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Press Release

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Monetary Policy Review – June 2012

The policy measures adopted by the Central Bank and the government during the period February to April 2012 to curtail the growth of credit, reduce import demand and thereby stabilise the external sector have begun to have an effect on the relevant variables.

The increase in private sector credit in absolute terms in April 2012 was only Rs. 18.7 billion, significantly lower than the average monthly growth of Rs. 51.8 billion in the first quarter 2012 and Rs. 27.4 billion in April 2011. Meanwhile, market interest rates, which had increased substantially so far in 2012 as a result of tight monetary conditions, have started to stabilise in recent weeks.

The cumulative trade data for the first four months of 2012 indicate that imports are decelerating at a rapid pace in line with the policy measures adopted. However, notwithstanding the incentives provided for exports as a result of the policy measures, exports too have declined year-on-year, due to global developments. Nevertheless, the depreciation of the exchange rate is expected to support export competitiveness, while further curtailing import expenditure, thereby significantly reducing the trade deficit in 2012.

Inflows to the Colombo Stock Exchange and the mobilisation of foreign capital by commercial banks have been in line with projections, while the receipt of expected foreign direct investment (FDI) inflows and workers' remittances are expected to realise the projected surplus in the balance of payments in 2012. In the meantime, gross official reserves increased to US dollars 5,835 million by April 2012 from US dollars 5,730 million in March 2012 and are expected to improve further during the rest of the year.

At the same time, the strong growth momentum of the economy last year is estimated to have continued into the first quarter of 2012 supported by all three major sectors. As a result, although growth is expected to gradually moderate from the second quarter onwards, it is expected that the previously estimated 7.2 per cent growth for the year 2012 would be achieved. Inflation has remained at single digit levels for the past 40 consecutive months, although it increased in May 2012 to 7 per cent on a year-on-year basis, mainly as a result of sharp revisions to several administratively determined prices and the depreciation of the exchange rate.

In this background, the Monetary Board is satisfied that the policy measures adopted thus far are yielding the desired results in the monetary and external sectors to ensure the long term growth and stability of the economy. Accordingly, the Monetary Board is of the view that the current monetary policy stance of the Central Bank is appropriate and should be maintained. Hence, the Bank's policy interest rates, viz., the Repurchase rate and the Reverse Repurchase rate will remain unchanged at 7.75 per cent and 9.75 per cent, respectively.

The next monthly statement on monetary policy is scheduled for 10 July 2012.