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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 – September 2014

The Sri Lankan economy performed strongly during the second quarter of 2014 with a real GDP growth of 7.8 per cent compared to the 7.6 per cent recorded in the first quarter of 2014. The growth in the second quarter was led by robust performance in the Industry sector, while the Agriculture and the Services sectors complemented the overall economic performance. The growth of 7.7 per cent in the first half of 2014 augurs well in meeting the expectations for the year.

The low inflation environment continued as inflation remained benign in August 2014 with year-on-year (y-o-y) headline inflation at 3.5 per cent and core inflation at 3.9 per cent (y-o-y). On an annual average basis, headline inflation was at 4.5 per cent while core inflation was at 3.2 per cent. Looking ahead, the positive impact of the recent reduction in administered prices for energy and fuel is expected to be reflected in price levels from October. Accordingly, inflation is projected to remain comfortably at around 3-4 per cent by end year, compared to the previously envisaged range of 4-5 per cent.

The external sector remained buoyant with the momentum derived from increased earnings from exports of goods and services and workers' remittances during July 2014. Although the trade deficit during the month widened particularly as a result of higher expenditure on petroleum imports in July 2014, on a cumulative basis, the trade deficit in first seven months of 2014 recorded a decline compared to the corresponding period in 2013. Along with these developments, continued inflows to the financial account resulted in an estimated surplus of over US dollars 2 billion in the balance of payments (BOP) during the first seven months of the year. So far during the year, the Central Bank has absorbed over US dollars 1 billion from the domestic foreign exchange market, and gross official reserves remained above US dollars 9 billion, equivalent to around 5.9 months of imports. In addition to the above foreign reserves, the Central Bank now also enjoys access to a further CNY 10 billion, equivalent to US dollars 1.6 billion, as a result of the bilateral Currency Swap agreement entered into with the People's Bank of China on 16th September 2014. This Swap facility, which is of a tenor of 3 years and renewable, is expected to further strengthen the external stability of the Sri Lankan economy.

The growth of broad money (M_{2b}) moderated in July 2014 to 11.9 per cent (y-o-y) from 13.3 per cent in the previous month, although net foreign assets (NFA) of the banking system continued to improve. On an aggregate basis, public corporations repaid debt to the banking system during the month, while net credit to the government (NCG) from the banking sector increased. The growth of credit to the private sector from commercial banks remained moderate during July 2014.

In the meantime, the Monetary Board has observed in recent months that the credit extended to the private sector by commercial banks has remained modest in spite of the continued easing of monetary policy, resulting in the accumulation of a large amount of excess liquidity in the domestic money market. In this regard, the Monetary Board has been of the view that such liquidity must ideally be utilised for productive economic activities instead of remaining unutilised for a considerable length of time in the system. The Board has also noted that these excess funds have been placed by several commercial banks on a continuous basis with the Central Bank under its standing deposit facility window, although such window has been essentially designed to provide an opportunity for OMO participants to deposit their excess liquidity at infrequent intervals to tide over temporary liquidity excesses. In that background, the Monetary Board was of the view that an appropriate monetary policy action needs to be implemented to address these concerns, particularly in view of continued low levels of inflation and benign inflation expectations.

Accordingly, the Monetary Board, at its meeting held on 22nd September 2014, decided to limit the access of OMO participants to the Standing Deposit Facility (SDF) of the Central Bank at the currently applicable SDF Rate of 6.50 per cent to a maximum of three times per calendar month, and any deposits at the SDF window exceeding three times by an OMO participant to be accepted at a reduced interest rate of 5.00 per cent per annum. This measure will be effective from 23rd September 2014 until further notice. For the remainder of the month of September 2014, access to OMO at the SDFR will be limited to twice per participant. In addition, the daily auction facility will be suspended with effect from 23rd September 2014 until further notice. The Standing Lending Facility Rate (SLFR) will remain unchanged at 8.00 per cent.

The Monetary Board is of the view that the above measures would actively encourage commercial banks to utilise the substantial amounts of excess liquidity to enhance the flow of bank credit to the private sector at more reasonable interest rates, and thereby support the growth momentum of the economy, given the low inflation environment.

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

Monetary Policy Decision: Access to Standing Deposit Facility rationalised		
Period	**Number of Times**	**Rate Applicable**
23rd to 30th September 2014	2	6.50%
	Exceeding 2	5.00%
During a calendar month from 1st October 2014	3	6.50%
	Exceeding 3	5.00%