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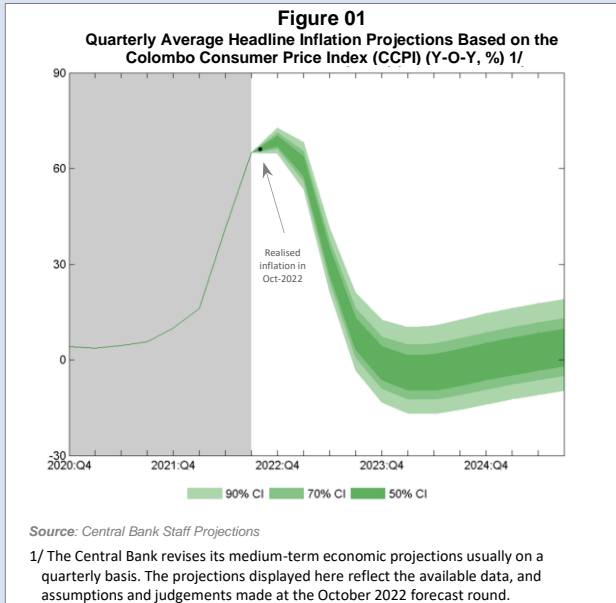
Monetary Policy Review: No. 08 - November 2022

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 23 November 2022, 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 14.50 per cent and 15.50 per cent, respectively, after considering the recent and expected developments in the domestic and global economy and macroeconomic projections. The Board noted that the maintenance of tight monetary policy stance is necessary to contain any demand driven inflationary pressures in the economy, while helping to further strengthen disinflation expectations, thus enabling to steer headline inflation towards the targeted level of 4-6 per cent over the medium term.

Headline inflation marked a turnaround as expected

Supported by favourable supply side developments and tight monetary policy measures, headline inflation pivoted towards the envisaged disinflation path in October 2022, after passing the peak in September 2022. Accordingly, headline inflation, based on both the Colombo Consumer Price Index (CCPI) and the National Consumer Price Index (NCPI), decelerated, while a deceleration was observed in core inflation. The deceleration in inflation is expected to continue in the ensuing period, supported by subdued aggregate demand pressures, expected improvements in domestic supply conditions, normalisation in global commodity prices, and the timely passthrough of such reductions to domestic prices, along with the favourable statistical base effect. Global as well as domestic risks to the inflation outlook in the near term are tilted to the downside, thereby supporting the disinflation path (Figure 01) and stabilising inflation at the desired levels towards the end of 2023.



Note: A forecast is neither a promise nor a commitment.

The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colours. The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. Specially, the thick green shaded area represents the 50 per cent confidence interval, implying there is a 50 per cent probability that the actual inflation outcome will be within this interval. The confidence bands show the increasing uncertainty in forecasting inflation over a longer horizon.

The projection reflects the available data, and assumptions and judgements made at the October 2022 forecast round. The projections are conditional on forecasts of global fuel and food prices that are anticipated to ease gradually, which in turn are expected to be reflected in domestic prices; below potential level growth in Sri Lanka's major trading partners; and

tightening global financial conditions implied by the current and anticipated monetary policy stance of the USA. Further, the projections are conditional on the model-consistent interest rate path and the achievement of medium-term fiscal targets. Moreover, domestic food supply conditions are assumed to ease in 2023. Given the prevailing domestic and global economic uncertainties and geopolitical tensions, the risks associated with the projections are much higher than in normal times. Any notable change in these assumptions could lead to the realised inflation path deviating from the above. The Central Bank remains committed to communicating anticipated changes in the inflation outlook to the public on a regular basis, to enable them to make informed decisions.

Domestic economic activity is expected to remain tepid during 2022

The real economy is expected to contract in 2022 impacted by the stability-oriented policy measures that led to tightened monetary and fiscal conditions, along with supply side constraints and prevailing uncertainties, among others. Nevertheless, economic activity is expected to make a gradual, yet sustainable recovery, supported by envisaged improvements in supply conditions, improved market confidence, and the impact of corrective policy measures being implemented to stabilise the economic conditions.

Tight monetary and liquidity conditions have slowed the expansion of money and credit aggregates

Outstanding credit extended to the private sector by commercial banks is expected to have contracted for the fifth consecutive month in October 2022, reflecting the impact of increased market lending interest rates and the moderation in economic activity. Market deposit interest rates have also risen notably disproportionate to the adjustment in the policy interest rates. The continued excessive upward adjustment in market interest rates, despite the improvements in domestic money market liquidity and the deceleration of inflation, has resulted in persistent

anomalies in the interest rate structure. Meanwhile, yields on government securities are showing some signs of easing recently, and are expected to moderate further. Going forward, the anomaly in market interest rates is expected to be rectified, benefiting mainly from the notable reduction in the overall money market liquidity deficit and the anchoring of inflation expectations in line with the envisaged disinflation path. Further, the high risk premia attached to the yields on government securities are expected to shrink in the period ahead as the debt restructuring process progresses and fiscal sector performance improves with the consolidation measures in place.

The external sector remains resilient despite the heightened balance of payments pressures

The merchandise trade deficit for the ten months ending October 2022 contracted significantly, owing to the robust export earnings and a substantial decline in import expenditure due to policy measures taken to curtail demand for imports, amidst the shortage in foreign exchange. Workers' remittances are expected to improve in the period ahead with rising departures for foreign employment, while the tourism sector is set to mark an improvement in view of the upcoming season for tourist arrivals. Amidst the improvements observed in liquidity in the domestic foreign exchange market, the Central Bank continued to facilitate the import of essential goods to ensure the availability of energy, power and other supplies necessary for uninterrupted economic activity. Meanwhile, the exchange rate remained broadly stable. The gross official reserves were estimated at US dollars 1.7 billion as of end October 2022, including the swap facility from the People's Bank of China, equivalent to around US dollars 1.4 billion, which has certain conditionalities on usability. Risks to external demand could emerge amidst moderating global growth prospects in the near term, however, rising prospects of the tourism sector and workers' remittances would help offset any negative spillovers to a large extent.

Policy interest rates are maintained at current levels as conditions are sufficiently tight

In consideration of the current and expected developments, both locally and globally, as indicated above, the Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 23 November 2022, 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 14.50 per cent and 15.50 per cent, respectively. The Board was of the view that the prevailing tight monetary policy stance is necessary to rein in any underlying demand pressures in the economy. However, the Board noted with concern the anomalous rise in market interest rates, particularly deposit interest rates and short-term lending interest rates, despite the recent improvements in

overall money market conditions and the adverse implications on business and economic activity. The Central Bank would expect a moderation of excessive market interest rates, in line with the prevailing policy interest rates. If an appropriate downward adjustment in the market interest rates would not take place in line with the envisaged disinflation path, the Central Bank will be compelled to impose administrative measures to prevent any undue movements in market interest rates. At the same time, the Board reiterates its continued commitment to restoring price stability and ensuring financial system stability, and remains confident that inflation would follow the projected disinflation path underpinned by the prevailing monetary policy stance, while supporting the economy to reach its potential over the medium term. Further, the Board remains ready to react appropriately to any materialisation of risks to the forecast.

Monetary Policy Decision	Policy interest rates and SRR unchanged	
	Standing Deposit Facility Rate (SDFR)	14.50%
	Standing Lending Facility Rate (SLFR)	15.50%
	Statutory Reserve Ratio (SRR)	4.00%

INFORMATION NOTE:

A press conference, chaired by Governor Dr. P Nandalal Weerasinghe, will be held on 24 November 2022 at 11.30 am at the Atrium of the Central Bank of Sri Lanka, and proceedings will be livestreamed on Facebook and YouTube.

The release of the next regular statement on monetary policy review will be on 19 January 2023.

Annexure I

Table 01: Inflation

Month		Mar 22	Apr 22	May 22	Jun 22	Jul 22	Aug 22	Sep 22	Oct 22
Headline Inflation (Year-on-Year % change)	CCPI (2013=100)	18.7	29.8	39.1	54.6	60.8	64.3	69.8	66.0
	NCPI (2013=100)	21.5	33.8	45.3	58.9	66.7	70.2	73.7	70.6
Core Inflation (Year-on-Year % change)	CCPI (2013=100)	13.0	22.0	28.4	39.9	44.3	46.6	50.2	49.7
	NCPI (2013=100)	17.3	27.9	37.7	49.3	57.3	60.5	64.1	62.4

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)								
	Jan 22	Feb 22	Mar 22 (a)	Apr 22 (a)	May 22 (a)	Jun 22	Jul 22	Aug 22	Sep 22
Reserve Money	1,337	1,324	1,387	1,482	1,415	1,453	1,436	1,386	1,379
Broad Money (M _{2b})	10,668	10,755	11,576	11,941	11,897	11,901	11,955	11,987	12,051
Net Foreign Assets (NFA)	(1,216)	(1,275)	(1,889)	(2,195)	(2,083)	(2,122)	(2,124)	(2,035)	(1,893)
Net Domestic Assets (NDA)	11,883	12,030	13,464	14,136	13,980	14,023	14,079	14,022	13,944
Net Credit to the Government (NCG)	6,054	6,100	6,556	6,569	6,523	6,697	6,826	6,990	7,043
Credit to Public Corporations / SOBEs	1,192	1,238	1,548	1,725	1,750	1,729	1,754	1,700	1,703
Credit to the Private Sector	7,018	7,051	7,534	7,753	7,755	7,714	7,673	7,614	7,577
Broad Money (M ₄)	13,058	13,167	13,992	14,356	14,340	14,335	14,410	14,451	14,540

(a) The sharp depreciation of the Sri Lanka rupee during March to May 2022 remains the key reason for the augmentation of monetary and credit aggregates during that period.

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End May 22	End Jun 22	End Jul 22	End Aug 22	End Sep 22	End Oct 22	As at 23 Nov 22
Key Policy Interest Rates of the Central Bank							
Standing Deposit Facility Rate	13.50	13.50	14.50	14.50	14.50	14.50	14.50
Standing Lending Facility Rate	14.50	14.50	15.50	15.50	15.50	15.50	15.50
Average Weighted Call Money Rate (AWCMR)	14.50	14.50	15.50	15.50	15.50	15.50	15.50(a)
Treasury bill yields (Primary market)							
91-day	23.65	23.85	28.86	32.89	31.94	33.05	32.92
182-day	24.22	24.40	29.24	31.28	30.59	32.53	32.45
364-day	24.30	23.84	29.53	30.50	29.85	29.60	29.52
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	22.11	22.62	24.94	25.76	25.95	27.46	28.61(b)
Average Weighted Lending Rate (AWLR)	13.46	15.06	15.94	16.86	17.58	-	-
Average Weighted New Lending Rate (AWNLR)	20.00	21.50	22.42	24.18	24.93	-	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	6.99	8.41	9.56	10.49	11.63	12.60	-
Average Weighted Fixed Deposit Rate (AWFDR)	8.97	11.06	12.60	13.90	15.41	16.66	-
Average Weighted New Deposit Rate (AWNDR)	16.98	17.15	19.11	21.29	22.06	-	-
Average Weighted New Fixed Deposit Rate (AWNFR)	17.19	17.45	19.42	21.62	22.55	-	-

(a) As of 21 November 2022

(b) For the week ending 18 November 2022

Source: Central Bank of Sri Lanka