

Monthly Economic Update (MEU)

October 2025

Economic Intelligence Unit
The Ceylon Chamber of Commerce



The
Ceylon
Chamber of
Commerce

EIU

Highlights

Global Economy

Global trade: moderating after boost from front-loading. Following an extended pause, on August 7, the U.S. administration implemented modified versions of the reciprocal tariffs originally announced in April. Additional country-specific tariffs on India and Brazil also came into force in August, and the scope of steel and aluminum tariffs was expanded.

Commodity markets: falling energy prices. In August, overall commodity prices fell by 2 percent, mainly due to a notable 4 percent decline in energy prices. This drop was driven by increased oil and gas supplies—oil prices eased as U.S. inventories rose and OPEC+ production expanded, while natural gas prices declined in both Europe and the U.S. because of high storage levels and strong supply. Conversely, agricultural prices increased by about 2 percent, largely due to sharp rises in coffee prices, as Arabica and Robusta surged following new U.S. tariffs on Brazilian imports.

Gold Prices Reach Record High as Base Metals Decline. Base metals prices edged lower in August (m/m), while precious metals extended their rally for an eighth consecutive month. Gold prices reached a new record high of over US\$3,700/oz by mid-September, supported by expectations of policy rate cuts in the United States and continued strong safe-haven demand.

When Innovation Meets Inflation: The Risk Behind the AI Rush. There are clear similarities between today's surge in tech investments and the dot-com boom of the late 1990s. Back then, the excitement was around the internet; today, it's centered on artificial intelligence. We're witnessing soaring valuations, rapid investment growth, and strong consumer spending fueled by rising asset values. However, this momentum carries risks—if investment and consumption continue to rise sharply, central banks may need to tighten monetary policy to manage inflationary pressures, just as they did in the late 1990s. On the other hand, a sudden market correction could quickly erode wealth, dampen spending and investment, slow economic activity, and tighten overall financial conditions.

Sri Lankan Economy

Sri Lanka's GDP grew by 4.8% (y-o-y) in H1 2025, marking eight consecutive quarters of expansion. Growth was led by industry (7.9%) and services (3.3%), supported by rebounds in textiles and apparel, construction, food and beverage manufacturing, and strong performance in financial and tourism-related services. Agriculture grew by 0.6%, constrained by adverse weather.

Inflation, measured by the CCPI, turned positive at 1.2% (y-o-y) in August 2025 after deflation since September 2024, due to base effects, food price fluctuations, and higher energy tariffs. Core inflation remained positive, while the NCPI turned positive earlier, in May 2025.

Private sector credit rose sharply by 19.6% (y-o-y) in July 2025, supported by monetary easing and lower lending rates (10.4%) and deposit rates (6.2%). Net credit to the government increased 4.7%, while bank exposure to the sovereign fell from 33.6% to 30.7% of assets. However, credit to SOEs contracted by 10.2% (y-o-y) in July 2025.

Despite a strong current account surplus and net FX purchases by the Central Bank, reserve accumulation slowed and the rupee depreciated. Continued inflows from development partners, including two IMF EFF tranches (March and July 2025), supported the balance of payments. However, external debt servicing remained high at US\$1.4 billion in H1 2025. The Central Bank purchased US\$1.2 billion in FX, a 38.8% decline (y-o-y) compared to early 2024. Gross usable reserves stood at US\$4.8 billion (end-August 2025), unchanged from end-2024, while import cover fell to 2.5 months (July 2025) from 3 months previously. Net foreign assets of the banking system, after strengthening in 2024, declined to US\$2.9 billion (July 2025). The rupee depreciated 3.1% (year-to-date), following a 19.4% cumulative appreciation in 2023–2024.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

4.9% Q2-2025
4.1% (Q2-2024)

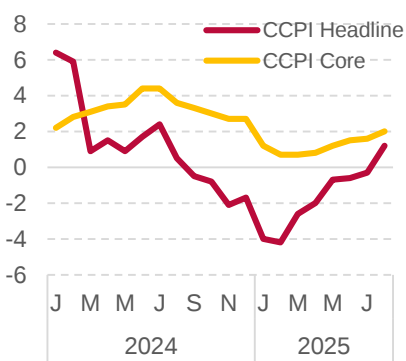
Movement of Purchasing Managers' Index- Aug 2025

Manufacturing PMI **55.2**
Services PMI **68.9**
Construction PMI (July) **60.0**

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

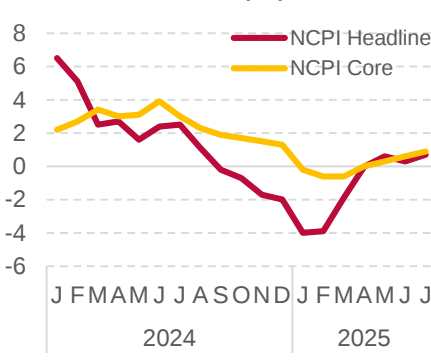
Inflation

CCPI Inflation (%) - Base 2021



Aug 2025
Headline **1.2%**
Core **2%**

NCPI Inflation (%) - Base 2021



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

External Sector

Merchandise Trade

Aug 2025

Trade Deficit **USD 414mn**
Exports **USD 1,282mn**
4.1% y-o-y growth

Imports **USD 1,696mn**
2.6% y-o-y growth

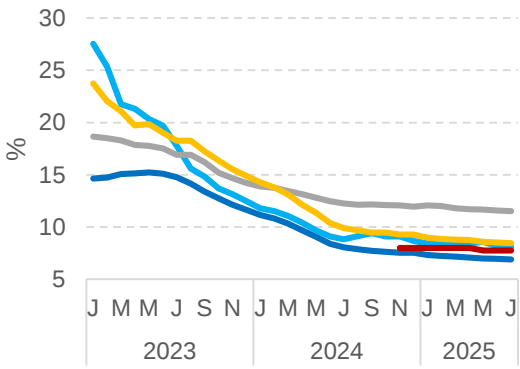
Services Trade **USD 558mn**
10.9% y-o-y decline

Tourist Arrivals **198,235**
Aug 2025 20% y-o-y growth

Tourism Earnings **USD 259mn**

Workers' Remittances **USD 681mn**
17.9% 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

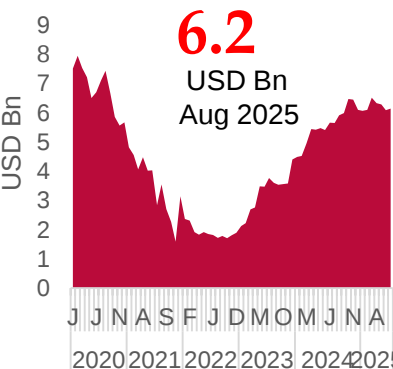
August 2025
20.5%

Exchange Rate



Depreciation of LKR thus far 2025
3.3%

Official Reserves



KEY INSIGHTS

Sri Lankan Economy

Forex reserves and Inflows

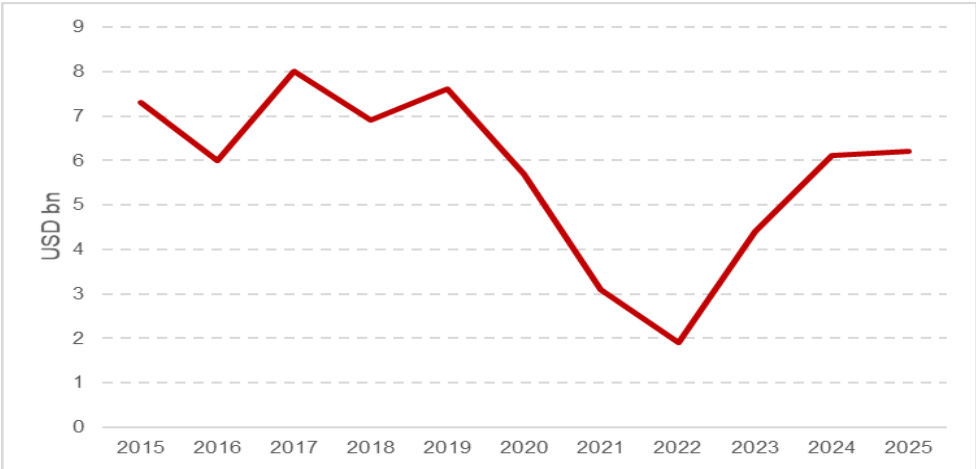
Sri Lanka's external sector remained stable through 2025 with the help of continuous foreign exchange influx through remittances and moderate tourism earnings growth. Gross official reserves (GOR) were above the level of the US \$6 billion until the first half of the year, showing step-by-step improvement in the external position through the IMF-backed reform plan. As per the Central Bank of Sri Lanka (CBSL), the gross official reserves were US \$6.1 billion at end-January 2025 and also went up to US \$6.3 billion at end-May 2025.

The increase is a slight upsurge from the level at end-December 2024, that is, US \$6.09 billion. The reserve stability remained due to the continued foreign exchange demand from the CBSL, continuous accumulation of the disbursements under the IMF, and the improvement in confidence for the Sri Lanka domestic foreign exchange. Worker remittances remained the prime source of external inflows during 2025. Statistics released through CBSL showed that remittance inflow were US \$1.81 billion for the first quarter during 2025, compared to the first quarter during 2024. Total remittances up to end-May 2025 were US \$3.1 billion with monthly remittance flows staying at US \$600 million or so, showing renewed confidence among overseas Sri Lankans. These inflows have been helpful for the maintenance of exchange rate stability and for reserve build-up, notwithstanding relatively high import demand due to the gradual removal of import restrictions.

CBSL's latest external sector press statements note that the reserve number includes the bilateral swap agreement with the People's Bank of China (PBoC), among the reported gross aggregate. Yet, even excluding swap facilities, usable reserves are higher up than levels witnessed earlier this year, 2024.

Overall, Sri Lanka's 2025 reserve cushion indicates a cautious but steady recovery. Continuation of remittance inflows, strong earnings from tourism, and prudent monetary discipline will facilitate keeping the reserves at or above the minimum threshold of the US \$6 billion mark for the remainder of the year, if debt restructuring and macro reforms stand the test.

Gross Official Reserves



Movement of the Sri Lanka rupee against Selected Currencies

2023	2024	2025(up to 30 Sep)
12.10%	10.70%	-3.30%
7.90%	17.80%	-14.10%
6%	12.30%	-9.60%
14.30%	13.90%	-5.60%
19.50%	22.50%	-8.10%
10.80%	21.70%	-8.50%
12.60%	13.90%	0.30%

KEY INSIGHTS

Sri Lankan Economy

Sri Lanka's Fifth IMF Review: A Milestone in Economic Recovery

Sri Lanka has reached a significant milestone in its economic reform journey with the successful conclusion of the Fifth Review under the IMF's Extended Fund Facility (EFF). Following a mission from September 24 to October 9, 2025, a staff-level agreement was reached, paving the way for IMF Executive Board approval and a potential disbursement of approximately USD 347 million.

The review commends Sri Lanka's progress in stabilising its economy. Real GDP grew by 4.8% year-on-year in the first half of 2025, while inflation turned positive at 1.5% in September. Gross official reserves rose to around USD 6.1 billion, and revenue collection improved due to tax reforms and broader structural changes. Notably, the external debt restructuring process is nearing completion an essential step toward restoring fiscal sustainability.

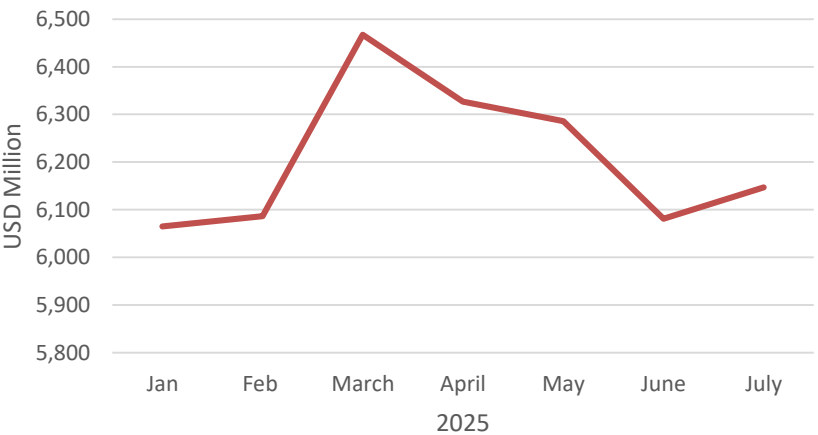
Looking ahead, the IMF emphasises the importance of continued fiscal consolidation. The 2026 Budget is expected to maintain a primary surplus of around 2.3% of GDP. Strengthening tax compliance and reducing exemptions are key to sustaining revenue growth. The Central Bank is urged to maintain price stability, avoid monetary financing, and continue building reserves. Structural reforms remain critical. These include strengthening the financial sector, liberalising trade, and enhancing governance. However, risks persist. Public debt remains high, and the country is vulnerable to global economic shocks and export sector challenges. Additionally, fragile public finances and potential political instability could hinder reform momentum.

Approval of the Fifth Review is expected to boost investor confidence and improve Sri Lanka's external position. However, the real test lies in sustained reform implementation. Translating macroeconomic gains into inclusive growth, job creation, and poverty reduction will require resilience, political will, and institutional strength. In conclusion, while Sri Lanka has made commendable progress, the road ahead demands unwavering commitment to reform and prudent economic management to ensure long-term stability and prosperity.

IMF Disbursement Summary USD Million



Gross reserves USD Million



KEY INSIGHTS

Global Economy

Global Growth, Inflation, and Policy Outlook: Navigating Uncertainty

The global economy is adjusting to a rapidly changing policy landscape marked by rising protectionism and uncertainty. Following the tariff hikes introduced by the United States earlier this year, subsequent policy adjustments have moderated some shocks. However, uncertainty over trade stability, fiscal sustainability, and labor dynamics continues to weigh on global prospects.

Growth Outlook:

As per the World Economic Outlook (WEO) update of the IMF, global growth is projected to slow to **3.2% in 2025** and **3.1% in 2026**, with advanced economies expanding by around **1.5%** and the U.S. moderating to **2%**. Emerging market and developing economies (EMDEs) are expected to grow just above **4%**. Early-year resilience was driven by front-loaded trade and inventory adjustments, but as these temporary factors fade, momentum is softening. Declining immigration in advanced economies could further constrain labor supply and potential output.

Inflation and Risks:

Global inflation is expected to decline to **4.2% in 2025** and **3.7% in 2026**, remaining above target in the U.S. but subdued elsewhere. Key downside risks include prolonged policy uncertainty, escalating protectionism, fiscal vulnerabilities, and potential market corrections, especially in technology sectors. Geopolitical or climate-induced commodity price shocks could also disrupt stability, particularly in low-income, import-dependent nations.

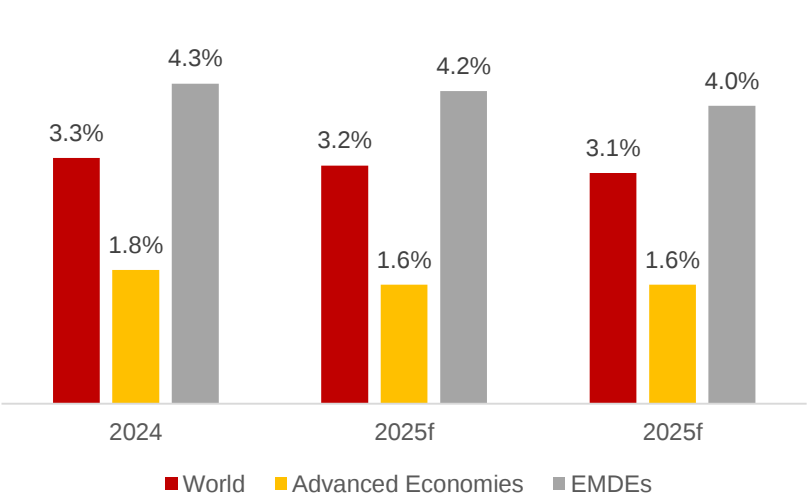
Policy Priorities:

As highlighted in the report, policymakers must act decisively to restore confidence through:

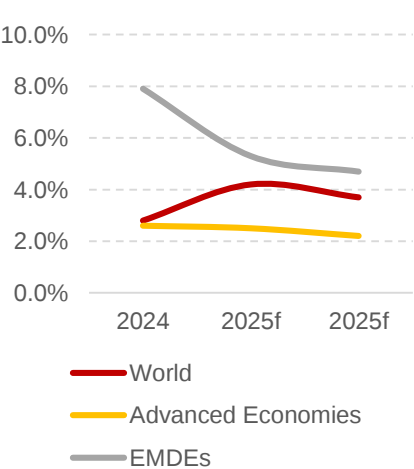
- Stable trade frameworks** that are transparent, predictable, and modernized for the digital era.
- Fiscal discipline** with realistic consolidation plans and well-targeted, temporary support.
- Independent monetary policy** to anchor inflation expectations and maintain credibility.
- Structural reforms** promoting labor mobility, digitalization, and institutional strength to boost long-term growth.

As global fragmentation deepens, coordinated, rules-based, and credible policy actions remain essential to sustain recovery and rebuild economic resilience.

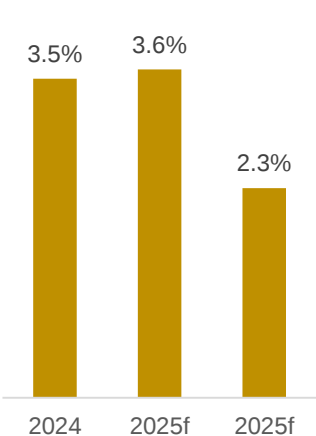
Global Growth: Projected to Slow



Inflation: Expected to Decline



Growth in Merchandise Trade Volume



KEY INSIGHTS

Global Economy

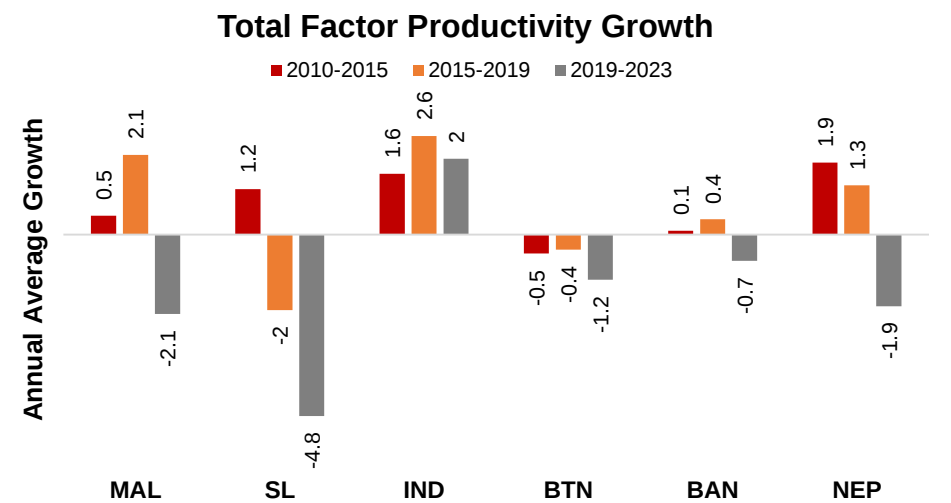
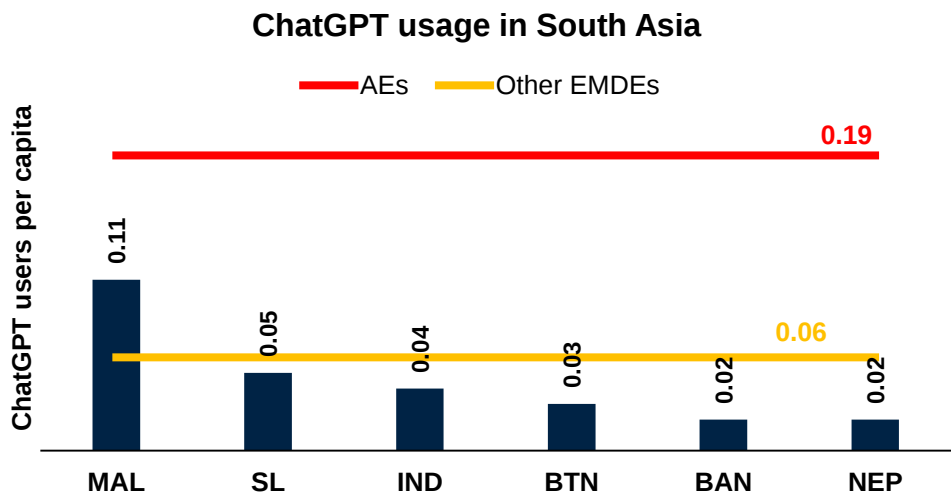
AI Adoption in South Asia: Opportunities and Challenges for Inclusive Growth

Artificial Intelligence (AI) is rapidly reshaping economies worldwide, and South Asia is beginning to feel its effects. Although the region’s workforce remains largely insulated from the immediate risks of automation, given the predominance of low-skill and agricultural employment, AI’s transformative potential is undeniable. The World Bank notes that only about 7% of South Asian jobs are highly exposed to AI without human complementarity, compared to 15% in other emerging markets. However, around 15% of jobs in South Asia are highly complementary with AI, suggesting significant scope for productivity gains among skilled and educated workers.

Labour market dynamics highlight both promise and risk. The demand for AI skills in South Asia has surged, with AI-related jobs commanding a 30% wage premium over other white-collar positions. However, young and moderately educated workers face higher displacement risks, particularly in routine white-collar roles such as customer service and data entry. The most substantial productivity gains are anticipated in finance, ICT, and professional services, sectors already central to South Asia’s growth model.

AI adoption in the region remains limited but is accelerating. Engagement in AI-related research, start-up activity, and venture capital investment has risen sharply over the past decade, especially in India. The region’s relatively low total factor productivity, about two-thirds that of other emerging markets, presents a strong case for AI-driven efficiency improvements. Yet, realising this potential requires addressing critical constraints such as inadequate digital infrastructure, unreliable electricity, and insufficient access to quality education and technical training.

Although Sri Lanka exhibits one of the highest AI exposure rates in the region, it also underscores the importance of equipping workers with adaptable skills and ensuring inclusive access to digital technologies to leverage productivity gains. Sri Lanka's total factor productivity growth (annual average) for the period 2019-2023 is -4.8%. This is mainly due to the economic crisis the nation experienced. However, it shows that leveraging on AI can provide a transformative change to the nation in the upcoming years.



Evolving Landscape

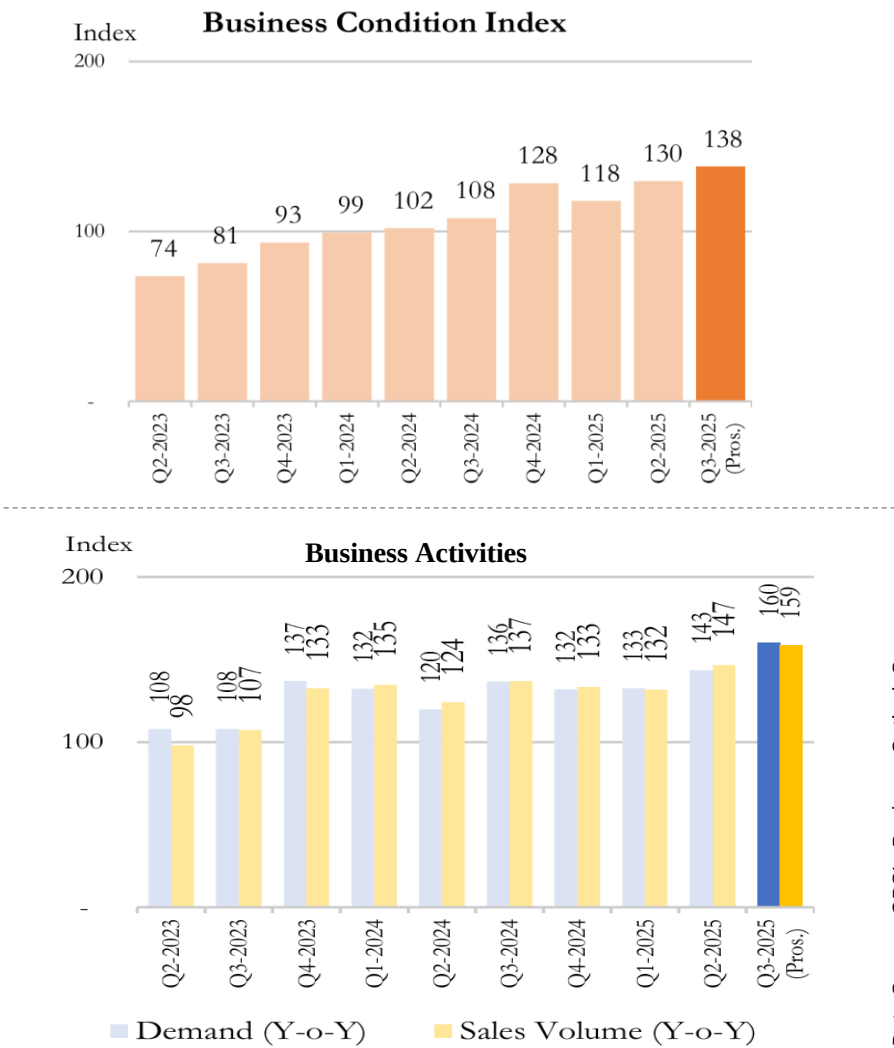
Macroeconomic Stability Drives Improved Business Sentiment Across Sectors in 2025

The **Business Condition Index** for Q3 2025 shows a continued rise in business confidence, building on the positive trend from Q2 2025. This improvement reflects growing optimism across all major sectors—Agriculture, Industry, and Services—indicating a broad-based strengthening of the overall business climate. Firms identified **lower interest rates** and a **stable exchange rate** as the primary factors behind this improvement.

Looking ahead to Q3 2025, **demand and sales volumes** are expected to grow year-on-year, with all sectors contributing to the expansion. Notably, the **Agriculture sector**, which had previously underperformed, is projected to rebound strongly, leading to higher **capacity utilisation**. The **investment outlook** remains positive, with firms planning to allocate funds primarily toward **expanding operations** and **upgrading existing facilities**. However, **skilled labour shortages** are anticipated to persist below the neutral threshold, particularly in the Agriculture and Industry sectors. Additionally, **demand for bank credit** is expected to increase across all sectors, driven mainly by operational needs.

During **Q2 2025**, business conditions had already shown significant progress, with stronger **demand, sales, and capacity utilisation** supported by all three sectors. **Investment activity** also improved during the quarter, reflecting increased business optimism. Nonetheless, both **skilled and unskilled labour availability** declined compared to Q2 2024, highlighting ongoing labour market constraints. At the same time, **access to bank credit** improved, and firms reported a higher demand for credit to meet operational requirements.

Overall, the data from Q2 and Q3 2025 signal a steady recovery in business sentiment and activity, supported by macroeconomic stability and sectoral resilience, despite lingering labour shortages.



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