



CHARTING A SUSTAINABLE FUTURE: HOW SRI LANKA'S BANKS ARE POWERING ECONOMIC REVIVAL

The year 2024 marked a significant turning point for Sri Lanka's banking sector. Amid ongoing economic challenges, the successful completion of the sovereign debt restructuring process served as a major milestone that brought much-needed clarity and direction to the country's financial outlook. This progress helped restore liquidity to the market and rebuild investor confidence, allowing the sector to shift away from a reactive crisis management mode and instead focus on long-term strategic planning. The shift was made possible by improved macroeconomic conditions, including lower inflation, falling interest rates, and greater exchange rate stability, all of which helped create an environment suitable for sustained financial and commercial growth.

However, the transition was not without its challenges. While the debt restructuring was essential for stability, it also brought about short-term financial stress across the sector. Many institutions experienced impairments, which highlighted the urgent need for stronger capital reserves and better fiscal discipline. This experience created a renewed focus within the industry on risk management and responsible growth. As a result, banks began reassessing their priorities, placing greater emphasis on financial resilience, prudent lending, and more careful capital deployment.

Despite these initial difficulties, the overall performance of the banking sector in 2024 showed steady improvement. Total banking sector assets increased by 8.7% year-on-year, reaching Rs. 22.2 trillion by the end of the year. Gross loans and advances grew by 4.1%, showing that credit demand was beginning to pick up and that lenders were regaining confidence. A particularly positive

development was the improvement in the Stage 3 Loans Ratio, which measures non-performing loans. It dropped from 12.8% to 12.3%, suggesting a meaningful improvement in asset quality. At the same time, the Capital Adequacy Ratio (CAR) increased from 17.0% to 18.4%, reflecting sound capital management and adjustments in risk-weighted assets. Taken together, these indicators pointed to the sector regaining its balance and building up operational strength.

Confidence in the banking system was further enhanced by a key international development — the upgrade of Sri Lanka's sovereign credit rating in December 2024 from 'CCC-' to 'CCC+'. This move had a ripple effect, prompting Fitch Ratings to upgrade the National Long-Term Ratings of ten domestic banks and reaffirm the ratings of five others in January 2025. These upgrades helped to improve the international image of Sri Lanka's banking sector and opened up greater access to foreign capital, adding more momentum to the country's financial recovery.

Meanwhile, regulatory reforms introduced by the Central Bank of Sri Lanka played a central role in strengthening the overall system. Amendments to the Banking Act introduced improved

governance measures, updated liquidity ratios, limits on large exposures, stricter guidelines on related-party transactions, and clear standards for offshore banking operations. A significant development was the launch of the Bank Recapitalisation Strategy, which focused on improving the capital strength of nine systemically important financial institutions. The Banking (Special Provisions) Act was also updated to give institutions better tools to handle

insolvency risks with streamlined processes and transparency.

International support also contributed meaningfully to the sector's recovery. The Asian Development Bank approved a USD 200 million policy-based loan under the second phase of its Financial Sector Stability and Reforms Program. This program is designed to improve regulatory oversight, enhance asset quality, and promote financial inclusion — especially for women and underserved communities. Key elements of the initiative include the strengthening of early warning systems, better stress-testing practices, and tighter controls over credit concentration. The program also includes tools to expand access to finance for micro, small, and medium enterprises (MSMEs) and to support women entrepreneurs through digital identity verification and simplified credit access.

Looking ahead, the Central Bank has laid out a clear policy direction for continued sector development. One major initiative involves encouraging market-driven mergers among licensed banks to increase efficiency and strengthen financial health. Offshore banking is also expected to expand, particularly through collaboration with the Colombo Port City Economic Commission, with the goal of making Sri Lanka a more competitive international financial hub. Other forward-looking plans include the implementation of the Sustainable Finance Roadmap 2.0 and the full rollout of the Government Digital Payment Platform (GDPP), both aimed at increasing digital adoption and promoting environmental

sustainability in the financial system.

The broader economic outlook for the country is cautiously optimistic. The International Monetary Fund (IMF) projects a 3% growth rate through mid-2025, along with moderate inflation. These conditions are generally favorable for increased lending and business investment. However, the prevailing low-interest-rate environment — while helpful for stimulating economic activity — poses challenges for banks, particularly in terms of maintaining healthy net interest margins. To address this, banks will need to rethink their strategies, diversify their income streams, focus on operational efficiency, and grow fee-based income sources to protect profitability.

At the same time, credit risk management continues to be a priority. The temporary suspension of the parate execution law and the introduction of targeted relief programs for SMEs add new layers of complexity to lending practices. Furthermore, potential exchange rate volatility — driven by the need to service external debt and the easing of import restrictions — could place pressure on the rupee. However, these risks are expected to be partially balanced by steady foreign exchange inflows from exports, remittances, tourism, and access to new international funding channels. The recent upgrades in sovereign credit ratings also help to boost investor confidence and attract foreign capital.

The IMF has also emphasized the importance of maintaining fiscal discipline, particularly when it comes to reaching tax revenue goals and reforming state-owned





enterprises. Achieving the country's target of a primary budget surplus of 2.3% of GDP in 2025 will be critical for maintaining long-term stability and sustaining the positive momentum built over the past year.

In parallel, the banking sector is undergoing rapid digital transformation. The rise of new technologies is reshaping the competitive landscape and changing how services are delivered. Banks are increasingly investing in artificial intelligence, data analytics, and customer-focused digital platforms to meet evolving expectations and improve service delivery. With digital tools becoming central to the banking experience, cybersecurity has taken on greater importance. Ensuring system security and protecting customer data will require continued investment and attention.

Sustainability and financial inclusion have also become central themes in the sector's future planning. Financial institutions are expanding their green finance initiatives, supporting renewable energy projects, and introducing low-carbon financial instruments. These efforts are aligned with national development goals and global environmental standards. Moreover, greater investments in digital infrastructure are enabling banks to reach underserved populations and promote broader participation in the financial system. Initiatives focused on financial literacy and digital onboarding are also helping to include more Sri Lankans in the formal banking sector.

As Sri Lanka moves into 2025, the banking sector carries with it the hard-earned

lessons of the recent crisis and the momentum of a successful recovery. The structural reforms introduced in 2024 have laid a strong foundation for sustainable and inclusive growth. With strong governance practices, ongoing innovation, and a renewed focus on stakeholder trust, the sector is well positioned to support the country's economic recovery and contribute to its long-term development goals.

The road ahead will not be without challenges. Continued adaptability, strategic foresight, and a collective commitment to sound financial practices will be essential. However, with the groundwork already in place and a clear policy direction to follow, Sri Lanka's banking sector has an opportunity to lead the next phase of national growth — financing development, empowering communities, and building a more resilient and inclusive economy for future generations.



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