

MONETARY POLICY REPORT

FEBRUARY 2026



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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

The Monetary Policy Report is a biannual publication. The content of the current Report is based on the data available as of the January 2026 monetary policy round of the Central Bank, which concluded with the monetary policy announcement on 28 January 2026.

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MONETARY POLICY FRAMEWORK OF THE CENTRAL BANK OF SRI LANKA

Under the Central Bank of Sri Lanka Act, No. 16 of 2023 (CBA), the primary objective of the Central Bank of Sri Lanka is to achieve and maintain domestic price stability. By maintaining low and stable inflation, the Central Bank contributes to promoting sustained economic growth over the long term, thereby supporting the well-being of the public.

The Central Bank conducts monetary policy to achieve and maintain domestic price stability. The Monetary Policy Board (MPB)¹ is responsible for formulating monetary policy and implementing a flexible exchange rate regime that is consistent with the Flexible Inflation Targeting (FIT) framework. This framework aims to keep inflation aligned with the target set out in an agreement between the Minister of Finance and the Central Bank. This agreement is known as the Monetary Policy Framework Agreement (MPFA). The current agreement, published in the Government Gazette in October 2023, requires the Central Bank to maintain quarterly headline inflation at 5%.² A margin of ±2 pps is allowed under MPFA (i.e., 3.0 % – 7.0%) to measure potential deviations from the target and for accountability purposes. A breach of the margin for two consecutive quarters requires the MPB to submit a report to Parliament through the Minister of Finance, which shall also be made available to the public.

The Central Bank uses its policy instruments to steer short-term market interest rates along the desired path to achieve the inflation target. Under the current monetary policy framework, the Overnight Policy Rate (OPR) serves as the Central Bank's primary monetary policy instrument to signal and implement its policy stance, with the Average Weighted Call Money Rate (AWCMR) serving as its operating target. Accordingly, once the OPR is announced, the Central Bank conducts and calibrates its monetary operations to maintain the AWCMR at or close to the OPR. In doing so, due consideration is also given to prevailing and anticipated domestic liquidity conditions. Subsequently, overnight market interest rates, aligned with the monetary policy stance, are transmitted through financial markets to the broader economy, ultimately influencing inflation.

Monetary policy decisions are forward-looking and data-driven. Given that monetary policy actions impact inflation with a lag, a forward-looking approach is essential. The MPB meets six times a year

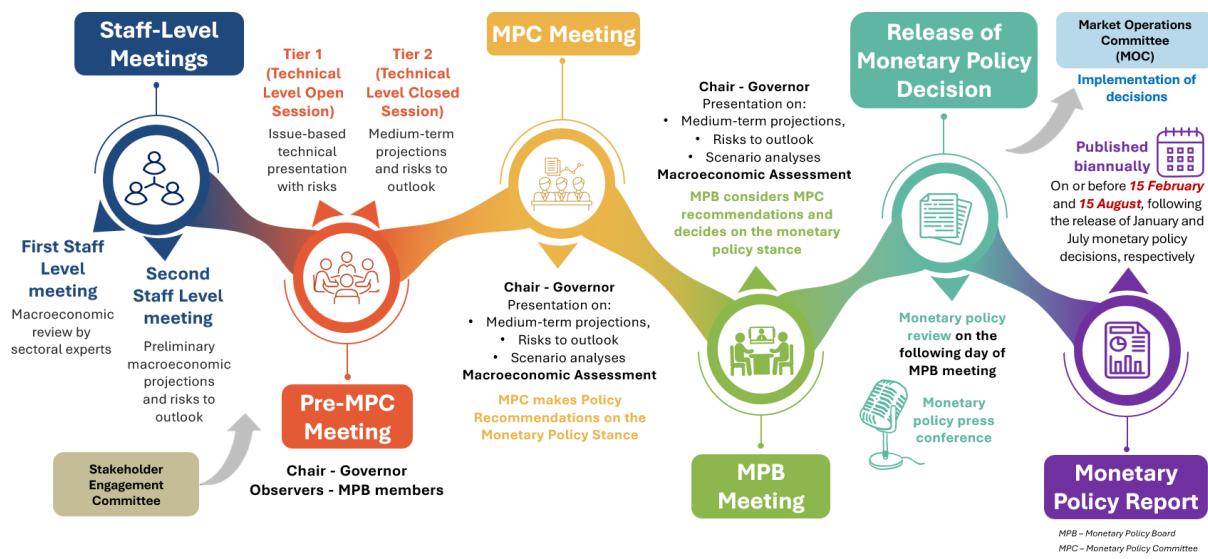
¹ The MPB of the Central Bank consists of the Governor, members of the Governing Board, two other appointed members, who are experts in Economics or Finance as well as the Deputy Governors in charge of price stability and financial system stability.

² The inflation target was communicated to the public in the [Extraordinary Gazette No. 2352/20](#). Quarterly headline inflation refers to the simple average of the y-o-y percentage changes in the monthly Colombo Consumer Price Index (CCPI) during the three months of the corresponding quarter.

to decide on the appropriate monetary policy stance. In making its decisions, the MPB evaluates current inflation dynamics and its outlook, the state of the economy and future economic prospects, and the associated risks and uncertainties surrounding such forecasts. The evaluation also takes into consideration the projected key global trends and uncertainties. The projections discussed during these meetings are based on available data, near-term forecasts of key macroeconomic variables, projections of global indicators, as well as expert staff judgements. The Monetary Policy Committee (MPC), an internal committee chaired by the Governor, provides policy recommendations for the consideration of the MPB, following detailed technical and policy deliberations.

The Monetary Policy Report, an important element of the FIT framework, is prepared as per Sections 27 and 80 of the CBA. These sections mandate the Central Bank to publish a biannual report that explains recent trends in inflation, underlying sources of inflation, medium-term inflation projections, including key risks to those projections and implementation of its monetary policy and the achievement of its objectives. This report serves as a testament to the Central Bank's commitment to policy transparency and credibility. In addition, it serves to raise public awareness on current economic affairs in the domestic economy, as well as the global economy, while providing an assessment of the economic growth outlook along with associated risk.

Figure 01: Monetary policy decision-making process in Sri Lanka (Six times a year)



EXECUTIVE SUMMARY

Sri Lanka's macroeconomic stability continued to strengthen in 2025, alongside notable progress in implementing critical structural and policy reforms. Although the year was marked by both severe domestic and global shocks, the economy demonstrated resilience, underscoring the effectiveness of decisive measures to strengthen policy buffers and the meaningful progress achieved in restoring stability and reinforcing economic fundamentals.

Marking the end of an eleven-month deflationary phase, inflation turned positive in August 2025. Thereafter, inflation accelerated only gradually and remained unchanged for three consecutive months through October to December 2025. Despite temporary supply chain disruptions caused by Cyclone Ditwah, which placed some upward pressure on food prices in December, overall inflation remained stable.

Inflation is projected to accelerate gradually and is expected to move towards the 5% target by H2-2026. This increasing trajectory can be broadly attributed to the gradual recovery in demand conditions, while the expected gradual transition of energy and transport inflation to its usual pace and the relatively elevated volatile food inflation also support this path. Inflation is expected to stabilise around the 5% target over the medium term, with the support of appropriate policy measures. Core inflation is also anticipated to stabilise at a level consistent with the headline inflation target. While both upside and downside risks to the inflation outlook remain, the overall balance of risks is assessed to be broadly neutral over the near and medium term.

The Central Bank continued its accommodative monetary policy stance, supported by subdued inflationary conditions in the economy and the benign inflation outlook. Although some tightening in short-term money market interest rates was tolerated towards the latter part of 2025, this tightening eased subsequently, aided by improved liquidity conditions and a more even distribution of liquidity among banks. Overall, the market interest rate structure adjusted downwards during 2025. In the low-interest rate environment, reflecting the improving economic activity and increased vehicle imports, credit flows to the private sector continued to expand during the year.

The external sector performance improved in 2025, with the current account estimated to have recorded a surplus for the third consecutive year. The Sri Lanka rupee depreciated by 5.6% against the USD in 2025, while remaining broadly stable in early 2026. Amidst servicing the country's highest post-crisis external debt service payments, gross official reserves increased

by end-2025 supported by significant net foreign exchange purchases by the Central Bank, together with inflows from multilateral institutions.

Fiscal sector performance continued to strengthen during the first eleven months of 2025 with sustained revenue-based fiscal consolidation measures. In response to the damages caused by Cyclone Ditwah, the Government implemented a series of relief measures, including initiatives to restore affected infrastructure, supported by a supplementary budget for 2026.

The economy recorded a robust expansion during the first nine months of 2025. Despite the slowdown in economic activity immediately following the disruptions caused by Cyclone Ditwah in late 2025, timely policy interventions are expected to support a faster recovery, generate positive spillover effects across sectors, and reinforce overall economic momentum, thereby indicating greater resilience in the period ahead. Leading indicators also point to continued resilience in economic activity, while stronger credit expansion and the prevailing accommodating monetary conditions are expected to further support this momentum. However, external headwinds arising from rising global trade frictions and heightened geopolitical uncertainties could weigh on overall economic performance and growth prospects.

1. MONETARY POLICY SUMMARY

The Central Bank of Sri Lanka continued its accommodative monetary policy stance in 2025 and thus far in 2026. Since the reduction of the Overnight Policy Rate (OPR) by 25 bps in May 2025 to 7.75%, the policy interest rate was maintained at the same level. The continuation of this policy stance was largely supported by the persistence of low inflation and the benign inflation outlook in the context of a gradual recovery of overall demand.

At the 5th Monetary Policy Review in September 2025, the Central Bank decided to maintain OPR at the current level, for the second consecutive review following the policy rate cut in May 2025. This was supported by the return of inflation to positive territory in August 2025, as expected, after eleven consecutive months of deflation. Moreover, inflation was projected to gradually converge towards the target, with inflation expectations moving closer to the target. Meanwhile, ongoing downward adjustments in market interest rates, high growth momentum, and resilient external sector also favoured the decision.

In November 2025, the Central Bank held the policy rate unchanged as inflation was projected to converge towards the inflation target, albeit with a delay, amid depreciation pressures observed with the acceleration in import demand. Additionally, monetary conditions remained sufficiently accommodative, supporting the continued expansion of credit to the private sector, reflecting increased credit flows to support growing economic activity and rising import demand, particularly for vehicle imports.

Given the moderate inflation outturn and the expected convergence of inflation towards the target by H2-2026, OPR was maintained at the same level at the recent monetary policy review in January 2026. The continued resilience of domestic economic activity despite the impact of Cyclone Ditwah, together with strong external sector performance, supported this decision. Meanwhile, a larger-than-expected expansion in private-sector credit also warranted a neutral stance. That said, the Central Bank will continue to closely monitor developments on the domestic front as well as conditions surrounding global geopolitical and policy uncertainties, *inter alia*, to decide on the appropriate policy stance, going forward.

In summary, the Central Bank has reduced its policy interest rate by a total of around 800 bps (8.0 pps) during the monetary policy easing cycle, which commenced in June 2023.

The MPB will meet in March 2026 for the second monetary policy review of the year.

Monetary Policy Decisions since the last Monetary Policy Report

(August 2025 – January 2026)

No.05
2025



September 2025

OPR was **maintained**
at 7.75%

No.06
2025



November 2025

OPR was **maintained**
at 7.75%

No.01
2026



January 2026

OPR was **maintained**
at 7.75%

2. INFLATION AND ECONOMIC OUTLOOK

Medium-term macroeconomic projections made by the Central Bank staff, in support of the monetary policy decision during January 2026, are summarised in this section, with a focus on the projections of inflation and real economic growth.³ These projections reflect the available data, near-term forecasts of key variables, global macroeconomic projections, and assumptions and staff judgements made at the January 2026 monetary policy round. These projections are considered the *baseline forecast* in this Report.

2.1. Baseline Forecast

According to the latest near-term projections, inflation is expected to increase gradually over the coming months. Medium-term projections indicate that headline inflation will continue to accelerate and move towards the target of 5% in H2-2026, supported by gradually strengthening demand conditions. Inflation is expected to stabilise around the target over the medium term with the implementation of appropriate policy measures. The nowcasts suggest that real Gross Domestic Product (GDP) growth in Q4-2025 has been lower than the first three quarters of 2025, reflecting Cyclone Ditwah-related disruptions. Given this, real GDP growth for 2025 is likely to be around 4.5%. Meanwhile, economic growth for 2026 is currently projected to be in the range of 4% to 5%, continuing the growth momentum recorded in the previous two years. Over the medium term, growth is expected to remain modest. However, prospects are subject to considerable uncertainty due to the volatile global geopolitical environment and any possible positive spillovers from the ongoing structural reforms in the economy.

Prospects for Inflation⁴

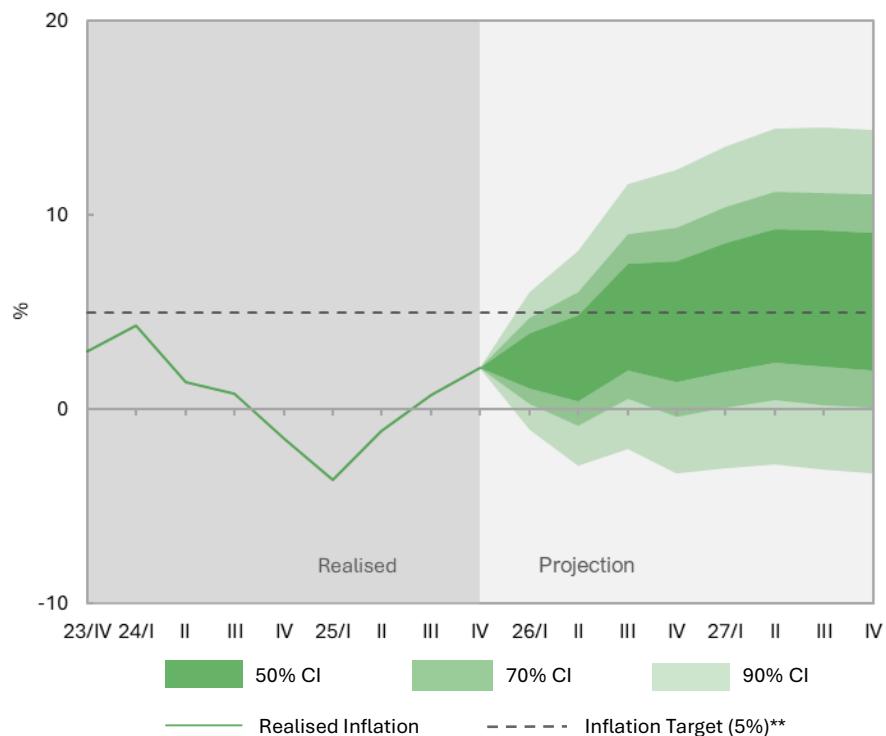
Since reaching positive territory in August 2025 after a period of deflation, inflation has been increasing gradually, with a mild uptick in core inflation and the easing of energy and transport deflation, partly influenced by the electricity tariff increase in June 2025. Inflation is expected to continue its gradual increase in the period ahead and move towards the target by H2-2026. This trajectory reflects the gradual pickup in demand conditions and the anticipated return of energy

³ The Central Bank uses a Quarterly Projection Model (QPM), a semi-structural macroeconomic model, to arrive at medium-term macroeconomic projections. These are updated during each monetary policy round, using data on the latest economic developments, including, but not limited to, global macroeconomic forecasts and monthly releases of inflation data and quarterly releases of GDP data by the Department of Census and Statistics (DCS). As part of the efforts in adopting continuous improvements to the modelling infrastructure, some parameters of the QPM have been updated, reflecting recent developments in the overall economic environment.

⁴ Headline inflation is measured based on the Colombo Consumer Price Index (CCPI, 2021=100).

and transport inflation to positive levels following an extended period of deflation. With no anticipated electricity price revision in Q1-2026, energy and transport inflation is now expected to rise more gradually than previously projected. Medium-term projections indicate that headline inflation will continue its gradually increasing trajectory and converge towards the target of 5% with the implementation of appropriate policy measures.

Figure 02: Baseline Headline Inflation Forecast (Quarterly, CCPI, y-o-y)
Based on the Projections during the January 2026 Monetary Policy Round



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

Note: Realised data shown in the fan chart are based on the CCPI (2021=100, seasonally adjusted).

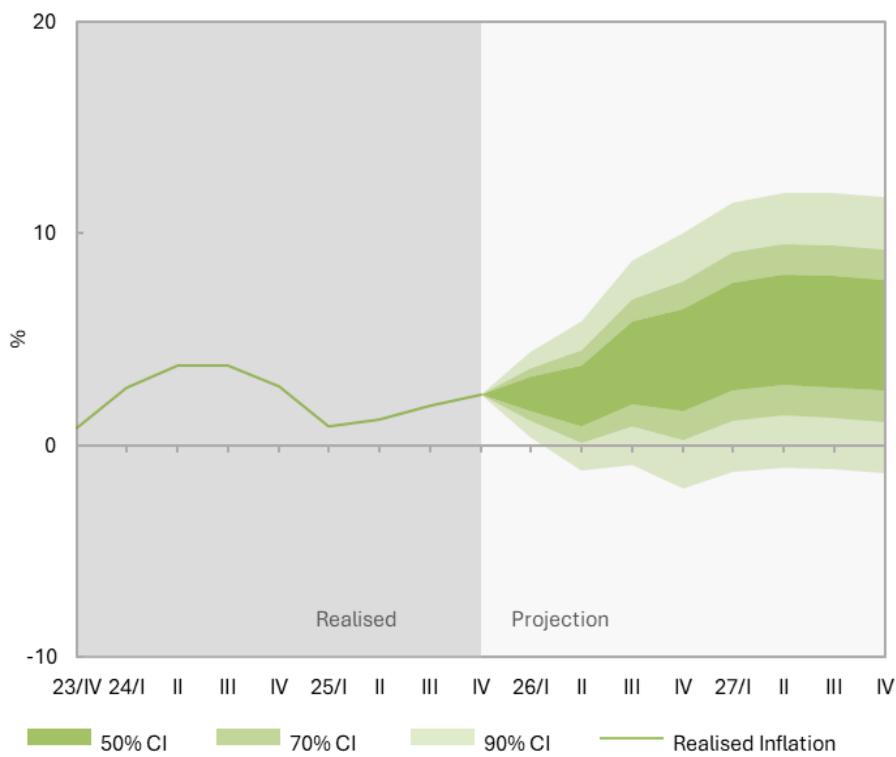
Source: Central Bank Staff Projections

Note: A forecast is neither a promise nor a commitment

The projections reflect the available data, assumptions and judgements made at the monetary policy round in January 2026. They are conditional on the forecasts of global energy and food prices; the gradual growth recovery of Sri Lanka's major trading partners; the anticipated fiscal path of the Government; and global financial conditions implied by the US Fed Funds rate. Moreover, the projections are conditional on the model-consistent interest rate path and the resulting macroeconomic responses, including that of the exchange rate. Further, no major macroeconomic policy shifts are anticipated in the baseline projections. Thus, the continuation of the IMF-EFF and efforts on fiscal consolidation are implied. Any notable deviation from the underlying assumptions and judgements could lead to the realised inflation path deviating from the projected path. Medium-term macroeconomic projections, together with the fan charts, will be continuously updated during each monetary policy round. Given the volatile global environment and the uncertainties in the domestic economy, the baseline forecasts are exposed to various potential upside and downside risks. Details on risks to the baseline forecast are discussed in the "Risks to Realisation of Baseline Projections" section.

Core inflation, which reflects the underlying demand conditions in the economy, is expected to gradually increase and stabilise at a level consistent with the headline inflation target. The anticipated strengthening of domestic demand conditions is expected to support this gradual increase in core inflation. In addition, imported inflation, which is partly driven by global food prices and global inflation trends, is also expected to contribute to the anticipated trend in core inflation. Together, these factors indicate how the underlying cost structure of everyday goods and services, excluding volatile food, and energy and transport components captured outside the core basket, is expected to evolve in the period ahead. This, in turn, guides the projected path of underlying inflationary trends in the economy.

Figure 03: Baseline Core Inflation Forecast (Quarterly, CCPI, y-o-y)
Based on the Projections during the January 2026 Monetary Policy Round



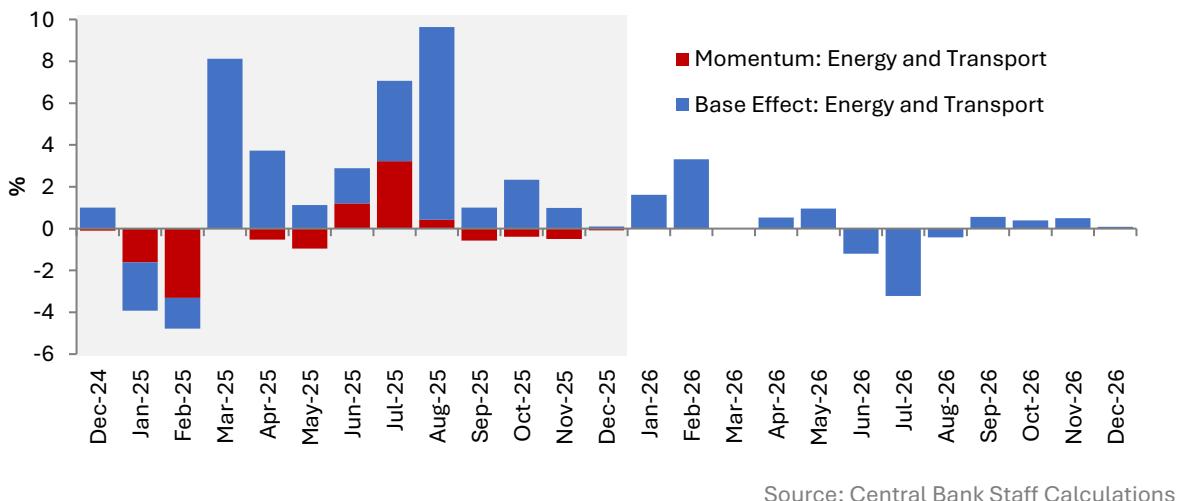
Note: Realised data shown in the fan chart are based on the CCPI (2021=100, seasonally adjusted). See the explanatory note in Figure 02 above.

Source: Central Bank Staff Projections

Energy and transport inflation, which remained at large negative levels for nearly two years, has recorded a gradual acceleration, reaching low deflation levels in recent months. It is expected to turn positive in the near-term, partly contributed by the statistical base effect, thereby contributing to a gradual increase in headline inflation towards the target. However, energy and transport inflation remains subject to developments in global fuel prices, the outlook for which

is subject to heightened uncertainty, particularly amid the recent escalation of geopolitical tensions. Weather-related uncertainties also would shape the outlook for energy inflation.

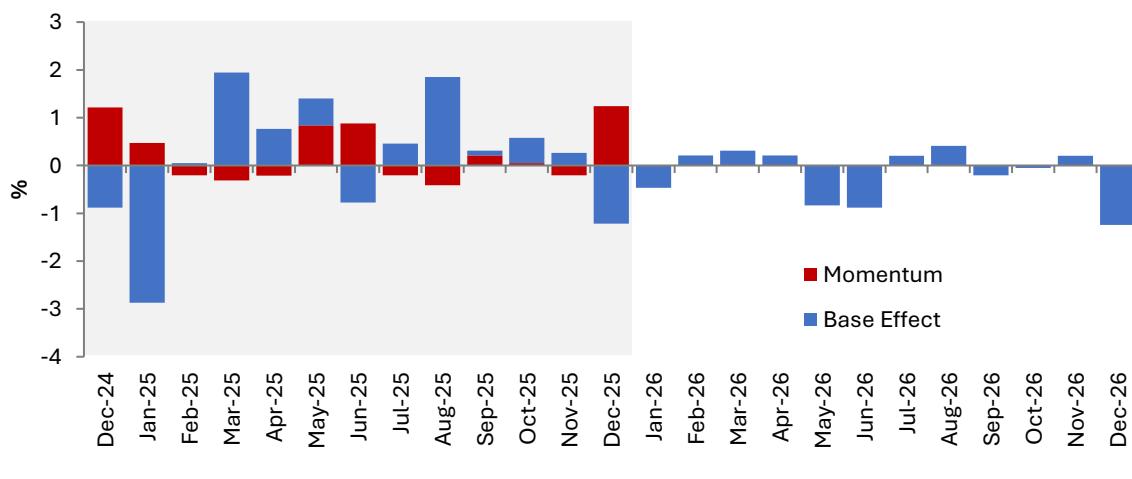
Figure 04: Energy and Transport Inflation: Momentum and Base Effect (CCPI, 2021=100)⁵



Source: Central Bank Staff Calculations

Meanwhile, compared to other components of inflation, volatile food inflation is expected to remain elevated in the near term. The impact on agricultural output as a result of Cyclone Ditwah could have some upside impact on volatile food inflation due to possible disruptions and delays to normal production and harvesting cycles. Nevertheless, immediate re-cultivation and restoration efforts in Cyclone-affected areas are expected to contribute to minimising this impact. Given the recent experiences of frequent extreme weather events, the trajectory of volatile food inflation is expected to be associated with considerable uncertainty.

Figure 05: Headline Inflation: Momentum and Base Effect (CCPI, 2021=100)⁵



Source: Central Bank Staff Calculations

⁵ Please refer to Box A of the Monetary Policy Report – August 2025 for a detailed discussion on base effect and momentum.

Inflation Expectations

As per the Inflation Expectations Survey conducted by the Central Bank, short-term inflation expectations of the corporate sector broadly moved in line with the realised inflation. Accordingly, 3-month, 6-month, and 1-year ahead inflation expectations followed an overall upward trend from June 2025 to December 2025. Meanwhile, the corporate sector's medium-term inflation expectations, covering 2-year and 3-year horizons, also increased over the same period, converging towards the inflation target of 5%.

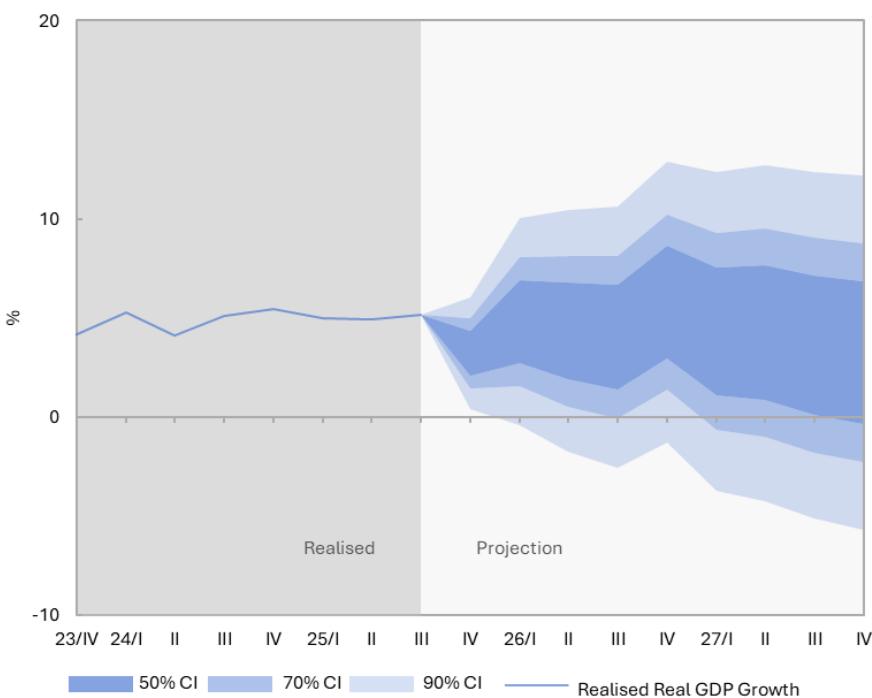
Prospects for Real Economic Growth

Based on leading economic indicators, survey findings, and staff evaluations, real GDP growth is expected to have moderated in Q4-2025, representing a slowdown relative to the steady growth observed in the first three quarters of 2025. This moderation is primarily attributed to Cyclone Ditwah-related disruptions and is expected to be broad-based across all sectors, although the pace of the slowdown in non-agriculture sectors is anticipated to be mild. The near-term growth outlook suggests a moderate path, albeit with higher volatility during 2026, largely reflecting statistical base effects from the second half of 2025. Eased monetary conditions remain supportive of growth, and increased government expenditure following Cyclone Ditwah is also expected to impart an expansionary support in the near term.

Against this backdrop, the output gap, which is estimated to be close to zero in the near term, is projected to turn positive over the medium term. Meanwhile, the medium-term growth trajectory is expected to be partly affected by the negative fiscal impulse arising from the envisaged primary account surpluses over the period. Further, the positive foreign output gap is estimated to narrow and turn negative in the near term and to remain negative over the medium term, as growth momentum moderates across both advanced and emerging market economies.

It is noteworthy that the medium-term economic growth outlook is subject to considerable uncertainty. The continuation of the ongoing economic recovery momentum is conditional upon the timely and effective implementation of targeted structural reforms and growth-enhancing strategies. Moreover, recurrent weather-related shocks could constrain mid to long-term growth, underscoring the need for policies that promote sustainable and climate-resilient economic growth. Developments in the growth outlook of Sri Lanka's trading partners, amid global trade and policy uncertainties, will also shape Sri Lanka's growth trajectory in the period ahead.

Figure 06: Baseline Quarterly Real GDP Growth Forecast (y-o-y)
Based on the Projections during the January 2026 Monetary Policy Round



See the explanatory note in Figure 02 above.

Source: Central Bank Staff Projections

2.2. Key Assumptions Underpinning the Forecast

A summary of the key assumptions used in arriving at medium-term forecasts at the monetary policy round in January 2026 is provided in this section.

Global Environment

Global economic conditions remain subject to elevated uncertainty, amid recent trade policy developments in the United States (US) and ongoing geopolitical tensions, although global growth outcome for 2025 and the outlook for 2026 are expected to be stronger than previously anticipated. Economic activity across both advanced and emerging market economies is expected to remain relatively resilient in the near term, notwithstanding trade-related frictions, geopolitical uncertainties, and still relatively tight global financial conditions, before gradually moderating over the medium term. According to the Global Projections Model Network (GPMN),⁶ the export-weighted foreign output gap⁷ is projected to weaken and turn negative towards late

⁶ The Central Bank uses projections of global macroeconomic indicators prepared by GPMN as inputs for medium-term projections. Projections used in the January 2026 monetary policy round are based on preliminary projections received on 20 January 2026.

⁷ The export-weighted foreign output gap is calculated as a weighted average of trade partners' output gaps provided in GPMN projections by using normalised shares of exports corresponding to six major trading partners of Sri Lanka.

2026, remaining subdued over the medium term amid an anticipated slowdown in the US, the Eurozone and the United Kingdom. With signs of persistent inflationary pressures, monetary policy easing in the US is expected to proceed gradually, with the US Federal Reserve maintaining a cautious stance, in view of inflation risks and heightened uncertainty. Commodity markets are expected to remain influenced by geopolitical developments and evolving global demand conditions. Brent crude oil prices are projected to decline initially into the forecast horizon, but are expected to record a gradual increase afterwards. Global food inflation is expected to turn negative in the near term, before gradually picking up thereafter.

Fiscal Path

The assumptions related to the fiscal path incorporated in the current projections have been updated according to the information presented with the Supplementary Budget Estimate 2026, and published by the Ministry of Finance, Planning and Economic Development in December 2025.

External Current Account

A current account surplus is estimated for 2025, even though a marginal deficit is estimated in Q4-2025. The surplus in 2025 mainly reflects higher workers' remittances and improved tourism earnings, notwithstanding a wider trade deficit.

2.3. Risks to Realisation of Baseline Projections

There are both upside and downside risks to the realisation of baseline projections of inflation and GDP growth presented in this report. An exposition of such risks, as per the monetary policy round in January 2026, is provided in this section. The realisation of one or more risks discussed in this section could lead to actual inflation and/or GDP growth deviating from the projected baseline path. In the event of the realisation of both upside and downside risks, the direction of the actual inflation or GDP growth will be shaped by the relative strength of these risks.

Risks to Realisation of Inflation Projections

Several upside risks could potentially drive inflation on a higher trajectory than the projected path. Demand pressures are gradually building amid strong credit growth and recovering economic activity, with temporary Cyclone Ditwah-related disbursements possibly adding to near-term consumption. Given the inherent lags in the transmission of credit growth to economic activity, any excessive private sector credit growth could pose upside risks to demand pressures over the medium term. Depreciation pressures could exceed projections if import

demand rises faster than expected. Economic recovery and Ditwah-related reconstruction could raise imports, and a wider-than-anticipated trade deficit may increase foreign exchange demand and exert pressure on the currency. Repeated adverse weather events could disrupt agricultural production and could lead to variations in the electricity generation mix, while soil quality erosion may reduce agricultural productivity over time. Any resulting persistent supply-side disruptions may raise food and energy prices. If these effects persist, inflation could exceed current projections. Global geopolitical and macroeconomic conditions remain volatile with persistent uncertainties surrounding the US and other major economies. Disruptions to global supply chains and commodity markets could increase price volatility and pose upside risks to domestic inflation.

When downside risks are considered, inflation may remain subdued for longer than expected despite its recent gradual increase. Sticky price-setting behaviour, including wage adjustments and administered price revisions, could delay the return of inflation to the target level. Improved continuity in recultivation following Ditwah-related disruptions is expected to support agricultural output and ease food price pressures. Targeted government support may further strengthen the agricultural supply. A slower-than-expected increase in fuel costs, reflecting lower global oil prices, could moderate energy and transport inflation. Uncertainty regarding global price movements and tariff adjustments continues to pose risks to inflation projections.

As per the judgements at the current monetary policy round, risks to inflation projections are assessed to be balanced in both the near and medium term.

Risks to Realisation of Economic Growth Projections

Downside risks to growth projections in the near to medium term could arise due to global trade frictions and elevated geopolitical uncertainty, which may negatively affect growth in key trading partners and major tourism source markets. Slower growth and heightened uncertainty globally could weaken tourist arrivals and tourism service exports, while also reducing demand for Sri Lanka's merchandise exports. These external headwinds may lower export earnings and foreign exchange inflows, weighing on overall economic activity and growth prospects. On the positive side, a faster-than-expected recovery following Ditwah-related disruptions could support output growth, particularly through the resumption of agricultural and construction activities. Infrastructure reconstruction and timely government support may strengthen the recovery and generate spillovers to services, supporting a broad-based expansion.

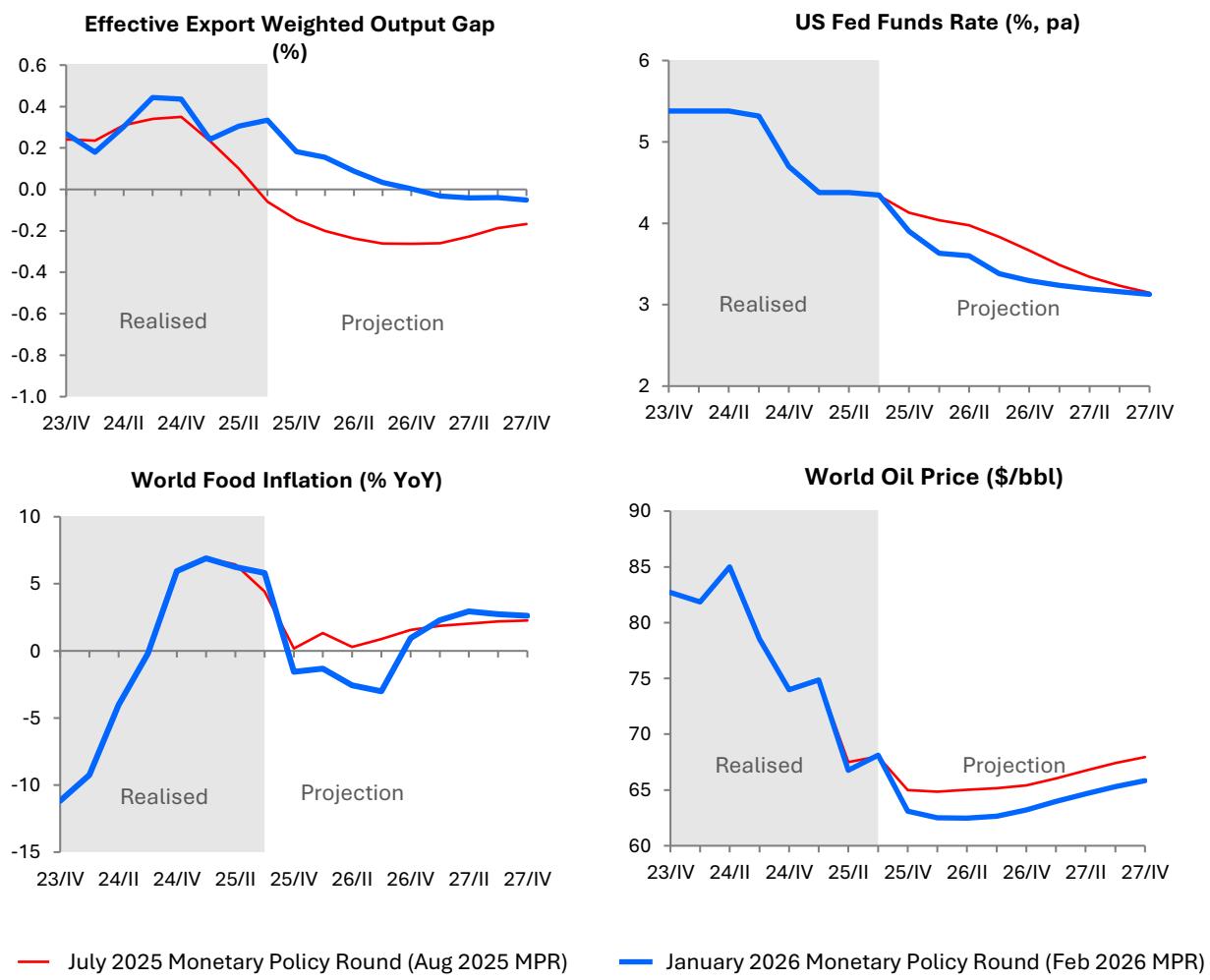
2.4. Comparison with the Previous Forecast⁸

Key Assumptions Used for Medium-Term Projections

Based on global projections used during the monetary policy round in January 2026, the outlook for the export-weighted foreign output gap of Sri Lanka's major trading partners has improved, compared to the global projections used in the July 2025 monetary policy cycle, which was presented in MPR-August 2025. This change was primarily due to revised projections related to the US and Eurozone economies. Global projections used during the January 2026 monetary policy round indicate a lower food inflation trajectory during 2026, followed by a slightly higher trajectory in 2027, compared to the July 2025 monetary policy cycle. The trajectory of world oil prices was revised downward compared to the path projected in July 2025, amidst expectations of improved supply, whilst balancing risks arising from high geopolitical instability. Meanwhile, monetary policy loosening in the US is expected to be faster now than previously projected, reflecting expectations of a lower policy rate over the medium term amidst slowing labour market conditions. The fiscal path has been revised in the current projections based on information presented with the Supplementary Budget Estimate 2026, whereas the projections during the July 2025 monetary policy round were based on the Fiscal Strategy Statement 2026. Among other changes, the current update internalises a higher budget deficit for 2026.

⁸ This Section compares the current forecasts with the forecast presented in the MPR in August 2025, which were derived during the July 2025 monetary policy round.

Figure 07: Global Projections (Quarterly)



Note: In the latest GPMN projections, Q3-2025 is considered the most recent realised time period until the complete realised data set becomes available from the multitude of countries it takes into account

Sources: QPM, GPMN (Updated on 25/06/2025 and 20/01/2026)

Inflation Path

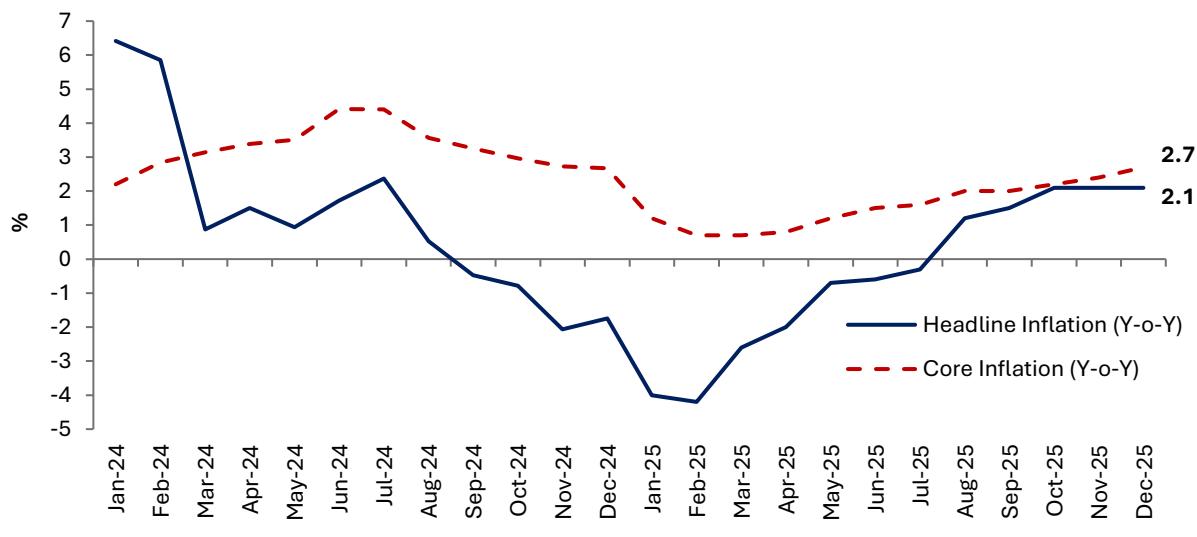
Compared to the projections published in MPR-August 2025, realised y-o-y headline inflation in Q3-2025 was broadly in line with the projected level. However, realised inflation in Q4-2025 was slightly below the previous projection. Inflation projections also remain broadly lower than the path in the previous MPR, particularly during 2026, reflecting a lower global oil path and moderate food prices. In addition, the lower-than-anticipated increase in underlying prices may also have contributed to this lower inflation trajectory. Consistent with the previous projection, inflation is expected to accelerate gradually and converge towards the target over the medium term, supported by improving demand conditions in the economy. Core inflation is anticipated to remain broadly lower than the path anticipated in the previous MPR over the near term, while it is expected to be on a slightly higher trajectory towards the latter part of the forecast horizon, reflecting strengthening domestic demand.

3. CURRENT ECONOMIC DEVELOPMENTS

3.1. Inflation

Headline inflation, which reached positive levels in August 2025 after eleven months of deflation, followed an increasing trend thereafter, while remaining below the target level.

Figure 08: Movements in Headline and Core Inflation (CCPI, 2021=100)



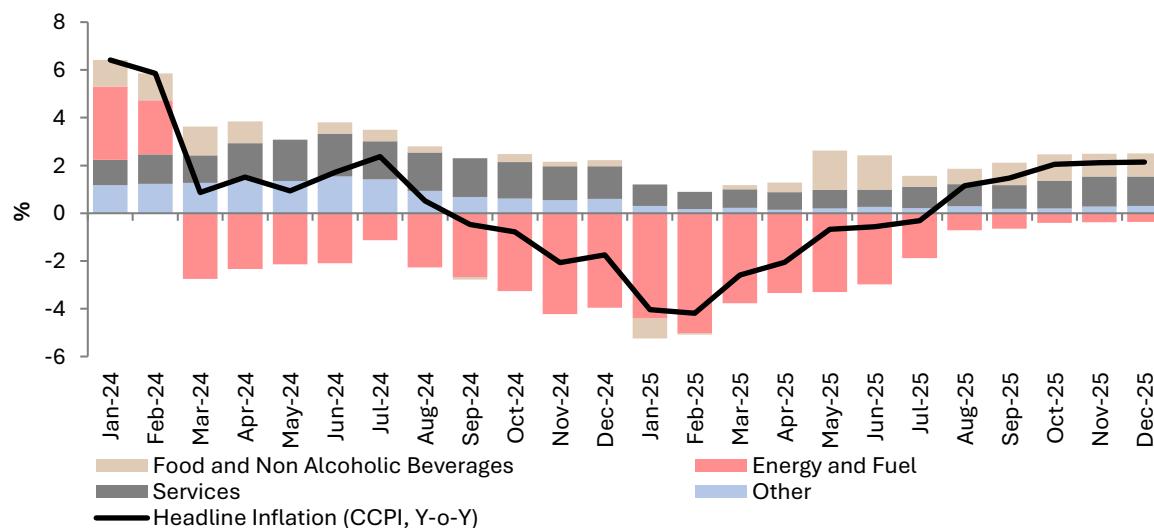
Source: Department of Census and Statistics

The Colombo Consumer Price Index (CCPI, 2021=100) based headline inflation (y-o-y) turned positive in August 2025, marking the end of an 11-month deflationary phase. This turnaround was mainly supported by the easing of deflationary pressures in the energy and transportation category, following the upward revision of electricity tariffs implemented in mid-June 2025, along with statistical base effects. Thereafter, CCPI-based headline inflation trended upwards gradually, reaching 2.1% in October 2025, and remained unchanged through December 2025.⁹ Despite monthly increases in food prices due to supply chain disruptions caused by Cyclone Ditwah and heightened demand for food during the festive season, their impact was not reflected in y-o-y headline inflation in December 2025, due to the favourable statistical base effect. Meanwhile, CCPI-based food inflation decelerated to 3.0% (y-o-y) in December 2025 from 4.3% (y-o-y) recorded in June 2025, whereas non-food inflation accelerated to 1.8% (y-o-y) from -2.8% (y-o-y) over the same period. Meanwhile, the National Consumer Price Index (NCPI, 2021=100) based

⁹ In January 2026, CCPI based headline inflation (y-o-y) accelerated to 2.3%.

headline inflation (y-o-y) showed an overall upward trend during H2-2025. Accordingly, NCPI-based headline inflation accelerated to 2.9% in December 2025 from 0.3% in June 2025.

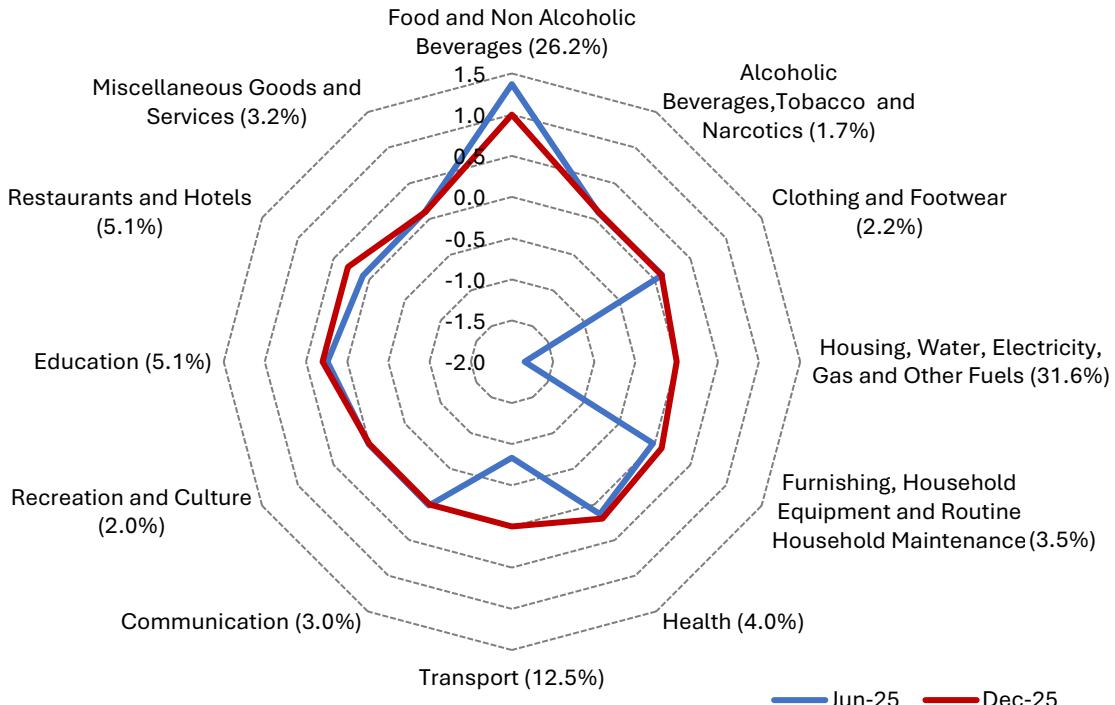
Figure 09: Contribution to y-o-y Headline Inflation (CCPI)



Note: Services-specific components are extracted from the overall (Headline) CPI baskets of goods and services (2021=100) using the Classification of Individual Consumption According to Purpose (COICOP) 2018

Sources: Department of Census and Statistics
Central Bank Staff Calculations

Figure 10: Subcategory-wise Contribution to y-o-y Headline Inflation (CCPI)

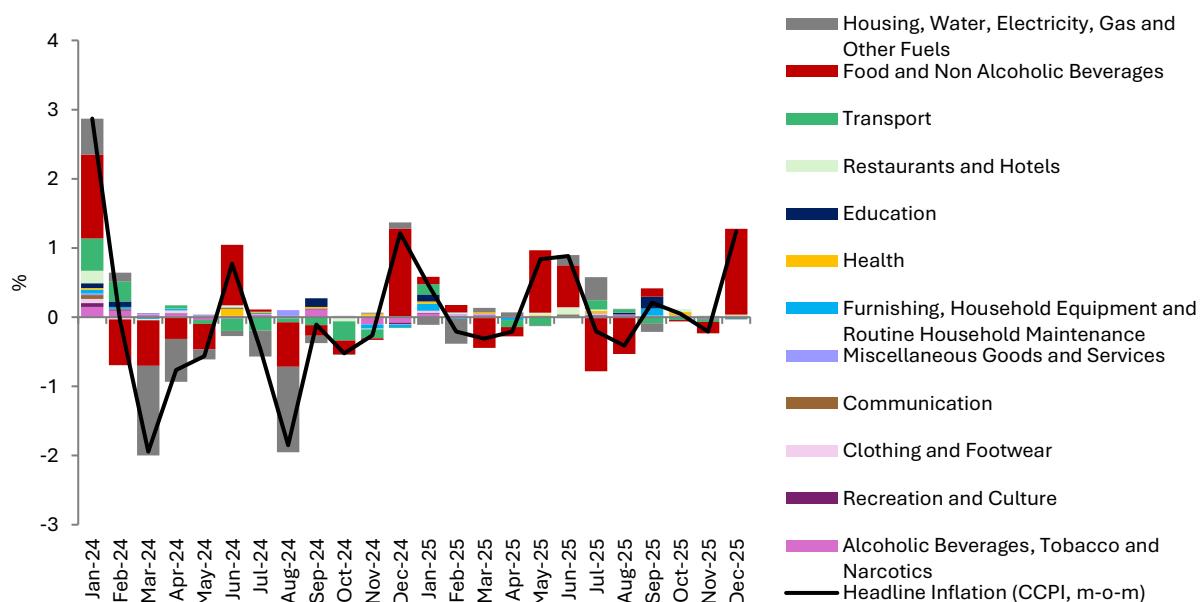


Note: Weights of subcategories in the CCPI basket are given in parentheses. To reflect developments since the publication of the August 2025 MPR, the latest available data for December 2025 are compared with those reported in June 2025.

Sources: Department of Census and Statistics
Central Bank Staff Calculations

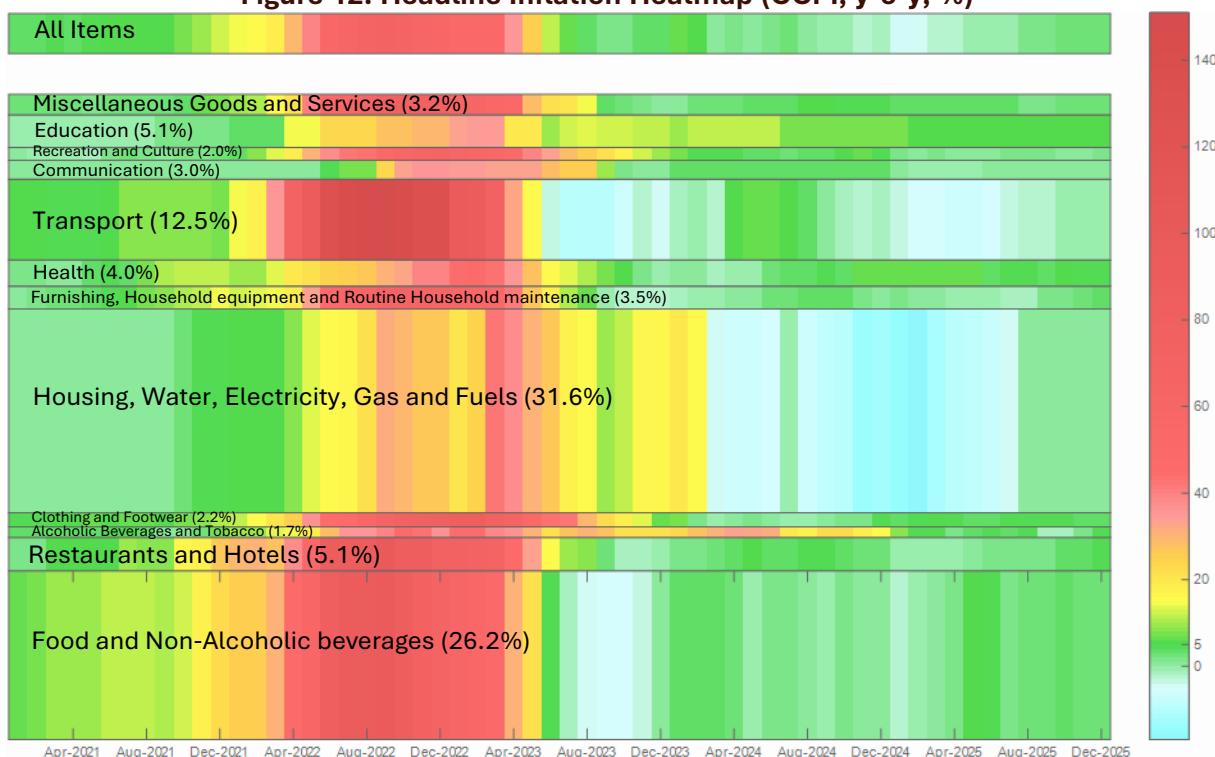
On a m-o-m basis, CCPI-based headline inflation declined marginally in July and August 2025, driven by the easing of food prices with the availability of the Yala harvest, which more than offset the upward pressures from the electricity tariff revision implemented in mid-June 2025. With the normalisation of harvest-related supply effects, headline inflation (m-o-m) recorded a marginal increase in September 2025 and remained broadly unchanged in October 2025. However, in November 2025, headline inflation (m-o-m) declined mainly due to the moderation of prices of several volatile food items. Thereafter, headline inflation (m-o-m) increased sharply in December 2025, reflecting the impact of supply disruptions caused by Cyclone Ditwah as well as high seasonal festive demand during the month.

Figure 11: Contribution to m-o-m Headline Inflation (CCPI)



Sources: Department of Census and Statistics
Central Bank Staff Calculations

Figure 12: Headline Inflation Heatmap (CCPI, y-o-y, %)



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

CCPI-based core inflation (y-o-y), which reflects the underlying inflation trends in the economy, continued to accelerate during H2-2025. Accordingly, core inflation accelerated gradually to 2.7% in December 2025 from 1.5% in June 2025.¹⁰ Similarly, NCPI-based core inflation (y-o-y) followed an upward trend, recording 2.6% in December 2025 from 0.6% in June 2025.

As quarterly headline inflation continued to deviate from the target of 5% from the lower side of the margin of ± 2 pps stipulated in the Monetary Policy Framework Agreement (MPFA), for consecutive quarters in Q1-2025 and Q2-2025, the Report required under Section 26(5) of the CBA was submitted to the Parliament through the Hon. Minister of Finance by the Central Bank and made available for the public subsequently. This marked the fourth such report submitted with the breach of the inflation target from the lower side. Further, with quarterly headline inflation remaining below the lower margin of 3% for two consecutive quarters in Q2-2025 and Q3-2025, a follow-up (fifth) report has been submitted to the Hon. Minister of Finance by the Central Bank. Further, with the realised quarterly inflation for Q4-2025 remaining below the lower margin, the Central Bank will be submitting its next follow-up (sixth) report in early 2026.

¹⁰ In January 2026, CCPI based core inflation (y-o-y) was recorded at 2.3%.

Box A: Digging Deeper into the Recent Deflation Episode in Sri Lanka

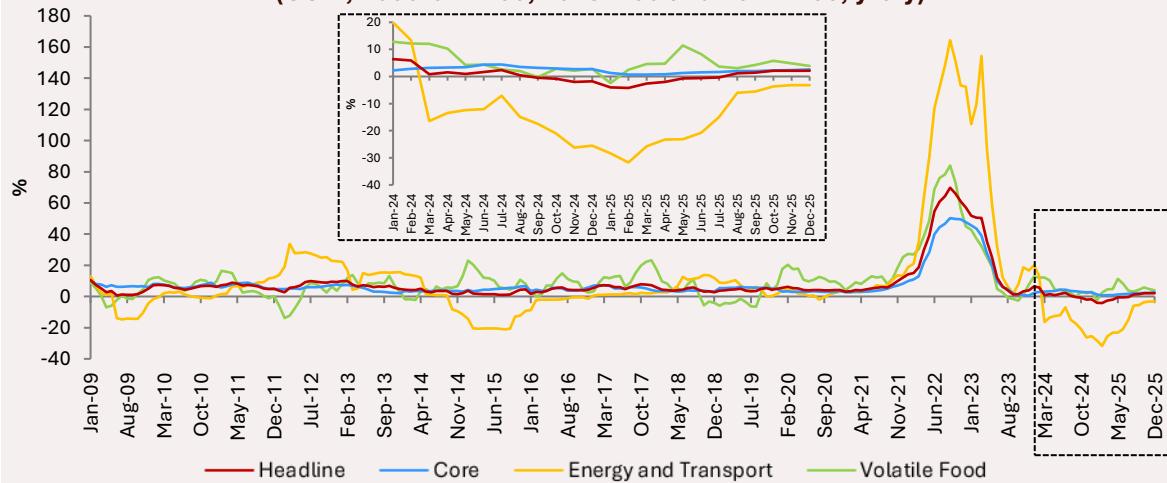
Behaviour of headline inflation in the past years

Following the unprecedented surge that peaked in September 2022, headline inflation transitioned into a sustained disinflationary phase, reaching single-digit levels by mid-2023. The downward trajectory persisted, with headline inflation entering negative territory in September 2024, recording a deflation for the first time since March 1995.¹ The deflationary episode continued for eleven months. Inflation returned to positive levels in August 2025, and thereafter remained in low positive levels while continuing its gradual upward trajectory.

Driving forces of the deflationary episode

The deflationary episode was contributed to by multiple factors, with the energy and transport sectors making the largest downward impact, primarily due to administrative price adjustments amid moderating global energy prices. Within the energy and transport category, the decline was largely driven by significant downward revisions to electricity tariffs implemented in March and July 2024 and January 2025. In addition, multiple downward adjustments in the prices of petrol, auto diesel, kerosene, and LP gas further reinforced the deflationary trend, though smaller in magnitude. However, it is noteworthy that these downward adjustments in energy-related prices followed the historic upward price corrections that took place in the preceding years with the implementation of cost-reflective pricing. Moreover, low core inflation,² which reflected subdued demand pressures, was also a contributory factor for the recorded low headline inflation. Core inflation has remained below the pre-crisis levels in recent periods (on average, core inflation remained around 5% during the period from 2010 to 2020).

**Figure A.1: Movement of Headline, Core, Energy and Transport, and Volatile Food Inflation
(CCPI, 2006/07 =100, 2013=100 and 2021=100, y-o-y)**



Note: Inflation rates for each category have been derived based on the respective base year applicable during the period. When splicing, prominence is given to the most recent base year for periods where multiple observations exist.

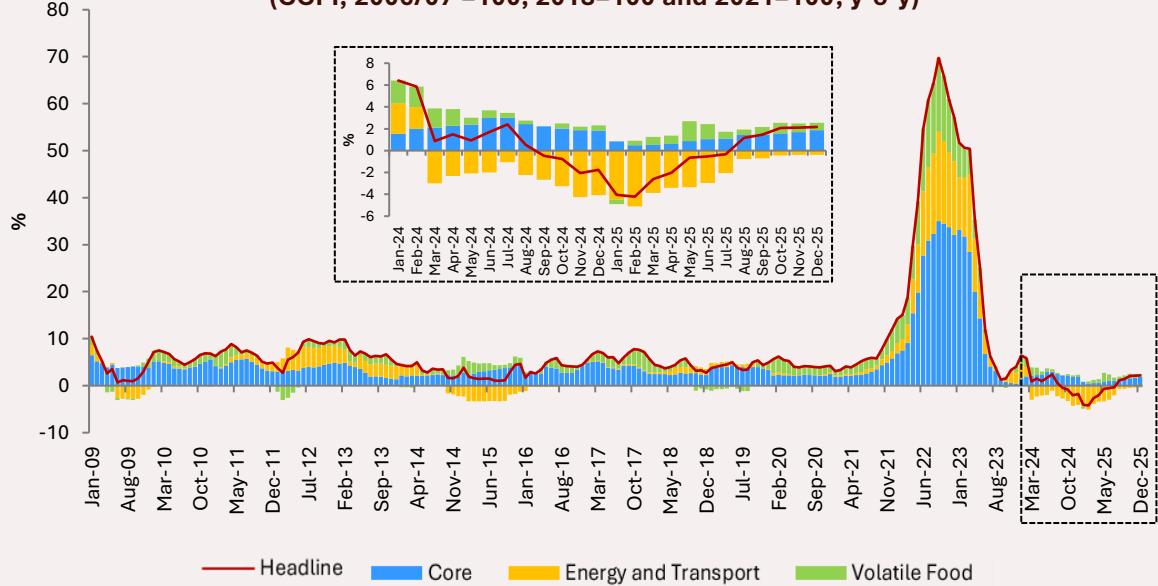
Sources: Department of Census and Statistics
Central Bank Staff Calculations

¹Headline Inflation has been derived based on the respective base year applicable during the period. When splicing, prominence is given to the most recent base year for periods where multiple observations exist. It is noteworthy that when considering the CCPI published in the respective month, negative inflation has been published in July-Sep 2015 using 2006/07=100 base. However, when the 2013=100 base is used such deflation can not be observed during 2015.

²Core inflation is derived by excluding the volatile items of food, energy and transport from the headline inflation. These excluded items are represented as Volatile Food and Energy and Transport components in the graphs presented in this box article.

Figure A.1 illustrates the movements of headline inflation, core inflation, energy and transport inflation and volatile food inflation. This highlights that the movement of energy and transport inflation has remained substantially large compared to the other components in the last four years. Meanwhile, Figure A.2 illustrates the contribution of core inflation, energy and transport inflation and volatile food inflation to headline inflation. The negative contribution of energy and transport inflation to headline inflation in the recent period has remained sizeable. At the same time, it is also observed that the core inflation contribution has remained low relative to pre-crisis periods. It is noteworthy that although Sri Lanka previously experienced periods of energy and transport deflation, most notably during the period of mid 2009 to the beginning of 2010 and again from late 2014 to late 2016, these episodes did not translate into headline deflation due to sizeable core and volatile food inflation recorded in these periods.

**Figure A.2: Contribution to Headline Inflation
(CCPI, 2006/07 =100, 2013=100 and 2021=100, y-o-y)**



Note: Contribution to y-o-y headline inflation from each category has been derived based on the respective base year applicable during the period. When splicing, prominence is given to the most recent base year for periods where multiple observations exist.

Sources: Department of Census and Statistics
Central Bank Staff Calculations

Unlike headline inflation, core inflation did not turn negative as domestic demand conditions began to recover, as indicated by the notable growth momentum that was recorded in recent times. The acceleration of core inflation is driven by the pickup in aggregate demand conditions with eased monetary conditions. However, the pace of acceleration continues to remain at a gradual pace. In addition to the above factors, the statistical base effect arising from VAT-induced price increases and elevated food inflation in early 2024 also exerted downward pressure on y-o-y inflation in early 2025.

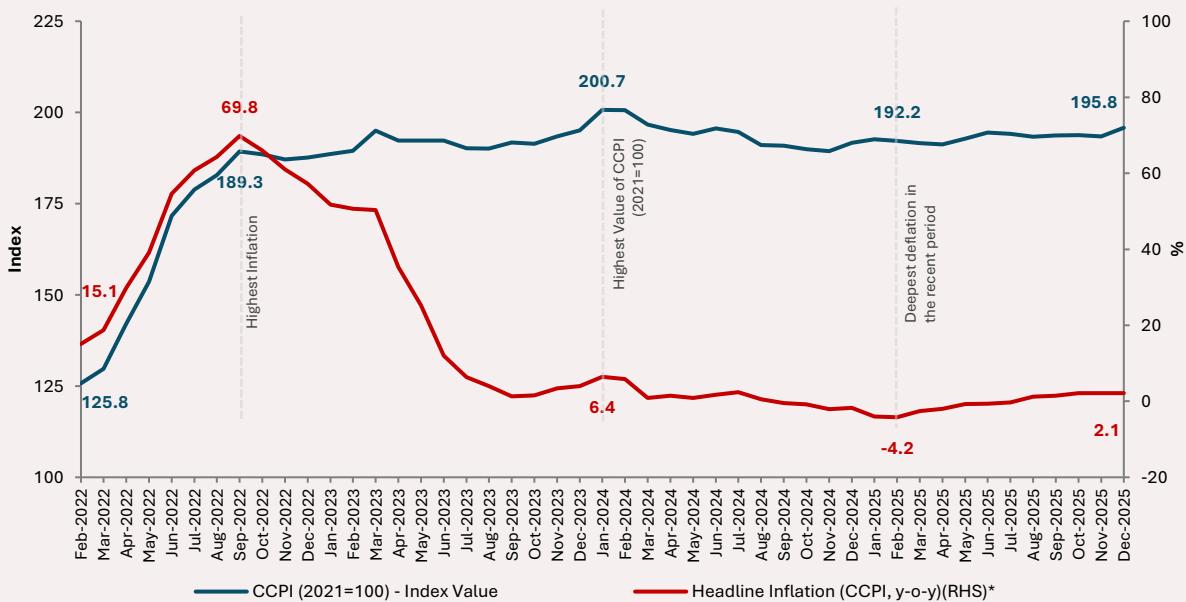
Reflecting these cumulative influences, deflation deepened to 4.2% in February 2025, after which the deflationary trend began to ease gradually. Gradual improvements to aggregate demand driving core inflation, increases in food prices in certain months, and the upward revision of electricity tariffs in mid June 2025 collectively contributed to the end of the deflationary episode. It is noteworthy that this transitory deflationary episode has not resulted in a prolonged activity slowdown, as reflected by the recorded healthy real GDP growth rates, recovering labour market conditions as indicated by a low unemployment rate and a gradual increasing trend in the labour force participation rate compared to its low level recorded in the aftermath of the crisis, increasing credit growth to the private sector, and the significant pickup in imports.

Therefore, the recent deflationary episode can also be perceived as a correction of prices after the peak inflation during the crisis, rather than being caused mainly by an economic slowdown and a deflationary spiral, where falling prices in turn lead to further slowdown in economic activity.

Elevated price base with contained inflation

Despite the return of headline inflation to positive levels after the deflationary phase, the increase in inflation over recent months has remained relatively low (see Figure A.3). This outcome partly reflects the substantial upward reset in the cost base of the CCPI basket observed during the 2022 inflationary shock. This shock was the combined impact of rapid depreciation of the Sri Lanka rupee, supply-side disruptions, and steep upward adjustments of energy prices after a prolonged period of relatively stagnant energy pricing, alongside the lagged transmission effects of prolonged eased monetary conditions. The energy price adjustments observed in 2022 can therefore be considered as a correction of prices in response to underlying developments of related costs over an extended period. In contrast, recent energy price movements have been consistent with the cost-reflective pricing framework, characterised by more frequent electricity tariff revisions and regular monthly price adjustments for fuel and LP gas, resulting in more gradual and predictable price dynamics. Consequently, the prevailing inflation environment could be characterised as operating from a relatively stable, albeit higher price base. As a result, businesses could be adopting a cautious approach in setting prices, with a concern that significant price increases could lead to notable declines in sales volumes, especially during a modest recovery in the purchasing power of the general public. Moreover, the Energy and Transport category, which was the principal driver of deflation, has continued to recover only gradually from the negative territory. This recovery has been influenced predominantly by statistical base effects and phased periodic price adjustments rather than sharp intermittent changes in response to developments of underlying costs over a prolonged period. These dynamics have contributed to the gradual recovery of headline inflation.

Figure A.3: Consumer Price Index vs Headline Inflation (CCPI, 2013=100 and 2021=100)



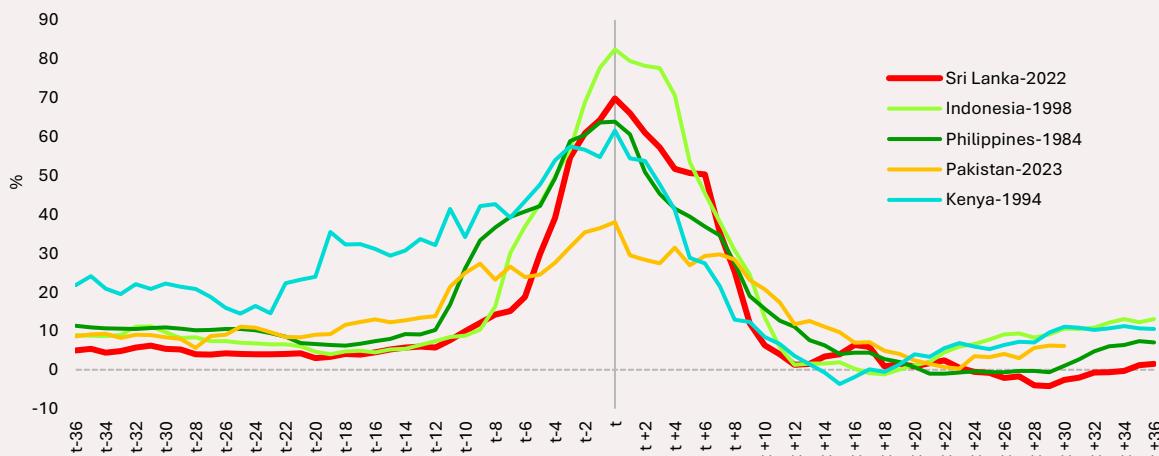
*Note: Inflation for 2022 is based on CCPI (2013=100).

Source: Department of Census and Statistics

Country comparison

A comparison with selected developing economies (Figure A.4), including regional economies such as the Philippines, Indonesia and Pakistan, indicates a broadly similar pattern in post-peak inflation dynamics. These economies have also recorded elevated inflation levels in their histories, followed by gradual, and in some cases, steep disinflationary paths before eventually normalising. Taken together, these cross-country experiences reveal an inflation cycle broadly similar to that observed in Sri Lanka following the 2022 peak. Economies could undergo a very low inflationary phase that may even briefly enter marginal deflation before stabilising, following aggressive monetary policy responses to address a significant surge in inflation and elevated price levels. As depicted in Figure A.4, there is evidence to suggest that such low inflation episodes could be transitory, with inflation subsequently normalising within a narrow and less volatile range.

Figure A.4: Comparison of Movement in Inflation with Regional Economies that Experienced Inflationary Peaks (monthly, y-o-y)



Note: Time period t was taken as the month of peak inflation.

Sources: International Monetary Fund
Department of Census and Statistics

Conclusion

Following the unprecedented surge that peaked in September 2022, headline inflation declined steadily, supported by appropriate monetary policy tightening. It entered into a transitory deflationary period caused mainly by the downward adjustments to energy and transport prices, before returning to low but gradually increasing positive levels. Before the crisis, the prices of consumer items such as electricity and fuel had not been adjusted for several years, even with the gradual increase in production costs. In 2022, with the sharp increase in the cost of production, businesses set higher prices, and the administered prices of the energy and transport sectors were adjusted. In addition, there were notable second-round effects of these price revisions. All these adjustments could have led to a structural shift in the price base. With the prices remaining elevated relative to pre-crisis levels, and amidst deteriorated purchasing power of most economic agents, businesses may have adopted cautious pricing strategies, leading to a moderate inflation trajectory in the recent period. Tight policy measures in response to the unprecedented surge in inflation prevented a runaway inflationary condition and contributed to a rapid disinflation. Core inflation remained positive throughout the period and commenced a gradual acceleration. Moreover, there are clear signs of improving demand conditions in the economy as indicated by several other economic indicators. With headline inflation returning to positive territory, price movements have become more measured and predictable, suggesting a transition towards a more stable price environment rather than the emergence of prolonged deflationary risks with spiral effects on demand. In conclusion, despite the recent deflationary episode and the gradual pace of inflation acceleration, inflation is expected to gradually align towards the target of 5%, although the speed at which the convergence happens could be slower than anticipated.

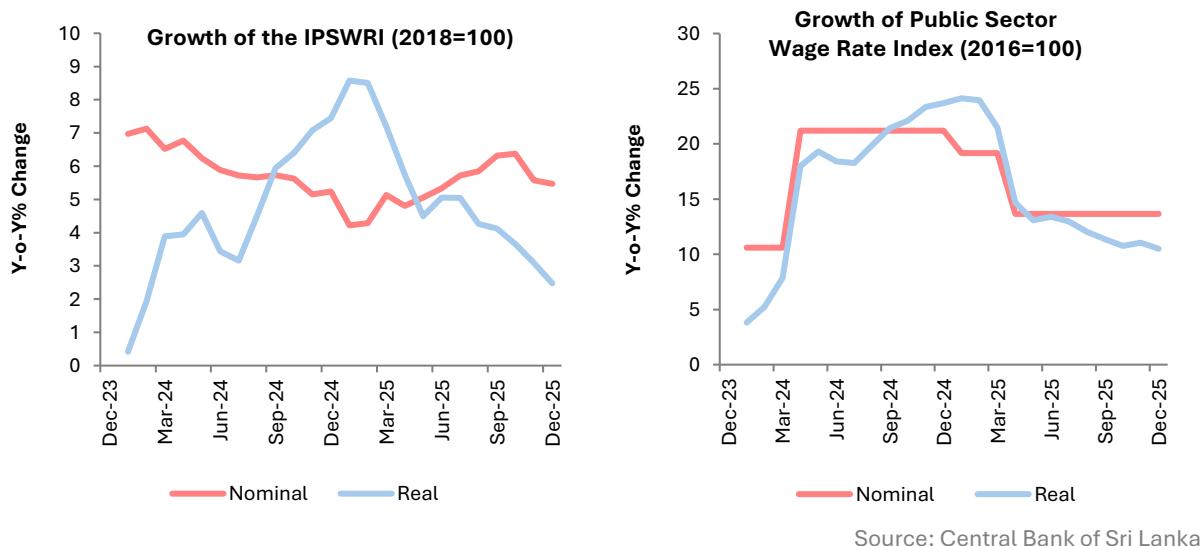
Similar to preceding quarters, the deviation in inflation from the target in recent quarters was mainly driven by supply-side factors, particularly low inflation in the energy and transport categories. However, the deviation has been narrowing in the recent quarters, as projected.

According to available information,¹¹ both the Informal Private Sector Wage Rate Index (IPSWRI, 2018=100) and the Public Sector Wage Rate Index (2016=100) recorded increases during H2-2025.

In the informal private sector, nominal wage growth continued to rise during H1-2025, while real wage growth remained relatively high but began to ease. During H2-2025, nominal wage growth increased further and peaked around Q3, before moderating slightly towards the end of the year. In contrast, real wage growth declined steadily throughout H2-2025, falling to significantly lower levels compared to H1-2025, reflecting the normalisation of inflation conditions.

In the public sector, wage growth was notable in H1-2025, driven by salary revisions and arrears payments, with both nominal and real wage growth peaking in early 2025. During H2-2025, wage growth moderated and stabilised, with nominal growth remaining broadly unchanged at a lower level. Real wage growth decelerated further, reflecting the effects of earlier salary revisions and arrears payments that were largely completed in the first half of the previous year, and the normalisation of inflation from earlier low levels in H2-2025.

Figure 13: Movements in the IPSWRI (2018=100) and Public Sector Wage Rate Index (2016=100)



¹¹ Information in this section is primarily based on the public sector wage rate index (2016=100) and informal private sector wage rate index (2018=100) compiled by the Central Bank.

3.2. Real Sector

Sri Lanka's economy recorded a robust expansion in Q3-2025, reflecting a strong growth momentum throughout the first nine months of 2025.

As per the GDP estimates published by the Department of Census and Statistics, the economy grew by 5.0% (y-o-y) during the first nine months ending September 2025, compared to 4.9% growth recorded during the corresponding period of 2024. Further, during Q3-2025, the economy recorded a growth of 5.4% (y-o-y) with positive contributions from all three major economic sectors. The growth recorded in Agricultural activities was largely driven by the growing of oleaginous fruits (coconut, king coconut, oil palm), animal production and the growing of vegetables. The significant growth in Industry activities was led by growth in the subsectors of manufacturing, construction, and mining and quarrying activities. Meanwhile, the expansion in Services activities was mainly attributable to growth in financial services, transportation and wholesale and retail trade activities.

Table 01: Estimates of Real GDP Growth (y-o-y, %) (Provisional)

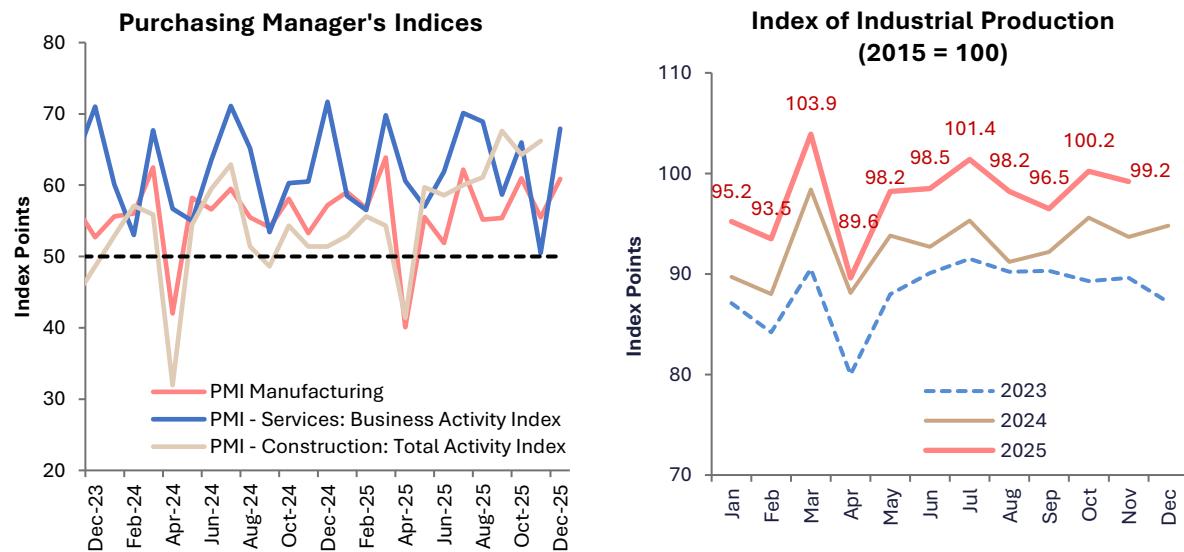
Economic Activity	2024					2025			
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	9M
Agriculture	0.9	2.7	3.7	-2.2	1.2	-0.7	2.0	3.6	1.6
Industry	11.2	9.7	10.1	13.1	11.0	9.7	5.8	8.1	8.0
Services	2.5	1.9	2.6	2.5	2.4	2.8	3.9	3.5	3.4
GDP	5.1	4.1	5.3	5.4	5.0	4.8	4.9	5.4	5.0

Source: Department of Census and Statistics

Leading indicators reflected greater resilience in economic activity during Q4-2025, despite the disruptions caused by Cyclone Ditwah towards the end of the quarter. Consistent with the continued growth momentum observed in the previous quarters, the Index of Industrial Production (IIP) recorded a y-o-y growth during the latter part of 2025. Reflecting the positive improvements, the Purchasing Managers' Indices (PMIs) for Services, Manufacturing and Construction recorded expansions during H2-2025.¹² However, the Agriculture activities are expected to deliver mixed outcomes in Q4-2025, primarily reflecting disruptions caused by adverse weather conditions.

¹² As per the latest data release, PMI for Services and Manufacturing further improved to 67.9 and 60.9, respectively, in December 2025, while Construction total activity index was at 67.1 by December 2025. Meanwhile, IIP was recorded as 99.0 in December 2025.

Figure 14: Movements in Purchasing Managers' Indices and Index of Industrial Production



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

On the expenditure front at constant prices, GDP growth in Q3-2025 was underpinned by consumption expenditure, primarily driven by the notable growth in household final consumption expenditure. However, Gross Capital Formation marginally contracted during Q3-2025 due to the decline in Changes in Inventories and Acquisitions less Disposals of Valuables, even though Gross Fixed Capital Formation contributed positively to the growth. Further, net external demand contracted in Q3-2025, as the growth of imports of goods and services outpaced that of exports at constant prices.

Table 02: Aggregate Demand (Provisional)

Item	Constant (2015) Prices							
	2024 Q3		2024 9M		2025 Q3		2025 9M	
	Rs. bn	Y-o-Y %	Rs. bn	Y-o-Y %	Rs. bn	Y-o-Y %	Rs. bn	Y-o-Y %
Domestic Demand	3,189	9.7	9,218	6.4	3,391	6.3	9,807	6.4
Consumption	2,611	4.1	6,979	0.7	2,821	8.0	7,518	7.7
Investment (Gross Capital Formation)	577	44.4	2,240	29.3	570	(1.3)	2,289	2.2
Net External Demand	(35)	(139.9)	4	(97.0)	(65)	(88.0)	(121)	(3,189.7)
+ Exports of Goods and Services	795	9.0	2,272	11.9	827	4.0	2,406	5.9
- Imports of Goods and Services	830	29.0	2,268	19.5	892	7.5	2,528	11.4
GDP	3,154	5.3	9,222	4.9	3,326	5.4	9,686	5.0

Source: Department of Census and Statistics

3.3. Monetary Sector

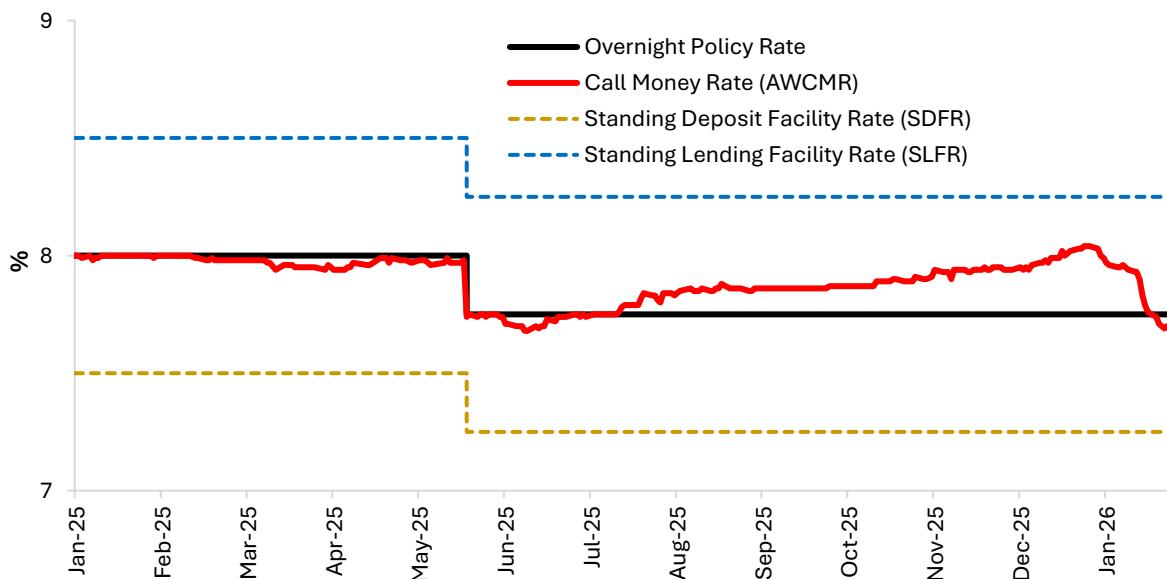
Interest Rates

The overall market interest rate structure has broadly adjusted downwards during 2025 in line with the accommodative monetary policy stance of the Central Bank, while anomalies observed in short-term interest rates during the latter part of 2025 have corrected in early 2026.

Following the policy rate reduction of 25 bps in May 2025, the Average Weighted Call Money Rate (AWCMR) adjusted further downwards and hovered around OPR until late July. However, AWCMR commenced gradually increasing thereafter due to the persistent asymmetry in the distribution of domestic money market liquidity among participatory institutions. Accordingly, AWCMR remained above the OPR, recording a deviation of around 30 bps by the end of 2025. This deviation was tolerated by the Central Bank as there was no necessity to inject additional liquidity to the system, given the continued growth of private sector credit and imports. With the improvements in overall market liquidity and the partial easing of disparities in liquidity distribution, AWCMR moved below OPR in late January 2026, recording a decline of around 30 bps by 27 January from the level recorded at the end of 2025.

In line with the movements in AWCMR, the Average Weighted Repo Rate (AWRR) also increased during the latter part of 2025, before moderating in early 2026.

Figure 15: Movements in the OPR and AWCMR

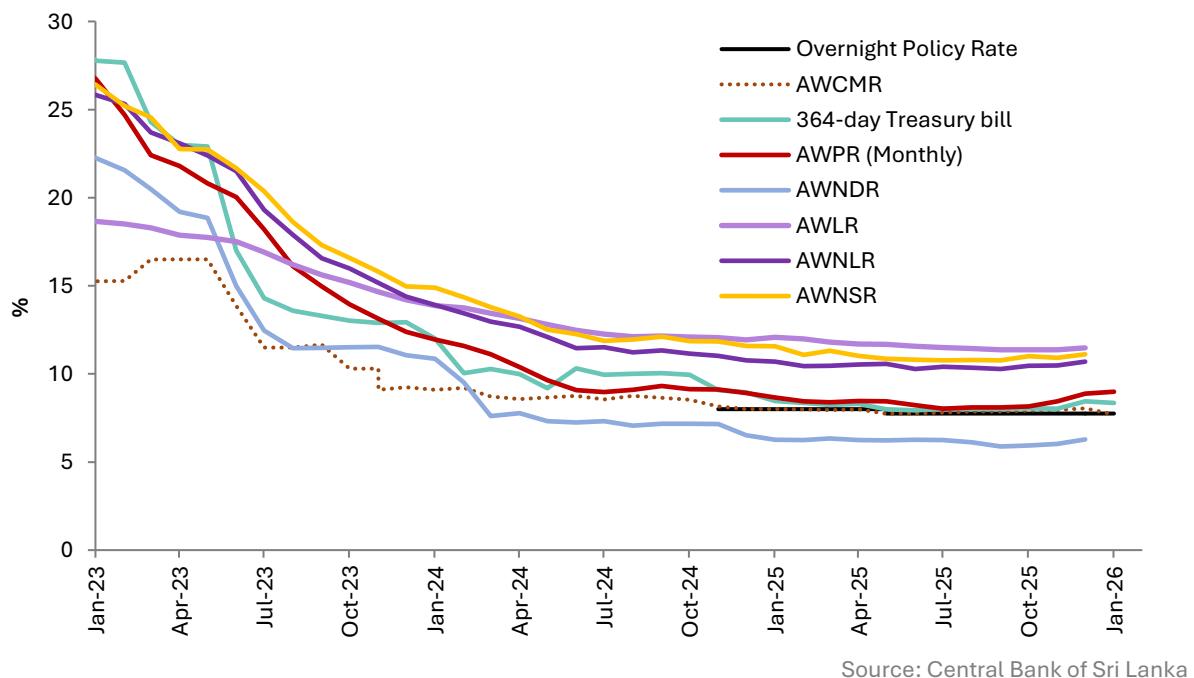


Source: Central Bank of Sri Lanka

The Average Weighted Prime Lending Rate (AWPR), which remained stabilised at low levels, witnessed upward pressure reflecting the behaviour of short-term market rates, including the government securities yields, and rising deposit interest rates during the latter part of 2025. Accordingly, the monthly AWPR rose by around 85 bps during the period from August to December 2025. However, weekly AWPR recorded a decline in early 2026 in line with the downward adjustments in AWCMR.

Despite the cumulative reduction in the other market lending and deposit interest rates during 2025, some increase was observed in December 2025, partially reflecting the pressure observed in short-term rates and Treasury bill yields, and liquidity constraints experienced by some banks.

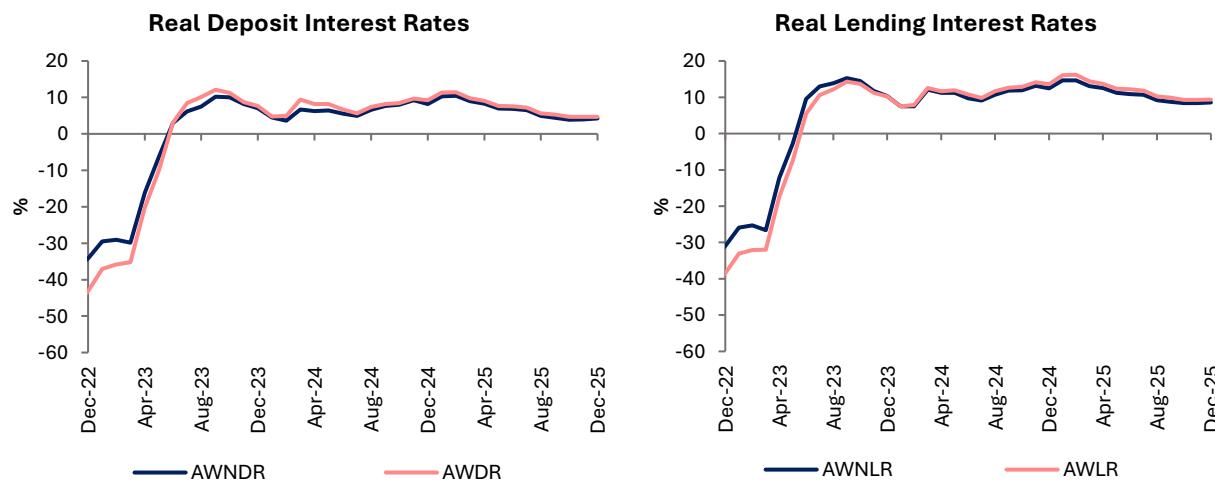
Figure 16: Movement in Selected Market Interest Rates



Treasury bill yields across all maturities in the primary auctions declined by 50-90 bps during 2025, supported by the low inflation environment and the accommodative monetary policy stance. Despite some upward pressures observed in yields in mid-July, partly reversing their over-reduction in yields at shorter tenors, yields remained relatively stable in most of 2025. However, yields registered a notable upward adjustment in late December 2025, fuelled by market sentiment on possibly higher government borrowing for post-Cyclone recovery efforts. Nevertheless, Treasury bill yields showed some easing at recent auctions, with the market appetite for longer-tenor Treasury bonds remaining steady. Despite these intermittent volatilities, the overall secondary market yield curve remains below the levels recorded at the end of 2024.

Meanwhile, real interest rates witnessed a drop recently, with inflation turning positive in August 2025 and increasing thereafter. Going forward, real interest rates are likely to ease further with the expected convergence of inflation towards the target.

Figure 17: Ex-Post Real Interest Rates



Note: The monthly real interest rate is derived by adjusting the nominal interest rate for the y-o-y headline inflation rate (CCPI-based).

Source: Central Bank of Sri Lanka

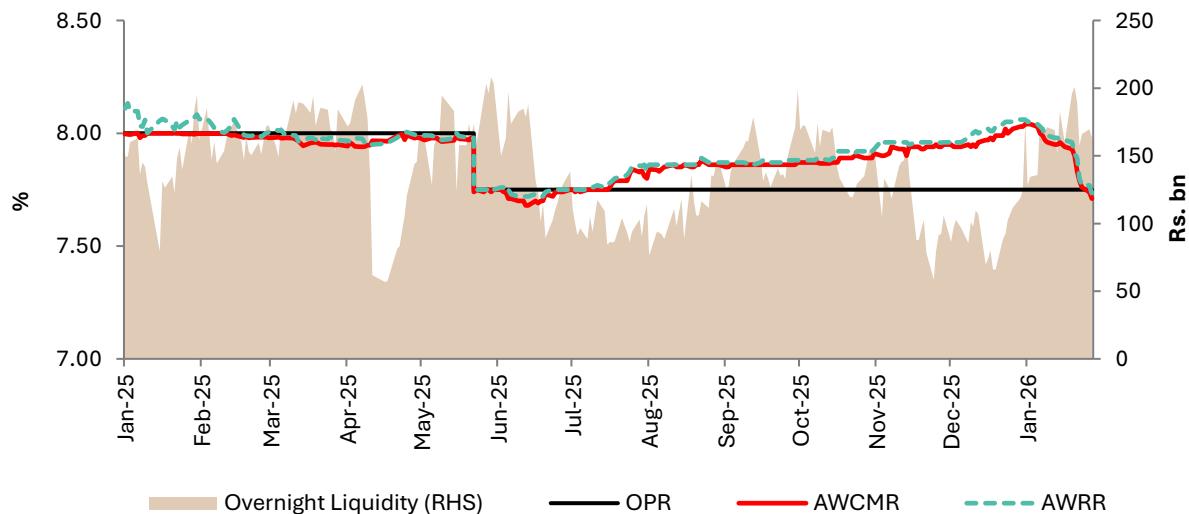
Domestic Money Market Liquidity

Liquidity conditions in the domestic money market continued to remain at a surplus with some volatility during 2025.

Domestic money market liquidity remained at an average of Rs. 136 bn during 2025. This surplus liquidity during the year was largely supported by the net foreign exchange purchases by the Central Bank from the domestic foreign exchange market and foreign currency swaps between the Central Bank and Licensed Commercial Banks (LCBs). Meanwhile, cash withdrawals and use of rupee liquidity by the Government to obtain foreign exchange from the Central Bank in order to service its foreign currency debt, as well as coupon receipts to the Central Bank on account of its Treasury bond holding, contributed to the draining of liquidity during the year. As at 27 January 2026, domestic money market liquidity surplus improved to an average of around Rs. 165 bn, mainly supported by the net purchases of foreign exchange by the Central Bank.

In terms of money market activity, both the call market and the repo markets have been active, with a continuous increase in transaction volumes.

Figure 18: Behaviour of Overnight Liquidity, AWCMR and AWRR



Source: Central Bank of Sri Lanka

Domestic Credit Conditions and Money Supply

During 2025, broad money supply (M_{2b}) continued to expand, supported by the notable increase in private sector credit and the rise in Net Foreign Assets (NFA) of the banking system.

During 2025, credit to the private sector by LCBs increased notably by around Rs. 2.1 tn. Accordingly, credit to the private sector grew by 25.2% (y-o-y) in 2025, compared to the growth of 10.7% (y-o-y) in 2024. A notable acceleration in private sector credit was observed since June 2025, with monthly expansion of credit exceeding Rs. 200 bn for six consecutive months, except in December 2025. This expansion in private sector credit during 2025 was largely due to the expansion in economic activity, as well as increased demand for financing for vehicle imports after the relaxation of restrictions on vehicle imports in early 2025. Moreover, the slowdown in public sector credit has created additional space for the expansion of credit to the private sector. Meanwhile, credit extended to the private sector by LCBs during 2025 remained broad-based. In terms of sector-wise disbursements of credit to the private sector, the Services sector continues to dominate thus far in 2025, followed by credit to the Industry sector, while personal loans and advances also remain notable. Further, credit to the private sector by Finance Companies (FCs) recorded a cumulative expansion of Rs. 789 bn in 2025, registering a y-o-y growth of 49.3% by the end of 2025, mainly reflecting the increased financing for vehicle imports. Despite the notable expansion in credit to the private sector by LCBs, the private sector credit-to-GDP ratio stood at 29.8% as at Q3-2025, relatively below the pre-crisis level.

Figure 19: Monthly Change in Outstanding Credit to the Private Sector by LCBs

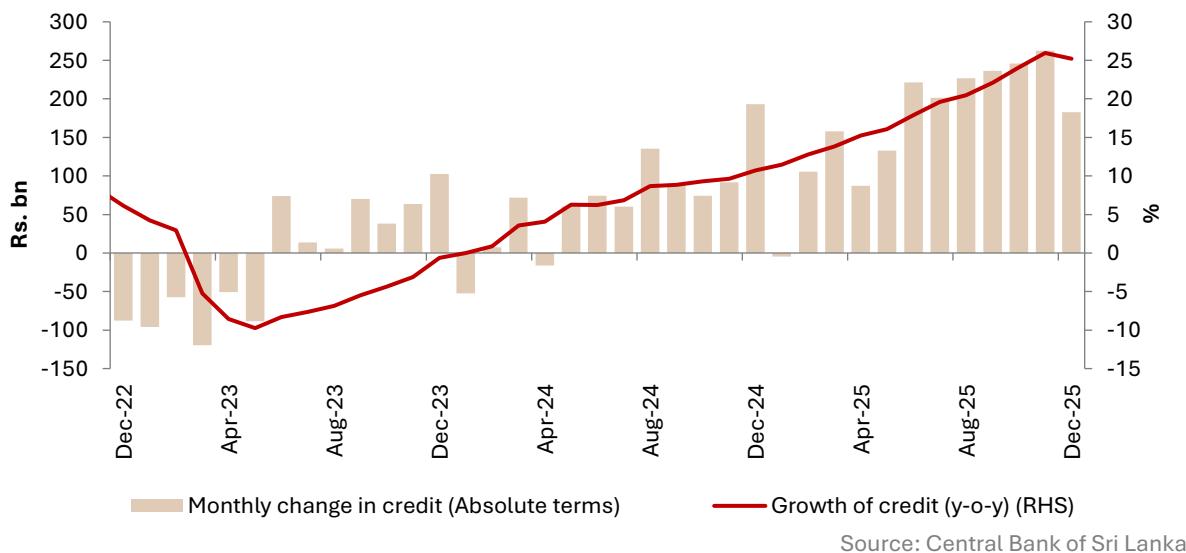
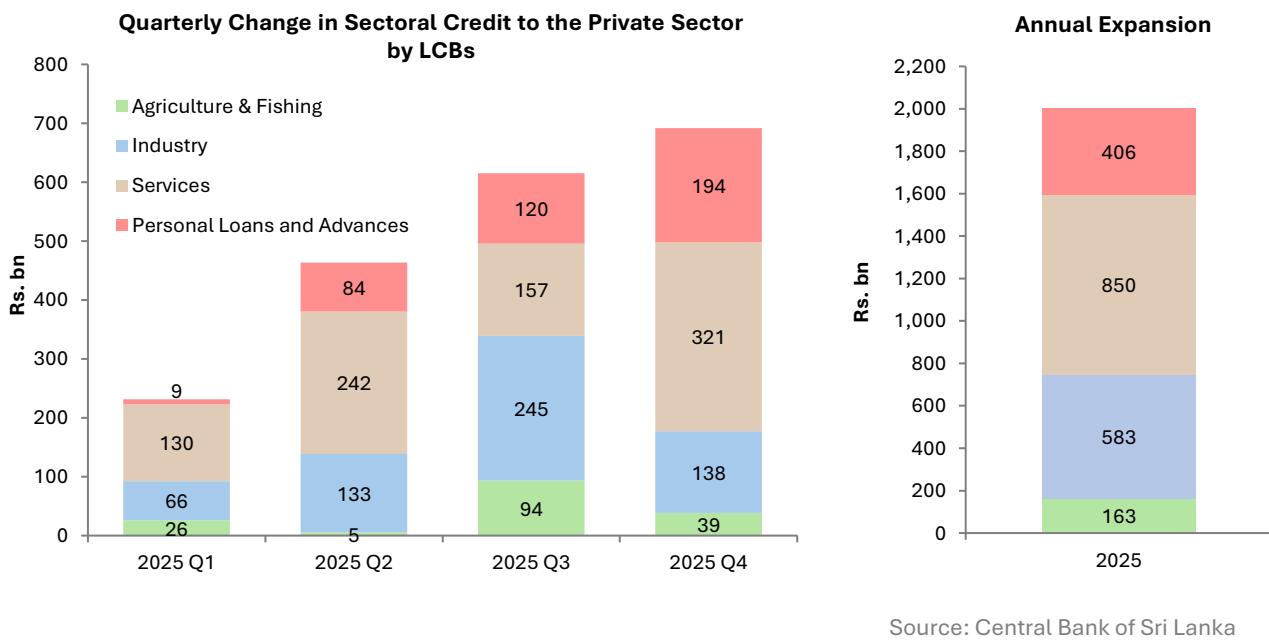


Figure 20: Sectoral Credit to the Private Sector by LCBs



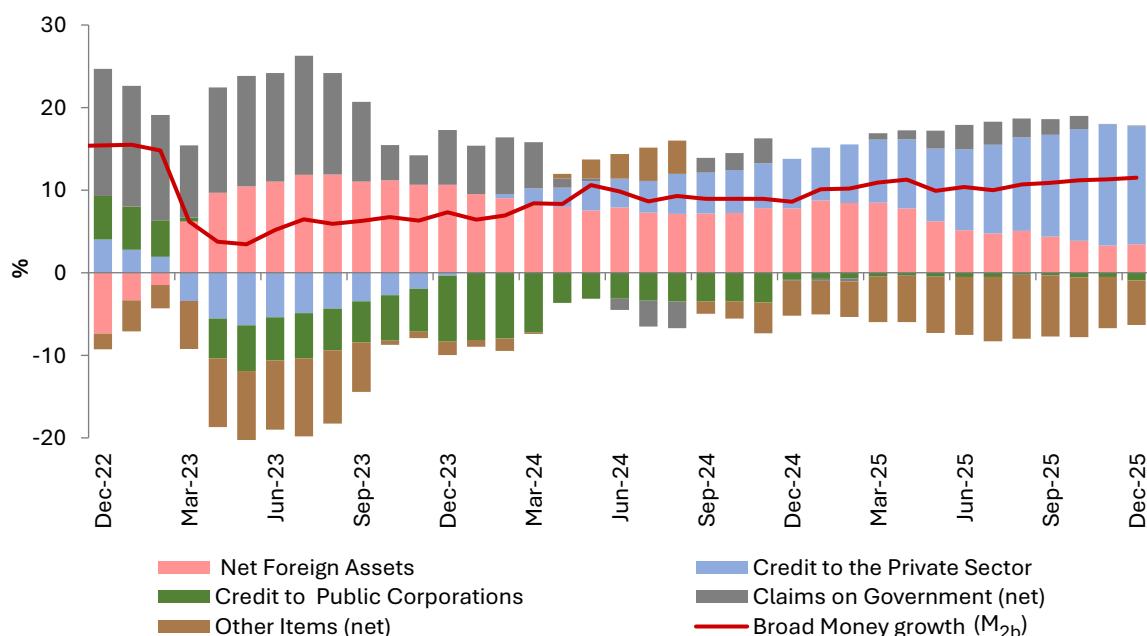
Net Credit to the Government (NCG) by the banking system recorded a marginal increase of Rs. 15 bn during 2025. The increase in NCG by the Central Bank during this period was entirely attributable to valuation (fair value) adjustments on the Central Bank holdings of government securities amidst a moderation in bond yields despite the increase in the holdings of government securities. NCG by LCBs recorded a cumulative contraction of Rs. 39 bn during 2025, mainly reflecting the buildup of government deposits with state banks, indicating the Government's efforts to accumulate buffers.

Credit granted to State-Owned Business Enterprises (SOBEs) by LCBs contracted notably by Rs. 137 bn in 2025, mainly on account of the partial net repayments made by key SOBEs, including the Road Development Authority, National Water Supply and Drainage Board, Ceylon Electricity Board, and Ceylon Fertilizer Corporation.

NFA of the banking system continued to improve during 2025, reflecting improved external sector performance. Contributing to the overall expansion, NFA of the Central Bank rose significantly, largely supported by the Central Bank's foreign exchange purchases to strengthen its official reserves. NFA of LCBs recorded only a marginal increase during the year.

In line with these developments, the y-o-y growth of broad money (M_{2b}) accelerated to 11.5% by the end of 2025 from 8.6% recorded at the end of 2024.

Figure 21: Contribution to y-o-y Growth of Broad Money (M_{2b})



Note: The relative increase in the negative value of other items (net) of the Central Bank and LCBs during 2025 was largely due to increased retained earnings and reserves.

Source: Central Bank of Sri Lanka

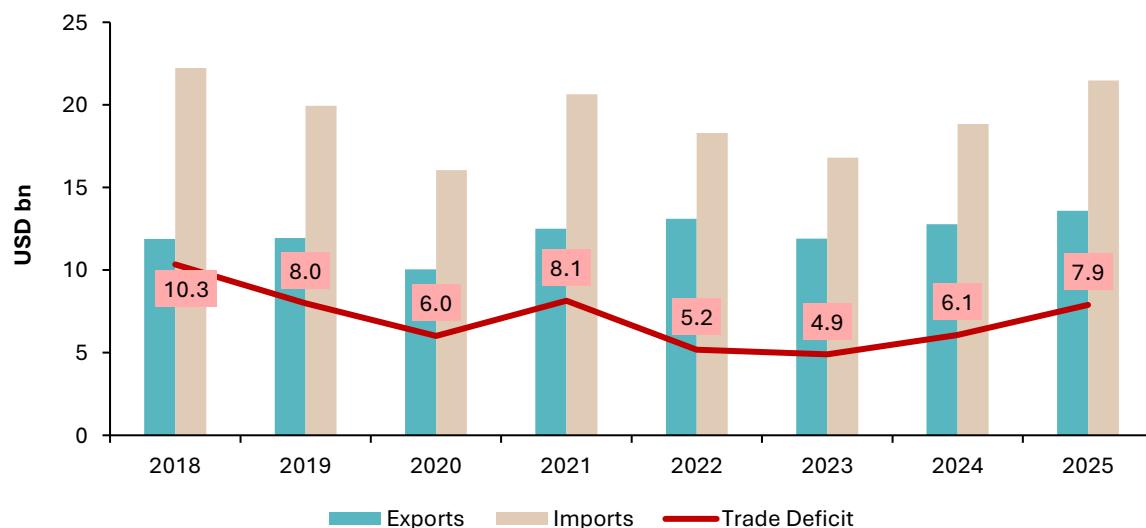
3.4. External Sector

Despite the widening of the merchandise trade deficit, the current account is estimated to have recorded a surplus in 2025, which is the highest ever annual surplus. The Gross Official Reserves (GOR) increased during the year amidst foreign debt service payments, largely supported by net forex purchases by the Central Bank and receipts from the multilateral institutions. Meanwhile, the Sri Lanka rupee recorded a 5.6% depreciation against the USD following two consecutive years of appreciation.

Balance of Payments

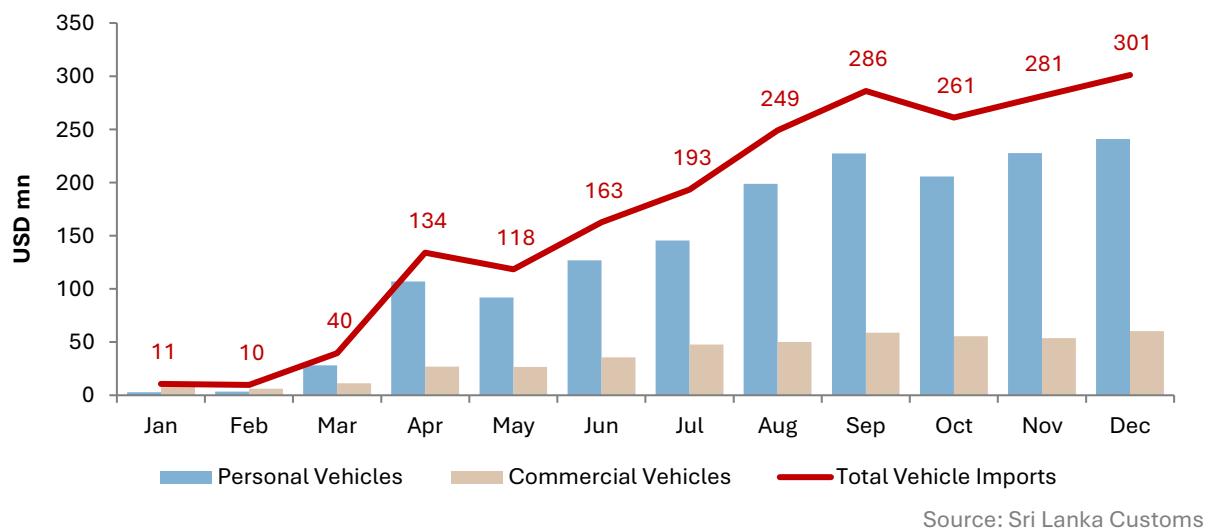
The external current account is provisionally estimated to have recorded a surplus of USD 1.7 bn in 2025. This was driven by strong performances in the services and secondary income accounts, along with a significant narrowing of the primary income account deficit. The merchandise trade deficit widened to USD 7.9 bn in 2025, from USD 6.1 bn recorded in 2024. This was mainly due to the expansion in import expenditure by 14.0%, outpacing the growth in export earnings of 6.3% in 2025 compared to 2024. Export earnings amounted to USD 13.6 bn in 2025, registering the highest level on record and surpassing the previous peak of USD 13.1 bn achieved in 2022. Meanwhile, expenditure on imports amounted to USD 21.5 bn in 2025, driven mainly by higher vehicle imports, after the previous peak recorded in 2018 at USD 22.2 bn. With the relaxation of restrictions on vehicle imports in January 2025, a marked increase in vehicle imports was observed since April 2025. Accordingly, expenditure on vehicle imports, including personal and commercial vehicle imports, surged in 2025, amounting to USD 2.0 bn, thereby exerting upward pressure on import expenditure and widening the merchandise trade deficit.

Figure 22: Merchandise Trade Account



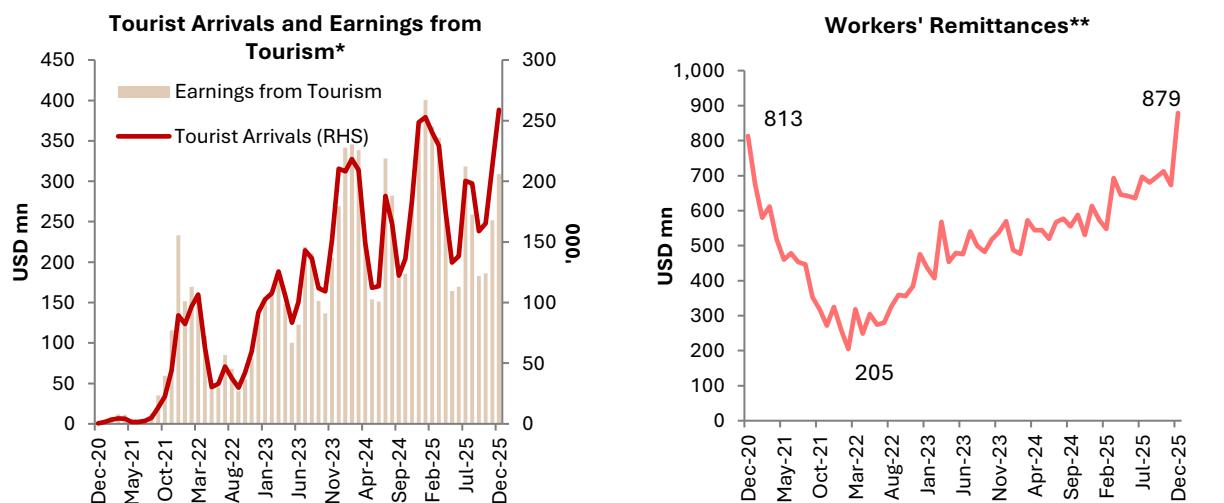
Sources: Central Bank of Sri Lanka
Sri Lanka Customs

Figure 23: Composition of Personal and Commercial Vehicle Imports



Though historically the highest tourist arrivals were recorded in 2025, earnings from tourism were estimated to be USD 3.2 bn, recording a y-o-y growth of 1.6% compared to 2024 due to the downward revision of estimates of average expenditure per day and the average duration of stay by the Sri Lanka Tourism Development Authority (SLTDA). Further, workers' remittances amounted to around USD 8.1 bn in 2025,¹³ recording a growth of 22.8% (y-o-y), compared to USD 6.6 bn recorded in 2024.

Figure 24: Tourism and Workers' Remittances

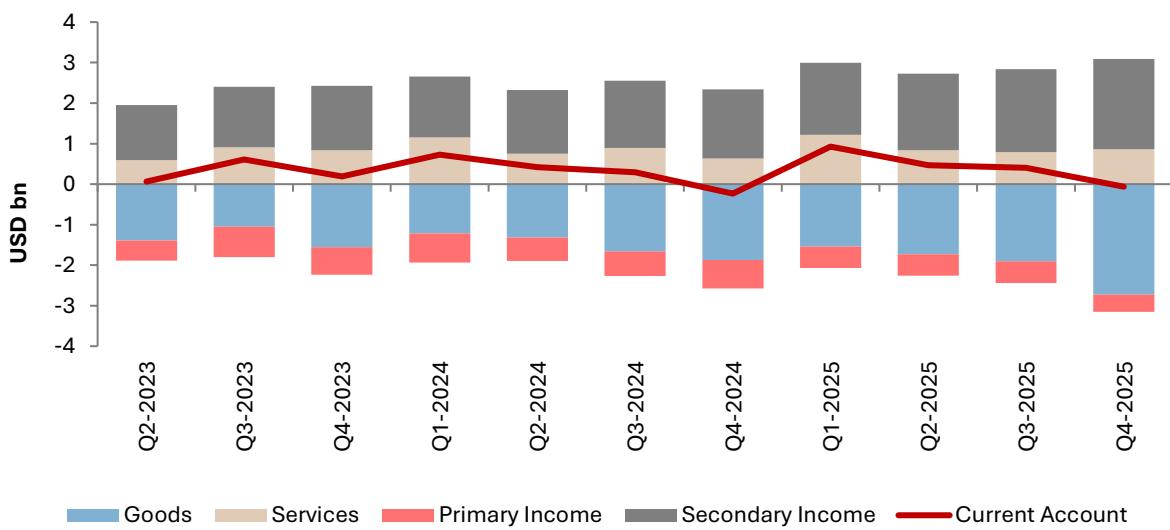


Sources: Central Bank of Sri Lanka
Sri Lanka Tourism Development Authority

Sources: Central Bank of Sri Lanka
Licensed Banks

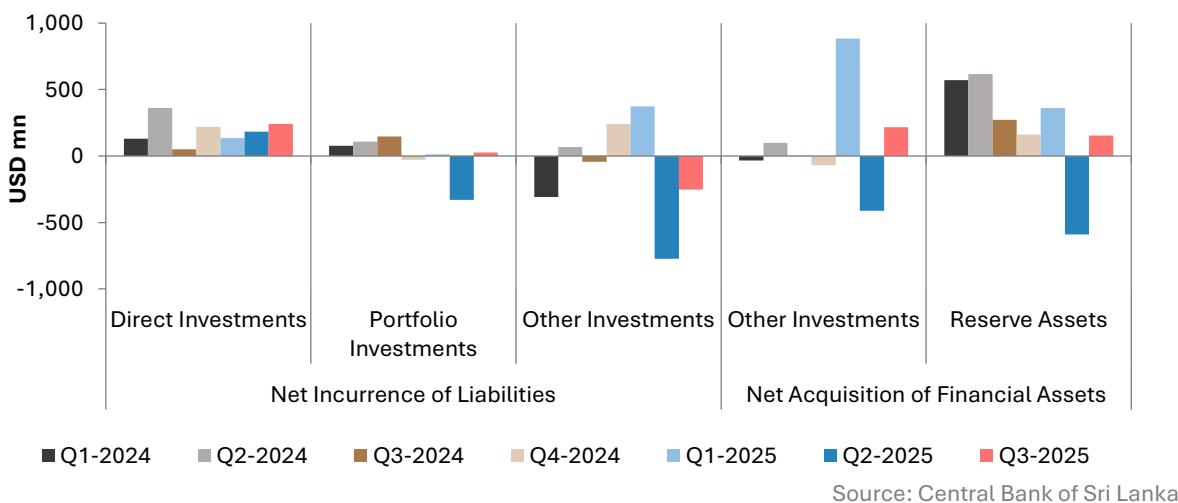
¹³ Workers' remittances may include other remittances, such as those received following Cyclone Ditwah.

Figure 25: External Current Account



Despite favourable developments in the external current account, the performance of the financial account has remained subdued. Foreign direct investment (FDI) inflows, including foreign loans to direct investment enterprises (DIEs) from unrelated parties during the nine months ending September 2025, amounted to USD 891 mn, compared to USD 589 mn during the corresponding period of 2024. Meanwhile, during 2025, foreign investments in the government securities market recorded a net inflow of USD 248 mn, while foreign investments in the Colombo Stock Exchange (CSE), including primary and secondary market transactions, recorded a net outflow of USD 122 mn during 2025.

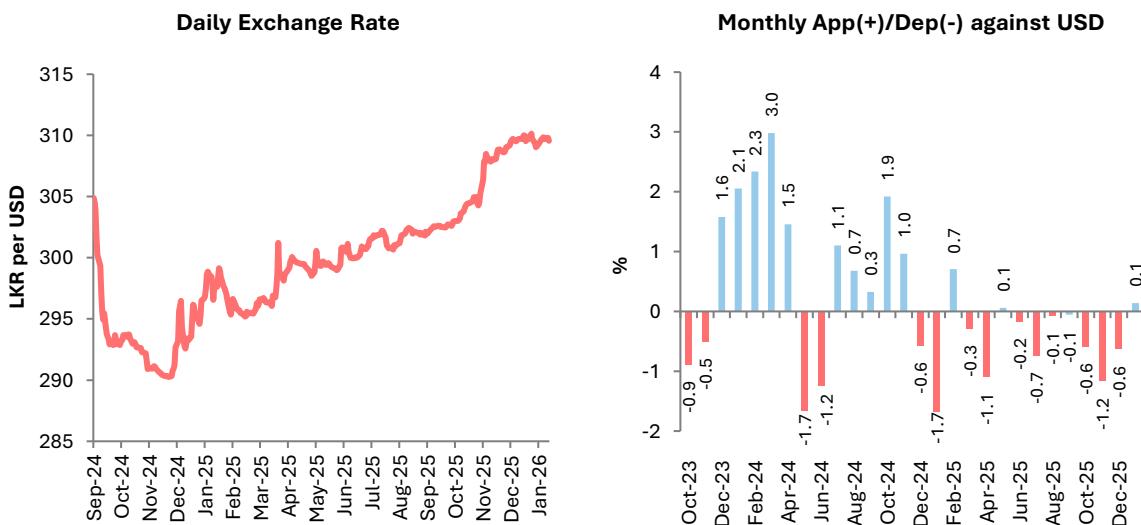
Figure 26: Financial Account



Exchange Rate

The Sri Lanka rupee experienced some depreciation pressure during the latter part of 2025, largely driven by increased import demand. Accordingly, the Sri Lanka rupee depreciated against the USD by 5.6% in 2025. The Sri Lanka rupee has remained relatively stable with a marginal appreciation of 0.1% (YTD) against the USD. Meanwhile, reflecting cross-currency movements, the Sri Lanka rupee depreciated against other major currencies, such as the Euro, the Pound sterling, the Chinese yuan, the Japanese yen, the Indian rupee, and the Australian dollar during 2025. Moreover, both the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) declined in 2025 in line with the nominal depreciation of the Sri Lanka rupee.

Figure 27: Exchange Rate Movements



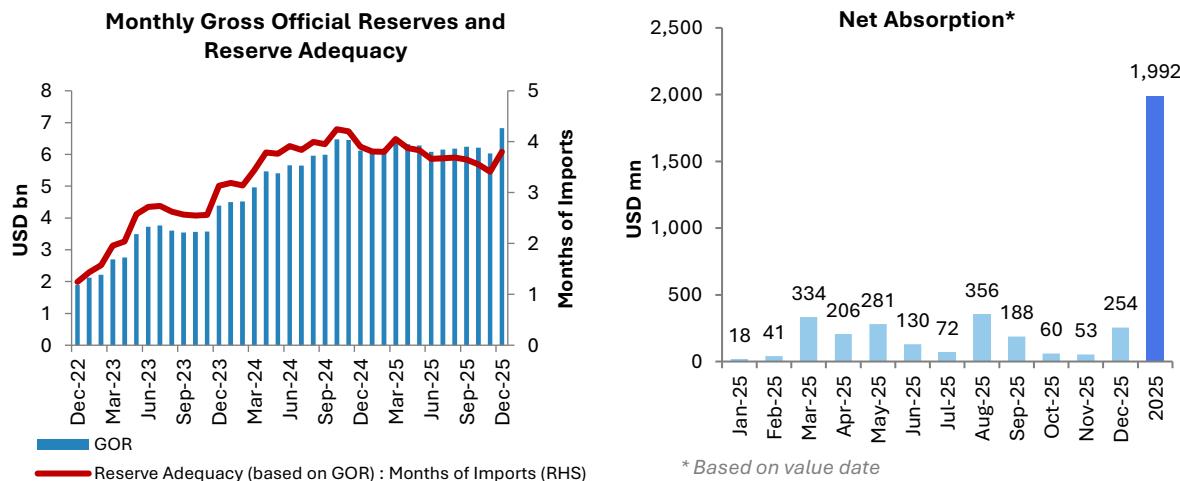
Source: Central Bank of Sri Lanka

Reserve Assets

GOR¹⁴ were built up to USD 6.8 bn by the end of 2025 from USD 6.1 bn at end 2024, amid continued foreign debt service payments of the Government and the Central Bank. The reserve accumulation during the year was largely supported by net forex purchases of around USD 2.0 bn (based on the value date) by the Central Bank from the domestic forex market. Inflows from multilateral institutions, mainly the inflows from the Asian Development Bank, and the disbursement of two tranches of Extended Fund Facility (EFF) and Rapid Financing Instrument (RFI) by the International Monetary Fund (IMF) also helped enhance GOR.

¹⁴ Includes the swap facility by the People's Bank of China (PBoC), which is subject to conditionalities on usability.

Figure 28: Monthly Gross Official Reserves, Reserve Adequacy and Net Absorption



Note: GOR include the PBoC swap facility, which is subject to conditionalities on usability

Source: Central Bank of Sri Lanka

3.5. Fiscal Sector

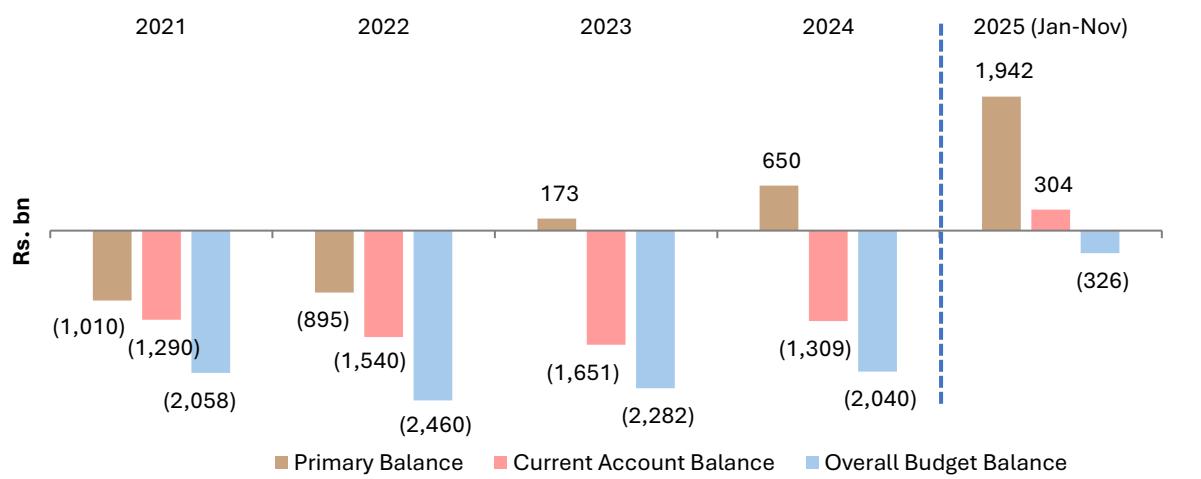
Fiscal sector performance further strengthened, driven by continued robust revenue-based fiscal consolidation measures during the first eleven months of 2025.

Government revenue and grants recorded a y-o-y growth of 35.4% in nominal terms during January-November 2025. This increase was primarily driven by tax revenue, which grew by 36.8% compared to the previous year, reaching Rs. 4,611.5 bn during the corresponding period. Such notable growth in tax revenue is attributed to increases in tax collections from excise duties, VAT, income taxes, import duties, the Special Commodity Levy (SCL), and the Social Security Contribution Levy (SSCL). During the same period, the Government achieved around 98% of its annual tax revenue target, largely driven by vehicle import-related taxes. Similarly, non-tax revenue also increased by 19.2% during the eleven months ending November 2025 compared to the corresponding period in 2024. Meanwhile, total expenditure and net lending increased by 8.3% y-o-y during January-November 2025. This increase was primarily driven by the higher spending on subsidies and transfers, salaries and wages and interest payments. Furthermore, capital expenditure increased by 6.6% during January-November 2025, in comparison to the corresponding period of 2024, gaining momentum after experiencing a slowdown in early 2025.

With these positive fiscal developments, all three key fiscal balances, both in nominal terms and in GDP (projected) terms, improved during January-November 2025. Accordingly, overall fiscal deficit narrowed while the primary balance recorded a substantial increase in surplus, reaching

Rs. 1,941.8 bn during January-November 2025, compared to Rs. 927.8 bn during the same period in 2024.

Figure 29: Key Fiscal Balances



The fiscal sector is confronted with the challenge of restoring disrupted lives of the people and reconstructing damaged infrastructure following Cyclone Ditwah. To address this, the Government has implemented several relief measures, alongside initiatives to rebuild damaged infrastructure across the country. Accordingly, the anticipated overperformance of the primary surplus has provided space to finance disaster relief measures during 2025. Further, the Parliament has approved a Supplementary Estimate of Rs. 500 bn for Budget 2026. This additional financing will be met through the utilisation of existing cash buffers, while the borrowing limit for 2026 will remain unchanged at Rs. 3,740 bn, as announced in Budget 2026.

3.6. Financial Sector

The financial sector remained resilient with improving performance, supported by favourable macroeconomic conditions.

The resilience of the financial sector continued to improve during 2025. Total assets of the banking sector expanded during 2025, mainly due to the considerable increase in loans and receivables. Accordingly, total assets recorded a y-o-y growth of 12.6% at the end of 2025 and stood at Rs. 24.9 tn. Furthermore, growth of gross loans and receivables notably accelerated to 21.5% (y-o-y) and reached Rs. 13.9 tn at the end of 2025, amidst the eased monetary conditions.

Overall default risk of the banking sector, as reflected by the Stage 3 loans ratio, declined to 9.4% at the end of 2025 compared to 12.3% in 2024. Profit After Tax (PAT) of the sector increased during

the year, reporting Rs. 369.1 bn in 2025, compared to Rs. 324.2 bn in 2024, recording a y-o-y growth of 13.8%. However, profitability indicators, such as Return on Equity (ROE), Return on Assets (ROA), and Net Interest Margin (NIM), slightly declined at the end of 2025 compared to the end of 2024.

Liquidity of the banking sector, as measured by Liquidity Coverage Ratios (LCRs), declined at the end of 2025 compared to the end of the previous year, along with the significant credit expansion during the period. Accordingly, Rupee LCR declined to 283.9% at the end of 2025, compared to 349.9% at the end of 2024, whilst all currency LCR declined to 249.7% at the end of 2025, compared to 313.8% at the end of 2024. However, the sector LCRs were well above the minimum requirement of 100%. Meanwhile, the Total Capital Adequacy Ratio (CAR) of the banking sector improved to 18.7% at the end of September 2025, compared to 18.5% the year before, supported by the higher growth in total regulatory capital compared to the growth in Risk Weighted Assets (RWA). Accordingly, regulatory capital increased by 19.2% (y-o-y), against a growth in RWA by 17.6% (y-o-y) at the end of September 2025.

FCs sector recorded a y-o-y expansion of 44.0% in its asset base at the end of 2025, mainly supported by increased loans and advances. Accordingly, the gross loans and advances of the sector recorded a significant growth of 51.9% y-o-y at the end of 2025, driven by increased vehicle and gold-backed loans. Consequently, the credit portfolio of the sector was highly concentrated on loans against vehicles and gold, reflecting the sector's reliance on collateralised lending. Gross Stage 3 loans ratio of the sector decelerated to 6.1% by the end of 2025, compared to 11.5% reported at the end of 2024, indicating an improvement in credit quality. Liquidity position of the sector remained above the regulatory requirement at the end of 2025 with a liquidity surplus of Rs. 74.3 bn. Furthermore, the sector reported a PAT of Rs. 61.5 bn for the period April – December 2025, recording a growth of 45.0% y-o-y for the first nine months of the financial year 2025/26. In terms of capital adequacy, FCs sector recorded a CAR of 18.7% by the end of 2025.

Table 03: Key Financial Soundness Indicators of the Banking and FCs Sectors

Key Indicators (%)	as at end 2024	as at end 2025 (Provisional)
Banking Sector		
Gross Stage 3 Loans Ratio	12.3	9.4
Return on Assets	2.6	2.5
Return on Equity	17.4	16.6
Net Interest Margin	4.4	4.3
Capital Adequacy Ratio	20.3	17.9
Finance Companies Sector		
Gross Stage 3 Loans Ratio	11.5	6.1
Return on Assets	5.8	6.3
Return on Equity	12.8	16.2
Net Interest Margin	10.9	10.6
Capital Adequacy Ratio	21.3	18.7

Source: Central Bank of Sri Lanka

In 2025, the equity market demonstrated a notable growth, with the All-Share Price Index (ASPI) and the Standard & Poor's Sri Lanka 20 (S&P SL20) index of the Colombo Stock Exchange (CSE) achieving annual gains of 41.9% and 26.6%, respectively, compared to annual growth rates of 49.7% and 58.5% recorded in 2024. The upward trend in the equity market was mainly driven by heightened participation from domestic investors. Despite the strong annual performance, market indices dipped slightly from mid-November, with ASPI and S&P SL20 declining by 4.4% and 6.1%, respectively, between 12 November and end 2025. However, the market regained a bullish momentum in early 2026, with ASPI and S&P SL20 recording YTD gains of 5.9% and 8.4%, respectively, as of 27 January 2026.

During 2025, 21 companies listed on the CSE raised Rs. 133.2 bn through corporate debenture issuances, with interest rates ranging from 9.75% to 13.15%, compared to Rs. 94.8 bn raised by 10 companies at interest rates ranging from 12.00% to 15.25% during 2024. However, during 2025, CSE experienced a net foreign outflow in the secondary market, resulting in a cumulative net foreign outflow of USD 127.7 mn.

3.7. Global Developments

Global economic projections signal greater resilience in growth supported by surging technological advancements and policy stimulus despite looming policy and geopolitical uncertainty. Global inflation is expected to further ease with softening demand and lower energy prices. After an extended period of global monetary policy easing, the global monetary policy stance has recently shifted from dovish to a more cautious stance, amidst challenging economic conditions.

In 2026, global growth is expected to be primarily driven by emerging market and developing economies (EMDEs), which are projected to expand by 4.0%, while advanced economies (AEs) are expected to grow by 1.8%.¹⁵ The growth outlook remains tilted to the downside due to trade and geopolitical tensions, which could affect supply chains and commodity prices. Further, larger fiscal deficits and high public debt, which could put pressure on long-term interest rates and, in turn, on broader financial conditions, also remain as downside risks to global growth prospects. Global inflation projections are broadly unchanged from the previous projections as overarching trends of softening demand and lower energy prices remain intact.¹⁶

Global policy uncertainty, as indicated by the World Policy Uncertainty Index,¹⁷ remains elevated, despite the recent drop. In the meantime, the World Trade Uncertainty Index¹⁸ also remains elevated, exhibiting trade tensions due to a combination of escalating geopolitical conflicts, major shifts in trade policies towards protectionism and the rise of economic nationalism.

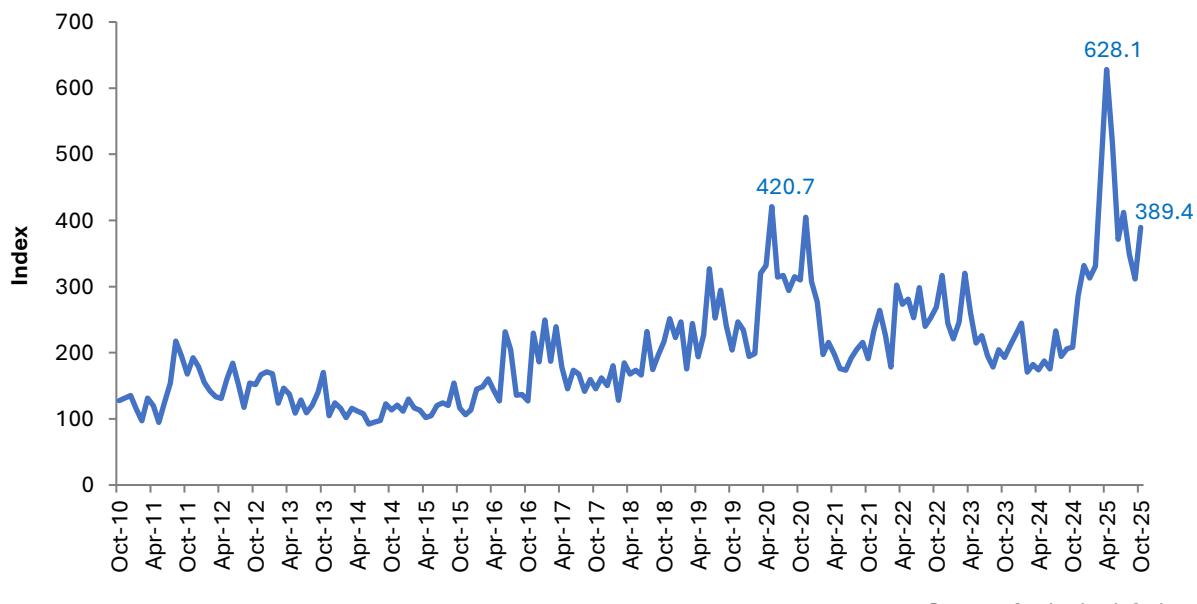
¹⁵ According to the IMF's latest update of the World Economic Outlook (WEO, January 2026) released on 19 January 2026, global growth is projected to remain resilient at 3.3% in 2026 and at 3.2% in 2027, revised slightly up since the October 2025 World Economic Outlook.

¹⁶ Global inflation is projected at 3.8% in 2026 and 3.4% in 2027, unchanging from that in the October 2025 WEO.

¹⁷ <https://fred.stlouisfed.org/series/GEPUCURRENT>

¹⁸ <https://worlduncertaintyindex.com/data/>

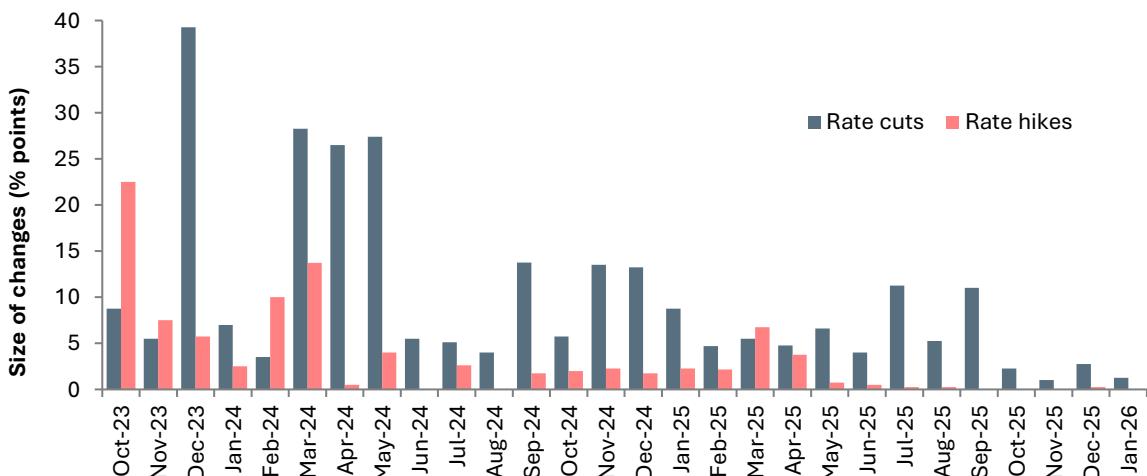
Figure 30: Global Economic Policy Uncertainty Index



Source: fred.stlouisfed.org

Global monetary policy is leaning more towards a neutral or cautious stance, reflecting careful policy deliberations amidst heightened global economic uncertainty. Following four consecutive rate cuts in 2025, the European Central Bank (ECB) maintained its three key interest rates unchanged since June 2025. Following the rate cut in October 2025, the U.S. Federal Reserve (FED) further reduced the federal funds rate in December 2025, marking the third rate reduction in 2025. The FED has cited moderation in economic activity, a slowing of job gains and an edged-up unemployment rate and elevated inflation as factors considered in this policy decision, while noting that uncertainty surrounding the economic outlook remains elevated. In December 2025, the Bank of England (BoE) cut the Bank Rate, citing the subdued economic growth amidst falling inflation. The Bank of Japan (BoJ), the only central bank that tightened monetary policy during December 2025, justified the decision by citing uncertain trade policies and a moderate rise in inflation. People's Bank of China kept its benchmark lending rates unchanged, indicating moderately loose monetary policy amidst a slowdown in the economy. Meanwhile, the Reserve Bank of India (RBI) decided to reduce the policy repo rate in December 2025, as the country experiences strong growth and low inflation. Following this benchmark interest cut, the RBI announced that it would continue with a neutral policy stance going forward.

Figure 31: Global Policy Rate Changes

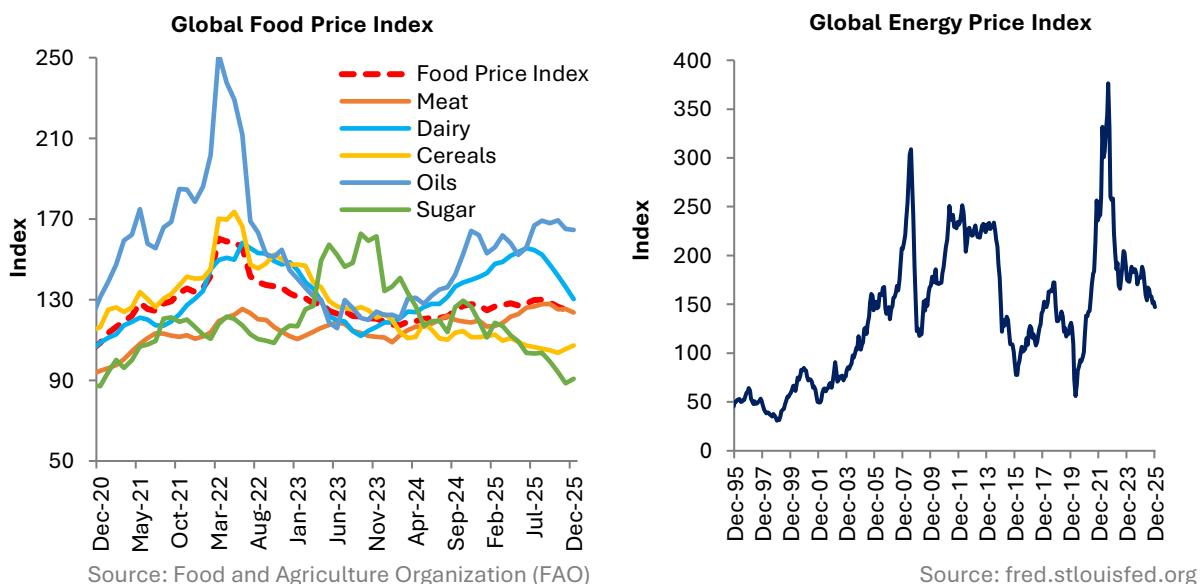


Note: Based on the data available as of 27 January 2026.

Source: <https://www.cbrates.com>

Global food and energy prices remain at moderate levels at present compared to levels recorded in 2025. However, global oil prices indicated some intermittent volatility due to supply-side concerns in 2025. However, prices experienced some upward pressure in January 2026, driven by supply uncertainties amid heightened geopolitical tensions in Venezuela and Iran. The Food and Agriculture Organisation (FAO) food price index declined to 124.3 points in December 2025 from 127.3 points recorded at the end of 2024 after reaching 130.0 points in August 2025. This was mainly due to a decline in price indices of dairy products, sugar, and cereal, with the favourable supply conditions.

Figure 32: Movements of Global Energy Prices and FAO Food Prices



LIST OF ACRONYMS

AEs	Advanced Economies
ASPI	All Share Price Index
AWCMR	Average Weighted Call Money Rate
AWDR	Average Weighted Deposit Rate
AWLR	Average Weighted Lending Rate
AWNDR	Average Weighted New Deposit Rate
AWNLR	Average Weighted New Lending Rate
AWNSR	Average Weighted New SME Lending Rate
AWPR	Average Weighted Prime Lending Rate
AWRR	Average Weighted Repo Rate
bbl	One barrel of oil
BOE	Bank of England
BOJ	Bank of Japan
bps	basis points
CAR	Capital Adequacy Ratio
CBA	Central Bank of Sri Lanka Act, No. 16 of 2023
CCPI	Colombo Consumer Price Index
CI	Confidence Interval
COICOP	Classification of Individual Consumption According to Purpose
CPI	Consumer Price Index
CSE	Colombo Stock Exchange
DCS	Department of Census and Statistics
DIEs	Direct Investment Enterprises
ECB	European Central Bank
EFF	Extended Fund Facility
EMDEs	Emerging Market and Developing Economies
FAO	Food and Agriculture Organization
FCs	Finance Companies
FDI	Foreign Direct Investment
FED	US Federal Reserve
FIT	Flexible Inflation Targeting
GDP	Gross Domestic Product

GOR	Gross Official Reserves
GPMN	Global Projection Model Network
IIP	Index of Industrial Production
IMF	International Monetary Fund
IPSWRI	Informal Private Sector Wage Rate Index
LCBs	Licensed Commercial Banks
LCR	Liquidity Coverage Ratio
LKR	Sri Lankan Rupee
MOC	Market Operations Committee
m-o-m	month-on-month
MPB	Monetary Policy Board
MPC	Monetary Policy Committee
MPFA	Monetary Policy Framework Agreement
MPR	Monetary Policy Report
NCG	Net Credit to the Government
NCPI	National Consumer Price Index
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets
NIM	Net Interest Margin
OPR	Overnight Policy Rate
PAT	Profit After Tax
PBoC	People's Bank of China
PMI	Purchasing Managers' Index
PMIs	Purchasing Managers' Indices
pps	percentage points
QPM	Quarterly Projection Model
QR	Quick Response
RBI	Reserve Bank of India
RHS	Right Hand Side
REER	Real Effective Exchange Rate
RFI	Rapid Financing Instrument
ROA	Return on Assets
ROE	Return on Equity
RWA	Risk Weighted Assets

SCL	Special Commodity Levy
SDFR	Standing Deposit Facility Rate
SLFR	Standing Lending Facility Rate
SME	Small and Medium Enterprises
SOBEs	State-Owned Business Enterprises
SSCL	Social Security Contribution Levy
S&P SL20	Standard & Poor's Sri Lanka 20
US	United States
USD	United States Dollar
VAT	Value Added Tax
WEO	World Economic Outlook
y-o-y	year-on-year
YTD	year to date

