



First Capital
A Janashakthi Group Company

“MONETARY STANCE STEADY, INDICATORS RESIST FURTHER EASING”

PRE-POLICY ANALYSIS

21st Nov 2025

FIRST CAPITAL RESEARCH

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Previous Pre-policy report: Recap – Accurate

The Central Bank of Sri Lanka keeps the Overnight Policy Rate (OPR) unchanged

In line with our expectations. The Monetary Policy Board decided to maintain the Overnight Policy Rate (OPR) at the current level of 7.75%. The Board arrived at this decision after considering both domestic and global developments. The Board is of the view that the current monetary policy stance will support steering inflation towards the target of 5%.

Key Arguments considered by CBSL for its policy stance held on 23rd Sep 2025

- ✓ Headline inflation based on the Colombo Consumer Price Index (CCPI) turned positive in August 2025, ending eleven months of deflation. Inflation is projected to gradually increase towards the target of 5% by mid-2026.
- ✓ The economy is estimated to have grown by 4.8% in 1H2025. Leading indicators reflect a continuation of this momentum into 3Q2025.
- ✓ Credit to the private sector recorded a notable and broad-based expansion thus far in 2025. This expansion has been supported by the low-interest-rate environment and the recovery in economic activity. The continued expansion in private sector credit is expected to further support domestic economic activity in the period ahead.
- ✓ The external sector remained resilient, supported by improved inflows from tourism and workers' remittances, despite a widening trade deficit.
- ✓ All three major rating agencies have now raised Sri Lanka's sovereign ratings, confirming the improved credit standing. Meanwhile, global financial conditions have eased, although geopolitical uncertainties remain.



Expected Monetary Policy Stance

- As per our view, at the upcoming policy meeting there is a **60% probability for the Central Bank to maintain current policy rates**, given that key economic indicators provide no justification for a rate cut at this stage.
- However, there is a **40% probability for CBSL to reduce rates, with a 30% probability for rates to be reduced by 25bps and 10% probability is assigned for a rate reduction of 50bps**, offering further stimulus to accelerate the economy.
- Further, there is an **80% probability to keep SRR unchanged**; while considering the improved liquidity levels in the system, we consider a **20% probability for an SRR hike of 100bps**.

Expected Monetary Policy Stance	Probability
Raising Policy Rates by 50bps	0%
Policy Rates to remain unchanged	60%
Cutting Policy Rates by 25bps	30%
Cutting Policy Rates by 50bps	10%
Cutting Policy Rates by 100bps	0%

40%

As per our view, at the upcoming policy meeting there is a 60% probability for the Central Bank to maintain current policy rates, given that key economic indicators provide no justification for a rate cut at this stage.

Expected Stance on SRR	Probability
Raising SRR by 150bps	0%
Raising SRR by 100bps	20%
SRR to remain unchanged	80%
Cutting SRR by 50bps	0%
Cutting SRR by 100bps	0%

Considering the reduction of SRR by 200bps to 2.0% on 09th Aug-23, we expect SRR to remain unchanged at the same level. However, there is a 20% probability for CBSL to raise SRR by 100bps.

Analysis of upcoming policy decision on 25th Nov

Arguments **for** a Monetary Relaxation

40%



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

- To support the potential sluggishness of the economy
- Inflation turns positive in Aug-25, yet far below CBSL envisaged targets
- The AWSR continues to remain higher, thus limiting growth in SMEs
- Stagflation concerns in US, lowers global growth outlook

- Sustained credit momentum suggests no need for policy action
- Slow reserve build-up constraining external stability
- AWCMR unlikely to respond amid tightening liquidity conditions
- Depreciation of the LKR against the USD
- Potential removal of the Social Security Contribution Levy (SSCL)

The above-mentioned factors argue against a relaxation in policy rates at the upcoming policy meeting

Arguments **against** a Monetary Relaxation

60%



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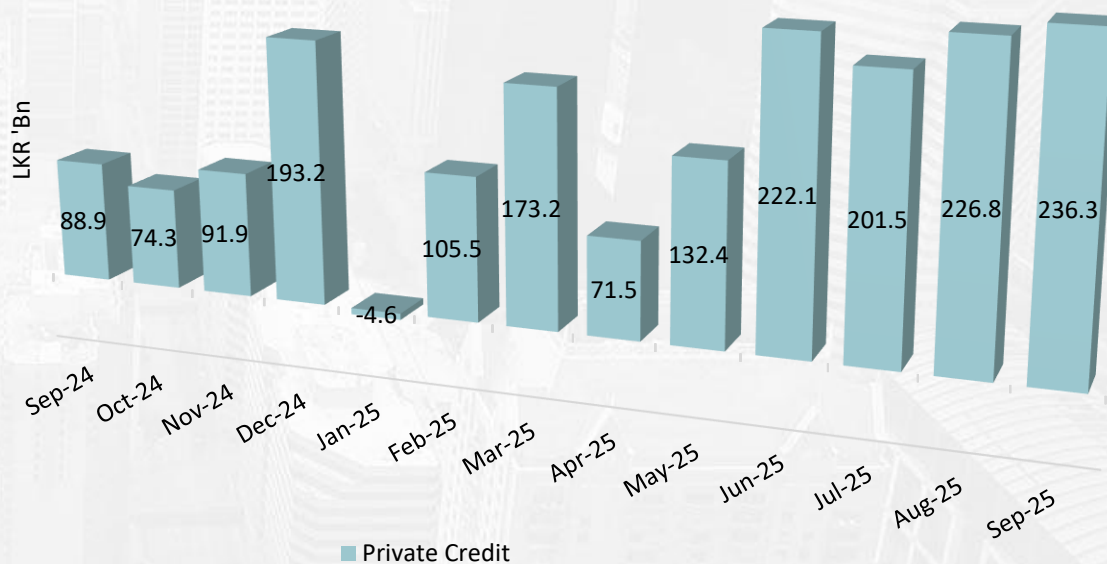
Arguments *against a relaxation* in monetary policy

Arguments against a relaxation in monetary policy



Sustained credit momentum suggests no need for policy action

Following the relaxation of ban on vehicle imports in Feb-25, private sector credit growth has accelerated sharply. In Sep-25 alone, lending rose by a record LKR 236.3Bn, bringing cumulative credit expansion for Jan-Sep 2025 to over LKR 9.5Tn. According to CBSL data, domestic bank lending to the private sector reached LKR 247.1Bn in Sep-25, a 23.6%YoY increase, while the CBSL's Willingness to Lend Index continued to improve through 3Q2025. Survey evidence points to sustained momentum into 4Q2025, supported by favourable economic conditions and expectations of steady activity, including the recovery in construction. Meanwhile, the external sector also recorded a monthly current account deficit in Sep-25, after surpluses during Jan-Aug 2025, aligning with the increase in demand for vehicles and the associated rise in import expenditure. Against this background, a rate cut seems unnecessary, as it may trigger increased consumer imports and accelerate credit growth to overheating levels.

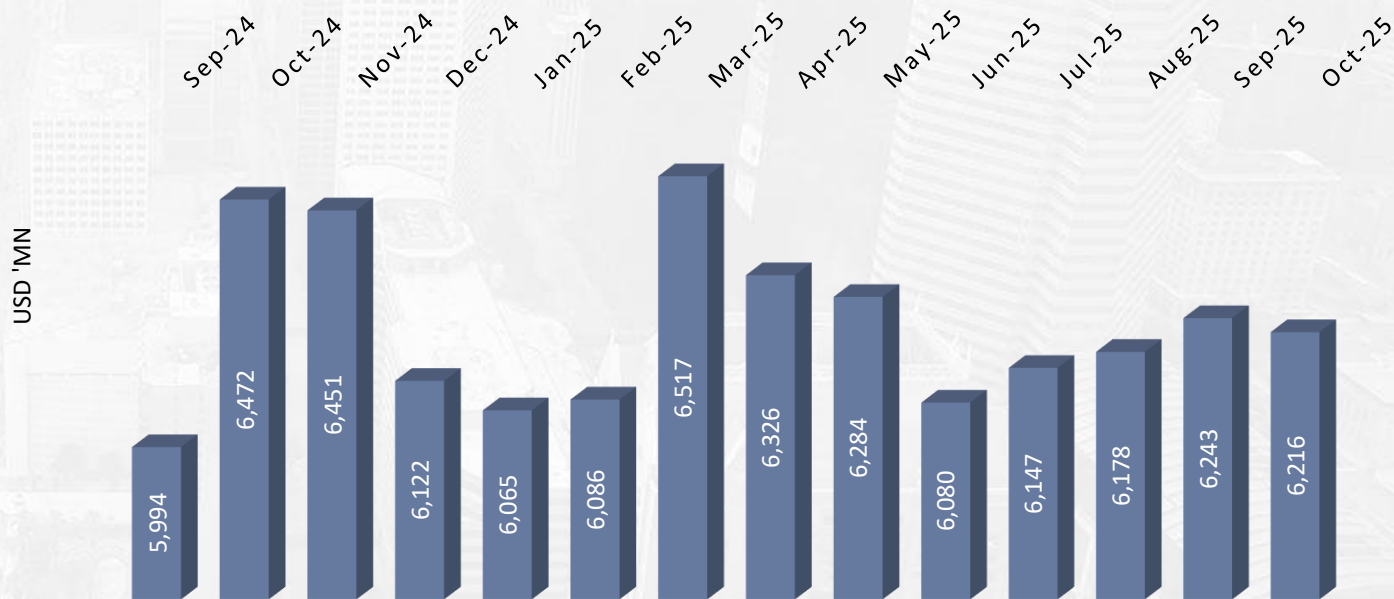


Arguments against a relaxation in monetary policy



Slow reserve build-up constraining external stability

Sri Lanka's external buffers remain fragile despite some expected inflows. Official reserves slipped to USD 6.21Bn in Oct-2025 from USD 6.24Bn in Sep-25, a decline of about USD 27.0Mn, and currently provide only around three months of import cover, leaving the economy with limited space to absorb external shocks. Near-term risks remain elevated, with projected FX outflows of USD 316.0Mn in Nov-25 and USD 2,036.0Mn over the next three months, largely reflecting the settlement of currency swaps. At the same time, import pressures continue to build, adding strain to the external position. Although reserves are expected to improve gradually through the Central Bank's USD purchases, higher tourism receipts during the peak season, stronger worker remittances toward year-end, and the anticipated IMF-EFF 6th tranche disbursement in Dec-25, these inflows may only partially offset the sizeable near-term outflows. A moderation in pent-up vehicle-import demand could also help ease pressure on the balance of payments, but the overall reserves trajectory is likely to remain volatile as authorities work toward meeting the IMF estimates of USD 7.2Bn for 2025E and USD 9.0Bn for 2026E.



Arguments against a relaxation in monetary policy



AWCMR unlikely to respond amid tightening liquidity conditions

The Average Weighted Call Money Rate (AWCMR), which serves as the CBSL's primary operational target under its current policy framework, has remained slightly above the OPR amid tightening liquidity in the banking system. Following the Sep-25 policy review, the OPR was maintained at 7.75%, while the AWCMR averaged around 7.94%, implying a modest spread of approximately 19 basis points. Meanwhile, banking system liquidity, which had been relatively volatile ranging between LKR 120.0-150.0Bn in recent months, supported by CBSL's USD purchases has shown increased volatility in the past few weeks, reaching a low of LKR 87.6Bn in mid-November. In this context, any policy rate reduction at present is likely to have a limited impact on the AWCMR, as tighter liquidity conditions are exerting upward pressure on interbank rates, constraining the transmission of monetary easing in the interbank money market.

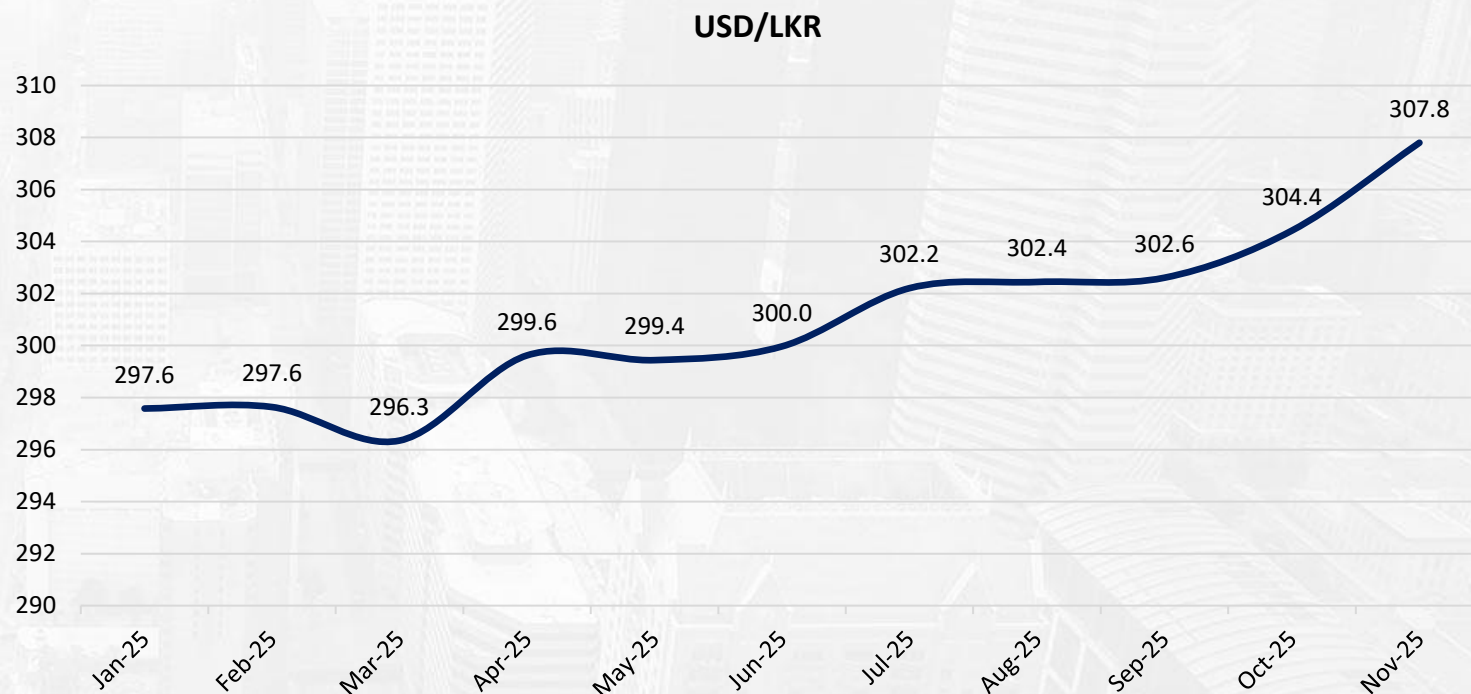


Arguments against a relaxation in monetary policy



Depreciation of the LKR against the USD

The LKR has depreciated by 5.4% YTD, with approximately 1.6% of this decline occurring since mid-Oct-25. Seasonal factors, including the onset of the festive period, have boosted import demand, while continued vehicle imports have added further pressure on the foreign exchange market. Consequently, USD demand has risen sharply, maintaining downward pressure on the currency. In this environment, a further policy rate cut could exacerbate capital outflows, narrow the interest-rate differential, and stimulate additional import demand, thereby heightening stress on the already fragile exchange rate. Additional depreciation would also raise the domestic cost of essential imports and complicate external debt-servicing obligations. Against this backdrop, the CBSL is expected to prioritise exchange-rate stability over further monetary easing at this stage.



Arguments against a relaxation in monetary policy



Potential removal of the Social Security Contribution Levy (SSCL)

The government's proposal to exempt financial services from the SSCL marks a positive policy development, expected to lower borrowing costs and support economic activity. The amendment bill, gazetted in early Oct-25, aims to remove the levy for all institutions engaged in financial services in Sri Lanka, with the exemption slated to take effect from 01 Jan 2026, subject to parliamentary approval. Currently, banks are liable for a 2.5% levy on Profit Before Tax. Removing the SSCL is intended to directly reduce the cost of financial intermediation, which could, in turn, ease lending rates for borrowers. Against this backdrop, the CBSL is likely to adopt a cautious "wait-and-see" approach, as an immediate adjustment to the policy rate may not be necessary if the levy is successfully abolished.

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Arguments *for a relaxation* in monetary policy

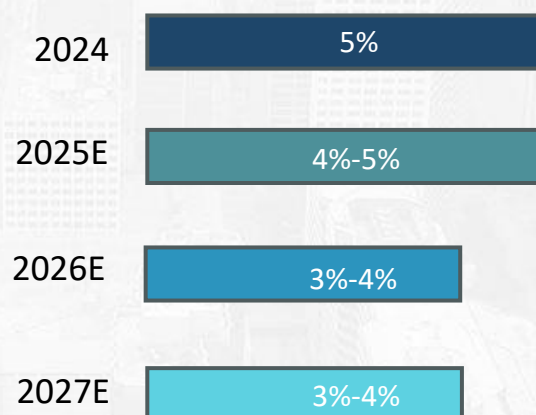
Arguments for a relaxation in monetary policy



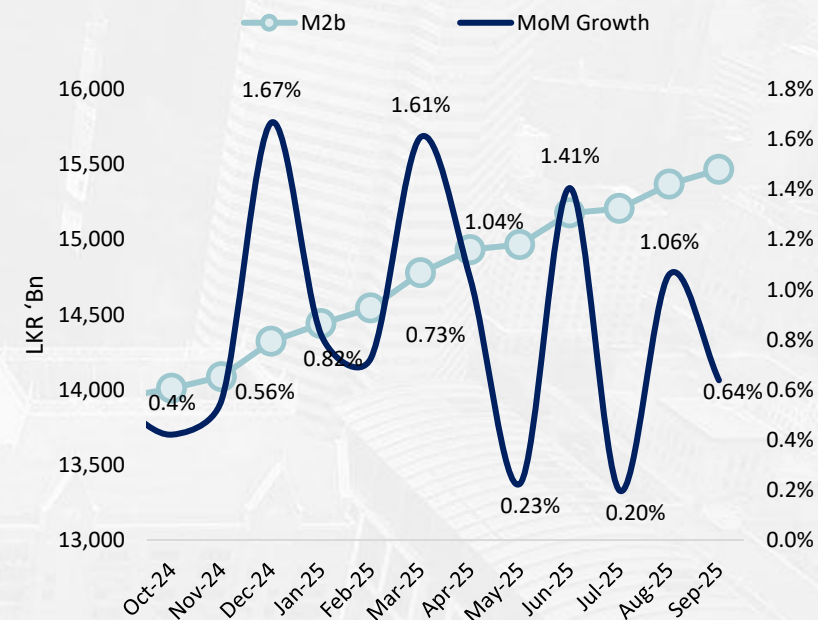
To support the potential sluggishness of the economy

Sri Lanka's GDP growth expanded by 4.8% in 1H2025, underpinned by broad-based sectoral gains. However, this momentum is expected to ease in the coming quarters, largely due to subdued government capital expenditure, with only about 35% of the LKR 1.3Tn annual allocation utilized by 3Q2025. On the demand side, household consumption is projected to ease as elevated taxes and slowing growth conditions continue to moderate disposable incomes. The combination of restrained household spending and limited government investment points to a gradual moderation in overall economic activity. This slowdown is further reflected in the sluggish expansion of the M2b money multiplier, which stood at approximately 8.98x in Aug-25. Externally, escalating global headwinds, including rising U.S. tariffs, present additional downside risks. Against this backdrop, the CBSL may consider a cautious policy rate reduction to support domestic economic activity while balancing macro-financial stability.

GDP Growth Expectations



M2b Growth – Sep 2025

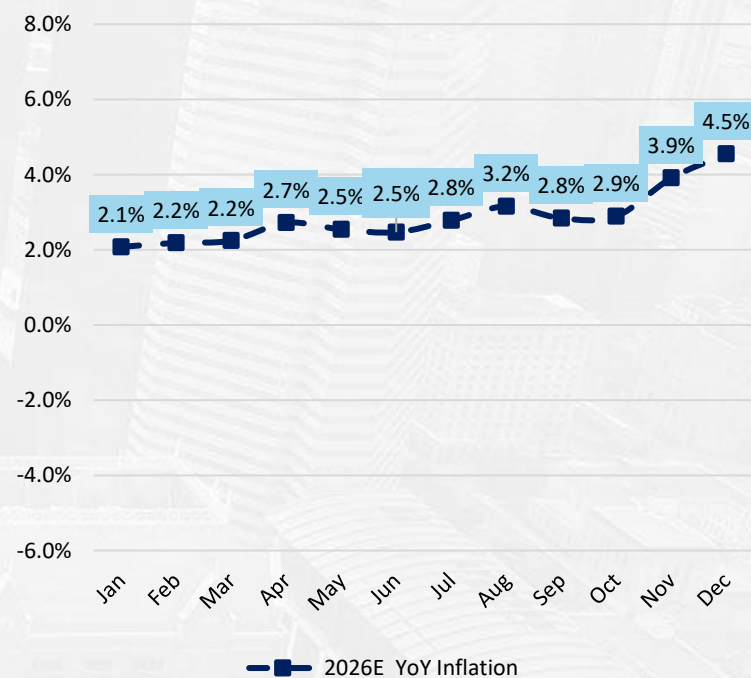
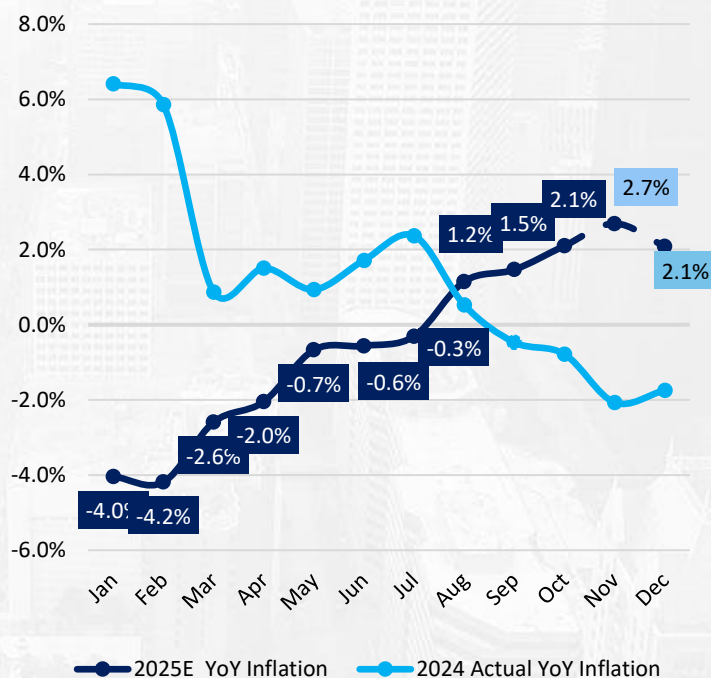


Arguments for a relaxation in monetary policy



Inflation turns positive in Aug-25, yet far below CBSL envisaged targets

Sri Lanka's CCPI inflation turned positive in Aug-25, rising 1.2%YoY after 11 consecutive months of deflation. The index gained further momentum in Sep-25 and recorded YoY growth of 2.1% in Oct-25, signaling continued convergence toward the inflation target. Despite these recent upticks, inflation remains below the CBSL's target. Looking ahead, we at FCR expect inflation to trail the CBSL's envisaged 5% target during 4Q2025 and through 2026, with annual averages projected at around -0.4% for 2025E and 2.9% for 2026E. This outlook largely reflects delays in the transmission of economic recovery across the broader economy, compounded by elevated tax burdens that continue to constrain consumption. Accordingly, we believe the CBSL has the option to consider an additional rate cut to stimulate demand and guide inflation toward its 5% objective.

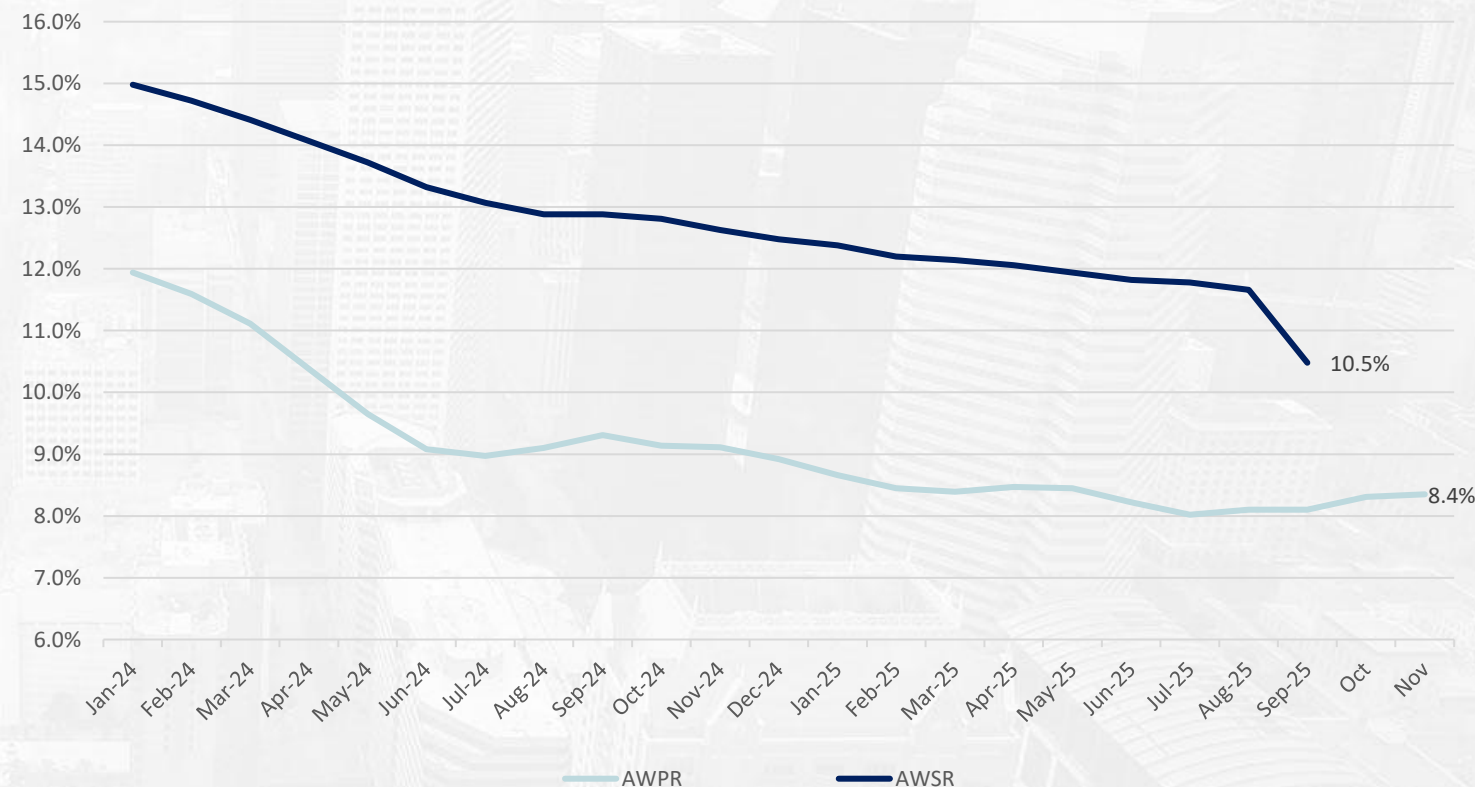


Arguments for a relaxation in monetary policy



The AWSR continues to remain higher, thus limiting growth in SMEs

The Average Weighted SME Rate (AWSR) remains elevated at 10.5%, well above the AWPR at 8.4%, continuing to constrain credit uptake and impede growth within the SME sector. Given that SMEs contribute over 50% of GDP, ensuring access to funding at reasonable borrowing costs is critical to sustaining activity and supporting sectoral expansion. Although the recent Budget outlines several initiatives to extend concessionary lending to SMEs, historical trends indicate that these benefits have not fully materialized, as borrowing costs have remained persistently high. In this context, a policy rate reduction could help ease financial pressures on SMEs, thereby facilitating improved credit flows and supporting stronger growth outcomes.



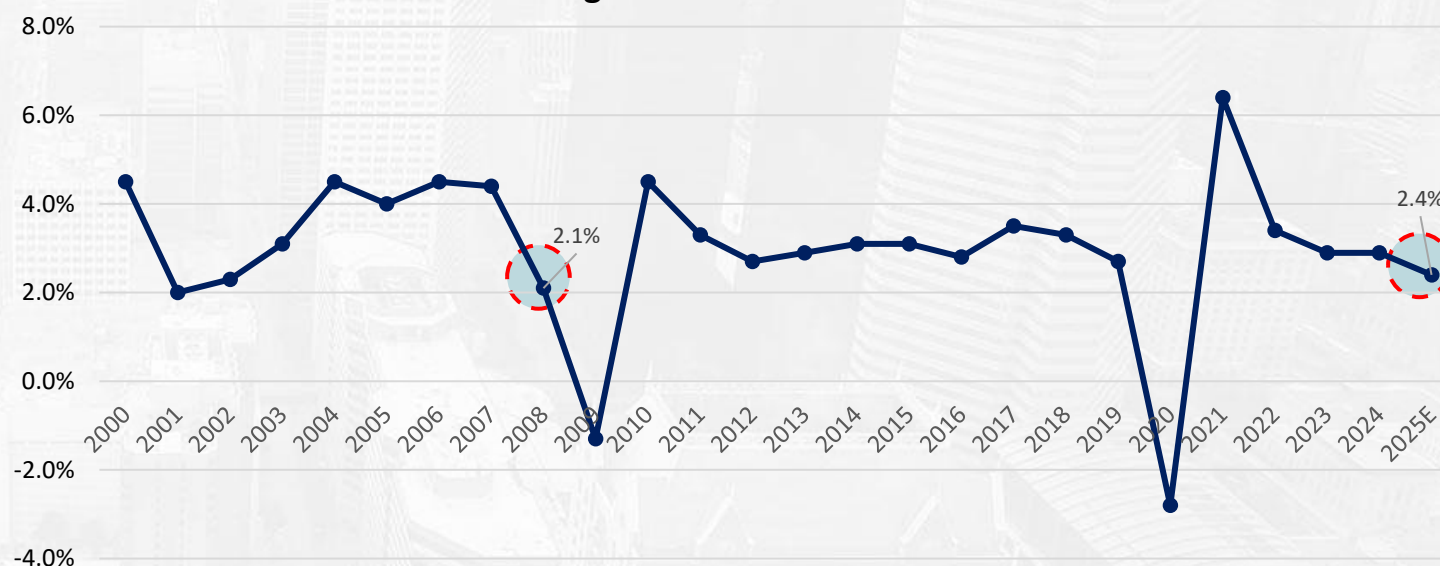
Arguments for a relaxation in monetary policy



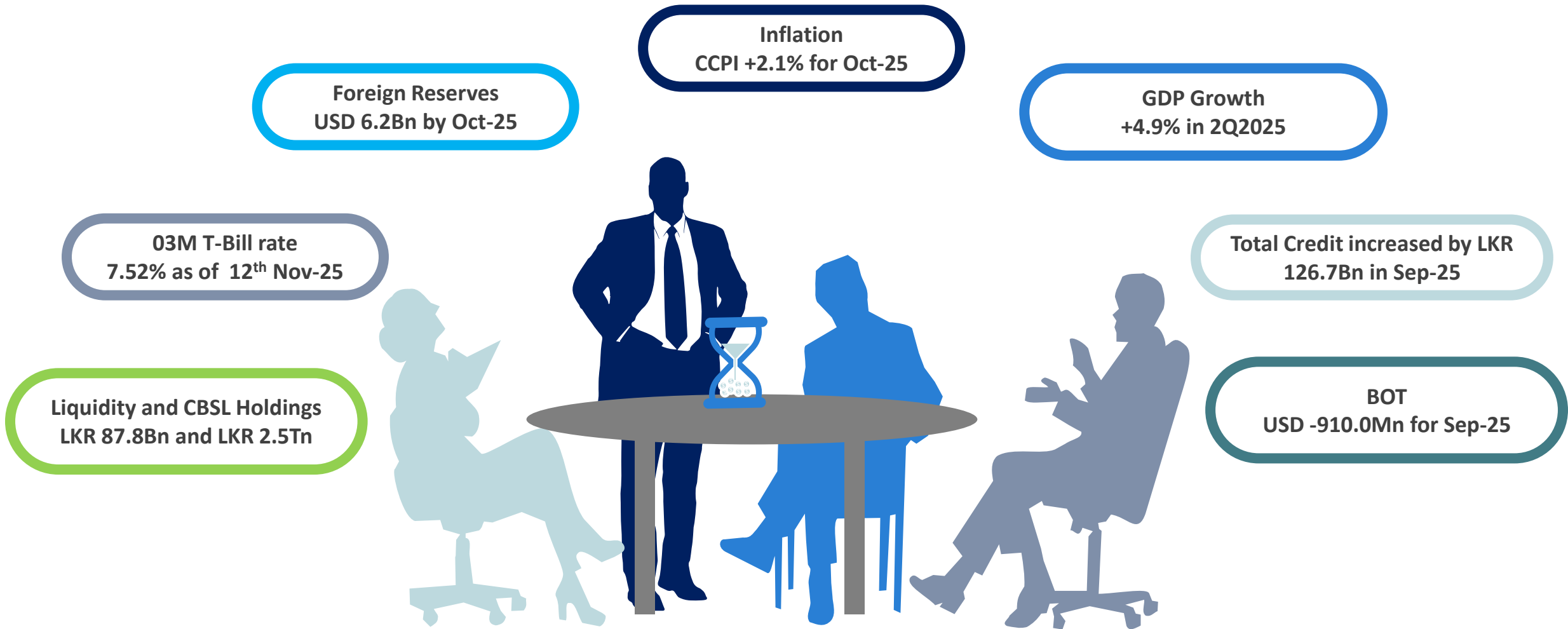
Stagflation concerns in US, lowers global growth outlook

Fitch Ratings projects global growth at 2.4%YoY for 2025E, an upward revision of 0.2 bps since Jun-25, yet notably slower than the 2.9% recorded last year and still below long-term trend. This deceleration is driven primarily by emerging stagflation risks in the U.S., where inflation has been edging higher while employment growth shows signs of cooling. In response, the Federal Reserve implemented a 25bps rate cut in Sep-25 and again in Oct-25, lowering the target range to 3.75%-4.00%. With the U.S. and other major central banks now moving into a rate-reduction cycle, and given that the projected global growth rate of 2.4%YoY would mark the slowest pace since 2008 (excluding the crisis-distorted years of 2009 and 2020), we expect the CBSL may consider aligning with global monetary easing. A policy rate cut would help mitigate potential spillover effects from a weakening global economic environment and support domestic growth conditions.

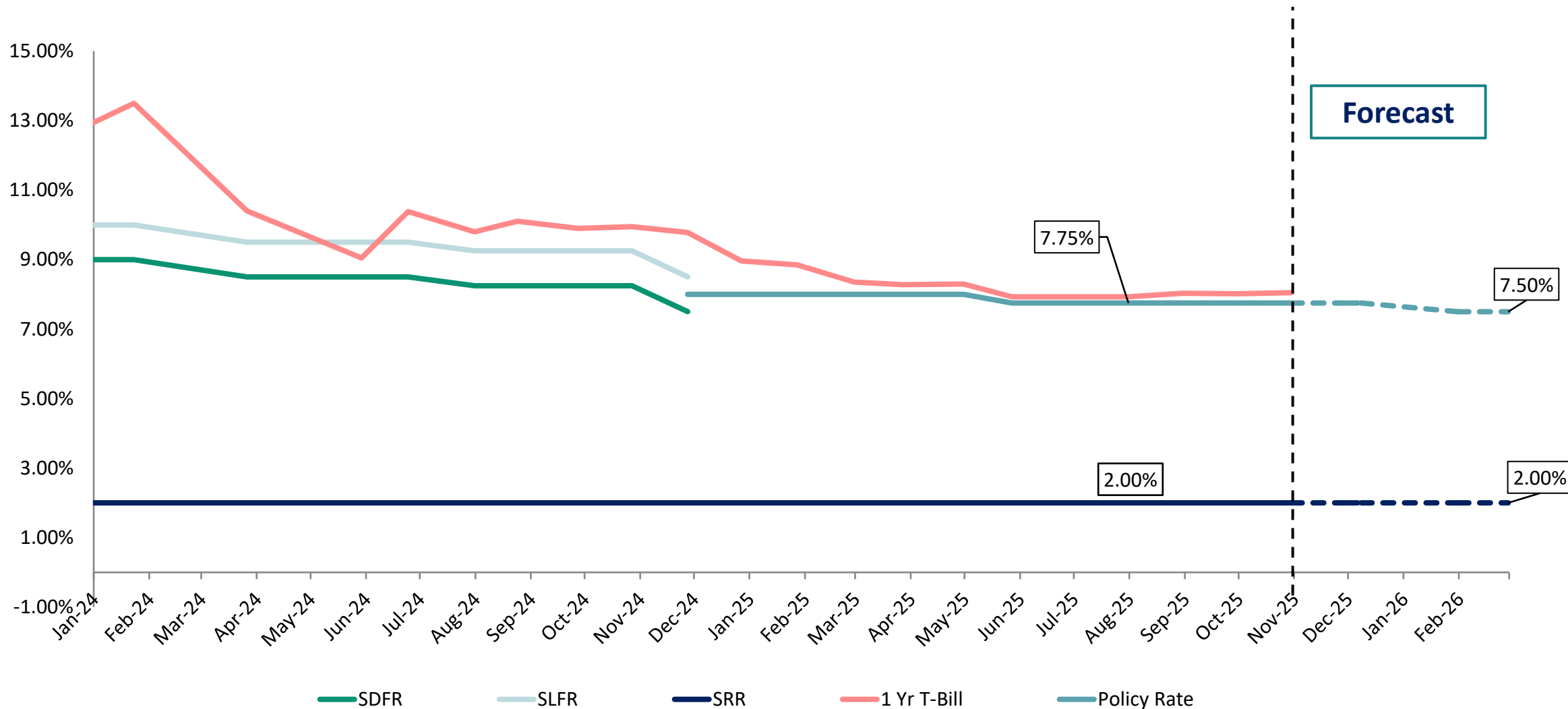
Global growth between 2000-2025



Factors in consideration at the policy review



Monetary Policy Rates



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MANAGING RISKS”*

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