

05 March 2020

Review of the Monetary Policy Stance

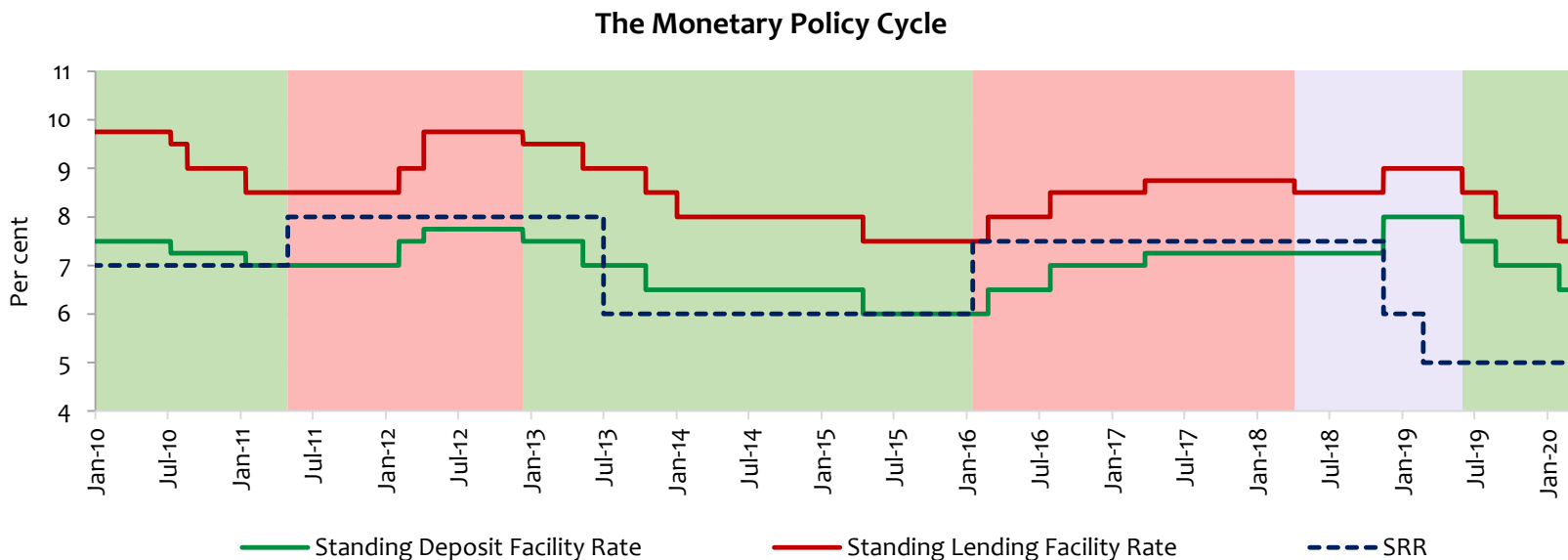
No. 02 of 2020



Economic Research Department
Central Bank of Sri Lanka

Policy interest rates maintained at current levels...

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



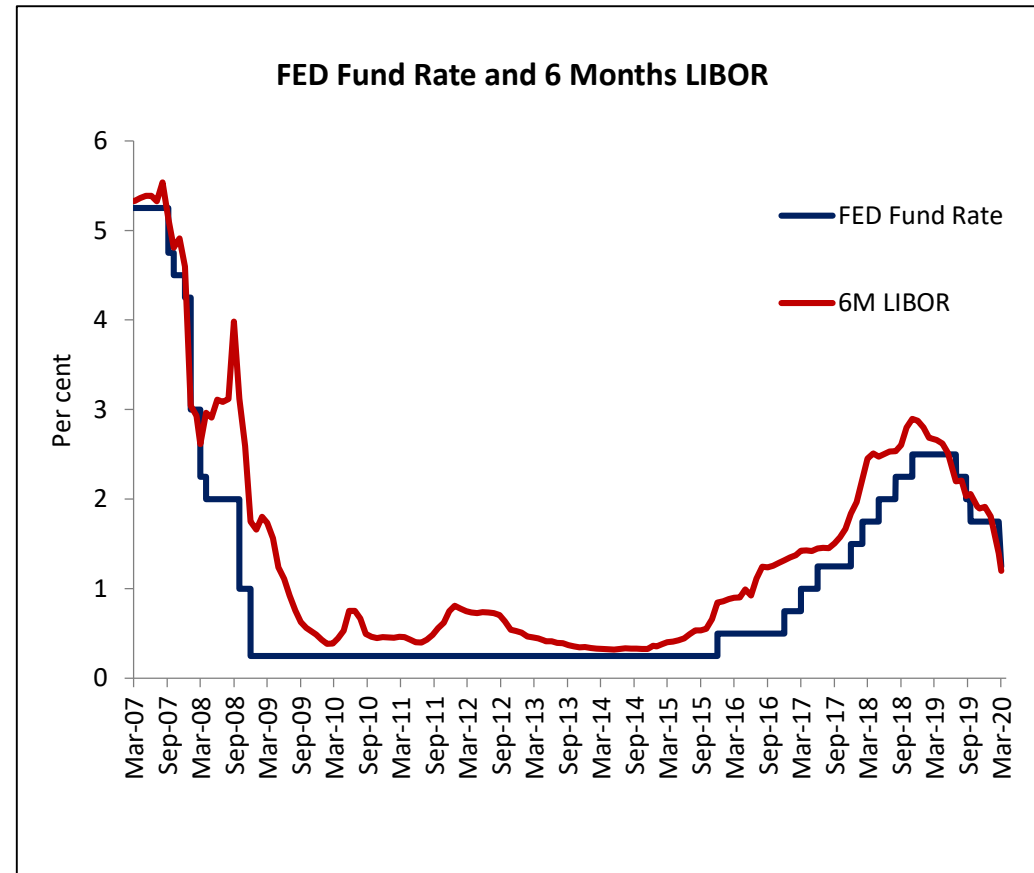
The escalation of the coronavirus (COVID-19) outbreak to a 'global health emergency' and its potential to become a pandemic pose significant threats to global economic recovery in 2020...

- Many economies are becoming increasingly accommodative amidst global growth concerns
- Policymakers around the globe are expected to intensify policy support to address the effect of the outbreak on global demand and supply conditions

As of 04 March 2020

Period	No. of decisions favoring easier policy stance	Monetary Policy Stance	
		No. of Central Banks loosening the stance	No. of Central Banks tightening the stance
Thus far in 2020 (As of 04 Mar 20)	37	30	04
2019	182	67	17
2018		32	43
2017		34	28
2016		46	29
2015		34	48

Source: centralbanknews.info



The COVID-19 outbreak is likely to affect Sri Lanka's economic performance...

Direct Impact from China

In 2019, 18% of consumer goods imports, 16% of intermediate goods imports and 33% of investment goods imports originated from China

Imports

Supply chain disruptions could affect exports. However, buildup of stock prior to the Chinese New Year has dampened this effect to some extent. Merchandise exports to China amounted to 2% of total exports in 2019

Exports

Chinese tourists totalled 9% (167,863) of arrivals in 2019. During first two months of 2020, there was a 55.1% Y-o-Y decline in arrivals from China. In February 2020 arrivals from China declined by 92.5% to 2,096

Tourism

Chinese workers in Sri Lanka are conservatively estimated at around 8,000. Several projects have been delayed due to the non-return of workers after the Chinese New Year

Workers

Impact from the Global Economic Slowdown

Exports

Global economic slowdown could affect prices of as well as demand for Sri Lankan merchandise exports and service exports. A slowdown in port activities is also expected

Tourism

The slowdown in global tourism will affect the tourism sector, which has seen a notable recovery since the Easter Sunday attacks. This will also affect value chain in tourism including food, beverages and transport sectors

Remittances

Spread of the virus to countries such as South Korea and Italy could have some downward effect on remittance inflows. In 2019, 3% of total foreign employment migration was to South Korea and Italy. Further spread in the Middle East could have a severe impact on remittances

Petroleum

Crude oil prices have declined to USD 52.00 bbl by 05 March 2020 from USD 66.60 bbl at end 2019. In 2019, Sri Lanka's total fuel imports amounted to USD 3.9 bn

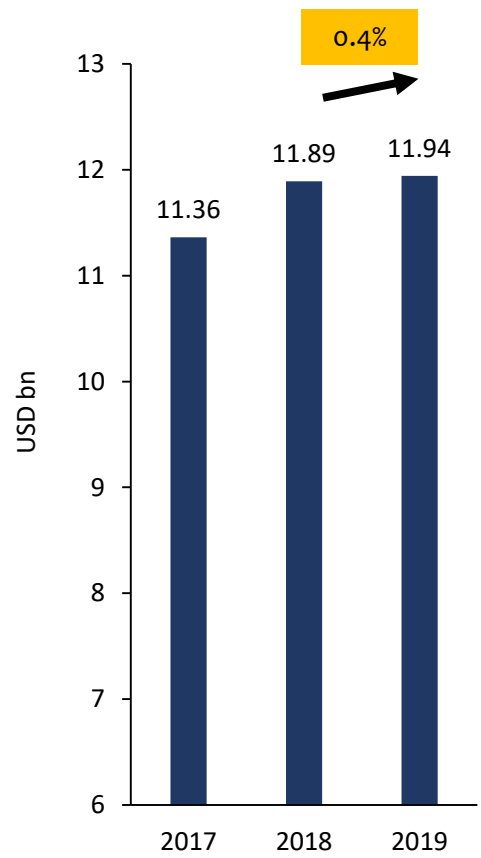
Interest rate and Investments

Major economies are likely to become more accommodative, which could help ease costs of refinancing. However, the current flight to quality of investment flows could dampen the cost advantage

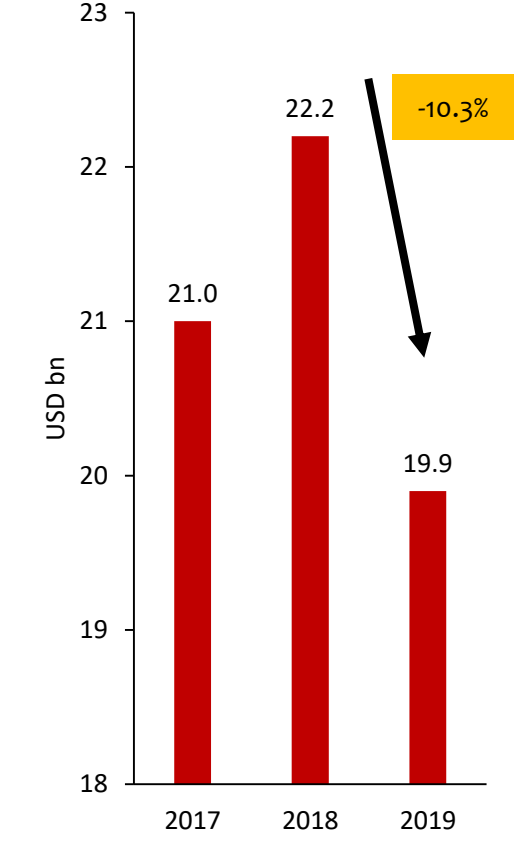
The exact impact on the Sri Lankan Economy would depend on the extent of the global spread of the COVID-19 outbreak, its persistence and policy responses of major economies and trading partners

The trade deficit contracted significantly during 2019, as a result of a sharp decline in the growth of imports and a marginal growth of exports...

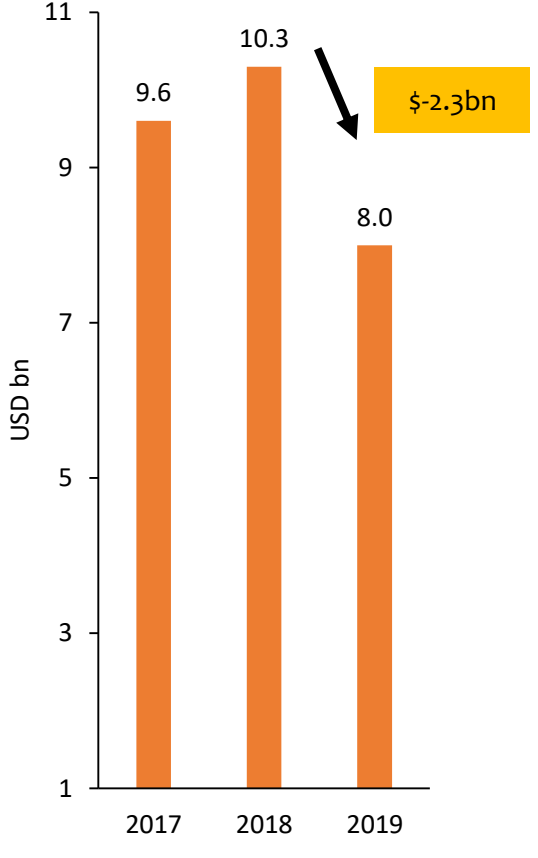
Exports



Imports

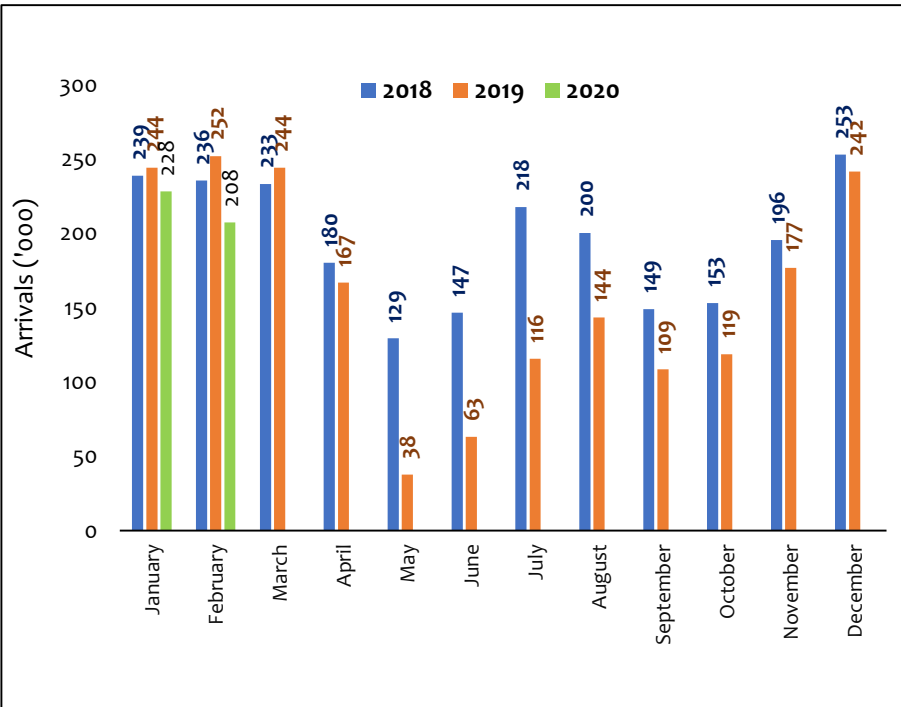


Trade Deficit



The COVID 19 outbreak will have some impact on the Tourism sector in 2020...

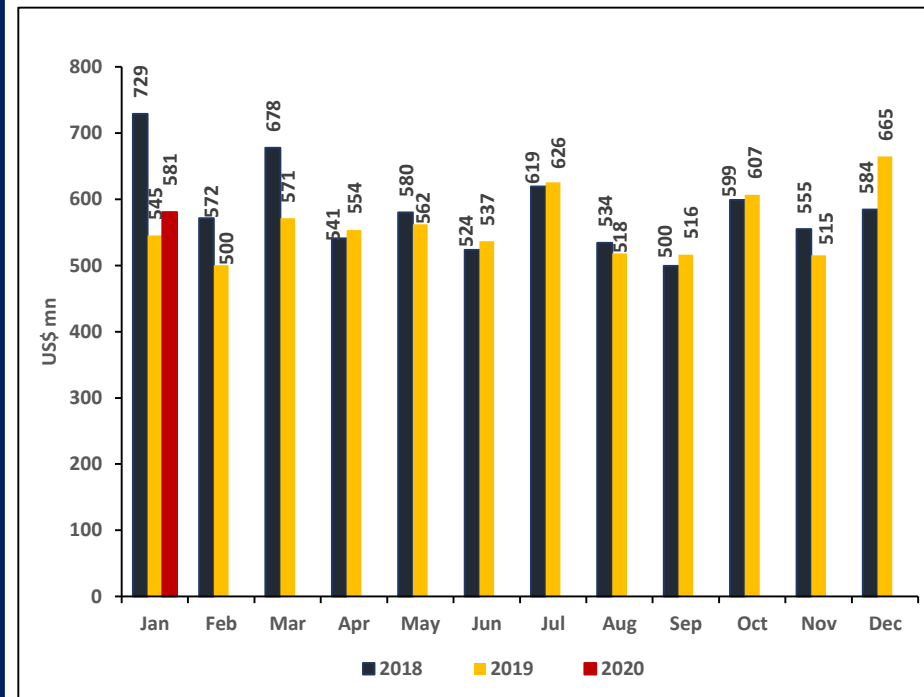
Tourist Arrivals



- Tourist Arrivals: Jan-Feb 2020, decreased by 12.2% (y-o-y)
- Tourist Arrivals decreased by 18.0% (y-o-y) in 2019 (2019: 1,913,702)

Workers' remittances grew in Dec 2019 as well as Jan 2020 on Y-o-Y basis...

Workers' Remittances



Workers' remittances in Jan 2020

- Increased by 6.5% (y-o-y) to USD 580.9 mn
- 2019: USD 6.7 bn (-4.3% y-o-y) (USD 7.0 bn in 2018)

The Sri Lankan rupee remained broadly stable with a marginal depreciation so far during 2020...

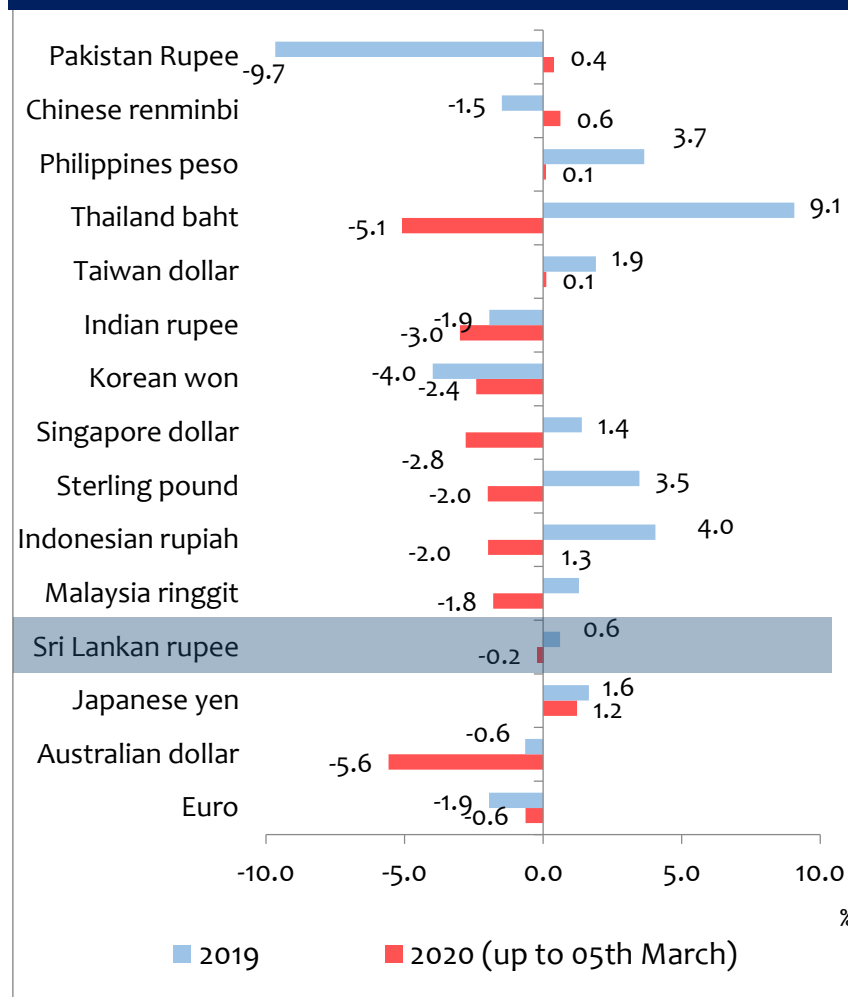
**Movement of Sri Lankan Rupee against USD
(up to 05 Mar 2020)**



LKR Movement Against Other Currencies

Currency	2019	up to 05 Mar 2020
	App(+)/Dep(-)	App(+)/Dep(-)
US dollar	+0.6 %	-0.2 %
Pound sterling	-2.8 %	+1.8 %
Euro	+2.6 %	+0.4 %
Japanese yen	-1.0 %	-1.4 %
Indian rupee	+2.6 %	+2.9 %

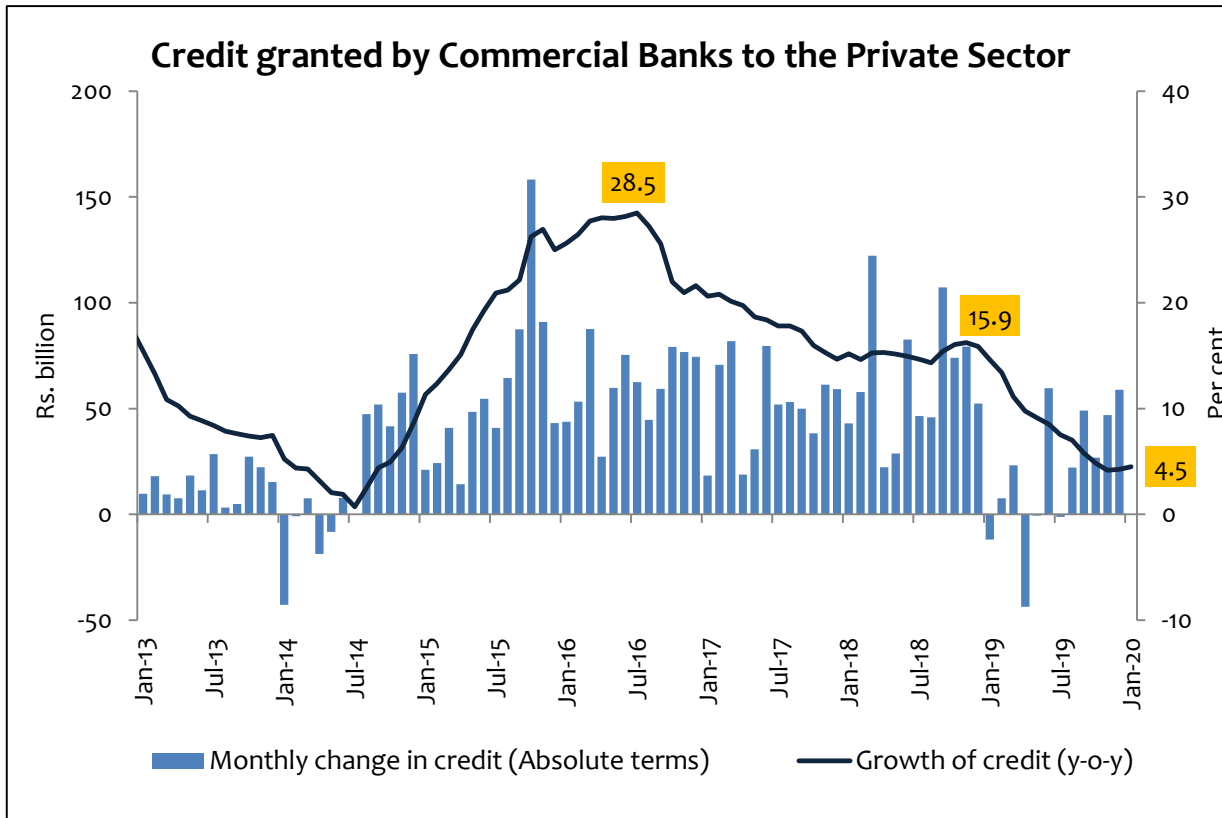
Movements in selected International Currencies against the USD



Gross official reserves recorded at USD 7.5 bn by end January 2019, providing an import cover of 4.5 months

The y-o-y growth of credit extended to the private sector continued to accelerate in January 2020...

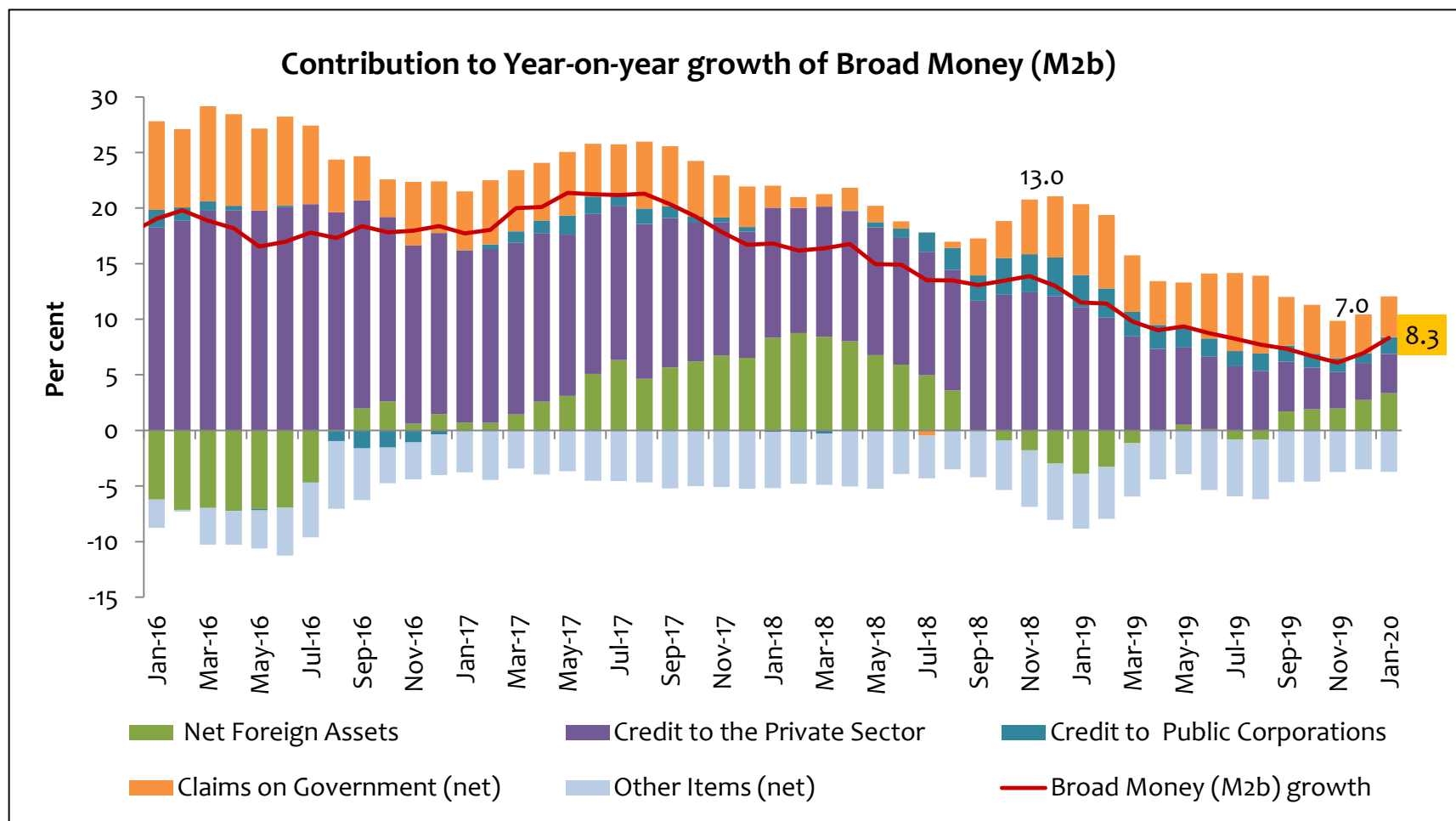
- Y-o-y growth of credit to the private sector, which started to show some recovery in Dec 2019 with a growth of 4.3%(revised), marginally increased to 4.5% in Jan 2020
 - In absolute terms, the increase in credit to the private sector in Jan 2020 was marginal



With the ongoing pass-through of policy measures to market lending rates and improving business confidence, the growth of credit to the private sector is expected to accelerate further

Driven by the domestic credit expansion, broad money growth (year-on-year) also accelerated in January 2020...

- M_{2b} growth picked up to 8.3% (y-o-y) in Jan 2020 from 7.0% in Dec 2019

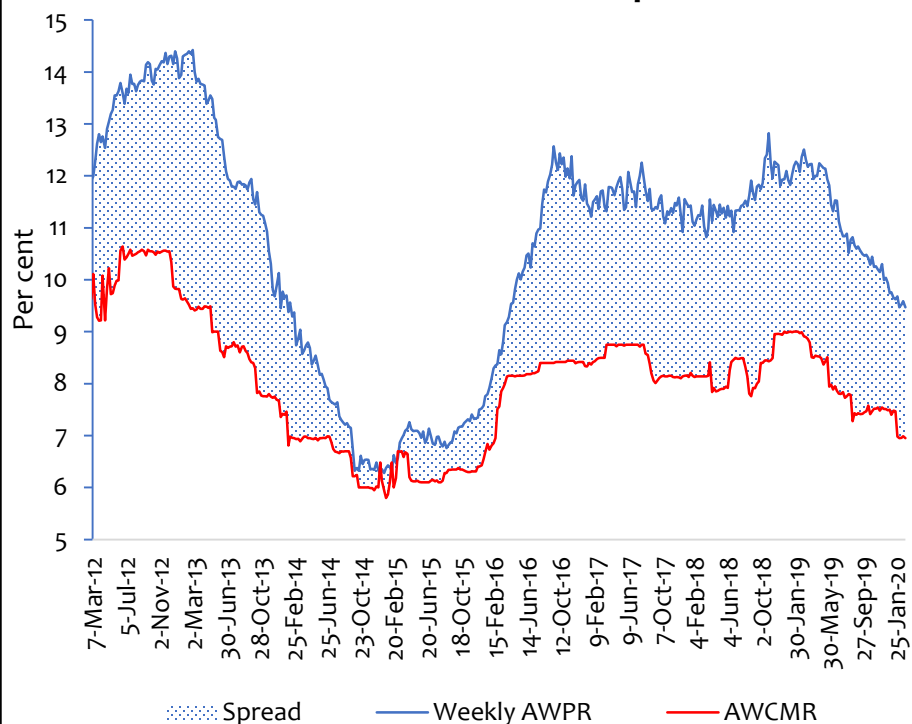


Market lending rates are expected to reduce further...

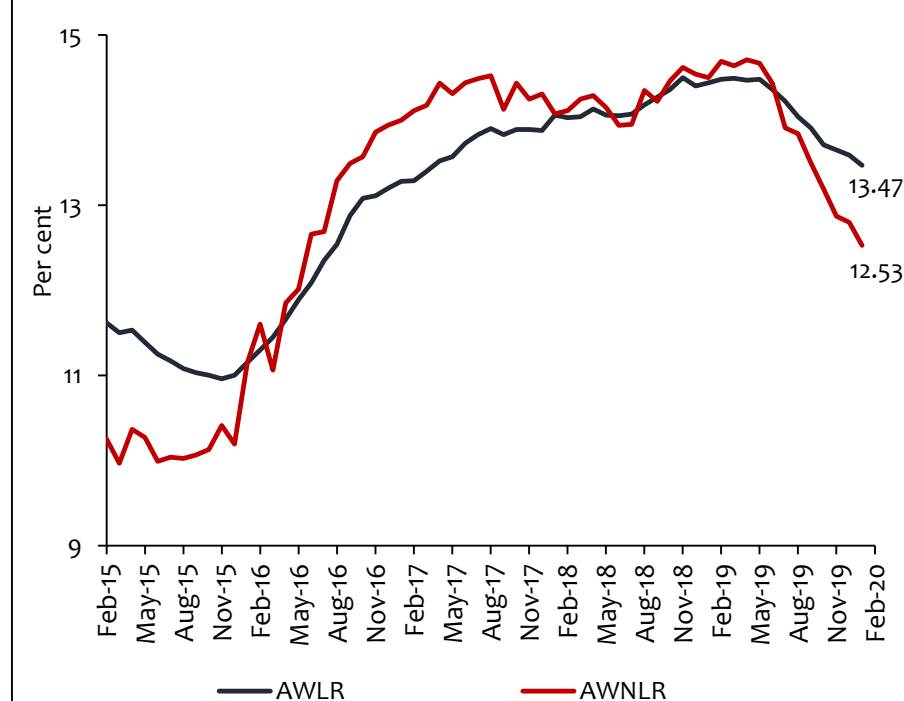
Weekly AWPR declined by 27 bps to 9.47% as of 28 Feb 2020 from end 2019

AWLR and AWNLR declined by 12 bps & 27 bps to 13.47% and 12.53%, respectively, in Jan 2020 from the previous month

Market Interest Rates and Spreads



Lending Rates



A faster downward adjustment in market lending rates is required to pass the full benefit of recent policy measures to borrowers, thereby to the economy

Inflation showed an unexpected uptick, driven by a rapid acceleration in food inflation...

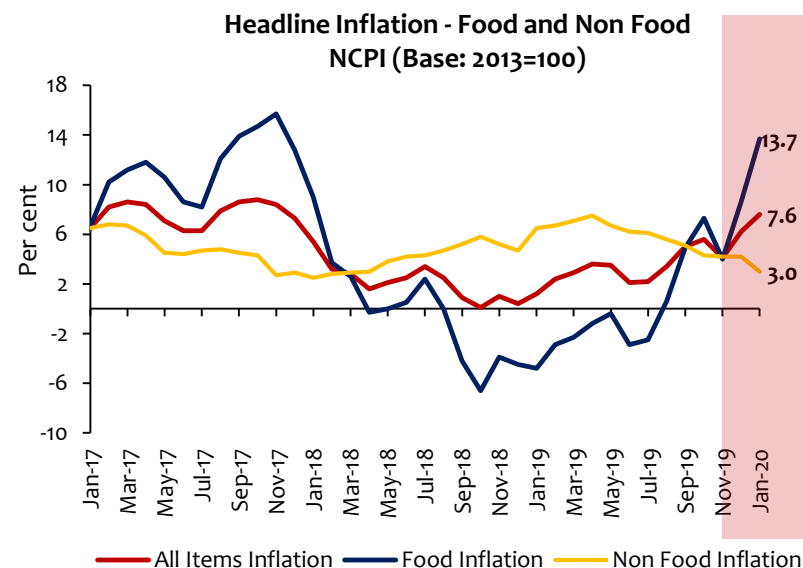
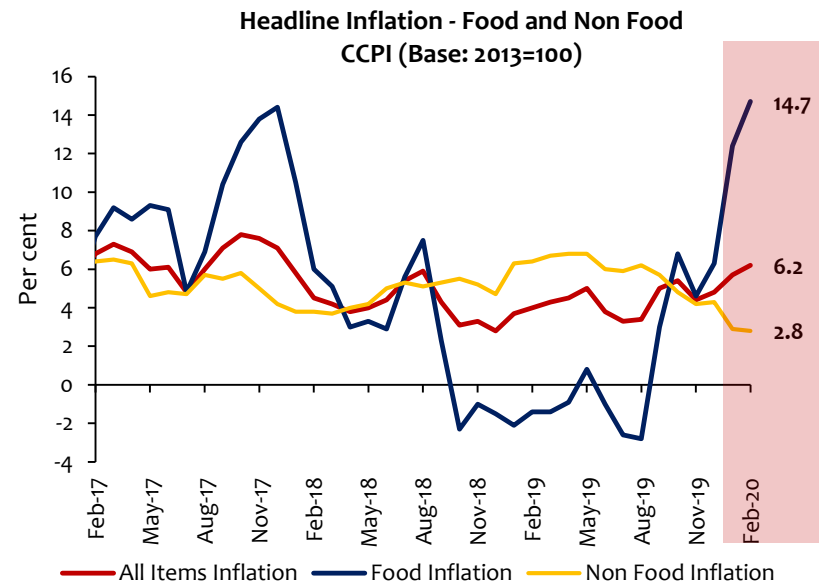
Headline inflation (%)

	Dec-16	Dec-17	Dec-18	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb 20
based on CCPI (2013=100)										
Y-o-Y	4.5	7.1	2.8	3.4	5.0	5.4	4.4	4.8	5.7	6.2
Annual average	4.0	6.6	4.3	3.8	3.9	4.0	4.1	4.3	4.5	4.6
based on NCPI (2013=100)										
Y-o-Y	4.2	7.3	0.4	3.4	5.0	5.6	4.1	6.2	7.6	
Annual average	4.0	7.7	2.1	2.0	2.3	2.8	3.0	3.5	4.1	

Core inflation (%)

	Dec-16	Dec-17	Dec-18	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb 20
based on CCPI (2013=100)										
Y-o-Y	5.8	4.3	3.1	5.6	5.6	5.5	5.1	4.8	3.0	3.2
Annual average	4.4	5.9	3.5	5.0	5.1	5.3	5.4	5.5	5.3	5.1
based on NCPI (2013=100)										
Y-o-Y	6.7	2.7	3.1	5.9	5.6	5.6	5.5	5.2	3.9	
Annual average	5.9	4.9	2.4	5.0	5.2	5.4	5.6	5.7	5.6	

- Downward adjustment food prices since end February with improving supply conditions
- Inflation is expected to stabilise within the 4-6% range over the medium term despite transitory deviations arising from supply side disruptions



Monetary Policy Decision

- **Policy Interest rates unchanged**
 - **There is ample space for market lending rates to reduce without a further adjustment in policy rates at this juncture.**
 - **Such downward adjustment in the market lending rates would also help weather any short term impact on financial markets and the real economy arising from the COVID-19 outbreak.**
- **The Central Bank will continue to monitor domestic and global macroeconomic and financial market developments, including the impact of the spread of COVID-19 globally and its effects on Sri Lanka, with a view to maintaining stable economic conditions in the period ahead, while standing ready to provide liquidity to domestic financial markets as necessary**

Thank you