

1950-2020 **Stability**
Sustainability
Shared Prosperity



Review of the Monetary Policy Stance

July 2020

Economic Research Department
Central Bank of Sri Lanka

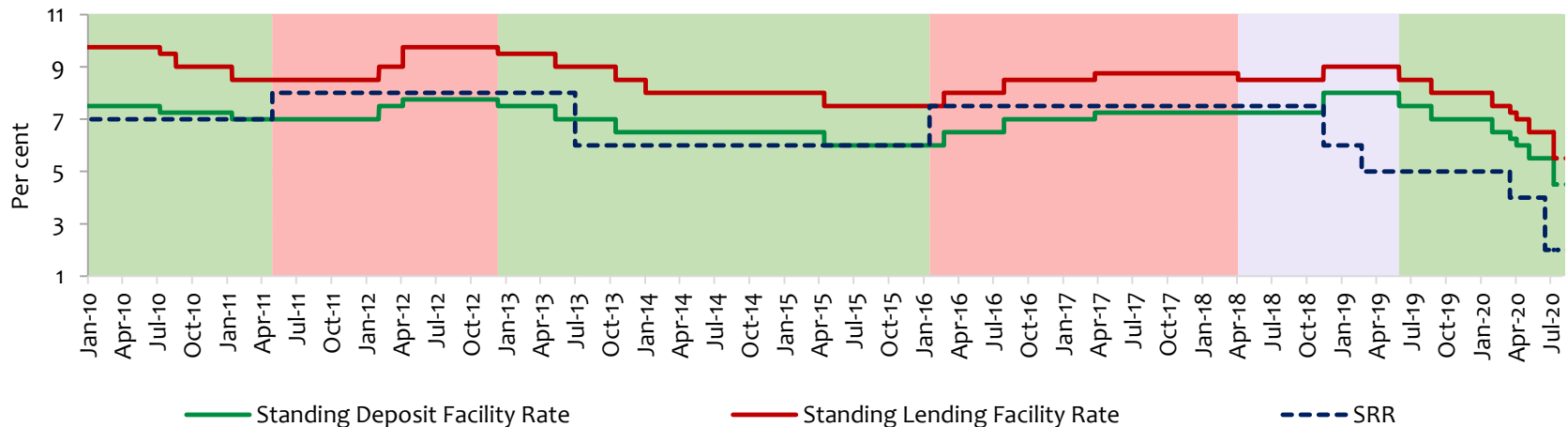
Monetary Policy Decision:

- The Central Bank of Sri Lanka Reduces its Policy Interest Rates by 100 bps

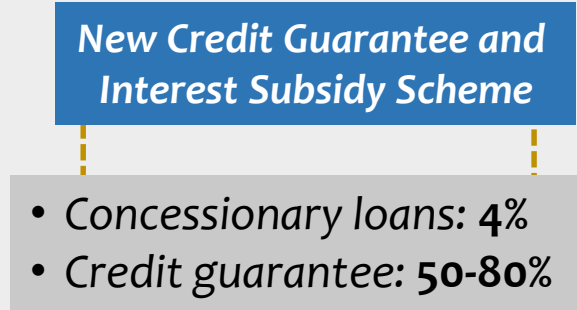
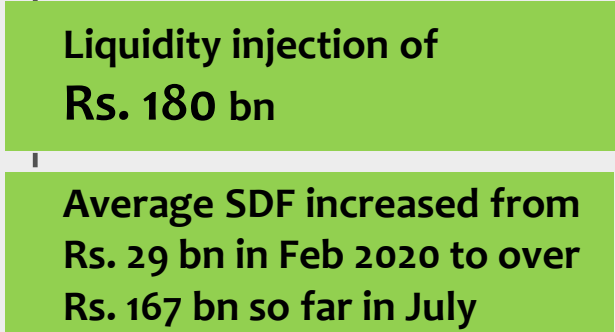
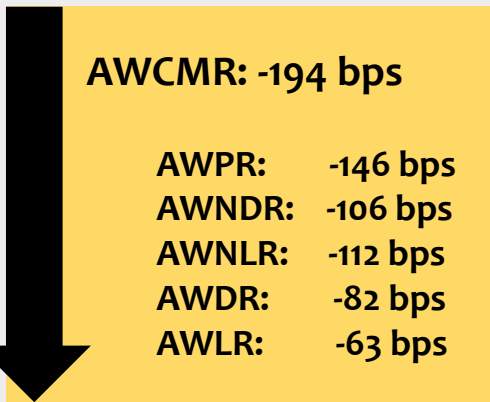
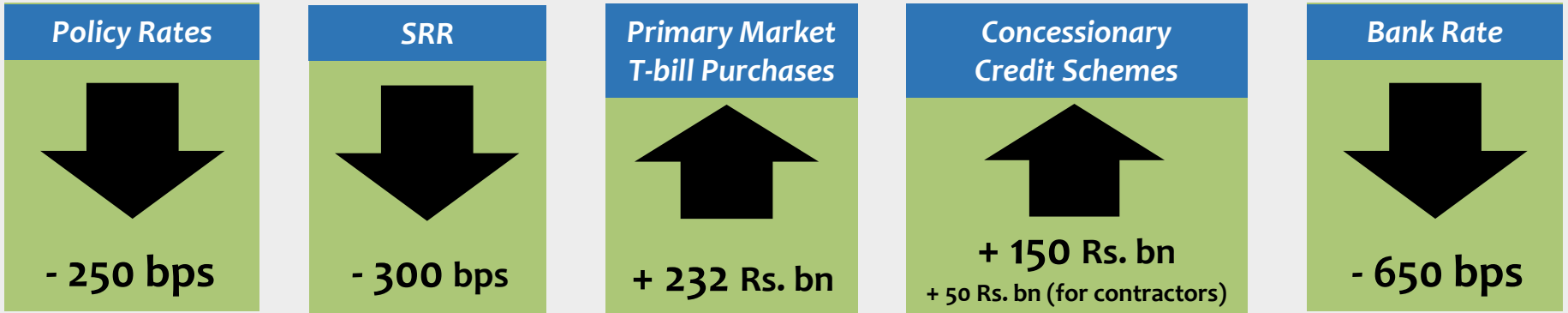
Standing Deposit Facility Rate (SDFR)	4.50%
Standing Lending Facility Rate (SLFR)	5.50%

Bank Rate (automatically adjusted with SLFR)	8.50%
Statutory Reserve Ratio (SRR)	2.00% (unchanged)

The Monetary Policy Cycle



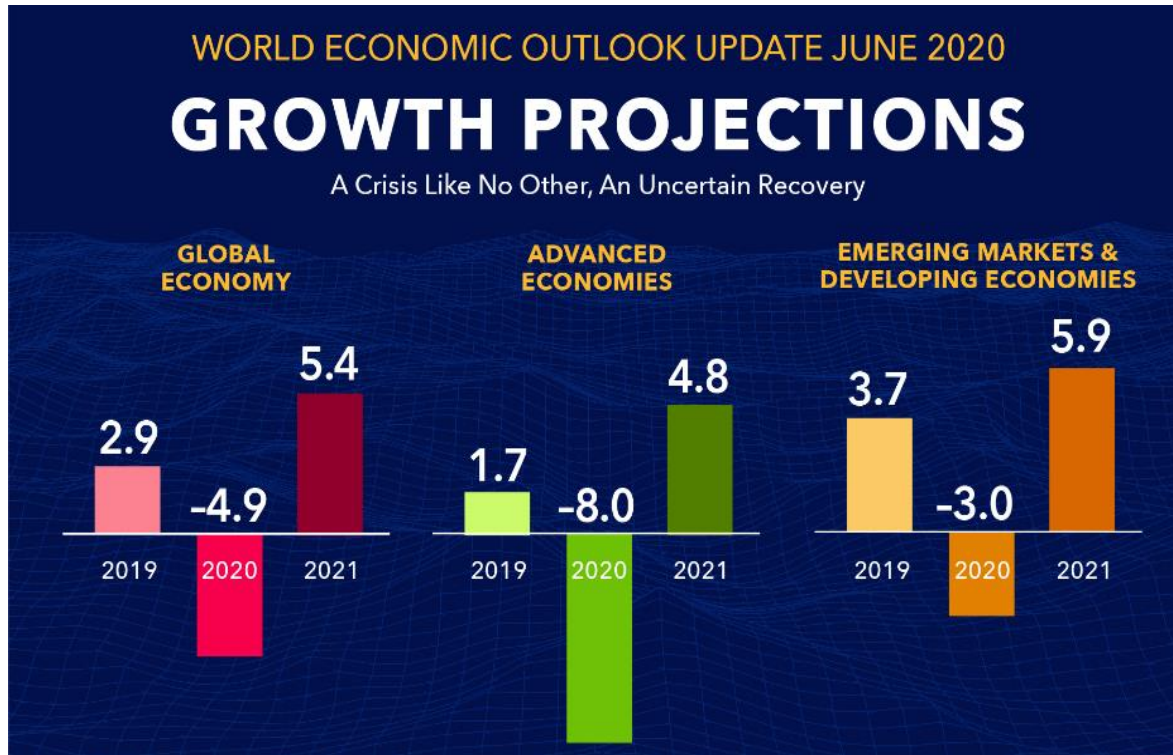
The Central Bank has taken number of policy, operational and regulatory measures to revive the economy...



Credit Support Schemes



The spread of the COVID-19 pandemic has severely impacted near term growth prospects globally...



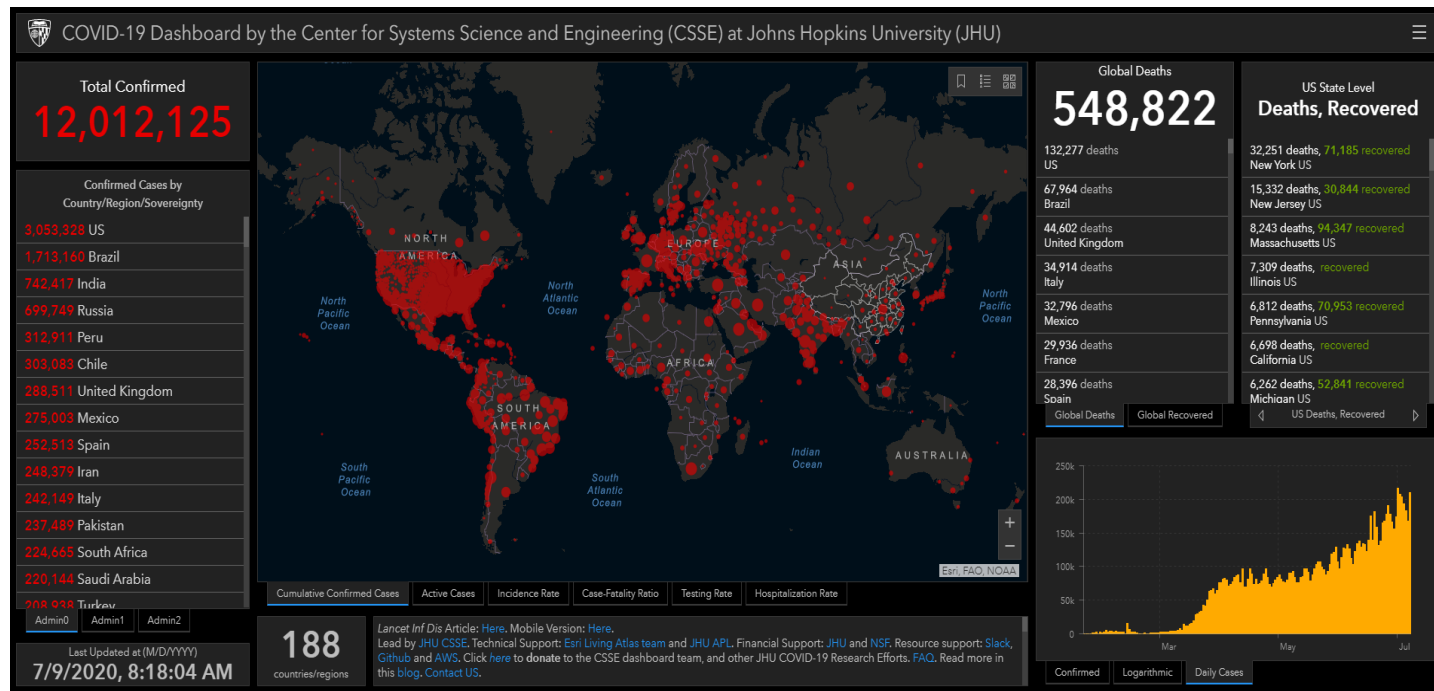
- Global growth projections for 2020 lowered by 1.9% to -4.9% from April forecast, reflecting the larger than anticipated disruptions to the economic activity in the first half of 2020
- A more gradual recovery is expected in 2021, with global growth projected at 5.4%

Response by central banks around the world:
Thus far in 2020

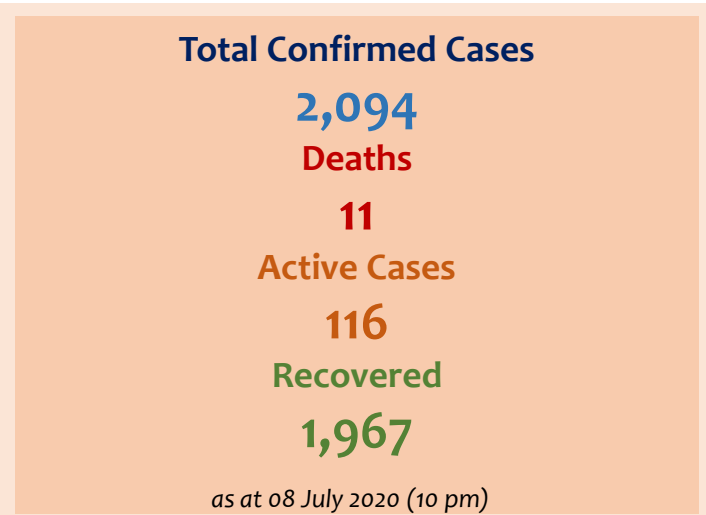
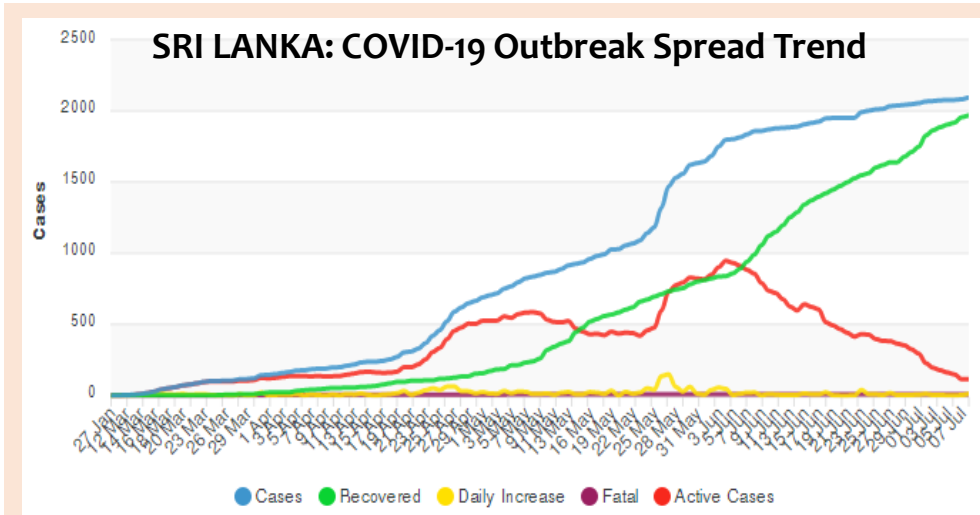
346 steps to ease monetary policy

Incl. **205** rate cuts

Spread of the COVID-19 outbreak has necessitated urgent policy action...



Source: <https://coronavirus.jhu.edu/map.html>



Source: <https://www.epid.gov.lk/web/>

Economic Impact of COVID-19 and Lockdown Measures

Adverse effects felt on:

Merchandise Exports	Tourism, Logistics	Remittances	Portfolio Capital Flows and FDI
Foreign Borrowing	Government Revenue	Government Expenditure	Domestic Businesses
Economic Growth	Unemployment and Incomes	Financial System	Sovereign Outlook

Mitigatory factors include:

Lower Imports	Lower Energy Prices	Lower Taxes	Low Inflation Pressures
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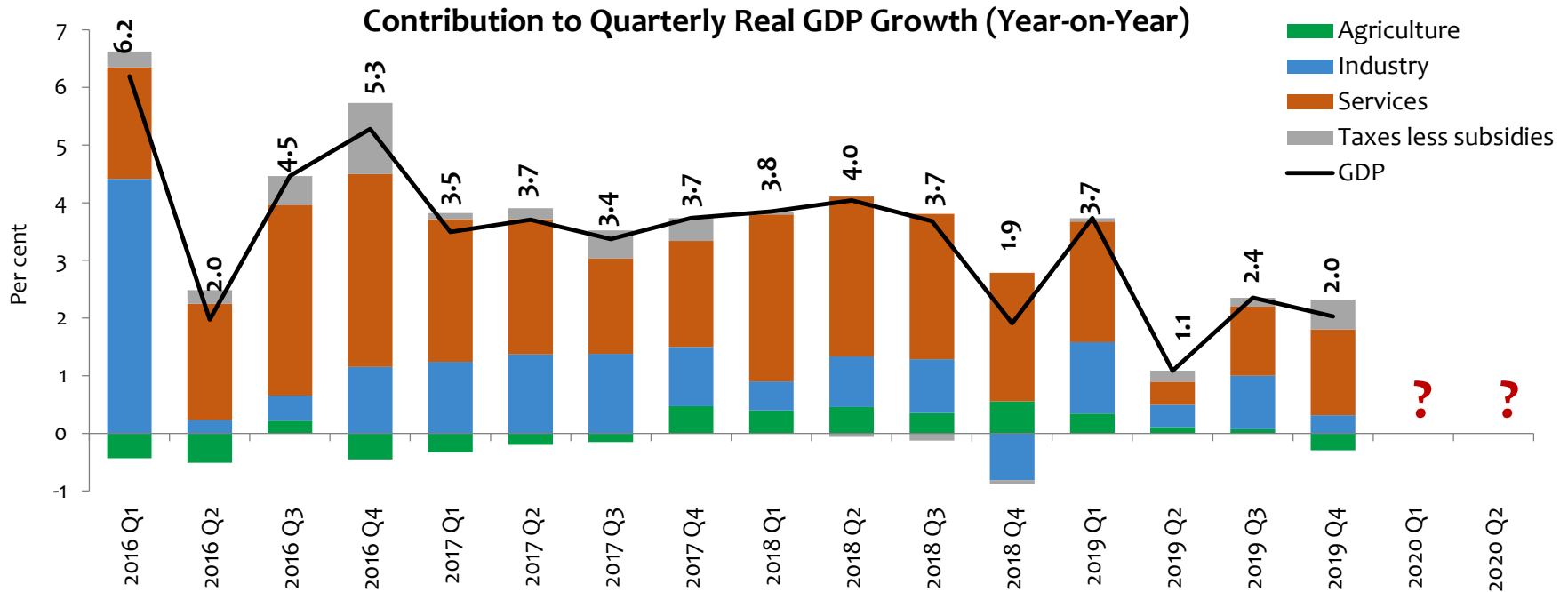
Corrective measures include:

Reduced Interest Rates	Enhanced Liquidity and Concessionary Credit	Import and Capital Restrictions	Measures to Attract Foreign Currency Inflows
CBSL financing of the Government	Promote Domestic Production	Safety Net Payments	Relaxing Financial Regulations

Further measures needed to:

<p>Short Term</p> <ul style="list-style-type: none"> • Explore all avenues to raise foreign currency financing • Ensure transmission of policy easing to market lending rates • Ensure credit flows to needy sectors 	<p>Medium/Long Term</p> <ul style="list-style-type: none"> • Introduce structural reforms aimed at high economic growth • Reduce debt levels through fiscal consolidation • Maintain economic stability and build policy buffers
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Available indicators for Sri Lanka also suggest that the economic growth is likely to have been severely affected during the second quarter of 2020...

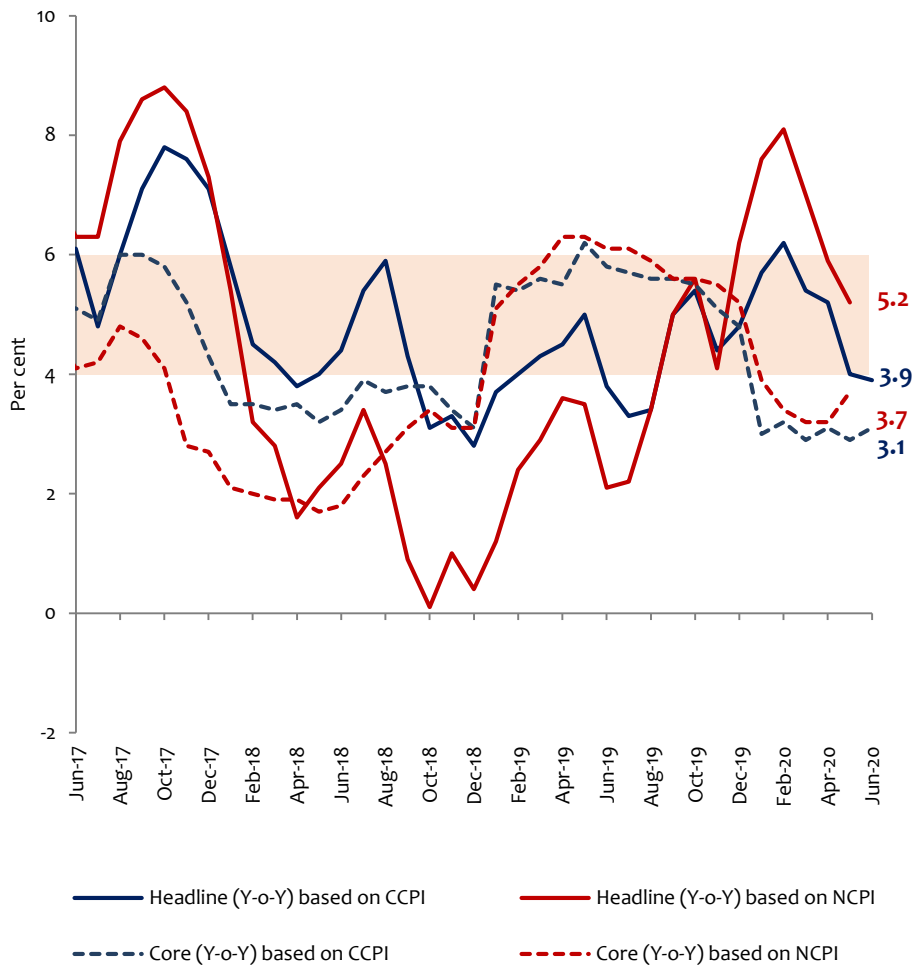


Source: Department of Census and Statistics

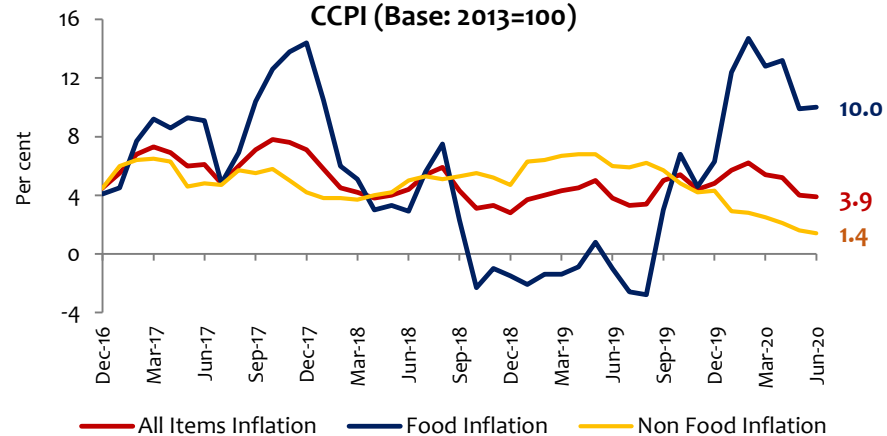
- A rebound is expected during the second half of the year with the support of monetary and fiscal stimulus measures
- However, the introduction of growth promoting and confidence enhancing structural reforms is imperative to foster high and sustainable economic growth over the medium term

Meanwhile, inflation remains subdued...

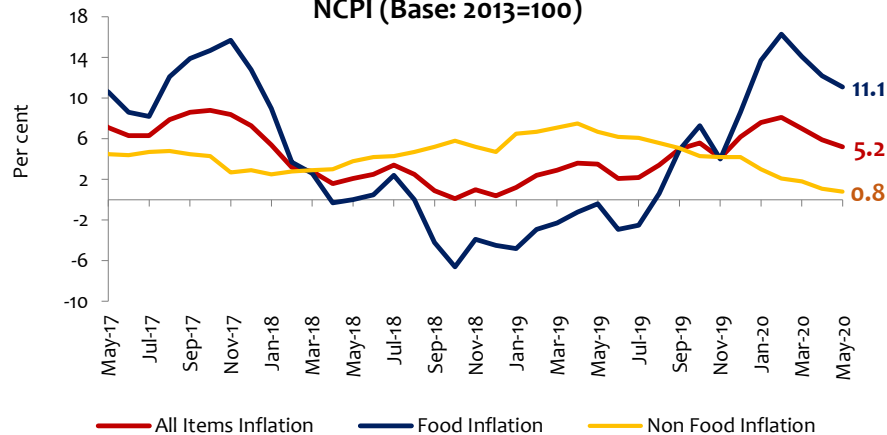
Movements in Headline and Core Inflation (y-o-y)



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



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



Source: Department of Census and Statistics

Foreign inflows have moderated notably amidst the Covid-19 outbreak...

- Export earnings **declined by 29.7% to USD 3.5 bn** during the first five months compared to USD 4.9 bn in the same period of 2019
- Import **expenditure declined by 19.3% to USD 6.6 bn** during first five months of 2020 compared to USD 8.2 bn in the same period of 2019

- Tourist arrivals up to end June 2020 decreased by 49.7% (y-o-y) to 507,311
- **No tourist arrivals recorded since end March**

- **Workers' Remittances from Jan-May 2020 decreased by 11.9% to USD 2.4 bn compared to USD 2.7 bn in the same period of 2019**

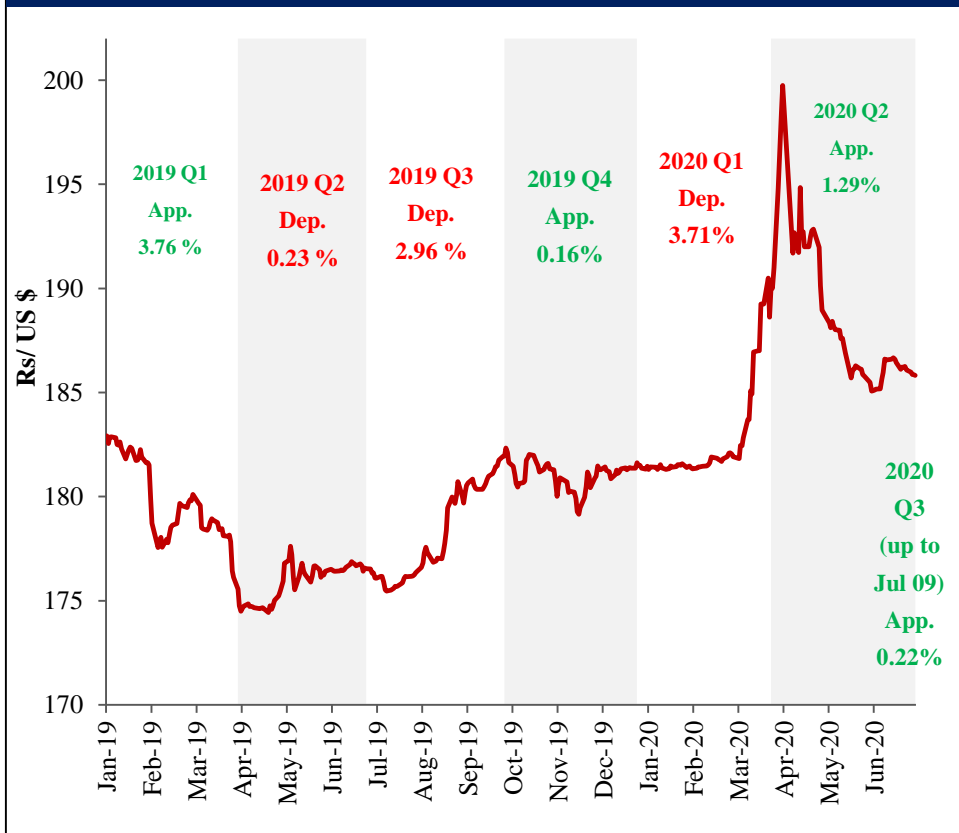
- A net outflow was recorded in the Government Securities market since March 2020

- Foreign investments in CSE have recorded a net outflow of USD 118 mn up to 08 July 2020

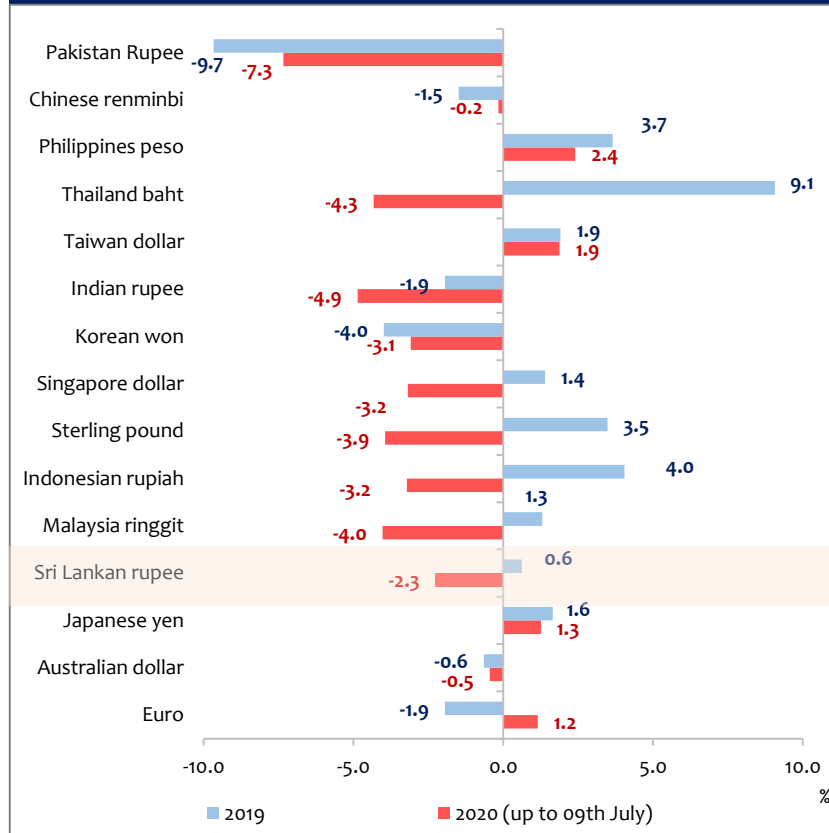
- FDI, including foreign loans to BOI companies amounted USD 192 mn in the first quarter of 2020

The Sri Lankan rupee, which remained volatile briefly from mid-March to mid-April 2020, recorded a notable appreciation thereafter...

Movement of Sri Lankan Rupee against USD (up to 09 July 2020)



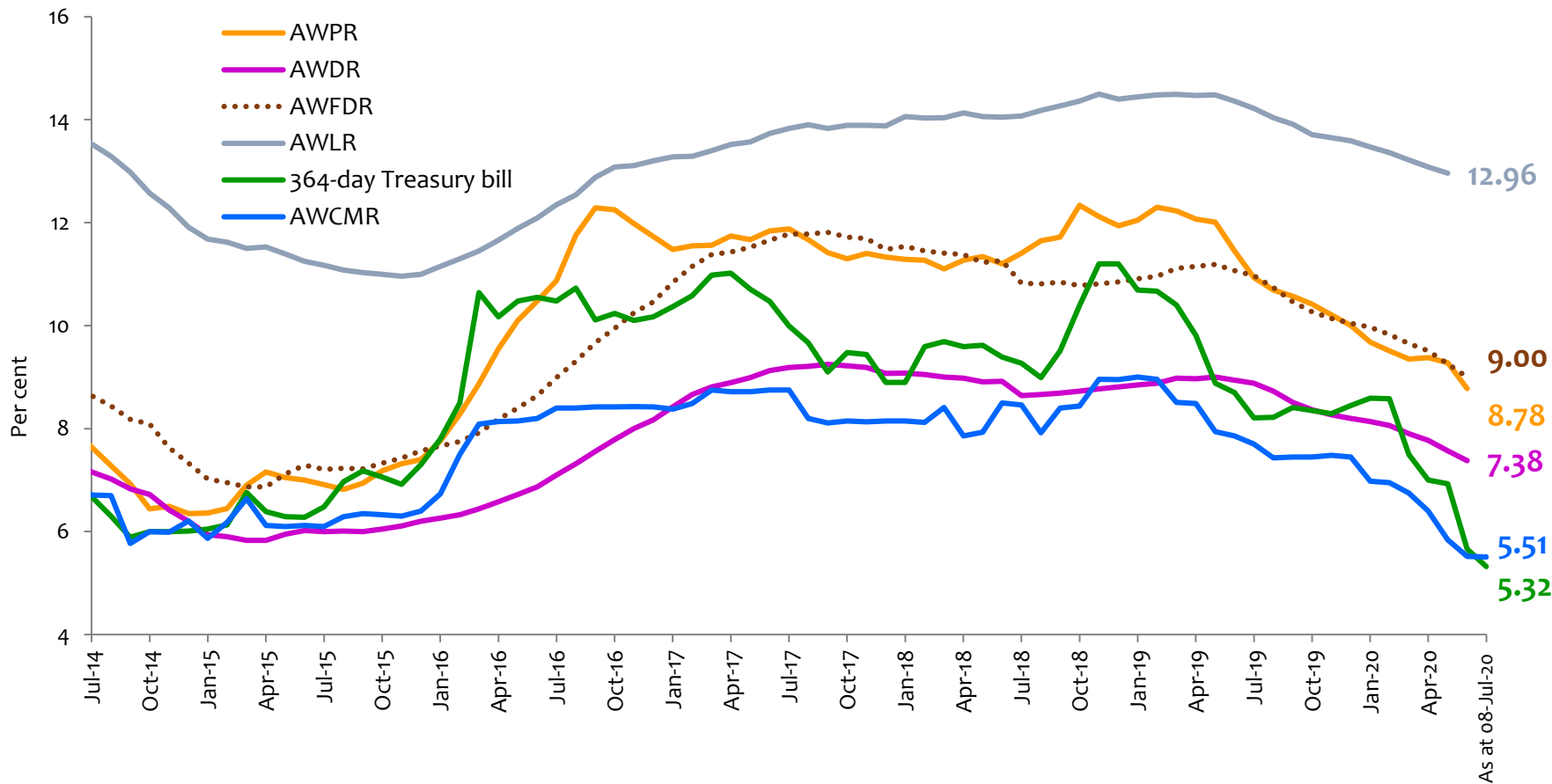
Movements in selected International Currencies against the USD



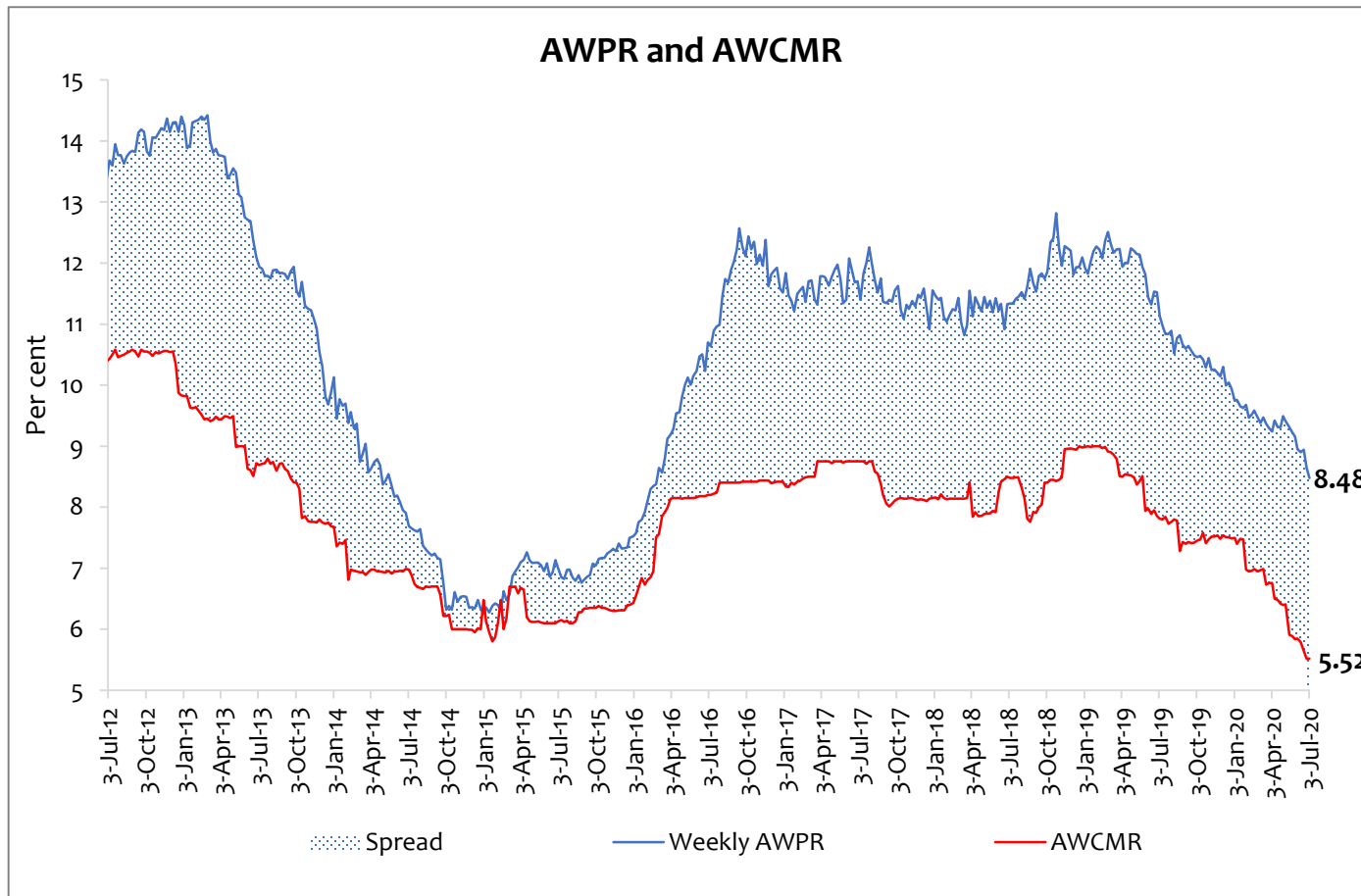
Gross official reserves stood at USD 6.7 bn by end June 2020, sufficient to cover 4.2 months of imports

Market interest rates continued to decline reflecting the impact of policy rate reductions and the surplus liquidity in the domestic money market...

Movement of Selected Market Interest Rates



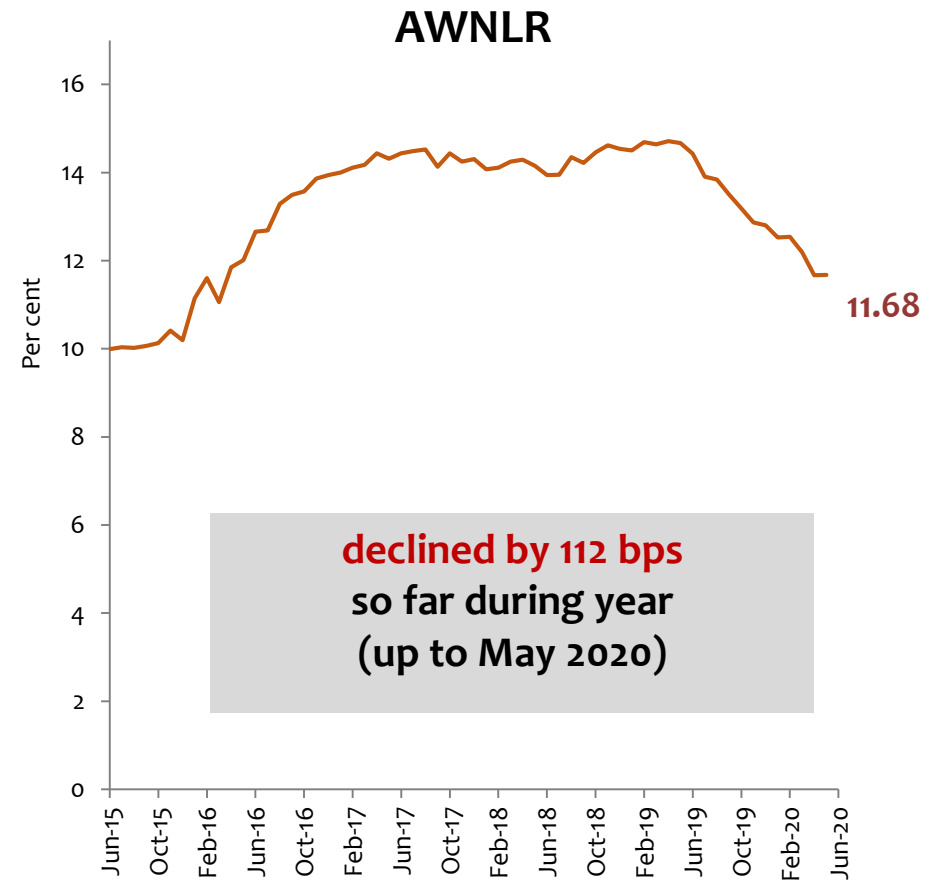
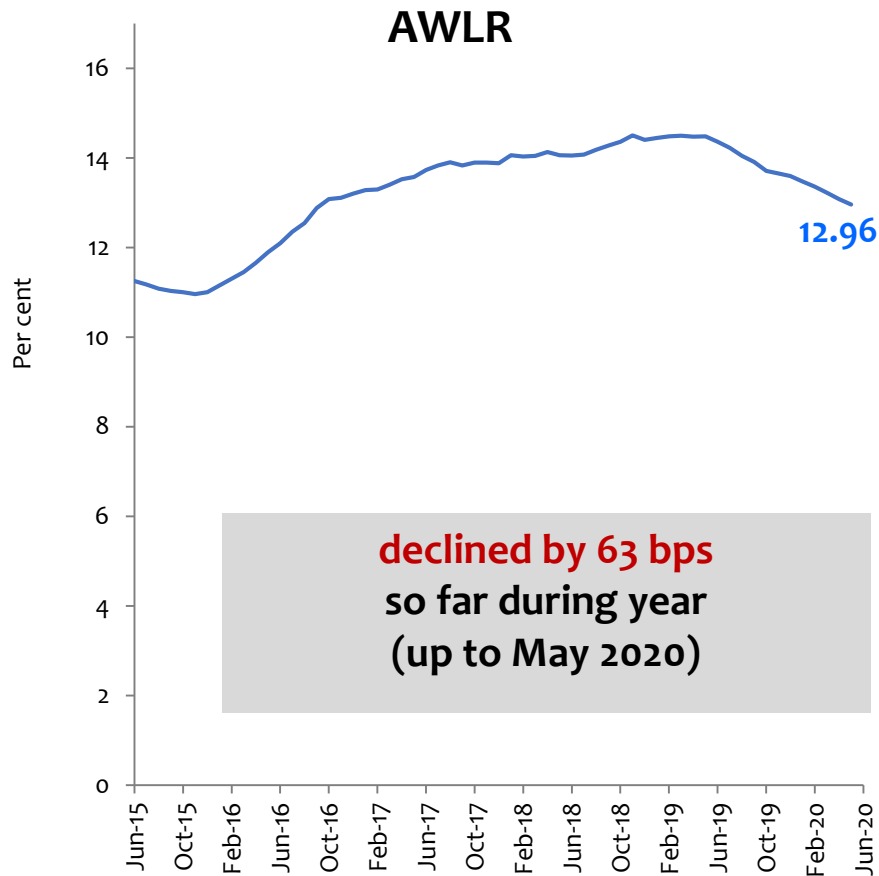
However, the decline in market lending rates has been sluggish compared to policy easing...



Weekly AWPR	
27-Dec-19	9.94
31-Jan-20	9.68
28-Feb-20	9.47
06-Mar-20	9.38
13-Mar-20	9.47
20-Mar-20	9.37
27-Mar-20	9.29
03-Apr-20	9.24
09-Apr-20	9.42
17-Apr-20	9.31
24-Apr-20	9.31
30-Apr-20	9.49
06-May-20	9.41
15-May-20	9.31
22-May-20	9.23
29-May-20	9.16
04-Jun-20	8.95
12-Jun-20	8.90
19-Jun-20	8.94
26-Jun-20	8.65
03-Jul-20	8.48

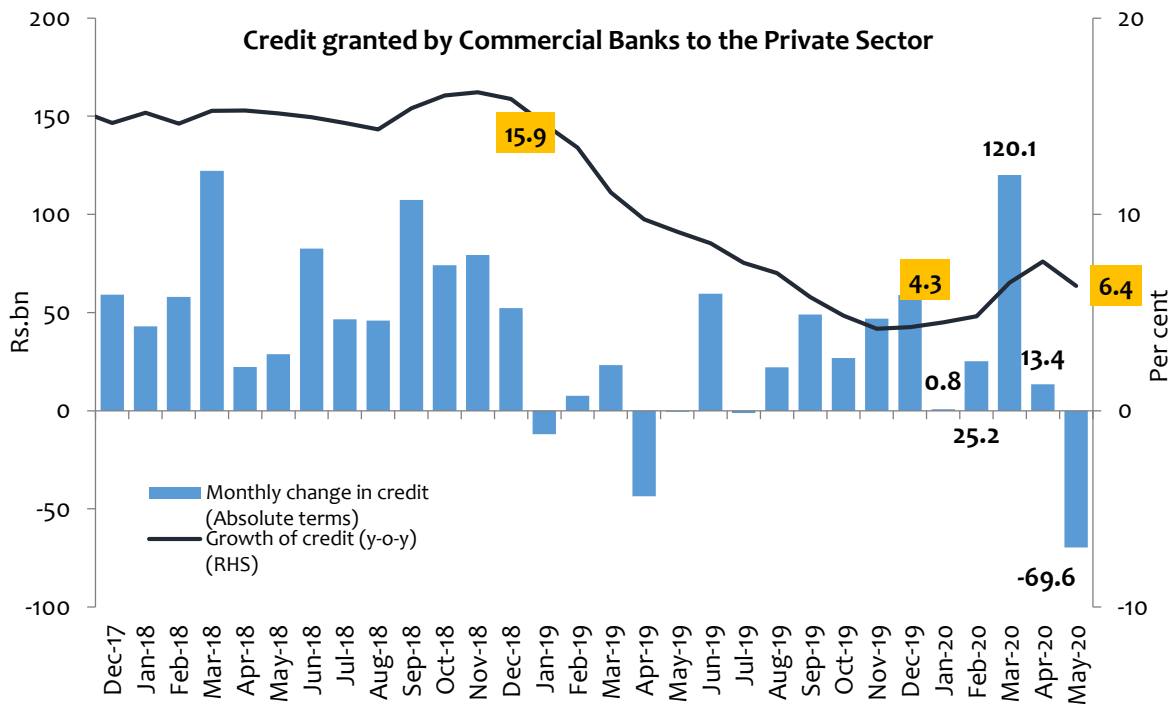
As AWPR declined only by 146 bps thus far in 2020 in response to 150 bps reduction in policy rates (by 3 July 2020) and 300 bps reduction in SRR

Further space remains for market lending rates to adjust downwards towards a single digit interest rate structure...



Despite high levels of surplus liquidity available to banks, credit extended to the private sector contracted significantly in May 2020...

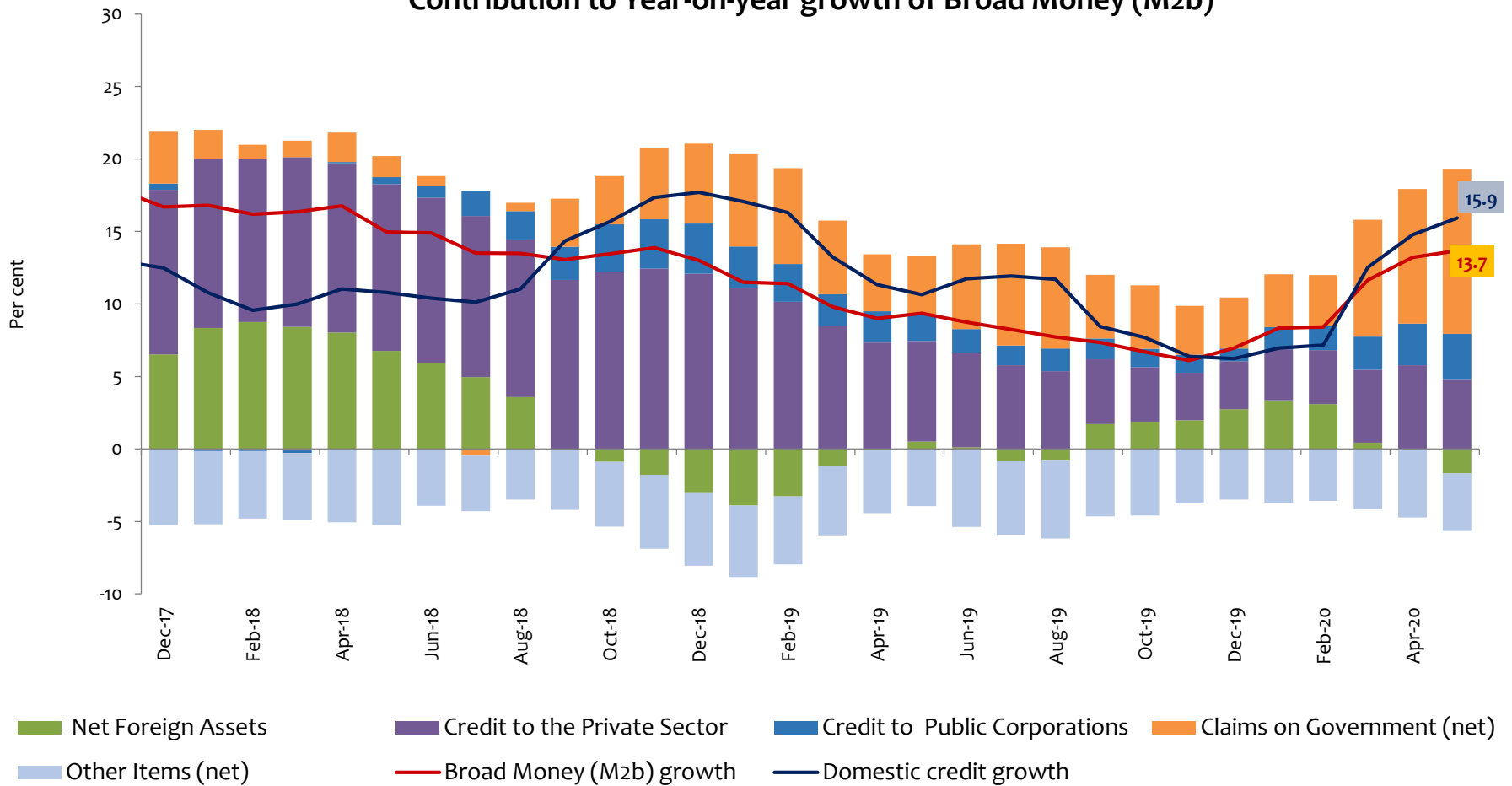
- Growth of credit to the private sector, which continued to pickup since Dec 2019, dropped in May 2020 to 6.4% (from 7.6% in April)
- On a cumulative basis, credit to private sector increased only by Rs. 89.9 bn during the first 5 months of 2020



Credit extended to the private sector is likely to pick up in the period ahead supported by the expected sharp reduction in lending rates and highly concessional credit schemes introduced to support COVID-19 hit businesses...

The notable increase in credit to the public sector drove the increase in domestic credit as well as the overall monetary expansion during the first five months of 2020...

Contribution to Year-on-year growth of Broad Money (M2b)



Monetary Policy Decision

- The Monetary Board strongly reiterated that all financial institutions led by **LCBs must pass on the full benefit of the cumulative reduction of 250 bps** in policy interest rates without delay
- LCBs are also expected to **release to the private sector borrowers, the enhanced levels of liquidity with the reduction of SRR by 300 bps** thus far during the year, which has also reduced the cost of funds of banks
 - Additional liquidity must be used to **lend to productive sectors of the economy**, along with concessionary credit schemes already announced by the Central Bank to help needy sectors of the economy