

Monthly Economic Update (MEU)

September 2026

Economic Intelligence Unit
The Ceylon Chamber of Commerce



EIU

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

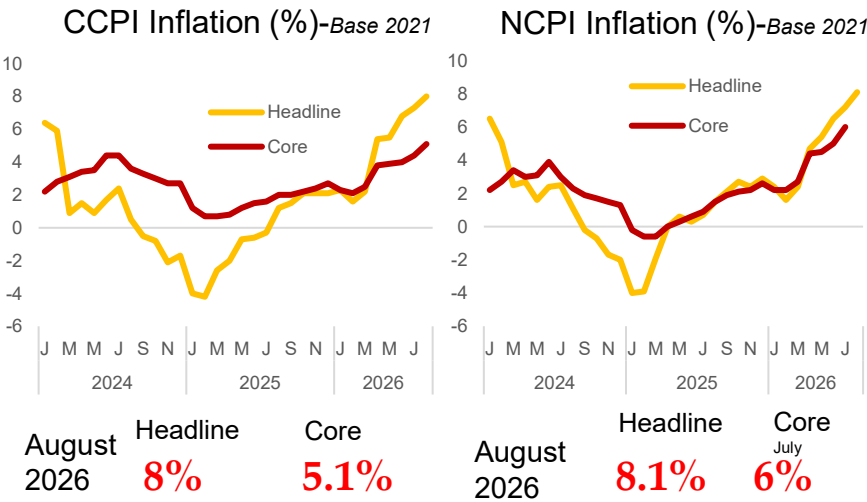
4.2% For the Q2 of the year 2026
The Sri Lankan Economy grew by 4.2% in Q2 2026 compared to 5.0% growth in Q2 2025. All three major economic activities positively contributed to this growth. Further, the GDP implicit price deflator for the quarter was recorded as 6.9%.

Movement of Purchasing Managers' Index- August 2026

Manufacturing PMI **53**
Services PMI **65.6**
Construction PMI (Jul) **61.4**

All indices recorded an increase compared to the previous month, except manufacturing PMI.

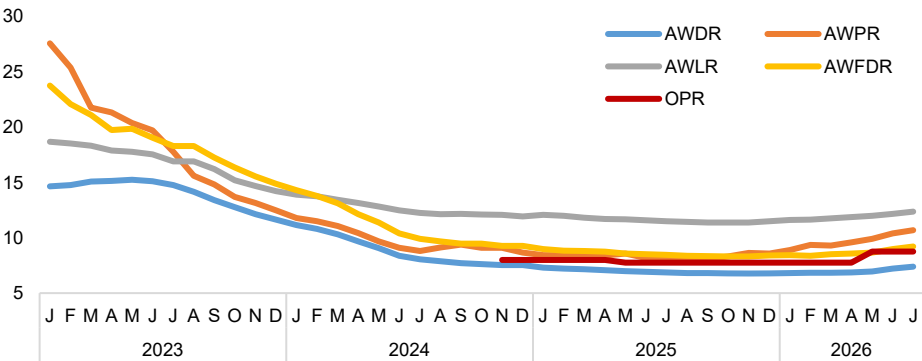
Inflation



External Sector

Merchandise Trade	July 2026	
Trade Deficit	USD 1,018 mn	
Exports	USD 1,854 mn	-3.4% y-o-y growth
Imports	USD 2,251 mn	19.6% y-o-y growth
Services Net Exports	USD 244 mn	-23% y-o-y growth
Tourist Arrivals	191,704	-2.0% y-o-y growth
Tourism Earnings	USD 264.4mn	-10% y-o-y growth
Workers' Remittances	USD 748.6mn	19.8% y-o-y growth

Interest Rates



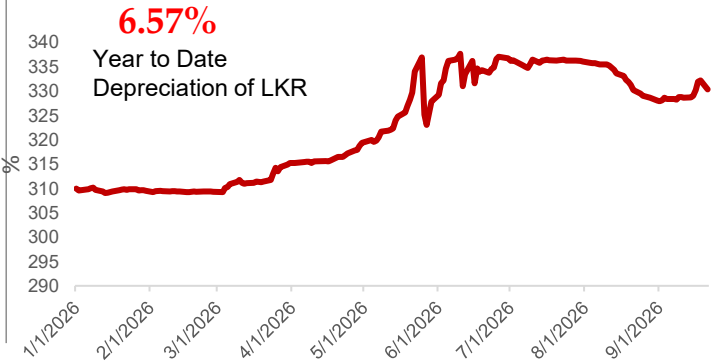
Growth in Credit to Private Sector

July 2026

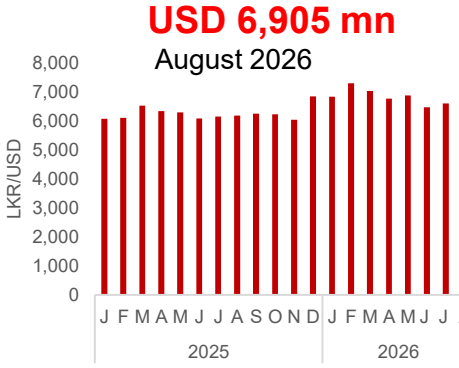
26.4%

Overnight Policy Interest Rate (OPR): 8.75%

Exchange Rate



Official Reserves



Highlights

Local Economy

Q2 Growth Reaches 4.2%, but the Recovery Is Uneven

Real GDP expanded 4.2% year on year in Q2 2026, marking the 12th consecutive quarter of positive growth and confirming that the economy continued to recover. However, the expansion was uneven across sectors: industry provided the strongest support, agriculture contracted and services recorded more moderate growth. Middle East tensions, risks to crude-oil supply and subdued tourism performance added uncertainty, meaning the headline growth rate should be viewed alongside the economy's continued exposure to external shocks and sector-specific weakness.

Fitch Upgrades Sri Lanka to 'B-' With Stable Outlook

Fitch Ratings upgraded Sri Lanka's Long-Term IDRs to 'B-' from 'CCC+' and assigned a Stable Outlook, citing macro-stabilisation reforms, stronger fiscal and external balances and rebuilding reserves. Continued fiscal discipline and improved revenue collection are expected to sustain primary surpluses and put debt on a downward path. However, Fitch cautioned that debt-to-GDP and debt-service burdens remain high relative to peers, while foreign-exchange reserve buffers are still modest as external repayments rise over the next five years.

Industry Accelerates as Agriculture Contracts

Industrial activity grew 7.3%, led by construction growth of 13.9% and a 17.4% expansion in mining and quarrying. By contrast, agriculture contracted 2.3%, while services grew 2.7%, supported by IT, insurance and financial services. The pattern shows that the recovery is being driven by investment- and industry-related activity rather than broad-based gains across the economy, leaving agricultural incomes and slower-growing services as important areas to monitor.

Geopolitical Disruptions Increase External-Sector Risks

Threats to Middle East energy supplies and major shipping routes could raise Sri Lanka's fuel, freight and imported-input costs, with knock-on effects for production, consumer prices and export competitiveness. These risks emerge as the Jan–July trade deficit widened to US\$6.5 billion from US\$3.9 billion and tourism earnings fell 11.5%. Remittances provided an important offset, increasing 21.4% to US\$5.4 billion, but businesses remain exposed to shipping delays, currency movements and higher operating costs.

Inflation and Currency Pressures Remain in Focus

NCPI headline inflation stood at 7.2% in July 2026, while core inflation reached 6.0%, indicating that price pressures extended beyond the most volatile items. The rupee had also depreciated 6.57% year to date, which could raise the local cost of imported fuel, materials and consumer goods. Together, these trends underline the need to sustain the recovery without allowing stronger demand, import growth or exchange-rate pressure to undermine purchasing power and macroeconomic stability.

External Government Debt Rises Above US\$38 Billion

Sri Lanka's external government debt reached US\$38,008 million at end-June 2026, an increase of US\$345 million, or 0.9%, from end-2025. The composition also shifted: multilateral and bilateral borrowing rose while commercial debt declined, moving the financing mix further toward official creditors. This may improve the maturity and cost profile of new financing, but the higher debt stock keeps fiscal discipline, repayment capacity and careful debt management central to the recovery.

Global Economy

Middle East Tensions Put Energy and Trade Routes at Risk

Disruptions around the Strait of Hormuz, Bab el-Mandeb and the Red Sea threaten the movement of oil, LNG, fertiliser, food commodities and other traded goods. Even without a complete closure, heightened security risks can raise insurance and freight costs, lengthen shipping routes and make delivery schedules less predictable. The resulting pressure could feed into energy and food prices, weaken margins for import-dependent businesses and encourage companies to diversify suppliers, routes and inventory strategies.

Oil Prices: Middle East Tensions Keep Crude Elevated

WTI is trading near \$99.50/bbl and Brent near \$103/bbl, down from Sept 11 peaks of ~\$104 and ~\$109 as Saudi Arabia reroutes supply around the Strait of Hormuz. Escalating U.S.–Iran tensions remain the key risk: analysts see Brent near \$80 if things calm down, but above \$120 if Hormuz disruptions persist.

The Federal Reserve Returns to Tightening

The Federal Reserve raised its policy rate by 25 basis points on 16 September 2026 to a target range of 3.75%–4.00%, responding to persistent inflation. Higher U.S. rates can support the dollar and tighten financial conditions globally as capital shifts toward dollar assets. Emerging markets may therefore face higher borrowing costs, weaker capital inflows and greater currency pressure, while companies with dollar-denominated debt or imported inputs may experience a direct increase in financing and operating costs.

Developing Economies Face a Historic Youth Employment Test

About 1.2 billion young people are expected to enter labor markets across developing economies over the next decade, creating an unprecedented need for productive and stable employment. Slower growth, higher living costs and economic uncertainty are already making the transition from education to work more competitive. Without faster job creation and better alignment between training and employer needs, underemployment and skills mismatches could persist even as businesses struggle to recruit workers with the capabilities required for new industries.

KEY INSIGHTS

Sri Lankan Economy

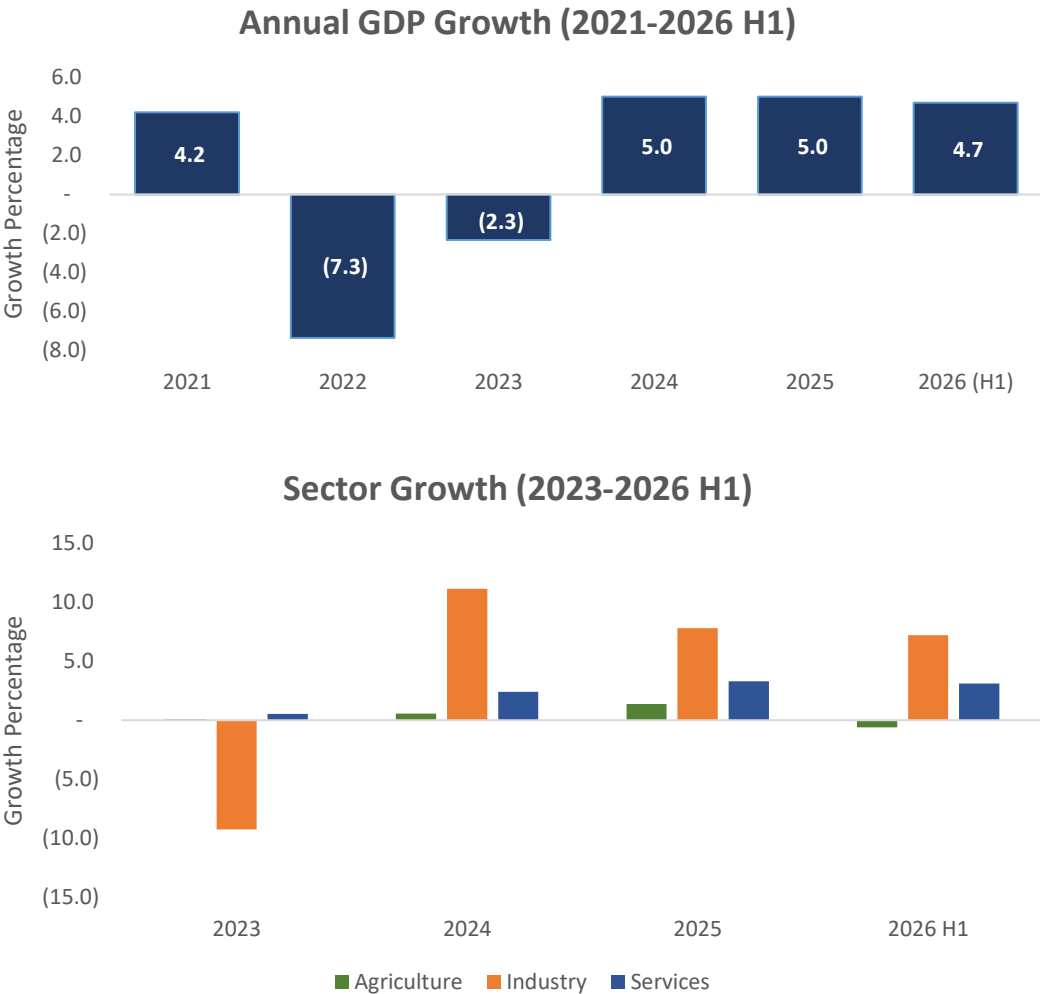
Q2 Economic Performance – 4.2% GDP Growth

Sri Lanka’s economy recorded **4.2% real GDP growth in Q2 2026**, with GDP at constant 2015 prices increasing to Rs. 3,029.8 billion from Rs. 2,908.6 billion in Q2 2025. At current prices, GDP increased by 11.3% to Rs. 8,254.2 billion. The growth performance was supported primarily by the industrial sector, while agriculture contracted and services recorded a more moderate expansion. The quarter was characterised by heightened uncertainty arising from escalating tensions in the Middle East, concerns over crude oil supply and subdued tourism performance. At the same time, increased imports supported the availability of raw materials and machinery for industrial activity.

Agricultural activities contracted by **2.3%**, compared with 2.5% growth in Q2 2025. The decline was largely driven by significant contractions in freshwater fishing and aquaculture (61.0%), rice cultivation (15.1%), sugar cane and tobacco (14.7%), and marine fishing and aquaculture (10.1%). Declines were also recorded in tea, rubber, plant propagation and other perennial crops. These were partly offset by stronger performance in forestry and logging (9.7%), spices (7.0%), oleaginous fruits (6.2%), cereals (5.2%) and fruits (1.9%).

Industrial activities expanded by **7.3%**, accelerating from 5.7% in Q2 2025 and emerging as the strongest-performing major sector. Construction grew by 13.9%, while mining and quarrying expanded by 17.4%. Manufacturing increased by 3.2%, supported by growth in wood products, non-metallic mineral products, furniture, machinery and equipment, and basic metals. Electricity, gas and air-conditioning supply also expanded by 6.8%.

Services grew by **2.7%**, slower than the 4.0% growth recorded in Q2 2025. Most service activities expanded, led by IT programming and consultancy (10.0%), insurance (8.0%) and financial services (7.7%). Telecommunications, real estate, transportation, accommodation and food services also recorded growth. However, public administration and defence contracted by 2.4%.



KEY INSIGHTS

Local Economy

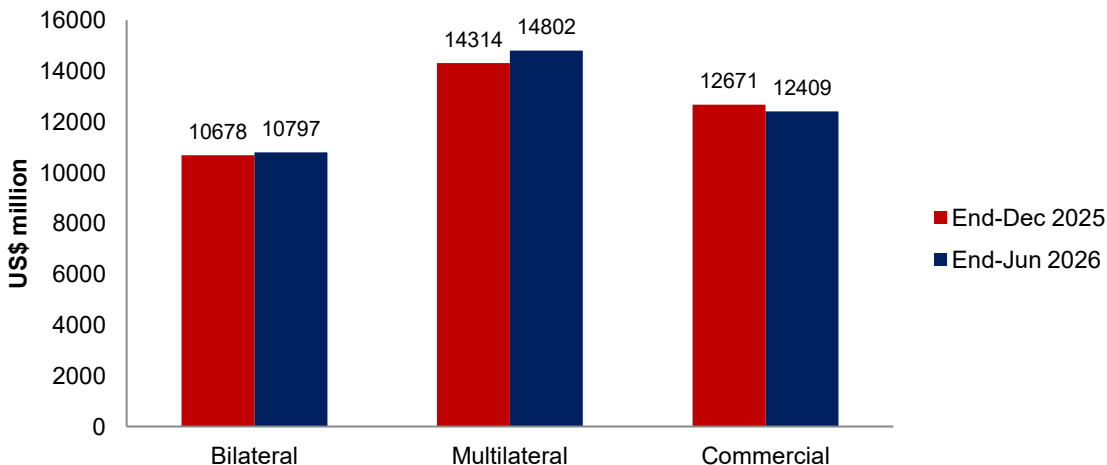
Sri Lanka External Debt Brief - Bilateral and Multilateral Loans Rise, Commercial Debt Falls in H1 2026

Sri Lanka's government external debt rose to US\$38,008 million by the end of June 2026, up US\$345 million (0.9%) from US\$37,663 million at the end of December 2025, according to the Public Debt Management Office's (PDMO) Q2 2026 Statistical Debt Bulletin. The composition of that debt shifted further toward concessional, official-sector financing and away from costlier commercial borrowing. Bilateral loans, led by China, rose 1.1% (up US\$119 million) to US\$10,797 million, from US\$10,678 million at end-2025. China remained by far the largest bilateral creditor, with US\$5.01 billion outstanding, followed by Japan at US\$2.27 billion and India at US\$853.9 million; non-Paris Club countries now account for 59% of bilateral debt against 41% for Paris Club nations.

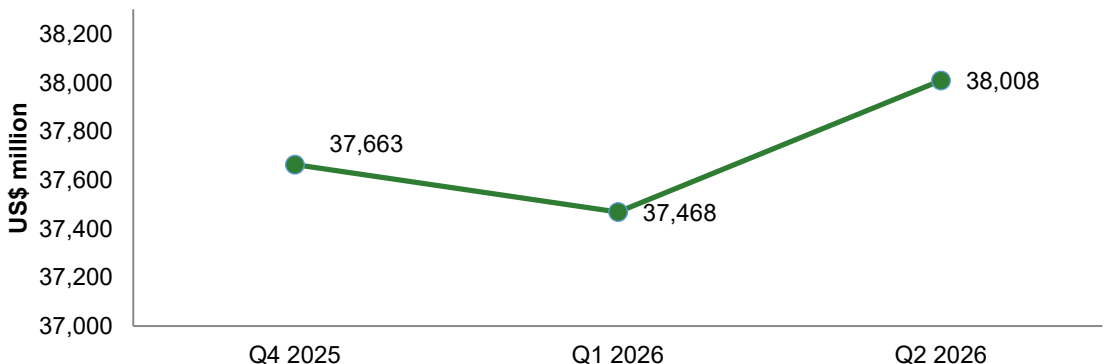
Multilateral loans grew faster, rising 3.4% (up US\$488 million) to US\$14,802 million, driven in part by a US\$687 million increase in IMF exposure. The Asian Development Bank and World Bank together still dominate this category, holding more than 78% of total multilateral debt. Commercial debt moved in the opposite direction, falling 2.1% (down US\$262 million) to US\$12,409 million, continuing the steady drawdown that followed Sri Lanka's 2022 default and subsequent restructuring. About 81% of that remaining commercial debt consists of International Sovereign Bond issuances, with the rest in foreign-currency term financing facilities. By share of the total, multilateral debt now makes up 38% of external government debt, commercial debt 34%, and bilateral debt 28%. Quarter-on-quarter, the pattern was uneven: Q1 2026 saw external debt tick down by a nominal US\$195 million, before Q2 2026 added US\$540 million, pushing the total back above US\$38 billion.

The figures are, as of end-June 2026, are the latest official external debt data available. The PDMO publishes the Statistical Debt Bulletin quarterly, with a roughly two-month lag after each quarter closes (the Q2 2026 bulletin, covering data to June 30, was issued August 28, 2026). Based on the PDMO's established publication pattern, the Q3 2026 bulletin is expected around late November 2026.

External Debt by Creditor Type (US\$ million)



Total External Debt, Quarterly Trend (US\$ million)



KEY INSIGHTS

Global Economy

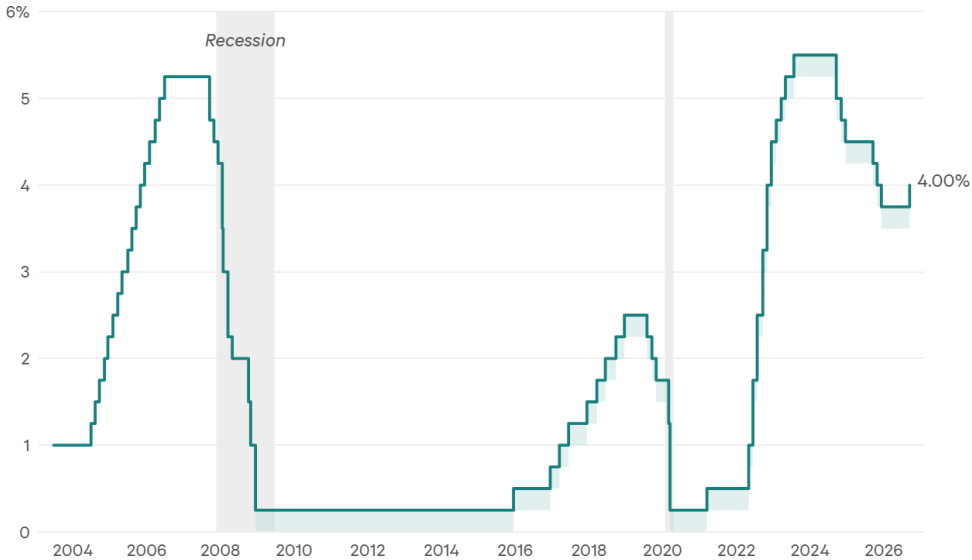
Federal Reserve Returns to Tightening as Inflation Pressures Persist

The U.S. Federal Reserve delivered its first interest rate hike in more than three years on 16 September 2026, raising the federal funds rate by 25 basis points to a target range of 3.75% to 4.00%. The decision, approved unanimously by the Federal Open Market Committee (FOMC), marks a significant shift in monetary policy after rates had remained unchanged since 2023. The rate hike was primarily driven by persistent inflation, which continues to exceed the Fed's long-term target of 2%. While the U.S. economy remains resilient, supported by robust consumer spending, strong productivity growth, and a healthy labour market, policymakers judged that inflationary pressures, exacerbated by rising energy prices and geopolitical tensions, required a firmer policy response. Fed Chair Kevin Warsh noted that inflation has been “too high for too long,” underscoring the central bank's commitment to restoring price stability.

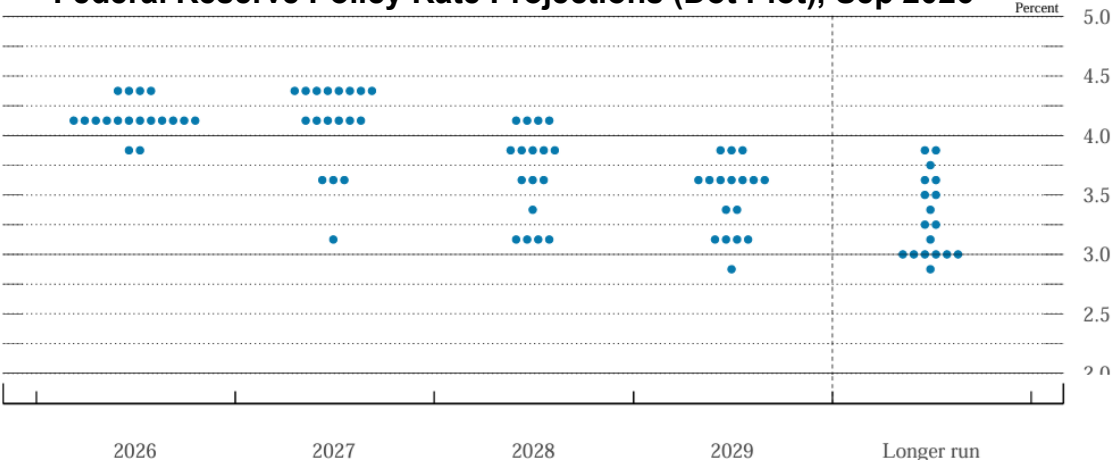
A notable fact is that this was the first Fed rate increase since July 2023, ending a three-year pause in tightening. Markets had largely anticipated the move, but the accompanying projections were more revealing. The Fed's latest "dot plot" suggests that most policymakers expect at least one additional rate hike before the end of 2026, as the median projection lies between 4.00% and 4.25%. For the global economy, higher U.S. interest rates typically strengthen the U.S. dollar and tighten global financial conditions. Emerging and frontier economies often face increased borrowing costs, lower capital inflows, and greater currency pressures as investors shift funds towards U.S. assets offering higher returns.

For Sri Lanka, the implications are mixed. A stronger dollar could increase the cost of servicing external debt and place downward pressure on the rupee. Higher global financing costs may also complicate access to international capital markets. However, stronger U.S. economic growth, which partly motivated the Fed's decision, could support global demand and trade flows, benefiting export-oriented economies over the medium term. Investors will now turn their attention to the next FOMC meeting scheduled for 27-28 October 2026, where markets will assess whether the Fed maintains its current stance or signals further tightening.

The Fed raises rates for the first time since 2023



Federal Reserve Policy Rate Projections (Dot Plot), Sep 2026



KEY INSIGHTS

Global Economy

Asia's Graduate Employment Crisis: Closing the Skills Gap in an AI-Driven Economy

As developing economies navigate a period of technological transformation, a growing challenge is emerging beneath the surface of labor markets: the increasing difficulty faced by young graduates in securing employment that matches their qualifications. A recent article published in the September 2026 edition of the IMF's Finance & Development magazine highlights how a record number of young people are entering the workforce at a time when rapid technological change, particularly the adoption of artificial intelligence (AI), is reshaping the demand for skills across industries.

According to the article, approximately 1.2 billion young people are expected to enter labor markets across developing economies over the next decade, representing the largest youth cohort ever recorded. At the same time, many economies are experiencing slower growth, higher living costs, and increased economic uncertainty, creating a more competitive job market for new entrants. One of the most striking findings is the growing mismatch between educational attainment and labor market outcomes. Across Asia, unemployment rates among young people with post-secondary education are often higher than those of the broader population. The challenge is particularly evident in South Asia, where unemployment among educated youth ranges from around 36% in Bangladesh to 43% in Sri Lanka. The IMF notes that many highly educated young workers are struggling to find positions that align with their qualifications and skills.

While AI and automation hold significant potential to enhance productivity and economic growth, they are also transforming the nature of entry-level work. Tasks traditionally assigned to junior employees are increasingly being automated, raising concerns about how young professionals will gain practical experience and enter the workforce. However, technological progress does not necessarily imply fewer jobs. Evidence cited in the article suggests that productivity-enhancing technologies can also stimulate investment, support business expansion, and create new forms of employment.

For the private sector, this presents both a challenge and an opportunity. As businesses accelerate digital transformation, there is a growing need for workers who combine technical competencies with adaptable skills such as critical thinking, problem-solving, communication, and digital literacy. Employers, educational institutions, and policymakers will therefore need to collaborate more closely to ensure that curricula, vocational training, and reskilling programs remain responsive to evolving industry demands.

As Sri Lanka seeks to strengthen its competitiveness and attract investment, addressing the gap between education outcomes and labor market needs will be critical. The future workforce must not only be qualified but also equipped with the skills required to thrive in an increasingly technology-driven economy.

Unemployment Rates by Education Level and Age Group Across Selected Asian Economies



EVOLVING LANDSCAPE

Evolving Global Geopolitical Landscape: Implications for Sri Lanka's Private Sector

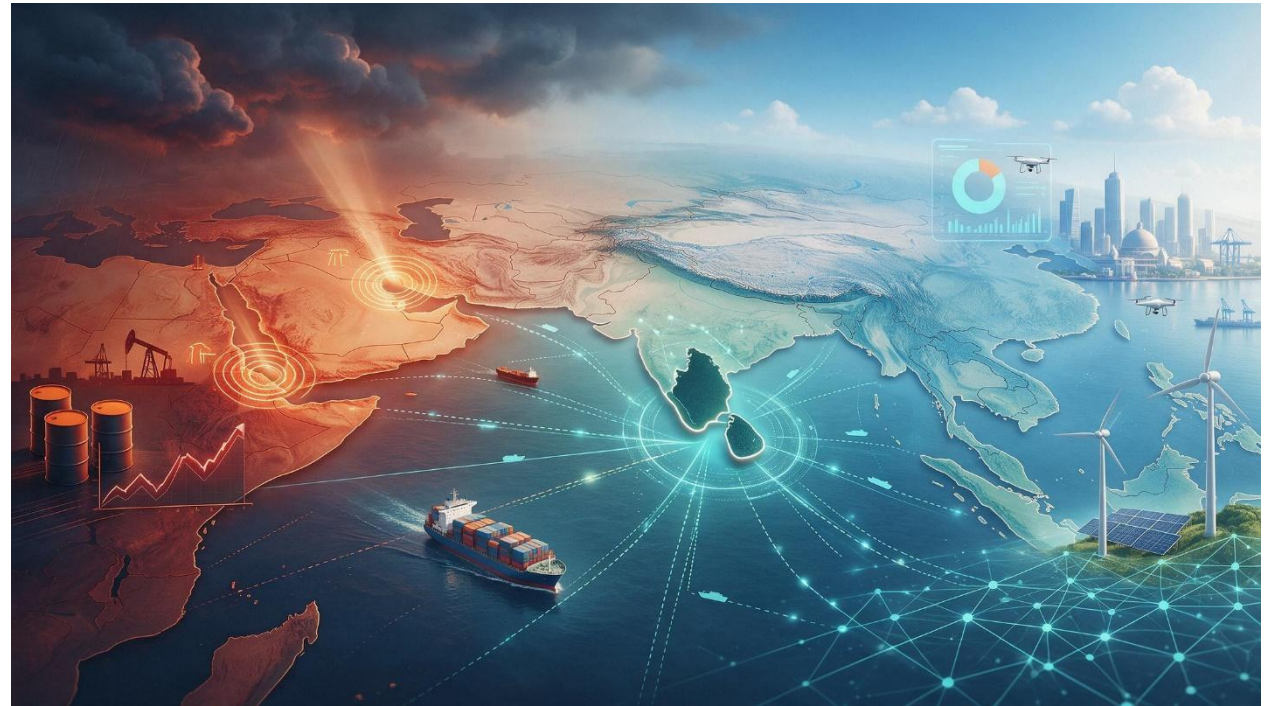
As at 21 September 2026, the global economic environment is being reshaped by intensifying geopolitical tensions, particularly in the Middle East, disruptions around the Strait of Hormuz and growing insecurity near the Bab el-Mandeb and Red Sea. These developments threaten critical energy and maritime trade routes, increasing risks to oil, LNG, fertiliser, food commodities, shipping insurance and freight costs. Trade tensions between the United States and China are also placing agriculture, energy and strategic minerals at the centre of wider economic competition.

For Sri Lanka, these developments create renewed external-sector vulnerabilities. Higher energy and freight costs could increase import expenditure, production costs and consumer prices, while longer shipping routes may affect delivery schedules and export competitiveness. The Central Bank reported that Sri Lanka's merchandise trade deficit widened to USD 6.5 bn during Jan–July 2026, compared with USD 3.9 bn during the same period in 2025. Tourism earnings declined by 11.5% y-o-y to approx. USD 1.8 bn, although workers' remittances increased by 21.4% to USD 5.4 bn.

The private sector should therefore prioritise long term resilience over short-term cost minimisation. Importers and manufacturers should review inventory levels, supplier concentration, freight contracts, insurance coverage and foreign-exchange exposure.

Exporters should diversify markets, strengthen compliance and explore higher-value products less vulnerable to freight volatility. Businesses dependent on fuel, packaging, fertiliser or imported inputs should prepare scenario-based budgets using alternative price and exchange-rate assumptions.

At the same time, opportunities may emerge for Sri Lankan logistics, maritime services, renewable energy, ICT-enabled trade facilitation, food processing and regional supply-chain partnerships. Stronger engagement with India, the Gulf, ASEAN and African markets could reduce dependence on traditional routes and buyers. In this evolving landscape, disciplined cash-flow management, market diversification and timely intelligence will be essential for protecting competitiveness and sustaining private-sector growth.



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