 For the purpose of this analysis, the financial sector comprises LBs and FCs.

Figure 5.2 Concentration of Motor Vehicle Related Credit and Gold Backed Credit in the Financial Sector



institutions, coupled with their strong growth relative to overall credit and its sensitivity to collateral value correction, warranted strong macroprudential oversight and the strengthening of borrower based policy measures.

Gold backed lending recorded a notable acceleration during the review period. As a result, the share of gold backed lending in total financial sector credit increased from 9.8% at end 2024 to 12.0% by end June 2026, reflecting its growing importance within the loan portfolios of regulated financial institutions. This rapid expansion of gold backed lending coincided with a sustained increase

Figure 5.1 Total Credit Growth of the Financial Sector

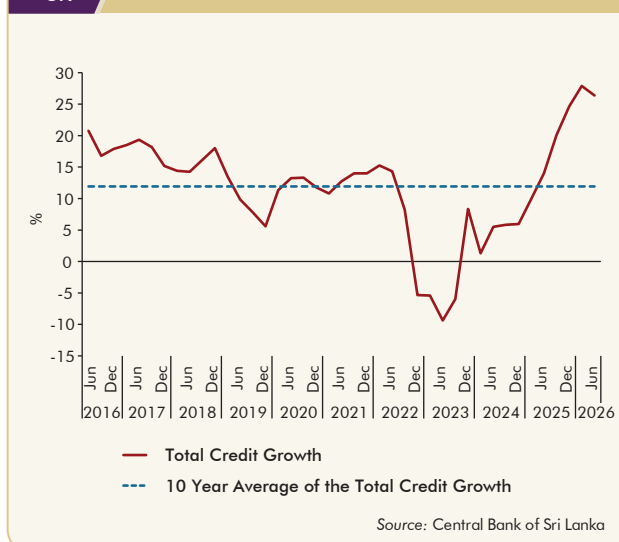


Figure 5.3 Growth of Motor Vehicle Related Credit and Gold Backed Credit in the Financial Sector

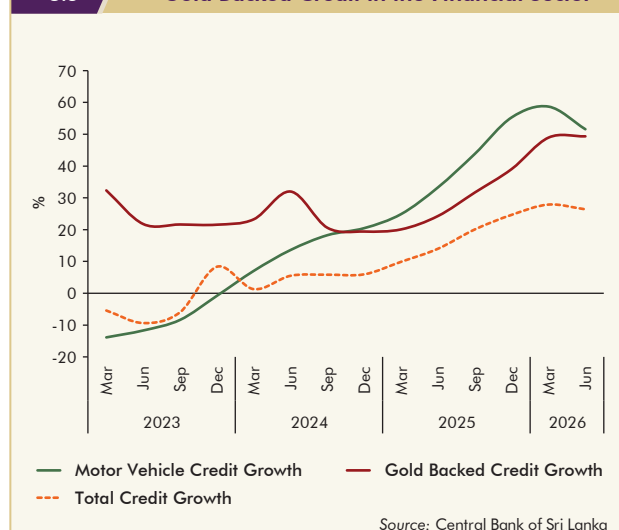
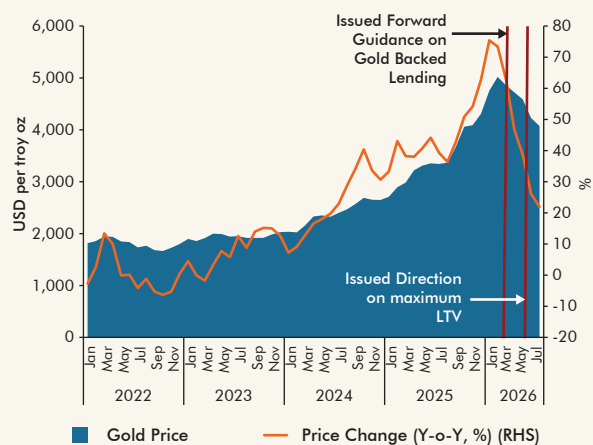


Figure 5.4
Movements of Global Gold Prices



in global gold prices, which improved collateral values and supported the growth of lending against gold collateral. While rising gold prices strengthened collateral coverage, the increasing concentration of exposures in this lending segment heightened the financial sector's sensitivity to potential adverse corrections in gold prices and borrower repayment risk.

While global gold prices increased steadily throughout 2025, heightened price volatility emerged from end January 2026 onwards, exposing both borrowers and lenders to greater uncertainty regarding the value of gold collateral and reinforced the need for stronger risk controls. Recognising the risks posed by increasing volatility in global gold prices and the rapid expansion of gold backed lending, the Central Bank issued Guidance on Managing Risks in Gold Backed Lending in March 2026, requiring LBs and FCs to exercise enhanced prudence in gold backed lending operations through conservative valuation practices and strengthened risk management measures.³ Building on these supervisory measures, the Central Bank subsequently introduced a maximum LTV ratio of 70% for credit facilities backed by gold collateral, effective from 25 May 2026, with a view to mitigating excessive leverage, strengthening borrower based safeguards

and enhance the resilience of regulated institutions to adverse movements in gold prices. The introduction of LTV limit is expected to moderate excessive risk taking and reduce the build-up of vulnerabilities arising from the rapid growth of gold backed lending.⁴

Following the relaxation of motor vehicle import restrictions in early 2025, demand for motor vehicle related credit expanded significantly, driven by pent-up demand. Consequently, motor vehicle related credit grew rapidly, substantially outpacing the growth of overall credit extended by the financial sector. The share of motor vehicle related credit to total credit in financial sector rose from 9.8% at end December 2024 to 12.9% by end June 2026. The rapid expansion and increasing concentration of motor vehicle-related credit raised concerns regarding the buildup of systemic risks, warranting closer macroprudential oversight.

Against this backdrop, the Central Bank strengthened the applicable LTV requirements on two occasions, in November 2025 and May 2026, with a view to containing excessive leverage, enhancing borrower resilience, and mitigating systemic risks arising from the rapid expansion of motor vehicle financing.⁵ The successive policy measures reduced the maximum permissible LTV ratio for new⁶ commercial vehicles from 80% to 60% and for other new vehicle categories to 40%, while the corresponding limit for used⁷ vehicles was reduced from 70% to 60%.

In addition to tightening the macroprudential stance, the Central Bank also simplified the LTV framework on motor vehicles to improve its operational effectiveness. As part of the November

3 Guidance on Managing Risks in Gold Backed Lending: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/cdg/msd_letter_to_ceos_of_banks_20260311_e.pdf

4 Central Bank of Sri Lanka Act Directions No. 02 of 2026: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/CBSL_Act_Directions_No_2_of_2026_e.pdf

5 Central Bank of Sri Lanka Act Directions No. 03 of 2025: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/CBSL_Act_Directions_No_3_of_2025_e.pdf

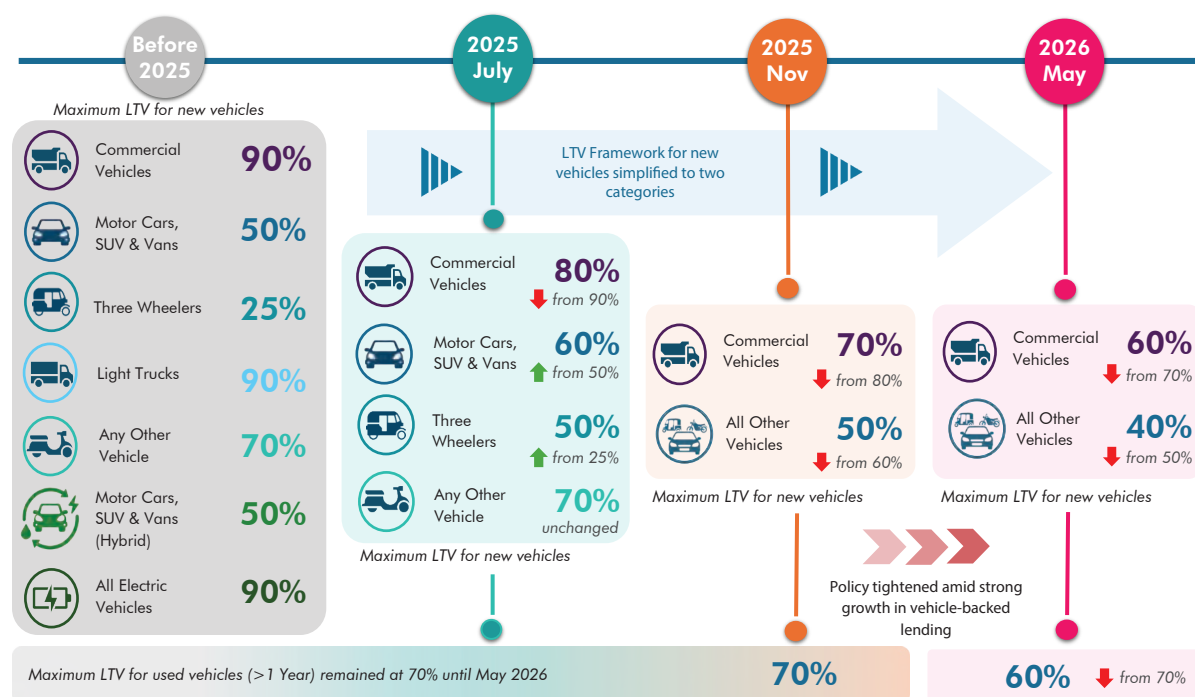
Central Bank of Sri Lanka Act Directions No. 01 of 2026: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/laws/CBSL_Act_Directions_No_1_of_2026_e.pdf

6 New vehicles refer to unregistered vehicles and vehicles which have been used in Sri Lanka for less than one year since the first registration.

7 Used vehicles are vehicles which have been used in Sri Lanka for more than one year since the first registration.

Figure 5.5

Progressive Tightening and Simplification of the Motor Vehicle LTV Framework



Source: Central Bank of Sri Lanka

2025 revision, the framework for new vehicles was streamlined from a multi category structure to a simplified framework comprising two broad categories. The subsequent revisions maintained this streamlined structure while further tightening the applicable limits. The simplified framework enhanced transparency, improved consistency across regulated institutions, reduced operational complexity, and strengthened the effectiveness of the LTV ratio as a borrower-based macroprudential policy tool. Moreover, the Central Bank also observed a marked increase in credit extended by LBs to FCs during the review period. This largely reflected the heightened funding requirements of FCs amid the rapid expansion of credit, particularly for motor vehicle financing. While such funding supported the growth of credit intermediation, it also increased the interconnectedness between LBs and FCs, potentially amplifying the transmission of risks across the financial system. Therefore, the Central Bank continues to closely monitor these developments to ensure that any emerging vulnerabilities or systemic risks are identified and addressed in a timely manner.

As part of its efforts to mitigate systemic risk and strengthen the resilience of the banking sector, the Central Bank regularly assesses banks with the potential to generate significant spillover effects on the wider financial system. In line with the criteria for designating Domestic Systemically Important Banks (D-SIBs) issued in April 2025, the annual assessment of D-SIBs was conducted in 2026 using audited data as at end 2025, and the assessment confirmed that the existing list of five designated D-SIBs, remains appropriate.

5.2 Policies Related to Licensed Banks

The Central Bank introduced several prudential regulations and policy measures to reinforce the resilience of the banking sector while strengthening risk management, compliance frameworks and fostering sound governance practices. As part of these efforts, the Banking (Special Provisions) Act Directions No. 01 of 2025 was issued by informing LBs to prepare Recovery Plans (RCPs) considering the nature, scale,

structure, complexity, interconnectedness of the bank and submit the Board approved RCPs to the Central Bank. Further, an amendment to the Banking Act Determination No. 04 of 2024 on Approved Securities for Accommodation Granted to Related Parties of Licensed Banks was issued, specifying the letter of undertaking issued by the General Treasury assuring budgetary provisions and timely settlement, as an approved security, for opening Letters of Credit by LBs on behalf of Government Ministries, Departments, and State Owned Enterprises, subject to specified disclosure requirements. In view of the adverse effects of cyclonic and flood disasters that occurred in late 2025, the Central Bank issued a Circular to all LBs requesting to provide relief measures to individuals and businesses whose income or business was directly affected by the cyclonic and flood disasters. Moreover, the Central Bank entered into a Memorandum of Understanding (MoU) with Sri Lanka Accounting and Auditing Standards Monitoring Board on 1 December 2025 for the purpose of sharing information and enhancing cooperation in the areas of supervision, regulation, crisis management, and resolution of financial institutions and providing capacity building and technical assistance.

The Central Bank, with a view to facilitating the present economic recovery path of the country by promoting resilience and financial stability, introduced the Framework for Banking Sector Consolidation, in October 2025. Subsequently, in December 2025, the Central Bank informed locally incorporated small sized banks of the proposed bi-annual evaluation mechanism and issued the Framework to LBs on 23 January 2026, requiring them to pursue appropriate consolidation strategies. The Framework establishes a proportionate assessment and consolidation mechanism for locally incorporated small sized LBs with assets below Rs. 400 bn. Under the Framework, such institutions are assessed bi-annually based on quantitative and qualitative indicators, while LBs that consistently fail to meet prescribed standards may be required to consolidate. It also outlines consolidation strategies and broader guidance to support growth, strengthen governance,

enhance technological capabilities, improve access to capital, and address key considerations such as regulatory approvals, human resource management, depositor protection, and market conduct. Accordingly, the Central Bank will assess consolidation proposals and grant necessary approvals under Banking Act No. 30 of 1988, as amended, whilst providing regulatory guidance where appropriate. Further, it is expected that banking sector consolidation will facilitate financially and operationally sound banks, thereby strengthening the resilience and stability in the banking sector while supporting inclusive and sustainable growth of the economy. Recently, the Government of Sri Lanka has approved restructuring of two state owned, small, specialised banks and the Central Bank will facilitate such initiatives with a view to strengthening the soundness of the banking sector in Sri Lanka.

In addition, targeted regulatory initiatives were implemented during the review period to enhance institutional resilience, operational soundness, and risk sensitivity within the banking sector. The Central Bank, having considered the developments in the banking sector arising from new business activities, and developments in digitalised business processes and operations, issued the Banking Act Directions No. 01 of 2026 on Outsourcing of Business Operations of Licensed Banks in March 2026, with the objective of ensuring that LBs adopt a sound and prudent framework for outsourcing of business operations. Further, Banking Act Directions No. 02 of 2026 on Capital Requirements under Basel III for Licensed Commercial Banks and Licensed Specialised Banks revised the risk weight treatment applicable to gold backed credit facilities by replacing the previously applicable zero risk weight with positive risk weights differentiated according to the applicable LTV ratio, while assigning higher risk weights to facilities with elevated LTV ratios.

Most recently, the Central Bank issued Banking Act Directions No. 03 of 2026 on the Assessment of Beneficial Owners of Licensed Banks, to ensure the proper identification, assessment, and monitoring of their beneficial owners.

Further, the Central Bank issued Banking Act Directions No. 04 of 2026 on Identifying, Reporting and Managing Operational Loss Events of Licensed Banks, to strengthen operational risk management and resilience within LBs by ensuring the timely identification, reporting, and management of operational loss events.

To ensure smooth functioning of the banking system, the Central Bank has introduced several other regulatory measures from time to time during the period under consideration. These regulations include an amendment to Circular No. 03 of 2024 on Guidelines for the Establishment of Mobile Banking Units of Licensed Commercial Banks and Banking Act Determination on Annual Licence Fee for Licensed Banks. In addition, several proposed regulations including Directions for Banks Licensed under the Colombo Port City Economic Commission Act, Directions on Liquidity Risk Management for LBs, Directions on Sustainable Finance Activities of LBs, Amendments to Directions on Classification, Recognition and Measurement of Credit Facilities and Guidelines for Qualified External Auditors of LBs are expected to be issued in the near future, strengthening the safety, soundness, and resilience of the banking sector.

5.3 Policies Related to Finance Companies, Licensed Microfinance Companies, and Primary Dealer Companies

The legal, regulatory and supervisory framework for FCs sector was further enhanced through the amendments to the legislative framework, introduction of standards aimed at improving risk management practices and the implementation of enhanced supervisory approaches and processes. Accordingly, the legal framework governing FCs sector is expected to be further strengthen through the proposed amendments to Finance Business Act, No. 42 of 2011, mainly recognising the need for strengthening the regulation and supervision of FCs, investigation and prosecution of unauthorized finance business, resolution and winding up of non-viable FCs. Further, several

Directions on Liquidity Risk Management, RCPs for FCs, assessment of beneficial owners of FCs, structural changes of FCs, amendments to maximum interest rates on deposits and debt instruments, and amendments to methodology for computing the credit risk weighted assets applicable for retail claims secured by gold were issued by the Central Bank during the period under consideration. Moreover, a circular was issued by requesting all FCs to provide relief measures to individuals and businesses whose income or business had been directly affected by the cyclonic and flood disasters that occurred during the latter part of 2025. Greater supervisory attention was given on strengthening compliance of FCs sector with AML/CFT/CPF requirements, internal controls and risk management practices, while ensuring that regulated entities maintained adequate financial buffers to withstand emerging risks and vulnerabilities.

The Central Bank continued its efforts to strengthen the resilience and long-term viability of the FCs sector through a well planned consolidation programme. The revised framework for Phase II of the Masterplan for the consolidation was introduced in December 2024 aiming to develop a more resilient FCs sector with an execution period of three years, from 31 March 2025 to 31 March 2028. FCs have been submitting quarterly self-assessed scores commencing from 31 March 2025, using the reporting format provided by the Central Bank. Based on the reported scores, appropriate supervisory communications were issued to FCs that scored below the prescribed threshold, emphasizing the need to take necessary measures to comply with the criteria and expectations set out in the Masterplan.

In addition to the regulatory initiatives implemented for FCs, targeted measures were introduced to strengthen the resilience and risk management frameworks of other Non-Bank Financial Institutions. The risk management framework for Licensed Microfinance Companies (LMFCs) was further strengthened through issuing a Direction on Credit Risk Management for Licensed Microfinance Companies requiring LMFCs to establish a sound credit risk management framework.

Additionally, to enhance the resilience of the Primary Dealer Companies sector, a Direction was issued on Minimum Core Capital Requirement in a view of providing a financial buffer to absorb potential risks and unexpected losses.

5.4 Policies Related to Payments and Settlements

The Central Bank successfully implemented the ISO20022 payment messaging standard mandated by Society for Worldwide Interbank Financial Telecommunications (SWIFT) for its user community to ensure more secure, efficient, and effective payment messaging. Adoption of SWIFT's ISO20022 standard marked a significant milestone in the global transition to an improved and versatile payment messaging standard, with more detailed and structured payment information being transmitted, thereby facilitating automation and interoperability, whilst reducing manual intervention and processing errors, promoting transparency and traceability, and facilitating fraud detection and risk management in relation to cross-border payments. Further, a new risk mitigation mechanism was introduced to better manage credit risk relating to Sri Lanka's Fast Payment System, the Common Electronic Fund Transfer Switch (CEFTS) and the Common ATM Switch (CAS), with effect from 1 June 2026. The new mechanism established by way of issuing the Payment and Settlement Systems Circular No. 04 of 2026 requires participants of CEFTS and CAS, which are participants of the Real Time Gross Settlement System (RTGS), to comply with the applicable Net Debit Cap (NDC) as well as the applicable Settlement Guarantee Amount (SGA) in the RTGS, with effect from 1 June 2026.

In view of the increased prevalence of financial frauds and scams involving digital payment channels, the Central Bank took policy initiatives to safeguard consumers by strengthening the security of digital payment methods and enhancing public awareness of scam related risks. Following the implementation of strengthened customer identification and verification requirements

for mobile payment applications, together with continuous public awareness initiatives, the number of reported fraud and scam incidents involving digital payment channels which had increased sharply in mid-2025 showed a declining trend thereafter. Furthermore, the procurement of a centrally deployed fraud management system for retail payment systems operated by LankaPay (Pvt) Ltd (LPPL) is in the pipeline, which will help address fraud risk relating to digital payments.

5.5 Policies on Deposit Insurance and Resolution of Financial Institutions

The Central Bank took several measures to strengthen the resolution regime of the country. Accordingly, resolution plans for LFIs are being progressively developed to support the effective management of institutional distress. The Financial Stability Fund (FSF), established under the Banking (Special Provisions) Act, No. 17 of 2023 (BSPA) to support the implementation of resolution measures, has been operationalised with the development of its operational framework. Further, to strengthen the implementation of the resolution framework, the Central Bank established a Panel of Independent Professional Valuers and conducted an awareness session on their role in resolution of LBs and FCs as per the BSPA. In addition, to enhance stakeholder preparedness for resolution, awareness sessions were conducted for the Key Management Personnel and Chief Executive Officers of LBs and FCs respectively. The Central Bank has continued its engagement with an international and a national consultant appointed by the Asian Development Bank to secure technical assistance and align the resolution framework with international best practices while undertaking a working mission with such consultants to further strengthen the resolution framework and support the implementation of key resolution initiatives.

The operational preparedness and effectiveness of the Sri Lanka Deposit Insurance Scheme (SLDIS) were further strengthened during the review period through a series of policy, institutional, and operational enhancements. With

the aim of enhancing the operational efficiency of the SLDIS in managing large scale or simultaneous payouts during times of crises, a contingency plan for the SLDIS was developed as a Performance Based Condition of the Financial Sector Safety Net Strengthening Project (FSSNP). To minimize overreliance on a single Agent Bank and ensure the effective disbursement of compensation payments, measures were taken to establish a pool of accredited Agent Banks, comprising LBs with wider branch networks and adequate resources. With the aim of providing a structured framework for the utilisation of SLDIS resources in support of resolution decisions, SLDIS Policy on providing financial assistance to facilitate the transfer of assets and liabilities of a Member Institution as a resolution measure was established during the period. Further, policy and institutional measures, including the establishment of a MoU with the Ministry of Finance on government backstop funding arrangements, were introduced under the FSSNP to align the deposit insurance framework with international best practices and the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems.

5.6 Policies Related to Financial Consumer Protection

The Central Bank continued to strengthen the financial consumer protection framework through enhanced market conduct supervision, regulatory oversight, complaint management, and financial consumer awareness initiatives, thereby promoting the fair treatment of financial consumers across the regulated financial sector. During the first half of 2026, the supervisory framework was further expanded through thematic reviews on the early settlement practices relating to term loans offered by LBs and FCs and the Parate execution process of LBs, as response to significant volume of consumer complaints received in these areas. Moreover, a Key Risk Indicator (KRI) Dashboard for Market Conduct Supervision was developed by the Central Bank to advance the offsite market conduct supervisory framework. To

further strengthen the complaint handling framework, the Online Complaint Management System (CMS) was introduced on 15 May 2026 which enables financial consumers to submit complaints electronically through a standardised digital platform. Work has been commenced on a customer complaints dashboard for the Financial Consumer Relations Department of the Central Bank to strengthen data driven supervision and improve complaint monitoring. In parallel, initiatives were undertaken to streamline the existing complaint categorisation framework, while a comprehensive user guide is being developed to improve the consistency and quality of complaint classification and analysis. Further, the Central Bank continued its effort to promote financial consumer awareness through targeted education and outreach programmes while strengthening its efforts to detect, investigate, and prevent prohibited schemes in line with its mandate to safeguard financial consumers and preserve the stability and integrity of the financial system.

5.7 Policies Related to Anti-Money Laundering, Countering the Financing of Terrorism and Countering the Proliferation Financing

During the year ended June 2026, the FIU continued to strengthen Sri Lanka's AML/CFT framework through a range of regulatory, supervisory, and policy initiatives. To assist reporting institutions in identifying emerging risks and suspicious activities, the FIU issued six sets of red flag indicators during the period covering the areas of identification of suspicious transactions relating to Authorised Dealers/Restricted Dealers, Terrorist Financing (TF), Proliferation Financing (PF), and scam operations in Sri Lanka involving foreign nationals. In addition, three circulars were issued during this period under review by and updating of Institutional Risk Assessments in line with the National Money Laundering (ML), TF, and PF Risk Assessment 2024/25, certification of database screening against sanctioned individuals and entities and the application of enhanced due diligence measures and countermeasures for jurisdictions identified by the Financial Action Task Force (FATF) as higher risk jurisdictions.

As part of its supervisory and enforcement efforts, during the year ending June 2026, the FIU imposed financial penalties on twenty institutions, including financial institutions and Designated Non-Finance Businesses and Professions (DNFBPs), for non-compliance with the provisions of the Financial Transactions Reporting Act, No. 06 of 2006 (FTRA). Furthermore, during the period, Sri Lanka's third National Risk Assessment (NRA) 2024/25 coordinated by the FIU was completed, which evaluated the country's ML/TF/PF risks. Meanwhile, the country's key AML/CFT laws, namely, the Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA), the Prevention of Money Laundering Act, No. 05 of 2006 (PMLA), and the FTRA, were amended in line with international standards to further strengthen Sri Lanka's AML/CFT regime. Accordingly, the Prevention of Money Laundering (Amendment) Act No.16 of 2026, the Financial Transactions Reporting (Amendment) Act, No.17 of 2026 and the Convention on the Suppression of Terrorist Financing (Amendment) Act No.18 of 2026 were certified by the Hon. Speaker on 4 August 2026.

Sri Lanka is currently undergoing the third Mutual Evaluation (ME) on AML/CFT/CPF framework conducted by the Asia Pacific Group (APG) on Money Laundering. The ME process commenced with the submission of Sri Lanka's Risk and Context Report to the APG, followed by submission of the Technical Compliance Report and Effectiveness Report. The onsite visit is scheduled to take place during October–November 2026. Demonstrating strong performance by both the public and private sector during the onsite visit will be crucial in achieving a positive outcome. Failure to secure a favourable outcome could result in an adverse listing by the FATF causing potential economic and financial implications for Sri Lanka.

5.8 Policies Related to Financial Inclusion

As part of measures of the Central Bank in the area of Financial Inclusion, the End of Term (EOT) Evaluation of National Financial Inclusion

Strategy (NFIS) Phase I and the National Financial Inclusion Survey were initiated with the support of the Alliance for Financial Inclusion (AFI) and were completed in mid-2026. The findings of the EOT Evaluation and the Financial Inclusion Survey will provide key evidence based inputs for the development of NFIS Phase II which is expected to be formulated through an extensive stakeholder consultation process. Furthermore, implementation of the Financial Literacy Roadmap of Sri Lanka (2024–2028) continued during the year, focusing on strengthening institutional partnerships, rolling out the National Financial Literacy Curriculum, and identifying effective delivery channels. As part of the efforts to support the rollout of the National Financial Literacy Curriculum, the process of digitising the content of the Curriculum was initiated. This initiative aims to provide a cost effective and innovative approach to delivering financial literacy, while broadening access and promoting more engaging and interactive learning through gamification, supported by a user friendly digital platform incorporating self-paced learning, assessments, and certification. Efforts continued to build trainer capacity and expand the development and dissemination of financial literacy content targeting children and youth, women, Micro, Small, and Medium Enterprises (MSMEs), and other vulnerable groups, in collaboration with relevant stakeholders. As part of these efforts, the Central Bank launched the “Financial Literacy Month” in October 2025 to enhance financial literacy and raise public awareness of sound financial management practices. A wide range of awareness and educational programs were conducted throughout the month through print, digital, and social media, as well as face-to-face outreach activities, enabling broader public engagement and reinforcing the importance of informed financial decision making. Moreover, Regional Offices of the Central Bank continued to function as key outreach arms that extended their local engagement activities to support regional presence of the Central Bank and strengthen financial literacy among the community by conducting awareness sessions, Financial Literacy Day events and regional forums across the country.

5.9 Financial System Oversight Committee (FSOC)

In accordance with Section 70(2)(d) of the Central Bank of Sri Lanka Act, No. 16 of 2023, the FSOC assessed the development in economy that could adversely impact financial system stability during the 12-month period ended June 2026. The FSOC convened five meetings during this period, in which a range of issues relevant to financial system stability were discussed. While these discussions contributed to the Committee's oversight of risks and vulnerabilities within the financial system, no recommendations were issued by the FSOC during the period under review.

Further, an agreement between the Central Bank and the Insurance Regulatory Commission of Sri Lanka (IRCSL) was signed during the review period to facilitate the exchange of information on developments in the insurance sector. As the macroprudential authority, the Central Bank is required to maintain effective cooperation arrangements with relevant financial sector regulators to ensure the effective discharge of its macroprudential responsibilities and the preservation of financial system stability. In this regard, this agreement will strengthen the Central Bank's macroprudential surveillance and policy formulation by enhancing access to information relevant to assessing systemic risks across the financial sector.

5.10 Policies on Sustainable Finance

During the year, the Central Bank continued implementation of the Sustainable Finance Roadmap 2.0 which includes scaling up action

for the financial sector of Sri Lanka and engaged with domestic and international stakeholders for building capacities in climate related policies and actions for the financial sector. As a key initiative under the implementation plan of the Roadmap 2.0, the development of a Sustainable Finance Taxonomy progressed with the support of the International Finance Corporation (IFC), which is expected to be launched in early 2027. The updated taxonomy is expected to broaden the scope of sustainable economic activities in line with the strategic priorities and expanded coverage envisaged under the Roadmap 2.0. The Central Bank conducted a series of capacity building and awareness raising actions for operationalising the current Green Finance Taxonomy, with the technical assistance received from the European Union under its Green Recovery Facility. In a backdrop of heightened climate vulnerabilities, the Central Bank engaged with domestic and international fora in understanding and better applying the climate policies and benchmark practices in the local context. These engagements during the year included consultations with public sector institutions, as well as engagements with financial sector stakeholders, including financial sector regulators, financial institutions, and industry associations. The Central Bank also participated in various policy discussions and stakeholder consultations initiated by corporate sector chambers and non-governmental organisations working in the area. Further, the Central Bank attended international knowledge events on climate and sustainability while contributing to global collaboratives such as International Platform for Sustainable Finance (IPSF), Sustainable Banking and Finance Network (SBFN) and AFI as a member country during 2026.

Key Policy Changes and Regulatory Actions Implemented for the Financial Sector¹

Macprudential Surveillance

07 November 2025	Central Bank Act (CBA) Directions No. 03 of 2025 on “Loan to Value Ratios for Credit Facilities Granted in Respect of Motor Vehicles”, was issued under Section 105(1) of the CBA to Licenced Banks, Finance Companies and Registered Finance Leasing Establishments, revising the maximum Loan to Value (LTV) ratios applicable to credit facilities granted for the purpose of purchase or utilisation of motor vehicles. Accordingly, CBA Directions No. 02 of 2025 was revoked upon the issuance of this Direction.
24 May 2026	CBA Directions No. 01 of 2026 on “Loan to Value Ratios for Credit Facilities Granted in Respect of Motor Vehicles”, was issued under Section 105(1) of the CBA to Licenced Banks, Finance Companies, and Registered Finance Leasing Establishments revising the maximum LTV ratios applicable to credit facilities granted for the purpose of purchase or utilisation of motor vehicles. Accordingly, CBA Directions No. 03 of 2025 was revoked upon the issuance of this Direction. CBA Directions No. 02 of 2026 on ‘Loan to Value Ratios for Credit Facilities Secured by Gold Collateral’ was issued under Section 105(1) of the CBA to Licenced Banks and Finance Companies, introducing a maximum LTV ratio applicable to credit facilities secured by gold collateral.

Financial Institutions

Licenced Banks

17 July 2025	The Banking Act Determination No. 04 of 2024 on “Approved Securities for Accommodation Granted to Related Parties of Licenced Banks” was amended and issued, specifying the letter of undertaking issued by the General Treasury, assuring budgetary provision and timely settlement, provided such commitments are disclosed in the financial statements of the Government of Sri Lanka, as an approved security, for the opening of Letters of Credit (LCs) by Licenced Banks on behalf of Government Ministries, Departments, and State-Owned Enterprises.
17 September 2025	Directions were issued under the Banking (Special Provisions) Act No. 17 of 2023 (BSPA), requiring Licenced Banks to prepare Recovery Plans under the BSPA, in order to ensure the resilience of Licenced Banks. Accordingly, the previous Banking Act Directions issued in this regard were revoked.
02 December 2025	Circular No. 03 of 2024 on “Guidelines for the Establishment of Mobile Banking Units (MBUs) of Licenced Commercial Banks (LCBs)” was amended with respect to the requirement for obtaining prior approval to conduct MBU activities.
05 December 2025	Circular on “Relief Measures to Assist Individuals and Businesses Affected by the Recent Cyclonic and Flood Disasters” was issued in view of the adverse impacts of recent cyclonic and flood disasters and the need to grant effective relief to those affected borrowers of Licenced Banks, requesting all Licenced Banks to provide appropriate relief measures to individuals and businesses whose income or business activities had been directly affected.
10 December 2025	Banking Act Determination on “Annual Licence Fee” was issued to Licenced Banks specifying the revised licence fee structure applicable for the year 2026.

¹ Includes major financial sector policy measures implemented since 01 July 2025 until 31 July 2026.

25 March 2026	Banking Act Directions on “Outsourcing of Business Operations of Licenced Banks” was issued considering the developments in the banking sector arising from new business activities and the increasing digitalization of business processes and operations, in order to ensure that Licenced Banks adopt sound and prudent frameworks for outsourcing their business operations.
27 May 2026	Direction No. 01 of 2016 on “Capital Requirements under Basel III for Licenced Commercial Banks and Licenced Specialised Banks” was amended to revise the risk weights applicable to exposures secured by gold.

Finance Companies (FCs), Specialised Leasing Company (SLC), Licensed Microfinance Companies (LMFCs) and Primary Dealer Companies (PDCs)

04 July 2025	The Finance Business Act, No. 42 of 2011 (FBA) was contravened by Nation Lanka Finance PLC continuously. Accordingly, the company was prohibited from mobilising public funds, including accepting new deposits in whatsoever manner. Further, resolution actions were initiated under the provisions of the BSPA with effect from 04 July 2025, and an administrator was appointed to the Company.
05 July 2025	The Governing Board of the Central Bank, in terms of the Regulations issued under the Registered Stock and Securities Ordinance (RSSO) and the Local Treasury Bills Ordinance (LTBO), extended the suspension of Perpetual Treasuries Limited (PTL) from carrying on the business and activities of a Primary Dealer for a further period of six months, with effect from 05 July 2025, in order to continue with the investigations being conducted by the Central Bank.
20 August 2025	Direction on “Credit Risk Management for LMFCs” was issued, requiring LMFCs to establish a credit risk management framework to identify, measure, monitor and control credit risk aligning with the nature, volume and complexity of the activities of LMFCs.
16 September 2025	Direction on “Minimum Core Capital Requirement of PDCs” was issued to strengthen the resilience of the sector by establishing a financial buffer to absorb potential risks and unexpected losses.
07 November 2025	Direction on “Liquidity Risk Management” was issued, requiring FCs to establish a robust liquidity risk management framework, through formulation of a liquidity risk management strategy, policy and procedures, governance structure and effective liquidity risk management process to identify, measure, monitor and report, control and mitigate liquidity risk. Proposed amendments to FBA were issued for public consultation, inviting views, suggestions, and comments from the stakeholders and general public ² .
05 January 2026	The Governing Board of the Central Bank, in terms of the Regulations issued under RSSO and LTBO, extended the suspension of PTL from carrying on the business and activities of a Primary Dealer for a further period of six months with effect from 05 January 2026, in order to continue with the investigations being conducted by the Central Bank.
09 January 2026	Circular on “Relief Measures to Assist Individuals and Businesses Affected by the Recent Cyclonic and Flood Disasters” was issued in view of the adverse impacts of the cyclone Ditwah and associated flood disasters and the need to grant effective relief to those affected borrowers of FCs, requesting all FCs to provide appropriate relief measures to individuals and businesses whose income or business activities has been adversely affected by the disasters.
12 January 2026	Direction on “Amendments to Maximum Interest Rates” was issued, revising the maximum interest rates applicable to deposits and debt instruments offered by FCs.

² The views, suggestions, and comments received from the general public and stakeholders were incorporated appropriately to the proposed amendments to FBA. Currently, the process of obtaining the required approvals for the amendments to FBA is in progress.

16 February 2026	Direction on “Recovery Plans for FCs” was issued, requiring FCs to prepare, maintain and execute effective and comprehensive recovery plans to proactively identify and address the financial impacts of severe stress events, thereby safeguarding the stability and continuity of FCs operations, while preventing failure or resolution.
17 March 2026	Direction on “Assessment of Beneficial Owners of FCs” was issued, requiring FCs to identify and maintain adequate, accurate and up-to-date information on the beneficial owner(s) of FCs, to prevent criminals or their associates from holding or being the beneficial owner(s) of, significant or controlling interest of FCs, and to ensure transparency of ownership and control structures of FCs.
27 May 2026	Direction on “Amendments to Capital Adequacy Requirements” was issued, revising the methodology for computing the credit risk weighted assets amount applicable to retail claims secured by gold.
10 June 2026	The registration of “Co-operative Leasing Company Limited” was cancelled in terms of Section 9(1) (f) of Finance Leasing Act, No. 56 of 2000 (as amended), with effect from 10 June 2026, due to its repeated failure to comply with the Finance Leasing (Reporting Requirements) Direction No. 2 of 2010, failure to meet the requirements stipulated by the Central Bank under the Masterplan for Consolidation of Non-Bank Financial Institutions, despite several extensions granted to enable compliance with the same, and the failure to develop a viable plan to ensure the sustainability of its business operations.
03 July 2026	The licence issued to Nation Lanka Finance PLC (NLFP) under the FBA to carry on finance business was cancelled in terms of Section 66(2) of the BSPA, with effect from 03 July 2026, due to continued deterioration of the financial position and considering that the continuation of its current status would be further detrimental to the interests of depositors and other stakeholders. Accordingly, the Central Bank decided to proceed with the winding up of NLFP in terms of the provisions of Part V of the BSPA.
05 July 2026	The Governing Board of the Central Bank, in terms of the Regulations issued under RSSO and LTBO, extended the suspension of PTL from carrying on the business and activities of a Primary Dealer for a further period of six months, with effect from 05 July 2026, in order to continue with the investigations being conducted by the Central Bank.

Insurance³

21 July 2025	Guidelines on “Incorporating a Framework to Implement Key Pillars: Sustainable Development Goals (SDGs), Environmental, Social, and Governance (ESG) Principles, and Sustainable Finance Initiatives, in the Insurance Industry” were issued to insurance companies.
25 July 2025	Guidelines on “Anti-Money Laundering and Countering the Financing of Terrorism Programme” were issued to insurance companies and insurance brokering companies.
15 August 2025	Direction No. 03 of 2025 on “Compliance with the Minimum Net Capital Requirement by Insurance Brokers” was issued to insurance brokers in terms of Section 96A of the Regulation of Insurance Industry Act, No. 43 of 2000 (RII Act), revising Direction No. 19 issued on 24.07.2019 and Direction No. 19 (Amended) issued on 03.06.2020.
01 September 2025	Circular No. 01 of 2025 on “Optional Compensation Scheme for Third-Party Victims of Motor Vehicle Accidents for Death or Permanent Disability” was issued to general insurance companies.
12 October 2025	Guidelines on “Market Conduct of the Insurers” were issued to insurance companies, to establish minimum standards for ensuring the fair treatment of policyholders throughout the insurance lifecycle, from product design to claims settlement.

³ These are policy measures taken by the Insurance Regulatory Commission of Sri Lanka (IRCSL).

28 October 2025	Direction No. 04 of 2025 on “Insurance Product Information Document” was issued to the industry, establishing a framework for the preparation of Insurance Product Information Document, containing the key features of the policy documents of life and general insurance products in simple language, with a view to safeguarding the interests of policyholders.
30 October 2025	Circular No. 02 of 2025 on “Enforcement Action for Non-Compliance with AML-CFT” was issued to the industry to ensure that enforcement actions are effective, proportionate, dissuasive, consistent, and timely, in line with the Financial Transactions Reporting Act, No. 06 of 2006 (FTRA), Insurers (Customer Due Diligence) Rules, No. 01 of 2019, the RII Act, and international standards.
17 November 2025	Circular No. 03 of 2025 on “Premium Payment for General Insurance Policies” was issued to general insurance companies, revising the provisions of Circular No. 01 of 2023 dated 09.09.2023 and prescribing requirements in respect of premium payments for general insurance policies.
05 December 2025	Direction No. 05 of 2025 on “Disclosure of Premiums and Other Charges” was issued to all general insurance companies to disclose all types of premium, in respect of basic premium, Strike, Riot, Civil Commotion and Terrorism (SRCC & T) premium, premiums for additional covers or endorsements, and all other types of policy charges (including the fixed and variable types of charges) applicable for the policy, separately in all the documents issued to policyholders and prospective policyholders.
08 December 2025	Direction No. 06 of 2025 on “Cyclone Ditwah” was issued to all general insurance companies, requiring them to refrain from declaring or distributing any dividends for the financial years 2024 and 2025 that had not already been declared or distributed. This measure was implemented as insurers have not yet fully assessed the extent of their exposure in view of the prevailing national situation arising from Cyclone Ditwah.
	Circular No. 04 of 2025 on “Premium Payment for General Insurance Policy” was issued to the general insurance companies, extending the time periods specified in Circular No. 03 of 2025 on the “Requirements on Premium Payment for Policies of General Insurance”
12 January 2026	Direction No. 01 of 2026 on “Principal Officers of Insurance Companies and Insurance Brokering Companies” was issued to the industry, requiring the Principal Officer of an insurer or insurance broker to be the highest-ranking executive of the company, responsible for the overall management and supervision of its business and for ensuring that all communications with IRCSL are brought to the attention of the Board of Directors.
20 February 2026	Direction No. 02 of 2026 on “Advertisement” was issued to the industry establishing mandatory standards for all insurance-related advertisements to ensure transparency and protect the public from misleading information.
03 March 2026	Circular No. 1 of 2026 on “Enforcement procedure for Non-Compliance of AML/CFT/CPF Obligations” was issued to the industry, establishing a risk-based enforcement procedure for insurers and insurance brokers that fail to comply with AML/CFT/CPF obligations.
11 March 2026	Direction No. 03 of 2026 on “Suitability of Persons of Insurers” was issued to insurers, requiring them to ensure the suitability of their Directors, Senior Management, Key Persons in Control Functions, and Beneficial Owners through ongoing assessments of competence, integrity, and financial soundness and submit internal self-assessments to the IRCSL annually, within 14 working days of relevant changes or appointments, or when circumstances arise that may materially affect an individual’s suitability.
31 March 2026	The Direction No. 04 of 2026 on “Banks, Licenced Finance Companies (LFCs), Licenced Leasing Companies” was issued to the industry (engaged in general insurance business) regulating interaction between general insurance businesses and Banks, Finance Companies, and Leasing Companies.
	Direction No. 05 of 2026 on “Premium Payment for Policies of Motor Insurance” was issued to the general insurance companies allowing them to grant a credit period of 30 days from the date of commencement of the cover for the payment of motor insurance premiums.

02 April 2026	Direction No. 06 of 2026 was issued to general insurance companies directing them to issue only Digital Motor Insurance Cards to policyholders with effect from 01 May 2026, as part of efforts to modernize motor insurance in line with national digitalisation initiatives and enhanced public security.
10 April 2026	Direction No. 04 of 2026 was issued to the industry, requiring insurers to accept insurance leads generated by Banks, LFCs and Licenced Leasing Companies only through registered insurance brokers, while preserving the policyholder's right to choose any insurance broker or insurance agent without discrimination.
17 April 2026	Direction No. 05 of 2026 was circulated to general insurance companies, informing them that insured persons under Motor Insurance Policies may grant a credit period of up to 30 days from the policy inception date to pay the full premium.
06 May 2026	Amendments to Determination No. 14 were circulated to insurance companies revising Compliance Certificate (B) for General Insurance / Long Term Insurance in the regulatory reporting formats of Annual Returns.
07 May 2026	Direction No. 07 of 2026 was issued to industry, replacing Item 3 of Direction No. 01 of 2026 and revising the requirements applicable to Principal officers. Amendments to Determination No. 12 were circulated to insurance companies revising Compliance Certificate (B) in the regulatory reporting formats of Quarterly Returns.
01 June 2026	Amended Terms and Conditions on the "Placement of Reinsurance" were issued to the industry, clarifying that foreign reinsurance brokers may directly place reinsurance business for insurers or brokers from within their own jurisdictions and merely participating in tenders or bid meetings in Sri Lanka does not constitute conducting brokering business in Sri Lanka.

Financial Markets

Money Market

24 March 2026	Rules on "Reserve Requirement" No.01 of 2026 was published in Gazette (Extraordinary) Notification No. 2481/09.
27 March 2026	Circular No.01 of 2026 on "Operating Instructions on Reserve Requirement" was issued to all Licenced Commercial Banks in respect of the calculation and maintenance of Reserve Requirement (Required reserves) with the Central Bank.

Capital Market⁴

January 2026	Commission approval was obtained for policy measures pertaining to Shariah Compliant Debt Products and Whitelist Indices, including expansion of the pool of Accredited Shariah Scholars, reduction of the number of scholars required to certify Sukuk products and Whitelist Indices, prior to publishing of the Index, from three to two, amending the relevant Securities and Exchange Commission of Sri Lanka (SEC) Guidelines and the issuance of related Directives.
February 2026	Following Commission approval, Directives were issued to the Colombo Stock Exchange (CSE), Market Institutions, Market Intermediaries, and Accredited Shariah Scholars, setting out revised requirements for Sharia compliance certification of Sukuk Products and Whitelist Equity Indices, and Updating the Guidelines applicable to Accredited Shariah Scholars.

⁴ These are policy measures implemented by the Securities and Exchange Commission (SEC).

June 2026	Representing the SEC as Members of the Sub Committee on Virtual Assets (VAs) and Virtual Asset Service Providers (VASPs). i. In support of fulfilling the Financial Action Task Force (FATF) requirements, and in recognition of the increasing significance of VAs and the associated opportunities and risks, a Sub-Committee on VASPs was established under the policy direction of the AML/CFT National Coordinating Committee (NCC). ii. Accordingly, a Cabinet Memorandum was developed by the Ministry of Digital Economy (MoDE) to introduce a regulatory framework for VAs and VASPs.
	Concurrence of the Commission was obtained for the establishment of a National Coordination Mechanism for Green, Social, Sustainability and Sustainability Linked (GSS+) Finance Initiatives in Sri Lanka.
July 2026	The SEC, the CSE, and the Institute of Chartered Accountants of Sri Lanka signed a Corporative Memorandum of Understanding (MoU) to support the introduction of XBRL reporting for listed entities.

Financial Infrastructure

Payments and Settlements

23 December 2025	The Money or Value Transfer Service (MVTs) Providers Regulations No. 01 of 2025 were amended and issued with effect from 31 December 2025. The amended regulations require both overseas and domestic money transfer service providers to register under the regulatory and supervisory framework of the MVTs Regulations.
20 January 2026	Customer transaction limits and fees applicable to JustPay were revised with effect from 2 February 2026 to promote the adoption of digital payments. Accordingly, the maximum transaction limit was increased from Rs. 50,000/- to Rs. 150,000/-. In addition, for transactions valued between Rs. 8,001/- and Rs. 150,000/-, the customer fee was set at Rs. 20/- per transaction, while the merchant fee was fixed at Rs. 40/- per transaction.
13 March 2026	LANKAQR code-based facilities were expanded to facilitate Peer-to-Peer (P2P) fund transfers up to Rs. 5,000/- to enhance the adoption and effective use of LANKAQR. In addition, the Merchant Discount Rate (MDR) for merchant presented LANKAQR code-based payments and the fee for P2P fund transfers made through LANKAQR were waived for transactions up to Rs. 5,000/- or below, with effect from 31 March 2026.
	With effect from 16 March 2026, all members of the Board and Senior Management operating a Mobile Phone based e-Money System are required to submit annual declarations to the Central Bank, confirming compliance with applicable regulatory standards, including relevant FATF recommendations.
25 May 2026	The Liability Manager (LM) functionality applicable to the Common Electronic Fund Transfer Switch (CEFTS) and the Common ATM Switch (CAS), operated by Lanka Pay (Pvt) Ltd. (LPPL), was discontinued with effect from 01 June 2026. Concurrently, the Central Bank introduced a Net Debit Cap (NDC) and Settlement Guarantee Amount (SGA) based credit risk mitigation mechanism, requiring CEFTS and CAS participants that are also participants of the Real-Time Gross Settlement (RTGS) system to comply. This mechanism is aimed at guaranteeing the settlement of the multilateral net clearing balances relating to CEFTS and the CAS.
17 June 2026	With effect from 01 October 2026, the maximum transaction value limit for Peer-to-Peer (P2P) fund transfers through LANKAQR was increased to Rs. 50,000/-, subject to a maximum transaction fee of Rs. 25/-.

Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT)

10 September 2025	Guidelines No. 04 of 2025 on “Reporting Information under Section 15(1)(a) of the Financial Transactions Reporting Act No. 6 of 2006” was issued.
11 September 2025	Guidelines No. 05 of 2025 on “Reporting Information under Section 15(1)(a) of the Financial Transactions Reporting Act No. 6 of 2006” was issued.
	Guideline No.06 of 2025 regarding “Requests for Information under Section 15(1)(a) of the Financial Transactions Reporting Act No.6 of 2006” was issued.
	Guidelines No. 07 of 2025 on “Reporting Information under Section 15(1)(a) of the Financial Transactions Reporting Act No. 6 of 2006” was issued.
16 December 2025	Red Flag Indicators No. 03 of 2025 on “Identification of Suspicious Transactions relating to Authorized Dealers and Restricted Dealers” was issued.
11 March 2026	Red Flag Indicators No. 01 of 2026 on “Terrorist Financing for Reporting Institutions” was issued.
	Red Flag Indicators No. 02 of 2026 on “Terrorist Financing for Law Enforcement Authorities” was issued.
13 March 2026	Circular No. 01 of 2026 on “Review and Update of Institutional Risk Assessments” in line with the National Money Laundering, Terrorist Financing and Proliferation Financing Risk Assessment 2024/25.
12 May 2026	Red Flag Indicators No. 03 of 2026 on “Proliferation Financing for Reporting Institutions” was issued.
	Red Flag Indicators No. 04 of 2026 on “Proliferation Financing for Regulators and Competent Authorities” was issued
15 May 2026	Red Flag Indicators No. 05 of 2026 on “Scam Operations in Sri Lanka Involving Foreign Nationals” was issued.
22 May 2026	Circular No. 02 of 2026 on “Certification of Database Screening against Sanctioned Individuals/Entities” was issued.
07 July 2026	Circular No. 03 of 2026 was issued on the “Application of Enhanced Due Diligence (EDD) Measures and Countermeasures” in respect of jurisdictions identified by the FATF as higher-risk jurisdictions.
09 July 2026	The Prevention of Money Laundering (Amendment) Bill was passed in Parliament with the required special majority, in accordance with the determination of the Supreme Court. The Financial Transactions Reporting (Amendment) Bill was passed, with amendments, without a division, while the Convention on the Suppression of Terrorist Financing (Amendment) Bill was passed without amendments and without a division.

Foreign Exchange Management

18 December 2025	An Order issued under Section 22 of the Foreign Exchange Act, No. 12 of 2017 (FEA), and published in Extraordinary Gazette Notification No. 2467/67 dated 18 December 2025, relaxing several restrictions/limitations imposed under the Order dated 20 June 2025 in respect of foreign exchange outflows from the country.
30 January 2026	Rules No. 01 of 2026 on “Repatriation of Export Proceeds into Sri Lanka” were issued under the provisions of the CBA, and published in Extraordinary Gazette No. 2473/30 dated 30 January 2026, allowing exporters of goods to utilise the repatriated export proceeds for investments in debt securities denominated in foreign currency issued by the Government of Sri Lanka. Upon parliamentary approval, these rules came into effect on 03 March 2026.

03 March 2026	Directions No. 01 of 2026 on “Personal Foreign Currency Accounts (PFCAs)” were issued to facilitate making investments in debt securities denominated in foreign currency issued by the Government of Sri Lanka.
	Directions No. 02 of 2026 on “Business Foreign Currency Accounts (BFCAs)” were issued to facilitate making investments in debt securities denominated in foreign currency issued by the Government of Sri Lanka.
	Directions No. 03 of 2026 dated 03 March 2026 were issued on “Colombo Port City Investment Account - Investee (CPCIA-Investee)” to facilitate making the investments in debt securities denominated in foreign currency issued by the Government of Sri Lanka.
	Directions No. 04 of 2026 on “Special Foreign Currency Account – Designated Agent (SFCA-DA)” were issued to facilitate the transactions of the designated agents in respect of debt securities denominated in foreign currency issued by the Government of Sri Lanka.
09 June 2026	Rules No. 02 of 2026 on “Repatriation of Export Proceeds into Sri Lanka” were issued under the CBA and published in the Extraordinary Gazette No. 2492/10 dated 09 June 2026, reducing the mandatory conversion period of the residual amount of the export proceeds repatriated to Sri Lanka, after making the authorized payments, from three months to one month. Upon parliamentary approval, these rules came into effect on 10 June 2026.
18 June 2026	Regulations No. 01 of 2026 on “Foreign Exchange (Overseas Investments Made by Persons Resident in Sri Lanka)”, were issued under Section 29 read with Section 7 of the FEA and published in the Extraordinary Gazette No. 2493/36 dated 18 June 2026 to regulate overseas investments of the person resident in Sri Lanka.
	Regulations No. 02 of 2026 on “Foreign Exchange (Fund Transfers Abroad by Emigrants)”, were issued under Section 29 read with Section 7 of the FEA and published in Extraordinary Gazette No. 2493/37 dated 18 June 2026 to regulate fund transfers abroad by the emigrants.
	An Order issued under Section 22 of the FEA and published in Extraordinary Gazette No. 2493/38 dated 18 June 2026 relaxing several restrictions/limitations imposed under the Order dated 18 December 2025 in respect of foreign exchange outflows from the country.

Deposit Insurance and Resolution

04 July 2025	A resolution action for Nation Lanka Finance PLC (NLFP) was implemented under the BSPA and an Administrator was appointed by the Central Bank in its capacity as the Resolution Authority.
06 August 2025	A Panel of Independent Professional Valuers for the resolution of licenced financial institutions was appointed.
17 September 2025	A set of resolution triggers for FCs was developed to facilitate timely intervention in failing institutions.
15 December 2025	BSPA Directions No. 02 of 2025 on “Display of Membership of the Sri Lanka Deposit Insurance Scheme and availability of Deposit Insurance Coverage” was issued.
20 March 2026	BSPA Directions No. 02 of 2026 on “Amendment to the BSPA Directions No. 01 of 2024 on data templates for resolution planning for Licenced Banks” was issued, exempting foreign banks from the submission of resolution data templates for resolution planning of Licenced Banks.
01 April 2026	The term of the Administrator appointed to NLFP under the BSPA was extended for further period of six months.
20 April 2026	Instructions No. 01/2026 under Section 44(13) of the BSPA, were issued to all Member Institutions (MIs) of Sri Lanka Deposit Insurance Scheme (SLDIS), requiring them to submit information on deposit products for the purpose of maintaining an updated repository of deposit products of MIs and strengthening oversight.

23 April 2026	An SLDIS Policy on providing financial assistance to facilitate the transfer of assets and liabilities of a member institution as a resolution measure was formulated.
	A Contingency Plan was developed to establish a framework for the SLDIS to respond swiftly and effectively to the unexpected failure of an MI, including systemically important financial institutions, and to the simultaneous failure of multiple MIs or in cases of severe financial crises.
11 May – 22 May 2026	A Payout Simulation Exercise (PSE) was conducted to assess the operational readiness and timely executability of initiation of the compensation process in the event of a licence cancellation of a Licenced Bank.
03 July 2026	The licence issued to NLFP under the FBA to carry on finance business, was cancelled in terms of section 66(2) of the BSPA, and compensation payments to insured depositors of NLFP commenced under SLDIS.
04 July 2026	The term of the Administrator appointed to NLFP under the BSPA was extended for a further period of six months.

Financial Consumer Relations

18 November 2025	Determination of SGO as a prohibited scheme.
11 February 2026	An instruction on disclosure of annual effective rate of interest was issued to all Licenced Banks and all LFCs.
24 February 2026	Determination of ICAN advertising (Pvt) Ltd company as a prohibited scheme.
01 July 2026	Determination of Infinity Rover (Pvt) Ltd company as a prohibited scheme.

Appendix
1

Financial Soundness Indicators - Banking Sector

	2021 (%)	2022 (%)	2023 (%)	2024 (%)	2025* (%)	2026 Jun** (%)
1. Capital Adequacy						
1.1 Capital Adequacy Ratio (a)	16.5	16.2	11.8	17.8	19.2	18.2
1.2 Tier 1 Capital Ratio (b)	13.2	13.2	15.2	16.7	15.9	14.8
1.3 Net Non-performing Loans (c) to Equity Capital & Reserves	11.5					
1.4 Net Stage 3 Loans (d) to Equity Capital & Reserves		44.0	40.9	31.5	23.7	21.2
1.5 Debt to Equity Capital & Reserves	148.9	117.1	79.1	62.9	71.4	74.4
1.6 Equity Capital & Reserves to Total Assets	8.7	8.2	8.7	9.3	9.5	9.7
2. Asset Quality						
2.1 Non-performing Loans (e) to Total Loans & Advances	4.5					
2.2 Stage 3 Loans (f) to Total Loans & Advances (f)		11.3	12.8	12.3	9.7	9.1
2.3 Net Non-performing Loans (c) to Total Loans & Advances	1.7					
2.4 Net Stage 3 Loans (d) to Total Loans & Advances (f)		6.2	6.5	5.5	4.0	3.5
2.5 Total Provisions (g) to Total Loans & Advances	3.4					
2.6 Total Provision Coverage Ratio (h)	75.8					
2.7 Total Impairment Coverage Ratio (i)		7.9	8.6	8.5	7.3	7.1
2.8 Specific Provision Coverage Ratio (j)	64.0					
2.9 Stage 3 Impairment Coverage Ratio (k)		45.2	49.0	54.1	58.5	61.3
2.10 Total Provisions (g) to Total Assets	2.1					
2.11 Total Impairment (l) to Total Assets		4.7	4.7	4.5	4.1	4.2
2.12 Total Loans & Advances to Total Assets	61.9	58.3	54.0	51.8	55.8	58.6
2.13 Investments to Total Assets	29.1	30.5	35.8	41.0	37.7	34.3
2.14 Total Income to Average Assets (m)	8.1	12.2	13.8	10.5	10.7	11.2
2.15 Net Interest Income to Average Assets (n)	3.2	3.9	3.5	4.1	4.3	4.4
2.16 Operating Income (o) to Average Assets (p)	4.2	5.3	4.5	4.4	5.4	5.8
3. Earnings & Profitability						
3.1 Return on Equity (ROE) – After Tax (q)	14.5	10.4	11.5	17.4	16.9	17.5
3.2 Return on Assets (ROA) – Before Tax (r)	1.6	0.9	1.5	2.6	2.5	2.5
3.3 Return on Assets (ROA) – After Tax (s)	1.2	0.8	1.0	1.6	1.6	1.7
3.4 Interest Income to Total Income	87.8	88.1	92.6	96.9	89.5	87.3
3.5 Net Interest Income to Total Income	40.2	31.8	25.4	39.3	40.0	39.5
3.6 Non-Interest Income to Total Income	12.2	11.9	7.4	3.1	10.5	12.7
3.7 Non-Interest Expenses (Operating Expenses) to Total Income	22.0	13.7	13.3	19.2	19.1	19.1
3.8 Staff Expenses to Non-Interest Expenses	45.2	53.5	50.8	54.3	53.8	52.4
3.9 Staff Expenses to Total Income	9.9	7.3	6.7	10.4	10.3	10.0
3.10 Provision Charge to Total Income	6.7					
3.11 Impairment Charge to Total Income		19.9	6.1	-6.8	2.3	4.9
3.12 Total Cost to Total Income (t)	69.5	70.0	80.5	76.9	68.6	66.9
3.13 Efficiency (Operating Cost) Ratio (u)	48.1	31.4	40.5	45.3	37.8	36.6
3.14 Net Interest Margin (v)	3.4	4.0	3.7	4.4	4.3	4.4
4. Liquidity						
4.1 High Quality Liquid Assets (All Currency) to Total Assets	19.7	18.5	32.2	38.6	33.8	29.5
4.2 Rupee LCR	221.0	217.8	340.9	349.9	283.3	272.5
4.3 All Currency LCR	176.2	191.2	288.4	313.8	249.6	229.7
5. Assets / Funding Structure						
5.1 Deposits to Total Assets	76.4	78.8	81.5	81.1	79.9	79.2
5.2 Borrowings to Total Assets	13.1	9.6	6.9	5.8	6.8	7.2
5.3 Capital to External Funds (w)	9.9	9.3	9.8	10.7	11.0	11.3
5.4 Credit to Deposits	82.7	73.9	66.3	63.9	69.9	74.0
5.5 Credit to Deposits & Borrowings	70.6	65.9	61.1	59.6	64.4	67.8
5.6 Credit to Deposits & Borrowings & Capital	64.2	60.3	55.7	53.8	58.0	61.0

Source: Central Bank of Sri Lanka

* Revised

** Provisional

(a) The ratio of regulatory capital to risk-weighted assets

(b) The ratio of core capital to risk-weighted assets

(c) Non performing loans net of interest in suspense and specific provisions

(d) Net of Stage 3 impairment and including undrawn portion

(e) Net of interest in suspense

(f) Including undrawn portion

(g) Specific loan loss provisions and general loan loss provisions

(h) The ratio of specific provisions and general provisions to non-performing advances net of interest in suspense

(i) The ratio of total impairment to total loans and receivables

(j) The ratio of specific provisions to non-performing advances net of interest in suspense

(k) The ratio of stage 3 impairment to stage 3 loans

(l) Individual impairment and collective impairment

(m) Total income (annualized) as a percentage of average assets

(n) Net interest income (annualized) as a percentage of average assets

(o) Operating income (gross income) includes net interest income and non-interest income

(p) Operating income (annualized) as a percentage of average assets

(q) Profit after tax (annualised) as a percentage of average equity

(r) Profit before tax (annualised) as a percentage of average assets

(s) Profit after tax (annualised) as a percentage of average assets

(t) The ratio of interest expenses and non-interest expenses to interest income and non-interest income

(u) The ratio of operating expenses to gross income

(v) The ratio of net interest income (annualised) to average assets

(w) Deposits and borrowings (debt)

Appendix
2

Financial Soundness Indicators - Licensed Commercial Banks

	2021 (%)	2022 (%)	2023 (%)	2024 (%)	2025* (%)	2026 Jun** (%)
1. Capital Adequacy						
1.1 Capital Adequacy Ratio (a)	16.7	16.0	18.3	20.1	19.0	18.1
1.2 Tier 1 Capital Ratio (b)	13.2	13.1	15.1	16.6	15.6	14.6
1.3 Net Non-performing Loans (c) to Equity Capital & Reserves	9.9					
1.4 Net Stage 3 Loans (d) to Equity Capital & Reserves		43.5	40.2	29.7	22.8	20.2
1.5 Debt to Equity Capital & Reserves	154.6	118.0	75.0	61.4	71.9	75.6
1.6 Equity Capital & Reserves to Total Assets	9.0	8.6	9.0	9.6	9.8	10.0
2. Asset Quality						
2.1 Non-performing Loans (e) to Total Loans & Advances	4.3					
2.2 Stage 3 Loans (f) to Total Loans & Advances (f)		11.5	13.0	12.2	9.7	9.1
2.3 Net Non-performing Loans (c) to Total Loans & Advances	1.4					
2.4 Net Stage 3 Loans (d) to Total Loans & Advances (f)		6.5	6.9	5.8	3.9	3.4
2.5 Total Provisions (g) to Total Loans & Advances	3.4					
2.6 Total Provision Coverage Ratio (h)	80.4					
2.7 Total Impairment Coverage Ratio (i)		8.2	8.9	8.7	7.4	7.3
2.8 Specific Provision Coverage Ratio (j)	67.9					
2.9 Stage 3 Impairment Coverage Ratio (k)		46.2	50.1	56.0	60.0	63.0
2.10 Total Provisions (g) to Total Assets	2.2					
2.11 Total Impairment (l) to Total Assets		5.1	5.0	4.7	4.3	4.4
2.12 Total Loans & Advances to Total Assets	64.5	59.9	55.6	52.9	57.1	59.9
2.13 Investments to Total Assets	26.6	28.5	33.8	39.8	36.2	32.8
2.14 Total Income to Average Assets (m)	7.9	12.2	13.7	10.3	10.6	11.2
2.15 Net Interest Income to Average Assets (n)	3.1	4.0	3.6	4.1	4.2	4.3
2.16 Operating Income (o) to Average Assets (p)	4.2	5.6	4.7	4.4	5.4	5.9
3. Earnings & Profitability						
3.1 Return on Equity (ROE) – After Tax (q)	13.8	11.0	11.8	17.8	16.8	17.6
3.2 Return on Assets (ROA) – Before Tax (r)	1.6	1.0	1.6	2.7	2.5	2.5
3.3 Return on Assets (ROA) – After Tax (s)	1.2	0.9	1.1	1.6	1.6	1.7
3.4 Interest Income to Total Income	86.3	86.9	92.1	96.8	88.6	86.2
3.5 Net Interest Income to Total Income	39.7	32.7	26.4	39.5	39.4	38.8
3.6 Non-Interest Income to Total Income	13.7	13.1	7.9	3.2	11.4	13.8
3.7 Non-Interest Expenses (Operating Expenses) to Total Income	22.2	13.4	13.2	19.1	18.9	18.6
3.8 Staff Expenses to Non-Interest Expenses	43.6	51.4	48.4	52.0	51.9	49.8
3.9 Staff Expenses to Total Income	9.7	6.9	6.4	9.9	9.8	9.3
3.10 Provision Charge to Total Income	7.3					
3.11 Impairment Charge to Total Income		21.8	6.6	-8.3	2.5	5.6
3.12 Total Cost to Total Income (t)	68.8	67.5	78.8	76.4	68.0	66.1
3.13 Efficiency (Operating Cost) Ratio (u)	48.2	29.2	38.3	44.7	37.1	35.4
3.14 Net Interest Margin (v)	3.3	4.1	3.8	4.3	4.2	4.3
4. Liquidity						
4.1 High Quality Liquid Assets (All Currency) to Total Assets	17.2	17.3	31.1	38.0	32.6	28.2
4.2 Rupee LCR	216.3	213.1	346.1	351.0	276.0	267.4
4.3 All Currency LCR	162.7	190.5	285.4	311.0	240.7	221.7
5. Assets / Funding Structure						
5.1 Deposits to Total Assets	75.1	77.9	81.3	80.6	79.4	78.7
5.2 Borrowings to Total Assets	14.1	10.1	6.7	5.9	7.1	7.6
5.3 Capital to External Funds (w)	10.3	9.7	10.2	11.1	11.3	11.6
5.4 Credit to Deposits	87.6	76.9	68.4	65.5	71.9	76.2
5.5 Credit to Deposits & Borrowings	73.7	68.1	63.1	61.1	66.0	69.5
5.6 Credit to Deposits & Borrowings & Capital	66.9	62.0	57.3	55.0	59.3	62.3

Source: Central Bank of Sri Lanka

* Revised

** Provisional

(a) The ratio of regulatory capital to risk-weighted assets

(b) The ratio of core capital to risk-weighted assets

(c) Non performing loans net of interest in suspense and specific provisions

(d) Net of Stage impairment and including undrawn portion

(e) Net of interest in suspense

(f) Including undrawn portion

(g) Specific loan loss provisions and general loan loss provisions

(h) The ratio of specific provisions and general provisions to non-performing loans net of interest in suspense

(i) The ratio of total impairment to total loans and receivables

(j) The ratio of specific provisions to non-performing advances net of interest in suspense

(k) The ratio of stage 3 impairment to stage 3 loans

(l) Individual impairment and collective impairment

(m) Total income (annualized) as a percentage of average assets

(n) Net interest income (annualized) as a percentage of average assets

(o) Operating income (gross income) includes net interest income and non-interest income

(p) Operating income (annualized) as a percentage of average assets

(q) Profit after tax (annualised) as a percentage of average equity

(r) Profit before tax (annualised) as a percentage of average assets

(s) Profit after tax (annualised) as a percentage of average assets

(t) The ratio of interest expenses and non-interest expenses to interest income and non-interest income

(u) The ratio of operating expenses to gross income

(v) The ratio of net interest income (annualised) to average assets

(w) Deposits and borrowings (debt)

Appendix
3

Financial Soundness Indicators - Licensed Specialised Banks

	2021 (%)	2022 (%)	2023 (%)	2024 (%)	2025* (%)	2026 Jun** (%)
1. Capital Adequacy						
1.1 Capital Adequacy Ratio (a)	14.6	18.5	20.1	22.9	22.7	19.9
1.2 Tier 1 Capital Ratio (b)	12.0	14.8	16.8	19.8	20.3	17.9
1.3 Net Non-performing Loans (c) to Equity Capital & Reserves	27.6					
1.4 Net Stage 3 Loans (d) to Equity Capital & Reserves		50.3	49.6	53.5	35.7	33.4
1.5 Debt to Equity Capital & Reserves	93.6	106.4	129.5	81.4	64.8	58.8
1.6 Equity Capital & Reserves to Total Assets	6.4	5.6	5.9	6.5	7.2	7.4
2. Asset Quality						
2.1 Non-performing Loans (e) to Total Loans & Advances	6.5					
2.2 Stage 3 Loans (f) to Total Loans & Advances (f)		9.0	10.6	12.9	10.2	9.2
2.3 Net Non-performing Loans (c) to Total Loans & Advances	4.1					
2.4 Net Stage 3 Loans (d) to Total Loans & Advances (f)		6.4	7.3	8.8	6.0	5.4
2.5 Total Provisions (g) to Total Loans & Advances	2.8					
2.6 Total Provision Coverage Ratio (h)	43.8					
2.7 Total Impairment Coverage Ratio (i)		4.3	5.5	6.1	5.7	5.3
2.8 Specific Provision Coverage Ratio (j)	37.5					
2.9 Stage 3 Impairment Coverage Ratio (k)		31.4	34.0	34.5	40.8	40.6
2.10 Total Provisions (g) to Total Assets	1.2					
2.11 Total Impairment (l) to Total Assets		1.9	2.4	2.6	2.4	2.4
2.12 Total Loans & Advances to Total Assets	44.0	45.4	42.0	43.2	44.6	46.6
2.13 Investments to Total Assets	46.5	46.8	51.3	51.7	50.5	48.3
2.14 Total Income to Average Assets (m)	9.0	11.5	14.7	12.1	11.5	11.3
2.15 Net Interest Income to Average Assets (n)	3.9	2.8	2.6	4.5	5.1	5.2
2.16 Operating Income (o) to Average Assets (p)	4.1	2.9	3.1	4.8	5.4	5.5
3. Earnings & Profitability						
3.1 Return on Equity (ROE) – After Tax (q)	21.5	3.4	7.7	12.4	18.0	17.1
3.2 Return on Assets (ROA) – Before Tax (r)	1.7	0.3	0.4	1.4	2.1	2.2
3.3 Return on Assets (ROA) – After Tax (s)	1.3	0.2	0.4	0.8	1.3	1.2
3.4 Interest Income to Total Income	97.4	98.6	97.0	97.7	97.0	97.1
3.5 Net Interest Income to Total Income	43.7	24.1	17.8	37.3	44.4	45.9
3.6 Non-Interest Income to Total Income	2.6	1.4	3.0	2.3	3.0	2.9
3.7 Non-Interest Expenses (Operating Expenses) to Total Income	20.5	16.7	14.0	19.7	20.9	23.4
3.8 Staff Expenses to Non-Interest Expenses	55.7	67.2	67.8	70.3	67.8	70.6
3.9 Staff Expenses to Total Income	11.4	11.2	9.5	13.9	14.2	16.5
3.10 Provision Charge to Total Income	3.0					
3.11 Impairment Charge to Total Income		3.4	2.6	4.1	1.3	-0.9
3.12 Total Cost to Total Income (t)	74.3	91.2	93.2	80.1	73.5	74.7
3.13 Efficiency (Operating Cost) Ratio (u)	47.3	65.4	67.2	49.7	44.1	48.0
3.14 Net Interest Margin (v)	4.1	2.8	2.6	4.6	5.1	5.2
4. Liquidity						
4.1 High Quality Liquid Assets (All Currency) to Total Assets	37.4	27.9	40.4	43.9	44.7	41.4
4.2 Rupee LCR	235.3	235.3	313.2	342.4	340.4	307.2
4.3 All Currency LCR	240.4	194.5	308.1	336.5	330.9	296.9
5. Assets / Funding Structure						
5.1 Deposits to Total Assets	85.7	85.9	83.7	85.4	84.6	84.4
5.2 Borrowings to Total Assets	6.1	6.0	7.7	5.3	4.7	4.4
5.3 Capital to External Funds (w)	7.2	6.1	6.5	7.2	8.1	8.4
5.4 Credit to Deposits	52.5	52.9	50.2	50.6	52.7	55.2
5.5 Credit to Deposits & Borrowings	49.0	49.5	46.0	47.6	49.9	52.5
5.6 Credit to Deposits & Borrowings & Capital	45.7	46.6	43.2	44.4	46.2	48.4

Source: Central Bank of Sri Lanka

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(a) The ratio of regulatory capital to risk-weighted assets

(b) The ratio of core capital to risk-weighted assets

(c) Non performing loans net of interest in suspense and specific provisions

(d) Net of Stage 3 impairment and including undrawn portion

(e) Net of interest in suspense

(f) Including undrawn portion

(g) Specific loan loss provisions and general loan loss provisions

(h) The ratio of specific provisions and general provisions to non-performing advances net of interest in suspense

(i) The ratio of total impairment to total loans and receivables

(j) The ratio of specific provisions to non-performing advances net of interest in suspense

(k) The ratio of Stage 3 impairment to Stage 3 loans

(l) Individual impairment and collective impairment

(m) Total income (annualized) as a percentage of average assets

(n) Net interest income (annualized) as a percentage of average assets

(o) Operating income (gross income) includes net interest income and non-interest income

(p) Operating income (annualized) as a percentage of average assets.

(q) Profit after tax (annualised) as a percentage of average equity

(r) Profit before tax (annualised) as a percentage of average assets

(s) Profit after tax (annualised) as a percentage of average assets

(t) The ratio of interest expenses and non-interest expenses to interest income and non-interest income

(u) The ratio of operating expenses to gross income

(v) The ratio of net interest income (annualised) to average assets

(w) Deposits and borrowings (debt)

Appendix
4Financial Soundness Indicators - Finance Companies Sector¹

	2021 Mar (%)	2022 Mar (%)	2023 Mar (%)	2024 Mar (%)	2025 Mar* (%)	2026 Mar** (%)	2026 Jun** (%)
1. Capital Adequacy							
1.1 Regulatory Capital to Risk Weighted Assets (RWCAR)	14.8	17.3	22.0	21.9	20.9	20.4	19.3
1.2 Tier 1 Capital to Risk Weighted Assets (Tier 1 RWCAR)	13.6	15.8	20.7	21.0	20.0	18.5	17.3
1.3 Regulatory Capital to Total Assets	15.0	16.3	18.9	18.7	17.8	17.0	16.3
1.4 Borrowings to Equity (times)	1.1	1.1	0.7	0.6	0.7	1.8	1.8
1.5 Investment Properties to Regulatory Capital	16.6	16.9	17.3	18.0	18.5	13.2	13.1
1.6 Net stage 3 Loans to Regulatory Capital	15.6	9.2	43.2	37.5	20.0	11.9	15.3
1.7 Tier 1 Capital after Adjustments to Assets (Leverage Ratio)	13.7	14.8	17.8	18.0	17.1	15.5	14.6
2. Asset Quality							
2.1 Gross Stage 3 Loans to Total Loans & Advances	11.3	9.0	15.9	14.7	8.6	4.5	5.1
2.2 Net Stage 3 Loans to Total Loans & Advances	2.8	1.8	10.6	9.4	4.5	2.4	3.0
2.3 Impairment for Total Loans & Advances	7.2	6.3	7.6	7.0	5.5	3.1	3.2
2.4 Stage 3 Impairment Coverage Ratio	64.0	69.6	33.3	35.7	47.4	45.8	41.0
3. Earnings & Profitability							
3.1 Return on Assets (Annualised)	3.1	5.3	3.8	5.5	6.6	6.2	5.7
3.2 Return on Equity (Annualised)	12.8	20.8	9.4	12.9	15.2	17.3	15.6
3.3 Interest Income to Interest Expenses	204.2	252.1	171.2	185.3	237.1	238.5	217.9
3.4 Net Interest Income to Profit After Tax	381.3	213.5	407.3	321.4	289.7	280.6	346.4
3.5 Operating Cost to Net Interest Income	70.6	63.6	62.8	60.7	58.1	55.3	53.9
3.6 Net Interest Income to Average Assets (Annualised)	7.4	8.0	8.5	10.0	10.7	9.9	10.4
3.7 Net Interest Income to Interest Income	51.0	60.3	41.6	46.0	57.8	58.1	54.1
3.8 Net Interest Income to Total Income	43.1	50.0	38.7	42.0	52.7	52.4	50.0
3.9 Non-Interest Income to Total Income	15.6	17.2	6.8	8.7	8.8	9.7	7.5
3.10 Non-Interest Expenses to Total Cost	42.4	49.2	29.4	33.2	45.3	43.0	37.0
3.11 Efficiency Ratio (Impairment Adjusted)	62.4	49.1	58.6	52.4	48.6	47.1	49.8
3.12 Cost to Income Ratio	81.7	67.0	82.8	76.8	67.6	67.4	72.8
4. Liquidity							
4.1 Liquid Assets to Total Assets	8.9	9.8	14.0	14.8	11.8	8.9	8.5
4.2 Liquid Assets to Deposits and Borrowings	12.6	14.1	19.2	21.0	16.7	11.5	10.9
4.3 Excess/Deficit in Liquid Assets to Required Liquid Assets	160.5	76.6	125.4	140.8	99.3	66.1	58.5
4.4 Net Loans to Total Borrowings	375.5	337.4	412.2	488.7	438.2	249.5	243.9
5. Assets / Funding Structure							
5.1 Borrowings to Total Assets	20.2	22.6	17.3	14.1	17.1	32.1	32.9
5.2 Credit to Deposits	149.9	159.9	138.3	132.4	147.9	184.1	185.8
5.3 Credit to Deposits & Borrowings	110.0	111.3	105.6	105.8	112.2	107.3	106.9
5.4 Investment to Total Assets	11.4	11.3	20.2	22.7	17.4	13.6	13.5

¹ Financial year of the majority of the FCs spans between 01 April of a given year and 31 March of the following year

Source: Central Bank of Sri Lanka

* Revised

** Provisional



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