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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Press Release

Issued By Economic Research Department

Date 14-07-2014

Monetary Policy Review – July 2014

The low inflation environment has continued, with year-on-year inflation remaining benign in June 2014 recording its lowest level since February 2012, while the annual average inflation has trended downwards. Headline inflation (y-o-y) for June 2014 recorded 2.8 per cent from 3.2 per cent in the previous month, while core inflation remained low at 3.5 per cent in June, although marginally higher than 3.3 per cent in May 2014. Prices of some items in the food category increased, but the base effect and the decline in non-food prices have contributed to the low inflation. Looking ahead, year-on-year inflation is expected to remain comfortably within mid-single digit levels during the remainder of the year in spite of weather related variations in agricultural produce.

In the external sector, the trade deficit has contracted for the eighth consecutive month in May 2014 led by a contraction in expenditure on imports while an increase in earnings from exports was observed mainly as a result of higher industrial and agricultural exports. Inflows from workers' remittances and earnings from tourism have continued to grow. In the meantime, increased foreign inflows, on a net basis, were recorded due to investments in Government securities and inflows to the

Colombo Stock Exchange and the private sector. Given the substantial foreign inflows, the Central Bank has absorbed around US dollars 735 million from the domestic foreign exchange market by 10 July 2014. Gross Official Reserves as at end May 2014 remained strong at US dollars 8.8 billion, equivalent to 5.9 months of imports.

Broad money (M_{2b}) recorded a y-o-y growth of 13 per cent in May 2014. The improvement in net foreign assets (NFA) of the banking system largely contributed to the growth of broad money supply during the month. Indicating a positive trend, net credit to the government (NCG) contracted by around Rs. 11.5 billion during the month, while credit to public corporations also recorded a marginal decrease. Nevertheless, lower credit disbursements to the private sector by commercial banks along with the decline in pawning advances resulted in a deceleration of the growth of private sector credit by the banking sector to 2.2 per cent (y-o-y) in May 2014. As markets remained sufficiently liquid, the continued moderation of growth of credit to the private sector is deemed temporary in view of gradually adjusting bank lending rates. At the same time, given the continued low inflation environment, the Central Bank would continue to encourage the banks to utilise the available space to reduce market lending rates further while tightening their spreads to provide further stimulus to the private sector to demand credit from the banks. Further, in support of credit granted on gold backed loans, the Central Bank introduced a new credit guarantee scheme for pawning advances in June 2014 for Licensed Commercial Banks and Licensed Specialised Banks engaged in pawning activities, to provide enhanced levels of credit to their customers. This scheme would assist farmers, small business owners and the SME sector entrepreneurs who use pawning advances for their economic and business activities.

Meanwhile, the Central Bank has also noted with satisfaction, the recent steps adopted by several bank and non-bank financial institutions supervised by the Central Bank, to introduce a number of investment instruments providing long term benefits aimed at senior citizens who rely on interest income. Such innovative financial products and schemes would provide the essential comfort to this segment of the

population in a sustained low inflation environment. At the meeting held on 11th July 2014, the Monetary Board also noted the ongoing downward adjustments in market lending rates, which would result in the expected benefits of low cost of finance being fully transmitted to productive sectors of the economy.

In the above background, the Monetary Board 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.