

Monthly Economic Update (MEU)

August 2025

**Economic Intelligence Unit
The Ceylon Chamber of Commerce**



EIU

Highlights

Sri Lankan Economy

Economy is Expected to Reach to a 4.5% Growth during the year 2025- CBSL

As per the recent projections of the the Central Bank of Sri Lanka, the economy is expected to achieve around 4.5% growth during the year 2025. However, the uncertainties due to US tariffs, escalating global uncertainties and weather related shocks have been identified as key downside risks to this growrg projection.

Inflation Gradually Moving Out of Deflation

Since March 2025, CCPI-based headline inflation has been easing out of its deflationary phase. By July 2025, deflation narrowed to 0.3%, compared to 0.6% in June, reflecting a gradual shift towards positive price growth. This change has been mainly driven by food price adjustments and the upward revision of electricity tariffs in mid-June. The Central Bank anticipates a return to positive inflation in Q3, with a further pickup expected in Q4.

Monetary Sector – Rates easing, Credit Rising

Following the introduction of the Overnight Policy Rate (OPR) as the Central Bank's key policy rate in November 2024, a 25 basis point rate cut in May 2025 drove market interest rates further downward. In its latest policy review in July, the Central Bank kept the OPR unchanged, signaling a wait-and-see approach. While interest rates have eased overall, the spread between lending and deposit rates remains above pre-crisis levels but is expected to narrow gradually. Meanwhile, credit to the private sector continues to pick up, growing by 17.1% in July, supported by low rates and improving business confidence.

External Sector – Strong Inflows, Rising Imports

Sri Lanka's external sector showed steady progress in the first half of 2025, supported by higher exports, tourism earnings, and worker remittances, even as the trade deficit widened. Exports grew by around 7%, led by apparel, textiles, tea, and industrial products. Tourism earnings rose by about 20%, reflecting a steady recovery, while remittances surged by nearly 40%, strengthening the external position and supporting a current account surplus. However, imports increased sharply, driven by higher demand for fuel, vehicles, and intermediate goods.

Fiscal Performance – Revenue Growth with Rising Expenditure

Sri Lanka's fiscal sector showed continued improvement in the first half of 2025, supported by strong revenue growth. Total revenue and grants recorded a significant increase compared to the same period in 2024, driven mainly by higher tax revenues, particularly from VAT, income tax, and excise duties. On the expenditure side, government spending also rose, reflecting increased allocations for subsidies and transfers, salaries and wages, and interest payments. As a result, while the fiscal position is improving, pressures on expenditure remain high.

Global Economy

UK DCTS: Liberalised Rules of Origin and Regional Sourcing Boost for Sri Lanka

The UK's 2023 Developing Countries Trading Scheme (DCTS) offers Sri Lanka lower tariffs and simplified rules of origin for 65 developing nations. From 2026, reforms will let Sri Lankan garment exporters source inputs globally while retaining tariff-free access, boosting competitiveness and supporting over 350,000 direct jobs. For non-apparel goods, regional cumulation with 18 Asian countries will expand tariff-free opportunities and simplify supply chains. These changes are expected to reduce costs, strengthen exports, and integrate Sri Lanka further into global markets, offering significant potential for economic recovery and sustained growth in key sectors.

Tariffs Reshape Global Trade Geometry

In 2025, global trade is being transformed as U.S. tariffs disrupt goods, investment, and alliances, causing sharp declines in key sectors and rerouting trade flows. U.S.-China commerce has fractured, while countries like Vietnam, Mexico, and India benefit from supply chain shifts. Investment patterns are shifting, with domestic U.S. manufacturing seeing gains but global FDI slowing, creating pressures on emerging markets. Geopolitically, new trade blocs are forming, potentially fragmenting the system, while South-South trade and regional integration, including ASEAN and the African Continental Free Trade Area, are gaining ground. Tariffs are driving a strategic realignment with lasting global impact.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

4.8% Q1-2025
5.1% (Q1-2024)

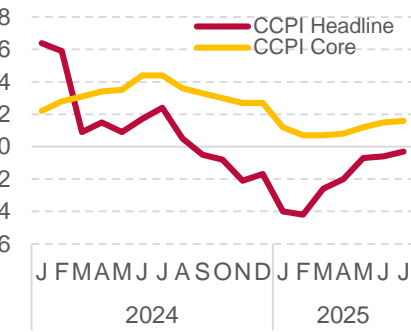
Movement of Purchasing Managers' Index- July 2025

Manufacturing PMI **62.2**
Services PMI **70.1**
Construction PMI (June) **58.6**

All three indices recorded an expansion indicating the overall outlook of three sectors remain positive in the next 3 months

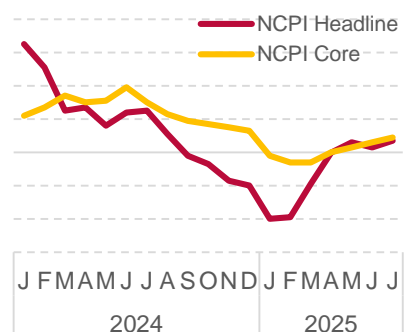
Inflation

CCPI Inflation (%) - Base 2021



Ju1 2025
Headline **-0.3%**
Core **1.6%**

NCPI Inflation (%) - Base 2021



Jun 2025
Headline **0.7%**
Core **0.9%**

External Sector

Merchandise Trade

June 2025

Trade Deficit **USD 540mn**
Exports **USD 1,142mn**
6% y-o-y growth

Imports **USD 1,682mn**
16% y-o-y growth

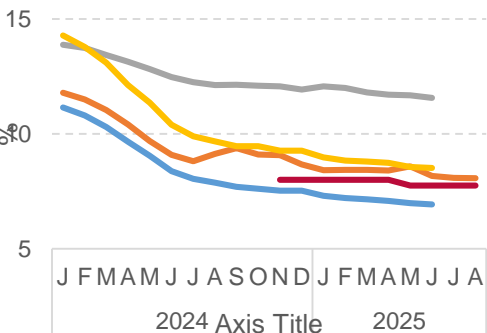
Services Trade **USD 244mn**
18% y-o-y growth

Tourist Arrivals **200,244**
July 2025
76% y-o-y growth

Tourism Earnings **USD 319mn**
3% y-o-y growth

Workers' Remittances **USD 636mn**
22% y-o-y growth

Interest Rates



AWDR
AWPR
AWLR
AWFDR
Overnight Policy Rate

Overnight Policy Interest Rate (OPR): **7.75%**

Growth in Credit to Private Sector

June 2025
17.9%

Exchange Rate

USD:LKR Exchange Rate



Depreciation of LKR thus far 2025
3%

Official Reserves



6.14
USD Bn
July 2025

KEY INSIGHTS

Sri Lankan Economy

Key Insights from the CBSL Monetary Policy Report

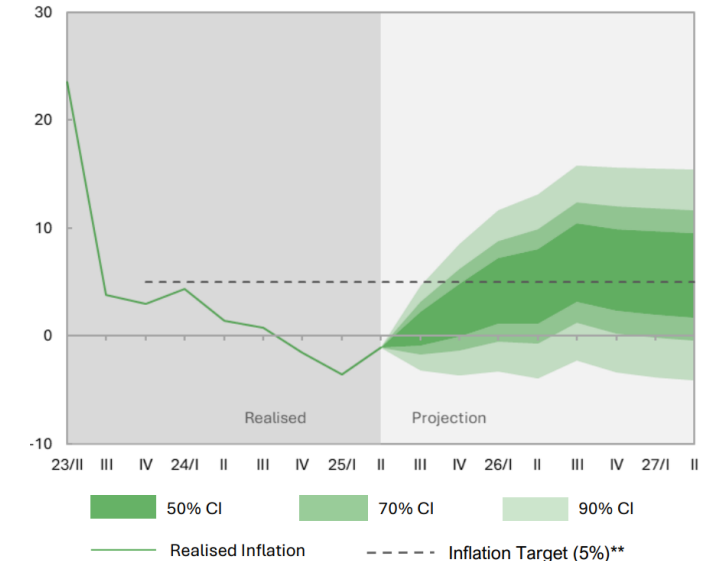
After nearly a year of deflation (by cheaper energy and transport costs) price pressures are re-emerging. Headline inflation is set to move back into positive territory from Q3-2025, pushed up by higher food prices, June's electricity tariff hike, and the statistical base effect. The Central Bank expects inflation to steadily climb to its 5% target by mid-2026, with a brief overshoot later that year before settling back in line with the target. A temporary overshoot beyond the target in the second half of 2026 is anticipated before inflation stabilises around the target level, supported by a balance of demand recovery and appropriate policy measures.

Core inflation has remained in low positive territory but is expected to pick up in tandem with the normalisation of demand conditions and imported inflation pressures, particularly through global food prices. Unlike headline inflation, core inflation is forecast to stabilise with lower volatility, converging with the 5% target over the medium term. This outlook is, however, subject to risks from volatile global energy markets, food supply disruptions, and shifts in external financial conditions.

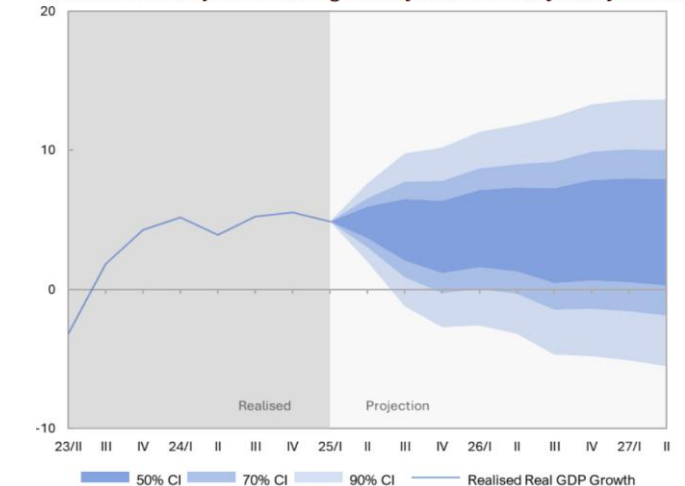
On the growth front, momentum has been encouraging. Following strong outturns in 2024 and early 2025, GDP growth for 2025 is projected at around 4.5%. Expansion has been broad-based, with industry and agriculture leading, alongside robust credit flows under a relaxed monetary stance. Short-term growth prospects remain positive, with Q2 and Q3-2025 expected to record solid performances across all three major sectors.

Looking ahead, medium-term growth is expected to continue at a modest but steady pace, aided by accommodative monetary policy and recovering aggregate demand. However, external conditions pose a significant drag. The recent imposition of a 20% tariff on Sri Lankan exports by the US underscores the fragility of external demand. Sustaining growth will therefore hinge on structural reforms, fiscal consolidation, and efforts to boost investor confidence. Addressing corruption vulnerabilities and fostering private-sector-led investment will be decisive in ensuring that the current momentum translates into durable, broad-based growth.

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



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



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UK DCTS: Liberalised Rules of Origin and Regional Sourcing Boost for Sri Lanka

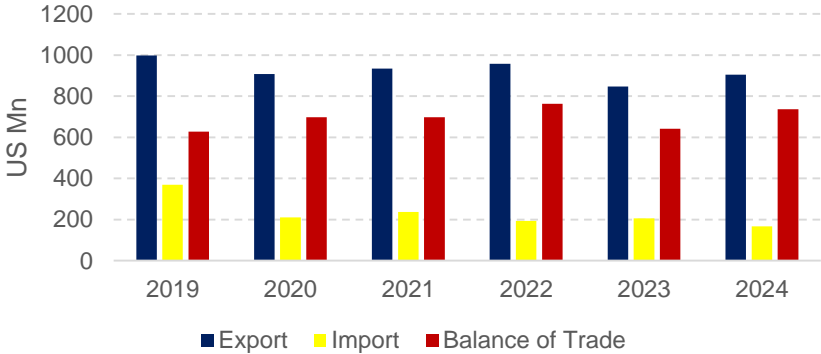
As an independent trading nation, the UK restructured its trade with developing countries for the benefit of all. In the Summer of 2023, the United Kingdom replaced its Generalized Scheme of Preferences (GSP) with the Developing Countries Trading Scheme (DCTS). The DCTS is one of the world's most generous trade preference schemes, designed to increase trade with developing nations. It lowers tariffs, streamlines rules of origin for least developed countries, and makes it easier for countries to access new Enhanced Preferences. The UK DCTS provides preferential access to the UK market for 65 developing countries, and Sri Lanka enjoys Enhanced Preference, giving lower tariffs on many products. From early 2026, the UK will introduce sweeping reforms that make exporting easier and more flexible, especially for the garment sector, which is Sri Lanka's largest export industry.

Under current rules, tariff-free access requires sourcing most inputs from South Asia and completing two major production steps locally, such as fabric making and garment assembly. The new rules will remove these restrictions, allowing Sri Lankan manufacturers to source up to 100% of garment inputs from any country while still qualifying for tariff-free access to the UK. This aligns Sri Lanka with lower-income countries like Bangladesh and is expected to make garments more competitive. The Joint Apparel Association Forum (JAAF) welcomed the move, noting it will boost exports, strengthen industry competitiveness, support jobs, and expand value for global brands and UK consumers.

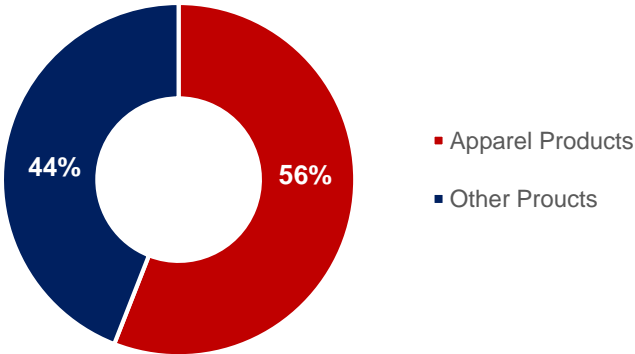
For non-apparel products, the UK has created an Asia Regional Cumulation Group of 18 countries, including India, Pakistan, Vietnam, Bangladesh, and Sri Lanka. Inputs sourced from this group will count as Sri Lankan-made if final processing occurs locally. This expansion helps integrate Sri Lanka into regional supply chains, simplifies rules of origin, and allows more products to benefit from tariff-free access.

The reforms are expected to lower costs, increase competitiveness, and support Sri Lanka's economic recovery, particularly as the country faces competition from regional rivals with lower production costs. With the UK importing US\$1.3 billion of garments in 2024, these changes represent a significant opportunity for Sri Lanka to strengthen exports, secure livelihoods for over 350,000 workers directly employed in apparel, and support more than a million people across the sector's value chain. Exporters should review supply chains and prepare documentation to fully utilise the benefits when the updated DCTS comes into effect, ensuring Sri Lanka continues to grow its presence in the UK market.

Sri Lanka's Trade with UK



Main Items Exported from SL to UK in 2024



KEY INSIGHTS

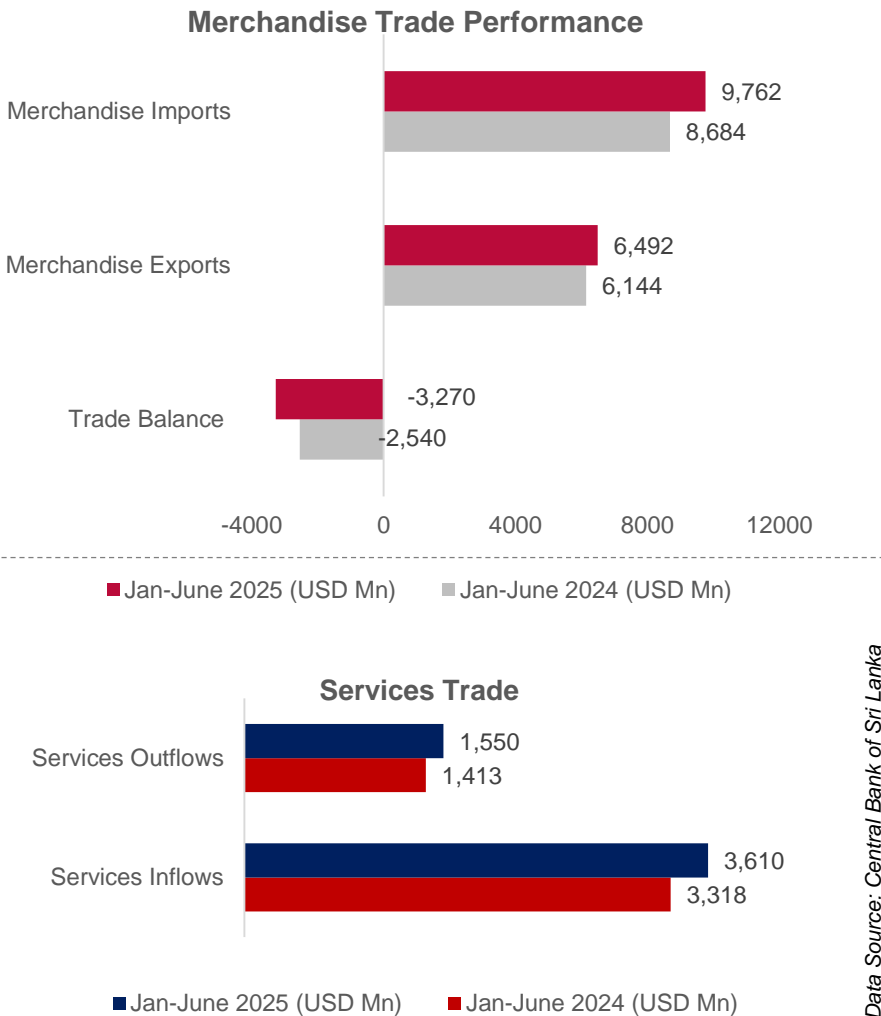
Sri Lankan Economy

Exports, Tourism, and Remittances Drive Sri Lanka’s External Sector Recovery in Early 2025

In the first half of 2025, Sri Lanka’s external sector recorded steady progress, supported by strong inflows from exports, tourism, and worker remittances, even though the merchandise trade deficit widened compared to the previous year. Data released by the Central Bank of Sri Lanka shows that total exports of goods and services reached around US\$10.1 billion between January and June, which was about 7 percent higher than the same period in 2024. Merchandise exports were estimated at US\$6.5–6.8 billion in 1H 2025, compared with US\$6.14 billion in 1H 2024, marking growth of roughly 5–7 percent. The main contributors were apparel and textiles, which remained the backbone of exports, along with tea and selected industrial products. Services exports also strengthened, driven mainly by tourism. Inflows from tourism reached approximately US\$1.7 billion during the first six months of 2025, higher than the US\$1.4 billion earned in the same period of 2024. Worker remittances remained one of the most reliable sources of foreign exchange, showing significant growth.

In 1H 2025, remittances rose to nearly US\$3.7 billion, compared to about US\$2.6 billion in the first five months of 2024, reflecting a sharp increase of almost 40 percent. This growth in remittances, together with improved earnings from services, helped Sri Lanka sustain a current account surplus, even as the merchandise trade deficit widened. Imports rose strongly in the first half of 2025 due to higher demand for fuel, vehicles, and intermediate goods. As a result, the merchandise trade deficit expanded from US\$2.54 billion in 1H 2024 to a larger gap in 2025, reflecting the rebound in domestic demand and import growth. Another key factor during this period was the improvement in the terms of trade. While both import and export prices declined, the fall in import prices was sharper, giving Sri Lanka a slight advantage. In terms of trading partners, India and the UAE continued to be the leading sources of imports, while the US and EU remained the country’s largest export destinations.

Although the first half of 2025 shows stronger results compared to 2024, several risks remain. If imports continue to outpace exports, the trade deficit could expand further, putting pressure on reserves. The external sector also relies heavily on remittances and tourism, both of which are vulnerable to changes in global labour markets and international travel trends. Looking forward, Sri Lanka will need to strengthen its export base by moving into higher value-added products, promote services such as IT and logistics alongside tourism, and ensure remittances continue to flow through formal, low-cost channels. At the same time, careful management of imports and foreign debt will be important to protect the balance of payments. Overall, compared to 2024, the first half of 2025 reflected stronger performance and greater stability, but sustaining these improvements will require consistent policy support and structural reforms to improve export competitiveness and resilience.



KEY INSIGHTS

Sri Lankan Economy

Tourism Sector Performance – 1H 2025

Sri Lanka’s tourism sector demonstrated robust growth in the first half of 2025, signaling a strong post-pandemic recovery and renewed global interest in the island as a travel destination. Tourist arrivals reached 1.17 million, marking a 15.6% year-on-year increase compared to the same period in 2024. This growth was consistent across all months, with January and June showing the highest increases at 21.4% and 21.8%, respectively.

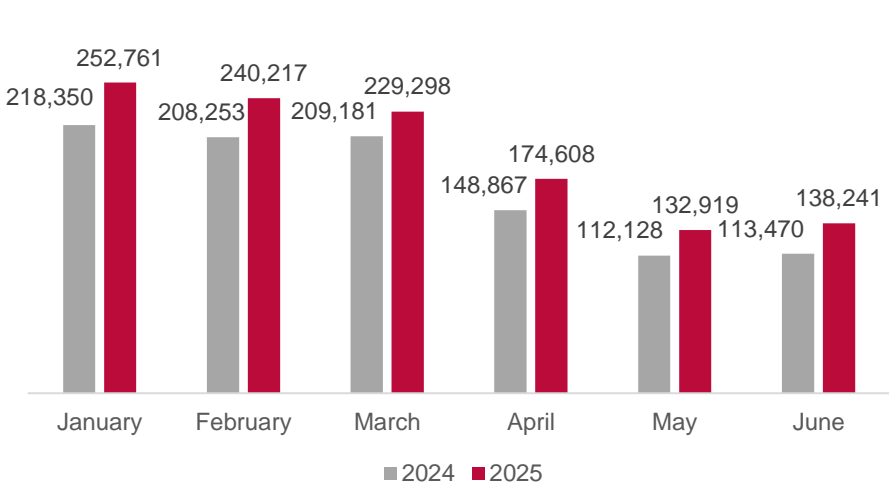
Europe remained the dominant source region, contributing 50.7% of arrivals, followed by Asia-Pacific at 42.1%, with India leading as the top individual market (241,994 arrivals, up 31.2%). Notably, Bangladesh emerged as the fastest-growing market with a 112% increase, reflecting rising regional travel demand. The average stay duration was 8.34 nights, and tourism income totaled USD 1.71 billion, with a daily expenditure per tourist of USD 171.74.

Visitor purpose analysis revealed that Pleasure/Vacation was the primary driver (54%), followed by Visiting Friends and Relatives (VFR) and MICE travel. Seasonal trends were evident, with leisure travel peaking in January–March and VFR surging in June. Health/Ayurveda and VFR tourists had the longest average stays, at 15.22 and 10.91 days, respectively, indicating high-value segments. Accommodation infrastructure expanded, with 4,638 registered establishments and 56,702 rooms, up 6.2% from 2024. Growth was concentrated in the Western, Southern, and Central Provinces, which accounted for 78% of total room capacity. However, regions like the Northern and Uva Provinces remained underdeveloped, highlighting opportunities for balanced regional investment.

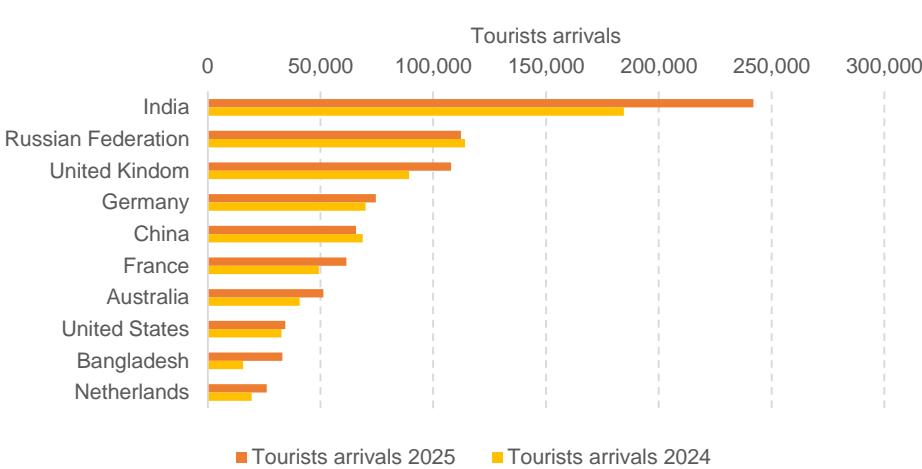
Air connectivity was dominated by Sri Lankan Airlines, followed by Indigo, Qatar Airways, and Emirates, reflecting strong links with India and the Middle East. Major departure hubs included Dubai, Doha, and Chennai, reinforcing the strategic importance of regional and Gulf connections. Tourist attraction visitation also surged, with Sigiriya, Yala, and Hurulu Ecological Park leading in both footfall and revenue. Foreign visitors contributed over 90% of income across wildlife parks and cultural sites, underscoring the sector’s reliance on international tourism.

Overall, the first half of 2025 reflects a resilient and diversifying tourism sector, with strong performance indicators and emerging markets offering promising avenues for future growth.

Tourist Arrivals by month 2024 & 2025



Top ten markets to Sri Lanka, January to June 2024 & 2025



KEY INSIGHTS

Global Economy

Tariffs Reshape Global Trade Geometry

In 2025, global trade is undergoing a profound transformation as tariffs increasingly redefine the flow of goods, investment, and strategic alliances. The United States' sweeping tariff regime imposing blanket duties on imports and targeted levies on over 150 countries has triggered a cascade of economic and geopolitical shifts.

The immediate impact has been a sharp contraction in global trade volumes. Key sectors such as electronics, automotive, and machinery deeply embedded in global value chains have seen output declines of up to 16%. U.S.-China trade, once the backbone of global commerce, has fractured, with bilateral flows plummeting and rerouting through third-party nations.

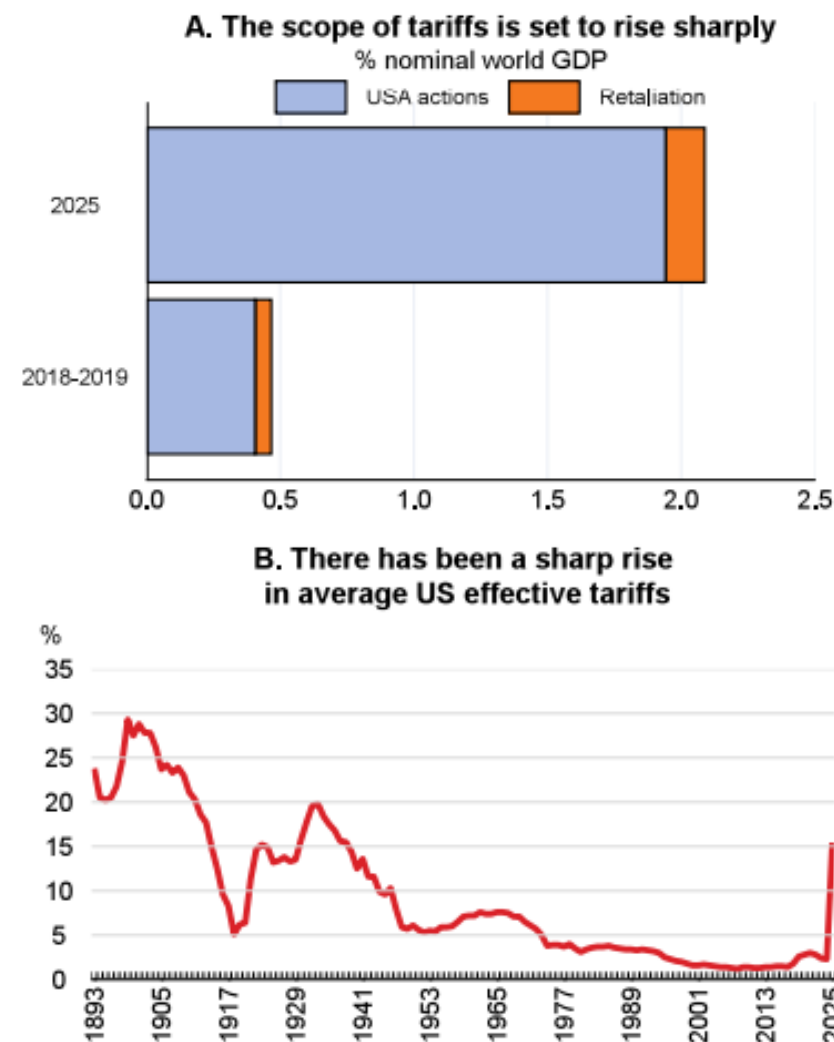
This disruption has prompted a “great trade rearrangement.” Multinational corporations are reassessing supply chains, prioritizing resilience over cost-efficiency. Countries like Vietnam, Mexico, and India are emerging as alternative hubs, benefiting from trade diversion and new bilateral agreements. Meanwhile, China is accelerating its pivot toward regional markets and yuan-based trade settlements.

Tariffs have also reshaped investment patterns. While some U.S. manufacturing sectors have seen a boost in domestic investment, foreign direct investment has slowed globally. Emerging markets exposed to U.S. trade volatility are experiencing capital flight and currency pressures, complicating their growth trajectories.

Geopolitically, the tariff landscape is fostering new blocs. The U.S. and its allies are consolidating trade frameworks based on strategic alignment, while China is deepening ties within Asia, Africa, and Latin America. This bifurcation risks fragmenting the global trade system into competing spheres of influence.

Despite the turbulence, opportunities are emerging. South–South trade is expanding, particularly within Asia, offering a buffer against external shocks. Regional integration efforts such as the African Continental Free Trade Area and ASEAN's digital trade initiatives are gaining momentum.

Ultimately, tariffs are not just economic tools they are instruments of strategic realignment. As nations adapt, the geometry of global trade is being redrawn, with long-term implications for growth, diplomacy, and development.



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.

Jackson Hole 2025: A Turning Point for Global Central Banking

The annual Jackson Hole Economic Symposium was held in Wyoming, USA last week, bringing together central bankers, policymakers, academics, and financial market participants. Since 1978, this gathering has served as one of the most influential platforms for debating long-term monetary policy challenges. This year's theme, *"labour Markets in Transition: Demographics, Productivity, and Macroeconomic Policy,"* provided a timely backdrop, as global central banks grapple with slowing growth, shifting labour dynamics, and the aftershocks of trade and immigration policies.

Powell's Shift: From Patience to Preparation

Federal Reserve Chair Jerome Powell's address dominated headlines. After nearly two years of holding interest rates steady, Powell signalled a dovish turn, hinting that the Fed is preparing to cut rates as early as September. While inflation has eased closer to the 2% target, cracks in the labour market have become more visible, with hiring slowing sharply and unemployment inching up. Powell argued that the balance of risks has shifted: inflation is less threatening than before, while a weakening labour market now poses the bigger danger.

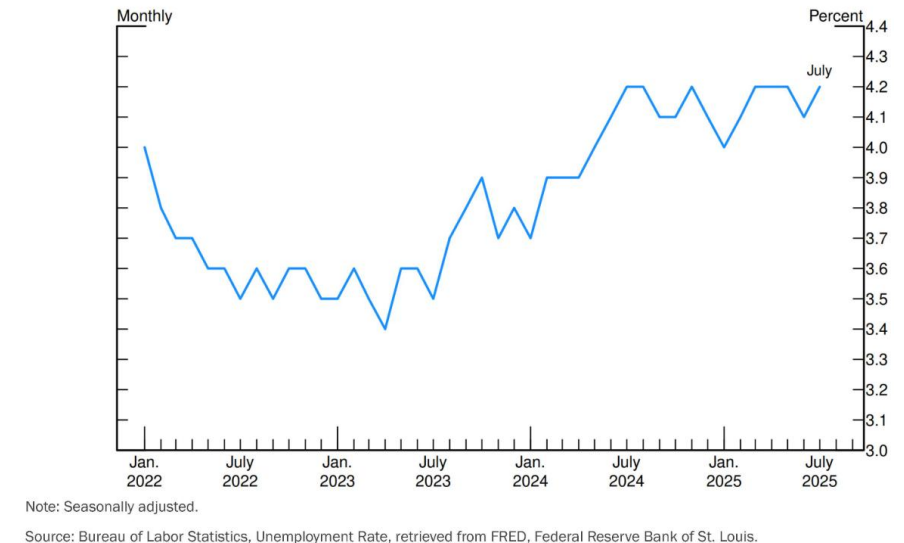
Labour Markets: Fragile Equilibrium

The discussion revealed that the U.S. labour market, once remarkably resilient, is entering a fragile equilibrium. Payroll growth has slowed from 168,000 jobs per month in 2024 to barely 35,000 this year. Both supply and demand for workers are softening, partly due to falling immigration. While this has kept unemployment increases modest, it risks a sudden jump if conditions worsen. Other central bankers highlighted similar trends elsewhere: aging populations and restrictive migration policies are tightening labour supply, raising questions about long-term growth potential.

Tariffs, Prices, and Productivity Pressures

Another recurring theme was the impact of tariffs and trade frictions. Recent U.S. tariffs are already feeding into higher consumer prices, adding to the complexity of monetary policy. Powell noted that while these effects might prove temporary, they risk becoming entrenched if trade tensions persist. Demographics also loomed large in discussions, with several speakers stressing that slower population growth will cap productivity and leave economies more dependent on foreign labour. This message reinforced the need for policy frameworks that balance price stability with structural realities

Figure 1: Unemployment Rate



Evolving Landscape cont'd

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Politics and Central Bank Independence

Perhaps the most politically charged undercurrent was concern about central bank independence. With growing pressure from Washington for the Fed to deliver rate cuts, several participants warned that politicizing monetary policy could undermine its credibility and destabilize global markets. The symposium made clear that the trust central banks have built, credibility painstakingly earned over decades, remains one of their most valuable assets in anchoring expectations and guiding economies through turbulence.

What It Means for the World

Taken together, the Jackson Hole discussions point to an important shift in global monetary conditions. If the Fed leads with rate cuts, many other central banks may follow, easing financial conditions worldwide. At the same time, structural labour shortages, shifting trade dynamics, and political interference create a more uncertain backdrop for growth. Central banks face a dual challenge: managing near-term risks without losing sight of long-term structural reforms.

For Sri Lanka, the outcomes from Jackson Hole carry significant indirect consequences. A Fed pivot toward rate cuts could ease global financial conditions, lowering external borrowing costs and stabilizing capital flows. Softer US monetary policy may also support remittance inflows and reduce pressure on the rupee. However, rising tariffs and volatile trade conditions highlight risks to Sri Lanka's export prospects. The symposium's focus on labour market transitions also resonates locally, underscoring the need to boost productivity and address demographic challenges. Above all, preserving central bank independence is vital for sustaining policy credibility.

Figure 3: Real GDP

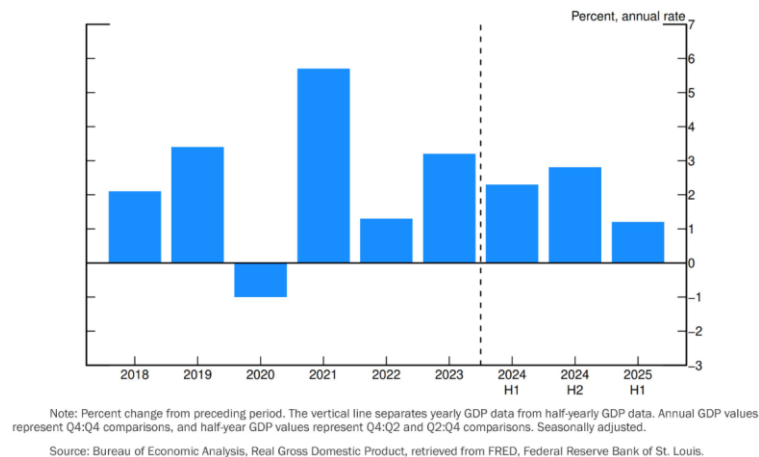
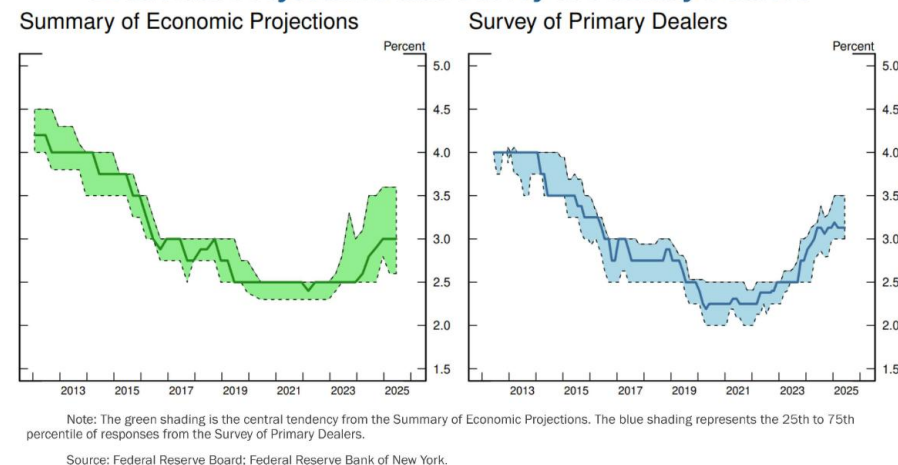


Figure 6: Longer-Run Federal Funds Rate: Summary of Economic Projections and Survey of Primary Dealers



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