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Press Release

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Monetary Policy Review – October 2012

The tight monetary policy measures implemented by the Central Bank to moderate private sector credit expansion continued to prove effective and the overall private sector credit growth moderated substantially to 28.7 per cent, year-on-year in August, falling below 30 per cent for the first time since March 2011. In absolute terms, the expansion of credit in August was Rs. 14 billion compared to the average monthly increase of Rs. 51.8 billion in the first quarter of 2012. Despite the slowdown of credit to the private sector, broad money growth in August was higher than the previous month, reflecting higher public sector borrowing.

Year-on-year inflation declined for the second consecutive month reaching 9.1 per cent in September. While short term pressures on inflation arising from recent revisions to administratively determined prices and uncertain global supply conditions remain elevated, the tight monetary policy stance is expected to prevent second round effects of supply side factors entrenching into future inflation, and thereby help maintain inflation at mid-single digit levels over the medium term.

In the meantime, the global economy continued to recover at a slow pace, although the US economy showed some positive signs, supported by the recent stimulus measures implemented by the Federal Reserve. Further, the protracted economic downturn in the euro area has weakened the demand for their imports. With 7.4 per cent GDP growth projected for the third quarter, the Chinese economy has also showed some signs of slowdown. In view of these setbacks to the global economic recovery, the IMF has revised its outlook for global growth to 3.3 per cent in 2012, and 3.6 per cent for 2013. This slowdown is likely to have a negative impact on emerging markets and developing economies, which mainly depend on external demand.

Reflecting such trend, growth of Sri Lankan exports too has decelerated during the last six months, albeit moderately, whilst demand management measures introduced in early 2012 have resulted in imports falling substantially. With the resultant improvement in the trade balance, together with other inflows, the balance of payments has recorded a surplus of US dollars 305.9 million by August, and helped to raise the current level of official reserves to US dollars 7 billion, which is equivalent to around 4.3 months of imports.

Taking into account the developments discussed above, the Monetary Board of the Central Bank of Sri Lanka was of the view that the current monetary policy stance is appropriate, and decided, at its meeting held on 22 October 2012, to maintain the policy rates of the Central Bank unchanged at their current levels. Accordingly, the Repurchase rate and the Reverse Repurchase rate would remain at 7.75 per cent and 9.75 per cent, respectively.

The date for the release of the next regular statement on monetary policy will be announced in due course.