PRESS RELEASE
Communications Department, 30, Janadhipathi Mawatha, Colombo 01, Sri Lanka
+94 11 2477424 / +94 11 2477423 +94 11 2346257
communications@cbsl.lk / dcommunications@cbsl.lk www.cbsl.gov.lk

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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: No. 01 - January 2021

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 18 January 2021, 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 during 2020, 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. As announced in November 2020, the Board decided to introduce priority sector lending targets for the micro, small and medium scale enterprises (MSME) sector to support a broadbased economic revival, in consultation with the banking community.

The spread of COVID-19 continued across the globe causing widespread economic disruptions, but recent progress on vaccines has brightened the global economic outlook

Amidst economic disruptions caused by the spread of COVID-19 in multiple waves and variants, most central banks across the globe are expected to continue their accommodative monetary policy stance. Recent progress on COVID-19 vaccines has brightened the global economic outlook, but the potentially slow rollout of vaccines across developing economies may hamper the early return of activity to pre-pandemic levels.

The spread of COVID-19 has weighed on Sri Lanka's growth prospects in 2020, but the outlook for 2021 remains positive

As per the GDP estimates published by the Department of Census and Statistics (DCS), the Sri Lankan economy, which contracted by 1.7 per cent and 16.3 per cent in the first and second quarters of 2020, respectively, rebounded in the third quarter of 2020 and recorded a growth of 1.5 per cent. However, the onset of the second wave of COVID-19 is expected to have dampened the momentum in the fourth quarter of 2020. Accordingly, the economy is expected to have contracted by around 3.9 per cent in 2020. Nevertheless, the economy is well poised to rebound in 2021, supported by the unprecedented policy stimulus measures introduced by the Government and the Central Bank, improved domestic economic sentiments, alongside the improving prospects of the global economy.

External sector is expected to remain resilient with the support of appropriate policy measures, amidst domestic and global challenges

Cushioning the adverse impact of the pandemic on the balance of payments, the trade deficit continued to narrow, while the rebound of workers' remittances continued through the second half of 2020. The trade deficit is expected to have narrowed by over US dollars 2.0 billion in 2020 in comparison to the previous year. Workers' remittances have grown by 5.8 per cent to US dollars 7.1 billion in 2020, with a historic high level of remittance receipts in December 2020. With these developments, the external current account deficit is estimated to have narrowed substantially in 2020. Measures taken by the Government to promote exports of goods and services are expected to buttress the external sector in 2021. Reopening the country for tourist arrivals under strict health guidelines could help improve external sector conditions in the period ahead. Gross official reserves were estimated at US dollars 5.7 billion at end 2020, with an import cover of 4.3 months. Amidst hostile global market conditions, the Government and the Central Bank continued to explore avenues of financial flows to the country, while discussions with domestic and foreign counterparts in this regard have made notable progress.

Reflecting the impact of transmission of monetary easing measures, market interest rates continued to adjust downwards in 2020, and the low interest rate structure is expected to be maintained

The Central Bank relaxed its monetary policy stance to unprecedented levels in 2020 with a view to reviving the economy affected by the pandemic. In response, both market deposit and lending rates declined notably in 2020. Most market interest rates have declined to single digit levels, while some have reached their historic lows. Although deposit rates are not expected to decline further, the high level of excess liquidity in the domestic money market leaves sufficient space for market lending rates to adjust downward, thereby providing low cost funds to the economy.

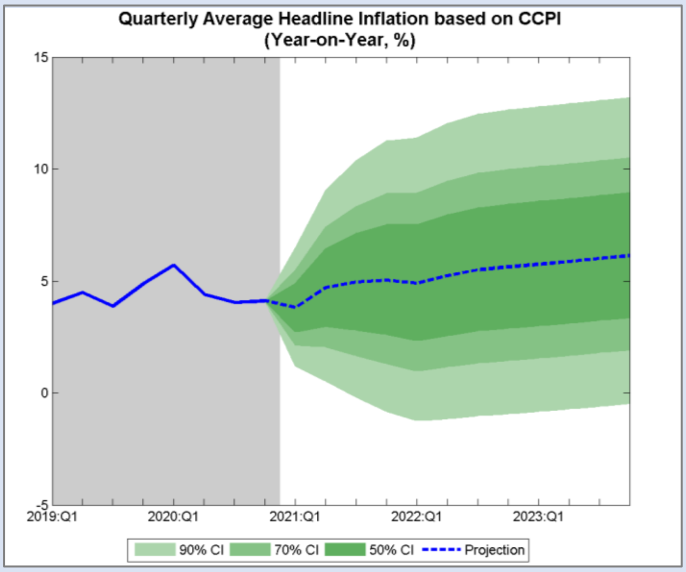
The expansion in money and credit supply observed in the latter part of 2020 is expected to continue in 2021 supported by persistent low interest rates, yet notable inflationary pressures are unlikely, given the slack in the economy

Despite the impact of the second wave of COVID-19, credit extended to the private sector continued to expand during the second half of 2020 supported by policy easing measures adopted by the Central Bank. Meanwhile, overall domestic credit expanded notably, driven by the substantial increase in credit to the public sector. Reflecting the impact of increased domestic credit, the growth of broad money (M_{2b}) continued to accelerate in 2020 providing ample liquidity to support domestic economic activity. Credit to all sectors of the economy is expected to gather pace in 2021 supported by the continued decline in lending rates, implementation of special loan schemes at low interest rates along with the rising demand for credit, driven by improved investor sentiment and the envisaged revival in domestic economic activity.

Headline inflation is projected to remain subdued in the near term, and the improvements in domestic supply conditions are expected to ease price pressures on a sustained basis

Headline inflation, based on the Colombo Consumer Price Index (CCPI), remained mostly within the targeted range of 4-6 per cent during 2020. CCPI based core inflation remained low reflecting subdued aggregate demand pressures in the economy. Meanwhile, headline and core inflation, based on the National Consumer Price Index (NCPI), also remained at subdued levels particularly towards end 2020. With the pandemic induced weak global and domestic economic conditions, inflation is expected to remain low in the near term. However, with the expected improvement in domestic aggregate demand conditions supported by significant policy stimuli and the anticipated improvement in external conditions, inflation could briefly accelerate over the medium term. Nevertheless, the envisaged improvements to domestic supply conditions, supported largely by pro-growth policies and reforms introduced by the Government, are likely to negate demand driven price pressures in the period ahead.

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 colours. The projection reflects the available data and assumptions and judgements made at the January 2021 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 the 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.

Policy rates are maintained at current levels and priority sector lending targets for micro, small and medium scale enterprises (MSME) sector to be introduced

In consideration of the current and expected macroeconomic developments highlighted above, the Monetary Board was of the view that the current monetary policy stance is appropriate. Accordingly, the Board decided to maintain the policy interest rates of the Central Bank at their current levels. Furthermore, in support of the envisaged economic revival, the Monetary Board underscored the need to promote the MSME sector, which is the mainstay of the economy. Thus, the Board decided to introduce priority sector lending targets for the MSME sector in consultation with the banking community.

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 19 January 2021 at 11.00 a.m. via Zoom and will be livestreamed on Facebook.

The release of the next regular statement on monetary policy will be on 04 March 2021.

Annexure I

Table 01: Real GDP Growth (Provisional)

Economic Activities	Year-on-Year, % Change								
	2019					2020			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual	First Quarter	Second Quarter	Third Quarter	First nine months
Agriculture	5.0	1.5	1.0	-4.1	**0.6**	-6.2	-5.9	4.3	**-2.5**
Industries	3.9	1.6	3.5	1.4	**2.7**	-7.8	-23.1	0.6	**-9.5**
Services	3.7	0.7	2.1	2.7	**2.3**	3.1	-12.9	2.1	**-2.6**
GDP	**3.7**	**1.1**	**2.4**	**2.0**	**2.3**	**-1.7**	**-16.3**	**1.5**	**-5.3**

Source: Department of Census and Statistics

Table 02: Inflation

Month		May 20	Jun 20	Jul 20	Aug 20	Sep 20	Oct 20	Nov 20	Dec 20
Headline Inflation (Year on year, % change)	CCPI (2013=100)	4.0	3.9	4.2	4.1	4.0	4.0	4.1	4.2
	NCPI (2013=100)	5.2	6.3	6.1	6.2	6.4	5.5	5.2	-
Core Inflation (Year on year, % change)	CCPI (2013=100)	2.9	3.1	3.2	3.2	2.9	3.0	3.0	3.5
	NCPI (2013=100)	3.7	4.4	4.5	4.6	4.8	4.5	4.5	-

Source: Department of Census and Statistics

Table 03: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)					Year - on - Year, % Change				
	Jul 20	Aug 20	Sep 20	Oct 20	Nov 20	Jul 20	Aug 20	Sep 20	Oct 20	Nov 20
Reserve Money	879	880	891	928	936	-1.1	-3.7	-2.5	2.2	1.9
Broad Money (M_{2b})	8,507	8,692	8,870	9,017	9,136	15.7	17.5	19.2	20.9	22.3
Net Foreign Assets (NFA)	(2)	32	(66)	(247)	(281)	-101.6	-71.6	-151.9	-313.7	-390.1
Net Domestic Assets (NDA)	8,509	8,660	8,936	9,264	9,417	17.5	18.9	22.1	26.2	27.7
Net Credit to the Government (NCG)	3,734	3,781	3,980	4,261	4,360	38.1	37.4	45.7	56.2	61.4
Credit to Public Corporations	983	1,023	1,018	1,003	1,011	34.7	37.0	34.8	27.1	25.9
Credit to the Private Sector	5,830	5,909	5,996	6,055	6,097	4.2	5.2	5.8	6.4	6.2
Broad Money (M_4)	10,432	10,638	10,860	11,049	11,194	14.9	16.5	17.9	19.5	20.8

Source: Central Bank of Sri Lanka

Table 04: Interest Rates

Interest Rate (%)	End Jul 20	End Aug 20	End Sep 20	End Oct 20	End Nov 20	End Dec 20	As at 18 Jan 21
Policy Rates of the Central Bank							
Standing Deposit Facility Rate	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Standing Lending Facility Rate	5.50	5.50	5.50	5.50	5.50	5.50	5.50
Average Weighted Call Money Rate (AWCMR)	4.53	4.53	4.53	4.53	4.54	4.55	4.55
Treasury bill yields (Primary market)							
91-day	4.59	4.56	4.51	4.57	4.64	4.69	4.70
182-day	4.68	4.68	4.64	4.69	4.76	4.80	4.78
364-day	4.86	4.89	4.89	4.96	5.00	5.05	5.02
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	7.47	6.66	6.19	5.85	5.83	5.81	5.88 (a)
Average Weighted Lending Rate (AWLR)	12.29	11.84	11.21	10.82	10.55	-	-
Average Weighted New Lending Rate (AWNLR)	9.85	9.12	8.82	8.73	8.71	-	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	7.16	6.74	6.44	6.23	6.01	5.80	-
Average Weighted Fixed Deposit Rate (AWFDR)	8.69	8.26	7.90	7.59	7.37	7.14	-
Average Weighted New Deposit Rate (AWNDR)	5.78	5.49	5.31	5.10	4.96	-	-
Average Weighted New Fixed Deposit Rate (AWNFDR)	5.96	5.66	5.46	5.25	5.07	-	-

(a) For the week ending 15 January 2021

Source: Central Bank of Sri Lanka