Monthly Economic Update (MEU)

February 2025

Economic Intelligence Unit
The Ceylon Chamber of Commerce

Highlights

Sri Lankan Economy

Inflation Trends and Economic Growth of Sri Lanka: Projections for 2025

The Central Bank of Sri Lanka projects lower-than-expected inflation in Q1-2025 due to reduced electricity tariffs and subdued food prices, but inflation is expected to rise in Q2-2025 and peak in Q2-2026 before stabilizing at 5% over the medium term. Real GDP growth for 2024 is estimated at 5%, driven by the industrial sector and supported by lower interest rates.

The Government releases its Debt Management Strategy

The Public Debt Management Act No. 33 of 2024, effective from November 25, 2024, mandates the formulation of a Medium-Term Debt Management Strategy (MTDS) to ensure fiscal sustainability. The MTDS 2025-2029 aims to optimize the government's debt portfolio through a domestic-oriented financing strategy (80:20 domestic-to-external ratio), focusing on long-term treasury bonds and concessional loans to reduce refinancing risks and borrowing costs. Key fiscal targets include raising the revenue-to-GDP ratio to 15% by 2025, reducing the budget deficit to below 5% of GDP by 2026, and maintaining a primary surplus of at least 2.3% of GDP from 2025 onward, aligning with the IMF-EFF program.

External Sector Performance for the year 2024

Sri Lanka's external sector showed significant improvement in 2024, marked by strengthened reserves and robust current account inflows for the second consecutive year. Despite a widening merchandise trade deficit and record-high import expenditure in December, inflows from services, including tourism and IT/BPO, along with a 10% increase in workers' remittances, bolstered external earnings. Tourist arrivals surpassed 2 million, generating USD 3,169 million in earnings, while the Central Bank's record-high forex purchases increased gross official reserves to USD 6.1 billion by year-end, contributing to a 10.7% appreciation of the Sri Lankan Rupee against the US dollar.

Highlights of the National Budget 2025

The National Budget 2025 outlines a comprehensive strategy for economic recovery, fiscal consolidation, and structural reforms, focusing on export growth, investment promotion, and digital transformation. Key initiatives include expanding trade through the National Export Development Plan (2025–2029), introducing new investment-friendly legislation, and enhancing digital infrastructure with a Rs. 3 billion allocation. The budget also emphasizes social welfare, increasing support for vulnerable groups, and improving public sector governance through SOE reforms, while maintaining fiscal discipline under the IMF-EFF program to ensure long-term debt sustainability.

Global Economy

The World Bank Projects a 2.7% Global Growth for 2025 and 26.

The World Bank projects global economic growth to stabilize at 2.7% annually in 2025 and 2026, reflecting moderate expansion but insufficient to drive long-term development. Emerging markets and developing economies face significant challenges, with slow per capita income growth and limited prospects for achieving middle-income status without major policy reforms. To foster resilient growth, policymakers must prioritize macroeconomic stability, address debt vulnerabilities, and implement structural reforms to mitigate risks and support long-term progress.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

5.5% in Q3-2024

1.6% (Q3-2023)

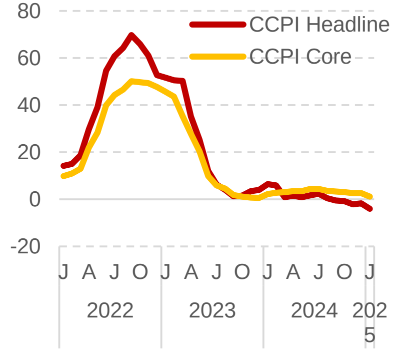
Movement of Purchasing Managers' Index-Jan 2025

Manufacturing PMI	59.0
Services PMI	58.5
Construction PMI (Dec)	51.4

All three indices recorded an expansion

Inflation

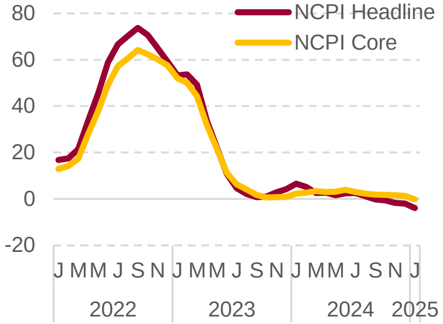
CCPI Inflation (%)-*Base 2021*



Jan 2025

Headline	Core
-4.0%	1.2%

NCPI Inflation (%)-*Base 2021*

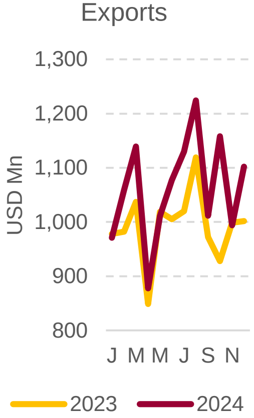


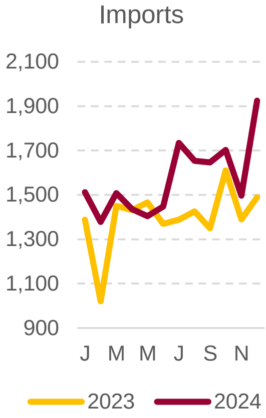
Jan 2025

Headline	Core
-4.0%	-0.2%

External Sector

Merchandise Trade





Trade Deficit
Dec 2024
69%

Services Account Balance
Dec 2024
12.3%

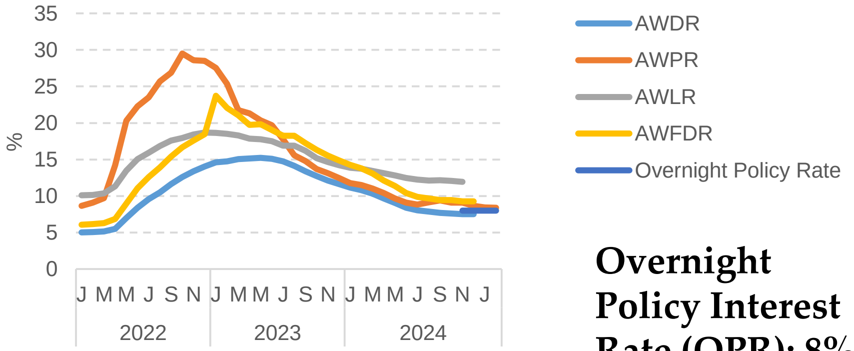
Tourism
Dec 2024

Arrivals
18%

Earnings
34%

Workers' Remittances
Jan 2025 18%

Interest Rates



Overnight Policy Interest Rate (OPR): 8%

Growth in Credit to Private Sector

Dec 2024

10.7%

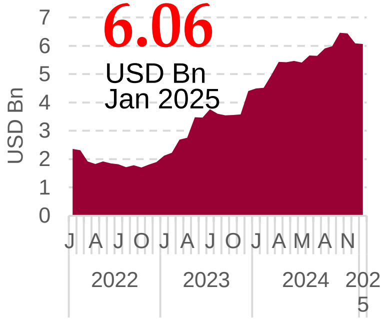
Exchange Rate

Depreciation of LKR thus far 2025

0.9%

Official Reserves

6.06
USD Bn
Jan 2025



KEY INSIGHTS
Sri Lankan Economy

Inflation Trends and Economic Growth of Sri Lanka: Projections for 2025

The Central Bank of Sri Lanka released its bi-annual inflation report on February 14, 2025. According to the latest projections, headline inflation is expected to be lower than anticipated in Q1-2025, primarily due to the significant downward revision of electricity tariffs on January 18, 2025, and relatively subdued food inflation. Additionally, the statistical base effect will further reduce year-on-year inflation in Q1-2025, as early 2024 saw price increases driven by VAT adjustments and supply-side disruptions from adverse weather.

Inflation is projected to rise in Q2-2025, averaging close to zero, before increasing further in Q3-2025, approaching the 5% target. This sharp acceleration is attributed to an unfavourable base effect, rising global food inflation, and emerging demand pressures. Inflation is expected to peak in Q2-2026, reaching approximately 2 percentage points above the target, before gradually declining from Q3-2026 onward. The base effect, a key driver of this temporary surge, is expected to fade, allowing inflation to stabilize at 5% over the medium term with appropriate policy measures.

Real GDP growth in Q4-2024 is expected to be strong, continuing the positive momentum from the first three quarters of 2024, driven mainly by the industrial sector. Annual GDP growth for 2024 is projected at around 5%. Near-term growth is expected to be moderate, with some expansionary support from increased fiscal space due to lower interest rates. This temporary fiscal boost is likely to widen the positive output gap. However, without significant pro-growth structural reforms, the economy is projected to operate below full capacity over the medium term.

It is noteworthy that the economic growth trajectory over the medium term is subject to considerable uncertainty. In this context, a sustained pickup in investment activity supported by both domestic and foreign savings would be decisive in maintaining the current growth momentum. Meanwhile, the continuation and implementation of planned structural reforms would be crucial for the economy to achieve its full potential in the medium term.

Figure 01: Projected Headline Inflation (Quarterly, CCPI, y-o-y, %)
Based on the Projections during the January 2025 Monetary Policy Round

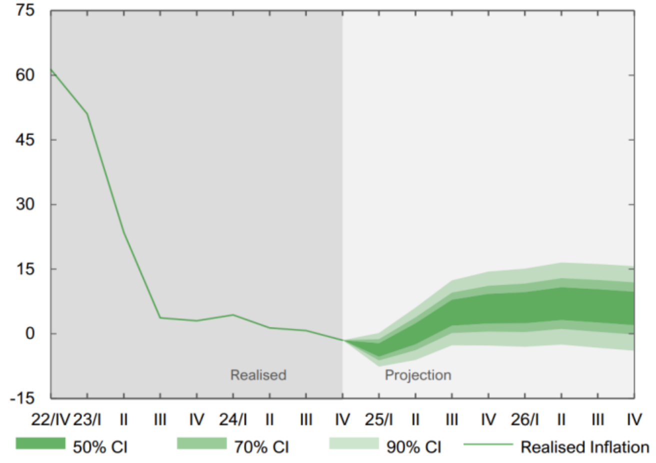
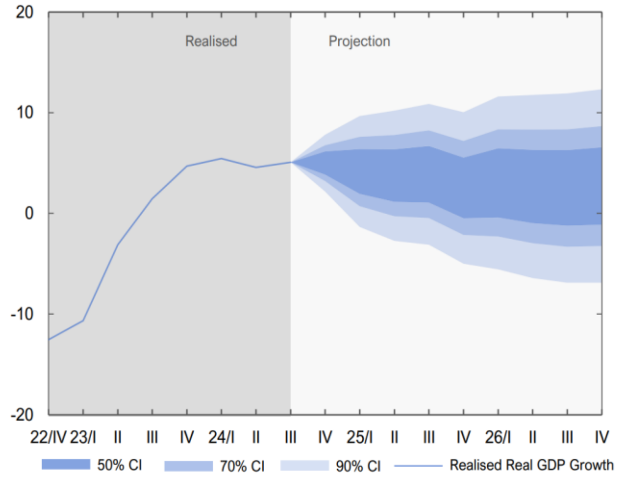


Figure 04: Projected Quarterly Real GDP Growth (y-o-y, %)
Based on the Projections during the January 2025 Monetary Policy Round



Data Source: CBSL

KEY INSIGHTS
Sri Lankan Economy

The Government releases its Debt Management Strategy

The Public Debt Management Act No. 33 of 2024 (PDMA), enacted on June 18, 2024, and effective from November 25, 2024, establishes a framework for effective public debt management in Sri Lanka. A key requirement under the PDMA is the formulation and implementation of a Medium-Term Debt Management Strategy (MTDS), aligned with the Medium-Term Fiscal Framework (MTFF) to ensure fiscal sustainability.

The MTDS 2025-2029, covering five years from 2025 to 2029, is designed to optimize the government's debt portfolio while adhering to public debt management objectives. It provides strategic guidance for borrowing decisions, ensuring the fiscal deficit is funded while balancing cost and risk considerations. The MTDS will undergo annual reviews, with the first update scheduled for November 2025.

To achieve debt sustainability, the government has committed to fiscal reforms aimed at increasing revenue and managing expenditure to reduce the budget deficit. The key fiscal targets for 2025-2029 include:

- Raising the revenue-to-GDP ratio to 15% in 2025 and maintaining or exceeding this level.
- Keeping government expenditure within 20% of GDP.
- Reducing the budget deficit to below 5% of GDP by 2026 and beyond.
- Maintaining a primary surplus of at least 2.3% of GDP from 2025 onward.
- Lowering the government debt-to-GDP ratio, gross financing needs, and foreign debt service to sustainable levels in line with the IMF-EFF program.

The MTDS Analytical Tool (MTDS AT) by the World Bank and IMF assesses Sri Lanka's debt portfolio using key risk and cost parameters, including debt-to-GDP ratio, cost of debt, refinancing risk, interest rate risk, and exchange rate risk. Among the four debt management strategies which were tested, the optimal approach prioritizes a domestic-oriented financing strategy with an 80:20 domestic-to-external financing ratio. This strategy focuses on increasing medium- to long-term treasury bond issuance to reduce refinancing risks and borrowing costs, gradually reducing reliance on treasury bills to ease short-term refinancing pressures and prioritizing concessional bilateral and multilateral loans with fixed interest rates to minimize external risks. By adopting this approach, Sri Lanka aims to enhance debt sustainability, mitigate risks, and ensure a stable financing environment.

		Current – End 2024	Chosen Strategy
Nominal Debt as % of GDP		98.3	71.2
Present Value debt as % of GDP		94.1	66.4
Interest Payment as a % of GDP		7.4	4.9
Implied interest rate %		7.5	6.9
Refinance Risk	Debt maturing in 1Y	19.1	11.3
	Debt maturing in 1Y (% of GDP)	17.6	8.0
	ATM External Portfolio (Yrs)	9.8	8.9
	ATM Domestic Portfolio (Yrs)	5.0	3.6
	ATM Total Portfolio	6.7	6.7
Interest rate risk	ATR Yrs	6.5	6.3
	Debt refixing in 1yr (% of total)	21.4	17.4
	Fixed rate debt incl T-bills (% of total)	97.3	93.5
	T-bills (percent of total)	13.9	6.7
FX risk	FX debt as % of total	37.5	40.7
	ST FX debt as % of reserves	29.2	19.5

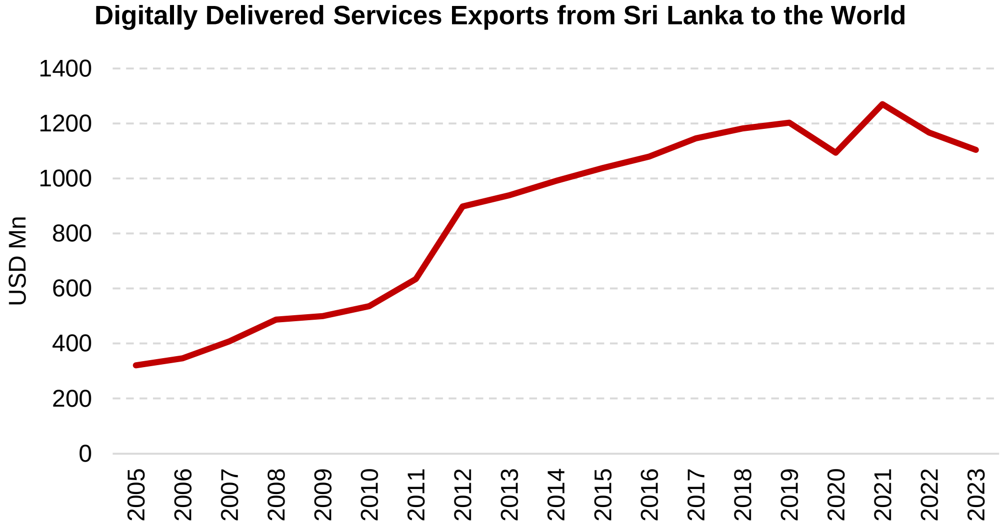
Data Source: MoF

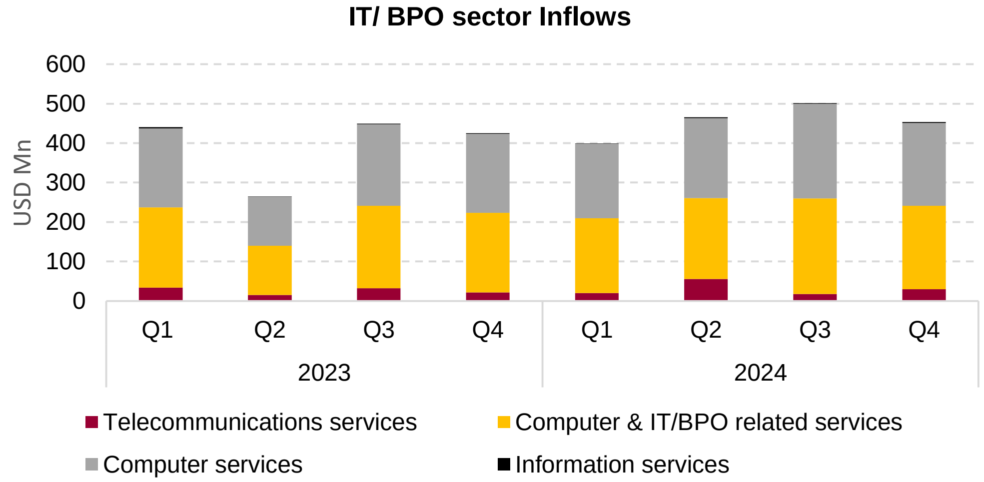
KEY INSIGHTS
Sri Lankan Economy

Tax on Digital Services as per the National Budget 2025

Sri Lanka's 2025 Budget introduces new VAT and income tax measures affecting digital services and service exports. Starting April 1, 2025, non-resident sellers and digital marketplaces must pay an 18% VAT on B2C digital services. This includes streaming, apps, online gaming, e-learning, search engines, online advertising, SaaS, and ride-sharing platforms. Electronic marketplaces must also report VAT for third-party sales, excluding payment providers without promotional roles. Guidance on registration and compliance will be issued in March 2025, with a VAT registration threshold of LKR 60 million per year (about $185,000). B2B transactions will likely use a zero-rating reverse charge mechanism. Additionally, individuals and freelancers in Sri Lanka who provide services to foreign clients and bring back foreign exchange will face a 15% services export tax. This tax is imposed on the gains and profits derived from these services, rather than the total income received. This means that individuals can deduct their expenses related to providing these services before calculating the taxable amount. The tax will apply if the foreign exchange earnings are remitted through the banking system in Sri Lanka.

This tax applies if the money is remitted through the banking system. Previously, such incomes were exempt to encourage foreign exchange earnings. The new tax measures also include changes to individual income tax rates, with income up to 1.8 million rupees exempt, the next 500,000 rupees taxed at 6%, and the following 500,000 rupees at 18%. These changes aim to increase government revenue and ensure fair competition but may impact Sri Lanka's digital services export sector. Sri Lanka government expects US$ 18.2 bn from the ICT sector for 2025. However with these tax measures sector could face higher compliance costs and prices for consumers, affecting its competitiveness in the global market. The new VAT and income tax regulations aim to create a fair tax environment but may pose challenges for the digital services industry, potentially affecting the growth of Sri Lanka's digital service exports. This could impact the industry's contribution to the country's export revenue.





Data Source: MoF, CBSL

KEY INSIGHTS
Global Economy

The World Bank Projects a 2.7% Global Growth for 2025 and 26.

The World Bank forecasts that global economic growth will stabilize at 2.7% annually in 2025 and 2026. While this signals a moderate expansion as inflation eases and monetary policies loosen, it remains insufficient to drive sustained global development. The global economy appears to be settling into a low-growth trajectory, with mounting risks that could further undermine recovery and long-term progress.

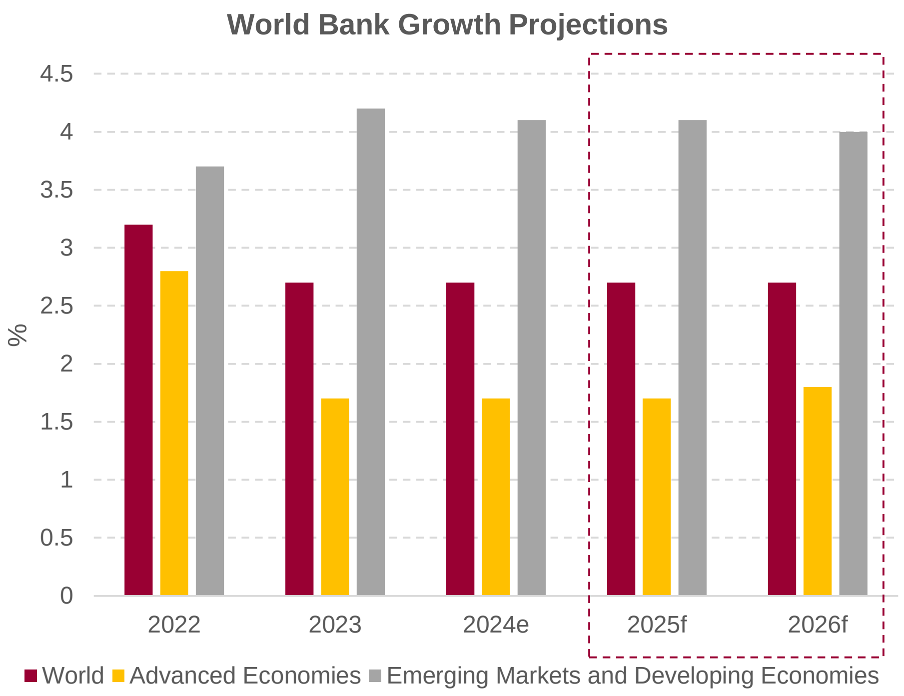
Emerging markets and developing economies (EMDEs), responsible for 60% of global growth, face particularly challenging prospects. Per capita income growth in these regions continues to lag, raising concerns about their ability to converge with advanced-economy living standards. Without significant policy reforms, most low-income countries are unlikely to achieve middle-income status by mid-century.

Several factors contribute to the subdued outlook. Policy uncertainty, adverse trade policy shifts, and geopolitical tensions pose significant risks. Additionally, persistent inflation, extreme weather events driven by climate change, and weaker growth in major economies threaten to exacerbate existing vulnerabilities. Conversely, faster-than-expected progress on disinflation and stronger demand in key economies could present upside potential for global growth.

In this challenging environment, decisive policy action is imperative. Globally, there is a need to safeguard trade flows, address mounting debt vulnerabilities, and intensify efforts to combat climate change. At the national level, policymakers must prioritize macroeconomic stability by ensuring price stability, enhancing revenue collection, and optimizing public expenditures to maintain fiscal sustainability.

Long-term growth will require a comprehensive strategy addressing structural challenges. Policies that enhance human capital, promote labor force inclusion, mitigate the impact of conflicts, and tackle food insecurity are crucial. Without such measures, the global economy risks prolonged stagnation, particularly for the most vulnerable nations.

As the world navigates these complex dynamics, coordinated and proactive policy responses will be essential to foster resilient and inclusive global growth in the years ahead.



Data Source: The World Bank

With the aim of keeping our members updated on latest global trends, especially those influencing Sri Lanka, 'Evolving Landscape' section was added to the MEU. This section guide our members in strategic planning, innovation and competitiveness and helping them identify sector-specific opportunities and challenges.

Highlights of the National Budget 2025: Sri Lanka

The 2025 Budget of Sri Lanka outlines a strategic roadmap aimed at economic recovery, fiscal consolidation, and structural reforms to enhance growth. The budget focuses on several key areas, including export expansion, investment promotion, digital transformation, infrastructure development, and social welfare.

Export Expansion and Investment Promotion
The government aims to expand exports through the National Export Development Plan (2025–2029) by facilitating market access for MSMEs and strengthening Sri Lanka's trade agreements, particularly through the Regional Comprehensive Economic Partnership (RCEP). Enhancing trade facilitation is a priority, with the introduction of a new Customs Law and the implementation of the Trade National Single Window (TNSW). Double Taxation Avoidance Agreements (DTAs) will be expanded beyond the existing 44 agreements to attract foreign investment.

To enhance investment, sector-specific industrial zones and eco-industrial parks will be established through Public-Private Partnerships (PPPs). The Economic Transformation Act will be revised to reflect emerging developments. Additionally, a new Investment Protection Bill and Public-Private Partnership Bill will be introduced to facilitate private sector engagement and investment security.

Digital Economy and Infrastructure Modernization
The budget prioritizes digital transformation with the implementation of the Sri Lanka Unique Digital Identification (SL-UDI) and legislative measures for cybersecurity and data protection. The government seeks to boost the digital economy to USD 15 billion by 2030, with ICT exports targeted at USD 5 billion. A Rs. 3 billion allocation will support digital economy initiatives, including strengthening digital payment infrastructure.

Infrastructure development remains a key focus, particularly in logistics. The completion of the East and West Container Terminals and proposed projects such as Colombo North Port and Veyangoda Integrated Multimodal Cargo and Logistics Center are expected to ease congestion and boost trade. The government has allocated Rs. 1 billion for advanced scanning systems at Colombo Port and Bandaranaike International Airport.

Tourism and SME Development
A shift in tourism strategy will focus on value creation rather than just visitor numbers. Local destinations will be branded and developed, with Rs. 500 million allocated for infrastructure improvements. The government will enhance digital ticketing and tourist safety measures while expanding Bandaranaike International Airport's Terminal 2 with Japanese investments.
SMEs are recognized as a backbone of economic development, with the government moving toward the establishment of a development bank. Credit access will be facilitated through the National Credit Guarantee Institution (NCGI). Further, Rs. 1 billion has been allocated to an Innovation Invention Fund for research commercialization, and Rs. 500 million will support youth entrepreneurs in agriculture.

Evolving Landscape cont'd

With the aim of keeping our members updated on latest global trends, especially those influencing Sri Lanka, 'Evolving Landscape' section was added to the MEU. This section guide our members in strategic planning, innovation and competitiveness and helping them identify sector-specific opportunities and challenges.

Fiscal Management and Debt Sustainability

The budget aligns with the Medium-Term Fiscal Framework (MTFF), targeting a revenue-to-GDP ratio of 15% by 2025 while keeping expenditure within 20% of GDP. The government aims to sustain a primary surplus of at least 2.3% of GDP while reducing gross financing needs and foreign debt service in line with the IMF-EFF program. A domestic-oriented debt management strategy will maintain an 80:20 domestic-to-external financing ratio, with a shift toward long-term treasury bonds over treasury bills.

Public Sector Reforms and Governance

A major reform in public sector governance includes establishing a state-owned enterprise (SOE) Holding Company to improve efficiency. The budget limits the number of ministers to 21 and rationalizes public expenditure, including vehicle and property allocations. Efforts to strengthen anti-corruption measures include enacting the Proceeds of Crime Bill and increasing financial support to the Commission to Investigate Allegations of Bribery and Corruption (CIABOC).\

Social Welfare and Sustainable Development

The budget increases allocations for social protection, with Rs. 232.5 billion earmarked for programs such as Aswesuma, which sees benefit payments rise to Rs. 10,000 for the poor and Rs. 17,500 for the extremely poor. Monthly allowances for kidney patients and people with disabilities increase to Rs. 10,000, while elderly persons will receive Rs. 5,000.

Education and healthcare receive substantial funding, with Rs. 135 billion allocated to university infrastructure and Rs. 604 billion for healthcare services. Investments in irrigation and agriculture include Rs. 5 billion for maintaining a buffer stock of rice and Rs. 2.5 billion to improve dairy farming productivity. Energy sector reforms prioritize renewable energy investments and restructuring the regulatory framework to attract competitive tariff-based investments.

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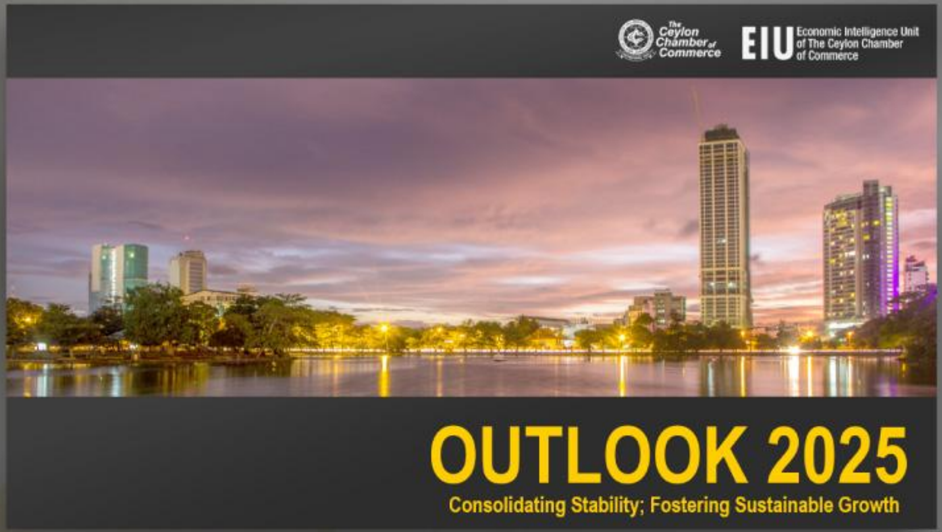

The **10th Edition** of the **"Outlook 2025"** report, published by the Economic Intelligence Unit (EIU) of the Ceylon Chamber of Commerce, provides an in-depth analysis of Sri Lanka's macroeconomic performance and future outlook, along with insights into global economic trends. This edition also examines the performance and prospects of ten key sectors of the economy: **Agriculture, Tourism, Retail, Apparel, Digital & IT-BPO, Energy, Logistics & Transport, Banking, Finance & Insurance, Fisheries, and Poultry.**

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For more info, contact
Sanjaya Ariyawansa 011-55 888 09/ economist@chamber.lk
Saumya Amarasiriwardane 011-55 888 83/ saumya@chamber.lk


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