Favourable export income received in the last several years has led to a gradual decline in the external debt service ratio (the external debt service payments as a percentage of exports of goods and non-factor services) from 23 in 1975 to 20 in 1976 and to 19 per cent in 1977. Meanwhile, the domestic debt service ratio (debt service payments as a ratio of Government revenue) has demonstrated a tendency to increase over the last decade or more. In 1977, it increased by 5 percentage points to 17 per cent. If the Government desires to keep the debt burden at manageable levels, it is essential to raise the quality of public investments.

MONETARY AND BANKING DEVELOPMENTS

Money Supply

The year 1977 witnessed a very sharp monetary expansion for the second year in succession, when the money supply rose by Rs. 1200 million. This was an increase of 29 per cent, as against a rise of 35 per cent in 1976, 5 per cent in 1975 and 6 per cent in 1974. In fact, money supply has almost doubled itself over the four years 1973 to 1977; and over four-fifths of this increase occurred in 1976 and 1977.

The average of monthly money supply data during the year 1977 showed an increase of 32 per cent over the previous year. In other words, the money supply during 1977 was, by and large, a third higher than the level that prevailed during the previous year. By contrast, the average rise was 22 per cent in 1976, 2 per cent in 1975 and 18 per cent in 1974. A detailed comparison can be seen in Table 15 that follows.

As in 1976, seasonal factors failed to exert a significant influence on the course of money supply in 1977. Except in the month of July, there was a continuous expansion in money supply throughout the year. This is largely explained by the nature of the major underlying factor responsible for the monetary expansion; namely, the growth in external banking assets, which does not normally display any seasonal pattern. Moreover, commercial bank credit to co-operative institutions was also devoid of the usual seasonal fluctuations. In general, bank advances to co-operatives have tended to rise rather sharply during the first half of the year but taper off during the fourth quarter as the repayment of these advances gathers momentum. In 1977, advances to co-operative institutions rose rather sharply during the first 3 quarters of the year and continued to remain high during the rest of the year. Overall, the pattern of monetary expansion in 1977 was characterised by a very sharp increase in the first quarter, moderate increases in the second and third quarters and an acceleration in the fourth quarter.

The composition and the underlying factors responsible for this monetary expansion are shown in Table 16. The increase in money supply was made up of an increase in demand deposits by Rs. 489 million and an increase in currency held by the public of Rs. 711 million.

TABLE 15

Changes in Money Supply 1975-1977

End Period	Money Supply – Rs. Million			Monthly Change %			Change Over previous Year %		
	1975	1976	1977	1975	1976	1977	1975 over 1974	1976 over 1975	1977 over 1976
January	2938	3127	4203	– 0.2	+ 0.3	+ 0.9	+ 6.1	+ 6.4	+ 34.4
February	2930	3213	4429	– 0.2	+ 2.7	+ 5.4	+ 4.5	+ 9.7	+ 37.9
March	3044	3391	4710	+ 3.8	+ 5.5	+ 6.3	+ 0.4	+ 11.4	+ 38.9
April	3046	3516	4764	+ 0.1	+ 3.7	+ 1.2	+ 5.3	+ 15.4	+ 35.5
May	2972	3582	4808	– 2.4	+ 1.9	+ 0.9	+ 6.1	+ 20.5	+ 34.2
June	3026	3728	4947	+ 1.7	+ 4.1	+ 2.9	+ 3.4	+ 23.2	+ 32.7
July	2982	3666	4893	– 1.4	– 1.7	– 1.1	+ 0.2	+ 23.0	+ 33.5
August	2932	3851	4912	– 1.6	+ 5.1	+ 0.4	– 2.2	+ 31.3	+ 27.5
September	3017	3889	5024	+ 2.8	+ 1.0	+ 2.3	– 3.5	+ 28.9	+ 29.2
October	3047	3988	5062	+ 1.0	+ 2.5	+ 0.7	– 2.2	+ 30.9	+ 26.9
November	3047	4019	5254	+ ...	+ 0.8	+ 3.8	+ 1.3	+ 31.9	+ 30.7
December	3088	4166	5366	+ 1.3	+ 3.7	+ 2.1	+ 4.8	+ 34.9	+ 28.8
Monthly Average	3005	3678	4864	+ 0.4	+ 2.5	+ 2.1	+ 1.9	+ 22.4	+ 32.5

Source: Central Bank of Ceylon.

TABLE 16

Changes in Money Supply and Causal Factors – 1975–1977*

Rs. Million

	End 1975 over End 1974	End 1976 over End 1975	End 1977 over End 1976
1. Composition			
1.1 Demand deposits	+ 72	+ 607	+ 489
1.2 Currency	+ 71	+ 471	+ 711
2. Net Change in Money Supply	+ **143**	+ **1077**	+ **1200**
3. Analysis			
3.1 External Banking Assets (Net) ...	– **215**	+ **470**	+ **1943**
3.2 Private Sector	+ **131**	+ **70**	– **70**
3.2.1 Commercial bank credit			
– to government corporations ...	– 47	+ 43	+ 614
– to co-operatives	– 11	+ 113	+ 568
– to other private sector ...	+ 226	+ 427	+ 618
3.2.2 Time & saving deposits			
– of government corporations ...	– 32	+ 42	– 294
– of co-operatives	– 7	– 21	– 45
– of other private sector ...	– 28	– 487	– 856
3.2.3 Other assets and liabilities (net) of commercial banks	+ 30	– 46	– 676
3.3 Government Sector	+ **272**	+ **541**	– **676**
3.3.1 Commercial bank credit ...	– 8	+ 367	+ 132
3.3.2 Central Bank credit	+ 171	+ 363	– 187
3.3.3 Bank deposit and cash balances ...	+ 120	– 273	– 223
3.3.4 Other assets and liabilities (net) of Central Bank	– 11	+ 83	– 398
3.4 Items in transit	– **47**	– **3**	+ **4**

Source: Central Bank of Ceylon.

* Sign indicates effect on Money Supply

The major contributory factor for the expansion in money supply in 1977 was a remarkable growth in external banking assets. Altogether, the net external banking assets registered a phenomenal increase of Rs. 1,943 million[1] largely reflecting the very strong balance of payments position that emerged during the year. This was the second year in succession when the growth in external banking assets made a significant contribution to an increase in money supply. The external banking assets (net) rose by Rs. 470 million in the previous year, in contrast to a decline of Rs. 215 million in 1975.

In sharp contrast to the expansionary impact of Rs. 70 million in the previous year, the operations of the private sector (defined to include government corporations and co-operative institutions) resulted in a contractionary impact on the money supply of an equal magnitude in 1977. This was the first time since 1970 when the private sector has contributed to a contraction in the money supply. A very substantial build up of time and savings deposits by government corporations and other private sector constituents and a sharp increase in commercial banks' other liabilities and accounts (net) were the important contributory factors for this development.

When the private sector is disaggregated into sub-sectors, the operations of co-operative institutions and government corporations were expansionary on the money supply to the tune of Rs. 523 million and Rs. 320 million, respectively. On the other hand, the other private sector constituents contributed to a contractionary impact of Rs. 238 million during the year, while changes in commercial banks' other liabilities and accounts (net) were contractionary to the extent of Rs. 676 million. The latter represents very largely the profits made by commercial banks during the year, adjustments made in respect of forward foreign exchange transactions and FEECs kept in suspense following the unification of the exchange rate, amounts received under guarantees on account of cultivation loans and the undisbursed receipts under the Guaranteed Price Scheme. The expansionary impact of the operations of government corporations and co-operative institutions in 1977 was solely due to increased bank credit utilised by these sectors. In all, commercial bank credit to government corporations rose by Rs. 614 million during the year, while bank credit to co-operative institutions increased by Rs. 568 million. On the other hand, although bank credit to other private sector constituents rose by Rs. 618 million, its expansionary impact was more than offset by a very substantial rise in the time and savings deposits of this sector. Altogether, these deposits increased by Rs. 856 million, thereby contributing to a net contractionary impact of Rs. 238 million on the money supply during the year.

The rise in time and savings deposits of other private sector constituents was very much more marked in the last quarter of the year, when these deposits increased by Rs. 422 million. This was almost of the same magnitude of the increase during

1. In all, the book value of net external banking assets rose by Rs. 3,597 million during the year. A considerable part of this amounting to Rs. 1,199 million represented increases resulting from the revaluation of existing assets following exchange rate changes. There was also an increase of Rs. 456 million due to differences in the exchange rate used for recording the drawing of SDR 55 million from the IMF for asset and liability purposes. As this part of the increase in external banking assets has no effect on the course of money supply, it has been excluded from the analysis of factors underlying the changes in money supply.

the first three quarters of the year. The sharp growth in time and savings deposits in the last quarter of the year could be largely attributed to the positive impact of the interest rate reforms introduced in early September. Had it not been for this favourable development, the overall monetary expansion during the year would have been considerably larger.

An important feature of the monetary developments in 1977 has been the changed influence of government financial operations on the money supply. During the year under review, government financial operations with the banking system produced a contractionary impact of Rs. 676 million on the money supply. However, the overwhelmingly larger share (Rs. 398 million) of this represented a very sharp increase in other liabilities and accounts (net) of the Central Bank[1], the main items of which being the unreconciled claims of the Asian Clearing Union and the net profits of the Bank.

Government sector operations, excluding changes in the Central Bank's other liabilities and accounts (net) resulted in a contractionary impact of Rs. 278 million on the money supply, which is in sharp contrast to the expansionary impact of Rs. 457 million on this account in the previous year. After two years of successive expansionary deficits in the Budget, the contractionary impact in 1977 appears to be one of the most welcome developments from the view point of reducing monetary instability in the economy.

In sum, a very sharp increase in external banking assets caused the money supply to rise by a record Rs. 1,200 million in 1977. If not for some favourable trends in the Government Budget and the substantial build up of time and savings deposits by other private sector constituents, particularly during the last quarter of the year, the monetary developments during the year would have been considerably worse. Notwithstanding these favourable trends, the money supply registered a sharp increase for the second year in succession with consequent implications on the problem of maintaining price stability.

Commercial Banking

For the second consecutive year, the resources of commercial banks registered a sharp increase in 1977. Altogether, commercial bank resources increased by Rs. 3,701 million or by 47 per cent during the year. Following the pattern of the previous year, a sharp growth in deposits provided the main impetus to the resource build up. The growth in time and savings deposits was overwhelmingly large; these rose by Rs. 1,250 million during the year, while demand deposits increased by

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1. The book value of Central Bank's other liabilities and accounts (net) in fact rose by Rs. 2,053 million during the year. The major underlying factor for this increase was a sharp rise in the International Reserve Revaluation Account which rose by Rs. 1,655 million in 1977. Changes in the International Reserve arising from revaluation of existing assets following exchange rate changes, profits or losses falling on commercial banks due to such exchange rate changes and profits or losses accruing to the Central Bank from its forward foreign exchange commitments are reported in this account. The rise in the International Reserve Revaluation Account in respect of these transactions was of the order of Rs. 1,199 million. In addition, a sum of Rs. 456 million was credited to this account during the year owing to differences in the exchange rate used for recording the drawing of SDR 55 million from the IMF for asset and liability purposes.

Rs. 601 million. Resource accumulation was further augmented by increases in paid-up capital, reserve funds and undistributed profits, inter-bank and foreign borrowings, and in other liabilities. The monthly average ratio of liquid assets to total deposits and the monthly average ratio of cash to total deposits which declined in the preceding 2 years, registered a notable increase in 1977 – the former rising from 30 per cent in 1976 to 34 per cent in 1977 and the latter from 11 per cent to 14 per cent. These changes indicated a significant improvement in the liquidity position of commercial banks by the end of 1977, when compared with the position as at the end of 1976.

The increased resources mobilised by commercial banks were utilised for providing credit to government corporations, co-operative institutions and the other domestic private sector, maintaining reserves with the Central Bank, procuring fixed and other assets and for increasing external balances. In all, commercial bank advances to government corporations rose by Rs. 614 million during the year, while those in favour of co-operative institutions rose by Rs. 568 million. Commercial bank advances and investments on account of other domestic private sector rose by Rs. 618 million. On the other hand, this sector's deposits with commercial banks increased by Rs. 1,164 million, resulting in a net out flow of resources from this sector to commercial banks amounting to Rs. 546 million. In 1977, commercial banks increased their reserves with the Central Bank by Rs. 328 million, while their foreign exchange balances (net) rose by Rs. 638 million. In addition, commercial banks utilised Rs. 570 million to build up their fixed and other assets and their till cash increased by Rs. 100 million.

Bank Branch Expansion

Following the opening of 77 branches in the previous year, commercial banks opened 76 new branch offices in 1977. Of this, 49 were branches opened by the Bank of Ceylon at Agricultural Service Centres (whose activities were not as comprehensive as in a main branch), while the balance 27 were full branches. In comparison, the number of Agricultural Service Centre branches opened during the previous year was 42 and the number of full branches 35. As at the end of 1977, the total number of Agricultural Service Centre branches in the island totalled 390, while the number of full branches amounted to 325. Apart from the branches it was obliged to set up at Agricultural Service Centres, the Bank of Ceylon also opened 10 new full branches in 1977, bringing the total number of branches to 79. The People's Bank opened 18 new branch offices during 1977, bringing the total number of its branches to 205 as at the end of the year.

Several issues have been raised in regard to the speedy lateral expansion of the banking network in recent times. First, the rapid expansion has evidently overstrained the trained bank personnel available. Secondly, the location of branches in rural areas has raised the question of their security, there being several bank hold-ups in 1977. Thirdly, questions have been raised as to the financial viability of the large number of new branches and the need for competition among such a number of branches.

There is no doubt that the rapid expansion of the branch network of the major banks have overstrained their trained cadres, leading sometimes to a general lowering of banking standards. Hence, there is a pressing need for training of more bankers in an organized manner, which the proposed Institute of Bank Management is expected to do. The safety of bank branches is vital for the continuing confidence of the public in the banking system, and the government has recently tightened security measures at branches. On the other hand, it may not be prudent to stifle the competitive expansion of the banking network which has been witnessed in recent times. A single monolithic banking network might result in some cost savings, but this will be achieved at the expense of quality and service, which are likely to be poor in a monopolistic situation. On the question of viability of branches, it is not absolutely clear that the financial non-viability of some of the new branches in the initial years is due to excessive competition. New branches do take some time to show positive financial results, even in urban areas. It is also important to bear in mind that the rural branches have been the vehicle of channelling rural credit and that they have in turn mobilized a considerable volume of savings.

Interest Rates

In 1977, there was a fundamental change in Sri Lanka's interest rate policy, resulting in a movement to a considerably higher plateau of rates against a background of widespread inflationary pressures in the economy. The major thrust of the interest rate reform in 1977 was directed at the short end of the market and the upward revisions in Bank rate provided the lead in the drive towards higher rates. The first revision of Bank rate was on January 26, when it was raised by 2 percentage points to 8.5 per cent. It was further raised by 1½ percentage points to 10 per cent, from August 31, 1977. The latter revision was combined with some restrictions on Central Bank accommodation to commercial banks, so as to make it more effective in influencing the deposit and lending rates of commercial banks. A little later, the National Savings Bank was induced to raise the interest rates it pays on its deposits. The National Savings Bank's rate on savings deposits was raised from 7.2 to 8.4 per cent on September 7. Effective same date, the rate on fixed deposits was raised sharply from 7.5 to 12.0 per cent per annum in the case of 6 months deposits; to 15.0 per cent in the case of 12 month deposits and to 18.0 per cent per annum on 18 month deposits.

As anticipated, this upward revision of short-term interest rates triggered off an increase in the deposit and lending rates of commercial banks. The rate on savings deposits of commercial banks rose from 5.5 per cent to 7.2 per cent, while the maximum rates on 3 months, 6 months and 12 months time deposits moved upto 8.5 per cent, 12 per cent and 15 per cent, respectively. This was followed by an upward movement in the rate on inter-bank call loans – the minimum rate rising from 5 to 7 per cent and the maximum rate from 8 to 9.5 per cent – particularly in view of the increased pressure that was building up in this market following the restriction of Central Bank accommodation at the Bank rate and the progressive withdrawal of the concession of allowing a part of commercial banks' till cash be treated as required reserves. The high deposit rates of commercial banks soon percolated into their lending rates. The minimum and maximum discount rates on commercial bills rose from 8.5 per cent and 13 per cent to 11 per cent and 21 per cent, respectively. The minimum and maximum rates on loans and overdrafts secured by all categories of securities moved up rather sharply from a minimum of 6.5 per cent and a maximum of 14 per cent to a minimum of 10 per cent and a maximum of 20 per cent. Later in the year, the higher short-term rates were allowed to exert their influence on the Treasury bill rate and the rate on 3 months Treasury bills rose from 5.0 per cent in October to 9.0 percent in November.

On the other hand, the changes in long-term rates were fairly modest. The revision of the National Savings Bank deposit rates in September was accompanied by an upward revision of the Government Bond rate (10–12 year bonds) from 9 per cent to 10 per cent. The maximum lending rate of the Development Finance Corporation rose from 12.5 per cent to 13 per cent and that of the State Mortgage Bank, from 12 per cent to 16 per cent. The minimum and maximum rates of the Agricultural and Industrial Credit Corporation moved up from 9 and 12 per cent to 12 and 15 per cent, respectively. On the other hand, there were no changes in the lending rates of the National Housing Department and the Medium and Long-term Credit Fund of the Central Bank.

In sum, the interest rate changes that occurred in 1977 represent a land-mark in Sri Lanka's interest rate policy. For the first time, interest rates which hitherto failed to reflect market conditions were permitted to move in step with the general economic conditions in the country. Occurring against the background of widespread inflationary pressures, the merits of this change in the short-run could be viewed in the light of its contribution to containing the rate of monetary expansion in the immediately succeeding period. During the four-month period ended December, 1977 total time and savings deposits of the non-bank private sector with commercial banks rose by Rs. 583 million, as compared with an increase of Rs. 613 million during the first 8 months of the year. Thus, the average monthly rate of accumulation of time and savings deposits with commercial banks very nearly doubled from Rs. 77 million during the pre-interest reform period to Rs. 146 million in the post-interest reform period. But for this favourable development, the rate of monetary expansion in 1977 and the attendant inflationary pressures would have been considerably higher.

Rural Credit

The total credit disbursement under the Comprehensive Rural Credit Scheme, the rural banks scheme and credit channelled by the Bank of Ceylon sub-offices at Agricultural Service Centres, reached a record level of Rs. 448 million in 1977. This was an increase of 177 per cent or near trebling of the credit channelled to the rural sector in 1976. Of the total loans disbursed, Rs. 417 million or 93 per cent was meant for crop cultivation. Of this amount, Rs. 276 million or 66 per cent has been granted by the People's Bank under the Comprehensive Rural Credit Scheme.

Loans for paddy cultivation amounted to Rs. 342 million and accounted for 76 per cent of the total credit under the three schemes. A major proportion of this has been disbursed under the Comprehensive Rural Credit Scheme.

Loans for subsidiary food crops amounted to Rs. 49 million or 11 per cent of the total loan disbursements. Loans for sugar cane and cotton amounted to Rs. 26 million or 6 per cent. Loans granted by rural banks and Bank of Ceylon for housing, electrification and digging wells amounted to Rs. 14 million.

As at end of the year, the total credit granted for paddy cultivation under the Comprehensive Rural Credit Scheme for the incomplete Maha 1977/78 season amounted to Rs. 293 million. This is the highest ever amount granted for any one cultivation season. Loans for subsidiary food crops, sugar cane and cotton also showed a record increase during the season. As the loan disbursements for this season have not ceased by the end of December, 1977 the final commitment for the season could well be above Rs. 400 million.

This was largely the outcome of a relaxation of lending criteria in August, 1977 for the following Maha season. As the weather was found to be favourable for this season, the Government directed the Bank of Ceylon and People's Bank to lend to past loan defaulters as well. The need to produce an Agro-identity Card as evidence of possession of land for cultivation in the case of Bank of Ceylon was dispensed with. Similarly done away with was the requirement of a minimum period membership of a co-operative society of at least one year to obtain loans from People's Bank. To be eligible for loans, the farmer only had to produce a document from a village level official, of possession of land for cultivation. Incidentally, such rural credit continued to be covered by a Central Bank guarantee (in the event of default) of upto 75 per cent and re-finance facilities upto 100 per cent at an interest rate of $1\frac{1}{2}$ per cent per year.

The relaxation of lending criteria for rural agriculture was adopted in the face of growing default of such loans in the past. Evidently, the past overdue loans were to be re-scheduled. The rate of default of agricultural loans in the past is indicated in Table 17.

The total amount of paddy loans granted by the banking sector under the New Agricultural Credit Scheme of 1967 and subsequently under the Comprehensive Rural Credit Scheme (which superseded the former in 1973) amounted to Rs. 625 million upto Maha 1976/77. Of this amount, Rs. 266 million or 43 per cent were in default by end of 1977.

In the light of this experience, the relaxation of lending criteria could be deemed to be a calculated risk. There was an expectation that intensive efforts will be made for recoveries and that procedures would be tightened up from the next (1978) Yala season.

The need for ensuring recovery of agricultural loans has been repeatedly emphasised in past Annual Reports. There is a serious dilemma faced by policy makers in this field. On the one hand, agricultural credit is so vital for sustaining the farmer that without it, the prospects of raising agricultural production are remote. On the other hand, liberalization of lending criteria and slackness in enforcing recoveries lead not only to gross abuse of the schemes, but also create inflationary tendencies;

TABLE 17

Cultivation Loans Granted under Rural Credit Schemes* - (as at 31st December, 1977)

Amount in Rupees Million

Cultivation Year	Loans granted			Recoveries			Percent of recoveries		
	Paddy	Other Crops	All Crops	Paddy	Other Crops	All Crops	Paddy	Other Crops	All Crops
1967/68 — 1969/70 ...	180.1	19.4	199.5	128.4	15.5	143.9	71.3	79.9	72.1
1970/71 — 1972/73 ...	88.2	24.8	113.0	57.2	19.0	76.2	64.8	76.6	67.4
1973/74 ...	111.1	26.2	137.3	59.2	15.2	74.4	53.3	58.0	54.2
1974/75 ...	85.4	27.8	113.2	41.9	15.7	57.6	49.1	56.5	50.9
1975/76 ...	74.3	29.6	103.9	41.1	14.1	55.2	55.3	47.6	53.1
1976/77 ...	99.2	76.3	175.5	34.3	14.1	48.4	34.6	18.5	27.6
Total ...	638.3	204.1	842.4	362.1	93.6	455.7	56.7	45.9	54.1
1977/78** ...	292.6	8.9	301.5	0.4	...	0.4	0.1	...	0.1

* Loans upto 1973 were granted under the New Agricultural Credit Scheme. Since then, loans have been granted under the Comprehensive Rural Credit Scheme, which replaced the former scheme.

** Incomplete data, Maha Season only.

Sources: People's Bank, Bank of Ceylon, Hatton National Bank Limited.

weaken the banking system, and discourage the more responsible farmers who repay loans. It should be a matter of highest priority for the Government to work out clear policy guidelines on the operation of rural credit schemes.

Monetary Policy

Against the background of a very sharp monetary expansion for the second year in succession, a series of monetary policy measures were introduced in 1977 with a view to restraining the rate of monetary expansion. In the first instance, Bank rate was raised by 2 percentage points to 8.5 per cent in January, 1977 which was further raised by $1\frac{1}{2}$ percentage points to 10 per cent, with effect from August 31, 1977. Secondly, the upward revision of Bank rate on the latter occasion was combined with some restrictions on Central Bank accommodation to commercial banks. Commercial bank borrowings from the Central Bank at the Bank rate were restricted to 7 per cent of selected items of assets as at June 30, 1977. Accommodation in excess of this limit was subjected to a penal rate of 15 per cent for 30 days and an additional 1 percentage point for each period of 30 days beyond the initial 30 day period. On November 16, 1977, the level of Central Bank accommodation at Bank rate was further reduced to 4 per cent of the selected items of assets as on September 30, 1977. This limit was, however, revised upwards on December 23, 1977 by Rs. 100 million, for export financing only: this revision was necessitated by the higher credit requirements of the export sector following the exchange rate reform. Thirdly, a gradual reduction of the proportion of the reserve requirement which the commercial banks were permitted to hold as till cash imposed in October, 1976 was continued. This till cash concession was withdrawn altogether from December 2, 1977 from which date the commercial banks were required to maintain their reserves wholly in the form of rupee deposits with the Central Bank. Fourthly, the banks were also informed of the requirement (imposed previously) not to increase their advances for non-essential purposes and to non-bank companies engaged in lending money and in hire-purchase activities.

The raising of Bank rate in August was followed by an upward revision of the deposit rates of the National Savings Bank from September 7, 1977. This in turn induced a rise in the deposit and lending rates of commercial banks. The fixed deposit rates of commercial banks moved upto 8.5 to 15 per cent and their lending rates, to a range of 10 to 21 per cent. It must, however, be mentioned that commercial bank lending to the domestic agricultural sector was not affected by the foregoing measures, as such lending continued to carry refinance facilities from the Central Bank at concessionary rates without change.

Although the rate of monetary expansion in 1977 was not significantly lower than that of 1976, there is evidence to suggest that the monetary policy measures activated in 1977 have helped considerably to contain the rate of monetary expansion. The major underlying factor behind the monetary expansion in 1977 was the growth in net external banking assets and monetary policy per se has little control over the growth in these assets. In fact, a restrictive monetary policy would have helped these assets to grow still further by restraining the flow of imports. The operations of the private sector, where the monetary policy is expected to exert its greatest influence, resulted in a contractionary influence of Rs. 70 million during the year.

What is most noteworthy is that the operations of this sector resulted in a contractionary influence of Rs. 781 million during the last 4 months of the year. The most important factor for this favourable development was a substantial build-up of time and savings deposits of other private sector constituents following the interest rate reform introduced during August/September 1977. Had it not been for the monetary policy measures put into operation in 1977, the rate of monetary expansion during the year would have been considerably higher. The consequences of such a monetary expansion occurring on the heels of a sharp monetary expansion in the previous year would have been to further accentuate the inflationary pressures in the economy.