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The Central Bank of Sri Lanka Maintains its Monetary Policy Stance

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 18 May 2022, decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at the current levels of 13.50 per cent and 14.50 per cent, respectively. The Board is of the view that although inflation is projected to remain elevated in the near term, the substantial policy measures taken by the Board, at its meeting held on 08 April 2022, combined with the other measures to stem the firming up of aggregated demand pressures, are expected to contain any further build-up of inflation expectations and ease inflationary pressures in the period ahead.

A faster passthrough to market interest rates is observed following the significant monetary policy tightening measures

Market interest rates have notably adjusted upwards reflecting the significant monetary policy tightening measures taken by the Central Bank in April 2022. The interest rates on deposit and lending products of financial institutions have adjusted upwards considerably, correcting some anomalies that prevailed in the market interest rate structure. Although domestic credit in rupee terms recorded a significant expansion in March 2022, mainly due to the valuation impact of foreign currency denominated loans, the parity adjusted domestic credit expansion is estimated to have slowed. Meanwhile, the resultant expansion of broad money growth has been weighed down by the contraction in net foreign assets (NFA) of the banking system. It is envisaged that the elevated interest rate structure would attract more deposits into the banking system. However, the expansion of domestic credit, particularly to the private sector, would remain restrained due to the passthrough of the significantly tight monetary policy measures. Meanwhile, yields on government securities, which increased considerably in the recent past, are expected to moderate and stabilise at lower levels in the period ahead with the necessary fiscal adjustments together with renewed efforts to restore political stability in the country.

Inflation is projected to remain elevated in the coming months before moderating thereafter, supported by the realisation of the full impact of the policy measures

Headline inflation is projected to remain escalated in the near term on account of domestic supply shortages, increased global commodity prices, the effects of the large depreciation of the Sri Lanka rupee against the US dollar thus far during the year, along with the impact of aggregate demand pressures. However, inflation is expected to moderate thereafter reflecting the impact of corrective policy measures of the Central Bank and the expected improvements in both domestic and global supply conditions. Moreover, it is envisaged that the recent tightening of monetary conditions and the strengthening of monetary policy communication will help anchor inflation expectations of the public in the period ahead.

The external sector continues to face heightened challenges, which are being addressed by an array of measures

The guidance provided by the Central Bank to all licensed banks in the determination of the interbank spot exchange rate, since mid-May 2022, is expected to minimise any excessive volatility in the domestic foreign exchange market. This, coupled with the recent tightening of the monetary policy stance, restrictions on imports on open account terms, and the reduction in the proportion of mandatory foreign exchange sales by the banks to the Central Bank, is expected to ease pressures on the Sri Lanka rupee, while also gradually improving liquidity in the domestic foreign exchange market. Moreover, these measures are anticipated to help mobilise foreign exchange to finance essential imports, until sizeable bridging finance is made available. Some recovery in foreign exchange inflows in terms of workers' remittances is expected due to the notable reduction in the gap between the official exchange rate and the rate offered by the grey market and the continued increase in migration of workers. However, the near term outlook of the tourism sector is likely to remain unfavourable due to both global and domestic factors. Meanwhile, gross official reserves as of end April 2022 were provisionally estimated at US dollars 1.8 billion, including the swap facility from the People's Bank of China equivalent to around US dollars 1.5 billion, which is subject to conditionalities on usability. The Central Bank and the Government have commenced technical level discussions with the International Monetary Fund aimed at working towards a programme to address the macroeconomic challenges faced by the economy, while expeditious arrangements are being made to commence the external debt restructuring process. Meanwhile, negotiations have already begun with bilateral and multilateral partners to obtain bridging finance in order to secure foreign exchange required to finance imports of essential goods and strengthen the social safety net programmes.

Economic growth is expected to record a setback this year

Economic activity is expected to be affected considerably by the ongoing supply shortages, energy-related issues and social tensions, as reflected by several leading indicators. Demand management policies of the Central Bank and anticipated fiscal consolidation measures are also expected to keep aggregate demand subdued during the year. Meanwhile, global economic growth is also expected to moderate in response to the tightening of monetary policy by the central banks globally to counter inflationary pressures along with the spillover effects of the geopolitical tensions in Eastern Europe.

The policy measures implemented by the Central Bank need to be reinforced by adequate and timely policy adjustments by the Government

In order to prevent further deterioration of economic conditions and complement the efforts of the Central Bank implemented thus far, urgent measures are required to restore greater political stability through consensus governance and social harmony. In addition, swift policy actions are required to strengthen the fiscal performance that would help avoid excessive reliance on monetary financing and maintain fiscal sustainability over the medium term. Furthermore, expeditious and transparent revision of tariffs in the energy sector remains a priority in order to strengthen the financial position of energy-related state owned business enterprises, while improving the efficiency of social welfare programmes to support the vulnerable groups of the society impacted by the unprecedented economic circumstances.

Policy rates are maintained at current levels

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 18 May 2022, decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at the current levels of 13.50 per cent and 14.50 per cent, respectively. The Board was of the view that the policy measures that have already been implemented by the Central Bank would continue to be further transmitted to the financial markets, while some signs of tighter monetary policy already being observed in real economic activity. The Central Bank would continue to monitor domestic and global macroeconomic and financial market developments and stand ready to take appropriate measures proactively to help reinforce greater macroeconomic stability in the economy in the period ahead.

Monetary Policy Decision:	Policy rates and SRR unchanged
Standing Deposit Facility Rate (SDFR)	13.50%
Standing Lending Facility Rate (SLFR)	14.50%
Statutory Reserve Ratio (SRR)	4.00%

INFORMATION NOTE:

A press conference, chaired by Governor Dr. P Nandalal Weerasinghe, will be held on 19 May 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 07 July 2022.

Annexure I

Table 01: Inflation

Month		Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22	Apr 22
Headline Inflation (Year on year % change)	CCPI (2013=100)	5.7	7.6	9.9	12.1	14.2	15.1	18.7	29.8
	NCPI (2013=100)	6.2	8.3	11.1	14.0	16.8	17.5	21.5	-
Core Inflation (Year on year % change)	CCPI (2013=100)	5.0	6.3	7.0	8.3	9.9	10.9	13.0	22.0
	NCPI (2013=100)	4.8	7.2	8.8	10.8	12.9	14.1	17.3	-

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)								
	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21	Jan 22	Feb 22	Mar 22 (a)
Reserve Money	1,064	1,089	1,296	1,286	1,288	1,306	1,337	1,324	1,387
Broad Money (M _{2b})	10,304	10,514	10,488	10,582	10,546	10,647	10,668	10,755	11,575
Net Foreign Assets (NFA)	(699)	(701)	(722)	(837)	(906)	(982)	(1,216)	(1,275)	(1,889)
Net Domestic Assets (NDA)	11,003	11,215	11,210	11,418	11,452	11,629	11,883	12,030	13,464
Net Credit to the Government (NCG)	5,411	5,531	5,595	5,665	5,714	5,832	6,045	6,094	6,543
Credit to Public Corporations / SOBEs	1,141	1,137	1,123	1,194	1,185	1,188	1,192	1,238	1,548
Credit to the Private Sector	6,661	6,796	6,825	6,860	6,920	6,981	7,017	7,051	7,529
Broad Money (M ₄)	12,563	12,790	12,742	12,873	12,862	12,985	13,058 (b)	13,167	-

(a) The sharp depreciation of the Sri Lanka rupee in March 2022 remains the key reason for the augmentation of monetary and credit aggregates in rupee terms in March 2022

(b) Revised

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End Nov 21	End Dec 21	End Jan 22	End Feb 22	End Mar 22	End Apr 22	As at 18 May 22
Key Policy Interest Rates of the Central Bank							
Standing Deposit Facility Rate	5.00	5.00	5.50	5.50	6.50	13.50	13.50
Standing Lending Facility Rate	6.00	6.00	6.50	6.50	7.50	14.50	14.50
Bank Rate	9.00	9.00	9.50	9.50	10.50	17.50	17.50
Average Weighted Call Money Rate (AWCMR)	5.92	5.95	6.48	6.48	7.49	14.50	14.50
Treasury bill yields (Primary market)							
91-day	7.53	8.16	8.63	8.61	12.92	23.53	24.07
182-day	8.02	8.33	8.55	8.53	12.25	23.96	24.69
364-day	8.16	8.24	8.55	8.53	12.28	24.09	24.50
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	8.00	8.61	8.52	8.99	9.85	16.38	19.36 (a)
Average Weighted Lending Rate (AWLR)	9.79	9.87	10.12	10.13	10.35	-	-
Average Weighted New Lending Rate (AWNLR)	9.18	9.48	9.76	10.07	10.73	-	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	4.82	4.94	5.01	5.07	5.17	5.52	-
Average Weighted Fixed Deposit Rate (AWFDR)	5.75	5.94	6.05	6.15	6.30	6.84	-
Average Weighted New Deposit Rate (AWNDR)	6.27	6.45	6.58	6.50	7.68	-	-
Average Weighted New Fixed Deposit Rate (AWNDFDR)	6.52	6.67	6.79	6.75	8.06	-	-

(a) For the week ending 13 May 2022

Source: Central Bank of Sri Lanka