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CENTRAL BANK OF SRI LANKA

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# **Press Release**

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## **Monetary Policy Review – December 2013**

Several noteworthy, positive macroeconomic developments were reported during the past month indicating that the monetary policy decisions implemented throughout 2013 were timely and appropriate.

Real GDP growth accelerated in the third quarter of 2013. Inflation reduced significantly to levels lower than anticipated, while the external sector showed further progress. The turnaround in the financial position of key public corporations prompted substantial repayments by these institutions to the banking sector, facilitating an increased flow of financial resources for private investment. Credit extended to the private sector by banks picked up strongly in October 2013. These factors augur well for future economic growth, while continued downward adjustments to longer term market interest rates would bolster market confidence and nurture positive investor sentiments.

All key sectors of the economy contributed positively to the real GDP growth of 7.8 per cent in the third quarter of 2013. The Agriculture sector grew by 7.0 per cent recovering from the contraction observed in the second quarter. The Industry

sector grew by 8.1 per cent reflecting a moderation from the higher growth rates observed in the first two quarters of the year, while the Services sector growth accelerated to 7.9 per cent from 6.6 per cent in the previous quarter. The sound, broad based growth performance in the third quarter strengthens expectations of over 7 per cent economic growth for the year.

Headline inflation decreased to 5.6 per cent in November 2013 on a year-on-year (y-o-y) basis, from 6.7 per cent in the previous month, mainly on account of the moderation in prices of both food and non-food items during the month. In the meantime, core inflation continued to decline, and was at its lowest at 2.4 per cent (y-o-y), in November 2013. Annual average headline inflation also declined to 7.3 per cent in November from 7.6 per cent in the previous month. The outlook for inflation continues to remain favourable supported by subdued international commodity prices, improved domestic supply conditions and well contained demand driven inflationary pressures. In this background, according to current projections, inflation is expected to remain benign, at mid-single digit levels throughout 2014 as well.

External sector indicators were robust in October 2013 with earnings from merchandise exports increasing significantly amidst moderating expenditure on imports, resulting in a narrower trade deficit. Earnings from exports recorded its highest ever monthly value, increasing by 35.1 per cent (y-o-y), in October 2013, reaching US dollars 1,041 million. The growth in exports heightens expectations of a durable recovery of the advance economies leading to enhanced growth in export proceeds for the rest of the year, as well as for 2014. The cumulative expenditure on imports declined by 1.1 per cent (y-o-y) for the first ten months of 2013, while the contraction during the month of October was 2.8 per cent. Meanwhile, the Sri Lankan rupee continued to remain stable against the US dollar within the flexible exchange rate regime, as a result of improving external trade activity, increased workers' remittances and tourist earnings, increased inflows to the financial sector, and strengthened market expectations.

In October 2013, credit extended to the private sector increased by Rs. 27.2 billion in absolute terms. Credit from Domestic Banking Units (DBUs) of commercial banks contributed around Rs. 20.1 billion to the absolute increase in credit during the month, similar to the levels witnessed in September 2013, signalling a take-off in credit disbursements. Credit granted to public corporations contracted for the second consecutive month, with repayments during October 2013 amounting to Rs. 12.5 billion. Meanwhile, broad money growth accelerated to 18.3 per cent (y-o-y), with increased credit to the private sector as well as a significant increase in net foreign assets (NFA) of the banking sector and increased net credit to government (NCG) during the month. NCG is expected to decline in line with the revised projections for bank borrowing as presented in the National Budget for 2014. Going forward, the expected continued improvements in public corporations and fiscal consolidation are likely to facilitate maintaining monetary expansion as desired in the period ahead.

Taking the above factors into consideration, the Monetary Board at its meeting held on 6<sup>th</sup> December 2013, was of the view that the current monetary policy stance is appropriate, and accordingly, decided to maintain the Repurchase rate and the Reverse Repurchase rate of the Central Bank of Sri Lanka unchanged at 6.50 per cent and 8.50 per cent, respectively. Broad guidance with regard to the conduct of monetary policy in 2014 will be elucidated in the Road Map: Monetary and Financial Sector Policies for 2014 and beyond, expected to be announced on 2 January 2014.

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