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## Monetary Policy Review: No. 07 - October 2021

### The Central Bank of Sri Lanka maintains policy interest rates at their current levels

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 13 October 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 5.00 per cent and 6.00 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 reiterated its commitment to maintaining inflation at the targeted levels over the medium term with appropriate measures, while supporting the economy to reach its potential in the period ahead.

#### The global economy continues to recover

The global economic recovery is expected to continue despite large disparities across countries. As per the World Economic Outlook (WEO) of the International Monetary Fund (IMF) released on 12 October 2021, the global economy is projected to grow by 5.9 per cent in 2021 and 4.9 per cent in 2022. Economic prospects remain divergent across countries, mainly due to disparities in access to COVID-19 vaccines and policy support. Consumer price inflation in most countries increased significantly, reflecting the impact of pandemic related supply-demand mismatches and the surge in commodity prices, compared to their low base from a year ago.

#### The Sri Lankan economy is making headway, despite the pandemic related disruptions

As per the estimates of the Department of Census and Statistics (DCS), the Sri Lankan economy witnessed a strong recovery during the second quarter of 2021, recording a real growth of 12.3 per cent, year-on-year, following the growth of 4.3 per cent, year-on-year, in the first quarter of 2021. With the gradual return to normalcy after phasing out the COVID-19 related lockdown measures, alongside the successful rolling out of the COVID-19 vaccination programme and growth supportive policy measures, the momentum of economic activity is expected to sustain in the period ahead. Available indicators and projections suggest that the real economy would grow by around 5 per cent in 2021, and gradually traverse to a high and sustained growth trajectory over the medium term, following near-term stabilisation measures that are being put in place by the Government and the Central Bank.

#### The planned coordinated efforts by the Government and the Central Bank are expected to strengthen the external sector in the period ahead

Earnings from exports marked a notable improvement and recorded over US dollars 1 billion for the third consecutive month in August 2021. Expenditure on imports has also increased, partly reflecting the surge in global commodity prices, resulting in an expansion in the trade deficit during the eight months ending August 2021, over the corresponding period of last year. Outlook for tourism improved

with the easing of travel restrictions globally and the successful vaccination drive domestically. Despite the moderation of workers' remittances observed in recent months, a rebound is expected in the period ahead with the improved growth outlook for major foreign employment source countries and greater stability in the domestic foreign exchange market. The realisation of foreign investments in the real sector and the timely adoption of remedial measures by the Central Bank as enunciated in *'The Six-month Road Map for Ensuring Macroeconomic and Financial System Stability'* are gradually easing pressures in the domestic foreign exchange market. Furthermore, the Central Bank continued to intervene in the foreign exchange market to provide liquidity for essential imports, including fuel. The depreciation of the Sri Lankan rupee against the US dollar is recorded at 6.8 per cent thus far in 2021. The Sri Lankan rupee remains largely undervalued as reflected by the real effective exchange rate (REER) indices. In the meantime, gross official reserves were estimated at US dollars 2.6 billion by end September 2021. This, however, does not include the bilateral currency swap facility with the People's Bank of China (PBoC) of CNY 10 billion (equivalent to approximately US dollars 1.5 billion). Gross official reserves are expected to improve with the measures that are being pursued by the Government and the Central Bank to attract fresh foreign exchange inflows, as outlined in the *Six-month Road Map*, thereby reinforcing the stability of the external sector in the period ahead.

### **Market interest rates have adjusted upwards in response to the tightening of monetary and liquidity conditions, while credit and monetary expansion remained elevated**

In response to the tightening of monetary policy in August 2021, most market deposit and lending rates have adjusted upwards. Further, yields on government securities witnessed a sharp upward adjustment with the removal of maximum yield rates for acceptance at primary auctions. Following these upward adjustments, greater stability is expected in market interest rates in the period ahead. Reflecting the increased demand for credit amidst the low interest rate environment, credit extended to the private sector expanded as envisaged during the eight months ending August 2021. The momentum of credit expansion is expected to continue during the remainder of the year, with the recovery in economic activity and continued efforts to channel credit flows to productive and needy sectors of the economy. Meanwhile, credit obtained by the public sector from the banking system, particularly net credit to the Government, also increased notably during the eight months ending August 2021. With increased domestic credit, the growth of broad money ( $M_{2b}$ ) continued to remain elevated.

### **Some inflationary pressures are observed, particularly due to emerging global price developments**

Inflation accelerated in recent months due to high food inflation and some acceleration in non-food inflation. The surge in global commodity prices prompted the Government to remove maximum retail prices on several essential commodities. Along with resultant upward adjustments in other market prices, this is likely to cause headline inflation to deviate somewhat from the targeted levels in the near term. While such supply side developments in the near term do not warrant monetary policy tightening, measures already taken by the Central Bank in relation to interest rates and market liquidity would help stabilise demand pressures over the medium term.

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

In consideration of the current and expected macroeconomic developments as highlighted above, the Monetary Board was of the view that the current level of policy interest rates is appropriate. The Central Bank will continue to monitor domestic and global macroeconomic and financial market

developments and stand ready to take appropriate measures, as and when necessary, with the aim of maintaining inflation in the desired range under the flexible inflation targeting framework in the medium term, while supporting and sustaining the economic recovery.

**Monetary Policy Decision: Policy rates and SRR unchanged**

Standing Deposit Facility Rate (SDFR)	5.00%
Standing Lending Facility Rate (SLFR)	6.00%
Bank Rate	9.00%
Statutory Reserve Ratio (SRR)	4.00%

**INFORMATION NOTE:**

A press conference chaired by Governor Ajith Nivard Cabraal will be held on 14 October 2021 at 11.00 am at the Atrium of the Central Bank of Sri Lanka and will be livestreamed on Facebook and YouTube.

The release of the next regular statement on monetary policy will be on 25 November 2021.

## Annexure I

**Table 01: Real GDP Growth (Provisional)**

Economic Activities	Year-on-Year % Change							
	2020					2021		
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual	First Quarter	Second Quarter	First Half
<b>Agriculture</b>	-6.5	-8.2	3.1	1.3	<b>-2.4</b>	6.1	8.1	<b>7.1</b>
<b>Industries</b>	-7.9	-23.1	0.6	1.3	<b>-6.9</b>	5.5	22.1	<b>12.1</b>
<b>Services</b>	2.9	-12.9	2.1	1.9	<b>-1.5</b>	3.0	7.5	<b>5.1</b>
<b>GDP</b>	<b>-1.8</b>	<b>-16.4</b>	<b>1.3</b>	<b>1.3</b>	<b>-3.6</b>	<b>4.3</b>	<b>12.3</b>	<b>8.0</b>

Source: Department of Census and Statistics

**Table 02: Inflation**

Month		Feb 21	Mar 21	Apr 21	May 21	Jun 21	Jul 21	Aug 21	Sep 21
<b>Headline Inflation (Year-on-Year % Change)</b>	CCPI (2013=100)	3.3	4.1	3.9	4.5	5.2	5.7	6.0	5.7
	NCPI (2013=100)	4.2	5.1	5.5	6.1	6.1	6.8	6.7	-
<b>Core Inflation (Year-on-Year % Change)</b>	CCPI (2013=100)	2.6	3.1	3.0	3.2	3.2	3.7	4.1	5.0
	NCPI (2013=100)	4.1	4.3	4.1	4.2	4.1	4.4	4.7	-

Source: Department of Census and Statistics

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

Indicator	Outstanding Amount (Rs. billion)								
	Dec 20	Jan 21	Feb 21	Mar 21	Apr 21	May 21	Jun 21	Jul 21	Aug 21
Reserve Money	964	976	978	1,029	1,031	1,036	1,065	1,064	1,089
Broad Money (M <sub>2b</sub> )	9,406	9,533	9,651	9,839	9,947	10,033	10,165	10,304	10,514
Net Foreign Assets (NFA)	(209)	(321)	(386)	(430)	(431)	(429)	(481)	(699)	(701)
Net Domestic Assets (NDA)	9,615	9,854	10,037	10,269	10,378	10,462	10,646	11,003	11,215
Net Credit to the Government (NCG)	4,548	4,758	4,793	5,005	4,965	5,024	5,195	5,513	5,682
Credit to Public Corporations	1,002	1,058	1,080	1,098	1,093	1,113	1,132	1,141	1,137
Credit to the Private Sector	6,171	6,197	6,276	6,388	6,446	6,501	6,585	6,661	6,796
Broad Money (M <sub>4</sub> )	11,462	11,643	11,790	12,010	12,154	12,265	12,402	12,563	12,790

Source: Central Bank of Sri Lanka

**Table 04: Interest Rates**

Interest Rate (%)	End Apr 21	End May 21	End Jun 21	End Jul 21	End Aug 21	End Sep 21	As at 13 Oct 21
<b>Key Policy Interest Rates of the Central Bank</b>							
Standing Deposit Facility Rate	4.50	4.50	4.50	4.50	5.00	5.00	5.00
Standing Lending Facility Rate	5.50	5.50	5.50	5.50	6.00	6.00	6.00
<b>Average Weighted Call Money Rate (AWCMR)</b>	4.64	4.66	4.93	5.10	5.79	5.94	5.92
<b>Treasury bill yields (Primary market)</b>							
91-day	5.11	5.13	5.18	5.22	5.87	6.70	8.04
182-day	5.14	5.14	5.19	5.23	5.90	6.99	7.20(a)
364-day	5.18	5.18	5.23	5.25	5.93	7.01	7.28(a)
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	5.86	5.65	5.51	5.76	6.01	6.42	6.71(b)
Average Weighted Lending Rate (AWLR)	9.73	9.64	9.50	9.45	9.38	-	-
Average Weighted New Lending Rate (AWNLR)	7.95	7.74	7.47	8.09	8.04	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	5.07	4.97	4.87	4.77	4.75	4.75	-
Average Weighted Fixed Deposit Rate (AWFDR)	6.09	5.94	5.82	5.67	5.62	5.64	-
Average Weighted New Deposit Rate (AWNDR)	4.77	4.77	4.98	4.99	5.19	-	-
Average Weighted New Fixed Deposit Rate (AWNDFDR)	4.92	4.90	5.10	5.15	5.35	-	-

(a) Rate at the auction held on 06 October 2021

(b) For the week ending 08 October 2021

Source: Central Bank of Sri Lanka