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Press Release

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Monetary Policy Review: No. 5 – 2018

The Central Bank of Sri Lanka maintains policy interest rates at current levels

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 02 August 2018, decided to maintain policy interest rates at their current levels. Accordingly, the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) of the Central Bank will remain at 7.25 per cent and 8.50 per cent, respectively. The Board's decision is consistent with its aim of stabilising inflation at mid-single digit levels in the medium term, thereby contributing to a high and sustainable growth trajectory of the Sri Lankan economy. In arriving at its decision, the Board carefully considered the current and expected domestic and global economic developments.

Strengthening of global growth amidst increased uncertainty

The latest update to the World Economic Outlook (WEO, July 2018) of the International Monetary Fund (IMF) confirmed the strengthening of the global economy in 2018 and 2019 despite less synchronised expansion across economies. The balance of risks is biased to the downside amidst monetary policy tightening in the United States and other major economies, strengthening of the US dollar, pressures on currencies of many emerging market economies and escalating trade tensions. Some emerging market economies have responded to these risks by tightening their monetary policies and allowing their exchange rates to adjust appropriately.

A gradual pickup in domestic economic growth is expected from the second quarter of 2018

As per the developments observed in leading indicators and current projections, Sri Lanka's real economic growth is expected to record a gradual acceleration from the second quarter of the year. Improved weather conditions are expected to favourably impact agriculture activities and related industries in the second half of 2018 and support the overall growth momentum, which is expected to be led by the expansion in services and industry related activities. The economy is projected to reach its potential over the medium term benefiting from a competitive flexible exchange rate, a low inflation environment and a stronger policy framework to support exports and investment, amidst continued fiscal consolidation.

Inflation to remain in mid-single digits in spite of the recent uptick

Year-on-year headline inflation, which remained in low-single digits during the period February-June 2018, accelerated in July 2018 as expected. This was mainly due to the recent transitory price pressures stemming from upward adjustments to domestic petroleum prices and higher volatile food prices, as well as the base effect. Although inflation is projected to remain at the higher end of the inflation target of 4 – 6 per cent in August as well, the onset of the harvest towards the end of the third quarter of 2018 is expected to lower inflation thereafter. Stable underlying inflation, together with firmly anchored inflation expectations indicate well contained aggregate demand pressures, and supports the projection of mid-single digit inflation in the medium term.

Short term market interest rates are responding to surplus rupee liquidity, while monetary expansion continued its gradual deceleration

Responding to prevailing surplus liquidity conditions in the domestic money market, short term interest rates have begun to adjust downwards. Yields on government securities in both primary and secondary markets have also declined recently. In line with these developments, it is expected that other market interest rates, particularly interest rates on lending would adjust downwards in the period ahead, thereby reducing high real interest rates faced by borrowers at present.

The growth of credit extended to the private sector by commercial banks continued its gradual decline towards the desired levels. Along with the deceleration in private sector credit growth and a reduction in credit extended to the government by the banking sector on a net basis, the overall monetary expansion also decelerated in June 2018. These trends in monetary and credit expansion

indicate greater monetary stability, consistent with the envisaged medium term growth path of the economy.

External sector recorded a mix performance

The growth of export earnings outpaced the growth of import expenditure in May 2018, thereby containing the trade gap to some extent. Supporting the current account, earnings from tourism and workers' remittances continued to increase so far during the year. The recently introduced measures to address the excessive growth of import of gold and motor vehicles are expected to reduce the pressure on the balance of payments stemming from trade account dynamics. Meanwhile, as observed in other emerging market economies, some outflows of foreign investment from the rupee denominated government securities market were experienced recently. Despite an outflow from the secondary market, the Colombo Stock Exchange (CSE) attracted net inflows as a result of primary market transactions. Although some pressure on the exchange rate was observed since late April 2018 mainly reflecting the impact of the US dollar's broad-based strengthening in global markets, the depreciation pressure has eased to some extent from late July 2018. Reflecting these developments, the exchange rate has depreciated against the US dollar by 4.2 per cent so far during the year. The Central Bank has absorbed US dollars 133.9 million, on a net basis, from the domestic market by end July 2018. The gross official reserve position was estimated at US dollars 8.4 billion at end July 2018 compared to US dollars 8.0 billion recorded at end 2017.

Policy interest rates maintained at current levels

Based on current and expected macroeconomic developments, the Monetary Board of the Central Bank was of the view that the continuation of the current monetary stance is appropriate. Accordingly, the Monetary Board decided to maintain the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) of the Central Bank at their current levels.

Monetary Policy Decision: Policy rates unchanged

Standing Deposit Facility Rate (SDFR)	7.25%
Standing Lending Facility Rate (SLFR)	8.50%
Statutory Reserve Ratio (SRR)	7.50%

INFORMATION NOTE:

A press conference with Governor Dr. Indrajit Coomaraswamy will be held today (03 August 2018) at 11.30 am at the John Exter International Conference Hall (JEICH) of the Central Bank of Sri Lanka.

The release of the next regular statement on monetary policy will be on 28 September 2018.

DATA ANNEXURE:

Table 01: Inflation

Month		Mar 18	Apr 18	May 18	Jun 18	Jul 18
Headline Inflation (Year on year % change)	CCPI (2013=100)	4.2	3.8	4.0	4.4	5.4
	NCPI (2013=100)	2.8	1.6	2.1	2.5	-
Core Inflation (Year on year % change)	CCPI (2013=100)	3.4	3.5	3.2	3.4	3.9
	NCPI (2013=100)	1.9	1.9	1.7	1.8	-

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)				Year - on - Year % Change			
	Mar 18	Apr 18	May 18	Jun 18	Mar 18	Apr 18	May 18	Jun 18
Reserve Money	997	1,000	973	999	11.8	12.9	13.2	12.0
Broad Money (M _{2b})	6,607	6,692	6,671	6,748	16.4	16.8	15.0	14.9
Net Foreign Assets (NFA)	106	119	74	101	128.6	135.0	123.4	141.1
Net Domestic Assets (NDA)	6,500	6,572	6,597	6,646	7.5	8.2	7.8	8.6
Net Credit to the Government (NCG)	2,278	2,322	2,324	2,273	2.9	5.3	3.8	1.7
Credit to Public Corporations	557	581	608	619	-2.6	0.8	4.8	8.5
Credit to the Private Sector	5,022	5,044	5,073	5,156	15.3	15.3	15.1	14.9
Broad Money (M ₄)	8,112	8,218	8,207	8,244	16.7	16.8	15.1	14.2

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End Mar 18	End Apr 18	End May 18	End Jun 18	End Jul 18	As at 2 Aug 18
Policy Rates of the Central Bank						
Standing Deposit Facility Rate	7.25	7.25	7.25	7.25	7.25	7.25
Standing Lending Facility Rate	8.75	8.50	8.50	8.50	8.50	8.50
Weighted Average Call Money Rate (AWCMR)	8.41	7.86	7.93	8.50	8.46	8.34
Treasury bill Yields (Primary Market)						
91-day	8.17	8.10	8.34	8.32	8.24	8.17
182-day	-	-	8.93	8.85	8.74	-
364-day	9.69	9.59	9.62	9.39	9.27	9.23
Lending Rates						
Average Weighted Prime Lending Rate (Weekly)	11.55	11.21	11.42	11.33	11.44 (a)	-
Average Weighted Lending Rate (AWLR)	14.04	14.13	14.06	14.05	-	-
Average Weighted New Lending Rate (AWNLR)	14.25	14.29	14.15	13.94	-	-
Deposit Rates						
Average Weighted Deposit Rate (AWDR)	9.00	8.98	8.91	8.92	8.64	-
Average Weighted Fixed Deposit Rate (AWFDR)	11.41	11.38	11.23	11.26	10.82	-
Average Weighted New Deposit Rate (AWNDR)	10.33	10.75	10.67	10.57	-	-

(a) Weekly AWPR as at week ending 26 July 2018

Source: Central Bank of Sri Lanka