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Press Release

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Monetary Policy Review – July 2016

The increasing trend in both headline and core inflation continued, reflecting the rise in demand driven inflationary pressures in the economy. Supply side disruptions arising from adverse weather conditions and the revisions introduced to the tax structure by the government also contributed to the upward movement in inflation in the past two months. Meanwhile, in the real sector, the available indicators suggest a continuation of the growth momentum in economic activity. In particular, power generation, tourism and port related services, construction sector, investment goods imports as well as the purchasing managers' indices (PMI) for manufacturing and services sectors have shown improvements over the past few months.

On the monetary front, market interest rates have adjusted upwards in response to the monetary tightening measures adopted in early 2016 and continued low levels of rupee liquidity in the domestic money market. Although some deceleration in the growth of broad money (M_{2b}) supply was observed in the month of May 2016, monetary expansion remained above the desired levels. In spite of the increase in market interest rates, credit granted to the private sector by commercial banks increased at the high pace of 28.0 per cent, year-on-year, in May 2016, in comparison to 28.1 per cent in April 2016. Provisional data also indicates that the high growth of credit to the private sector has continued during the month of June as well. The continued appetite for bank credit by the private sector in spite of the upward movement in market interest rates could create excessive demand and high inflation in the economy in future.

The sustained increase in domestic credit also caused a wider trade deficit. Accordingly, the cumulative trade deficit during the first five months of 2016 registered an increase of 1.4 per cent, year-on-year. Increased earnings from tourism and other services exports, workers' remittances,

and long term financial flows to the government, eased the pressure on the balance of payments to some extent.

Taking into consideration the developments discussed above, the Monetary Board, at its meeting held on 28 July 2016, was of the view that further tightening of monetary policy is required to curb excessive demand in order to pre-empt the escalation of inflationary pressures and to support the balance of payments. Accordingly, the Monetary Board decided to increase the main policy interest rates of the Central Bank, namely, the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR), by 50 basis points each, to 7.00 per cent and 8.50 per cent, respectively, effective from the close of business on 28 July 2016. The Board is of the view that tightening of monetary policy in a forward looking manner will ensure the maintenance of inflation at mid-single digits in the medium term, which is supportive of the growth momentum in the economy. As such, the current policy adjustment is not expected to have a significant impact on the long end of the yield curve. The Central Bank will continue to monitor macroeconomic developments closely and make appropriate adjustments to the monetary policy stance, as necessary.

Monetary Policy Decision:	Policy rates increased
Standing Deposit Facility Rate (SDFR)	7.00%
Standing Lending Facility Rate (SLFR)	8.50%
Statutory Reserve Ratio (SRR)	7.50%