



## Monetary Policy, Interest Rates, Money and Credit

**T**he Central Bank maintained an extremely accommodative monetary policy stance from the onset of the pandemic in early 2020 through mid August 2021. Such accommodative policy helped reduce market interest rates to historically low levels and provide adequate liquidity to the domestic money market, thereby helping individuals and businesses affected by the pandemic, while also helping to revive economic activity from the adverse effects of the pandemic. The Central Bank provided significant funding support to the Government amidst disruptions to government cashflows due to the pandemic. Supported by the low cost of funds and high levels of liquidity in the domestic money market, credit extended to the private sector expanded substantially, which, along with the expansion in credit to the public sector, resulted in a notable growth of domestic credit and money supply thus far in 2021. With the gradual normalisation of economic activity alongside possible inflationary pressures over the medium term, the Central Bank tightened its monetary policy stance in mid August 2021, while also rectifying some anomalous behaviour of interest rates observed between local and foreign currency deposits amidst the escalation of pressures on the external sector. Following the tightening of the monetary policy stance, the short term money market rates adjusted upwards, and other market interest rates are also expected to increase and stabilise at higher levels.

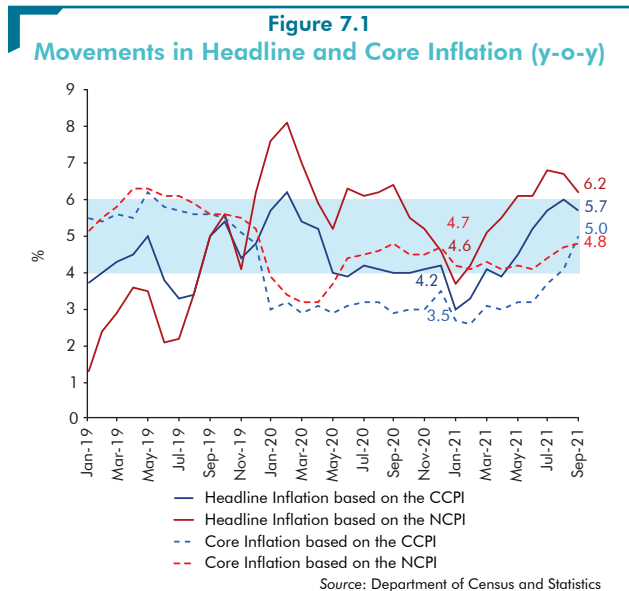
### 7.1 Monetary Policy Stance of the Central Bank

The unprecedented adverse effects of the pandemic on individuals, businesses and overall activity warranted an extremely accommodative monetary policy stance for a prolonged period. The Central Bank lowered the policy interest rates, i.e., the SDFR and the SLFR, and the Bank Rate, along with the SRR applicable on all rupee deposit liabilities of LCBs to historic low levels, while providing large amounts of liquidity to the domestic money market. Consequently, the overall interest rate structure moved downwards notably, thereby availing low cost funds to both private and public sectors. Further, the debt moratoria and concessionary loan schemes introduced in 2020, extended further support to individuals and businesses affected by the pandemic. In addition, considering the cashflow difficulties faced by the Government amidst the pandemic, the Central Bank provided an unprecedented amount of financial

**The Central Bank, which initiated an unprecedented easing of monetary policy since early 2020 with the outbreak of the COVID-19 pandemic, tightened its monetary policy stance in mid August 2021...**

support to the Government. However, the Central Bank began to rollback the monetary support by tightening the monetary policy stance in mid August 2021 with the aim of addressing imbalances in the external sector and financial markets, while preempting any buildup of excessive inflationary pressures over the medium term, amidst improved growth prospects. Following the tightening of monetary policy, liquidity in the domestic money market declined to deficit levels, resulting in an upward adjustment in short term market interest rates. While allowing the interest rates on rupee deposits to increase, the Central Bank imposed a ceiling interest rate on foreign currency deposit products of LCBs and NSB in August 2021 to address anomalies between interest rates of rupee and foreign currency products in the market.

The CCPI (2013=100) based y-o-y headline inflation, which remained well below the lower bound of the target range during the early months of 2021, accelerated gradually thereafter, driven mainly by increases in food



prices. Upward revisions to several administratively determined prices in line with rising global commodity prices also fuelled inflation. Following a similar trend, y-o-y headline inflation as measured by the NCPI (2013=100) also accelerated and remained relatively high due to the large weight assigned to the food category. Core inflation, which prevailed subdued during the first half of the year, accelerated gradually thereafter, mainly due to upward price adjustments to several other food items as well as infrequent price adjustments relating to sectors, such as education, health, restaurants and hotels, in the non-food category. Demand pressures on inflation were also reflected in inflation trends in recent months, with the gradual normalisation of economic activity.

**Inflation followed an upward trend in recent months, driven mainly by supply-side disruptions caused by the pandemic and adverse weather conditions, while also reflecting the gradual buildup of demand pressures...**

The Central Bank continued to conduct monetary policy under the framework of flexible inflation targeting, where the AWCMR serves as the operating target and is maintained at desired levels in accordance with the Central Bank’s objective of maintaining inflation within the target of 4-6% over the medium term, while supporting sustained growth in the economy. In

terms of monetary policy communication, the Central Bank unveiled 'The Six-Month Road Map for Ensuring Macroeconomic and Financial System Stability' in October 2021 to inform all the stakeholders on the

**The objective of monetary policy continued to be maintaining inflation at mid-single digit levels over the medium term, while supporting the economy to reach its potential growth path...**

proposed framework to stabilise the economy particularly in the near term. In addition to the regular press releases on the monetary policy stance, the Central Bank has decided to commence publishing a comprehensive Monetary Policy Report from early 2022 to provide greater clarity to stakeholders of the future trajectory of key macroeconomic variables.

### 7.2 Market Liquidity and Movements in Interest Rates

Rupee liquidity in the domestic money market, which remained at significant surplus levels until mid 2021, was reduced notably through the increase in the SRR commencing September 2021. Surplus liquidity during 2021 was mainly due to the substantial amount of liquidity provided through the purchases of government securities by the Central Bank at primary market auctions and direct allocations. However, foreign loan

repayments of the Government using gross official reserves, sizeable withdrawals of currency by the public from the banking system, and maturities of foreign currency buy-sell swaps with domestic banks, caused liquidity in the domestic money market to decline to marginal deficit levels by mid August 2021. Meanwhile, the tightening of the monetary policy stance resulted in a further decline of rupee liquidity in the market September 2021 onwards. In view of asymmetric liquidity distribution and volatility in liquidity levels, the Central Bank commenced conducting open market operations, while maintaining deficit levels of rupee liquidity in the market. Both overnight and term repo auctions were conducted with a view to steering the AWCMR to desired levels, amidst the asymmetric distribution of liquidity within banks. The Central Bank also conducted reverse repo auctions occasionally to inject liquidity to remedy the frequent access to the Standing Lending Facility window of the Central Bank by certain banks. In response to liquidity conditions, the AWCMR gradually adjusted towards the upper bound of the policy rate corridor during the period under review.

**Increase in SRR by 2 pps absorbed around Rs. 170 bn liquidity from the domestic money market...**

Most market interest rates, which were in a downward trend due to eased monetary conditions, changed course following the tightening of monetary policy in mid August 2021. The unprecedented level of monetary easing amidst ample liquidity in the domestic money market helped maintain retail market interest rates at low levels. Continuing the trend that was observed in 2020, market deposit rates showed an overall reduction until June 2021. Market lending rates also recorded historically low levels during 2021. In particular, rates on loans for MSMEs, a sector that was severely affected by the pandemic, reduced noticeably, on average, in line with the overall trend in market lending rates. However, lending rates on selected products and segments, particularly unsecured loans and loans for non prime customers, remained somewhat high. Moreover, with market interest rates declining to low levels, real returns on deposits, particularly savings deposits and short term fixed deposits, turned negative. However, with the tightening of monetary conditions, new deposit rates commenced increasing, while new market lending interest rates began adjusting upwards gradually.

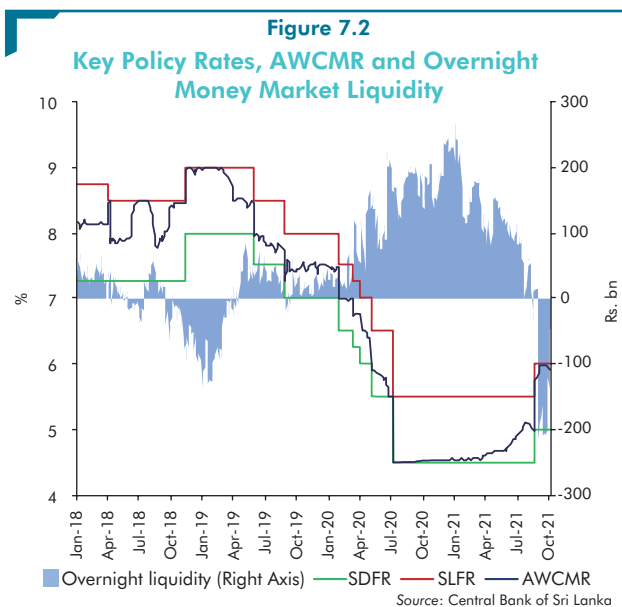
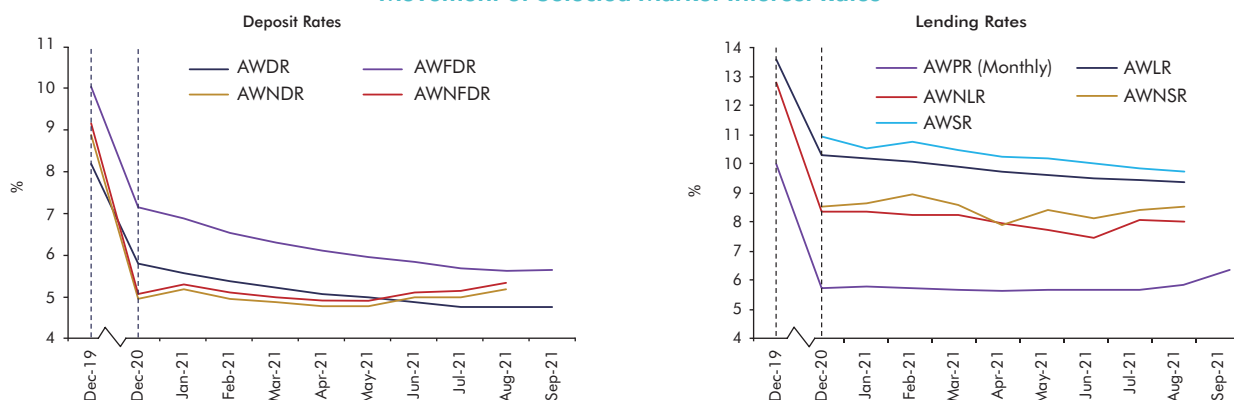


Figure 7.3  
Movement of Selected Market Interest Rates



Source: Central Bank of Sri Lanka

Meanwhile, yields on government securities, which also declined notably during 2020, adjusted upwards gradually since late 2020 along with the adjustments to maximum yield rates for acceptance at primary auctions of government securities, mainly reflecting the increased borrowing requirement of the Government. The expanded budget deficit and reduced foreign currency inflows to the Government caused upward pressure on yields on government securities. Following the monetary tightening in mid August 2021 and the removal of maximum yield rates for acceptance at primary auctions in mid September 2021 to better reflect market preferences, yields on government securities continued to adjust upwards.

Interest rates on foreign currency deposits increased significantly, mainly reflecting competition among banks to mobilise foreign exchange amidst constrained liquidity in the domestic foreign exchange market. In order to eliminate the buildup of interest rate anomalies between domestic currency and foreign currency financial instruments, a maximum interest rate was imposed on foreign currency deposits of licensed banks in late August 2021.

### 7.3 Money and Credit

The growth of broad money supply ( $M_{2b}$ ) has remained above 20% since October 2020, and the overall stock of  $M_{2b}$  increased to Rs. 10.5 tn by end August 2021. The easing of monetary policy stance to an unprecedented level, which caused a notable expansion of domestic credit, both to the private sector and the public sector, contributed to the increase in broad money supply.

In terms of the assets side of  $M_{2b}$ , the expansion in the money supply was driven entirely by the increase in NDA of the banking system, while NFA of the

banking system contracted notably, mainly due to the decline in NFA of the Central Bank. The increased funding requirement of the Government, amidst the pandemic and limited access to international capital markets, was met largely through the banking system. Accordingly, continuing the trend observed in 2020, NCG by the banking system increased notably during

**Accommodative monetary policy measures adopted by the Central Bank and excessive monetary financing of the Government's borrowing requirement resulted in a rapid expansion of broad money supply from mid 2020 through August 2021...**

the period from January to August 2021. This included the significant financial support provided by the Central Bank to the Government by way of purchasing Treasury bills. Accordingly, NCG from the Central Bank increased notably during the eight months ending August 2021. With the notable increase of yields on government securities, following the increase in policy

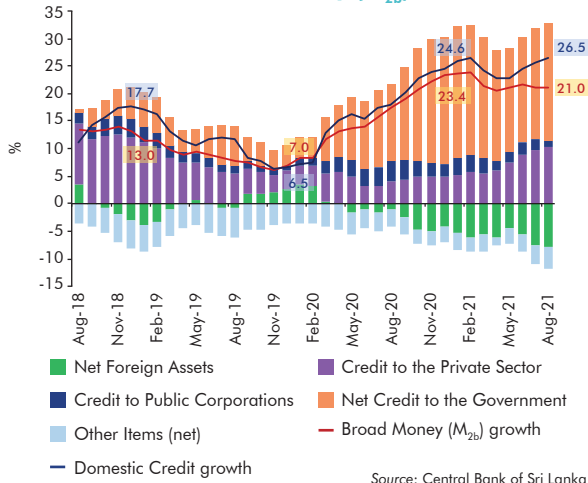
Table 7.1  
Developments in Monetary Aggregates (a)

	Aug - 21	Change (y-t-d)
$M_{2b}$	10,513.6	1,107.9
NFA	- 701.0	- 491.5
NDA	11,214.6	1,599.4
NCG	5,682.1	1,134.1
SOBEs	1,136.9	134.7
PSC	6,795.5	624.6

(a) Provisional

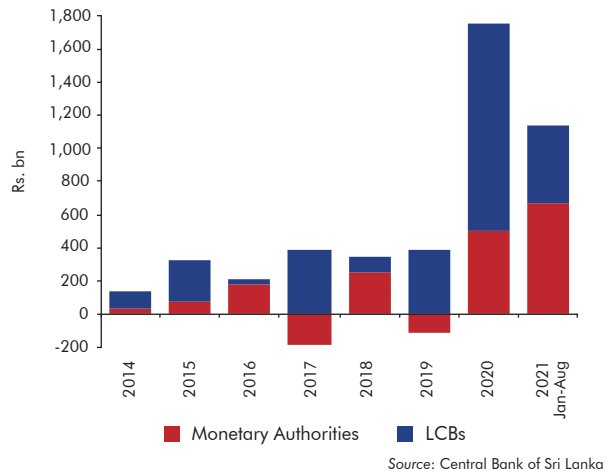
Source: Central Bank of Sri Lanka

**Figure 7.4**  
Contribution to y-o-y Growth of Broad Money ( $M_{2b}$ )



Source: Central Bank of Sri Lanka

**Figure 7.5**  
Annual Change in NCG from the Banking System



Source: Central Bank of Sri Lanka

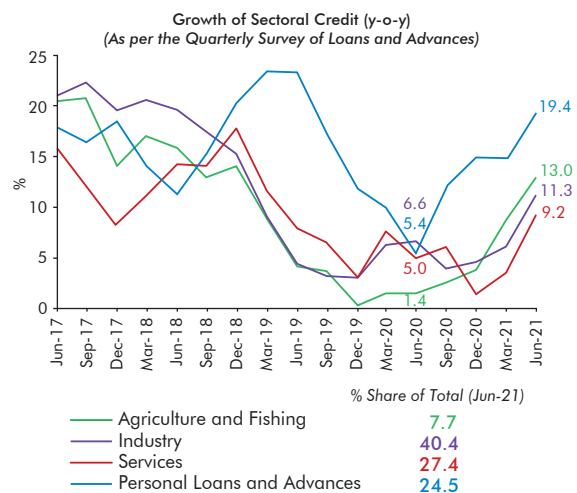
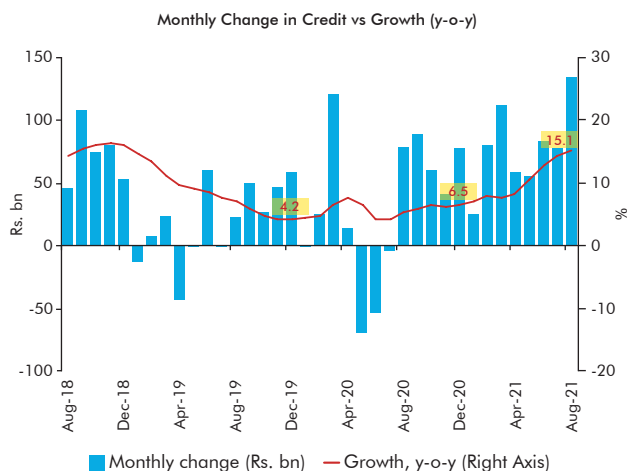
**The unprecedented expansion of NCG continued together with large credit flows to SOBEs, while the growth of credit extended to the private sector has also picked up notably thus far during 2021...**

interest rates and the removal of maximum yield rates for acceptance in mid September 2021, the need for the Central Bank's subscription at primary market auctions of government securities is expected to gradually ease in the period ahead. Credit obtained by SOBEs from LCBS, both in terms of rupee and foreign currency, expanded during the period from January to August 2021, broadly

reflecting the weak financial position of most SOBEs, exacerbated by the outbreak of the pandemic.

Credit extended to the private sector gathered pace, recording a y-o-y growth of 15.1% by end August 2021. This was mainly supported by the ultra low market interest rates, concessionary loan schemes, relaxation of import restrictions alongside the gradual recovery of economic activity. Credit extended to the private sector expanded considerably by Rs. 624.6 bn during the eight months ending August 2021, compared to the annual increase of Rs. 374.1 bn during 2020. With various credit schemes that have been announced in support of the pandemic-stricken businesses and individuals, a notable increase in credit from the banking system towards productive sectors of the economy, including the MSME sector, has been observed thus far during the year.

**Figure 7.6**  
Credit Extended to the Private Sector by LCBS



Source: Central Bank of Sri Lanka

**Table 7.2**  
**Movements of Interest Rates**

% per annum

Interest Rate	End 2018	End 2019	End 2020	End Sep 2021
<b>Key Policy Rates</b>				
Standing Deposit Facility Rate (SDFR)	8.00	7.00	4.50	5.00
Standing Lending Facility Rate (SLFR)	9.00	8.00	5.50	6.00
<b>Average Weighted Call Money Rate (AWCMR)</b>	8.95	7.45	4.55	5.94
<b>Yield Rates on Government Securities</b>				
<b>Primary Market (a)</b>				
<b>Treasury bills</b>				
91-day	10.01	7.51	4.69	6.70
182-day	9.99	8.02	4.80	6.99
364-day	11.20	8.45	5.05	7.01
<b>Treasury bonds</b>				
2-year	-	9.79	5.65	8.12
3-year	11.88	9.65	5.99	8.10
4-year	-	-	6.32	8.55
5-year	11.69	9.87	6.79	7.31
10-year	10.20	10.23	9.99	8.86
<b>Secondary Market</b>				
<b>Treasury bills</b>				
91-day	9.67	7.52	4.63	6.48
182-day	9.96	7.88	4.73	6.59
364-day	10.91	8.36	4.98	6.72
<b>Treasury bonds</b>				
2-year	11.16	8.60	5.56	7.37
3-year	11.42	9.08	5.96	8.17
4-year	11.54	9.46	6.40	8.92
5-year	11.58	9.67	6.65	9.31
10-year	11.87	10.05	7.55	10.15
<b>Licensed Commercial Banks (b)</b>				
<b>Interest Rates on Deposits</b>				
Savings Deposits	0.50-8.50	0.20-7.50	0.10-7.00	0.10-6.00 (c)
1 Year Fixed Deposits (d)	4.53-15.00	3.55-15.00	0.25-15.00	0.25-15.00 (c)
Average Weighted Deposit Rate (AWDR) (e)	8.81	8.20	5.80	4.75
Average Weighted Fixed Deposit Rate (AWFDR) (e)	10.85	10.05	7.14	5.64
Average Weighted New Deposit Rate (AWNDR) (e)	10.94	8.89	4.93	5.19 (c)
Average Weighted New Fixed Deposit Rate (AWNFDR) (e)	11.27	9.17	5.08	5.35 (c)
<b>Interest Rates on Lending</b>				
Average Weighted Prime Lending Rate (AWPR)-Monthly	11.94	10.00	5.74	6.39
Average Weighted Lending Rate (AWLR)	14.40	13.59	10.29	9.38 (c)
Average Weighted New Lending Rate (AWNLR)	14.54	12.80	8.38	8.04 (c)
<b>Other Financial Institutions (f)</b>				
<b>Interest Rates on Deposits</b>				
National Savings Bank				
Savings Deposits	4.00	4.00	3.50	3.50
1 Year Fixed Deposits	10.50	9.83	5.25	5.50
Licensed Finance Companies (g)				
Savings Deposits	5.21-7.77	5.14-7.10	3.40-4.74	3.26-4.50 (c)
1 Year Fixed Deposits	11.63-13.21	10.98-11.97	6.56-7.21	6.64-7.61 (c)
<b>Interest Rates on Lending</b>				
National Savings Bank	6.75-16.25	12.00-14.50	7.00-10.00	7.50-11.50
State Mortgage and Investment Bank (h)	10.50-20.00	10.25-18.00	8.73-12.50	7.50-12.50
Licensed Finance Companies (g)				
Finance Leasing	16.17-28.80	14.75-27.40	14.31-28.97	13.26-27.00 (c)
Hire Purchase	15.16-18.65	13.40-24.82	13.71-20.05	21.28-25.26 (c)
Loans against Real Estate (i)	18.94-19.21	15.53-16.71	19.95-22.30	-
Loans against Immovable Properties (i)	-	-	-	13.89-16.50 (c)
<b>Corporate Debt Market</b>				
Debentures	12.00-14.75	12.30-15.50	9.00-13.25	8.00-12.00
Commercial Paper	13.10-15.00	13.00-16.25	6.50-15.50	6.25-11.50 (c)

(a) Weighted average yield rates at the latest available auction

(b) Based on the rates quoted by LCBs

(c) As at end August 2021

(d) Maximum rate is a special rate offered by certain LCBs.

(e) Since July 2018, AWDR and AWFDR were calculated by replacing senior citizens' special deposit rate of 15% with relevant market interest rates to exclude the impact of special rates. Same method was applied to calculate AWNDR and AWNFDR since June 2018.

(f) Based on the rates quoted by other selected Financial Institutions

(g) 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.

(h) Lending for housing purposes only

(i) "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

**Table 7.3**  
**Developments in Monetary Aggregates and Underlying Factors**

Rs. bn

Item	2018 Dec	2019 Dec (a)	2020 Dec	2021 Aug (b)
<b>1. Reserve Money</b>	<b>961.1</b>	<b>932.6</b>	<b>964.4</b>	<b>1,089.3</b>
(% change y-o-y)	2.3	-3.0	3.4	23.8
Net Foreign Assets of the Central Bank	750.5	896.0	526.8	-83.9
Net Domestic Assets of the Central Bank	210.6	36.6	437.7	1,173.1
<b>2. Narrow Money (M<sub>1</sub>)</b>	<b>830.8</b>	<b>865.5</b>	<b>1,177.2</b>	<b>1,355.2</b>
(% change y-o-y)	4.7	4.2	36.0	28.0
<b>3. Broad Money (M<sub>2b</sub>)</b>	<b>7,128.3</b>	<b>7,624.1</b>	<b>9,405.7</b>	<b>10,513.6</b>
(% change y-o-y)	13.0	7.0	23.4	21.0
3.1 Net Foreign Assets (NFA)	-67.0	100.7	-209.5	-701.0
Monetary Authorities (c)	750.5	896.0	526.8	-83.9
Licensed Commercial Banks (LCBs)	-817.5	-795.3	-736.2	-617.1
3.2 Net Domestic Assets (NDA)	7,195.3	7,523.4	9,615.2	11,214.6
Domestic credit	8,833.4	9,410.7	11,721.2	13,614.5
Net Credit to the Government (NCG)	2,516.7	2,795.9	4,548.1	5,682.1
Central Bank	472.8	363.0	868.9	1,534.4
Licensed Commercial Banks (LCBs)	2,043.9	2,432.9	3,679.2	4,147.7
Credit to Public Corporations / SOBEs	755.4	818.0	1,002.2	1,136.9
Credit to the Private Sector	5,561.4	5,796.9	6,170.9	6,795.5
(% change y-o-y)	15.9	4.2	6.5	15.1
Other Items (net)	-1,638.1	-1,887.3	-2,106.0	-2,399.9
<b>4. Broad Money (M<sub>4</sub>)</b>	<b>8,729.6</b>	<b>9,444.5</b>	<b>11,461.9</b>	<b>12,790.1</b>
(% change y-o-y)	12.0	8.2	21.4	20.2
4.1 Net Foreign Assets (NFA)	-133.7	88.8	-217.1	-712.9
Monetary Authorities (c)	750.5	896.0	526.8	-83.9
Licensed Commercial Banks (LCBs)	-817.5	-795.3	-736.2	-617.1
Licensed Specialised Banks (LSBs)	-66.7	-11.9	-7.6	-12.0
4.2 Net Domestic Assets (NDA)	8,863.3	9,355.8	11,679.0	13,503.0
Net Credit to the Government (NCG)	3,100.0	3,483.0	5,365.7	6,594.6
Central Bank	472.8	363.0	868.9	1,534.4
Licensed Commercial Banks (LCBs)	2,043.9	2,432.9	3,679.2	4,147.7
Licensed Specialised Banks (LSBs)	518.6	613.9	742.2	825.8
Licensed Finance Companies (LFCs)	64.8	73.2	75.5	86.6
Credit to Public Corporations / SOBEs (by LCBs)	755.4	818.0	1,002.2	1,136.9
Credit to the Private Sector	7,501.1	7,793.3	8,284.5	9,033.1
(% change y-o-y)	14.9	3.9	6.3	13.6
Licensed Commercial Banks (LCBs)	5,561.4	5,796.9	6,170.9	6,795.5
Licensed Specialised Banks (LSBs)	753.8	814.2	936.5	1,035.6
Licensed Finance Companies (LFCs)	1,185.9	1,182.2	1,177.1	1,202.0
Other Items (net)	-2,493.3	-2,738.4	-2,973.4	-3,261.6
Memorandum Items:				
Money Multiplier (M <sub>2b</sub> )	7.42	8.18	9.75	9.65
Velocity (M <sub>2b</sub> average) (d)	2.11 (a)	2.04	1.76	-

(a) Revised

(b) Provisional

(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

(d) Based on GDP estimates by the Department of Census and Statistics

Source: Central Bank of Sri Lanka

## Abbreviations and Acronyms

AWCMR	: Average Weighted Call Money Rate	MSMEs	: Micro, Small and Medium scale Enterprises
AWDR	: Average Weighted Deposit Rate <sup>1</sup>	NCG	: Net Credit to the Government
AWFDR	: Average Weighted Fixed Deposit Rate <sup>2</sup>	NCPI	: National Consumer Price Index
AWLR	: Average Weighted Lending Rate <sup>3</sup>	NDA	: Net Domestic Assets
AWNDR	: Average Weighted New Deposit Rate <sup>4</sup>	NFA	: Net Foreign Assets
AWNDFDR	: Average Weighted New Fixed Deposit Rate <sup>5</sup>	NSB	: National Savings Bank
AWNLR	: Average Weighted New Lending Rate <sup>6</sup>	pps	: Percentage Points
AWNSR	: Average Weighted New SME Loan Rate <sup>7</sup>	PSC	: Private Sector Credit
AWPR	: Average Weighted Prime Lending Rate <sup>8</sup>	SDFR	: Standing Deposit Facility Rate
AWSR	: Average Weighted SME Loan Rate <sup>9</sup>	SLFR	: Standing Lending Facility Rate
bn	: Billion	SMEs	: Small and Medium scale Enterprises
CCPI	: Colombo Consumer Price Index	SOBEs	: State Owned Business Enterprises
LCBs	: Licensed Commercial Banks	SRR	: Statutory Reserve Ratio
LFCs	: Licensed Finance Companies	tn	: Trillion
LSBs	: Licensed Specialised Banks	y-o-y	: Year-on-Year
M <sub>2b</sub>	: Consolidated broad money supply	y-t-d	: Year-to-Date

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

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

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

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

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

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

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

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

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