CBSL'S POLICY AGENDA FOR 2026

FLASH NOTE

CBSL PRESENTS ITS POLICY AGENDA FOR 2026, EMPHASISING THE THEME OF THE YEAR: "RESILIENCE THROUGH STABILITY AND REFORM"

Overview

The Central Bank of Sri Lanka (CBSL) unveiled its policy agenda for 2026 on 8th January, marking a strategic shift from last year's stabilisation theme to a focus on resilience and reform. Building on the macroeconomic stability achieved during 2024–2025, the CBSL aims to strengthen the economy's capacity to absorb shocks, including climate-related disruptions such as Cyclone 'Ditwah', and to advance structural reforms to support long-term growth. The agenda emphasises the Institution's commitment to advancing structural reforms, with a continued focus on maintaining price stability, which aims to safeguard the soundness of the financial system and promote inclusive growth through transparent, data-driven policymaking.

Key Economic Highlights – 2025

Inflation remained below target for most of the year; the accommodative policy stance continued.

Private sector credit expanded across key sectors, including households.

Gross Official Reserves (GOR) rose to USD 6.8Bn, the highest since the crisis, supported by USD 2.0Bn in net FX purchases.

The external current account posted a surplus for the third consecutive year.

The Overnight Policy Rate (OPR) mechanism was operationalised; however, short-term rate deviations emerged late in the year.

Policies for 2026 and Beyond

The policies that were presented fell under three dominant areas:

1. Price Stability and Monetary Operations
2. Policies Aimed at Financial System Stability
3. Other Policies and Functions of the CBSL

Price Stability and Monetary Operations:

- **Inflation Targeting:** Inflation is expected to return to the 5% target by 2H2026; Cyclone Ditwah's impact to be incorporated into forecasts.

- **Monetary Policy:** Continued data-driven approach with enhanced modelling and high-frequency data integration.

- **SRR Reforms:**
  - Reserve Maintenance Period redefined to a stricter structure, requiring banks to maintain higher daily reserves more consistently.
  - Removal of the till-cash concession, which means banks can no longer count cash held in their vaults toward their statutory reserve requirement, increases the amount of reserves banks must hold with the CBSL.
  - Higher daily minimum reserve requirement reinstated, reversing COVID-era relaxations.

- **FX Market:**
  - Introduction of benchmark intra-day reference exchange rate to improve transparency and pricing.
  - Continued accumulation of foreign reserves through market-based FX purchases.
  - Exchange rate flexibility is maintained to absorb external shocks.

Policies Aimed at Financial System Stability:

- **Banking Sector:** Continued recapitalisation and consolidation under Master Plan Phase II; enhanced risk-based supervision aligned with Basel Core Principles.

- **Macroprudential Tools:** Strengthening of systemic risk oversight; Counter Cyclical Buffer (CCyB) framework to be implemented.

- **Climate Risk:** Expanded green finance taxonomy to include social dimensions; climate risk integrated into financial stability assessments.

- **Resolution Framework:** Finalization of crisis resolution mechanisms and institutional readiness.

- **Deposit Insurance:** Strengthening of the Sri Lanka Deposit Insurance Scheme (SLDIS) with World Bank support and public awareness initiatives.

- **Reserve Management:** Reintroduction of an investment tranche to optimize returns; NEER/REER base years to be updated.

Other Policies and Functions of CBSL:

- **Financial Inclusion:** Formulation of Phase II of the National Financial Inclusion Strategy (NFIS), with a focus on underserved segments and inclusive green finance.

- **Consumer Protection:** Enhanced market conduct supervision, proactive complaint resolution, and strengthened transparency requirements.

- **Digital Payments:** Legal reforms to modernize payment systems and promote cross-border integration.

- **FX Management:** Continued liberalization of capital flows and review of the FX policy framework.

Implications:

- CBSL's 2026 roadmap signals a vigilant but steady "hold" stance on policy rates in early 2026, aiming to guide inflation gradually toward the 5% target while managing post-cyclone supply-side risks

- Given that short-term interbank rate pressures have emerged due to liquidity asymmetries and rising credit demand, the CBSL prefers to address these pressures through targeted liquidity operations and SRR reforms.

- This reflects the Central Bank's focus on fine-tuning liquidity conditions to preserve monetary stability while supporting growth, rather than making broader rate adjustments prematurely, although moderate rate changes are not completely ruled out if circumstances warrant them.

- From a market perspective, SRR tightening is expected to place an upward pressure on short-term rates, while long-term yields should remain anchored amid contained inflation expectations, supported by fiscal consolidation and reserve accumulation.

- In equity markets, existing interest rates and expanding credit are likely to support earnings recovery, particularly in the consumer, construction, and banking sectors.

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