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Press Release

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Monetary Policy Review – August 2013

The prudent demand management policies along with favourable supply conditions have resulted in a continued low inflation environment in Sri Lanka. Inflation has remained at single digit levels for 4 ½ years with headline inflation (year-on-year) for July 2013 easing further to 6.1 per cent from 6.8 per cent in June 2013 and core inflation (year-on-year) also declining in July 2013 to its record low of 3.1 per cent from 4.3 per cent in the previous month. Looking ahead, inflation is expected to remain in single digits during the remainder of 2013, and in mid-single digits in 2014, with such conditions being conducive for sustained economic growth and improved domestic and international investor confidence.

In the external sector, merchandise exports in June 2013 have showed some turnaround, recording a positive year-on-year growth after the decline observed in the past 15 months. Meanwhile, imports have also inched up in June (year-on-year), driven partially by the importation of certain one-off items, expanding the trade deficit during the month. However, the cumulative performance in merchandise trade depicts a salutary 7.1 per cent decline in the trade deficit for the first six months of 2013. Earnings from tourism and workers' remittances have continued to improve, while the financial inflows have been substantial in the first half of the year. Notable inflows to the financial account include FDI inflows amounting to US dollars 537.0 million, net inflows to the stock market of US dollars 120.2 million, net inflows to the Government securities market amounting to US dollars 664.4 million and inflows to commercial banks of US dollars 664.3 million during the period. Such inflows display that the foreign investor confidence on Sri

Lanka has remained unchanged despite the volatility caused by global markets reacting to the prospects of the tapering of quantitative easing by advanced economies.

The recent global developments have been reasonably encouraging with the US economy and the Eurozone showing signs of economic recovery in the second quarter of the year. The positive developments in advanced economies, if continued, would augur well for domestic economic growth as a result of a stronger performance of the external sector. At the same time however, the wide fluctuations of currencies of trading partners and competitors in the international market would need to be closely monitored in order to address any adverse effects on Sri Lanka's external balance in the period ahead.

Year-on-year growth of broad money (M_{2b}) decelerated to 15.8 per cent in June 2013 from 16.3 per cent in the previous month. The growth of credit extended to the private sector increased by 8.9 per cent on a year-on-year basis in June in comparison to the growth of 9.3 per cent in May 2013. With the market interest rates continuing to decline in response to the relaxation of the monetary policy stance since December 2012, it is expected that the growth of credit to the private sector would increase towards the desired levels during the second half of the year. A simultaneous reduction in credit to public corporations over the same period, mainly as a result of improving profitability of key state owned enterprises, would also help maintain broad money growth at levels envisaged for the year.

Considering the above, the Monetary Board at its meeting held on 15th August 2013, was of the view that the current monetary policy stance is appropriate, and therefore, decided to maintain the Repurchase rate and the Reverse Repurchase rate of the Central Bank of Sri Lanka unchanged at 7.00 per cent and 9.00 per cent, respectively. At the same time, the Board noted that there is yet more space for market lending rates to decline further, and that the reduction of lending rates on medium to long term credit facilities thus far, has been inadequate to reflect the current monetary policy stance and the low inflation environment.

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