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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Press Release

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Monetary Policy Review – February 2012

Inflation, as measured by the change in the Colombo Consumers' Price Index (CCPI, base 2006/07), continued to moderate, with year-on-year inflation declining to 3.8 per cent in January 2012 from 4.9 per cent in December 2011. While this is the 36th consecutive month with single digit inflation, improvements in domestic food supplies such as most varieties of vegetables, potatoes and big onions mainly contributed to the continuation of low inflation, whereas non-food inflation showed an increase during the month. Meanwhile, year-on-year core inflation in January 2012 remained unchanged from the previous month at 4.7 per cent.

Consequent to the increased domestic economic activity, low interest rates, as well as the unexpectedly high energy prices in the international market, the total expenditure on imports increased substantially to US dollars 18.4 billion during the first eleven month of 2011 widening the trade deficit. This was in spite of earnings from exports increasing by 22.2 per cent to US dollars 9.6 billion during the period. Increased earnings from tourism, increased workers' remittances, and other inflows to the services account helped cushion the impact on the current account deficit, while the Central Bank had to intervene by supplying foreign exchange, on a net basis, to mitigate the undue pressure on the domestic foreign exchange market. As a result, despite higher inflows of foreign direct investments and inflows to the Government, gross official reserves (excluding Asian Clearing Union balances) declined to US dollars 5.9 billion by end December 2011, representing the equivalent of 3.6 months of imports.

Meanwhile, credit granted by commercial banks to the private sector increased by 34.5 per cent, year-on-year, in December 2011, substantially exceeding projections. Provisional estimates indicate that within the credit extended to the private sector by commercial banks, trade related credit and credit driven by import related items such as motor vehicles and consumer durables increased significantly. Import related credit increased by over 34 per cent during 2011, while the increase in credit for export activity was only around 8 per cent during the year. Pawning also displayed a significant increase in 2011. In addition, credit granted to the Government and public corporations by commercial banks increased considerably, and in particular, a higher petroleum import bill and the inadequate adjustment to domestic petroleum prices led to increased borrowings by the Ceylon Petroleum Corporation (CPC).

At the same time, excess liquidity in the domestic money market declined from Rs.124 billion as at end 2010 to the current level of around Rs 15 to 20 billion, and such decline in liquidity in the domestic money market led to market interest rates recording an upward movement in recent months. With excess liquidity declining, commercial banks also competitively raised interest rates paid on deposits, with rates on 3-month and 6-month term deposits showing a considerable increase during the past few months.

Taking into consideration these macroeconomic developments, the Monetary Board of the Central Bank of Sri Lanka is of the view that the continuous increase in credit extended to the private sector by commercial banks needs to be addressed for two main reasons: First, to curtail import related credit, thereby reducing the trade deficit and the current account deficit, and second, to effectively ensure that inflation remains at the mid-single digit levels in the second half of 2012 as well, notwithstanding the sharp build up of credit in 2011.

Accordingly, the Monetary Board, at its meeting held on 2nd February 2012, decided to increase both the Repurchase rate and the Reverse Repurchase rate of the Central Bank by 50 basis points each. Hence, the Repurchase rate and the Reverse Repurchase rate of the Central Bank will be 7.50 per cent and 9.00 per cent, respectively. The Monetary Board also decided to direct commercial banks to moderate their credit disbursements so that the overall credit growth in 2012 will not exceed 18 per cent of their respective loan book outstanding at the end of 2011, while credit growth of up to 23 per cent will be allowed for those banks, which finance the excess up to 5 per cent of the credit growth, from funds mobilised from overseas. In addition, the Central Bank will monitor on a regular basis, the targets for inflows as set out in the "Road Map: Monetary and Financial Sector Policies for 2012 and beyond", with regard to foreign direct investments (FDI), earnings from tourism, workers' remittances, Tier 2 capital of banks, inflows to the stock market, inflows to the government securities market, and a credit line for petroleum imports, which would help increase net foreign exchange inflows to the country, thereby enabling the balance of payments to record a healthy surplus in 2012. The Monetary Board is of the view that these adjustments to the monetary policy stance of the Central Bank, as well as other measures that may be adopted by relevant Government authorities would materially reduce the need for the Central Bank to supply foreign exchange to the market, on a net basis, during 2012.

The date for the release of the next regular statement on monetary policy will be announced in due course.