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CENTRAL BANK OF SRI LANKA

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# Press Release

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## Monetary Policy Review: August 2020

### **The Central Bank of Sri Lanka continues its accommodative monetary policy stance**

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 19 August 2020, decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at their current levels of 4.50 per cent and 5.50 per cent, respectively. The Board recognised the necessity to continue the accommodative monetary policy stance, particularly as market lending rates are yet to reflect the full passthrough of policy easing measures implemented thus far. The Board decided to adopt targeted measures to reduce specific interest rates that it considered to be excessive, which would help marginal borrowers. The Board anticipates a further reduction in overall market lending rates, thereby encouraging borrowing for productive economic activity and reinforcing support for COVID-19 hit businesses as well as the broader economy, given the conditions of subdued inflation.

### **Global monetary easing continued amidst the rapid spread of the COVID-19 pandemic**

The rapid spread of the COVID-19 pandemic and related containment measures have resulted in a significant downturn in the global economy in the first half of the year. In response, almost all central banks of advanced economies as well as emerging market and developing economies continued to implement monetary easing measures, alongside fiscal stimulus by respective governments, in support of the recovery of economic activity.

## **Domestic economic activities, which were adversely affected by the COVID-19 pandemic, are expected to recover in the second half of 2020**

As per the provisional estimates released by the Department of Census and Statistics (DCS), the Sri Lankan economy contracted by 1.6 per cent in the first quarter of 2020, contrary to the expectations of the Central Bank. As per the available indicators, the adverse impact of COVID-19 on economic activity during the second quarter of 2020 is likely to be substantial. However, a faster rebound of economic activity is expected, especially in the fourth quarter of 2020, supported by improved political stability, the resultant improvement in business confidence, and the lagged impact of monetary and fiscal stimulus. This expected rebound in the fourth quarter is essential for the country to record a positive growth rate during this year. The enhanced focus on domestic production for import substitution as well as to export is expected to drive near term growth, with potentially significant implications on the longer horizon. Sustaining the growth momentum beyond the near term would require reforms to address structural issues in the economy.

## **External sector has improved with the support of proactive policy measures**

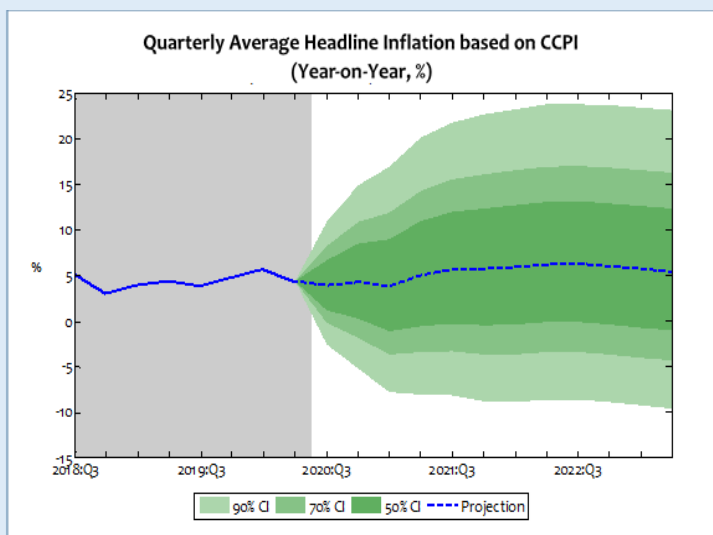
The external sector continued to demonstrate resilience, reflecting the impact of prudent measures implemented amidst the COVID-19 outbreak. The trade deficit has narrowed during the first half of 2020, as the contraction of imports outpaced the contraction of exports, supported by import restrictions and subdued global petroleum prices. Some improvement in workers' remittances was observed in June, in contrast to the declining trend observed since March 2020. However, the tourism sector, which has been forced to rely on domestic tourism for its survival in the face of the pandemic, is poised to witness a sizable decline in foreign exchange earnings in 2020. Depreciation of the Sri Lankan rupee against the US dollar has been limited to 1.3 per cent thus far during the year, following a significant depreciation recorded during March-April 2020. With the Central Bank buttressing its reserves through foreign currency purchases from the market and foreign currency swaps with the Reserve Bank of India and licensed banks, gross official reserves were estimated at US dollars 7.1 billion by end July 2020, providing an import cover of 4.7 months.

## **No demand driven inflationary pressure is expected during the forecast horizon**

Headline and core inflation, based on the Colombo Consumer Price Index (CCPI) accelerated marginally in July 2020, yet remaining at relatively low levels. The National Consumer Price Index (NCPI) based headline and core inflation also accelerated in June 2020, mainly reflecting the impact of food inflation. In spite of such short term fluctuations, inflation is expected to remain broadly within the desired 4-6 per cent range in the near to medium term, with appropriate policy measures.

**Headline Inflation (CCPI based) Projection: Inflation is projected to remain subdued in the near term. Impact of the measures to stimulate economic growth and the normalisation of global oil prices could exert some upward pressures on inflation towards mid-2022.**

**Figure: 01**



**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 and judgments made at the August 2020 forecast round.

The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. Specially, 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.

Source: CBSL Staff Projections

### **Slow growth of credit to the private sector is expected to recover gradually in the period ahead**

Growth of credit extended to the private sector by commercial banks decelerated in June 2020, year-on-year, while the outstanding volume of credit contracted during June 2020 for the second consecutive month, in spite of the large surplus liquidity in the market. However, a gradual recovery in credit extended to the private sector is expected in the period ahead, driven by increased economic activity, improving business sentiment with enhanced political stability, declining market lending rates and rising credit disbursement on account of concessional credit schemes for businesses affected by the pandemic. Credit to the public sector, in the meantime, soared in recent months reflecting the government’s heightened funding requirement, thereby causing a notable expansion of broad money thus far in 2020.

### **The impact of monetary easing measures is reflected in the recent notable decline in market interest rates**

A noticeable decline in market lending rates was observed in July 2020 in response to the series of policy and regulatory measures adopted by the Central Bank thus far in 2020. With the gradual reduction in market lending rates, interest rates applicable on new lending by commercial banks, on average, have now reduced to single digit levels. The Average Weighted Prime Lending Rate (AWPR) has also declined significantly in recent weeks. While the recent decline in overall

market interest rates is encouraging, some market lending rates still remain excessive, affecting marginal borrowers in particular. Overall market lending rates are expected to decline further, commensurate with monetary easing measures adopted in the recent past, enhancing the affordability of credit, which is imperative to support the recovery of economic activity in the period ahead.

**Policy rates maintained at current levels, while further measures to promote lending introduced**

In consideration of the current and expected macroeconomic developments as highlighted above, the Monetary Board, at its meeting held on 19 August 2020, was of the view that the current accommodative monetary policy stance is appropriate, and decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at their current levels of 4.50 per cent and 5.50 per cent, respectively. Considering bank lending rates of certain financial products which continue to remain high, the Board decided to revise downward the caps on interest rates on credit cards to 18 per cent per annum, on pre-arranged temporary overdrafts to 16 per cent per annum and on pawning facilities to 10 per cent per annum. Moreover, the Board was of the view that penal interest rates need to be capped at 2 percentage points over the regular interest rates charged on the relevant credit facility. Directions to effect these regulated interest rates will be issued shortly. The Central Bank will continue to monitor domestic and global macroeconomic and financial market developments and take further measures to support the economy to return to a higher growth path without delay, given subdued levels of inflation.

**Policy rates and SRR unchanged.**

Standing Deposit Facility Rate (SDFR)	4.50%
Standing Lending Facility Rate (SLFR)	5.50%
Bank Rate	8.50%
Statutory Reserve Ratio (SRR)	2.00%

**Regulated interest rates revised downwards.**

Maximum interest rate on Credit Cards	18.00%
Maximum interest rate on Pre-arranged Temporary Overdrafts	16.00%
Maximum interest rate on Pawning Facilities	10.00%
Penal interest rate over the regular interest rate	2.00 percentage points

**INFORMATION NOTE:**

The monetary policy press conference will be held on 20 August 2020 at 11.00 am at the Atrium of the Central Bank of Sri Lanka.

The release of the next regular statement on monetary policy will be on 08 October 2020.

Data Annexure:

**Table 01: Real GDP Growth (Provisional)**

Economic Activities	Year - on - Year % Change										
	2018					2019					2020
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual	First Quarter
Agriculture	5.9	6.6	5.1	8.2	<b>6.5</b>	5.0	1.5	1.0	-4.1	<b>0.6</b>	-5.6
Industries	1.6	3.5	3.5	-3.4	<b>1.2</b>	3.9	1.6	3.5	1.4	<b>2.7</b>	-7.8
Services	5.1	4.6	4.4	4.2	<b>4.6</b>	3.7	0.7	2.1	2.7	<b>2.3</b>	3.1
<b>GDP</b>	<b>3.8</b>	<b>4.0</b>	<b>3.7</b>	<b>1.9</b>	<b>3.3</b>	<b>3.7</b>	<b>1.1</b>	<b>2.4</b>	<b>2.0</b>	<b>2.3</b>	<b>-1.6</b>

Source: Department of Census and Statistics

**Table 02: Inflation**

Month		Dec 19	Jan 20	Feb 20	Mar 20	Apr 20	May 20	Jun 20	Jul 20
<b>Headline Inflation</b> (Year on year % change)	CCPI (2013=100)	4.8	5.7	6.2	5.4	5.2	4.0	3.9	4.2
	NCPI (2013=100)	6.2	7.6	8.1	7.0	5.9	5.2	6.3	-
<b>Core Inflation</b> (Year on year % change)	CCPI (2013=100)	4.8	3.0	3.2	2.9	3.1	2.9	3.1	3.2
	NCPI (2013=100)	5.2	3.9	3.4	3.2	3.2	3.7	4.4	-

Source: Department of Census and Statistics

**Table 03: Monetary Sector Developments (Provisional)**

Indicator	Outstanding Amount (Rs. billion)					Year - on - Year % Change				
	Feb 20	Mar 20	Apr 20	May 20	Jun 20	Feb 20	Mar 20	Apr 20	May 20	Jun 20
Reserve Money	963	1,014	1,022	997	869	0.03	5.3	10.5	17.3	-0.6
Broad Money (M <sub>2b</sub> )	7,793	8,098	8,259	8,293	8,365	8.4	11.6	13.2	13.7	14.0
Net Foreign Assets (NFA)	127	63	119	-15	24	232.5	104.8	0.6	-113.5	-78.1
Net Domestic Assets (NDA)	7,666	8,036	8,140	8,308	8,341	5.2	11.3	13.4	15.6	15.4
Net Credit to the Government (NCG)	2,928	3,199	3,264	3,428	3,562	9.5	22.4	26.2	32.1	33.5
Credit to Public Corporations	833	868	934	953	951	16.5	23.6	28.7	31.1	30.3
Credit to the Private Sector	5,824	5,944	5,958	5,888	5,834	4.8	6.5	7.6	6.4	4.3
Broad Money (M <sub>4</sub> )	9,676	9,973	10,160	10,199	10,262	9.6	12.0	13.3	13.6	13.4

Source: Central Bank of Sri Lanka

**Table 04: Interest Rates**

Interest Rate (%)	End Feb 20	End Mar 20	End Apr 20	End May 20	End Jun 20	End Jul 20	As at 19 Aug 20
<b>Policy Rates of the Central Bank</b>							
Standing Deposit Facility Rate	6.50	6.25	6.00	5.50	5.50	4.50	4.50
Standing Lending Facility Rate	7.50	7.25	7.00	6.50	6.50	5.50	5.50
<b>Average Weighted Call Money Rate (AWCMR)</b>	6.95	6.75	6.40	5.84	5.52	4.53	4.53
<b>Treasury bill yields (Primary market)</b>							
91-day	7.42	7.00	6.75	6.69	5.50	4.59	4.59
182-day	8.06	7.25	6.80	6.82	5.53	4.68	4.71
364-day	8.58	7.50	7.00	6.93	5.66	4.86	4.90
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	9.47	9.24	9.49	9.16	8.48	7.47	7.00 <sup>(a)</sup>
Average Weighted Lending Rate (AWLR)	13.36	13.22	13.08	12.96	12.64	12.29	-
Average Weighted New Lending Rate (AWNLR)	12.54	12.19	11.67	11.68	11.18	9.85	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	8.06	7.90	7.77	7.57	7.38	7.16	6.74
Average Weighted Fixed Deposit Rate (AWFDR)	9.83	9.65	9.51	9.26	9.00	8.69	8.26
Average Weighted New Deposit Rate (AWNDR)	8.55	8.22	7.83	7.83	7.20	5.78	-

(a) For the week ending 14 August 2020

Source: Central Bank of Sri Lanka