OPERATING LANDSCAPE

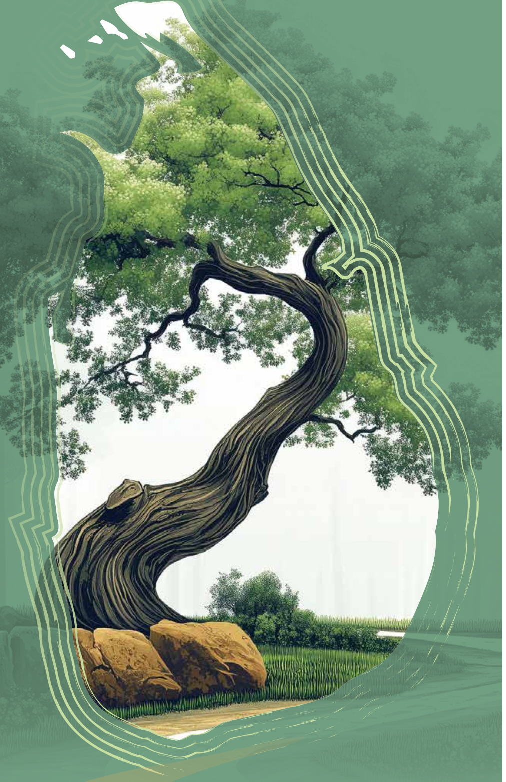
Responding to A Changing Landscape

Enabling Dynamic Growth

We're relying on our inherent dynamism and energy to conquer strong headwinds, and remain agile and responsive in the face of changing conditions.

In Japanese gardens, trees such as the willow or cherry are trained or pruned to create a cascading, sweeping form that represents elegance and the beauty of movement. This 'weeping' form signifies the transience and impermanence of life – correlating to an environment that is constantly shifting and evolving. The trees' graceful movement embodies the nature of water, representing responsiveness and adaptability in the face of change.

OPERATING ENVIRONMENT



The Sri Lankan economy achieved significant strides in restoring macroeconomic stability in 2024. These positive developments, coupled with decisive regulatory and policy measures to strengthen the financial sector's regulatory framework, led to a more stable and resilient financial system. As a result, financial institutions benefited from a relatively more favourable operating environment during the year notwithstanding persisting challenges. The following section discusses key developments in the macro environment with its implications on the banking sector and NDB in particular.

KEY DEVELOPMENTS IN THE OPERATING ENVIRONMENT DURING 2024

Rebound in global trade

Global trade witnessed a rebound in 2024, recovering from the sharp downturn in 2023. Growth however was driven mainly by developed countries with sectors such as apparel and ICT products showing strong performances during the year.

Stabilisation of the Sri Lankan economy

The recovery momentum which commenced towards the latter part of 2023 continued in 2024 with GDP estimated to have grown by 5.0% in 2024 compared to the 2.3% contraction in 2023. The growth was driven mainly by a rebound in the industrial sector, as well as a strong performance in tourism-related service sectors.

Declining inflationary pressures

Inflation declined steadily throughout 2024 with headline inflation reaching deflationary levels towards the end of the year. This was driven by the higher-than-predicted downward revisions to the energy prices, stronger currency as well as the decline in food prices.

Continuation of accommodative monetary policy

CBSL continued to ease monetary policy during the year reducing policy rates on three occasions during the year.

Improved foreign exchange earnings

The external sector continued its positive momentum in 2024 contributing to stronger Rupee during the year. Consequently, the Sri Lanka Rupee continued to appreciate during the year appreciating by 10.7% against the US dollar during the year.

Successful completion of debt restructuring process by GOSL

External Debt Restructuring (EDR) process was concluded in December 2024 with Sri Lanka, finalising agreements with its major official bilateral creditors, including China, through a Memorandum of Understanding (MoU) with the Official Creditor Committee (OCC)

Upgrading of Sovereign Rating

Following the finalisation of International Sovereign Bonds restructuring, Fitch upgraded Sri Lanka's long-term foreign-currency rating to 'CCC+' from 'RD'(Restricted Default). and local-currency IDR to 'CCC+' from 'CCC-'. This was followed by Moody's rating agency also upgrading Sri Lanka's credit rating on 23 December 2024 to Caa1 from Ca.

Enactment of the Banking (Amendment) Act No. 24 of 2024

The Banking (Amendment) Act No. 24 of 2024 was effected in July 2024 with a view to further strengthening the legal and regulatory framework applicable for licensed commercial banks and licensed specialised banks (licensed banks)

Impact on Banking Sector

- The decline in inflationary pressures reduced pressure on household and corporate balance sheets, **softening credit risk** faced by financial institutions
- Reduction in market interest rates and resurgence in consumer confidence due to improving economic conditions in the country contributed to a **gradual increase in credit demand,** albeit significantly lower than pre-crisis levels.
- Market interest rates continued to adjust downward in response to a continuation of the accommodative monetary policy adopted by CBSL, **partially correcting imbalances in the interest rate structure** observed in the past.
- **The banking sector's exposure to the public sector showed signs of correction** as the Central Government absorbed certain credit facilities of a major State-Owned Enterprise as part of the SOE restructuring. However, overall sovereign exposure continued to rise, driven by increased bank investments in government securities, which offered higher yields compared to other market interest rates.

We continued to closely monitor developments in the market, proactively responding with strategic interventions to ensure resilience, and sustainable growth. Our strategic responses to industry dynamics and the resultant performance compared to industry performance is discussed below.

Industry Performance 2024	Bank's Response	Comparative Performance
Credit Growth		
Credit growth of the Banking sector witnessed a gradual resurgence during the year supported by the continuation of an accommodative monetary policy and gradual uptick in economic activity. Further, credit demand to the private sector witnessed an increase while the dependence of State Owned Enterprises declined due to the Central Government absorbing certain credit facilities of a major State Owned Enterprise.	We continued to take a cautious approach to lending, selectively pursuing quality growth opportunities to support the national economy. **Strategic Action Taken in 2024** ⦿ Prioritisation of capital efficient lending across business segments ⦿ Leveraging existing relationships to drive quality credit growth ⦿ Focus on key sectors such as exports and renewable energy to drive targeted portfolio growth **Link to Strategy** Business Focus Empowered Stakeholders	**Growth in Gross Loans and Advances to Customers**

%	2024	2023
Banking Sector	4.1	(2.6)
NDB	2.7	(14.4)

OPERATING ENVIRONMENT

Industry Performance 2024

Bank's Response

Comparative Performance

Credit Quality

Overall industry Non-Performing Loans (NPLs) decreased during the year, indicating a decline in the overall default risk of the Banking sector. Notwithstanding this improvement, the Non-Performing Loans (NPL) ratio remained elevated highlighting continued challenges in the market.

Preserving portfolio quality remained a key focus during the year and we continued to proactively identify portfolio stresses and support our customers through financial difficulties.

Strategic Action Taken in 2024

- Proactive management of Stage 2 portfolio
- Strengthening of risk management and monitoring mechanisms
- Strengthening and up-skilling the Remedial Management (Business Revival) Unit to rehabilitate financially distressed borrowers

Link to Strategy

Business Focus

Operational Excellence

NPL Ratio

%	2024	2023
NDB	5.2	8.6

Net Interest Income

Net Interest Margin (NIM) of the Banking sector increased in 2024 due to a notable decline in interest expenses as compared to interest income. This was mainly on account of the reduction in deposit rates outpacing that of lending rates.

NIM was a key strategic pillar of our midterm strategy and we continued to focus on optimising our cost of funds, enhancing the quality of our asset book, and effectively re-pricing our deposit portfolio.

Strategic Action Taken in 2024

- Efficient assets and liability management, including timely re-pricing
- CASA drive to increase low cost fund base

Link to Strategy

Business Focus

Operational Excellence

Net Interest Margins

%	2024	2023
Banking Sector	4.3	3.6
NDB	4.3	4.0

Industry Performance 2024 | **Bank's Response** | **Comparative Performance**

Liquidity

Industry Performance 2024

Rupee liquidity condition of the Banking sector, significantly improved during the year mainly due to increased investments in Rupee denominated government securities by banks. In addition, a considerable amount of funds maintained by the sector with financial institutions abroad indicated prudent foreign currency liquidity management by banks.

Bank's Response

We continued to maintain a diverse portfolio of borrowings in terms of currencies, maturities, instruments and investor types in order to avoid excessive reliance on individual markets and funding sources. Close monitoring of liquidity matrices meanwhile ensured that we maintained a strong liquidity position throughout the year.

Strategic Action Taken in 2024

- Optimised investments in government securities
- Regular cash flow projections to manage liquidity
- Enhanced engagement through ALCO to manage liquidity
- Strengthened stress testing and reviewing related parameters and economic triggers

Link to Strategy

Business Focus

Comparative Performance

All Currency Liquid Coverage Ratio

%	2024	2023
Banking Sector	313.8	288.4
NDB	308.3	228.6

Capital Adequacy

Industry Performance 2024

Banking sector capital adequacy improved during the year as a result of improved profitability across the sector and new issuance of Tier II debenture capital. In addition, the shift towards investments with risk free government securities also contributed to the improved capital adequacy of the banking sector.

Strategic Action Taken in 2024

- Issue of LKR 10.0 Bn Basel III compliant listed, rated, unsecured, subordinated, redeemable debentures via two tranches in September and December 2024, LKR 5.0 Bn per tranche

Link to Strategy

Business Focus

Total Capital Ratio

%	2024	2023
Banking Sector	18.3	16.9
NDB	19.1	15.9

Sector Profitability

Industry Performance 2024

Profitability of the Banking sector improved, significantly in 2024 supported by the increase in net interest income and reduction in impairments across the sector.

Strategic Action Taken in 2024

- Focused efforts to increase fee and commission income through transaction drive
- Maintained a strong cost discipline across the organisation

Link to Strategy

Business Focus

Operational Excellence

PAT Growth

%	2024	2023
Banking Sector	60.8	22.9
NDB	68.2	84.6

OPERATING ENVIRONMENT

OUTLOOK

The financial sector is expected witness a rebound in credit demand, enhanced asset quality, and a continued buildup of capital buffers in 2025 as global and domestic macro-economic factors continue to improve. Notwithstanding this favourable outlook, deep-seated macrofinancial imbalances created by the unprecedented gravity of the economic and financial crisis of the last two years will continue to pose challenges unless prudently managed. A strong commitment to implement timely and well-sequenced policy measures and reforms by all stakeholders will therefore be of utmost importance to maintain the current growth momentum. Going forward NDB will remain focused on addressing potential challenges while strategically capitalising on emerging opportunities.

Opportunities

- Whilst credit demand from household and institutional sectors recorded an expansion in 2024, the debt stock of both sectors remained below the levels observed during the first half of 2022, reflecting the potential for further expansion of credit in the short term.
- The lifting of import restrictions, including restrictions on vehicle imports is likely to increase demand for import funding.
- The successful completion of the EDR and the subsequent sovereign rating upgrade have restored investor confidence, creating opportunities to access external financial resources including concessionary funding lines.
- Progressive action taken to enhance the national payment digital infrastructure such as developing the Government Digital Payment Platform (GDPP), as well as the Governments focus of digitisation of government services likely to enhance opportunities for digital financial services and products.
- Increased focus on sustainable finance including Green Lending

Challenges

- Delay in credit pick-up and negative impact on repayment capacities due to lingering impact of economic crisis on real income levels.
- The higher propensity towards risk taking during an expansionary phase of a credit cycle could heighten the buildup of vulnerabilities such as excessive leverage, asset bubbles and deteriorating credit quality
- Challenges in attracting low cost funds amidst low deposit rates
- Continued downward pressure on lending rates could narrow the net interest income of financial institutions thereby affecting profitability.
- Government securities, which led to significant returns to investing financial institutions in the recent past, may gradually subside
- Adapting to new legislation affecting banking operations and compliance may pose challenges
- Potential spillovers from a negative trade outlook driven by possible US policy shifts, including broader tariffs that could disrupt global value chains and reduce international trade volumes