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## Monetary Policy Review: No. 01 – January 2022

### The Central Bank of Sri Lanka adopts further policy measures to strengthen macroeconomic stability

#### Economic activity is expected to record a gradual recovery following a temporary setback

As per the data released by the Department of Census and Statistics, domestic economic activity that was disrupted with the outbreak of the third wave of the COVID-19 pandemic and related mitigative measures is estimated to have contracted by 1.5 per cent, year-on-year, during the third quarter of 2021. However, economic activity towards the latter part of 2021 appears to have gathered momentum as several leading indicators point towards activity returning to normalcy along with the successful vaccination drive of the Government. Accordingly, the economy is expected to have recorded a growth of around 4.0 per cent in 2021.

#### External sector remains resilient amidst heightened challenges

With the normalisation of global economic activity, a notable improvement in export performance was observed, with monthly exports remaining in excess of US dollars 1 billion, consecutively since June 2021. Meanwhile, expenditure on imports increased significantly, partly reflecting the increased international prices, the demand for intermediate goods, and a more than expected demand for consumer goods. The increase in imports was also underpinned by the availability of low cost credit, which led the trade deficit to widen to pre-pandemic levels in 2021. Meanwhile, developments in the tourism sector appear to be promising with the influx of tourists in recent months. Although inflows in the form of workers' remittances have reduced somewhat in the latter half of 2021, the introduction of special incentive schemes and the actions taken by the authorities to curb illegal fund transfers have generated renewed interest in routing funds through formal channels. The Sri Lanka rupee depreciated by 7.0 per cent against the US dollar in 2021 and has been broadly stable thus far in 2022. At the same time, the Central Bank was able to fulfil the timely settlement of the International Sovereign Bond (ISB) of US dollars 500 million on 18 January 2022. As of end 2021, the gross official reserves were estimated at US dollars 3.1 billion.

## **Credit flows to the private sector continue to expand**

Credit extended to the private sector, which slowed down during September and October 2021, has picked up recently, partly reflecting the increased credit flows to finance imports. In the meantime, credit obtained by the public sector from the banking system, particularly net credit to the Government, continued to expand. Despite the recent deceleration observed due to the decline in net foreign assets of the banking system, with the significant expansion in domestic credit, the growth of broad money ( $M_{2b}$ ) remained elevated by end November 2021. Meanwhile, most market lending rates have adjusted upwards, while deposit rates have also increased albeit at a slower pace. Further, yields on government securities have increased amidst enhanced market subscriptions at primary auctions for government securities.

## **Supply side factors remain the key driver of domestic price pressures amidst the possible signs of demand pressures**

Inflationary pressures in the domestic front continued to be fuelled by supply side disruptions, upward adjustments to administered domestic prices, and the strengthening of underlying demand conditions in the economy as reflected in the rise in core inflation. Such supply driven price pressures are expected to be transitory, although the possible build-up of demand driven inflationary pressures may compel the adoption of proactive monetary policy measures, which will also help in managing inflation expectations.

## **Monetary and other policy measures are expected to strengthen the macroeconomic stability**

In consideration of the current and expected macroeconomic developments, the Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 19 January 2022, decided to adopt several policy measures with the view to strengthening macroeconomic stability. Accordingly, the Monetary Board decided to:

- a) increase the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 50 basis points each, to 5.50 per cent and 6.50 per cent, respectively;
- b) distribute the financing of essential import bills for fuel purchases among the licensed banks in proportion to their foreign exchange inflows;
- c) mandate all registered tourist establishments to accept foreign exchange only in respect of services rendered to persons resident outside Sri Lanka;
- d) extend the payment of an additional Rs. 8.00 per US dollar for workers' remittances paid in addition to the incentive of Rs. 2.00 per US dollar offered under the "Incentive Scheme on Inward Workers' Remittances" until 30 April 2022, reimburse the transaction cost borne by Sri Lankan migrant workers through the payment of Rs. 1,000 per transaction, when remitting money to rupee accounts via licensed banks and other formal channels with effect from 01 February 2022 and introduce higher interest rates for both foreign currency and rupee denominated deposits of migrant workers.

The Monetary Board was of the view that the above measures will curtail the possible build-up of underlying demand pressures in the economy, which would also help ease pressures in the external sector, thus promoting greater macroeconomic stability. In keeping with this policy stance, the Central Bank expects a corresponding increase in interest rates, particularly in deposit rates, thereby encouraging savings, while discouraging excessive consumption, which also fuels imports. Therefore, financial institutions are urged to swiftly pass on this increase to deposit rates of the customers. Moreover, the anticipated adjustment in market interest rates will facilitate the reduction in the Treasury bill holdings of the Central Bank through increased market subscriptions, as enunciated in the *Six-Month Road Map for Ensuring Macroeconomic and Financial System Stability*. Meanwhile, the materialisation of the expected foreign exchange inflows through bilateral arrangements and other import financing arrangements with friendly countries are expected to ensure a healthy level of gross official reserves in the period ahead and further strengthen the external sector in the economy.

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

Standing Deposit Facility Rate (SDFR)	5.50%
Standing Lending Facility Rate (SLFR)	6.50%
Bank Rate (automatically adjusted with SLFR)	9.50%
Statutory Reserve Ratio (SRR)	4.00%

**INFORMATION NOTE:**

A press conference chaired by Governor Ajith Nivard Cabraal will be held on 20 January 2022 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 08 March 2022.

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	Third Quarter	First Nine Months
<b>Agriculture</b>	-6.5	-8.2	3.1	1.3	<b>-2.4</b>	6.3	8.5	1.7	<b>5.3</b>
<b>Industries</b>	-7.9	-23.1	0.6	1.3	<b>-6.9</b>	5.5	22.1	-2.1	<b>6.8</b>
<b>Services</b>	2.9	-12.9	2.1	1.9	<b>-1.5</b>	3.0	7.5	-1.6	<b>2.7</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>-1.5</b>	<b>4.4</b>

Source: Department of Census and Statistics

**Table 02: Inflation**

Month		May 21	Jun 21	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21
<b>Headline Inflation (Year on year % change)</b>	CCPI (2013=100)	4.5	5.2	5.7	6.0	5.7	7.6	9.9	12.1
	NCPI (2013=100)	6.1	6.1	6.8	6.7	6.2	8.3	11.1	-
<b>Core Inflation (Year on year % change)</b>	CCPI (2013=100)	3.2	3.2	3.7	4.1	5.0	6.3	7.0	8.3
	NCPI (2013=100)	4.2	4.1	4.4	4.7	4.8	7.2	8.8	-

Source: Department of Census and Statistics

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

Indicator	Outstanding Amount (Rs. billion)								
	Mar 21	Apr 21	May 21	Jun 21	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21
Reserve Money	1,029	1,031	1,036	1,065	1,064	1,089	1,296	1,286	1,288
Broad Money (M <sub>2b</sub> )	9,839	9,947	10,033	10,165	10,304	10,514	10,488	10,582	10,546
Net Foreign Assets (NFA)	(430)	(431)	(429)	(481)	(699)	(701)	(722)	(837)	(906)
Net Domestic Assets (NDA)	10,269	10,378	10,462	10,646	11,003	11,215	11,210	11,418	11,452
Net Credit to the Government (NCG)	5,005	4,965	5,024	5,195	5,513	5,682	5,792	5,923	6,074
Credit to Public Corporations/ SOBES	1,098	1,093	1,113	1,132	1,141	1,137	1,123	1,194	1,185
Credit to the Private Sector	6,388	6,446	6,501	6,585	6,661	6,796	6,825	6,860	6,920
Broad Money (M <sub>4</sub> )	12,010	12,154	12,265	12,402	12,563	12,790	12,742	12,873	12,862

Source: Central Bank of Sri Lanka

**Table 04: Interest Rates**

Interest Rate (%)	End Jul 21	End Aug 21	End Sep 21	End Oct 21	End Nov 21	End Dec 21	As at 19 Jan 22
<b>Key Policy Interest Rates of the Central Bank</b>							
Standing Deposit Facility Rate	4.50	5.00	5.00	5.00	5.00	5.00	5.00
Standing Lending Facility Rate	5.50	6.00	6.00	6.00	6.00	6.00	6.00
<b>Average Weighted Call Money Rate (AWCMR)</b>	5.10	5.79	5.94	5.93	5.92	5.95	5.95
<b>Treasury bill yields (Primary market)</b>							
91-day	5.22	5.87	6.70	8.43	7.53	8.16	8.49
182-day	5.23	5.90	6.99	8.16	8.02	8.33	8.44
364-day	5.25	5.93	7.01	8.18	8.16	8.24	8.48
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	5.76	6.01	6.42	7.82	8.00	8.61	8.58 (a)
Average Weighted Lending Rate (AWLR)	9.45	9.38	9.37	9.49	9.79	-	-
Average Weighted New Lending Rate (AWNLR)	8.09	8.04	8.14	8.78	9.18	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	4.77	4.75	4.75	4.79	4.82	4.94	-
Average Weighted Fixed Deposit Rate (AWFDR)	5.67	5.62	5.64	5.70	5.75	5.94	-
Average Weighted New Deposit Rate (AWNDR)	4.99	5.19	5.53	5.96	6.27	-	-
Average Weighted New Fixed Deposit Rate (AWNDFDR)	5.15	5.35	5.69	6.19	6.52	-	-

(a) For the week ending 13 January 2022

Source: Central Bank of Sri Lanka