

**(D) CENTRAL BANKING**

The International reserve of the Central Bank stood at Rs. 282.2 million as at end of December 1965, showing an increase of Rs. 146.3 million for the year. This increase reflected the purchase of Rs. 30.1 million of foreign securities by the Central Bank from Government institutions in May 1965 and also the net purchases of foreign currencies equivalent to Rs. 53.5 million from the International Monetary Fund. In the first half of 1965, the Central Bank obtained temporary accommodation from commercial banks abroad but these sums were re-paid in full by July. Hence the year end position did not reflect this short term borrowing. The international reserve showed an upward trend in the first ten months of the year, with the exception of the month of June when there was a slight decline. In November and December, the reserve declined markedly from the peak figure of Rs. 320.3 million reached at the end of October to Rs. 288.3 million at the end of November and to Rs. 282.3 million at the end of December.

Total domestic assets of the Central Bank amounted to Rs. 1,443.8 million and showed a decrease Rs. 5.4 million or 0.4 per cent for the first time since 1957. This decrease was the result of a conscious effort on the part of the Government not to increase its resort to finance from Treasury bills; the Central Bank's holding of Treasury bills declined by Rs. 38.7 million in 1965<sup>1</sup>, and but Central Bank loans and advances to the Government increased by Rs. 28.0 million. On the other hand Central Bank advances to commercial banks declined by Rs. 12.8 million while 'other assets and accounts' increased by Rs. 18.2 million to give a net decline in domestic assets of Rs. 5.4 million.

**Credit Policy**

Commercial bank credit to the private sector which had increased by Rs. 136.9 million in 1963 and Rs. 62.8 million in 1964, increased further by Rs. 44.8 million in the first five months of 1965. As was pointed out in the Annual Report for 1964, the extension and intensification of import control measures in 1963 and 1964 had given rise to a situation in which the continued increase in bank credit was likely to result in the emergence of excess monetary demand aggravated by the speculative hoarding of goods. On the basis of the Central Bank's assessment of the prevailing monetary situation the Monetary Board imposed the following measures :-

- (i) Increased the Bank Rate, which had remained at 4 per cent from August 13th 1960, to 5 per cent with effect from the 28th May 1965.

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1. Figures of Treasury bills purchased by the Central Bank are reported under the category 'Government and Government Guaranteed Securities' in Table 5 of the appendix to this Report.

- (ii) Imposed a ceiling on the expansion of commercial bank credit to the private sector<sup>1</sup> by limiting the increase in the total commercial bank advances under the four asset items of loans, overdrafts, import bills financed and local bills financed. In imposing the ceiling, the Central Bank impressed on the commercial banks that each bank's ceiling should be observed in such a manner as to minimize the availability of credit for non-essential purposes and thereby ensure the maximum of credit for productive purposes within the ceiling. The ceiling on the expansion of commercial bank credit was part of a monetary stabilization programme agreed to with the International Monetary Fund.
- (iii) With effect from 18th June 1965, the People's Bank which as a new bank had hitherto been exempt from placing a special reserve with the Central Bank, was required to maintain a special reserve of 28 per cent of any increase in demand deposits above the level of such liabilities as at the close of business on the 9th June 1965. The special reserve ratio imposed on 10th February, 1961 on all other commercial banks remained unchanged at 38 per cent. It was thought not desirable that the special reserve requirement of February 1961 should be imposed on the People's Bank in its formative years.

In November 1965, margin requirements against letters of credit and commercial bank advances for the purpose of financing certain categories of imports were withdrawn. This was because margin requirements were superfluous as a method of restraining imports with the extension of direct controls to cover virtually all imports.

### Banking Development

A development in the field of banking in 1965 was the progress of the pilot project in rural banking conducted by the People's Bank. As indicated earlier, by July 1965 all eight multipurpose co-operatives that had been selected to function as rural banks in the previous year were in operation. These banks were empowered to accept savings deposits from the public as well as from their own members. Credit facilities were also made available to each rural bank by the branch of the People's Bank located nearest to the rural bank. Recoveries of loans are supervised by officers of the People's Bank who also provide managerial assistance to societies when necessary. The People's Bank also provides a short course of training for personnel appointed to manage rural banks.

This scheme of rural banks is modelled on the experience elsewhere in the field of co-operative banking. Rural banks as operated in Ceylon incorporate a blend of the advantages of unit banking and branch banking. They are—

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1. Private sector was defined to include state-owned corporations in keeping with the practice of the past.

- (i) The de-centralisation of the lending decision through the use of local knowledge available to the Committee of Management of each co-operative. Such knowledge has proved useful in solving the problem of security which has greatly inhibited the lending of commercial banks through branch offices located in rural areas.
- (ii) Access to overdraft facilities with the People's Bank which mobilises resources from surplus areas through its system of branches.
- (iii) The lower costs of operation made possible by the economies resulting from the minimising of centralised management and also by the local recruitment of staff.

The Banker's Training Institute, sponsored by the Central Bank in association with commercial banks, continued to make steady progress in 1965. Candidates for the first examination of the Institute held in May 1965 numbered 293. The course available to the candidates for the examination in 1966 includes a comprehensive series of lectures, together with tutorials, and the facilities of a Library which was begun in December 1965. The total number of students on the roll at the close of the year was 1,200.

In August 1965, the Central Bank appointed an internal committee of officers of the Bank to constitute "a Banking Development Committee" which was required to report on the following :-

- (i) The deficiencies in existing credit, banking and savings facilities.
- (ii) To suggest ways and means of overcoming such deficiencies either through direct Central Bank action or through any other existing institution or by setting up new institutions.

On an interim recommendation of this committee, the Monetary Board has approved the creation of a Development Finance Division within the Department of Bank Supervision of the Central Bank. The new Division has been created for the purpose of following up closely the availability of term finance for both industry and agriculture. An important function of the Division would be to make available adequate expertise in project evaluation for new investment in industry and agriculture.

The Central Bank had under consideration, at the end of the year, a reduction of the rate of interest charged and the relaxing of procedures under its Refinancing Scheme. These changes have been given effect to subsequently.