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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: November 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 25 November 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 arrived at this decision after carefully considering the macroeconomic conditions and expected developments on the domestic and global fronts. The Board, having noted the reduction in overall market lending rates so far during the year, stressed the need for a continued downward adjustment in lending rates to boost economic growth in the absence of demand driven inflationary pressures, particularly considering the significant levels of excess liquidity prevailing in the domestic money market. In order to support the economic revival, the Board decided to introduce maximum interest rates on mortgage backed housing loans for salaried workers, while lending targets for selected sectors of the economy will be introduced in the near future.

The second wave of COVID-19 has destabilised global growth prospects, but vaccine expectations have helped improve sentiments

Accommodative monetary policies adopted by almost all central banks across the globe continued amidst weak economic activity. Growing uncertainty, triggered by the second wave of COVID-19, has led central banks to further expand unconventional policy measures, including quantitative easing, while governments with adequate fiscal space continued to provide additional stimulus to their respective economies. However, the recent breakthroughs in relation to COVID-19 vaccines have helped improve sentiments worldwide.

The Sri Lankan economy was seen as having recovered strongly during the third quarter of 2020, before the disruptions caused by the second wave of COVID-19

Available economic indicators suggest a notable recovery in economic activity in the third quarter of 2020. The onset of the second wave of COVID-19 in October adversely affected this momentum to some extent. However, the impact of the containment measures on economic activity is not expected to be large, as mobility restrictions were imposed only in selected areas, and most of these restrictions have already been lifted in many areas. Despite this disturbance to the near term growth prospects, the economy is expected to rebound strongly in 2021 and sustain its growth momentum over the medium term, supported by the stimulus measures already in place and the effective implementation of the pro-growth policy proposals announced in the Government Budget 2021.

External sector remains resilient amidst challenging global developments

Provisional data indicate that the deficit in the trade account continued to narrow significantly, on a year-on-year basis, for the sixth consecutive month in October 2020. Workers' remittances increased for five consecutive months. These developments have largely cushioned the balance of payments effects of the pandemic arising from tourism sector developments. The exchange rate has stabilised after witnessing some speculation driven pressure prior to the presentation of the Budget 2021. Thus far during the year, the Sri Lankan rupee has recorded a depreciation of 2.0 per cent against the US dollar. Gross official reserves were estimated at US dollars 5.9 billion at end October 2020, with an import cover of 4.2 months. Measures that are being introduced to improve the domestic production economy, to enhance exports and to attract foreign direct investment, along with political stability, policy consistency and the projected recovery in the global economy, are expected to strengthen Sri Lanka's external sector in the period ahead.

Market interest rates continued to decline responding to monetary easing measures adopted thus far

Monetary easing measures implemented so far during the year are being transmitted to the economy as reflected by the decline in most market interest rates. Both deposit and lending rates have declined notably, while some interest rates have reached historic lows. However, the pace of reduction of market interest rates has slowed in the recent past. The historically low levels of policy interest rates and the Statutory Reserve Ratio, as well as the availability of significant excess liquidity in the domestic money market, provide further space for market lending rates to adjust downwards in support of the recovery of domestic economic activity.

The expansion in money and credit supply continued

Supported by policy easing measures adopted by the Central Bank thus far during the year, credit extended to the private sector increased for the third consecutive month in October 2020. Meanwhile, the loan schemes at low interest rates proposed by the Government in the Budget 2021 are expected to reinforce the efforts to direct funds to needy sectors of the economy. However, the momentum of credit disbursement to the private sector rests on the speed of containment of the second wave of COVID-19 and its impact on domestic economic activity. Meanwhile, credit to the public sector from the banking system continued to expand. The resultant substantial increase in domestic credit caused an acceleration in the growth of broad money (M_{2b}) in October 2020.

Inflation remains subdued in the near term, and any build-up of inflationary pressures over the medium term will be addressed proactively when required

Inflation, as reflected by the movements in the national and urban price indices, eased in October 2020, with headline inflation remaining within the targeted range of 4-6 per cent and core inflation remaining low, reflecting subdued underlying demand pressures. With price declines observed in certain food items, near term inflation is expected to remain low. Inflation is expected to gradually gather pace over the next two years with the expected improvement in aggregate demand, stimulated by accommodative monetary and fiscal policies and the normalisation of global oil prices. Supply side effects of policies adopted to incentivise domestic production activity would have some offsetting effects on the demand side effects noted. Headline inflation is therefore expected to remain within the targeted range over the medium term.

Policy rates are maintained at current levels and lending targets for selected sectors are expected to be introduced, while maximum interest rates are imposed on mortgage backed housing loans

In consideration of the current and expected macroeconomic developments highlighted above, the Monetary Board, at its meeting held on 25 November 2020, was of the view that the prevailing surplus liquidity conditions provide sufficient space for a further reduction in market lending rates without an adjustment to policy interest rates. Accordingly, the Board 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. Furthermore, complementing the concessional loans schemes proposed by the Government in the Budget 2021, the Monetary Board decided to introduce a maximum interest rate on mortgage backed housing loans obtained by salaried employees from licensed banks. Accordingly, licensed banks will be made to charge only 7 per cent per annum for such loans, at least for the first five years of the loan tenure. The remaining tenure of the loan is to be charged at the monthly Average Weighted Prime Lending Rate (AWPR) plus a margin of up to 1 percentage point. Directions to this effect will be issued to licensed banks shortly. The Monetary Board urges all financial institutions, led by licensed commercial banks (LCBs), to pass on the benefit of the low interest rate environment expeditiously to their borrowers, in respect of new as well as existing facilities. The Board also recognised the need to promote economic sectors with higher growth and earning potential, and in this regard, decided to introduce lending targets in the near future for selected sectors in conformity with the policies of the Government.

The Central Bank will continue to monitor domestic and global macroeconomic and financial market developments and take further measures appropriately to ensure that the economy promptly reverts to its true potential of a high growth trajectory, while maintaining inflation in the targeted 4-6 per cent range under its flexible inflation targeting framework.

Monetary Policy Decision:	**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%

INFORMATION NOTE:

The virtual monetary policy press conference will be held on 26 November 2020 at 11.00 a.m. via Zoom and will be livestreamed on Youtube and Facebook.

The release of the next regular statement on monetary policy will be on 21 January 2021.

Annexure I

Table 01: Inflation

Month		Mar 20	Apr 20	May 20	Jun 20	Jul 20	Aug 20	Sep 20	Oct 20
Headline Inflation (Year on year % change)	CCPI (2013=100)	5.4	5.2	4.0	3.9	4.2	4.1	4.0	4.0
	NCPI (2013=100)	7.0	5.9	5.2	6.3	6.1	6.2	6.4	5.5
Core Inflation (Year on year % change)	CCPI (2013=100)	2.9	3.1	2.9	3.1	3.2	3.2	2.9	3.0
	NCPI (2013=100)	3.2	3.2	3.7	4.4	4.5	4.6	4.8	4.5

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)					Year - on - Year % Change				
	Jun 20	Jul 20	Aug 20	Sep 20	Oct 20	Jun 20	Jul 20	Aug 20	Sep 20	Oct 20
Reserve Money	869	879	880	891	928	-0.6	-1.1	-3.7	-2.5	2.2
Broad Money (M_{2b})	8,365	8,507	8,692	8,870	9,017	14.0	15.7	17.5	19.2	20.9
Net Foreign Assets (NFA)	24	-2	32	-66	-247	-78.1	-101.6	-71.6	-151.9	-313.7
Net Domestic Assets (NDA)	8,341	8,509	8,660	8,936	9,264	15.4	17.5	18.9	22.1	26.2
Net Credit to the Government (NCG)	3,562	3,734	3,781	3,980	4,261	33.5	38.1	37.4	45.7	56.2
Credit to Public Corporations	951	983	1,023	1,018	1,003	30.3	34.7	37.0	34.8	27.1
Credit to the Private Sector	5,834	5,830	5,909	5,996	6,055	4.3	4.2	5.2	5.8	6.4
Broad Money (M_4)	10,262	10,432	10,638	10,860	11,049	13.4	14.9	16.5	17.9	19.5

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End May 20	End Jun 20	End Jul 20	End Aug 20	End Sep 20	End Oct 20	As at 25 Nov 20
Policy Rates of the Central Bank							
Standing Deposit Facility Rate	5.50	5.50	4.50	4.50	4.50	4.50	4.50
Standing Lending Facility Rate	6.50	6.50	5.50	5.50	5.50	5.50	5.50
Average Weighted Call Money Rate (AWCMR)	5.84	5.52	4.53	4.53	4.53	4.53	4.55
Treasury bill yields (Primary market)							
91-day	6.69	5.50	4.59	4.56	4.51	4.57	4.64
182-day	6.82	5.53	4.68	4.68	4.64	4.69	4.76
364-day	6.93	5.66	4.86	4.89	4.89	4.96	5.00
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	9.16	8.48	7.47	6.66	6.19	5.85	5.95 (a)
Average Weighted Lending Rate (AWLR)	12.96	12.64	12.29	11.84	11.21	10.82	-
Average Weighted New Lending Rate (AWNLR)	11.68	11.18	9.85	9.12	8.82	8.73	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	7.57	7.38	7.16	6.74	6.44	6.23	6.01
Average Weighted Fixed Deposit Rate (AWFDR)	9.26	9.00	8.69	8.26	7.90	7.59	7.37
Average Weighted New Deposit Rate (AWNDR)	7.83	7.20	5.78	5.49	5.31	5.10	-
Average Weighted New Fixed Deposit Rate (AWNFDR)	7.96	7.37	5.96	5.66	5.46	5.25	-

(a) For the week ending 20 November 2020

Source: Central Bank of Sri Lanka