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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 – June 2014

The Sri Lankan economy registered a notable growth of 7.6 per cent in the first quarter of 2014 over the growth of 6.1 per cent recorded in the corresponding period of the previous year. The growth in the economy was led by contributions from the Industry and Services sectors although a slowdown was observed in the Agriculture sector owing to adverse weather conditions. Going forward, the growth momentum is likely to continue during the remainder of the year with improved global economic conditions and expected improvements in domestic credit conditions enabling the economy to achieve the envisaged growth of 7.8 per cent for 2014.

Reaching its lowest level since February 2012, headline inflation (y-o-y) decelerated significantly to 3.2 per cent, while core inflation (y-o-y) decelerated to 3.3 per cent in May 2014, underpinned by well managed inflation expectations and subdued demand conditions. Inflation is expected to remain in mid-single digits during the year.

In the external sector, data for April 2014 indicates that external trade continued to remain buoyant during the month despite a modest decline in expenditure on imports, which resulted in a further contraction in the trade deficit. Inflows from workers' remittances remained robust alongside a significant increase in earnings from tourism reflecting the continued influx of tourists. On account of these developments, together with the inflows from the proceeds of the seventh international sovereign bond in mid April 2014, gross official reserves as at end April 2014 strengthened further to its highest level of US dollars 8.9 billion, equivalent to 5.9 months of imports. In view of the increased foreign currency inflows, the Central Bank has also absorbed around US dollars 550 million from the domestic foreign exchange market.

Broad money (M_{2b}) recorded a y-o-y growth of 13.2 per cent in April 2014. The improvement in net foreign assets (NFA) of the banking system largely contributed to the growth of broad money supply during the month. Net credit to the government (NCG) contracted by around Rs. 6.8 billion during the month, while credit to public corporations recorded only a marginal increase. Subdued credit demand from the public sector along with the deceleration of private sector credit by the banking sector to 3.3 per cent (y-o-y) in April 2014 dampened the expansion of broad money during the month. In spite of the relaxed monetary policy environment since December 2012, the continued moderation of growth of credit to the private sector seems to reflect the customary transmission lag of around 18 months and the contraction in gold backed loans since April 2013. However, with the realisation of the effects of the eased monetary policy stance, a turnaround in credit growth could be expected in the second half of the year. The implementation of the credit guarantee scheme in relation to pawning advances is also expected to further stimulate private sector credit growth.

The Monetary Board, at the meeting held on 17th June 2014, also noted that interest rates on bank deposits have reduced to expected levels, although the lending rates in the market have still not adjusted in line with the decline in the deposit rates. As a result of such slower-than-expected adjustment in market lending rates, corporates have increasingly resorted to alternative sources of financing, such as corporate debt and equity issuances, suppliers' credit, and funds raised from abroad under relaxed exchange control regulations to meet their needs. Nevertheless, a reasonable level of expansion in bank credit disbursed to productive sectors of the economy is considered beneficial for the continued growth in economic activity. In this regard, the Central Bank is of the firm view that the banks now have adequate space to reduce market lending rates further to encourage the private sector to demand credit from the banking sector, while also tightening the spread between lending and deposit rates of banks to a more reasonable level. Accordingly, the Monetary Board also decided to urge banks to lower their market lending rates in order to reflect these changing circumstances.

In this background, the Monetary Board decided that the current level of policy interest rates 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.