

Monetary Policy Review No. 6 of 2021: Press Conference

19 August 2021



Review of the Monetary Policy Stance

August 2021

Economic Research Department
Central Bank of Sri Lanka

Monetary Policy Decision

The Central Bank of Sri Lanka increased the policy interest rates and the SRR with a view to addressing the imbalances on the external sector of the economy and to preempt the buildup of any excessive inflationary pressures over the medium term, amidst improved growth prospects...

Policy interest rates increased by 50 bps and SRR^(a) increased by 2.00 percentage points

Standing Deposit Facility Rate (SDFR)	5.00%
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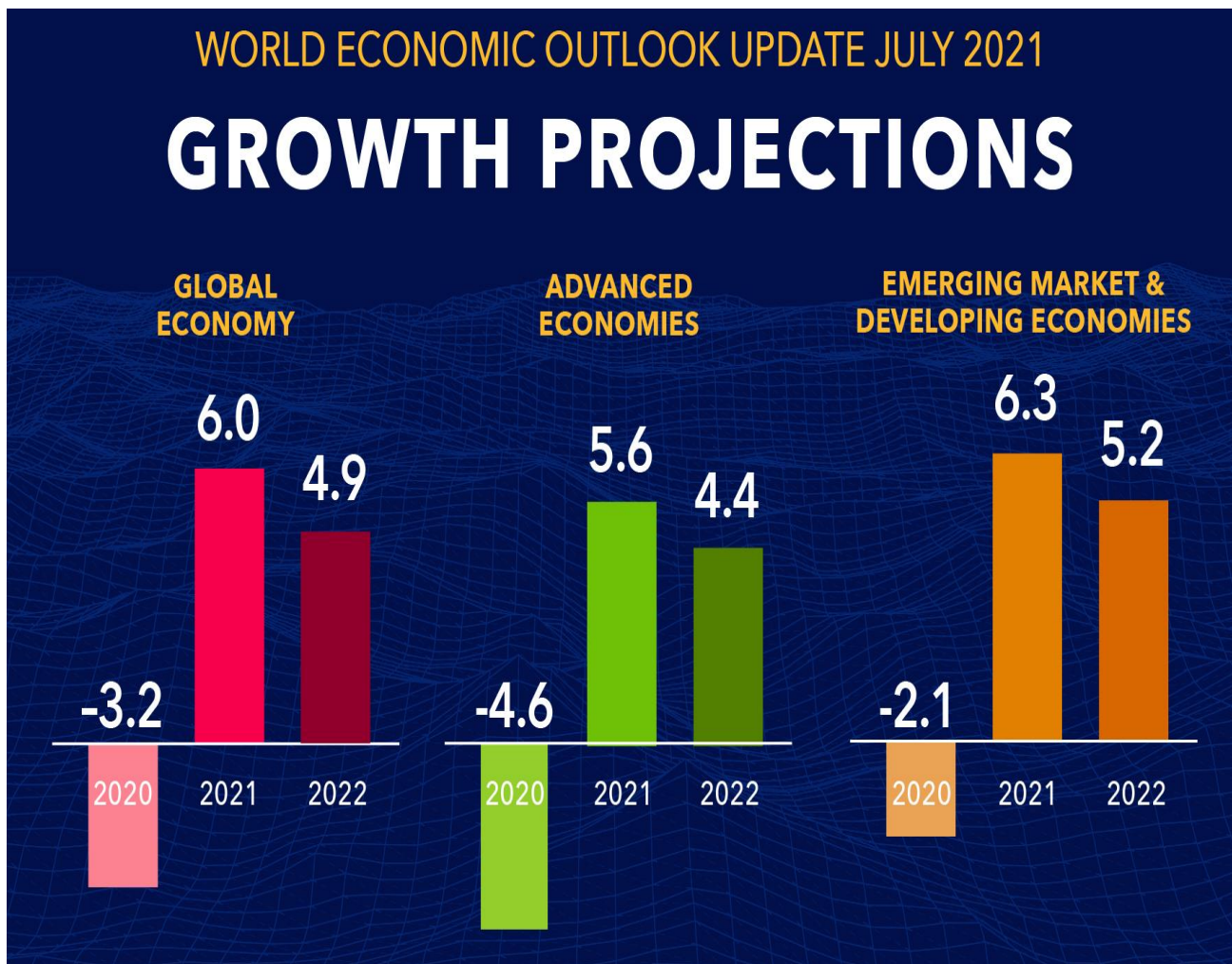
Standing Lending Facility Rate (SLFR)	6.00%
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Bank Rate (automatically adjusted with SLFR)	9.00%
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Statutory Reserve Ratio (SRR)	4.00%
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(a) SRR increased to 4.00 with effect from 1 September 2021

The global economy is set to make a gradual recovery in 2021, although normalisation of economic activity would largely be uneven across regions...



Source: IMF

Real GDP Growth (Y-o-Y, %)

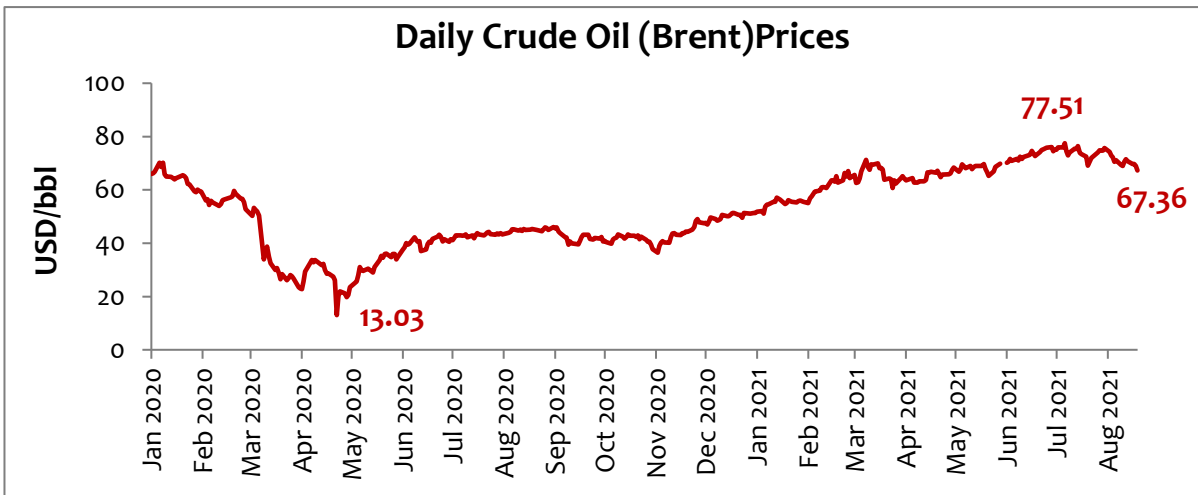
	2019	2020	2021 (Projection)	2022 (Projection)
World Output	2.8	-3.2	6.0	4.9
Advanced Economies	1.6	-4.6	5.6	4.4
United States	2.2	-3.5	7.0	4.9
Euro Area	1.3	-6.5	4.6	4.3
Japan	0.0	-4.7	2.8	3.0
United Kingdom	1.4	-9.8	7.0	4.8
Emerging Market and Developing Economies	3.7	-2.1	6.3	5.2
Russia	2.0	-3.0	4.4	3.1
China	6.0	2.3	8.1	5.7
India	4.0	-7.3	9.5	8.5
Brazil	1.4	-4.1	5.3	1.9
ASEAN	4.9	-3.4	4.3	6.3
Sri Lanka	2.3	-3.6	4.0	4.1

Source: IMF WEO - July 2021

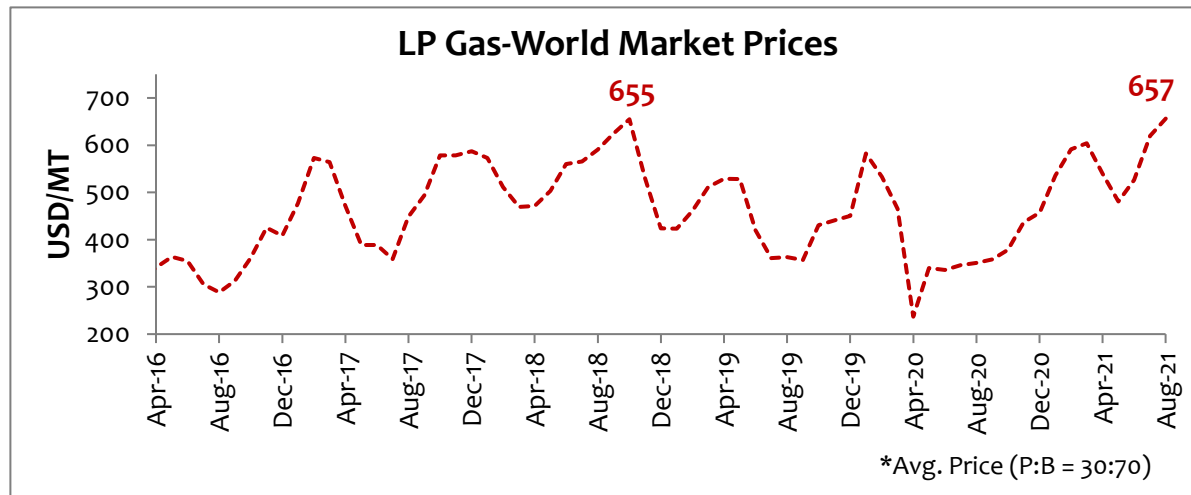
Source: IMF WEO - April 2021



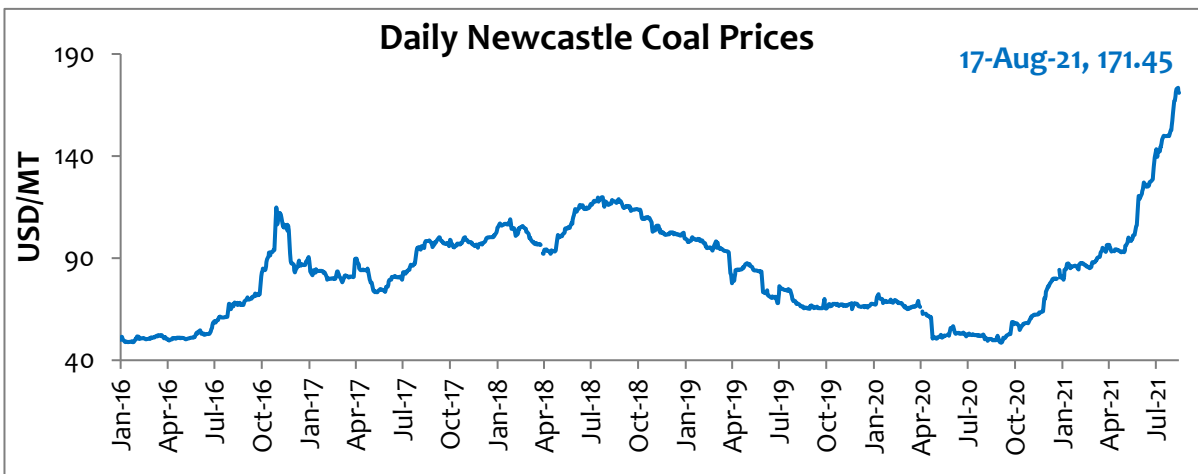
Global food and commodity prices are on the rise...



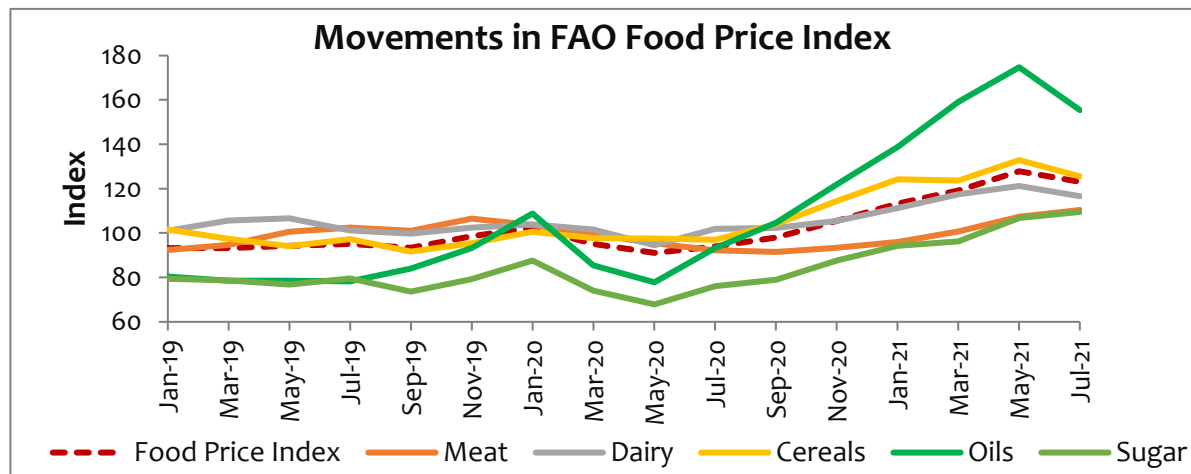
Source: Bloomberg



Source: Saudi Aramco

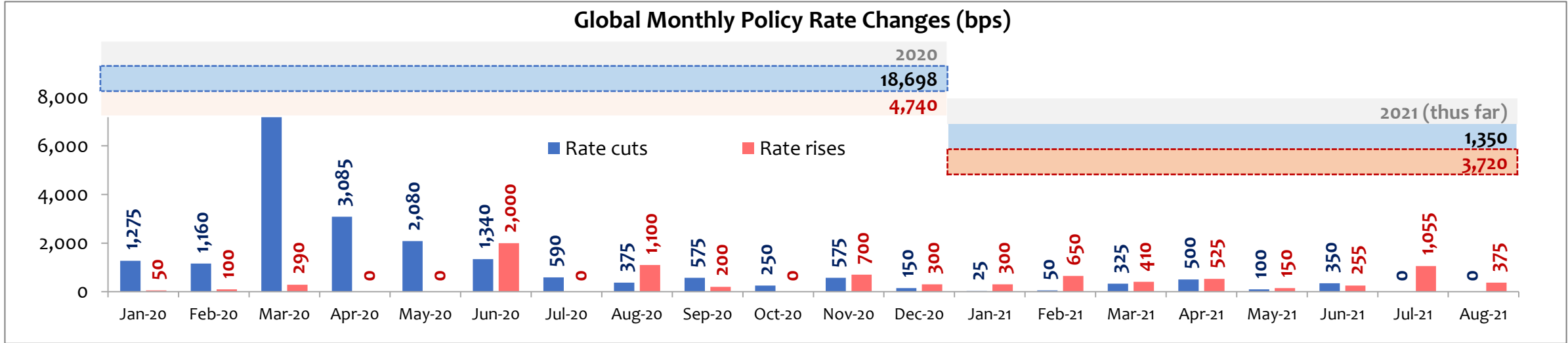


Source: Reuters



Source: Food and Agriculture Organization

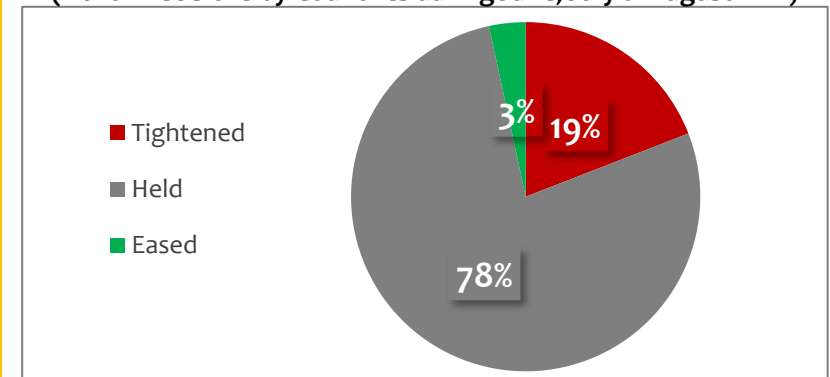
Some central banks have already commenced tightening monetary policy while several others have signalled a possible tightening in the period ahead...



Source: <http://www.centralbanknews.info>

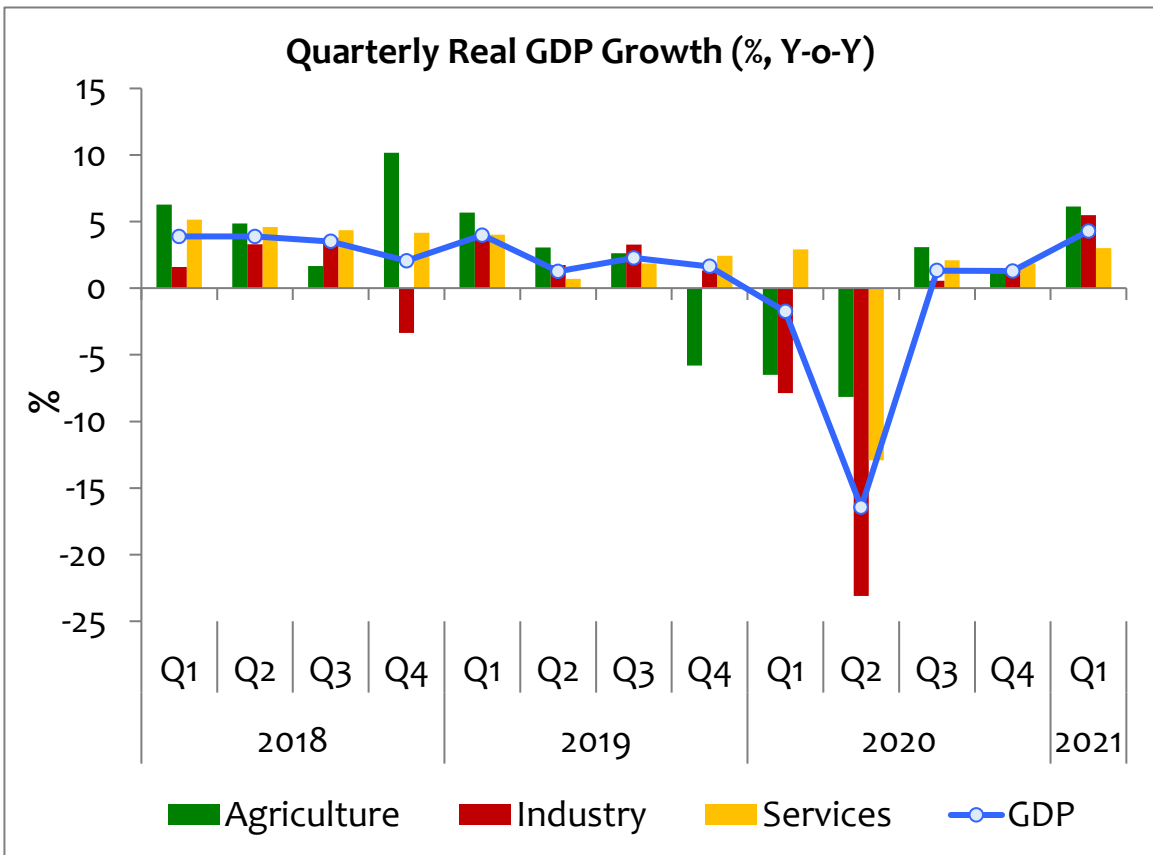
- Most countries have experienced transitory price pressures due to supply-demand mismatches amidst the pandemic
- Such transitory pressures could become more persistent, thereby warranting preemptive action by central banks in order to ensure stability in the period ahead

Global Monetary Policy Decisions
(No. of Decisions by Countries during June, July & August 2021)



Source: Respective Central Banks

The Sri Lankan economy is on a recovery path despite the pandemic related disruptions...



Economic Activity	Growth Rates (%)										
	2019					2020					2021*
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual	
Agriculture	5.7	3.1	2.6	-5.8	1.0	-6.5	-8.2	3.1	1.3	-2.4	6.1
Industry	3.9	1.7	3.3	1.3	2.6	-7.9	-23.1	0.6	1.3	-6.9	5.5
Services	4.0	0.7	1.8	2.4	2.2	2.9	-12.9	2.1	1.9	-1.5	3.0
Taxes less Subsidies	1.3	2.6	1.8	2.9	2.4	-10.8	-30.4	-2.9	-0.8	-8.0	11.2
GDP	4.0	1.3	2.3	1.6	2.3	-1.8	-16.4	1.3	1.3	-3.6	4.3

Source: Department of Census & Statistics

* Provisional estimates | Sources: Department of Census & Statistics

• With the successful rolling out of the national COVID-19 vaccination programme and the Government’s strategy to impose only selective mobility restrictions, the momentum of activity is expected to sustain in the period ahead

The Central Bank has supported the Government's efforts to manage the COVID-19 pandemic and revive the economy through unprecedented monetary stimuli...

Addressing COVID-19 pandemic related economic and social implications was the immediate challenge, particularly in 2020

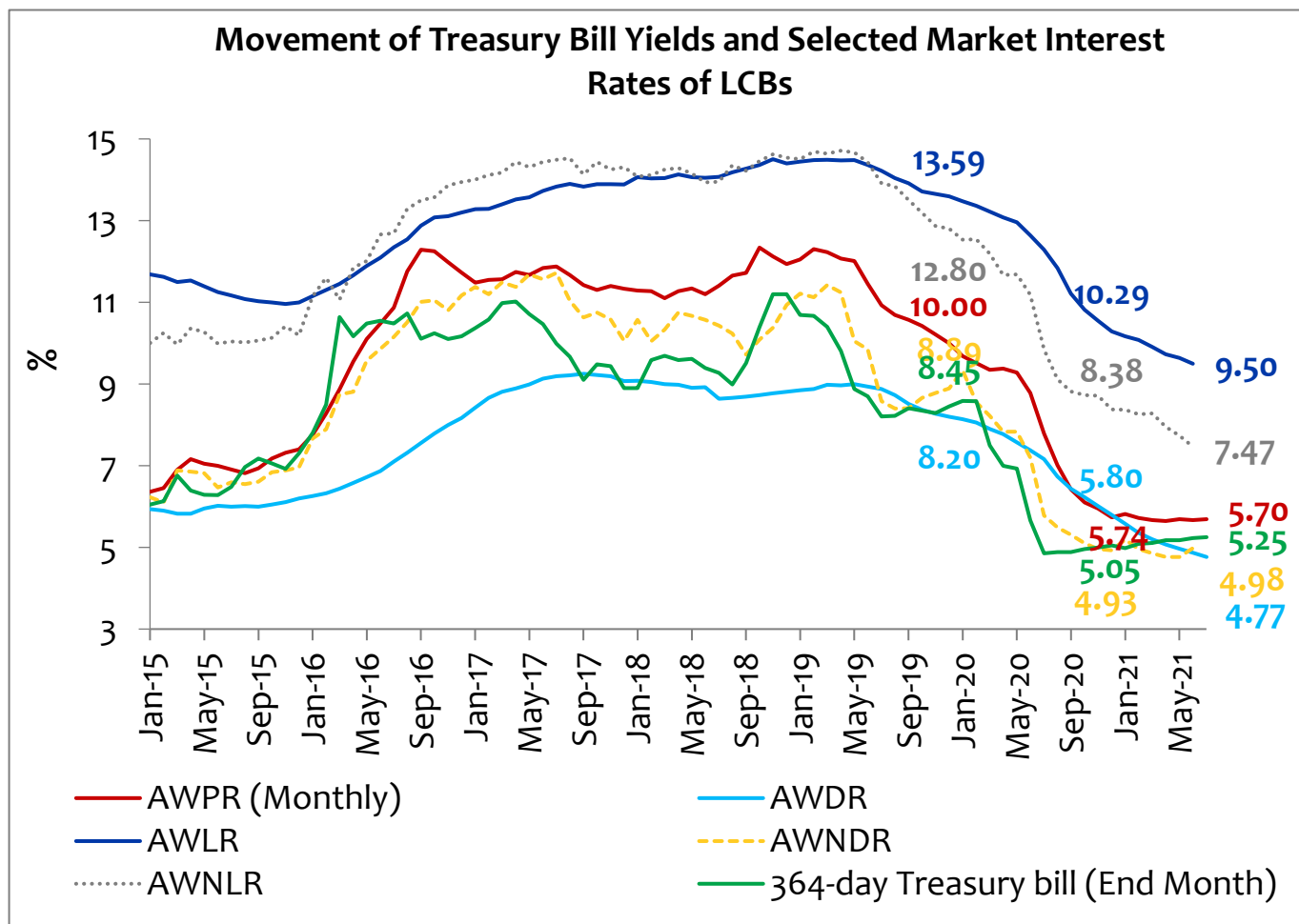
The Central Bank was compelled to do the heavy lifting of the pandemic response given the lack of fiscal space

Estimated Direct benefits to the economy from the monetary easing measures adopted by the Central Bank since the COVID-19 outbreak

Measures	Value (Rs. Bn)		As a % of Nominal GDP (based on 2020)	As a % of Reserve Money (at end 2020)
	2020	2021 (end June)		
Purchase of Treasury bills from the Primary Market and Direct Allocation (since March 2020)	831	917 (latest)	11.6%	181.2%
COVID-19 Saubagya Refinance Scheme	180	-	1.2%	19.3%
Injection of liquidity through reduction in the SRR	180	-	1.2%	19.3%
Central Bank Profit Transfers	24	15	0.3%	4.2%
Saving in terms reduced interest rates to the Private Sector (Assuming end period outstanding credit volume, at AWLR)	204	112	2.1%	33.3%
Saving in terms of reduced interest rates to the Public Sector (Govt. + SOBE) (Assuming end period outstanding credit volume, at 1-year T-bill rate)	189	85	1.8%	29.2%
Total	1,607	1,129	18.2%	283.7%

These measures complemented the Government's response made through fiscal concessions, financial support to needy people and increased health related expenses

With the gradual transmission of accommodative monetary policy measures, most market deposit and lending interest rates declined to their historic low levels...



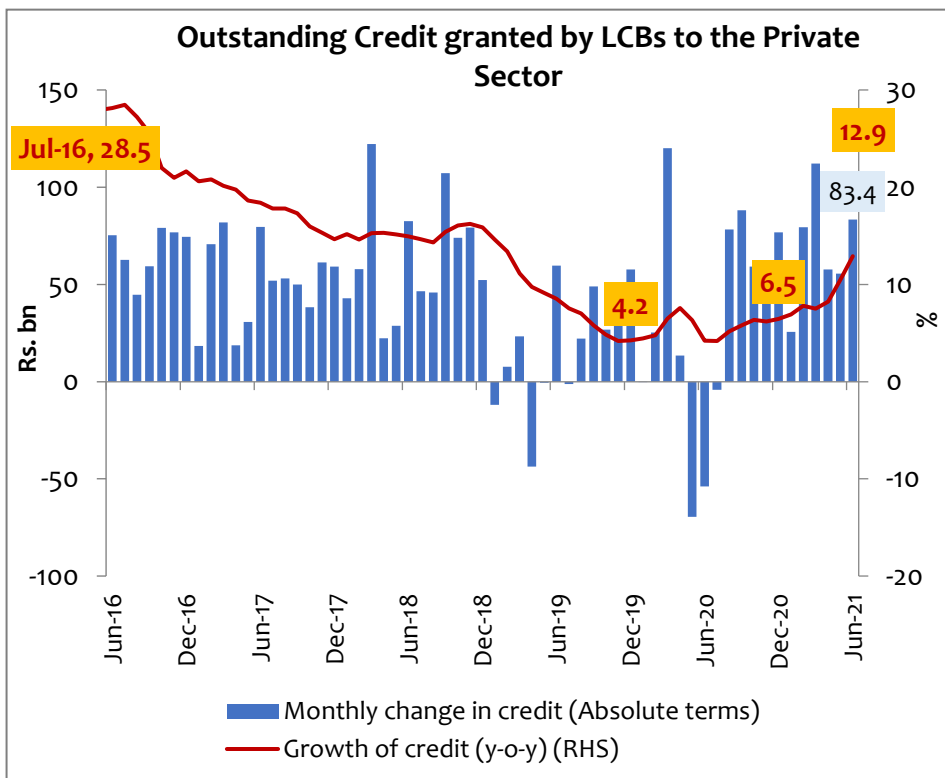
Source: Central Bank of Sri Lanka

Adjustments in Interest Rates

Interest Rate	End 2020	As at 18 August 2021	From end 2019 to end 2020	From end 2020 to so far in 2021
	%	%	bps Change	bps Change
AWCMR	4.55	5.09	-290	54
91-day T-bill	4.69	5.33	-282	64
182-day T-bill	4.80	5.34	-322	54
364-day T-bill	5.05	5.32	-340	27
Weekly AWPR	5.81	5.71	-393	-10
Monthly AWPR	5.74	5.70	-426	-4
AWLR	10.29	9.50	-330	-79
AWNLR	8.38	7.47	-442	-91
AWDR	5.80	4.77	-240	-103
AWFDR	7.14	5.67	-291	-147
AWNDR	4.93	4.98	-396	5
AWNDR	5.08	5.10	-409	2

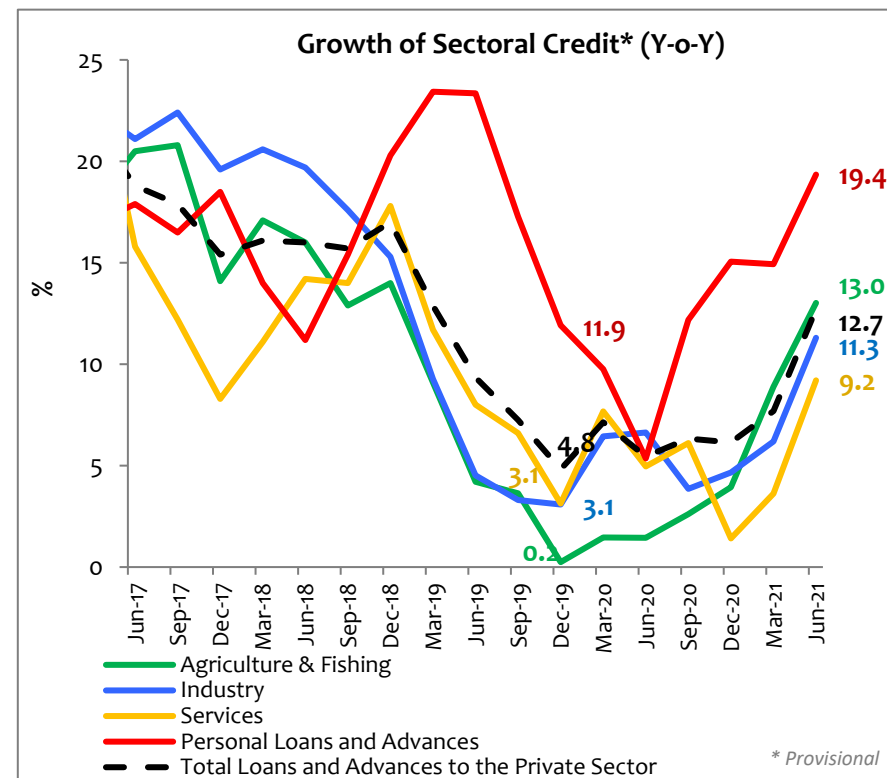


Supported by the low interest rate environment, credit to the private sector expanded notably during the first half of 2021, surpassing the annual expansion of credit observed in 2019 and 2020...



Source: Central Bank of Sri Lanka

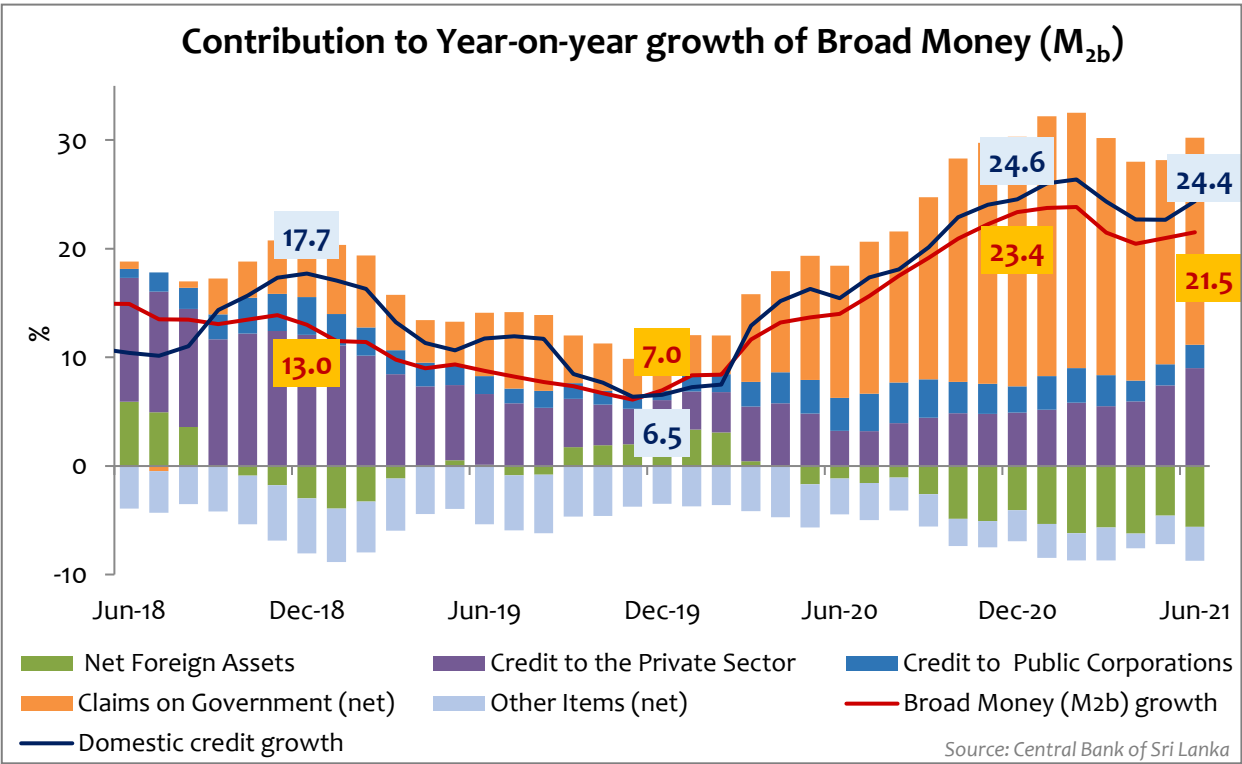
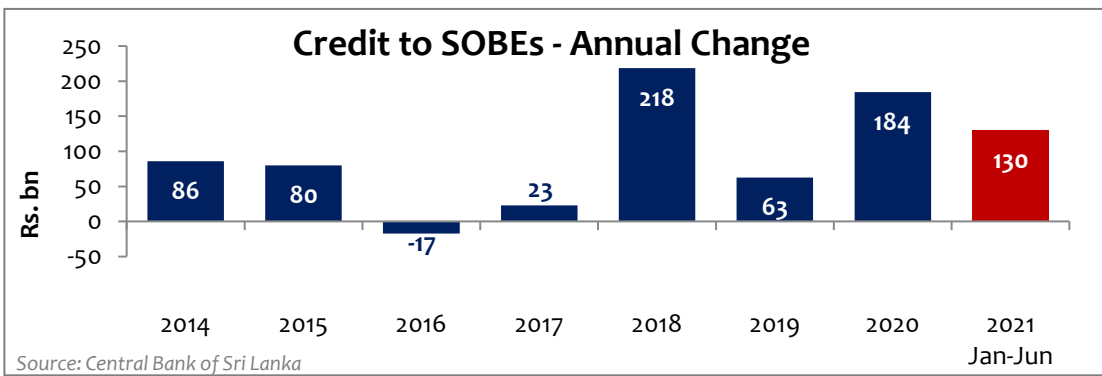
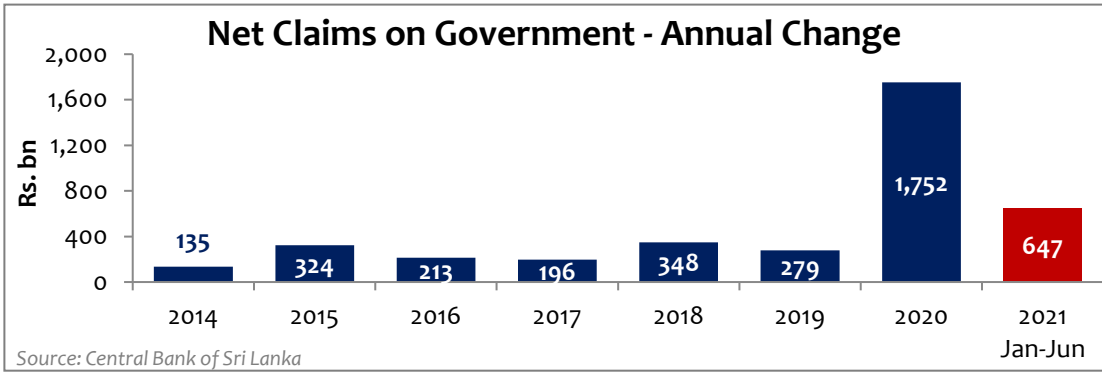
Credit to the Private Sector		
	Annual Change (Rs. bn)	Y-o-Y Growth (%)
End 2018	762.1	15.9
End 2019	235.5	4.2
End 2020	374.1	6.5
End Jun 2021	414.0 (YTD)	12.9



Source: Central Bank of Sri Lanka

The momentum of credit expansion is expected to continue in the period ahead, with increased credit flows to productive and needy sectors of the economy

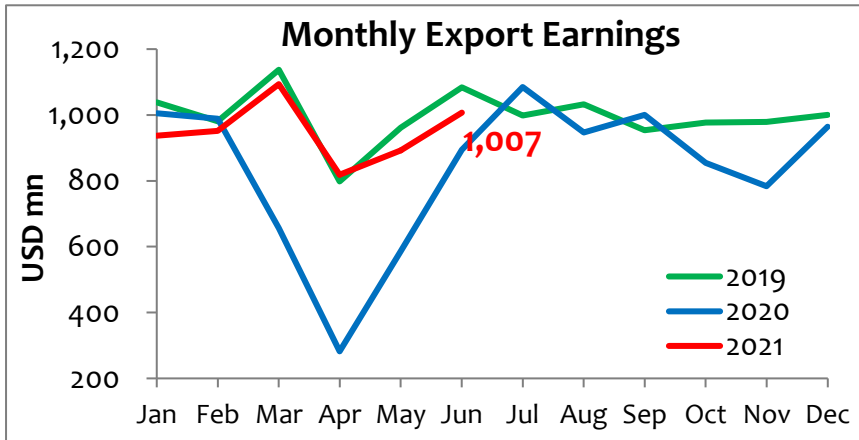
Credit obtained by the public sector from the banking system, particularly net credit to the Government, also increased notably thus far during the year, amidst the impact of the pandemic on government revenue and recurrent expenditure...



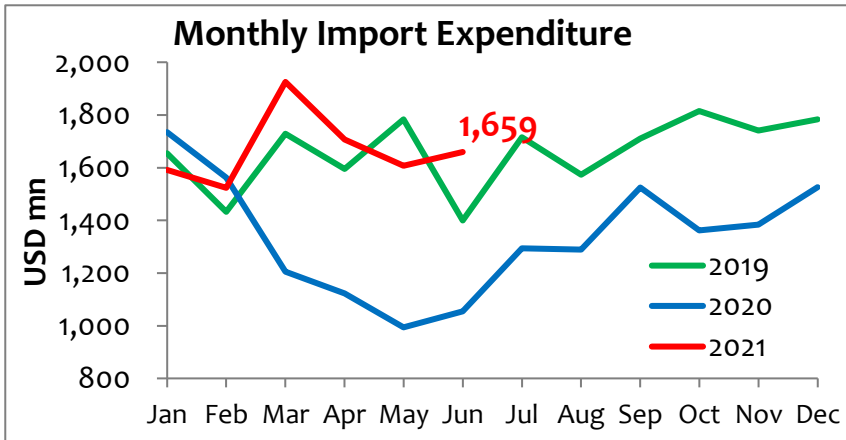
Reflecting the impact of increased domestic credit, the growth of broad money (M_{2b}) remained elevated

The external sector continued to face a multitude of challenges, requiring coordinated measures...

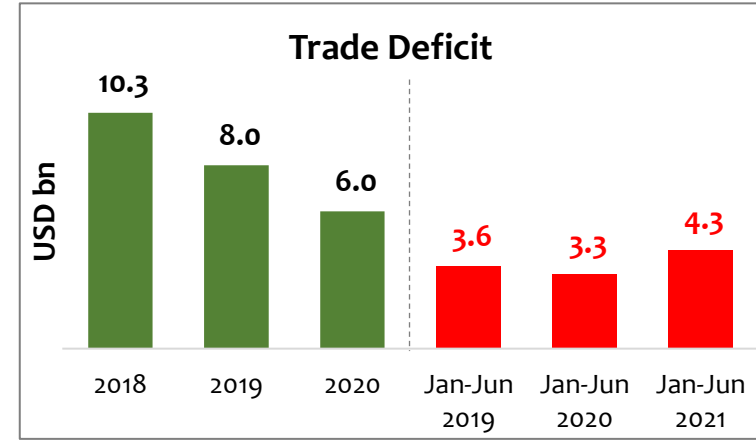
With the increase in import expenditure outweighing the improvements observed in earnings from exports, the trade deficit continued to widen during the first half of 2021 over the corresponding period of last year...



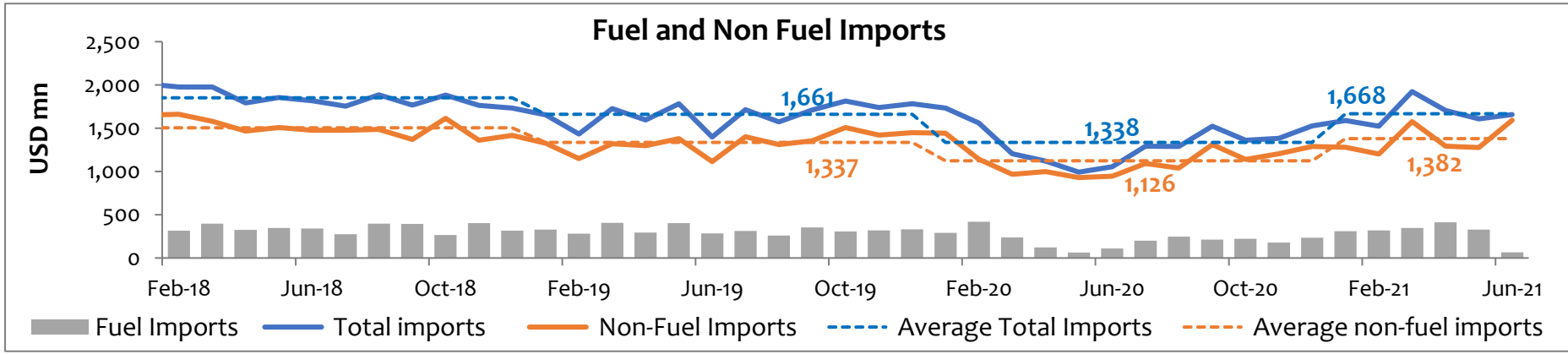
Source: Sri Lanka Customs



Source: Sri Lanka Customs



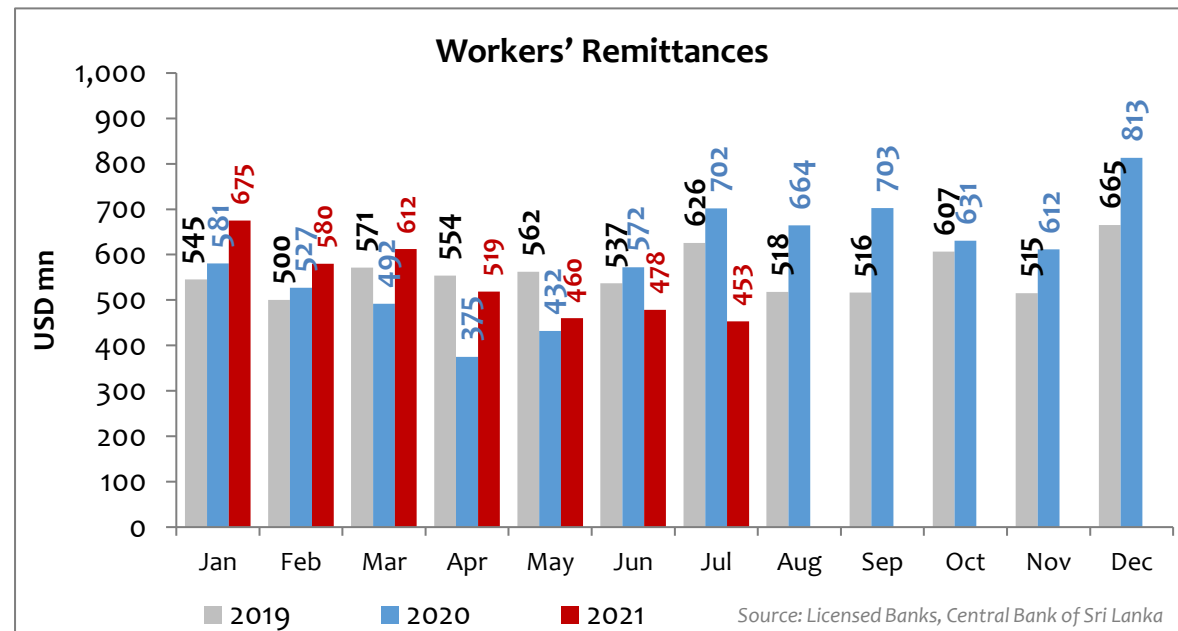
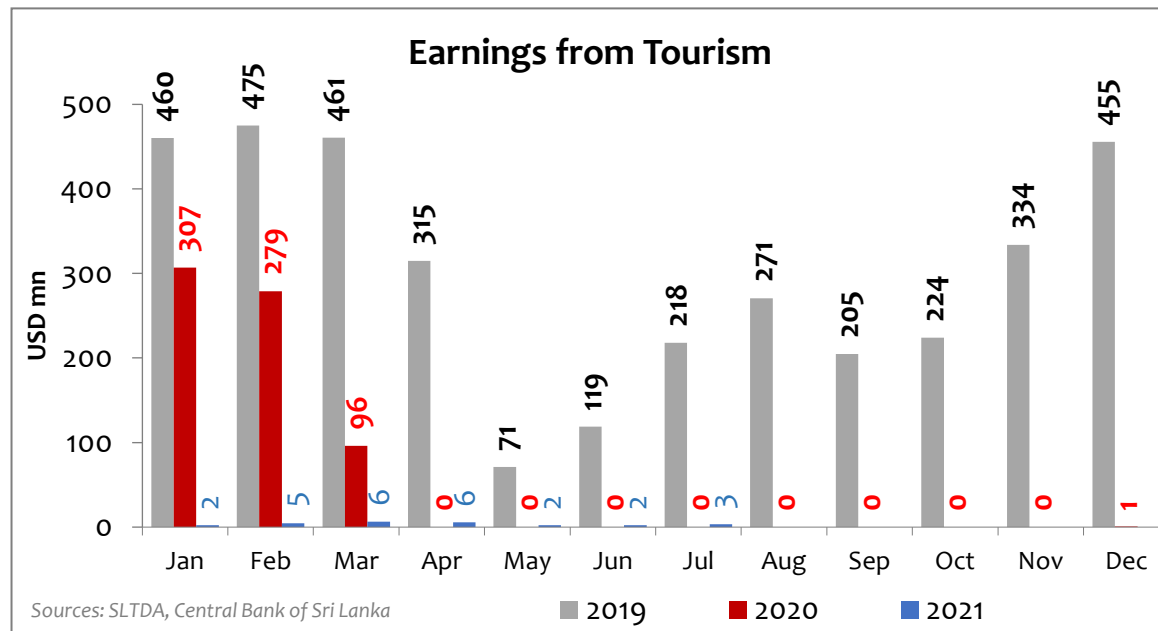
Sources: Sri Lanka Customs, Central Bank of Sri Lanka



Sources: Exporters and importers of petroleum, Sri Lanka Customs, Central Bank of Sri Lanka

Category	Jan-Jun (USD mn)		
	2019	2020	2021
Exports Earnings	5,999	4,413	5,699
Expenditure on Imports	9,596	7,675	10,015
Trade Balance	-3,597	-3,262	-4,316

The expected recovery in the tourism industry could be further delayed, while some deceleration is also observed in workers' remittances...



Earnings from Tourism

- 2021 - USD 26.0 mn (Jan-Jul)
- 2020 - USD 681.9 mn (Jan-Jul)

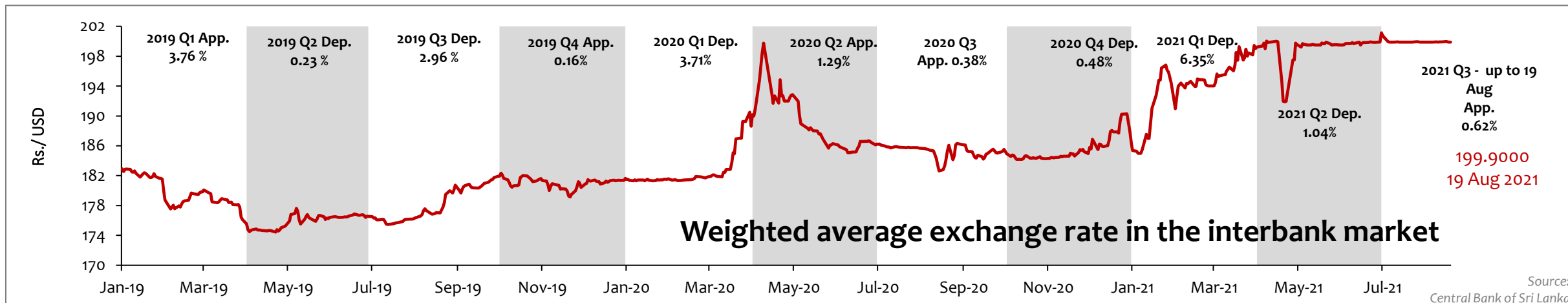
Earnings from Tourism (USD bn)

Actual			Medium term Projection				
2018	2019	2020	2021	2022	2023	2024	2025
4.4	3.6	0.7	0.2	2.0	3.6	4.0	4.4

- 2021 Jul : USD 453 mn (-35.4% y-o-y)
- 2021 (Jan-Jul) : USD 3,778 mn (2.6% y-o-y)
- 2020 (Jan-Jul) : USD 3,682 mn
- 2020: Workers' remittances increased by 5.8% (y-o-y)

Workers' remittances, which recorded a significant growth in 2020 as well as in the first few months of 2021, have also displayed some deceleration

Limited conversion by exporters and the advancing of imports together with some speculative activity, prompted by anomalies between interest rates on the rupee and foreign currency products in the financial market, exerted undue pressure on the exchange rate in the domestic market...



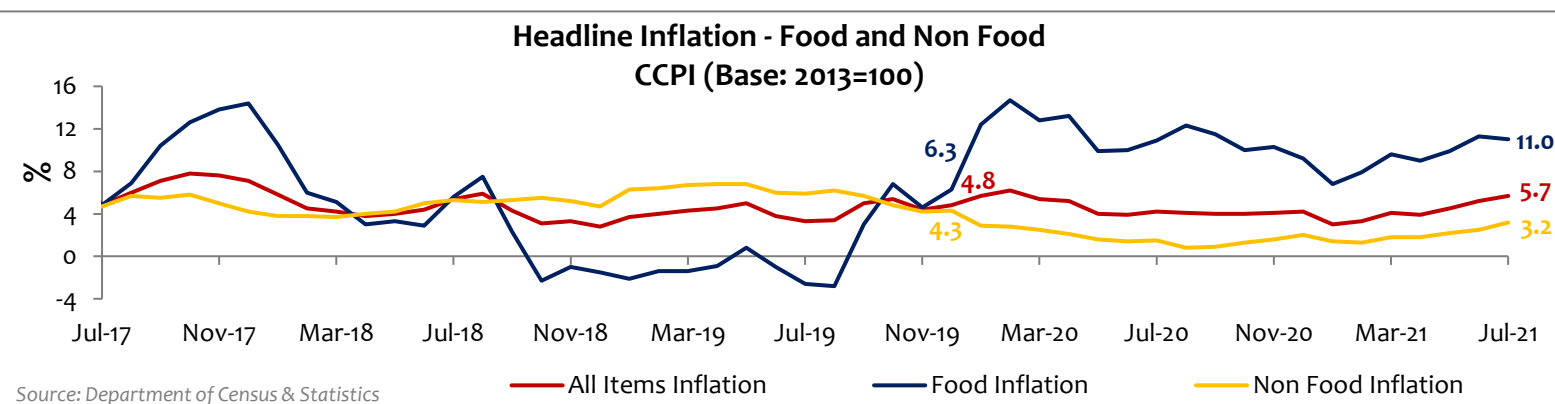
LKR Movement Against Other Currencies

Currency	2019 App(+)/Dep(-)	2020 App(+)/Dep(-)	up to 19 Aug 2021 App(+)/Dep(-)
USD	+0.6 %	-2.6 %	-6.7 %
Pound sterling	-2.8 %	-6.2 %	-7.2 %
Euro	+2.6 %	-11.2 %	-1.7 %
Japanese yen	-1.0 %	-7.5 %	-0.3 %
Indian rupee	+2.6 %	0.0 %	-5.3 %

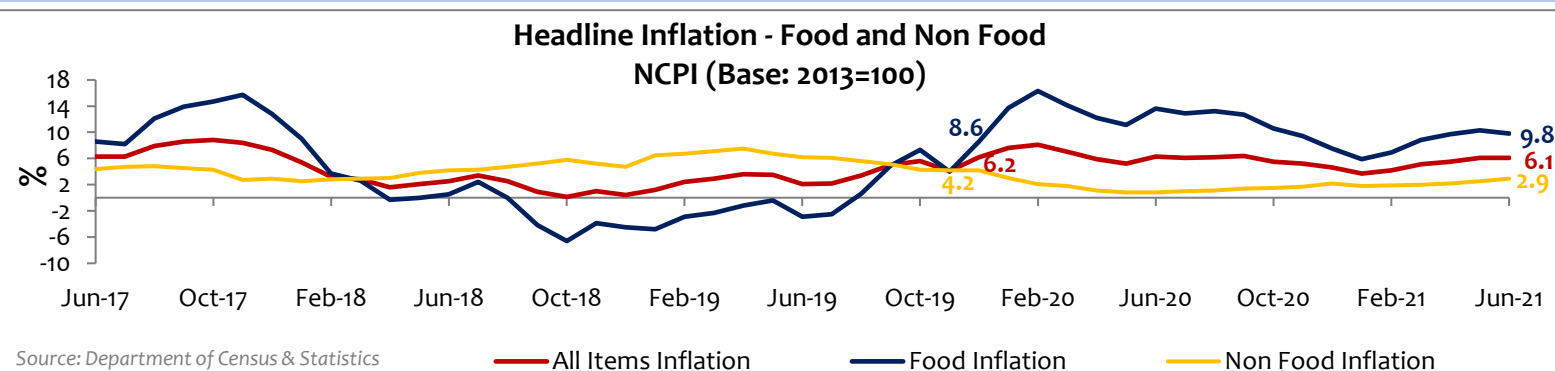
- Gross official reserves were estimated at USD 2.8 bn (excluding swap facility with PBoC) with an import cover of 1.8 months by end July 2021
- The level of official reserves are expected to be reinforced in the near term, with measures that are being taken by the Government and the Central Bank to secure foreign financing from several sources



Inflation, which remained moderate during early 2021, accelerated somewhat in recent months due to high food inflation and some acceleration in non-food inflation...



- CCPI based food inflation decelerated to 11.0% (y-o-y) in July 2021, compared to 11.3% in June 2021
- CCPI based non-food inflation accelerated to 3.2% (y-o-y) in July 2021, compared to 2.5% in June 2021



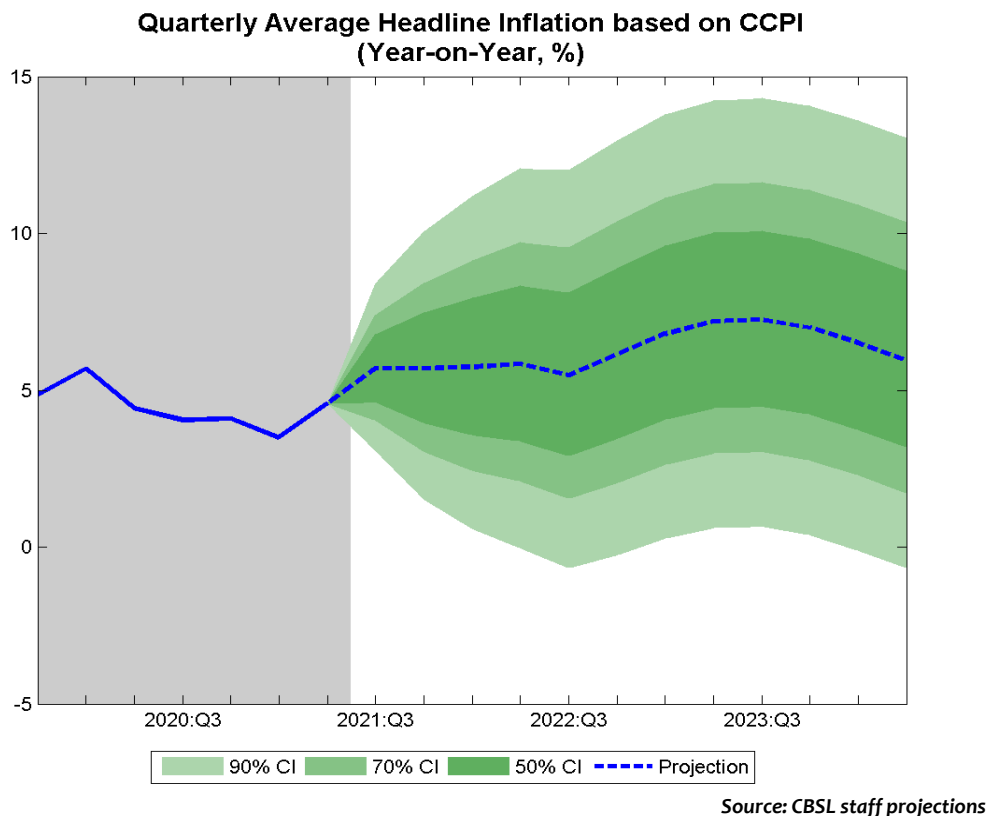
- NCPI based food inflation decelerated to 9.8% (y-o-y) in June 2021 compared to 10.3% in May 2021
- NCPI based non-food inflation accelerated to 2.9% (y-o-y) in June 2021 from 2.5% in May 2021

Headline Inflation (%)					
	Dec-19	Dec-20	May-21	Jun-21	Jul-21
based on CCPI (2013=100)					
Y-o-Y	4.8	4.2	4.5	5.2	5.7
Annual average	4.3	4.6	3.9	4.1	4.2
based on NCPI (2013=100)					
Y-o-Y	6.2	4.6	6.1	6.1	-
Annual average	3.5	6.2	5.4	5.4	-

Core Inflation (%)					
	Dec-19	Dec-20	May-21	Jun-21	Jul-21
based on CCPI (2013=100)					
Y-o-Y	4.8	3.5	3.2	3.2	3.7
Annual average	5.5	3.1	3.0	3.0	3.1
based on NCPI (2013=100)					
Y-o-Y	5.2	4.7	4.2	4.1	-
Annual average	5.7	4.1	4.4	4.4	-



Possible upside pressures on inflation are being addressed through preemptive policy measures...



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

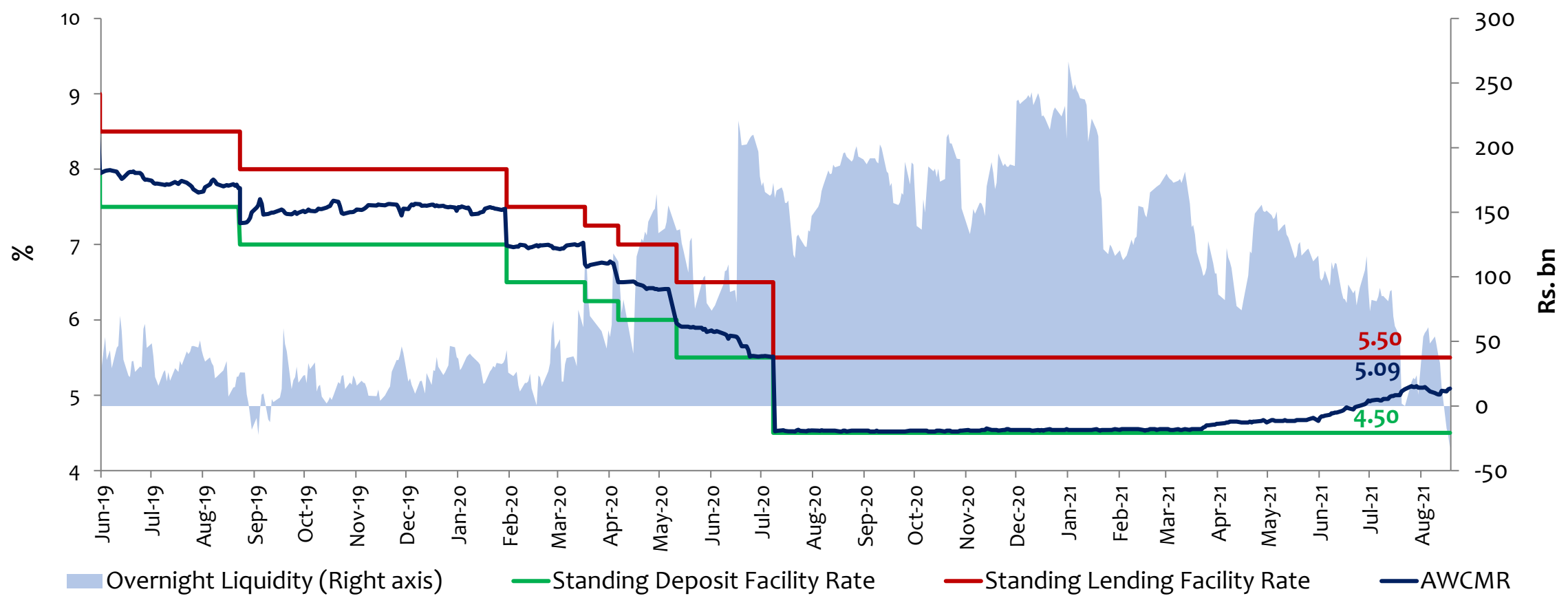
The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colors. The projection reflects the data available and assumptions and judgments made at the August 2021 forecast round.

The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. Specially, the thick green shaded area represents 50% confidence interval, implying that there is a 50% 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.

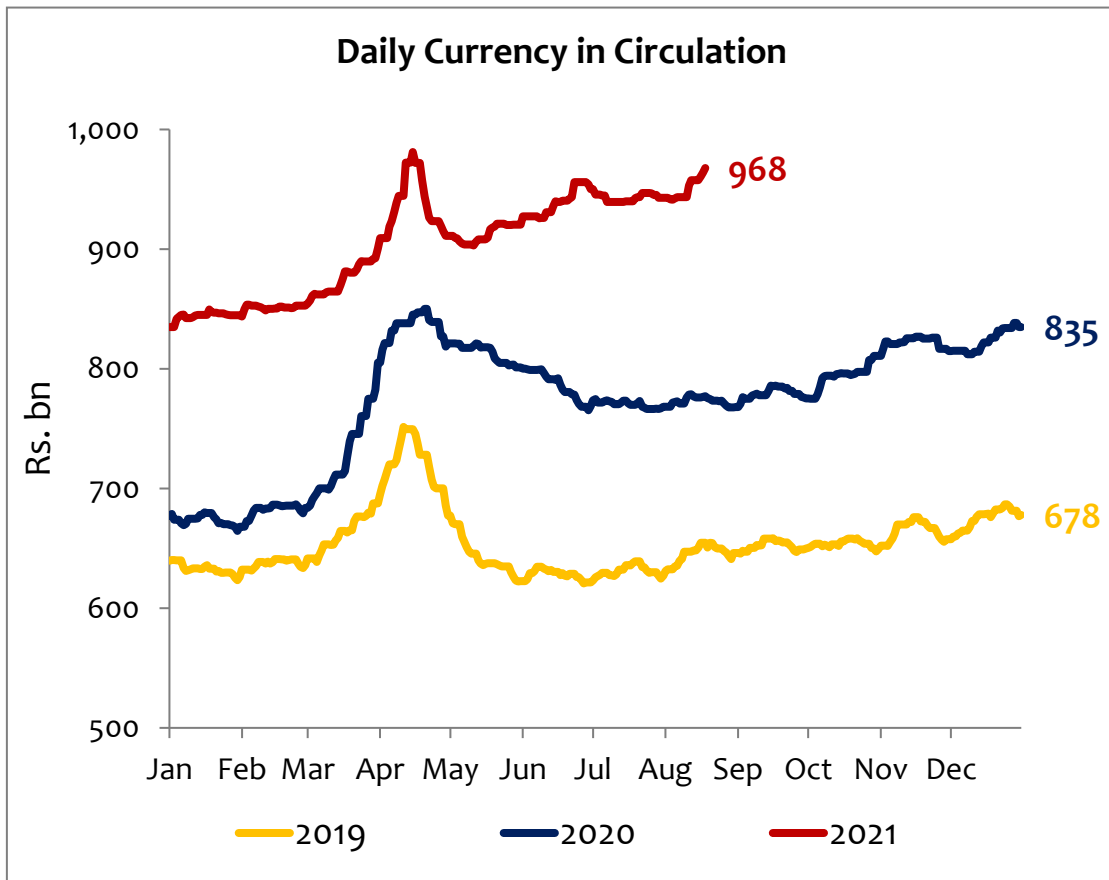
- Inflation is projected to hover around the upper bound of the desired 4-6% target range in the near term
- The envisaged improvements in aggregate demand conditions and the likely increases in global energy and other commodity prices may generate some inflationary pressures in 2022, requiring preemptive policy measures to ensure the maintenance of inflation in mid-single digit levels over the medium term

High levels of excess liquidity maintained in the domestic money market since early 2020 have gradually declined to deficit levels...

Policy Rates, AWCMR and Overnight Money Market Liquidity

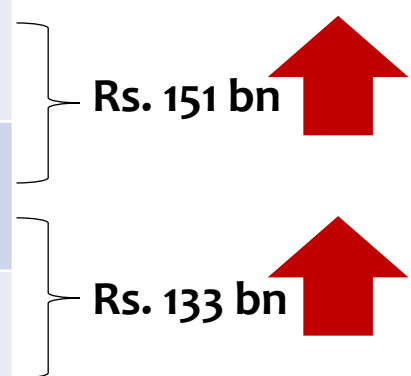


The upward adjustments in market interest rates and the expected liquidity deficit in the domestic money market would also help the economy to absorb the large amount of currency held by the public observed since the onset of the pandemic in early 2020...



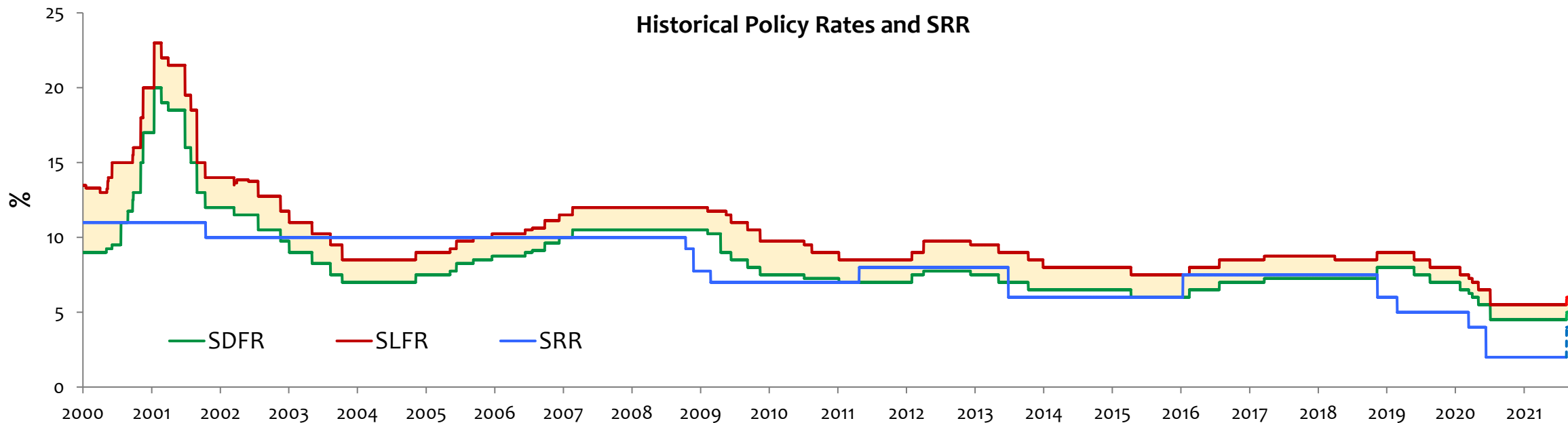
Source: Central Bank of Sri Lanka

Currency in circulation	
Period	Amount
End 2019	Rs. 678.0 bn
End February 2020	Rs. 683.7 bn
End 2020	Rs. 834.8 bn
Latest (18 Aug 2021)	Rs. 967.6 bn



Source: Central Bank of Sri Lanka

In consideration of the current and expected macroeconomic developments discussed above, the Monetary Board decided to rollback some extraordinary support provided to the economy at the onset of the COVID-19 pandemic...



Source: Central Bank of Sri Lanka

The Central Bank will continue to monitor domestic and global macroeconomic and financial market developments and take appropriate measures to ensure that the economy reverts to its potential, while maintaining inflation in the targeted 4-6% range under its flexible inflation targeting framework...

Thank You