Strong economies need strong banks: Building the system Sri Lanka’s next decade will need

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The IMF, in its successive reviews of Sri Lanka’s recovery program, has consistently emphasized that a sustained recovery requires a sound banking sector. This, in turn, means a sector capable of channeling credit into the productive economy, mobilizing savings, and facilitating investment, all of which represent the nation’s

most critical needs.

That observation deserves attention, because it cuts against a public conversation now underway about whether banking profitability in Sri Lanka reflects value created or value extracted. The question is fair. Banks intermediate citizens' savings into credit that builds the economy, while serving as the nexus of connectivity to global banking networks. This, in turn, facilitates international trade and global payments on which Sri Lanka's economic recovery hinges. The relationship between bank performance and national performance is direct and should be carefully scrutinized.


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The value beneath the surface

Such a surface-level reading, however, misses some key factors. First, what banking strength was delivered through the crisis? When sovereign default came in 2022, no Sri Lankan depositor lost their savings. There were no withdrawal restrictions of the kind seen in Lebanon, Argentina, or Cyprus. Trade finance lines kept essential imports moving when foreign currency was scarce. While efforts were made to mitigate its total impact, Domestic Debt Optimization (DDO) in 2023 was also absorbed by banks at material cost to their own balance sheets. This sensitive fiscal restructuring was made possible because the banking sector was strong enough to take the hit. A weakly capitalized system could not have done any of this.

Net Interest Margins (NIM) are another misunderstood factor. Where on the surface, Sri Lankan banks appear to be earning high NIM, this narrow view misses the outsized tax burden placed on the Sri Lankan banking industry, which is among the largest contributors to state revenue, paying corporate income tax, VAT on financial services, and other levies totaling in excess of 50 percent.

In HNB's case, for every rupee retained as profit after all taxes in FY2025, approximately a rupee was paid to the state. That contribution is appropriate for the current moment. But it means the margin which appears wide in headline terms is substantially narrower once the state's share is accounted for. In such an environment, a high NIM is necessary to continue operating while maintaining the strength and stability needed to face future headwinds.

Most importantly, the banking sector materially expanded private sector credit through 2025. Against the Government's 95 billion rupees MSME financing program, several private banks, including HNB, deployed at or above their full allocations within the window.

At HNB, the loan book grew by approximately 30 percent over the financial year, with non-performing loan ratios improving over the same period. Far from retreating from the real economy, this represents capital being actively deployed into productive sectors at scale. This, in turn, helped to cushion the worst impacts of the successive crises that hit the Sri Lankan economy from 2019 onwards.

Why a strong banking system matters now more than ever

Strong economies require strong banks. The question Sri Lanka now faces is how to channel the strength of its banking sector to accelerate the next phase of recovery. As an industry, our first priority is to rebuild access to development funding. Twenty-five to thirty years ago, Sri Lankan banks had access to long-tenor concessional funding through development institutions, which allowed on-lending to priority sectors at lower rates. Those channels need to be reactivated.

The most direct route to cheaper SME credit is not a regulatory cap on lending rates, which would compress credit supply. Instead, we must seek to engage further with long-term concessional funding lines through partners such as the ADB, the IFC, the World Bank, the EU, KfW, and JICA.

Banks lend at rates that reflect their cost of funding. With funding costs reduced,

the lending rate follows, and that is ultimately what will provide the grassroots of the Sri Lankan economy with the affordable capital they require to shift from recovery to revitalization.

Our second priority is digital infrastructure and inclusion. Sri Lanka's digital payments ecosystem is still scaling, well short of advanced economies and regional peers. That matters for the public conversation about fees. Even India's UPI, often cited as a zero-cost model, processed 228 billion transactions in 2025 against an operating shortfall of around USD one billion in FY24, and Indian regulators are now actively debating tiered fees to keep the platform viable.

The reality is that zero-cost digital payments have not proven sustainable anywhere at scale across time. Even though digital payments offer banks much lower operating costs than a physical banking model, they also entail substantial costs to establish, scale up, secure, maintain, and improve.

While digital banking delivers efficiency gains over time, the assumption that each additional transaction costs progressively less overlooks the realities of regulated financial infrastructure. Processing capacity, cybersecurity, compliance certification, and software licensing all carry costs that grow with transaction volume. Annual maintenance contracts escalate by 10-15 percent each year, and exchange rate depreciation increases the cost of imported technology. The path to lower per-transaction costs is real, but it requires sustained investment, and that investment must be funded.

Much of what appears as a bank fee also includes pass-through costs from international card networks and domestic payment infrastructure, with the bank's own margin a small share. The path to lower fees runs through scale, and that scale requires sustained investment from all stakeholders.

Regulatory evolution is another key priority. Sri Lanka built a regulatory framework appropriate to crisis containment. The next phase needs frameworks calibrated for sustainable credit expansion: priority-sector guidance, risk-weighted incentives for productive lending, and supervisory engagement that treats credit growth as part of the public good rather than solely as a source of risk. Other emerging-market central banks have shown how to do this without compromising stability. At the same time, the trust customers place in their banks is earned daily, and as an industry, we should hold ourselves to the highest standards. Fee disclosure, grievance mechanisms, and the quality of service to retail and small business

customers are areas where the sector can and should do more, and where my own institution is committed to continuous improvement.

A multi-pronged approach to progress

These focus areas must be a core part of our industry's transformation agenda over the next decade, and each requires a banking sector that is well-capitalized and operationally strong. A weakly capitalized sector could not absorb concessional development funding at scale. It could not invest in inclusive digital infrastructure. It could not extend the kind of patient credit a recovery requires.

The country that emerged from sovereign default in 2023 is not the country Sri Lanka is meant to be. In the early 2000s, this was one of South Asia's most promising emerging economies, with the human capital, geographic position, and institutional foundations to compete with any peer in the region.

The crisis may have interrupted that trajectory, but it did not erase it. How our industry moves forward will play a pivotal role in how quickly we can recover and build resilience in a new, extremely volatile moment in the global economic landscape.

The institutions that will carry that ambition forward have to be strong enough to bear its weight. Banks are among them. The question is not whether Sri Lanka can afford a strong banking sector. It is whether Sri Lanka can build the renewed economy it deserves without one.