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CENTRAL BANK OF SRI LANKA

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# Press Release

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## Monetary Policy Review – September 2015

Headline inflation, on a year-on-year basis, remained in the negative territory at -0.2 per cent for the second consecutive month in August 2015. Headline inflation, on an annual average basis, moderated further to 1.0 per cent in August 2015 from 1.3 per cent in the previous month. Meanwhile, core inflation increased to 3.9 per cent in August 2015 on a year-on-year basis, from 3.5 per cent in the previous month. However, annual average core inflation remained unchanged since June 2015 recording 2.8 per cent in August 2015. Going forward, headline inflation is expected to remain comfortably within 2.0-3.0 per cent by year end, supported by improved domestic supply conditions and subdued global commodity prices.

In the monetary sector, broad money ( $M_{2b}$ ) recorded a year-on-year growth of 16.2 per cent in July 2015, driven entirely by the expansion in domestic credit aggregates. While credit granted to the private sector by commercial banks increased by 21.0 per cent, on a year-on-year basis, in absolute terms, credit granted to the private sector in July 2015 was Rs. 40.9 billion totaling to Rs. 245.9 billion during the first seven months of 2015. The increased credit flows to the private sector have been sustained mainly due to prevailing low market interest rates amidst low inflation environment. Meanwhile, the Central Bank has observed with concern the recent rapid growth of exposure of banks and financial institutions to certain categories of lending, in particular lending in respect of motor vehicles. Accordingly, with a view to preempt this trend which could develop into a system-wide risk to the financial sector, as a prudential measure, the Central Bank decided to impose a maximum Loan to Value (LTV) ratio of 70 per cent in respect of loans and advances

granted for the purpose of purchase or utilisation of motor vehicles by banks and financial institutions supervised by the Central Bank. Going forward, the Central Bank will continue to be vigilant on the overall trends in the growth of credit as well as monetary aggregates and take preemptive measures in the case of emerging risks threatening the maintenance of price stability on a sustainable basis.

On the external front, the decline in expenditure on imports in July 2015 has been greater than the decline in earnings from exports, narrowing the deficit in the trade account of the month. With the Central Bank's decision to allow greater flexibility in the determination of the exchange rate, so far in 2015, the rupee has depreciated by around 7 per cent against the US dollar. The recent depreciation of the exchange rate, which would enhance exports, while curtailing non-essential imports, is expected to have a favourable impact on the trade balance. Such improvement, together with regular inflows of workers' remittances and earnings from tourism along with other inflows to the services account would help narrow the deficit in the current account balance and strengthen the resilience of the external sector. Meanwhile, the gross official reserves, which stood at US dollars 6.8 billion at end July 2015, are estimated to have decreased to US dollars 6.4 billion by end August 2015. However, official reserves are expected to increase during the remainder of the year with the expected long term external financial flows to the government.

According to the Department of Census and Statistics (DCS), the Sri Lankan economy is estimated to have grown by 6.7 per cent during the second quarter of 2015, recording a growth rate of 5.6 per cent for the first half of 2015 compared to 1.3 per cent recorded in the corresponding period of 2014. Economic growth during the second quarter has been largely supported by the improved performance in the Services sector along with positive contributions from the Industry and Agriculture sectors.

Taking the above developments in the economy into consideration, the Monetary Board, at its meeting held on 25 September 2015, was of the view that the current monetary policy stance is appropriate. Accordingly, 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 6.00 per cent and 7.50 per cent, respectively.

<b>Monetary Policy Decision:</b>	<b>Policy rates unchanged</b>
Standing Deposit Facility Rate (SDFR)	6.00%
Standing Lending Facility Rate (SLFR)	7.50%
Statutory Reserve Ratio (SRR)	6.00%