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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: No. 03 – May 2025

The Central Bank of Sri Lanka further reduces the Overnight Policy Rate (OPR)

The Monetary Policy Board decided to reduce the OPR by 25 bps to 7.75% at its meeting held yesterday, thereby easing monetary policy further.[1] The Board arrived at this decision after carefully considering the developments both domestically and globally. The Board is of the view that this measured easing of monetary policy stance will support steering inflation towards the target of 5%, amidst global uncertainties and current subdued inflationary pressures.

Deflationary conditions have begun to ease since March 2025, as predicted. The latest projections show signs of a more gradual pickup in inflation in the near term than previously anticipated. Accordingly, inflation is expected to turn positive in early third quarter of 2025 and gradually align with the target thereafter. Core inflation is also expected to increase gradually in the coming months from current low levels. Inflation expectations are also aligning with the inflation target.

Recent leading economic indicators reflect sustained progress in domestic economic activity. However, global uncertainties, which could have implications on Sri Lanka, have escalated from the time of the previous monetary policy review.

Meanwhile, most market interest rates have stabilised at lower levels. With the current policy easing, the Board expects further downward adjustments in lending rates. Credit flows to the private sector remain strong with key economic sectors benefitting from such expansion. This credit expansion is expected to continue throughout the year, with further support from the latest easing.

Thus far during the year, the external sector performance remains robust. This is supported by inflows in the form of earnings from tourism and workers' remittances, despite the widening of the trade deficit. Continued net forex purchases by the Central Bank helped strengthen the official reserves amidst debt

[1] Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR), which are linked to OPR with pre-determined margins of ± 50 bps, are reduced to 7.25% and 8.25%, respectively

servicing and other forex outflows. The Sri Lanka rupee recorded some depreciation against the US dollar so far during the year, following two years of annual appreciation against major currencies.

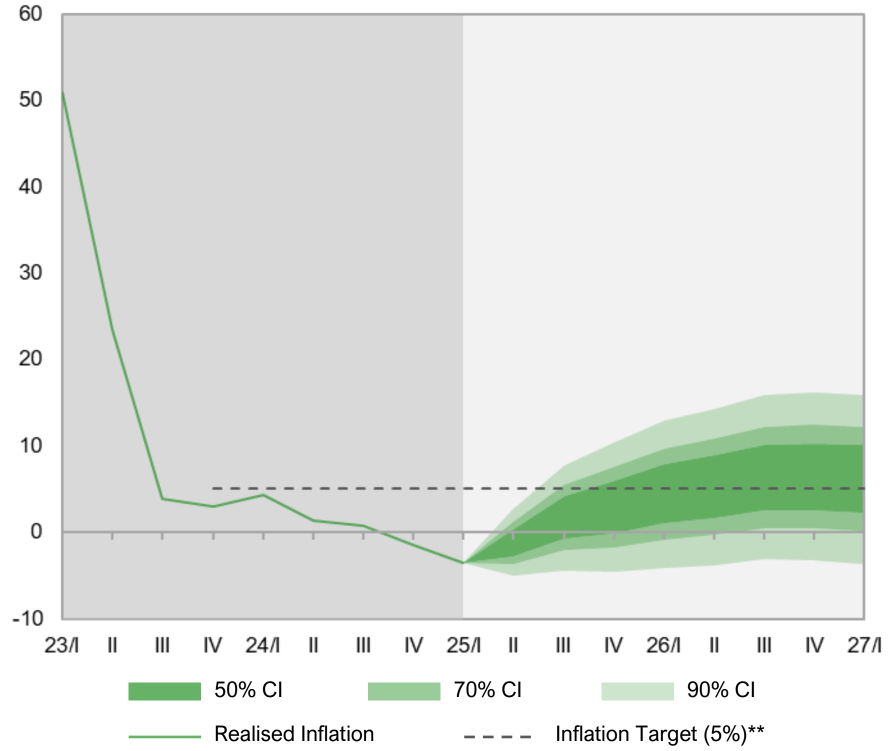
The Board will carefully assess incoming data on the domestic and global fronts and take measures, as appropriate, to ensure that inflation stabilises around the target of 5%, while supporting the economy to reach its potential.

The release of the next regular statement on the monetary policy review will be on 23 July 2025.

Annexure 01:

Headline Inflation Projections* (Quarterly, CCPI, Y-o-Y, %)

Based on the Projections during the May 2025 Monetary Policy Round



** *The inflation target (5%) was agreed under the Monetary Policy Framework Agreement (MPFA) signed between the Central Bank and the Minister of Finance in October 2023.*

* Realised data in the fan chart are based on the CCPI (2021=100, seasonally adjusted). Projections are based on all available data at the forecast round in May 2025.

Note: The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colours. The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. For example, the thick green shaded area represents the 50% confidence interval, implying that there is a 50% probability that the actual inflation outcome will be within this interval. The confidence bands show the increasing uncertainty in forecasting inflation over a longer horizon.

***Note:* A forecast is neither a promise nor a commitment.**

The projections reflect the available data, assumptions, and judgements made at the forecast round in May 2025. They are conditional on the forecasts of global energy and food prices, the expected growth path of Sri Lanka's major trading partners, the anticipated domestic fiscal path in line with the IMF-EFF programme, and global financial conditions implied by the Fed Funds rate. Further, the projections are conditional on the model-consistent interest rate path and the resulting macroeconomic responses. Any notable changes in these assumptions could lead to the realised inflation path deviating from the projected path.

There are upside risks to the realisation of inflation projections stemming from factors such as the possible adverse weather conditions affecting agricultural production, and the possibility of higher-than-anticipated demand pressures amidst strong credit growth. Meanwhile, downside risks to the realisation of inflation projections include a possible persistent slowdown in global demand leading to a more-than-anticipated reduction in global energy prices.

Data Annexure is accessible at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/mpr03_2025_e.pdf