SRI LANKA-CHINA ECONOMIC BRIEF

KEY DEVELOPMENTS AND TRENDS: 2023–2025

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ARUTHA

Sri Lanka-China Economic Brief

Synthesis of Key Developments and Trends: 2023–2025

January 2026

This brief was written by Umesh Moramudali and Thilina Panduwawala. It was edited by Yolani Fernando and Rehana Thowfeek.

Research, editorial, and layout design support by Shaheen Abdul Gani.

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GLOSSARY OF TERMS

Agreement in Principle (AIP)
The initial agreement that acts as a stepping stone towards a final agreement, in this context, with a creditor or group of creditors. It outlines the overall structure of the debt restructuring, that all the parties have reached consensus on.

BRICS
BRICS is an informal group of states comprising the Federative Republic of Brazil, the Russian Federation, the Republic of India, the People's Republic of China and the Republic of South Africa.

New Development Bank (NDB)
Formerly referred to as the BRICS Development Bank, NDB is a multilateral development bank established by the BRICS nations. NDB finances projects and innovates tailored solutions to help build a more inclusive, resilient, and sustainable future for the planet.

International Sovereign Bonds (ISBs)
Foreign currency denominated sovereign bonds issued by a government to foreign investors and typically listed in a major bond trading center like New York, London and Singapore. ISBs are issued under foreign law, usually English or New York law.

Image courtesy of
Mohamed Ansaf via Pexels

KEY TAKEAWAYS

- **China remains Sri Lanka's largest bilateral creditor and top import source, accounting for over one-fifth of imports.** During 2022 and 2023, China dropped to the 2nd biggest import source as India became Sri Lanka's top import source, but as growth rebounded, China reemerged as the top import source of Sri Lanka.

- In spite of initial reluctancies, Chinese creditors were the first to finalize debt restructuring. **China EXIM Bank (ChEXIM) finalized debt restructuring in September 2024, followed by China Development Bank (CDB) in December 2024.**

- Debt restructuring with Chinese banks followed two tracks: ChEXIM finalized deals alongside bilateral creditors like Japan and India, while CDB finalized debt restructuring alongside International Sovereign Bond (ISB) holders.

- **After the debt restructuring, ChEXIM are observed to be more risk averse in lending to Sri Lanka** as evident through the Central Expressway Project (CEP) loan disbursements. The loan amount was reduced by ~50% (from USD 989 million to USD 500 million) alongside converting the loan to an RMB denominated one to reduce the cost for ChEXIM.

- **Post-default, Chinese engagement is shifting from debt-financed projects toward equity-based FDI and private sector partnerships**, exemplified by Sinopec's Hambantota refinery and the surge of Chinese EV brands.

- **Sri Lanka's trade relationship with China remains structurally imbalanced**: Sri Lanka runs a persistent deficit with China, while relying on the US for export surpluses. US tariffs in 2025 have heightened this vulnerability.

- **Diplomatically, Sri Lanka seeks to balance ties with China and India**, while managing exposure to the US–China rivalry.

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EXECUTIVE SUMMARY

China remains central to Sri Lanka's economic and diplomatic landscape, particularly in the aftermath of its sovereign default. The debt restructuring process underscored China's dual role as both a bilateral and commercial creditor, while trade and investment links highlight a structural asymmetry — Sri Lanka imports heavily from China but exports little in return. At the same time, Chinese investments are shifting from loan-driven megaprojects toward equity-based ventures and consumer-oriented sectors such as electric vehicles. Diplomatically, Sri Lanka continues to walk a tightrope between China, India, and the United States, seeking to balance great-power interests while safeguarding its economic recovery.

CHINA–SRI LANKA AT A GLANCE (2024–2025)

China's Share of Sri Lanka's Imports

Largest import partner, ahead of India (20%)

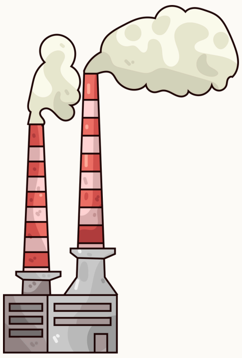
~22–23%
(Jan-Aug 2025)

China's Share of Sri Lanka's Exports

Minimal compared to US (23%)

~2%
(Jan-Aug 2025)

Largest Chinese FDI



Sinopec Hambantota refinery – biggest in Sri Lanka's history. Agreement signed, but project facing delays

US$3.7bn

Outstanding Debt Restructured with ChEXIM

39 loans were restructured with maturity extensions and interest rate reductions

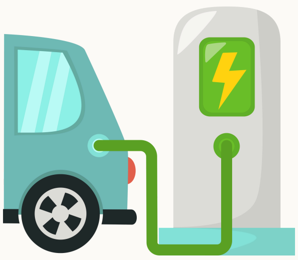
US$4.2bn

Shift in Financing

ChEXIM loans converted to RMB to reduce dollar risk

RMB loans introduced

Chinese EV Imports



90% of EVs are from China in Jan-Aug 2025 [1]

Led by BYD, Deepal, SERES, etc.

Multilateral Agreements

Sri Lanka joined NDB in 2024; BRICS membership bid under review

[1] https://www.themorning.lk/articles/x9ucvZDWvywcOv9E2RC6

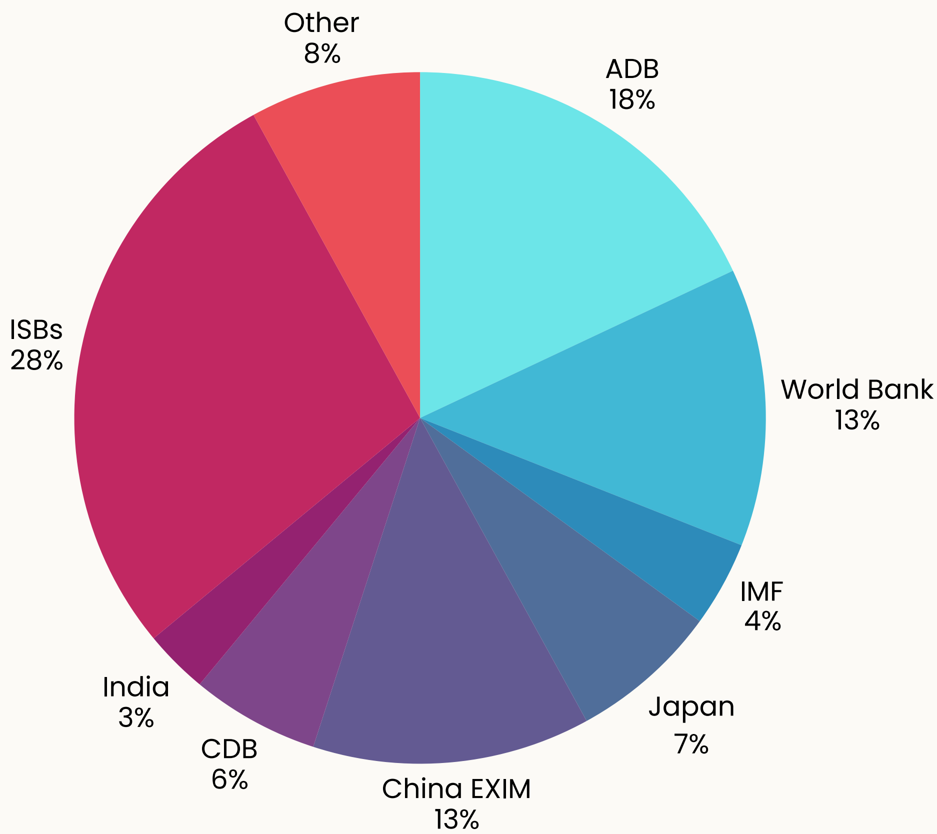
Image courtesy of
Je Vais Partout via Google Photos

1. DEBT DYNAMICS

After declaring sovereign default, Sri Lanka initiated the debt restructuring process in mid 2022. Chinese creditors played a crucial role in Sri Lanka's debt restructuring process as the largest bilateral creditor, amounting to approximately 20% of Sri Lanka's total foreign debt.[2] **China's role in Sri Lanka's debt restructuring was shaped by the dual-track negotiations required with its two main policy banks**. ChEXIM, treated as an official bilateral creditor, concluded the restructuring of 39 loans amounting to over US$4 billion[3] by September 2024. The agreement extended maturities up to 20 years without imposing principal haircuts, effectively easing Sri Lanka's repayment burden. In contrast, CDB, classified as a commercial creditor, negotiated alongside Sri Lanka's ISB holders. An Agreement in Principle was announced in parallel with Sri Lanka's ISB restructuring,[4] in December 2024. **After concluding the debt restructuring, Sri Lanka's outstanding debt to ChEXIM Bank and CDB is USD 4,946 million[5] and USD 2,430 million respectively.**

[2] https://www.reuters.com/world/asia-pacific/sri-lankas-debt-china-close-20-public-external-debt-study-2022-11-30/
[3] https://www.treasury.gov.lk/api/file/1f0bf050-f038-4bcf-8781-c366acc251b4
[4] https://economynext.com/sri-lanka-reaches-isb-restructuring-deal-finalises-agreement-with-china-dev-bank-official-180060/
[5] Public Debt Bulletin of Sri Lanka, PDMO - https://www.treasury.gov.lk/api/file/3a624fa9-143b-4ccb-a42a-ecf42efbc1e5

Figure 1: Sri Lanka's Outstanding Foreign Debt - End June 2025



Source: Statistical Debt Bulletin Second Quarter, 2025 Public Debt Management Office

China was initially reluctant to restructure debt within the parameters of the International Monetary Fund (IMF) Debt Sustainability Analysis (DSA) framework. Subsequently, however, they agreed to restructure debt within these parameters.[6] **China was the first bilateral lender to finalize debt restructuring, and they finalized it in September 2024.** However, there were no principal haircuts (a reduction of the outright loan amount), instead they provided maturity extensions and interest rate reductions for loans obtained from ChEXIM and CDB.

As we have repeatedly highlighted in the previous briefs, Chinese lending practices are an evolving process and often affiliated with Chinese SOEs. We observe a continuation of this trend as **Chinese policy banks become more risk averse to lend to Sri Lanka post-debt restructuring**. This is evident through the renegotiations of the Central Expressway Project (CEP) – Phase 1.

[6] https://thediplomat.com/2025/01/beyond-debt-china-sri-lanka-economic-relations-in-a-new-era/

Sri Lanka is currently renegotiating a loan agreement originally signed in March 2019 with ChEXIM to finance Phase I of the Central Expressway, spanning from Kadawatha to Mirigama. The project was awarded to the Chinese construction firm MCC, with a total loan value of US$989 million.[7] Progress, however, was severely disrupted by the COVID-19 pandemic and the subsequent economic crisis, leading to significant delays. By 2022, merely US$51.5 million, which amounts to approximately 5% of the total load had been disbursed.[8]

Since then, both Sri Lanka's economic context and construction costs have changed considerably. Of the original loan, approximately US$930 million remained undisbursed.[9] Following recent negotiations, the EXIM Bank of China has agreed to provide US$500 million out of the total remaining amount of US$930 million.[10] Moreover, ChEXIM agreed to provide this amount in renminbi (RMB) instead of U.S. dollars, to continue the project. The change of currency does not affect the project as the project contractor MCC (also a Chinese firm) agreed to accept payments in RMB. The Sri Lankan government now intends to cover the shortfall (around USD 430 million) from domestic sources to ensure completion of Phase I of the Central[11] Expressway. Consequently, the loan amount has been reduced from US$989 million to US$500 million, and the interest rate, which was initially 2.5%, is expected to rise to somewhere in the range between 2.5% and 3.5% under the revised terms. **This reflects the risk averse approach of ChEXIM in post debt restructuring era.**

This signals that it is difficult for Chinese SOEs to secure project contracts by extending loans to Sri Lanka through Chinese policy banks, ChEXIM and CDB. It is evident that Chinese SOEs are shifting from unsolicited loan-financed projects to equity-based ventures, exemplified by Sinopec's investment in Hambantota. **These shifts underscore a transformation in the financial architecture of China–Sri Lanka relations, reflecting both lessons from the default and China's broader push to internationalise the RMB.**

[7] https://www.sundaytimes.lk/250727/news/mega-projects-local-firms-told-to-find-foreign-loans-606905.html
[8] China – Sri Lanka Brief – 4 - https://arutharesearch.org/2025/02/14/sri-lanka-china-economic-brief-issue-iv/ and recording of the Committee of Public Finance (COPF) of Sri Lanka
[9] https://www.themorning.lk/articles/rALNu6w2aRcTdLXnydqD
[10] https://www.themorning.lk/articles/rALNu6w2aRcTdLXnydqD
[11] https://www.themorning.lk/articles/tElzKWtTopqofxpr9LH6

2. TRADE RELATIONS

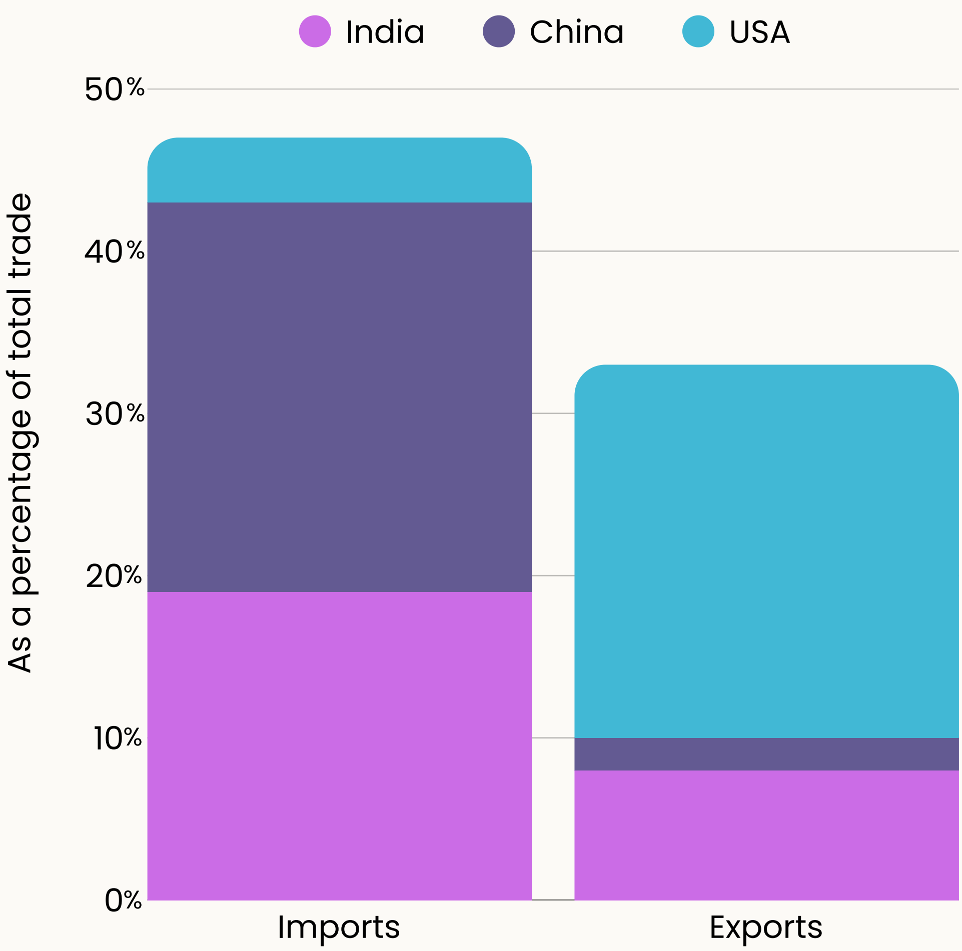
By 2024–2025, China had firmly reestablished itself as Sri Lanka's largest source of imports, consistently accounting for around 22–23 percent of total imports, ahead of India. The composition of imports from China reflects their centrality to Sri Lanka's economy: fabrics and textiles for the apparel sector, machinery and steel for construction, and consumer electronics for household demand. **Following the relaxation of vehicle import restrictions in 2025, imports of Chinese electric vehicles surged**, led by brands such as BYD which entered the market through a partnership with major Sri Lankan conglomerate John Keels Holdings (JKH).

However, recent developments may affect this momentum. Since July 2025, Sri Lanka Customs has detained over 2,000 BYD electric vehicles over a dispute on their declared motor capacity, a key factor in determining the excise tax applied to the imported vehicle. The imported vehicles were declared as 100 kW models, subject to an excise tax of approximately Rs. 2.4 million, but authorities suspect they may be 150 kW versions, which would raise the duty to Rs. 5.4[12] million. JKH maintains that the vehicles imported are 100 kW models imported directly from BYD in China and has assured its stakeholders that it is actively engaged with authorities to resolve the matter.

[12] https://economynext.com/sri-lanka-customs-to-release-506-disputed-byd-evs-with-bank-guarantee-239356/

Sri Lanka continues to rely on China for intermediate goods that feed into its export industries, while its direct exports to China remain negligible — around 2 percent of total exports. This dominance in imports has created a persistent and widening trade deficit. In contrast, the United States continues to absorb nearly a quarter of Sri Lanka's exports, primarily apparel, producing a trade surplus that balances the overall external account. However, the imposition of US tariffs on Sri Lankan apparel in 2025 has threatened this model, further exposing Sri Lanka's structural dependence on Chinese inputs and heightening the risk of being caught between competing trade powers.

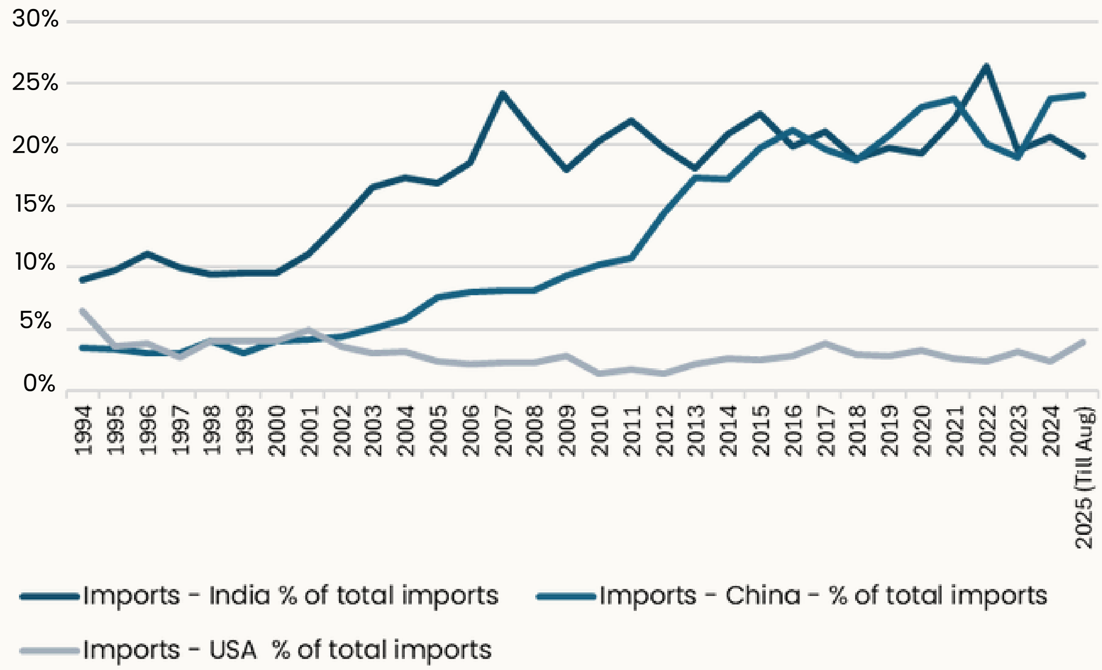
Figure 2: Sri Lanka's Trade Dynamics with Major Powers amidst Trade Wars



Source: Constructed based on EDB data

The dominance of Chinese imports is not a one-off case. As our previous briefs have highlighted, Chinese imports have been on an upward trajectory after the year 2000. This was largely driven by increasing reliance of apparel raw materials from China, Chinese financed infrastructure projects and the rise of electronic items, of which China is the major import source.

Figure 3: Sri Lanka's Imports from Major Economies



Source: Constructed based on EDB data

Conversely, Sri Lanka's export to China remain stagnant. While Sri Lanka's exports to US also remain stagnant, US continued to be Sri Lanka's largest export market accounting for nearly 25% of country's total exports.[13] This makes Sri Lanka very vulnerable to US tariff changes, as indicated by the concerns raised by analysts, business sector and government actions to negotiate with US.

[13] https://economynext.com/sri-lanka-customs-to-release-506-disputed-byd-evs-with-bank-guarantee-239356/

Figure 4: Sri Lanka's Exports from Major Economies

Source: Constructed based on EDB data

3. INVESTMENT RELATIONS

Chinese investment patterns have undergone a marked transformation in the post-default era. **The Sinopec oil refinery in Hambantota, worth US$3.7 billion**[14]**, stands out as the single largest foreign direct investment in Sri Lanka's history, and a clear departure from the earlier reliance on debt-financed infrastructure projects.** Beyond energy, Chinese companies have shown interest in sectors such as auto manufacturing, construction, and technology, pointing to a diversification of investment channels.

Colombo Port City remains a flagship project, with several ventures granted Primary Business of Strategic Importance status and extensive tax concessions. Yet IMF conditionalities requires Sri Lanka to revisit these generous incentives, raising questions about the pace of future inflows. Alongside these state-to-state projects, Chinese firms are embedding themselves more deeply in Sri Lanka's private sector. Partnerships with local conglomerates to distribute electric vehicles, renewable energy solutions, and consumer products suggest a more enduring commercial presence that extends beyond traditional SOE-led projects.

[14] China – Sri Lanka Economic Brief 4 - https://arutharesearch.org/2025/02/14/sri-lanka-china-economic-brief-issue-iv/

Image courtesy of Aaron Favila

4. DIPLOMATIC RELATIONS

On the diplomatic front, **Sri Lanka has sought to maintain a careful balance between China and India while also managing its ties with the United States**. President Anura Kumara Dissanayake's visit to Beijing in January 2025 underscored the importance of the China relationship, producing 15 MoUs and investment pledges worth up to US$10 billion.[15] Yet Colombo simultaneously advanced discussions with New Delhi on the Trincomalee refinery and oil tank farm project,[16] signalling its determination to avoid overdependence on any single partner.

Regional geopolitics have added further complexity. The temporary ban on Chinese research vessels in 2024, later lifted under pressure, highlighted the strategic sensitivities of Sri Lanka's location in the Indian Ocean. At the multilateral level, Colombo's application to join BRICS and its admission to the New Development Bank in 2024 positioned Sri Lanka closer to China-led initiatives, complementing its IMF-supported reform path. Meanwhile, the imposition of US tariffs on apparel in 2025 has sharpened the economic stakes of Sri Lanka's diplomatic balancing act, **reinforcing the reality that its external strategy must carefully navigate between the imperatives of China, India, and the United States.**

[15] https://economynext.com/sri-lanka-signs-15-mous-with-china-president-xi-jinping-pledges-backing-199627/
[16] https://economynext.com/sri-lanka-discussing-oil-refinery-in-trinco-with-india-president-200288/

Image courtesy of Sri Lanka Guardian

CONCLUSION

Sri Lanka's relations with China are in a period of structural transition. The post-default environment has seen a shift from debt-heavy loans to equity-based FDI, from state-to-state megaprojects to deeper private sector linkages, and from bilateral dependency to entanglement in multilateral platforms. For Sri Lanka, the central challenge is to leverage Chinese trade and investment for economic recovery while mitigating the risks of a widening trade deficit, project governance challenges, and geopolitical vulnerability. **How Colombo manages these dynamics will shape not only the trajectory of China–Sri Lanka relations, but also the country's broader integration into a contested regional and global order.**

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info@arutharesearch.org
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