

TAX CUTS
2019



FISCAL DRAIN
EMPTY RESERVES



MACROECONOMIC INDICATOR DYNAMICS

THROUGHOUT

SRI LANKA'S CRISIS PERIOD

AND FUTURE PREDICTIONS

US-IRAN WAR
GEOPOLITICAL TENSIONS
OIL PRICE SURGE
GLOBAL UNCERTAINTY

**EXPORTS
PARALYZED**

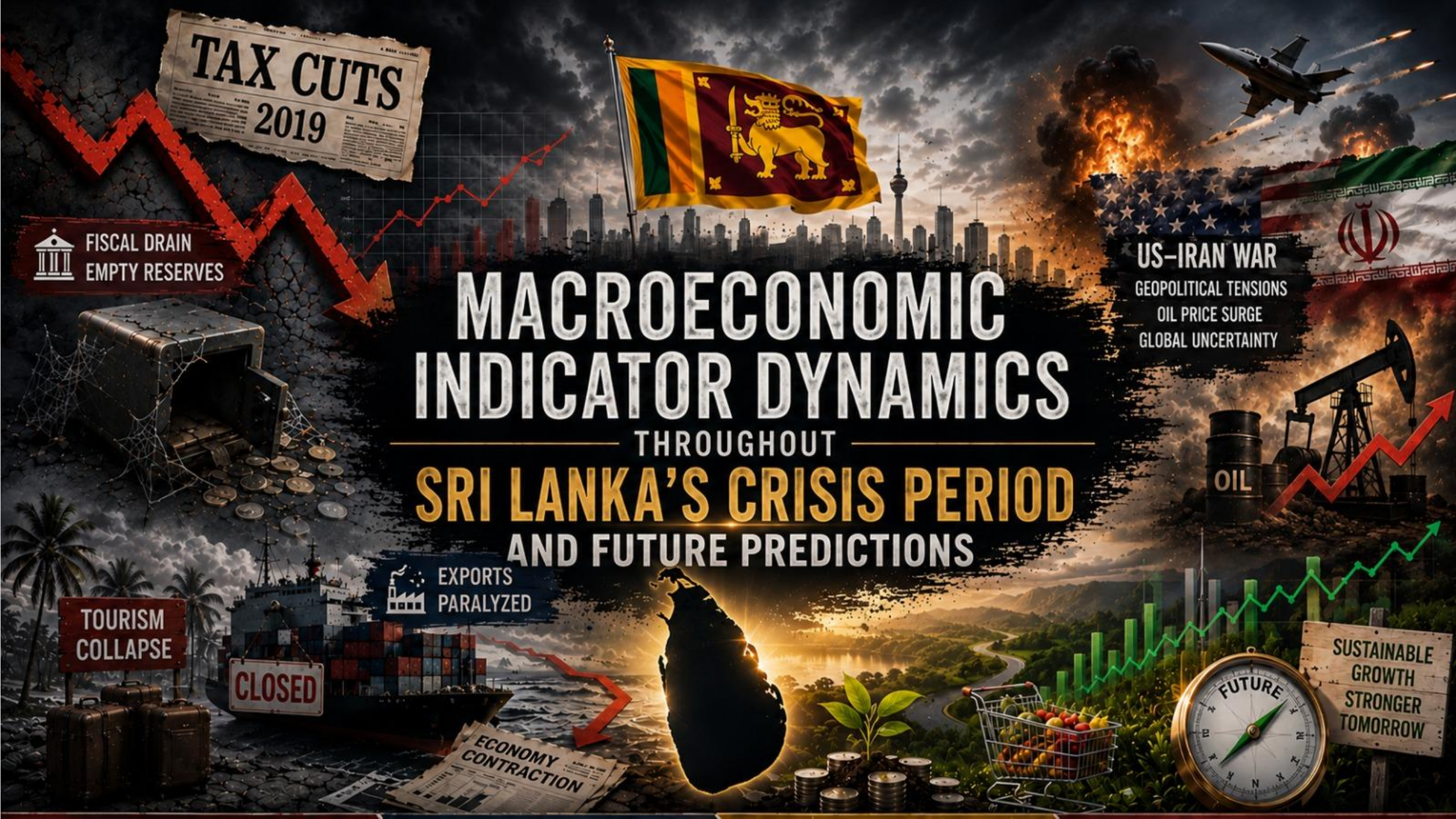
**TOURISM
COLLAPSE**

CLOSED

**ECONOMY
CONTRACTION**



**SUSTAINABLE
GROWTH
STRONGER
TOMORROW**

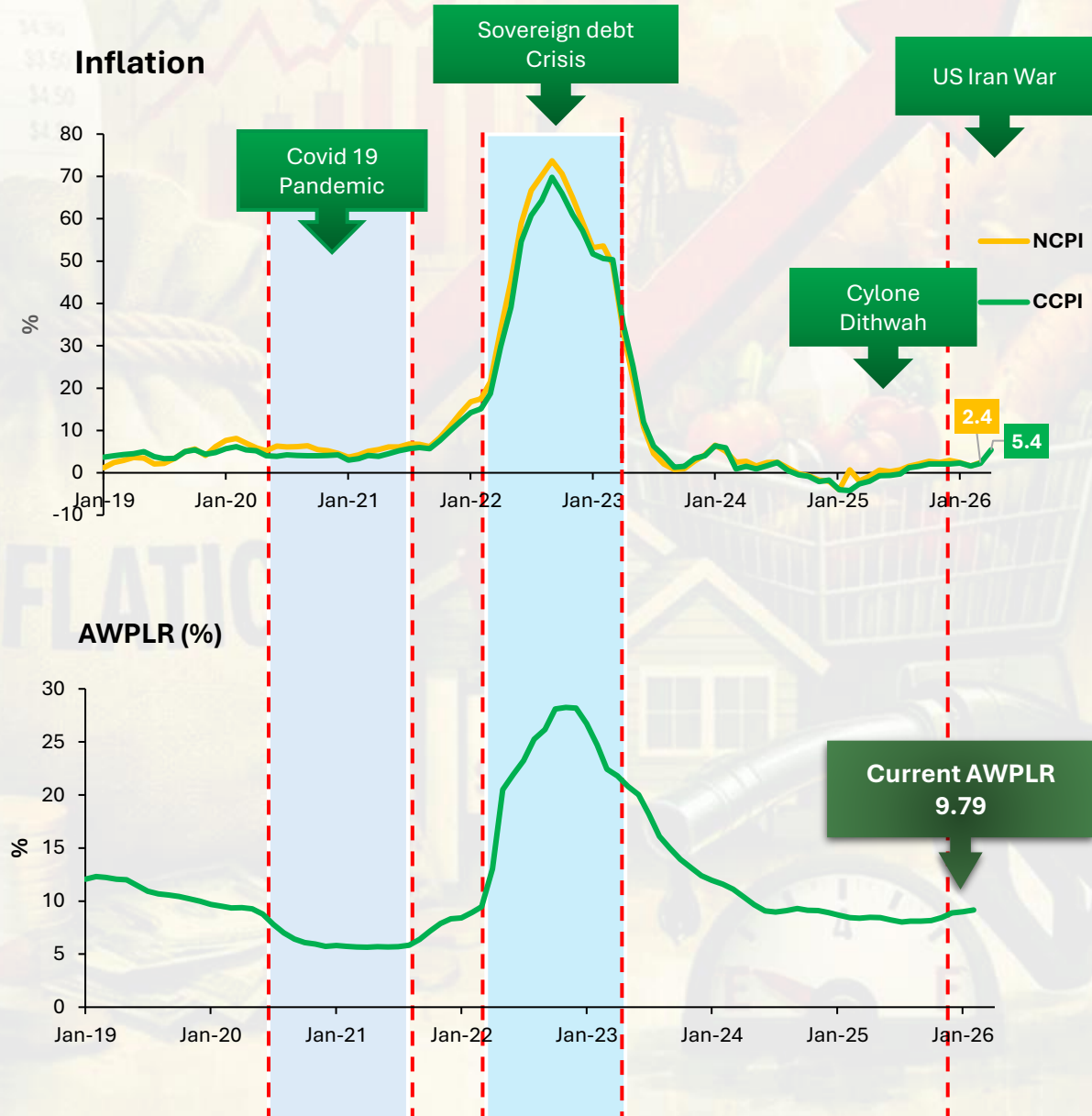


Macroeconomic Indicator Dynamics Throughout Sri Lanka's Crisis Periods

Sri Lanka's crisis period clearly demonstrates a strong macroeconomic link between the exchange rate, inflation, and interest rates. From 2020 onwards, declining foreign reserves and weak Foreign Exchange (FX) inflows caused a sharp depreciation of the rupee, which significantly increased import costs in the highly import-dependent economy. This triggered a rapid surge in inflation, which peaked above 70% during the 2022 sovereign debt crisis. In response, the Central Bank (CBSL) implemented aggressive monetary tightening, pushing the Average Weighted Prime Lending Rate (AWPLR) above 28% to control inflation and stabilize the currency. As International Monetary Fund (IMF) -supported reforms improved reserves and confidence, inflation moderated, the exchange rate stabilized around LKR 300, and interest rates gradually declined confirming the strong and cyclical relationship among these three variables.

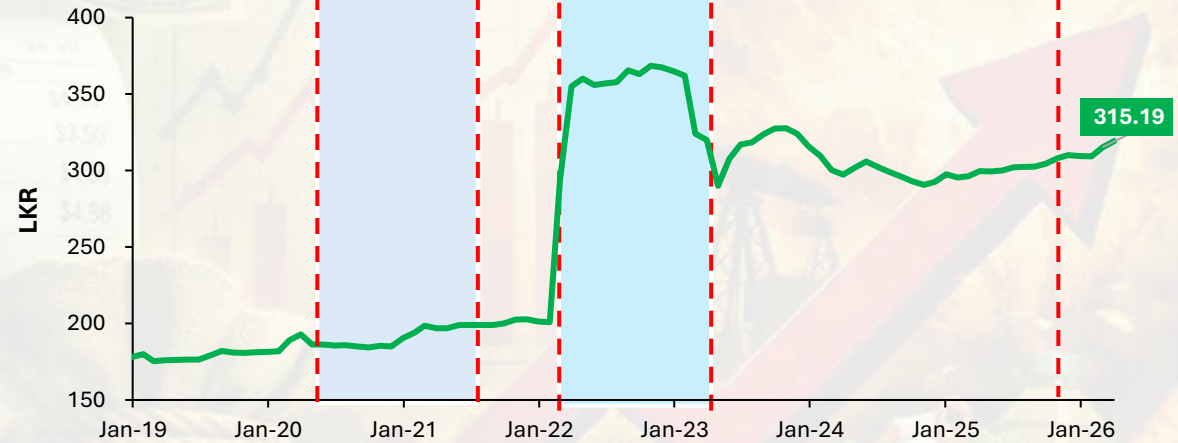
Macroeconomic Indicator Dynamics Throughout Sri Lanka's Crisis Periods

Sri Lanka experienced major economic shocks from 2020 onwards due to the COVID-19 pandemic, the 2022 sovereign debt crisis, and currently Sri Lanka is facing global geopolitical tensions, which significantly affected inflation, interest rates, and exchange rate stability in the country. Inflation rose sharply due to supply chain disruptions, currency depreciation, fuel shortages, and higher import costs, while AWPLR initially declined during the pandemic due to expansionary monetary policies but increased significantly in 2022 following aggressive interest rate hikes to control inflation.

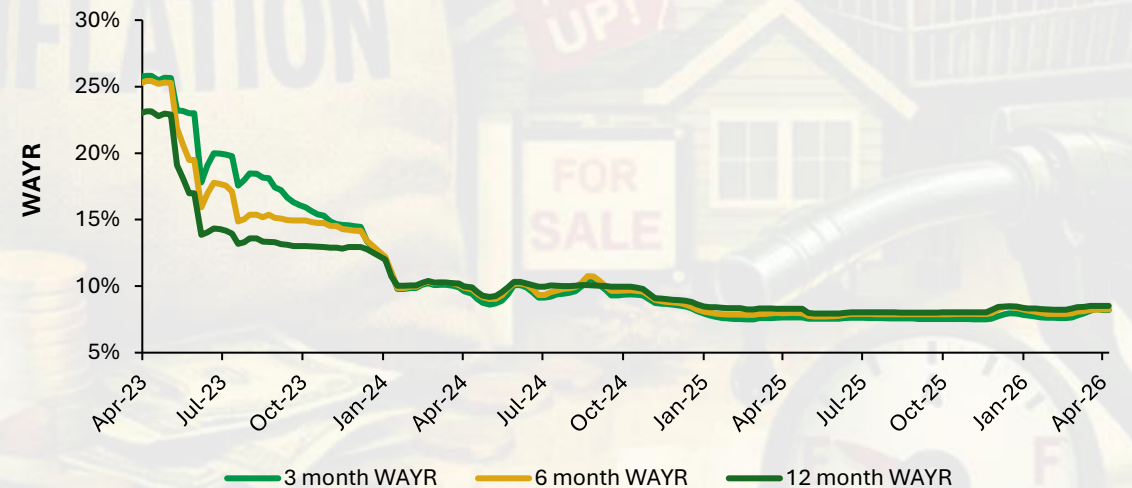


The Sri Lankan Rupee had also been depreciating sharply due to weak foreign exchange inflows and reserve shortages. During the post-sovereign debt-crisis period, inflation and interest rates gradually moderated, supported by IMF backed reforms and improved foreign reserve management, although economic vulnerabilities remained.

Exchange Rate



Weighted Average Yield Rates (WAYR)





Covid 19 Period



Fluctuation of Key Economic Indicators – Covid 19 Period

In late 2019, tax cuts were introduced to boost economic growth, but they significantly reduced government revenue. By the time COVID-19 began in March 2020, the country's fiscal position was already weak, with limited reserves to manage the crisis.

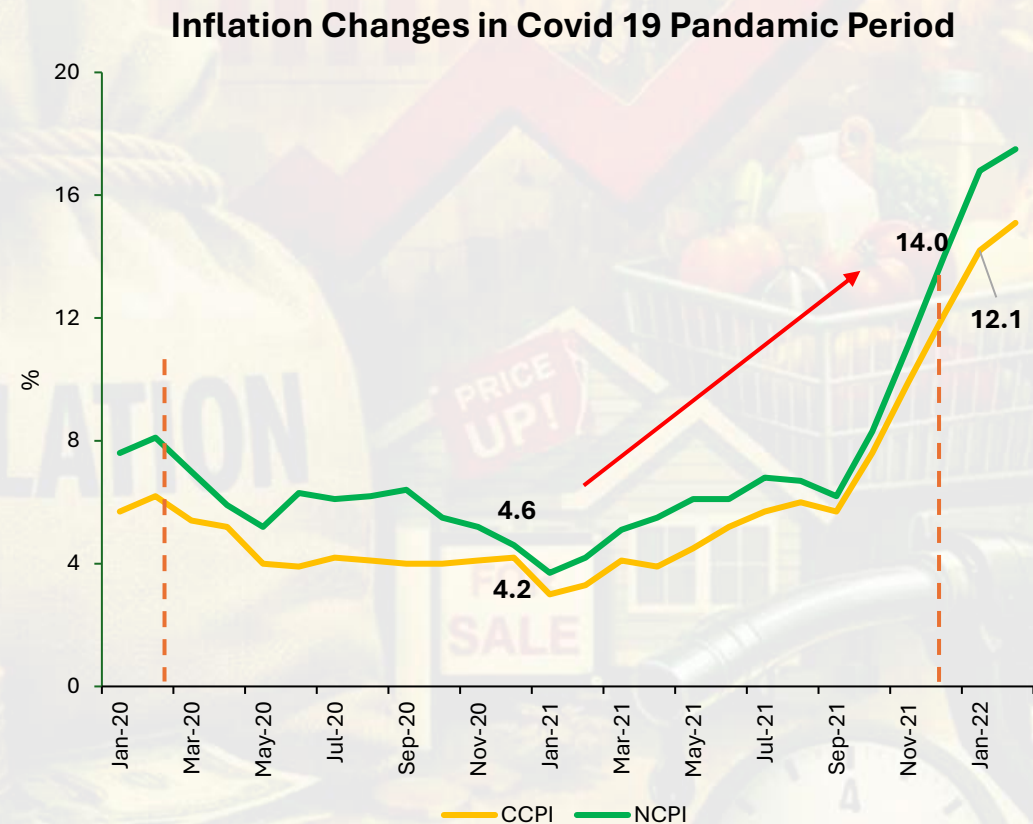
The pandemic severely impacted the economy, especially tourism and export industries. Tourism collapsed due to travel restrictions, while exports were disrupted by lockdowns and global supply chain issues, leading to a sharp economic contraction.

In response, the CBSL implemented emergency measures, including lowering interest rates and injecting liquidity into the financial system. These actions aimed to support businesses, maintain financial stability, and ensure continued money flow during the lockdown period, helping the economy survive the crisis.

Fluctuation of Key Economic Indicators – Covid 19 Period

Inflation

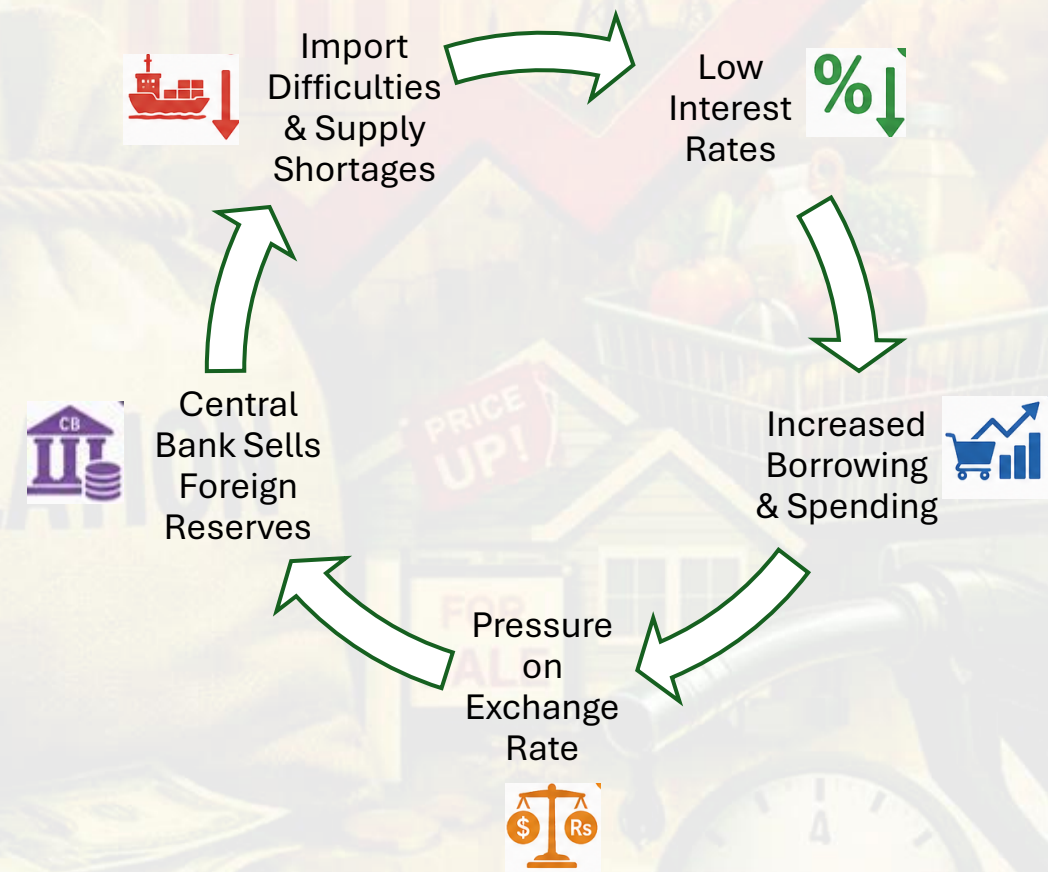
Inflation stayed fairly low and stable during 2020, but it began rising quickly toward the end of 2021. The Colombo Consumer Price Index (CCPI) increased from 4.2% in December 2020 to 12.1% by December 2021, while the National Consumer Price Index (NCPI) rose even higher to 14.0%. This shows how price pressures built up significantly over the year, affecting the overall cost of living.



Fluctuation of Key Economic Indicators – Covid 19 Period

Inflation

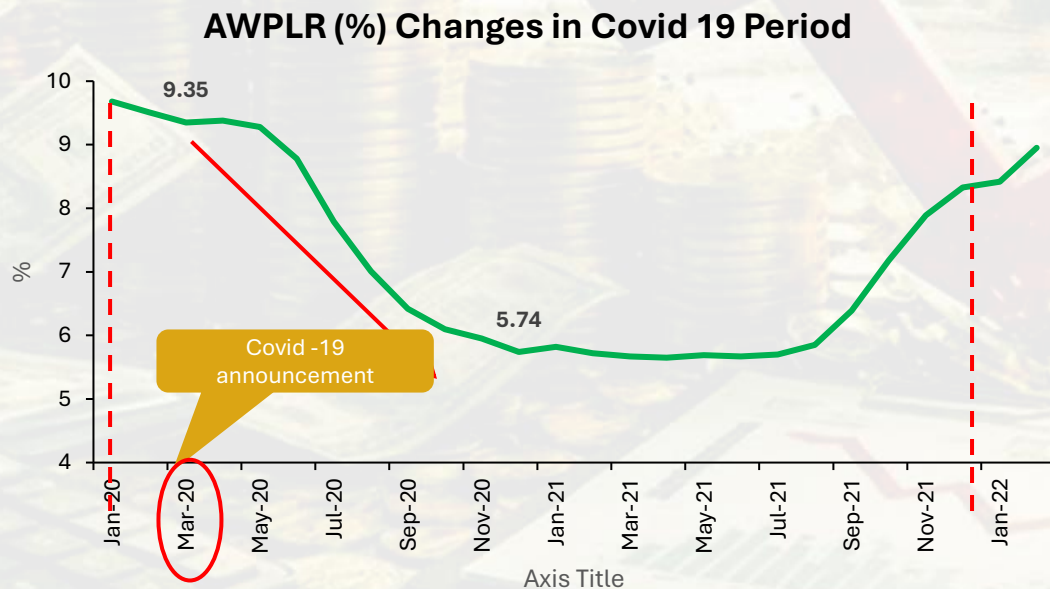
The economy entered a self-reinforcing negative cycle where each policy outcome intensified the next problem. Low interest rates increased borrowing and spending, which pushed up demand. To control the exchange rate, the CBSL sold foreign reserves, but this gradually depleted its buffer. As reserves fell, the country struggled to import enough goods, creating supply shortages.



Fluctuation of Key Economic Indicators – Covid 19 Period

Interest Rates

AWPLR dropped from 9.35% to 5.74% by December 2020



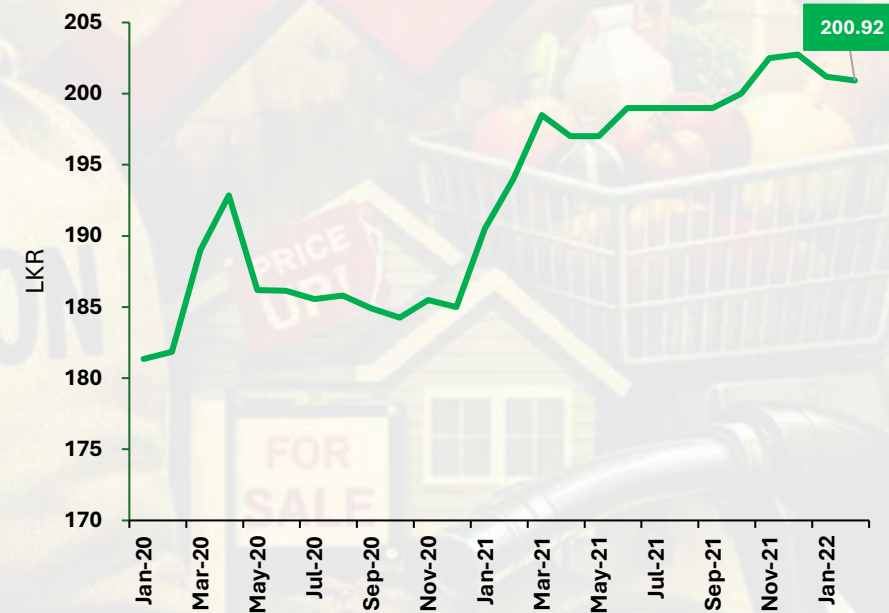
After the COVID-19 pandemic hit, the CBSL sharply reduced interest rates to encourage people and businesses to borrow and spend more money in the economy. As a result, the AWPLR dropped from 9.35% in March 2020 to a record low of 5.74% by December 2020. The government also introduced special loan schemes like the “Saubagya” program, which offered loans at a very low 4% interest rate to support businesses and economic activity during the crisis.

Fluctuation of Key Economic Indicators – Covid 19 Period

Exchange Rate

In 2021, the CBSL tried to keep the exchange rate stable. To maintain a stable exchange rate, it repeatedly sold foreign currency from its reserves into the market whenever demand for dollars increased, in order to prevent the rupee from depreciating further. To reduce the pressure on foreign currency reserves, the government placed restrictions on importing non-essential goods, aiming to limit how much foreign exchange was leaving the country. However, despite these controls, very low interest rates and growing consumer spending kept import demand high, which in turn increased the need for US dollars and continued to strain the foreign exchange market.

Exchange Rate Changes in Covid 19 Period





Sovereign debt crisis



Fluctuation of Key Economic Indicators – Sovereign debt crisis

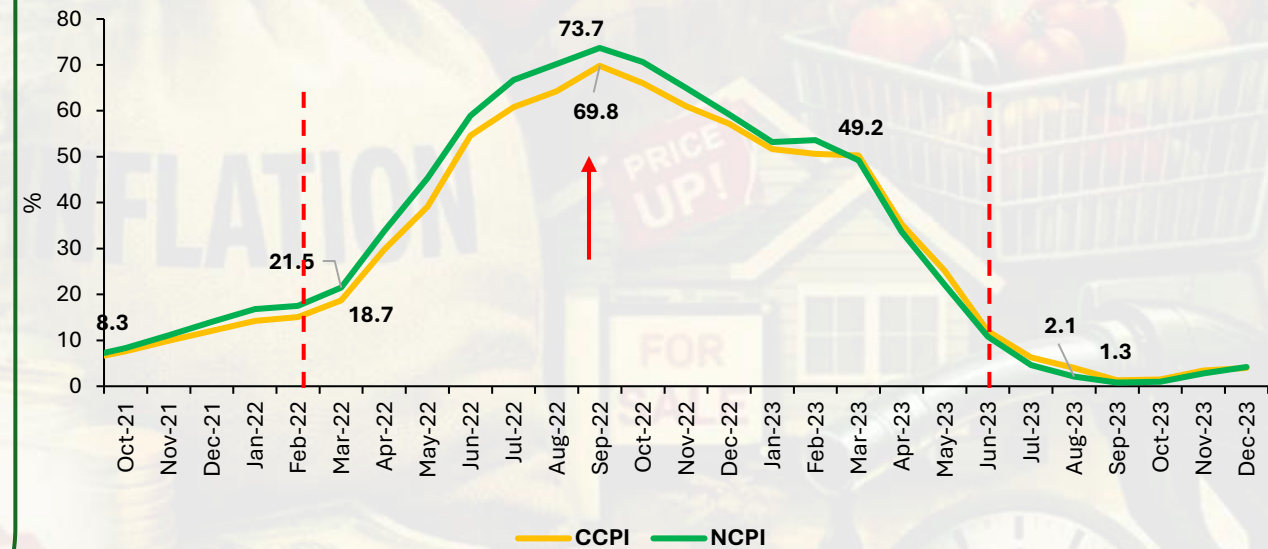
Inflation

Sri Lanka's economy entered a deep crisis in 2022, with record fiscal deficits financed by CBSL printing and domestic borrowing. This "financial repression" kept interest rates artificially low, fueling demand and inflation.

CCPI inflation hit 70% mid 2022 and fell to 1.3% by Sep 2023. By end-2023, headline inflation was 4% (2021=100 base). The decline was aided by very tight monetary and fiscal policy from mid 2022, normalizing supply conditions, lower commodity prices, and the stronger rupee.

Historically Highest Inflation Recorded in 2022.
2022 September CCPI = 69.8 & NCPI = 73.7

Inflation changes of 2022 crisis period in Sri Lanka

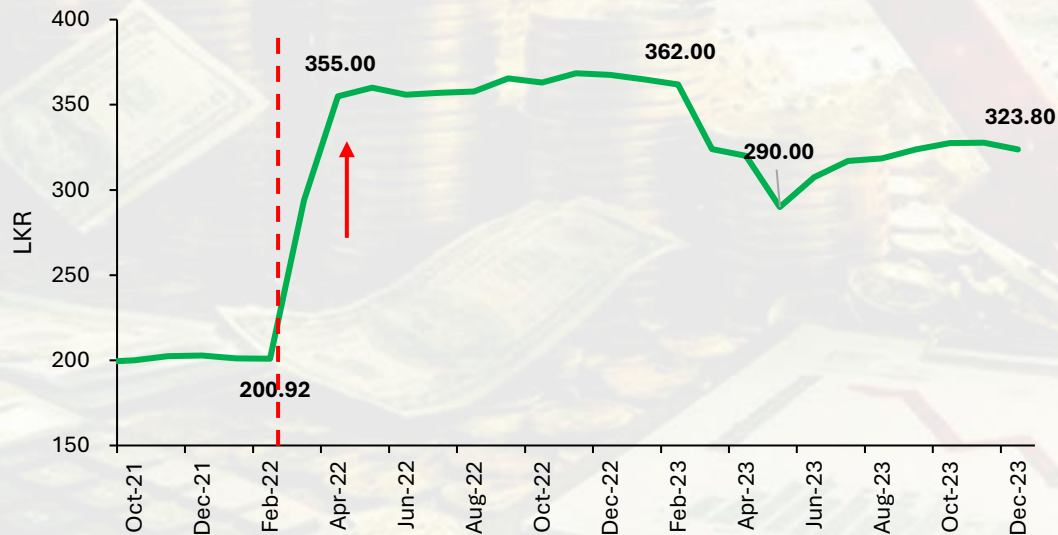


Fluctuation of Key Economic Indicators – Sovereign debt crisis

Exchange Rate Pressures

2022 November Exchange rate = 368.50

Exchange Rate changes of crisis period in Sri Lanka



Until March 2022, the rupee was tightly managed. With reserves near exhaustion, authorities allowed the rupee to float in Mar 2022 . The resulting depreciation immediately fed into inflation.

The rupee fell from 200 in late-2021 to 368 per USD by end-2022 (-45%). In mid-2022 the CBSL introduced a daily exchange rate guidance band (May 2022–Mar 2023) to avoid further volatility .

By 2023, increased forex inflows (exports, remittances, MDB financing) and improved sentiment led to rupee appreciation. The rupee rose 24.8% by June 2023.

Fluctuation of Key Economic Indicators – Sovereign debt crisis

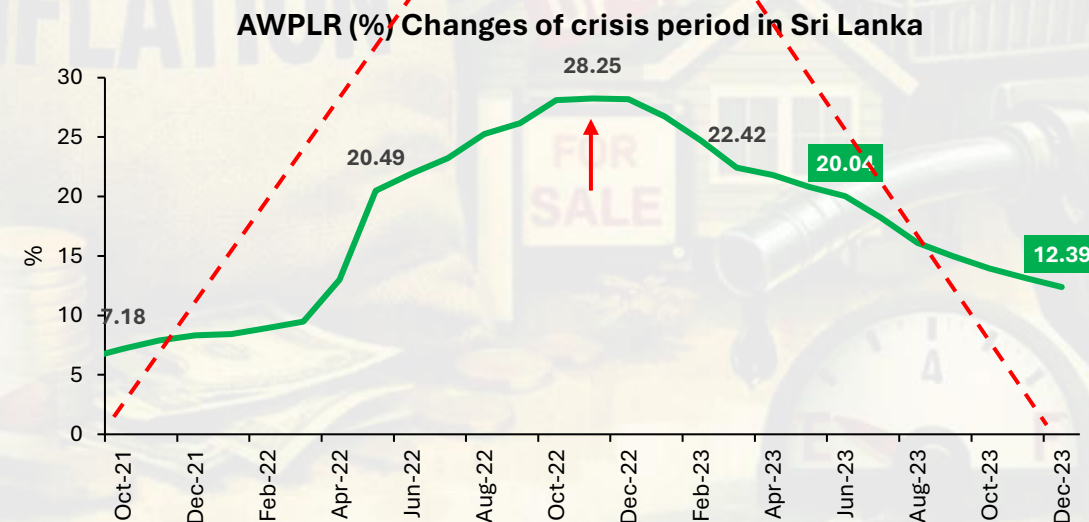
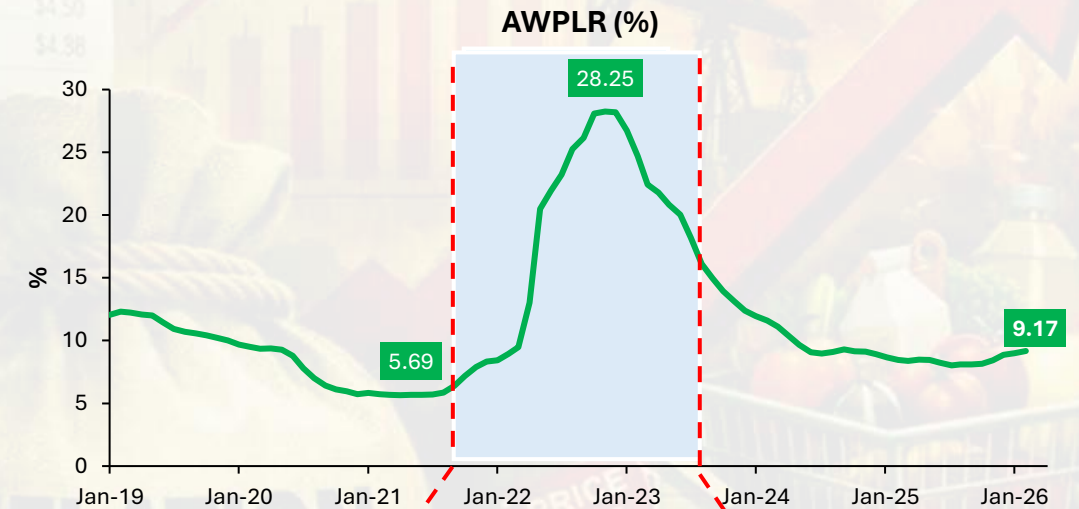
Interest Rates and Financial Repression

AWPLR rose slowly showing early signs of stress, but the economy was still stable.

Things changed quickly in March 2022. AWPLR jumped from 9.47% to over 20% by May, reflecting the start of the crisis. At this point, the depreciation of exchange rate pushed import prices up, which fueled inflation and made the situation worse in a feedback loop.

The worst came in late 2022, when it peaked at 28.25%. Inflation stayed very high, and the weaker currency kept adding pressure across the economy.

From early 2023, things slowly improved, falling to around 20% by June. This shows that stabilization measures started working, but inflation and currency pressure were still high, so the recovery was only partial.





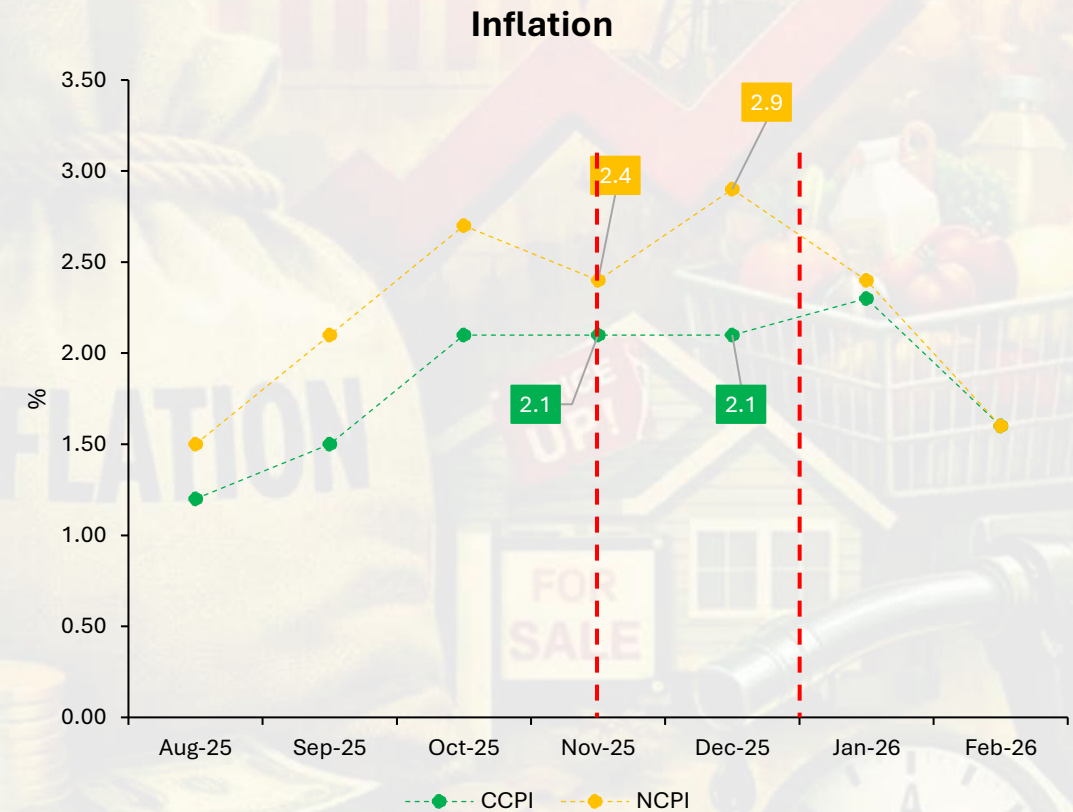
Cyclone Dittwah Period



Fluctuation of Key Economic Indicators – Cyclone Ditwah Period

Inflation

During the Cyclone Ditwah disaster period, Sri Lanka experienced a short-term economic shock mainly through supply disruptions and infrastructure damage. NCPI and CCPI both increased temporarily due to reduced agricultural output, food shortages, and higher transportation and distribution costs, leading to moderate inflation in essential goods.

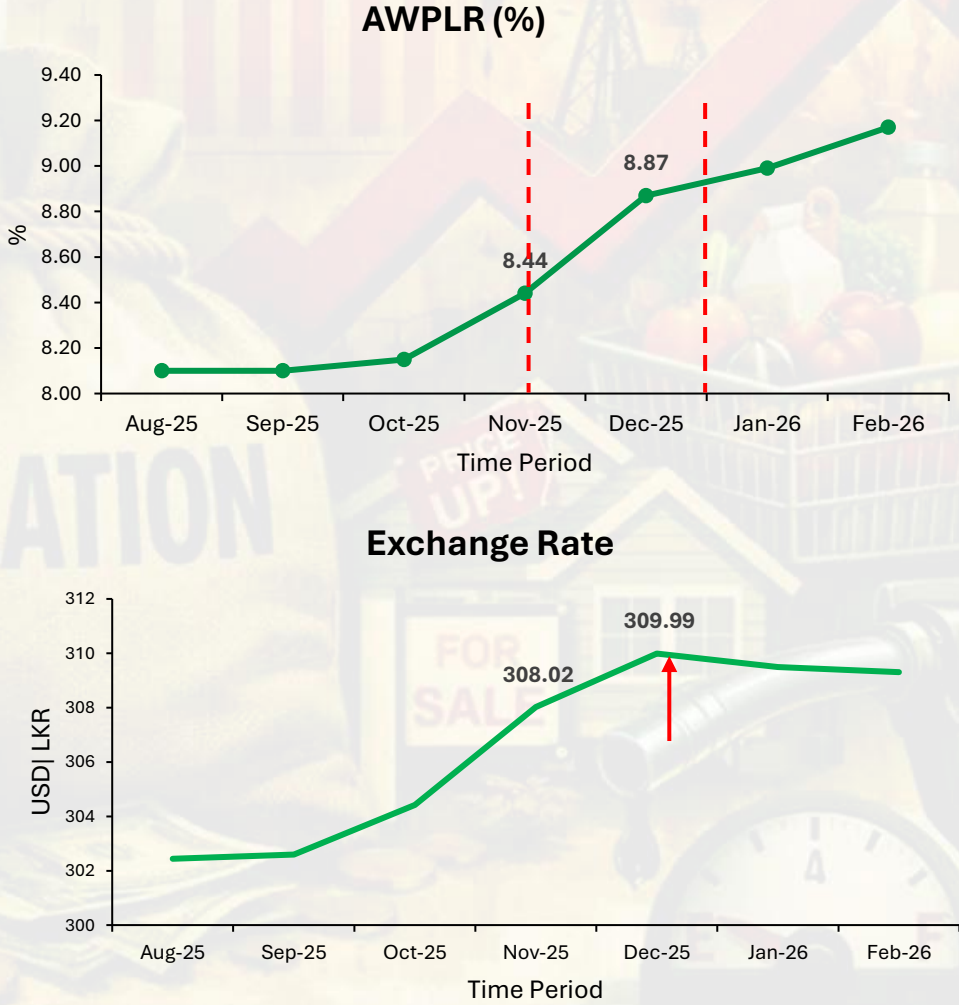


Fluctuation of Key Economic Indicators – Cyclone Ditwah Period

Interest Rates and Exchange rates

AWPLR remained largely stable, with only slight upward pressure due to short-term risk perceptions and liquidity needs in affected sectors, while the exchange rate showed mild depreciation due to increased import demand for reconstruction materials.

Overall, the impact was temporary and less severe compared to major economic crises, with effects mainly concentrated on inflation and supply-side disruptions.





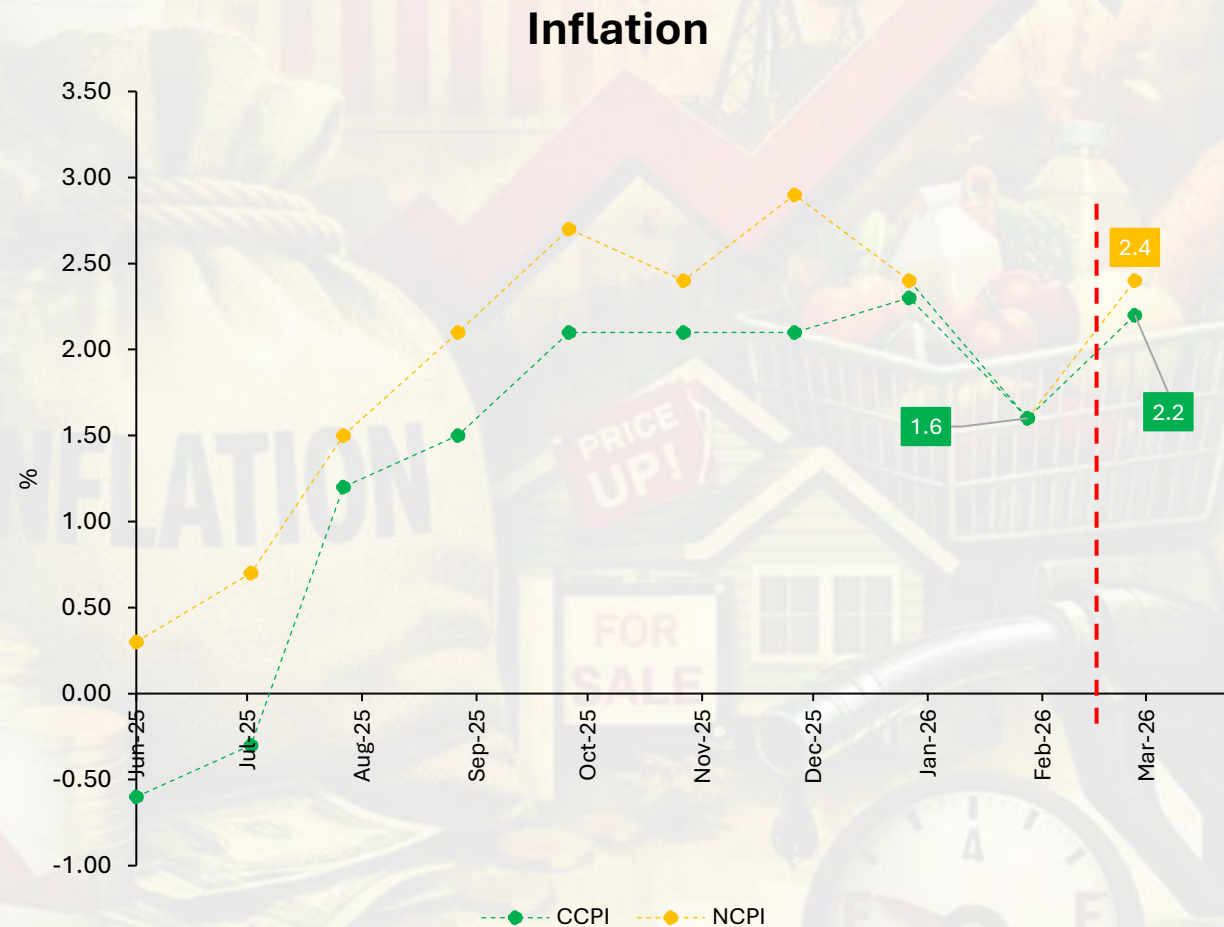
US Iran war Period



Fluctuation of Key Economic Indicators – US Iran War Period

Inflation

During the US–Iran geopolitical tension period, Sri Lanka experienced moderate but persistent macroeconomic pressure mainly through global oil price volatility and imported inflation. NCPI and CCPI showed a gradual upward movement due to higher fuel and food import costs, which increased overall inflationary pressure in the economy. However, the increase was not as sharp as the 2022 Sovereign debt crisis, but rather a steady inflationary trend driven by external cost-push factors.

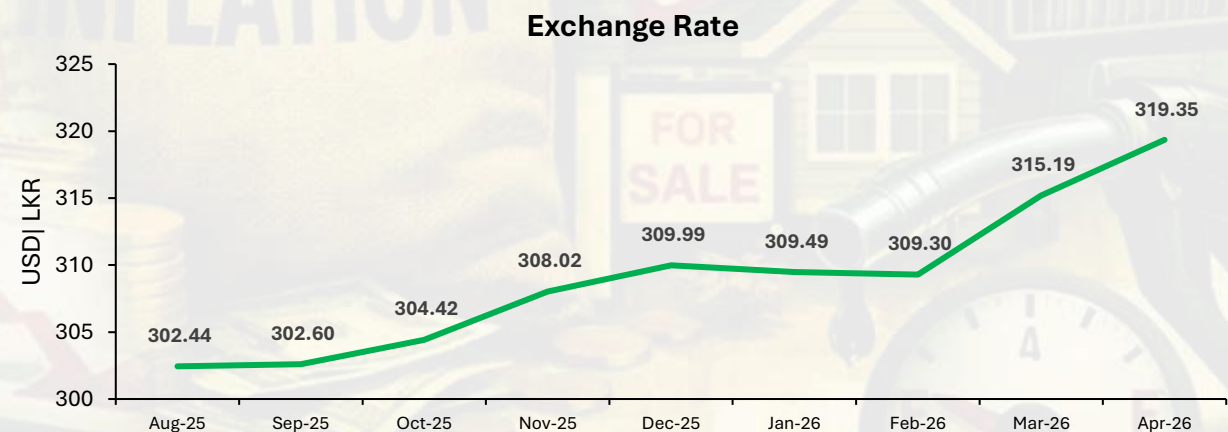
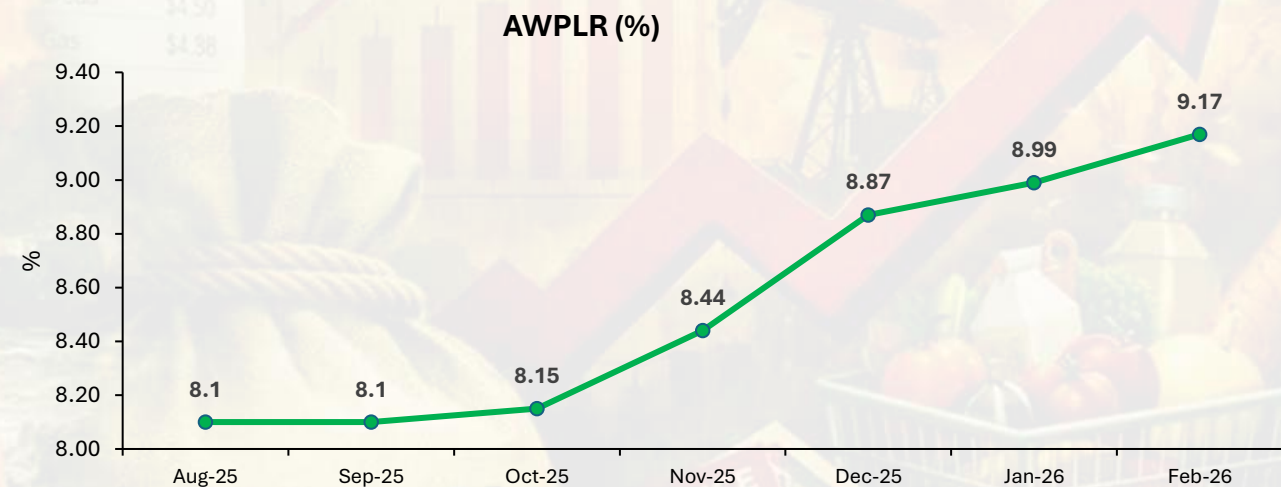


Fluctuation of Key Economic Indicators – US Iran War

Interest Rates and Exchange Rates

AWPLR remained relatively stable to slightly easing in line with the post Sovereign debt crisis, although banks remained cautious due to global uncertainty and inflation expectations.

Meanwhile, the exchange rate showed mild depreciation pressure due to higher import bills and oil price fluctuations, but overall volatility was contained compared to the Sovereign debt crisis period, supported by improved reserves and IMF-backed stabilization policies.

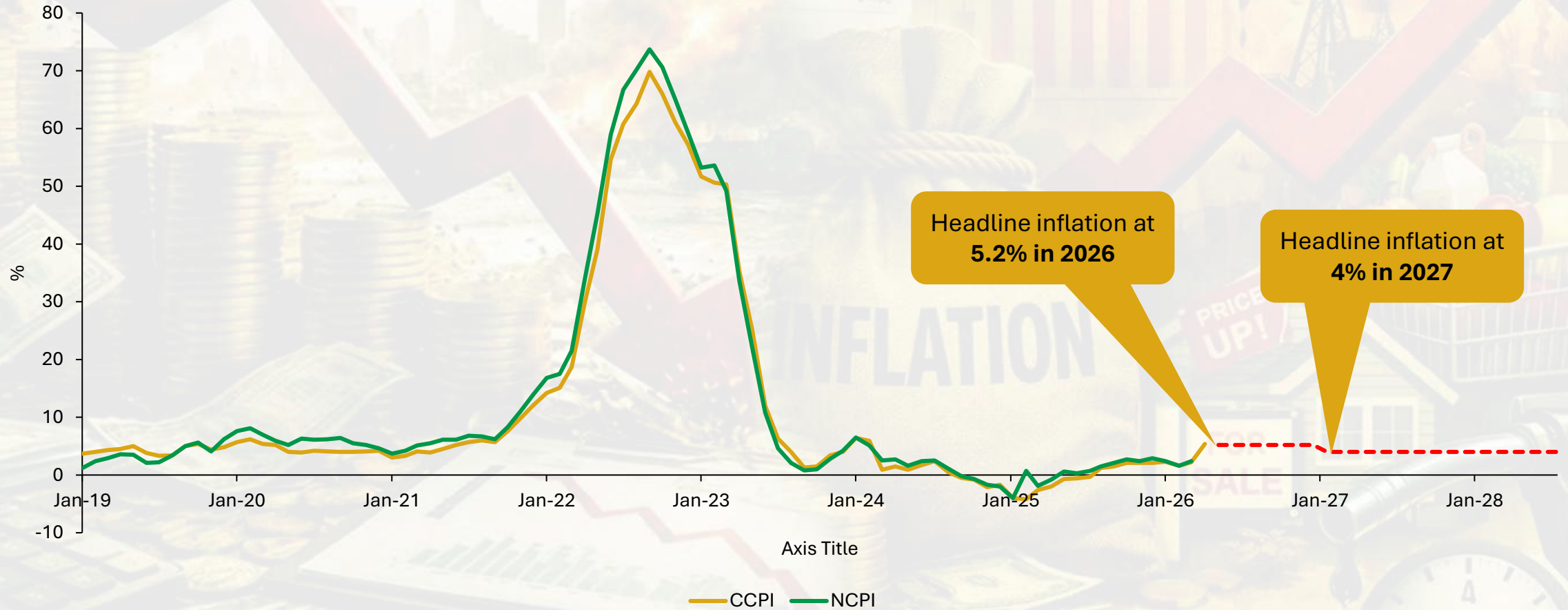




Future Predictions



The Asian Development Bank (ADB) Projects Headline Inflation



Future Projetcion



Based on April 2026 IMF and regional data, Sri Lanka's inflation is expected to remain relatively stable, having recovered from deflationary pressures in 2024. ADB projects headline inflation at **5.2% in 2026** and **4% in 2027**. While inflationary pressures are stabilizing, the IMF warns that the economy remains vulnerable to external shocks. supported by improved reserves and IMF-backed stabilization policies. Based on IMF reports as of April 2026, Sri Lanka is seeing economic stabilization with a projected 3.1% Gross Domestic Product (GDP) growth in 2026, following a strong 5% rebound in 2024 and sustained recovery in 2025.



Based on April 2026 reports, the World Bank projects Sri Lanka's GDP growth to slow to **3.6% in 2026**, down from an estimated 4.6% in 2025, while headline inflation rose to 5.4% in April 2026. The AWPLR is expected to reflect these stabilization efforts and energy price pressures as the economy navigates external shocks and structural reforms.



THE WORLD BANK

Future Forecasting

For monetary indicators, policy rates and AWPLR are expected to remain relatively stable in the near term, with a gradual easing bias depending on inflation trends. The CBSL is likely to maintain a cautious stance, keeping interest rates steady to ensure inflation remains anchored around the target while supporting credit growth and economic recovery. Regarding the exchange rate, forecasts suggest continued but controlled depreciation pressure, as Sri Lanka remains import-dependent, especially for fuel and intermediate goods. However, stronger foreign reserves, IMF-backed reforms, and improved export and remittance inflows are expected to reduce volatility compared to previous crisis periods

Source :IMF , World Bank data ,ADB

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