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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

Communications Department

30, Janadhipathi Mawatha, Colombo 01, Sri Lanka.

Tel : 2477424, 2477423, 2477311

Fax: 2346257, 2477739

E-mail: dcommunications@cbsl.lk, communications@cbsl.lk

Web: www.cbsl.gov.lk

Press Release

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Monetary Policy Review – January 2016

Broad money supply (M_{2b}) continued to expand at a high rate with a year-on-year growth of 17.2 per cent in November 2015, following the growth of 17.0 per cent in the previous month. In November 2015, the net foreign assets (NFA) of the banking sector improved with the receipt of the proceeds of the International Sovereign Bond (ISB) of US dollars 1.5 billion issued on 27 October 2015. The issuance of the ISB also facilitated a reduction of net credit obtained by the government (NCG) from the banking sector during the month of November, while credit obtained by public corporations also declined. Meanwhile, credit extended to the private sector by commercial banks remained the key driver of broad money growth, recording an increase of 27.0 per cent (year-on-year) in November 2015, compared to the growth of 26.3 per cent in October. In absolute terms, the monthly increase in private sector credit was Rs. 91.2 billion, leading to a cumulative expansion in private sector credit of Rs. 647.7 billion during the first eleven months of 2015.

In order to arrest the possible build-up of demand pressures on inflation through excessive credit creation, the Central Bank increased the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of commercial banks by 1.50 percentage points to 7.50 per cent with effect from 16 January 2016. Accordingly, excess rupee liquidity in the domestic money market, which averaged around Rs. 90 billion in December 2015 and in the first two weeks of January 2016, declined to around Rs. 42 billion, on average, thereafter. The increase in SRR also induced an

upward adjustment in market interest rates, and the growth of credit extended to the private sector by commercial banks is expected to decelerate in the period ahead, albeit with a time lag.

In spite of the high growth of broad money, inflation remained subdued supported by low international commodity prices and broadly favourable domestic supply conditions. Colombo Consumers' Price Index (CCPI, 2006/2007=100) based headline inflation decelerated to 2.8 per cent, on a year-on-year basis, in December 2015 from 3.1 per cent in November 2015, and annual average headline inflation was 0.9 per cent. Headline inflation based on the National Consumer Price Index (NCPI, 2013=100) decelerated to 4.2 per cent, on a year-on-year basis, in December 2015 from 4.8 per cent in the previous month, and registered a value of 3.8 per cent on an annual average basis. CCPI based core inflation edged up in December 2015, recording 4.5 per cent, on a year-on-year basis, in comparison to 4.3 per cent in the previous month.

On the external front, export earnings contracted by 9.3 per cent in November 2015 causing a cumulative decline of 4.4 per cent during the first eleven months of the year. Import expenditure also recorded a decline of 11 per cent in November 2015, and the cumulative decline in expenditure on imports was 2.1 per cent during the first eleven months of 2015. Reflecting these developments, the deficit in the trade account narrowed for the fifth consecutive month in November 2015. Nevertheless, on a cumulative basis, the trade deficit expanded marginally by 1.0 per cent to US dollars 7,566 million during the first eleven months of the year. Earnings from tourism are estimated to have increased by 17.8 per cent during 2015, although workers' remittances declined by 0.5 per cent during the year, mainly reflecting a decline of receipts from the Middle East. Gross official reserves were estimated at US dollars 7.3 billion by end 2015, while the Sri Lanka rupee, which depreciated by 9.0 per cent against the US dollar in 2015, recorded a marginal appreciation thus far during 2016.

At its meeting held on 25 January 2016, the Monetary Board observed that the policy adjustments made on the monetary and external fronts are still being transmitted gradually to the macroeconomy, and accordingly, 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.

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