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## Monetary Policy Review: No. 04 - May 2021

### **The Central Bank of Sri Lanka continues its accommodative monetary policy stance to support the sustained recovery of the economy**

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 19 May 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. In the context of the prevailing low inflation environment and well anchored inflation expectations, and the renewed challenges posed by the third wave of the COVID-19 pandemic, the Board remains committed to maintaining the current accommodative monetary policy stance to support the sustained revival of the economy.

### **The third wave of the COVID-19 pandemic has disrupted the ongoing recovery of economic activity**

The Sri Lankan economy, which rebounded notably during the second half of 2020 and early 2021 as per available indicators, is experiencing renewed disruptions due to the emergence of the third wave of the COVID-19 pandemic and related preventive measures, including isolations. While its adverse effects on economic activity are expected to be lesser than during the first two waves due to the selective nature of mobility restrictions and the ongoing vaccination drive, the third wave has once again highlighted the disruptive nature of the pandemic and the challenges faced in sustaining the economic recovery amidst the pandemic. It has also highlighted the need for continued fiscal and monetary support to place the recovery process on a firm footing.

### **The external sector remains resilient despite a multitude of challenges**

The merchandise trade deficit widened in March 2021, driven by a higher increase in expenditure on imports than the increase in earnings from exports. Meanwhile, the notable increase in workers' remittances continued during the period from January to April 2021, over the corresponding period of the previous year. However, the recent surge in the global spread of COVID-19, could affect the recovery of the tourism industry, while posing renewed challenges to the external sector. The Sri Lankan rupee depreciated by 6.6 per cent against the US dollar thus far in 2021, and the continuation of the existing restrictions on non-essential imports and selected foreign exchange outflows is expected to help ease the pressure on the domestic foreign exchange market. Meanwhile, the measures taken by the Government and the Central Bank helped secure foreign exchange inflows into the country, with additional standby arrangements to bolster confidence in the Sri Lankan economy. As at end April 2021, gross official reserves were estimated at US dollars 4.5 billion, equivalent to 3.2 months of imports. This does not include the bilateral currency swap facility with the People's Bank of China (PBoC).

## **Prevailing historically low interest rates have resulted in an acceleration of private sector credit**

Reflecting the gradual transmission of the monetary policy easing measures adopted by the Central Bank thus far, market interest rates have displayed a broadbased decline to their historic low levels. The prevailing accommodative monetary policy stance and the high level of rupee liquidity maintained in the domestic market are aimed at supporting the economic recovery through the provision of affordable credit to productive sectors of the economy. Accordingly, credit extended to the private sector increased notably during the first quarter of 2021, with increased credit disbursements to all key sectors of the economy. The introduction of priority sector lending targets for banks on lending to the micro, small and medium scale enterprises (MSME) sector will continue to provide further support for promoting credit to the needy sectors of the economy. Meanwhile, credit obtained by the public sector from the banking system continued to rise during the first quarter of 2021. Yields on government securities also showed some increase, reflecting the impact of the increased financing requirement of the Government amidst the decline in revenue and the increase in expenditure, including pandemic related expenses. The expansion of domestic credit caused the growth of broad money ( $M_{2b}$ ) to remain elevated.

## **Inflation is expected to remain within 4-6 per cent range in the near to medium term, while any pressures over the medium term will be addressed with appropriate measures**

Inflation remained subdued thus far in 2021, supported by well anchored inflation expectations and subdued aggregate demand conditions. While some inflationary pressures could emerge in the near term driven by supply-side disruptions due to the third wave of the pandemic as well as adverse weather conditions, inflation is expected to remain broadly within the desired target range of 4-6 per cent during the remainder of the year. Although the effects of the fiscal and monetary stimulus measures are expected to exert some upward pressure on inflation over the medium term with the envisaged improvements in aggregate demand conditions, such pressures will be mitigated through timely measures by the Central Bank, thereby ensuring the maintenance of inflation in mid-single digit levels in the medium term, while facilitating the sustained and high economic growth in the period ahead.

## **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 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.

<b>Monetary Policy Decision:</b>	<b>Policy rates and SRR unchanged</b>
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 20 May 2021 at 11.00 a.m. via Zoom and will be live-streamed on Facebook.

The release of the next regular statement on monetary policy will be on 08 July 2021.

## Annexure I

**Table 01: Inflation**

Month		Sep 20	Oct 20	Nov 20	Dec 20	Jan 21	Feb 21	Mar 21	Apr 21
Headline Inflation (Year on year % change)	CCPI (2013=100)	4.0	4.0	4.1	4.2	3.0	3.3	4.1	3.9
	NCPI (2013=100)	6.4	5.5	5.2	4.6	3.7	4.2	5.1	-
Core Inflation (Year on year % change)	CCPI (2013=100)	2.9	3.0	3.0	3.5	2.7	2.6	3.1	3.0
	NCPI (2013=100)	4.8	4.5	4.5	4.7	4.2	4.1	4.3	-

Source: Department of Census and Statistics

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

Indicator	Outstanding Amount (Rs. billion)					Year-on-Year % Change				
	Nov 20	Dec 20	Jan 21	Feb 21	Mar 21	Nov 20	Dec 20	Jan 21	Feb 21	Mar 21
Reserve Money	936	964	976	978	1,029	1.9	3.4	4.3	1.5	1.5
Broad Money (M <sub>2b</sub> )	9,136	9,406	9,533	9,651	9,839	22.3	23.4	23.7	23.8	21.5
Net Foreign Assets (NFA)	(281)	(209)	(321)	(386)	(430)	-390.1	-308.0	-458.9	-496.1	-1,629.0
Net Domestic Assets (NDA)	9,417	9,615	9,854	10,037	10,269	27.7	27.8	29.4	30.4	27.2
Net Credit to the Government (NCG)	4,363	4,548	4,758	4,793	5,005	61.5	62.7	63.1	61.9	54.7
Credit to Public Corporations	1,011	1,002	1,058	1,080	1,098	25.9	22.5	29.0	29.7	26.5
Credit to the Private Sector	6,094	6,171	6,197	6,276	6,388	6.2	6.5	6.9	7.8	7.5
Broad Money (M <sub>4</sub> )	11,194	11,462	11,643	11,790(a)	12,010	20.8	21.4	21.6	21.9	20.4

(a) Revised

Source: Central Bank of Sri Lanka

**Table 03: Interest Rates**

Interest Rate (%)	End Nov 20	End Dec 20	End Jan 21	End Feb 21	End Mar 21	End Apr 21	As at 19 May 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>	4.54	4.55	4.55	4.55	4.62	4.64	4.67
<b>Treasury bill yields (Primary market)</b>							
91-day	4.64	4.69	4.69	4.90	5.05	5.11	5.12
182-day	4.76	4.80	4.75	4.99	5.10	5.14	5.14
364-day	5.00	5.05	4.98	5.09	5.11	5.18	5.18
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	5.83	5.81	5.90	5.76	5.78	5.86	5.72 (a)
Average Weighted Lending Rate (AWLR)	10.55	10.29	10.17	10.08	9.91	-	-
Average Weighted New Lending Rate (AWNLR)	8.71	8.38	8.37	8.26	8.28	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	6.01	5.80	5.58	5.36	5.20	5.07	-
Average Weighted Fixed Deposit Rate (AWFDR)	7.37	7.14	6.88	6.53	6.29	6.09	-
Average Weighted New Deposit Rate (AWNDR)	4.96	4.93	5.19	4.96	4.86	-	-
Average Weighted New Fixed Deposit Rate (AWNFDR)	5.07	5.08	5.30	5.09	4.99	-	-

(a) For the week ending 13 May 2021

Source: Central Bank of Sri Lanka