SRI LANKA

Sri Lanka's economic recovery remains strong, supported by consumption and investment, robust remittances and tourism inflows, and significant revenue improvements. Poverty levels have declined but vulnerability remains high as real wages and labor force participation are below pre-crisis levels. Medium-term growth prospects hinge on sustained macroeconomic stability and the implementation of structural reforms that boost trade and attract non-debt-creating flows.

Population[1] million **21.9**	Poverty[2] millions living on less than $4.20/day **2.5**
Life expectancy at birth[3] years **77.5**	School enrollment[4] primary (% gross) **95.9**
GDP current US$, billion **..**	GDP per capita current US$ **..**

Sources: WDI, MFMod, and official data. 1/ 2024. 2/ 2019 (2021 PPPs). 3/ 2023. 4/ 2022.

Key conditions and challenges

After experiencing a balance of payments crisis and a sovereign debt default in 2022, the Sri Lankan economy began recovering in 2024. The crisis, caused by long-standing structural weaknesses and macroeconomic imbalances, and exacerbated by exogenous shocks, led to a contraction of 9.5 percent over 2021–23. Macroeconomic stability was restored with the implementation of reforms, including cost-reflective utility pricing and new tax measures. Real GDP expanded by 5 percent (y-o-y) in 2024. From its peak of 69.8 percent (y-o-y) in September 2022, inflation fell to single digits by mid-2023. External buffers were rebuilt, with usable reserves rising to US$4.7 billion by end-2024 (equivalent to 3 months of imports), from US$500 million at end-2022. The primary balance was in surplus in 2023–24. Public and publicly guaranteed (PPG) debt-to-GDP remains elevated at 103.9 percent (end-2024) but has fallen from end-2022 levels (119.2 percent).

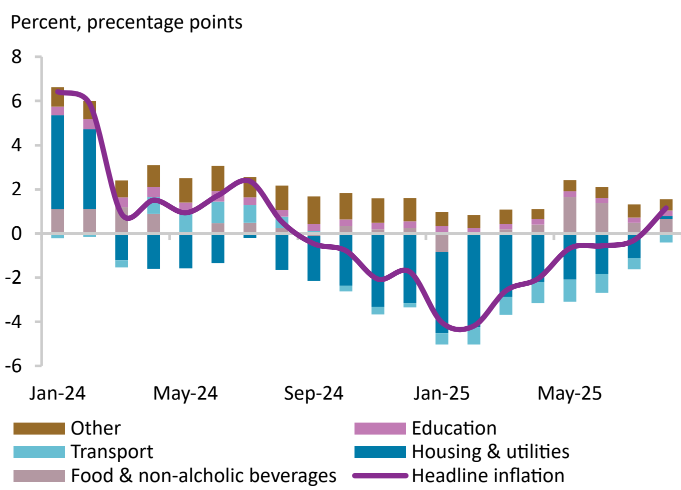
Despite these improvements, the recovery is unfinished. Real output is below 2018 levels, poverty is double its 2019 levels, and the labor market recovery is slow. Long-term prospects for growth, jobs, and poverty reduction are hinged on increasing female employment, retaining skilled labor (in the context of an aging society), modernizing the labor law, improving the tax morale, strengthening trade linkages, improving logistics performance, and improving the business environment.

Recent developments

The economy grew by 4.8 percent (y-o-y) in H1 2025, as industry, led by textiles, construction, and food manufacturing, continued to rebound, and services, led by financial and tourism-related services, grew steadily. Private consumption is beginning to recover, amidst rising wages, high credit growth, deflation, and a stable rupee.

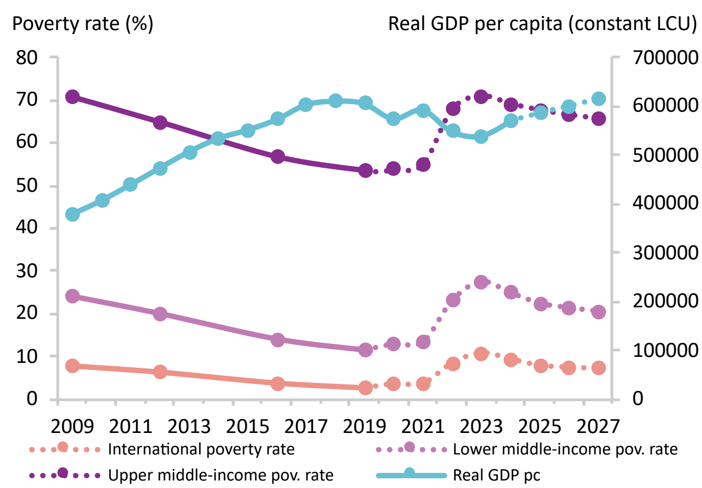
After eleven months of deflation, headline inflation turned positive in August 2025 (1.2 percent, y-o-y), driven by higher food prices and a rebound in administered energy prices. To steer inflation closer to its 5 percent target, the central bank cut policy rates by 25 basis points in May 2025 (a cumulative 825 basis point reduction since 2023). Accommodative monetary policy contributed to lower lending rates and a sharp pick-up in private sector credit growth to 19.6 percent (y-o-y) in July 2025.

FIGURE 1 / Contributors to headline inflation



Sources: Department of Census and Statistics and World Bank calculations.
Note: Utilities include water, electricity, gas and other fuels

FIGURE 2 / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: See footnotes in table on the next page.

The merchandise trade deficit widened by 22.5 percent (y-o-y) during January-July 2025, as imports – driven mainly by vehicles and consumer goods – outpaced sluggish exports. However, robust tourism earnings and remittances kept the current account in surplus (US$1.7 billion during January-July 2025). External debt restructuring and development partner inflows contributed to a stable balance of payments. Despite continued (but slower) foreign exchange purchases by the central bank, usable reserves remained at end-2024 levels, and the rupee depreciated 3.2 percent against the dollar by end-August 2025 after appreciating in 2023-24. Further, the US imposed a 44 percent tariff on Sri Lankan imports in April 2025, revised down to 20 percent in August.

The primary surplus increased during January-July 2025, supported by a 26.5 percent growth (y-o-y) in revenue, mainly from taxes on imports and reduced capital expenditure. External debt restructuring is nearly concluded, with almost 98 percent of Eurobonds exchanged and several bilateral agreements with official creditors finalized.

While reductions in transport and energy costs in H1 2025 eased pressures on household budgets, crisis impacts persist. Poverty and malnutrition rates remain higher than pre-crisis levels, with food prices rising despite the recent deflation, raising concerns about prolonged food insecurity and longer-term human capital accumulation. Due to the scarring effects of the contraction, labor force participation was 47.4 percent in 2024, its lowest level since 2015. Real wages remain about 15 percent below their 2019 levels, with women (29.8 percent) and urban areas (44.3 percent) particularly affected. Spatial inequalities remain high.

Outlook

Despite strong recent performance, in the absence of growth-enhancing structural reforms, medium-term growth prospects remain modest at 3.1 percent and are expected to be driven primarily by a recovery in consumption, with limited contribution from investment and exports. As demand picks up, inflation is projected to increase towards its target range. The current account is expected to remain in a moderate surplus, supported by lower global oil prices, tourism-led increases in service exports, and buoyant remittances. Continued primary surpluses are expected in the medium-term, and PPG debt is projected to trend downward. Supported by moderate inflation and economic growth, poverty is projected to decline in 2025 and beyond.

However, downside risks remain high. Moderating global growth and the recalibration of global trade could dampen export demand, deter investment, and result in potential trade-related job losses. The continued reliance on value-added and trade taxes could hinder the recovery in consumption and exports. Close monitoring of private sector credit growth is needed. Persistent under-execution of the capital budget poses risks for long-term growth.

To boost growth prospects and revitalize private sector led job creation, it is critical to maintain macroeconomic stability, policy consistency, and undertake structural reforms. This includes addressing rigidities in labor regulation and reliance on public sector employment that have constrained labor market dynamism and recovery in labor incomes. Higher broad-based growth that creates jobs across the country and increases labor incomes will contribute to sustained poverty reduction and increase households' resilience to shocks.

Recent history and projections	2022	2023	2024	2025e	2026f	2027f
Real GDP growth, at constant market prices	-7.3	-2.3	5.0	4.6	3.5	3.1
Private consumption	1.2	-1.9	4.0	3.8	3.7	3.6
Government consumption	1.4	-5.4	-1.8	0.6	0.8	1.0
Gross fixed capital investment	-24.6	-8.8	19.3	10.9	7.5	3.2
Exports, goods and services	9.8	13.2	12.5	6.2	0.5	1.9
Imports, goods and services	-19.9	8.9	22.5	8.3	4.0	2.4
Real GDP growth, at constant factor prices	-7.0	-2.6	4.6	4.6	3.5	3.1
Agriculture	-4.1	1.6	1.2	1.4	1.3	1.2
Industry	-16.0	-9.2	11.0	9.4	5.4	4.0
Services	-2.6	-0.2	2.4	2.8	2.9	2.9
Employment rate (% of working-age population, 15 years+)	47.5	46.8	47.3	47.3	47.3	47.3
Inflation (consumer price index)	46.4	17.4	1.2	-0.2	3.7	4.1
Current account balance (% of GDP)	-2.0	1.7	1.2	1.1	0.5	0.4
Net foreign direct investment inflow (% of GDP)	1.2	0.8	0.7	0.5	0.6	0.7
Fiscal balance (% of GDP)	-10.2	-8.3	-6.8	-4.5	-3.2	-2.8
Revenues (% of GDP)	8.4	11.2	13.7	15.3	15.6	16.0
Debt (% of GDP)[1]	114.2	104.7	99.1	98.2	96.0	93.5
Primary balance (% of GDP)[2]	-3.7	0.6	2.2	3.0	3.0	3.1
International poverty rate ($3.00 in 2021 PPP)[3]	8.4	10.7	9.3	7.8	7.4	7.1
Lower middle-income poverty rate ($4.20 in 2021 PPP)[3]	23.1	27.5	24.9	22.3	21.3	20.4
Upper middle-income poverty rate ($8.30 in 2021 PPP)[3]	67.8	70.9	69.2	67.5	66.5	65.7
GHG emissions growth (mtCO2e)	-5.6	-3.9	4.3	5.0	5.6	4.9

Source: World Bank, Poverty and Economic Policy Global Departments. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast. Data in annual percent change unless indicated otherwise.
1/ The series uses central government debt figures.
2/ The primary balance excludes interest payments received.
3/ Calculations based on SAR-POV harmonization, using 2019-HIES. Actual data: 2019. Nowcast: 2020-2024. Forecasts are from 2025 to 2027.