7

MONETARY POLICY, INTEREST RATES, MONEY AND CREDIT

7.1 Overview

With the view to reviving subpar economic activity and weak growth of credit to the private sector, the Central Bank adopted an accommodative monetary policy in May 2019 and reinforced it in August 2019 and early 2020, supported by muted inflation, well-anchored inflation expectations, a relatively stable external sector and increasingly easing monetary policy globally. The reduction of the policy interest rates by the Central Bank in May and August 2019 following forward guidance provided to the market in April 2019, was intended to reduce market lending rates and boost credit flows to the private sector. This was in addition to the reduction of the Statutory Reserve Ratio (SRR) on all rupee deposit liabilities of Licensed Commercial Banks (LCBs) by 1.00 percentage point with effective from 01 March 2019. To facilitate a faster reduction in market lending rates by reducing the cost of funds of financial institutions, the Central Bank imposed ceilings on interest rates of deposit products of financial institutions in April 2019, while maintaining adequate levels of liquidity in the domestic money market. In response to deposit caps, deposit interest rates and yields on government securities displayed a notable reduction. Yet, lending rates remained downward rigid, and as a temporary measure, the Central Bank imposed ceilings on lending rates of licensed banks in September 2019 aimed at inducing a sizable reduction in market lending rates, while removing caps on deposit rates of licensed banks. Consequently, market lending rates started to decline gradually and the credit disbursed by LCBs to the private sector started accelerating in absolute terms towards the latter part of 2019. However, as new deposit rates started to rise following the removal of deposit caps, the Central Bank lowered policy rates further by 50 basis points in January 2020, considering the need for a continued reduction in market lending rates to support the envisaged recovery in economic activity. Meanwhile, with the aggravation of the COVID-19 outbreak both globally and domestically, it became evident by March 2020 that domestic economic and financial market activity could be further affected through various channels. Accordingly, the Central Bank, in an emergency move, reduced the Standing Deposit Facility Rate (SDFR) and the Standing Lending facility Rate (SLFR) by a further 25 basis points with effect from 17 March 2020 while reducing the SRR on all rupee deposit liabilities of LCBs by 1.00 percentage point to 4.00 per cent, with effect from the reserve maintenance period commencing 16 March 2020, *in addition to taking steps to inject large amounts of liquidity to the domestic market through various operational measures. A further reduction in policy interest rates by 25 basis points was effected from the close of business on 03 April 2020. The overall reduction in policy interest rates during the period from 31 May 2019 to 03 April 2020 amounted to 200 basis points, resulting in the SDFR and the SLFR to remain at 6.00 per cent and 7.00 per cent, respectively, as at the close of business on 03 April 2020.*

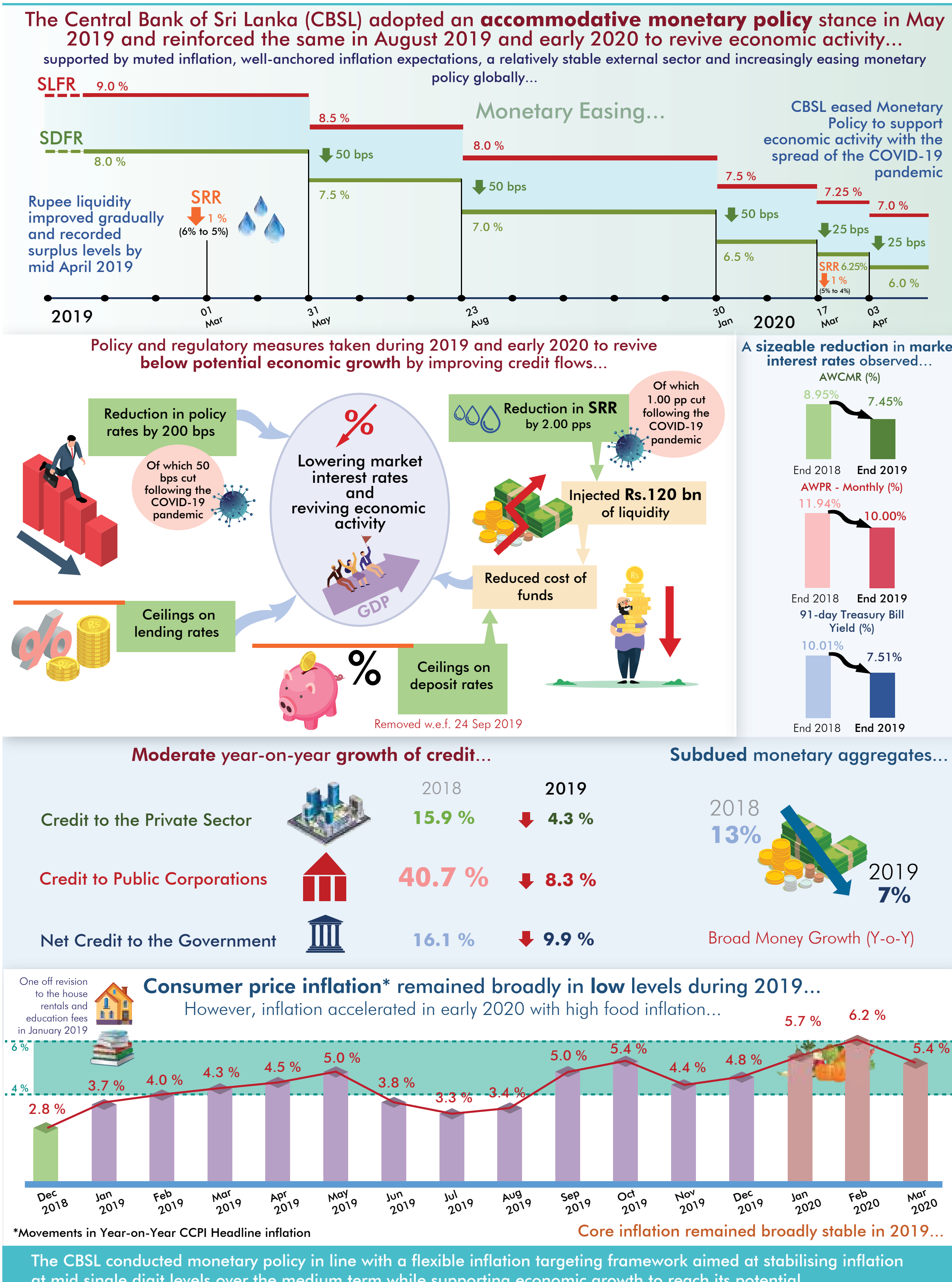
Reflecting subdued economic activity during the year and weak business confidence that prevailed during early 2019, growth of credit extended to the private sector decelerated significantly in 2019 compared to 2018, in spite of the recovery in absolute credit disbursements towards the end of 2019. Meanwhile, the reliance of the government on the banking system also moderated in 2019 compared to 2018 with the availability of foreign funds through the issuance of International Sovereign Bonds (ISBs), as well as increased financing from the non banking sector. Reflecting these developments, the year-on-year growth of broad money (M_{2b}) decelerated to 7.0 per cent by end 2019 in comparison to 13.0 per cent by end 2018.

Meanwhile, consumer price inflation remained broadly in low levels during 2019 reflecting the persistent negative output gap caused by subdued demand conditions along with well anchored inflation expectations. However, inflation accelerated in early 2020 with domestic supply side disruptions causing high food inflation. Projections indicate that inflation is likely to remain within the desired 4-6 per cent range in the medium term underpinned by appropriate policy measures aimed at maintaining low and stable inflation, while supporting the revival of economic activity under flexible inflation targeting.

7.2 Monetary Policy Stance of the Central Bank of Sri Lanka

The Central Bank adopted an accommodative monetary policy stance in 2019 amidst prolonged subpar economic activity exacerbated by Easter Sunday attacks, muted inflation, favourable inflation outlook, rapidly decelerating private sector credit growth, and increasingly easing monetary policy globally. Prior to shifting to an accommodative policy stance, the Central Bank provided forward guidance to the market in April 2019 on the likelihood of a reduction of policy interest rates to address the rapid deceleration of private sector credit growth and below potential economic growth. The SDFR and the SLFR of the Central Bank were then reduced by 50 basis points each to 7.50 per cent and 8.50 per cent, respectively, in May 2019, thus ending the neutral monetary policy stance maintained since April 2018. Meanwhile, the Central Bank reduced the SRR applicable on all rupee deposit liabilities of LCBs by a further 1.00 percentage point in March 2019 with a view to addressing the persistent deficit levels in the domestic money market, following which liquidity turned into surplus levels from mid April 2019. Despite improved liquidity, market interest rates remained downward rigid. As such, considering the need to expedite the monetary policy transmission through the financial system, the Central Bank was compelled to impose interest rate ceilings on deposit products of licensed banks and non bank financial institutions with effect from 26 April 2019, as high interest rates offered on deposits were viewed as one major cause for the high cost of funds in the financial sector. With this measure, market deposit rates started to reduce notably, while market lending rates remained slow to adjust. With a view to inducing a sizable reduction in market lending rates, the Central Bank reduced the SDFR and the SLFR further by 50 basis points to 7.00 per cent and 8.00 per cent, respectively,

Figure 7.1
Monetary Sector Performance



effective 23 August 2019. Moreover, the overly persistent delay in the transmission of policy measures to market lending rates necessitated the Central Bank to order licensed banks to reduce lending rates on 24 September 2019, while withdrawing the caps on deposit interest rates offered by licensed banks. Supported by monetary policy, operational and regulatory measures taken by the Central Bank, market lending rates showed a gradual downward movement during the remainder of the year. Meanwhile, with the removal of caps on deposit interest rates offered by banks, new deposit rates increased during September through December 2019, while yields on Treasury bills also trended upwards towards end 2019 and in January 2020. Considering the need to signal the expectation of a continued reduction in market lending rates to support the revival of economic activity in the context of the favourable inflation outlook and well contained inflation expectations, the Central Bank reduced the SDFR and the SLFR further by 50 basis points to 6.50 per cent and 7.50 per cent, respectively, effective 30 January 2020. Meanwhile, considering the urgent need to support economic activity and the financial sector with the rapid spread of the COVID-19 pandemic and its possible further spread in Sri Lanka, at an emergency meeting to review the monetary policy stance on 16 March 2020, the Central Bank reduced the SDFR and the SLFR of the Central Bank by 25 basis points to 6.25 per cent and 7.25 per cent, respectively, with effect from 17 March 2020. At the same time, in order to enable LCBs to execute their financial transactions smoothly and reduce their cost of funds further, the Central Bank reduced SRR on all rupee deposit liabilities of LCBs

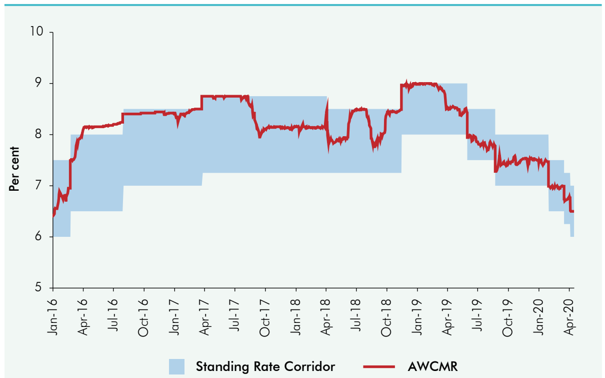
Table 7.1
Recent Monetary Policy Measures

Date	Measure
02-Mar-2015	Withdrawal of the 5.00% special SDF rate, which was applied on OMO participants who deposit at the SDF more than three times per calendar month.
15-Apr-2015	SDFR and SLFR reduced by 50 basis points to 6.00% and 7.50%, respectively.
03-Sep-2015	The exchange rate allowed to be determined based on demand and supply conditions in the foreign exchange market.
30-Dec-2015	SRR increased by 1.50 percentage points to 7.50% to be effective from the reserve period commencing 16-Jan-2016.
19-Feb-2016	SDFR and SLFR increased by 50 basis points to 6.50% and 8.00%, respectively.
28-Jul-2016	SDFR and SLFR increased by 50 basis points to 7.00% and 8.50%, respectively.
24-Mar-2017	SDFR and SLFR increased by 25 basis points to 7.25% and 8.75%, respectively.
04-Apr-2018	SLFR reduced by 25 basis points to 8.50%. Accordingly, the width of the SRC narrowed to 125 basis points from 150 basis points.
14-Nov-2018	SRR reduced by 1.50 percentage points to 6.00% to be effective from the reserve period commencing 16-Nov-2018. SDFR increased by 75 basis points to 8.00% and SLFR increased by 50 basis points to 9.00%. Accordingly, the width of the SRC narrowed to 100 basis points from 125 basis points.
22-Feb-2019	SRR reduced by 1.00 percentage point to 5.00% to be effective from the reserve period commencing 01-Mar-2019.
31-May-2019	SDFR and SLFR reduced by 50 basis points to 7.50% and 8.50%, respectively.
23-Aug-2019	SDFR and SLFR reduced by 50 basis points to 7.00% and 8.00%, respectively.
30-Jan-2020	SDFR and SLFR reduced by 50 basis points to 6.50% and 7.50%, respectively.
17-Mar-2020	SDFR and SLFR reduced by 25 basis points to 6.25% and 7.25%, respectively.
17-Mar-2020	SRR reduced by 1.00 percentage point to 4.00% to be effective from the reserve period commencing 16-Mar-2020.
03-Apr-2020	SDFR and SLFR reduced by 25 basis points to 6.00% and 7.00%, respectively, to be effective from the close of business on 03-Apr-2020.

Source: Central Bank of Sri Lanka

Note : The Central Bank imposed interest rate caps on deposit products of licensed banks and non - bank financial institutions with effect from 26 April 2019. The Central Bank imposed caps on lending rates while withdrawing caps on deposits rates of licensed banks with effect from 24 September 2019.

Figure 7.2
Standing Rate Corridor and Average Weighted Call Money Rate (AWCMR)

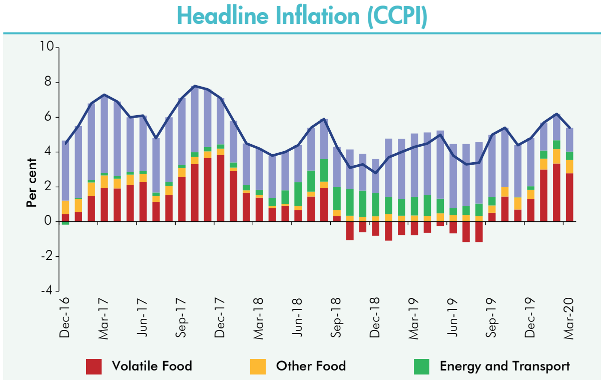


Source: Central Bank of Sri Lanka

by 1.00 percentage point to 4.00 per cent, effective from the reserve maintenance period commencing 16 March 2020, thus providing additional liquidity of around Rs. 65 billion to the domestic money market. The SDFR and the SLFR of the Central Bank were further reduced by 25 basis points to 6.00 per cent and 7.00 per cent, respectively, effective from the close of business on 03 April 2020, and this decision is expected to complement the measures that have been taken thus far to ease market conditions, and enable the domestic financial market to provide further relief to businesses and individuals affected by the outbreak of the COVID-19 pandemic and restrictions placed to contain its spread within the country.

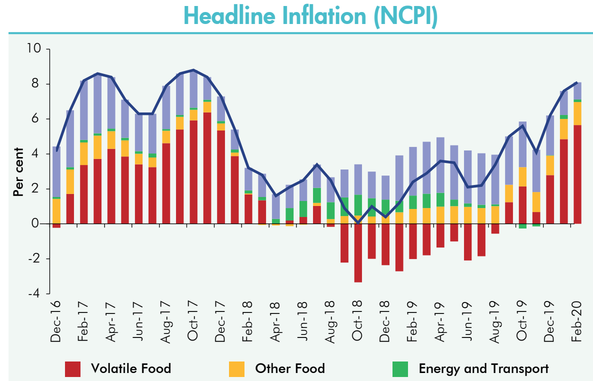
Supporting the adoption and maintenance of an accommodative monetary policy stance by the Central Bank, consumer price inflation broadly remained low during 2019, reflecting subdued demand conditions along with well anchored inflation expectations. Headline inflation, as measured by the year-on-year change in the Colombo Consumer Price Index (CCPI, 2013=100) was largely stable around mid single digit levels in 2019, while the National Consumer Price Index (NCPI, 2013=100) based headline inflation remained low during the year, before recording a supply driven uptick in December 2019. Headline inflation, as measured by the year-on-year change in the CCPI, which was at 2.8 per cent in December 2018, accelerated towards the mid single digit level by May 2019. Some softening of inflation was experienced during June through August 2019 due to the deceleration of both food and non food inflation. However, inflation accelerated thereafter and hovered around 5.0 per cent levels amidst disruptions in the domestic food supplies due to adverse weather conditions. Accordingly, year-on-year headline inflation based on the CCPI was recorded at 4.8 per cent by end 2019. Driven by food inflation, CCPI based headline inflation accelerated in the first two months in 2020 to record 6.2 per cent in February 2020, before decelerating to 5.4 per cent in March 2020 as food inflation eased with improved domestic supplies. On an annual average basis, CCPI based headline inflation remained unchanged at 4.3 per cent at end 2019 compared to end 2018. Year-on-year headline inflation based on the NCPI, which attaches a higher weight on food than the CCPI, accelerated to 6.2 per cent by December 2019, compared to 0.4 per cent in December 2018, and accelerated further to 8.1 per cent by February 2020, due to increased food prices. Meanwhile, NCPI based annual average inflation accelerated to 3.5 per cent by end 2019 from 2.1 per cent at end 2018. As per the Inflation

Figure 7.3
Contribution to Year-on-Year Headline Inflation (CCPI)



Source: Department of Census and Statistics

Figure 7.4
Contribution to Year-on-Year Headline Inflation (NCPI)



Source: Department of Census and Statistics

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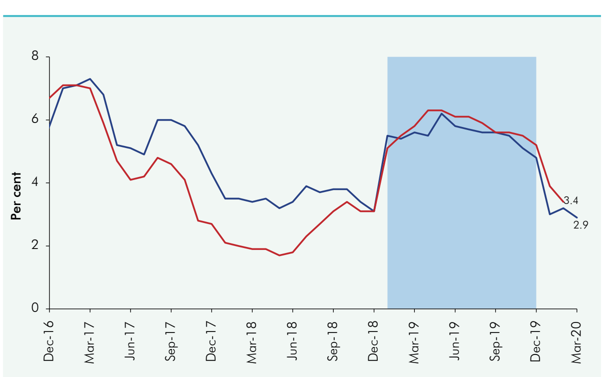
Expectations Survey of the Central Bank, inflation expectations of the corporate sector remained broadly in the mid single digit range during 2019, while inflation expectations of the household sector remained high, particularly during the second quarter of 2019. During 2019, CCPI based inflation remained within the inner band of the quantitative performance criteria under the IMF-Extended Fund Facility (EFF) Programme. Inflation is expected to be maintained in mid single digit levels over the medium term supported by adequate and timely policy measures, although short term fluctuations in inflation due to supply side factors need to be managed through appropriate policy adjustments by the government.

Core inflation, which reflects the underlying trend in inflation and hence more useful for monetary policy purposes, remained broadly stable in 2019 following an elevation in January 2019 due to the upward adjustments to the prices of certain items in the non food category. Adjustments to house rentals and expenses on education, upward revisions in taxes on alcoholic beverages and tobacco, and an increase in administratively determined prices mainly contributed to the elevation of core inflation in January 2019. In addition, increases in prices across the health category and commodity prices alongside the lagged effect of the depreciation of the Sri Lankan rupee in 2018 resulted in a modest rise in year-on-year core inflation towards May 2019. However, CCPI based year-on-year core inflation decelerated gradually from June 2019 onwards, and registered 4.8 per cent in December 2019, compared to 3.1 per cent in December 2018. CCPI based annual average core inflation reached 5.5 per cent by end 2019, compared to 3.5 per cent recorded at end 2018. NCPI based year-on-year core inflation, which recorded 3.1 per cent at end 2018, rose to 6.3 per cent by April 2019, before decelerating thereafter. Declining non food prices mainly aided NCPI based core inflation to decelerate to 5.2 per cent by end 2019. Meanwhile, annual average core inflation, based on NCPI, accelerated to 5.7 per cent at end 2019 from 2.4 per cent recorded at end 2018. However, with the dissipation of one off adjustments that were made at the beginning of 2019, core inflation based on both CCPI and NCPI decelerated sharply in the first quarter of 2020. Accordingly, CCPI based year-on-year core inflation moderated to 2.9 per cent by March 2020 and NCPI based core inflation declined to 3.4 per cent in February 2020, also supported by the decline in prices in the telecommunication and data services category following the downward revision of the telecommunication levy effective from December 2019.

Figure 7.5
Movements in Year-on-Year Core Inflation



Source: Department of Census and Statistics

The accommodative monetary policy stance was also aimed at ensuring the availability of sufficient money and credit flows to the economy. The year-on-year growth of broad money supply (M_{2b}) and credit to the private sector continued to decelerate during the year, although some recovery was observed towards the end of 2019 supported by the accommodative monetary policy stance of the Central Bank. The deceleration in broad money growth can entirely be attributed to the moderation of net domestic assets (NDA) of the banking sector on account of the slowdown in credit extended to the private sector during the year amidst high market lending rates and subdued economic activity. Meanwhile, credit obtained by the government as well as State Owned Business Enterprises (SOBEs) from the banking system increased during 2019, albeit at a slower pace compared to 2018. With the increased reserve accumulation by the Central Bank as well as LCBs, net foreign assets (NFA) of the banking system returned to positive levels in 2019. Considering the significantly low demand for credit by the private sector and the risk-averse nature of credit supply by banks, the government initiated several measures during 2019 and in early 2020, which are complementary to monetary easing measures of the Central Bank, thereby supporting credit flows to the private sector and the overall economic activity. Accordingly, in support of the recovery of the tourism industry in the aftermath of the Easter Sunday attacks, a debt moratorium was announced for tourism related industries to be effective until 31 March 2020. In addition, a special credit support scheme for small and medium enterprises (SMEs) was introduced in January 2020 with a view to facilitating a broad based recovery in activity along with the support of fiscal incentives announced by the government. Under this scheme, borrowers of the SME sector could request a grace period for repayment of capital payments, while non performing loans (NPLs) could also be considered for availing concessions. The outbreak of the COVID-19 pandemic necessitated further decisive measures to be adopted by the government, the Central Bank and the financial sector, and accordingly, a series of measures was introduced to support the sectors and persons affected by the ongoing disruptions to economic activity.

The Central Bank conducted monetary policy in line with a flexible inflation targeting framework, aimed at stabilising inflation at mid single digit levels over the medium term while supporting economic growth to reach its potential level. Under this framework, monetary policy is formulated in a forward looking manner, backed by data driven analyses with the support of the model based Forecasting and Policy Analysis System (FPAS). The operational target of the current framework, namely, the Average Weighted Call Money Rate (AWCMR), is guided by policy interest rates, consistent with the objective of maintaining inflation within 4-6 per cent. Modelling and forecasting capacity, internal decision making process and external monetary policy communication are continuously being improved in line with the flexible inflation targeting framework. The unprecedented developments arising from the spread of the COVID-19 pandemic could cause the Central Bank to take extraordinary measures to mitigate the effect of the pandemic on the Sri Lankan economy and the financial sector in the short run, but is not envisaged to affect the Central Bank's ability to maintain mid single digit level of inflation in the medium term, thereby supporting sustained economic growth.

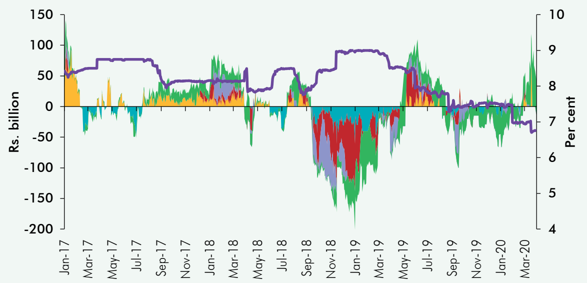
The Central Bank strengthened monetary policy communication further with a view to enhancing transparency and accountability of the decision making process and improving the effectiveness of monetary policy actions. The content of the press release on the Monetary Policy Review was further improved, enhancing clarity and transparency of monetary policy decisions. In addition, the Central Bank began publishing its explicit inflation projections by way of a fan chart covering a 3-year horizon on a quarterly basis commencing January 2020. The publication of medium term inflation projections is expected to firmly anchor inflation expectations, while also helping the public to assess performance of the Central Bank. Meanwhile, the livestreaming of the press conference on the review of the monetary policy stance was commenced in November 2019, thus providing real time access to a wider audience. Further, the Central Bank conducted several awareness programmes on the improvements to the monetary policy framework for targeted audiences. Information on key macroeconomic developments was regularly published through the publications of the Central Bank, including the Annual Report, the Recent Economic Developments Report, while web publications of macroeconomic statistics continued on a daily, weekly, monthly and quarterly bases. Moreover, the Central Bank communicated its policy decisions and expected developments to the public via other modes of communication such as information notes, bulletins and other publications, seminars, meetings, lectures and speeches, which helped enhance the transparency and accountability of the monetary policy process.

7.3 Movements in Interest Rates

Market Liquidity and Short Term Interest Rates

Rupee liquidity in the domestic money market, which was in deficit since September 2018, improved gradually to record surplus levels by mid April 2019, mainly reflecting the impact of monetary policy and operational measures implemented from the last quarter of 2018. Money market liquidity remained in deficit at the beginning of 2019, despite the permanent liquidity injection through the reduction in the SRR applicable on all rupee deposit liabilities of commercial banks by 1.50 percentage points to 6.00 per cent with effect from mid November 2018. The Central Bank continued to conduct overnight, short term and long term reverse repurchase transactions as well as outright purchases of Treasury bills to inject liquidity to the market, thereby easing pressure on overnight interest rates. However, as deficit liquidity conditions persisted, the Central Bank reduced the SRR by a further 1.00 percentage point to 5.00 per cent with effect from 01 March 2019. The SRR reductions in November 2018 and March 2019 added around Rs. 150 billion of liquidity to the domestic money market on a permanent basis. Meanwhile, market liquidity improved further with the purchases of Treasury bills by the Central Bank in the primary market in January 2019 in view of the disruptions to the government borrowing programme due to the political impasse during the fourth quarter of 2018, and the conversions of proceeds from the ISBs by the government. With these injections and the continuous return of currency after the festive season, liquidity conditions in the domestic money market improved to record a surplus by mid April 2019. Further increase in money market liquidity with the foreign currency purchases by the Central Bank from the domestic foreign exchange market required the Central Bank to mop up excess liquidity by carrying out Open Market Operations (OMOs) comprising overnight, short term and long term repurchase transactions during the period from May through July 2019 to maintain the AWCMR around the middle of the policy rate corridor. However, liquidity distribution amongst banks remained uneven at times, compelling the Central Bank to conduct reverse repurchase transactions on overnight and short term bases, in addition to several outright purchases of Treasury bills since mid August 2019, thereby mitigating the impact of asymmetric liquidity distribution, while maintaining the AWCMR around the middle of the policy rate corridor. However, by end August 2019, money market liquidity turned into deficit

Figure 7.6
Rupee Liquidity in the Domestic Money Market and Liquidity Management



Source: Central Bank of Sri Lanka

levels, reflecting the impact of maturing Treasury bill holdings of the Central Bank, early retirement of Treasury bills, maturing of swaps and scheduled foreign loan repayments as well as sales of foreign exchange to prevent disorderly adjustments in the exchange rate. Meanwhile, the Central Bank extended its outright transactions to include Treasury bonds with effect from September 2019, considering the projections of sustained liquidity deficits in the money market. Accordingly, Central Bank purchases of Treasury bonds on an outright basis during 2019 added Rs. 47.7 billion of long term liquidity to the market. Subsequently, money market liquidity turned into surplus levels by mid September 2019, and overnight liquidity surplus stood at Rs. 37.9 billion by end 2019. Further, a Liquidity Support Facility (LSF) for Standalone Primary Dealers for government securities was introduced with effect from 06 September 2019, as access to OMO auctions by standalone primary dealers was restricted in 2018. Meanwhile, to prevent disruptions to economic activity and the possible financial market stress due to the spread of the COVID-19 pandemic, the Central Bank took measures to further enhance liquidity conditions in the market through monetary policy and operational measures in the first quarter of 2020.

The overnight interbank AWCMR, which remained around the upper bound of the policy rate corridor since September 2018 due to deficit liquidity conditions, started to decline gradually from March 2019 and remained around the middle of the policy rate corridor thereafter, as liquidity conditions improved in line with the accommodative monetary policy stance of the Central Bank. Reflecting the deficit liquidity conditions in the domestic money market, the AWCMR remained mostly around the upper bound of the policy rate corridor during the period from September 2018 to February 2019. With the reduction in the SRR effective from March 2019, liquidity conditions improved and the AWCMR adjusted downward towards the middle of the policy rate corridor. Following the reduction in policy interest rates by 50 basis points by end May 2019, the AWCMR also declined and remained mostly below the middle of the policy rate corridor until August 2019. The AWCMR declined further as policy interest rates were reduced further by 50 basis points in August 2019, while OMOs were carried out to maintain the AWCMR around the middle of the policy rate corridor. The AWCMR declined by 150 basis points to 7.45 per cent by end 2019 from 8.95 per cent at end 2018. The weighted average yields

Table 7.2
Selected Money Market Rates

Per cent per annum

	AWCMR		Overnight OMO Auction		SLIBOR Overnight		SLIBOR 12 Month	
	End Period	Average for the Month	Repo	Reverse Repo	End Period	Average for the Month	End Period	Average for the Month
Dec-16	8.42	8.41	7.43	-	8.44	8.43	12.00	12.00
Dec-17	8.15	8.13	7.25	-	8.15	8.15	12.18	12.19
Dec-18	8.95	8.96	-	8.98	9.00	9.00	11.80	11.77
Mar-19	8.51	8.80	-	8.59	8.59	8.88	11.96	11.97
Jun-19	7.86	7.94	7.74	-	7.91	7.97	11.47	11.51
Sep-19	7.45	7.45	7.38	7.45	7.45	7.46	10.58	10.64
Dec-19	7.45	7.51	-	7.50	7.51	7.54	10.33	10.42

Source: Central Bank of Sri Lanka

at daily OMO reverse repurchase auctions also decreased to 7.50 per cent by end 2019 from 8.98 per cent at end 2018, while weighted average yields at daily OMO repurchase auctions also declined in line with policy rate reductions in 2019. Meanwhile, the Sri Lanka Interbank Offered Rates (SLIBOR) also declined during 2019. By end 2019, overnight SLIBOR and 12-month SLIBOR were at 7.51 per cent and 10.33 per cent, respectively, compared to 9.00 per cent and 11.80 per cent at end 2018. To support economic activity further, the Central Bank reduced policy interest rates by another 75 basis points during the first quarter of 2020, and the AWCMR also declined. Meanwhile, the Central Bank decided to discontinue the compilation and publication of SLIBOR with effect from 01 July 2020. This decision was taken in consideration of the lack of usage of SLIBOR in benchmarking loan products in the domestic financial market, the global trend of phasing out the compilation and publication of offered rates including the London Interbank Offered Rate (LIBOR), requests from several LCBs to discontinue the reporting of offered rates in the context of thin interbank market volumes for longer tenures, and the availability of alternative benchmark interest rates in the domestic financial market. The Central Bank will continue to publish SLIBOR based on the offered rates submitted by the LCBs until 30 June 2020, enabling market participants to switch to alternative benchmark interest rates.

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Yields on Government Securities

Reflecting eased monetary conditions, yields on government securities showed a notable decline during 2019, although a marginal uptick in yields on Treasury bills was observed towards the latter part of 2019 due to weakened sentiments amidst the rising funding requirement of the government. Surplus liquidity conditions along with the accommodative monetary policy stance of the Central Bank, availability of foreign financing with the proceeds of ISB issuances in March and June 2019, streamlined Treasury bond primary auction system and well anchored inflation expectations resulted in a notable decline in yields on government securities during 2019 compared to the levels observed at end 2018. The release of liquidity through the reduction of the SRR in November 2018 and March 2019 by the Central Bank prompted most commercial banks to increase investment in government securities, given the sluggish growth of credit to the private sector. The imposition of caps on deposit interest rates offered by financial institutions in April 2019, which resulted in a notable decline in deposit interest rates, would also have contributed to reducing yields on government securities due to the possible shift of savings from financial institutions to government securities. However, some uptick in yields on Treasury bills was observed during late 2019, reflecting the impact of outflows of foreign investment from the government securities market, uncertainty in the direction of fiscal policy and increased funding requirement of the government. In spite of this uptick, primary market yields on 91-day, 182-day and 364-day Treasury bills decreased by 250 basis points, 197 basis points and 275 basis points to 7.51 per cent, 8.02 per cent and 8.45 per cent, respectively, during 2019.

Figure 7.7
Primary Market Treasury Bill Yields (a)

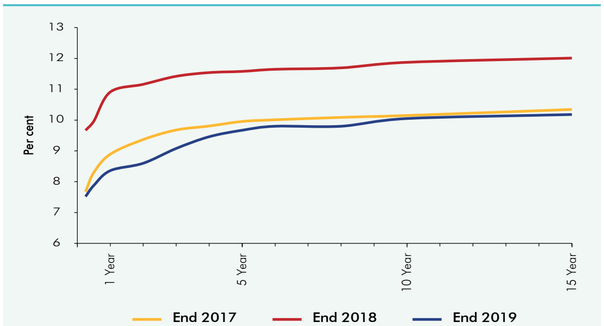
Source: Central Bank of Sri Lanka

(a) Yields for some weeks are not available due to non-acceptance of bids or not offering relevant tenors

Consistent with the overall reduction in market interest rates, yields on Treasury bonds in the primary market declined substantially during 2019, while the government also issued foreign currency denominated debt instruments at competitive yields. The government relied more on short to medium term Treasury bond issuances during the first half of 2019, while Treasury bonds with longer maturities of 10 to 20 years were issued mostly during the second half of 2019. Accordingly, Treasury bond yields on short to medium maturities declined by around 182-223 basis points, while yields on longer maturities recorded a decline of around 131-200 basis points in the primary market during 2019. With these declines, yields on maturities of 10 years, 15 years and 20 years were recorded at 10.23 per cent, 10.59 per cent and 10.68 per cent, respectively, by end 2019. Further, in early 2020, yields on 10-year Treasury bonds fell below 10 per cent, recording the lowest yields on 10-year maturities after 2015. Noticeably, the upward pressure observed in the yields on Treasury bills towards end 2019 was not observed in the primary Treasury bond market. Meanwhile, the government issued foreign currency denominated debt securities, namely, Sri Lanka Development Bonds (SLDBs) and ISBs during the year, which also helped ease the pressure on yields on rupee denominated debt instruments to some extent. The government issued short and medium term US dollar denominated SLDBs at various fixed and floating rates in auctions held in January and May 2019, thereby raising US dollars 179.7 million, and US dollars 165.5 million, respectively. Interest rates of SLDB issuances across all tenures showed mixed movements during 2019. Further, the two ISB issuances in March and June 2019 raised US dollars 2.4 billion and US dollars 2.0 billion, respectively. In March 2019, ISBs of 5-year and 10-year tenures were issued at 6.85 per cent and 7.85 per cent, respectively, which were 441-521 basis points above the corresponding US Treasury yields at the time. ISBs of 5-year and 10-year tenures were issued in June 2019 at 6.35 per cent and 7.55 per cent, respectively, which were 460-553 basis points above the corresponding US Treasury yields at the time of issuance.

Reflecting the overall downward adjustment in primary market yields, the secondary market yield curve for government securities shifted downwards during the year 2019 with a greater downward shift in short to medium term yields. Accordingly, yields on 91-day, 182-day and 364-day Treasury bills in the secondary market decreased by 215 basis points, 208 basis points and 255 basis points, respectively, to 7.52 per cent, 7.88 per cent and 8.36 per cent by end 2019, compared to the yields recorded at end 2018. Treasury bond yields also decreased by around 164 to 256 basis points during 2019. Secondary market yields on 2-year bonds decreased by 256 basis points to 8.60 per cent, while yields on 5-year and 10-year Treasury bonds decreased by 191 basis points and 182 basis points, respectively, to 9.67 per cent and 10.05 per cent by end 2019, in comparison to the yields at end 2018. The downward shift in the yield curve

Figure 7.8
Secondary Market Yield Curve for Government Securities



Source: Central Bank of Sri Lanka

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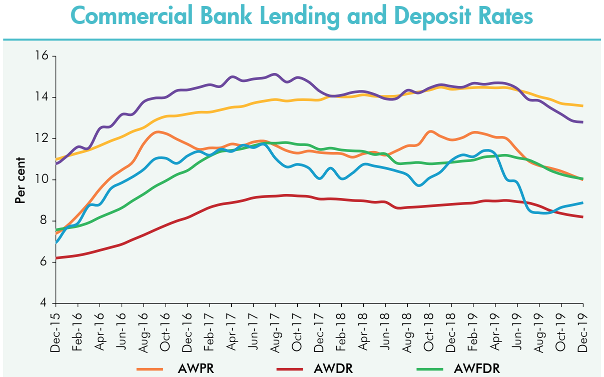
reflected improved market sentiments following the ISB issuances, eased monetary policy and monetary conditions, and also well anchored inflation expectations.

Deposit and Lending Interest Rates

A notable decline in deposit interest rates of LCBs was observed since May 2019, in response to policy and regulatory measures taken by the Central Bank during the year. The reduction in policy interest rates in May and August 2019, improved liquidity conditions and the imposition of maximum interest rate caps on deposit products of banks and non bank financial institutions with effect from 26 April 2019, caused the decline in interest rates on deposits. Accordingly, the Average Weighted Deposit Rate (AWDR), which captures the movements in interest rates of the outstanding stock of interest bearing rupee deposits held with LCBs, declined by 77 basis points to 8.20 per cent by end 2019 from 8.97 per cent at end April 2019. Further, the Average Weighted Fixed Deposit Rate (AWFDR), which is based on interest rates of outstanding time deposits held with LCBs, also decreased by 110 basis points to 10.05 per cent by end 2019 from 11.15 per cent at end April 2019. At end 2018, AWDR and AWFDR were 8.81 per cent and 10.85 per cent, respectively. Meanwhile, the

Figure 7.9
Commercial Bank Lending and Deposit Rates

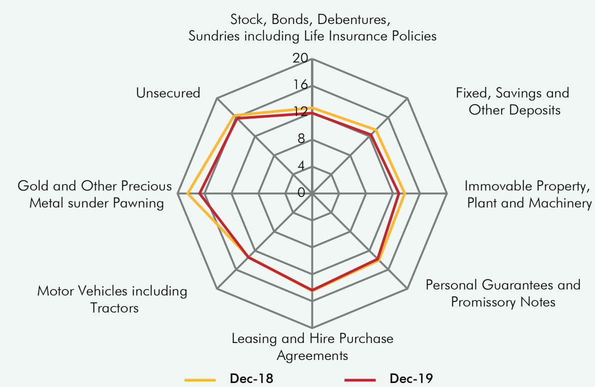


Source: Central Bank of Sri Lanka

Average Weighted New Deposit Rate (AWNDR), which captures the rates on all newly mobilised interest bearing rupee deposits during a month, declined by 284 basis points to 8.40 per cent by August 2019 from 11.24 per cent at end April 2019. However, with the removal of deposit rate caps for licensed banks with effect from 24 September 2019, the AWNDR increased by 49 basis points during the period from September to end 2019. In spite of the reduced deposit interest rates, depositors benefitted from positive real returns during 2019, as inflation remained low relative to deposit rates.

Lending rates of commercial banks, which remained downward rigid despite the accommodative monetary policy measures of the Central Bank, declined notably with the imposition of caps on lending interest rates in September 2019. In spite of the adoption of an accommodative monetary policy stance and reduced cost of funds, particularly due to the imposition of deposit rate caps and the reduction in the SRR, market lending rates remained at elevated levels during the first nine months of the year. Accordingly, the Central Bank imposed ceilings on lending rates with effect from 24 September 2019 with the aim of enhancing the efficiency of the transmission of monetary policy measures to market interest rates. Specifically, the order issued by the Central Bank to licensed banks required a reduction of lending rates of rupee denominated loans and advances by 200 basis points by 15 October 2019 from the rates that prevailed at end April 2019. Further, LCBs were ordered to reduce their weekly average weighted prime lending rates by 150 basis points by 01 November 2019 and 250 basis points by 27 December 2019 from the levels reported as at 26 April 2019. In addition, the interest rates on credit card advances and pre-arranged temporary

Figure 7.10
Average Weighted Lending Rates by Type of Security (%)



Source: Central Bank of Sri Lanka

overdrafts were also capped at a maximum of 28 per cent per annum and 24 per cent per annum, respectively, with effect from 01 November 2019. In response to these monetary and regulatory measures, the weekly Average Weighted Prime Lending Rate (AWPR), which is based on interest rates applicable on short term loans and advances granted by all LCBs to their prime customers during a week, declined by 235 basis points to 9.74 per cent by end 2019 from 12.09 per cent recorded at end 2018. Moreover, the monthly AWPR, which is the simple average of weekly AWPR, declined by 194 basis points to 10.00 per cent by end 2019 from 11.94 per cent at end 2018. The Average Weighted New Lending Rate (AWNLR), which captures rates on all new loans and advances extended by commercial banks during a particular month, also declined by 174 basis points from end 2018 to 12.80 per cent by end 2019. The Average Weighted Lending Rate (AWLR), which is based on interest rates of all outstanding loans and advances extended by LCBs, declined by 81 basis points to 13.59 per cent during 2019. Meanwhile, bankwise average weighted lending rates were in the range of 9.41-16.66 per cent at end 2019 compared to the range of 10.96-17.25 per cent recorded at end 2018. Further, lending rates against all types of securities, except the category of motor vehicles including tractors, marked a reduction by end 2019 compared to the levels recorded at end 2018. However, the degree of adjustment of lending rates during the year has been less than envisaged.

The Legal Rate and the Market Rate of interest,[1] as determined by the Monetary Board and published in the Government Gazette at the end of each year, were 11.64 per cent per annum for 2020, compared to 11.50 per cent per annum for 2019. The Legal Rate and the Market Rate for 2020 were computed based on simple averages of monthly AWDR and AWLR of commercial banks, which prevailed during the preceding twelve months ending October 2019.

Interest Rates on Corporate Debt Instruments

Interest rates applicable on corporate debt instruments, which remained high during early 2019, declined gradually by end 2019. Interest rates on commercial paper, which is a short term debt instrument, ranged between 13.00-16.25 per cent during 2019 compared to a range of 13.10-15.00 per cent in 2018. Meanwhile, 30 new listings of debentures were reported by 14 corporates during 2019 with multiple maturities from 4 to 10 years, in comparison to 21 new listings reported in 2018. Most debentures were issued under fixed interest rates, which ranged between 12.30-15.50 per cent in 2019 compared to the range of 12.00-14.75 per cent in 2018. Floating rates were in the range of 12.93-13.60 per cent in 2019. Interest rates on corporate debt instruments declined during the latter part of the year in line with the decline in market interest rates.

1 The Legal Rate is defined under the Civil Procedure Code (Amendment) Act No. 6 of 1990 and is applicable to any legal action for the recovery of a sum of money. The Market Rate is defined under the Debt Recovery (Special Provisions) Act No. 2 of 1990 and is applicable only in relation to legal actions instituted by lending institutions for the recovery of debt exceeding Rs. 150,000 arising out of commercial transactions, where there is no agreed rate of interest.

Table 7.3
Movements of Interest Rates

Per cent per annum

Interest Rate	End 2018	End 2019
Policy Interest Rates		
Standing Deposit Facility Rate (SDFR)	8.00	7.00
Standing Lending Facility Rate (SLFR)	9.00	8.00
Average Weighted Call Money Rate (AWCMR)	8.95	7.45
Yield Rates on Government Securities		
Primary Market (a)		
Treasury bills		
91-day	10.01	7.51
182-day	9.99	8.02
364-day	11.20	8.45
Treasury bonds		
2-year	-	9.79
3-year	11.88	9.65
4-year	-	-
5-year	11.69	9.87
10-year	10.20	10.23
Secondary Market		
Treasury bills		
91-day	9.67	7.52
182-day	9.96	7.88
364-day	10.91	8.36
Treasury bonds		
2-year	11.16	8.60
3-year	11.42	9.08
4-year	11.54	9.46
5-year	11.58	9.67
10-year	11.87	10.05
Licensed Commercial Banks (b)		
Interest Rates on Deposits		
Savings deposits	0.50-8.50	0.20-7.50
1 Year Fixed Deposits (c)	4.53-15.00	3.55-15.00
Average Weighted Deposit Rate (AWDR) (d)	8.81	8.20
Average Weighted Fixed Deposit Rate (AWFDR) (d)	10.85	10.05
Average Weighted New Deposit Rate (AWNDR) (d)	10.94	8.89
Average Weighted New Fixed Deposit Rate (AWNFDR) (d)	11.27	9.17
Interest Rates on Lending		
Average Weighted Prime Lending Rate (AWPR)	11.94	10.00
Average Weighted Lending Rate (AWLR)	14.40	13.59
Average Weighted New Lending Rate (AWNLR)	14.54(e)	12.80
Other Financial Institutions (f)		
Interest Rates on Deposits		
National Savings Bank		
Savings Deposits	4.00	4.00
1 Year Fixed Deposits	10.50	9.83
Licensed Finance Companies (g)		
Savings Deposits	5.21-7.77	5.14-7.10
1 Year Fixed Deposits	11.63-13.21	10.96-11.97
Interest Rates on Lending		
National Savings Bank	6.75-16.25	12.00-14.50
State Mortgage and Investment Bank (h)	10.50-20.00	10.25-18.00
Licensed Finance Companies (g)		
Finance Leasing	16.17-28.80(e)	16.48-27.84
Hire Purchase	15.16-18.65	13.40-24.82
Loans against Real Estate	18.94-19.21(e)	15.53-16.71
Corporate Debt Market		
Debentures	12.00-14.75	12.30-15.50
Commercial Paper	13.10-15.00	13.00-16.25

Sources: Respective Financial Institutions
Colombo Stock Exchange
Central Bank of Sri Lanka

(a) Weighted average yield rates at the latest available auction.
(b) Based on the rates quoted by commercial banks.
(c) Maximum rate is a special rate offered by certain commercial banks.
(d) Since July 2018, AWDR and AWFDR were calculated by replacing Senior Citizens' special deposit rate of 15 per cent with relevant market interest rates to exclude the impact of special rates which are subsidised by the government. Same method was applied to calculate AWNDR and AWNFDR since June 2018.
(e) Revised.
(f) Based on the rates quoted by other selected Financial Institutions
(g) Interest rate ranges are based on the average maximum and average minimum rates quoted by LFCs which are applicable for deposits mobilised and loans granted during the respective months. Data for 2019 are provisional.
(h) Lending for housing purposes only.

Interest Rates on Foreign Currency Deposits

Despite the decline in global interest rates, interest rates applicable on foreign currency deposits maintained with commercial banks remained broadly unchanged during 2019, due to increased opportunities for domestic investment in foreign currency. The US Federal Reserve reduced its federal funds target rate three times during the year by a total of 75 basis points to 1.50-1.75 per cent by end 2019, compared to the tightening bias observed in 2018. However, the Bank of England, which increased its policy rate in early August 2018, kept the rate unchanged in 2019. Meanwhile, the European Central Bank announced a monetary stimulus package by re-commencing asset purchases in November 2019. However, the decline observed in interest rates applicable on foreign currency deposits of licensed banks domestically was not commensurate to the reduction observed in interest rates globally, due to increased opportunities for domestic investment in foreign currency, including greater demand for foreign currency from the government. Accordingly, interest rates pertaining to US dollar denominated domestic time deposits marginally declined to a range of 0.20 – 5.50 per cent by end 2019 from the range of 0.25-6.00 per cent at end 2018, while interest rates on the US dollar denominated savings deposits ranged between 0.02-4.50 per cent by end 2019 compared to the range of 0.02 – 4.12 per cent at end 2018. Interest rates applicable on the pound sterling denominated time deposits remained broadly unchanged in a range of 0.10-3.52 per cent by end 2019 compared to the range of 0.10-3.50 per cent at end 2018. Interest rates on savings deposits denominated in pound sterling also remained broadly unchanged in the range of 0.10 – 2.46 per cent by end 2019.

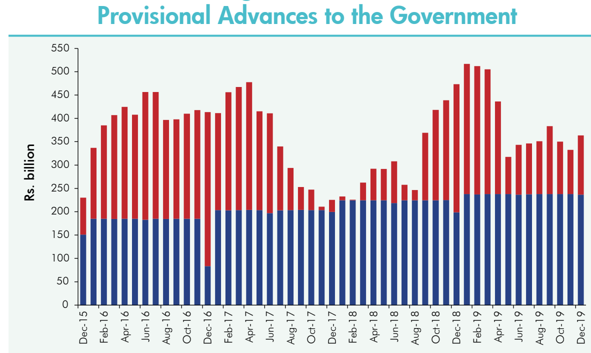
7.4 Movements in Monetary and Credit Aggregates

Reserve Money

Reserve money, which is the monetary base of the economy, recorded a contraction during 2019, reflecting the impact of the reduction in the SRR by 1.00 percentage point in March 2019. Accordingly, reserve money contracted by 3.0 per cent, year-on-year, at end 2019 compared to the growth of 2.3 per cent recorded at end 2018. In absolute terms, reserve money contracted by Rs. 28.5 billion to Rs. 932.6 billion during 2019, compared to an expansion of Rs. 21.3 billion in the previous year. With the reduction in the SRR in March 2019, commercial banks' deposits with the Central Bank decreased by Rs. 65.5 billion to Rs. 254.6 billion by end 2019, recording a negative growth of 20.5 per cent, year-on-year, and causing the contraction in reserve money. Currency in circulation, which is the largest component of reserve money, recorded a lower annual increase of Rs. 37.0 billion to Rs. 678.0 billion by end 2019, compared to the increase of Rs. 42.9 billion in 2018. Currency in circulation during the first half of the year slowed down primarily due to the opportunity cost of holding currency due to high market interest rates, particularly during the first four months of the year and subdued economic activity, impacted further by the Easter Sunday attacks. The decline in market deposit rates in response to monetary and regulatory measures and the gradual recovery of economic activity from the impact of the Easter Sunday attacks led to an increase in currency in circulation thereafter. Accordingly, currency in circulation recorded a moderate growth of 5.8 per cent by end 2019 on a year-on-year basis, in comparison to a growth of 7.2 per cent in 2018.

Viewed from the assets side, the negative growth of reserve money during 2019 can be attributed to the notable contraction in NDA of the Central Bank, which outweighed the expansion in NFA of the Central Bank. The contraction in NDA of the Central Bank, was mainly on account of the decline in net credit to the government (NCG). NDA of the Central Bank contracted by Rs. 173.9 billion to Rs. 36.6 billion by end 2019 in comparison to an increase of Rs. 116.9 billion during 2018. NCG by the Central Bank declined due to the reduction of government securities holdings of the Central Bank (net of repurchase transactions), which were mainly acquired during late 2018 under reverse repurchase agreements when injecting liquidity to the domestic money market. The decision by the Monetary Board not to subscribe to primary issuances of Treasury bills, except under exceptional circumstances, also contributed to the decline in NCG. Accordingly, holdings of government securities by the Central Bank (net of repurchase transactions) decreased by Rs. 147.6 billion to Rs. 126.9 billion by end 2019. However, provisional advances to the government increased by Rs. 38.0 billion to Rs. 236.6 billion by end 2019 with the utilisation of the due amount for 2019 by the government at the beginning of the year. Overall, NCG by the Central Bank declined by Rs. 109.8 billion during 2019. In contrast, NFA of the Central Bank increased by Rs. 145.5 billion during 2019, compared to the decline of Rs. 95.6 billion in 2018. The expansion in NFA was mainly due to

Figure 7.11
Central Bank Holdings of Government Securities and Provisional Advances to the Government



Source: Central Bank of Sri Lanka

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the increase in foreign assets of the Central Bank due to the sale of ISB proceeds by the government to the Central Bank and purchases of foreign exchange from the domestic foreign exchange market by the Central Bank and increased fixed income securities investments by the Central Bank, while a contraction was recorded in foreign liabilities of the Central Bank. This contraction in foreign liabilities of the Central Bank mainly during the last quarter of 2019 was due to the utilisation of foreign funds in the Deputy Secretary to the Treasury (DST) Accounts (which is considered as a foreign liability for statistical purposes) by the government and the decline in foreign currency payables of the Central Bank during the year.

The money multiplier, which is the ratio between the broad money supply (M_{2b}) and reserve money, increased notably in 2019, reflecting the effect of the reduction in the SRR during the year. The M_{2b} money multiplier increased to 8.18 by end 2019 compared to 7.42 recorded at end 2018, while on average, it stood at 8.03 in 2019 compared to an average of 6.92 recorded in 2018. Contributing to the rise in money multiplier, the currency to deposits ratio declined to 6.9 per cent by end 2019 from 7.1 per cent recorded at end 2018, mainly due to the prevalence of relatively high market deposit rates particularly in early 2019, despite the increase in the currency to deposit ratio towards the latter part of 2019 with the policy induced reduction in deposit rates during this period.

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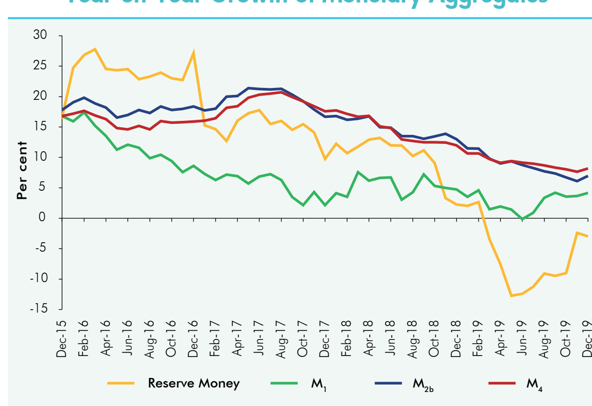
Narrow Money (M_1)

Narrow money (M_1), which comprises currency and demand deposits held by the public, grew moderately amidst subdued economic activity, and recorded a growth of 4.2 per cent, year-on-year, by end 2019, compared to the growth of 4.7 per cent at end 2018. Accordingly, narrow money increased by Rs. 34.7 billion during 2019, as a result of the increase in both currency and demand deposits held by the public. Currency held by the public recorded a moderate growth of 4.5 per cent, year-on-year, by end 2019, compared to 7.7 per cent at end 2018. In absolute terms, currency held by the public increased by Rs. 21.1 billion in 2019, compared to an increase of Rs. 33.7 billion during 2018. Meanwhile, demand deposits held by the public with commercial banks recorded a growth of 3.8 per cent, year-on-year, by end 2019, compared to the growth of 1.1 per cent at end 2018, reflecting the impact of lower deposit rates offered by LCBs, which in turn reduced the opportunity cost of maintaining demand deposits. In absolute terms, demand deposits held by the public with commercial banks increased by Rs. 13.5 billion during 2019, compared to an increase of Rs. 3.8 billion in 2018.

Broad Money (M_{2b}) and Domestic Credit

Broad money growth (M_{2b}) continued to decelerate during 2019, owing to the moderation in the growth of NDA of the banking system. Accordingly, the year-on-year growth of M_{2b} decelerated to 7.0 per cent by end December 2019

Figure 7.12
Year-on-Year Growth of Monetary Aggregates



Source: Central Bank of Sri Lanka

compared to the growth of 13.0 per cent at end 2018. The slowdown in the growth of broad money was largely due to the moderation in the growth of NDA of the banking system led by the notable deceleration in the growth of credit extended to the private sector, notwithstanding the expansion in NFA of the banking sector during the period under review. The recovery in the growth of credit extended to the private sector towards the end of 2019 supported an acceleration in broad money growth in December 2019.

Viewing from the liabilities side of broad money, the deceleration in the year-on-year growth of time and savings deposits held by the public with LCBs largely contributed to the slowdown in monetary expansion. Accordingly, the year-on-year growth of time and savings deposits decelerated significantly to 7.3 per cent by end 2019 compared to the growth of 14.2 per cent recorded at end 2018. In absolute terms, time and savings deposits of LCBs increased by Rs. 461.2 billion in 2019 compared to the increase of Rs. 782.7 billion recorded in 2018. The increase in time and savings deposits accounted for about 93 per cent of the year-on-year expansion in broad money in 2019, marginally below 95 per cent recorded in the previous year, while the remainder was due to the expansion in currency and demand deposits.

NFA of the banking system recorded an increase in 2019, reflecting the rise in NFA of both the Central Bank and LCBs, thereby positively contributing to the broad money expansion. NFA of the banking system, which remained negative during October 2018 through February 2019, turned to positive levels thereafter and recorded a cumulative increase of Rs. 195.3 billion in 2019, in comparison to a contraction of

Table 7.4
Developments in Monetary Aggregates

Rs. billion

Item	End 2018	End 2019 (a)	Change 2018 Amount	Change 2018 %	Change 2019 Amount	Change 2019 %
1. Currency Outstanding	640.9	678.0	42.9	7.2	37.0	5.8
1.1 Currency held by the Public	473.1	494.2	33.7	7.7	21.1	4.5
1.2 Currency with Commercial Banks	167.9	183.8	9.2	5.8	15.9	9.5
2. Commercial Banks' Deposits with the Central Bank (b)	320.1	254.6	(21.6)	(6.3)	(65.5)	(20.5)
3. Government Agencies' Deposits with the Central Bank (c)	...	0.1				
4. Reserve Money (1+2+3)	**961.1**	**932.6**	**21.3**	**2.3**	**(28.5)**	**(3.0)**
5. Demand Deposits held by the Public with Commercial Banks	357.7	371.3	3.8	1.1	13.5	3.8
6. Narrow Money Supply, M_1 (1.1+5)	**830.8**	**865.5**	**37.5**	**4.7**	**34.7**	**4.2**
7. Time and Savings Deposits held by the Public with Commercial Banks	5,596.5	6,047.2	724.5	14.9	450.7	8.1
8. Broad Money Supply, M_2 (6+7)	**6,427.3**	**6,912.7**	**762.0**	**13.5**	**485.4**	**7.6**
9. Adjusted Foreign Currency Deposits (d)	701.0	711.4	58.2	9.1	10.4	1.5
10. Consolidated Broad Money Supply, M_{2b} (8+9)	**7,128.3**	**7,624.1**	**820.2**	**13.0**	**495.8**	**7.0**
Money Multiplier, M_{2b}	**7.42**	**8.18**				
Velocity, M_{2b} (e)(f)	**2.12**	**2.04**				

(a) Provisional
(b) Includes both Commercial Banks' Deposits with the Central Bank and balances of Primary Dealers with the Central Bank
(c) Government Agencies' Deposits with the Central Bank amounted to Rs. 47.6 million at end 2018 and Rs. 55.7 million at end 2019
(d) Includes deposits of Resident Category of Offshore Banking Units (OBUs) and a share of foreign currency deposits with Domestic Banking Units (DBUs)
(e) Average for the year
(f) Revised

Source: Central Bank of Sri Lanka

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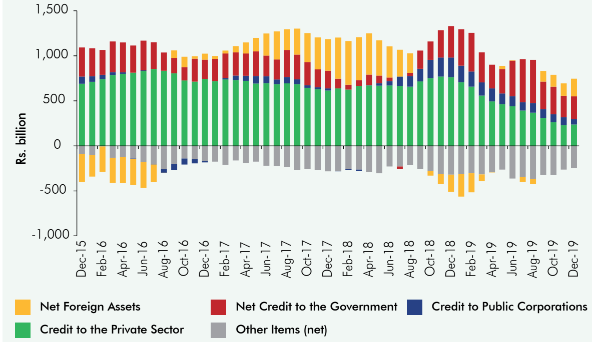
Rs. 188.5 billion in 2018. NFA of the Central Bank recorded an increase of Rs. 145.5 billion during 2019, following a contraction of Rs. 95.6 billion in 2018, on account of the combined impact of the increase in foreign assets and the decline in foreign liabilities of the Central Bank during the period under review. NFA of commercial banks also increased by Rs. 49.8 billion in 2019, compared to a decline of Rs. 92.9 billion in 2018, due to the expansion in NFA of Offshore Banking Units (OBUs) of LCBs, while NFA of Domestic Banking Units (DBUs) recorded a contraction during the year. NFA of OBUs increased by Rs. 77.7 billion in 2019 following a contraction of Rs. 41.9 billion in 2018, due to the increase in placements with banks abroad and lending to non residents along with the contraction in foreign liabilities, particularly in terms of lower borrowings from banks abroad and deposits from non residents. In contrast, NFA of DBUs declined by Rs. 27.9 billion during 2019, continuing the trend observed in the previous year. This was mainly due to the contraction in foreign

Figure 7.13
Contribution to Year-on-Year Change in Broad Money - M_{2b} (Assets Side)



Source: Central Bank of Sri Lanka

assets in the form of placements with banks abroad and an increase in foreign currency liabilities by way of borrowings from abroad and deposit liabilities of non residents.

NDA of the banking system expanded at a slower pace during the year, due to the slowdown in credit extended to both private and public sectors. In absolute terms, NDA of the banking system increased by Rs. 300.6 billion

Table 7.5
Assets Side of Reserve Money and Broad Money (M_{2b})

Rs. billion

Item	End 2018	End 2019 (a)	Change 2018 Amount	Change 2018 %	Change 2019 Amount	Change 2019 %
Reserve Money	**961.1**	**932.6**	**21.3**	**2.3**	**-28.5**	**-3.0**
Net Foreign Assets of the Central Bank	750.5	896.0	-95.6	-11.3	145.5	19.4
Net Domestic Assets of the Central Bank	210.6	36.6	116.9	124.8	-173.9	-82.6
Broad Money (M_{2b})	**7,128.3**	**7,624.1**	**820.2**	**13.0**	**495.8**	**7.0**
Net Foreign Assets	-67.0	128.3	-188.5	-155.1	195.3	291.4
Monetary Authorities (b)	750.5	896.0	-95.6	-11.3	145.5	19.4
Commercial Banks	-817.5	-767.7	-92.9	-12.8	49.8	6.1
Net Domestic Assets	7,195.3	7,495.9	1,008.8	16.3	300.6	4.2
Domestic Credit (c)	8,833.4	9,383.2	1,328.7	17.7	549.7	6.2
Net Credit to the Government (c)	2,516.7	2,767.1	348.2	16.1	250.4	9.9
Central Bank (c)	472.8	363.0	247.7	110.1	-109.8	-23.2
Commercial Banks	2,043.9	2,404.1	100.5	5.2	360.2	17.6
Credit to Public Corporations	755.4	818.0	218.4	40.7	62.6	8.3
Credit to the Private Sector	5,561.4	5,798.1	762.1	15.9	236.8	4.3
Other Items (net) (c)(d)	-1,638.1	-1,887.3	-319.9	-24.3	-249.2	-15.2

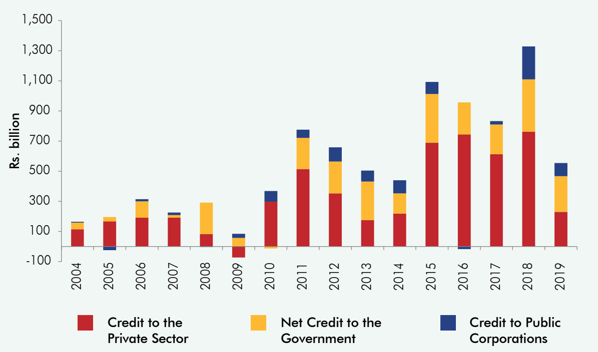
Source: Central Bank of Sri Lanka

(a) Provisional
(b) This includes NFA of the Central Bank as well as the government's Crown Agent's balance reported by the Department of State Accounts
(c) Revised
(d) Computed as the difference between other assets and other liabilities

in 2019 compared to a notable expansion of Rs. 1,008.8 billion in 2018. The moderation in NDA during the year was largely driven by the slowdown observed in the growth of credit extended to the private sector by commercial banks, while the growth of credit obtained by public sector, consisting of the government and SOBEs, also moderated compared to 2018.

NCG by the banking system continued to increase in 2019, albeit at a slower pace compared to 2018. On account of the increase in NCG by commercial banks, NCG by the banking system increased by Rs. 250.4 billion in 2019 compared to an increase of Rs. 348.2 billion in 2018. Accordingly, NCG by LCBs increased by Rs. 360.2 billion in 2019 compared to the increase of Rs. 100.5 billion in 2018. NCG by DBUs increased notably by Rs. 335.2 billion in 2019 following an increase of Rs. 66.6 billion in 2018 with the increase in investments in government securities, including Treasury bills, Treasury bonds and SLDBs, despite the decline in government overdraft balances with commercial banks during the year. The increase in investments in government securities by LCBs during the year is partly attributed to the improved liquidity levels of LCBs with the reduction in the SRR amidst subdued demand for credit by the private sector during the period under review. NCG by OBUs recorded an increase of Rs. 24.9 billion compared to an increase of Rs. 33.9 billion recorded in the previous year, on account of an increase in direct loans to the government, while investments in SLDBs by OBUs recorded a notable contraction during the year as SLDBs were not issued on a regular basis due to the availability of funds from ISBs in 2019. Meanwhile, NCG from the Central Bank contracted by Rs. 109.8 billion in 2019, in contrast to a notable expansion of Rs. 247.7 billion recorded in 2018, due to the decline in Treasury bill holdings (net of

Figure 7.14
Annual Increase in Domestic Credit



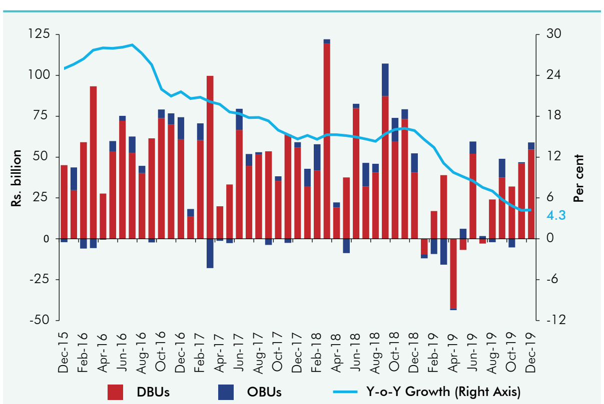
Source: Central Bank of Sri Lanka

repurchase transactions) of the Central Bank. This was mainly due to the decline in reverse repurchase transactions of the Central Bank with improved liquidity in the money market compared to end 2018, and the decision by the Monetary Board not to subscribe to primary issuances of Treasury bills, except under exceptional circumstances.

Credit extended to SOBEs by the banking system, which recorded a cumulative contraction during the first eight months of 2019, expanded thereafter reflecting increased borrowing by several key SOBEs. Accordingly, during the first eight months of 2019, credit obtained by SOBEs from the banking system declined by Rs. 8.5 billion, largely due to repayments made by the Ceylon Petroleum Corporation (CPC) during the first seven months of 2019, following a notable expansion of credit to SOBEs by Rs. 218.4 billion in 2018. However, borrowings of SOBEs in 2019 recorded an increase of Rs. 62.6 billion, partly reflecting the deteriorated financial position of most SOBEs towards the end of 2019. Credit obtained by the Road Development Authority (RDA) increased by Rs. 27.9 billion, while borrowings by the Ceylon Electricity Board (CEB) increased by Rs. 21.0 billion in 2019. Further, borrowings by CPC, which recorded a net repayment of Rs. 52.5 billion during the first seven months of 2019, increased thereafter recording an increase of Rs. 14.4 billion by end 2019, reflecting weakened financial performance. In addition, bank borrowings of the National Water Supply & Drainage Board (NWS&DB) and the State Pharmaceuticals Corporation (SPC) increased by Rs. 8.5 billion and Rs. 1.8 billion, respectively, during the year. Meanwhile, the Cooperative Wholesale Establishment (CWE), the Sri Lanka Ports Authority (SLPA) and the Ceylon Fertilizer Corporation repaid their liabilities to LCBs, by a total of Rs. 5.7 billion during the year.

The growth of credit to the private sector by commercial banks decelerated sharply in 2019, in contrast to the higher than projected expansion in the past few years, although some recovery in credit disbursements was observed towards the end of 2019 supported by the monetary policy easing measures. Accordingly, the year-on-year growth of credit extended to the private sector decelerated to 4.3 per cent by end 2019, recording the lowest annual growth since 2009, and significantly below the growth of 15.9 per cent recorded at end 2018. In absolute terms, credit to the private sector expanded only by Rs. 236.8 billion in 2019, which was remarkably low in comparison to the expansion of Rs. 762.1 billion recorded in 2018. The rapid slowdown in credit extended to the private sector, particularly in the first half of the year, was largely due to the relatively high market lending rates, settlement of arrears owed to private contractors by the government on account of various projects, which enabled repayments to the banking sector, and low demand for credit amidst uncertainty following the Easter Sunday attacks and weak business confidence as well as subdued economic activity. Meanwhile, due to the increase in non performing loan (NPL) volumes amidst the adverse business environment, banks followed a risk averse approach, which constrained credit disbursements to the private sector from the supply side. However, credit flows to the private sector displayed some recovery towards the end of 2019 in terms of absolute disbursements, supported by accommodative monetary policy measures of the Central Bank and the regulatory measures adopted to expedite the transmission of monetary easing measures into market lending rates. Accordingly, monthly credit disbursement by LCBs continued to expand from August 2019 onwards, and the increase in credit during the last five months of the year accounted for about 86 per cent of the annual expansion in credit to the private sector. As per the security wise analysis of advances, credit against Gold and Other Precious Metals under Pawning; Immovable Property; and Other Securities increased during the year, while credit against Personal Guarantees and Promissory Notes; and Fixed, Savings and Other Deposits recorded a contraction. Although it was expected that the year-on-year growth of private sector credit would pick up to around 12-13 per cent by end 2020, disruptions to economic activity due to the spread of the COVID-19 outbreak and measures to contain its further spread, are likely to result in a subdued demand for credit in 2020 as well. However, the envisaged decline in market lending rates supported by the current accommodative monetary policy stance, the expected expansion in economic activity supported by fiscal stimulus,

Figure 7.15
Credit to the Private Sector by Commercial Banks



Source: Central Bank of Sri Lanka

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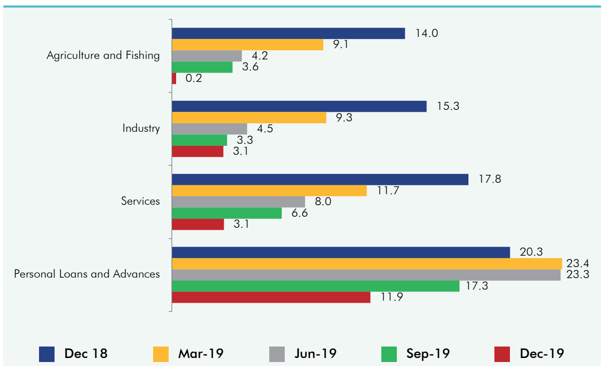
the announced debt moratorium and special credit support scheme for SMEs and other affected sectors are likely to help support an expansion in credit once COVID-19 related disruptions subside.

As per the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector, growth of credit to all major economic sectors continued to decelerate during 2019. Accordingly, reflecting the subdued activity in the agriculture sector, particularly in the second half of 2019, growth of credit to the Agriculture and Fishing sector decelerated substantially to 0.2 per cent, year-on-year, by end 2019, in comparison to the growth of 14.0 per cent at end 2018. Within this sector, credit flows to Tea; Vegetable and Fruit Cultivation and Minor Food Crops; and Rubber subsectors recorded a substantial decline by end 2019 compared to end 2018, reflecting mainly the impact of unfavourable weather conditions during the year. Nevertheless, credit granted to some agriculture sectors such as Paddy; Coconut; Livestock and Dairy Farming; and Fisheries subsectors recorded moderate expansions by end 2019 compared to end 2018. Meanwhile, growth of credit to the Industry sector decelerated to 3.1 per cent, year-on-year, by end 2019, from 15.3 per cent at end 2018. Within the Industry sector, credit

Figure 7.16
Year-on-Year Growth of Private Sector Credit to Key Sectors (%)



Source: Central Bank of Sri Lanka

Table 7.6
Classification of Outstanding Credit to the Private Sector Granted by Commercial Banks (a)(b)(c)

Rs. billion

Sector		End 2018	End 2019 (d)	% Share 2019	% Change 2019
Agriculture and Fishing		**470.0**	**471.1**	**7.8**	**0.2**
of which,	Tea	100.0	95.8	1.6	-4.2
	Rubber	34.4	25.9	0.4	-24.7
	Coconut	24.5	24.7	0.4	0.8
	Paddy	35.7	38.0	0.6	6.4
	Vegetable and Fruit Cultivation and Minor Food Crops	37.9	30.8	0.5	-18.6
	Fisheries	20.1	21.5	0.4	7.0
Industry		**2,354.4**	**2,427.0**	**40.4**	**3.1**
of which,	Construction	1,133.8	1,197.6	19.9	5.6
	Food and Beverages	124.6	130.8	2.2	4.9
	Textiles and Apparel	201.6	214.6	3.6	6.5
	Fabricated Metal Products, Machinery and Transport Equipment	202.7	192.3	3.2	-5.1
Services		**1,641.4**	**1,692.8**	**28.2**	**3.1**
of which,	Wholesale and Retail Trade	486.7	502.4	8.4	3.2
	Tourism	198.3	235.1	3.9	18.5
	Financial and Business Services	396.3	370.6	6.2	-6.5
	Shipping, Aviation and Freight Forwarding	25.4	27.2	0.5	7.2
Personal Loans and Advances (e)		**1,267.4**	**1,418.5**	**23.6**	**11.9**
of which,	Consumer Durables	228.4	239.1	4.0	4.7
	Pawning	171.7	211.0	3.5	22.8
	Credit Cards	106.6	131.0	2.2	22.9
Total		**5,733.1**	**6,009.4**	**100.0**	**4.8**

(a) Based on the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector

Source: Central Bank of Sri Lanka

(b) Includes loans, overdrafts and bills discounted and excludes cash items in the process of collection
(c) Total values in this Table differ from credit to the private sector values in Table 7.5 due to differences in the compilation methodologies
(d) Provisional
(e) Excludes personal housing loans, which have been included under 'Construction' classified under 'Industry' and includes Safety Net Scheme related loans.

to the Construction subsector, which accounted for around 49 per cent of the total credit flows to the Industry sector, recorded a moderate growth of 5.6 per cent, year-on-year, by end 2019, compared to the growth of 14.1 per cent at end 2018. Credit to other subsectors, namely Textiles and Apparel, and Food and Beverages also recorded moderate year-on-year growth rates of 6.5 per cent and 4.9 per cent, respectively, by end 2019, compared to the higher growth rates of 15.4 per cent and 18.6 per cent, respectively, at end 2018. Contributing to the slowdown in credit flows to the Industry sector, credit to Fabricated Metal Products, Machinery and Transport Equipment; Chemical, Petroleum,

Table 7.7
Maturity Analysis of Outstanding Credit to the Private Sector by Commercial Banks (a)(b)

Sector	Maturity	December 2018 (c)		December 2019 (d)	
		% Share	% Growth	% Share	% Growth
Agriculture and Fishing	Short Term	5.1	6.4	4.8	-1.2
	Medium Term	1.9	28.3	1.9	3.5
	Long Term	1.2	30.7	1.1	1.3
Industry	Short Term	14.2	18.5	13.5	-0.2
	Medium Term	9.4	8.1	9.0	1.2
	Long Term	17.5	17.0	17.9	6.8
Services	Short Term	11.0	17.5	10.5	-0.6
	Medium Term	9.5	11.0	9.2	1.9
	Long Term	8.1	27.3	8.5	9.8
Personal Loans and Advances	Short Term	9.3	23.5	10.2	14.5
	Medium Term	5.0	7.7	5.3	10.5
	Long Term	7.8	26.0	8.1	9.7
Total	Short Term	39.7	17.6	39.0	3.0
	Medium Term	25.8	10.4	25.5	3.4
	Long Term	34.5	21.7	35.6	8.0

(a) Based on the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector
(b) Classification of credit is based on original maturity and is as follows: up to one year - short term; between one to five years - medium term; over five years - long term
(c) Revised
(d) Provisional

Source: Central Bank of Sri Lanka

Pharmaceutical and Healthcare; and Rubber and Plastic Products subsectors recorded contractions by end 2019, reflecting subdued export and domestic demand. Meanwhile, growth of credit to the Services sector also decelerated to 3.1 per cent, year-on-year, by end 2019, compared to the growth of 17.8 per cent at end 2018. Slowdown in overall economic activity following the Easter Sunday attacks affected the Services sector activities significantly. Contributing to the slowdown in credit to the Services sector, growth of credit to the Financial and Business Services subsector declined by 6.5 per cent, year-on-year, by end 2019, compared to the high growth of 29.3 per cent at end 2018, amidst policy measures to curtail the importation of personal motor vehicles during 2019. Nevertheless, reflecting increased credit flows to the tourism sector in view of the debt moratorium granted to tourism related industries and other measures to boost the industry after the Easter Sunday attacks, credit to the Tourism subsector expanded notably and recorded a year-on-year growth of 18.5 per cent by end 2019, compared to the growth of 15.3 per cent at end 2018. Further, credit to Wholesale and Retail Trade and Shipping, Aviation and Freight Forwarding subsectors also recorded moderate expansions by end 2019 compared to end 2018. Personal Loans and Advances, which grew by over 20 per cent, year-on-year, during the first half of 2019, recorded a moderate growth of 11.9 per cent, year-on-year, by end 2019, compared to the growth of 20.3 per cent at end 2018. Within Personal Loans and Advances, the Consumer Durables subsector recorded a moderate growth of 4.7 per cent, year-on-year, by end 2019, compared to the growth of 8.7 per cent at end 2018. However, Pawning advances and Credit Card advances grew notably by 22.8 per cent and 22.9 per cent, year-on-year, respectively, by end 2019 in comparison to the growth rates of 15.7 per cent and 16.5 per cent, respectively, at end 2018. The latter was mainly due to attractive further promotional offers provided by commercial banks for their credit card users during the year. Further, in terms of maturity analysis of outstanding credit to the private sector by commercial banks, a slowdown was observed across all tenures. Accordingly, the growth of short term, medium term and long term facilities decelerated to 3.0 per cent, 3.4 per cent and 8.0 per cent, respectively, by end 2019, in comparison to 17.6 per cent, 10.4 per cent and 21.7 per cent, respectively, at end 2018.

Broad Money (M_4)

The growth of broad money supply (M_4), measured using the Financial Survey,[2] moderated during 2019, due to the notable deceleration in NDA of LCBs, despite some acceleration in NDA of Licensed Specialised Banks (LSBs) and Licensed Finance Companies (LFCs) during the year. The year-on-year growth of M_4, which closely follows the trend in M_{2b}, decelerated to 8.2 per cent by end 2019 compared to the growth of 12.0 per cent recorded at end 2018. Viewed from the liabilities side of M_4, total time and savings deposits held by the public at LCBs, LSBs and LFCs grew at a modest pace of 8.5 per cent, year-on-year, by end 2019, compared to 12.7 per cent recorded at end 2018. However, during 2019, the year-on-year growth of time and savings deposits held by the public with LSBs and LFCs accelerated to 17.8 per cent and 4.9 per cent, respectively, compared to 11.3 per cent and 1.0 per cent, respectively, recorded at end 2018, reflecting relatively high interest rates offered on deposits by the non bank sector. On the assets side, the absolute increase in M_4 was due to the expansion in NFA of both the Central Bank and licensed banks as well as the increase in NDA of both licensed banks and LFCs during the year. Accordingly, domestic credit of LSBs and LFCs increased by Rs. 160.3 billion, while NFA of LSBs increased by Rs. 54.7 billion during 2019.

2 The Financial Survey provides a broader measure of liquidity, covering all deposit taking institutions including LSBs and LFCs, in addition to LCBs and the Central Bank.

Reflecting subdued economic activity, the growth of credit to the private sector in M_4 also decelerated to 3.9 per cent, year-on-year, by end 2019 compared to 14.9 per cent at end 2018.

Table 7.8
Assets Side of Broad Money (M_4)
(Computed as per the Financial Survey)

Rs. billion

Item	End 2018	End 2019 (a)	Change 2018 Amount	Change 2018 %	Change 2019 Amount	Change 2019 %
Financial Survey (M_4)	8,729.6	9,444.5	933.7	12.0	714.9	8.2
Underlying Factors						
Net Foreign Assets	-133.7	116.3	-99.5	-291.2	250.0	187.0
Monetary Authorities (b)	750.5	896.0	-95.6	-11.3	145.5	19.4
LCBs	-817.5	-767.7	-92.9	-12.8	49.8	6.1
LSBs and LFCs	-66.7	-11.9	89.1	57.2	54.7	82.1
Net Domestic Assets	8,863.3	9,328.2	1,033.2	13.2	465.0	5.2
Domestic Credit (c)	11,356.5	12,066.6	1,514.8	15.4	710.1	6.3
Net Credit to the Government (c)	3,100.0	3,454.1	321.1	11.6	354.1	11.4
Central Bank (c)	472.8	363.0	247.7	110.1	-109.8	-23.2
LCBs	2,043.9	2,404.1	100.5	5.2	360.2	17.6
LSBs	518.6	613.9	-27.1	-5.0	95.3	18.4
LFCs	64.8	73.2	-0.03	-0.1	8.4	13.0
Credit to Public Corporations (LCBs)	755.4	818.0	218.4	40.7	62.6	8.3
Credit to the Private Sector	7,501.1	7,794.5	975.3	14.9	293.4	3.9
LCBs	5,561.4	5,798.1	762.1	15.9	236.8	4.3
LSBs	753.8	814.2	77.0	11.4	60.3	8.0
LFCs	1,185.9	1,182.2	136.1	13.0	-3.7	-0.3
Other Items (net) (c)(d)	-2,493.3	-2,738.4	-481.6	-23.9	-245.1	-9.8

(a) Provisional
(b) This includes NFA of the Central Bank as well as the government's Crown Agent's balance reported by the Department of State Accounts
(c) Revised
(d) Computed as the difference between other assets and other liabilities

Source: Central Bank of Sri Lanka

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The growth of credit granted to the private sector by LSBs and LFCs, which contributed around 26 per cent to credit extended to the private sector as per the financial survey, decelerated during 2019. Accordingly, year-on-year growth of credit granted to the private sector by LSBs moderated to 8.0 per cent at end 2019 from 11.4 per cent recorded at end 2018, while growth of credit granted to the private sector by LFCs declined notably to -0.3 per cent, by the end 2019, compared to 13.0 per cent recorded at end 2018. The contraction of credit extended to the private sector by LFCs in 2019 was partly due to the restrictions imposed on vehicle related lending and increased risk aversion due to rising NPLs in the non bank financial sector. Accordingly, in absolute terms, compared to the expansion of Rs. 975.3 billion during 2018, the expansion in credit extended to the private sector in M_4 was recorded at Rs. 293.4 billion during 2019. Meanwhile, NCG by LSBs increased by Rs. 95.3 billion in 2019 compared to a decline of Rs. 27.1 billion in 2018, while NCG by LFCs expanded by Rs. 8.4 billion in 2019, compared to a decrease of Rs. 35 million in 2018. Overall, NCG under M_4 increased by Rs. 354.1 billion in absolute terms in 2019, compared to Rs. 321.1 billion recorded in 2018.

7.5 Future Developments, Challenges and Outlook

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The outbreak of the COVID-19 pandemic and its potential significant impact on the domestic economy and financial markets underscores the need for alternative monetary policy instruments, particularly as the country moves to a low interest rate regime. Amidst the concerns about the potential economic setback due to the COVID-19 pandemic, the Central Bank proactively eased the monetary policy stance by lowering policy interest rates and the SRR while providing adequate liquidity to the market in order to meet urgent liquidity requirements of the economy. Meanwhile, the Central Bank purchased Treasury bills from the primary market to fulfill urgent cash requirements of the government under exceptional circumstances. However, the conventional monetary policy tools often render limited support in the wake of large economic shocks, particularly due to constrained policy spaces to allow larger adjustments in policy interest rates, and weak monetary transmission. Further, a significant reduction of interest rates to very low levels, as practiced in many developed countries, may lead to unintended consequences in countries such as Sri Lanka, given the considerable proportion of population that depend on interest income on savings, and the relatively underdeveloped alternative financial markets. In this context, the Central Bank may also need to explore alternative and unconventional monetary policy instruments, considering the size of the economic shock and potential economic consequences. For instance, the feasibility of allowing the Central Bank to engage in quantitative easing, through direct purchases of non government assets must be explored, thereby enabling the Central Bank to provide liquidity to the participants in the financial market directly, and also influence not only the shorter end of the yield curve but also the longer end of the yield curve within a short period of time. However, the underdeveloped capital markets in Sri Lanka could constrain the effectiveness of such policies, unless urgent measures are taken to broaden and deepen the capital market.

Credit extended to the private sector by the financial system measured as a percentage of GDP, which is a major indicator of financial deepening of the economy, remained moderate compared to Sri Lanka's regional peers, reflecting the need to broaden the financial system further to spur economic growth. As measured by the M_4

broad money supply, credit extended to the private sector by the financial system as a percentage of GDP was estimated at around 51.9 per cent by end 2019. Although the private sector credit to GDP ratio has gradually increased over the past, the pace of this increase remained well below the expansion in most regional peers such as Thailand, Malaysia and Vietnam. As per the latest World Development Indicators of the World Bank, private sector credit to GDP ratios in these countries ranged from 120 per cent to 161 per cent. The relatively low credit to GDP ratio in Sri Lanka can be attributed to several structural issues in the financial system including the weak financial outreach and lack of financial literacy. In addition, the cautious behaviour of investors as well as the financial institutions amidst economic, political and global uncertainties also explains the moderate level of credit to GDP ratio in the country. The prevalence of a large informal sector also contributes to the lower recorded levels of credit to GDP ratio. Further, as per the sectoral classification of private sector credit, higher credit to GDP ratios are observed in agriculture and industrial sectors, while a low level is observed in the services sector, which contributes around 60 per cent of the overall GDP. This partly reflects the need for improving efficiency in resource allocation. Such improvements in efficiency of allocating financial resources towards more productive sectors of the economy could also help the informal sector including micro, small and medium scale enterprises (MSMEs) to converge with the formal sector. Further, enhancing access to finance as well as financial literacy, along with measures to minimise the impact of large borrowings by the public sector are also priority areas in promoting credit to the private sector and economic growth over the medium term, in order to prevent possible crowding out effects in future.

Continuing the substantial progress made thus far on adopting flexible inflation targeting as the monetary policy framework, the Central Bank of Sri Lanka will pursue initiatives to ensure maintaining low and stable levels of inflation while supporting the economy to achieve its potential. An essential aspect of the institutionalisation process is streamlining of the monetary policy formulation process, which has continued to evolve into a proactive and preemptive data driven decision making process. In order to promote transparency and accountability, the Central Bank consistently engages with the general public through the regular issuance of forward looking monetary policy statements. The continuous improvements in the Central Bank's communications strategy are expected to improve the general public's understanding of the monetary policy framework, thereby further strengthening the ability of the Central Bank to anchor inflation expectations. Along with the increased efficacy of monetary policy making in managing demand driven inflation and inflation expectations by the Central Bank, the government is also expected to play a proactive role in addressing price pressures stemming from transitory supply side disruptions. Moreover, the government's continued commitment to fiscal consolidation is essential to sustain inflation at desired levels over the medium term, despite the possible fiscal slippage that could be expected in the near term due to the outbreak of the COVID-19 pandemic and the government's efforts to contain its spread and mitigate its economic impact. The necessary legal framework to update the 70-year old Monetary Law Act was prepared in 2019, which awaits finalisation upon further review by the government.