Monthly Economic Update (MEU)

July 2026

Economic Intelligence Unit
The Ceylon Chamber of Commerce

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

5.1% For the Q1 of the year 2026

The Sri Lankan Economy grew by 5.1% in Q1 2026 compared to 4.7% growth in Q1 2025. All three major economic activities positively contributed to this growth. Further, the GDP implicit price deflator for the quarter was recorded as 5.7%.

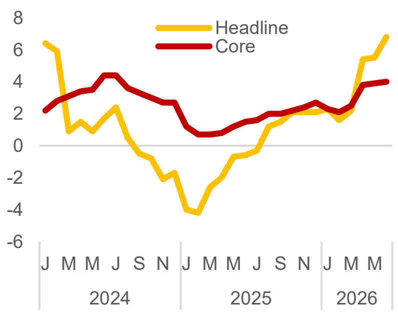
Movement of Purchasing Managers' Index- June 2026

Manufacturing PMI	53
Services PMI	58.5
Construction PMI	58.6

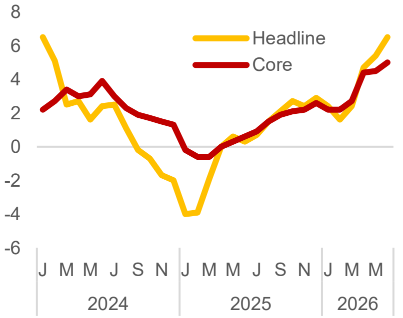
Manufacturing & Services indices recorded an increase compared to the previous month..

Inflation

CCPI Inflation (%)-*Base 2021*



NCPI Inflation (%)-*Base 2021*



	Headline	Core		Headline	Core
June 2026	6.8%	4%	June 2026	6.5%	5%

External Sector

Merchandise Trade
May 2026

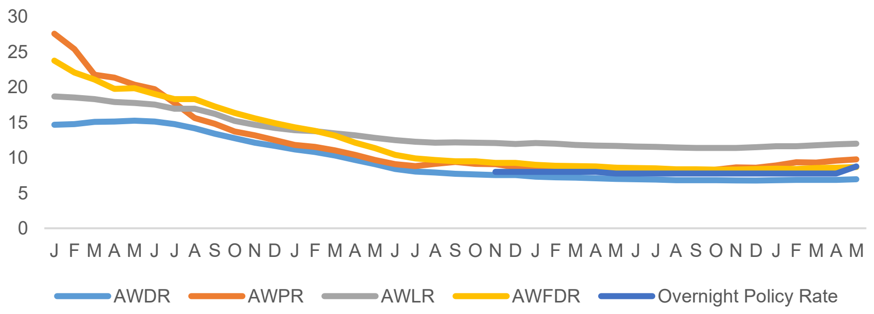
Trade Deficit	USD 968 mn	
Exports	USD 1700 mn	18.3% y-o-y growth
Imports	USD 2192 mn	45.4% y-o-y growth
Services Net Exports	USD 143.2 mn	-36.8% y-o-y growth

Tourist Arrivals June 2026 — **124,551**, -9.9% y-o-y growth

Tourism Earnings June 2026 — **USD 151.1mn**, -10.9% y-o-y growth

Workers' Remittances June 2026 — **USD 695mn**, 9.33% y-o-y growth

Interest Rates



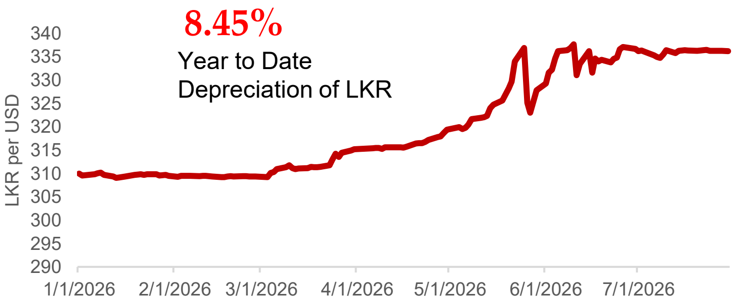
Growth in Credit to Private Sector

May 2026

27.8%

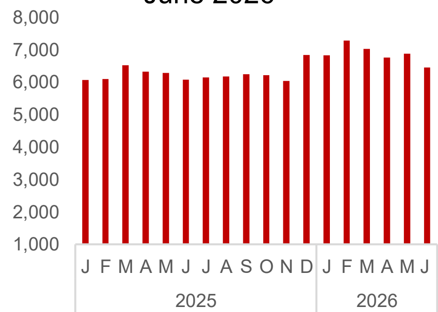
Overnight Policy Interest Rate (OPR): 8.75%

Exchange Rate



Official Reserves

USD 6,450 mn
June 2026



Highlights

Local Economy

Sri Lanka’s Income Reclassification as Upper- Middle Income Country

Sri Lanka was reclassified as an upper-middle-income country by the World Bank, effective 1 July 2026, reflecting continued macroeconomic recovery and improved economic stability following the 2022 crisis. The upgrade is expected to strengthen investor confidence and enhance the country's credibility with international financial institutions and development partners. However, household-level challenges, including the high cost of living, income disparities, and employment concerns, continue to persist. Going forward, the country's success will depend on translating these macroeconomic gains into inclusive growth and improved living standards for all citizens.

Sri Lanka Records Fiscal Surplus from Jan to May 2026

Sri Lanka's fiscal position strengthened significantly during the first five months of 2026, with total government revenue and grants increasing by 31% year-on-year to Rs. 2,537 billion, exceeding the 7% rise in total expenditure to Rs. 2,340 billion. This resulted in a budget surplus of Rs. 197 billion, reversing the Rs. 237 billion deficit recorded a year earlier, while the primary surplus improved to Rs. 1,131 billion. Revenue growth was driven by strong tax collections, particularly VAT receipts (up 29% to Rs. 826 billion) and income tax revenue (up 17% to Rs. 526 billion), supported by the resumption of motor vehicle imports. Meanwhile, interest payments declined by 5% to Rs. 934 billion, reflecting continued progress in fiscal consolidation and debt management.

S&P Keeps Sri Lanka at ‘CCC+/C

S&P Global Ratings affirmed Sri Lanka’s sovereign credit ratings at ‘CCC+/C’ with a stable outlook, indicating continued high credit risk but no expected near-term deterioration. The decision reflects ongoing economic recovery, with real GDP growth of 5.1% in Q1 2026 and projected full-year growth of 3.8%, supported by improved government revenue and IMF-backed reforms. However, Sri Lanka remains vulnerable to external risks, including higher energy prices, weaker tourism earnings, and reduced worker remittances, while the ‘CCC+’ rating continues to reflect challenges in accessing international capital markets.

Sri Lanka becomes the fourth among the highest score improvers in the IIF Survey

Sri Lanka recorded a significant improvement in sovereign investor relations and debt transparency practices, ranking as the fourth-highest score improver among 57 emerging and developing economies in the IIF Investor Relations and Debt Transparency Report 2026. The country’s Investor Relations Country Score increased to 43.67 out of 50 in 2026 from 37.33 in 2025, an improvement of 6.34 points, placing Sri Lanka within the top quartile of assessed economies. The progress was mainly driven by improvements in debt transparency and ESG data and policy dissemination, strengthening investor confidence, supporting international market access, and enhancing Sri Lanka’s credibility in global capital markets

Sri Lanka's Positioning for the EU's New GSP Framework

Sri Lanka’s future access to the EU’s GSP+ trade preferences will depend on stronger progress in sustainability, governance, and institutional reforms as the new GSP Regulation takes effect in January 2027. Sri Lanka remains the third-largest GSP+ beneficiary, with EUR 1.5 billion in exports entering the EU under GSP+ preferences in 2024 and estimated tariff savings of EUR 139 million. While the EU has recognized improvements in areas such as anti-corruption measures, labour protections, and climate reporting, continued eligibility will require effective implementation of reforms related to human rights, labour standards, environmental governance, and accountability.

The Central Bank of Sri Lanka keeps the Overnight Policy Rate (OPR) unchanged

The Central Bank of Sri Lanka maintained the Overnight Policy Rate (OPR) at 8.75% in its July 2026 Monetary Policy Review, as it continued to balance inflation risks with economic recovery. Headline inflation increased to 6.8% in June 2026, mainly driven by higher domestic energy and food prices, with inflation expected to remain above the 5% target in the near term before gradually moderating. External sector pressures eased somewhat, while gross official reserves reached USD 6.45 billion by end-June 2026 and worker remittances remained resilient. However, risks from renewed Middle East tensions, higher global commodity prices, and import-related pressures remain key concerns for the economic outlook.

Global Economy

The World Economic Outlook – July Forecast

The global economy is projected to grow by 3.0% in 2026 and 3.4% in 2027, below the 3.5% average growth recorded during 2024–25, as the impact of Middle East tensions is partly offset by stronger momentum from artificial intelligence (AI) investment and technology adoption. Global inflation is expected to rise from 4.1% in 2025 to 4.7% in 2026 before easing to 3.9% in 2027, indicating a temporary slowdown in the disinflation trend. However, risks remain tilted to the downside due to potential geopolitical conflicts, commodity price volatility, trade fragmentation, and financial pressures, highlighting the need for stronger fiscal management, price stability measures, and structural reforms.

The New Trade Policy Paradigm: From Free Trade to Strategic Competition

Global trade has entered a new era shaped by geopolitical tensions, economic security concerns, and strategic trade policies. Rising protectionist measures, supply chain disruptions, and policy uncertainty have weakened trade liberalization while accelerating regional integration and industrial policy interventions. As economies prioritize resilience over efficiency, trade policy has become a key instrument of economic and geopolitical strategy, reshaping global value chains and creating both challenges and opportunities for sustainable economic growth.

India’s Youth Crisis: How the “Cockroach” Protests Exposed Economic Frustrations

India’s “Cockroach” protests highlighted growing concerns among youth over limited employment opportunities, recruitment delays, and uncertainty in career pathways. The movement reflected frustrations with weaknesses in education and competitive examination systems, raising concerns about the effective utilization of human capital. The protests have increased pressure on authorities to improve transparency and accountability in recruitment processes to ensure that economic growth generates meaningful employment opportunities for young people.

KEY INSIGHTS
Sri Lankan Economy

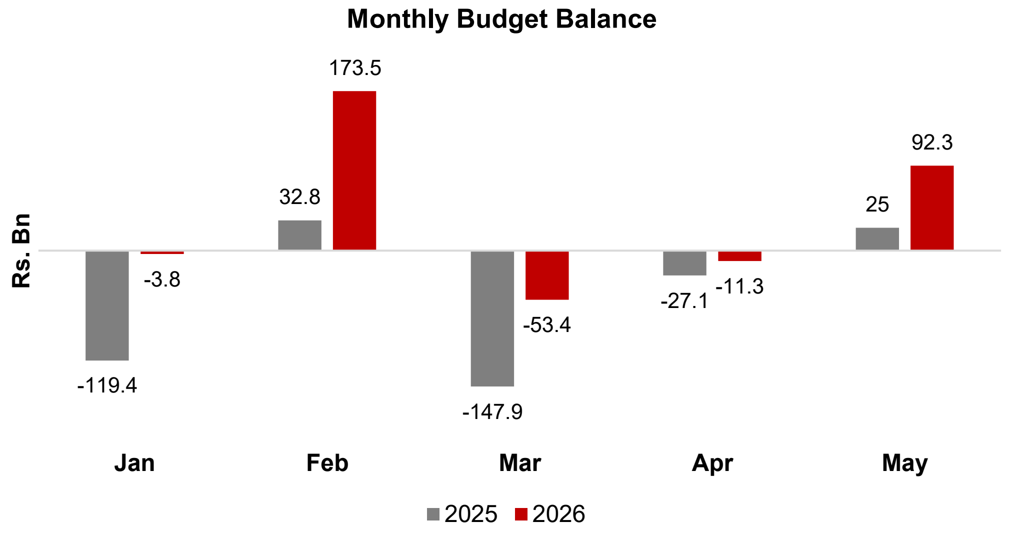
Sri Lanka Records Fiscal Surplus from Jan to May 2026

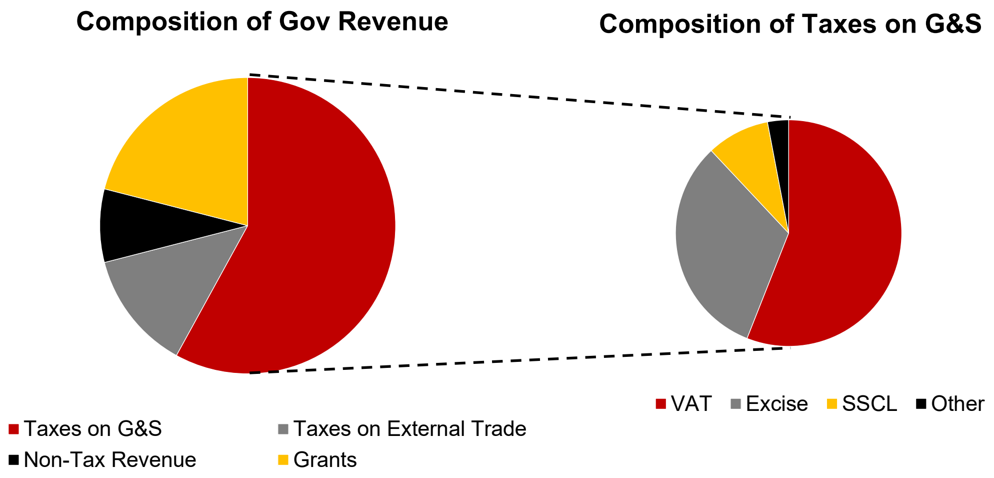
Sri Lanka's fiscal performance in the first five months of 2026 reflects a significant strengthening of public finances, with robust revenue growth outpacing expenditure increases and resulting in the return of a budget surplus. Total government revenue and grants increased by 31% year-on-year to Rs. 2,537 Bn from Rs. 1,942 Bn in the corresponding period of 2025, while total expenditure rose by a more moderate 7% to Rs. 2,340 Bn. As a result, the fiscal balance recorded a surplus of Rs. 197 Bn, reversing the deficit of Rs. 237 Bn recorded during the same period last year. The primary surplus also improved markedly to Rs. 1,131 Bn from Rs. 743 Bn, highlighting the continued progress in fiscal consolidation.

The improvement in revenue performance was largely driven by tax collections, which increased by 29% to Rs. 2,324 Bn and accounted for 92% of total revenue. Revenue from taxes on goods and services expanded substantially, supported by Value Added Tax (VAT) receipts which rose 29% to Rs. 826 Bn. Income tax revenue also increased by 17% to Rs. 526 Bn. A notable contribution came from the resumption of motor vehicle imports, which significantly boosted customs-related taxes. Revenue from excise duty on motor vehicles increased to Rs. 228 Bn from Rs. 86 Bn a year earlier, while total customs revenue reached Rs. 1,079 Bn, achieving nearly 49% of its annual target within five months. Non-tax revenue also recorded strong growth of 54% to Rs. 212 Bn.

On the expenditure side, fiscal discipline remained evident despite increased spending on public services and investment. Recurrent expenditure grew modestly by 5% to Rs. 2,113 Bn, while capital expenditure and net lending increased by 29% to Rs. 227 Bn, indicating a gradual shift towards supporting development and investment activities. Importantly, interest payments declined by 5% to Rs. 934 Bn compared with the same period in 2025, helping ease pressure on government finances. This combination of strong revenue mobilisation and controlled expenditure growth was instrumental in generating the fiscal surplus.

Although part of the revenue surge was supported by one-off factors such as motor vehicle-related taxes, the strong performance across major tax categories and improving primary balance suggest that revenue administration reforms and economic recovery are contributing to a more sustainable fiscal position. Maintaining revenue momentum while balancing expenditure demands will be critical to preserving fiscal stability and supporting debt sustainability in the period ahead.





Data Source: Ministry of Finance

KEY INSIGHTS
Sri Lankan Economy

S&P Keeps Sri Lanka at ‘CCC+/C

S&P Global Ratings has affirmed Sri Lanka’s long- and short-term sovereign credit ratings at ‘CCC+/C’, with a stable outlook. This means the agency sees Sri Lanka as still carrying high credit risk but not getting worse in the near term. A ‘stable’ outlook suggests S&P does not expect an immediate upgrade or downgrade over the next six to 12 months. The decision reflects two sides of Sri Lanka’s recovery. On the positive side, the economy has been growing again after the 2022 debt crisis. S&P said real GDP grew by 5.1% in the first quarter of 2026, while it expects full-year growth of around 3.8%. Government revenue has also improved, helped by tax reforms and the reopening of vehicle imports. These gains support the country’s ability to manage its debt and continue reforms under the IMF programme. However, the rating also shows that Sri Lanka is not yet out of danger. S&P warned that the country remains vulnerable to external shocks, especially higher energy prices, weaker tourism earnings, and slower worker remittances if instability in the Middle East continues. Because Sri Lanka depends heavily on imported fuel and fertiliser, a rise in global prices can quickly increase import costs, put pressure on foreign reserves, and push inflation higher.

The external position is another key area to watch. S&P expects the current account to move back into deficit as imports rise with the recovery. While stronger domestic activity is a positive sign, it also means Sri Lanka may need more foreign exchange to pay for fuel, food, machinery, and consumer goods. If export earnings, tourism income, and remittances do not grow fast enough, pressure on the rupee and reserves could return. For investors and lenders, the message is mixed. The stable outlook may give some confidence that Sri Lanka is continuing its recovery path and is not facing an immediate payment crisis. But the ‘CCC+’ rating still sits deep in speculative territory, meaning borrowing from international markets remains difficult and expensive. In practice, Sri Lanka will continue to rely heavily on official financing, debt restructuring progress, and confidence in its reform programme. A future upgrade would likely depend on stronger economic growth, better Government revenue, lower debt levels, and a healthier external position. On the other hand, a downgrade could happen if fiscal reforms weaken, reserves fall again, debt talks face setbacks, or the Government comes under renewed funding pressure. Therefore, the rating is best understood as a cautious vote of stability rather than a sign that the crisis has fully ended. Overall, S&P’s decision suggests that Sri Lanka has made progress since the worst of the crisis, but the recovery remains fragile. The country must keep improving revenue collection, control spending, rebuild reserves, and maintain reform momentum. If those conditions hold, Sri Lanka could gradually regain credibility with investors. If they weaken, the economy could again face pressure from debt, inflation, and external financing needs.

Sri Lanka Rating Component Scores

Key rating factor	Score
Institutional assessment	6
Economic assessment	5
External assessment	5
Fiscal assessment: flexibility and performance	4
Fiscal assessment: debt burden	6
Monetary assessment	4
Indicative rating	b-
Notches of supplemental adjustments and flexibility	-1
Final rating: foreign currency	CCC+
Notches of uplift	0
Final rating: local currency	CCC+

Key Economic Indicators

Indicator	Figure / Status	What it shows
Long-term rating	CCC+	High credit risk remains
Short-term rating	C	Weak short-term credit strength
Outlook	Stable	No immediate upgrade or downgrade expected
Q1 2026 real GDP growth	5.1%	Recovery is continuing
Expected full-year growth	Around 3.8%	Growth is positive but moderate

Data Source: S&P Global Ratings

KEY INSIGHTS
Sri Lankan Economy

Sri Lanka's Positioning for the EU's New GSP Framework

The European Union's latest GSP monitoring cycle signals that Sri Lanka's future access to preferential market access will increasingly depend on its ability to demonstrate progress not only in trade performance but also in sustainability, governance and institutional reform. As the EU's new GSP Regulation comes into effect from January 2027, all current GSP+ beneficiaries, including Sri Lanka, will be required to reapply and submit a Plan of Action for effective implementation under the new framework. The revised scheme introduces stronger sustainability, monitoring and transparency requirements, alongside an expanded set of international conventions.

Sri Lanka enters this transition from a position of significant economic interest. It remains the third-largest GSP+ beneficiary, after Pakistan and the Philippines, with EUR 1.5 billion of exports entering the EU under GSP+ preferences in 2024 and an estimated EUR 139 million in tariff savings. The country's exports continue to benefit from duty-free access in key sectors such as apparel, rubber products, processed foods and fisheries, underlining the importance of retaining GSP+ status for export competitiveness.

The broader report covering all GSP beneficiaries highlights that GSP+ remains the EU's principal mechanism for linking trade preferences with sustainable development outcomes. Across beneficiary countries, the EU identifies recurring challenges relating to civic space, freedom of expression, judicial independence, labour rights enforcement, child labour, environmental implementation, anti-corruption and data gaps. Several of these issues are also reflected in Sri Lanka's country assessment, suggesting that the country's reform agenda is closely aligned with broader trends observed across the GSP+ programme. Importantly, the EU acknowledges progress in Sri Lanka, including stronger anti-corruption measures, improvements in labour protections, enhanced human rights institutions and climate reporting efforts. However, the report emphasises that implementation remains the determining factor for continued GSP eligibility. Reforms relating to anti-terror legislation, civic freedoms, accountability, collective bargaining, child labour, environmental governance and anti-corruption enforcement are specifically highlighted as priority areas for future engagement.

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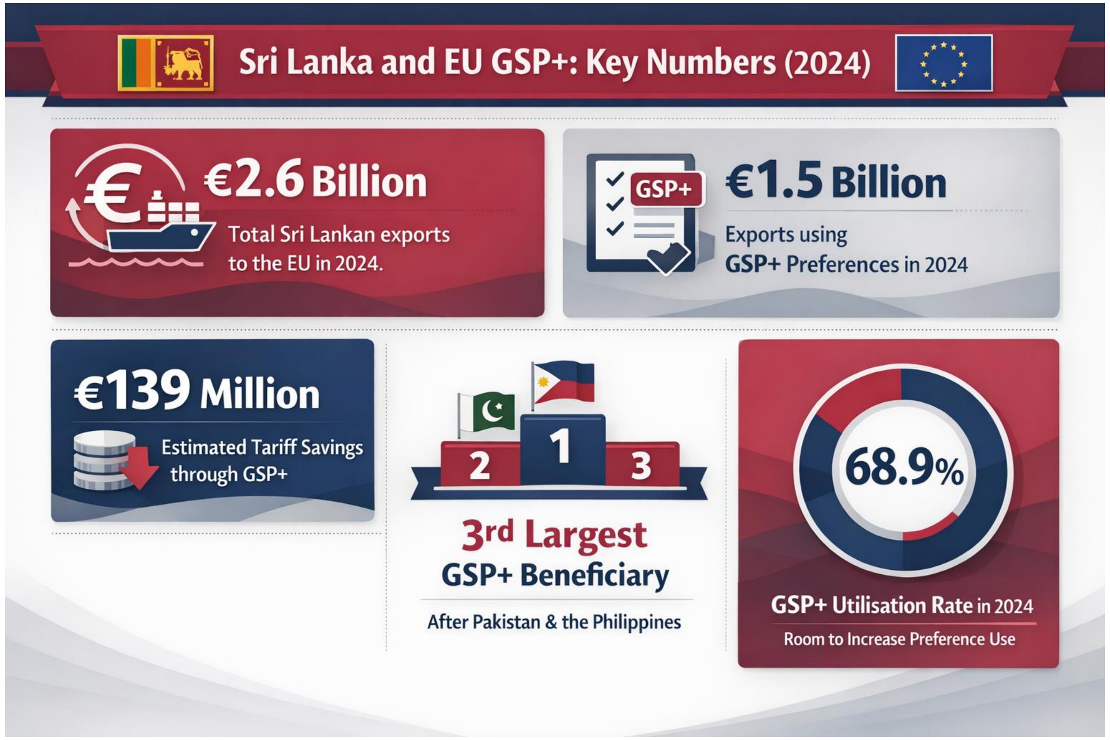
For Sri Lanka, the message is clear: under the new GSP framework, preferential market access will increasingly be assessed through the lens of measurable governance and sustainability outcomes. Continued progress in these areas will not only support a successful GSP+ reapplication but also strengthen investor confidence, improve the business environment and reinforce Sri Lanka's position within global value chains



Data Source: European Commission

KEY INSIGHTS
Global Economy

The New Trade Policy Paradigm: From Free Trade to Strategic Competition

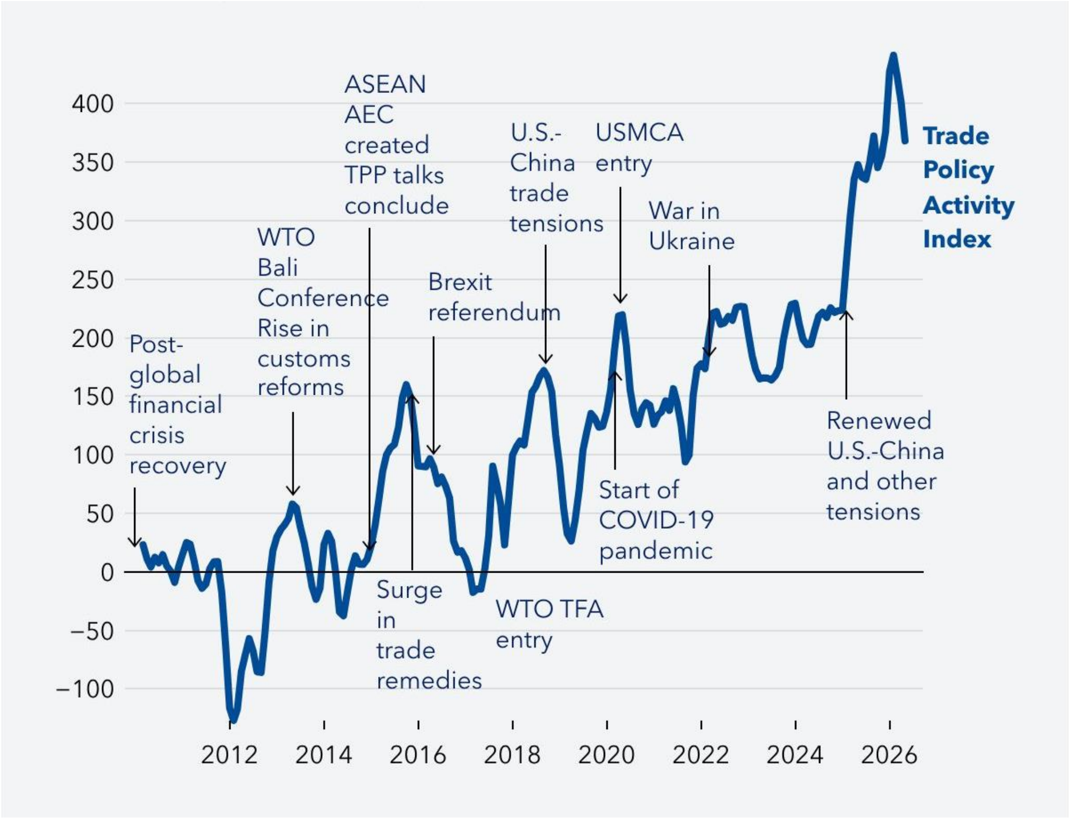
Trade tensions, geopolitical uncertainty, and shifting trade policies have fundamentally reshaped the global trading system over the past decade. Since the Global Financial Crisis, trade policy activity has steadily intensified, accelerating sharply from 2020 as governments increasingly used trade measures to advance strategic objectives such as national security, industrial development, supply chain resilience, and technological competitiveness. Major events—including the US–China trade dispute, the COVID-19 pandemic, the Russia–Ukraine war, renewed trade tensions in 2025, and the Strait of Hormuz crisis—have reinforced this trend towards a more interventionist global trade environment.

Recent evidence indicates that restrictive trade measures, including tariffs, import restrictions, export controls, and subsidies, have grown more rapidly than trade-facilitating measures. This shift is no longer limited to major economies but is increasingly evident across developing and emerging markets, contributing to greater uncertainty and the reconfiguration of global supply chains. Higher energy prices, transportation costs, and inflationary pressures arising from geopolitical conflicts have further slowed global trade growth and increased production costs, particularly for commodity-importing economies.

These developments have placed significant pressure on developing countries, many of which continue to struggle with weaker investment, rising debt burdens, and slower productivity growth. The persistence of policy uncertainty has discouraged private investment and complicated long-term business planning, with the 2020s increasingly viewed as a "lost decade" for many developing economies.

Despite these challenges, structural shifts are creating new opportunities. Regional trade agreements now account for around 60% of global trade, providing greater predictability through common rules on investment, standards, and services. Simultaneously, increased investment in clean energy and technology-driven sectors, particularly artificial intelligence and semiconductor value chains, is reshaping global production networks. Together, these trends illustrate a transition from globalization driven by efficiency towards one centred on resilience, regional integration, and strategic economic security, making predictable and rules-based trade policies more important than ever.

Global Trade Policy Activity as per TPA Index



Data Source: WTO, IMF and World Bank

Evolving Landscape

Sri Lanka's Income Reclassification as Upper- Middle Income Country

Sri Lanka's recent reclassification as an upper-middle-income country marks an important milestone in its economic recovery journey. This reclassification was officially recognized on 1 July 2026, when the World Bank released its 2026–2027 Country Income Classifications and upgraded Sri Lanka from a lower-middle-income economy to an upper-middle-income economy based on its Gross National Income (GNI) per capita. The upgrade signals that the country has made significant progress since the economic crisis of 2022 and reflects improvements in macroeconomic stability and growth. Furthermore, the achievement places Sri Lanka among a select group of countries that moved to a higher income category in 2026, strengthening its standing and credibility within the global economy.

From an international perspective, the income upgrade brings several advantages. It enhances Sri Lanka's credibility among foreign investors, development agencies, and international financial institutions. A higher income classification serves as a signal of economic stability, policy progress, and recovery, which can improve investor confidence and strengthen the country's ability to attract foreign direct investment. It may also improve Sri Lanka's reputation in global markets and reinforce confidence among lenders and development partners. The reclassification demonstrates resilience and indicates that the country has emerged from a period of severe economic distress with renewed growth momentum.

However, while the upgrade is symbolically significant, it also raises important questions about the realities experienced by ordinary citizens. Income classifications are primarily based on national income indicators such as GNI per capita rather than broader measures of living standards, income distribution, or household welfare. As a result, an improvement in aggregate economic indicators does not necessarily mean that all segments of society are experiencing better economic conditions.

Many households continue to face challenges related to the cost of living, employment security, debt burdens, and income disparities. Therefore, the extent to which this "upper-middle-income" status is reflected in the daily lives of citizens remains open to debate.

This highlights a broader challenge in development measurement: economic growth and income statistics can demonstrate national progress, yet they may not fully capture ground-level realities. Going forward, Sri Lanka's success should not only be judged by its classification status but also by its ability to translate macroeconomic gains into improved living standards, inclusive growth, and greater economic opportunities for all citizens. The true test of the upgrade will be whether its benefits are felt beyond economic indicators and within communities across the country.

Table 1: Reclassified in the World Bank Income Classification (Effective 1 July 2026)

Country	New Income Category (2026)	Previous Category (2025)	Atlas GNI per Capita 2025 (US$)	Atlas GNI per Capita 2024 (US$)
Sri Lanka	Upper-Middle Income	Lower-Middle Income	4,670	3,860

Table 2: World Bank Income Classification Thresholds

Income Group	Threshold as of July 1, 2026 (US$)	Threshold as of July 1, 2025 (US$)
Low Income	≤ 1,175	≤ 1,135
Lower-Middle Income	1,176 – 4,635	1,136 – 4,495
Upper-Middle Income	**4,636 – 14,375**	**4,496 – 13,935**
High Income	> 14,375	> 13,935

Data Source: World Bank

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