



**TARIFF
30%**



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SRI LANKA'S APPAREL SECTOR IN THE POST-TARIFF ERA

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FIRST CAPITAL RESEARCH

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***Please refer page 11 for an important disclaimer*

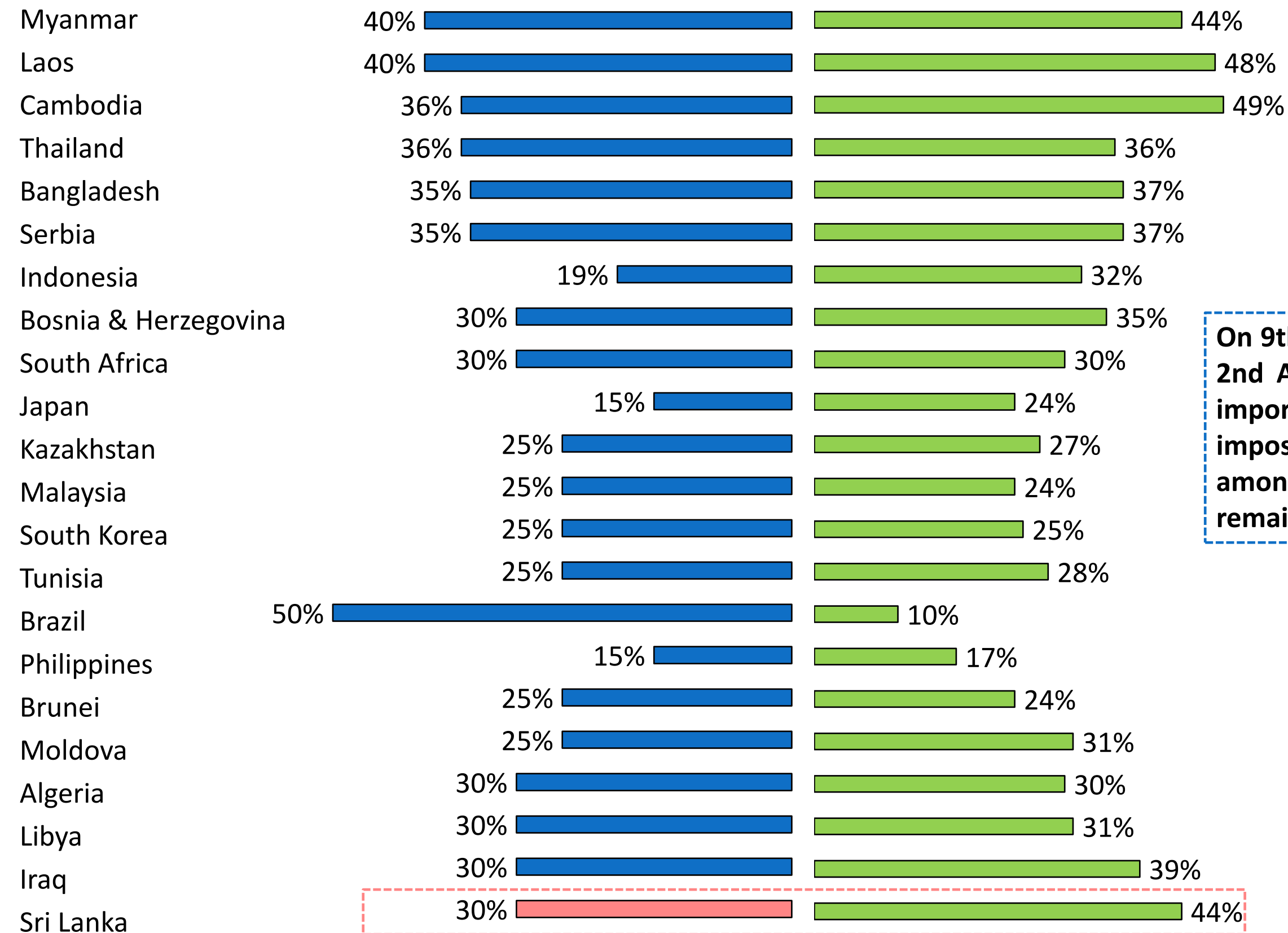
Summary of the 30.0% U.S. tariff impact

On 9th July 2025, U.S. has revised its earlier decision from 2nd April 2025 by lowering the reciprocal tariff rate on imports from Sri Lanka to 30.0%, down from the initially imposed 44.0%. Despite this reduction despite this reduction, a 30.0% tariff continues to impose a substantial cost burden, as the post-tariff average unit selling price remains significantly higher than the regional competitors.

Impact of 30.0% U.S. tariff

- ❑ According to industry experts, 60.0% to 70.0% of apparel exports are value-added products that require advanced skills and training. However, due to the simplicity of the sewing process, orders can be transferred within six months.
- ❑ Relocating orders to cheaper countries may reduce apparel volumes by 10.0% - 15.0% with an apparel export loss of USD 290.0Mn in the near-term.
- ❑ FCR anticipates apparel and textiles exports may reduce by 5.0% due to global economic slowdown by 2026E on par with the decline witnessed during 2009 world economic recession. Accordingly, FCR expects net export loss of USD 110.0Mn in short-term.
- ❑ Impact of 5.0% reduction in apparel exports due to global economic slowdown and 10.0% to 15.0% volume drop due to relocating in U.S. may impact GDP by adversely 0.6%, merchandise trade deficit by 4.2% and employment rate could reduce by c.11.0% in the apparel sector.
- ❑ In the short-term, order relocations are expected to shift toward Vietnam and India due to several key advantages.

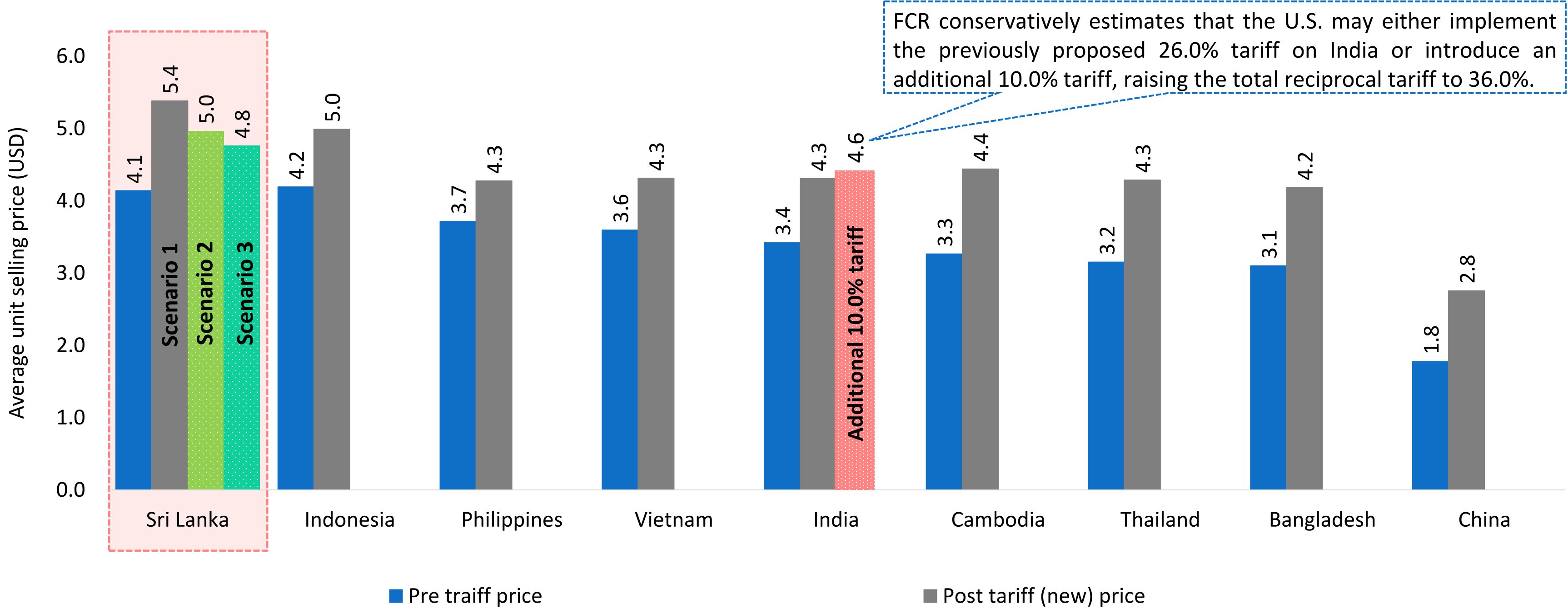
U.S. has reduced reciprocal tariff to 30.0% from previously imposed 44.0%



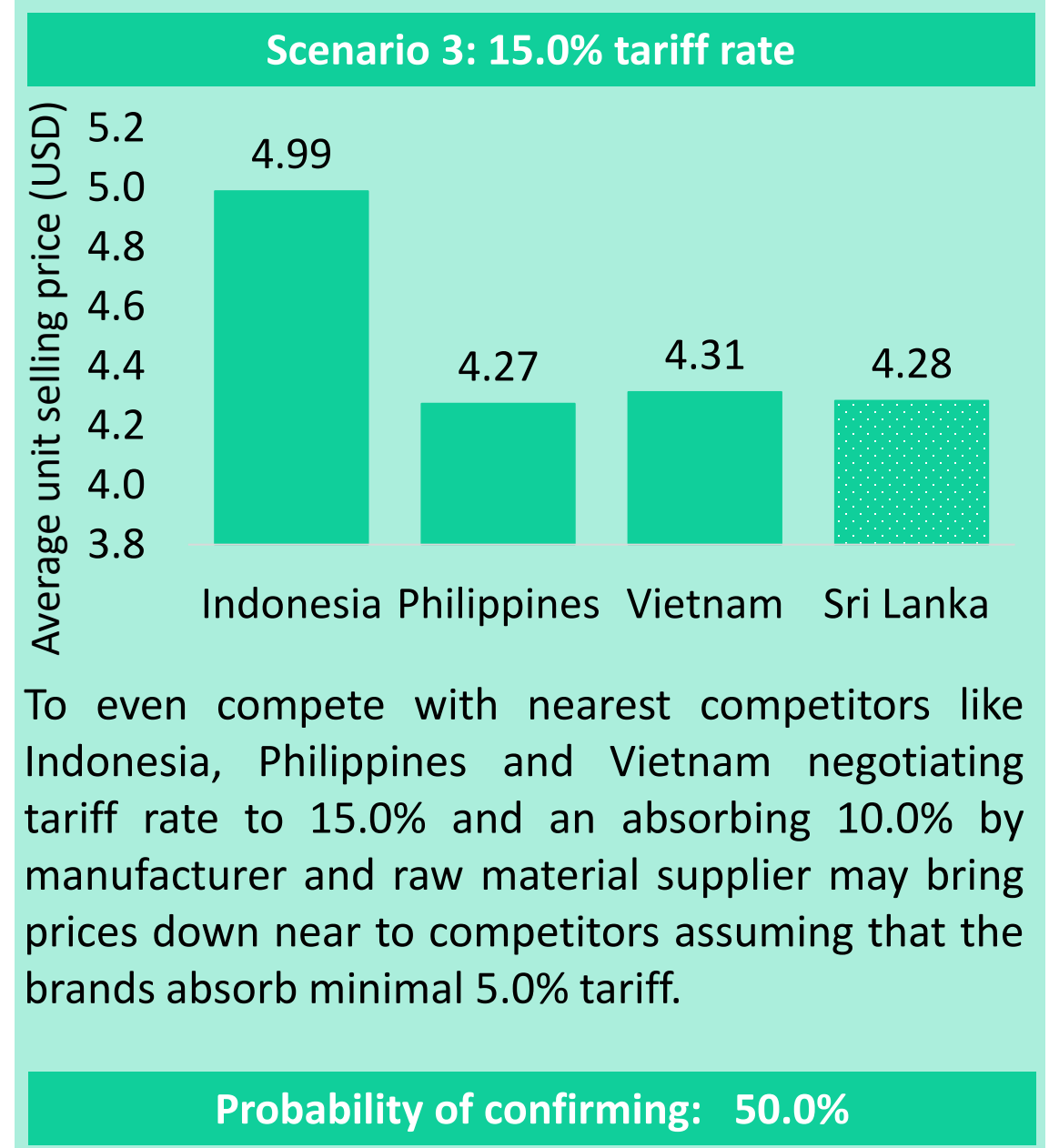
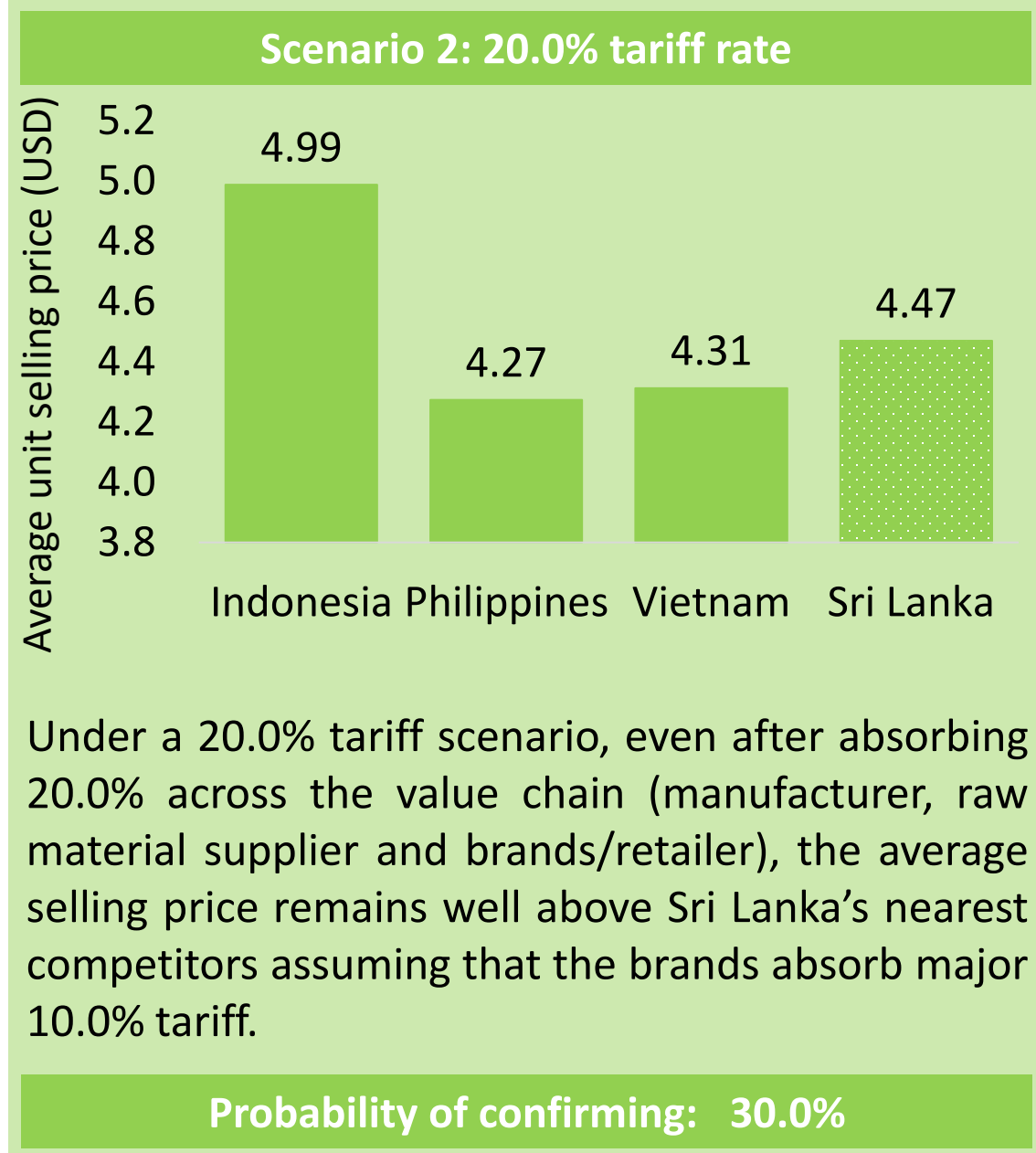
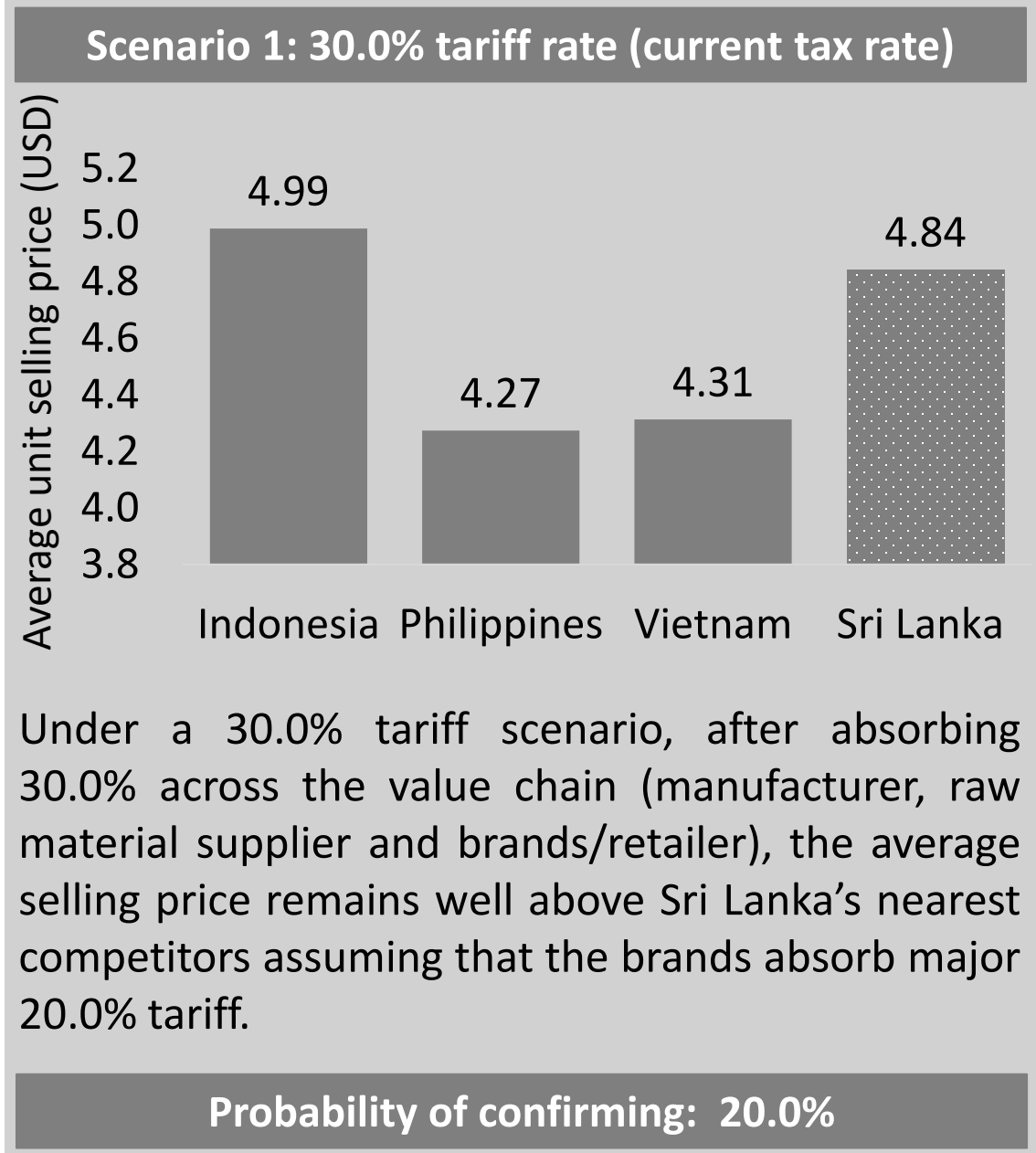
On 9th July 2025, U.S. has revised its earlier decision from 2nd April 2025 by lowering the reciprocal tariff rate on imports from Sri Lanka to 30.0%, down from the initially imposed 44.0%. This marks one of the sharpest reductions among the revised tariff rates. However, this 30.0% still remains burden to the exporters in Sri Lanka.

Despite the tariff reduction, 30.0% tariff continues to impose a substantial cost burden, as the post-tariff average unit selling price remains significantly higher than regional competitors

Even after reducing reciprocal tariff to 30.0% (scenario 01), Sri Lankan products remain more expensive by 7.9% compared to Indonesia, 20.6% compared to the Philippines and 19.8% compared to Vietnam, the nearest price competitors. FCR outlines two potential scenarios in addition to the 30.0% current tariff in which the tariff could be reduced to 20.0% (scenario 02) and 15.0% (scenario 03) in the future, subject to further discussions.



FCR outlines three possible tariff rate scenarios, with the 15.0% tariff rate scenario considered the most likely based on ongoing discussions with the U.S.

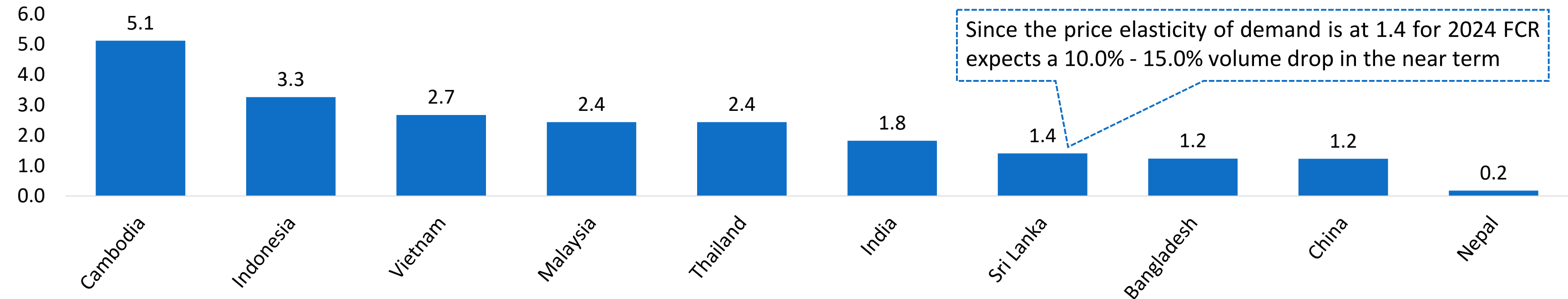


Bottomline: Industry experts in the textile and apparel sector highlight that garment manufacturers and contract manufacturers operate on extremely thin margins, typically between 3.0% and 5.0%, making it unfeasible for them to absorb any part of the proposed tariff. In the current environment, taking on this additional cost is considered impractical for these manufacturers. While there is some potential for fabric manufacturers and global brands/retailers to bear the tariff burden, the situation is complicated by the fact that approximately 70.0% of fabrics used in Sri Lanka are imported. This limits the bargaining power of Sri Lankan garment manufacturers when negotiating with fabric suppliers. As a result, the burden is likely to fall primarily on brands and retailers. However, if competing countries offer lower tariff rates, there is a strong likelihood that brands may shift their orders elsewhere, posing a significant risk to Sri Lanka's apparel export competitiveness.

FCR anticipates relocating orders to cheaper countries may reduce Sri Lankan apparel volumes by 10% - 15% with an apparel export loss of USD 290.0Mn in the near term under the 30.0% tariff scenario...

FCR anticipates a near-term slowdown in demand, with an expected apparel export loss of USD 290.0Mn under the 30.0% tariff scenario, as buyers shift towards cheaper alternatives available in the market

Price elasticity of demand of Asian peers in 2024



Why is Sri Lanka's price elasticity of demand relatively low compared to direct peers?

- ☐ Catering to specific product segments and high-quality production
- ☐ According to the expert's insights in the industry highly value-added nature of the products
- ☐ Adherence to international labor standards and ESG practices
- ☐ A reputation for reliability and efficiency
- ☐ Sri Lanka's skilled workforce

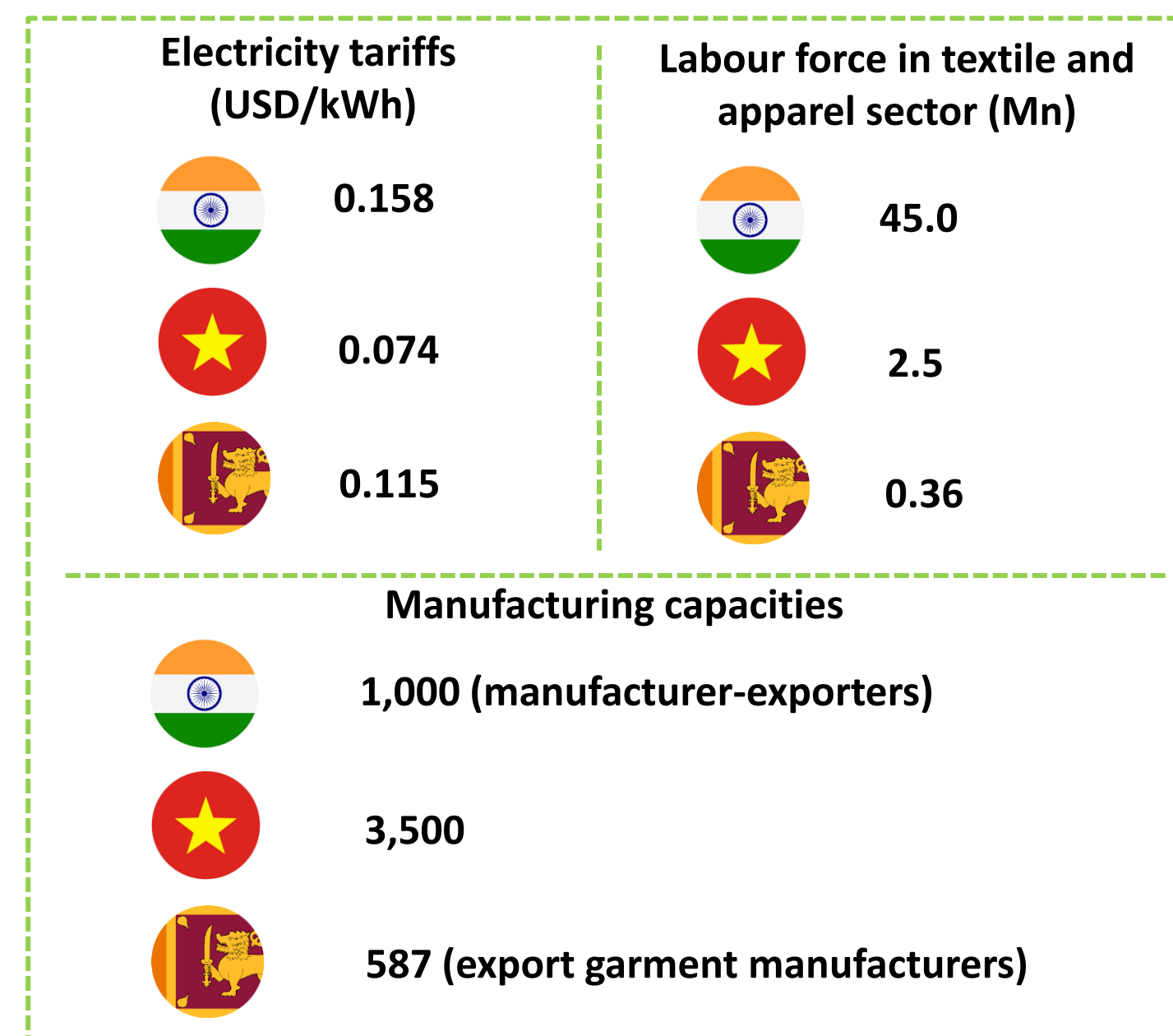
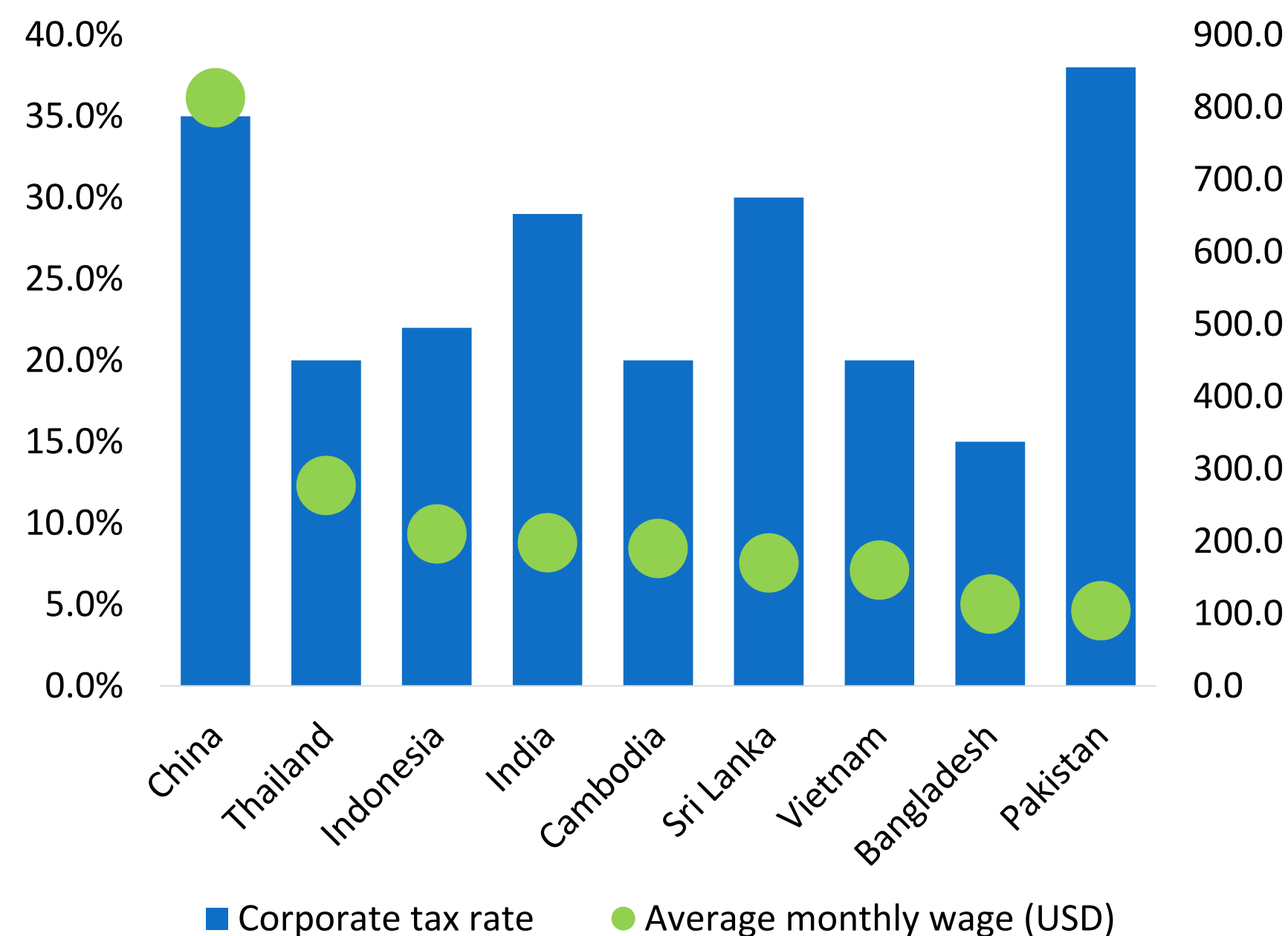
Expected apparel export value loss: USD 290.0Mn

Expected volume drop from 30.0% tariff rate: 10.0% - 15.0%

Expected average price increment of a U.S. garment: c.7.0%

...as India and Vietnam are well positioned to capture relocated orders

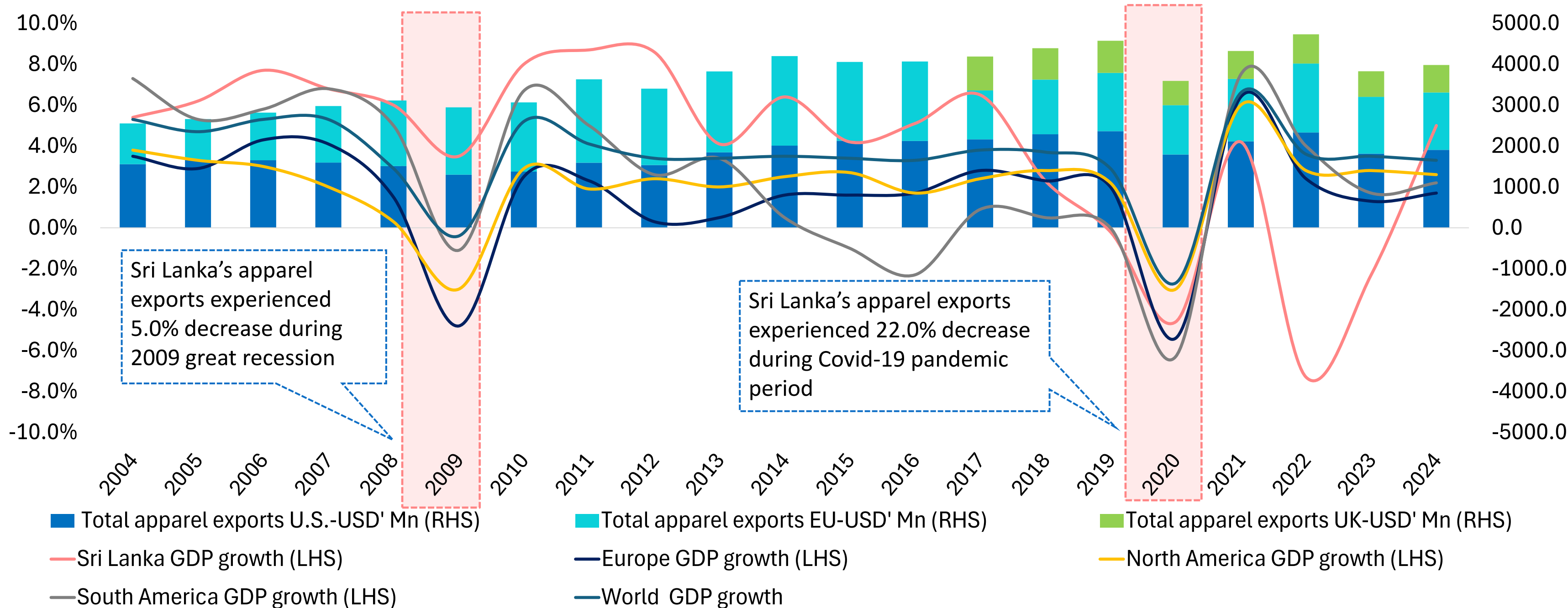
In the near term, order relocations are expected to shift toward Vietnam and India due to several key advantages. In India, despite higher labor costs compared to Sri Lanka, the ability to produce nearly all apparel inputs from fiber to accessories, has enabled strong vertical integration. This reduces costs and attracts buyers looking to minimize supply chain risks. Vietnam, on the other hand, offers low labor costs, strategic trade agreements, a focus on high value-added products, and a skilled workforce. According to industry experts, 60.0% to 70.0% of apparel exports are value-added products that require advanced skills and training. However, due to the simplicity of the sewing process, orders can be transferred within six months. Therefore, FCR believes that over the short term, order relocations to Vietnam and India are likely, given their capacity to meet these requirements.



Second order impact of the global economic slowdown driven by tariffs, may reduce Sri Lanka's apparel exports, resulting in a net export loss of USD 110.0Mn

What does history tell us?

During the 2009 great recession and Covid-19 pandemic period, Sri Lanka's apparel exports experienced 5.0% and 22.0% drop, respectively, primarily due to the global economic slowdown, as the world economy contracted by -0.4% and -2.7% respectively during these period. FCR anticipates apparel and textiles may reduce by 5.0% by 2026E on par with the decline witnessed during 2009 great recession. Accordingly, FCR expects net export loss of USD 110.Mn in the near-term.



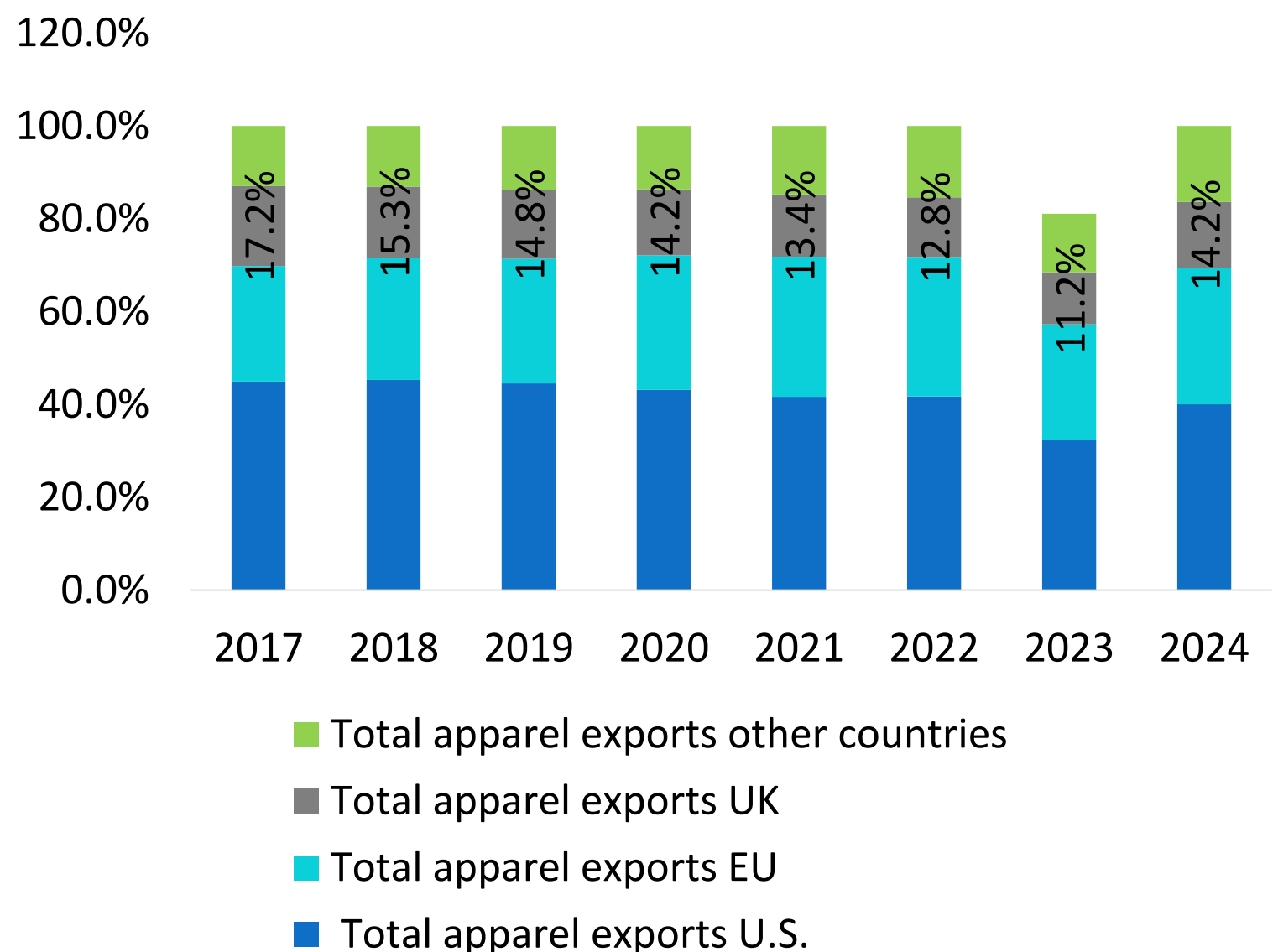
Impact of relocating orders and global economic slowdown on SL's GDP growth, merchandise trade deficit and employment in apparel sector under three different tariff scenarios

	Scenario 01: 30.0% tariff rate	Scenario 02: 20.0% tariff rate	Scenario 03: 15.0% tariff rate
Expected apparel volume reduction	c.20.0%	C.15.0%	C.13.0%
Impact on the GDP	c.0.60% reduction of GDP growth rate	c.0.48% reduction of GDP growth rate	c.0.44% reduction of GDP growth rate
Impact on merchandise trade balance	USD 255.0Mn net export loss with c.4.2% increase in merchandise trade deficit	USD 208.0Mn net export loss with c.3.4% increase in merchandise trade deficit	USD 190.0Mn net export loss with c.3.1% increase in merchandise trade deficit
Expected apparel export value decrease	USD 540.0Mn	USD 444.0Mn	USD 406.0Mn
Expected apparel import value decrease	USD 285.0Mn	USD 235.0Mn	USD 214.0Mn
Impact on manufacture of textiles, wearing apparel, leather and other related products in the GDP	c.15.3% decrease	c.12.5% decrease	c.11.4% decrease
Reduction of apparel and textile sector employment	c.11.0%	c.9.0%	c.8.0%

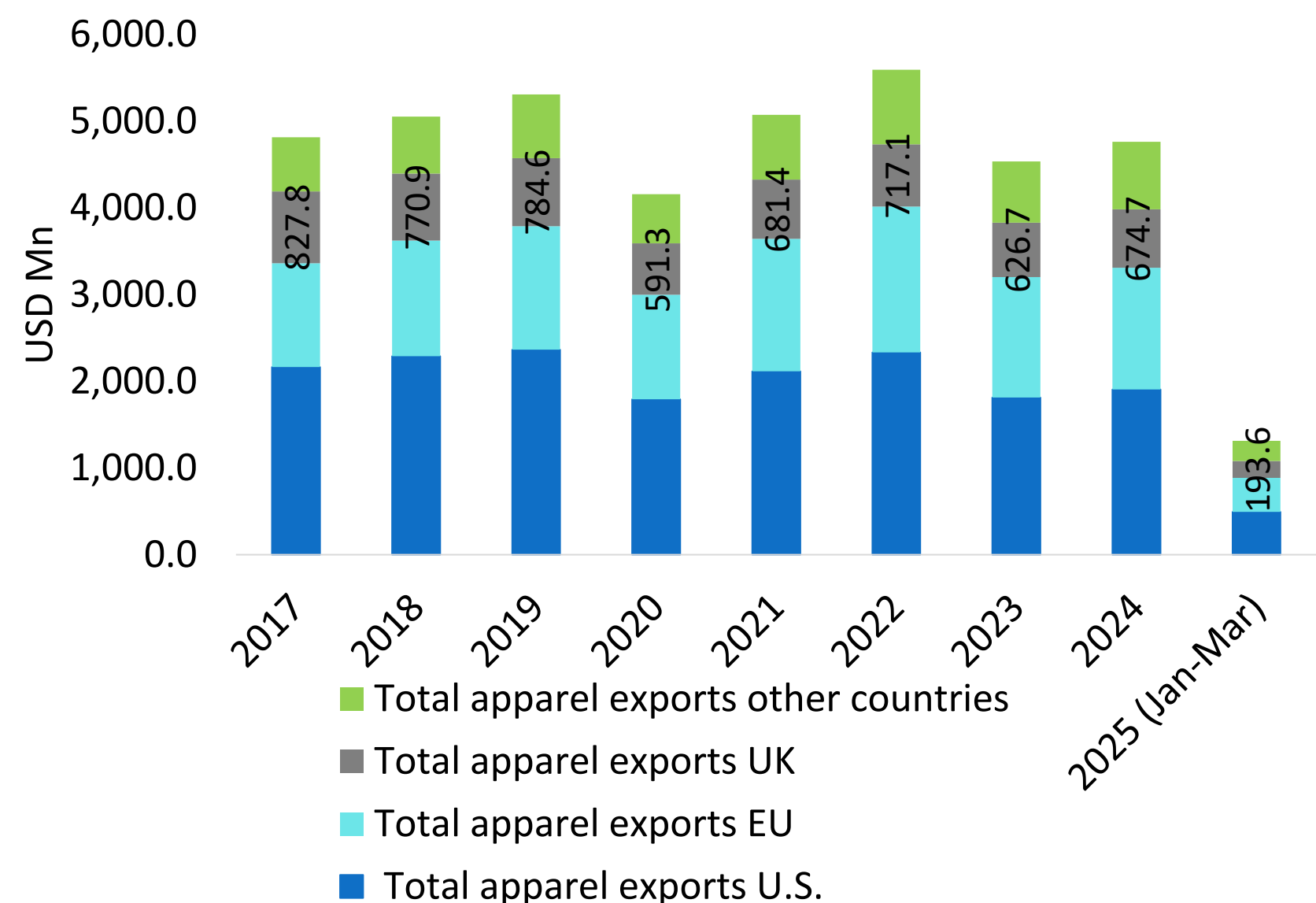
However, UK government decision to liberalize the tax rates on developing countries may increase the apparel export value in Sri Lanka

Sri Lanka will receive duty-free access to the UK for apparel exports under the UK's new Developing Countries Trading Scheme (DCTS), effective from early 2026. The most notable change is the relaxation of rules of origin for garments, allowing Sri Lankan manufacturers to source raw materials from a broader range of countries while still qualifying for 0% tariffs. This initiative, which replaces the GSP+ after Brexit, aims to support exports from countries like Sri Lanka, Nigeria, and the Philippines, while offering UK consumers access to more affordable, quality goods.

Apparel exports stands c.14.0% out of total Sri Lankan exports



Apparel export value to UK



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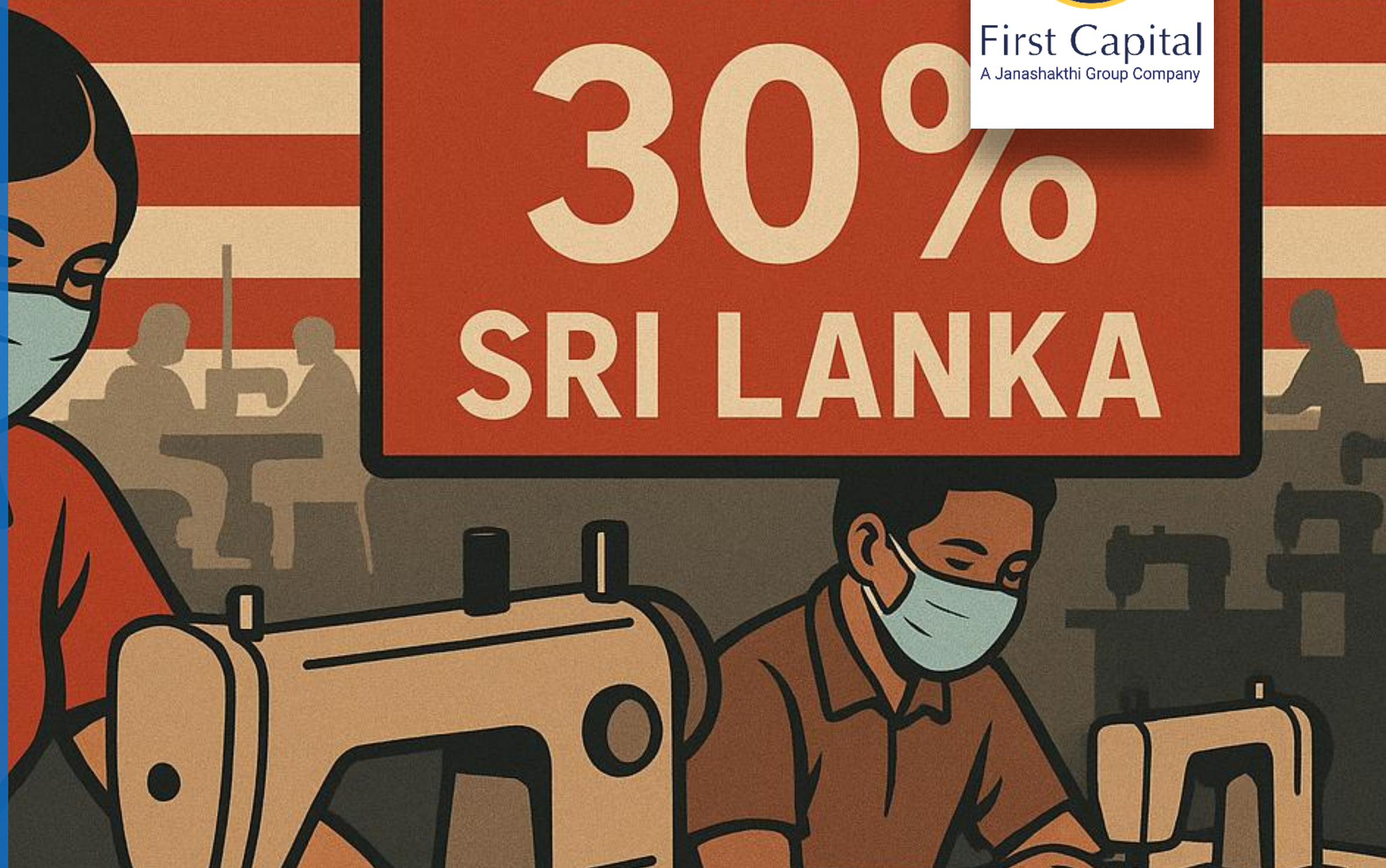
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