Financial Stability Review 2026



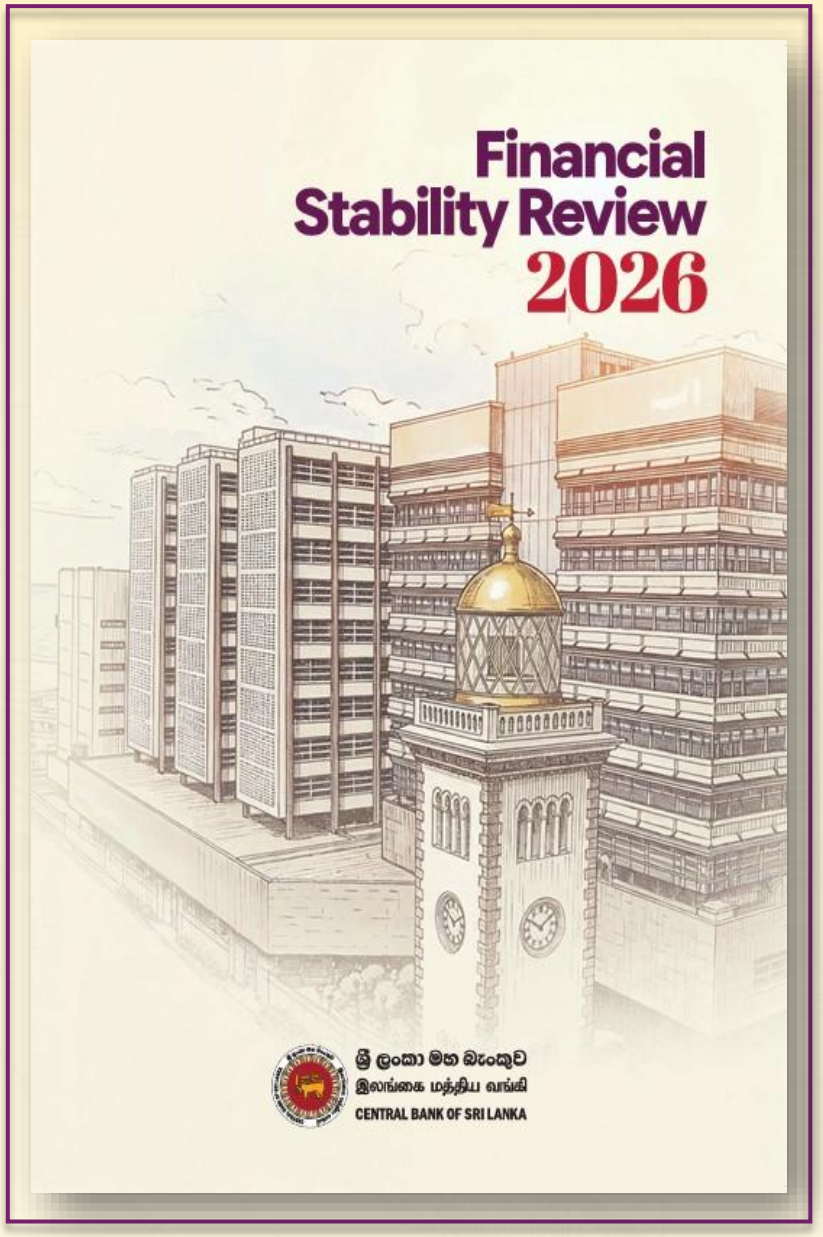
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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

Press Conference – 12.10.2026

Statutory Requirement...

As per the section 70 of the Central Bank of Sri Lanka Act, No. 16 of 2023, the Central Bank is required to publish the Financial Stability Review (FSR) on or before the thirty-first day in the month of October of each year.

FSR of 2026 provides an assessment of the overall stability of the financial system, highlights key risks and vulnerabilities that may affect financial stability, and outlines the measures undertaken by the Central Bank and other relevant financial sector authorities to monitor and address such risks and vulnerabilities during the period under review.



FSR 2026 consists of...

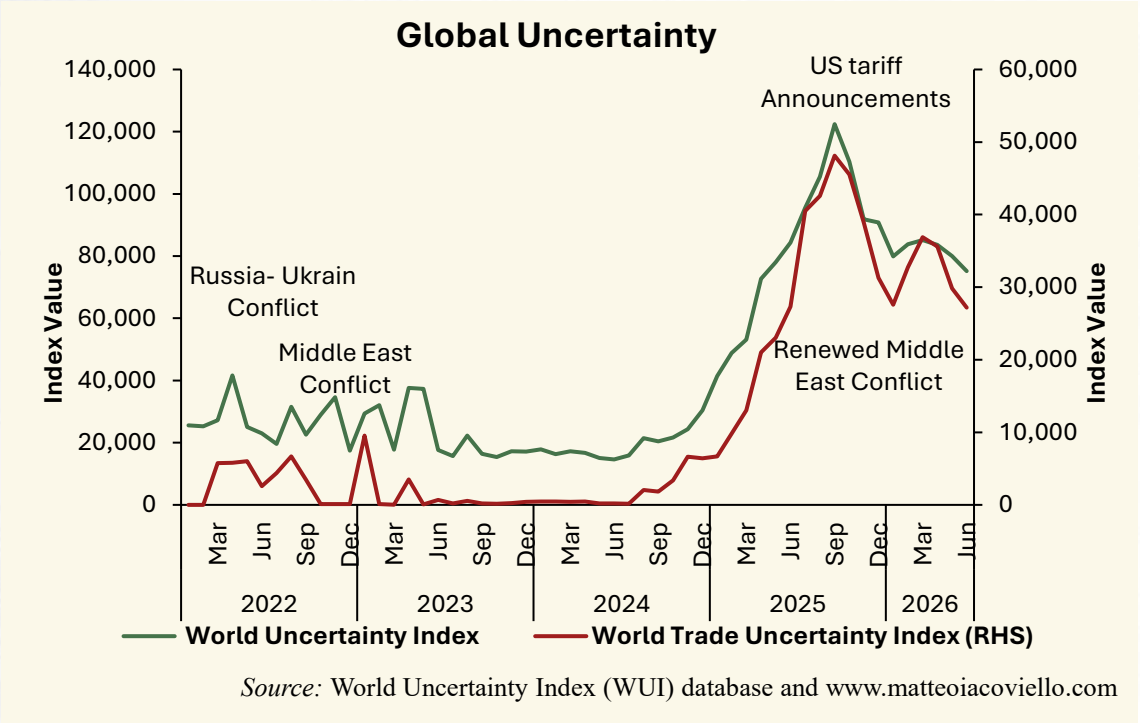
1. Executive Summary
2. Macrofinancial Conditions
3. Financial Markets
4. Financial Institutions
5. Household and Corporate Sectors
6. Policies for Financial Stability
7. Special Notes

Key Messages...

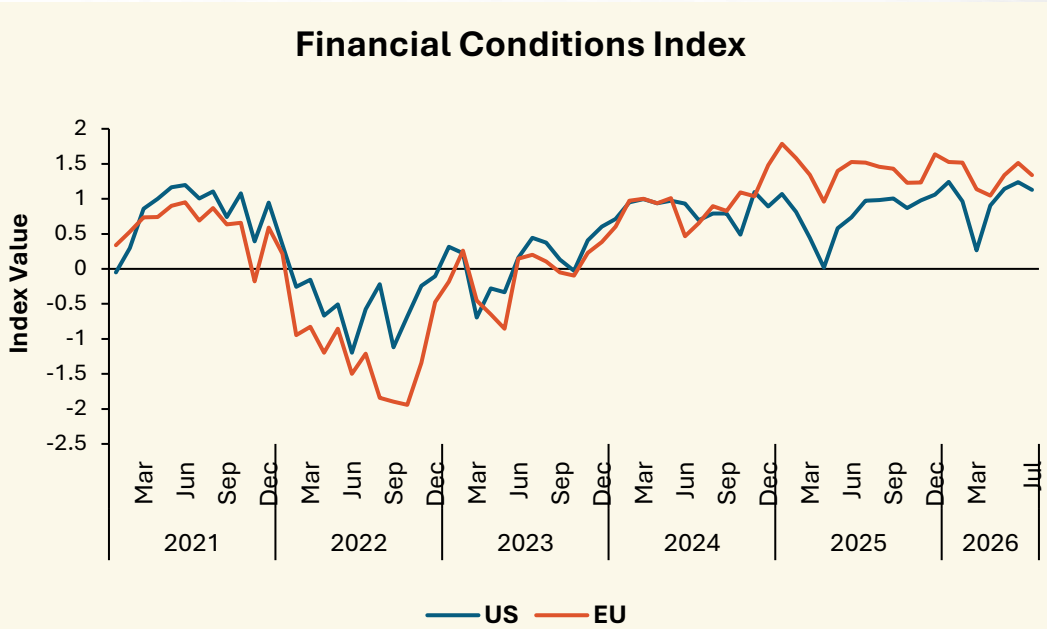
- Financial system resilience was maintained amid external and domestic vulnerabilities.
- Credit expanded rapidly supported by the significant growth in collateral-backed lending while leverage increased.
- Financial institutions remained resilient, amid emerging liquidity and capital pressures due to rapid credit expansion.
- Domestic financial markets remained broadly stable despite heightened global and domestic uncertainties.
- Macroprudential and regulatory measures were strengthened by CBSL to address emerging vulnerabilities and enhance resilience.

Chapter 01 - Macrofinancial Conditions

Global macrofinancial conditions became more challenging amid heightened geopolitical tensions, trade policy uncertainty and renewed inflationary pressures...



Source: World Uncertainty Index (WUI) database and www.matteoiacoviello.com

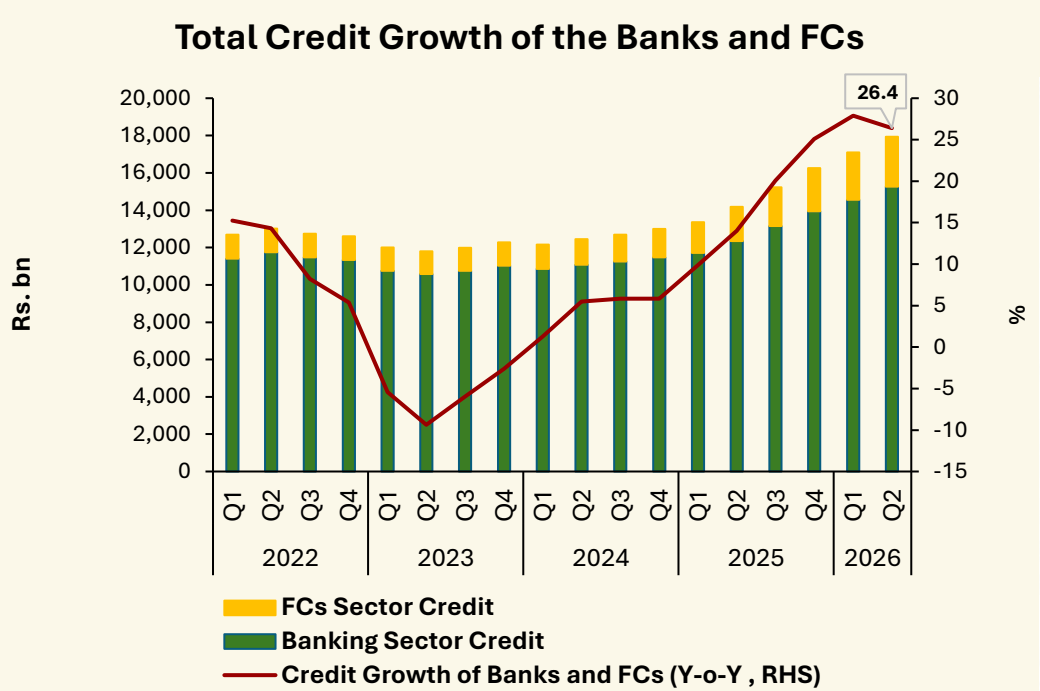


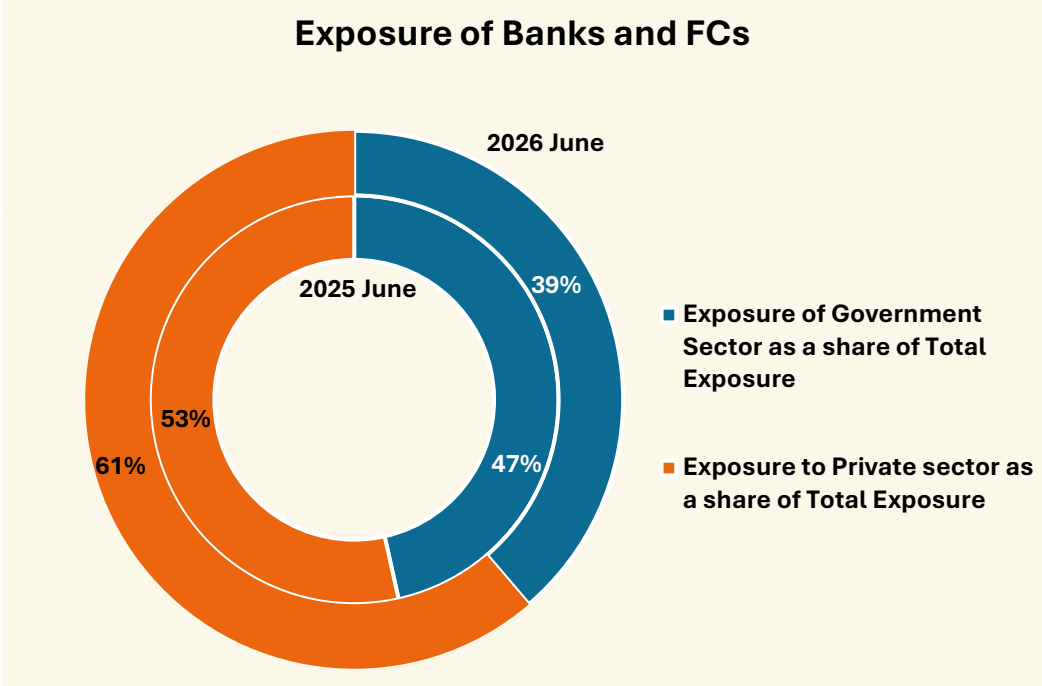
Source: Bloomberg

- Global uncertainty remained elevated, despite easing from the peaks recorded in 2025, amid escalating tensions in the Middle East.

- Elevated global uncertainty, renewed inflationary pressures and tighter global financial conditions could generate adverse spillovers to emerging market economies through commodity prices, external demand, exchange rates and capital flows.

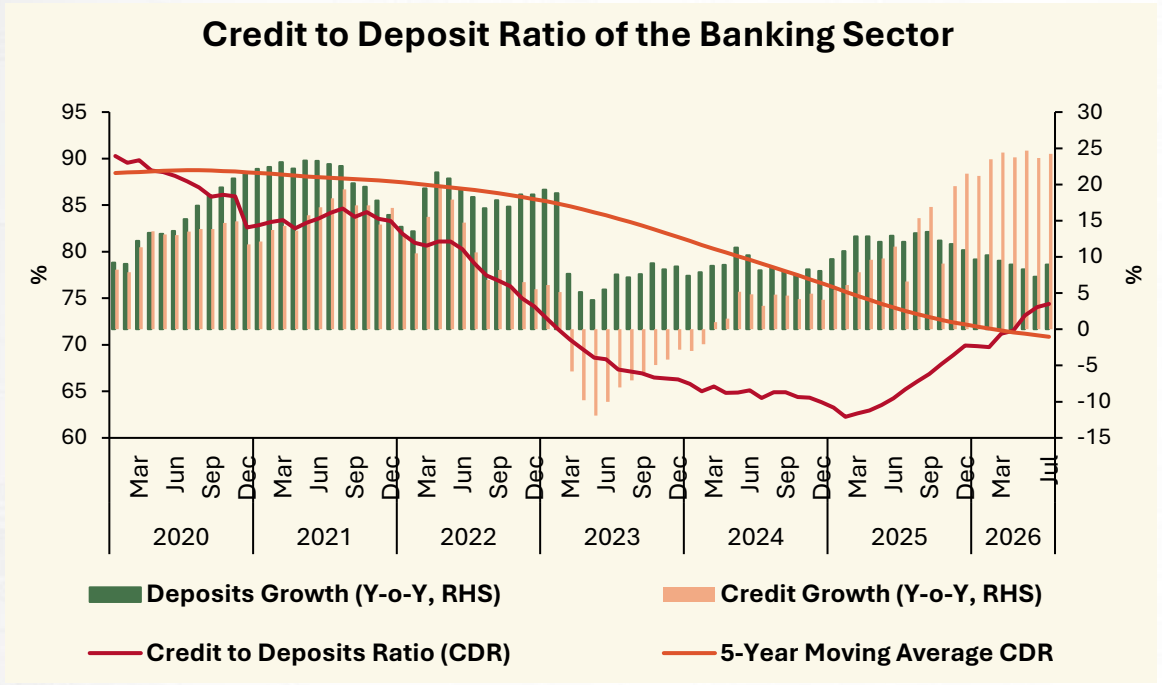
Rapid credit expansion continued, driven by collateral-backed lending...

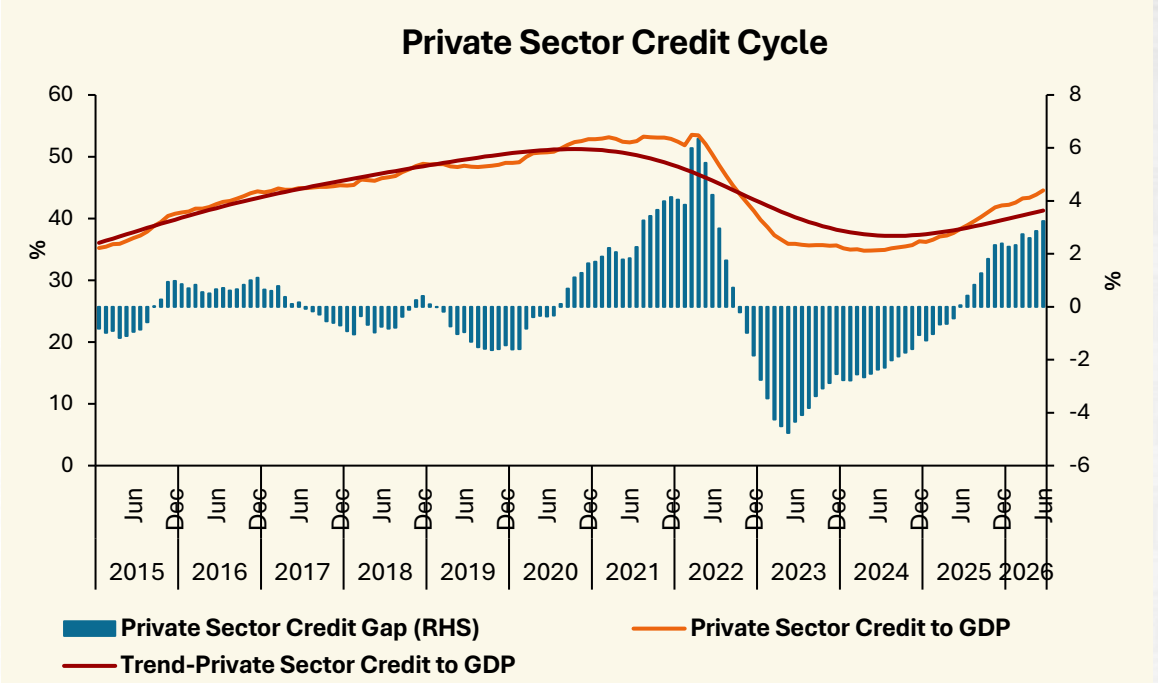




- Total credit of banks and FCs expanded, supported by household lending, particularly gold-backed lending and vehicle financing.
- Financial institutions' exposures continued to rebalance towards the private sector during the review period.

The expansionary phase of the credit cycle intensified, highlighting emerging systemic vulnerabilities...



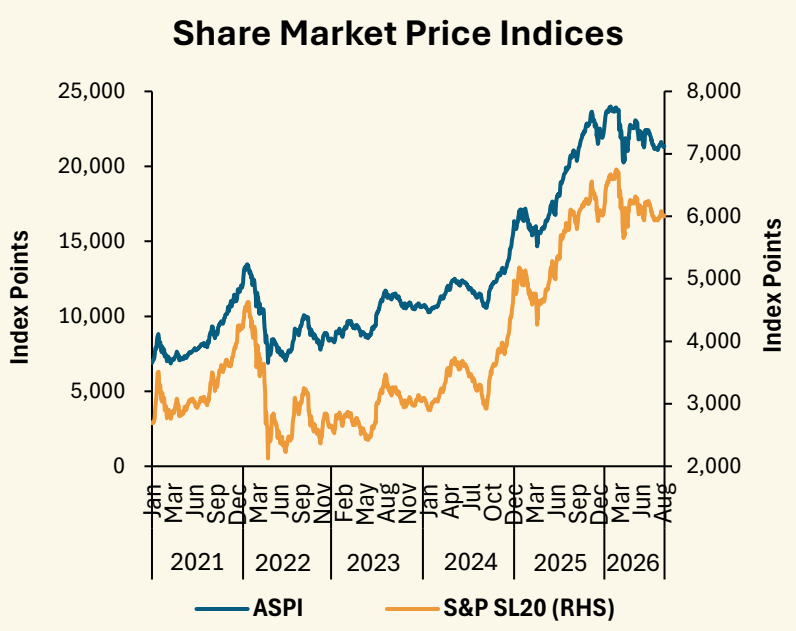


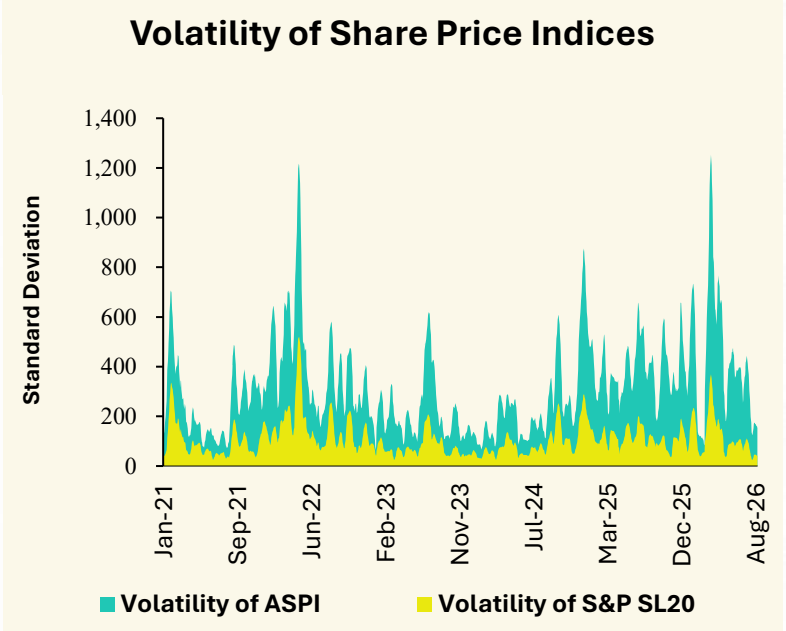
- Financial intermediation strengthened further as credit growth continued to outpace deposit growth.

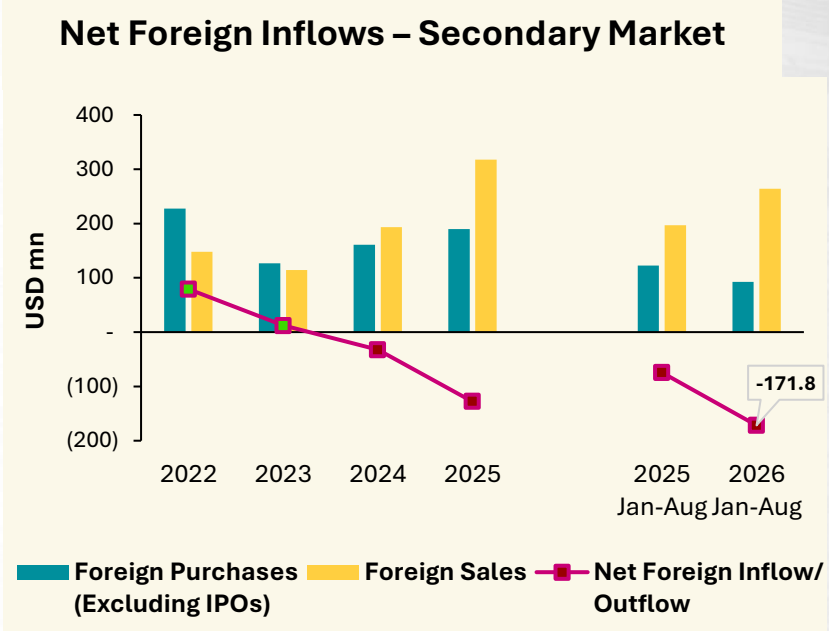
- The private sector credit gap remained positive and widened further during the review period, reflecting credit growth above its longer-term trend.

Chapter 02
Financial Markets and Payment Infrastructure

Colombo Stock Exchange (CSE) recorded subdued performance amidst heightened external uncertainties...

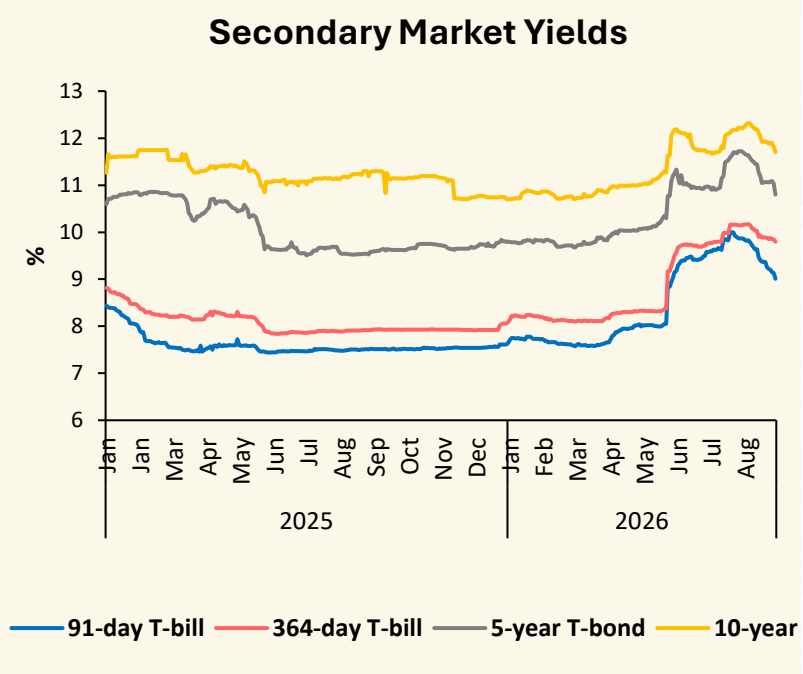


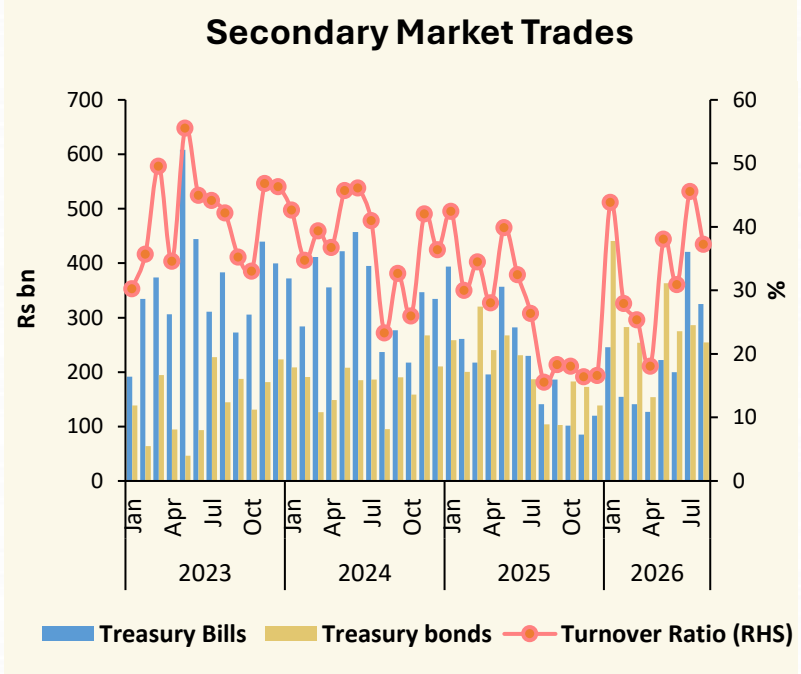


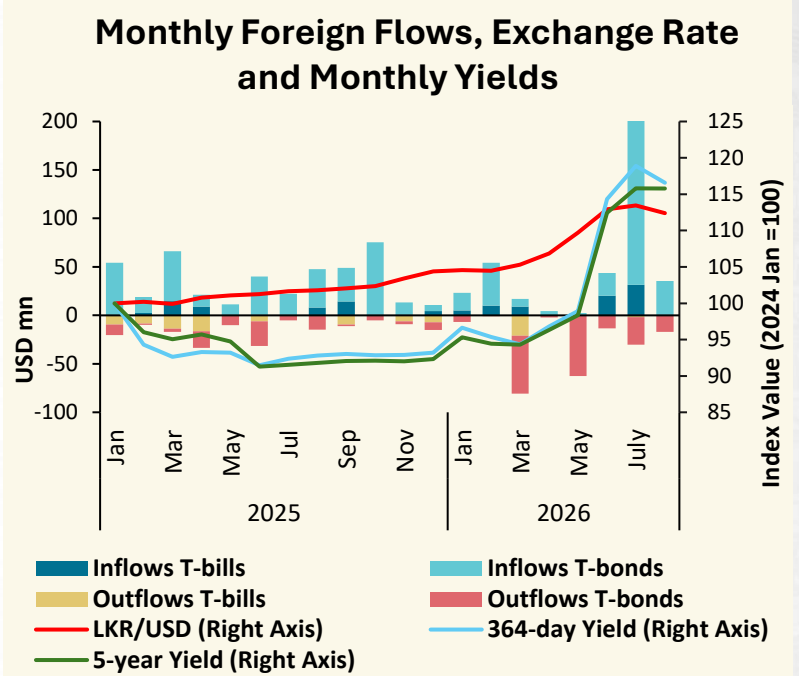


- Equity market performance moderated amid heightened external uncertainties, with the ASPI and S&P SL20 declined.
- Volatility levels of the share price indices remained elevated.
- Secondary market of CSE continued to record a net foreign outflow recording a cumulative outflow of USD 171.8 mn by end August 2026.

Government securities market faced rising yields across maturities ..





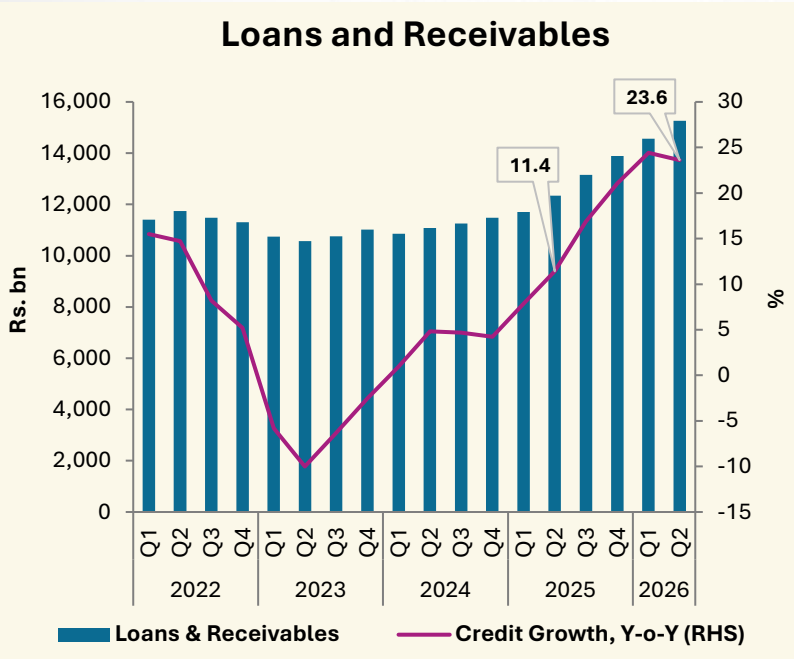


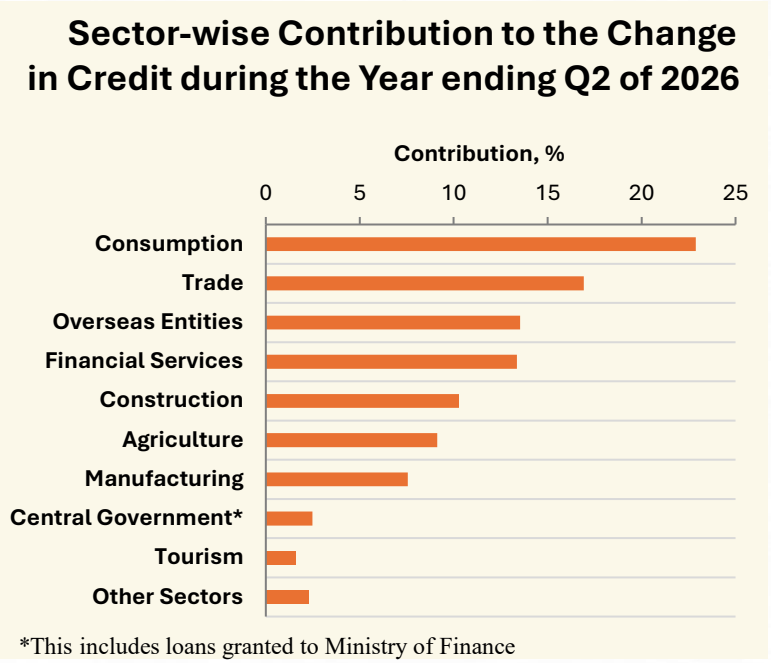
- Yields of Government securities increased across maturities with evolving market expectations and subsequently due to monetary policy tightening.
- Secondary market activity improved modestly.
- Higher domestic yields supported a recovery in foreign investor interest recording a net foreign inflow.

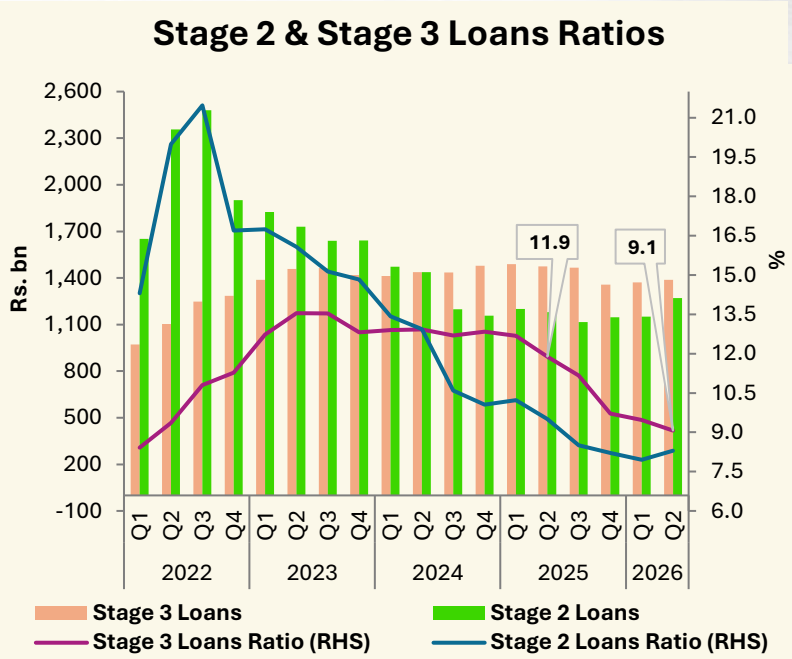
Chapter 03 - Financial Institutions

Banking Sector

The banking sector credit significantly grew, supported by conducive macroeconomic conditions, despite the recent unfavourable global uncertainties...

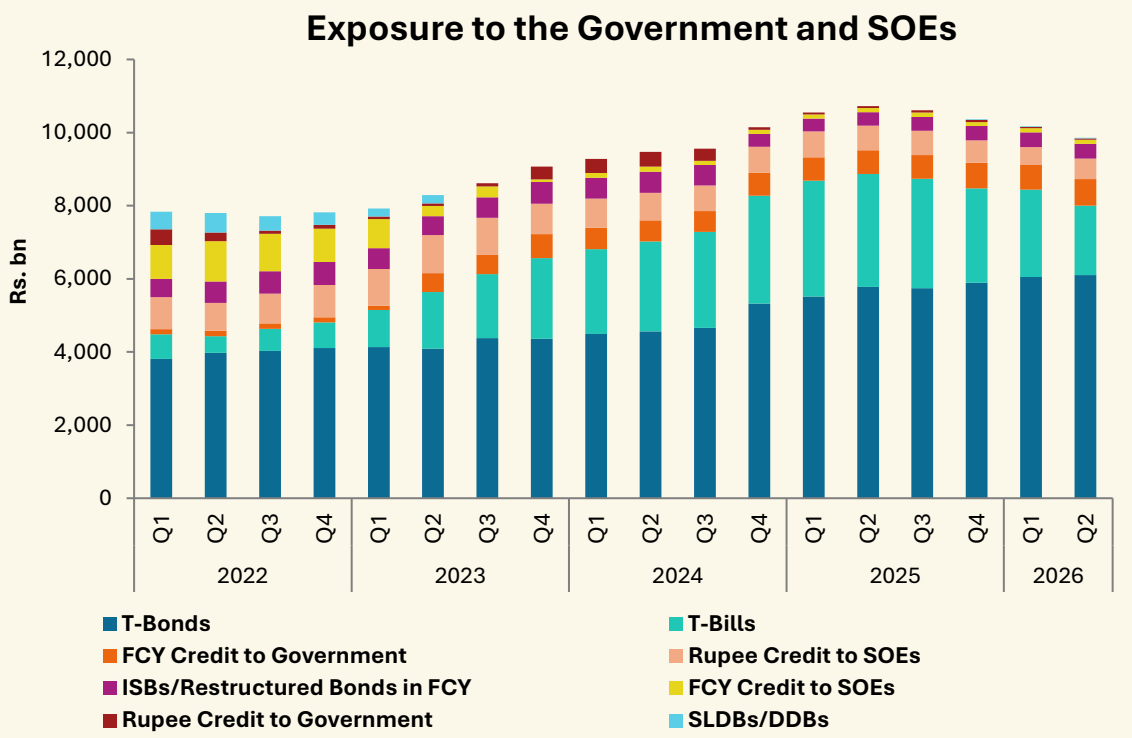


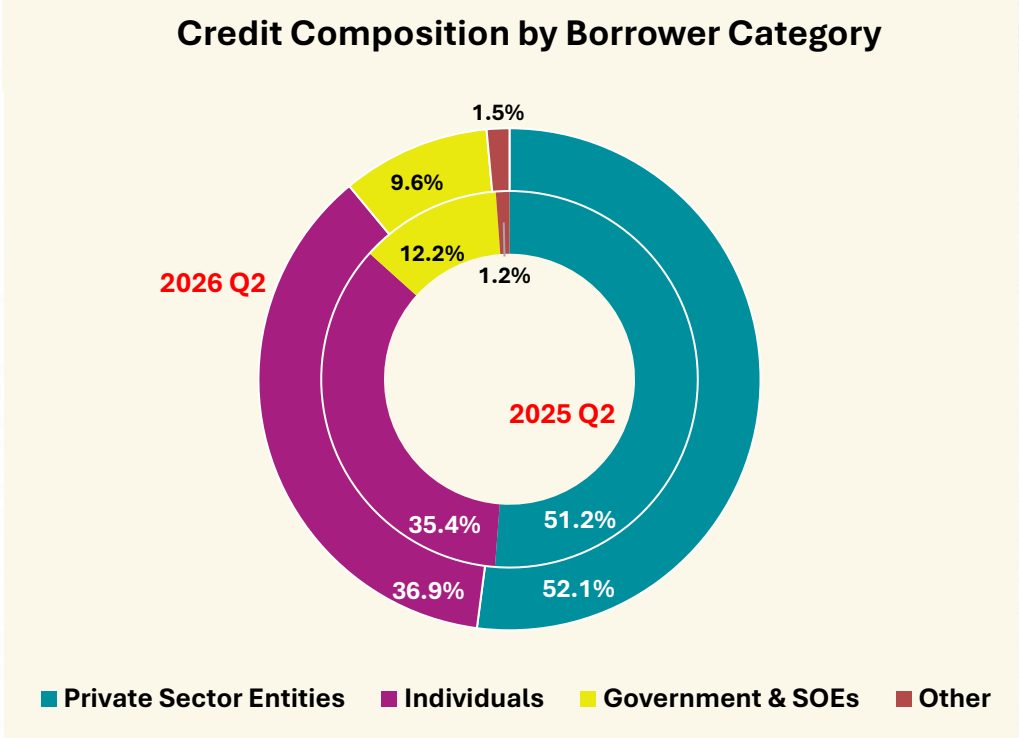




- Sector's credit growth continued at end Q2 of 2026, mainly supported by vehicle and gold-backed lending.
- Credit expansion was concentrated to consumption, trade, lending to overseas entities, financial services, and construction sectors.
- The Stage 3 loans ratio of the sector declined to 9.1% compared to 11.9% a year ago.

Sovereign exposure declined, though it remained a sizable share of the banking sector assets...

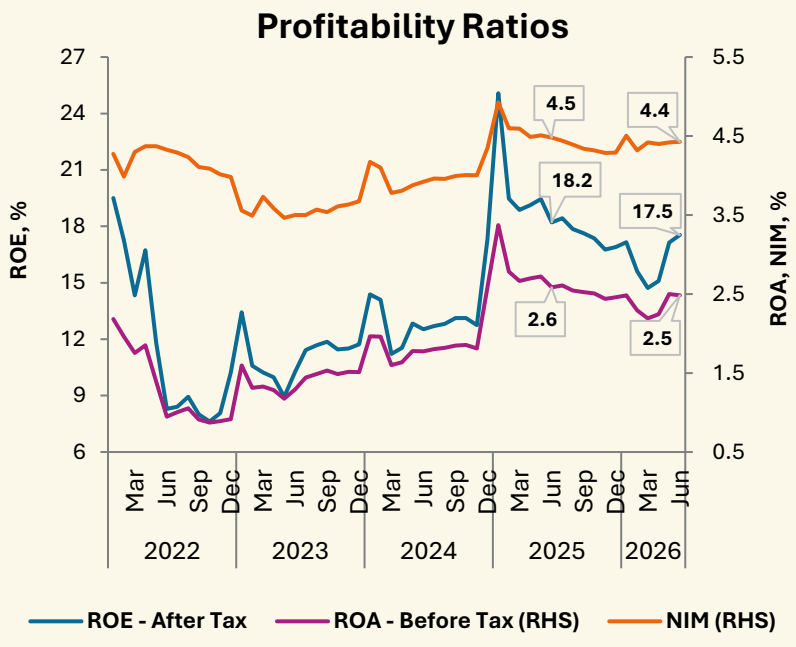


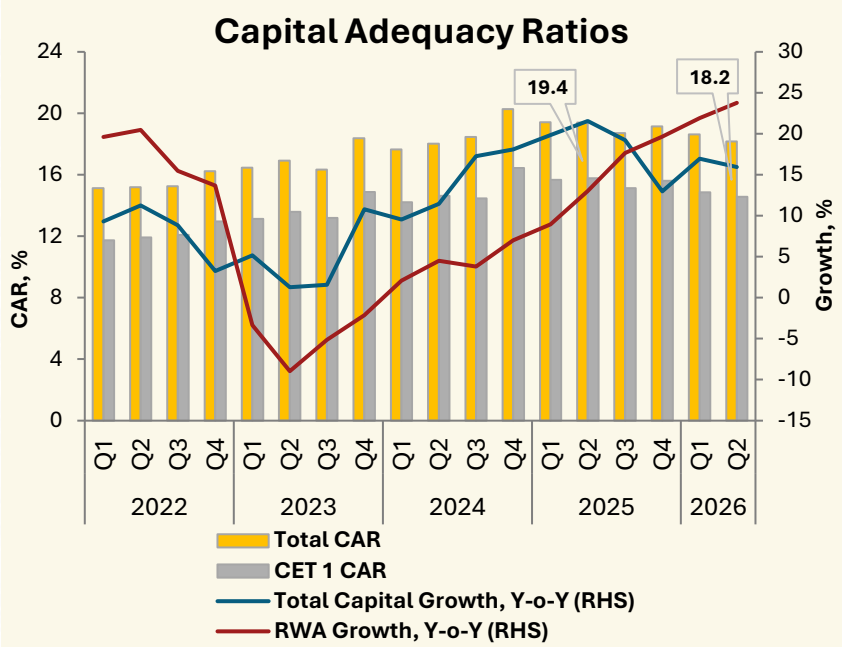


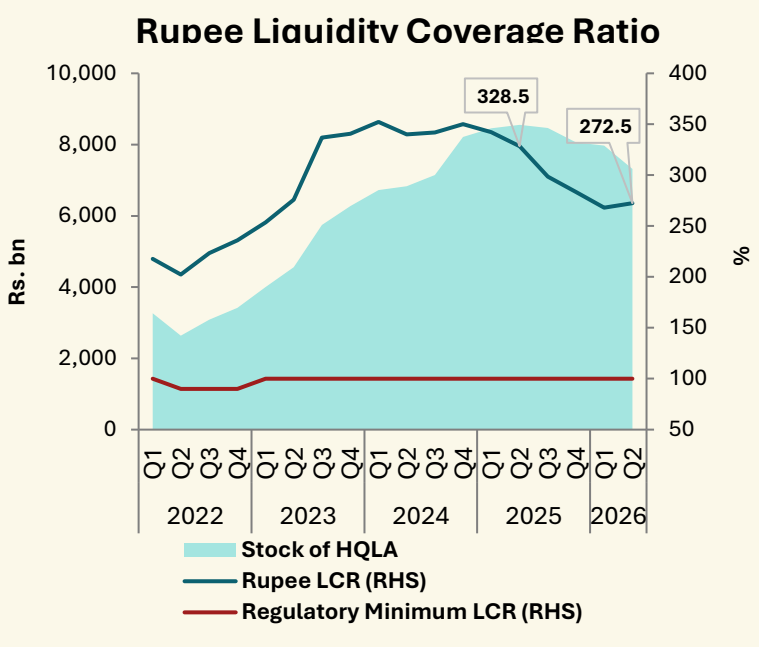
- The contraction in exposures to Government and SOEs was primarily attributable to a decline in banks' holdings of Treasury bills.

- The banking sector's credit exposure to Government and SOEs declined to a single digit level.

The banking sector maintained capital adequacy and liquidity above the regulatory requirements, although they declined as a result of the higher credit expansion...



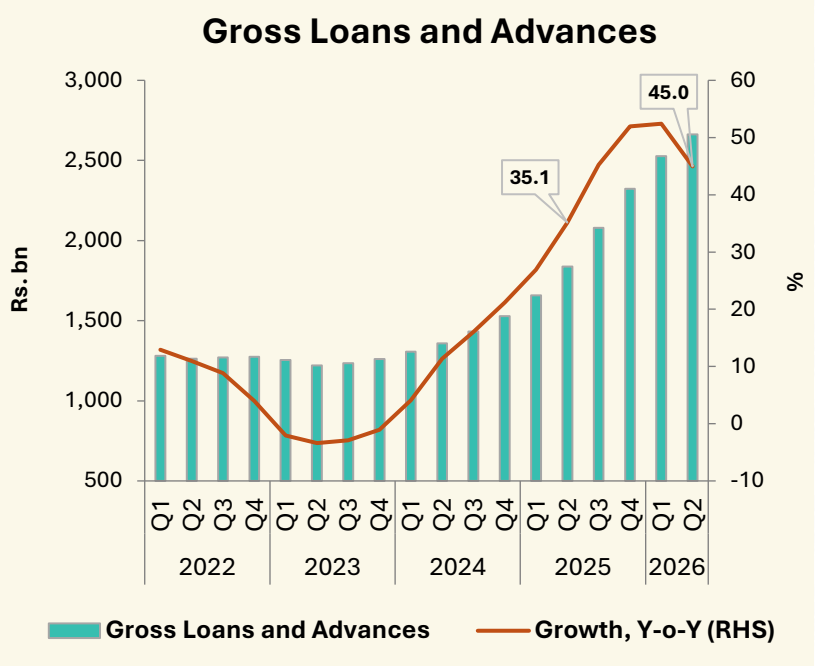


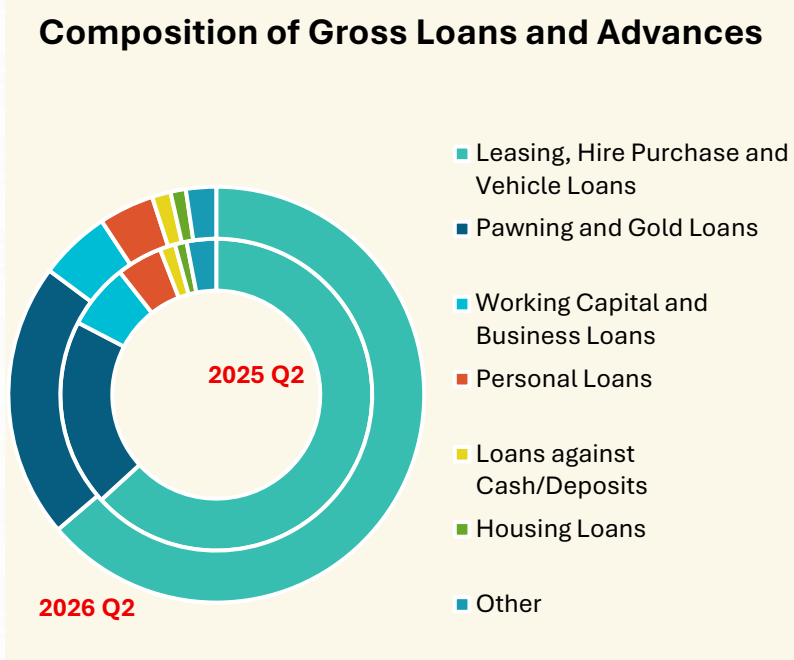


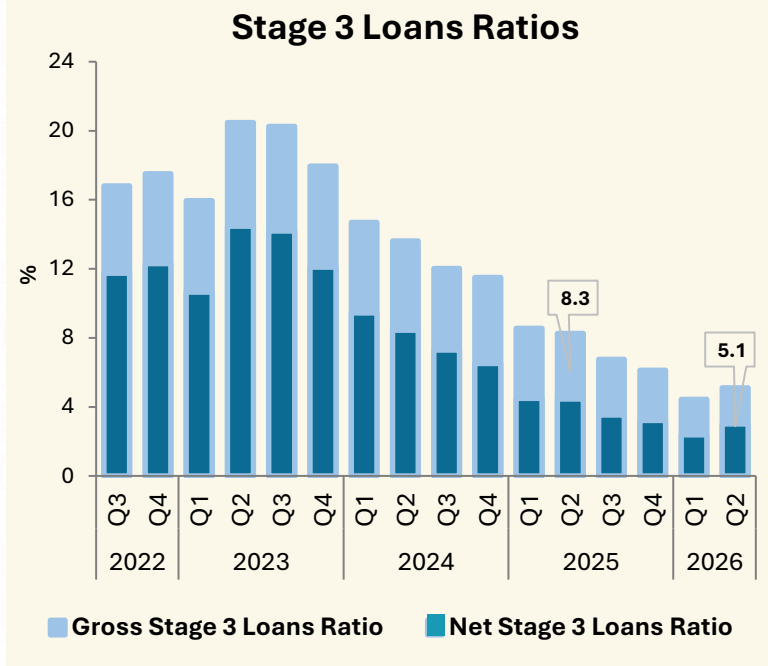
- ROE, ROA, and NIM of the sector declined in H1 of 2026, compared to H1 of 2025.
- Total CAR declined to 18.2% from 19.4% a year ago mainly due to the higher credit expansion.
- The Rupee LCR decreased as banks reallocated funds from HQLA to credit.

Finance Companies Sector

The FCs sector lending activities continued to expand while Stage 3 loans ratio decreased...

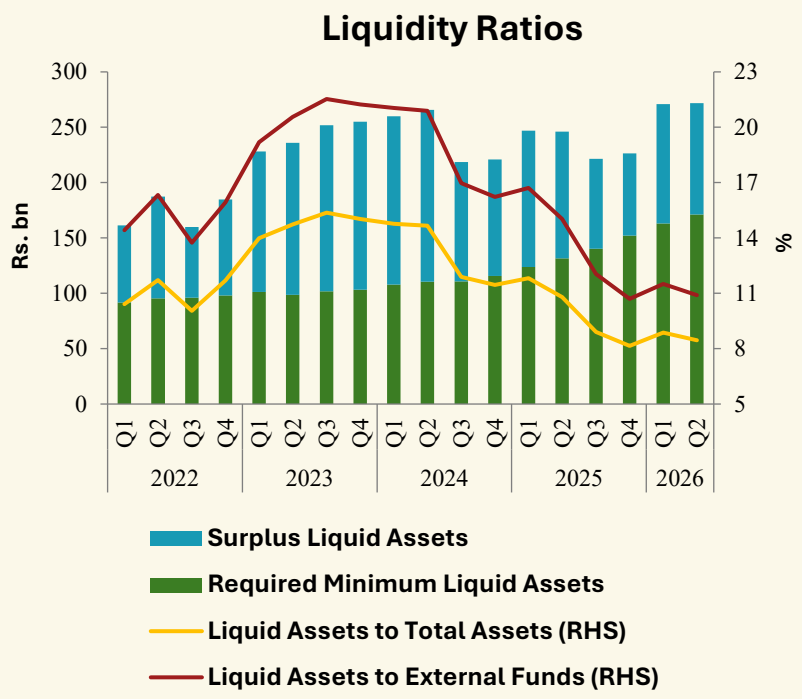


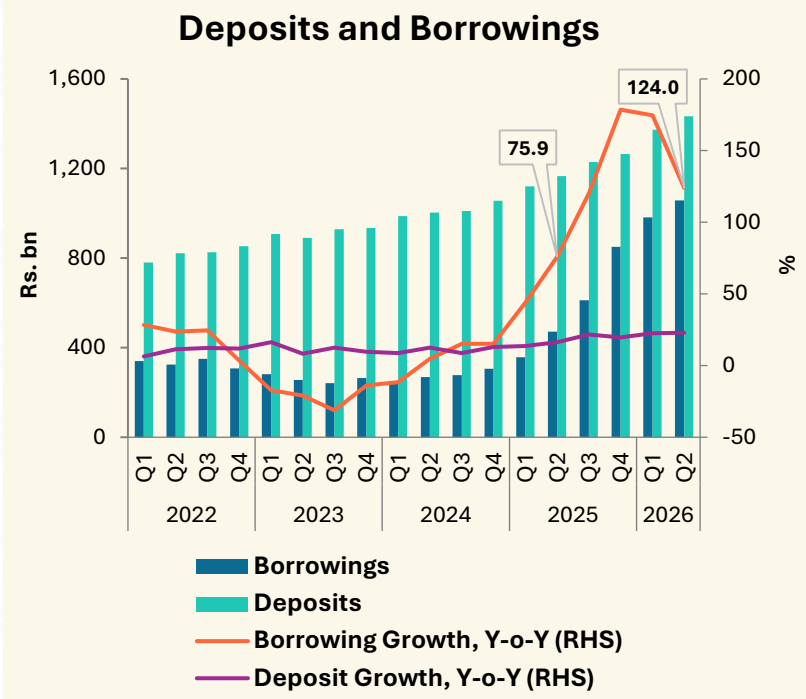


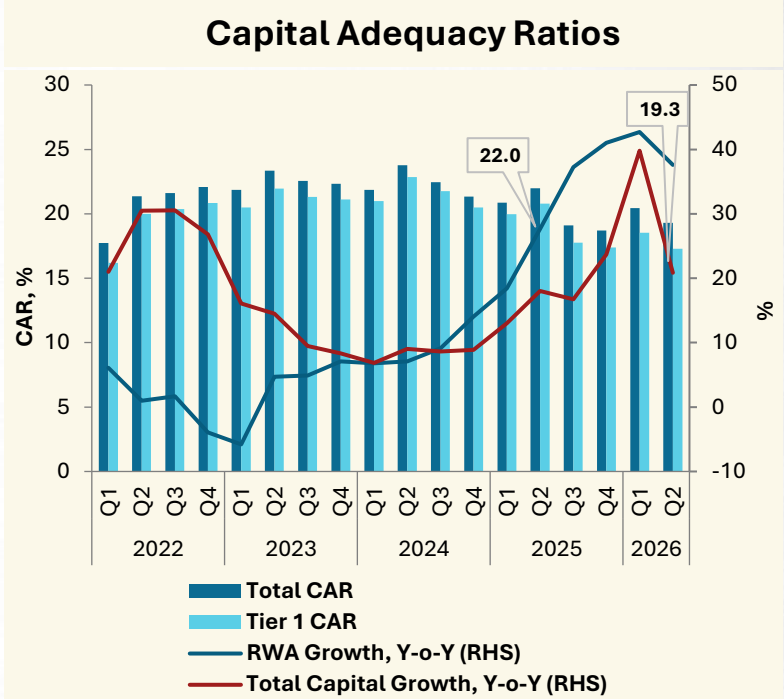


- Credit significantly grew by 45.0% at end Q2 of 2026.
- Vehicle-backed loans contributed to 65.0% of the increase in total credit, while gold-backed lending contributed to 25.8%.
- Gross Stage 3 loans ratio decreased to 5.1% as at end Q2 of 2026 compared to 8.3% recorded a year ago.

The FCs sector maintained liquidity and capital buffers well-above the minimum regulatory requirements...



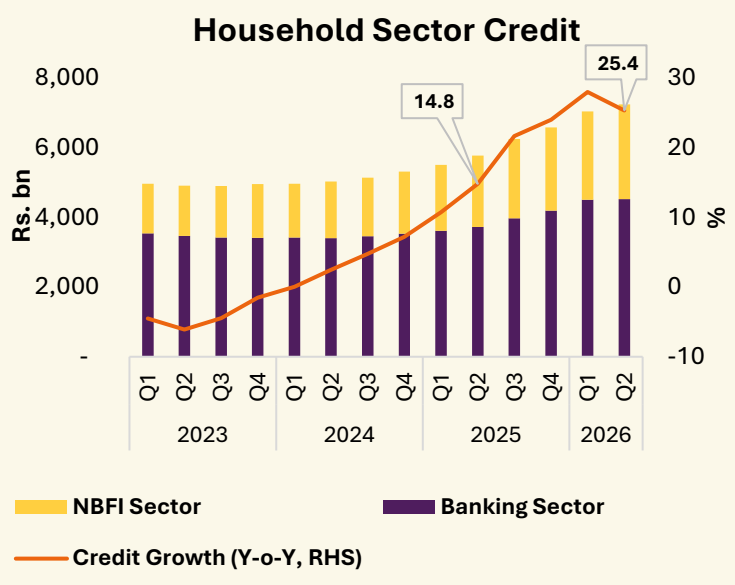


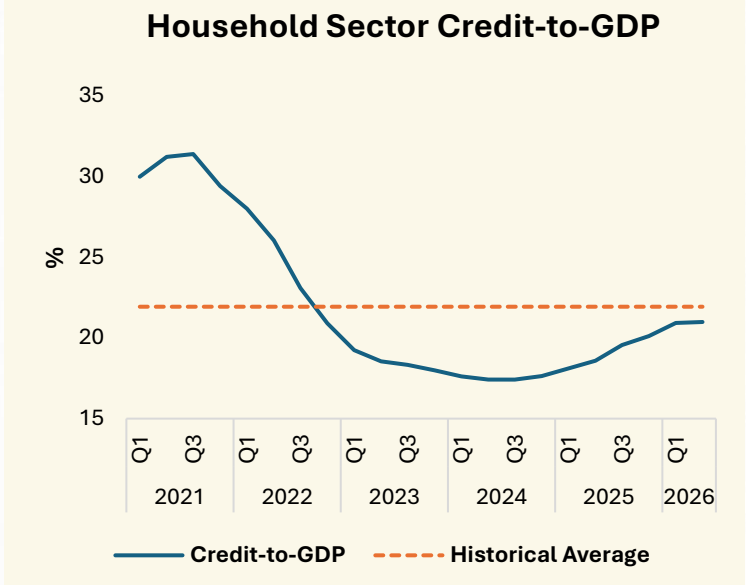


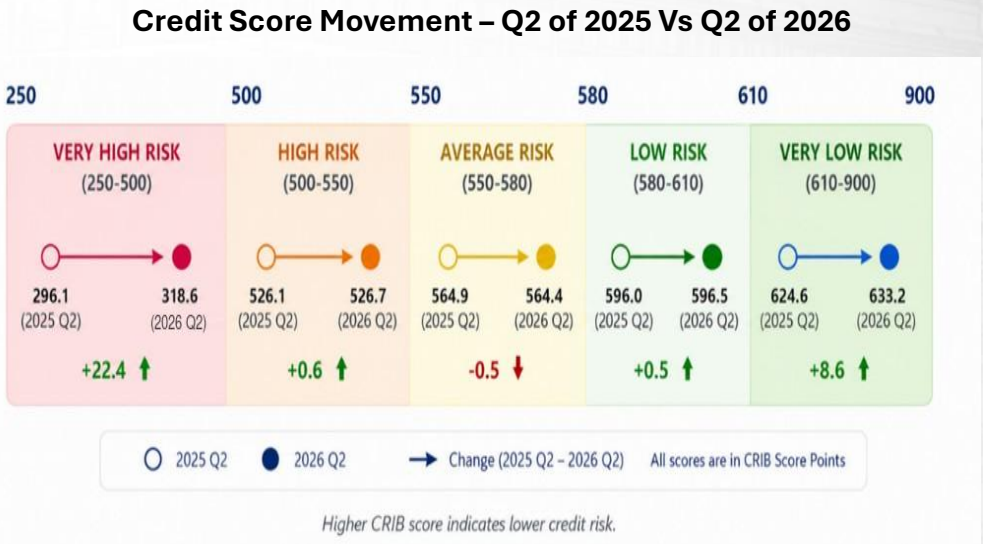
- The sector recorded a liquidity surplus of Rs.100.5 bn at end Q2 of 2026, despite it was a y-o-y decline of 12.3%.
- The borrowings increased significantly, as the sector increasingly relied on bank borrowings to support the credit growth.
- Total CAR declined to 19.3% at end Q2 of 2026 from 22.0% reported a year ago with the credit expansion.

Chapter 04 - Household and Corporate Sectors

Credit extended to the Household sector recorded a notable growth amidst improvement in credit scores...



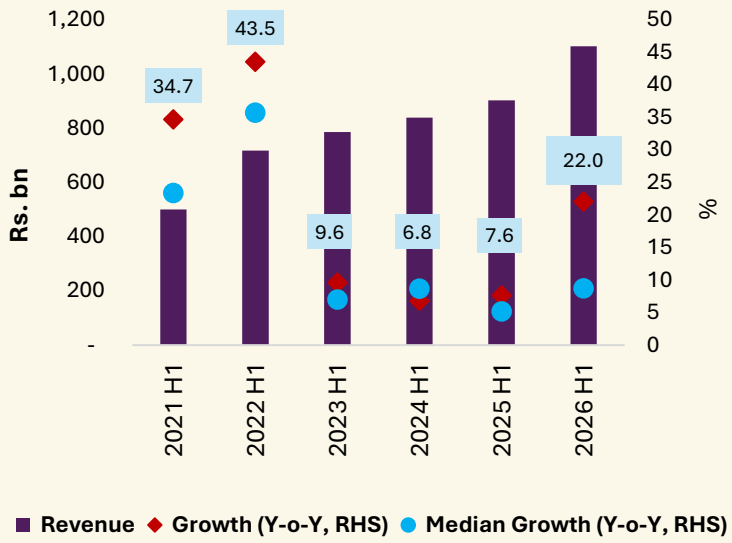




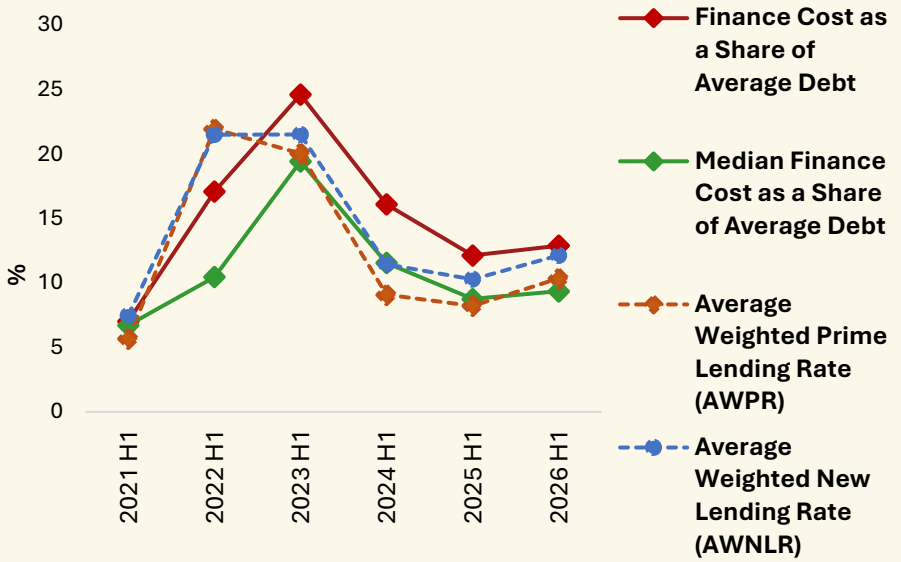
- Household sector credit recorded a growth of 25.4% y-o-y at end Q2 of 2026, considerably higher than the growth recorded at end Q2 of 2025.
- The Household sector credit-to-GDP ratio, a broad indication of household indebtedness, continued its upward trend observed since mid-2024.
- Weighted average CRIB scores increased across most of risk categories between Q2 of 2025 and Q2 of 2026.

The listed NFC sector recorded a notable improvement in revenue, despite a moderation in debt servicing capacity ...

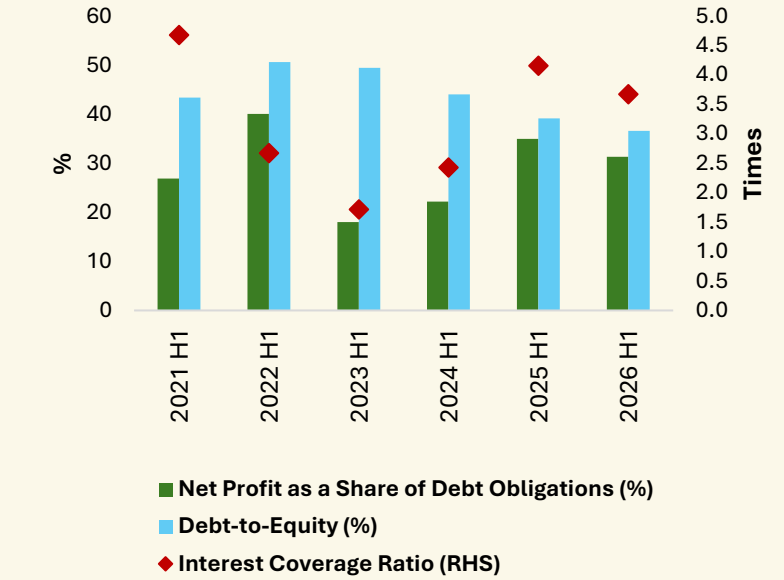
Revenue and Growth in Revenue in NFCs



Interest Expenses as a percentage of Average Debt



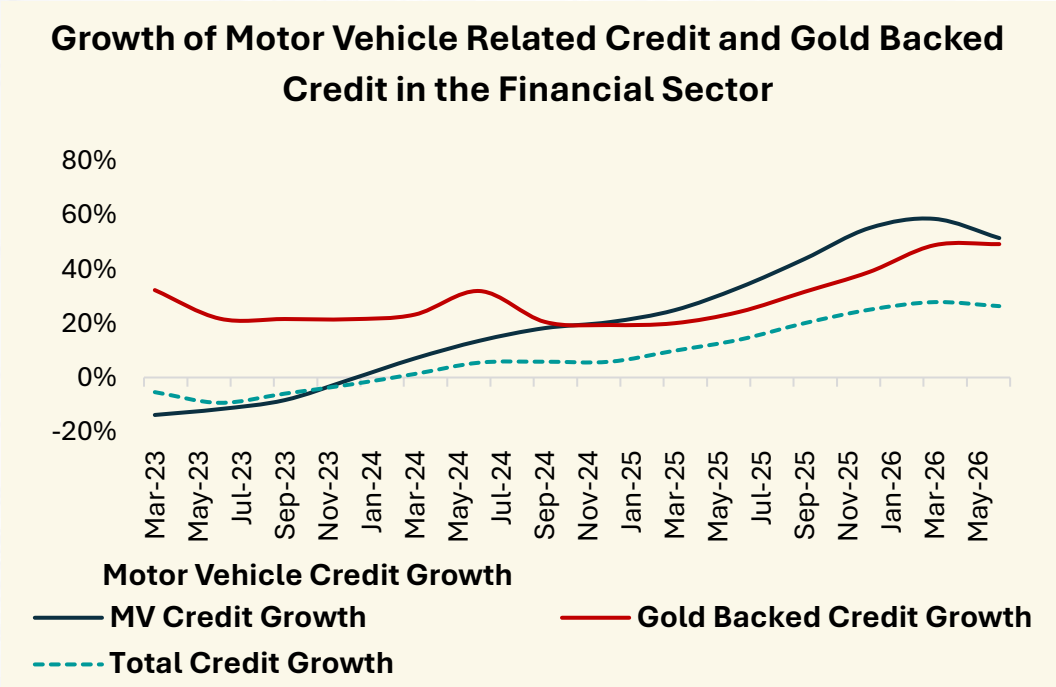
Key Financial Performance Indicators

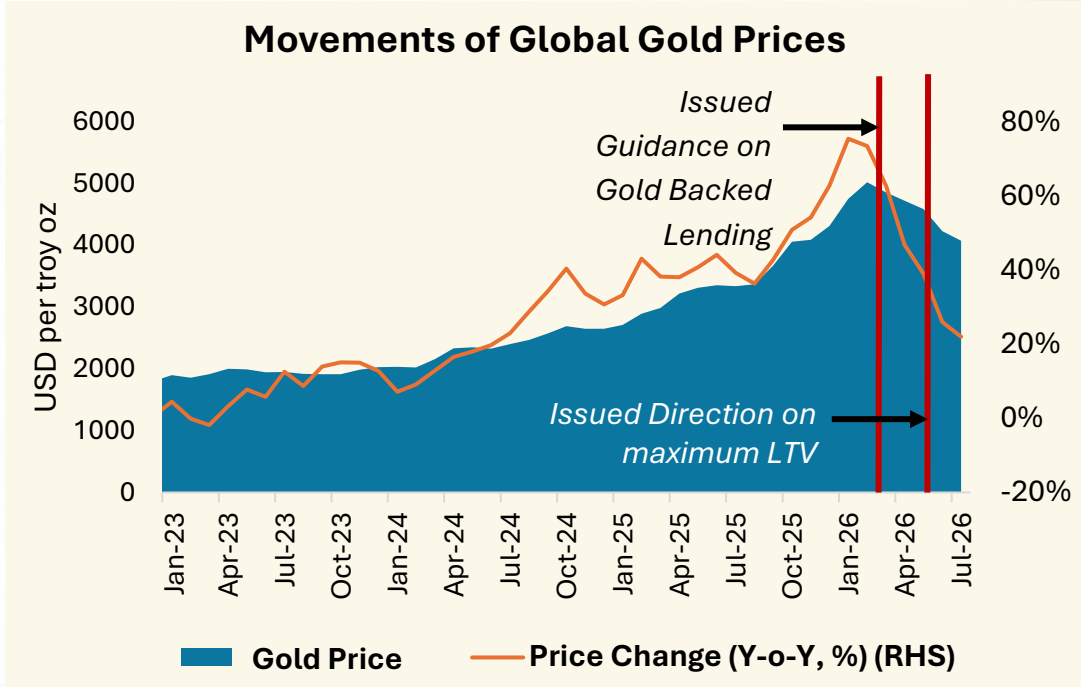


- Revenue of listed NFCs significantly expanded during H1 of 2026, compared with the corresponding period of the previous year.
- Finance costs as a share of average debt increased slightly in both aggregate and median terms, amid the rise in market interest rates.
- Despite the moderation in debt servicing capacity, leverage conditions improved modestly, and the aggregate ICR remained comfortably above one.

Chapter 05 - Policies for Financial Stability

The Central Bank deployed macroprudential tools and introduced prudential regulations against the backdrop of rapid credit expansion...





- Maximum LTV limit was introduced for credit facilities backed by gold collateral to mitigate the risks arising from the expansion of gold-backed credit and heightened price volatility.
- Maximum LTV limits for new commercial vehicles, other new vehicles and used vehicles was reduced with a view to containing excessive leverage.

The Central Bank implemented several policies to ensure financial system stability and resilience by considering evolving risks...

- The risk weight treatment applicable to gold backed lending by LBs and FCs was tightened.
- The framework for banking sector consolidation was introduced to promote stronger, resilient and sustainable banking sector through the consolidation of small-sized banks.
- The regulatory framework for FCs sector was further enhanced through the introduction of several directions while extending the continued efforts to strengthen compliance with AML/CFT/CPF requirements.
- The Central Bank continued to strengthen the financial consumer protection framework through enhanced market conduct supervision, regulatory oversight, complaint management, and financial consumer awareness initiatives, thereby promoting the fair treatment of financial consumers across the regulated financial sector.

"The outlook for financial stability remains broadly positive, provided that the ongoing economic recovery remains sustained, fiscal consolidation progresses, and prudent policy implementation continues. However, the outlook is contingent on external developments as well as domestic vulnerabilities arising from any excessive expansion and sectoral concentration of credit, along with evolving climate and cyber risks.

The Central Bank will continue to monitor and assess the stability of the financial sector within broader economic developments and take measures to implement proactive and timely polices in collaboration with relevant stakeholders to ensure continued stability of the financial system.

Special Notes...

01. Emerging Climate Risks: A Growing Concern for Financial System Stability

02. Systemic Risk Survey for H2 of 2026

03. Artificial Intelligence (AI) Adoption in Sri Lanka's Banking Sector: Survey Findings and Financial Stability Implications

Thank you !