

30 January 2020

Review of the Monetary Policy Stance

No. 01 of 2020



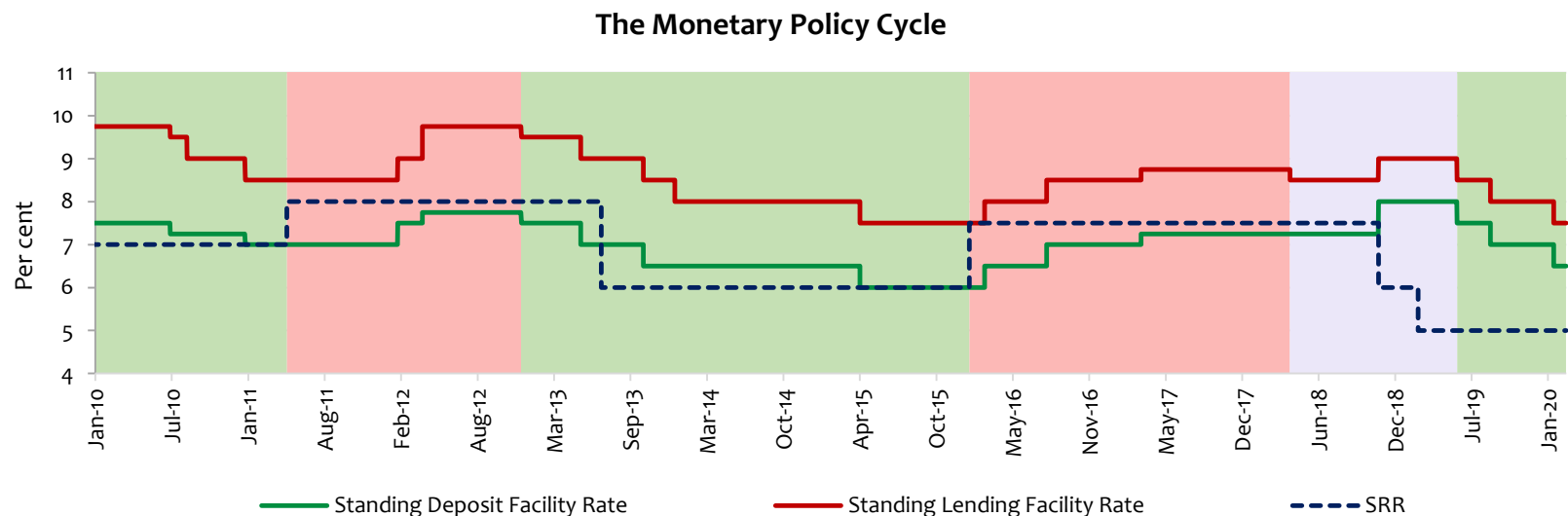
Economic Research Department
Central Bank of Sri Lanka

Monetary Policy Decision:

Review No. 01 of 2020

- The Central Bank of Sri Lanka Reduces its Policy Interest Rates by 50 bps

Standing Deposit Facility Rate (SDFR)	6.50%
Standing Lending Facility Rate (SLFR)	7.50%
Statutory Reserve Ratio (SRR)	5.00% (unchanged)



Global monetary policy continued to remain accommodative amidst concerns over low economic growth...

As of 27 January 2020

Period	No. times policy rates eased	Monetary Policy Stance	
		No. of Central Banks loosening the stance	No. of Central Banks tightening the stance
Thus far in 2020 (As of 27 Jan 20)	07	07	01
2019	182	67	24
2018		32	43
2017		34	28
2016		46	29
2015		34	48

Source: centralbanknews.info

- The IMF revised global growth projections downwards further owing to weaker than expected growth across emerging market economies, especially India
- Global growth prospects have been further threatened by the spread of coronavirus originated in China



Global Economy

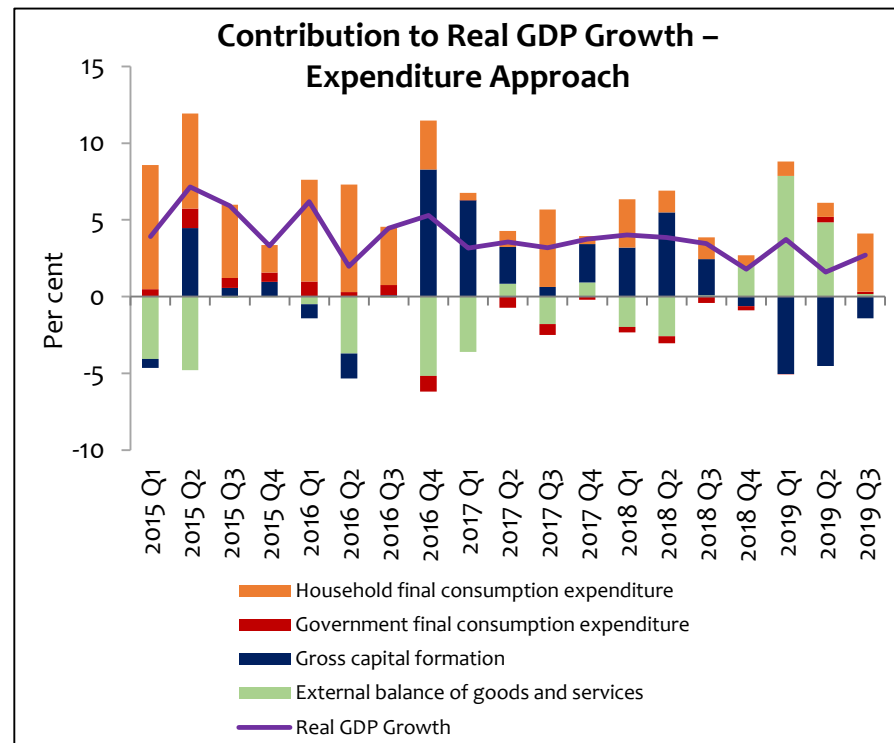
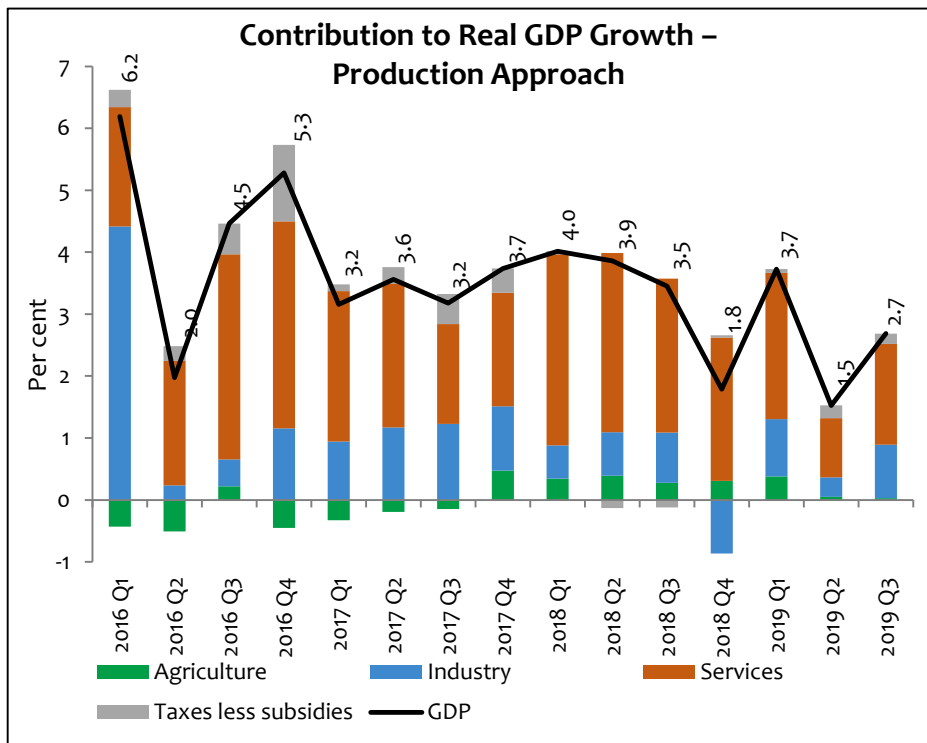


Advanced Economies



Emerging Markets & Developing Economies

A recovery in domestic economic growth is expected...



- As per available indicators, domestic economic activity has remained subdued in the Q4, 2019, primarily with subpar growth in Agriculture and Industry related activities
- A revival in economic activity is envisaged supported by appropriate fiscal and monetary measures, improved business confidence and political stability
- The economy is expected to reach its full capacity over the medium term, benefitting from the low and stable inflation environment, a competitive exchange rate, low lending rates as well as improved consumer and investor sentiment

Headline inflation accelerated in December 2019 owing to domestic supply disruptions...

Headline inflation (%)

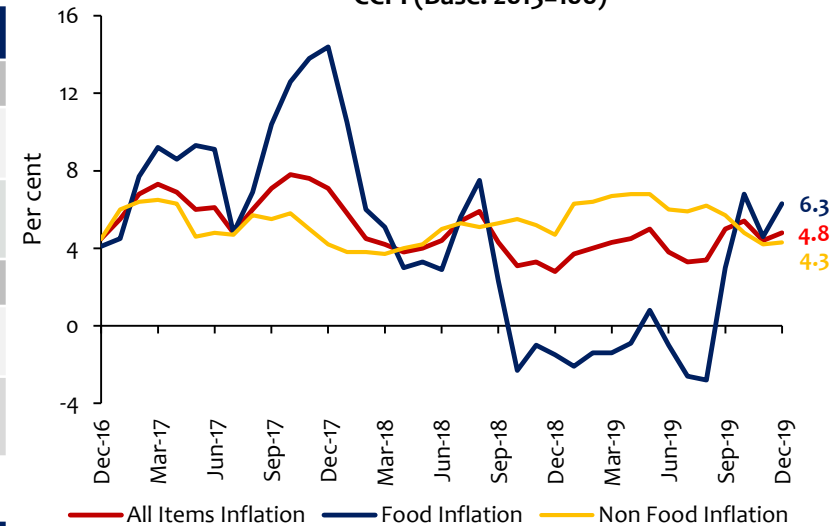
	Dec-16	Dec-17	Dec-18	May-19	Jun-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
based on CCPI (2013=100)										
Y-o-Y	4.5	7.1	2.8	5.0	3.8	3.4	5.0	5.4	4.4	4.8
Annual average	4.0	6.6	4.3	4.2	4.2	3.8	3.9	4.0	4.1	4.3
based on NCPI (2013=100)										
Y-o-Y	4.2	7.3	0.4	3.5	2.1	3.4	5.0	5.6	4.1	6.2
Annual average	4.0	7.7	2.1	2.0	2.0	2.0	2.3	2.8	3.0	3.5

Core inflation (%)

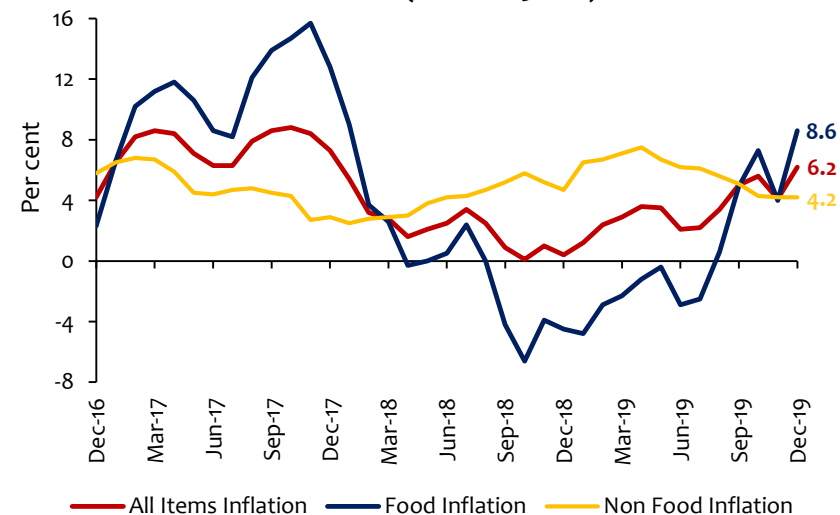
	Dec-16	Dec-17	Dec-18	May-19	Jun-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
based on CCPI (2013=100)										
Y-o-Y	5.8	4.3	3.1	6.2	5.8	5.6	5.6	5.5	5.1	4.8
Annual average	4.4	5.9	3.5	4.4	4.7	5.0	5.1	5.3	5.4	5.5
based on NCPI (2013=100)										
Y-o-Y	6.7	2.7	3.1	6.3	6.1	5.9	5.6	5.6	5.5	5.2
Annual average	5.9	4.9	2.4	4.0	4.4	5.0	5.2	5.4	5.6	5.7

- Reflecting subdued aggregate demand conditions, core inflation, measured using both CCPI and NCPI, decelerated

Headline Inflation - Food and Non Food
CCPI (Base: 2013=100)

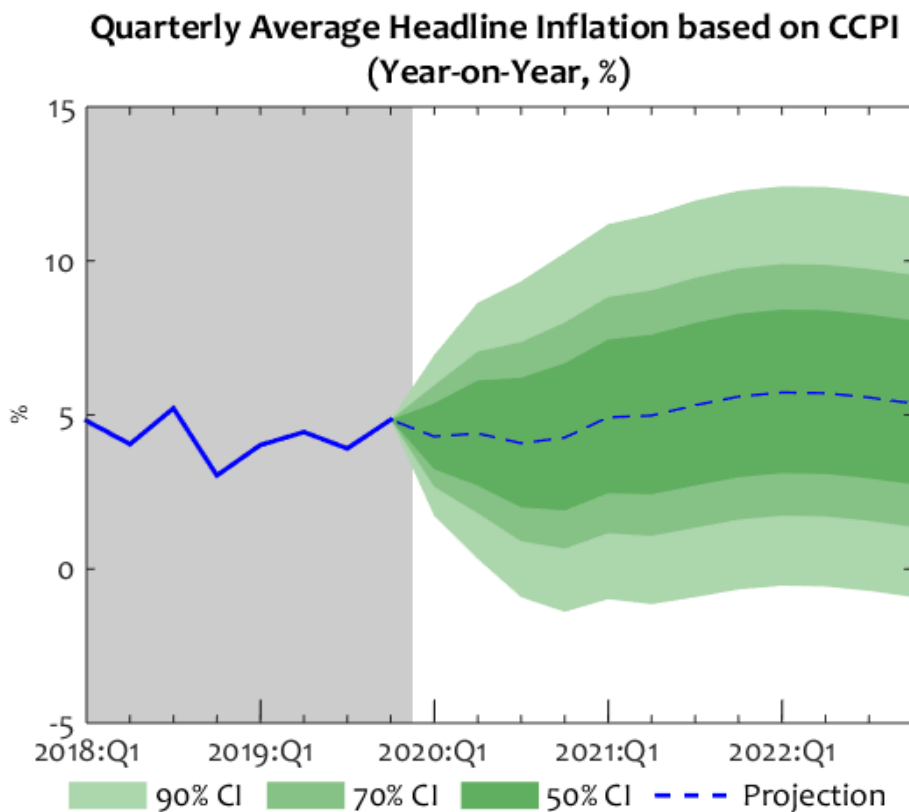


Headline Inflation - Food and Non Food
NCPI (Base: 2013=100)



Inflation is expected to remain in mid single digit levels in the medium term...

- In spite of short term fluctuations, the near term forecast suggests that inflation will hover below 5 per cent in 2020, and stabilise between 4-6 % thereafter, assisted by appropriate policy measures and underpinned by well anchored inflation expectations

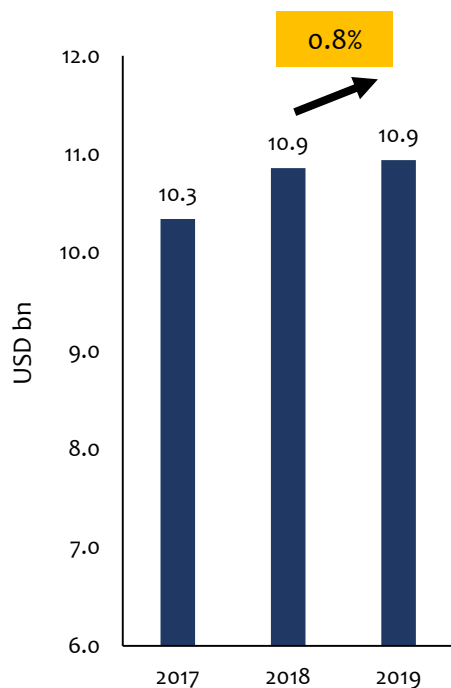


Note: A forecast is neither a promise nor a commitment.

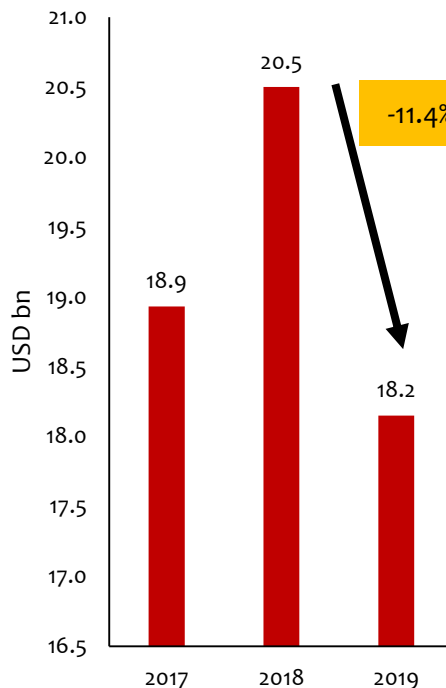
- The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colors. The projection reflects the available data and assumptions and judgments made at the January 2020 forecast round, and it may change at the next quarterly update in April 2020 as new information comes in and the assumptions and judgments are revised accordingly.
- The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. Specifically, the thick green shaded area represents 50 per cent confidence interval, implying there is a 50 per cent probability that the actual inflation outcome will be within this interval. The confidence bands show the increasing uncertainty in forecasting inflation over a longer horizon.

Trade performance during the first eleven months of 2019 improved with a notable contraction in imports, and a marginal improvement in merchandise exports...

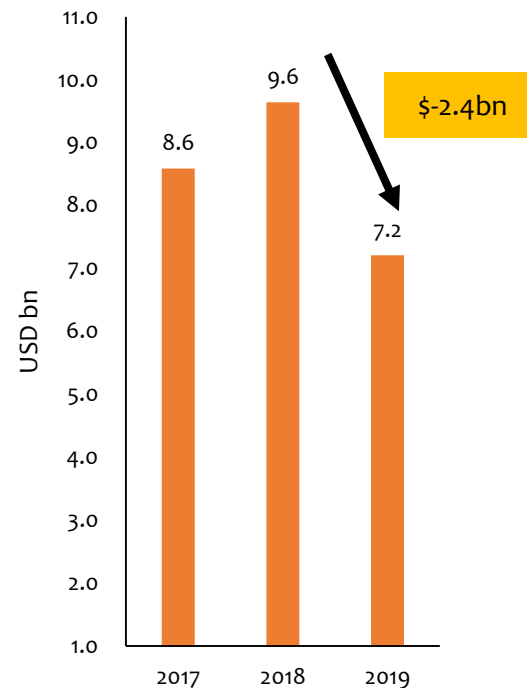
Exports (Jan-Nov)



Imports (Jan-Nov)



Trade Deficit (Jan-Nov)



Reduction in the Trade Deficit during Jan – Nov 2019 was mainly supported by the **decline in imports** of:

Personal vehicles

USD 764 mn
(-51.1%)

Gold

USD 436 mn
(-99.4%)

Refined petroleum

USD 303 mn
(- 11.0%)

Rice

USD 93 mn
(- 89.5%)

Transport equipment

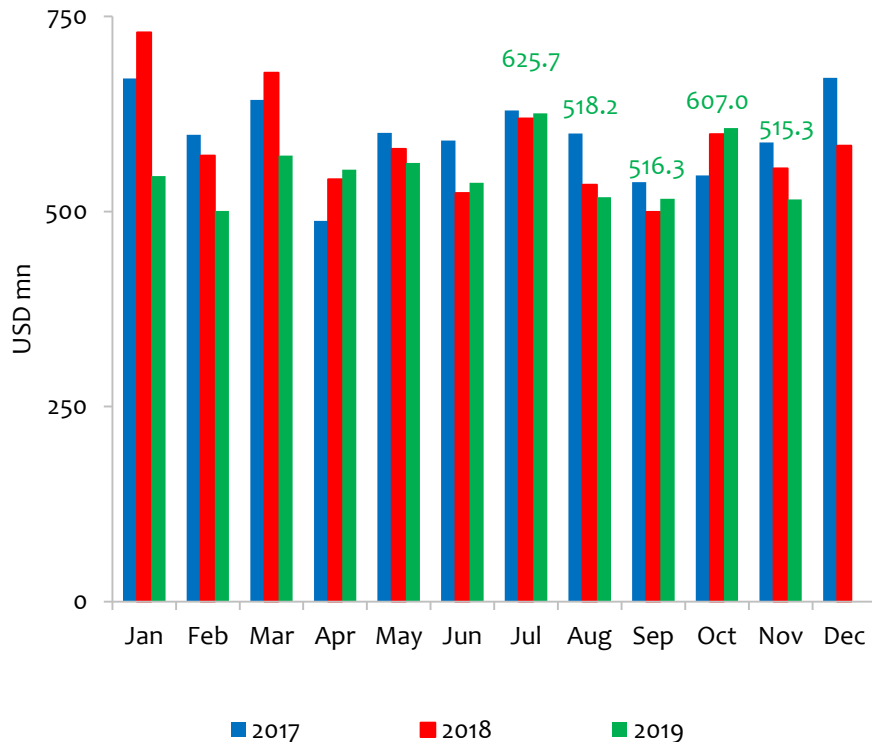
USD 98 mn
(- 15.8%)

Workers' remittances moderated, while tourist arrivals continued to improve, recovering gradually from the effects of the Easter Sunday attacks...

Workers' Remittances in November 2019

- Declined by 7.2% (y-o-y) to USD 515.3 mn (USD 7,015 mn in 2018)
- Jan-Nov 2019: USD 6.1 bn (-5.9% y-o-y)

Workers' Remittances



Tourist Arrivals

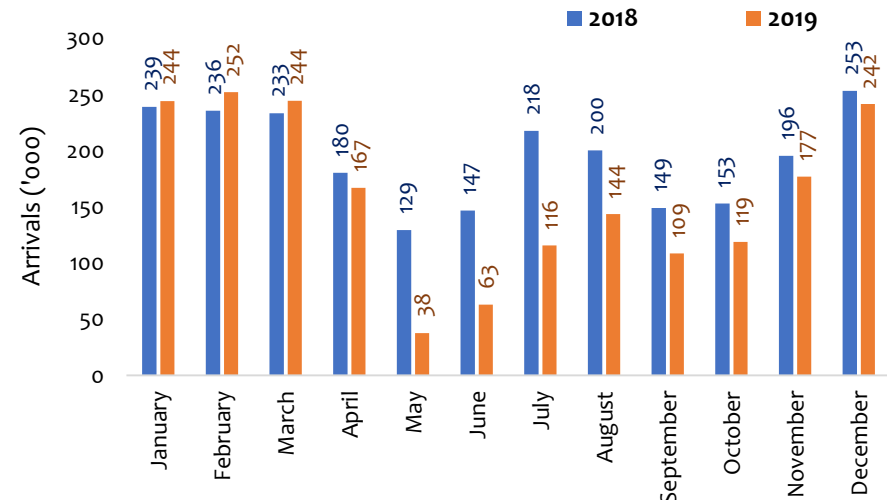
Month	Y-o-Y Growth
Apr-19	(7.5)
May-19	(70.8)
Jun-19	(57.0)
Jul-19	(46.9)
Aug-19	(28.3)
Sep-19	(27.2)
Oct-19	(22.5)
Nov-19	(9.5)
Dec-19	(4.5)

Tourist Arrivals decreased by 18.0% (y-o-y) (Jan-Dec)

- 2019 Jan-Dec: 1,913,702
- 2018 Jan-Dec: 2,333,796

Estimated tourist earnings could be revised downwards with reduced average spend per day for 2019, after Easter Sunday attacks in 2019

Tourist Arrivals



The Sri Lankan rupee, which appreciated by 0.6% against the US dollar in 2019, remained broadly unchanged so far during 2020...

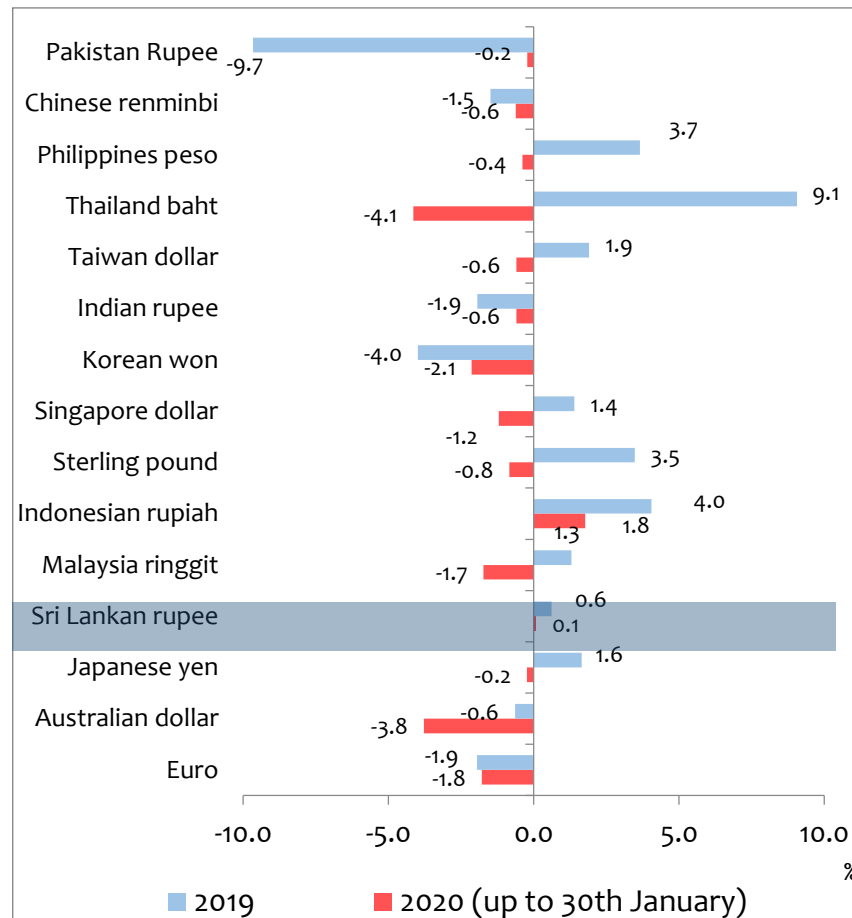
**Movement of Sri Lankan Rupee against USD
(up to 30 Jan 2020)**



LKR Movement Against Other Currencies

	2019	up to 30 Jan 2020
Currency	App(+)/Dep(-)	App(+)/Dep(-)
US dollar	+0.6 %	+0.1 %
Pound sterling	-2.8 %	+0.9%
Euro	+2.6 %	+1.9%
Japanese yen	-1.0 %	+0.3 %
Indian rupee	+2.6%	-0.7%

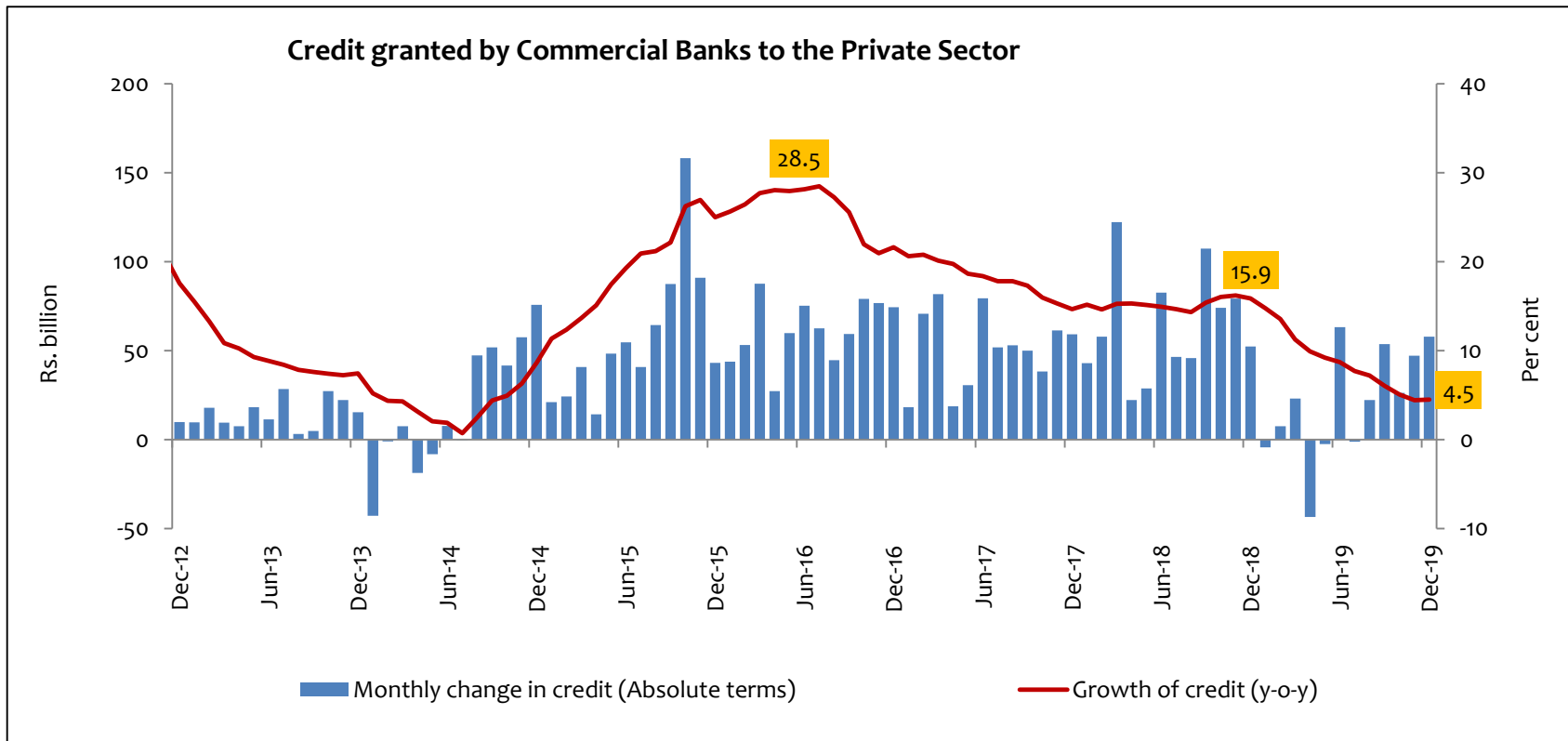
Movements in selected International Currencies against the USD



Gross official reserves increased to USD 7.6 bn by end December 2019, providing an import cover of 4.6 months

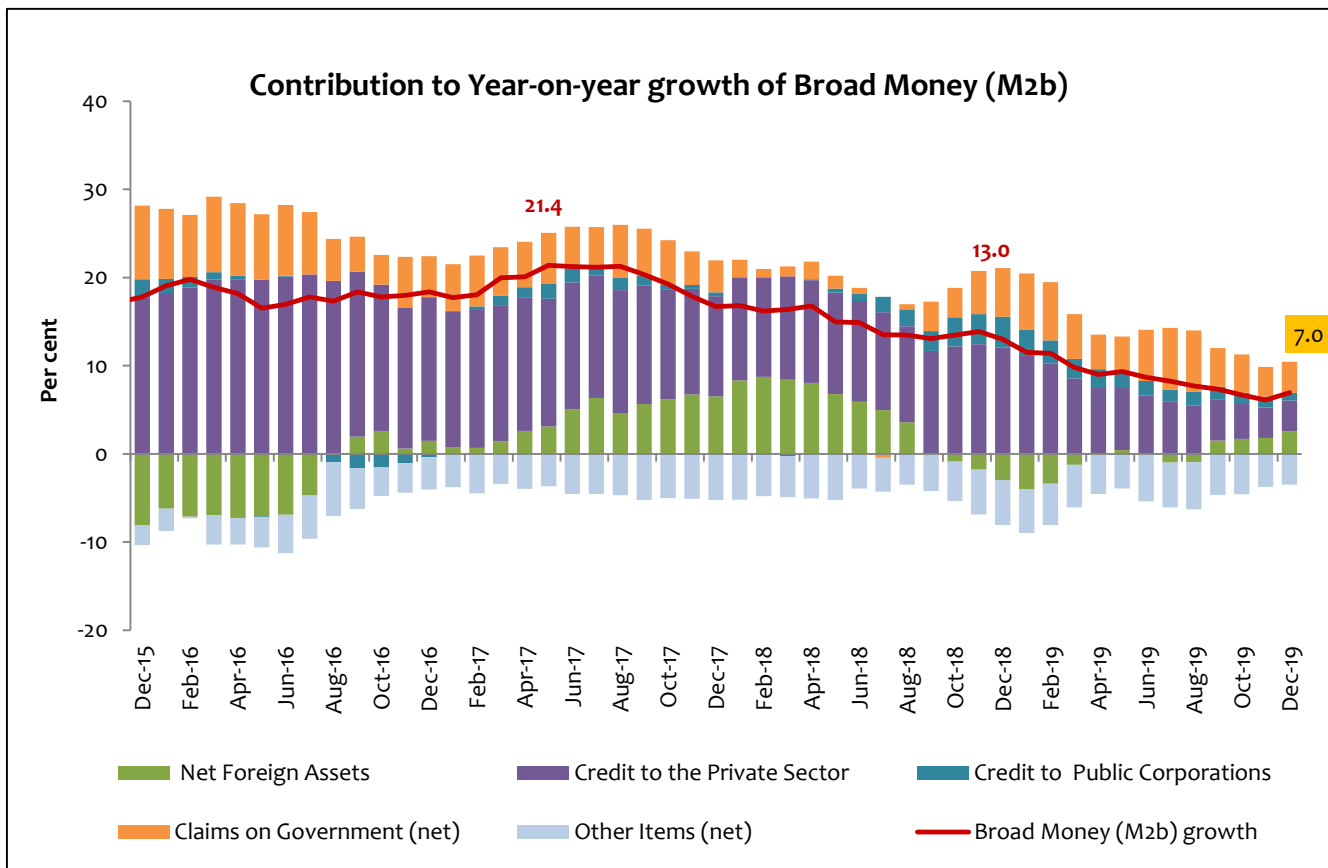
As expected, private sector credit growth picked up in Dec 2019, following a continued slowdown since Dec 2018...

- Supported by the accommodative monetary policy stance, y-o-y growth of credit to the private sector picked up to 4.5% in Dec 2019 compared to 4.4% in Nov 2019
- In absolute terms, credit expanded by Rs. 57.9 bn in Dec 2019 following an increase of Rs. 47.1 bn in Nov 2019
- Cumulative increase of credit was Rs 249.7 bn in 2019, compared to Rs. 762.1 bn in 2018



Broad money growth (M_{2b}) also picked up in Dec 2019, following the expansion in credit flows to the private sector...

- M_{2b} growth picked up to 7.0% (y-o-y) in Dec 2019 from 6.1% in Nov 2019
- Net Credit to the Government (NCG) by the banking sector expanded by Rs. 250.4 bn in 2019 compared to the increase of Rs. 348.2 bn in 2018
- Credit to SOEs increased by Rs. 62.6 bn in 2019 compared to the significant increase of Rs. 218.4 bn in 2018

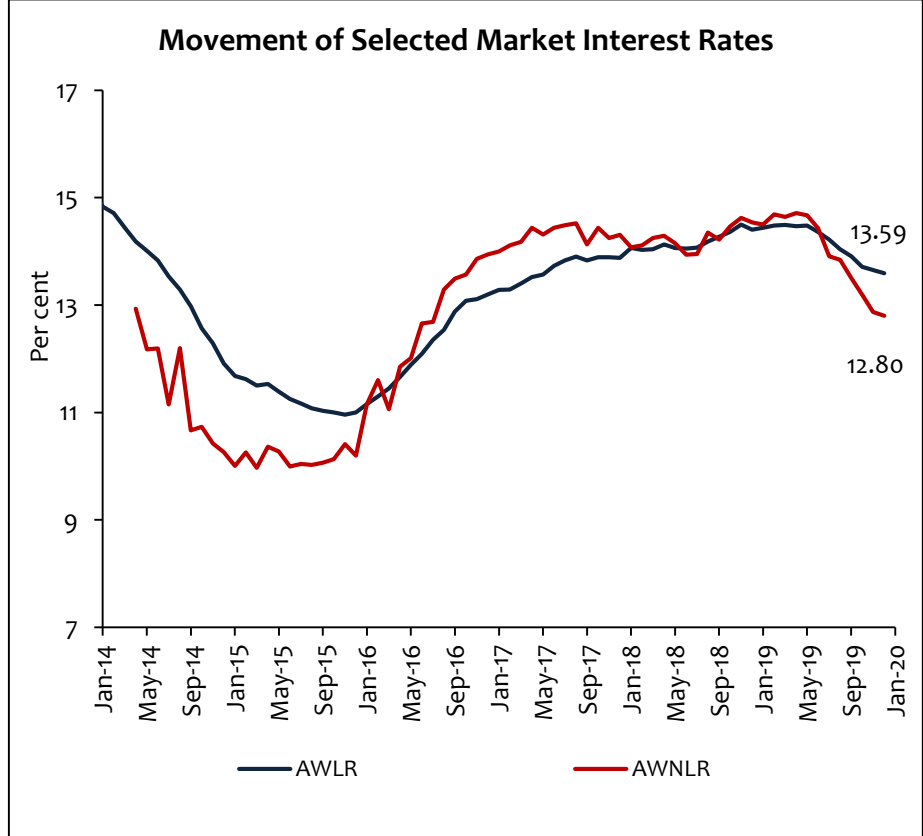
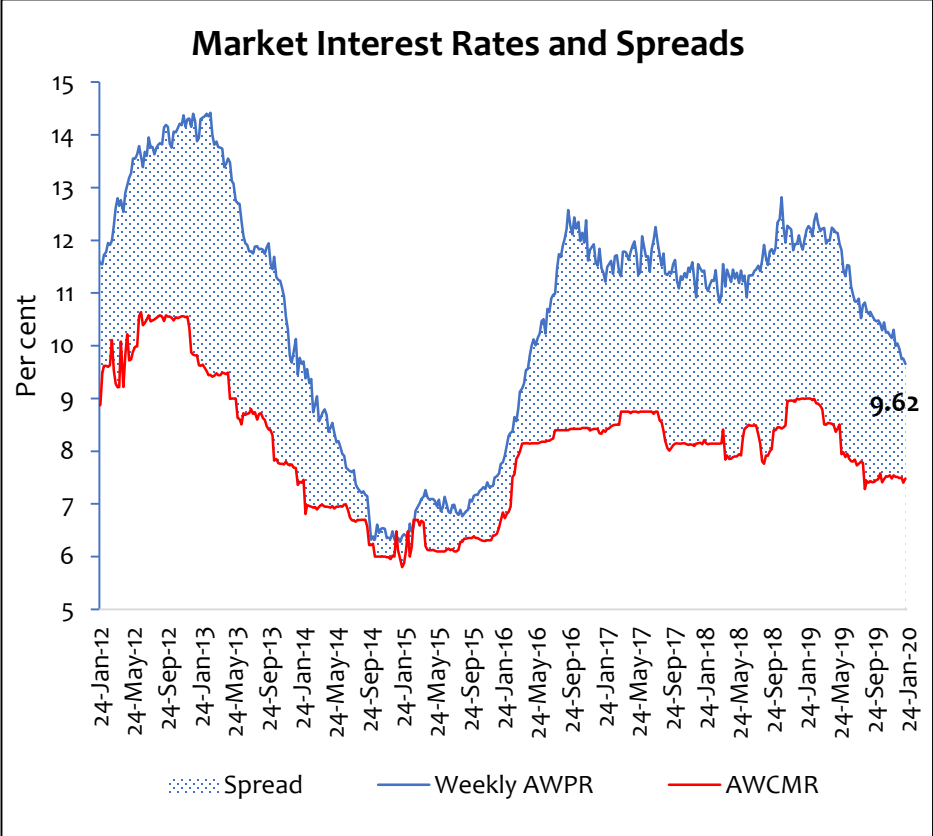


- Going forward, growth of money and credit aggregates is expected to accelerate with the envisaged continued decline in lending rates, the expected expansion in economic activity supported by fiscal stimulus, announced credit support package for SMEs and improved investor sentiment

Market lending rates continued to decline, but the pace of reduction has decelerated...

Weekly AWPR declined by 12 bps to 9.62% as of 24 Jan 2020 from end 2019

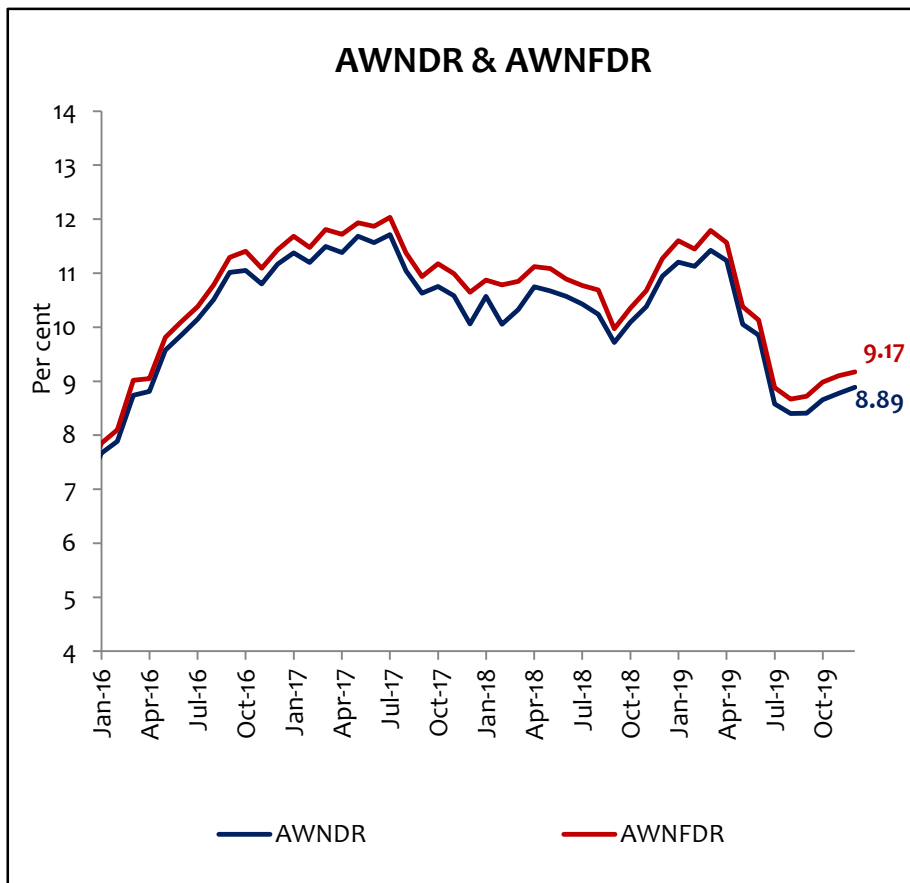
AWLR and AWNLR declined by 06 bps & 07 bps to 13.59% and 12.80%, respectively, in Dec 2019 from the previous month



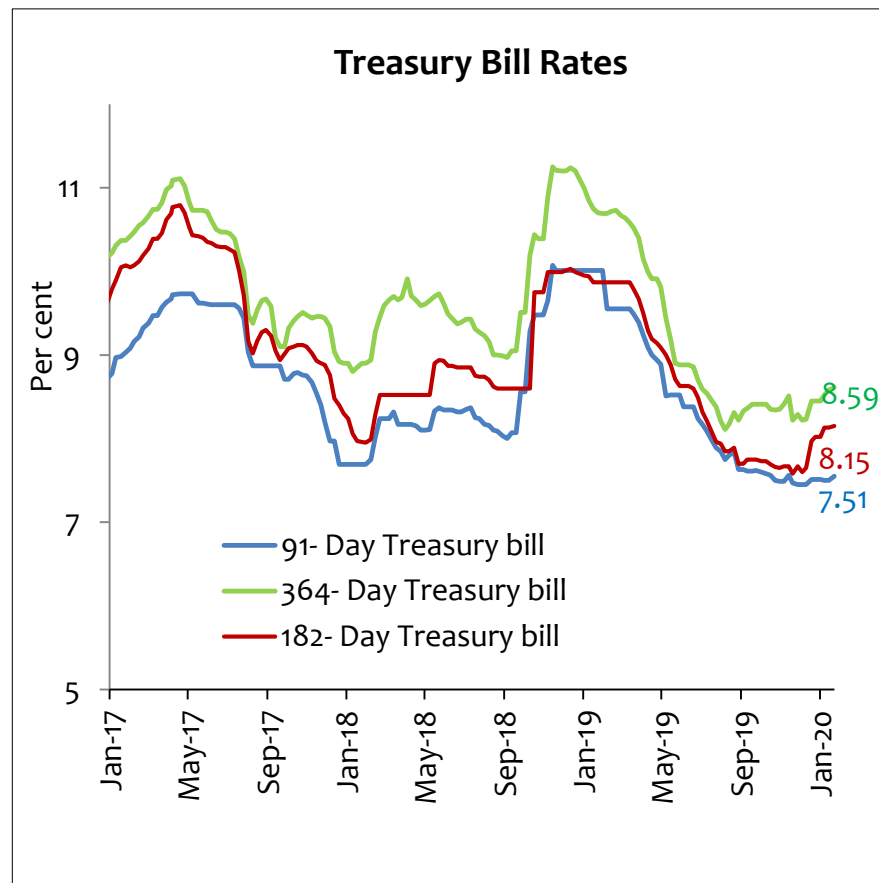
The reduction in lending rates thus far, except for the Average Weighted Prime Lending Rate (AWPR), has been less than envisaged

With the removal of caps on deposit interest rates offered by banks, new deposits rates have increased since September 2019...

AWNDR increased by 11 bps to 8.89% in Dec 2019 from the previous month



Yields on Treasury bills have trended upwards at recent auctions



If not addressed, these trends could result in an undesirable turnaround in market lending rates

Monetary Policy Decision

- **The monetary policy decision will support a continued reduction in market lending rates, ensuring a broad based and sustained recovery in economic activity**
- **It is essential that market lending rates reduce further in order to support the envisaged pickup in credit growth and economic activity**
- **The Central Bank will continue to monitor macroeconomic and financial market developments with a view to maintaining aggregate demand conditions at appropriate levels, thereby ensuring mid single digit inflation in the medium term**

Thank you