



First Capital
A Janashakthi Group Company

“A Tale of Two Curves: Firm Belly, Fragile Long End”

FIRST CAPITAL FIXED INCOME RECOMMENDATION | Jun 2026

FIRST CAPITAL RESEARCH

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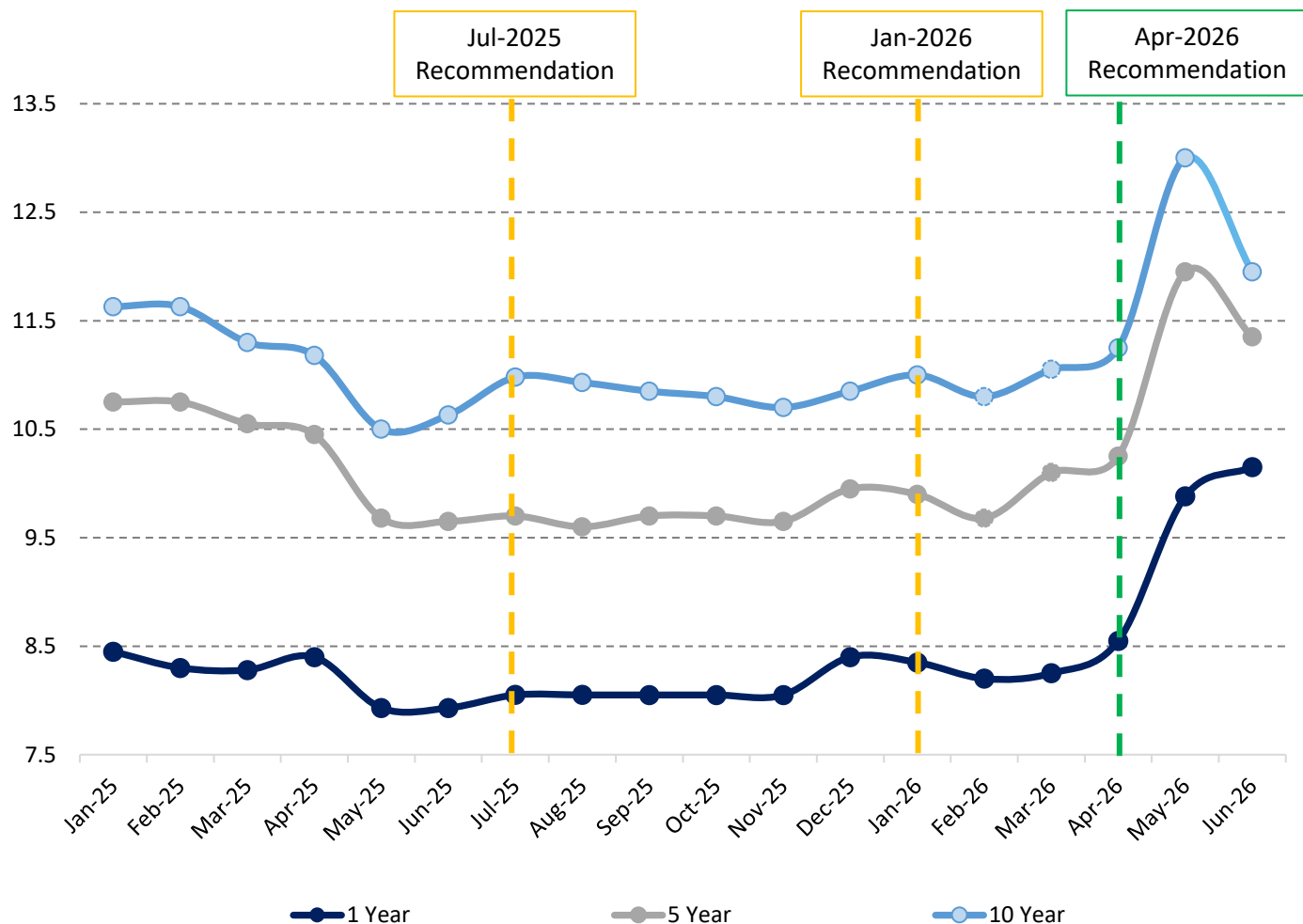


1. Previous Recommendation

“Yields may rise by 50-100bps during the next 12 months leading to Dec-26”



Accuracy of previous recommendations:



14th July 2025
“Yields to remain stable within the next 6-12 months, Shift to short tenors with a willingness to run a carry portfolio”
-Partly Accurate

22nd January 2026
“Yields may rise by 50-100bps during the next 12 months leading to Dec-26; Maintain a carry portfolio consisting of short tenors”
-Partly Accurate

06th April 2026
“Yields may rise by 50-100bps during the next 12 months leading to Dec-26; Maintain a carry portfolio consisting of short tenors”
-Accurate



Review on market movement: Apr – Jun 2026

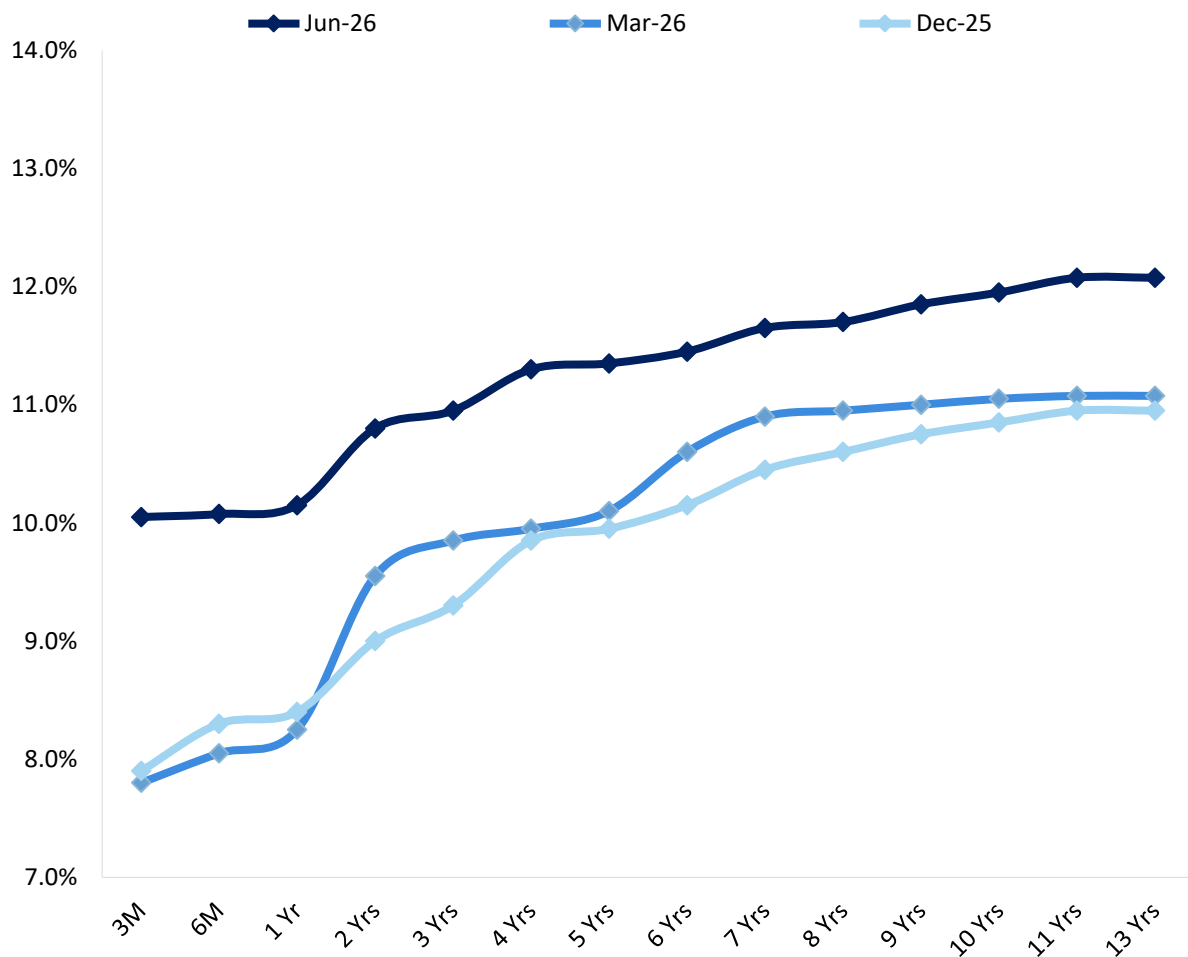
Consistent with FCR's expectations, the yield curve shifted higher during Apr-May 2026 following the escalation of the US-Iran war and CBSL's 100bps policy rate hike. The higher-than-anticipated increase in the OPR in May-26 is, however, expected to tone down rising inflation faster and keep the currency under control. Alongside easing inflation expectations, currency stabilization, and renewed optimism over a potential US-Iran agreement, have supported bond demand across the curve, leading to a sharp decline in yields and a return to our yield band target.

- ✓ *Heightened geopolitical tensions following the Israel-US strikes on Iran triggered a sharp rise in global oil prices, exerting upward pressure on domestic fuel costs. In response to rising inflationary risks and strengthening underlying demand, the Central Bank of Sri Lanka (CBSL) raised the Overnight Policy Rate (OPR) by 100bps at its May-26 Monetary Policy Meeting.*
- ✓ *As a result, the yield curve shifted materially higher between end-March and end-May, with the move exceeding FCR's expectations. Yields on the 1Y, 5Y, and 10Y maturities increased by 163bps, 185bps, and 195bps, respectively.*
- ✓ *However, easing inflation expectations, currency stabilization, and renewed optimism over a potential US-Iran agreement have supported bond demand across the curve, leading to a sharp decline in yields and a return to our target yield band.*
- ✓ *System liquidity averaged approximately LKR 170.0Bn during Apr-May 2026, compared with over LKR 300.0Bn earlier in the year. However, it fell below the LKR 50.0Bn threshold during the past week, extending its recent decline. The reduction was largely attributable to the CBSL's intervention through USD sales to support the LKR during a period of rising imports, coupled with sustained expansion in private sector credit. Liquidity is expected to ease marginally before stabilizing above LKR 100.0Bn over the remainder of the year.*
- ✓ *Private sector credit growth remained strong in Apr-26, expanding 27.0%YoY as outstanding credit increased by LKR 100.6Bn MoM to LKR 10.8Tn. Growth was supported by festive-season demand and higher working capital requirements among importers amid currency pressures. However, weaker external demand, geopolitical uncertainties, and domestic policy measures, including the 50.0% CID surcharge on vehicle imports and tighter LTV requirements are expected to moderate credit growth through 2026E.*
- ✓ *Although yields rose well above FCR's expectations during Apr-May 2026, the recent reversal has brought the belly and the tail end of the curve within our bands. Shorter tenor yields retain scope for further moderation toward our target bands.*



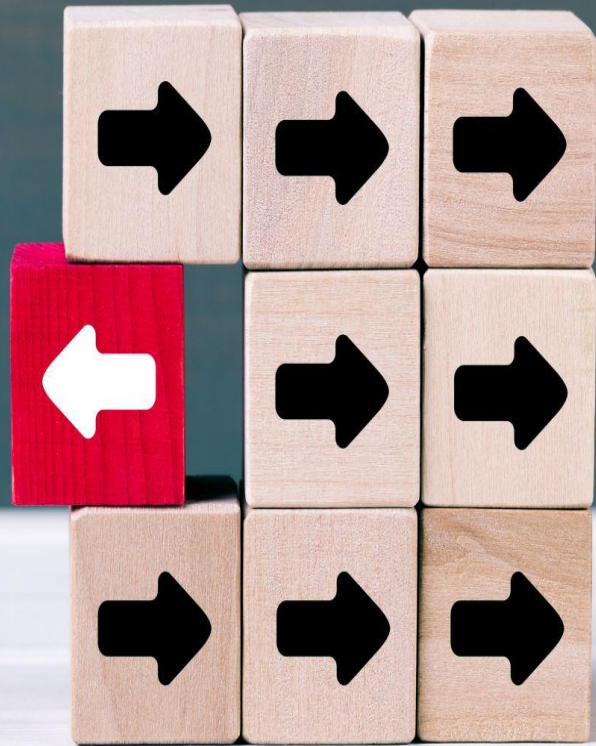
Overall yield curve movement

Yield curve Month-end comparison



Interest Rate Change (bps)

Tenor	Jun 2026	Mar 2026	Change (bps)	Dec 2025	Change (bps)
3M	10.05%	7.80%	+225	7.90%	+215
6M	10.08%	8.05%	+203	8.30%	+178
1 Yr	10.15%	8.25%	+190	8.40%	+175
2 Yrs	10.80%	9.55%	+125	9.00%	+180
3 Yrs	10.95%	9.85%	+110	9.30%	+165
4 Yrs	11.30%	9.95%	+135	9.85%	+145
5 Yrs	11.35%	10.10%	+125	9.95%	+140
6 Yrs	11.45%	10.60%	+85	10.15%	+130
7 Yrs	11.65%	10.90%	+75	10.45%	+120
8 Yrs	11.70%	10.95%	+75	10.60%	+110
9 Yrs	11.85%	11.00%	+85	10.75%	+110
10 Yrs	11.95%	11.05%	+90	10.85%	+110
11 Yrs	12.08%	11.08%	+100	10.95%	+113
13 Yrs	12.08%	11.08%	+100	10.95%	+113
15 Yrs	N/A	N/A	N/A	N/A	N/A
20 Yrs	N/A	N/A	N/A	N/A	N/A

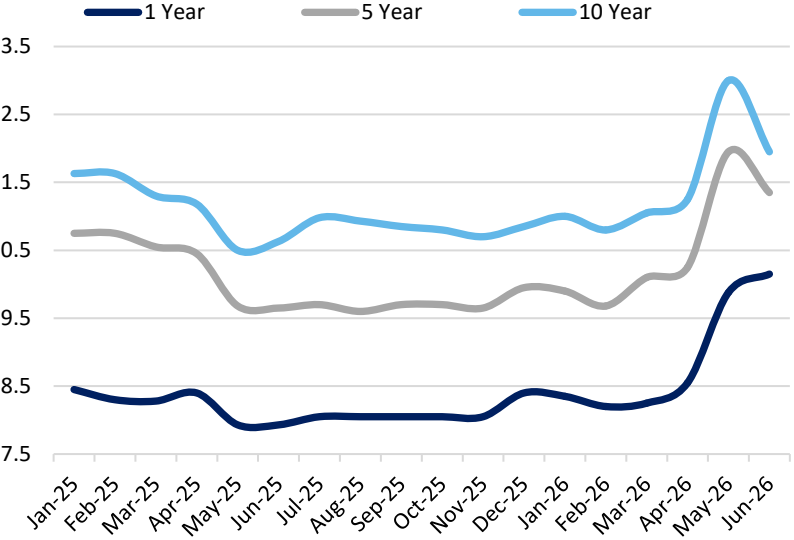


2. Outlook for Fixed Income Instruments

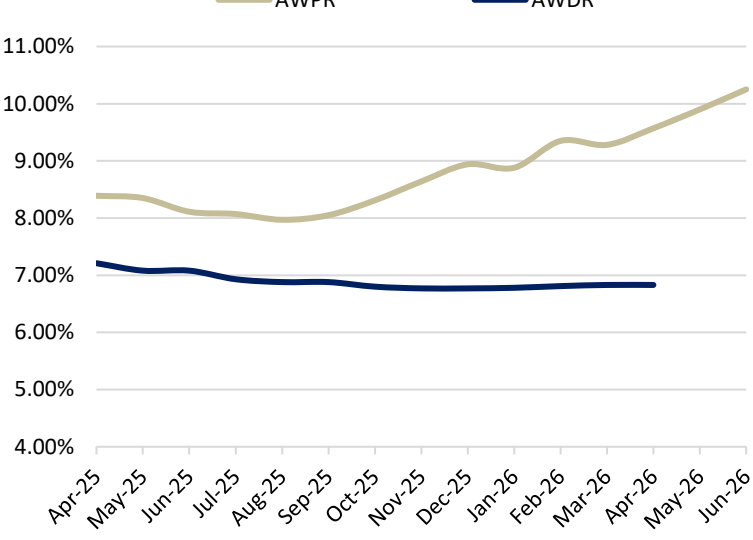
“Headwinds emerge; economic indicators may soften”

Economic indicators reflect the impact of the Middle East crisis

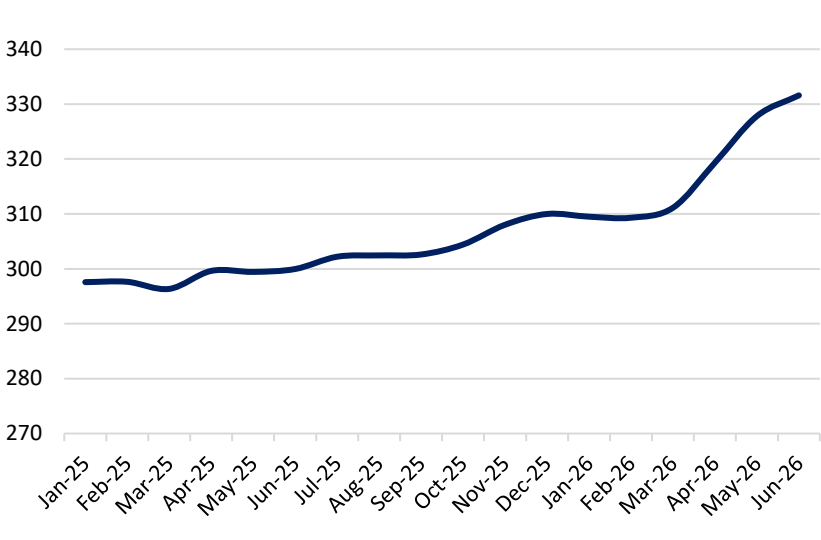
Mid and Long tenors exhibited an early adjustment



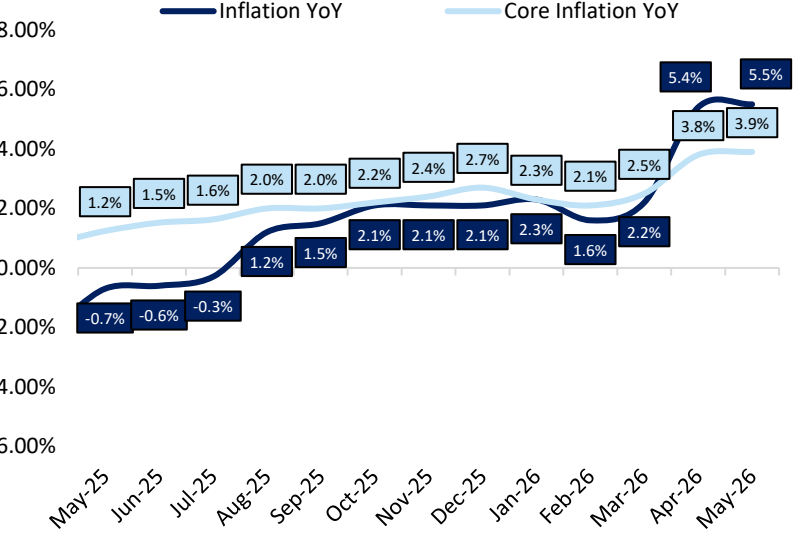
Lending rates edge higher during Jun-26



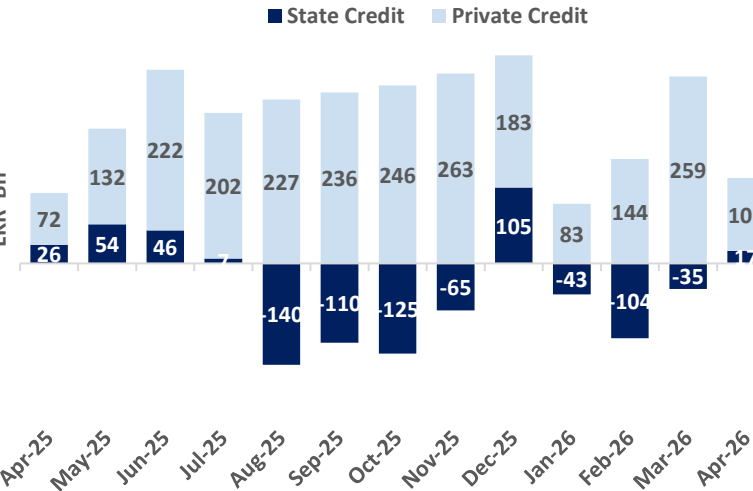
LKR continues to depreciate against the USD



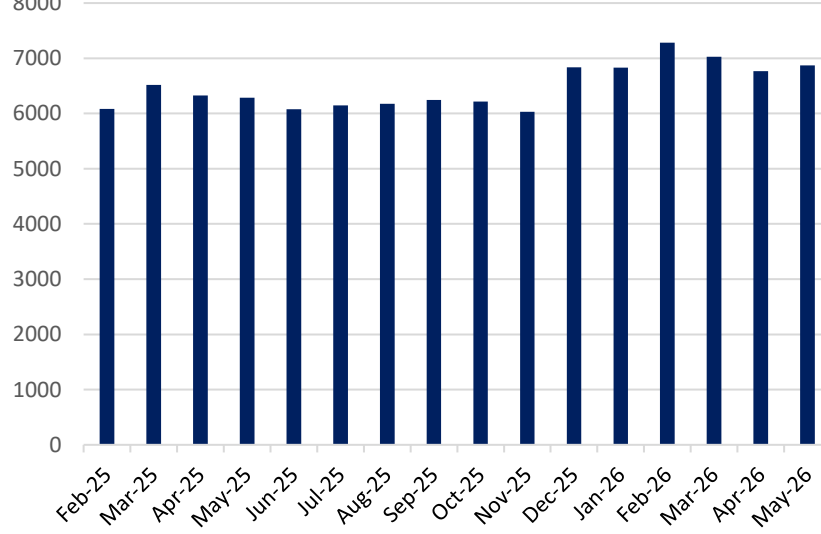
Inflation rose to 5.5% in May-26



Private sector credit grows 27.0%YoY in Apr-26



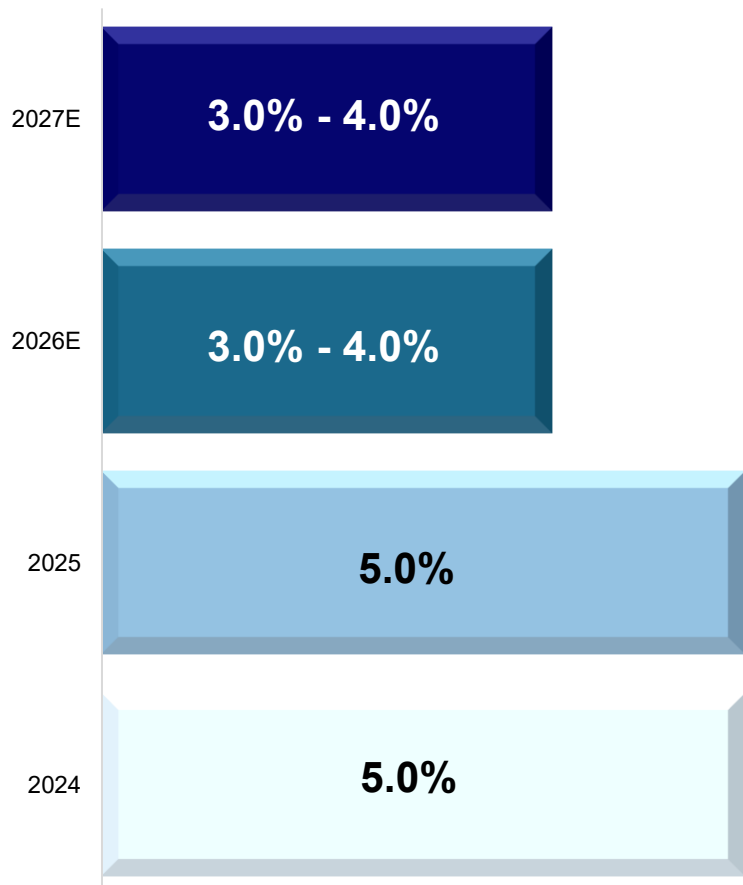
Reserves at USD 6.9Bn as of end May-26





The CBSL's 100bps rate hike appears excessive and is expected to dampen economic growth in the near term

Gross Domestic Product Growth (%) to moderate to 3.0%-4.0% in 2026E

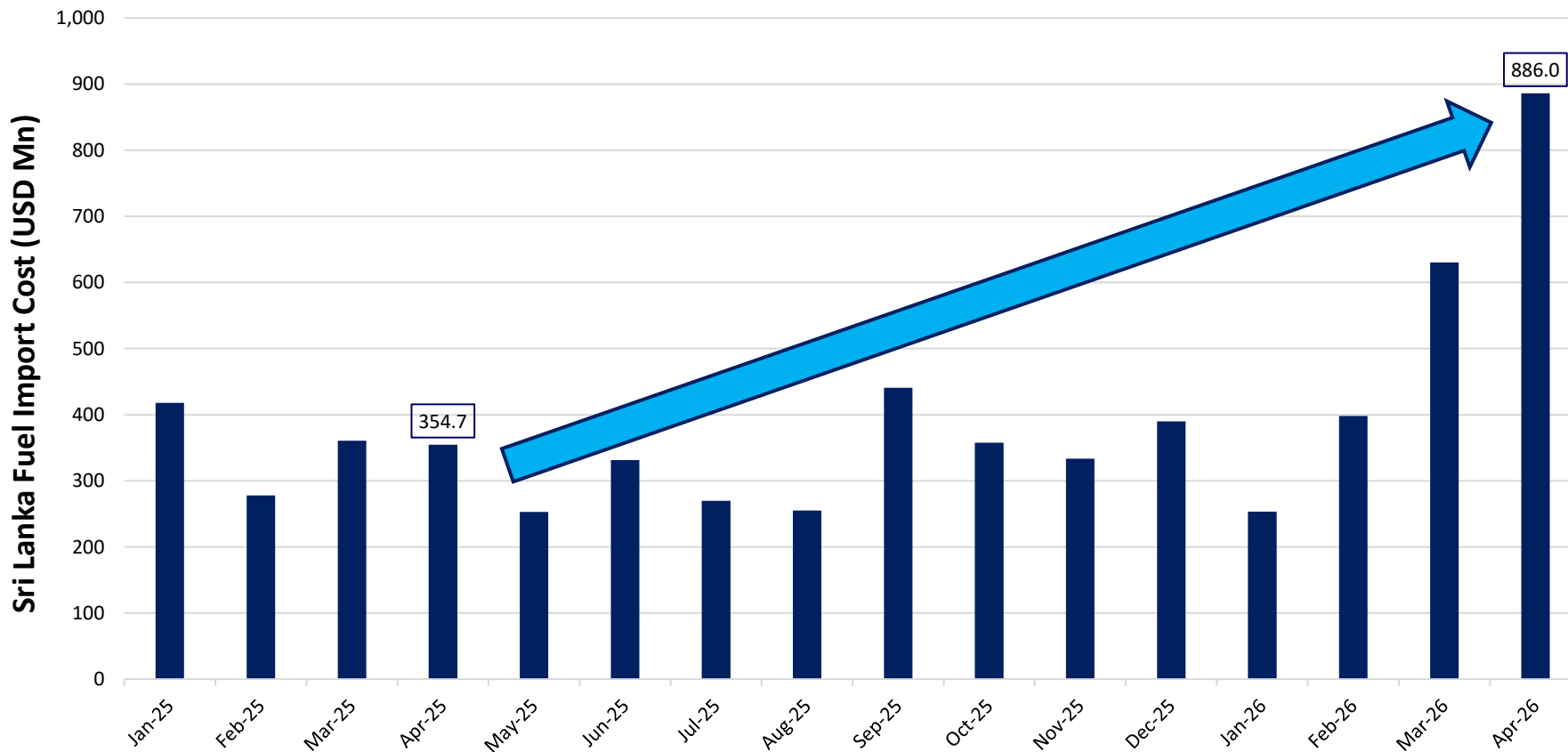


- ✓ FCR believes the recent 100bps policy rate hike may have been somewhat excessive, particularly in light of the recent moderation in economic activity. Although GDP growth accelerated to 5.1% in 1Q2026, the expansion was driven largely by a significant contribution from tax revenues and subsidies rather than a broad-based strengthening of underlying economic fundamentals.
- ✓ Household consumption is expected to come under pressure from elevated borrowing costs, reinforced by the recent OPR hike and credit card rate increases from 26.0% to 28.0% are likely to dampen credit demand and consumer spending. At the same time, persistent inflationary pressures are expected to further erode real incomes, adding additional constraints to consumption.
- ✓ On the fiscal side, slower-than-expected government capital expenditure also poses a constraint to growth, with only LKR 100.0Bn spent out of the allocated LKR 1.8Tn as of the end of 1Q2026.
- ✓ In addition, the external position is expected to come under renewed pressure, with a widening trade deficit driven by a higher import bill, particularly fuel-related and softer export growth.
- ✓ Accordingly, FCR expects growth to ease from 5.0% in 2025 to 3.0%-4.0% in 2026E.



Sri Lanka's fuel import bill has risen significantly...

Sri Lanka's fuel import bill more than doubled to USD 886.0Mn in Apr-26 compared to the corresponding period last year



Petroleum products, including both crude and refined fuels account for approximately 21-24% of Sri Lanka's total merchandise imports, making them a major component of the national import bill. Sri Lanka's fuel import bill more than doubled to USD 886.0Mn in Apr-26 compared to the corresponding period last year, with the country already accounting for approximately 53% of its total oil import expenditure for the entirety of last year within the first four months of 2026. According to FCR estimates, an increase in crude oil prices could raise the country's import bill by approximately USD 598.0-1,776.0Mn.

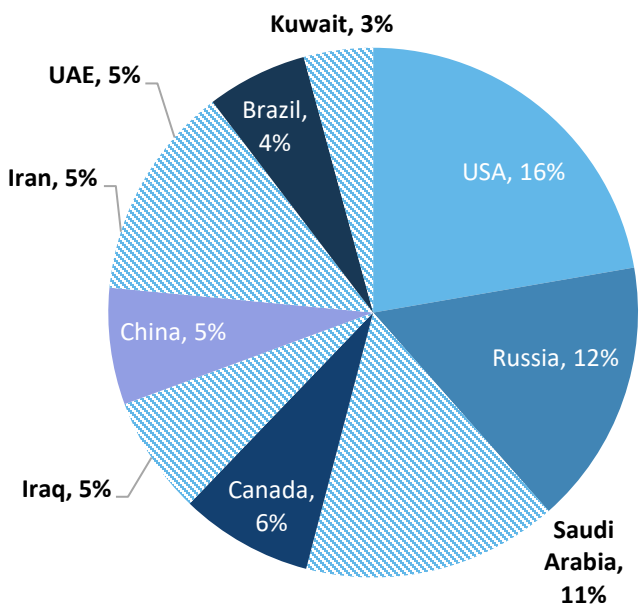
However, looking ahead, we expect fuel bill to normalize as govt. look to market price fuel inline with the delivered promise to IMF and reduce pressure from global oil imports.



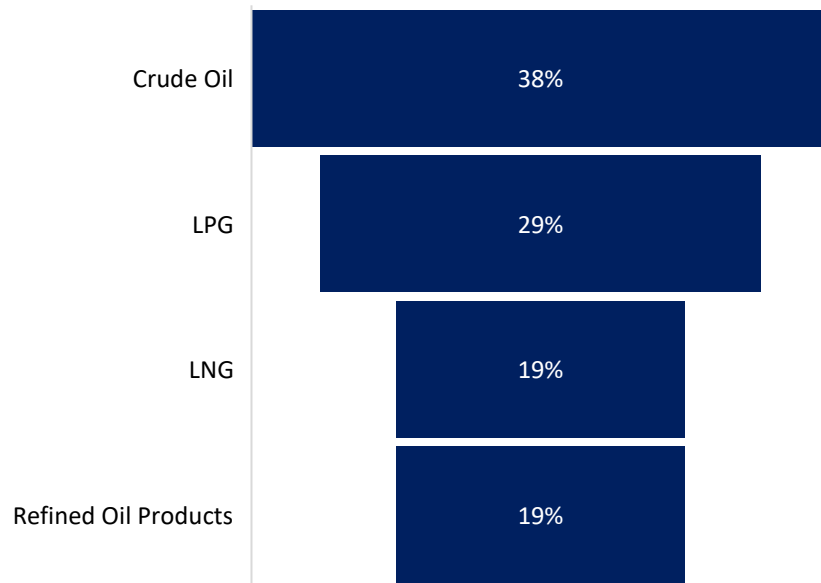
...amid persistent Middle East tensions, which had exerted upward pressure on global oil prices

Global oil markets remain under significant pressure amid the ongoing US-Iran conflict, which has effectively disrupted traffic through the Strait of Hormuz. Following the escalation of tensions in Feb-Mar 2026, Brent crude prices surged and have largely remained above USD 100/BBL. While prices have eased somewhat in recent days, they continue to be highly sensitive to developments in the Middle East.

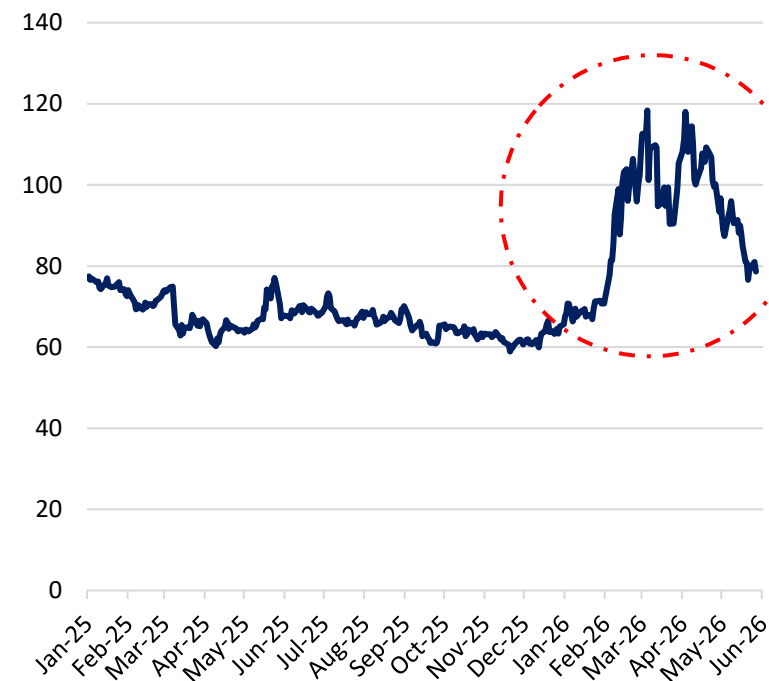
The Middle East region accounted for nearly 30.0% of Global Crude Oil Production in 2025...



...while the Strait of Hormuz serves as a key transit route for a significant share of global oil trade



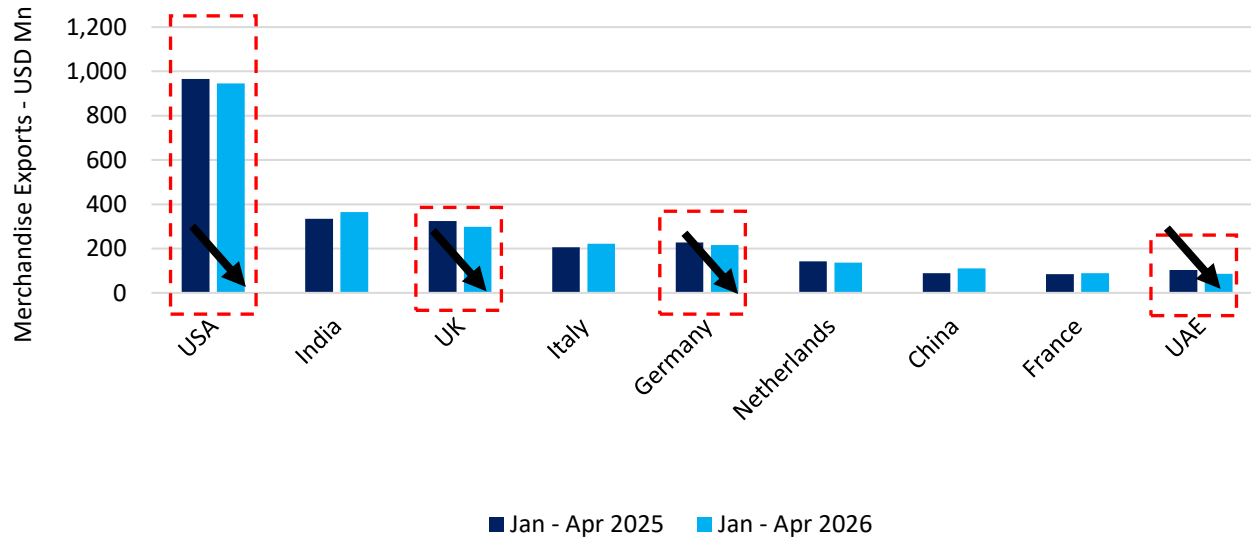
Brent crude oil futures (USD/BBL) has seen a slight dip in recent weeks



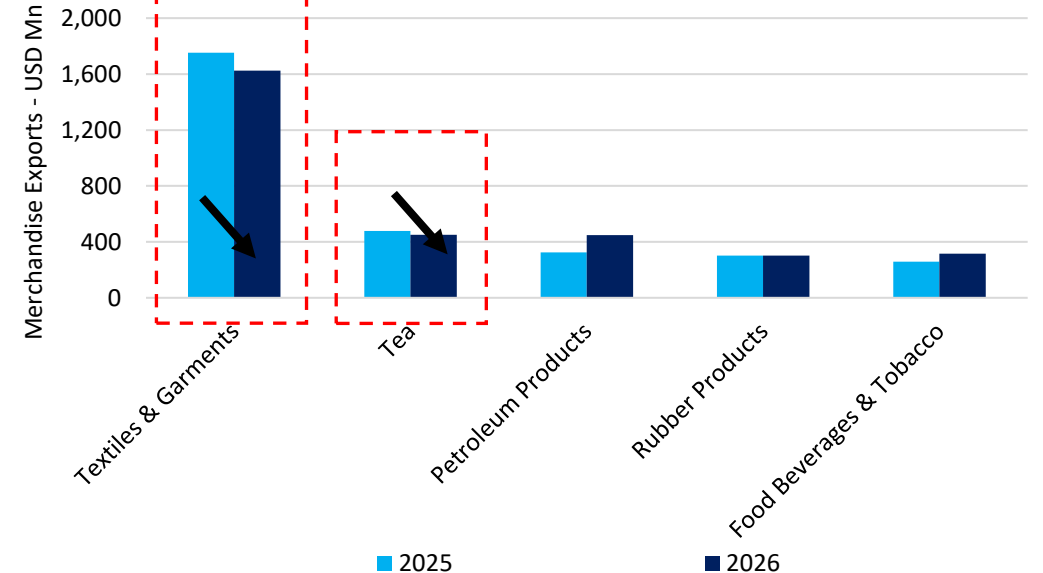
Although exports have grown overall, softer demand from key markets could weigh on near-term export earnings

- ✓ Merchandise exports rose by 5.1%YoY to USD 4.5Bn during Jan-Apr 2026 largely driven by improved demand across the agricultural and industrial product categories. Nevertheless, the Export Development Board (EDB) has revised its monthly export growth projection downward from 10.0% to slightly above 8.0%, reflecting the impact of prevailing external challenges.
- ✓ According to EDB data, export earnings from the apparel and textiles sector declined by 7.4%YoY during Jan-Apr 2026, reaching USD 1.6Bn. The contraction was primarily driven by weaker demand in key export destinations, particularly the US and the EU, which collectively account for over 50% of the sector's export market. Exports to the US fell by 5.7%, while shipments to the EU and the UK declined by 7.7% and 9.7%, respectively, contributing to the overall downturn in the sector.
- ✓ Sri Lanka's tea industry is also facing disruptions from the ongoing Middle East conflict - Tea exports, which comprised 12.0% of total merchandise exports, declined by 5.6%YoY to USD 451.6Mn during the first four months due to geopolitical tensions in the Middle East.

Demand from key export destinations declined during Jan-Apr 2026...



...along with a decline in key merchandise exports

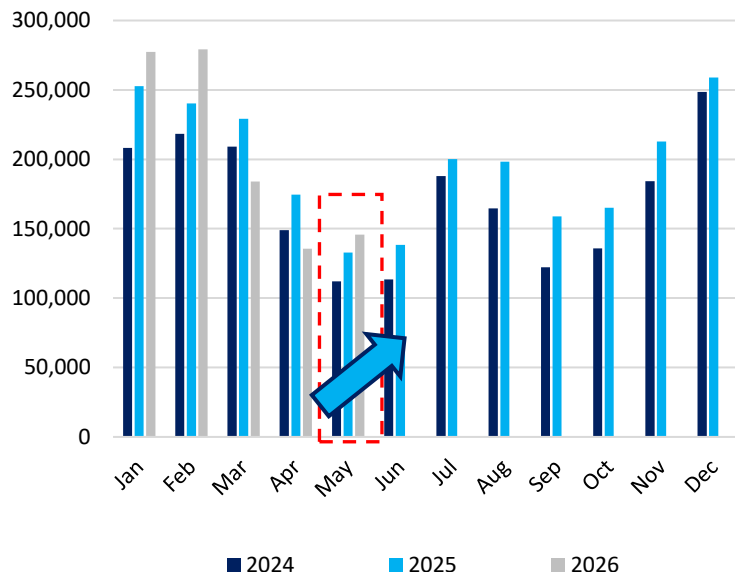




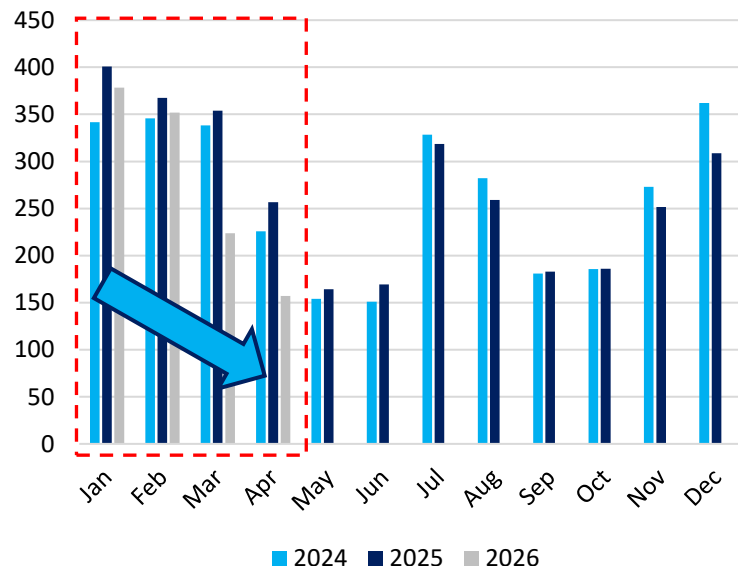
Tourist arrivals recovered modestly in May, though earnings remain at subdued levels

- ✓ According to Sri Lanka's Tourism Ministry, tourist arrivals declined by approximately 20.0% during Mar-Apr 2026, due to the Middle East conflict. This drop was largely driven by flight disruptions, with over 750 scheduled flights to Sri Lanka canceled, significantly impacting key international routes.
- ✓ Additionally, around 34% of visitors transit through Middle Eastern hubs such as Dubai, Doha, and Abu Dhabi, exacerbating the impact.
- ✓ Tourist arrivals recorded a modest recovery and slight YoY growth in May; however, sector earnings remained subdued, as arrivals from key source markets appear to have softened amid ongoing developments in the Middle East, reflecting Sri Lanka's exposure to the region.
- ✓ Accordingly, FCR has revised its tourism earnings estimates for 2026E and 2027E to account for the ongoing tensions.

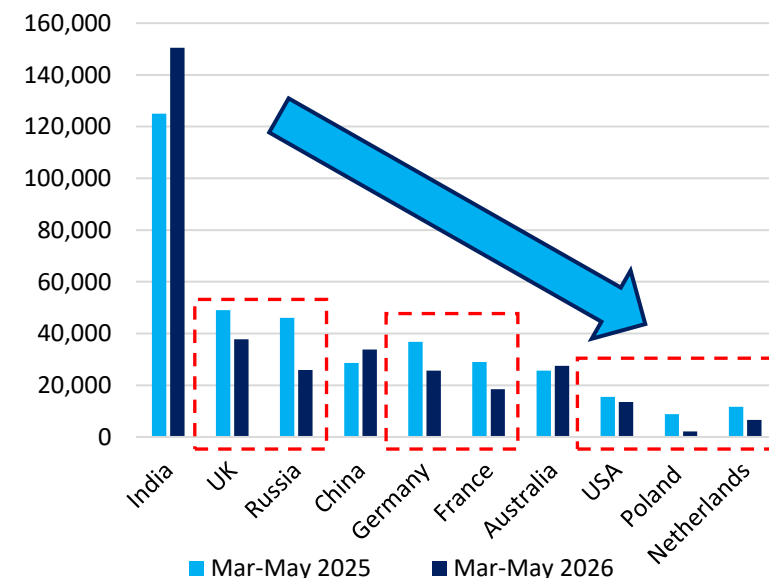
Whilst overall tourist arrivals to Sri Lanka witnessed a modest recovery in May-26...



...earnings from tourism continue to show a declining trend...



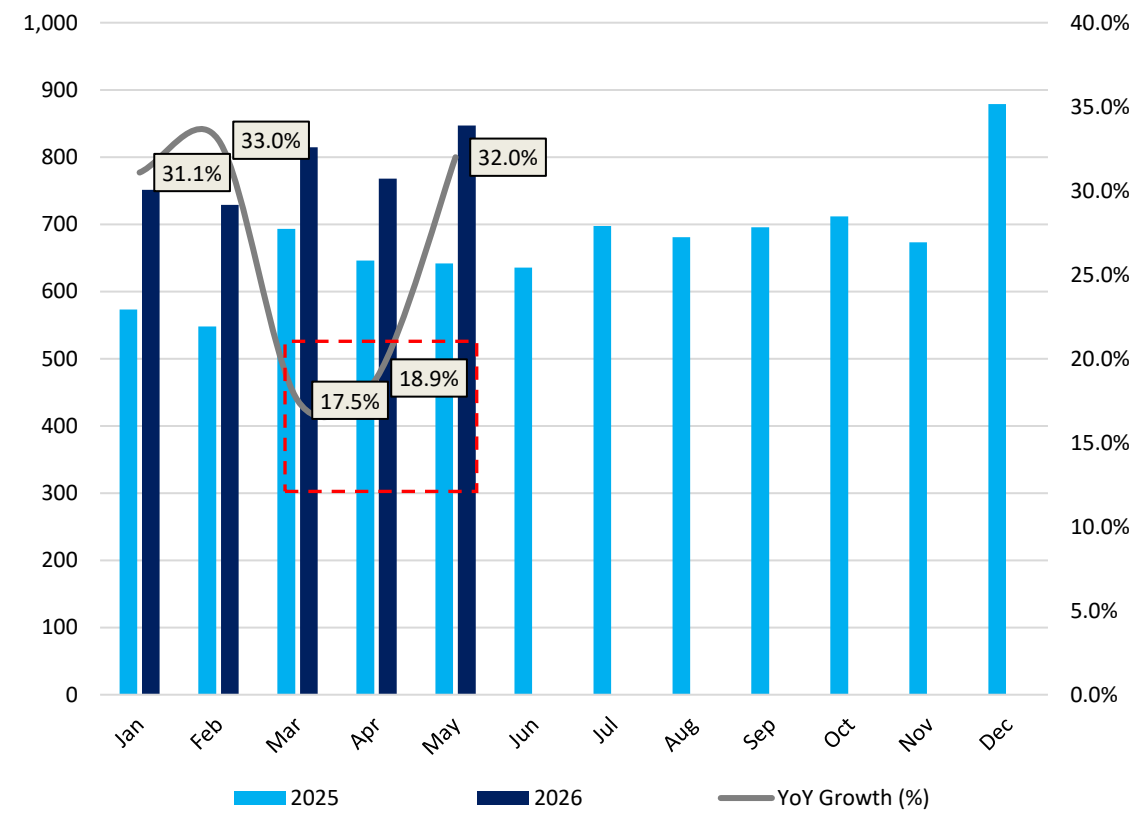
...as arrivals from key source markets, especially the EU, shows a declining trend, following the escalations in the Middle East





Worker remittances remain the only stable inflow; any setback could materially weigh on external stability

Worker remittances record strong growth during 1H2026

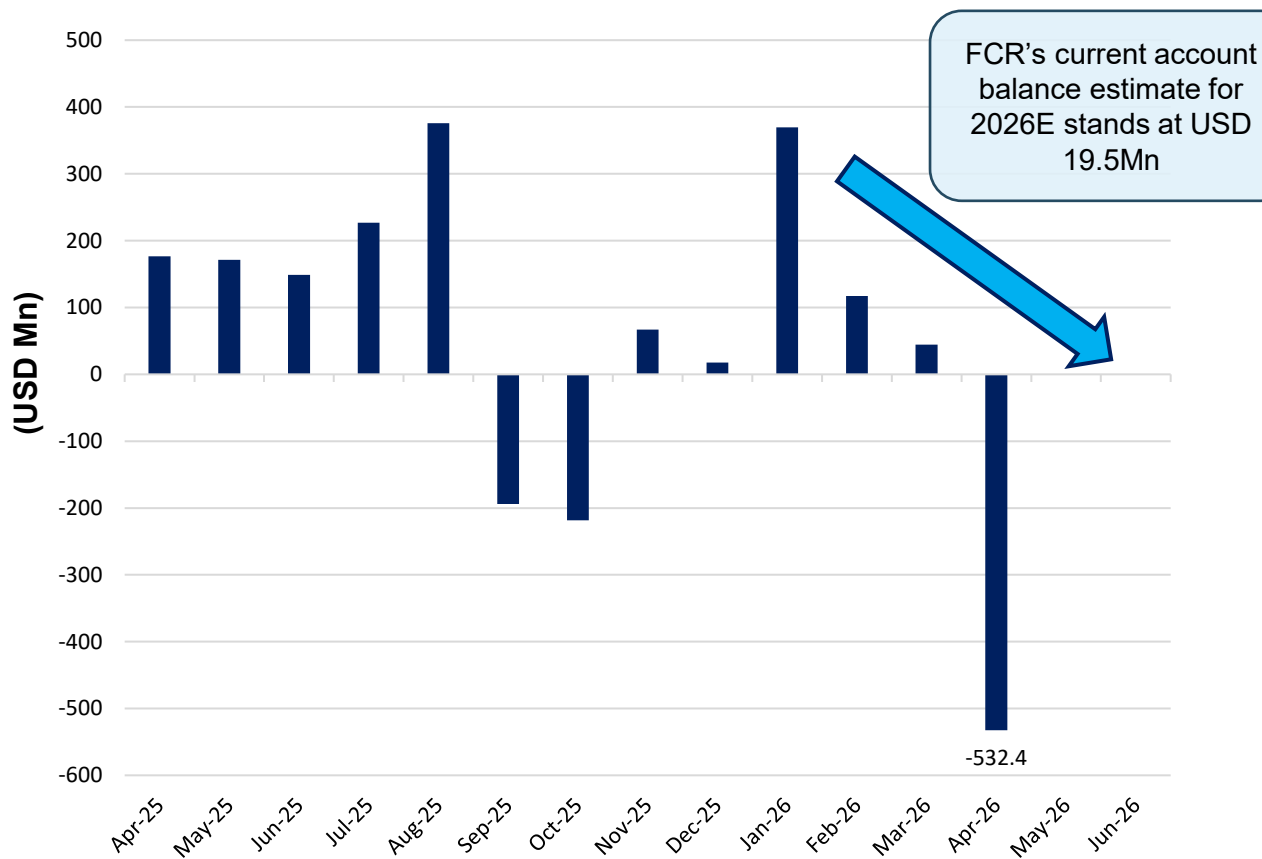


- ✓ Sri Lanka depends heavily on foreign remittances as a key source of foreign exchange, with annual inflows often exceeding USD 6.0Bn. A large share comes from Sri Lankan migrant workers in the Middle East, particularly in Saudi Arabia, UAE, Qatar and Kuwait, which together account for more than half of total inflows.
- ✓ Remittances have grown strongly in early 2026, rising by about 26.0% in the first five months compared with the same period in 2025, according to the Sri Lanka Bureau of Foreign Employment. This reflects continued demand for Sri Lankan workers abroad and stronger formal transfer channels.
- ✓ However, with many Sri Lankans employed in the hospitality sector, reduced tourism activity in the Middle East is likely to put downward pressure on wages. Additionally, economic uncertainty or project delays in Gulf countries could slow hiring in construction and services, limiting new employment opportunities for Sri Lankan workers.
- ✓ Since remittances remain a key support for Sri Lanka's external sector after the Sri Lankan economic crisis, a prolonged decline could pressure foreign exchange inflows and household incomes.



Collectively, these developments have strained Sri Lanka's current account balance...

The current account transitioned into a deficit in Apr-26



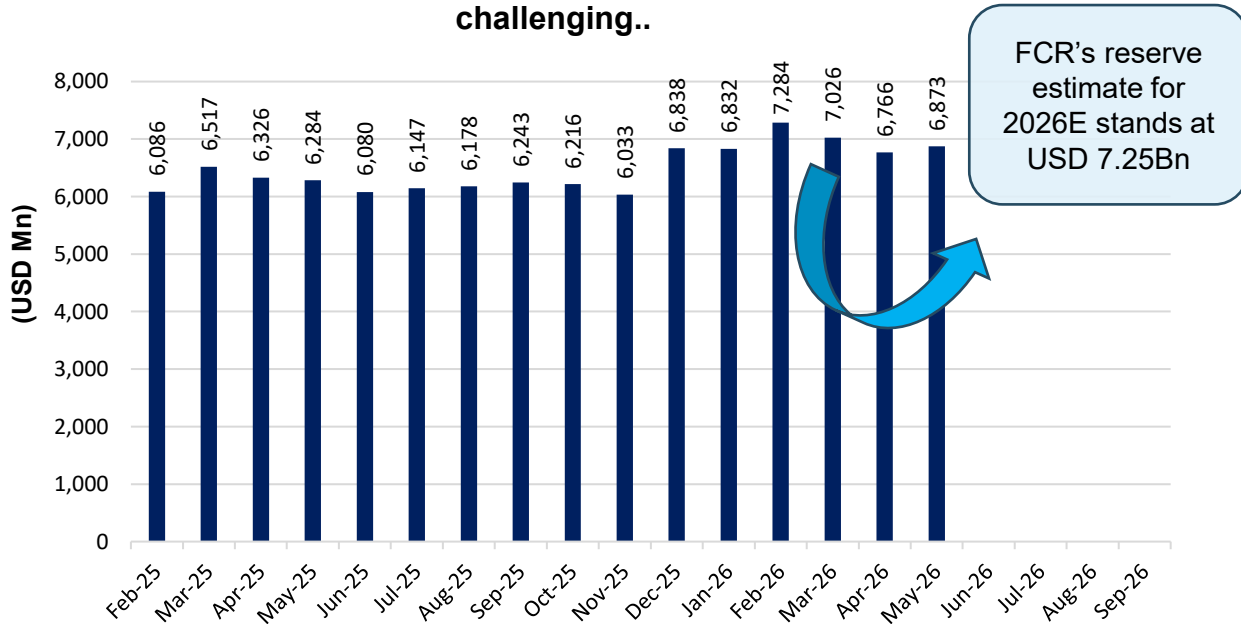
- ✓ In early 2026, the current account showed signs of stabilization, with a modest improvement in the overall balance driven mainly by stronger remittance inflows, as overseas workers increased transfers to support families affected by Cyclone Ditwah, partially offsetting earlier deterioration.
- ✓ Looking ahead, risks remain skewed to the downside. Continued instability in the Middle East could place further upward pressure on Sri Lanka's import bill through higher energy prices.
- ✓ Meanwhile, export earnings may weaken due to reduced tea demand from the region. A potential slowdown in tourism and remittance inflows, both closely linked to the Middle East, could further strain the current account and overall balance of payments (BoP).



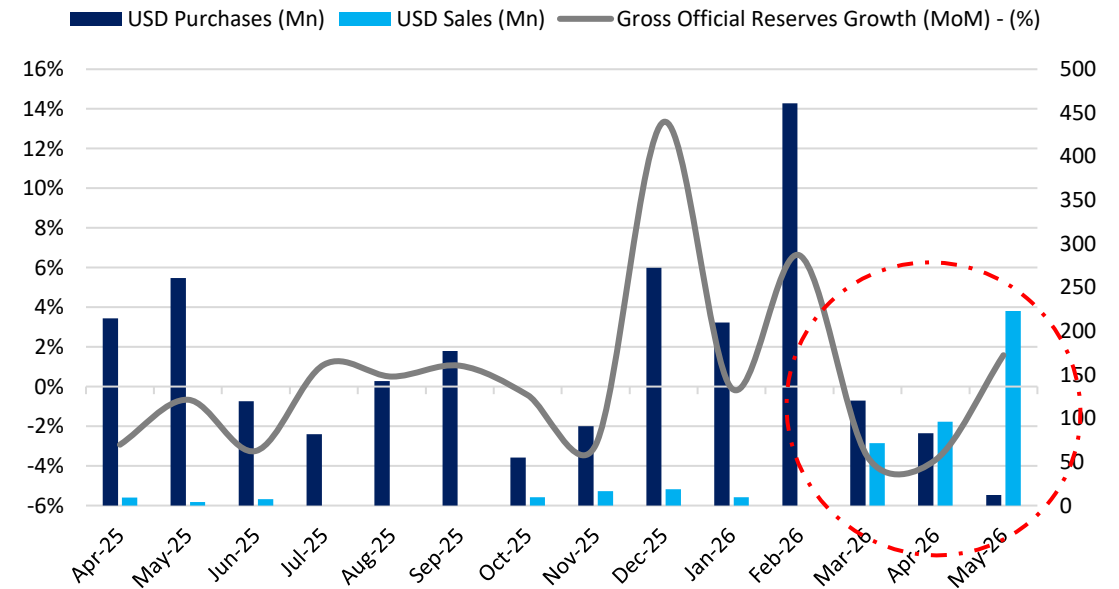
...dampening the rate of Gross Official Reserve accumulation...

- ✓ Gross Official Reserves was recorded at USD 6.9Bn at the end of May-26 amid wider trade deficit, external debt repayments and net foreign exchange sales by the CBSL.
- ✓ Meanwhile, towards the end of May-26, the International Monetary Fund (IMF) completed the combined fifth and sixth reviews of Sri Lanka's Extended Fund Facility (EFF) programme, approving an immediate disbursement of around USD 695.0Mn.
- ✓ Furthermore, the Asian Development Bank (ADB) has allocated USD 480.0Mn in budget support for Sri Lanka in 2026, which will further bolster the country's external buffers.
- ✓ However, as the current account transitions into a deficit, the CBSL may face increasing challenges in maintaining its current pace of reserve accumulation. Accordingly, FCR estimates reserves at USD 7.25Bn, notably lower than the IMF's estimate of USD 8.8Bn.

Reserve accumulation appears to be becoming increasingly challenging..



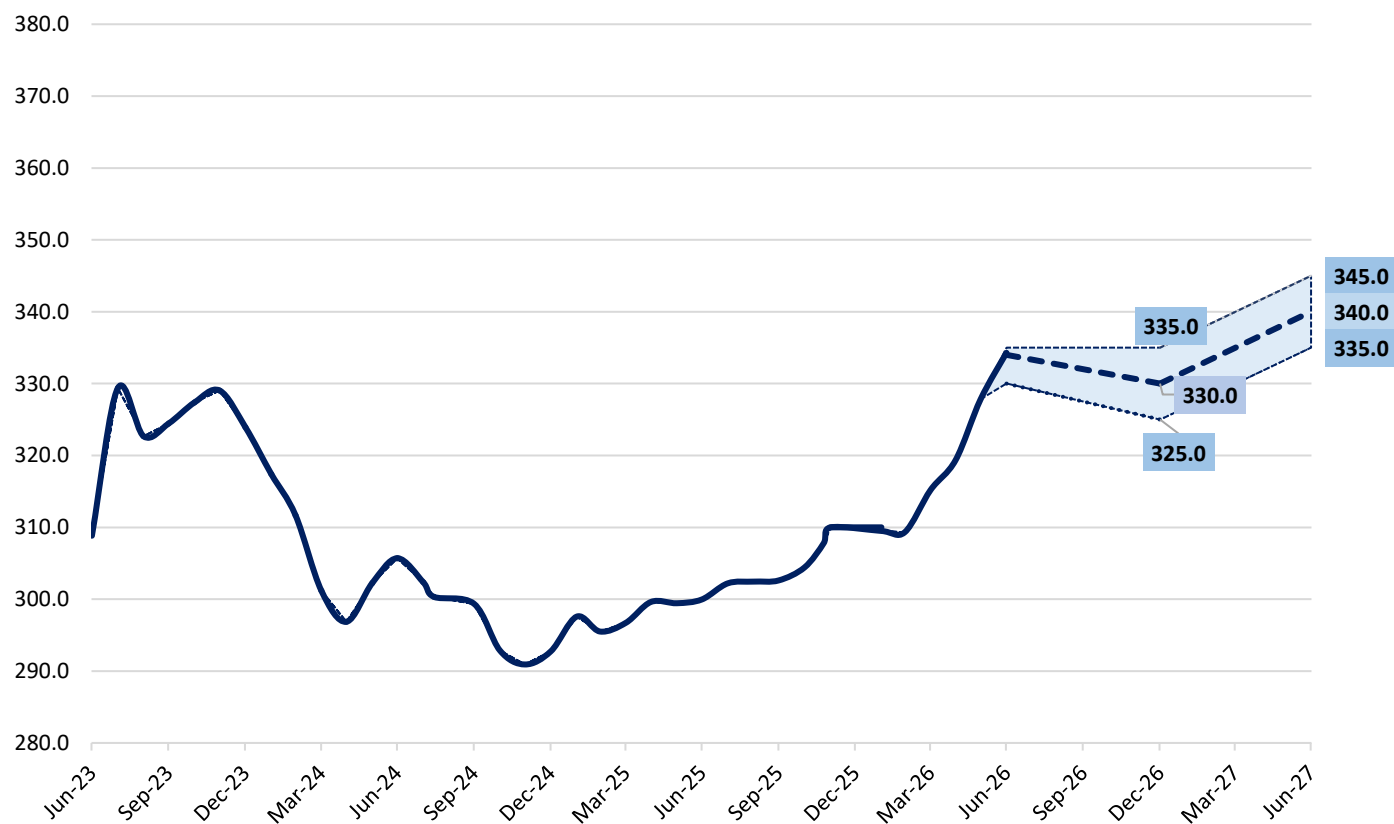
...amid rising USD sales by the CBSL





...while weighing on the LKR in the near term

FCR now expects the LKR to trade within a range of 325.0-335.0 in 2H2026E and 335.0-345.0 in 1H2027E

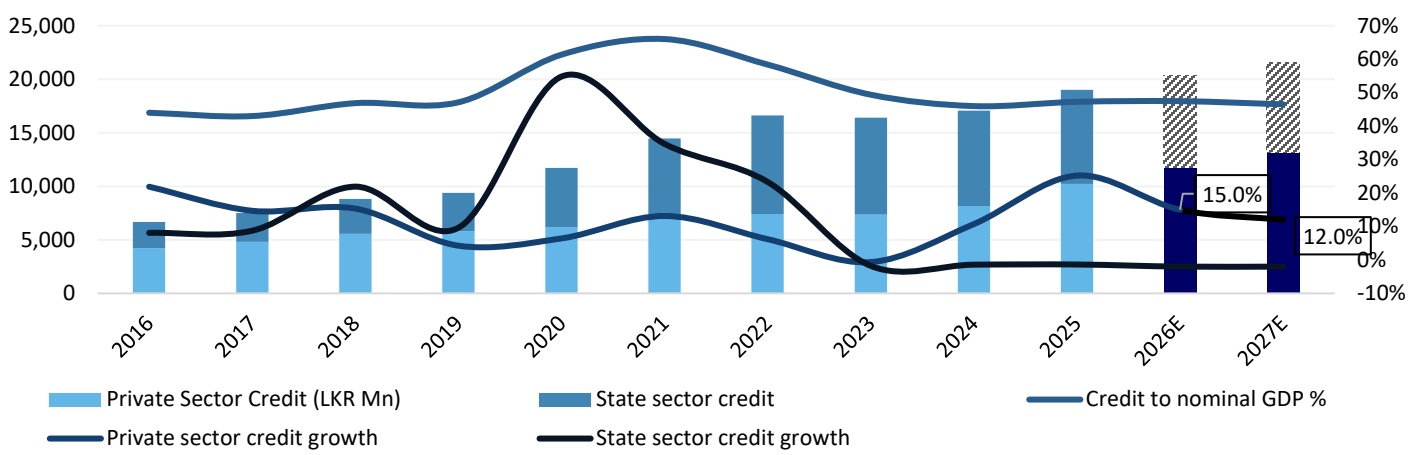


- ✓ FCR initially projected a 5% depreciation of the LKR in 2026E, with the currency expected to trade in the range of LKR 310.0-320.0 in 1H2026E and LKR 320.0-330.0 in 2H2026E.
- ✓ However, the LKR depreciated more sharply than initially expected during Apr-May 2026, largely driven by a surge in import demand amid the ongoing crisis.
- ✓ However, considering the steeper than expected OPR adjustment, FCR expects imports to tone down faster in the coming months, further moderating the existing demand in the economy and reducing the pressure on the currency.
- ✓ Accordingly, FCR now expects the LKR to trade within a range of 325.0-335.0 in 2H2026E and 335.0-345.0 in 1H2027E.



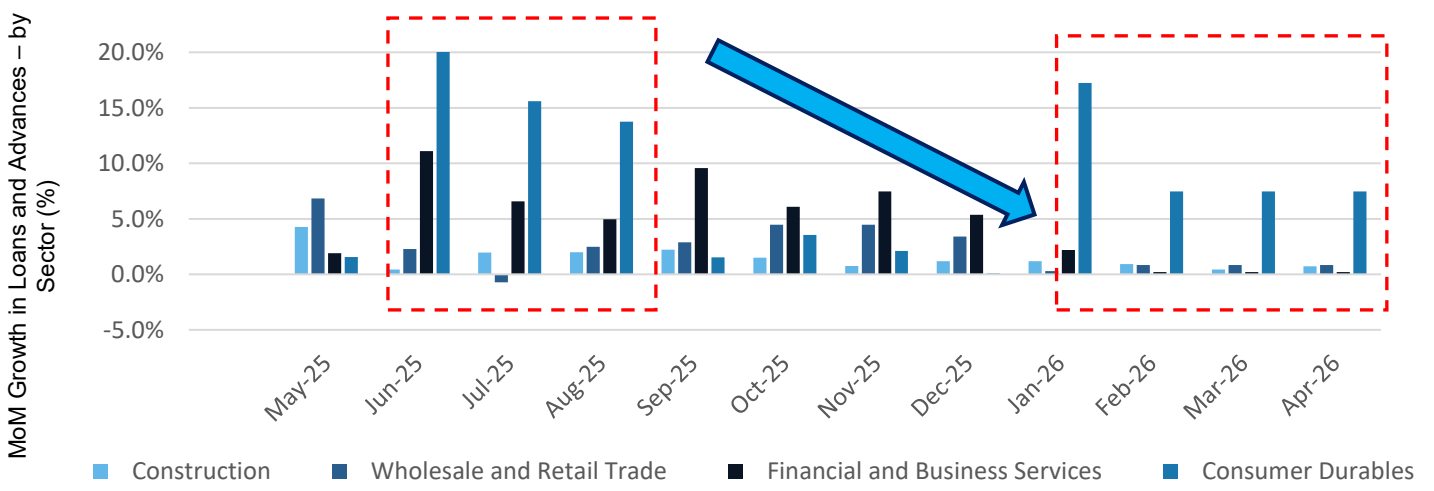
Concurrently, private sector credit growth may moderate amid higher borrowing costs and tighter financial conditions....

Private sector credit growth is expected to moderate to 15.0% in 2026E and 12.0% in 2027E



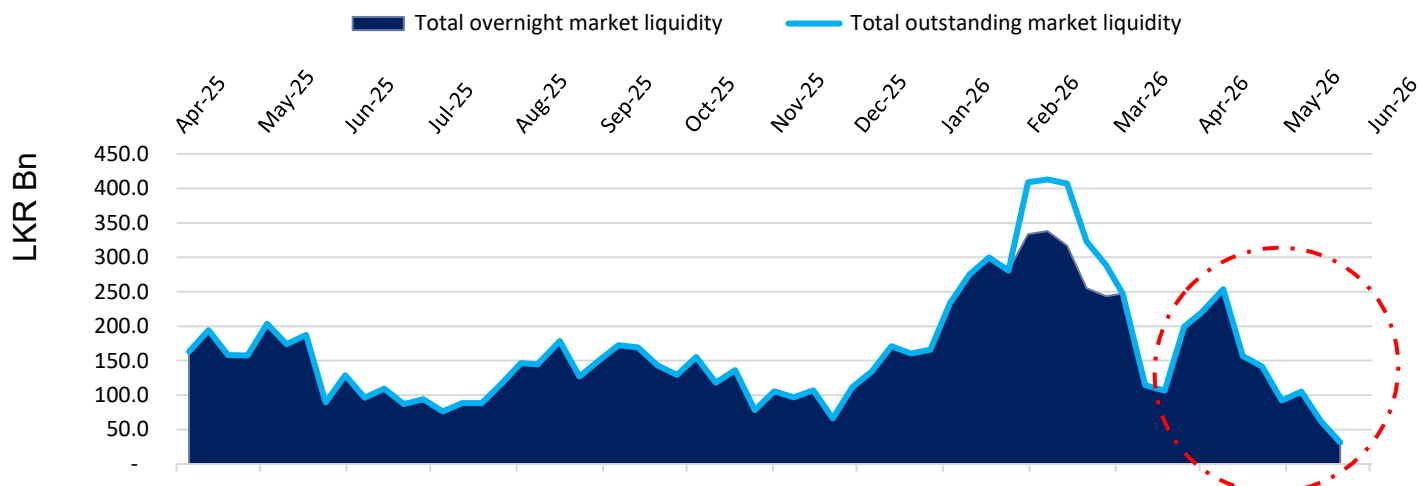
- ✓ Private sector credit grew by 27.0%YoY in Apr-26, with outstanding credit increasing by LKR 100.6Bn MoM to LKR 10.8Tn, supported by festive-season activity and higher working capital requirements among importers amid currency pressures.
- ✓ Looking ahead, the recent tightening of monetary policy is expected to temper borrowing demand, thereby weighing on private sector credit growth.
- ✓ In addition, lending activity is expected to slow due to subdued demand, the economic impact of Middle East tensions, and tighter domestic policy measures, including the temporary 50.0% CID surcharge on vehicle imports and stricter LTV limits.
- ✓ As a result, FCR's forecast for private sector credit growth now stands at 15.0% for 2026E and at 12.0% for 2027E, signaling a marked moderation from the strong 25.2% growth recorded in 2025.

MoM growth seen in specific key loan categories, have shown a decline in recent months

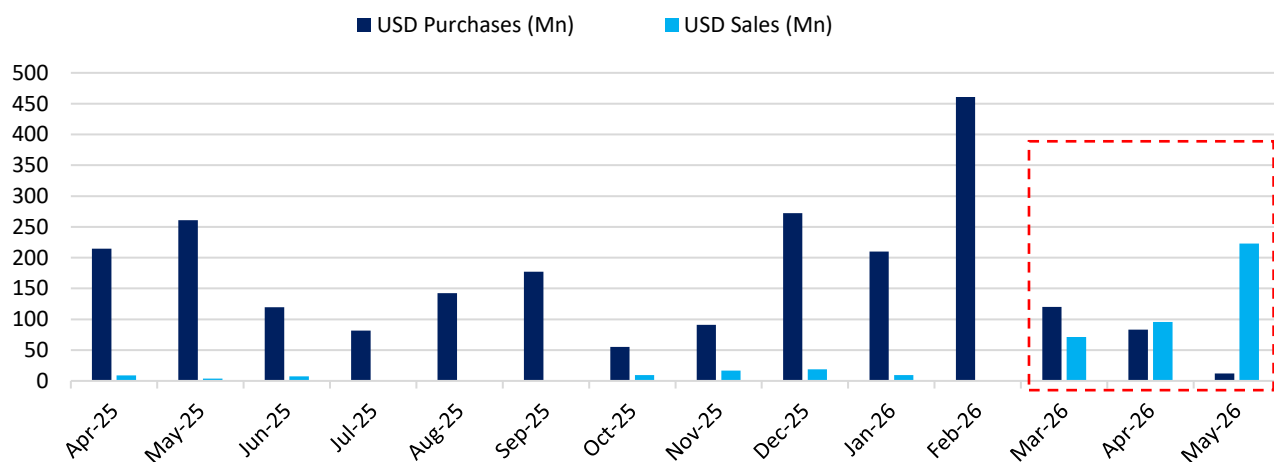


...facilitating a gradual strengthening of liquidity conditions

System liquidity has gradually retreated from the highs seen in recent months...



... amid the CBSL shifting from USD purchases to increased USD sales in recent months

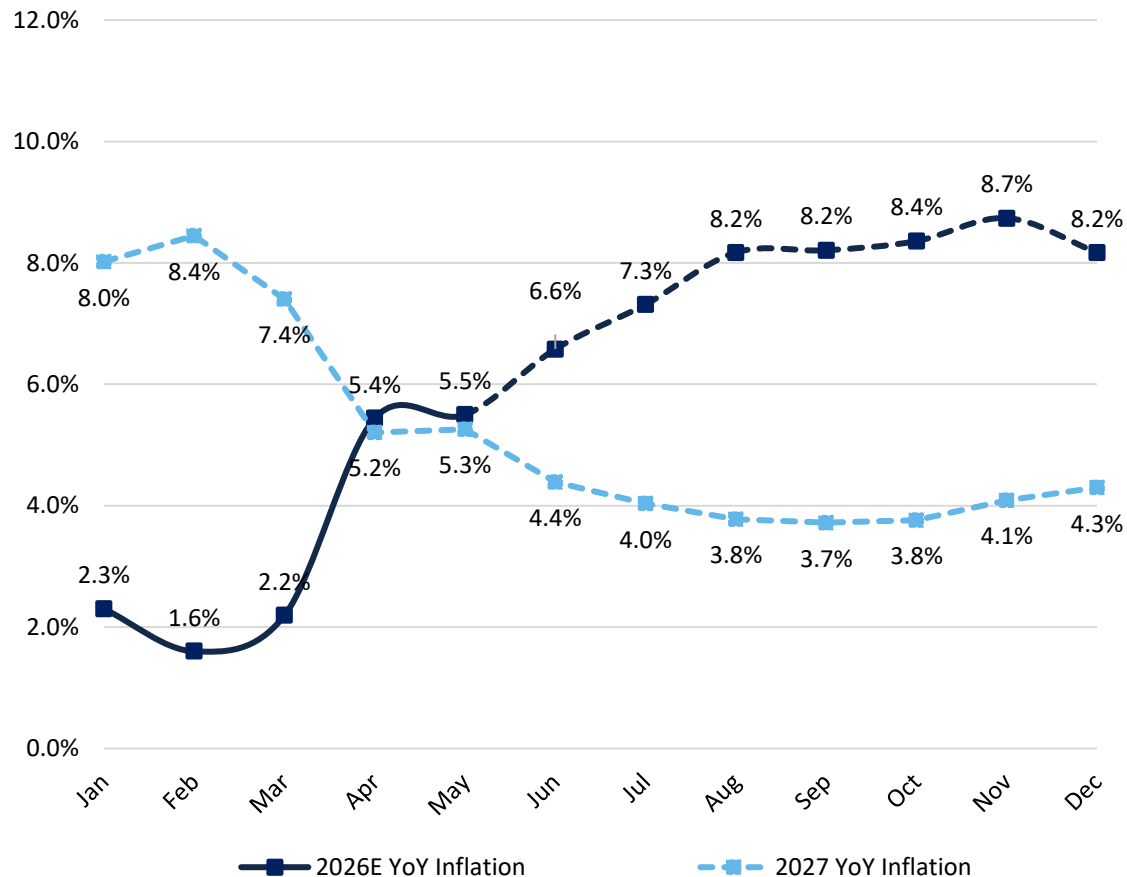


- ✓ System liquidity averaged approximately LKR 170.0Bn during Apr-May 2026, down from the excess liquidity of over LKR 300.0Bn recorded earlier in the year. Liquidity conditions have continued to tighten in recent weeks, with liquidity falling below LKR 50.0Bn. This decline was primarily driven by the CBSL's sustained USD sales to the market over the past three months, alongside continued expansion in private sector credit.
- ✓ Looking ahead, FCR expects liquidity conditions to gradually recover and remain above LKR 100.0Bn. The anticipated improvement is expected to be driven by slower credit growth amid rising borrowing costs and moderating economic activity.



Meanwhile, inflation is projected to accelerate, driven by ongoing fuel price adjustments and tariff hikes

Inflation is now projected to average approximately 6.0% for 2026E



- ✓ *Inflation is expected to remain elevated in the coming months, ranging between 6.0% and 8.0%, driven by higher domestic fuel costs, increased tariff rates, rising food inflation associated with El Niño-related weather conditions, and second-round inflationary effects.*
- ✓ *Beyond their direct impact on energy prices, rising fuel costs are expected to generate broader inflationary pressures through increased transportation, production, and distribution expenses across a wide range of sectors.*
- ✓ *The recent increase in electricity tariffs, together with the planned removal of electricity subsidies in Sep-26, is likely to further raise operating costs for businesses, with these higher costs potentially being passed on to consumers in the form of higher prices.*
- ✓ *Furthermore, food inflation is expected to accelerate, with prices likely to rise due to potential increases in fertilizer costs and the adverse impact of El Niño-related weather conditions.*
- ✓ *Consequently, inflation is now projected to average approximately 6.0% for the year.*
- ✓ *However, the inflation outlook remains sensitive to developments in global energy markets, with different crude oil price trajectories posing varying degrees of upside risk to both direct and second-round inflationary effects.*



3. Fixed Income Health Score

“Health score to improve towards 2H2026 and 1H2027 ”



FI Economic Health Score: Apr – Jun 2026

The Fixed Income Health Score has declined by 9 points since its last update in Apr-26. The decline was primarily driven by a sharp rise in inflation and a larger-than-expected reduction in market liquidity, which decreased from around LKR 300.0Bn in Feb and Mar 2026 to below LKR 50.0Bn by Jun-26. Furthermore, a weakening balance of payments (BoP) position, coupled with softer investor confidence, weighed on the overall Health Score.



Primary Criteria

$$- \quad 47 \quad - \quad 07 \quad = \quad 40$$

Secondary Criteria

$$- \quad 18 \quad - \quad 02 \quad = \quad 16$$

Economic Health Score
[Jun 2026]

$$= \quad 56$$

[As against 65 in Apr-26 & 73 in Jun-25 (1 Year ago)]



Changes to Health Score

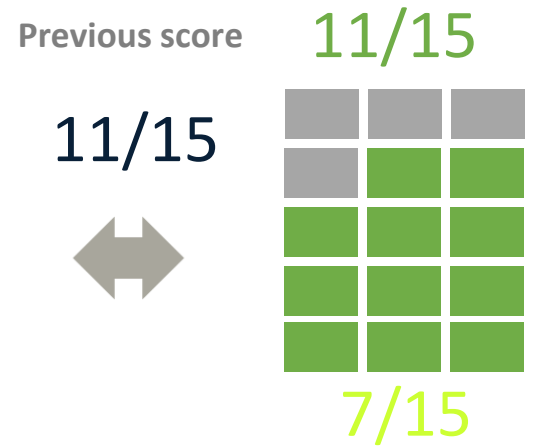
Primary Criteria: Apr – Jun 2026

40/75



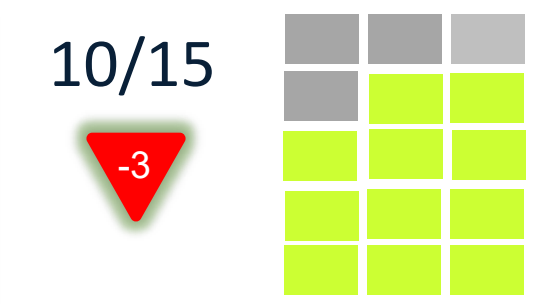
Foreign Reserves

Gross official reserves stood at USD 6.9Bn in May 2026, reflecting external debt repayments and net USD sales. The IMF also approved a USD 695.0Mn disbursement following the 5th and 6th EFF reviews.



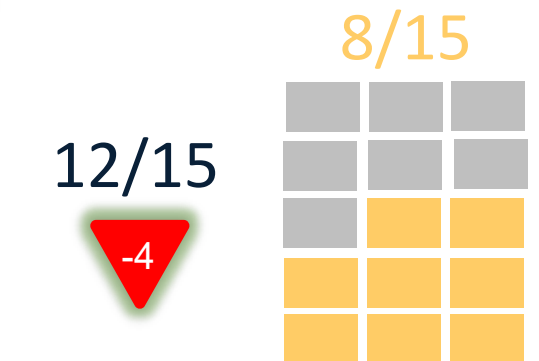
Liquidity

System liquidity moderated to an average of LKR 170.0Bn during Apr-May 2026 and has since declined below LKR 50.0Bn, reflecting CBSL USD sales and strong private sector credit growth.



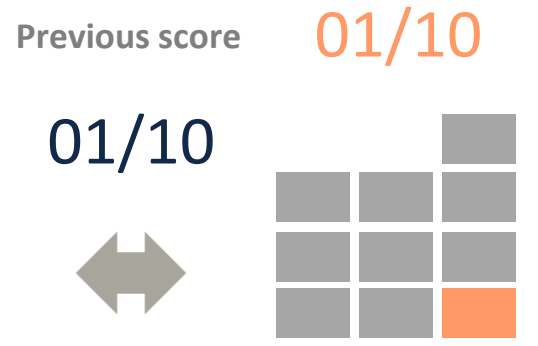
Inflation

Inflation rose sharply to 5.5%YoY in May-26, driven by higher global oil prices, which led to increases in domestic fuel and electricity tariffs.



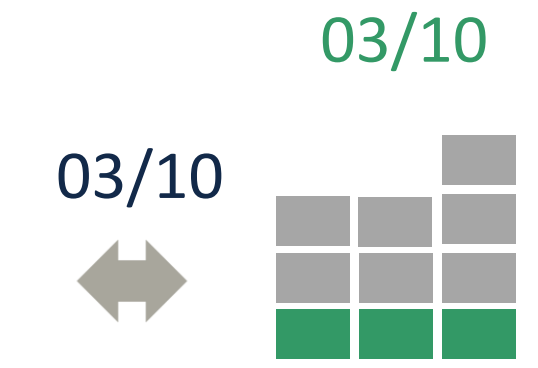
Foreign Activity

Foreign activity underwent little change since Mar-26 and continues to remain below the 5.0% threshold prescribed by the CBSL.



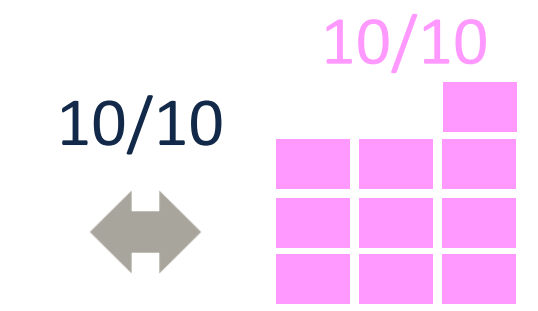
Credit

Private sector credit grew by 27.0%YoY in Apr-26, as outstanding credit increased by LKR 100.6Bn MoM to LKR 10.8Tn. Growth was supported by festive-season demand and higher working capital requirements among importers amid currency pressures.



CBSL Holdings

CBSL holdings remained broadly unchanged at LKR 2.5Tn.



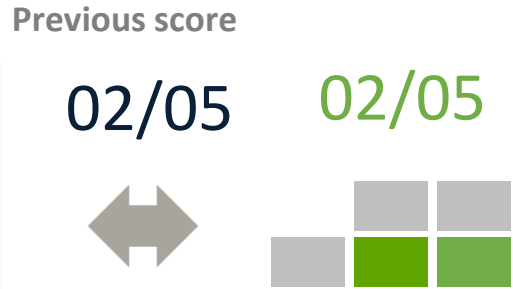


Changes to Health Score

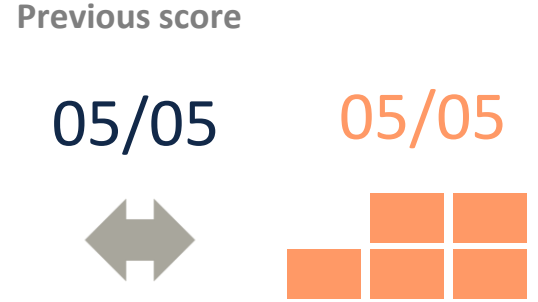
Secondary Criteria: Apr – Jun 2026

16/25

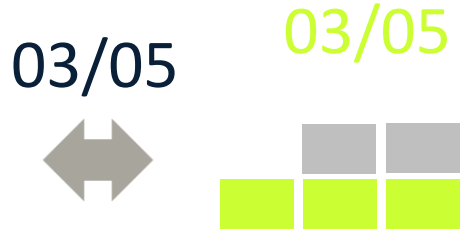
Rating Outlook
Backed by the stable outlook and recovery in economic indicators, S&P revised up their rating for Sri Lanka to CCC+ in Sep-25. With this all three agencies have revised up their rating for Sri Lanka from its previous SD rating.



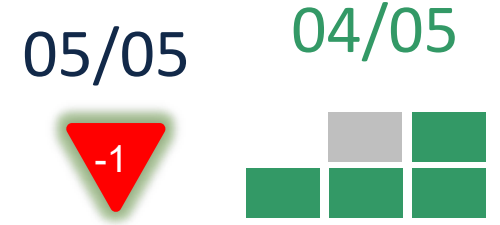
Political Risk
The political stability Sri Lanka achieved in 2025 continues to hold firm in May-26.



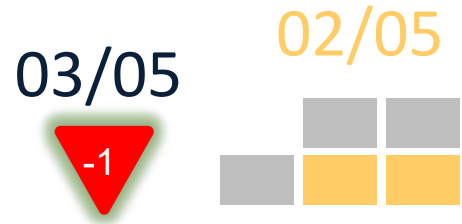
External Environment
Amid ongoing geopolitical tensions, the LKR has depreciated sharply, declining by approximately 8.0% YTD.



Investor Confidence
The business confidence index rose by seven points to 148 in May - from 141 in the month prior - marking a modest recovery following the sharp decline in April. The May index reflects a gradual adjustment in business sentiment to geopolitical tensions and mounting external pressures.



BOT & BOP
The current account shifted into a deficit in Apr-26, driven by a widening trade gap. Escalating tensions in the Middle East led to a sharp increase in global fuel prices, placing additional pressure on the current account balance.





4. New Recommendation

*“Dual advantage in short tenors;
continue short-end focus for
defensive positioning”*



FI Health expected enter the medium-low-risk territory; improvement anticipated towards 2H2026 and 1H2027

FI Health Score in 2025:

“A modest weakness was evident”

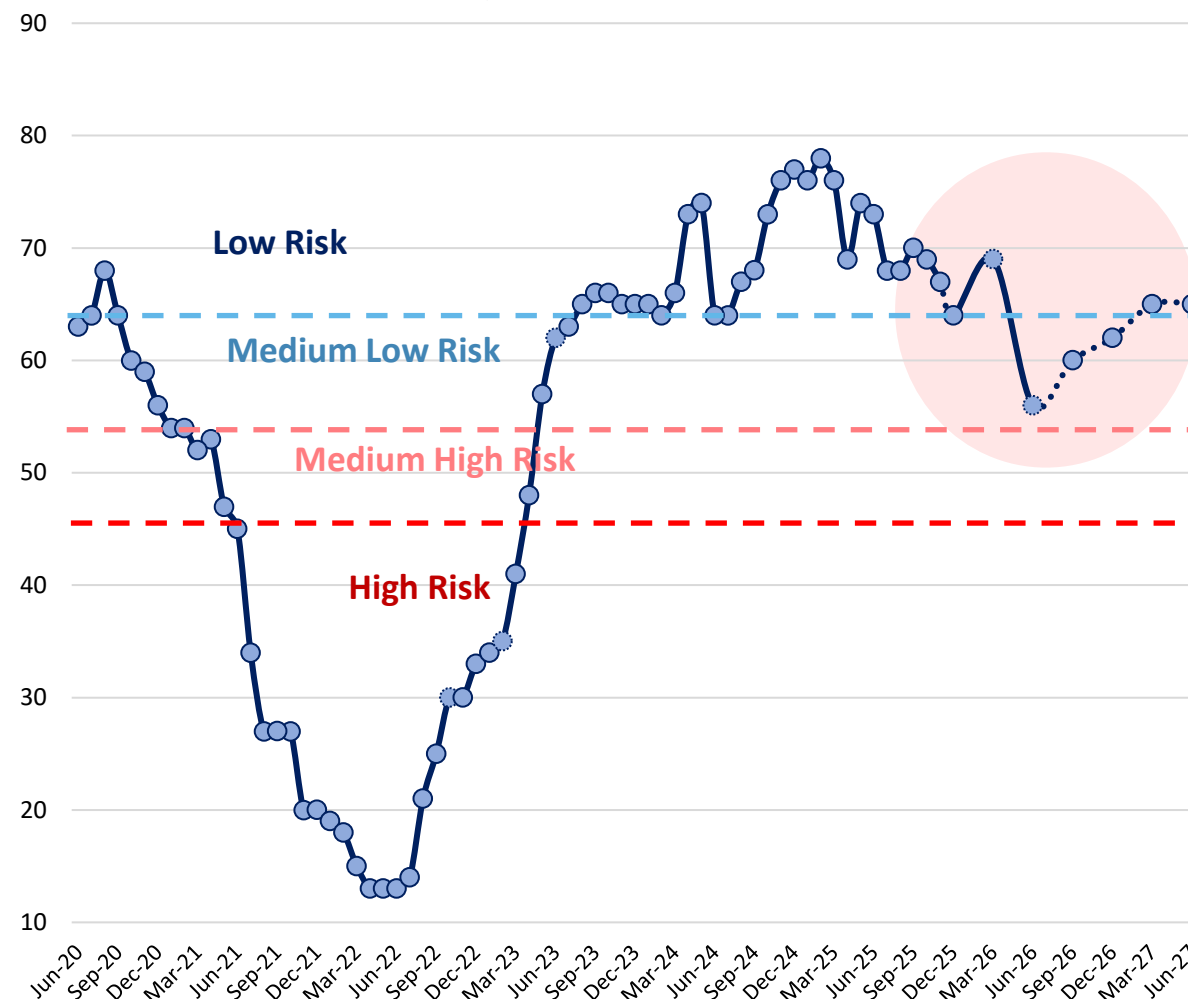
- ✓ Economic indicators underpinning the FI Health Score exhibited modest weakness in 2025, with the score edging lower, yet remaining above the medium-risk threshold.
- ✓ The decline reflected a contained build-up in official reserves, sustained expansion in private sector credit, rising inflation, and volatility in liquidity conditions.

FI Health Score in 2026E:

“Set to improve in 2H2026E and 1H2027E”

- ✓ The Health Score is expected to enter the medium-low risk threshold by mid-2026.
- ✓ However, an improvement in the Health Score is anticipated towards 2H2026 and 1H2027 aided by a possible slowdown in credit, improvement in liquidity conditions, moderation in inflation in 1H2027 and gradual buildup in reserves.
- ✓ **Considering the anticipated improvement in the Health Score, which is already believed to be priced into the yield curve, a stabilization in yields is expected during the upcoming 12-month period.**

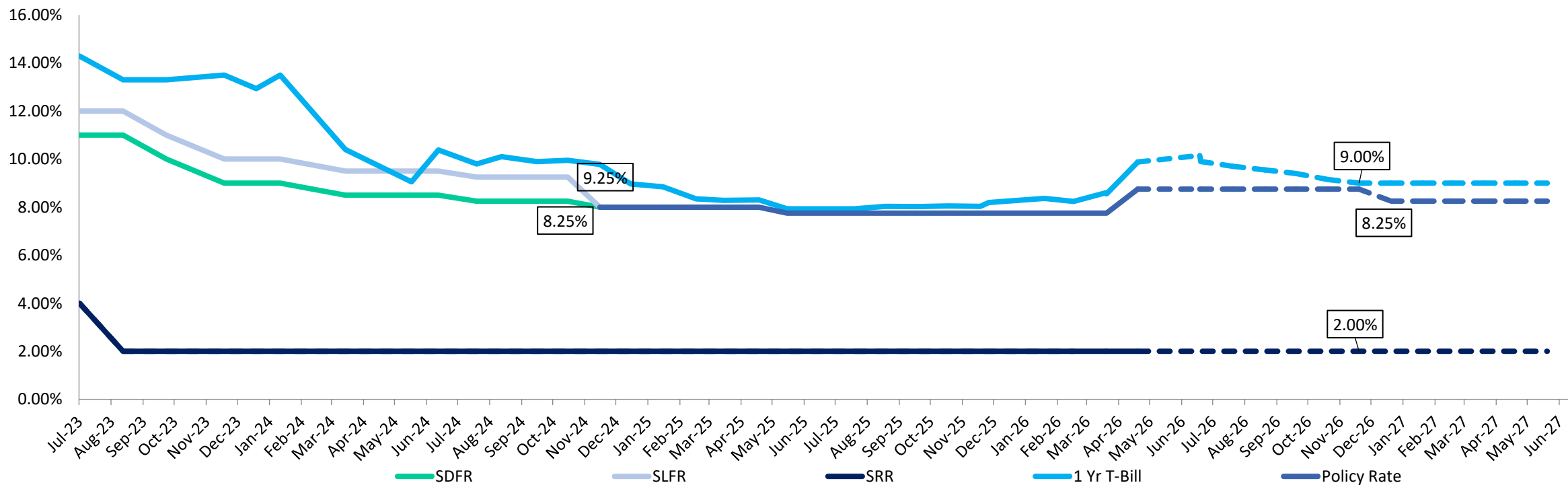
First Capital Fixed Income Health Score





OPR likely to be reduced towards the beginning of 2027E

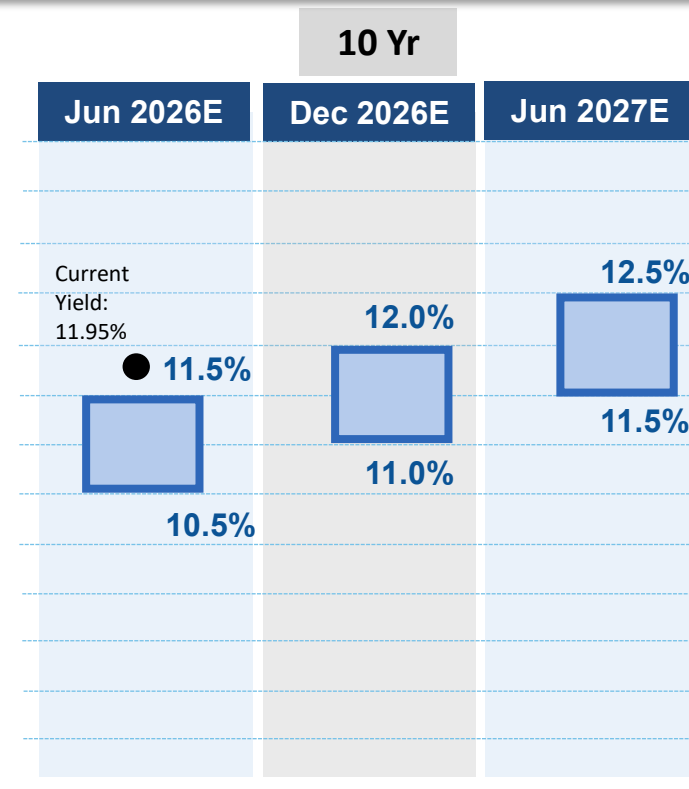
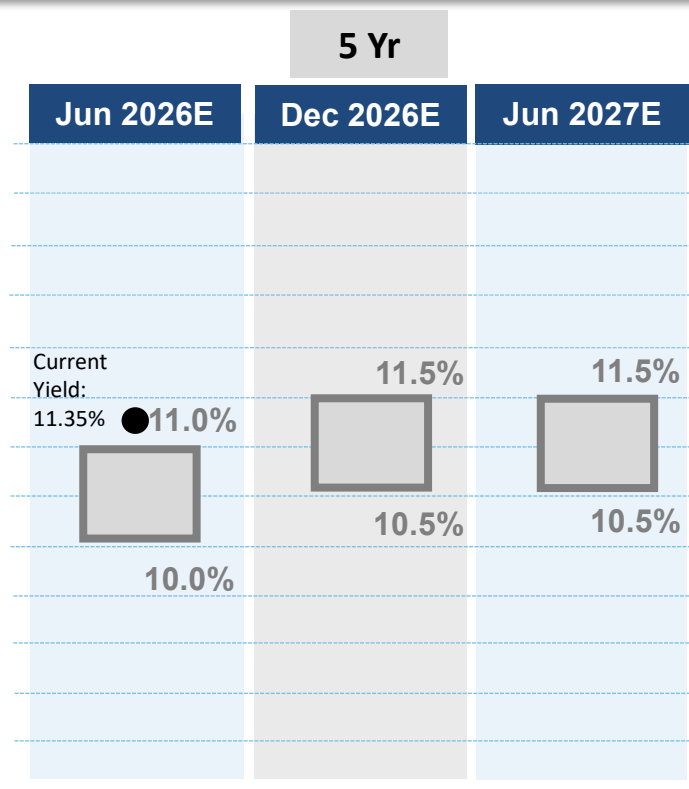
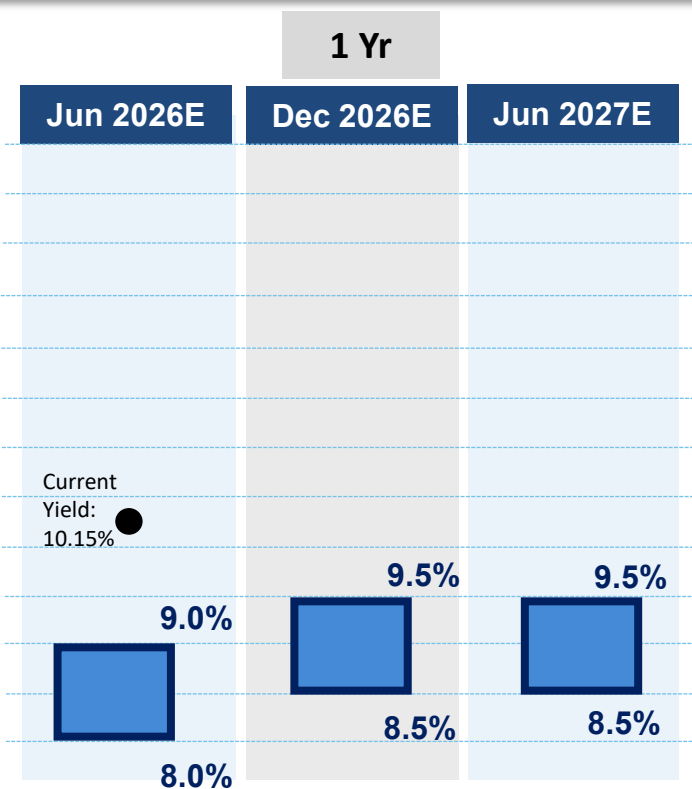
- ✓ The health score is expected to improve through 2H2026 and into 1H2027, supported by moderating private sector credit growth, improving liquidity conditions, easing inflation, and a gradual buildup in external reserves. We expect these indicators to gradually normalize following the CBSL's recent 100bps increase in the OPR. Nevertheless, as this improvement is already reflected in our health score, we expect yields to remain broadly stable over the next 12 months, leaving limited scope for policy rate cuts during the remainder of the year.
- ✓ However, GDP growth is expected to moderate to 3.0%-4.0% in 2026E-2027E, assuming a sustained ceasefire and global oil prices remain below USD 90/BBL, market-based fuel pricing is likely to soften domestic demand and economic activity. Coupled with easing inflationary and demand pressures, this should provide the CBSL with room to initiate a policy rate cut in early 2027E.





Mid to long tenors to remain stable, an opportunity lies in short tenors:

The 100bps rate hike delivered by CBSL in May-26, pushed the yield curve above and beyond our guidance signaling an overreaction from the investors. However, with direction from the PDMO with reduced WAYR acceptance and rejection of long tenors during last few auctions brought correction to the overreaction observed on the curve, which brought down yields to our stipulated levels. Looking ahead, with mid and longer tenors already within our bands, we believe there is more room for the short tenor to adjust down and move within our stipulated bands during 2H2026E and remain stable throughout 1H2027E. However, given that SL vulnerability to external shocks exposed yet again by Middle East war, amidst limited reserve buffers (currently covers 3.5months of imports), we anticipate investors to adapt a cautious stance and stay amongst short to mid tenors, whilst slight selling pressure is expected on the longer tenors, considering the rising external debt obligations from 2028E. Considering these assumptions, we continue to place a 50bps premia on the longer tenors in 1H2027E.

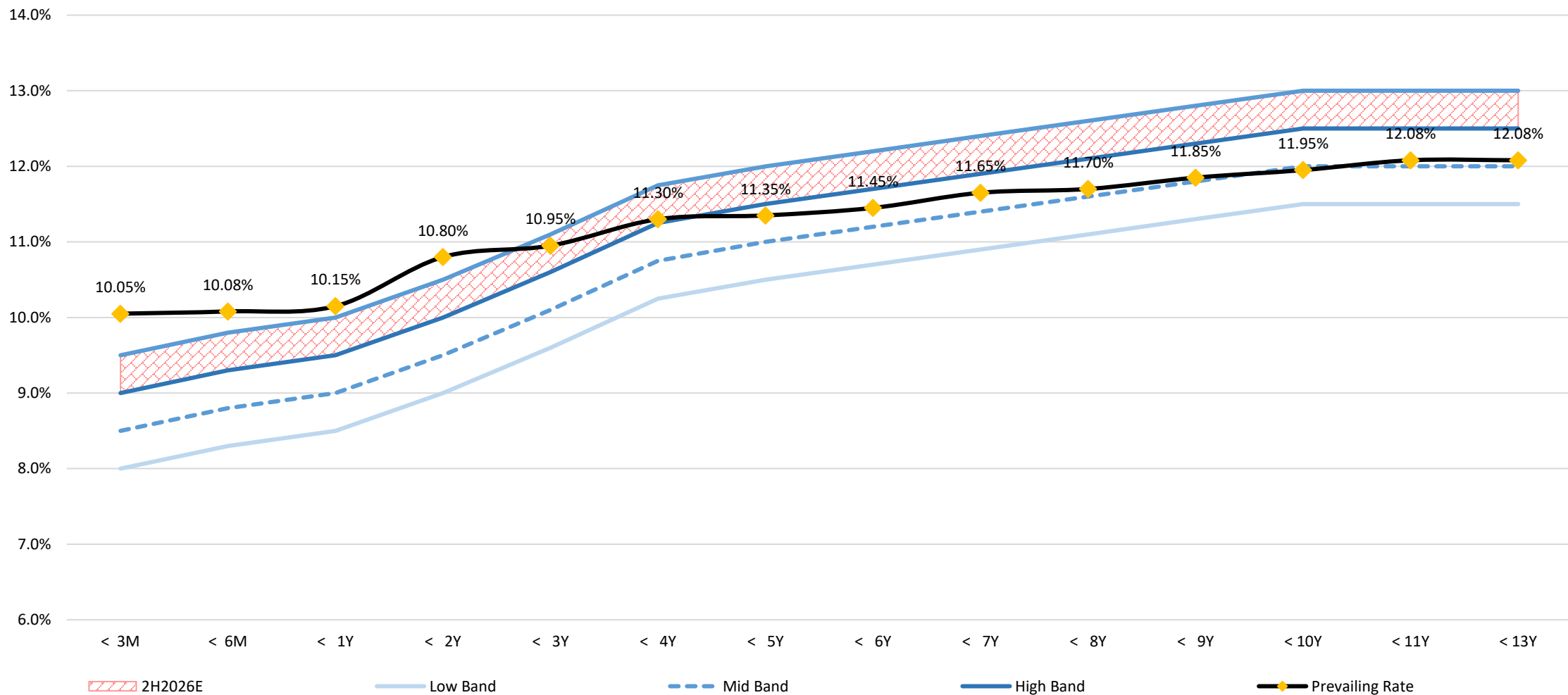


“Dual advantage on short tenors; continue short-end focus for defensive positioning”

- ✓ **Elevated inflation already factored in and countered by May-26 rate hike:** Given that the CBSL has already delivered a 100bps rate hike during May-26 policy review to counter the higher point to point inflation (beyond CBSL guided upper threshold of 7%), we believe that inflation has been brought under control. Taking in the assumption that the upcoming El-Nino weather will have a moderate impact on SL's inflation during 2H2026E, we believe any further upward pressure on the yield curve from inflation is unwarranted.
- ✓ **Private sector credit growth is expected to remain subdued amid higher borrowing costs and moderate liquidity levels:** Higher borrowing costs, weaker external demand, and tighter domestic policy measures, including import restrictions and stricter LTV limits are likely to constrain credit growth. This combination is likely to dampen investment appetite and slow overall lending activity across key sectors.
- ✓ **Liquidity is expected to stabilize above LKR 100.0Bn:** The expected improvement is likely to be supported by slower credit expansion, reflecting higher borrowing costs and a moderation in economic activity. Moreover, we expect liquidity to return in the coming months as importers slowly unlock the stuck liquidity in imported inventories during May-Jun 26 period (during the height of Rupee depreciation), whilst relatively higher primary balance supported by higher taxes, as also expected to benefit liquidity in the market.
- ✓ **Pressure on BOP to remain low in 2H2026E:** With the belief that fuel, be market priced during 3Q2026E (inline with the promise to IMF) coupled with low pressure stemming from global oil prices, we expect the pressure on BOP from imports to remain low during 2H2026E. However, larger current account balance is not expected, considering the lackluster growth observed from exports and tourism earnings.
- ✓ **Possibility of a rate cut with a possible slowdown in the economy:** GDP growth is expected to moderate to around 3.0%-4.0% in 2026E, reflecting weaker household consumption due to higher VAT and borrowing costs, alongside lower government capital expenditure. In response, a policy rate cut is likely towards the beginning of next year, to support economic activity.
- ✓ **Further space for moderation in short tenors.** With mid to long tenors already adjusted down, we believe an opportunity still lies in the short tenors. Considering the dual advantage of possible capital gains and option to maintain a carry till maturity, and limited scope from further reduction in mid to long tenors, we continue to advise investors to remain within shorter durations.



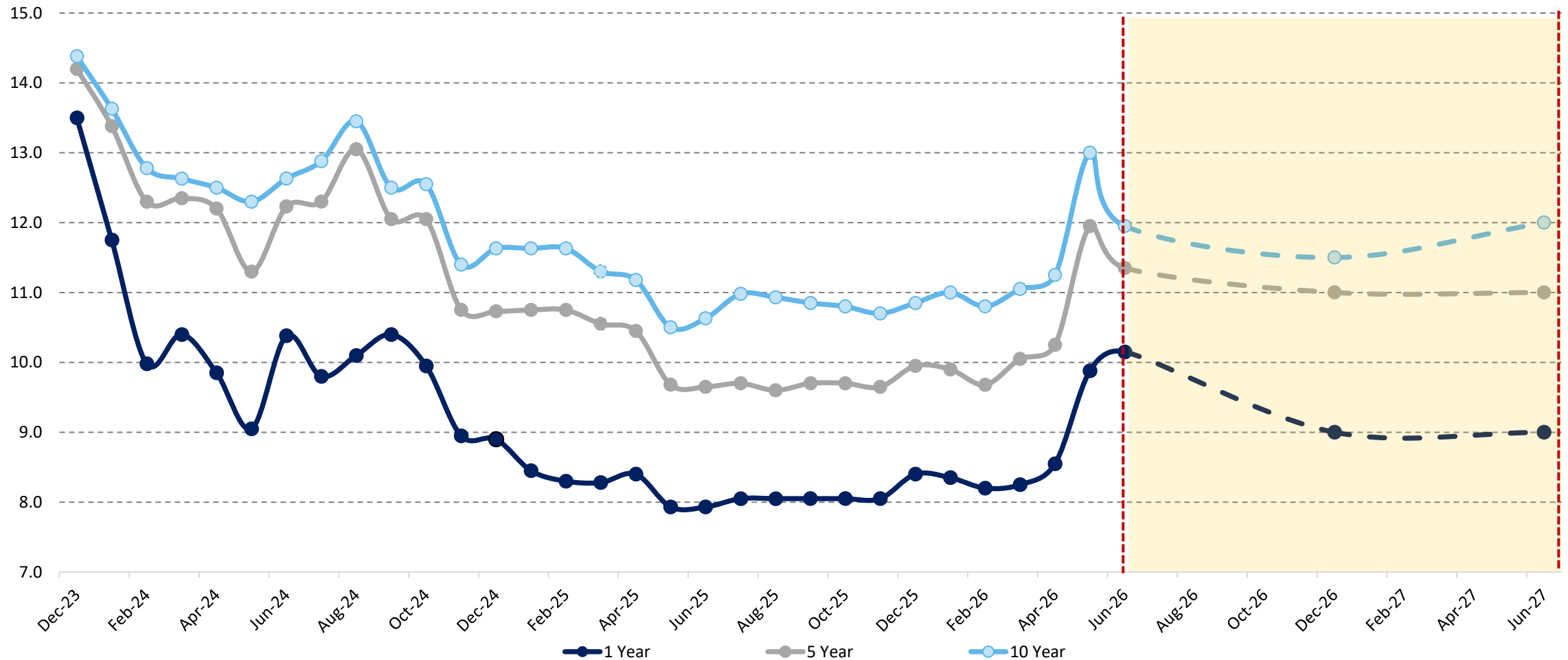
Short tenor yields are currently positioned above the forecast high band





Short tenors expected to adjust downwards in 2026E

Short-tenor yields are expected to normalize within FCR's range, while mid and longer-tenors are likely to remain stable



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Thank you!

*“SUCCESSFUL INVESTMENTS IS ABOUT
MANAGING RISKS”*



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