

First Capital
A Janashakthi Group Company

EASING INFLATION EXPECTATIONS AND MODERATING DOMESTIC DEMAND SUPPORT A POLICY HOLD

PRE-POLICY ANALYSIS | NOV 2026

16th Nov 2026

FIRST CAPITAL RESEARCH

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Previous Pre-Policy Report: Recap – Accurate

The Central Bank of Sri Lanka maintained the Overnight Policy Rate (OPR) at 8.75%

In line with our expectations, the Monetary Policy Board decided to **maintain the Overnight Policy Rate (OPR) at 8.75%**, after carefully considering the evolving conditions both globally and domestically.

Key Arguments Considered by CBSL for its Policy Stance Held on 29th September 2026

- ✓ It was noted that the effects of the monetary tightening carried out in May-26 alongside other measures had materialized to a great extent.
- ✓ The CBSL also recognized the uncertainty stemming from persistent geopolitical woes as well as the risks associated with El Niño conditions which could weigh on the economic outlook of Sri Lanka.
- ✓ It was highlighted that private credit growth had moderated in response to previous policy measures, while credit flows remain at adequate levels to support on-going economic activity.
- ✓ CBSL noted the rise in headline CCPI to 8.0%YoY in August-26, primarily reflecting the pass-through effects of high energy costs and stated that inflation would remain in high single digits till 1Q2027, before easing towards the 5.0% target.
- ✓ A moderation in import growth alongside a recovery in inflows from tourism supported current account resilience in August-26 while continued USD purchases by the CBSL strengthened reserve building efforts during this period.



Source: CBSL, First Capital Research

Expected Monetary Policy Stance

- We assign a **65% probability for a rate hold**, as moderating oil prices are expected to ease inflationary pressures and materially improve the near-term inflation outlook, while an apparent moderation in both credit and import growth points to a gradual moderation in domestic demand. Household vulnerabilities also warrant caution against further tightening. Meanwhile, improving external sector conditions, exchange rate stability and ample market liquidity provide additional support for maintaining the current policy stance. With fiscal consolidation already weighing on aggregate demand, we believe the cumulative impact of existing monetary and fiscal measures warrant a pause in further policy rate adjustments.
- We also assign a **30% probability for a rate hike,** reflecting persistent above-target inflation, potential El Niño-related food price pressures and the risk of a formal breach of the CBSL's inflation target. Meanwhile, prospective Fed tightening and broader global monetary tightening could add to exchange rate and capital flow pressures, strengthening the case for a rate hike to preserve policy credibility.
- A **5% probability has been assigned for a rate cut,** signifying the transitionary nature of this policy meeting. With the domestic economy now at a pivotal juncture, shifting from recovery to growth, monetary tightening is likely nearing its end, with growth promotion taking centre stage.

Expected Monetary Policy Stance	Probability
Raising Policy Rates by 50bps	0%
Raising Policy Rates by 25bps	30%
Policy Rates to remain unchanged	**65%**
Cutting Policy Rates by 25bps	5%
Cutting Policy Rates by 50bps	0%

As per our view, at the upcoming policy meeting there is a 65% probability for CBSL to maintain current policy rates. 30% has been assigned for a rate hike of 25bps while 5% has been assigned for a rate cut of 25bps.

Expected SRR Stance:

While the CBSL no longer announces its Statutory Reserve Ratio (SRR) decisions alongside the Monetary Policy Review, we no longer forecast SRR changes in our Pre-Policy Report.

Source: CBSL, First Capital Research

Analysis of Upcoming Policy Decision on 19th Nov

The below-mentioned factors argue against a hike in policy rates at the upcoming policy meeting

70%

Arguments against a Policy Rate Hike

- Declining oil prices likely to anchor the inflation outlook and limit the need for a rate hike
- Credit growth moderation supports a pause in further monetary tightening
- Household vulnerabilities strengthen the case for a measured policy stance
- External sector recovery gains momentum, supporting a policy rate hold
- Exchange rate stability supports the case for a policy hold
- Ample market liquidity could support an extended policy rate pause
- Fiscal consolidation is already weighing on aggregate demand

The below-mentioned factors argue for a hike in policy rates at the upcoming policy meeting

30%

Arguments for a Policy Rate Hike

- Inflation remains above the tolerance band, sustaining pressure on CBSL to uphold its policy credibility
- El Niño risks could reignite food inflation despite easing energy prices
- A potential Fed rate hike could add to external pressures, strengthening the case for domestic tightening
- Global monetary tightening is broadening beyond the Fed, further raising the bar for policy credibility



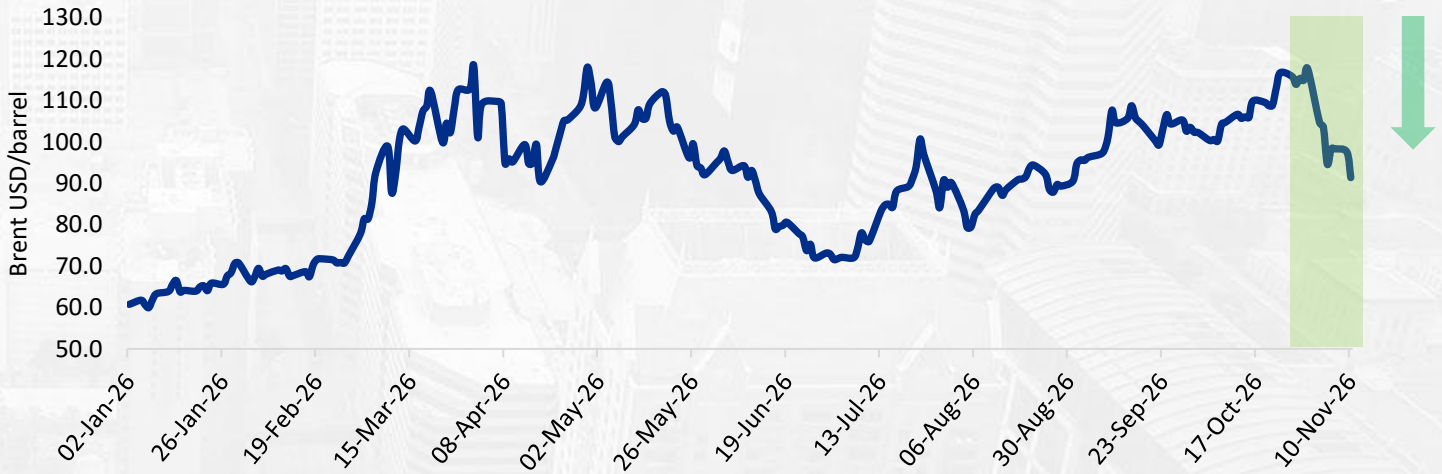
Arguments *against a hike* in monetary policy

Arguments against a hike in monetary policy

Declining oil prices likely to anchor the inflation outlook and limit the need for a rate hike

Higher energy prices have been the primary driver of elevated inflation, with second-round effects further intensifying upward pressure on the general price level. However, following the US midterm elections on the 3rd Nov-26 and the Democratic Party's victory, oil prices have continued to decline. The Republican Party's electoral setback under President Trump, alongside the loss of majority power by Prime Minister Netanyahu's party in the recent Israeli elections, has contributed to a significant shift in the geopolitical landscape. Growing optimism over a potential end to the Middle East conflict has further improved global sentiment, pushing oil prices below USD 100/barrel. Prices are likely to remain around these levels, particularly following President Trump's remarks that the war with Iran may now be over. Moreover, global energy prices have scope to decline further, with end-2027 Brent crude oil price forecasted at USD 78/barrel by Goldman Sachs. While the benefits of lower energy prices may take some time to filter through, a sustained decline in global oil prices would help ease domestic inflationary pressures and anchor inflation over the medium term. Against this backdrop, the CBSL has greater reason to allow the disinflationary effects of lower oil prices to run their course rather than resort to a policy rate hike to contain inflation.

Oil prices retreat below USD 100/barrel following US midterm results



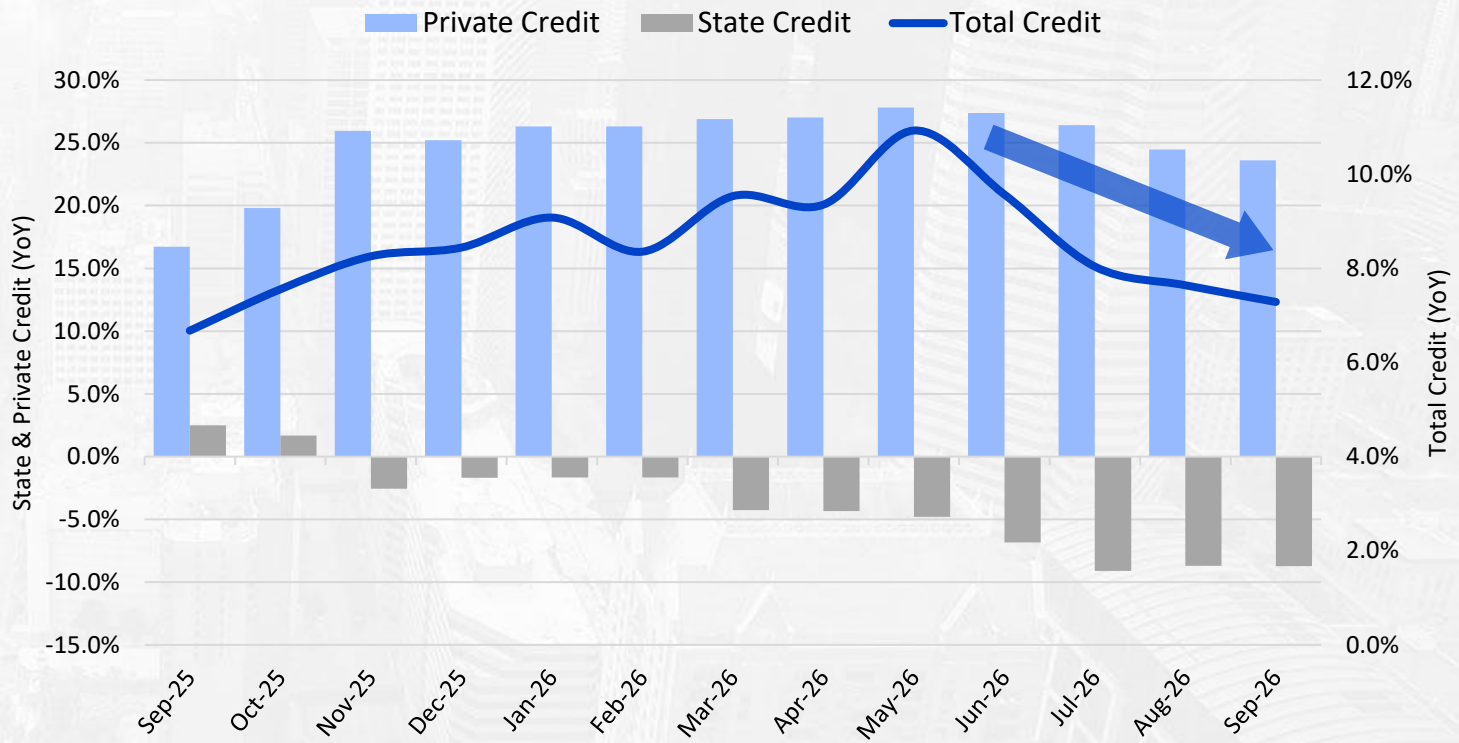
Source: Bloomberg, Goldman Sachs, First Capital Research

Arguments against a hike in monetary policy

Credit growth moderation supports a pause in further monetary tightening

Total credit growth has moderated to 7.3%YoY, with total new credit for Sep-26 declining by 12.6%YoY, reflecting both a sustained contraction in credit to the state sector and a gradual easing in private sector credit. The deceleration in private credit growth, which has been evident since Jun-26, follows the 100-bps increase in the OPR and points to a gradual transmission of tighter monetary conditions. This moderation also reflects the containment of underlying domestic demand, as corroborated by the gradual slowdown in import growth. Accordingly, with the impact of the May-26 rate hike having largely filtered through to the economy and demand conditions showing signs of moderation, there is no immediate need for further monetary policy tightening at this juncture.

Total credit growth dips to 7.3%YoY in Sep-26



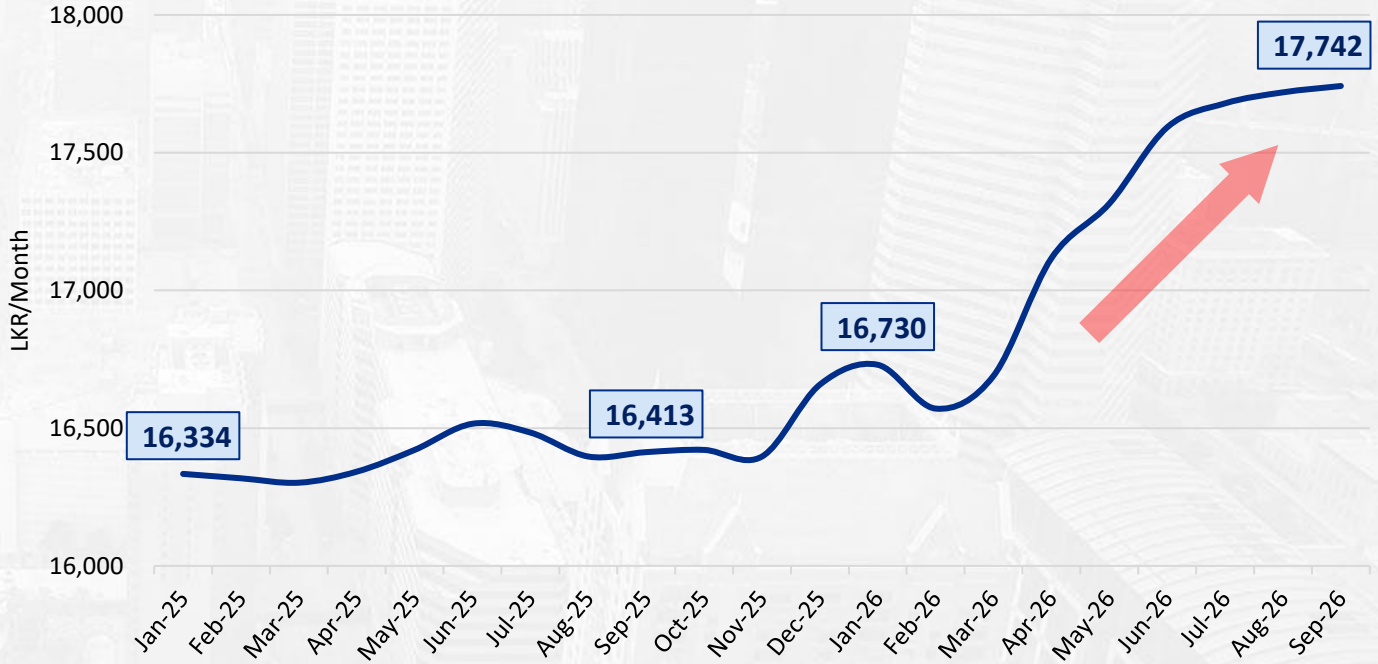
Source: CBSL, First Capital Research

Arguments against a hike in monetary policy

Household vulnerabilities strengthen the case for a measured policy stance

As Sri Lanka approaches the conclusion of its IMF-EFF programme, the country stands at a pivotal juncture in its economic recovery and growth trajectory. Elevated energy prices and rising living costs have placed considerable pressure on domestic consumers, particularly those at the lower end of the socio-economic spectrum. The IMF, in its combined fifth and sixth reviews, highlighted that a quarter of Sri Lanka's population lives below the official poverty line. Furthermore, recent data indicate that the national poverty line has risen to LKR 17,742 per month as at Sep-26, underscoring the cost-of-living pressures faced by households throughout the year. With the impact of the 100-bps rate hike in May-26 having largely filtered through the economy and inflation expectations remaining broadly anchored, a further rate hike could place additional strain on vulnerable households while weighing on Sri Lanka's broader growth prospects.

The National Poverty Line rose by 8.1%YoY in Sep-26



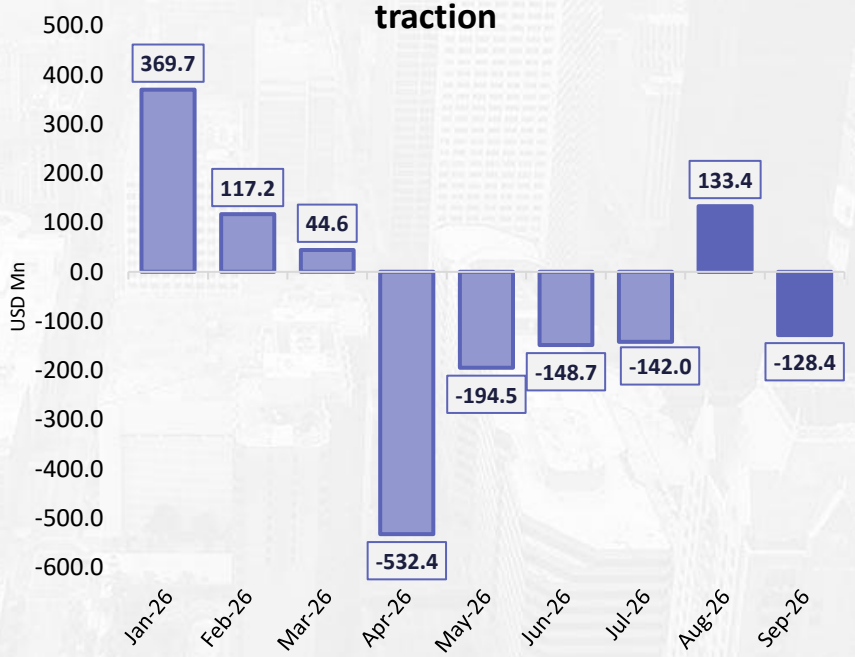
Source: DCS, IMF

Arguments against a hike in monetary policy

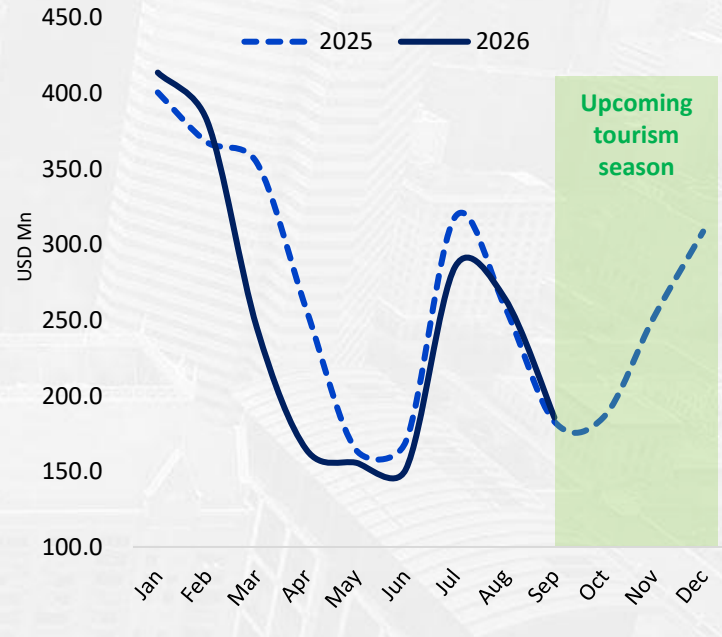
External sector recovery gains momentum, supporting a policy rate hold

Middle East turbulence continued to weigh on Sri Lanka's external sector performance. Nevertheless, the current account has begun to exhibit signs of recovery, recording a surplus of USD 133.4Mn in Aug-26, while the deficit in Sep-26 narrowed to USD 128.4Mn, down from USD 193.8Mn during the corresponding period last year. In September, export growth of 21.0%YoY provided significant support to the trade account. Import growth, meanwhile, remained relatively subdued at 2.9%YoY, reflecting, in part, the lagged effects of the 100-bps policy rate hike implemented in May-26. Looking ahead, the current account is expected to maintain its improving trajectory, underpinned by the forthcoming tourism season and the typically stronger remittance inflows observed during the final quarter of the year. The improving external position is likely to reinforce the CBSL's preference for a cautious, data-dependent policy stance, supporting a wait-and-see approach and an unchanged OPR at the upcoming policy meeting.

Current Account recovery has gained traction



Tourism earnings rebound ahead of peak season



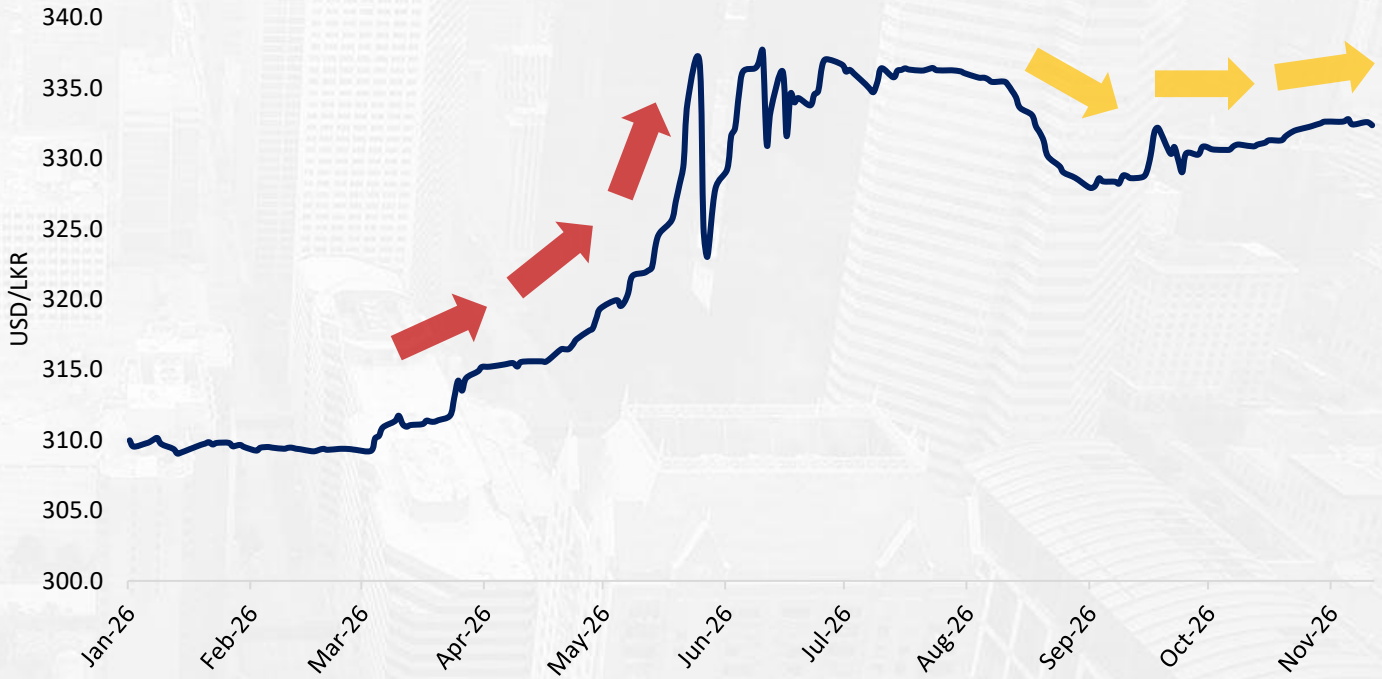
Source: CBSL

Arguments against a hike in monetary policy

Exchange rate stability supports the case for a policy hold

The LKR has remained largely stable against the US dollar following the volatility observed in mid-2026. While some mild depreciation pressure has emerged since August, the currency is expected to remain broadly stable over the near to medium term, supported by a moderation in the oil import bill and the resulting containment of external financing pressures. Furthermore, the seasonal uptick in tourism earnings and workers' remittances expected in the final quarter should provide additional support to foreign exchange inflows and strengthen the current account position. Accordingly, with external sector pressures remaining contained and limited near-term risks to exchange rate stability, a policy hold is warranted at the upcoming monetary policy meeting.

LKR stability underpins the near-term exchange rate outlook



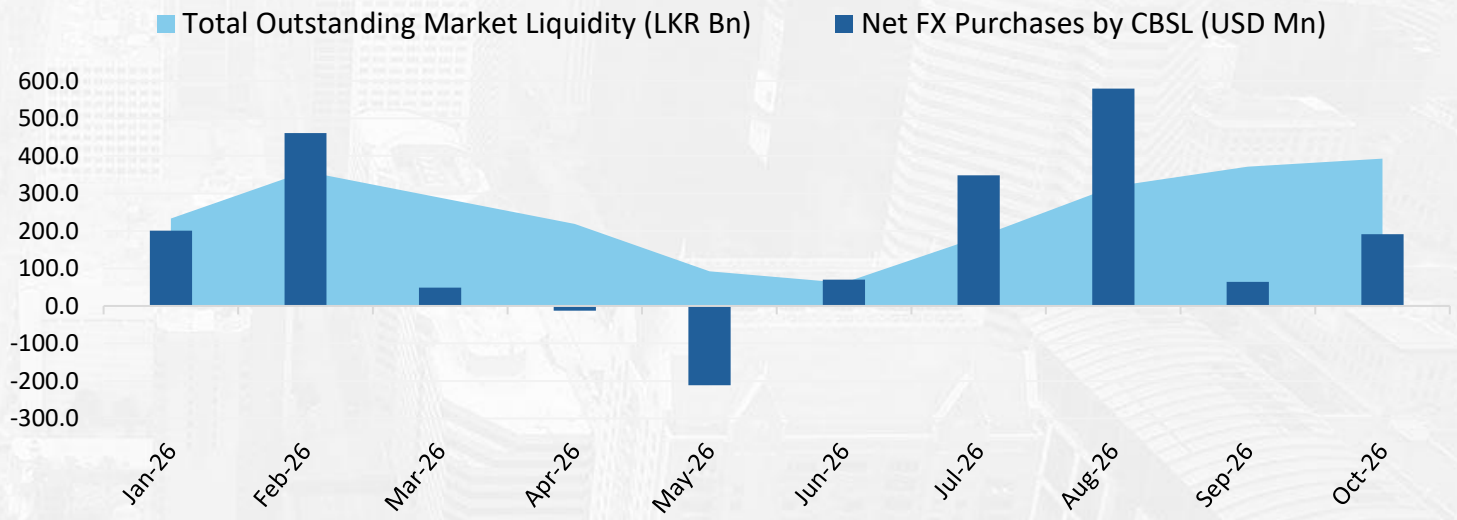
Source: CBSL

Arguments against a hike in monetary policy

Ample market liquidity could support an extended policy rate pause

With the current account showing signs of recovery and external deficits expected to remain contained, the CBSL is likely to step up its reserve accumulation efforts, particularly given the IMF-prescribed end-2026 reserve threshold of USD 8.6Bn, against the end-October level of USD 7.1Bn. Reflecting this trend, the CBSL purchased USD 191.3Mn from the domestic market in October, exceeding both the previous month's purchases and the corresponding period last year. As reserve accumulation gathers pace, sustained foreign exchange purchases would translate into higher LKR injections into the domestic banking system, potentially supporting rupee liquidity in the months ahead. This trend is already reflected in the average market liquidity levels seen in Oct-26, which stood at LKR 386.5Bn as well as in the latest liquidity figure which rose to a high of LKR 463.0Bn on the 12th of Nov-26. This improvement in domestic liquidity conditions would help offset any tightening pressures and reduce the immediate need for further policy rate increases, reinforcing the case for an unchanged OPR. Moreover, the CBSL's continued absorption of excess liquidity through OMOs further enables the management of liquidity while maintaining policy rates on hold.

Elevated market liquidity likely to persist in the near term



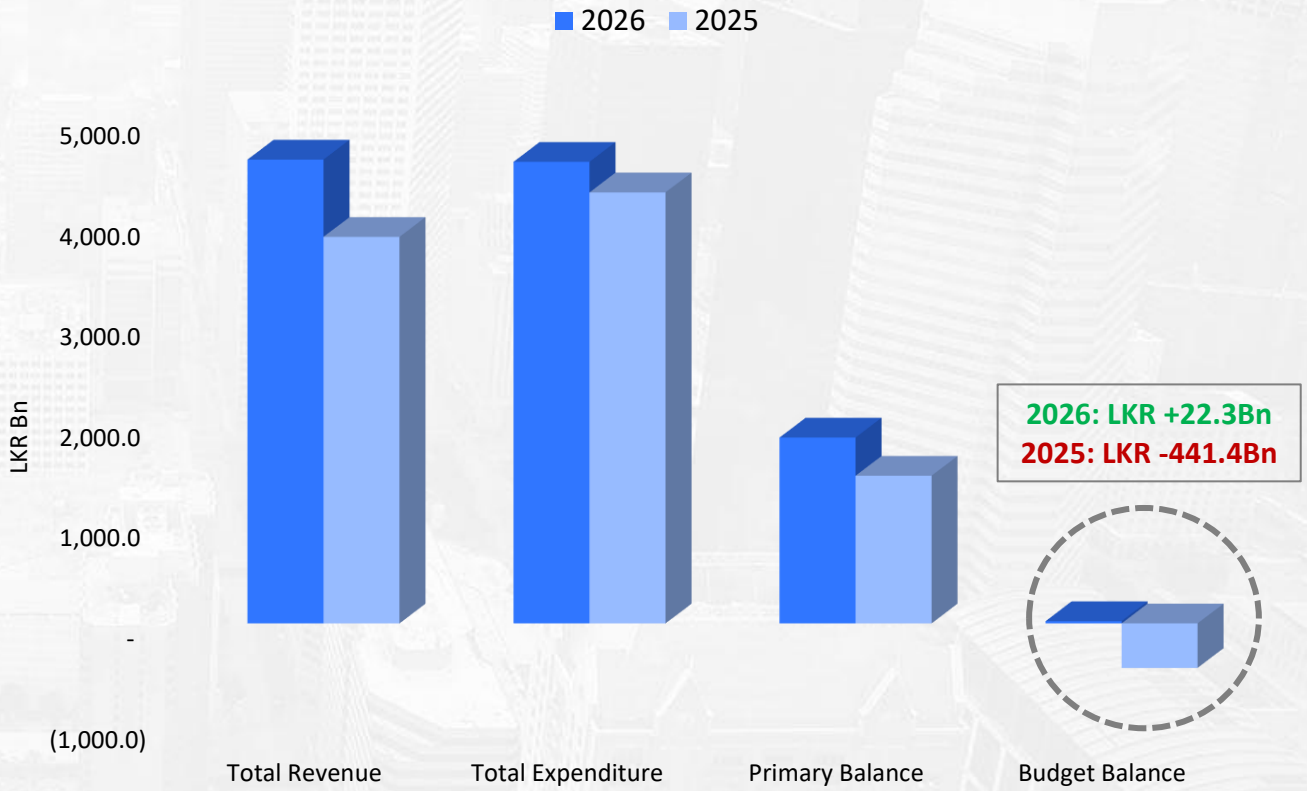
Source: CBSL

Arguments against a hike in monetary policy

Fiscal consolidation is already weighing on aggregate demand

During the first nine months of 2026, the government recorded a budget surplus of LKR 22.3Bn, compared to a deficit of LKR 441.4Bn during the corresponding period last year. This improvement was underpinned by a 20%YoY increase in total revenue, while growth in total expenditure was contained to 7%YoY. The revenue-led fiscal consolidation, coupled with expenditure restraint and tighter fiscal conditions, is already exerting a contractionary influence on aggregate demand. Against this backdrop, further monetary tightening may not be warranted.

During Jan-Sep of 2026 a budget surplus of LKR 22.3Bn was recorded



Source: MoF, First Capital Research

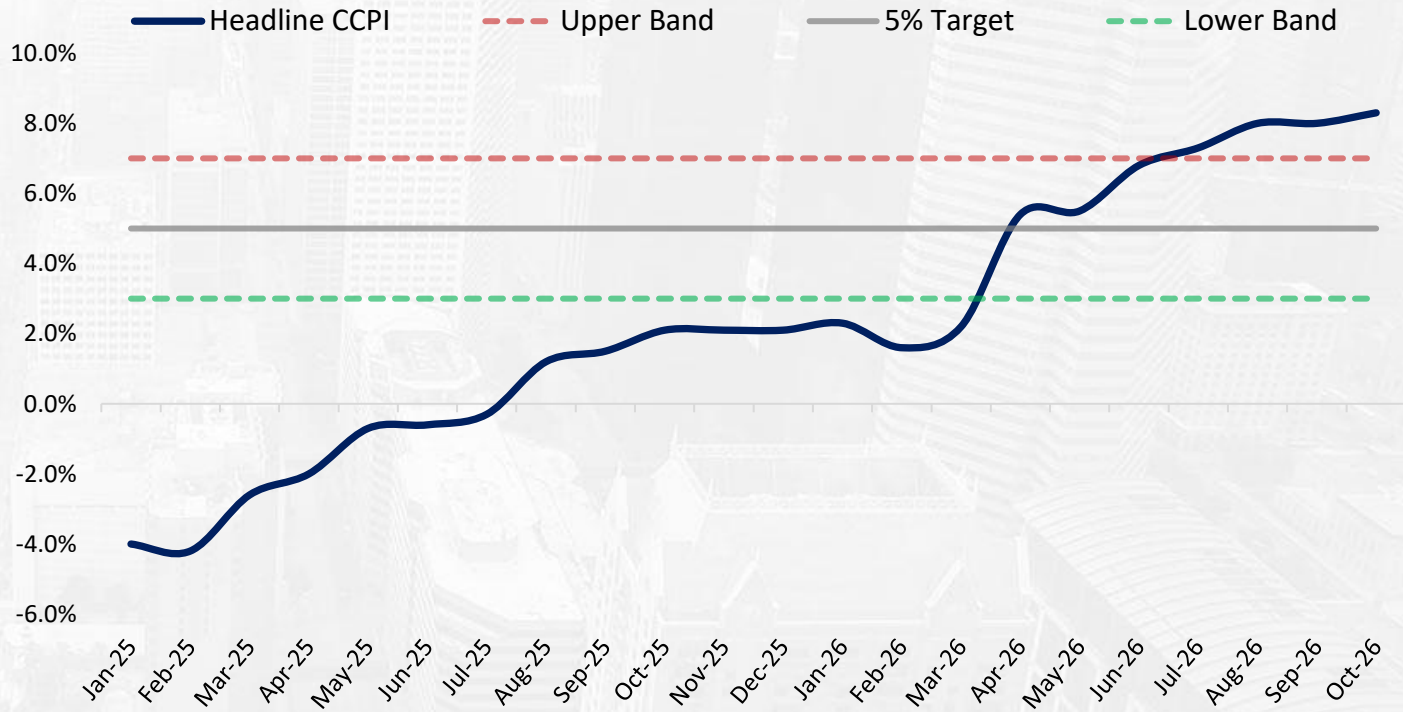


Arguments *for a hike* in monetary policy

Arguments for a hike in monetary policy

Inflation remains above the tolerance band, sustaining pressure on CBSL to uphold its policy credibility

Under the Monetary Policy Framework Agreement (PFA), the CBSL is deemed to have missed its inflation target if headline inflation deviates by more than ±2pp from the 5% target for two consecutive quarters. Headline inflation breached the upper tolerance band in 3Q2026 and accelerated further to 8.3%YoY in October, widening the deviation from the target. This places the CBSL in a challenging position, with average inflation for Nov–Dec needing to moderate to approximately 6.3% or below to avoid a formal breach of the MPFA. While the current inflation overshoot is largely supply-driven, the persistence of inflation above the tolerance band risks undermining policy credibility and anchoring higher inflation expectations. This strengthens the case for a pre-emptive rate hike to reinforce the CBSL's commitment to price stability.



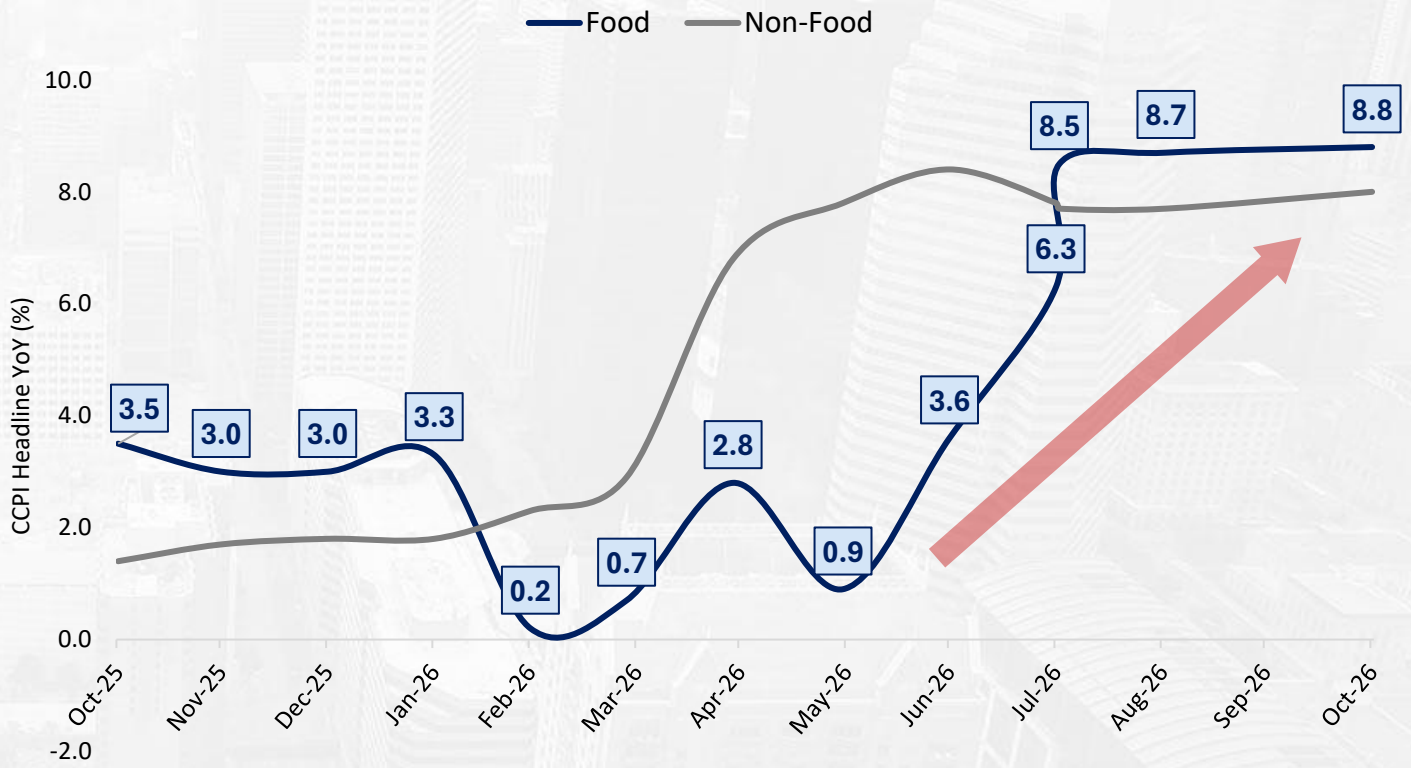
Source: CBSL, DCS, First Capital Research

Arguments for a hike in monetary policy

El Niño risks could reignite food inflation despite easing energy prices

While the moderation in global energy prices provides some relief to the near-term inflation outlook, emerging El Niño risks present a fresh source of upside pressure, particularly through food inflation. Adverse weather conditions could affect domestic agricultural output and food supply, placing further upward pressure on food prices and complicating the CBSL's efforts to bring inflation back within its target band. While a sustained acceleration in food inflation could strengthen the case for a tighter monetary policy stance, these pressures remain largely supply-driven and may therefore have limited responsiveness to further monetary tightening.

Food inflation (YoY) rose for the fifth consecutive month in Oct-26

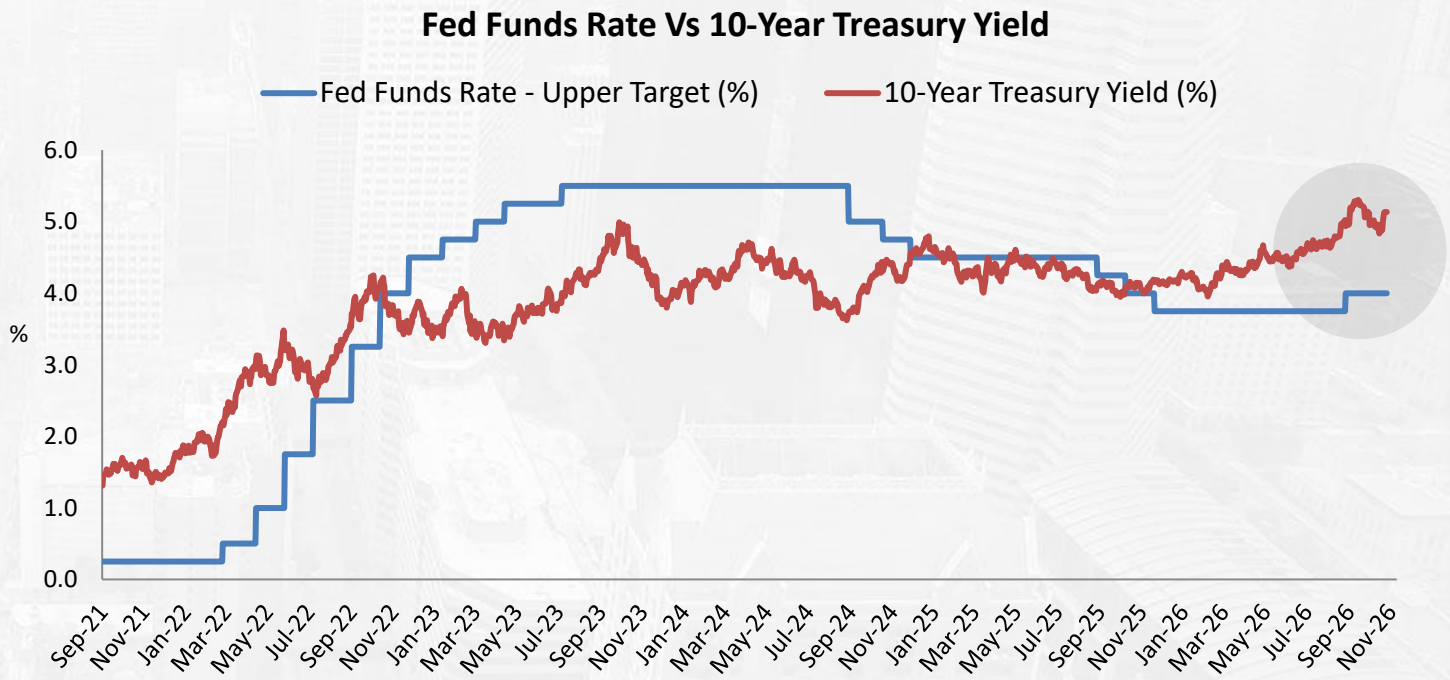


Source: CBSL, First Capital Research

Arguments for a hike in monetary policy

A potential Fed rate hike could add to external pressures, strengthening the case for domestic tightening

Inflation in the United States rose more than analysts had anticipated in October, prompting financial markets to reassess the likelihood of further monetary tightening by the Federal Reserve (Fed). Having raised its benchmark interest rate by 25-bps to 3.75%–4.00% in Sep-26, markets are now pricing in a further 25-bps hike at the December meeting. A potential Fed rate hike, or even the anticipation of one, could lend further strength to the US dollar, adding to depreciationary pressures on the LKR and introducing an additional external consideration for the CBSL. Higher US yields could also weigh on foreign investment flows, including FDI and foreign holdings of Treasury securities. This further strengthens the case for a rate hike to safeguard the relative attractiveness of domestic assets and limit potential capital outflow pressures.



Source: Bloomberg, First Capital Research

Arguments for a hike in monetary policy

Global monetary tightening is broadening beyond the Fed, further raising the bar for policy credibility

The policy response among major central banks following the escalation of Middle East tensions points to a broader shift towards containing inflationary pressures, particularly the potential second-round effects of higher energy prices. The Reserve Bank of India and Bank of Canada have already raised rates by 25bps, while the ECB remains alert to upside inflation risks and the Bank of Japan has signalled further tightening. This broader shift towards tighter monetary policy could increase competition for global capital, placing pressure on emerging markets such as Sri Lanka to maintain the relative attractiveness of domestic yields. While the CBSL's 100bps hike in May 2026 provides some policy buffer, sustained tightening across major economies could add to the case for further domestic rate adjustments.

Monetary Authority	Latest Policy Meeting	Decision
Reserve Bank of India	07 October	Raised rates by +25bp to 5.5%; first hike since 2023, driven by accelerating inflation and a weakening currency
Federal Reserve Bank (US)	28 October	Held rates; assessing the effect of September's hike, despite Middle East energy prices pushing inflation higher; December hike still possible
Bank of Canada	28 October	Raised rates by +25bp to 2.5%; first hike since July 2023, with the aim of containing the spillover of high fuel prices into broader inflation; signaled further tightening may follow
European Central Bank	29 October	Held rates; weighing rising energy prices and upside inflation risks against weakening growth prospects, while monitoring potential second-round effects.
Bank of Japan	30 October	Held rates; signalled further tightening as underlying inflation reaches the 2% target, supported by wage growth and persistent labour shortages.

Source: Respective Central Banks, First Capital Research

Factors in Consideration at the Policy Review

Inflation
CCPI +8.3% (YoY) for Oct-26

Foreign Reserves
USD 7.1Bn by Oct-26

GDP Growth
+4.2% in 2Q2026



03M T-Bill Rate
9.35% as of 11th Nov-26

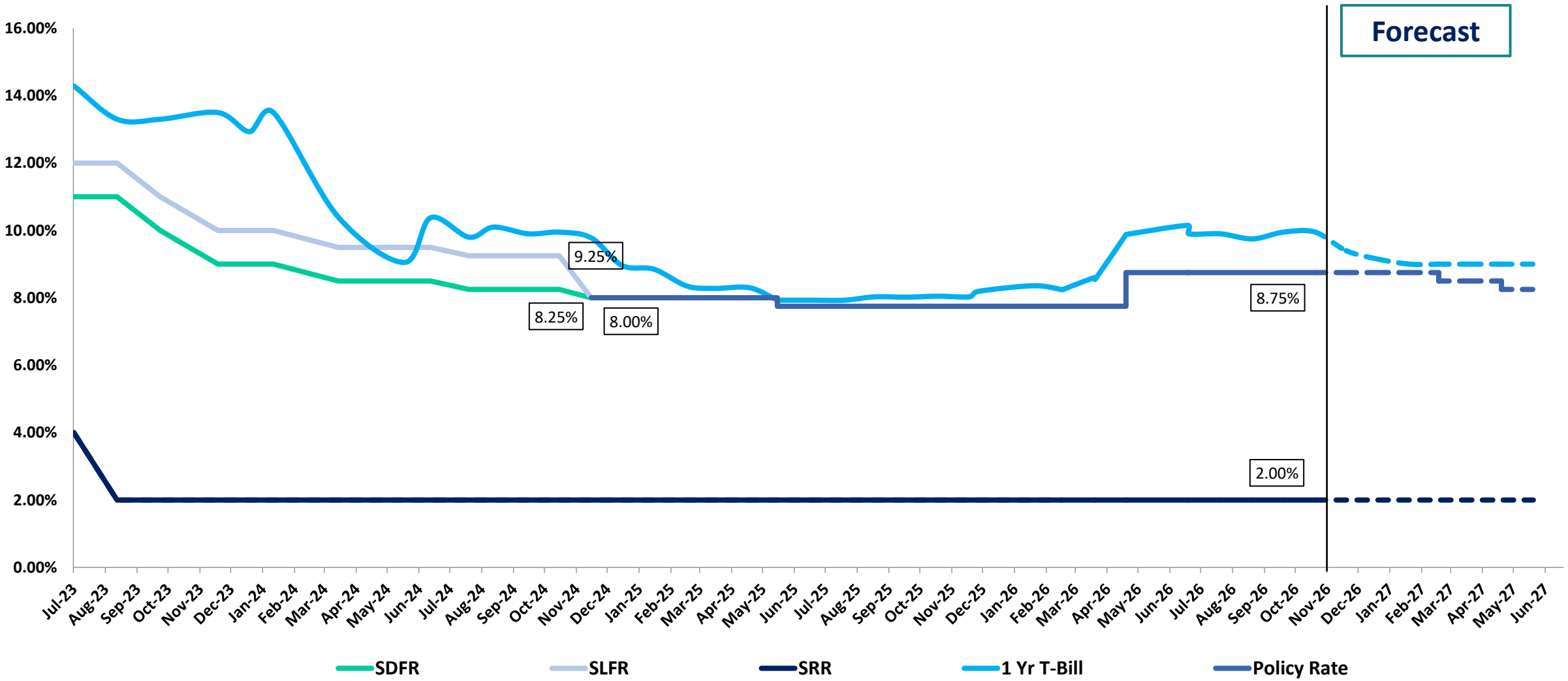
Total Private Sector Credit
Increased by LKR 212Bn in Sep-26

Liquidity and CBSL Holdings:
LKR 463.0Bn and LKR 2.5Tn
as at 12th Nov-26

BOT Deficit was
USD -128.4Mn for Sep-26

Source: CBSL, First Capital Research

Monetary Policy Rates



Source: CBSL, First Capital Research

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