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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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The Central Bank of Sri Lanka Reduces its Policy Interest Rates

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 22 August 2019, decided to reduce the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 50 basis points to 7.00 per cent and 8.00 per cent, respectively. The Board arrived at this decision following a careful analysis of current and expected developments in the domestic economy and the financial market as well as the global economy, with the aim of further supporting the revival of economic activity in the context of low inflation prevailing at present and the medium term inflation outlook, which is well anchored in the desired 4-6 per cent range.

Slowing global economic activity has prompted many countries to relax their monetary policies

Amidst weakening global demand due to uncertainties arising from trade tensions and geopolitical developments, many central banks in advanced and emerging market economies have reduced policy interest rates to support domestic economic growth, and have signalled that their stances will remain accommodative in the near term. Muted inflation and inflation outlook in these economies have acted in favour of such decisions.

Inflation is expected to remain in mid-single digit levels in the medium term

Headline inflation and core inflation, as measured by the year-on-year changes in both Colombo Consumer Price Index (CCPI) and National Consumer Price Index (NCPI), remained low in recent

months, partly driven by subdued food prices. Although recent upward adjustments to fuel prices as well as administratively determined prices of certain commodities could exert some transitory price pressures in the near term, inflation is likely to remain around the lower bound of the desired inflation target range of 4-6 per cent during the remainder of 2019. Along with well anchored inflation expectations and appropriate timely policy measures, inflation is expected to be maintained within this desired range over the medium term.

Economic growth is likely to be hampered by adverse domestic and global developments

Prevailing economic conditions and the developments observed in leading indicators point to modest economic growth during 2019 as well. Although economic growth is expected to recover gradually towards its potential in the medium term, domestic and global headwinds are likely to delay this recovery. Therefore, it is essential that the available policy spaces are utilised to support productive economic activity without disrupting the improvements achieved in relation to macroeconomic stability.

External sector remains resilient supported by an improved trade balance

The trade deficit continued to improve during the first half of 2019 with the sustained growth of exports and the notable contraction in the growth of imports. Tourist arrivals, which were impacted by the Easter Sunday attacks, continued to recover from the month of June. Workers' remittances recorded a marginal growth in June, although a cumulative moderation was observed during the first half of the year. Foreign financial flows, in the meantime, have been mixed with a net outflow from the Government securities market and a net inflow to the stock market, including primary inflows, thus far during the year. The Sri Lankan rupee appreciated against the US dollar by 2.4 per cent so far during the year, although some depreciation pressure was experienced during the past few days. The depreciation pressure, mainly driven by foreign withdrawals from the Government securities market by a few investors, is expected to be short-lived. Meanwhile, gross official reserves are estimated at US dollars 8.3 billion at end July 2019, providing an import cover of 5.0 months.

Monetary and credit aggregates moderated further

The year-on-year growth of credit disbursed to the private sector by licensed commercial banks continued to decelerate during the first seven months of 2019. Accordingly, the absolute increase in private sector credit remained far below the levels observed in the corresponding period of 2018. As per the Quarterly Survey on Loans and Advances to the private sector by licensed commercial banks, the year-on-year growth of credit towards agriculture, industry and services decelerated further in the second quarter of 2019, while the growth of personal loans and advances accelerated. The

deceleration in credit extended to the private sector caused a slowdown in the growth of overall monetary aggregates during the period as well.

A speedy reduction in market lending rates is needed to revive economic activity

Responding to the reduction of policy interest rates by 50 basis points in May 2019 and the improvement of liquidity conditions through the reduction of the Statutory Reserve Ratio (SRR) by 2.50 percentage points in two steps in November 2018 and March 2019, the Average Weighted Call Money Rate (AWCMR) has shown a notable decline. Yields on Government securities also declined substantially during the year, although some increase was observed in the past few days. The imposition of caps on deposit interest rates of financial institutions that was intended to expedite monetary policy transmission, along with the decline in the AWCMR, also resulted in a sharp decline in the cost of funds of these institutions. However, although the Average Weighted Prime Lending Rate (AWPR) declined considerably, all market lending rates, including the AWPR, are yet to show a downward adjustment commensurate to the decline observed in deposit interest rates. It is essential that market lending rates are lowered by bank and non-bank financial institutions in response to their reduced cost of funds, thereby boosting credit flows to productive sectors, and in turn help the revival of the economy.

The monetary policy decision is expected to ensure a faster reduction in market lending rates

In consideration of the current and expected macroeconomic developments as summarised above, the Monetary Board, at its meeting held on 22 August 2019, was of the view that a reduction of policy interest rates of the Central Bank is warranted. Accordingly, the Monetary Board decided to reduce the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 50 basis points to 7.00 per cent and 8.00 per cent, respectively. Supported by this decision, the Central Bank expects all market lending rates to reduce in line with the reduction already observed in deposit interest rates. The Central Bank will continue to closely monitor the developments in market lending rates and recommend the imposition of appropriate caps on market lending rates of financial institutions if the intended reduction is not realised within specified timelines. Such timelines and measures will be announced shortly in consultation with relevant stakeholders.

Monetary policy has been accommodative with two SRR reductions totalling 2.50 percentage points and two downward adjustments to policy interest rates, which have resulted in the lowering of the policy rate corridor from 8.00 - 9.00 per cent to 7.00 - 8.00 per cent. The Monetary Board intends

to review the impact of these measures as well as the fiscal performance and global developments, prior to deciding upon the future trajectory of monetary policy going forward.

Monetary Policy Decision: Policy rates reduced and SRR unchanged

Standing Deposit Facility Rate (SDFR)	7.00%
Standing Lending Facility Rate (SLFR)	8.00%
Statutory Reserve Ratio (SRR)	5.00%

INFORMATION NOTE:

A press conference with Governor Dr. Indrajit Coomaraswamy will be held on 23 August 2019 at 11.30 am at the Atrium of the Central Bank of Sri Lanka.

The release of the next regular statement on monetary policy will be on 11 October 2019.

Data Annexure:

Table 01: Inflation

Month		Dec 18	Jan 19	Feb 19	Mar 19	Apr 19	May 19	Jun 19	Jul 19
Headline Inflation (Year on year % change)	CCPI (2013=100)	2.8	3.7	4.0	4.3	4.5	5.0	3.8	3.3
	NCPI (2013=100)	0.4	1.2	2.4	2.9	3.6	3.5	2.1	2.2
Core Inflation (Year on year % change)	CCPI (2013=100)	3.1	5.5	5.4	5.6	5.5	6.2	5.8	5.7
	NCPI (2013=100)	3.1	5.1	5.5	5.8	6.3	6.3	6.1	6.1

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)					Year - on - Year % Change				
	Mar 19	Apr 19	May 19	Jun 19	Jul 19	Mar 19	Apr 19	May 19	Jun 19	Jul 19
Reserve Money	963	924	849	875	888	(3.4)	(7.6)	(12.7)	(12.4)	(11.3)
Broad Money (M _{2b})	7,253	7,295	7,295	7,338	7,355	9.8	9.0	9.4	8.7	8.2
Net Foreign Assets (NFA)	23	110	103	99	105	(78.2)	(7.6)	38.3	(2.2)	(39.0)
Net Domestic Assets (NDA)	7,230	7,185	7,192	7,239	7,251	11.2	9.3	9.0	8.9	9.5
Net Credit to the Government (NCG)	2,613	2,584	2,594	2,667	2,703	14.7	11.3	11.6	17.3	21.4
Credit to Public Corporations	703	726	726	730	729	26.2	24.9	19.4	17.9	14.6
Credit to the Private Sector	5,588	5,544	5,542	5,605	5,604	11.3	9.9	9.2	8.7	7.7
Broad Money (M ₄)	8,902	8,968	8,980	9,051	9,082	9.7	9.1	9.4	9.2	9.0

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End Jan 19	End Feb 19	End Mar 19	End Apr 19	End May 19	End Jun 19	End Jul 19	As at 22 Aug 19
Policy Rates of the Central Bank								
Standing Deposit Facility Rate	8.00	8.00	8.00	8.00	7.50	7.50	7.50	7.50
Standing Lending Facility Rate	9.00	9.00	9.00	9.00	8.50	8.50	8.50	8.50
Average Weighted Call Money Rate (AWCMR)	9.00	8.96	8.51	8.49	7.94	7.86	7.70	7.75
Treasury bill yields (Primary market)								
91-day	-	9.55	9.39	8.89	8.52	8.24	7.85	7.84
182-day	9.87	9.87	9.67	9.09	8.63	8.49	7.94	7.89
364-day	10.69	10.67	10.40	9.81	8.88	8.70	8.21	8.31
Lending Rates								
Average Weighted Prime Lending Rate (Weekly)	12.27	12.51	12.23	12.20	11.82	11.52	10.89	10.77
Average Weighted Lending Rate (AWLR)	14.44	14.48	14.49	14.47	14.48	14.36	14.22	-
Average Weighted New Lending Rate (AWNLR)	14.41	14.60	14.56	14.62	14.59	14.35	13.88	-
Deposit Rates								
Average Weighted Deposit Rate (AWDR)	8.85	8.88	8.98	8.97	9.00	8.94	8.88	8.73
Average Weighted Fixed Deposit Rate (AWFDR)	10.91	10.96	11.11	11.15	11.19	11.07	10.97	10.74
Average Weighted New Deposit Rate (AWNDR)	11.21	11.13	11.42	11.24	10.05	9.85	8.58	-

Source: Central Bank of Sri Lanka