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Press Release

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Monetary Policy Review – March 2014

The Sri Lankan economy yet again emphasised its strong potential with broad-based GDP growth taking place in all three sectors of the economy in 2013. Well sustained by low and stable inflation, the economy, which grew by 7.3 per cent in 2013 compared to 6.3 per cent in 2012, signalled a shift towards a higher and sustainable growth trajectory.

According to recently released data from the Department of Census and Statistics, the final quarter of 2013 recorded a GDP growth of 8.2 per cent and exhibited a surge in performance in the Agriculture and Industry sectors, while the Services sector growth indicated some moderation. During the year, the Industry sector showed a robust growth of 9.9 per cent, while the Agriculture and Services sectors recorded growth rates of 4.7 per cent and 6.4 per cent, respectively. Substantiating the deceleration seen in consumer price inflation during the year, the GDP deflator for 2013 recorded 6.7 per cent, declining from 8.9 per cent in 2012.

Buttressed by subdued demand conditions and improved domestic supply of most food items, consumer price inflation remained at mid-single digit levels in February 2014 recording the 61st consecutive month in single digits. Both year-on-

year headline and core inflation moderated in February recording 4.2 per cent and 3.1 per cent, respectively, compared to 4.4 per cent and 3.5 per cent, respectively, in January 2014. Looking ahead, inflation is expected to remain at mid single digits throughout 2014. Although the outlook for inflation remains encouraging from a demand perspective, the Central Bank will continue to closely monitor possible supply disruptions resulting from the drought conditions experienced in certain parts of the country.

In the external sector, earnings from exports grew by 23.2 per cent, year-on-year, during January 2014, thus sustaining its growth momentum, which commenced in June 2013. Expenditure on imports increased by 7.9 per cent during the month. Reflecting the recovery in exports and the muted growth in imports, the trade deficit contracted by 5.9 per cent in January 2014 to US dollars 756 million. Inflows, on account of workers' remittances recorded a healthy increase in January 2014 while earnings from tourism gathered momentum during the first two months of 2014. Further, supported by net inflows to the Government securities market, valuation gains, and the proceeds from the international Sovereign bond issuance in January, gross official reserves increased to US dollars 8.0 billion as at end January 2014, which is equivalent to 5.3 months of imports.

In the monetary sector, broad money (M_{2b}) expanded by 16 per cent in January 2014, primarily due to higher net credit to the government (NCG) as credit flows to the private sector and public corporations contracted. NCG from the banking system increased by around Rs. 68.3 billion in January 2014, but is expected to decline in February with the utilisation of proceeds from the Sovereign bond. Credit to the private sector by commercial banks moderated, growing only by 5.2 per cent in January 2014 in comparison to 7.5 per cent in December 2013, largely due to the settlement of short term advances by corporates during the month as well as the decline seen in pawning and trade related credit. However, the Monetary Board is of the view that the deceleration of the growth in credit to the private sector is temporary, and going forward, private sector credit is likely to rebound from the

second quarter of the year, supported by declining market lending rates, sufficient liquidity levels and increased demand for exports from the advanced economies.

Considering the above, the Monetary Board, at its meeting held on 20th March 2014, was of the view that the current monetary policy stance is appropriate, and therefore, decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank unchanged at their current levels of 6.50 per cent and 8.00 per cent, respectively.

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