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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: No. 01 - January 2023

The Central Bank of Sri Lanka maintains policy interest rates at their current levels

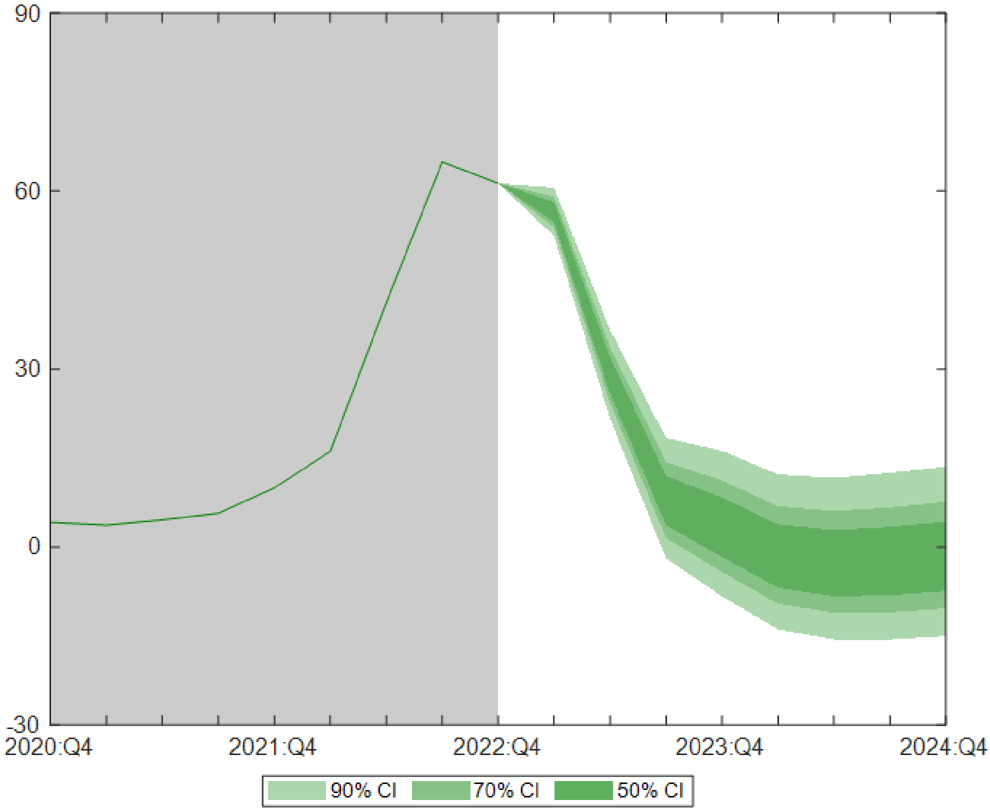
The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 24 January 2023, decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at their current levels of 14.50 per cent and 15.50 per cent, respectively. The Board, having noted the recent and expected developments and projections on the domestic and global macroeconomic fronts, was of the view that the maintenance of the prevailing tight monetary policy stance is imperative to ensure that monetary conditions remain sufficiently tight to rein in inflationary pressures. Such tight monetary conditions, together with the tight fiscal policy, are expected to adjust inflation expectations downward, enabling the Central Bank to bring inflation rates towards the desired levels by end 2023, thereby restoring economic and price stability over the medium term.

Inflation continued to decline as envisaged in recent months and is projected to follow a faster disinflation path

Year-on-year headline and core inflation, based on both the Colombo Consumer Price Index (CCPI) and the National Consumer Price Index (NCPI), continued to decelerate in December 2022 for the third consecutive month, as expected. The downward adjustment in inflation rates is expected to continue through 2023, supported by subdued aggregate demand resulting from tight monetary and fiscal policies, expected improvements in domestic supply conditions, and the passthrough of easing global commodity prices to domestic prices, along with the favourable statistical base effect.

Headline Inflation Projections

CCPI (2013=100, quarterly average, y-o-y, %)



Source: *Central Bank Staff Projections*

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, assumptions and judgements made at the January 2023 forecast round. They are conditional on current 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 resulting macroeconomic responses, and the achievement of medium-term fiscal targets. Any notable change in these assumptions could lead to the realised inflation path deviating from the above.

Given the prevailing domestic and global economic uncertainties and geopolitical tensions, the risks associated with the current projections are much higher than in normal times. In particular, upside risks to inflation projections could arise due to possible upward adjustments in energy prices, any second round effects of electricity tariff hikes; delays in passing downward adjustments of global energy and food prices to domestic consumers; any deviation of the expected fiscal consolidation path, and possible supply disruptions due to dampened economic activity, etc. However, the reduced purchasing power of the public; adoption of further remedial measures to contain supply disruptions driven inflationary pressures; and any possible quicker than anticipated easing of world commodity prices could soften inflationary pressures, exerting downside risks to inflation projections.

The Central Bank remains committed to communicating any changes to the inflation outlook to the public on a regular basis, enabling the public to make informed decisions.

Domestic economic activity is expected to recover towards the latter part of 2023, compared to the large contraction in 2022

As per the GDP estimates published by the Department of Census and Statistics (DCS), the real economy is estimated to have contracted by 7.1 per cent in the nine months ending September 2022, on a year-on-year basis. With tighter monetary and fiscal policies in place, along with disruptions to domestic supply conditions, real activity in the final quarter of 2022 is also expected to have remained subdued. The economy is expected to make a gradual recovery during the year supported by the expected improvements in domestic supply conditions, underpinned by the timely implementation of corrective policy measures. Meanwhile, the anticipated improvements in foreign exchange flows and the resultant enhancement in business and investor sentiment are expected to reinforce the expected recovery in the period ahead.

Excessive market interest rates have begun to adjust downward and are expected to ease further in the period ahead

Early signs of a gradual easing of excessive market interest rates have been observed recently in response to the administrative measures adopted by the Central Bank, along with the improvements in domestic money market liquidity and overall sentiments in the domestic markets. Recent measures adopted by the Central Bank to reduce the overreliance of licensed commercial banks on the standing facilities of the Central Bank and the concurrent conduct of open market operations helped improve liquidity in the domestic money market. This prompted activity in the interbank money market. Improved liquidity conditions, along with improved investor sentiment on the anticipation of "financing assurances" from official creditors, led to a notable moderation in the yields on government securities recently, reflecting the easing of the high risk premia attached to government securities. Meanwhile, the market deposit rates have also shown a notable moderation, benefiting from improved liquidity conditions. These developments are expected to pave the way for an easing of excessive market interest rates in the period ahead. Nevertheless, outstanding credit extended to the private sector by commercial banks continued to contract in response to the tight monetary conditions and the moderation in economic activity. Monetary expansion also moderated from peak levels, albeit at a slower pace.

The external sector remains resilient despite heightened challenges, and the outlook remains positive with the expected improvements in relation to "financing assurances" from creditors

The merchandise trade deficit is estimated to have contracted significantly in 2022, compared to recent years, owing to an improvement in export earnings and a substantial compression of import expenditure on account of policy measures taken to curtail non urgent imports and foreign exchange liquidity constraints. The gradual improvement in workers' remittances, together with the revitalisation of tourism, helped improve the external current account balance in recent months while easing excessive pressures in the domestic foreign exchange market. As a result, the exchange rate has remained relatively stable, and recorded a marginal appreciation against the US dollar, thus far in 2023. Gross official reserves were estimated at US dollars 1.9 billion as of end 2022, including the swap facility from the People's Bank of China, equivalent to around US dollars 1.4 billion. The envisaged finalisation of the IMF-EFF arrangement in the period ahead and the resultant developments that follow, along with the improvements in the external current account, are expected to enhance the external sector outlook.

Policy interest rates are maintained at current levels

In consideration of the current and expected developments, both domestic and global, as indicated above, the Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 24 January 2023, 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 current monetary policy stance is appropriate to ensure that underlying monetary conditions in the economy remain sufficiently contained to drive inflation along the envisaged disinflation path. While some downward adjustment in market interest rates has been observed lately, the Monetary Board is of the view that there is sufficient space for excessive market interest rates, including lending interest rates to Small and Medium Sized Enterprises (SMEs), to adjust downwards considering the recent improvements in domestic money market conditions and sentiments along with the moderation in the yields on government securities.

However, the Board was also of the view that the anticipated further decline in the yields on government securities due to the narrowing of risk premia is unlikely to result in a significant improvement in underlying monetary conditions. The Central Bank will continue to closely monitor monetary conditions in the period ahead and will remain prepared to take swift and proactive measures, as appropriate.

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 25 January 2023 at 1.30 pm 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 the monetary policy review will be on 02 March 2023.

Annexure I

Table 01: Real GDP Growth (Provisional)

Economic Activities	Year-on-Year % Change (a)								
	2021					2022			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual	First Quarter	Second Quarter	Third Quarter	First Nine Months
Agriculture	6.4	11.2	-2.8	-3.1	**2.5**	-6.8	-8.4	-8.7	**-8.0**
Industries	6.0	21.6	-2.0	1.4	**5.6**	-4.7	-10.0	-21.2	**-11.9**
Services	3.5	8.3	-1.7	4.3	**3.3**	0.7	-2.2	-2.6	**-1.3**
GDP	**4.0**	**16.3**	**-5.8**	**2.0**	**3.3**	**-1.6**	**-8.4**	**-11.8**	**-7.1**

(a) Based on rebased GDP estimates (base year 2015)

Source: Department of Census and Statistics

Table 02: Inflation

Month		May 22	Jun 22	Jul 22	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22
Headline Inflation (Year-on-Year % change)	CCPI (2013=100)	39.1	54.6	60.8	64.3	69.8	66.0	61.0	57.2
	NCPI (2013=100)	45.3	58.9	66.7	70.2	73.7	70.6	65.0	59.2
Core Inflation (Year-on-Year % change)	CCPI (2013=100)	28.4	39.9	44.3	46.6	50.2	49.7	49.4	47.7
	NCPI (2013=100)	37.7	49.3	57.3	60.5	64.1	62.4	60.1	57.5

Source: Department of Census and Statistics

Table 03: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion)								
	Mar 22 (a)	Apr 22 (a)	May 22 (a)	Jun 22	Jul 22	Aug 22	Sep 22	Oct 22	Nov 22
Reserve Money	1,387	1,482	1,415	1,453	1,436	1,386	1,379	1,342	1,318
Broad Money (M_{2b})	11,576	11,941	11,897	11,901	11,955	11,987	12,051	12,046	12,163
Net Foreign Assets (NFA)	(1,889)	(2,195)	(2,083)	(2,122)	(2,124)	(2,035)	(1,893)	(1,873)	(1,870)
Net Domestic Assets (NDA)	13,464	14,136	13,980	14,023	14,079	14,022	13,944	13,919	14,033
Net Credit to the Government (NCG)	6,556	6,569	6,523	6,697	6,826	6,990	7,043	7,178	7,293
Credit to Public Corporations / SOBEs	1,548	1,725	1,750	1,729	1,754	1,700	1,703	1,778	1,760
Credit to the Private Sector	7,534	7,753	7,755	7,714	7,673	7,614	7,577	7,530	7,499
Broad Money (M_4)	13,992	14,356	14,340	14,335	14,410	14,451	14,540	14,547	14,676

(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 04: Interest Rates

Interest Rate (%)	End Jul 22	End Aug 22	End Sep 22	End Oct 22	End Nov 22	End Dec 22	As at 24 Jan 23
Key Policy Interest Rates of the Central Bank							
Standing Deposit Facility Rate	14.50	14.50	14.50	14.50	14.50	14.50	14.50
Standing Lending Facility Rate	15.50	15.50	15.50	15.50	15.50	15.50	15.50
Average Weighted Call Money Rate (AWCMR)	15.50	15.50	15.50	15.50	15.50	15.50	15.36
Treasury bill yields (Primary market)							
91-day	28.86	32.89	31.94	33.05	32.91	32.64	30.08 (a)
182-day	29.24	31.28	30.59	32.53	32.27	32.20	29.07 (a)
364-day	29.53	30.50	29.85	29.60	29.46	29.27	28.25 (a)
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	24.94	25.76	25.95	27.46	27.89	27.24	27.54 (b)
Average Weighted Lending Rate (AWLR)	15.94	16.86	17.58	17.94	18.42	-	-
Average Weighted New Lending Rate (AWNLR)	22.42	24.18	24.93	25.83	26.04	-	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	9.56	10.49	11.63	12.60	13.37	14.06	-
Average Weighted Fixed Deposit Rate (AWFDR)	12.60	13.90	15.41	16.66	17.59	18.49	-
Average Weighted New Deposit Rate (AWNDR)	19.11	21.29	22.06	23.22	23.63	-	-
Average Weighted New Fixed Deposit Rate (AWNFDR)	19.42	21.62	22.55	23.61	24.05	-	-

(a) Rate at the auction held on 18 January 2023

(b) For the week ending 20 January 2023

Source: Central Bank of Sri Lanka