



# INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

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**Statement by Ms. Sitharaman  
India**

On behalf of  
Bangladesh, Bhutan, India, and Sri Lanka



**Statement by Ms. Nirmala Sitharaman, Minister of Finance and Corporate Affairs, India, and Member, International Monetary and Financial Committee (IMFC), representing the Constituency comprising Bangladesh, Bhutan, India and Sri Lanka, to  
the 53rd Meeting of the IMFC at the Spring Meetings, April 2026**

**Global Economy**

1. Just as the global economy was beginning to stabilize after last year's trade and policy uncertainties, it has been hit by another major shock: the ongoing conflict in the Middle East. Surging oil prices and disruptions to key trade routes have triggered one of the largest energy supply shocks since the 1970s. The global economy's resilience will once again be tested amid shrinking policy space. As this adverse supply shock rekindles inflationary pressures and weighs on growth—which, though resilient, remains modest by historical standards—it will sharpen difficult monetary policy trade-offs. With fiscal positions already stretched after successive crises, the scope for broad-based fiscal support is further constrained.
2. The fallout from the conflict—and the associated energy supply shock—will depend on the breadth, duration, and intensity of the conflict. While economies in the region will bear the most immediate costs, the adverse effects will extend far beyond, reflecting countries' reliance on the region for oil and energy supplies, trade and transport links, remittance flows, and broader financial and economic ties. For emerging market and developing economies (EMDEs), the challenge is especially acute: policy space is tighter; exposure to energy and commodity price shocks is greater; inflation expectations are more sensitive to these movements; and global risk-off episodes—together with tighter global financial conditions—could trigger large macro-financial spillovers, further complicating policy challenges.
3. Looking beyond the near term, medium-term growth is constrained by structural headwinds. Trade tensions are eroding a key engine of global expansion, while population aging, weak productivity growth, and climate risks add further drag. These pressures—together with geopolitical conflicts and higher defence spending—are straining public finances. In an environment of rising interest rates and slowing growth, debt-sustainability concerns become even more acute. For low-income countries, weaker aid flows further limit fiscal space,

squeezing essential social spending and increasing the risk of socio-political strains. Together, these forces pose a daunting challenge for policymakers.

4. The near-term priority is to safeguard macroeconomic stability through the prudent use of available policy levers, while strengthening underlying fundamentals and policy buffers to enhance resilience to shocks. This will require more robust policy frameworks, clear and consistent communication, and sustained structural reforms to raise potential growth. Furthermore, global cooperation is essential to avoid inferior outcomes resulting from rising barriers to trade in goods and services, investment, and labour mobility which would weigh on innovation, productivity, and long-run output. Progress on the green transition and supply-chain resilience likewise hinges on collective action.

5. In this context, the IMF can serve as a trusted macroeconomic advisor and a catalyst for global engagement. The Fund is well placed to provide policy advice and, where needed, financial support—working with other international organizations—to help countries address balance-of-payments pressures. It should also champion stronger cooperation among multilateral institutions and support a rules-based, non-discriminatory, open, inclusive, sustainable, and transparent trading system with the World Trade Organisation at its core. I welcome the IMF's review of its work on global imbalances, external sector assessments, surveillance, and debt sustainability, as well as emerging issues such as stablecoins. This effort will help strengthen the quality of the Fund's advice and reinforce the spirit of international cooperation.

## **India**

6. Despite global headwinds, India's economic trajectory remained resilient, underpinned by macroeconomic stability. We have recently released the new GDP series with base year 2022-23, updated methodologies and data sources. According to the second advance estimates, real GDP growth accelerated to 7.6 per cent in 2025-26, from 7.1 per cent a year ago. The quarterly growth also remained high at 7.8 per cent in Q3:2025-26, despite challenges on the trade front. High-frequency indicators point to sustained Q4 momentum, though the Middle East conflict could weigh on activity.

7. Looking ahead, growth is expected to remain resilient, with the Reserve Bank projecting GDP growth at 6.9 per cent in 2026-27. Rural demand is likely to stay steady on the back of favourable agricultural prospects, while urban demand should benefit from last year's income tax cuts, GST rationalisation and

monetary easing. Investment activity is supported by high-capacity utilisation, accelerating bank credit, conducive financial conditions, and the government's continued emphasis on infrastructure. In addition, several sector-specific measures announced in the Union Budget should further support growth. India has signed several bilateral and regional trade agreements with major partners, which should boost trade and investment, broaden export markets, and further integrate India into global value chains.

8. Low and stable inflation has lent strength to India's fundamentals, creating room for growth-supportive policies. Headline CPI inflation has remained below the 4 per cent target, and underlying price pressures have stayed subdued. The MPC has cut the policy repo rate by 125 basis points since February 2025 and currently maintains a neutral stance. The Reserve Bank has backed its monetary policy actions by proactively managing liquidity conditions to ensure orderly market conditions and strengthen policy transmission.

9. India's steadfast fiscal consolidation has been a cornerstone of macroeconomic stability in recent years. The Union Budget 2026-27 remained aligned with the medium-term consolidation path, budgeting a fiscal deficit of 4.3 per cent of GDP – consistent with the Government's debt-to-GDP target of  $50 \pm 1$  per cent by 2030-31. Fiscal policy in recent years has prioritised the quality of spending, with a strong focus on capital spending. Notably, India's general government debt declined during 2020-2025, in contrast to the rising trend seen among advanced and emerging market economies. India aims to prioritize spending in key developmental sectors to enhance the nation's social and physical infrastructure and to facilitate technology-led development. This strategy includes supporting India's medium-term growth outlook through (i) higher capital expenditure including strengthening states' capital expenditure; (ii) targeted sectoral initiatives in healthcare, MSMEs, and green transition; (iii) improving the quality and management of public spending through technological advancements; and, (iv) maintaining an active debt management approach.

10. India's external sector demonstrated resilience amidst a volatile global environment characterized by heightened trade policy uncertainty and geopolitical tensions. The current account deficit for 2025-26 (Q1-Q3) recorded 1 per cent of GDP, supported by buoyant services and remittance inflows. Gross FDI inflows remained resilient, cushioned by equity investments and greenfield projects. However, portfolio flows have exhibited volatility and experienced net outflows, reflecting broader global financial conditions. As on April 3, 2026,

foreign exchange reserves' buffer stood at US\$ 697 billion providing cover equivalent to goods and services imports of around 9 months. As of December 2025, external debt position (US\$765 billion) was comfortable with 91 per cent coverage by forex reserves.

11. The domestic financial system remains resilient and supportive of growth and financial inclusion. Scheduled commercial banks (SCBs) continue to demonstrate solid financial health, supported by substantial capital and liquidity reserves, enhanced asset quality, and sustained profitability. Stress testing has validated the resilience of these institutions in withstanding adverse conditions and maintaining capital well above the regulatory requirements. Non-Banking Financial Companies (NBFCs) also exhibit strong capital adequacy, improved asset quality, and steady profitability. Regulatory frameworks and macroprudential policies are being aligned to strengthen financial resilience while maintaining an appropriate balance between innovation and stability.

12. Despite easing US tariffs and recent trade agreements, the conflict in the Middle East has intensified external headwinds for India. As a major importer of crude oil and LPG—much of it routed through the Strait of Hormuz—India remains exposed to supply disruptions and price spikes. Any weakening of trade and remittance inflows from the region could widen the current account deficit. Heightened risk aversion has also triggered capital outflow, putting pressure on the exchange rate, equity markets and bond yields. We are closely monitoring developments and have taken proactive steps to mitigate spillovers to the domestic economy. These include invoking the Essential Commodities Act to ensure natural gas supplies for critical industries, ramping up domestic LPG refining, pursuing diplomatic efforts to secure safe passage for fuel carriers through the Strait of Hormuz, and intensifying measures to deter hoarding of petroleum products. The creation of an Economic Stabilisation Fund provides fiscal headroom and a buffer to respond swiftly to global shocks. Over time, India has also diversified its crude import basket and expanded domestic refining capacity.

## **Bhutan**

13. Bhutan's real GDP growth is projected to moderate from 8.71 percent in 2025 to 6.86 percent in 2026 as Punatsangchhu Hydroelectric Project Authority (PHPA-II) commissioning impact tapers. Growth remains above medium-term potential, primarily driven by hydropower construction and increased public capital expenditure. While averaging over 6 percent in the medium term,

performance will remain sensitive to hydropower investment cycles and project execution.

14. Bhutan's agricultural sector is slated to expand by 1.94 percent in 2026. Within this, livestock production is forecasted to increase by 2.41 percent, while the forestry and logging subsector is anticipated to grow by 4.24 percent, marking a stronger contribution than the previous year. The industrial sector is predicted to decelerate to 12.20 percent from 16.69 percent in 2025. This shift reflects a cooling in electricity growth, which is estimated to drop to 2.19 percent following the initial PHPA-II capacity surge. Conversely, the construction sector is poised for a massive 32.02 percent jump, underpinned by the expected commencement of major hydropower projects like Khorlochhu and Dorjilung. Finally, manufacturing and mining are envisioned to grow by 5.56 percent and 3.35 percent, respectively. While the new Norbugang Industrial Park is expected to bolster recovery, the manufacturing sector has yet to fully leverage low-cost energy due to lingering policy hurdles.

15. In 2026, aggregate demand is forecasted to be propelled primarily by public investment, with private investment serving as a secondary driver. Capital expenditure in FY 2025-26 is anticipated to rise substantially over the previous fiscal year. Simultaneously, private investment is envisioned to grow by 5.72 percent, bolstered by escalating spending linked to hydropower construction projects.

16. In the medium term, as capital expenditure gradually tapers off, its contribution to growth is anticipated to diminish, while private investment is expected to maintain relative stability. Government consumption is forecasted to grow by 4.28 percent in 2026, with an average projected growth of 4.11 percent reflecting consistent recurrent expenditure. Conversely, private consumption is envisioned to contract by 2.93 percent, with its growth contribution dropping to -1.40 percentage points (down from a previously estimated 1.24 percentage points). This downturn likely reflects heightened inflation expectations following GST implementation. Nevertheless, private consumption is expected to recover and strengthen over time in the medium-term.

17. While inflation and monetary conditions remain broadly stable under the currency peg, domestic reforms and liquidity dynamics are increasingly policy-relevant. Inflation averaged 3.51 percent in 2025, though temporary upward pressure is anticipated in 2026 following the introduction of the 5 percent GST. In the immediate future, GST implementation is expected to trigger upward price

adjustments; however, this impact should be short-lived due to tax pass-through mechanisms for existing inventory.

18. Labor market indicators suggest slight overall improvements, yet structural challenges persist for the younger demographic. Although the general unemployment rate reached 3.38 percent in 2025, youth unemployment remained high at approximately 18.20 percent, significantly exceeding the global average of 12.40 percent. Medium-term forecasts anticipate this figure will hover between 19 percent and 21 percent from 2026 to 2028.

19. The fiscal deficit for FY 2025-26 is forecasted at 3.23 percent of GDP, marking a significant improvement over previous estimates and demonstrating disciplined adherence to the 3 percent medium-term target under the 13<sup>th</sup> FYP. Public debt remains elevated at Nu 382,095 million, approximately 110.47 percent of GDP in Q2 of FY 2025-26, largely attributed to hydropower projects. Public debt reached a peak of 124.50 percent of GDP during the FY 2020-21 pandemic period. Following this high, the debt-to-GDP ratio moderated to 100.29 percent by FY 2024-25. This downward trajectory was catalysed by strengthened fiscal outturns and resilient GDP expansion over recent years.

20. The Money Supply for FY 2025-26 is forecasted at approximately Nu 296,187.212 million, a robust expansion of 18.98 percent. This figure marks a significant upward adjustment from the previous quarter's growth estimate of 11.43 percent (Nu 277,391.206 million), due to intensified government spending and credit expansion. Within the banking sector, liquidity remains ample with excess reserves surpassing Nu 12 billion, ensuring a steady flow of credit. On the assets side, the upward revision in the money supply is attributed to higher-than-anticipated convertible currency inflows from remittances and hydropower-related proceeds. These inflows have bolstered Net Foreign Assets to Nu 190,017.360 million. From a liability perspective, the composition of broad money reveals that liquidity is predominantly absorbed through the banking sector. Demand deposits, comprising both current and savings accounts, constitute 51.88 percent of the total supply, while time deposits account for 43.21 percent, indicating that the majority of the money supply is held in the form of bank deposits.

21. External balances continue to face structural pressures due to substantial capital import requirements, even as a temporary improvement in the trade deficit is anticipated as one-time surges subside. The current account deficit is slated to narrow from 19.47 percent of GDP in FY 2025-26 to 16.40 percent in FY 2026-

27, primarily due to the receding impact of previous import spikes. However, this figure is projected to widen sharply to approximately 27 percent of GDP in the coming years, due to a surge in capital-goods imports for hydropower projects and government investments, alongside a narrow export base. These pressures have been partially mitigated by improvements in services exports, rising inward remittances, and robust financial account inflows, including a significant one-time surge in FDI equity.

22. The trade deficit excluding electricity is estimated to expand to Nu 145,808.231 million in FY 2025-26, marking an 18.51 percent increase over previous assessments. This trajectory is mainly driven by a sharp rise in merchandise imports from Countries Other Than India (COTI), which are now calculated at Nu 68,844.465 million, a 61.33 percent jump compared to earlier expectations.

23. As of December 2025, total outstanding credit in the economy (provisional) reached Nu 274,080.44 million. Asset quality remains stable, with Non-Performing Loans (NPLs) totalling Nu 1,193.37 million, signalling a well-contained NPL ratio of 3.09 percent. The sectoral distribution of credit reveals sustained demand for housing finance, which accounts for Nu 77,305.11 million (28.2 %). For FY 2025-26, total sectoral credit is anticipated to reach Nu 278,712.375 million, with a moderated growth rate of 8.07 percent, compared to the more aggressive 17.02 percent expansion observed in the preceding year.

## **Bangladesh**

24. Bangladesh remains firmly committed to safeguarding macroeconomic stability, accelerating structural reforms, and strengthening climate resilience under the IMF-supported ECF, EFF, and RSF arrangements. The newly elected government has reaffirmed these priorities and initiated a comprehensive set of measures to reinforce policy credibility and ensure reform continuity.

25. Efforts are ongoing to stabilize the macroeconomic environment, rebuild fiscal and external buffers, and lay the foundations for resilient, inclusive, and sustainable growth. The following sections outline recent macroeconomic developments, assess progress under the IMF-supported reform agenda, and discuss program financing, as well as Bangladesh's strategic priorities in the context of evolving global challenges and opportunities.

## **Macroeconomic Developments and Policy Response**

26. Bangladesh's macroeconomic outlook is gradually improving, supported by decisive policy actions, coordinated fiscal and monetary policies and reform momentum under programs supported by different development partners, including the IMF and World Bank.

27. **Growth Outlook:** Bangladesh's economy has come under increasing pressure in recent years, which peaked during FY2023–24 and FY2024–25. These challenges stem from lingering effects of earlier external shocks, notably the COVID-19 pandemic and the Russia–Ukraine war, which exposed and intensified underlying structural vulnerabilities, particularly within the domestic financial sector. The political unrest in the first quarter of FY2024–25 adversely affected economic activity, contributing to lower exports and diminished productivity. More recently, the conflict in the Middle East has further constrained fiscal space and is expected to put considerable pressure on the balance of payments.

28. Over the past decade, the growth rate has decelerated to below 5 per cent from above 6 per cent over the last three fiscal years, reflecting both external headwinds and domestic constraints.

29. Going forward, growth is projected to recover to around 5.0% in FY2025–26. This recovery is expected to be supported by strong remittance inflows, export growth, and a revival in private investment. The new government is prioritizing investment-led growth, alongside productivity-enhancing reforms and deregulation, to restore medium-term growth to above 7 per cent. Key areas of focus include strengthening private sector dynamism, expanding infrastructure investment, and enhancing human capital development.

30. **Inflation Management:** Inflation has remained elevated, showing volatility, with a recent increase to 9.13% in February 2026, though the rates briefly eased in the second half of 2025. Food inflation decreased significantly to 7.60% in August 2025 from 14.10% in July 2024, though it stands at 9.30% in February 2026. However, efforts are underway to keep inflation at a moderate level by continuing with prudent fiscal policy, tighter monetary policy, improved food supply conditions and proper coordination between fiscal and monetary authorities. As per the latest reading, inflation eased marginally to 8.7% in March 2026.

31. **Monetary and Exchange Rate Policy:** Bangladesh Bank (BB) has transitioned to a fully market-based interest rate regime. Additionally, on May 14,

2025, it adopted the market-based exchange rate system, allowing greater flexibility in the forex market. While there are risks in the financial sector, particularly with high non-performing loans and strained capital adequacy in some banks, the government is prioritizing strengthened supervision, legal frameworks for bank resolution, and better governance to mitigate these risks. The position of foreign exchange reserve has also improved, and the gross foreign exchange reserves stood at over US\$34.35 billion on March 12, 2026, while it was US\$29.64 billion per BPM6.

32. **Fiscal Policy and Budget Execution:** The FY2025–26 revised budget targets a primary deficit of below 2.0% of GDP, and that reflects a commitment to fiscal consolidation while safeguarding priority social and infrastructure spending. The new government has placed strong emphasis on revenue mobilization, initiating reforms to broaden the tax base, rationalize expenditures, and improve compliance through increased digitization.

33. **External Sector and Debt Sustainability:** The current account deficit has been narrowing, supported by strong remittance growth and subdued import demand. Public debt remains sustainable; some concerns remain due to limited fiscal space. The government is committed to maintaining a prudent fiscal stance while strengthening debt transparency. However, these recent improvements are subject to external risks. A prolonged conflict in the Middle East and continued uncertainty in fuel supply could undermine the progress achieved.

34. **Structural Anchors:** The macroeconomic framework is underpinned by reforms in public financial management, financial sector oversight, and climate resilience. These are aligned with IMF program benchmarks and the government’s broader development strategy.

#### **Reform Progress Under IMF Program:**

35. Bangladesh has made substantial progress in implementing structural reforms across key areas, as outlined in the policy matrix:

36. **Tax Policy and Administration:** Reforms include the rationalization of income tax expenditures, expansion of the VAT base, separation of tax administration from policy functions, and automation of NBR processes. To support these efforts, the government has launched the “Strengthening Domestic Revenue Mobilisation Project,” aimed at enhancing tax compliance, broadening the revenue base, and modernizing core systems. The World Bank is providing

the majority of the financing, with the remainder funded by the Government of Bangladesh. The project is expected to be implemented over a five-year horizon.

37. **Public Financial Management (PFM):** Key reforms include improved cash forecasting, further rollout of the iBAS++ system, and enhanced fiscal reporting. The government is committed to strengthening budget credibility and transparency.

38. **Financial Sector Oversight:** Government is prioritizing strengthened supervision, legal frameworks for bank resolution, and better governance to mitigate the existing risks in the financial sector. The central bank is also advancing interest rate liberalization and FX market reforms.

39. **Climate Resilience and RSF Commitments:** Bangladesh is implementing reforms to integrate climate risk into public investment planning, enhance climate budgeting, and improve energy efficiency. These efforts are supported by the IMF's RSF disbursements and technical assistance.

### **Program Financing and Forward Commitments**

40. As of June 2025, Bangladesh has received \$3.64 billion under the ECF/EFF/RSF program, including the augmented disbursement following the third and fourth reviews.

41. The government remains committed to meeting performance criteria, prior actions, and structural benchmarks, including further reforms in tax policy, financial sector oversight, and climate resilience.

### **Strategic Priorities and Global Engagement**

42. Bangladesh reaffirms its commitment to:

43. Strengthening macroeconomic buffers through prudent fiscal and monetary policies and accelerating structural reforms to support inclusive growth and private sector development.

44. Enhancing transparency and governance, particularly in SOEs, public procurement, and financial sector regulation.

45. Deepening collaboration with development partners, including the IMF, World Bank, and regional institutions, to mobilize concessional financing and technical assistance.

46. Finally, Bangladesh appreciates the continued support of the IMF and the Executive Director's office and looks forward to constructive engagement during the Annual Meetings.

### **Sri Lanka**

47. Sri Lanka demonstrated resilience amidst global headwinds and domestic weather-driven calamities. Macroeconomic stability was restored and reforms to address deep-rooted structural impediments are progressing as planned. Performance under the Extended Fund Facilities (EFF) remains intact with the Executive Board approval reached for the fourth review in July 2025 and staff consultation on a combined review for the fifth and sixth reviews is currently under way. Financial and technical assistance of the World Bank and the Asian Development Bank continue to complement the macroeconomic adjustments under the EFF. With the completion of the restructuring deal for government-guaranteed debt owed by Sri Lankan Airlines, Sri Lanka's overall debt restructuring process was nearly completed by the first quarter of 2026.

48. Sri Lanka's journey toward stability and economic recovery was disrupted by Cyclone Ditwah, a severe natural disaster that struck in late November 2025. The socioeconomic damage was substantial. It has caused loss of over 600 human lives and directly and indirectly impacted millions of people. Public infrastructure, such as roads, bridges, railway lines, dams, reservoirs, and public buildings suffered sizeable destruction. The country received urgent humanitarian assistance and to rebuild Sri Lanka from multilateral donors, bilateral partners and international and local well-wishers. In response to authorities' requests, the IMF provided urgent budget support under the Rapid Financing Instrument (RFI) amounting to SDR 150.5 million (about US dollars 205 million) in December 2025 based on a preliminary impact assessment. Subsequently, Global Rapid Post-Disaster Damage Estimation (GRADE) of the World Bank estimated the direct physical damage to assets equivalent to US dollars 4.1 billion (around 4 per cent of GDP). Of which, damages to infrastructure contribute to the largest share of 42 per cent followed by damages to residential properties by 24 per cent. The authorities took several initiatives for early resettlement and bringing back normalcy. Several essential services, such as electricity provision, transport, telecommunication and water supply in affected regions are restored very quickly. A Supplementary Budget was approved by the Parliament in December 2025 for LKR 500 billion (around US dollars 1.6 billion) to support post-cyclone relief

and reconstruction efforts. This will be financed fully from the overperformance of fiscal primary surplus and no additional financing requirement is anticipated.

49. Sri Lanka sustained its economic recovery following the economic meltdown, registering 5 per cent real growth in 2024 and 2025, respectively. Moreover, several notable achievements related to economic recovery were registered in 2025. Nominal GDP surpassed US dollars 100 billion mark for the first time in history, US dollars 108 billion to be precise. This led to per capita GDP also reaching US dollars 5003 for the first time. These changes restore nominal GDP to its pre-crisis, pre-pandemic, and pre-Easter Sunday attack level. Such a recovery places the country in strong footing to focus its attention more on addressing reforms for sustained economic growth. Real GDP growth in 2025 was broad-based with all three production sectors favorably contributing, with a notable contribution from the industry sector. On the expenditure side, economic growth was driven by domestic consumption and investment, with domestic consumption contributing to 77.2 percent of GDP. Several leading indicators point towards the continuation of the growth momentum until February 2026, before the country faced with a shock following the tension in Middle East region.

50. After almost a year of deflation, inflation as measured by the Colombo Consumer Price Index (CCPI) began to rise in August 2025 and has stayed low since. Prolonged deflation in energy prices mainly contributed to this deflation episode. Meanwhile, benign price pressures in other categories also contributed to low inflation. With the gradual normalization of inflation since late 2025, inflation moved within the lower bound of the outer band defined in Monetary Policy Consultative Clause (MPCC) under the EFF in Q4 2025 and Q1 2026. Inflationary pressures after the cyclone were limited, mainly due to better food production, lower food prices, and policy measures that accelerated economic recovery. Headline inflation in March 2026 recorded at 2.2 per cent, while core inflation was at 2.5 percent. However, the spillover effects of the surge in global energy prices, tighter supply disruptions following the Middle East crisis are anticipated to reverse this trend and accelerate inflation in the near term. Accordingly, inflation is projected to move towards the inflation target of 5 per cent in Q2 2026. The Central Bank of Sri Lanka (CBSL) continued prudent monetary policy with the continuation of the monetary policy easing stance commenced in mid-2023. Anticipated normalization of inflation in the forthcoming period along with economy operating closer to its potential and increased global uncertainty supported the adoption of neutral policy stance

recently. Aligning with the Overnight Policy Rate of the CBSL, overall market interest rates have broadly stabilized at low levels lately.

51. The external sector of the country demonstrated resilience and some improvements in the post-crisis period. This was reflected in the external current account recording surpluses for three consecutive years, compared to historical deficits. Import restrictions and exchange rate depreciation initially drove reduced import demand after the crisis, supporting current account surplus. However, the surplus continued even after the complete removal of such restrictions and subsequent pent-up demand for vehicles. External current account recorded a surplus of US dollars 1.7 billion (around 1.6 per cent of GDP) in 2025, largely supported by services exports and workers' remittances. Merchandise exports recorded a growth of 6.3 per cent, while imports recorded a notable growth of 14 per cent, contributed mainly by sizeable vehicle imports (nearly 10 per cent of total imports). The United States, India, and the United Kingdom remained the top export destinations, while China, India, and the United Arab Emirates continued to be the leading sources of imports in 2025. Workers' remittances improved over US dollars 8.0 billion level, which continued to fully cushion merchandise trade deficit. Similar dynamics of the external current account continued in 2026 up to February 2026. Meanwhile, external buffers have been built continuously through the Central Bank purchases of forex domestically. Accordingly, Gross Official Reserves improved to US dollars 6.8 billion by end 2025 and US dollars 7.3 billion by end February 2026. Reserves are at their highest in recent years, even as post-debt restructuring payments resume. In line with the greater flexibility in exchange rate, currency depreciated by 5.6 per cent against US dollar in 2025 and 1.6 per cent by end March 2026.

52. Fiscal performance in recent years improved with the revenue-based consolidation adopted by the government, along with strengthened legal framework and institutional arrangements for public financial management. Revenue and primary balance in 2025 exceeded budget estimates and the targets under the EFF. Primary balance reached 5.4 per cent of GDP compared to the EFF target of 2.3 per cent, registering an impressive overperformance. This was largely driven by the notable improvement in tax revenue. Tax revenue grew by 36.3 per cent compared to the previous year, reaching 15.4 per cent of GDP during 2025. Increased collections from excise duties, Value Added Tax (VAT) and income taxes are attributable to these healthy revenue records. A notable rise in revenue came from pent-up demand for vehicle imports. On the other hand,

growth in expenditure was moderate and was supported by a reduction in interest payments. Primary expenditure as a share of GDP was maintained within the cap specified in the Public Finance Management Act. These developments led to narrowing the budget deficit to 2.3 per cent of GDP, the lowest in several decades. The Government primarily utilised domestic sources to fund its budget and debt servicing obligations. The attainment of a primary surplus exceeding expectations contributed to the reduction of debt servicing costs. Measures to widen tax net, reduce revenue leakages and tax expenditure continued as part of the fiscal reform. Fiscal performance continued similar path in the first quarter of 2026 as well.

53. The financial system demonstrated greater stability and improved performance in 2025, supported by strengthened macroeconomic conditions. Benefiting from improved fiscal discipline, banking sector exposure is gradually shifting from the government and government institutions to private sector. Banking sector assets recorded a growth of 12.5 per cent at end 2025, primarily driven by loans and receivables with notable growth credit to the private sector. A further improvement to credit quality was evident with Stage 3 loan to total loans improving to 9.7 per cent in 2025 from 12.3 per cent in the previous year with notable credit expansion. Higher credit expansion was reflected in slight decline in liquidity coverage ratios and capital adequacy ratios of the banking sector in 2025, compared to the previous year. Yet all these ratios remain well above the regulatory requirements. Profitability of the banking sector improved in 2025, mainly driven by higher net interest income and the recognition of a gain from derecognition of financial assets in 2025, compared to a loss recorded in 2024. Finance companies sector also recorded steady performance in 2025, in terms of asset growth, profitability and asset quality.

54. Conflicts erupted in the Middle East region in late February 2026 poses new risks and challenges to Sri Lanka. As an energy net importer nation, Sri Lanka faces difficulties on maintaining energy security due to supply chain disruption to key energy products. Additionally, sudden exponential surge in crude oil, refined petroleum products and LP gas have multiple spillover effects on broader segments of the economy. Sri Lanka's external sector outlook could be reshaped by the potential impact of this conflict on tourism, trade, and remittances, although the magnitude of the impact remains uncertain. Meanwhile, the overall macroeconomic impacts through the balance of payments, inflation, economic activity, financial market spillovers, food security and investment could

be multifaceted, if the conflict last longer. The magnitude and duration of these implications will largely depend on its duration, spread and damages to supply chains. On a positive note, Sri Lanka is in a relatively better position to withstand these challenges compared to the recent past, provided that this shock is transitory. Thanks to the macroeconomic adjustment effected after the crisis to restore macroeconomic stability and to build buffers. Persistently benign inflation outturn and well anchored inflation expectations would be conducive in withstanding the current global shock driven inflation episode, if there is no further escalation in global energy and food prices and shipping costs. Several policy initiatives have been taken by the authorities to mitigate the macroeconomic impacts and to ensure energy and food security. Demand management measures are focused on energy price passthrough, fuel rationing and fiscal commitment to partly absorb the price shock through limited subsidies and conservation measures. Meanwhile, efforts are underway to enhance energy supply and build stocks. Balance of payments pressures are managed through exchange rate adjustment with minimal intervention. However, as a small open economy that is still in the recovery phase from an unprecedented socioeconomic crisis, the space available to withstand severe and prolonged global shock is much constrained.

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