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## Monetary Policy Review: No. 03 – April 2022

### The Central Bank of Sri Lanka Significantly Tightens its Monetary Policy Stance to Stabilise the Economy

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 08 April 2022, decided to increase the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 700 basis points to 13.50 per cent and 14.50 per cent, respectively, effective from the close of business on 08 April 2022. The Board, having noted the inflationary pressures that could further intensify in the period ahead, driven by the build-up of aggregate demand, domestic supply disruptions, exchange rate depreciation and the elevated prices of commodities globally, was of the view that a substantial policy response is imperative to arrest the buildup of added demand driven inflationary pressures in the economy and preempt the escalation of adverse inflationary expectations, to provide the required impetus to stabilise the exchange rate and also to correct anomalies observed in the market interest rate structure.

#### The external sector is facing continued heightened challenges

Although the momentum in the export sector continued with earnings exceeding US dollars 1 billion for several consecutive months, elevated levels of expenditure on imports have led to the continued widening of the trade deficit. Tourist arrivals have indicated a promising recovery, although recent geopolitical tensions, as well as domestic economic uncertainty along with power and energy outages and supply interruptions, could weigh on this recovery to some extent. Workers' remittances are showing signs of recovery following the adjustment to the exchange rate and the continued increase in worker migrations. With greater market orientation in the determination of the exchange rate, the rupee has recorded a depreciation of 33.0 per cent against the US dollar thus far in 2022 (by 08 April 2022). The gross official reserves as of end March 2022 were provisionally estimated at US dollars 1.9 billion. Nevertheless, the excessive depreciation of the exchange rate amidst the lacklustre performance in foreign exchange inflows warrants certain policy actions.

#### Inflation is on the rise due to both supply side factors and mounting aggregate demand pressures

Headline inflation continued to accelerate driven by the supply side disruptions, while underlying demand pressures in the economy remain intact as reflected by the continued acceleration in core inflation. The emerging developments indicate that inflationary pressures would continue in the near term driven by elevated prices of global commodities and their direct and second round impact on domestic prices, in addition to the price impact that could arise with the depreciation of the Sri Lanka rupee requiring the Central Bank to take further proactive measures.

## **Market interest rates are adjusting upwards gradually**

Market interest rates have been gradually adjusting upwards in response to tight monetary policy measures adopted thus far. However, adjustments in deposit rates remain inadequate to attract deposits into the banking system from the excessive currency in circulation. Yields on government securities have also increased notably compared to other market rates given the higher government borrowing requirement thus creating anomalies in the market interest rate structure. Although a slowdown in the growth of broad money ( $M_{2b}$ ) was observed due to the decline in net foreign assets (NFA) of the banking system, net domestic assets (NDA) of the banking system have increased significantly.

## **Adverse developments in both global and domestic fronts have posed challenges to the domestic economic performance**

As per the GDP estimates published by the Department of Census and Statistics (DCS), the Sri Lankan economy grew by 1.8 per cent, year-on-year, in the last quarter of 2021. Accordingly, the Sri Lankan economy has recovered from the contraction of 3.6 per cent in 2020 and recorded a growth of 3.7 per cent in 2021. Growth prospects for 2022 are affected by the recent adverse developments on the global front in terms of supply chain disruptions and rising commodity prices as well as on the domestic front, particularly interruptions to power and energy supply and other shortages.

## **Monetary and other policy measures are expected to further tighten monetary conditions**

Considering the severity of the external shocks, rising inflationary pressures and continued imbalances in the economy, the Monetary Board was of the view that a comprehensive set of policy measures, along with other initiatives that have an impact on the overall economy, is essential to safeguard stability on all fronts and to counter 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 08 April 2022, decided to increase the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 700 basis points to 13.50 per cent and 14.50 per cent, respectively, effective from the close of business on 08 April 2022. The Monetary Board also decided to remove caps imposed on lending interest rates applicable to credit cards, pre-arranged temporary overdrafts, and pawning facilities to facilitate the effective transmission of the policy adjustment. The Board noted that such policy and regulatory actions, upon quick transmission, would raise the cost of funds, thereby containing the expansion of money and credit; inducing the return of excessive currency in circulation to the banking system; eliminating interest rate anomalies; easing the pressure on the exchange rate; and containing the build-up of demand pressures in the economy. Financial institutions are urged to raise interest rates on their products, particularly deposit rates for the benefit of the depositors. In line with the current monetary policy stance, the Central Bank would also continue with the ongoing programme to reduce its holdings of Treasury bills and hence unwind monetary stimulus.

The Central Bank and the Government have already begun working closely with the International Monetary Fund (IMF) to formulate a sustainable solution to overcome the macroeconomic challenges faced by the country at present. Negotiations to obtain bridging financing have already commenced with interested counterparties. The Monetary Board firmly believes that the policy measures adopted thus far by the Central Bank and further measures that are expected to be taken by the Government and the Central Bank would reinforce greater stability in prices as well as in the

external, monetary, and financial sectors, while restoring the confidence of stakeholders of the economy on the way forward.

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

Standing Deposit Facility Rate (SDFR)	13.50%
Standing Lending Facility Rate (SLFR)	14.50%
Bank Rate (automatically adjusted with SLFR)	17.50%
Statutory Reserve Ratio (SRR)	4.00%

**INFORMATION NOTE:**

The release of the next regular statement on monetary policy will be on 19 May 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	Fourth Quarter	Annual
<b>Agriculture</b>	-7.1	-7.8	3.5	2.0	<b>-2.2</b>	4.1	9.8	0.8	-4.9	<b>2.0</b>
<b>Industries</b>	-8.0	-23.0	0.5	1.5	<b>-6.9</b>	5.9	22.7	-1.6	-0.2	<b>5.3</b>
<b>Services</b>	2.9	-13.0	2.0	1.7	<b>-1.6</b>	2.9	7.3	-1.5	3.8	<b>3.0</b>
<b>GDP</b>	<b>-1.9</b>	<b>-16.4</b>	<b>1.3</b>	<b>1.3</b>	<b>-3.6</b>	<b>4.2</b>	<b>12.4</b>	<b>-1.5</b>	<b>1.8</b>	<b>3.7</b>

Source: Department of Census and Statistics

### Table 02: Inflation

Month		Aug 21	Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22
<b>Headline Inflation (Year on year % change)</b>	CCPI (2013=100)	6.0	5.7	7.6	9.9	12.1	14.2	15.1	18.7
	NCPI (2013=100)	6.7	6.2	8.3	11.1	14.0	16.8	17.5	-
<b>Core Inflation (Year on year % change)</b>	CCPI (2013=100)	4.1	5.0	6.3	7.0	8.3	9.9	10.9	13.0
	NCPI (2013=100)	4.7	4.8	7.2	8.8	10.8	12.9	14.1	-

Source: Department of Census and Statistics

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

Indicator	Outstanding Amount (Rs. billion)								
	Jun 21	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22
Reserve Money	1,065	1,064	1,089	1,296	1,286	1,288	1,306	1,337	1,324
Broad Money (M <sub>2b</sub> )	10,165	10,304	10,514	10,488	10,582	10,546	10,647	10,668	10,755
Net Foreign Assets (NFA)	(481)	(699)	(701)	(722)	(837)	(906)	(982)	(1,216)	(1,275)
Net Domestic Assets (NDA)	10,646	11,003	11,215	11,210	11,418	11,452	11,629	11,883	12,030
Net Credit to the Government (NCG) (a)	5,124	5,411	5,531	5,595	5,665	5,714	5,832	6,045	6,094
Credit to Public Corporations / SOBEs	1,132	1,141	1,137	1,123	1,194	1,185	1,188	1,192	1,238
Credit to the Private Sector	6,585	6,661	6,796	6,825	6,860	6,920	6,981	7,017	7,051
Broad Money (M <sub>4</sub> )	12,402	12,563	12,790	12,742	12,873	12,862(a)	12,985	13,055	-

(a) Revised

Source: Central Bank of Sri Lanka

**Table 04: Interest Rates**

Interest Rate (%)	End Oct 21	End Nov 21	End Dec 21	End Jan 22	End Feb 22	End Mar 22	As at 08 Apr 22
<b>Key Policy Interest Rates of the Central Bank</b>							
Standing Deposit Facility Rate	5.00	5.00	5.00	5.50	5.50	6.50	13.50 (a)
Standing Lending Facility Rate	6.00	6.00	6.00	6.50	6.50	7.50	14.50 (a)
<b>Average Weighted Call Money Rate (AWCMR)</b>	5.93	5.92	5.95	6.48	6.48	7.49	7.49
<b>Treasury bill yields (Primary market)</b>							
91-day	8.43	7.53	8.16	8.63	8.61	12.92	14.12 (b)
182-day	8.16	8.02	8.33	8.55	8.53	12.25	15.36 (b)
364-day	8.18	8.16	8.24	8.55	8.53	12.28	15.69 (b)
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	7.82	8.00	8.61	8.52	8.99	9.85	10.44
Average Weighted Lending Rate (AWLR)	9.49	9.79	9.87	10.12	10.13	-	-
Average Weighted New Lending Rate (AWNLR)	8.78	9.18	9.48	9.76	10.07	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	4.79	4.82	4.94	5.01	5.07	5.17	-
Average Weighted Fixed Deposit Rate (AWFDR)	5.70	5.75	5.94	6.05	6.15	6.30	-
Average Weighted New Deposit Rate (AWNDR)	5.96	6.27	6.45	6.58	6.50	-	-
Average Weighted New Fixed Deposit Rate (AWNDFDR)	6.19	6.52	6.67	6.79	6.75	-	-

(a) Effective from the close of business on 08 April 2022

(b) Rate at the auction held on 06 April 2022

Source: Central Bank of Sri Lanka