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## Monetary Policy Review: No. 03 - April 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 07 April 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 remains committed to maintaining the low interest rate structure, thereby ensuring continued support for a sustained economic recovery, in the context of the prevailing low inflation environment and well anchored inflation expectations.

#### **The global economy is expected to recover faster than expected, supported by policy stimulus measures and the rollout of COVID-19 vaccines**

As per the World Economic Outlook (WEO) of the International Monetary Fund (IMF) in April 2021, global growth in 2020 was estimated to have recorded a lower than expected contraction of 3.3 per cent, reflecting the faster recovery of economic activity during the second half of 2020 underpinned by extraordinary policy support. Global growth projections were revised upwards to 6.0 per cent in 2021 and 4.4 per cent in 2022. The pace of economic recovery varies across regions and countries, reflecting the differences in the speed of vaccine rollout, the degree of economic policy support, and structural features.

#### **The Sri Lankan economy rebounded notably from the effects of the COVID-19 pandemic**

As per the GDP estimates published by the Department of Census and Statistics (DCS), the contraction of the Sri Lankan economy at 3.6 per cent in 2020 was lower than initial projections. Despite the second wave of COVID-19 in the country, the Sri Lankan economy grew by 1.3 per cent in the last quarter of 2020 from a year earlier. Supported by the growth-conducive environment made possible by the accommodative monetary and fiscal policies, the successful containment of the spread of COVID-19 locally, and the stronger-than-expected recovery of leading trading partners, the Sri Lankan economy is expected to record a high growth momentum in the medium term.

#### **External sector remains resilient despite some near term challenges**

The merchandise trade deficit continued to narrow during January 2021, while preliminary data for February 2021 showed a further reduction in the trade deficit, driven by a larger contraction in expenditure on imports over earnings from exports. Workers' remittances continued to record a healthy growth thus far in 2021 and this momentum is expected to continue in the remainder of the year. The tourism sector is expected to recover gradually with the opening of the borders along with

the successful rollout of vaccinations locally and globally. Meanwhile, the Central Bank and the Government continue to engage with investment and lending partners to secure foreign financing and remain committed to honouring foreign currency debt service obligations on time. Recently, the Central Bank entered into a bilateral currency swap arrangement with the People's Bank of China (PBOC) amounting to CNY 10 billion (equivalent to approximately US dollars 1.5 billion). Although the Sri Lankan rupee experienced some volatility recently, the continuation of the existing restrictions on non-essential imports and certain foreign exchange outflows, among others, is expected to help cushion pressures in the domestic foreign exchange market. Gross official reserves were estimated at US dollars 4.1 billion (excluding the swap facility with the PBOC), with an import cover of 3 months, at end March 2021.

### **Market interest rates declined to historic lows, reinforcing the recovery of activity**

Reflecting the impact of monetary policy easing measures adopted thus far, most market interest rates declined to their historic lows. Nevertheless, some upward pressure on yields on government securities was observed recently, in contrast to monetary policy expectations. Thus, the Central Bank reiterates the necessity to maintain the low interest rate structure, amidst the significantly high excess liquidity in the domestic money market, thereby facilitating the take-off of domestic investment.

### **Credit to the private sector expanded notably thus far in 2021, reflecting the impact of growth supportive policies**

Growth of credit extended to the private sector gathered pace in February 2021. This momentum is expected to continue, supported by low lending rates, surplus liquidity in the domestic money market and the expected rise in lending to micro, small, and medium enterprise (MSME) sector. Credit to the public sector, particularly net credit to the Government, from the banking system continued to grow, resulting in a notable expansion of domestic credit and an acceleration of broad money growth.

### **Inflation is expected to remain subdued in the near term and any upward pressures over the medium term could be mitigated, to a large extent, by the envisaged supply side improvements**

The gradual easing of domestic food prices and subdued demand conditions in the economy are likely to support subdued inflation in the near term. However, pressures on inflation could emerge over the medium term due to the envisaged improvements in aggregate demand conditions and the projected recovery in global commodity prices, among others. Such pressures could be neutralised, to a large extent, by the envisaged improvements on the supply side 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 observed the stronger than expected growth performance towards the end of 2020 and underscored the need for maintaining the prevailing low interest rate structure to support the sustained economic recovery in the period ahead. The Central Bank will continue to monitor domestic and global macroeconomic

and financial market developments and stand ready to take proactive measures to help the economy to sustain the 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 08 April 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 20 May 2021.

## Annexure I

## Data Annexure

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	Fourth Quarter	Annual
Agriculture	5.7	3.1	2.6	-5.8	1.0	-6.5	-8.2	3.1	1.3	-2.4
Industries	3.9	1.7	3.3	1.3	2.6	-7.9	-23.1	0.6	1.3	-6.9
Services	4.0	0.7	1.8	2.4	2.2	2.9	-12.9	2.1	1.9	-1.5
<b>GDP</b>	<b>4.0</b>	<b>1.3</b>	<b>2.3</b>	<b>1.6</b>	<b>2.3</b>	<b>-1.8</b>	<b>-16.4</b>	<b>1.3</b>	<b>1.3</b>	<b>-3.6</b>

Source: Department of Census and Statistics

Table 02: Inflation

Month		Aug 20	Sep 20	Oct 20	Nov 20	Dec 20	Jan 21	Feb 21	Mar 21
Headline Inflation (Year-on-year % change)	CCPI (2013=100)	4.1	4.0	4.0	4.1	4.2	3.0	3.3	4.1
	NCPI (2013=100)	6.2	6.4	5.5	5.2	4.6	3.7	4.2	-
Core Inflation (Year-on-year % change)	CCPI (2013=100)	3.2	2.9	3.0	3.0	3.5	2.7	2.6	3.1
	NCPI (2013=100)	4.6	4.8	4.5	4.5	4.7	4.2	4.1	-

Source: Department of Census and Statistics

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

Indicator	Outstanding Amount (Rs. billion)					Year-on-Year % Change				
	Oct 20	Nov 20	Dec 20	Jan 21	Feb 21	Oct 20	Nov 20	Dec 20	Jan 21	Feb 21
Reserve Money	928	936	964	976	978	2.2	1.9	3.4	4.3	1.5
Broad Money (M <sub>2b</sub> )	9,017	9,136	9,406	9,533	9,651	20.9	22.3	23.4	23.7	23.8
Net Foreign Assets (NFA)	(247)	(281)	(209)	(321)	(386)	-313.7	-390.1	-308.0	-458.9	-496.1
Net Domestic Assets (NDA)	9,264	9,417	9,615	9,854	10,037	26.2	27.7	27.8	29.4	30.4
Net Credit to the Government (NCG)	4,263	4,363	4,548	4,758	4,793	56.2	61.5	62.7	63.1	61.9
Credit to Public Corporations	1,003	1,011	1,002	1,058	1,080	27.1	25.9	22.5	29.0	29.7
Credit to the Private Sector	6,054	6,094	6,171	6,197	6,276	6.3	6.2	6.5	6.9	7.8
Broad Money (M <sub>4</sub> )	11,049	11,194	11,462	11,643	11,799	19.5	20.8	21.4	21.6	21.9

Source: Central Bank of Sri Lanka

**Table 04: Interest Rates**

Interest Rate (%)	End Oct 20	End Nov 20	End Dec 20	End Jan 21	End Feb 21	End Mar 21	As at 07 Apr 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	4.54	4.55	4.55	4.55	4.62	4.64
<b>Treasury bill yields (Primary market)</b>							
91-day	4.57	4.64	4.69	4.69	4.90	5.05	5.08
182-day	4.69	4.76	4.80	4.75	4.99	5.10	5.12
364-day	4.96	5.00	5.05	4.98	5.09	5.11	5.15
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	5.85	5.83	5.81	5.90	5.76	5.78	-
Average Weighted Lending Rate (AWLR)	10.82	10.55	10.29	10.17	10.08	-	-
Average Weighted New Lending Rate (AWNLR)	8.73	8.71	8.38	8.37	8.26	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	6.23	6.01	5.80	5.58	5.36	5.20	-
Average Weighted Fixed Deposit Rate (AWFDR)	7.59	7.37	7.14	6.88	6.53	6.29	-
Average Weighted New Deposit Rate (AWNDR)	5.10	4.96	4.93	5.19	4.96	-	-
Average Weighted New Fixed Deposit Rate (AWNDR)	5.25	5.07	5.08	5.30	5.09	-	-

Source: Central Bank of Sri Lanka