

Provident Fund continued to be the major subscribers to rupee loans. The NSB increased its relative share of contribution from 22 per cent in 1978 to 38 per cent in 1979, owing to increased fixed deposits with the bank. Though the Employees' Provident Fund increased its contribution during the year by 45 per cent, its relative share fell from 33 to 28 per cent. With regard to administrative borrowings, there was a repayment of Rs. 164 million, thereby reducing the outstanding liability to Rs. 540 million. The total outstanding liability of long and medium domestic debt thus rose to Rs. 15,470 million in 1979.

The total foreign debt outstanding as at end of 1979 recorded an increase of Rs. 1,258 million or 9 per cent, compared with the preceding year's increase of Rs. 3,988 million. The total foreign debt outstanding consisted of project loans (Rs. 5,570 million), commodity loans (Rs. 8,901 million) and IMF Trust Fund loans (Rs. 1,370 million). The outstanding liability was greatly reduced on account of remission by creditors to the extent of Rs. 804 million. The U.K. government wrote off debts to the tune of Rs. 792 million. Exchange rate variations in favour of Sri Lanka also reduced the liability by about Rs. 316 million. In 1979, gross receipts of foreign loans amounted to Rs. 2,878 million, comprising project loans of Rs. 857 million, commodity loans of Rs. 1,422 million and IMF Trust Fund loan of Rs. 599 million. With a repayment of Rs. 499 million, the net transfer of resources amounted to Rs. 2,379 million.

The major sources of project loans during the year were, Netherlands (Rs. 188 million), International Development Association (Rs. 181 million), Asian Development Bank (Rs. 160 million), United States of America (Rs. 144 million), Federal Republic of Germany (Rs. 52 million), India (Rs. 35 million), International Bank for Reconstruction and Development (Rs. 33 million) and Kuwait (Rs. 26 million). Major donors of commodity loans were United States of America (Rs. 473 million), Japan (Rs. 398 million), Federal Republic of Germany (Rs. 250 million), India (Rs. 113 million), Canada (Rs. 96 million) and France (Rs. 90 million).

When compared with last year, the proportion of foreign loans in the total public debt declined from 47 to 45 per cent, due to remissions by creditors and favourable exchange rate changes. Unlike last year, there was a decreasing dependence on foreign resources to finance the budget deficit. As a percentage of the deficit, foreign resources amounted to 48 per cent in 1979, when compared with last year's share of 62 per cent.

The domestic debt service ratio (public debt service payments as a ratio of government revenue) increased from 14 per cent in 1978 to 15 per cent in 1979, as the rate of increase of revenue was only 9 per cent, when compared with the rate of growth of domestic debt by 20 per cent.

MONEY AND BANKING

The healthy containment of monetary expansion within a manageable limit of 11 per cent in 1978 was negated in 1979, when money supply grew by 29 per cent. This was largely the result of growth in external banking assets (net) and in credit to government. In continuation of the trends observed since the 1977 interest rate reforms, there was continued acceleration of deposit mobilization by commercial banks; time and savings deposits alone rising by Rs. 2,483 million, as compared with a rise of Rs. 1,572 million in 1978. Despite relatively high interest rates, demand for credit remained high. Commercial bank branch expansion accelerated in 1979, although the reorganization of the Agricultural Service Centre branches of the Bank of Ceylon would have led to a decline in the spread of banking activity; and three new foreign banks opened in Colombo.

The Central Bank introduced a Foreign Currency Banking Scheme, as a step towards achieving the eventual objective of developing an off-shore banking centre in Colombo. Bank rate remained unchanged, but the penal rates were raised to a range of 15 to 25 per cent, while Central Bank accommodation at Bank rate was enhanced. Commercial banks' deposit and lending rates remained virtually unchanged, except for a notable rise in the inter-bank call loan rate. Central Bank refinance of medium and long-term investments were increased and rationalized. Enforcing a credit ceiling on public corporations in order to prevent a pre-emption of credit to other private sector proved ineffective, and the task was entrusted to the Treasury.

Money Supply

The main feature of monetary developments in 1979 was a significant re-acceleration in the rate of monetary expansion following the substantial moderation observed in the previous year. The money supply, narrowly defined as the sum total of currency and demand deposits held by the public, rose by Rs. 1,733 million or 29 per cent during 1979, as against an increase of Rs. 570 million or 11 per cent in 1978. This meant that, in 1979, the annual rate of monetary expansion retrogressed to the same level that prevailed in 1977.

The money growth of 1978 and 1979 showed some contrasting developments. In 1978, the annual rate of monetary expansion progressively declined from 35 per cent in January to 12 per cent in August, and since then, after a modest increase in September, decreased again, reaching 11 per cent by December. On the other hand, in 1979, the annual rate of monetary expansion increased from 7 per cent in January to 25 per cent by August, and stagnated thereafter until December, when it rose sharply to reach 29 per cent. Reflecting this contrast, the monthly average rise in money supply, which was 0.9 per cent in 1978, rose to 2.2 per cent in 1979, but the annual average increase in money supply, month by month over the corresponding levels of the previous year, declined from 20 per cent during 1978 to 17 per cent during 1979.

A substantial increase in external banking assets (net) was the principal factor responsible for the acceleration in the rate of monetary expansion observed during 1979. The external sector was expansionary on the money supply to the extent of Rs. 1,236 million. The operations of the government sector, which exerted a substantial contractionary impact on the money supply in 1978, also contributed to the monetary expansion in 1979 to the tune of Rs. 477 million. This was wholly due to increased recourse by the government to the banking system. On the other hand, although the net impact of the operations of the private sector on the money supply was contractionary to the extent of Rs. 222 million, commercial bank credit to the private sector (including government corporations and co-operative institutions) rose by nearly Rs. 2,600 million, which was largely offset by a considerable build-up of time and savings deposits by this sector, amounting to over Rs. 2,400 million.

It was evident that despite inflationary pressures in the economy, the growth in time and savings deposits of the private sector reflected the continuing flow of savings into the institutional media in response to the 1977 interest rate reform. If not for this favourable development, the overall monetary expansion during the year would have been very much larger. In fact, the ability of the banking system to mobilize deposits on this scale enabled it to meet most of the growing credit requirements of the private sector without fuelling inflationary pressure.

TABLE 1 . 24
Change in Money Supply 1977 - 1979

End Period	Money Supply (Rs. Million)			Monthly Changes (Per cent)			Annual Changes (Per cent)		
	1977	1978	1979	1977	1978	1979	1977 over 1976	1978 over 1977	1979 over 1978
January	4203	5679	6091	+ 0.9	+ 5.8	+ 2.6	+ 34.4	+ 35.1	+ 7.3
February	4429	5830	6489	+ 5.4	+ 2.7	+ 6.5	+ 37.9	+ 31.6	+ 11.3
March	4710	6001	6752	+ 6.3	+ 2.9	+ 4.0	+ 38.9	+ 27.4	+ 12.5
April	4764	6025	6727	+ 1.2	+ 0.4	- 0.4	+ 35.5	+ 26.4	+ 11.7
May	4808	5876	6694	+ 0.9	- 2.5	- 0.5	+ 34.2	+ 22.2	+ 13.9
June	4947	5864	6692	+ 2.9	- 0.2	- ...	+ 32.7	+ 18.5	+ 14.1
July	4893	5570	6667	- 1.1	- 5.0	- 0.4	+ 33.5	+ 13.8	+ 19.7
August	4912	5523	6895	+ 0.4	- 0.8	+ 3.4	+ 27.5	+ 12.4	+ 24.8
September	5024	5804	7088	+ 2.3	+ 5.1	+ 2.8	+ 29.2	+ 15.5	+ 22.1
October	5062	5835	7159	+ 0.7	+ 0.5	+ 1.0	+ 26.9	+ 15.3	+ 22.7
November	5254	5955	7233	+ 3.8	+ 2.1	+ 1.0	+ 30.7	+ 13.3	+ 21.5
December	5366	5936	7669	+ 2.1	- 0.3	+ 6.0	+ 28.8	+ 10.6	+ 29.2
Monthly Average ..	4864	5825	6846	+ 2.1	+ 0.9	+ 2.2	+ 32.5	+ 20.2	+ 17.5

Source: Central Bank of Ceylon.

As in the previous year, some element of seasonality was observed during 1979 in the pattern of monetary growth. Generally, commercial bank credit to co-operative institutions rise during the first half of each year and tend to decline sharply thereafter, especially during the fourth quarter of each year. Conforming to this pattern, bank credit to co-operative institutions declined sharply during the fourth quarter of 1979. The movements in external banking assets which do not normally display a seasonal pattern, were expansionary on the money supply throughout 1979, except during the first quarter. The financial operations of government corporations were expansionary during the first and fourth quarters of the year and contractionary during the second and third quarters. The operations of the 'other private sector' were expansionary throughout, more prominently during the second half of 1979. As in the case of the operations of the semi-government sector, the government sector's operations with the banking system resulted in an expansionary impact during the first and fourth quarters and a contractionary impact during the rest of the year, infusing a further element of seasonality into the pattern of monetary growth in 1979. Although the behaviour of some sub-sectors within the private sector and the movements in net external banking assets were devoid of a clear seasonal character, the monetary developments in 1979 seem to suggest the re-emergence of some element of seasonality into the pattern of monetary growth.

Overall, the tendency for the money supply to register sharp increases during the first quarter of each year was prominently displayed in 1979. Thereafter, the money supply showed negative growth until August, thereby broadly following the same path as in the previous year. Since August, 1979 the money supply continued to rise, which in the case of the previous year, occurred only from September onwards. A contrasting experience however was seen in December when the money supply registered a sharp increase, as against the marginal decline in the same month of the previous year. The growth of money supply in 1979 was largely due to the increase in the net external banking assets, the behaviour of which, as mentioned previously, was devoid of any seasonal character. Thus, the emerging seasonality in money growth was largely influenced by the operations of the government sector.

The composition of money supply and the underlying factors responsible for its change are shown in Table 1.25. The increase in money supply was made up of a growth in demand deposits by Rs. 974 million and an increase in currency held by the public of Rs. 759 million. With the larger increase, the demand deposit component rose from 49.2 per cent of total money supply in 1978 to 50.8 per cent by the end of 1979.

This was the fourth year in succession when the external sector exerted a significant expansionary influence on the money supply. The external banking assets net after adjusting for exchange rate changes, which registered an increase of Rs. 1,943 million in 1977 and Rs. 1,523 million in 1978, rose by a further Rs. 1,236 million in 1979. Following the general pattern observed in recent years, the major share of this increase was reflected in the International Reserve of the Central Bank. The net foreign exchange holdings of commercial banks also registered an increase during the year.

Despite a worsening of the trade balance and the current account of the balance of payments in 1979, the external banking assets net recorded a substantial increase largely on account of increased resources available in the capital account.

TABLE 1.25

Changes in Money Supply and Causal Factors 1977 - 1979

Rs. Million

Item	End 1977 over End 1976	End 1978 over End 1977	End 1979 over End 1978
1. Composition			
1.1 Demand deposits	+ 489	+ 347	+ 974
1.2 Currency	+ 711	+ 224	+ 759
2. Net Change in Money Supply	<u>+ 1,200</u>	<u>+ 570</u>	<u>+ 1,733</u>
3. Analysis			
3.1 External Banking Assets (Net)*	+ 1,943	+ 1,523	+ 1,236
3.2 Private Sector	- 70	+ 688	- 222
3.2.1 Commercial Bank Credit to - Government Corporations	+ 614	+ 693	+ 984
Co-operatives†	+ 509	+ 205	- 439
Other private sector	+ 618	+ 1,890	+ 2,022
3.2.2 Time and Savings Deposits of - Government Corporations	- 294	- 200	- 951
Co-operatives	- 45	- 54	- 76
Other private sector	- 856	- 1,351	- 1,406
3.2.3 Other Assets and Liabilities (Net) of Commercial banks	- 617	- 495	- 358
3.3 Government Sector	- 676	- 1,520	+ 477
3.3.1 Commercial Bank credit	+ 132	- 113	+ 63
3.3.2 Central Bank credit	- 187	+ 38	+ 767
3.3.3 Bank deposits and cash balances	- 223	- 1,050**	+ 227
3.3.4 Other Assets and Liabilities (Net) of Central Bank	- 398	- 394	- 580
3.4 Items in transit	+ 4	- 121	+ 242

Source: Central Bank of Ceylon.

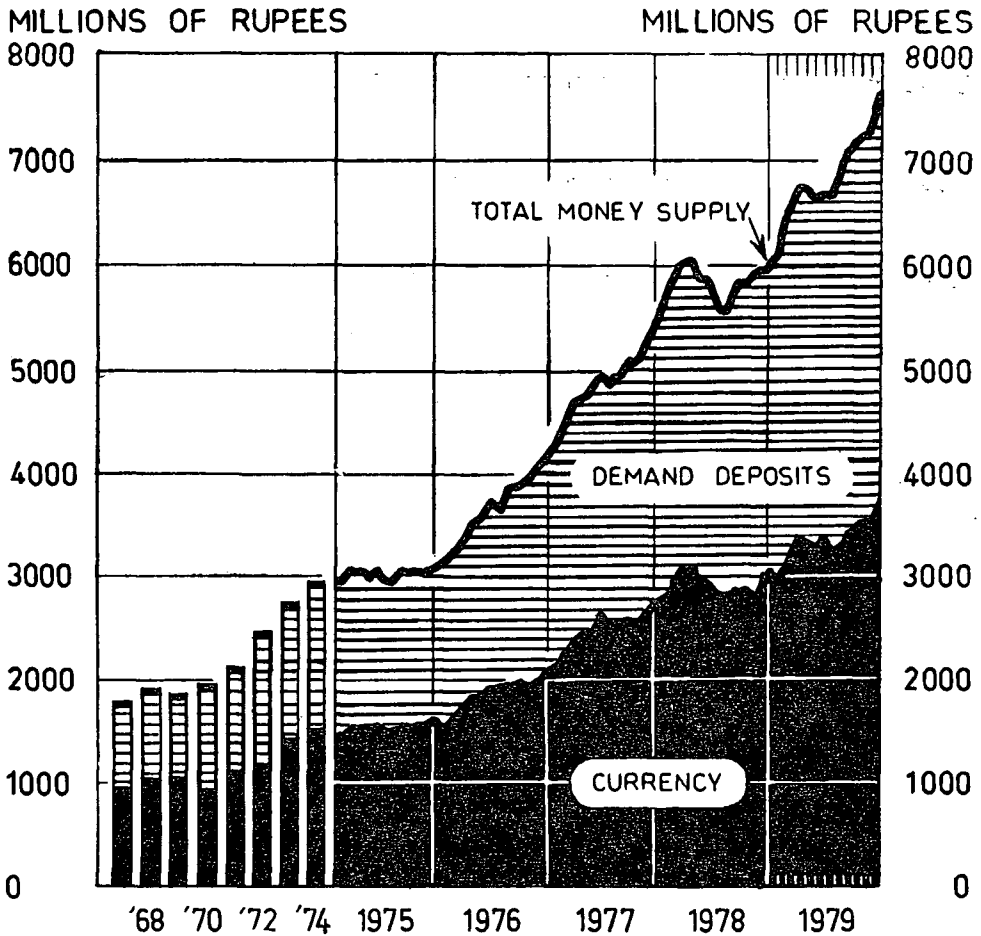
Signs indicate effect on Money Supply.

* Changes in external banking assets attributable to exchange rate changes with contra entry in other liabilities and accounts (net) of Central Bank have been excluded from the analysis. The respective changes in 1977, 1978 and 1979 were + Rs. 1,655 million + Rs. 361 million and - Rs. 18 million.

† Credit to co-operative institutions has been adjusted to take account of monies held in Paddy Marketing Board Suspense Account pending liquidation of matured Goods Receipts. The changes for 1977, 1978 and 1979 amounted to + Rs. 59 million, + Rs. 238 million and + Rs. 672 million respectively. Following this adjustment bank credit to co-operative institutions in 1977 and 1978 reported in the respective Annual Reports have been changed.

** A sum of Rs. 390 million transferred by the Government to the Central Bank for the National Development Bank is included.

MONEY SUPPLY



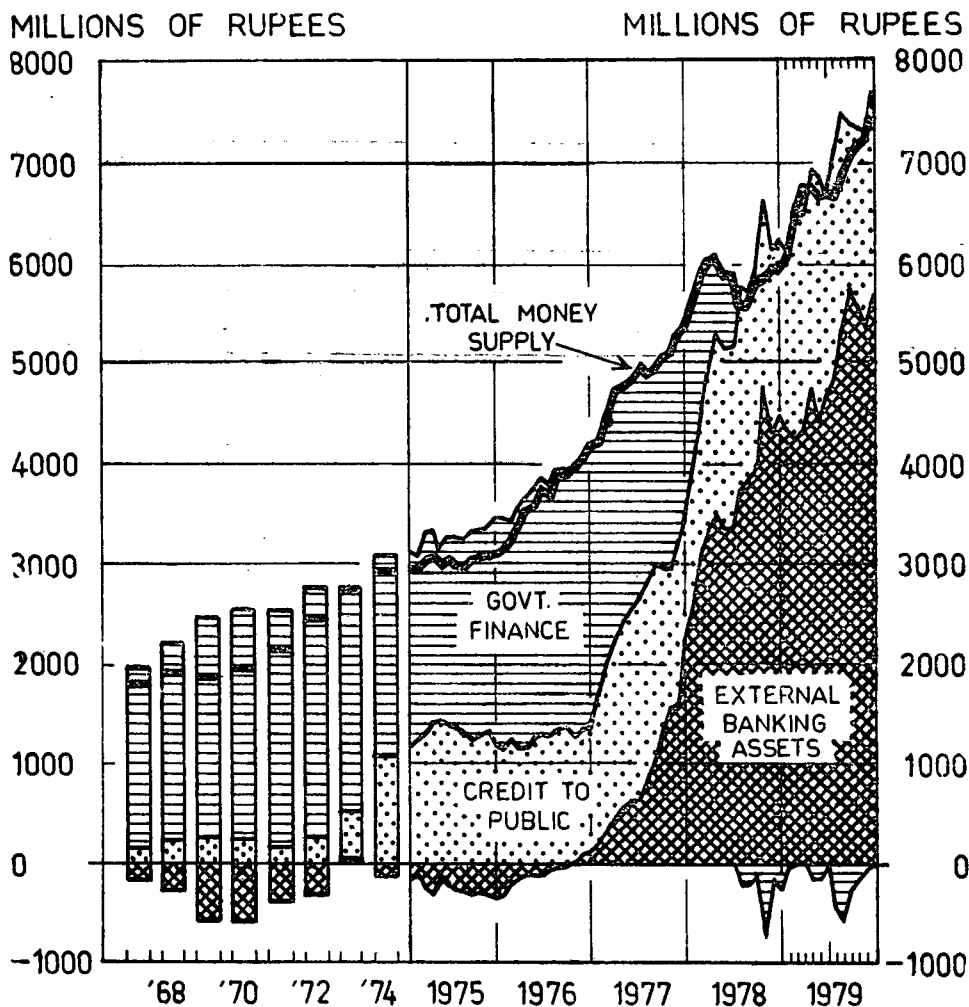
Dept. of Economic Research

Source: Central Bank of Ceylon

Money Supply is defined as "all currency and demand deposit owned by persons other than commercial banks and the Government"

SOURCES OF MONEY SUPPLY

1967 - 74 END YEAR: 1975 ONWARDS END MONTH FIGURES



Dept. of Economic Research

Source: Central Bank of Ceylon

This chart indicates the origin of Money Supply in Sri Lanka

- (a) "Government Finance" shows the claims of the banking system on the Government net of rupee cash holdings of the Government.
- (b) "Credit to public" shows the claims of the banking system on the private sector net of time and savings deposits

When net external banking assets were negative, the total money supply line is below the line limiting Government finance and when the Government's contribution is negative, the total money supply line is below the line limiting credit to public.

Changes in external banking assets attributable to exchange rate changes with contra entry in the International Reserve Revaluation Account have been excluded commencing January, 1977.

In contrast to a considerable expansionary impact of Rs. 688 million in the previous year, the operations of the private sector exerted a contractionary effect on the money supply amounting to Rs. 222 million during 1979. Bank credit to the other private sector (i.e. to all other than the government, public corporations and co-operatives, defined as 'other private sector') rose by Rs. 2,022 million, against an increase of Rs. 1,890 million in the preceding year. Borrowings by public corporations from the commercial banks increased by Rs. 984 million, while credit to co-operative institutions declined by Rs. 408 million.

The operations of the 'other private sector', which exerted an expansionary impact on money supply in the previous year, continued to be expansionary during 1979. Bank credit to this sector rose by a record Rs. 2,022 million, reflecting the expanded role of this sector in economic activity and the higher prices at which the transactions were financed. However, the expansionary impact of the operations of this sector was contained at Rs. 616 million, owing to an increase of Rs. 1,406 million in its time and savings deposits with the banking system.

In 1979, credit to the public corporations rose by a record Rs. 984 million. This was the combined outcome of a higher level of borrowings amounting to Rs. 1,124 million during the first half of the year, offset marginally by a reduction of Rs. 140 million during the second half. These heavy borrowings were sometimes due to higher level of activity, especially for higher levels of imports, but there was also evidence of excessive resort to credit on account of inappropriate pricing policies, lack of financial discipline, and failure to exercise a reasonable degree of inventory control. On the other hand, some commercial banks appeared to show an extra-ordinary preference to financing of public corporations, irrespective of their financial position. However, on account of a rise in time and savings deposits of this sector by Rs. 951 million, the expansionary impact of this sector's operations was contained at Rs. 33 million. The deposit growth of this magnitude was largely made possible by substantial deposits made by the National Development Bank with the banking system.

Commercial bank credit to co-operative institutions declined by Rs. 439 million in 1979. This contrasted with an increase of Rs. 205 million during 1978 and Rs. 509 million in 1977. The decline was mainly reflected in the advances for paddy purchases under the Guaranteed Price Scheme, which recorded a decrease of Rs. 387 million. Meanwhile, advances for cultivation and marketing purposes also dropped by Rs. 75 million and Rs. 17 million, respectively. However, credit for 'other' purposes showed a marginal increase of Rs. 40 million, leading to an overall reduction in credit to this sector. The sharp drop in credit to co-operative institutions in 1979 meant that the credit availability to the rural agricultural sector suffered a considerable set-back in 1979.

In contrast to the experience in 1977 and 1978, when the government fiscal operations led to a substantial monetary contraction, the government sector's operations with the banking system in 1979 resulted in a significant expansionary impact of Rs. 1,057 million. This was the combined outcome of a considerable increase in bank credit to the government and a decrease in government deposits with the banking system. Commercial bank credit to government increased by Rs. 63 million, while credit from the Central Bank rose by a record Rs. 767 million, resulting in a net increase of Rs. 830 million in bank credit to government. In addition, government's deposits with the banking system dropped by Rs. 227 million. However, the monetary expansion arising from these transactions was reduced to Rs. 477 million, by an increase in Central Bank's other assets and liabilities (net) of Rs. 580 million during the year. The latter consisted mainly of the surplus made by the Central Bank and an allocation of Special Drawing Rights by the International Monetary Fund.

Commercial Banking

Conforming to the developments observed in the past few years, the resources of commercial banks registered a sharp increase in 1979. The increase in total resources during the year was Rs. 4,817 million or 35 per cent, which was of the same magnitude as in the previous year. Changes in all major categories of liabilities contributed to enlarge the resource base of commercial banks. However, following the pattern observed in recent years, the growth in deposits provided the main impetus to the resource build-up, accounting for 72 per cent of the total increase in resources during the year. Both demand, and time and savings deposits registered large increases, but the growth in time and savings deposits amounting to Rs. 2,483 million accounted for the overwhelmingly larger share. As in the last year, this reflected the impact of the interest rate reform of 1977. Resource accumulation through increased deposits was further augmented by increases in paid-up capital, reserve funds and undistributed profits, foreign borrowings and in other liabilities. However, domestic inter-bank borrowings dropped by Rs. 552 million during the year.

Against a substantial accrual of resources, the demand for credit from the private sector continued to remain high. Commercial bank credit to the private sector, including government corporations, increased by Rs. 2,567 million in 1979. The ratio of liquid assets to demand deposits moved up slightly from 85 per cent in 1978 to 88 per cent in 1979, indicating a slight improvement in the liquidity position of commercial banks. Also, commercial banks' borrowings from the Central Bank at Bank rate and at penal rates, which stood at Rs. 255 million at the end of 1978, declined to Rs. 195 million at the end of 1979. On the other hand, the ratio of liquid assets to total deposits dropped from 37 per cent in 1978 to 34 per cent in 1979. Taking all these changes together, it would appear that the liquidity position of the banking system at the end of 1979 was not significantly different from the position prevailing at the end of the previous year.

The increased resources mobilized by the banking system were in turn utilized for providing credit to government corporations and the private sector, and for financing inter-bank transactions. Commercial bank advances to government corporations increased by Rs. 984 million, but on account of an increase of Rs. 1,286 million in this sector's deposits with the banking system, there was a net inflow of resources from this sector to the banks. The latter, however, was mainly accounted for by the deposits made by the National Development Bank and the National Savings Bank with the banking system. Commercial bank credit to co-operatives declined by Rs. 439 million, but this sector's deposits with the commercial banks increased by Rs. 151 million, resulting in a net inflow of resources of Rs. 590 million from this sector. On the other hand, commercial banks' accommodation to the other private sector rose by Rs. 2,022 million, but the net outflow of resources to this sector was reduced to a mere Rs. 60 million by a rise of Rs. 1,962 million in private sector's deposits with the banking system. Taking the private sector as a whole (i.e. including government corporations and co-operative institutions), although bank advances to this sector rose by Rs. 2,567 million, there was a net resource inflow of Rs. 832 million from this sector to commercial banks, owing to an increase of Rs. 3,399 million in this sector's total deposits with the banking system. Utilization of resources within the banking system amounted to Rs. 828 million during the year. This was very largely the outcome of an increase in their fixed and other assets amounting to Rs. 749 million. However, net inter-bank transactions increased by Rs. 25 million, while banks' till cash rose by Rs. 54 million. Table 1.26 summarizes the changes in commercial banks' resources and their utilization on a net basis.

TABLE 1 . 26

Changes in Commercial Banks' Resources and their Utilization

Rs. million

Sectors	End 1976/ End 1977	End 1977/ End 1978	End 1978/ End 1979
1. Government	25.6	220.8	15.6
2. Central Bank	197.6	126.1	- 872.2
3. Government Corporations	- 197.3	- 282.0	302.6
4. Co-operative Institutions†	- 416.0	- 213.8	589.8
5. Other Private Sector	546.1	- 350.5	- 60.2
6. Inter Bank	482.1	484.3	276.2
7. Foreign Sector	- 637.7	15.0	- 252.1

Source: Central Bank of Ceylon.

† Credit to co-operative institutions has been adjusted to take account of monies held in Paddy Marketing Board Suspense Account pending liquidation of matured Goods Receipts. The changes for 1977, 1978 and 1979 amounted to + Rs. 58.9 million, + Rs. 238.0 million and + Rs. 672.4 million, respectively.

Bank Branch Expansion

Official statistics show that there was a growth in commercial bank branch expansion in 1979. Altogether, the total number of branches of commercial banks rose by 73 in 1979, as compared with an increase of 22 in the previous year. This was made up of 44 new branches opened by the Bank of Ceylon, 25 by the People's Bank, 1 branch by the Hatton National Bank and 3 new foreign banks which commenced operations during the year. But, for security and economic reasons, the Bank of Ceylon "relocated" 240 of its 390 Agricultural Service Centre (ASC) branches, which almost amounted to a down-grading of these branches to that of an extension office of a nearby full fledged branch. Even the earlier ASC branches provided a minimal service, but on account of the recent change, it is doubtful whether they could now be treated as bank branches at all. If this factor is taken into account, the number of bank branches should be deemed to have declined in 1979.

A salient feature of commercial banking in 1979 was the departure from the hitherto pursued policy of not allowing new foreign banks to operate in Sri Lanka. In fulfilling the objective of the Government to attract more foreign investments, it became necessary to allow the foreign banks of good repute to open branches in the country. Accordingly, three new foreign banks, viz. the Banque De L'Indochine Et De Suez (Indosuez Bank), the Bank of Credit and Commerce International (Overseas) Ltd. and the Citibank N. A. opened branches in Sri Lanka during 1979, bringing the total number of commercial banks operating in the country to 14.

Another innovation during 1979 was the launching of the Foreign Currency Banking Scheme, which enabled the establishment of foreign currency banking units (FCBUs) in the country. These banking units were permitted to deal only in foreign currency and with non-residents, approved residents and GCEC enterprises only. It was anticipated that this would be a forerunner of the development of an off-shore banking centre in Sri Lanka. As at the end of the year, 11 commercial banks were given approval by the Central Bank to operate as foreign currency banking units. Initially, they were permitted to transact in the US dollar and the Pound Sterling; but later, this was extended to cover 8 major international currencies. These units were permitted to accept deposits from, and grant loans to non-residents and GCEC enterprises, in foreign currency. As at the end of 1979, the total assets and liabilities of these units stood at US\$ 39 million (Rs. 602 million).

The National Savings Bank opened 9 branches during the year. Thus, its total number of branches stood at 36 as at the end of the year.

Interest Rates

Apart from some minor changes, there were no fundamental changes in the level and structure of interest rates during 1979. Both the government securities (10-12 years) rate and the Treasury bill rate remained unchanged at 10 and 9 per cent, respectively. There were no changes in the interest rates offered by the commercial banks and the NSB, on savings and time deposits. However, a newly established foreign bank offered an incentive rate of 9 per cent on savings deposits of Rs. 5000 and above in December. The lending rates of commercial banks also remained unchanged at about the same level as at the end of the previous year, ranging between 10 to 21 per cent, depending on the type of security provided.

Bank rate remained at 10 per cent, as during the previous year. However, effective from 4th September, a progressively increasing graduated scale of penal rates ranging between 15 and 25 per cent was introduced in order to discourage commercial banks from resorting to excessive Central Bank credit.

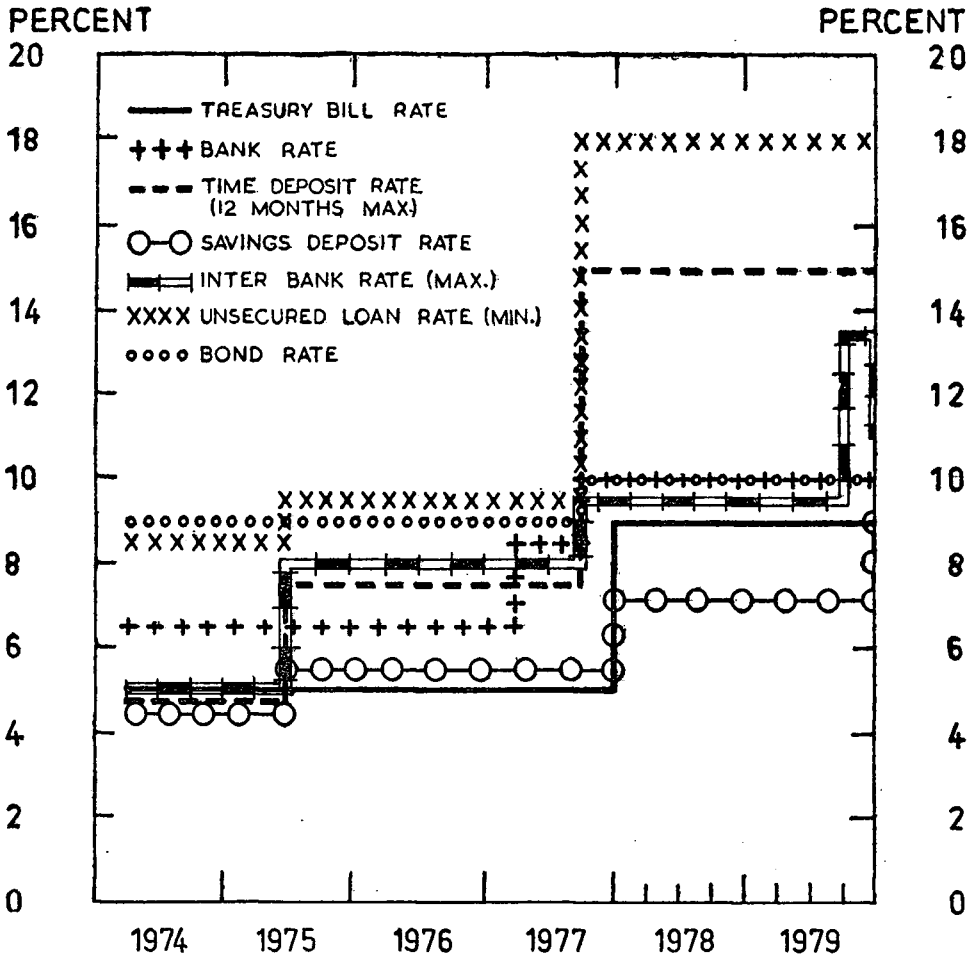
The fairly high penal rates did not directly affect the deposit and lending rates of commercial banks, but pushed up the inter-bank call loan rate from the previous levels of 7 and 9½ per cent to a level between 10 and 13½ per cent. Analyzed in the context of fairly heavy borrowing by banks, especially the major banks at high penal rates, this would indicate a relatively high insensitivity of major banks to current interest costs. The lending rates of the National Housing Department remained unchanged during the year, while those of the Development Finance Corporation recorded an increase of 1 percentage point in September. The maximum lending rate of the State Mortgage and Investment Bank moved up by 4 per cent from September, 1979. The National Development Bank, which commenced business on 1st October, charged 10-12 per cent on its refinance loans, in keeping with government policy. The refinance loans from the Medium and Long-term Credit Fund of the Central Bank were re-classified into three broad categories and, effective from 1st August, 1979 the interest rates were revised. Up to this date, 6½ per cent was charged on loans for the development of agriculture and industry, while a rate of 7½ per cent was charged on loans for the development of trade, commerce or business. After the revision, the refinance loans for agriculture and fisheries approved by ministries were made at 6½ per cent, for approved investments carrying tax holidays and for agriculture and fisheries outside those approved by ministries at 9 per cent, and other production loans at 11 per cent.

Central Banking

The total assets/liabilities of the Central Bank rose by Rs. 2,596 million or 18 per cent during 1979, as compared with an increase of Rs. 2,711 million or 23 per cent in the previous year. Following the pattern observed in the two preceding

MONEY RATES

END QUARTERLY FIGURES



years, the increase was in the external assets (the International Reserve) of the Bank, which rose by Rs. 1,828 million. The transactions with the IMF resulted in a net receipt of Rs. 1,900 million, while net purchases from commercial banks yielded Rs. 3,563 million. Interest earned on foreign investments amounted to Rs. 588 million. At the same time, payments out of International Reserve were mainly in respect of certain imports of the Government and government agencies, amounting to Rs. 3,319 million, and amortization of governments' foreign loans amounting to Rs. 1,015 million.

The domestic assets of the Central Bank increased by Rs. 768 million during the year. Credit to government, which recorded a marginal increase of Rs. 38 million in the previous year, increased substantially by Rs. 768 million in 1979. The Bank's holdings of government and government guaranteed securities increased by Rs. 586 million, while the provisional advances rose by Rs. 181 million. On the other hand, loans and advances to others decreased by Rs. 428 million. Of this, a noticeable feature was the decrease in Central Bank's accommodation to commercial banks by Rs. 60 million. The Central Bank invested Rs. 26 million in the share capital of the National Development Bank and the Sri Lanka Export Credit Insurance Corporation. The other assets and accounts of the Central Bank increased by Rs. 402 million, mainly as a result of a substantial increase in the Asian Clearing Union (ACU) Account, of Rs. 649 million.

On the liabilities side, the domestic liabilities of the Central Bank increased by Rs. 1,722 million in 1979. Of this, the currency issue increased by Rs. 812 million, or by 23 per cent, as compared with an increase of Rs. 289 million or 9 per cent in the previous year. The deposit liabilities, excluding those of the international institutions, declined by Rs. 114 million. This was mainly caused by a decrease of Rs. 305 million in the deposits of the Government, in sharp contrast to the increase of Rs. 944 million registered in the previous year. The decrease in the deposits of the Government, coupled with the increase in credit reflected the extent of Central Bank resources utilized by the Government in 1979. The Central Bank transferred Rs. 150 million to the Medium and Long-term Credit Fund in order to meet the increased demand for investment credit. The 'other liabilities and accounts' of the Central Bank also rose by Rs. 847 million in 1979. This mainly represents ACU items in transit, surplus of the Central Bank and an SDR allocation.

In sharp contrast to the decrease of Rs. 85 million in 1978, the external liabilities increased considerably by Rs. 874 million during 1979. Since the Central Bank's borrowings abroad declined by Rs. 86 million during the year, this increase was wholly confined to an increase in the deposits of foreign institutions by Rs. 960 million. The latter arose wholly due to increased net borrowings from the IMF during the year.

Monetary Policy

As mentioned earlier, the year 1979 witnessed a significant acceleration in the rate of monetary expansion, following the substantial moderation achieved in 1978. During the first half of the year, money growth was somewhat moderate, which obviated the necessity for any tightening of monetary policy. Hence, policy measures introduced in 1977 and 1978 were continued during the first eight months. The highlights of these policy measures were a Bank rate of 10 per cent, restrictions on Central Bank's accommodation to commercial banks at Bank rate and a penal rate of 15 per cent on borrowings in excess of this ceiling, non-recognition of commercial banks' till-cash as reserves, and a continuation of the ceiling on advances for non-essential purposes. Further, a ceiling had been imposed on

advances to non-bank companies engaged in lending money and hire purchase activities, except credit granted for financing capital equipment and new commercial vehicles. An overall ceiling on credit to public corporations and statutory boards had also been imposed at the behest of the government.

The second half of 1979 witnessed increased pressure in the monetary scene, which necessitated the adoption of measures to moderate the anticipated growth in money supply. The policy stance was directed at rationalizing the existing policy and introducing marginal changes, where necessary, with a view to improving their effectiveness. It was also considered prudent to regulate on the basis of costs, rather than fall back on quantitative restrictions. Accordingly, further restrictions were made on Central Bank accommodation to commercial banks, with a view to limiting the credit creating capacity of the latter. Experience showed that the penal rate of 15 per cent did not serve as a sufficient deterrent to discourage commercial banks from resorting to heavy borrowings from the Central Bank. Hence, it was decided to rationalize the availability of Central Bank credit, by enhancing the level of accommodation available at Bank rate to facilitate easy management of short-term liquidity problems, whilst at the same time, discouraging recourse to Central Bank credit in excess of such enhanced amounts, by subjecting such credit to a graduated scale of penal rates. With effect from 4th September, 1979, the volume of accommodation available at Bank rate was raised from Rs. 402 million to Rs. 613 million, consisting of Rs. 403 million general accommodation, which was 4 per cent of selected assets of commercial banks, outstanding as at June 30, 1979; and Rs. 210 million export credit re-financing, distributed on the basis of outstanding export credit as at December 31, 1978. Any excess of borrowings above these limits were subject to a graduated scale of penal rates of 15 per cent on the first 10 per cent of eligibility, 16 per cent on the second 10 per cent of eligibility, 18 per cent on the third 10 per cent of eligibility, 20 per cent on the fourth 10 per cent of eligibility, 22 per cent on the fifth 10 per cent of eligibility and thereafter, at 25 per cent per annum.

The introduction of a graduated scale of penal rates discouraged most of the banks from borrowings from the Central Bank at penal rates, thereby restricting their credit creating capacity. For instance, the average monthly increase in bank credit to private sector which amounted to Rs. 282 million during the eight-month period ended August, dropped to Rs. 78 million in the four-month period ended December, 1979.

The experience during the first half of 1979, showed that there was increased pressure from government corporations for commercial bank credit and the two state sector banks felt themselves obliged to provide accommodation in excess of the ceiling. Therefore, the ceiling on credit to government corporations was withdrawn from 4th September. As there was yet a need for concerted action to prevent public corporations from pre-empting too much of the available commercial bank resources from the private sector proper, the Public Enterprises Division of the General Treasury was requested to exercise strict control over the borrowing operations of the public corporations.

The policy measures adopted during the second half of the year helped to maintain the rate of growth of the money supply at a level considerably lower than which would otherwise have been the case. However, in December alone, the money supply rose by 6 percentage points, indicating the need to carefully watch the monetary situation in the period ahead. As the major underlying factors responsible for monetary expansion were the growth in external banking assets and the expansionary impact of government fiscal operations, an immediate resort to further monetary measures was therefore not considered desirable, as it would have affected private sector operations adversely.