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Press Release

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Monetary Policy Review: No. 1 – 2020

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 29 January 2020, 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 6.50 per cent and 7.50 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. This decision supports a continued reduction in market lending rates, thereby facilitating the envisaged recovery in economic activity given the favourable medium term outlook for inflation, which is well anchored within the 4-6 per cent range.

Global monetary policy continued to remain accommodative amidst concerns over low economic growth

Downward revisions to global growth projections were announced in the January 2020 update of the World Economic Outlook (WEO) of the International Monetary Fund (IMF), owing to weaker than expected growth across emerging market economies, especially India. Global economy is estimated to have grown by 2.9 per cent in 2019 and projected to grow by 3.3 per cent and 3.4 per cent in 2020 and 2021, respectively. Meanwhile, global growth prospects have been further threatened by the spread of coronavirus originated in China. In light of subdued global growth and softening inflationary pressures, central banks of advanced economies continued to maintain an accommodative policy stance, while a number of emerging market economy central banks eased monetary policy further thus far in 2020.

A recovery in domestic economic growth is expected

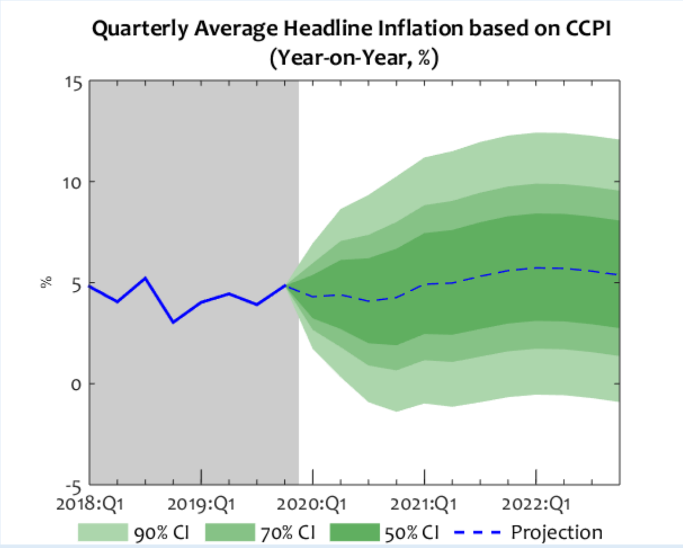
As suggested by available indicators and latest estimates, domestic economic activity has remained subdued in the fourth quarter of 2019, primarily with subpar growth in Agriculture and Industry related activities. However, in 2020, a revival in economic activity is envisaged supported by appropriate fiscal and monetary measures, improved business confidence and political stability. The economy is expected to reach its full capacity over the medium term, benefitting from the low and stable inflation environment, a competitive exchange rate, low lending rates as well as improved consumer and investor sentiment. The growth momentum of the economy is expected to be sustained through the implementation of appropriate structural reforms designed in line with the policy priorities of the government.

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

Headline inflation, as measured by the year-on-year change in Colombo Consumer Price Index (CCPI), accelerated in December 2019 owing to domestic supply disruptions. In spite of such short term fluctuations, the near term forecast suggests that inflation will hover below 5 per cent in 2020, and stabilise between 4-6 per cent thereafter, assisted by appropriate policy measures and underpinned by well anchored inflation expectations. Meanwhile, National Consumer Price Index (NCPI) based headline inflation, which attaches a higher weight to the food basket, also accelerated in December 2019. Nevertheless, reflecting subdued aggregate demand conditions, core inflation, measured using both CCPI and NCPI, decelerated.

Headline Inflation (CCPI based) Projection: Inflation, which is projected to hover below 5 per cent in 2020, is expected to gradually stabilise in mid single digit levels thereafter. The Monetary Board will stand ready to respond to any build-up of demand driven price pressures in the foreseeable future.

Figure: 01



Source: CBSL Staff Projections

Note: A forecast is neither a promise nor a commitment. The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colors. The projection reflects the available data and assumptions as well as judgments made at the January 2020 forecast round, and it may change at the next quarterly update in April 2020 as new information becomes available and the assumptions and judgments are revised accordingly.

The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. Specifically, the thick green shaded area represents 50 per cent confidence interval, implying there is a 50 per cent probability that the actual inflation outcome will be within this interval. The confidence bands show the increasing uncertainty in forecasting inflation over a longer horizon.

External sector remains resilient amidst growing macroeconomic headwinds

Trade performance during the first eleven months of 2019 improved over the previous year with a notable contraction in imports and a marginal improvement in merchandise exports, resulting in a significant decline in the trade deficit. A faster than anticipated recovery in the tourism sector helped mitigate the impact of Easter Sunday attacks to a larger extent, although arrivals and earnings remained low compared to 2018. Workers' remittances moderated somewhat in 2019 reflecting the trend observed in recent years. Meanwhile, renewed foreign interest on the rupee denominated Government securities market resulted in a net inflow during the year thus far, although the Colombo Stock Exchange witnessed a marginal net outflow of foreign investment from the secondary market during this period. The Sri Lankan rupee, which appreciated by 0.6 per cent against the US dollar in 2019, remained broadly unchanged so far during 2020. Gross official reserves are estimated at US dollars 7.6 billion at end 2019, providing an import cover of 4.6 months.

The pickup in money and credit growth observed in December 2019 is expected to continue in 2020

Supported by the accommodative monetary policy stance, growth of credit extended to the private sector picked up in December 2019, on a year-on-year basis, following a continued slowdown since December 2018. Driven by domestic credit expansion, broad money growth (year-on-year) also picked up in December 2019. However, the absolute expansion in credit extended to both private and public sectors remained modest during 2019, compared to that of 2018. Going forward, the growth of money and credit aggregates is expected to accelerate with the envisaged continued decline in lending rates, expected expansion in economic activity supported by fiscal stimulus, announced credit support package for Small and Medium Enterprises (SMEs) and improved investor sentiment.

Market lending rates continued to decline, but the pace of reduction has decelerated

In response to monetary and regulatory measures taken by the Central Bank, market lending rates adjusted downwards, but the pace of reduction has decelerated. The reduction in lending rates thus far, except for the Average Weighted Prime Lending Rate (AWPR), has been less than envisaged. With the removal of caps on deposit interest rates offered by banks, new deposits rates have increased since September 2019. Yields on Treasury bills have trended upwards at recent auctions. If not addressed, these trends could result in an undesirable turnaround in market lending rates.

The monetary policy decision will support a continued reduction in market lending rates, ensuring a broad based and sustained recovery in economic activity

In consideration of the current and expected macroeconomic developments as highlighted above, the Monetary Board, at its meeting held on 29 January 2020, was of the view that it is essential that market lending rates reduce further in order to support the envisaged pickup in credit growth and economic activity. 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 6.50 per cent and 7.50 per cent, respectively, with effect from 30 January 2020. The Central Bank will continue to monitor macroeconomic and financial market developments with a view to maintaining aggregate demand conditions at appropriate levels, in the period ahead.

Monetary Policy Decision:	**Policy rates reduced by 50 basis points**
Standing Deposit Facility Rate (SDFR)	6.50%
Standing Lending Facility Rate (SLFR)	7.50%
Statutory Reserve Ratio (SRR)	5.00% (unchanged)

INFORMATION NOTE:

A press conference with Governor Prof. W D Lakshman will be held on 30 January 2020 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 05 March 2020.

Data Annexure:

Table 01: Inflation

Month		Dec 18	Mar 19	Jun 19	Aug 19	Sep 19	Oct 19	Nov 19	Dec 19
Headline Inflation (Year on year % change)	CCPI (2013=100)	2.8	4.3	3.8	3.4	5.0	5.4	4.4	4.8
	NCPI (2013=100)	0.4	2.9	2.1	3.4	5.0	5.6	4.1	6.2
Core Inflation (Year on year % change)	CCPI (2013=100)	3.1	5.6	5.8	5.6	5.6	5.5	5.1	4.8
	NCPI (2013=100)	3.1	5.8	6.1	5.9	5.6	5.6	5.5	5.2

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)					Year - on - Year % Change				
	Aug 19	Sep 19	Oct 19	Nov 19	Dec 19	Aug 19	Sep 19	Oct 19	Nov 19	Dec 19
Reserve Money	913	915	908	919	933	-9.1	-9.5	-9.0	-2.4	-3.0
Broad Money (M_{2b})	7,397	7,443	7,456	7,473	7,624	7.7	7.4	6.7	6.1	7.0
Net Foreign Assets (NFA)	102	113	102	83	115	-39.0	1,374.4	698.7	292.9	272.1
Net Domestic Assets (NDA)	7,295	7,331	7,355	7,390	7,509	8.9	5.8	5.0	4.3	4.4
Net Credit to the Government (NCG)	2,752	2,732	2,729	2,702	2,767	21.1	12.5	12.6	9.6	9.9
Credit to Public Corporations	747	755	789	803	818	16.8	15.1	12.5	12.2	8.3
Credit to the Private Sector	5,626	5,680	5,706	5,753	5,811	7.2	6.1	5.1	4.4	4.5
Broad Money (M_4)	9,133	9,211	9,244	9,269 [(a)]	9,412	8.7	8.3	8.1	7.6	7.8

(a) Revised

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End Jul 19	End Aug 19	End Sep 19	End Oct 19	End Nov 19	End Dec 19	As at 29 Jan 20
Policy Rates of the Central Bank							
Standing Deposit Facility Rate	7.50	7.00	7.00	7.00	7.00	7.00	7.00
Standing Lending Facility Rate	8.50	8.00	8.00	8.00	8.00	8.00	8.00
Average Weighted Call Money Rate (AWCMR)	7.70	7.43	7.45	7.45	7.48	7.45	7.47
Treasury bill yields (Primary market)							
91-day	7.85	7.63	7.62	7.49	7.45	7.51	7.51
182-day	7.94	7.70	7.75	7.65	7.67	8.02	8.15
364-day	8.21	8.22	8.41	8.35	8.29	8.45	8.59
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	10.89	10.66	10.49	10.44	10.15	9.74	9.62[a]
Average Weighted Lending Rate (AWLR)	14.22	14.04	13.91	13.71	13.65	13.59	-
Average Weighted New Lending Rate (AWNLR)	13.91	13.84	13.50	13.19	12.87	12.80	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	8.88	8.73	8.51	8.37	8.27	8.20	8.14
Average Weighted Fixed Deposit Rate (AWFDR)	10.97	10.74	10.46	10.27	10.14	10.05	9.97
Average Weighted New Deposit Rate (AWNDR)	8.58	8.40	8.41	8.66	8.78	8.89	-

(a) For the week ending 24 January 2020

Source: Central Bank of Sri Lanka