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MONETARY POLICY, INTEREST RATES, MONEY AND CREDIT

7.1 Overview

The Central Bank reversed its accommodative monetary policy stance in 2021 to contain the build-up of inflationary pressures and address the imbalances on the external front. The monetary policy support extended by the Central Bank during the pandemic, continued into most of 2021 causing market interest rates to decline to historically low levels, while facilitating the funding needs of the Government and the private sector to support the economy in its phase of recovery. Accordingly, credit to both the public and private sectors expanded considerably underpinned by the abundance of low cost funds, thereby causing the expansion of broad money supply. With the aim of preempting any build-up of excessive inflationary pressures over the medium term and addressing imbalances in the external sector and financial markets, the Central Bank decided to increase policy interest rates and the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of Licensed Commercial Banks (LCBs) in August 2021. Along with monetary tightening, foreign loan repayments of the Government using gross official reserves, and increased currency in circulation caused a reduction in liquidity in the domestic money market. Triggered by such tight policy measures, short term market interest rates adjusted upwards followed by a gradual increase in other market interest rates, including yields on government securities that were also allowed to increase supported by the removal of maximum yield rates for acceptance on government securities auctions in the primary market. With challenges emanating from the external sector and inflation fronts, particularly considering the breach of the achievement of 12 consecutive years of single digit inflation, measures were taken to further tighten the monetary policy stance during the first quarter of 2022 to contain underlying demand pressures in the economy and anchor inflation expectations. The restrictive policy measures included the raising of policy interest rates, easing of caps on domestic lending rates, removal of caps on foreign currency deposit rates and raising of rates relevant to concessional mortgage-backed housing loans. Following the sharp depreciation of the rupee and the sustained rise in global commodity prices, sharp upward adjustments to domestic prices were observed posing substantial upside risks to inflation. In response, the Central Bank significantly tightened its stance on monetary policy in April 2022 by raising its policy interest rates by 700 basis points, the highest single-day adjustment in recent history, while removing almost all caps imposed on lending products. Such policy response, along with the expected suppression of import demand following the rupee depreciation and the anticipated improvements in supply conditions of key commodities globally, is expected to arrest the build-up of underlying demand pressures in the economy, thereby restoring price and economic stability over the medium term.

7.2 Monetary Policy Stance

The Central Bank, which continued to provide unprecedented monetary stimulus since the onset of the pandemic to support economic activity and the government cashflow, commenced tightening its monetary policy stance since August 2021 with the aim of preempting the build-up of excessive inflationary pressures beyond desired levels in the economy and addressing imbalances in the external sector and financial markets. The continuation of the extraordinary monetary policy accommodation during the first half of 2021 was required to contain the impact of the multiple waves of the COVID-19 pandemic since early 2020, which severely disrupted economic activity. The ultra accommodative monetary policy stance of the Central Bank and the large infusion of liquidity to the domestic money market brought most market interest rates to their historic lows during 2021, thereby reducing the cost of funds for both private and public sectors. Accordingly, credit to the private sector remained robust supporting the recovery of economic activity. Credit to the public sector, particularly net credit to the Government from the banking system, including the monetary financing from the Central Bank, expanded substantially during the year. The Central Bank provided financial support to the Government by way of purchasing a significant amount of Treasury bills from the primary market, as well as direct allocations of Treasury bills to the Central Bank to meet the emergency funding needs of the Government amidst disruptions to its cashflows due to lower than expected revenue mobilisation and high expenditure. The resultant expansion in domestic credit caused broad money aggregates to remain elevated, although its expansion was moderated by the notable decline in net foreign assets (NFA) of the banking

Table 7.1
Recent Monetary Policy Measures

Date	Measure
22 Feb 2019	SRR reduced by 1.00 percentage point to 5.00% to be effective from the reserve period commencing 01 Mar 2019
31 May 2019	SDFR and SLFR reduced by 50 basis points to 7.50% and 8.50%, respectively
23 Aug 2019	SDFR and SLFR reduced by 50 basis points to 7.00% and 8.00%, respectively
30 Jan 2020	SDFR and SLFR reduced by 50 basis points to 6.50% and 7.50%, respectively
17 Mar 2020	SDFR and SLFR reduced by 25 basis points to 6.25% and 7.25%, respectively
17 Mar 2020	SRR reduced by 1.00 percentage point to 4.00% to be effective from the reserve period commencing 16 Mar 2020
27 Mar 2020	Introduced a concessional loan scheme, the Saubagya COVID-19 Renaissance Facility (Phase I - Refinance Scheme), up to a cumulative value of Rs. 50 billion at an interest rate of 4.00%
03 Apr 2020	SDFR and SLFR reduced by 25 basis points to 6.00% and 7.00%, respectively, to be effective from the close of business on 03 Apr 2020
16 Apr 2020	Bank Rate reduced by 500 basis points to 10.00% and allowed to automatically adjust in line with the SLFR, with a margin of +300 basis points
06 May 2020	SDFR and SLFR reduced by 50 basis points to 5.50% and 6.50%, respectively, to be effective from the close of business on 06 May 2020 and Bank Rate automatically adjusted to 9.50%
16 Jun 2020	SRR reduced by 2.00 percentage points to 2.00% to be effective from the reserve period commencing 16 Jun 2020
16 Jun 2020	Extended the Saubagya COVID-19 Renaissance Facility (Phase II) up to Rs. 150 billion at an interest rate of 4.00%
09 Jul 2020	SDFR and SLFR reduced by 100 basis points to 4.50% and 5.50%, respectively, and Bank Rate automatically adjusted to 8.50%
19 Aug 2021	SDFR and SLFR increased by 50 basis points to 5.00% and 6.00%, respectively, and Bank Rate automatically adjusted to 9.00%
19 Aug 2021	SRR increased by 2.00 percentage points to 4.00% to be effective from the reserve period commencing 01 Sep 2021
20 Jan 2022	SDFR and SLFR increased by 50 basis points to 5.50% and 6.50%, respectively, and Bank Rate automatically adjusted to 9.50%
04 Mar 2022	SDFR and SLFR increased by 100 basis points to 6.50% and 7.50%, respectively, and Bank Rate automatically adjusted to 10.50%
07 Mar 2022	Allowed an adjustment in the exchange rate
08 Apr 2022	SDFR and SLFR increased by 700 basis points to 13.50% and 14.50%, respectively, to be effective from the close of business on 08 Apr 2022 and Bank Rate automatically adjusted to 17.50%

Source: Central Bank of Sri Lanka

Note: The Central Bank imposed/revised caps on interest rates as follows:
- 26.04.2019: Imposed caps on interest rates of deposit products of licensed banks and non-bank financial institutions
- 24.09.2019: Imposed caps on lending rates while withdrawing caps on deposit rates of licensed banks
- 27.04.2020: Imposed caps on interest rates of pawning advances of licensed banks
- 24.08.2020: Revised caps on interest rates (tightened) of selected lending products of licensed banks
- 26.11.2020: Imposed caps on interest rates of mortgage-backed housing loans of licensed banks
- 24.08.2021: Imposed caps on interest rates to be paid in respect of foreign currency deposit products of LCBs and NSB
- 30.12.2021: Revised caps on interest rates (linked to 364-day Treasury bill yield) to be paid in respect of foreign currency deposit products of LCBs and NSB
- 31.12.2021: Revised caps on interest rates (linked to AWPR) of mortgage-backed housing loans of licensed banks
- 04.03.2022: Revised caps on interest rates (relaxed) of selected lending products of licensed banks
- 11.03.2022: Removed caps on interest rates to be paid in respect of foreign currency deposit products of LCBs and NSB
- 08.04.2022: Decided to remove caps on interest rates of selected lending products of licensed banks

Figure 7.1
Monetary Sector Developments

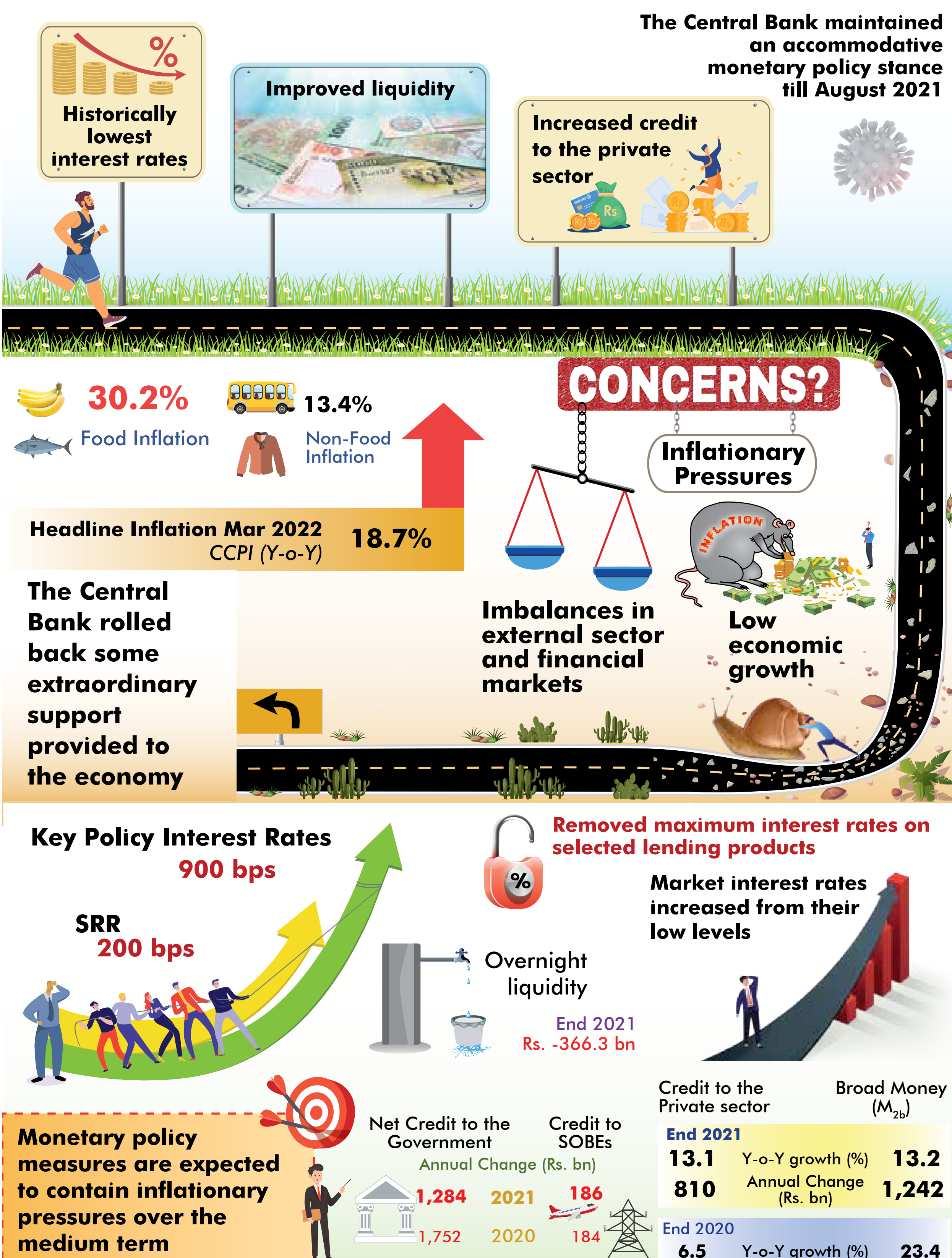

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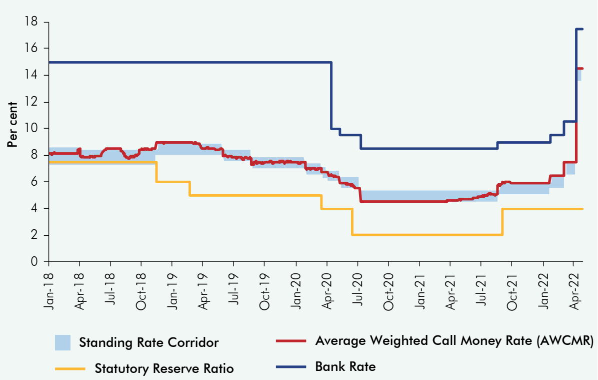
Figure 7.2
Movements in Key Policy Instruments and the Operating Target



Source: Central Bank of Sri Lanka

system during 2021. As some signs of imbalances in the economy were witnessed, particularly the build-up of demand pressures and pressures in the external sector and financial markets, the Central Bank was compelled to commence tightening monetary and liquidity conditions during the second half of 2021 with a view to stabilising the overall macroeconomy. Accordingly, the policy interest rates of the Central Bank, i.e., the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) were raised by 50 basis points each in mid-August 2021 to 5.00 per cent and 6.00 per cent, respectively. The Statutory Reserve Ratio (SRR) was also increased by 2 percentage points to 4.0 per cent effective September 2021 causing an absorption of Rs. 170 billion from the banking system, alongside several other measures. In addition, due to tight liquidity in the domestic foreign exchange market, interest rates offered by some banks for foreign currency deposits increased notably, requiring the Central Bank to impose a ceiling on interest rates offered for foreign currency deposit products of Licensed Commercial Banks (LCBs) and National Savings Bank (NSB) in August 2021 to address the anomalies between interest rates of rupee and foreign currency deposits. Following the tightening of the monetary policy stance, overall liquidity in the domestic money market turned into large deficit levels, resulting in a gradual upward adjustment in the market interest rates structure.

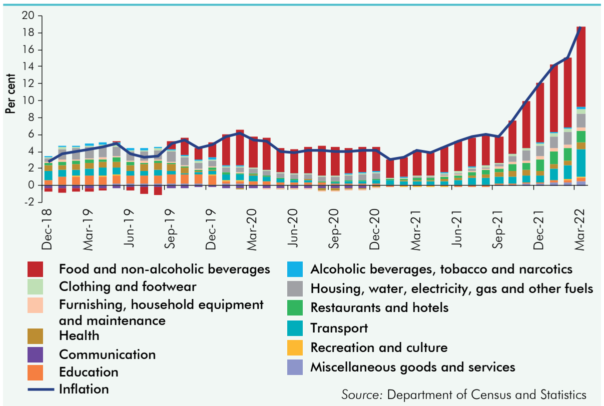
However, with inflation continuing to accelerate beyond desired levels amidst sustained pressures in the external sector along with the accommodative fiscal policy stance, the monetary policy measures adopted in August 2021 turned more hawkish in 2022. Accordingly, policy interest rates were increased by 150 basis points, in aggregate, during the period from January to March 2022, thereby containing the expansion of money and credit, which also fuel demand for imports, while also preventing the possible build-up of adverse inflationary expectations amidst the continued rise in prices generated by unfavourable supply side developments. Reflecting the impact of tightened monetary policy and the revisions to the other regulatory measures, market interest rates commenced adjusting upwards gradually. The maximum interest rate imposed on foreign currency deposits of LCBs and NSB was eased in December 2021 allowing to reflect prevailing market conditions and subsequently removed in March 2022. Further, the interest rate applicable on the special mortgage-backed housing loan scheme for salaried employees introduced in December 2020 was also revised. In addition, caps imposed in August 2020 on interest rates of domestic lending products were revised upwards in March 2022. Although monetary policy was systematically tightened to contain inflationary pressures in the economy, the significant depreciation of the rupee, which along with the sustained rise in global commodity prices, particularly international crude oil prices, led to immediate sharp upward adjustments in domestic prices, thereby posing substantial upside risks to inflation. Having identified the need to counter the effects of such inflationary pressures and pre-empt the escalation of adverse inflationary expectations among other concerns, the Central Bank decided to further tighten its stance on monetary policy in April 2022 by significantly raising its policy interest rates by 700 basis points, the highest single-day adjustment in recent history, along with the decision to remove almost all caps imposed on lending products. Supported by these measures, market interest rates are expected to increase notably thus discouraging excessive consumption and encouraging savings. This would enable the easing of underlying demand pressures in the economy as well as expectations, thereby aiding to retrace inflation back to the desired single digit levels over the medium term, thus ensuring overall macroeconomic stability.

The Central Bank conducted its communication policy in 2021 principally to publicise accurate information on Central Bank actions to shape expectations and the behaviour of economic agents, with a view to supporting economic stability in the near term amidst multiple external challenges to the economy. In this regard, the Central Bank used conventional communication channels as well as social media and digital platforms to disseminate information in an opportune manner. The year began with the unveiling of the *'Road Map: Monetary and Financial Sector Policies for 2021 and Beyond'* in early 2021 that enunciated monetary policy and financial sector policies for the medium term. With the intensification of challenges and mounting uncertainties, the Central Bank presented *'The Six-Month Road Map for Ensuring Macroeconomic and Financial System Stability'* in October 2021 with a view to strengthening the economy and delivering macroeconomic stability by providing an assurance to the market based on a three-pronged framework. The Central Bank continued to communicate the monetary policy stance during the year focusing on guiding the market, which was accompanied with medium term projections as relevant, to anchor stakeholder expectations. Amidst intermittent restrictions on social distancing, the Central Bank continued to conduct online sessions of monetary policy press conferences, while also having regular in-person sessions whenever possible. In addition to live streaming of such occasions via social media, the Central Bank took necessary measures to issue press releases, conduct webinars, seminars and interviews on a frequent basis in three languages emphasising its policies for stability and enhancing awareness of stakeholders. Further, even amidst the challenges posed by the pandemic situation, the regular trilingual publications of the Central Bank, including the Annual Report and the Recent Economic Developments, were released. The Central Bank also kept up with the publication of key macroeconomic statistics on its official website in daily, weekly, monthly and quarterly frequencies.

7.3 Developments in Inflation

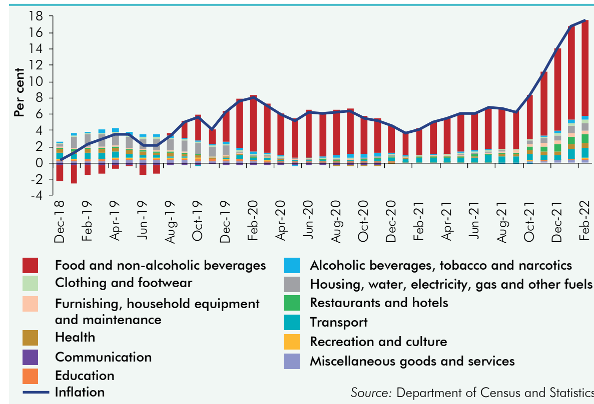
Headline inflation accelerated in 2021 driven mainly by global and domestic supply side disturbances, the surge in global commodity prices, upward revisions to administered prices, while also reflecting gradually firmed up demand pressures amidst increased disposable incomes. Headline inflation, as measured by the year-on-year change in the Colombo Consumer Price Index (CCPI, 2013=100) and the National Consumer Price Index (NCPI, 2013=100), which remained at relatively low levels at the beginning of the year, accelerated thereafter driven by the acceleration of food inflation as well as non-food inflation. The elevated food inflation was mostly due to supply side disruptions owing to pandemic related restrictions and the drop in production of certain food items (rice, vegetables, etc.). Further, extensive rise in global prices of oil, gas and certain other commodities led to several upward revisions in domestic prices of goods and services. With the effects of sudden price adjustments spilling over to

Figure 7.3
Contribution to Year-on-Year Headline Inflation (CCPI)



Source: Department of Census and Statistics

Figure 7.4
Contribution to Year-on-Year Headline Inflation (NCPI)



Source: Department of Census and Statistics

other sectors along with the removal of Maximum Retail Prices as a method of absorbing external price shocks, both food inflation and non-food inflation accelerated notably during the latter part of 2021. Moreover, the rise in non-food inflation was fuelled by the increase in expenditure of categories such as health due to pandemic related high-cost driven factors. Accordingly, following an era of 12 consecutive years of single digit inflation, year-on-year headline inflation based on the CCPI accelerated to 12.1 per cent by end 2021 from 4.2 per cent at end 2020. Annual average inflation also rose to 6.0 per cent in 2021 from 4.6 per cent recorded in 2020. Following a similar trend, year-on-year headline inflation based on the NCPI also accelerated to 14.0 per cent by end 2021 from 4.6 per cent at end 2020. Annual average inflation based on the NCPI was recorded at 7.0 per cent in 2021 compared to 6.2 per cent recorded in the previous year. The acceleration of inflation continued in early 2022 as well with year-on-year headline inflation based on the CCPI recording 18.7 per cent in March 2022, while that of NCPI accelerating to 17.5 per cent in February 2022.

Reflecting the lagged effect of significant monetary accommodation, core inflation, which measures the underlying demand driven component of inflation, also followed an upward trend in the second half of 2021. The year-on-year core inflation which remained at moderate levels at the beginning of 2021 accelerated thereafter. Although volatile food, energy and transport categories are excluded when measuring core inflation, several upward price revisions made to certain other food items such as milk powder, bread

Table 7.2
Movements of Year-on-Year Inflation

Per cent

		Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Mar-22
Headline Inflation	**CCPI (2013=100)**	**4.5**	**7.1**	**2.8**	**4.8**	**4.2**	**12.1**	**18.7**
	Food Inflation	4.1	14.4	-1.5	6.3	9.2	22.1	30.2
	Non Food Inflation	4.5	4.2	4.8	4.3	2.0	7.5	13.4
	NCPI (2013=100)	**4.2**	**7.3**	**0.4**	**6.2**	**4.6**	**14.0**	**17.5 (a)**
	Food Inflation	2.3	12.8	-4.5	8.6	7.5	21.5	24.7 (a)
	Non Food Inflation	5.8	2.9	4.7	4.2	2.2	7.6	11.0 (a)
Core Inflation	**CCPI (2013=100)**	**5.8**	**4.3**	**3.1**	**4.8**	**3.5**	**8.3**	**13.0**
	NCPI (2013=100)	**6.7**	**2.7**	**3.1**	**5.2**	**4.7**	**10.8**	**14.1 (a)**

(a) As at end February 2022

Source: Department of Census and Statistics

BOX 8

A Review of Recent Global Inflation Episodes

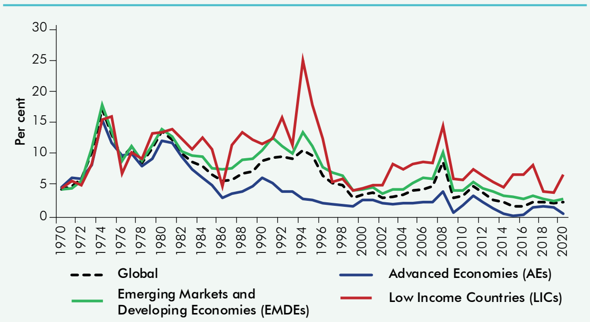
Introduction

Central banks are concerned about maintaining low and stable inflation, i.e., price stability, which is their prime objective. By design, monetary policy is biased towards acting to arrest excessive inflation and hence protecting the purchasing power of the public, particularly the poor, as inflation disproportionately harms low income and fixed income earners. With concerted policy efforts and continuous improvements to monetary policymaking, including the adoption of an inflation targeting framework, global inflation witnessed a clear downward trend in the last several decades. However, frequent high inflation episodes were witnessed globally as well as domestically due to several reasons. Having a comprehensive analysis of such recent events is vital for appropriate policy responses, which would be beneficial in encountering such episodes in the future and mitigating adverse implications.

High Inflation Episodes in History

Even though global inflation was on a downward trend in the aftermath of World War II, there have been occasional high inflation episodes in some countries due to the elimination of price controls, supply shortages, pent-up demand, and policy mistakes in some circumstances. Literature provides for different trends and characteristics of the movements in global inflation over time, based on different classes of economies (Figure B 8.1).

Figure B 8.1
Global Inflation (1970 - 2020)



Source: Ha, J. M. et al. (2021)

Note: Global inflation is the median headline consumer inflation of 193 countries; advanced economies cover inflation in 36 countries; emerging markets and developing economies covers inflation in 157 countries of which 27 countries are classified as low income.

Aggravated pressures on the US dollar due to large monetary expansion in the late 1960s as led by gold convertibility began to cause inflationary pressures on the economy and this spread to the rest of the world via the balance of payments deficit of the country. This is referred to as the beginning of "The Great Inflation" and resulted in the collapse of the Bretton Woods Agreement[1] by the early 1970s, along with the suspension of dollar convertibility to gold by the authorities of the United States. However, extended by the oil price surge in 1973 with the formation of an embargo by the Organisation of Arab Petroleum Exporting Countries (OAPEC), global median consumer price inflation peaked in 1974. Advanced economies responded to the price shock by monetary policy tightening and as a result, inflation tended to decline only in mid-1980s as policy transmission was disturbed by another surge in oil prices in the early 1980s, which was caused by the Iranian Revolution and subsequent Iran-Iraq War. Accordingly, median consumer price inflation in advanced economies, which was at double digit levels in 1974 declined to lower single digits by 1986 and assured the central bank credibility even amidst threats of deep recessions. This was reflected in the quadrupled interest rates in the United States within the five years from 1976 to 1981, which in turn resulted in a sharp contraction of the output between early 1981 and 1982. Some advanced economies in Europe also responded to this peak in inflation in a more stringent manner. The success of this containment of inflation during the period known as "The Great Moderation" is greatly attributed to the stabilisation of the macroeconomy through policy measures. It was characteristic for most of the countries who witnessed high inflation to adopt inflation targeting as their policy framework, resulting in global disinflation with lesser volatility. However, emerging markets and developing economies, and low income countries experienced a delayed correction of the high inflation rates which in general started in the mid-1990s. This was mostly due to structural issues in their economies such as the populist political culture, persistent and substantial fiscal and current account deficits, which sometimes existed in parallel to fixed exchange rate regimes, deteriorating terms of trade for commodity exporters, and supply side issues compared to industrial economies. Efforts to contain inflation in these economies also resulted in serious output losses during the period from 1989 to 1994, amidst civil wars, in some cases.

1 In July 1944, delegates from 44 countries met in Bretton Woods, New Hampshire, United States to agree on the Bretton Woods System, where gold was determined as the basis for the United States dollar and other currencies were pegged to the United States dollar value.

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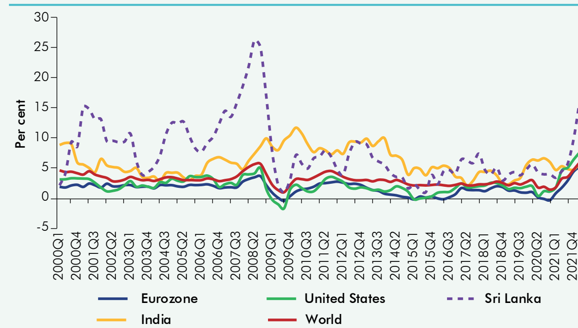
Period	Reasons for High Inflation
1973 - 1982	Two oil price surges; first due to an embargo by the Organisation of Arab Petroleum Exporting Countries (OAPEC), and second due to the decline in oil production caused by the Iranian Revolution and Iran-Iraq War.
2008	Global demand driven factors, including increased food prices and tripled oil prices during the period from 2004 to 2008 which was also contributed by the spillover effects of extra loose monetary policy conditions in the United States.
Current episode (since 2021)	COVID-19 pandemic related disruptions to supply chains, increased energy and commodity prices, increased fertiliser prices, disturbances due to elevated geopolitical tensions and reviving demand conditions due to normalising activity.

The downward trend in global inflation discontinued for a while in the early 2000s until economies were heading towards the Global Financial Crisis, when global energy prices and food prices were soaring. This was particularly due to rapid growth in emerging and developing economies that relied mostly on commodity-intensive economic growth. Strong demand persistently pushed energy prices and food prices upward until they collapsed with the financial crisis. The energy price surge was mostly driven by sluggish supply performances where the production and distribution capacity were slow to build-up as a response to rapidly increasing demand. Food prices also contributed to the prevailing high inflation, alongside demand from emerging and developing economies, and a number of other factors, including unfavourable weather conditions and growing use of export restrictions by food exporters, such as export restraints implemented by major grain exporting countries, including China, Ukraine, and Argentina.

However, in aftermath of the crisis, inflation reached low levels, where the global annual average median inflation reached 2.6 per cent by 2017. Particularly, about half of the advanced economies reported negative inflation rates in 2015, and every three out of four advanced economies reported low single digit inflation (Jongrim Ha et al., 2019). In emerging markets and developing economies, including those that were practicing inflation targeting, disinflation was prominent, and every three out of five economies recorded inflation rates below the target level.

Figure B 8.2
Global Inflation Dynamics since 2000
(Y-o-Y Quarterly Consumer Price Inflation)



Source: Global Projection Model Network
Department of Census and Statistics of Sri Lanka

High Inflation Episode since 2021

The current high inflation episode appears to be far wider and more persistent than previous episodes as it was triggered by several cost driven, and demand driven factors in combination. Supply side disruptions to major commodities, including energy related and agricultural commodities, due to the COVID-19 pandemic, supply chain issues, shortage of labour and increased demand for goods and services arising from normalisation of activity from the pandemic are the key contributors to this episode. Geopolitical tensions over the Russia-Ukraine war since late February 2022 pushed inflation trajectories further up on multiple fronts stemming from uncertainty, and commodity price hikes also contributed to inflation.

Along with these supply related causes of inflation, ample policy stimuli provided by monetary and fiscal authorities across the globe as well as additional policy support from the multilateral organisations to support the economies during the pandemic appears to have fueled inflation further, causing inflation originated from supply factors to persist for longer than initially anticipated. The combined effects of these forces lead to inflation recording several folds higher than the inflation targets and historical averages in many economies, regardless of economic status. Accordingly, in 2021, global inflation reached a near 14-year high. The United States experienced the highest inflation in 40 years with a year-on-year increase in the Consumer Price Index recording 7.9 per cent in February 2022. By February 2022, recording 6.2 per cent and 5.9 per cent increases over the last 12 months, the United Kingdom and New Zealand economies also experienced the highest level of inflation recorded in last three decades. The trend is set to continue as the leading economies, as well as the emerging market economies are expected to experience inflationary pressures in 2022 as well. Inflation in the Eurozone too mounted to a record high of about 5.0 per cent in 2021.

At the outset of the current high inflation episode, it was a widespread belief that these inflationary pressures are temporary, hence the need to respond through monetary policy would not arise as it could hamper growth recovery in the post-pandemic period. However, inflation worldwide is expected to persist for a longer period at a greater magnitude, than previously envisioned by global think tanks, due to ongoing supply chain disruptions and high energy prices. This made policymakers rethink prioritising stability over economic growth, and most central banks from advanced, emerging and developing economies commenced unwinding policy stimuli and started adopting a hawkish stance by tightening policy interest rates sharply and communicating their commitment for further tightening through forward guidance to fight inflation. The resultant tight global financial conditions are anticipated to contain global inflation back to the desired level with a policy lag. In addition to demand side measures, some countries are seeking possibilities of implementing certain supply side measures, such as change in conventional agricultural practices expecting to maintain realistic buffer stocks and revising import policies to avoid price rises of essential commodities.

Policy Responses in General and in Developing Countries

In general, monetary measures have been taken by central banks to address high inflation episodes

Figure B 8.3
Inflation by Country Characteristics

Source: Ha, J. M. et al. (2019)

supported by appropriate fiscal policies by governments. Central banks increase policy interest rates to increase the cost of borrowings and thereby discourage aggregate consumer spending. On the fiscal front, governments reduce inflationary pressures by increasing taxes and reducing government spending to address the demand-pull inflation. Also, price controls and subsidies play a major role in minimising the cost of production in controlling cost push inflation.

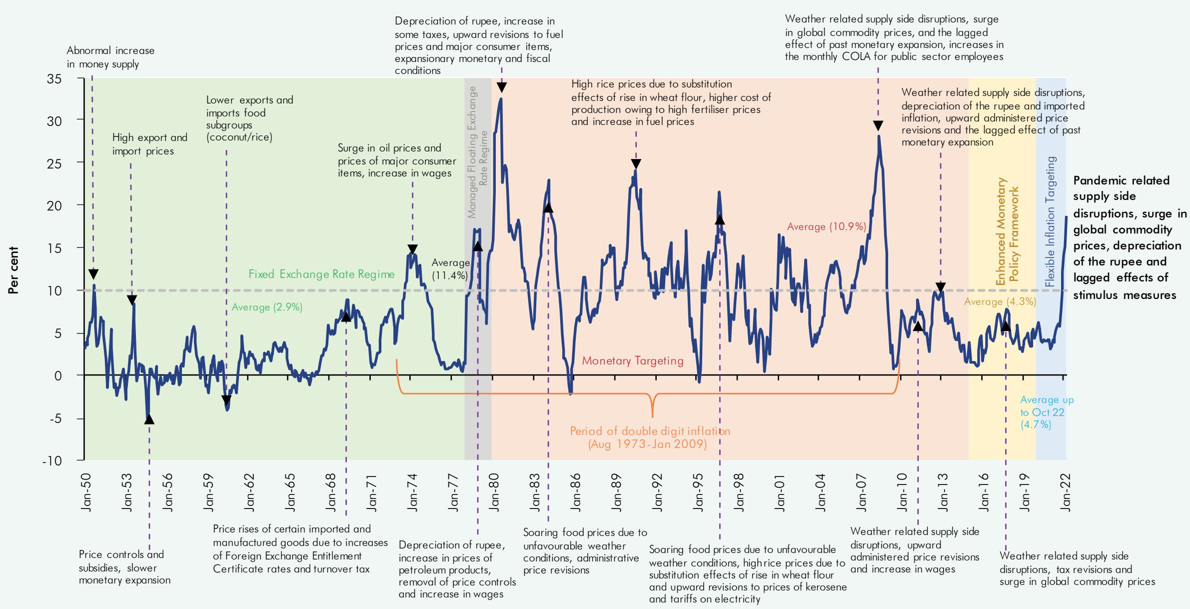
More importantly, transparent and independent central banks have been able to reduce inflation at a faster rate by anchoring inflation expectations through established credibility among economic stakeholders. Numerous assessments on the impact of central bank independence on macroeconomic stability support the assertion of a negative relationship between the central bank independence and inflation (Brumm 2002, 2011; Garriga and Rodriquez 2020; Berger, de Haan, and Eijffinger 2001). Empirically, central bank transparency has also been found to help anchor inflation expectations in advanced economies, thereby stabilising inflation and reducing uncertainty in inflation. (Weber 2016). Overall, appropriate stabilisation policies such as strengthening institutions, greater autonomy in central banking, and establishing an appropriate fiscal environment help decelerate structurally persistent inflation. Moreover, such policy commitments have been instrumental in successfully handling intermittent supply driven inflationary pressures as these pressures are perceived to be transitory by economic agents with well anchored expectations.

When investigating historical inflationary trends, it can be observed that compared to developed and emerging economies, many developing or low income countries have experienced high unvarying inflation over time. Therefore, it is a significant challenge for central banks in these countries to achieve low and stable inflation and to anchor inflation expectations. Although inflation in developing countries is more susceptible to external shocks such as energy prices and food prices, some of the reasons adduced for the sustained and persistent inflation rates in many developing countries are structural, including high budget deficits and financing such deficits by the central bank, high government expenditure, high military expenditure, low productivity, frequent weather shocks, high persistent inflation expectations by the economic agents, excess money supply and unstable exchange rates.

Figure B 8.3 shows the impact of global factors in driving inflation in domestic core inflation, which measures the underlying demand driven component of inflation, across countries.

Tight monetary and fiscal policies and control prices have helped control inflation; the impact of inflationary pressures was reduced via safety net interventions such

Figure B 8.4
Inflation based on the Colombo Consumer Price Index (CCPI) (Y-o-Y Changes)



Sources: Department of Census and Statistics, CBSL Annual Reports as cash transfers and food subsidies, at times to some extent. In many developing economies, active use of countercyclical policies including fiscal rules have aided insulation of economies from the impact of global shocks.

High Inflation Episodes in Sri Lanka

The Sri Lankan economy also has not been an exception to global inflation dynamics, cost push factors and structural limitations in demand management. Sri Lanka, too experienced, high inflation episodes during several periods due to transitory supply side disruptions, especially weather related, and surge in international commodity prices together with the lagged effect of monetary expansion largely to support deficit financing. Nevertheless, Sri Lanka maintained low and stable levels of inflation for over a decade, abetted by continuous improvements to policy formulation and policy communication, while addressing supply concerns temporarily through government intervention by reducing certain taxes on essential commodities, importation of certain commodities, imposing maximum retail prices for certain commodities, even within the limited fiscal space. The Central Bank has deployed monetary policy measures to contain demand driven inflationary pressures. Adopting a flexible inflation targeting (FIT) monetary policy framework aids the Central Bank to conduct monetary policy in an increasingly forward looking manner with the aim of maintaining inflation at low and stable levels in the medium term, thereby supporting to attain sustainable economic growth while ensuring Central Bank transparency and accountability. Since FIT involves the aim of achieving the envisaged inflation targets, which can be closely monitored through inflation forecasts, the monetary policy decision making process is facilitated by a forward looking model based comprehensive analysis on the deviations of the inflation forecasts from the desired targets. Therefore, shocks to such deviations can be addressed through proactive policy measures in a timely manner to bring inflation back to the desired target levels, while properly anchoring inflation expectations.

Similar to many countries across the globe, Sri Lanka is currently experiencing high levels of inflation. In addition to COVID-19 provoked circumstances, the recent acceleration in inflation was driven by supply side factors stemming from international commodity prices, which include fuel and some essential imported commodities. The removal of price controls and their spillover effects and the buildup of demand driven inflationary pressures stemming from pandemic related policy stimulus measures also contributed to inflation. Reflecting growing pressures from underlying demand conditions, core inflation, which does not capture volatile food prices, energy and transport costs, witnessed an increasing trend similar to other countries. Such demand driven pressures are taken care of through proactive policy measures taken by the Central Bank and the policy communication to reiterate commitment to revert inflation to the targeted range at the earliest. As such, the Central Bank increased policy rates in an aggressive manner, while devising preemptive policies to ensure that inflation returns to the targeted level at the fastest possible pace with minimal disruptions to economic recovery. Nonetheless, the government's intervention also remains vital to overwhelm the supply side concerns, while enabling monetary policy driven measures to arrest excessive inflationary pressure in the economy, and hence robust and coordinated policies are required to be adopted in a timely manner. The intervention of the Central Bank is vital to contain inflationary pressures building up from speculation by economic agents, and hence inflation expectations. It is important to have a mechanism established by the government, to detect early and take proactive policy decisions to contain any adverse inflationary developments arising from supply side disturbances. Such a policy mix is crucial for any country that wishes to quickly move back to targets to enjoy the luxury of stable and healthy levels of inflation, thereby ensuring sustainable economic growth which ensures high living standards of the public.

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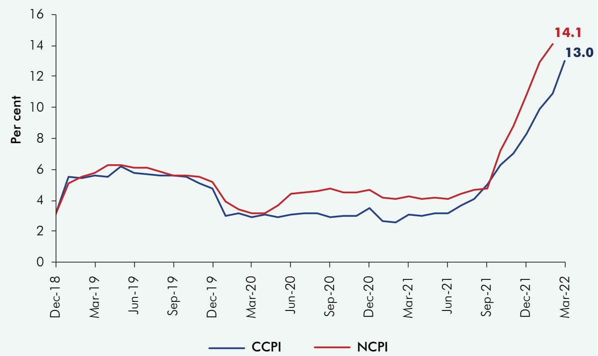
Figure 7.5
Movements in Year-on-Year Core Inflation



Source: Department of Census and Statistics

and bakery products, along with increases in the prices of non-food items such as health, restaurants and hotels, etc. contributed to the acceleration of core inflation in the latter part of 2021. The movements in core inflation were reflecting the gradual build-up of demand pressures underpinned by the significant fiscal and monetary policy stimuli provided during the pandemic. Year-on-year core inflation based on the CCPI accelerated from 3.5 per cent at end 2020 to 8.3 per cent by end 2021 and accelerated further to 13.0 per cent in March 2022, while annual average core inflation was at 4.4 per cent in 2021 compared to 3.1 per cent recorded in 2020. Core inflation based on the NCPI also accelerated from 4.7 per cent at end 2020 to 10.8 per cent, year-on-year, by end 2021 and further to 14.1 per cent in February 2022. The annual average core inflation at 5.5 per cent in 2021 compared to 4.1 per cent recorded in 2020. The actual and anticipated movements in core inflation prompted the Central Bank to take preemptive monetary policy measures to tighten monetary conditions with the view of arresting demand driven inflationary pressures and anchoring inflation expectations.

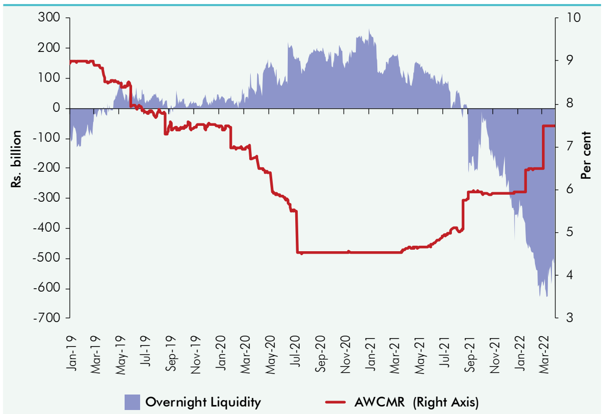
Inflation expectations of both the corporate and household sectors as gauged by the Inflation Expectations Survey of the Central Bank, remained elevated during 2021 induced by the movements in actual inflation. As per the survey findings, both the corporate and household sectors expect inflation to trend upwards in the near term owing to supply side disturbances. Changing global and domestic supply and demand conditions and the pandemic related mobility restrictions, increase in money supply, possible depreciation of the rupee, restrictions on imports, high demand during festive seasons, expansionary fiscal policy stance, possible increase of fuel and gas prices, increase in global commodity prices and imported items, drop in domestic supply especially due to fertiliser restrictions, and the expected recovery in the domestic economy were the most cited reasons by survey respondents for the increase in inflation expectations. In view of the monetary policy actions of the Central Bank and the resultant increase in interest rates, during the latter part of the year, inflation expectations of the corporate sector for the forthcoming period followed a decreasing trend, which also reflects improvements in supply conditions and relaxation of import restrictions as cited by the survey respondents.

7.4 Movements of Interest Rates

Market Liquidity and Short-Term Interest Rates

Rupee liquidity in the domestic money market, which recorded a substantial surplus until mid-2021, decreased significantly reaching a large deficit level by end 2021. Although the purchasing of government securities by the Central Bank at primary market auctions and the direct allocation of Treasury bills to the Central Bank injected a sizeable quantum of rupee liquidity into the domestic money market, several other factors caused a decline in liquidity during 2021. Foreign loan repayments of the Government using gross official reserves, currency withdrawals by

Figure 7.6
Rupee Liquidity in the Domestic Money Market and AWCMR



Source: Central Bank of Sri Lanka

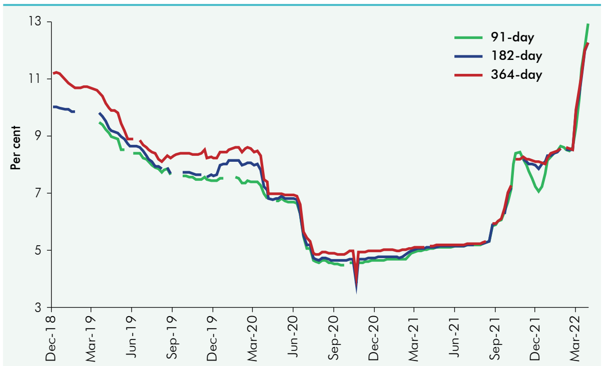
the public from the banking system, and maturities of foreign currency buy-sell swaps with domestic banks led to a continued reduction in liquidity in the domestic money market, causing a marginal deficit level by mid-August 2021. Liquidity in the domestic money market further decreased with the permanent liquidity absorption due to the increase in SRR applicable on all rupee deposit liabilities of LCBs by 2 percentage points to 4.0 per cent in September 2021. At the same time, following the tightening of the monetary policy stance by mid-August 2021, the Central Bank commenced open market operations to absorb excess liquidity from the market, with the view to steering the short term market interest rates. Meanwhile, the Central Bank conducted long-term reverse repo auctions, as needed, to inject liquidity on a longer term basis to ease the liquidity stress in some banks. Intervention in the domestic foreign exchange market by the Central Bank to provide foreign exchange to facilitate uninterrupted import of essentials also caused a reduction in market liquidity. Given these developments, daily average liquidity in the domestic money market, that recorded a surplus of around Rs. 137 billion during the first half of 2021, declined to a deficit of around Rs. 205 billion during the fourth quarter of 2021. By end-March 2022, the deficit in overnight liquidity in the domestic money market further increased and reached high levels exceeding Rs. 600 billion.

Reflecting the impact of the change in the monetary policy stance in mid-August 2021 and large deficit liquidity levels, the Average Weighted Call Money Rate (AWCMR), which is the operating target of the monetary policy framework, reached the upper bound of the Standing Rate Corridor. The AWCMR, which remained closer to the lower bound of the Standing Rate Corridor at the beginning of 2021, increased gradually towards the middle of the Standing Rate Corridor with the gradual reduction in liquidity in the domestic money market from the second quarter of 2021. Further, with the tightening of the monetary policy stance commencing August 2021, the AWCMR was allowed to adjust towards the upper bound of the Standing Rate Corridor. Accordingly, the AWCMR increased by around 240 basis points since August 2021 and reached 7.49 per cent by end-March 2022, in comparison to the cumulative policy rate adjustment of 200 basis points since August 2021. Meanwhile, weighted average rates on transactions in the repo market also closely followed the movements of the AWCMR, recording 7.50 per cent by end-March 2022.

Yields on Government Securities

Yields on government securities, which declined notably during 2020, recorded a significant increase during 2021 in view of the increased borrowing requirement of the Government, amidst the change in the monetary policy stance and the removal of maximum yield rates for acceptance at primary auctions of government securities. Limited foreign currency inflows to the Government to meet financing requirements and resultant

Figure 7.7
Primary Market Treasury Bill Yields (a)

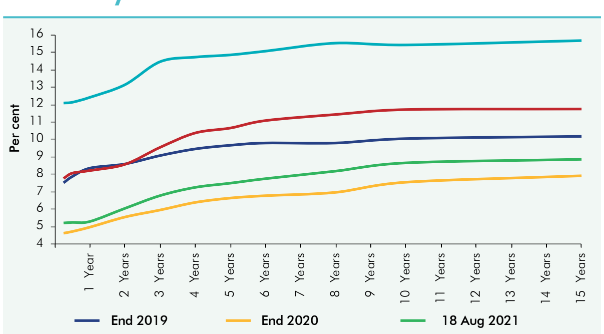


(a) Yields for some weeks are not available due to non-acceptance of bids or not offering relevant tenures

Source: Central Bank of Sri Lanka

higher reliance of the Government to borrow from domestic sources caused upward pressures on the yields on government securities throughout 2021. However, the prevalence of maximum yield rates for acceptance at primary auctions of government securities helped contain the increase in yields on government securities. Nevertheless, subsequent to the increase in policy rates in mid-August 2021, and the removal of maximum yield rates for acceptance at primary auctions of government securities in mid-September 2021, a notable increase in the yields on government securities was observed. A further notable increase in yields was observed in early 2022, reflecting the deteriorating investor sentiment on account of fiscal sector difficulties amidst the large borrowing requirement of the Government and its impact on overall economic activity, and policy rate increases undertaken in the first quarter of 2022.

Figure 7.8
Secondary Market Yield Curve for Government Securities



Source: Central Bank of Sri Lanka

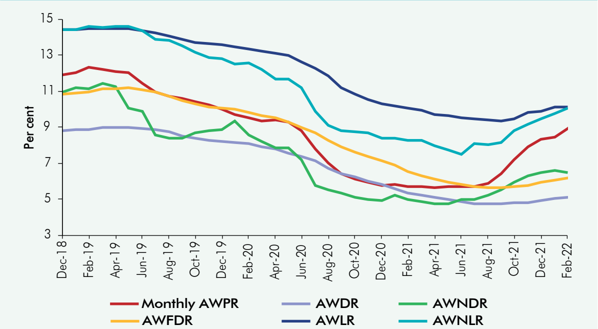
Accordingly, the primary market yields on Treasury bills increased by a range of 723-823 basis points across all tenures during the period from end 2020 till end-March 2022. With the removal of maximum yield rates for acceptance at primary auctions of government securities, market appetite increased, and larger shares of Treasury bill issuances were subscribed by market participants. However, the majority of the Treasury bills that were subscribed by the market during 2021, especially during the latter part of the year, were from the maturity bucket of 91 days, highlighting the preference of investors towards short term investments amidst perceived uncertainty. Primary market yields on Treasury bonds issued from the beginning of 2021 till end-March 2022 also increased by a range of 223-876 basis points across all tenures. Secondary market yields on government securities also recorded substantial increases across all maturities during the same period. Accordingly, during the period from end 2020 to end March 2022, secondary market yields on Treasury bills increased by a range of 740-746 basis points across all tenures, while the increase in the secondary market yields on Treasury bonds was in the range of 758-855 basis points. Meanwhile, the Government raised funds through US dollar denominated Sri Lanka Development Bonds (SLDBs) at various fixed rates in the range of 5.00-10.00 per cent during 2021 and 2022 till end-March 2022.

Deposit and Lending Interest Rates

Deposit interest rates of LCBs, which declined notably until August 2021 in response to policy and regulatory measures taken by the Central Bank to ease monetary conditions, increased at a relatively slow pace following the tightening of monetary policy in August 2021. The Average Weighted Deposit Rate (AWDR)[1] and the

1 AWDR reflects the movements in interest rates pertaining to all outstanding interest bearing rupee deposits held with LCBs.

Figure 7.9
Movement of Selected Market Interest Rates

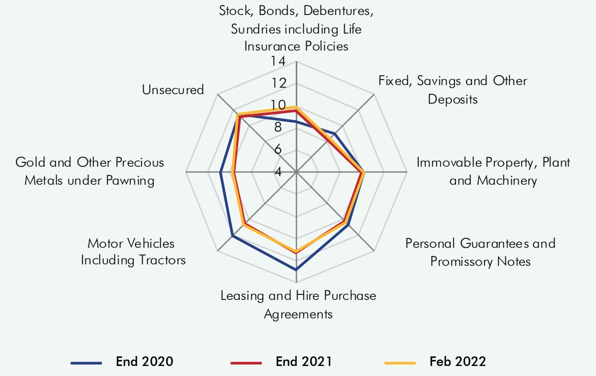


Source: Central Bank of Sri Lanka

Average Weighted Fixed Deposit Rate (AWFDR)[2] recorded their historically lowest levels of 4.75 per cent and 5.62 per cent, respectively, by end August 2021. Further, the Average Weighted New Deposit Rate (AWNDR)[3] and the Average Weighted New Fixed Deposit Rate (AWNFDR)[4] also recorded their lowest levels of 4.77 per cent in April 2021 and 4.90 per cent in May 2021, respectively. Accordingly, the average deposit interest rates had decreased by 345-443 basis points from 2019 onwards to reach these lowest rates. However, following the tightening of monetary conditions, all deposit rates commenced increasing with AWDR increasing by 32 basis points from August 2021 through end February 2022, while AWNDR also increased by 131 basis points during this period. It was observed that the pace of increase in deposit interest rates was slow compared to the increase in market lending rates. Furthermore, some deposit products of the banking sector recorded negative real interest rates during the latter part of 2021 as the upward adjustment in market deposit rates was overshadowed by the increase in the rate of inflation.

Market lending interest rates, which were on a downward trend due to accommodative monetary conditions, increased rapidly towards the latter part of the year following the tightening of monetary policy. Most market lending rates reached their historically lowest levels in 2021, where the monthly Average Weighted Prime Lending Rate (AWPR),[5] the Average Weighted Lending Rate (AWLR)[6] and the Average Weighted New Lending Rate (AWNLR)[7] recorded historic lowest values of 5.65 per cent in April 2021, 9.37 per cent in September 2021 and 7.47 per cent in June 2021, respectively, recording a reduction by a range of 422-533 basis points compared to end 2019. Subsequently, with the tightening of monetary conditions in August 2021, AWPR, AWLR and AWNLR increased by 310, 75 and 203 basis points, respectively, by end February 2022. According to type of securities, as recorded in AWLR by end February 2022, lending rates against documentary bills (excluding export bills purchased) indicated the highest interest rate compared to other categories, while lending rates against fixed, savings and other deposits and certificates of deposits recorded the lowest rate. By end

Figure 7.10
Average Weighted Lending Rates by Type of Securities (%)



Source: Central Bank of Sri Lanka

2 AWFDR is based on interest rates pertaining to all outstanding interest bearing rupee time deposits held with LCBs.

3 AWNDR is based on interest rates pertaining to all new interest bearing rupee deposits mobilised by LCBs during a particular month.

4 AWNFDR is based on interest rates pertaining to all new interest bearing rupee time deposits mobilised by LCBs during a particular month.

5 AWPR is based on interest rates applicable to short term rupee loans and advances granted by LCBs to their prime customers during a particular week.

6 AWLR is based on interest rates of all outstanding rupee loans and advances extended by LCBs.

7 AWNLR captures interest rates of all new rupee loans and advances extended by LCBs during a particular month.

Table 7.3
Movements of Interest Rates

Per cent per annum

Interest Rate	End 2020	End 2021	Change in bps
Key Policy Interest Rates			
Standing Deposit Facility Rate (SDFR)	4.50	5.00	50
Standing Lending Facility Rate (SLFR)	5.50	6.00	50
Average Weighted Call Money Rate (AWCMR)	4.55	5.95	140
Yield Rates on Government Securities			
Primary Market (a)			
Treasury bills			
91-day	4.69	8.16	347
182-day	4.80	8.33	353
364-day	5.05	8.24	319
Treasury bonds			
2-year	5.65 (b)	9.16 (c)	351
3-year	5.99 (b)	9.70 (c)	371
4-year	6.32 (b)	8.55 (c)	223
5-year	6.79 (b)	11.14 (c)	435
10-year	9.99 (b)	8.86 (c)	-113
Secondary Market			
Treasury bills			
91-day	4.63	7.77	314
182-day	4.73	8.07	334
364-day	4.98	8.22	324
Treasury bonds			
2-year	5.56	8.58	302
3-year	5.96	9.55	359
4-year	6.40	10.38	398
5-year	6.65	10.66	401
10-year	7.55	11.71	416
Licensed Commercial Banks (d)			
Interest Rates on Deposits			
Savings deposits	0.10-7.00	0.05-6.35	-
1 Year Fixed Deposits (e)	0.25-15.00	0.15-15.00	-
AWDR (f)	5.80	4.94	-86
AWFDR (f)	7.14	5.94	-120
AWNDR (f)	4.93	6.45	152
AWNFDR (f)	5.08	6.67	159
Interest Rates on Lending			
AWPR (Monthly)	5.74	8.33	259
AWLR	10.29	9.87	-42
AWNLR	8.38	9.48	110
Other Financial Institutions (g)			
Interest Rates on Deposits			
National Savings Bank			
Savings Deposits	3.50	3.50	0
1 Year Fixed Deposits	5.25	5.50	25
Licensed Finance Companies (h)			
Savings Deposits	3.40-4.74	3.46-4.75	-
1 Year Fixed Deposits	6.56-7.21	9.02-10.13	-
Interest Rates on Lending			
National Savings Bank	7.00-10.00	7.50-11.50	-
State Mortgage and Investment Bank (i)	8.73-12.50	7.50-12.50	-
Licensed Finance Companies (h)			
Finance Leasing	14.31-28.97	12.77-28.33	-
Hire Purchase	13.71-20.05	11.08-27.00	-
Loans against Real Estate (j)	19.95-22.30	-	-
Loans against Immovable Properties (j)	-	15.77-16.77	-
Corporate Debt Market			
Debentures	9.00-13.25	8.00-12.00	-
Commercial Paper	6.50-15.50	6.00-12.00	-

(a) Weighted average yield rates at the latest available auction.
(b) Last Primary Auction during 2020: 2 yr-28 Sep; 3 yr-11 Dec; 4 yr-12 Nov; 5 yr-11 Dec; 10 yr-13 Jan
(c) Last Primary Auction during 2021: 2 yr-11 Nov; 3 yr-13 Dec; 4 yr- 30 Aug; 5 yr-12 Oct; 10 yr- 29 Jul
(d) Based on the rates quoted by LCBs
(e) Maximum rate is a special rate offered by certain LCBs.
(f) Since July 2018, AWDR and AWFDR were calculated by replacing senior citizens' special deposit rate of 15 per cent with relevant market interest rates to exclude the impact of special rates. Same method was applied to calculate AWNDR and AWNFDR since June 2018.
(g) Based on the rates quoted by other selected Financial Institutions
(h) Interest rate ranges are based on the average maximum and average minimum rates quoted by LFCs which are applicable for deposits mobilised and loans granted during the respective months. Data for 2021 are provisional.
(i) Lending for housing purposes only
(j) "Loans against Real Estate" indicator changed to "Loans against Immovable Properties" from July 2021 onwards

Sources: Respective Financial Institutions
Colombo Stock Exchange
Central Bank of Sri Lanka

February 2022, AWLR across a number of security types remained lower than the rates observed by end 2020 despite the tightening of monetary policy commencing August 2021, highlighting the impact of the outstanding stock of loans and the space available for further upward adjustment of market lending rates, in the period ahead. When loans to small and medium sized enterprises (SMEs) as measured in the monthly SME Credit Survey[8] are considered, average interest rates on loans to the SME sector by licensed banks indicated the trend of overall average lending rates of LCBs, but remained higher. Accordingly, the Average Weighted SME Lending Rate (AWSR)[9] and the Average Weighted New SME Lending Rate (AWNSR)[10] reached 10.49 per cent and 10.04 per cent, respectively, by end 2021. In view of tightened monetary conditions, several maximum interest rates applicable on lending products were also revised upwards. Accordingly, the interest rate applicable on the special mortgage-backed housing loan scheme for salaried employees introduced in December 2020 was changed from the fixed rate of 7 per cent per annum for the first five years of the loan to a variable rate linked to monthly AWPR. Further, given tightened monetary conditions, caps imposed in August 2020 on interest rates of domestic lending products were revised upwards in March 2022, where the maximum interest rate applicable to credit cards was increased to 20 per cent per annum; on pre-arranged temporary overdrafts increased to 18 per cent per annum; and on pawning facilities increased to 12 per cent per annum, which were subsequently removed entirely in April 2022.

8 For the purpose of the monthly SME Credit Survey, banks are requested to consider lending to enterprises with an annual turnover not exceeding Rs. 1 billion and employ less than 300 employees.

9 AWSR is based on interest rates of all outstanding rupee loans and advances extended by licensed banks to the SME sector, excluding refinance schemes of the Government and the Central Bank.

10 AWNSR captures interest rates of all new rupee loans and advances extended by licensed banks during a particular month to the SME sector, excluding refinance schemes of the Government and the Central Bank.

The Legal Rate and the Market Rate of Interest,[11] as determined by the Monetary Board and published in the Government Gazette at the end of each year, were at 7.48 per cent per annum for 2022, compared to 10.12 per cent per annum for 2021. The Legal Rate and the Market Rate for 2022 were computed based on simple averages of monthly AWDR and AWLR of LCBs, which prevailed during the preceding twelve months from November 2020 to October 2021.

Interest Rates on Foreign Currency Deposits

Reflecting the increased competition among banks to mobilise foreign currency deposits amidst constrained liquidity in the domestic foreign exchange market, interest rates on foreign currency deposits recorded a sharp upward trend, which also required imposing certain measures to correct anomalies between foreign exchange and rupee interest rates. With the recovery of the global economy along with the support of vaccination programmes, monetary policy in many countries commenced tightening, mainly as a result of rising inflationary pressures. In view of tightening global interest rates, along with the liquidity conditions prevailing in the domestic foreign exchange market, certain interest rates on domestic foreign currency deposits offered by licensed banks were notably high, thereby creating interest rate anomalies between domestic and foreign currency deposit products. Hence, a maximum interest rate was imposed by the Central Bank on foreign currency deposits interest rates of LCBs and NSB in late August 2021 in order to iron out such interest rate anomalies, and as a result, foreign currency deposit interest rates, eased somewhat. However, with the gradual increase in interest rates on rupee denominated deposit products following the tightening of the monetary policy stance in August 2021, the cap for foreign currency deposit interest rates was also revised to better reflect market conditions and subsequently removed in March 2022. Accordingly, interest rates on US dollar denominated savings deposits were in the range of 0.03-4.60 per cent by end 2021, compared to the range of 0.03-4.00 per cent at end 2020. Interest rates pertaining to savings deposits denominated in pound sterling remained unchanged in the range of 0.03-3.00 per cent by end 2021, compared to end 2020. Meanwhile, interest rates on time deposits denominated in US dollars were in the range of 0.02-7.00 per cent by end 2021, in comparison to the range of 0.10-6.00 per cent recorded at end 2020. Further, interest rates applicable on pound sterling denominated time deposits were in the range of 0.02-5.75 per cent by end 2021, compared to the range of 0.05-4.25 per cent at end 2020.

7.5 Movements in Money and Credit Aggregates

Reserve Money

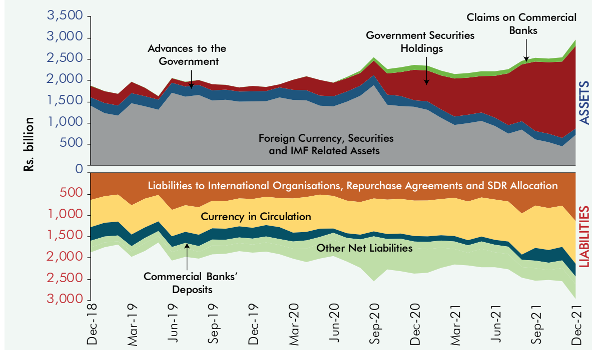
Reserve money, which reflects the monetary base of the economy, recorded a notable growth during 2021 reflecting the increase in currency in circulation and the impact of the increase in the SRR. Reserve money grew by 35.4 per cent, year-on-year, by end 2021, compared to the expansion of 3.4 per cent recorded at end 2020. In absolute terms, reserve money increased by Rs. 341.4 billion during 2021 to Rs. 1,305.8 billion by end 2021, compared to the increase of Rs. 31.8 billion during 2020. Accordingly, currency in circulation remained at elevated levels during the year with high precautionary demand for currency

11 The Legal Rate is defined under the Civil Procedure Code (Amendment) Act No. 6 of 1990, and is applicable to any action for the recovery of a sum of money. The Market Rate is defined under the Debt Recovery (Special Provisions) Act No. 2 of 1990, and applies only in relation to actions instituted by lending institutions for the recovery of debt exceeding Rs. 150,000 arising out of commercial transactions, where there is no agreed rate of interest.

by the public amidst the pandemic and associated lockdowns and also partly reflecting the economic activity returning to normalcy and relatively low interest rates offered for deposits. Accordingly, currency in circulation increased by Rs. 170.3 billion during the year to Rs. 1,005.1 billion by end 2021, over the Rs. 156.8 billion increase during 2020. The large increase in money released to the economy indicates the extra accommodative monetary policy conducted in the eight months ending August 2021. Meanwhile, following the upward adjustment to the SRR by 2 percentage points in September 2021, the deposits of LCBs maintained at the Central Bank also increased notably. Accordingly, by end 2021, deposits of LCBs with the Central Bank recorded a notable expansion of Rs. 171.1 billion to Rs. 300.7 billion.

Based on the assets side of the Central Bank balance sheet, the expansion in reserve money was entirely due to the increase in net domestic assets (NDA) of the Central Bank, while net foreign assets (NFA) of the Central Bank declined notably during 2021. The expansion in NDA of the Central Bank was mainly on account of the increase in the net credit to the government (NCG), which increased by Rs. 1,225.2 billion in 2021 compared to the increase of Rs. 505.9 billion during 2020. This reflects a substantial increase in the Central Bank's holdings of government securities (net of repurchase transactions) due to purchasing of Treasury bills at primary market

Figure 7.11
Composition of the Central Bank Balance Sheet



Source: Central Bank of Sri Lanka

Table 7.4
Developments in Monetary Aggregates

Rs. billion

Item	End 2020	End 2021 (a)	Change 2020 Amount	Change 2020 %	Change 2021 Amount	Change 2021 %
1. Currency Outstanding	834.8	1,005.1	156.8	23.1	170.3	20.4
1.1 Currency held by the Public	641.0	784.4	146.8	29.7	143.4	22.4
1.2 Currency with Commercial Banks	193.8	220.6	10.0	5.5	26.9	13.9
2. Commercial Banks' Deposits with the Central Bank (b)	129.6	300.7	-125.0	-49.1	171.1	132.0
3. Government Agencies' Deposits with the Central Bank (c)	0.03	0.01				
4. Reserve Money (1+2+3)	**964.4**	**1,305.8**	**31.8**	**3.4**	**341.4**	**35.4**
5. Demand Deposits held by the Public with Commercial Banks	536.1	675.4	164.9	44.4	139.3	26.0
6. Narrow Money Supply, M_1 (1.1+5)	**1,177.2**	**1,459.9**	**311.7**	**36.0**	**282.7**	**24.0**
7. Time and Savings Deposits held by the Public with Commercial Banks	7,318.6	8,179.0	1,271.4	21.0	860.4	11.8
8. Broad Money Supply, M_2 (6+7)	**8,495.8**	**9,638.9**	**1,583.1**	**22.9**	**1,143.1**	**13.5**
9. Adjusted Foreign Currency Deposits (d)	909.9	1,008.4	198.5	27.9	98.5	10.8
10. Consolidated Broad Money Supply, M_{2b} (8+9)	**9,405.7**	**10,647.3**	**1,781.6**	**23.4**	**1,241.6**	**13.2**
Money Multiplier, M_{2b}	**9.75**	**8.15**				
Velocity, M_{2b} (e)	**1.77 (f)**	**1.65**				

Source: Central Bank of Sri Lanka

(a) Provisional
(b) Includes both Commercial Banks' Deposits with the Central Bank and balances of Primary Dealers with the Central Bank
(c) Government Agencies' Deposits with the Central Bank amounted to Rs. 30.4 million at end 2020 and Rs. 5.5 million at end 2021
(d) Includes deposits of Resident Category of Offshore Banking Units (OBUs) and a share of foreign currency deposits with Domestic Banking Units (DBUs)
(e) Average for the year
(f) Revised

auctions, and the direct allocation of Treasury bills to the Central Bank. Accordingly, the holdings of government securities by the Central Bank rose substantially by Rs. 1,228.1 billion to Rs. 1,945.4 billion during 2021. Meanwhile, amidst the gradual recovery of economic activity, the Central Bank's claims on LCBs declined with the repayment of concessionary loans that were extended by the Central Bank through LCBs to support pandemic hit businesses and individuals. As a combined result, NDA of the Central Bank increased by Rs. 1,255.4 billion during 2021 compared to the increase of Rs. 401.1 billion in the previous year. Meanwhile, NFA of the Central Bank contracted notably by Rs. 914.0 billion to negative levels during 2021. Foreign currency assets of the Central Bank declined during the year mainly due to the foreign currency debt service payments by the Central Bank on behalf of the Government, including the repayment of the maturing repurchase agreement of US dollars 1.0 billion with the Federal Reserve Bank of New York in two legs in February and March 2021, and the settlement of the International Sovereign Bonds (ISBs) of US dollars 1.0 billion that matured in July 2021, while foreign currency liabilities of the Central Bank increased during this period. In addition, the Central Bank continued to supply foreign currency to the domestic foreign exchange market from its international reserves portfolio in order to facilitate the payments of essential imports.

The money multiplier, which is the ratio between broad money supply (M_{2b}) and reserve money, declined in 2021 as a result of the significant expansion in reserve money, which outweighed the impact of the expansion of broad money supply (M_{2b}). Accordingly, the money multiplier based on broad money (M_{2b}) decreased to 8.15 by end 2021 from 9.75 recorded at end 2020. Meanwhile, the currency to deposits ratio increased to 8.0 per cent by end 2021 from 7.3 per cent recorded at end 2020, while time and savings deposits held by the public increased comparatively at a slower pace over the preceding year.

Broad Money (M_{2b}) and Domestic Credit

In spite of the continued expansion of domestic credit, the growth of broad money supply (M_{2b}) moderated towards the latter part of 2021 due to the contraction in NFA of the banking system. Accordingly, the year-on-year growth of M_{2b} decelerated to 13.2 per cent by end 2021, compared to the growth of 23.4 per cent recorded at end 2020. The overall stock of M_{2b} increased by Rs. 1,241.6 billion to Rs. 10,647.3 billion by end 2021, from Rs. 9,405.7 billion level at end 2020. As the key source of M_{2b}, NDA of the banking system increased by Rs. 2,014.1 billion during 2021 mainly driven by the increase in domestic credit, while NFA of the banking system contracted by Rs. 772.5 billion during the year.

In terms of the liabilities side of M_{2b}, the increase in time and savings deposits held by the public with LCBs largely contributed to the monetary expansion during 2021, although a moderation was observed compared to the previous year. Accounting for about 77 per cent of the expansion of M_{2b} during the year, time and savings deposits of LCBs increased by Rs. 958.8 billion in 2021, compared to the significant increase of Rs. 1,469.9 billion recorded in 2020. The moderation in funds placed in time and savings deposits in 2021 was due to the notable decline in market deposit rates, thereby slowing the year-on-year growth of time and savings deposits of LCBs to 11.7 per cent by end 2021, compared to 21.7 per cent at end 2020. Meanwhile, with the

Table 7.5
Assets Side of Reserve Money and Broad Money (M_{2b})

Rs. billion

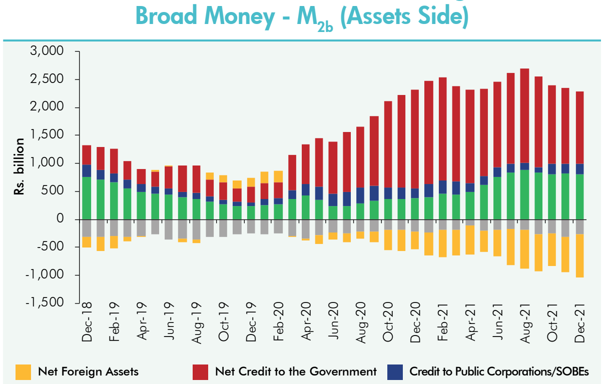
Item	End 2020	End 2021 (a)	Change 2020 Amount	Change 2020 %	Change 2021 Amount	Change 2021 %
Reserve Money	**964.4**	**1,305.8**	**31.8**	**3.4**	**341.4**	**35.4**
Net Foreign Assets of the Central Bank	526.8	-387.3	-369.2	-41.2	-914.0	-173.5
Net Domestic Assets of the Central Bank	437.7	1,693.1	401.1	1,095.6	1,255.4	286.8
Net Credit to the Government	868.9	2,094.1	505.9	139.3	1,225.2	141.0
Claims on Commercial Banks	114.5	143.2	112.7	6,181.0	28.7	25.1
Other Items (net) (b)	-545.7	-544.2	-217.5	-66.2	1.5	0.3
Broad Money (M_{2b})	**9,405.7**	**10,647.3**	**1,781.6**	**23.4**	**1,241.6**	**13.2**
Net Foreign Assets	-209.5	-982.0	-310.2	-308.0	-772.5	-368.8
Monetary Authorities (c)	526.8	-387.3	-369.2	-41.2	-914.0	-173.5
Commercial Banks	-736.2	-594.7	59.0	7.4	141.5	19.2
Net Domestic Assets	9,615.2	11,629.3	2,091.8	27.8	2,014.1	20.9
Domestic Credit	11,721.2	14,002.0	2,310.4	24.6	2,280.8	19.5
Net Credit to the Government	4,548.1	5,832.4	1,752.1	62.7	1,284.4	28.2
Central Bank	868.9	2,094.1	505.9	139.3	1,225.2	141.0
Commercial Banks	3,679.2	3,738.3	1,246.3	51.2	59.2	1.6
Credit to Public Corporations/SOBEs	1,002.2	1,188.1	184.2	22.5	185.9	18.6
Credit to the Private Sector	6,170.9	6,981.4	374.1	6.5	810.5	13.1
Other Items (net) (b)	-2,106.0	-2,372.7	-218.7	-11.6	-266.7	-12.7

(a) Provisional
(b) Computed as the difference between other assets and other liabilities
(c) This includes NFA of the Central Bank as well as the Government's Crown Agent's balance reported by the Department of State Accounts

Source: Central Bank of Sri Lanka

resurgence of pandemic-related uncertainties in 2021, demand deposits and currency held by the public (which reflects narrow money, M_1) expanded by Rs. 282.7 billion during the year, compared to the increase of Rs. 311.7 billion in 2020. Accordingly, the year-on-year growth of M_1 moderated to 24.0 per cent by end 2021, compared to the notable growth of 36.0 per cent at end 2020.

Figure 7.12
Contribution to Year-on-Year Change in Broad Money - M_{2b} (Assets Side)

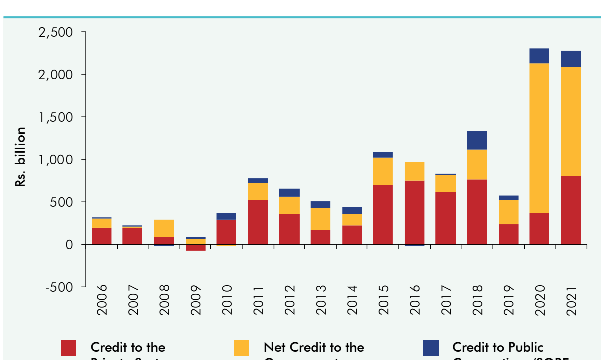


Source: Central Bank of Sri Lanka

Viewed from the assets side of M_{2b}, continuing the trend observed during 2020, NFA of the banking system contracted during 2021 due to the notable decline in NFA of the Central Bank, despite the improvement observed in NFA of LCBs. NFA of LCBs increased by Rs. 141.5 billion during 2021 over the increase of Rs. 59.0 billion recorded in 2020 with the expansion in NFA of both domestic banking units (DBUs) and offshore banking units (OBUs). NFA of DBUs increased by Rs. 45.6 billion, mainly on account of the considerable increase in foreign currency placements with banks abroad despite the increase in foreign currency liabilities in terms of deposit liabilities of non-residents. However, reduced conversion of funds received in the form of workers' remittances to the banking system could have stifled the possible improvement in NFA of DBUs during 2021. In the meantime, NFA of OBUs also increased by Rs. 95.9 billion in 2021 due to increased lending to non-residents, along with the notable decline in foreign borrowings.

NDA of the banking system continued to expand notably during 2021, driven by the increase in credit to both the public and the private sectors. Amidst limited access to foreign financing and the decline in government revenue, the Government's increased funding requirement was met largely through the domestic banking system, mainly the Central Bank. Continuing the trend observed in 2020, NCG by the banking system increased notably by Rs. 1,284.4 billion in 2021, of which around 95 per cent was funded by the Central Bank. Accordingly, NCG from the Central Bank increased by Rs. 1,225.2 billion during 2021. Meanwhile, provisional advances provided to the Government by the Central Bank declined to Rs. 150.1 billion in December 2021 from Rs. 198.2 billion recorded in early 2021 with the repayment of the advances by the Government following the revised budget estimates for 2021. Meanwhile, NCG by LCBs increased by Rs. 59.2 billion in 2021 compared to the notable increase of Rs. 1,246.3 billion in 2020, entirely due to the increase in NCG by DBUs, while NCG by OBUs recorded a contraction during the year. Accordingly, NCG by DBUs increased by Rs. 157.6 billion mainly due to investments in long term government securities as well as the increase in government overdraft balances provided by state banks. NCG by OBUs declined by Rs. 98.5 billion, compared to the increase of Rs. 22.3 billion recorded in the previous year, on account of the decline in direct foreign currency loans to the Government, maturing of ISBs held by LCBs, and reduced appetite towards reinvesting in SLDBs following maturity amidst the limited availability of foreign exchange within the banking system.

Figure 7.13
Annual Increase in Domestic Credit



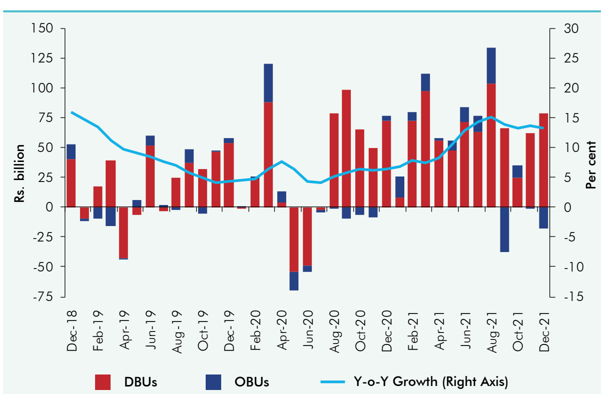
Source: Central Bank of Sri Lanka

Credit obtained by the State Owned Business Enterprises (SOBEs) from the banking system continued to expand in 2021, reflecting their weak financial positions and legacy issues. Accordingly, credit obtained by SOBEs from the banking system increased by Rs. 185.9 billion during 2021 following an increase of Rs. 184.2 billion in 2020. Contributing largely to the expansion of credit obtained by the SOBEs, in cumulative terms, bank borrowing by the Ceylon Petroleum Corporation (CPC) increased by Rs. 123.5 billion in 2021. Meanwhile, bank borrowing by the Road Development Authority (RDA) increased by Rs. 24.5 billion during 2021, while borrowing by the State Pharmaceuticals Corporation (SPC) increased by Rs. 14.6 billion, reflecting the increased financial need to facilitate pandemic related medical expenses. In addition, credit obtained by Ceylon Fertiliser Corporation (CFC), Cooperative Wholesale Establishment (CWE), SriLankan Airlines, National Water Supply & Drainage Board (NWS&DB), and Ceylon Electricity Board (CEB) also increased notably during 2021. Meanwhile, Sri Lanka Ports Authority

(SLPA), Paddy Marketing Board (PMB) and Urban Development Authority (UDA) made repayments to LCBs on a net basis during the year.

Credit extended to the private sector expanded notably during 2021, reflecting improved economic activity, buttressed by the low interest rate environment. Accordingly, credit extended to the private sector by LCBs increased by Rs. 810.5 billion during 2021, compared to the increase of Rs. 374.1 billion during 2020. Supported by accommodative monetary conditions, the growth of credit extended to the private sector by LCBs expanded gradually until August 2021 recording an expansion of about Rs. 624.6 billion during this period. Some moderation in the growth of credit to the private sector has been observed thereafter reflecting the impact of tight monetary and liquidity conditions in the market during the latter part of 2021. Possible loan capitalisation with the extended debt moratoria for COVID-19 affected businesses and individuals as well as priority sector lending targets to licensed banks, which were imposed in April 2021 to enhance credit flows to the SME sector, may have also contributed to the credit expansion during the year. Year-on-year growth of credit extended to the private sector, which grew by 6.5 per cent by end 2020, accelerated to 15.1 per cent by August 2021, before moderating to 13.1 per cent by end 2021.

Figure 7.14
Credit to the Private Sector by Commercial Banks



Source: Central Bank of Sri Lanka

Table 7.6
Sectoral Distribution of Loans and Advances Granted by Commercial Banks (a)(b)

Rs. billion

Sector	End 2020	End 2021 (c)	% Share 2021	% Change 2021
Agriculture and Fishing	489.7	543.6	7.6	11.0
of which, Tea	102.0	101.2	1.4	-0.8
Rubber	30.8	41.4	0.6	34.4
Coconut	27.8	33.7	0.5	21.2
Paddy	38.6	44.4	0.6	15.3
Vegetable and Fruit Cultivation and Minor Food Crops	29.2	30.9	0.4	5.8
Fisheries	20.5	24.0	0.3	17.0
Industry	2,540.1	2,880.5	40.2	13.4
of which, Construction	1,348.6	1,544.7	21.6	14.5
Food and Beverages	148.3	174.7	2.4	17.8
Textiles and Apparel	235.1	273.1	3.8	16.1
Fabricated Metal Products, Machinery and Transport Equipment	132.9	152.8	2.1	14.9
Services	1,716.7	1,976.0	27.6	15.1
of which, Wholesale and Retail Trade	501.8	549.8	7.7	9.6
Tourism	261.7	288.2	4.0	10.1
Financial and Business Services	350.1	437.2	6.1	24.9
Shipping, Aviation and Freight Forwarding	21.6	30.3	0.4	40.1
Personal Loans and Advances (d)	1,632.1	1,762.2	24.6	8.0
of which, Consumer Durables	330.8	375.0	5.2	13.3
Pawning	248.7	294.9	4.1	18.6
Credit Cards	127.8	143.1	2.0	12.0
Total (e)	6,378.6	7,162.3	100.0	12.3

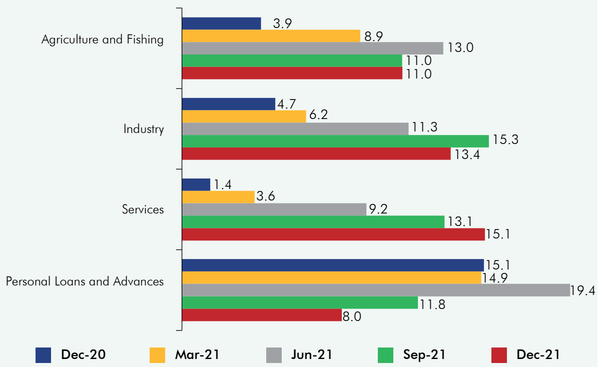
(a) Based on the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector

Source: Central Bank of Sri Lanka

(b) Includes loans, overdrafts and bills discounted and excludes cash items in the process of collection
(c) Provisional
(d) Excludes personal housing loans, which have been included under 'Construction' classified under 'Industry' and includes Safety Net Scheme related loans
(e) Total credit to the private sector as per the Quarterly Survey differ from that in the Monetary Survey due to differences in the compilation methodologies.

As per the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector, growth of credit to major economic sectors gathered pace during 2021 reflecting improved economic activity, although some moderation was observed in the growth of personal loans and advances towards end 2021. Overall, the increase in credit to Industry (by Rs. 340.4 billion) and Services (by Rs. 259.3 billion) sectors contributed around 43 per cent and 33 per cent, respectively, to the overall expansion of credit extended to the private sector by LCBs during 2021, while the increase in credit to Agriculture and Fishing (by Rs. 53.9 billion) and Personal Loans and

Figure 7.15
Year-on-Year Growth of Private Sector Credit to Key Sectors (%)



Source: Central Bank of Sri Lanka

Advances (by Rs. 130.1 billion) contributed around 7 per cent and 17 per cent, respectively. In terms of sectoral performance, credit to the Agriculture and Fishing sector recorded a growth of 11.0 per cent, year-on-year, by end 2021, compared to the moderate growth of 3.9 per cent by end 2020. Within this sector, credit flows to the Paddy, Rubber, Coconut, Vegetable and Fruit Cultivation and Minor Food Crops, and Fisheries subsectors recorded expansions during the year, while credit granted to the Tea subsector contracted marginally during 2021. Meanwhile, witnessing the recovery in most economic activities, the Industry and Services sector activities improved during 2021, recording healthy credit flows to most subsectors. Accordingly, growth of credit to the Industry sector accelerated to 13.4 per cent, year-on-year, by end 2021 from 4.7 per cent at end 2020. Within the Industry sector, credit to the Construction subsector, which accounted for around 54 per cent of the total credit flows to the Industry sector, recorded a notable growth of 14.5 per cent, year-on-year, by end 2021. Credit to other subsectors, namely Textiles and Apparel, and Food and Beverages also grew notably by end 2021. The growth of credit extended to the Services sector accelerated to 15.1 per cent, year-on-year, by end 2021, compared to the growth of 1.4 per cent at end 2020. Within the Services sector, reflecting improved trade related activities, credit to the Wholesale and Retail Trade subsector grew by 9.6 per cent, year-on-year, by end 2021, compared to the marginal contraction reported at end 2020. Reflecting increased credit flows to the tourism sector given the extended debt moratorium facilities and other measures to boost the industry during the pandemic along with its recovery, credit to the Tourism subsector expanded

Table 7.7
Maturity Analysis of Outstanding Credit to the Private Sector by Commercial Banks (a)(b)

Sector	Maturity	December 2020		December 2021 (c)	
		% Share	% Growth	% Share	% Growth
Agriculture and Fishing	Short Term	4.5	-1.7	4.6	14.6
	Medium Term	1.7	-5.3	1.6	9.2
	Long Term	1.5	44.0	1.4	2.4
Industry	Short Term	11.5	-9.2	12.3	19.7
	Medium Term	8.5	0.1	8.4	10.8
	Long Term	19.8	17.4	19.5	10.8
Services	Short Term	8.6	-12.6	9.2	19.9
	Medium Term	9.1	4.3	8.7	8.1
	Long Term	9.2	15.6	9.6	17.5
Personal Loans and Advances	Short Term	9.2	-3.6	9.7	17.3
	Medium Term	5.5	10.4	5.0	1.6
	Long Term	10.8	41.5	10.0	3.2
Total	Short Term	33.9	-7.7	35.7	18.4
	Medium Term	24.8	3.4(d)	23.8	6.0
	Long Term	41.3	23.3	40.5	10.0

(a) Based on the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector
(b) Classification of credit is based on original maturity and is as follows: up to one year - short term; between one to five years - medium term; over five years - long term
(c) Provisional
(d) Revised

Source: Central Bank of Sri Lanka

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considerably and recorded a year-on-year growth of 10.1 per cent by end 2021. Further, expansion in the Services sector credit was also supported by lending to Financial and Business Services and Transport subsectors. Growth of credit in the form of Personal Loans and Advances grew moderately by 8.0 per cent, year-on-year, by end 2021, compared to the growth of 15.1 per cent at end 2020. Contributing to the moderate expansion, growth of credit granted under Consumer Durables decelerated to 13.3 per cent, year-on-year, by end 2021 compared to the notable growth of 38.4 per cent at end 2020. Pawning related advances recorded a notable growth of 18.6 per cent, year-on-year, by end 2021 reflecting the increased appetite for such credit amidst increased gold prices and disruptions to cashflows. Credit card advances also improved by 12.0 per cent, year-on-year, by end 2021, in comparison to the contraction of 2.5 per cent at end 2020. Further, in terms of the maturity of outstanding credit to the private sector by LCBs, an increase was observed in short and medium term credit, while a slowdown was observed in long term credit facilities, possibly reflecting tight monetary conditions in the economy towards the end of the year.

Broad Money (M_4)

Following the similar trend in M_{2b}, the growth of broad money supply (M_4), as measured by the Financial Survey,[12] decelerated by end 2021. The year-on-year growth of M_4, gradually decelerated to 13.3 per cent by end 2021 from a growth of 21.4 per cent recorded at end 2020. Viewed from the assets side, the expansion of M_4 was driven entirely by the expansion in NDA, within which domestic credit by Licensed Specialised Banks (LSBs) increased by Rs. 259.6 billion, while that of Licensed Finance Companies (LFCs) rose by Rs. 103.6 billion during 2021. The expansion of total NCG based on M_4 amounted to Rs. 1,403.6 billion during the year, of which

12 The Financial Survey provides a broader measure of liquidity, covering all deposit taking institutions, including LSBs and LFCs, in addition to LCBs and the Central Bank.

Table 7.8
Assets Side of Broad Money (M_4)
(Computed as per the Financial Survey)

Rs. billion

Item	End 2020	End 2021 (a)	Change			
			2020		2021	
			Amount	%	Amount	%
Financial Survey (M_4)	11,461.9	12,985.4	2,017.4	21.4	1,523.5	13.3
Underlying Factors						
Net Foreign Assets	-217.1	-998.6	-305.9	-344.6	-781.5	-360.0
Monetary Authorities (b)	526.8	-387.3	-369.2	-41.2	-914.0	-173.5
LCBs	-736.2	-594.7	59.0	7.4	141.5	19.2
LSBs	-7.6	-16.6	4.3	36.0	-9.0	-117.9
Net Domestic Assets	11,679.0	13,984.0	2,323.2	24.8	2,305.0	19.7
Domestic Credit	14,652.4	17,296.4	2,558.3	21.2	2,643.9	18.0
Net Credit to the Government	5,365.7	6,769.3	1,882.8	54.1	1,403.6	26.2
Central Bank	868.9	2,094.1	505.9	139.3	1,225.2	141.0
LCBs	3,679.2	3,738.3	1,246.3	51.2	59.2	1.6
LSBs	742.2	844.5	128.4	20.9	102.3	13.8
LFCs	75.5	92.4	2.3	3.1	16.9	22.4
Credit to Public Corporations/SOBEs (LCBs)	1,002.2	1,188.1	184.2	22.5	185.9	18.6
Credit to the Private Sector	8,284.5	9,338.9	491.3	6.3	1,054.4	12.7
LCBs	6,170.9	6,981.4	374.1	6.5	810.5	13.1
LSBs	936.5	1,093.7	122.3	15.0	157.3	16.8
LFCs	1,177.1	1,263.8	-5.1	-0.4	86.7	7.4
Other Items (net) (c)	-2,973.4	-3,312.4	-235.1	-8.6	-339.0	-11.4

(a) Provisional
(b) This includes NFA of the Central Bank as well as the Government's Crown Agent's balance reported by the Department of State Accounts
(c) Computed as the difference between other assets and other liabilities

Source: Central Bank of Sri Lanka

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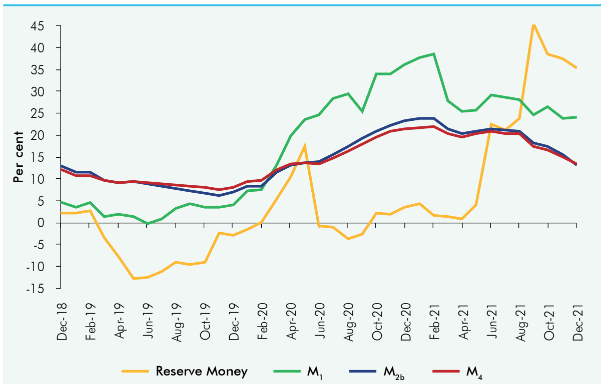
Figure 7.16
Year-on-Year Growth of Monetary Aggregates



Source: Central Bank of Sri Lanka

Rs. 102.3 billion was through LSBs and Rs. 16.9 billion was through LFCs. Further, underpinned by the low interest rate environment, credit extended to the private sector by licensed banks and LFCs grew by 12.7 per cent, year-on-year in 2021, from the growth of 6.3 per cent recorded in 2020. Credit extended by LSBs to the private sector increased by Rs. 157.3 billion in 2021, recording an annual growth of 16.8 per cent, year-on-year. Meanwhile, credit extended by LFCs to the private sector rose by Rs. 86.7 billion in 2021, marking an annual growth of 7.4 per cent, year-on-year. However, overall NFA of M_4 contracted by Rs. 781.5 billion during 2021, with NFA of LSBs declining by Rs. 9.0 billion during the year due to the increase in foreign liabilities.

On the liabilities side of M_4, the growth of time and savings deposits held by the public with licensed banks and LFCs moderated by end 2021. Accordingly, the growth of time and savings deposits as per M_4 moderated to 11.6 per cent, year-on-year, by end 2021, compared to the growth of 20.0 per cent at end 2020. Time and savings deposits held with LSBs grew by 13.5 per cent, year-on-year, by end 2021, compared to the growth of 21.6 per cent recorded in 2020. However, time and savings deposits held with LFCs grew by only 5.5 per cent, year-on-year, by end 2021, compared to the marginal contraction of 0.7 per cent recorded during 2020. While the overall growth of time and savings deposits as per M_4 moderated due to the slowdown in the mobilisation of interest bearing deposits by the banking sector, some improvement was observed in the time and savings deposits mobilised by LFCs during 2021.