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## Monetary Policy Review: No. 02 - March 2021

### The Central Bank of Sri Lanka reaffirms its commitment to continue the current accommodative monetary policy stance

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 03 March 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 noted the recent slowdown in credit disbursements to the private sector and inadequate lending to productive sectors of the economy, and stressed the need for the financial system to actively lend to productive sectors in order to support the ongoing recovery of domestic production-based economic activity. Further, the Board observed the recent uptick in certain market interest rates, and reemphasised its commitment to continue the low interest rate structure until the economy shows signs of sustained revival, in the context of the low inflation environment.

### The Sri Lankan economy is expected to make a notable recovery in 2021, supported by policy stimulus and improving business sentiments

Given the low inflation environment, the Central Bank is in the process of actively supporting the Government's economic agenda focused on developing a production-based economy. Positive sentiments fuelled by the COVID-19 vaccination drive in the country and the impact of growth-promoting policies are expected to support the economic revival over the short to medium term.

### The external sector performance is being closely monitored by the Central Bank

The trade deficit contracted by US dollars 2.0 billion in 2020 benefiting from the notable decline in expenditure on imports, which more than compensated the decline in earnings from exports. The trade deficit is expected to remain compressed in 2021, supported by appropriate measures taken by the Government. Workers' remittances continued to increase steadily from mid 2020, recording an annual increase of 5.8 per cent, and a further growth of 16.3 per cent in January 2021, from a year earlier. The tourism sector is expected to gradually recover in 2021 along with the rollout of vaccinations locally and globally. The exchange rate has recorded intermittent volatility, and the Central Bank has taken steps to dampen excessive speculation causing such volatility in the foreign exchange market. The Sri Lankan rupee has depreciated by 4.5 per cent against the US dollar thus far in 2021 following the 2.6 per cent depreciation in 2020. Gross official reserves were estimated at US dollars 4.8 billion, with an import cover of 3.7 months, at end January 2021. Discussions are continuing on securing foreign financing. Furthermore, increased non-debt creating foreign exchange inflows are expected, supported by the measures introduced by the Government

and the Central Bank. In spite of adverse speculation, all debt service obligations of the Government have been duly met thus far in 2021, and the Government remains committed to maintaining its impeccable debt service record in the future as well.

### **Monetary policy easing measures implemented since early 2020 have resulted in historically low interest rates**

Reflecting the transmission of monetary easing measures taken by the Central Bank in the recent past, both market deposit and lending rates have declined substantially towards establishing a single digit interest rate structure. Many market interest rates have declined to their historic lows. However, certain market interest rates, such as yields on government securities, have shown unwarranted volatility recently, which is not in line with monetary policy expectations. The Central Bank reiterates that the high level of excess liquidity in the money market and the reduction in policy interest rates thus far are intended to result in a stable low interest rate environment, while providing a positive real return to savers.

### **Credit to productive sectors remains crucial in ensuring a sustained economic recovery**

Reflecting the expansion in domestic credit, the growth of broad money ( $M_{2b}$ ) continued to accelerate. However, despite the substantial reduction in market lending rates, growth of credit towards productive sectors of the economy appears to remain inadequate. Going forward, the growth of credit to the private sector is expected to gather pace supported by low lending rates, the introduction of priority sector lending targets for banks on lending to the micro, small and medium scale enterprises (MSME) sector, and rising demand for credit driven by improving investor sentiments. Discussions with the banking community and other stakeholders are ongoing to rectify deficiencies in extending credit to productive, growth-supportive, sectors.

### **Inflation is projected to remain subdued in 2021**

Both headline and core inflation based on consumer price indices remain low, reflecting the subdued aggregate demand conditions in the economy, in spite of volatile food prices. Inflation is projected to remain subdued during the remainder of the year supported by the envisaged improvements in domestic supply conditions, which would also contribute towards maintaining inflation in the targeted range of 4-6 per cent over the medium term.

### **Policy rates are maintained at current levels**

In consideration of the current and expected macroeconomic developments highlighted above, the Monetary Board was of the view that the current accommodative monetary policy stance is appropriate. Accordingly, the Board decided to maintain the policy interest rates, i.e., 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 underscored the need for low lending rates to continue until the economy shows strong signs of sustained recovery. Further, the Board noted the need for banks to scale up lending to productive sectors of the economy and support domestic production in line with the national policy direction. The Central Bank will continue to monitor domestic and global macroeconomic and financial market developments and take further proactive measures to help the economy to reach a sustainable high growth trajectory, while maintaining inflation in the targeted 4-6 per cent range under the 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:**

A press conference chaired by Governor Deshamanya Professor W. D. Lakshman will be held on 04 March 2021 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 April 2021.

## Annexure I

### Data Annexure

**Table 01: Inflation**

Month		Jul 20	Aug 20	Sep 20	Oct 20	Nov 20	Dec 20	Jan 21	Feb 21
Headline Inflation (Year on year % change)	CCPI (2013=100)	4.2	4.1	4.0	4.0	4.1	4.2	3.0	3.3
	NCPI (2013=100)	6.1	6.2	6.4	5.5	5.2	4.6	3.7	-
Core Inflation (Year on year % change)	CCPI (2013=100)	3.2	3.2	2.9	3.0	3.0	3.5	2.7	2.6
	NCPI (2013=100)	4.5	4.6	4.8	4.5	4.5	4.7	4.2	-

Source: Department of Census and Statistics

**Table 02: Monetary Sector Developments (Provisional)**

Indicator	Outstanding Amount (Rs. billion)					Year - on - Year % Change				
	Sep 20	Oct 20	Nov 20	Dec 20	Jan 21	Sep 20	Oct 20	Nov 20	Dec 20	Jan 21
Reserve Money	891	928	936	964	976	-2.5	2.2	1.9	3.4	4.3
Broad Money (M <sub>2b</sub> )	8,870	9,017	9,136	9,406	9,533	19.2	20.9	22.3	23.4	23.7
Net Foreign Assets (NFA)	(66)	(247)	(281)	(209)	(321)	-151.9	-313.7	-390.1	-308.0	-458.9
Net Domestic Assets (NDA)	8,936	9,264	9,417	9,615	9,854	22.1	26.2	27.7	27.8	29.4
Net Credit to the Government (NCG) (a)	3,982	4,263	4,363	4,548	4,758	45.8	56.2	61.5	62.7	63.1
Credit to Public Corporations	1,018	1,003	1,011	1,002	1,058	34.8	27.1	25.9	22.5	29.0
Credit to the Private Sector (a)	5,994	6,054	6,094	6,171	6,197	5.8	6.3	6.2	6.5	6.9
Broad Money (M <sub>4</sub> )	10,860	11,049	11,194	11,462	11,643	17.9	19.5	20.8	21.4	21.6

(a) Revised

Source: Central Bank of Sri Lanka

**Table 03: Interest Rates**

Interest Rate (%)	End Sep 20	End Oct 20	End Nov 20	End Dec 20	End Jan 21	End Feb 21	As at 03 Mar 21
<b>Policy Rates of the Central Bank</b>							
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
<b>Average Weighted Call Money Rate (AWCMR)</b>	4.53	4.53	4.54	4.55	4.55	4.55	4.54
<b>Treasury bill yields (Primary market)</b>							
91-day	4.51	4.57	4.64	4.69	4.69	4.90	4.95
182-day	4.64	4.69	4.76	4.80	4.75	4.99	5.03
364-day	4.89	4.96	5.00	5.05	4.98	5.09	5.10
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	6.19	5.85	5.83	5.81	5.90	5.76	-
Average Weighted Lending Rate (AWLR)	11.21	10.82	10.55	10.29	10.17	-	-
Average Weighted New Lending Rate (AWNLR)	8.82	8.73	8.71	8.38	8.37	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	6.44	6.23	6.01	5.80	5.58	5.36	-
Average Weighted Fixed Deposit Rate (AWFDR)	7.90	7.59	7.37	7.14	6.88	6.53	-
Average Weighted New Deposit Rate (AWNDR)	5.31	5.10	4.96	4.93	5.19	-	-
Average Weighted New Fixed Deposit Rate (AWNDFDR)	5.46	5.25	5.07	5.08	5.30	-	-

Source: Central Bank of Sri Lanka