Monthly Economic Update (MEU)

March 2025

Economic Intelligence Unit
The Ceylon Chamber of Commerce

Highlights

Sri Lankan Economy

CBSL Keeps the Overnight Policy Rate Unchanged

The Central Bank of Sri Lanka (CBSL) decided to keep the Overnight Policy Rate unchanged at 8% during its recent Monetary Policy Board meeting. CBSL remains confident that the prevailing monetary policy stance will ensure inflation moves toward the target of 5% while supporting the growth of the domestic economy.

Economy marks the Highest Annual Growth since 2017

Sri Lanka’s economy returned to positive growth in 2024, marking its strongest expansion since 2017, driven by a rebound in industrial activity, improved external trade, and easing inflation. Key sectors, including construction, mining, and tourism, experienced notable recoveries, while agriculture showed mixed performance with growth in animal production and cereals but declines in other areas. Strengthening investor confidence, rising trade volumes, and favorable macroeconomic conditions position the economy for continued recovery in the coming years.

IMF Approves Third Review of Sri Lanka’s $2.9 Billion Bailout

The IMF completed the third review of Sri Lanka’s $2.9 billion bailout program, granting $334 million in immediate financial assistance, bringing total disbursements to $1.3 billion to support economic recovery and reforms. While Sri Lanka met most program targets, some structural benchmarks faced delays, and new commitments, including tax system changes, foreign loan reforms, and an asset recovery law, were introduced. The 2025 budget aligns with IMF requirements, reinforcing fiscal discipline and transparency, positioning the country for continued economic stabilization.

Inflation Remains Negative

Inflation remains negative at present mainly due to repeated reductions in electricity tariffs and fuel prices. The CBSL is expecting that Deflationary conditions are gradually ease from March 2025, with inflation projected to turn positive by mid-2025. Projections based on the currently available data suggest that inflation would reach the targeted levels by year-end.

External Sector Performance

Sri Lanka's external sector showed mixed performance in January 2025, with a higher current account surplus driven by improvements in services and secondary income despite a widening trade deficit. Tourism earnings reached a record high for January, while workers’ remittances maintained steady growth, supporting foreign exchange inflows. Gross official reserves remained strong at $6.1 billion, and the Sri Lankan rupee, recorded a 1.2% depreciation during the year 2025, up to now.

Global Economy

Global Trade in 2024: A Year of Growth Amid Uncertainty

Global trade reached a record $33 trillion in 2024, driven by strong services trade growth and robust expansion in developing economies like China and India, while many developed nations faced trade contractions. Despite solid annual growth, momentum slowed in late 2024, with widening trade imbalances and rising geopolitical risks threatening future trade stability. As 2025 begins, global trade remains uncertain, with protectionist policies and economic imbalances posing risks, though easing inflation and China’s stimulus efforts may offer some support.

Trump Administration Announces Reciprocal Tariffs, Impacting Global Trade

President Trump’s new Reciprocal Tariffs policy, set to take effect on April 2, aims to match tariffs imposed by other countries on U.S. exports, with the goal of reducing the trade deficit. While this could create opportunities for Sri Lanka if the focus remains on larger trade partners, broader economic challenges—such as rising costs, supply chain disruptions, and potential trade conflicts—could offset any benefits. Given the uncertainty, businesses must stay prepared for shifting global trade dynamics.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

5% Full year 2024

4.5% (2023)

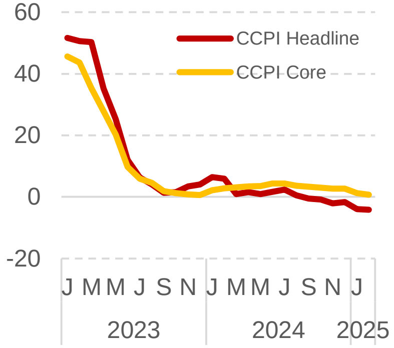
Movement of Purchasing Managers' Index-Feb 2025

Manufacturing PMI	56.8
Services PMI	56.5
Construction PMI (Jan)	52.9

All three indices recorded an expansion

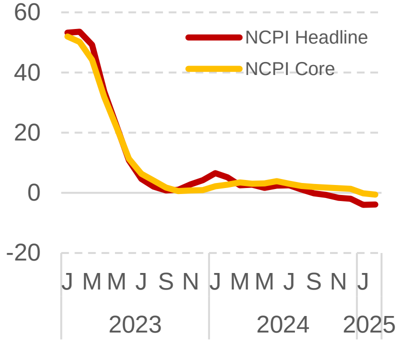
Inflation

CCPI Inflation (%)-*Base 2021*



Feb 2025	Headline	Core
	-4.2%	0.7%

NCPI Inflation (%)-*Base 2021*



Feb 2025	Headline	Core
	-3.9%	-0.6%

External Sector

Merchandise Trade
Jan 2025

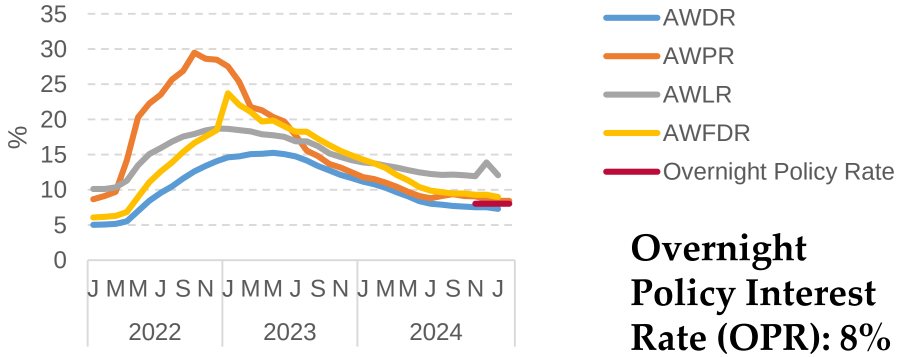
Trade Deficit	USD 733mn
Exports	USD 1,053mn 8.5% y-o-y growth
Imports	USD 1,786mn 18.1% y-o-y growth
Services Trade	USD 418mn 5% y-o-y growth

Tourist Arrivals 252,761
Feb 2025
10% y-o-y growth

Tourism Earnings
USD 367mn
6% y-o-y growth

Workers' Remittances
USD 548mn
15% y-o-y growth

Interest Rates



Growth in Credit to Private Sector

Jan 2025

11.4%

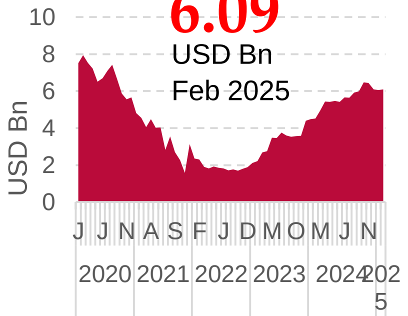
Overnight Policy Interest Rate (OPR): 8%

Exchange Rate

Depreciation of LKR thus far 2025

1.2%

Official Reserves



6.09
USD Bn
Feb 2025

KEY INSIGHTS
Sri Lankan Economy

Sri Lanka’s Economic Recovery Gains Momentum in 2024

After two consecutive years of GDP contraction in 2022 and 2023, Sri Lanka’s economy returned to positive growth in 2024, setting the stage for improved economic prospects. Also this marks the highest annual growth since 2017. The economy recorded its sixth consecutive quarter of expansion since Q3 2023, reflecting a steady recovery. This growth was supported by increased external trade, as both export and import volume indices saw notable improvements. The rise in container and cargo handling at Sri Lankan ports further signaled a strengthening trade sector. Falling inflation added to economic optimism, as declining input costs allowed producers to lower prices, improving consumer purchasing power. With inflation stabilizing, favorable macroeconomic conditions fueled expansion across key sectors, including manufacturing, accommodation, construction, mining, trade, transport, and personal services.

The agriculture sector recorded a 1.2% expansion in 2024, following the 1.6% growth in 2023. Major contributors included animal production (+14.1%) and cereal cultivation (+10.9%). However, some subsectors faced declines, notably plant propagation (-14.0%), other perennial crops (-11.9%), and coconut cultivation (-11.5%), indicating challenges within specific agricultural segments. Industrial activity rebounded strongly, growing by 11.0% in 2024, reversing the 9.2% contraction of the previous year. Growth was broad-based, with construction and mining & quarrying emerging as the strongest performers, both recording a 19.4% increase. This resurgence was driven by increased investment and infrastructure development, further reinforcing economic expansion. Meanwhile, the services sector expanded by 2.4%, recovering from a 0.2% decline in 2023. The standout performer was accommodation, food, and beverage services, which surged by 31.4%, benefiting from improved tourism. Postal and courier services also recorded a 6.3% increase, reflecting growing e-commerce activity.

Sri Lanka’s economic turnaround in 2024 reflects improved stability and renewed investor confidence. With key industries rebounding, trade strengthening, and inflationary pressures easing, the economy appears poised for sustained recovery in the coming years.

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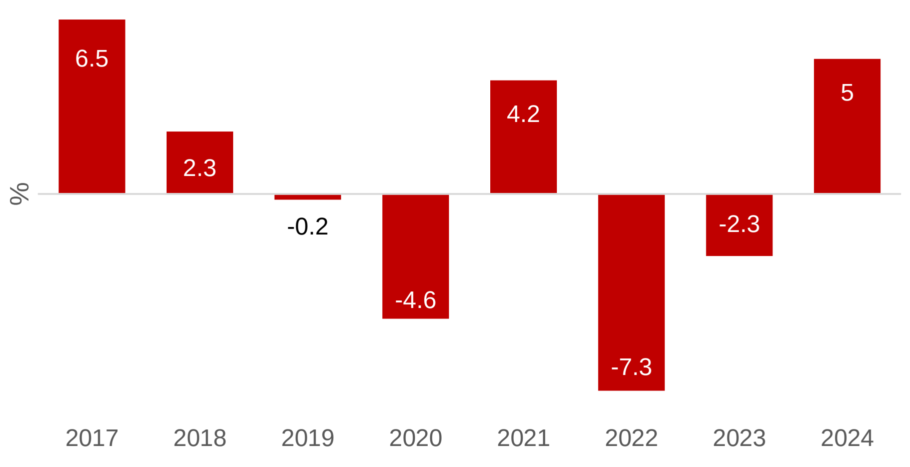
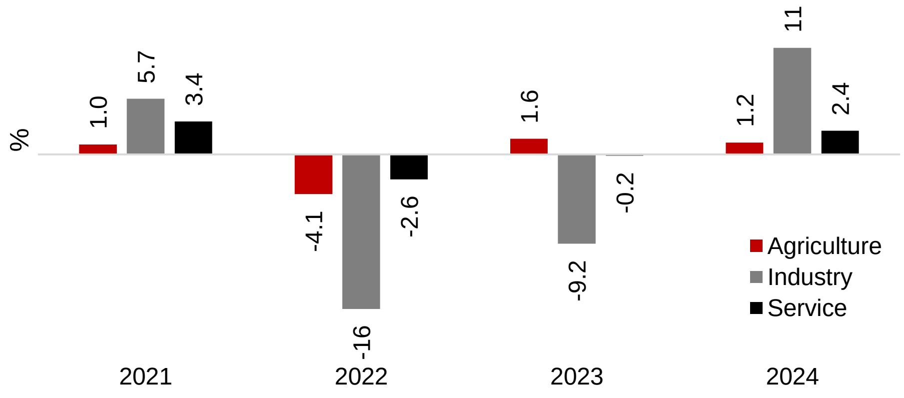
Real GDP Growth



Sectoral GDP Growth



Data Source: DCS

KEY INSIGHTS
Sri Lankan Economy

IMF Approves Third Review of Sri Lanka's $2.9 Billion Bailout

On 28 February 2025, the International Monetary Fund (IMF) completed the third review of Sri Lanka's $2.9 billion bailout program, granting the country immediate access to $334 million in financial assistance. This brings total disbursements under the program to $1.3 billion, supporting Sri Lanka's economic recovery and reform agenda. The approval follows the unveiling of the 2025 budget, which aligns with IMF commitments, including a primary surplus target of 2.3% of GDP for the year.

Sri Lanka demonstrated strong program performance, with all end-December Quantitative Performance Criteria (QPCs) and standard continuous Performance Criteria met, except for the Monetary Policy Consultation Clause (MPCC) and the Indicative Target (IT) on social spending. By end-January 2025, most Structural Benchmarks (SBs) were either completed or implemented with some delays. Additionally, key Prior Actions (PAs), such as lifting import restrictions, were fulfilled, while others—the 2025 budget and revenue measures—are progressing as planned.

Several **new and revised SBs** were introduced under this review:

- Abolish the SVAT system by the end of September 2025 and IRD will report the results of a simulation exercise to test the new refund arrangements which will come into place once SVAT is repealed by the end of June 2025.
- Submission to parliament of revisions of the Strategic Development Projects (SDP) Act, with IMF technical assistance, that introduce transparent, rules-based eligibility criteria, to increase the effectiveness of granted tax expenditures, and to limit the duration for which incentives can be granted by end August 2025
- Parliament to repeal the Foreign Loans Act in full by end April 2025
- Enact a comprehensive Asset Recovery Law to harmonize it with the United Nations Convention Against Corruption by end April 2025

Quantitative performance criteria

	End Dec Target	Actual
Primary Balance	Rs. 300 billion	Rs. 653.5 billion
Tax Revenue	Rs. 3,700 billion	Rs. 3,705 billion
Programme net Official International Reserves (floor)	(USD 1,212 million)	USD 322 million
Net credit to the government of CBSL (ceiling)	Rs. 2,560 billion	Rs. 2,514 billion
Headline Inflation	5% ± 3%	-1.4%
Social Spending (floor)	Rs. 205 billion	Rs. 186 billion

Data Source: MoF

KEY INSIGHTS
Global Economy

Global Trade in 2024:
A Year of Growth Amid Uncertainty – What Lies Ahead in 2025

Global trade expanded by nearly US$ 1.2 trillion in 2024, reaching a record US$ 33 trillion. This growth was largely driven by a 9% increase in services trade and a 2% rise in goods trade. While developing nations, particularly China and India, experienced above-average trade expansion, many developed economies faced trade contractions.

Trade imbalances widened, with the U.S. trade deficit increasing and China's trade surplus growing due to strong exports and stable demand. Despite robust annual growth, momentum slowed in the last two quarters, with goods trade increasing by less than 0.5% quarter-on-quarter (Q4), while services trade grew by around 1%.

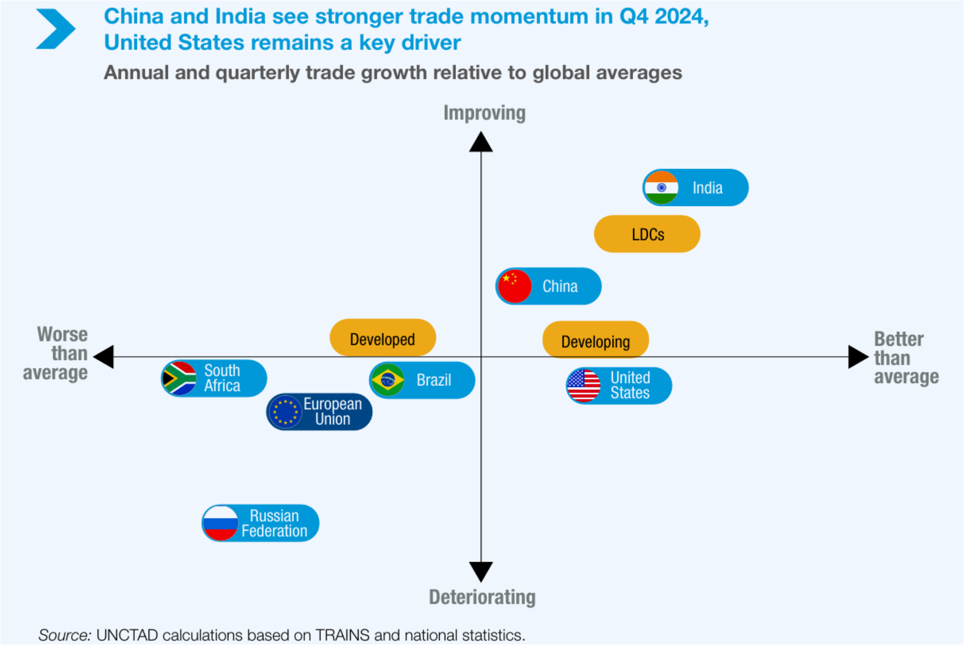
As we step into 2025, global trade remains stable, but geoeconomic tensions, protectionist measures, and trade disputes pose significant risks. The U.S. trade policy shifts, global imbalances, and geopolitical uncertainties could weigh on trade growth, with a potential downturn in global trade volumes. However, easing inflation and China's 2025 economic stimulus, targeting 5% GDP growth, may provide some support.

According to the UNCTAD, the 2025 trade outlook remains uncertain, emphasizing the need for balanced policies and stronger multilateral cooperation to ensure sustained global trade growth.

Global Trade Growth 2024

9% Growth in Services trade

2% Growth in Goods Trade



Data Source: UNCTAD

KEY INSIGHTS
Global Economy

Trump Administration Announces Reciprocal Tariffs, Impacting Global Trade

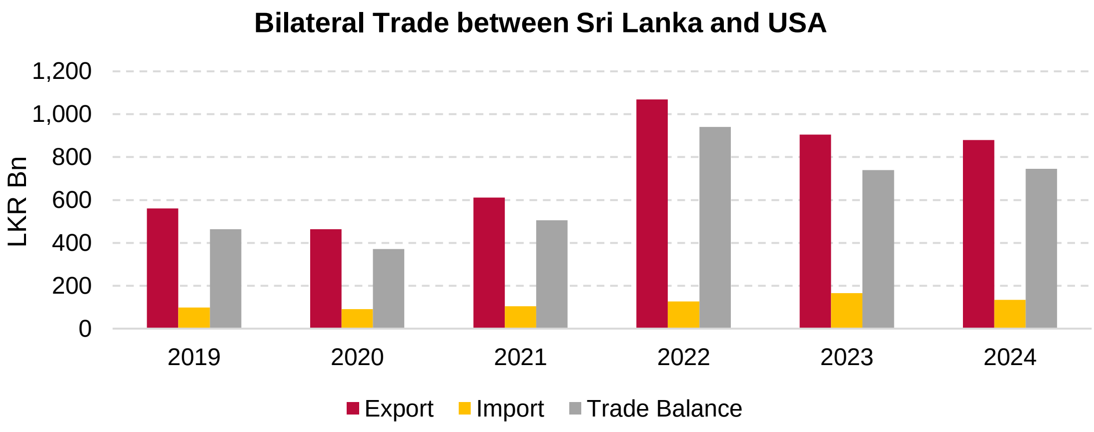
Since returning to the White House, President Trump has introduced several new trade policies, including the latest Reciprocal Tariffs. Under this policy, the United States will impose tariffs that match the rates charged by other countries on American exports.

The administration argues that the U.S. is often treated unfairly in global trade. For instance, data from Global Trade Alert indicates that India imposes tariffs 5–20% higher than the U.S. on 87% of imported goods.

These new tariffs, set to take effect on April 2, aim to reduce the U.S. trade deficit. However, many economists warn that trade imbalances actually benefit the U.S. economy. Because the U.S. dollar is the world's reserve currency, countries use their trade earnings to invest in U.S. assets like government bonds, stocks, and real estate. This investment keeps interest rates low and supports borrowing and spending in the U.S.

The proposed tariffs will add complexity to an already intricate system, which includes 13,000 tariff lines, 200 trading partners, and approximately 2.6 million individual tariff rates. If fully implemented, these measures could have significant global economic consequences. For Sri Lanka, the impact will depend on how the policy is enforced.

The U.S. is Sri Lanka's largest export market, accounting for 25% of total exports. If Sri Lanka is not directly affected by tariff hikes and the focus remains on larger trade partners, trade diversion could create new opportunities. However, this potential benefit may be offset by broader economic challenges, such as rising prices, supply chain disruptions, and reduced consumer spending in the U.S. Additionally, a U.S.-EU trade war could weaken the European economy, leading to lower import demand, including from countries like Sri Lanka. While the full effects remain uncertain, businesses must prepare for shifting trade dynamics in the months ahead.



Target Country	Applicable Rate	Effective Date	Possible Impact on Sri Lanka
Canada	25% non-energy 10% energy	In effect	Minimal Direct Impact
Mexico	25%	In effect	Benefit from Trade Diversion
China	10% energy	In effect	Benefit from Trade Diversion
EU	25%	Unknown	Minimal Direct Impact
Country –by – Country basis	Reciprocal tariffs: Rates are unknown	Unknown	Drastically reduce Sri Lanka's exports to the US

Data Source:IPS

Evolving Landscape

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.

Inland Revenue (Amendment) Act 2025: Balancing Tax Relief and Revenue Challenges

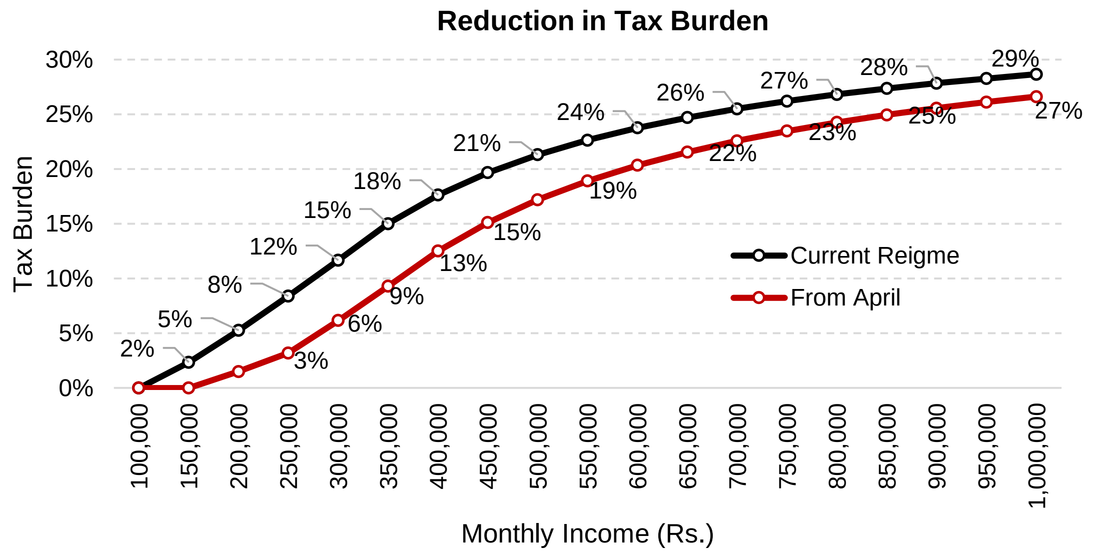
The Inland Revenue (Amendment) Bill was passed without amendments in Parliament on March 20, 2025, officially becoming the Inland Revenue (Amendment) Act No. 02 of 2025. This legislative revision seeks to address economic pressures faced by middle-income families while simultaneously ensuring government revenue sustainability. Key changes include adjustments to the personal income tax (PIT) structure, increased taxation on select industries, and modifications to withholding tax policies.

Revisions to Personal Income Tax (PIT)

A major change under the amendment is the revision of the PIT structure, effective April 1, 2025. The annual tax-free threshold has been raised from Rs. 1.2 million to Rs. 1.8 million, reducing the number of individual's subject to income tax. The tax slabs have also been restructured to reflect this adjustment.

Marginal Tax rate (%)	Annual Taxable Income	
	Current Regime (Rs. Mn)	Regime from 1 April (Rs. Mn)
0	Upto 1.2	Up to 1.8
6	1.2 – 1.7	1.8 – 2.8
12	1.7 -2.2	-
18	2.2 – 2.7	2.8 – 3.3
24	2.7 – 3.2	3.3 – 3.8
30	3.2 – 3.7	3.8 – 4.3
36	Over 3.7	Over 4.3

The Act reduces the tax burden across all income levels, with notable relief for lower- and middle-income earners. At Rs. 300,000 monthly income, the tax burden decreases from 13% to 9%, while at Rs. 500,000, it drops from 21% to 19%. Higher-income earners also see a marginal reduction, with the tax rate falling from 29% to 27% at Rs. 1 million. This adjustment enhances disposable income, potentially boosting consumption and economic activity. Overall, the amendments aim to provide targeted relief while maintaining a stable revenue base, ensuring a balanced approach to tax policy and economic growth.



Evolving Landscape cont'd

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The PIT currently accounts for 1.5% of GDP, generating Rs. 330 billion in 2024. However, the Ministry of Finance (MoF) estimates that the revised PIT structure will result in a revenue loss of Rs. 60 billion (0.2% of GDP). According to Inland Revenue Department (IRD) data, Sri Lanka has approximately 350,000 registered income tax files. Of these, 180,000 belong to individuals earning below Rs. 1.8 million annually, while 150,000 tax files are classified as self-assessment files, of which 97,000 are below the Rs. 1.8 million thresholds. This suggests that a significant portion of tax revenue is derived from individuals who do not formally file tax returns. This highlights broader concerns about tax compliance. The fact that a significant portion of tax revenue is derived from individuals who do not file returns underscores the need for improved tax administration. Expanding the tax net through better enforcement and digital tax solutions may be necessary to achieve long-term fiscal stability.

MoF estimates that the actual taxpayer population—including both filers and non-filers—is around 800,000. MoF estimates that out of this population the approximately one-fourth (200,000) tax files will go out of the tax net, due to the revision of the PIT structure.

Sector-Specific Taxation Adjustments

Recognizing the need to offset revenue losses from PIT adjustments, the amendment raises the corporate income tax rate on betting and gaming, tobacco, and liquor industries from 40% to 45%. This measure is projected to generate an additional Rs. 10–12 billion in tax revenue (0.04% of GDP), supplementing the Rs. 200 billion collected from these industries in 2024.

Further, the Act imposes a 15% income tax on the export of services, marking a shift from previous tax exemptions or lower tax rates. This policy is expected to contribute an additional 0.04% of GDP in tax revenue.

Adjustments to Withholding Tax on Interest

To enhance revenue collection from financial instruments, the amendment increases the Withholding Tax (WHT) on interest income from 5% to 10%. This measure is expected to bolster tax collections, particularly from high-interest-earning deposit holders.

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