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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Press Release

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Monetary Policy Review – December 2012

Strong policy measures were adopted by the Central Bank and the Government in the early part of the year to curtail excessive credit growth and contain the high import demand thereby arresting the imbalances that were emerging in the economy since the latter part of 2011. These measures were designed to curtail monetary expansion and possible future demand pressures while the reduction in the trade deficit was expected to dampen pressure on the external sector. At the same time, a one-off increase in headline inflation was anticipated on account of the upward revisions to several administratively determined prices, which were also a part of the overall stabilisation package. A modest slowing down of economic activity was also anticipated as a result of these demand management policies, which was reflected by the projections for economic growth during the year being revised downward to 6.8 per cent.

In the months following the imposition of these measures, a moderation in the money supply has been witnessed, largely on account of the deceleration in credit extended by commercial banks to the private sector. Broad money growth, year-on-year (y-o-y), declined to 18.2 per cent by October 2012 from a peak of 22.9 per cent in April. The growth of credit obtained by the private sector from commercial banks continued to decelerate, reaching 23.5 per cent (y-o-y), by October, from a high of over 35 per cent prior to March 2012. This growth is expected to decelerate further to around 19 per cent by end 2012. At the same time, in value terms, the drop in expenditure on imports has been greater than the decline in earnings from exports, narrowing the deficit in the trade account. Accordingly, the trade deficit contracted for the second consecutive month, declining by 1.0 per cent in October 2012, and this trend is expected to continue under the current flexible exchange rate regime.

The Central Bank has been carefully monitoring the developments in the various sectors of the economy vis-à-vis the projections for each of these sectors. As per current information, a reasonable leeway has emerged between actual credit growth and the ceiling imposed by the Central Bank, indicating a further slowdown in credit utilisation. Economic activity has also experienced some moderation with adverse weather conditions and the uncertainty in the global economy exerting some pressure on growth in 2012.

In the meantime, inflation, as measured by the y-o-y change in the Colombo Consumers' Price Index (CCPI), increased to 9.5 per cent in November 2012 from 8.9 per cent in the previous month. Inflation has remained near 9 per cent in the second half of the year as a result of the increases to administered prices and recent tariff adjustments while adverse weather conditions towards the third quarter caused prices, particularly of fresh food items, to remain high. Going forward, although the Monetary Board is satisfied that domestic aggregate demand has been contained to moderate levels, it is likely that y-o-y headline inflation could remain somewhat elevated in the immediate months due to supply side factors. However, as per current projections, inflation is expected to moderate towards the second quarter of 2013 and stabilise thereafter benefiting from the strong demand management policies introduced at the beginning of this year.

Having assessed the developments and outlook discussed above and taking into consideration the expected moderation in inflation towards the second quarter of 2013 and the need to support the economy to realise its growth potential in 2013 and beyond, the Monetary Board at its meeting held on 11 December 2012 was of the view that the current developments provide some space to ease monetary policy while maintaining overall macroeconomic stability. Therefore, in order to induce a downward adjustment in market interest rates, the Monetary Board decided to reduce the policy rates of the Central Bank by 25 basis points each while allowing the ceiling on rupee credit extended by banks to expire at end 2012. Accordingly, the Repurchase rate and the Reverse Repurchase rate of the Central Bank will be 7.50 per cent and 9.50 per cent, respectively, with immediate effect. At the same time, the Monetary Board was also of the view that the credit ceiling imposed for 2012 has served its purpose and such a policy measure may not be required in the near future.

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