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## Monetary Policy Review: No. 02 – March 2022

### The Central Bank of Sri Lanka further tightens the Monetary Policy Stance

#### Global economic growth to moderate, while inflation to remain higher

As per the January 2022 update of the World Economic Outlook (WEO) of the International Monetary Fund (IMF), the global economy is expected to moderate from 5.9 per cent in 2021 to 4.4 per cent in 2022. The recovery in the global economic activity is expected to weaken due to the spread of the Omicron COVID-19 variant, supply chain disruptions and geopolitical tensions in Eastern Europe. Global inflation is expected to remain high and persistent due to elevated energy prices and continuing supply chain disruptions, prompting stronger monetary policy responses by central banks globally.

#### Global and domestic developments have posed challenges to the recovery of the Sri Lankan economy

The domestic economy is expected to make headway underpinned by the successful COVID-19 vaccination drive of the Government and relaxed mobility restrictions. However, economic activity is somewhat affected by recent adverse developments in the global front, in terms of supply chain disruptions and rising commodity prices, as well as in the domestic front, particularly in the form of power and supply interruptions. These disruptions have to be addressed immediately to ensure the continuation of uninterrupted domestic production and the momentum in exports, while continuing with the efforts to strengthen the production economy through well-targeted growth policies.

#### External sector faces heightened challenges

Although earnings from merchandise exports continued to record over US dollars 1 billion for the eighth consecutive month in January 2022, expenditure on imports continued to increase at a higher pace. Tourist arrivals increased noticeably thus far during the year, although recent geopolitical tensions may affect the tourism industry to some extent. Meanwhile, a rebound in workers' remittances is expected in the period ahead as worker migrations have increased notably and due to the measures taken to combat illegal money transfers, while encouraging remittances through formal channels via several incentives. The Sri Lanka rupee was maintained broadly stable, while the gross official reserves as of end January 2022 are provisionally estimated at US dollars 2.4 billion, equivalent to 1.3 months of imports. At the same time, the Government and the Central Bank have been avidly pursuing avenues to attract fresh foreign exchange inflows while facilitating continued domestic economic activity.

## **Market interest rates are trending upwards**

The expansion of domestic credit, particularly credit to the public sector was robust. Nevertheless, some slowdown in the growth of broad money ( $M_{2b}$ ) was observed due to the decline in net foreign assets (NFA) of the banking system. Following the monetary tightening measures, market interest rates are adjusting upwards. However, the adjustment in deposit interest rates remains sluggish, which has been inadequate to attract deposits into the banking system from the excessive currency in circulation. Therefore, banks and financial institutions are urged to make the required adjustments to deposit interest rates in order to promote savings. Meanwhile, yields on government securities have also increased notably to reflect market conditions in view of the higher financing requirement of the Government.

## **Supply side factors have contributed to price pressures, while the build-up of aggregate demand pressures is also visible**

Supply side disruptions, increasing global commodity prices and associated domestic administrative price adjustments, and food supply disruptions have been the key drivers of rising inflationary pressures domestically. The acceleration in core inflation also reflects the firming up of aggregate demand conditions in the economy propagated by the accommodative monetary conditions and fiscal measures that were in place since the onset of the pandemic. While inflationary pressures are expected to remain elevated in the near term, the pressures emanating from the build-up of aggregate demand require proactive measures to anchor inflation expectations and retrace inflation to the desired levels over the medium term.

## **A policy package to support greater macroeconomic stability**

Considering the severity of the external shocks and continued disruptions to domestic economic activity, the Monetary Board was of the view that a comprehensive policy package containing both traditional and non-traditional measures, along with other initiatives that have an impact on the overall economy, is essential to counter such economic headwinds.

Accordingly, after carefully considering the current and expected macroeconomic developments both globally and domestically, the Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 03 March 2022, decided to reinforce its stance adopted in January 2022, and decided to:

- a) increase the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 100 basis points each, to 6.50 per cent and 7.50 per cent, respectively;
- b) revise upwards the caps imposed on interest rates applicable to credit cards to 20 per cent per annum, on pre-arranged temporary overdrafts to 18 per cent per annum, and on pawning facilities to 12 per cent per annum. Directions to effect these regulated interest rates will be issued shortly.

The Monetary Board was of the view that the above measures will dampen the possible build-up of underlying demand pressures in the economy, which would, in turn, help ease pressures in the external sector, thus promoting greater macroeconomic stability.

At the same time, concerted efforts will need to be urgently taken by the Government to complement the efforts taken by the Central Bank to overcome the present economic challenges. Therefore, as

its Economic and Financial Advisor, the Central Bank wishes to advise the Government to diligently consider;

- a) introducing measures to discourage non-essential and non-urgent imports urgently based on the previous recommendation made by the Central Bank
- b) increasing fuel prices and electricity tariffs immediately, to reflect the cost
- c) incentivising foreign remittances and investments further
- d) implementing energy conservation measures, while accelerating the move towards renewable energy
- e) increasing government revenue through suitable tax increases on a sustained basis
- f) mobilising foreign financing and non-debt forex inflows on an urgent basis
- g) monetising the non-strategic and underutilised assets, and
- h) postponing non-essential and non-urgent capital projects.

The above measures would ensure that a coordinated approach is adopted to overcome the challenging economic circumstances faced by the country and to prudently exit the COVID-related policy accommodation.

The Central Bank will continue to closely monitor the emerging macroeconomic and financial market developments, both globally and domestically, and will stand ready to take further measures as appropriate, with the aim of achieving stability in the fronts of inflation, the external sector and the financial sector, thereby supporting real economic activity on a sustained basis.

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

Standing Deposit Facility Rate (SDFR)	6.50%
Standing Lending Facility Rate (SLFR)	7.50%
Bank Rate (automatically adjusted with SLFR)	10.50%
Statutory Reserve Ratio (SRR)	4.00%

**Regulated interest rates revised upwards:**

Maximum interest rate on Credit Cards	20.00%
Maximum interest rate on Pre-arranged Temporary Overdrafts	18.00%
Maximum interest rate on Pawning Facilities	12.00%

**INFORMATION NOTE:**

A press conference chaired by Governor Ajith Nivard Cabraal will be held on 04 March 2022 at 12.30 pm 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 07 April 2022.

## Annexure I

**Table 01: Inflation**

Month		Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22
Headline Inflation (Year on year % change)	CCPI (2013=100)	5.7	6.0	5.7	7.6	9.9	12.1	14.2	15.1
	NCPI (2013=100)	6.8	6.7	6.2	8.3	11.1	14.0	16.8	-
Core Inflation (Year on year % change)	CCPI (2013=100)	3.7	4.1	5.0	6.3	7.0	8.3	9.9	10.9
	NCPI (2013=100)	4.4	4.7	4.8	7.2	8.8	10.8	12.9	-

Source: Department of Census and Statistics

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

Indicator	Outstanding Amount (Rs. billion)								
	Apr 21	May 21	Jun 21	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21
Reserve Money	1,031	1,036	1,065	1,064	1,089	1,296	1,286	1,288	1,306
Broad Money (M <sub>2b</sub> )	9,947	10,033	10,165	10,304	10,514	10,488	10,582	10,546	10,647
Net Foreign Assets (NFA)	(431)	(429)	(481)	(699)	(701)	(722)	(837)	(906)	(982)
Net Domestic Assets (NDA)	10,378	10,462	10,646	11,003	11,215	11,210	11,418	11,452	11,629
Net Credit to the Government (NCG)	4,965	5,024	5,195	5,513	5,682	5,792	5,923	6,074	6,287
Credit to Public Corporations / SOBEs	1,093	1,113	1,132	1,141	1,137	1,123	1,194	1,185	1,188
Credit to the Private Sector	6,446	6,501	6,585	6,661	6,796	6,825	6,860	6,920	6,981
Broad Money (M <sub>4</sub> )	12,154	12,265	12,402	12,563	12,790	12,742	12,873	12,861	12,985

Source: Central Bank of Sri Lanka

**Table 03: Interest Rates**

Interest Rate (%)	End Sep 21	End Oct 21	End Nov 21	End Dec 21	End Jan 22	End Feb 22	As at 03 Mar 22
<b>Key Policy Interest Rates of the Central Bank</b>							
Standing Deposit Facility Rate	5.00	5.00	5.00	5.00	5.50	5.50	5.50
Standing Lending Facility Rate	6.00	6.00	6.00	6.00	6.50	6.50	6.50
<b>Average Weighted Call Money Rate (AWCMR)</b>	5.94	5.93	5.92	5.95	6.48	6.48	6.49
<b>Treasury bill Yields (Primary Market)</b>							
91-day	6.70	8.43	7.53	8.16	8.63	8.61	9.33 (a)
182-day	6.99	8.16	8.02	8.33	8.55	8.53	9.88 (a)
364-day	7.01	8.18	8.16	8.24	8.55	8.53	9.95 (a)
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	6.42	7.82	8.00	8.61	8.52	8.99	-
Average Weighted Lending Rate (AWLR)	9.37	9.49	9.79	9.87	10.12	-	-
Average Weighted New Lending Rate (AWNLR)	8.14	8.78	9.18	9.48	9.76	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	4.75	4.79	4.82	4.94	5.01	5.07	-
Average Weighted Fixed Deposit Rate (AWFDR)	5.64	5.70	5.75	5.94	6.05	6.15	-
Average Weighted New Deposit Rate (AWNDR)	5.53	5.96	6.27	6.45	6.58	-	-
Average Weighted New Fixed Deposit Rate (AWNDFDR)	5.69	6.19	6.52	6.67	6.79	-	-

(a) Rate at the auction held on 02 March 2022

Source: Central Bank of Sri Lanka