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Central Banks of the SAARC Region

Da Afghanistan Bank

Maldives Monetary Authority

Bangladesh Bank

Nepal Rastra Bank

Royal Monetary Authority of Bhutan

State Bank of Pakistan

Reserve Bank of India

Central Bank of Sri Lanka

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Governor's Message

As Chair of SAARCFINANCE (SF), it is my great pleasure to present the 2024 edition of the annual SF e-newsletter. This edition highlights the achievements of SF members since the chairmanship transitioned from the State Bank of Pakistan to the Central Bank of Sri Lanka.

During the pandemic and its aftermath, SF meetings and seminars were held on virtual platforms. However, we are delighted to witness a gradual return to in-person gatherings since last year. This year, nearly all meetings and seminars have resumed in physical form. These in-person events are vital for effective networking and knowledge sharing among members.

A key highlight of such gatherings was the SF Governors' Symposium, hosted by Sri Lanka in Colombo, under the theme "Central Banking Amid Multi-faceted Global Economic Challenges". The President of Sri Lanka and Minister of Finance, Economic Stabilisation, and National Policies, delivered the keynote address at this event. The symposium's discussions centered on two critical themes: "Challenges and Opportunities Arising from Evolving Global Economic Dynamics and Their Implications for SAARC Countries" and "Revisiting Monetary Policy Processes and Paradigms in SAARC Countries". Central Bank Governors, Deputy Governors and Secretaries to the Treasuries from member countries served as panelists, sharing insights on the challenges they face in restoring or maintaining economic stability.

This year, three in-person seminars were also organised by the Reserve Bank of India, State Bank of Pakistan, and Bangladesh Bank, focusing on several critical areas: "Emerging Digital Technologies in Central Banking and Finance", "The Potential Role of Big Data in Economic Policy", and "Trade in Local Currencies", respectively. These seminars played a key role in facilitating the exchange of knowledge among members.

The SF Roadmap for cooperation continues to serve as the foundation of our collaborative efforts. Under this framework, technical assistance sessions, training programs, and seminars have been actively conducted. The SF Scholarship Scheme has also awarded numerous scholarships for PhD and master's programs to officials from ministries of finance and central banks across the region. I would like to extend my sincere thanks to the Reserve Bank of India for its ongoing support of the SF Scholarship Scheme, which remains a crucial resource for aspiring professionals.

Additionally, three new collaborative studies were launched this year, focusing on important issues: "The Implications of Climate Change and Environmental Sustainability for Monetary Policy and Financial Stability in SAARC Countries", "The Efficacy of Monetary Policy in the SAARC Region", and "Local Currency Settlement and Exchange Rate Management in SAARC Countries". The SF Working Group on Sustainable Finance, initiated by the previous Chair, also continues to make progress, holding its inaugural meeting this year to finalise its terms of reference.

It was a privilege to host the 45th SF Governors' Group meeting in Colombo, Sri Lanka, alongside the SF Coordinators' meeting. The Governors' Group meeting provided a valuable platform for high-level discussions on regional challenges and initiatives, fostering essential collaboration among member countries. At this meeting, the Governor of the Reserve Bank of India proposed revisiting the SF Roadmap for cooperation to align with new priorities. As many existing activities, such as collaborative studies and seminars, have become well-established within SF, this proposal was timely. Additionally, the Reserve Bank of India introduced a quarterly online seminar series on Financial Inclusion Learning (FILS), which was successfully launched with insightful presentations by scholars from both the Reserve Bank of India and State Bank of Pakistan. The continuation of the SF Swap Arrangement facility by Reserve Bank of India also deserves special commendation as it fulfils the liquidity needs of several central banks in the region.

The year was concluded with the 46th SF Governors' Group Meeting in Washington D.C. on the sidelines of the Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group and continued the discussions on collaborative research and capacity building initiatives as well as on regional financial assistance at times of economic distress. Moreover, the new SF Roadmap was adopted emphasising the three main areas of "enhancing cooperation in banking regulation and supervision", "financing for climate and sustainable development", and "evaluating the opportunities and challenges of emerging digital technologies in central banking operations".

With successfully crossing the Silver Jubilee milestone in 2023, the SF has made great strides in fostering cooperation over the past 25 years. However, there remains significant untapped potential for further integration, particularly in areas such as trade, financial resource sharing, and the exchange of technical expertise. As an integral part of the SAARC institutional framework, SF has immense potential to further advance regional cooperation in economic and financial affairs in the years to come.

I extend my heartfelt appreciation to the Governors of SF member countries, as well as the SF coordinators, alternate coordinators, and contributing officials from all member nations, for their invaluable contributions and dedicated efforts in producing this e-newsletter. I would also like to thank the editorial team at the Central Bank of Sri Lanka for their excellent work on this edition.

Finally, I express my sincere gratitude to all members for their active participation during my tenure as Chair. I am confident that the spirit of collaboration will continue to thrive in the years ahead. I wish the Governor of the Bangladesh Bank every success as he takes over as the new Chair of SF.

Dr. Nandalal Weerasinghe
Governor, Central Bank of Sri Lanka

SECTION 01
Meetings and Initiatives

45TH SAARCFINANCE GOVERNORS' MEETING AND SYMPOSIUM

The Central Bank of Sri Lanka (CBSL) hosted the 45th SAARCFINANCE Governors' Meeting and Symposium from 13-14 June 2024 in Colombo, Sri Lanka. The event brought together Governors, Finance Secretaries, and other delegates from Central Banks and Ministries of Finance in the SAARC region. The Secretary General of SAARC, Ambassador Md. Golam Sarwar also attended the inauguration.

SAARCFINANCE GOVERNORS' SYMPOSIUM

The SAARCFINANCE Governors' Symposium, themed "Central Banking amid Multi-faceted Global Economic Challenges" was held on 13 June 2024. The President of Sri Lanka and Minister of Finance, Economic Stabilisation, and National Policies, graced the inaugural ceremony and delivered the keynote speech. In his address, the President emphasised the importance of strengthening regional cooperation to tackle contemporary economic challenges and promote growth. He also reiterated the need for monetary and fiscal stability and highlighted ongoing efforts to strengthen the legal framework to ensure lasting stability in the country.

The day's proceedings included two insightful panel discussions.

The first panel discussion titled "Challenges and Opportunities of Evolving Global Economic Dynamics to SAARC Countries: Sharing Experience" featured distinguished panelists, Governor Maha Prasad Adhikari, Nepal Rastra Bank; Governor Ali Hashim, Maldives Monetary Authority; and Secretary to the Treasury K M Mahinda Siriwardana of Sri Lanka. The session was moderated by Dr. Ganeshan Wignaraja, Visiting Senior Fellow at Overseas Development Institute (ODI).

The discussion elaborated on the ongoing global economic challenges faced by SAARC members, including capital flow disruptions arising from persistent inflation, geopolitical tensions, and supply chain disruptions. These factors have increased volatility and uncertainty in the region's economies. Maintaining price stability has been particularly challenging due to the higher weight of food in the consumption basket and limited prospects for lower food and petroleum product prices in the short term. While projections from the World Bank and Asian Development Bank indicate faster growth in South Asia, panelists noted that this growth is largely driven by government spending with limited job creation. Debt sustainability was identified as another emerging challenge, driven by high fiscal deficits, increasingly financed through domestic debt mobilisation. Notably, the growing share of domestic debt in total outstanding public debt across many SAARC economies has led to rising debt servicing costs. The panel also reflected on lessons learned from the COVID-19 pandemic and the efforts of governments and central banks to support economic recovery.

The panelists also discussed on the emergence of artificial intelligence (AI) and the fintech revolution. The technological advancement has reshaped the global financial ecosystem, and the panelists emphasised that this transformation demands regional attention. Investing in cybersecurity infrastructure and cross-border payment systems, and strengthening regional Information and Communications Technology (ICT) connectivity are critical to ensuring the financial system's security. Additionally, the panel underscored the growing significance of green financing. As the international community looks to central banks to lead efforts in addressing climate risks, the panelists argued that central banks could play a pivotal role by implementing policies that attract green investments and contribute to enhancing the climate resilience.

The South Asian region, home to approximately one-fourth of the world's population, holds strategic importance for promoting regionalism. Therefore, policy coordination in the region would be crucial, particularly when inflation is driven by supply disruptions. The discussion emphasised the necessity for SAARC countries to adopt conducive policies for private sector to complement public investment initiatives. The conversation also highlighted that the diverse economic performances among SAARC member countries underscore the need for tailored policies and regional cooperation to address specific challenges. Additionally, cooperation among SAARC nations is essential for advancing the green financing agenda, addressing climate change, and reducing vulnerabilities through alternative financing models. In addition to financial cooperation, the region needs to focus on strategic initiatives and collaborative efforts for improving land and air connectivity, modernising customs processes, enhancing logistics services, and strengthening road and rail networks to promote trade and regional integration.

The symposium reiterated the need for a collaborative approach focusing on exchanging knowledge and experiences among SAARC countries. The discussions

highlighted the importance of regional cooperation, innovation, and sustainable development in promoting economic stability and prosperity in South Asia. As the region continues to navigate a complex global economic landscape, the insights and recommendations from this symposium will be crucial in shaping future policy decisions.

The second panel discussion was themed "Revisiting Monetary Policy Processes and Paradigms in SAARC Countries: Policy Puzzles, Solutions, and Lessons Learnt". Panelists were Governor Dasho Penjore, Royal Monetary Authority of Bhutan; Governor Dr. Nandalal Weerasinghe, Central Bank of Sri Lanka; and Deputy Governor Saleem Ullah, State Bank of Pakistan. The discussion was moderated by Dr. (Ms.) Dushni Weerakoon, Member of the Monetary Policy Board of the CBSL and Executive Director of the Institute of Policy Studies of Sri Lanka.

The COVID-19 pandemic tested the financial, economic, and psychological resilience of many South Asian countries, revealing significant challenges such as food and energy security concerns, job and income losses, business continuity disruptions, and the near collapse of tourism. The panelists noted that these countries faced severe pressure on their external accounts and exchange rates, which contributed to high inflation rates and vulnerable reserve positions.

Discussing the key lessons learned from the crisis, the discussion emphasised the importance of central bank independence and credible inflation targeting. The panel stressed the need for proactive monetary policy, accurate inflation forecasts for the next twelve to eighteen months, and timely responses to manage inflation expectations. Price stability, recognised as the primary mandate of the central banks, was reiterated as essential, in the absence of which the central banks would not be able to maintain market credibility. Furthermore, the discussion highlighted that the effectiveness of monetary policy depends on the central bank's ability to communicate its policies clearly and the need to educate the public about the bank's role and objectives. Strong coordination between monetary and fiscal policies, while maintaining mutual independence, was also underscored.

It was acknowledged that factors such as climate change, digitalisation, and asset price fluctuations could temporarily hinder the achievement of inflation targets. The discussion also underscored that successful monetary policy implementation and transmission depend largely on financial stability and a sustainable financial system.

The panel also explored the potential for expanding regional resource-pooling arrangements through swap facilities in South Asia, noting challenges stemming from limited financial integration and insufficient reserves, except in India. It was proposed that India promote the use of the Indian Rupee for regional trade, despite the lack of full currency convertibility, and that SAARC member countries enhance regional trade by fostering mutual trust and cooperation to make such financial arrangements more effective.

45TH SAARCFINANCE GOVERNORS' GROUP MEETING

The 45th SAARCFINANCE (SF) Governors' Group Meeting was held on 14 June 2024, focusing on further enhancing cooperation and collaboration among member nations on various contemporary economic and financial sector matters. The meeting was chaired by Governor Dr. Nandalal Weerasinghe, Central Bank of Sri Lanka (CBSL) and was attended by Governor Dasho Penjore, Royal Monetary Authority of Bhutan (RMA); Governor Shaktikanta Das, Reserve Bank of India (RBI); Governor Ali Hashim, Maldives Monetary Authority (MMA); Accountant General Mohamed Azad, Ministry of Finance and Treasury, Maldives; Governor Maha Prasad Adhikari, Nepal Rastra Bank (NRB); Deputy Governor Saleem Ullah, State Bank of Pakistan (SBP); and other delegates from the Central Banks in the SAARC region.

Starting the discussion, each member country's delegate briefly outlined the country's macro economic conditions. The progress of the SF Roadmap for cooperation was a key focus during the recent meeting, with members emphasizing the importance of enhancing the SF Database, financial inclusion and capacity building initiatives. Particular attention was also given to addressing existing data gaps in the SF database. As part of these efforts, the Governor of the RBI proposed a new initiative, that is, the introduction of a quarterly virtual knowledge-sharing series called the Financial Inclusion Learning Series (FILS). This series aims to provide a platform for SAARC central banks to exchange experiences, best practices, and challenges related to financial inclusion. The meeting also covered updates on the SF Scholarship Scheme, with members expressing their appreciation for its continued support. Additionally, discussions were held regarding the seminars conducted under SF's umbrella. One of the major proposals put forth by the Governor of the RBI was the revision of the SF Roadmap. Since many of the existing priorities have already been institutionalised, it was suggested that the roadmap be revisited to incorporate new, more relevant areas aligned with current global and regional developments. The proposed revisions would guide the SF agenda over the next five years and focus on emerging topics such as fintech, digitalisation, cybersecurity, climate change, and sustainable finance. The goal is to provide fresh momentum to existing initiatives while also addressing new challenges in the financial landscape. Furthermore, the meeting included a discussion on the SAARC Currency Swap Framework for 2024-2027, during which the Governor of the RBI provided an update on the framework. The Chair expressed gratitude to the RBI and the Government of India for extending the facility. In addition, the members

discussed the possibility of conducting trade payments in Indian Rupees (INR). Additionally, members who took part in the collaborative studies provided updates on their current progress.

Concluding the meeting, the Chair extended sincere thanks to all delegates for their support and their active participation, contributing to the success of the meeting and its associated events.

46TH SAARCFINANCE GOVERNORS' GROUP MEETING

The Central Bank of Sri Lanka, as the chair, hosted the 46th SAARCFINANCE (SF) Governors' Group Meeting on 24 October 2024 in Washington D.C. on the sidelines of the Annual Meetings of the International Monetary Fund (IMF) and the World Bank Group. The meeting was chaired by Governor Dr. Nandalal Weerasinghe of the Central bank of Sri Lanka and was attended by Governor Dasho Penjore of the Royal Monetary Authority of Bhutan, Secretary to the Treasury K. M. Mahinda Siriwardana of Sri Lanka, Governor Maha Prasad Adhikari of the Nepal Rastra Bank, Governor Dr. Ahsan H. Mansur of Bangladesh Bank, Governor Jameel Ahmad of State Bank of Pakistan, Deputy Governor Ahmed Imad of Maldives Monetary Authority, Deputy Governor Dr. Michael Debabrata Patra of Reserve Bank of India, Finance Secretary Dr. Md. Khairuzzaman Mozumder of Bangladesh and other delegates from the central banks in the SAARC region.

The meeting provided a valuable platform for South Asian central bank governors and finance secretaries to discuss regional economic challenges, strengthen financial cooperation, and coordinate policy initiatives. The discussions were held on collaborative research and capacity building initiatives as well as on regional financial assistance at times of economic distress. A key focus of the meeting was the discussion on revisiting the SF Roadmap for regional cooperation. It was agreed to

adopt the new Roadmap that emphasises three main areas: enhancing cooperation in banking regulation and supervision, financing for climate and sustainable development, and evaluating the opportunities and challenges of emerging digital technologies in central banking operations while continue the initiatives institutionalised under the outgoing Roadmap.

In concluding the meeting, the Chair expressed sincere gratitude to all delegates for their support throughout the SF Chair's tenure and, along with other members, extended congratulations to the Governor of Bangladesh Bank, who will now assume the role of SF Chair.

37TH SAARCFINANCE COORDINATORS' MEETING

The 37th SAARCFINANCE (SF) Coordinators' Meeting was held in Colombo on 14 June, 2024, focusing on outcomes from the 46th SF Governors' Group meeting. Key discussions included a proposal from the Governor of the Reserve Bank of India (RBI) to revise the Roadmap. The meeting also highlighted the SAARC Sync Portal as a valuable repository for strategic and historical documents, with an update provided on the new SAARC SWAP framework by the SF Coordinator for RBI. Members also discussed the proposal for a quarterly virtual seminar series aimed at fostering regional collaboration, featuring knowledge-sharing sessions from two countries each time. Additionally, the SF Coordinator for the Central Bank of Sri Lanka (CBSL) reported on the progress of the Sustainable Finance Working Group and addressed concerns from the Governor of Nepal Ratra Bank (NRB) regarding the reactivation of the SAARC Payment Council platform. In closing, the SF Coordinator for CBSL thanked participants for their contributions to the success of the event, including the 46th SF Governors' Group meeting and symposium.

38TH SAARCFINANCE COORDINATORS' MEETING

The 38th SAARCFINANCE (SF) Coordinators' Meeting, hosted virtually by the Central Bank of Sri Lanka on 04 October, 2024, focused on several key areas. These included updates on the revision of the SF Roadmap, progress on collaborative studies, and developments from the Sustainable Finance Working Group. The status of the SF Newsletter for 2024 and the proposed publication timeline were also discussed. Additionally, drafting of the agenda for the upcoming 46th SF Governors' Group Meeting was discussed at length. In closing, the SF Coordinator for the Central Bank of Sri Lanka thanked participants for their valuable contributions and continued support.

SAARCFINANCE Roadmap and Areas of Cooperation

Technical Assistance

The Reserve Bank of India (RBI), drawing inspiration from the Government of India's neighborhood first policy, continued its efforts for capacity building of central bank officials in the SAARC region. The RBI provided technical assistance to the Royal Monetary Authority of Bhutan (RMA) for developing monetary policy framework and a virtual experience sharing session on the Central Bank Digital Currency (CBDC) was organized for Nepal Rastra Bank (NRB) on November 20, 2023. Under the aegis of Joint Technical Coordination Committee (JTCC) between the RBI and NRB, RBI organised three observation visits on Banking Department, Legal Department and on Communication policy, respectively for officials of NRB during May 2024. An experience sharing session on monetary policy operations was also organised for officials of the Central Bank of Sri Lanka (CBSL) in August 2024.

Trainings

Under the capacity building initiative, the RBI has shared the calendar of programs of training establishments for the year 2024 with all the SAARCFINANCE (SF) members and the same is also made available on the SF Sync portal. The RBI started inviting participation in 2021 from member central banks to the training programs conducted by the RBI Academy. The RBI Academy saw good response from SAARC central banks with a total of 112 officers (83 from Bangladesh Bank (BB), 11 from RMA, 10 from NRB and 8 from CBSL) participating in virtual training programs conducted on various topics from January 2023 till date.

SAARCFINANCE Scholarship Scheme

The SF Scholarship Scheme for higher studies, introduced by the RBI in 2013, was revised in terms of scope and coverage during the chair of RBI in 2019-20, to further encourage research and capacity building in central banking/public policy under various streams.

For the academic year 2023-24, four scholarships were awarded and out of these, three officers from SAARC central banks (all from BB) secured admission in prominent institutions in India. For the academic year 2024-25, four scholarships were awarded in January 2024 and all the officers have already secured admission to pursue higher studies. Currently, 11 candidates from SAARC countries are pursuing higher studies in India under the SF Scholarship scheme, while two candidates have completed their higher studies.

Table 1.1: SF Scholarship Scheme

	Name	Organisation	Course	Institution/ University	Status
1	Mr. Mohammad Monirul Islam Sarker	Bangladesh Bank	Ph. D Economics	Jawaharlal Nehru University, Delhi	Completed
2	Mr. Suresh Kumar Dahal	Nepal Rastra Bank	Ph. D Economics	Sri Sathya Sai Institute of Higher Learning, Puttaparthi	Completed
3	Mr. Abdul Basir Omar Shah Khail	MoF, Afghanistan	Ph. D Economics	Sharda University, New Delhi	Ongoing

	Name	Organisation	Course	Institution/ University	Status
4	Mr. Bhaskar Podder	Bangladesh Bank	Ph. D Economics	Shiv Nadar University, Greater Noida, Uttar Pradesh	Ongoing
5	Mr. Arifuzzaman Khan	Bangladesh Bank	Ph. D Economics	Indian Institute of Technology Indore	Ongoing
6	Mr. Arun Kumar Shah	Nepal Rastra Bank	Ph. D Economics	Jawaharlal Nehru University, Delhi	Ongoing
7	Mr. Md. Julker Naim	Bangladesh Bank	MA Journalism and Mass Communication	Adamas University, Kolkata	Ongoing
8	Mr. Buddhadev Sinha	Bangladesh Bank	Ph. D Finance	Indian Institute of Technology Bombay	Ongoing
9	Mr. Himadri Shekhar Sarder	Bangladesh Bank	Ph. D Finance	Adamas University, Kolkata	Ongoing
10	Mr. Chop Kanta Subedi	Nepal Rastra Bank	Ph.D Economics	South Asian University, Delhi	Ongoing
11	Mr. Tika Ram Timilsina	Nepal Rastra Bank	Ph.D Economics	South Asian University, Delhi	Ongoing
12	Mr. Muhammad Jahangir Alam	Bangladesh Bank	Ph.D Economics	Indian Institute of Science, Bangalore	Ongoing
13	Mr. Muhammad Ehsanul Kabir	Bangladesh Bank	Ph.D Economics	Indian Institute of Technology Roorkee	Yet to commence

Collaborative Studies

As part of the SF mandate, SAARC central banks conduct collaborative research studies on topics relevant to their functions. Currently, three such studies are being conducted among the member countries.

The collaborative study on **"The Implications of Climate Change and Environmental Sustainability for Monetary Policy and Financial Stability in SAARC Countries"** is led by the Reserve Bank of India, with Bangladesh Bank serving as the co-lead. The study aims to explore how central banks can play a pivotal role in fostering long-term sustainable economic growth through the effective implementation of stabilisation policies that encompass both monetary measures and financial stability measures. The research on the subject is progressing in full swing with the Group members having finalised the Terms of Reference and data collection and the study is expected to be completed by November 2024.

The second collaborative study, titled **"Efficacy of Monetary Policy in the SAARC Region,"** is led by the State Bank of Pakistan, with Nepal Rastra Bank as the co-lead. Internal brainstorming and conceptualisation sessions have been conducted to develop the main objectives of the study, namely:

- to determine which of the four main channels of monetary policy (interest rate, credit, asset price or exchange rate) have the greatest impact in each country within the SAARC region
- to ascertain which macroeconomic conditions give rise to the enhanced effectiveness of one channel over another
- to recommend ways policymakers can use this information to effectively utilise strong monetary policy channels, as well as strengthen weaker ones.

Having identified needs from partner countries, a cross-country group was created to share relevant resources. Studies pertaining to the effectiveness of monetary policy channels and transmission were shared by each SAARC member central bank, with the exception of Royal Monetary Authority of Bhutan. These studies were incorporated in the literature review and provided insights on which channels warrant more focus in each respective country.

It was found that in most studies, VAR and SVAR models were used to quantify the impact of various monetary policy channels. In Pakistan, in most studies, the credit channel emerges as the dominant transmission channel, with a 100 bps monetary policy shock leading to reduction in inflation by 0.2 per cent and reduction in LSM growth by 0.3 per cent on the aggregate level[1] (Hussain et al. 2022). In India, a 1 per cent monetary policy shock lead to 0.1 per cent decrease in inflation and 0.1 per cent decrease in the growth rate of industrial production, with interest rate and credit channels appearing to be most dominant[2] (Kumar and Dash 2020). In Bangladesh, interest rate channel played an influential role in affecting monetary policy transmission, with the credit channel also playing a non-trivial role. A one standard deviation shock to the interest rate lead to a minimum of 0.1 per cent reduction in inflation[3]. In Sri Lanka, the interest rate channel was found to be the most dominant across most studies, though other channels, especially credit, are existent and effective. Following a monetary policy shock, the peak decline of industrial production is about 0.2 per cent, whereas inflation falls about 0.06 per cent[4]. In The Maldives, exchange rate fluctuations had most impact on inflation dynamics, owing to the exchange rate peg which is used as an intermediate target. There appears to be weak interest rate pass-through in Nepal; however, the national price levels converge to Indian inflation due to the exchange rate pegged to Indian rupee and exchange rate dynamics are observed to have a high impact on inflation.

There remains the need for a collective study of most SAARC countries, outlining conditions and regimes which contribute to the enhanced operation of particular transmission channels. This is especially relevant given the fact that these countries face similar macroeconomic and geo-strategic dynamics, yet diverge in terms of effective monetary policy transmission channels. Keeping these concerns at the forefront, operational execution of the study is in underway.

In addition to the two collaborative studies that have made considerable progress in recent months, a third study on **"Local Currency Settlement and Exchange Rate Management in SAARC Countries"** is also underway, led by the Maldives Monetary Authority, with the Reserve Bank of India as the co-lead.

1 Hussain, Fida, Fayyaz Hussain, and Kalim Hyder. "Monetary Policy Effectiveness in Pakistan: An In-depth Analysis of Four Transmission Channels." No. 109. SBP Working Papers. (2022)
2 Kumar, Ankit & Dash, Pradyumna, 2020. "Changing transmission of monetary policy on disaggregate inflation in India," Economic Modelling, Elsevier, vol. 92(C), pages 109-125.
3 Afrin, Sadia, 2017. "Monetary policy transmission in Bangladesh: Exploring the lending channel," Journal of Asian Economics, Elsevier, vol. 49(C), pages 60-80.
4 Musthafa, M. T., Le, T., & Suardi, S. (2023). Monetary policy transmission in Sri Lanka. Applied Economics, 56(2), 151–168. https://doi.org/10.1080/00036846.2023.2166671

Inclusion of SAARC Members in State Bank of Pakistan (SBP) webinar Series

The State Bank of Pakistan is dedicated to enhancing the skills and knowledge of its staff, fostering a deeper understanding, and encouraging informed discussions on emerging issues in economics, banking, and finance. In this regard, substantial progress has been made in developing its intellectual and educational resources. A key milestone was reached in 2020 with the launch of a dedicated webinar series focused on Economics and Finance. Eminent economists, bankers, and financial experts from across the world are invited as speakers to enlighten the audience on ground breaking research, foster innovative learning and encourage the flow of ideas. The audience ranges from central bank and government officials to financial sector experts, faculty members and students.

In today's rapidly evolving technological dynamics, progress can only be warranted if we keep at pace with global developments. Innovations in fields of economics, banking and finance call for the urgent need to adapt to new technologies and incorporate innovative ideas to deal with emerging challenges. Therefore, SBP's webinar series brings such innovative ideas on emerging topics like Central Bank Digital Currencies (CBDCs), Tokenisation, Cryptocurrencies, Inflation Expectations and Climate Change etc. Eminent Economists, scholars and academicians are invited to deliver their insights and expertise on unique topics. With this initiative, we have had the honor of hosting renowned names like Dr. Tim Besley, Dr. Stephen G. Cecchetti, Dr. Emi Nakamura, Dr. Matteo Aquilina and Dr. Manuel A. Muñoz, among many others.

For enhanced regional integration and cooperation, SBP has initiated to involve SAARC central banks in these webinars. This collaborative initiative serves as an important platform for knowledge sharing, enrichment of dialogue and strengthening the relationship between the member countries. Since June 2024, we have had the privilege of hosting 51 participants from Royal Monetary Authority of Bhutan and Central bank of Sri Lanka. By gathering central bankers from across the region, we aim to deepen our shared understanding of the common economic and financial challenges faced by the member countries.

SBP will continue its efforts towards enhanced involvement of SAARC central banks in its webinar series, in order to create a more interconnected and resilient economic landscape in South Asia. The free flow of ideas and experiences is critical for a deeper understanding of the common challenges faced by the SAARC community. This will not only help foster sustainable growth across the region but also highlights SBP's commitment to bring positive change within the SAARC region.

Working Group Meeting on Sustainable Finance

In 2022, the State Bank of Pakistan (SBP) hosted the 43rd SAARCFINANCE (SF) Group Meeting on 2-3 May 2023, along with the 2023 SF Governors' Symposium on "Climate Change and Green Finance". During the forum, a proposal was made to establish a Working Group on "Sustainable Finance". SBP initiated and circulated a draft of the Terms of Reference (ToR) in 2023. During 2024, Central Bank of Sri Lanka, as the Chair, advanced the work by finalising the Working Group with nominations from all members and held the inaugural virtual meeting on 16 July 2024, to discuss the ToRs and the way forward.

SAARC Payment Initiative activities during 2024

Introduction of SAARC PAYMENT INITIATIVE

The establishment of a regional payment initiative in SAARC region was initially conceived during the SF conference held at the Central Bank of Sri Lanka (CBSL) in July 2007. Later that year, the Governors of the SF group approved the proposal for establishing a SAARC Payment Initiative (SPI). SAARC Payment Council (SPC) started its operation on 28 March 2008. The first meeting of SPC was conducted immediately afterwards.

Goal of SAARC Payment Initiative

The goal of the SPI is to strengthen the existing payment and settlement systems (PSS) in the SAARC region to facilitate an efficient, robust, stable and convergent PSS that stands with the international standards.

The SPC acts as a forum of SAARC countries. It works to:

- Collectively evolve a high level strategic direction and implement a road map for PSS reforms of individual member countries;
- Standardize PSS to create a level playing field in promoting regional harmonization and integration of domestic PSS of member countries for the development of intra regional PSS;

Taking over of the Secretariat of SAARC Payment Initiative by BB

During the 20th SAARC Payment Council (SPC) meeting, Bangladesh Bank (BB) was entrusted with the responsibility of the secretariat of SPC from Reserve Bank of India. Afterwards, Bangladesh Bank (BB) amassed the duties and since then, two meetings were conducted with specific agenda.

As the Secretariat of SPI, BB performed several key tasks from January to December 2024. One of its responsibilities was maintaining and regularly updating the SPI website, with assistance from the Reserve Bank of India. Additionally, the SPC aimed to review payment and settlement systems (PSS) in the region to assess the status of PSS in member countries. In this process, a Risk Mitigation Matrix was developed in collaboration with the member countries and subsequently uploaded to the new SPI website in 2024.

SECTION 02
SAARCFINANCE Seminars

Reserve Bank India Organized a seminar on "Emerging Digital Technologies in Central Banking and Finance" under the Aegis of the SAARCFINANCE

The Reserve Bank of India (RBI) hosted the SAARCFINANCE (SF) seminar on Emerging Digital Technologies in Central Banking and Finance at Goa, India during 17-18 January 2024. The two-day seminar marked the fulfilment of the commitment made by the Reserve Bank in the 44th meeting of the SF Governors' Group held in October 2023. The seminar was attended, both in-person and virtually, by the central bank officials from SAARC countries viz. Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka and India.

Executive Director, Shri R Subramanian, RBI welcomed the participants of the Seminar, highlighting the importance of leveraging new frontiers of technologies in various functional areas of SAARC central banks. Deputy Governor, Dr. Michael D. Patra, RBI delivered keynote address at the Seminar. Dr. Patra illustrated the opportunities and challenges associated with the emerging digital technologies, global experiences on this front and emphasised on how central banks need to navigate this technological shift. The Deputy Governor also highlighted some of the recent initiatives and developments made by the RBI in the technological domain. He underscored the need for central banks to invest generously to develop niche capabilities in data science.

The Seminar witnessed interactive sessions on the different aspects of digital technologies ranging from Artificial Intelligence (AI), Machine Learning (ML), big tech and data science, frictionless credit, Sup Tech and the ensuing legal, governance, privacy and ethical issues. The sessions were led by Professor Pulak Ghosh (IIM, Bangalore), Mr. Rajesh Bansal (RBI Innovation Hub), Mr. Nipun Kalra and Deep Mukherjee (BCG), Mr. Rahul Matthan (Trilegal) and Ms. Geetha Giddi (RBI). Mr. Harish Natarajan and Venkat Bhargav from the World Bank covered the importance of Digital Public Infrastructure for financial inclusion in the case of India as well as for entire SAARC region. The delegates from SAARCFINANCE member-central banks deliberated upon various aspects of AI and also highlighted the efforts that the central banks are taking to adopt the emerging digital technologies.

SAARCFINANCE Seminar – "Emerging Digital Technologies in Central Banking and Finance"
17-18 January 2024

State Bank of Pakistan Organized a seminar on "The Potential Role of Big Data in Economic Policy"

On 06 March 2024, the State Bank of Pakistan (SBP) hosted a highly informative SAARCFINANCE (SF) Seminar titled 'The Potential Role of Big Data in Economic Policy.' The event welcomed distinguished delegates, subject matter experts, and esteemed speakers from across the SAARC region. Panelists from notable organizations, including the International Monetary Fund (IMF), World Bank, International Finance Corporation (IFC), Arab Monetary Fund (BUNA), Meta, Google, and the Pakistan Bureau of Statistics (PBS), contributed to the discussions. The seminar explored the significant impact of Big Data on economic policymaking. Emphasis was placed on the unprecedented volume of data generated by digital devices and its potential to drive sustained economic growth, societal welfare, poverty reduction, and enhanced living standards throughout the SAARC region. The discussion also covered the expanding role of Big Data in central banking and financial inclusion, with a focus on the SBP's use of data for policymaking. Specific examples included the use of Big Data analytics by the central bank for economic analysis, satellite imagery for various applications, and machine learning algorithms for fraud detection and prevention. Governor SBP, Mr. Jameel Ahmed addressed the legal and regulatory challenges related to privacy and confidentiality, calling for robust data protection laws. He highlighted the need to address the costs associated with technological infrastructure and the development of skilled human resources. The seminar concluded with a call for collaboration among SAARC member nations to foster a data-driven approach in the region, ensuring that policies are inclusive and responsive to the needs of all member countries.

SAARCFINANCE Seminar - "The Potential Role of Big Data in Economic Policy" - 06 March 2024

Bangladesh Bank Organized a seminar on "Trading in Local Currencies: Problems and Prospects for the SAARC Countries"

The SAARCFINANCE (SF) Seminar on "Trading in Local Currencies: Problems and Prospects for the SAARC Countries" has been organized by the SF Wing, Research Department of Bangladesh Bank on 12 July, 2024 at Hotel Radisson Blu in Chattogram. The Inaugural Session was graced by former Governor Abdur Rouf Talukder, Bangladesh Bank (BB), as the Chief Guest. Secretary Dr. Md. Khairuzzaman Mozumder, Finance Division, Ministry of Finance, People's Republic of Bangladesh, participated as the Special Guest. In addition, Deputy Governor Dr. Md. Habibur Rahman, BB delivered the Keynote Speech in the inaugural session and Dr. Aditya Gaiha, Chief General Manager (in-charge) from the Reserve Bank of India (RBI), was also present as a Special Guest.

The inaugural session of the SAARCFINANCE seminar began with Tilawat-e-Quran at 9:00 am. Executive Director (Research) Dr. Sayera Younus, of BB presented the Welcome Remarks. The audience included delegates from the central banks of SAARC member countries, including those present in person from Bangladesh, Bhutan, India, Nepal, Sri Lanka and, and those attending online from Pakistan and the Maldives, as well as officials from various government ministries, the Bangladesh Bank, different commercial banks, and representatives from various trade bodies in Bangladesh. In addition to the seminar, a meeting of a Collaborative Study team titled 'Local Currency Settlement in the Case of SAARC Counties' was held on the sidelines.

After welcome remarks, Deputy Governor Dr. Md. Habibur Rahman, BB, emphasized the benefits of trading in local currencies, such as reducing pressure on Forex reserves, enhancing bilateral trade, and lowering transaction costs in his key note speech. He also outlined challenges like exchange rate risk, currency convertibility issues, and the need for strong financial infrastructure and market confidence. He concluded that successful local currency trade requires stable currencies, supportive legal frameworks, and regional cooperation.

Dr. Aditya Gaiha, Special guest in the inaugural session at the SAARCFINANCE Seminar from RBI pointed the importance of local currency trading for policymakers, central banks, and economic stakeholders. He marked some challenges such as foreign exchange reserves, external liabilities, and macroeconomic instability exacerbated by post-COVID conditions and geopolitical tensions.

Secretary Dr. Md. Khairuzzaman Mozumder, Honorable the Finance Division, Ministry of Finance, People's Republic of Bangladesh, emphasised the importance of reducing reliance on dominant currencies for the SAARC region. He pointed Bangladesh's ongoing efforts, including bilateral trade agreements with India using local currencies, and stressed the potential benefits of local currency trading in enhancing economic resilience, regional integration, and growth. He expressed gratitude to Bangladesh Bank for organizing the seminar and urged collaborative efforts to overcome challenges and unlock the full potential of local currency trading.

The participants from SAARC member central banks from Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka presented their papers on "Trading in Local Currencies: Problems and Prospects for the SAARC Countries," and distinguished panelists discussed challenges such as currency stability and the need for robust financial infrastructure.

Former Governor Abdur Rouf Talukder BB, emphasized the strategic importance of trading in local currencies for reduced US dollar dependency, economic stability and regional integration. He discussed Bangladesh's policy changes and digital financial technologies to facilitate this trade and urged collaborative efforts to overcome challenges, also inviting foreign delegates to explore Chattogram's natural sceneries.

The primary objective of this seminar is to explore potential strategies and policies among the emerging economies of South Asia to reduce dependence on major global currencies such as the US dollar, Euro and Pound sterling. The seminar has delved into the exchange of information and experiences among the SAARC countries, uncovering various aspects of trade strategies in local currencies and ensuring their development in these regions.

SAARCFINANCE Seminar : "Trading in Local Currencies: Problems and Prospects for the SAARC Countries" 12 July 2024

Financial Inclusion Learning Series (FILS) - Quarterly Online Seminar

During the 45th SAARCFINANCE (SF) Governors Group meeting held on 14 June 2024 at Colombo, Governor of the Reserve Bank of India (RBI) proposed introducing a quarterly virtual knowledge-sharing series, called the Financial Inclusion Learning Series (FILS), to deepen the cooperation in the sphere of financial inclusion. This series would serve as a knowledge forum where SAARC central banks could share experiences, best practices, and challenges related to various aspects of financial inclusion. The topics of the FILS are expected to cover a broad spectrum of topics such as consumer protection, digitalisation, ombudsman schemes, and cybersecurity issues. These sessions would be open to all interested officers of the central banks, not restricted solely to the SF cells. Accordingly, the first session was held on 21 August 2024 IST with presentations from Deputy General Manager Dr. Ashish Srivastava, Financial Inclusion and Development Department of RBI and Senior Joint Director Umair Ahmad, Agriculture Credit and Financial Inclusion Department of the State Bank of Pakistan.

SECTION 03

Macroeconomic Developments And Recent Policy Measures In SAARC Countries

MACROECONOMIC DEVELOPMENTS IN SAARC COUNTRIES

AFGHANISTAN

Afghanistan's economy has seen multifaceted and multilayered disruptions over the past few years. The economic shock waves have had a draining impact on the financial system, demonstrating the vulnerabilities of the then-economic model. The sectoral structure of the economy has also been through significant changes. To give a perspective on the structural changes, in percentage terms, the share of the services sector in the GDP has shrunk from the mid-50s to the mid-40s. In contrast, the agricultural sector, i.e., the primary sector, has moved from 26 per cent to 34 per cent of the total GDP.

Against this backdrop, Afghanistan's economy is gradually coming out of the woods and is gaining momentum, suggesting the economy has just crossed the inflection point. The economy bottomed out during 2022-23, contracting further by 6.2 per cent. During the fiscal year 2023-24, the economy posted a growth rate of 2.7 per cent. The rate of expansion across sectors has been relatively even. Private consumption and government expenditure are the key drivers of this economic turnaround. Looking ahead, self-sufficiency and economic independence, as the new macroeconomic themes of the national economy, will play a pivotal role in shaping economic strategies.

There has been a significant correction in consumer prices during FY 2023-24. Consumer prices declined by 7.7 per cent on a YoY basis in 2023-24 after an 11 per cent rise during 2022-23, which means CPI has been through radical changes within the last two to three years. The changes are attributed to various international and domestic stimuli. Initially, tighter supply chain and geopolitical events spur the prices to new highs, followed by an episode of supply-chain easing, the pass-through effect of an appreciated local currency, and economic reforms within the domestic economy prompted a trend reversal of consumer prices in the country. It is worth mentioning that the deflationary pressures are steadily easing with expectations that the deflationary cycle will end in the fourth quarter of 2024.

The economic rebound did translate into higher demand for cross-border consumer goods. Whereas, at the same time, overall exports saw a moderation. The moderation generally stemmed from waning demand for coal exported to Pakistan. The Merchandise trade deficit accumulated to US dollars 6.3 billion in the FY 2023-24, and therefore, irrespective of strong growth in FDI and remittances, the current account deficit has widened.

After a brief turmoil in the forex markets of Afghanistan after the political change, Afghani was able to gain its lost ground. The national currency appreciated by 22 per cent during FY 2023-24. The appreciation is the result of initiatives taken by the Central Bank of Afghanistan and other relevant authorities, whereby a de-dollarization policy was adopted in the bordering provinces, pushing the demand for the national currency. The inflow of reserve currencies in the form of humanitarian assistance and remittances were the other strong pillars supporting the value of Afghani.

BANGLADESH

In the current fiscal year FY24, Bangladesh's economic conditions reflect a mix of resilience and challenges. According to provisional data from BBS, the countries real sector has experienced a GDP growth rate of 5.82 percent for the FY24, slightly up from 5.78 percent in the previous fiscal year. This growth has been significantly driven by the industry and service sectors, while agricultural sector also played a supportive role. Looking Ahead, Bangladesh economy shows positive signs with strong industrial growth, stable service sector, and rising private demand. Forecasts indicate that the economy aims to achieve targeted growth rate of around 6.7 percent for FY25.

Despite various fiscal and monetary measures to contain inflation, it remains persistently high during FY24. The CPI based average CPI inflation increased to 9.73 percent in June 2024, up from 9.02 percent in June 2023. Inflationary pressures continue to be a significant challenge for Bangladesh with the CPI inflation reaching 9.95 percent in August 2024, primarily driven by rising food prices. However, these pressures are expected to ease in the coming months following continued a tight monetary policy and projected lower global food and commodity prices. BB aims to bringing down inflation around 6.5 percent at the end of FY25.

On the fiscal front, a revised target for revenue collection is set at TK. 4780 billionin FY24 which is 9.5 percent of GDP (base year 2015-16). The tax revenue target for FY24 is revised to TK.4290 billion. In FY24, the total annual expenditure was set Taka.7144.18 billion which was 14.2 percent of GDP (base year 2015-16). In FY24 provisional expenditure on Annual Development Program (ADP) was TK.2450.00 billion. The fiscal deficit for FY24 was estimated to be at Taka 2329.18 billion which was 4.61 percent of annual GDP compared with a deficit equal to 4.55 percent in FY23. Bangladesh has consistently maintained prudent fiscal stance keeping a moderate budget deficit–usually around 5 percent of GDP to foster economic growth, reduce poverty, and improve social welfare. The national debt for FY24 was revised to be at TK. 19025.41 billion which was 37.69 percent of annual GDP, compared with a debt equal to 36.97 percent in FY23. Domestic debt accounted for 22.38 percent of GDP in FY24, a slight increase from 21.98 percent in FY23, while external debt also inched up to 15.31 percent in FY24, compared to 14.99 percent in FY23.

Regarding the monetary landscape, Broad money (M2) recorded 8.11 percent growth (y-o-y) at the end of July 2024 which is lower than the projected growth of 8.20 percent for September 2024, reflecting a tight monetary policy. Domestic credit as a percentage of GDP declined to 41.9 percent in FY24 from 42.9 percent in FY23. Domestic credit growth narrowed to 62.27 percent (y-o-y) at the end of July 2024 compared to 14.81 percent growth at the end of July 2023. Of the domestic credit, the public sector credit and private sector credit grew by 12.15 percent and 10.13 percent respectively at the end of July 2024. The growth projection of M2 is set at 8.4 percent and domestic credit growth is projected to be 11.6 percent for FY25. To manage continued inflationary pressure, BB has pursued a contractionary monetary policy stance for over a year through significantly increase in the policy rate. The policy rate was 6.0 percent in June 2023. The policy rate has been revised upward several times till now 2024 and re-fixed at 9.50 percent, with the Standing Lending Facility rate of 11.00 percent and the Standing Deposit Facility rate of 8.00 percent lowering the band from 2 percent to 1.50 percent. This aims to control inflation while supporting productive and employment-generating activities. The Weighted average call money rate was 6.06 percent in June 2023 which picked up to 9.08 percent in June 2024 and stood at 9.07 percent as on 22 September 2024, below the Standing Lending Facility (SLF) rate of 11.00 percent.

The external sector analysis reveals that Bangladesh's current account deficit narrowed to USD 193.00 million in the month of July of FY25 from USD 295 million in the month of July of FY24. Overall balance recorded a lower deficit of USD 641 million in the month of July of FY25 compared to USD 1066 million deficits in the month of July of FY24. The current account deficit as percentage of GDP stood at 1.5 percent in FY24 compared to 2.8 percent in FY23 and this continued improvement are expected with recovering remittances and a reduced trade deficit. The Gross foreign exchange reserves stood at USD 26.82 billion at the end of June 2024; however, according to BPM6 this gross foreign exchange reserves amounted to USD 21.79 billion. The foreign exchange reserves of July 2024 were sufficient to pay import cost of goods for 4.5 months. Recently, BB has introduced a Crawling Peg Exchange Rate System to manage abrupt fluctuations in exchange rate and mitigate inflationary pressure stemming from exchange rate pass-through to inflation. Under this system, scheduled banks are instructed to freely buy and sell dollars around the (Crawling Peg Mid-Rate)

CPMR to both customers and interbank participants. Exchange rate of Bangladeshi Taka against the US dollar was depreciated by 8.1 percent to 117.99 in FY24 from 108.35 of FY23. The Month average exchange rate under the crawling peg system was 118.9 BDT per USD in August 2024.

In brief, this is the outcome of real, fiscal, monetary and external sector of Bangladesh economy.

BHUTAN

The Bhutanese economy experienced robust growth averaging 4.9 percent during the post-COVID-19 pandemic years despite growing global uncertainties, demonstrating resilience and adaptability, and headline inflation moderated at 4.8 percent in April 2024. While the current account deficit persists, the overall balance of payment remains positive and sustainable. The banking sector performance improved with enhanced oversight and surveillance of financial sector risks, while domestic credit surged with higher demand for investment propelled by economic activities. Over the past year, Bhutan's macroeconomic fundamentals have strengthened, showing strong signs of economic resilience supported by fiscal and monetary policy measures.

Growth in broad money increased during the quarter ending FY 2022/23 recording 9.64 percent from 8.59 percent during FY 2021/22. The Consumer Price Index (CPI) inflation was recorded at 3.83 percent in FY 2022/23, a notable decrease from 6.54 percent in FY 2021/22. A fall in both food price and non-food prices led to the moderation in the overall price index.

As of the FY ending 2022/23, there has been a rise in the trade deficit to 25.2% of GDP from 21.1% of GDP in FY 2021/22. The heightened merchandise imports of Nu. 116,762.4 million towards the import of base metals (particularly iron and steel), machinery, vehicle and transport equipment, and mineral products for the government further pushed the deficit. The collective imports of the above merchandise goods made up 56.7 percent of the total imports for the review year. On the export front, merchandise exports registered a marginal growth of 3.2 percent whereas hydropower exports further dropped by Nu 3,119.6 million from the previous year's hydropower earnings of Nu 23,710.4 million. Although there was no significant variation in energy generation, domestic energy consumption increased by more than 50 percent compared to the last FY.

As of the end of FY 2022/23, international reserves amounted to USD 0.58 billion, while total external debt (including both convertible currency and rupee debt) reached USD 3.20 billion.

Going forward, to achieve high-income status, Bhutan must undergo significant economic transformation and implement policy reforms that reduce dependence on foreign grants and enhance competitiveness in both the hydro and non-hydropower sectors. The launch of the 13th Five-Year Plan (FYP) and the Economic Stimulus Program offers an opportunity to realign our policy priorities toward economic self-reliance and the creation of gainful employment.

To support these goals, the Royal Monetary Authority (RMA) will maintain an accommodative monetary policy stance in the medium term, primarily using reserve requirements as the key instrument for managing credit growth and money supply. While the RMA is aware of the potential for excess liquidity in the banking sector due to ambitious plan implementation, it will remain vigilant regarding credit growth and utilise appropriate monetary tools to prevent any additional credit creation from exerting undue pressure on inflation and external reserves.

Nevertheless, several risks persist, both externally and domestically. Domestically, delays in hydropower project commissioning, the realisation of contingent liabilities in the financial sector currently masked by pandemic-related support measures, and a high current account deficit present vulnerability that could hinder economic growth and lead to financial instability.

Externally, factors such as global commodity price volatility, rising geopolitical tensions, trade fragmentation, and climate change pose risks that could increase domestic inflation, impede the recovery of the tourism sector, and negatively impact export performance. Furthermore, prolonged periods of monetary policy tightening and abrupt cuts to fiscal support may heighten the risk of debt sustainability for least developed and developing countries. Addressing these challenges requires strong coordination between fiscal and monetary policy, combined with structural policy measures including improving the payment system, promoting digitalisation, and fostering innovative finance for climate change.

INDIA

Real Economy

The Indian economy exhibited resilience during 2023-24, notwithstanding persistent headwinds from subdued external demand, protracted geopolitical tensions and volatile global financial markets. Real GDP growth was sustained at 7 per cent and above for the third successive year in 2023-24, supported by robust growth in fixed investment on the back of the government's focus on capital expenditure. On the supply side, economic activity was lifted by the boost to the manufacturing sector's profitability from the correction in input prices and sustained momentum in services activity, even as the agricultural sector activity exhibited a slowdown.

Real GDP has been estimated to grow by 8.2 per cent in FY 2023-24 as compared to the growth rate of 7.0 per cent in FY 2022-23. Private final consumption expenditure (PFCE) – the mainstay of domestic aggregate demand – slackened in 2023-24. Government final consumption expenditure (GFCE) displayed a modest expansion in 2023-24 as the government remained committed towards its fiscal consolidation path. Deficient and uneven south-west and north-east monsoon pulled down both kharif and rabi production. India's industrial sector registered a strong growth aided by healthy corporate profits on the back of easing input cost pressures. The services sector growth was boosted by construction activity and financial, real estate and professional services. Proximate indicators of services sector such as air traffic, railway freight, automobile sales, steel consumption, GST E-way bills and foreign tourist arrivals recorded buoyant expansion.

The growth outlook remains buoyant, given the government's sustained focus on capital expenditure while maintaining fiscal consolidation. Strong corporate balance sheets, rising capacity utilisation, double digit credit growth, healthy financial sector, and the ongoing disinflation are likely to be other growth levers. Lingering geopolitical tensions, geoeconomic fragmentation and adverse climate shocks impart downside risks to the outlook.

Inflation

Headline inflation moderated during 2023-24 into the tolerance band on the back of anti-inflationary monetary policy, active supply management measures, and corrections in global commodity prices. Overall, headline inflation fell to 5.4 per cent during 2023-24, 129 basis points (bps) lower than a year ago. CPI headline inflation was primarily driven by prices of food and beverages, followed by health and education, housing, and clothing and footwear. Inflation in food and beverages hovered in a wide range of 3.3 per cent to 10.6 per cent in 2023-24. Core inflation exhibited a broad-based disinflation and has moved below 4 per cent from December 2023. Core inflation was reined in by monetary tightening, mending of global supply chains and corrections in input cost pressures.

The monetary policy committee (MPC) kept the policy repo rate unchanged and maintained the stance of withdrawal of accommodation through 2023-24. Liquidity conditions evolved in sync with the monetary policy stance.

External Sector

India's external sector strengthened during 2023-24 amidst multiple global headwinds emanating from sharp deceleration in world trade volumes, financial market volatility engendered by aggressive monetary policy tightening actions of systemic central banks and escalating geopolitical tensions. The correction in commodity prices and subdued external demand led to a contraction in merchandise exports and imports and a narrowing of the merchandise trade deficit. The buoyancy in services exports and private transfer receipts cushioned the current account deficit (CAD). India's current account deficit moderated to US dollars 23.2 billion (0.7 per cent of GDP) during 2023-24 from US dollars 67.0 billion (2.0 per cent of GDP) during the previous year.

Net FDI (i.e., net inward FDI minus net outward FDI) flows fell to US dollars 9.8 billion during 2023-24 from US dollars 28.0 billion a year ago. While gross inflows by non-residents remained resilient, repatriation/ disinvestment of FDI in India increased. Foreign portfolio investors turned large net buyers in the domestic market in 2023-24 after being net sellers in 2022-23. During 2023-24, net FPI inflows amounted to US dollars 44.1 billion as against an outflow of

US$ 5.2 billion during 2022-23. In 2023-24, there was an accretion of US dollars 63.7 billion to the foreign exchange reserves (on a BOP basis).

Fiscal Sector

General government finances exhibited improvement in terms of key deficit and debt indicators as the commitment to fiscal consolidation took hold amidst a directing of public expenditure towards growth-supportive measures with greater focus on capex. Tax revenues were buoyant, supported by resilient economic activity and improving compliance. Reflecting this, Central government's fiscal deficit declined to 5.6 per cent of GDP in 2023-24 from 6.4 per cent in 2022-23, and it is budgeted to decline further to 4.9 per cent in 2024-25. The Government expects fiscal deficit to reach below 4.5 per cent in 2025-26. States budgeted a combined fiscal deficit of 3.1 per cent of GDP in 2023-24 within the Centre's limit of 3.5 per cent for the year.

Financial sector

Indian financial sector remains sound and resilient, backed by sharp improvement in asset quality, robust capital position, and rise in profitability of banking sector. The gross non-performing assets (GNPA) ratio of scheduled commercial banks (SCBs) have declined to its lowest in a decade (2.8 per cent). Bank credit growth remained buoyant, supporting the growth in the economy.

Overall, Indian economy's outlook remains bright with continued strong growth and moderating inflation towards its target. The spillovers from protracted geopolitical tensions, volatility in international financial markets and geoeconomic fragmentation, however, continue to pose risks to the outlook.

MALDIVES

The Maldivian economy is estimated to have expanded by 4.10 per cent in 2023, 4.61 percentage points lower than the growth forecast of October 2023, and much lower than the 13.91 per cent growth recorded in 2022. The lower-than-projected economic growth was mainly on account of the slower-than-expected outturn in the construction sector, together with the contraction of the tourism sector, owing to the decline in resort bednights which drives the gross value added (GVA) of the sector instead of total tourist bednights. In 2023, real GDP growth was primarily driven by the expansion of the transport and communication sector. The Maldivian economy is estimated to maintain the upward growth trajectory in 2024, with real GDP growth reaching 4.9 per cent.

The average rate of inflation (as measured by the annual percentage change in the Consumer Price Index [CPI]) accelerated to 2.93 per cent in 2023, after recording 2.33 per cent in 2022. The pick-up in inflation during the year was mainly driven by the hike in general goods and services tax (G-GST) rate in January 2023. During the year, prices of food items, together with the cost of certain services such as services of restaurants and cafés, passenger transport services and health services, as well as prices of energy-related items contributed the most to positive inflationary pressures during the year. As for the outlook on prices, according to the May 2024 revised forecasts, inflation is expected to average at 2.6 per cent in 2024, with the implementation of the proposed subsidy reform. However, inflation is expected to be at 1.2 per cent if the reform is not implemented.

With regard to government finances, the overall fiscal deficit is estimated to have widened to 13.46 per cent of GDP in 2023, up from both the 11.61 per cent recorded in 2022 and the initial projection of 8.26 per cent for 2023. This was due to higher-than-expected expenditure, driven by delays in implementing the expenditure reduction policies outlined in the 2023 government budget, despite total revenue exceeding the budgeted target. Meanwhile, public external debt (excluding guaranteed debt) as a percentage of GDP is estimated to have widened and reached 37.61 per cent in 2023 from 34.86 per cent in 2022, while public debt level (excluding guaranteed debt) is estimated to have increased to 109.55 per cent of GDP during 2023, from 96.04 per cent in 2022. The expansion in national debt to MVR 124.89 billion during 2023 from MVR 106.66 billion at the end of 2022 was contributed by the rise in domestic debt as well as external debt of the government.

On the external front, according to revised estimates made in March 2024, the current account deficit is estimated to have widened from 16.30 per cent in 2022 to 21.38 per cent of GDP in 2023. The widening of the current account deficit was mainly due to reduced inflows on the services account, as travel receipts decreased, owing to the underwhelming performance of resort bednights. Looking at merchandise trade, the merchandise trade deficit narrowed in 2023, supported by both the growth in receipts from re-exports and domestic exports, as well as the decline in import expenditure. Meanwhile, gross international reserves as a percentage of imports declined in 2023 owing to the decline in gross international reserves primarily due to the increase in short-term foreign liabilities.

NEPAL

The National Statistics Office has estimated economic growth of 3.87 per cent for 2023/24 as compared to 1.95 per cent for 2022/23. Agriculture, industry and service sectors are estimated to grow by 3.05 per cent, 1.25 per cent and 4.50 per cent respectively.

Annual average consumer price inflation decreased from 7.74 per cent in 2022/23 to 5.44 per cent in 2023/24. The y-o-y consumer price inflation has significantly decreased from peak of 8.6 per cent in September 2022 to 3.57 per cent in July 2024.The annual average inflation in 2023/24 remained within 6.5 per cent, the target set by the monetary policy. The annual average wholesale price inflation also decreased from 8.47 per cent in 2022/23 to 3.92 per cent in 2023/24.

Broad money (M2) expanded 12.96 per cent in 2023/24 compared to the growth of 11.19 per cent in 2022/23. Reserve money expanded 8.30 per cent in 2023/24 compared to the growth of 10.41 per cent in 2022/23. Domestic credit expanded 6.11 per cent in 2023/24 compared to a growth of 8.82 per cent in 2022/23. Deposits at BFIs increased by 13.0 per cent in 2023/24 compared to an increase of 12.34 per cent in 2022/23. The private sector credit from BFIs increased 5.77 per cent in 2023/24 compared to a growth of 3.81 per cent in 2022/23.

The weighted average deposit rate of commercial banks stood at 5.77 per cent in mid-July 2024 compared to 7.86 per cent in mid-July 2023. The weighted average lending rate of commercial banks stood at 9.93 per cent in mid-July 2024 compared to 12.30 per cent in mid-July 2023. The weighted average 91-day treasury bills rate stood at 3.00 per cent in mid-July 2024, compared to 6.35 per cent in mid-July 2023.

Current account remained in surplus of 3.88 per cent of GDP in 2023/24 against a deficit of 0.87 per cent of GDP in 2022/23 reflecting decrease in the imports amid steady inflows of remittances and recovery in tourism services. It marks the reversal of the current account into surplus in 2023/24 from deficit of 12.53 per cent of GDP in 2021/22. Remittance inflows increased 14.52 per cent to USD 10.86 billion in 2023/24 compared to an increase of 13.94 per cent in 2022/23. Nepal's gross foreign exchange reserves stood around USD 15.27 billion on mid-July 2024 compared to USD 11.71 billion on mid-July 2023. Based on the imports of 2023/24, the foreign exchange reserves are sufficient to cover the prospective merchandise imports of 15.6 months, and merchandise and services imports of 13.0 months.

The government expenditure decreased by 0.94 per cent in 2023/24 compared to an increase of 8.50 per cent in 2022/23. Government revenue increased by 10.61 per cent in 2023/24 compared to decrease of 10.14 per cent in 2022/23. The government's domestic and external debt stood at 20.70 per cent and 21.95 per cent of GDP respectively in 2023/24. Such ratios were 21.11 per cent and 21.88 per cent of GDP in 2022/23.

PAKISTAN

During FY24, Pakistan's macroeconomic conditions exhibited improvements. Real economic activities recovered moderately from the previous year's contraction, aided by the Stand-By Arrangement (SBA) with the IMF, which helped alleviate external account stress. The current account deficit significantly narrowed due to continued contractionary monetary and fiscal policies, better agricultural output, and easing global commodity prices. Despite subdued domestic demand, inflationary pressures remained high, prompting the SBP to maintain a tight monetary policy with the policy rate at 22 per cent from July to May of FY24. However, in June 2024, the policy rate was reduced by 150 basis points due to improved inflation readings and favorable domestic conditions.

The real GDP is provisionally estimated to grow by 2.4 per cent in FY24, after showing a contraction of 0.2 per cent in FY23. The recovery is led by agriculture, while industry and services sectors also moderately recovered. The agriculture led the way with cotton, rice and wheat crops growing by double digits. Besides low base impact, attributed to damages from last year's floods, higher yields across most of the major and minor crops, better weather conditions and improved availability of inputs aided the growth performance. Meanwhile, output of Large-scale Manufacturing (LSM) witnessed a growth of 1.0 per cent during July-May 2024 compared to a contraction of 9.6 per cent in the same period last year. Growth during Jul-May 2024 is attributed to food, wearing apparel, leather products, wood products, coke and petroleum product, fertilizer, machinery and equipment, and pharmaceuticals.

The fiscal deficit stood at 6.8 per cent of GDP in FY24 compared to 7.8 per cent in the corresponding period last year. The decline in the fiscal deficit is attributed to primary balance, which posted surplus of 0.9 per cent of GDP during FY24 compared to 1.0 per cent deficit in FY23. This was largely due to an increase in revenues, while non-interest expenditure also decreased. Meanwhile, the total public debt reached Rs 67.5 trillion by end-March 2024, compared to Rs 59.2 trillion at end-March 2024.

The current account deficit has narrowed by 79.2 per cent to US dollars 0.7 billion during FY24 compared to US dollars 3.3 billion in the same period last year. A sizeable reduction in the trade deficit and increased workers' remittances, which outweighed higher interest payments and profit repatriation, mainly explains this improvement. Specifically, recovery in exports of goods have contributed to lower trade deficit. Meanwhile, the country's liquid FX reserves increased to US dollars 14.7 billion as of 12 July 2024, including SBP's reserves of US dollars 9.4 billion. Owing to reforms in exchange companies, improvement in current account and build-up of FX reserves, the PKR started stabilizing with Kerb-market premium plummeting since September-FY24. This brought confidence in the foreign exchange market leading to the strengthening of PKR in recent months. After depreciating in FY23, the PKR appreciated by 2.7 per cent against the US dollar during FY24.

The national CPI inflation clocked in at 23.4 per cent during FY23 against 29.2 per cent in the same period last year. The combined effect of contractionary monetary policy stance, fiscal consolidation, improved supply of food commodities, softening global commodity prices and a favorable base effect, kept inflation on almost a consistent declining trajectory during the second half of FY24.

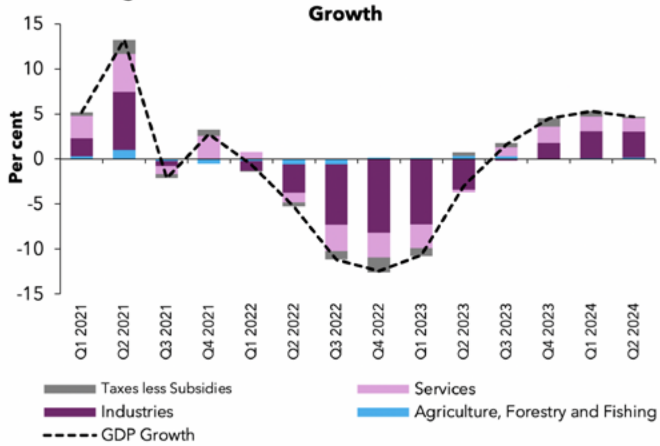
The broad money (M2) growth increased to 15.9 per cent during FY2024, compared to 14.2 per cent growth in the same period last year. This increase in M2 growth can be attributed to growth in Net Domestic Assets (NDA) due to an expansion in Government Borrowings from Scheduled Banks. Meanwhile, private sector credit grew by 4.0 per cent during FY24 compared to 2.3 per cent in the same period last year over increased demand in working capital requirements of businesses.

SRI LANKA

Real Sector

Following its deepest economic crisis in 2022, the Sri Lankan economy began to recover in the second half of 2023 recording a 3.0 per cent growth, supported by rapid disinflation and improved external resilience. As a result, the economic contraction for the year 2023 was limited to 2.3 per cent. The recovery observed in the second half of 2023 gained further momentum in the first half of 2024, with a year-on-year growth of 5.0 per cent as the economy benefitted from accommodative monetary policies and a low-inflation environment. High-frequency indicators of economic activity suggest strong performance in the third quarter of 2024, particularly in the industry and services sectors. The faster-than-expected rebound of the tourism sector continues to create positive spillover effects across related industries, while the industrial sector has surged, driven by relaxed import restrictions, lower credit costs, and rising construction activities, including the revival of several infrastructure projects. Although the agricultural sector has faced mixed results due to challenging weather conditions, it is expected to show positive growth later in the

Figure 3.1: Sector-wise Contribution to Real GDP Growth



year. Overall, the economy is expected to maintain its growth trajectory through the second half of 2024.

Price Situation

Following the high inflation episode in 2022 stemming from both domestic and global supply factors, currency depreciation, as well as demand-side factors owing to large monetary accommodation in the past, inflation has recorded a substantial deceleration, reaching lower single-digit levels towards end 2023, aided by substantial tightening of both monetary policy and fiscal policy. After a temporary increase of inflation in early 2024 due to the increase in Value Added Tax (VAT) and removal of VAT exceptions from several expenditure items in the consumer basket, year-on-year headline inflation, as reflected by the two official consumer price indices, decelerated further, reaching levels below the target of 5 per cent. This behaviour was mainly driven by downward energy price revisions. Accordingly, year-on-year headline inflation based on the Colombo Consumer Price Index (CCPI) decelerated to -0.5 per cent in September 2024 (CCPI, 2021=100) from its peak level of 69.8 per cent recorded in September 2022 (CCPI, 2013=100) and 4.0 per cent by end 2023 (CCPI, 2021=100). Following a similar trend, year-on-year headline inflation based on the National Consumer Price Index (NCPI) decelerated to 1.1 per cent in August 2024 (NCPI, 2021=100) from a peak level of 73.7 per cent in September 2022 (NCPI, 2013=100) and 4.2 per cent by end 2023 (NCPI, 2021=100). Year-on-year core inflation, which reflects underlying demand pressures in the economy, also decelerated to mid-single-digit levels. As indicated by the latest projections, headline inflation is expected to remain subdued in the near term, with the possibility of having several months of negative inflation. However, inflation is expected to stabilise at the target level of 5 per cent over the medium term, supported by appropriate policy measures.

External Situation

The external sector has shown a positive momentum thus far during 2024 with the current account recording a surplus for the first half of 2024. The current account recorded a surplus of US dollars 1,105 million for the first half of 2024 supported by significant inflows in terms of services exports and workers' remittances despite the widening of the trade and primary income account deficits. The trade deficit widened to US dollars 3.6 billion during the first eight months ending August 2024. Both export earnings and import expenditure increased during the period concerned, compared to the corresponding period of 2023. In the services account, earnings from tourism improved significantly with arrivals recording 1.5 million up to September 2024. Meanwhile, Workers' remittances grew by 11.5 per cent, year on year, to US dollars 4.8 billion during the period from January-September 2024. The performance of the financial account during the first half of the year remained subdued. FDI inflows in the first half of 2024 was around US dollars 0.5 billion. Total foreign investments in the government securities market recorded net outflows so far during the year. Meanwhile, foreign investment inflows to the Colombo Stock Exchange (CSE), including both primary and secondary market transactions, recorded a net inflow during the first nine months ending September 2024. The appreciation trend of the exchange rate observed since the latter part of 2023 continued thus far in 2024 despite some depreciation pressure observed from time to time. The Sri Lanka rupee recorded an overall appreciation of around 10.6 per cent against the US dollar as at 14 October 2024. The Gross Official Reserves (GOR) improved in the first nine months of 2024 reflecting favourable developments in the external sector. The GOR increased to US dollars 6.0 billion at end September 2024 from US dollars 4.4 billion at end December 2023. The GOR includes the swap facility from the People's Bank of China (PBOC), which is subject to conditionalities on usability. This increase was supported by some foreign inflows along with sizable net foreign exchange purchases by the Central Bank. A significant improvement in financial flows is expected following the successful completion of the external debt restructuring and continuation of the IMF programme, particularly in terms of additional financing from bilateral and multilateral partners.

Monetary Situation

In response to the eased monetary conditions resultant from the accommodative monetary policy measures implemented by the Central Bank of Sri Lanka since June 2023, the private sector credit by Licensed Commercial Banks (LCBs) expanded thus far in 2024, despite the uneven growth observed during early 2024. Accordingly, credit to the private sector recorded a cumulative expansion of Rs. 341.3

billion during January-August 2024, registering a year-on-year growth of 8.7 per cent by end of August 2024 compared to the negative growth of 0.6 per cent recorded at end 2023. The expansion in credit to the private sector was largely supported by the downward adjustment in market lending rates, while gradual pickup in demand for credit with the restoration of economic activity also contributed to the expansion of credit to the private sector. Going forward, the momentum in private sector credit is expected to sustain, supported by eased monetary conditions, while a rebound in domestic economic activity is also expected to bolster the credit demand in the period ahead. Moreover, the notable improvement in Net Foreign Assets (NFA) of the banking system was observed mainly driven by the increase in the NFA position of both the Central Bank and LCBs. However, Net Credit to the Government (NCG) by the banking system contracted thus far in 2024, largely due to the decline in NCG by the Central Bank due to the gradual unwinding of its government securities holdings. Meanwhile, credit to the State Owned Business Enterprises (SOBEs) by the banking system also contracted during the eight months ending August 2024. Reflecting these developments, the year-on-year growth of broad money (M_{2b}) remained at 9.3 per cent by end August 2024.

Interest Rate Structure

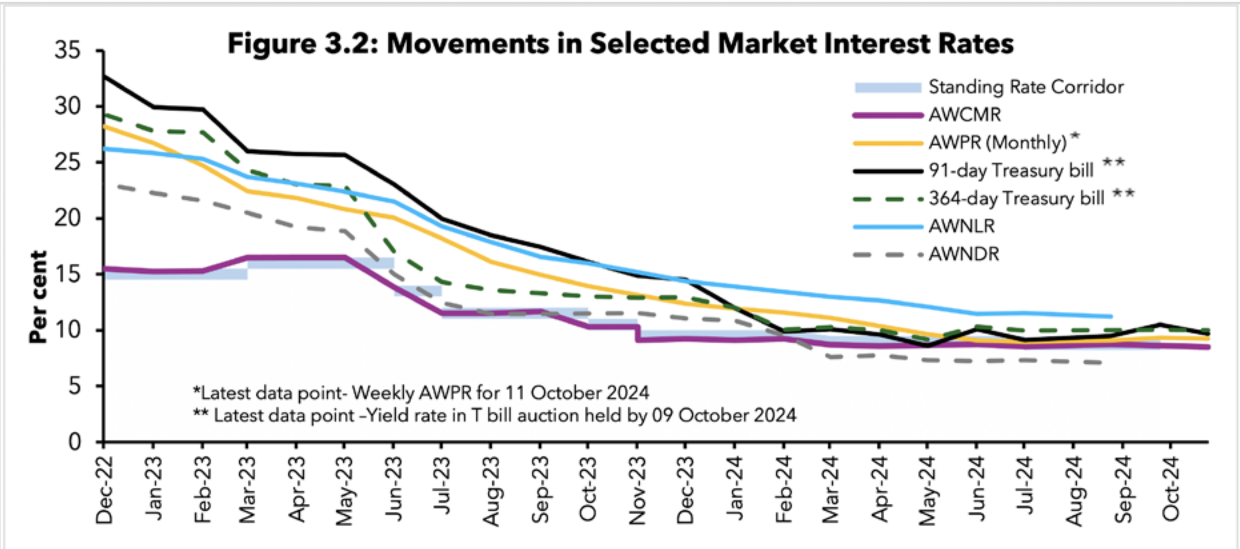
The downward trend in market interest rates, which was observed since the latter part of 2023, continued thus far in 2024 albeit some transitory anomalies were observed, particularly, yields on government securities in the recent months. Accordingly, reflecting eased monetary conditions and the improved liquidity conditions, both lending and deposit interest rates have gradually declined from the peak levels recorded in late 2022. Thus, new lending and new deposit rates have declined by around 11-12 percentage points since June 2023. Although, yields on government securities showed some increases since June 2024 partly due to political uncertainties, a reduction in yields was observed following the presidential election.

Fiscal Situation

Fiscal sector performance improved significantly during the first seven months of 2024, driven by robust revenue-based fiscal consolidation measures implemented by the Government. These measures were part of a stringent fiscal policy framework aimed at addressing the longstanding issues that contributed to the economic crisis faced by the country in 2022. The efforts were aligned with a comprehensive economic reform programme, which emphasised revenue-based fiscal consolidation in conjunction with the Extended Fund Facility (EFF) arrangement from the International Monetary Fund (IMF). These efforts led to a significant primary surplus and reduced the overall budget deficit.

Government revenue and grants grew by 42.5 per cent, year-on-year, in the first seven months of 2024, mainly due to VAT and excise duty reforms. Meanwhile,

Figure 3.2: Movements in Selected Market Interest Rates



AWCMR - Average Weighted Call Money Rate

AWPR - Average Weighted Prime Lending Rate

AWNLR - Average Weighted New Lending Rate

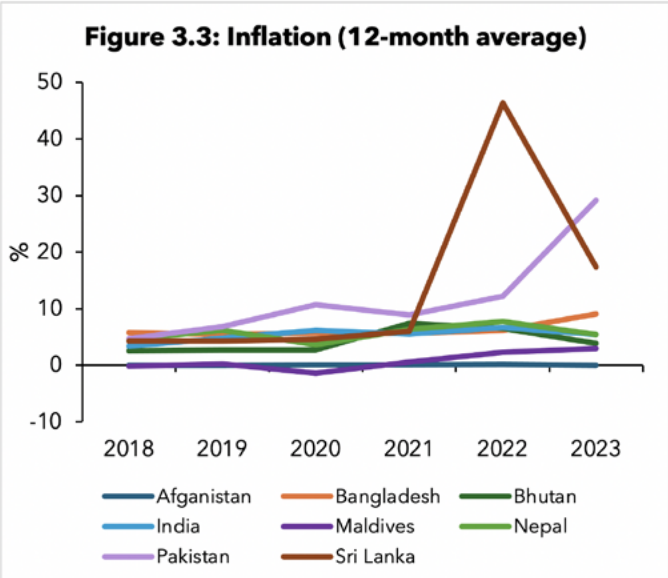
AWNDR - Average Weighted New Deposit Rate total expenditure slightly increased by 1.6 per cent. The Government's expenditure rationalisation efforts also kept non-interest recurrent spending in check. As a result, all key fiscal balances improved, with the primary balance recording a notable surplus of Rs. 519.4 billion. This positive trend is expected to continue under the Government's envisaged medium-term fiscal plan.

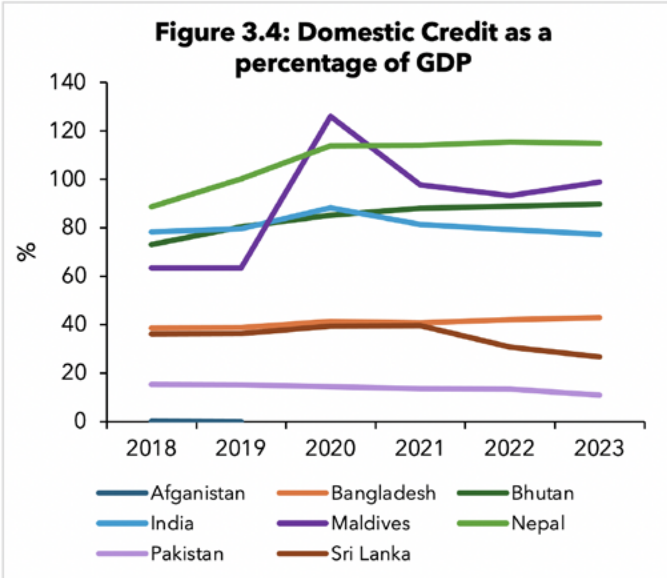
In the first seven months of 2024, the Government primarily relied on domestic sources to finance the budget deficit, as foreign financing remained limited due to the ongoing debt standstill. Provisional estimates indicate that central government debt decreased to Rs. 28,062.8 billion by the end of May 2024, down from Rs. 28,695.9 billion at the end of 2023, largely driven by the appreciation of the Sri Lankan Rupee against the US Dollar.

Following the successful completion of the Domestic Debt Optimisation (DDO) programme, marking a significant milestone for the official debt treatment process, Sri Lanka has successfully finalised its debt restructuring agreements with the members of the Official Creditor Committee (OCC) of Sri Lanka's major bilateral lenders and Exim Bank of China on June 26, 2024. Sri Lanka has reached agreements in principle with private creditors including International Sovereign Bondholders (ISBs) and is working towards conclusion of this process as well. These developments are pivotal in strengthening Sri Lanka's fiscal sustainability, boosting investor confidence, and laying a stable foundation for future economic growth.

TRENDS IN MACROECONOMIC SURVEILLANCE INDICATORS IN SAARC COUNTRIES

This section presents the standard set of charts typically featured in the SAARCFINANCE newsletter, highlighting key Economic Surveillance indicators that are part of the SAARCFINANCE database.





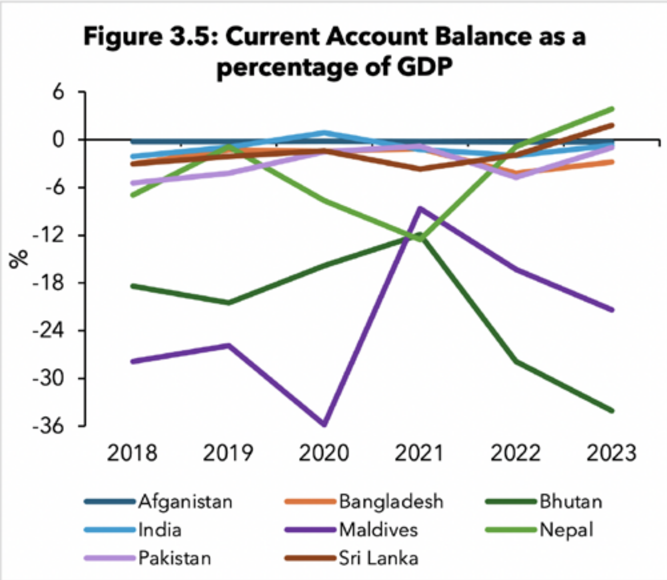


Figure 3.5: Current Account Balance as a percentage of GDP
6
0
-6
-12
-18
-24
-30
-36
%
2018
2019
2020
2021
2022
2023
Afganistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

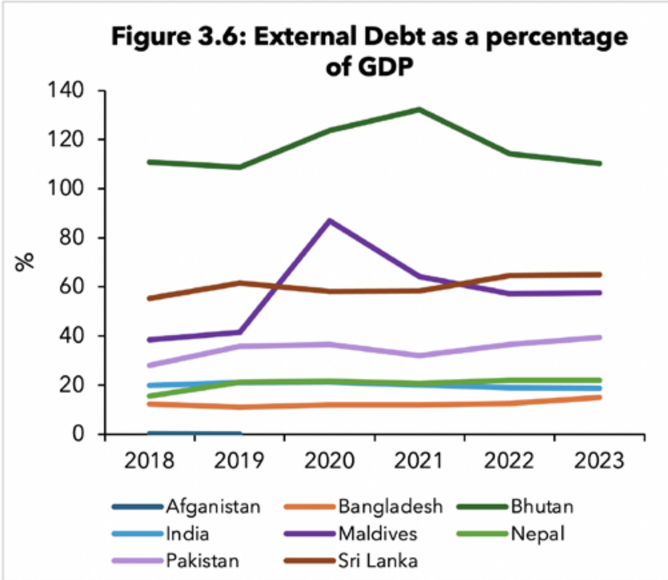


Figure 3.6: External Debt as a percentage of GDP
140
120
100
80
60
40
20
0
%
2018
2019
2020
2021
2022
2023
Afganistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

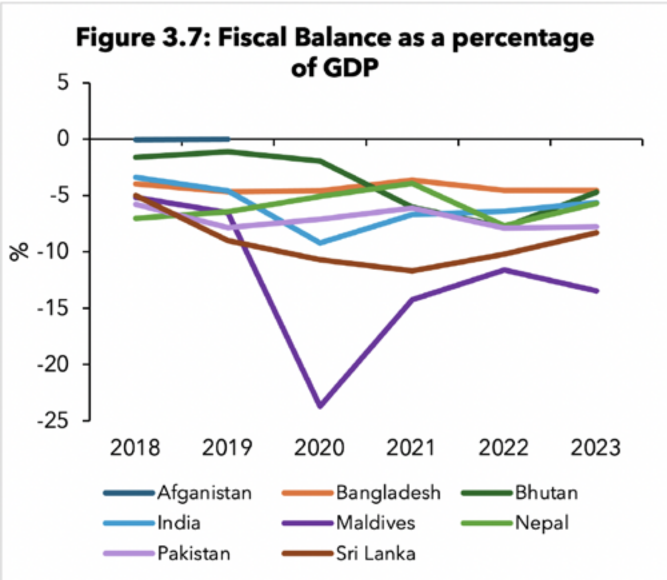


Figure 3.7: Fiscal Balance as a percentage of GDP
5
0
-5
-10
-15
-20
-25
%
2018
2019
2020
2021
2022
2023
Afganistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

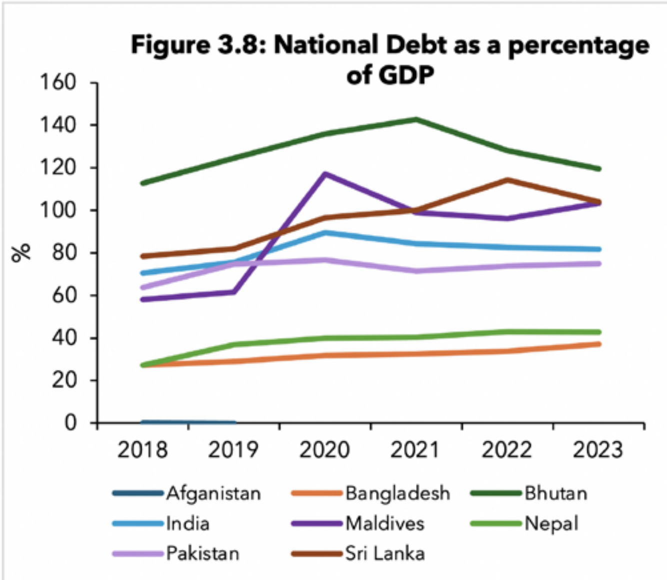


Figure 3.8: National Debt as a percentage of GDP
160
140
120
100
80
60
40
20
0
%
2018
2019
2020
2021
2022
2023
Afganistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

RECENT POLICY MEASURES IN SAARC COUNTRIES

AFGHANISTAN

Monetary stance

Da Afghanistan Bank implements Monetary Targeting as its monetary policy framework, with Reserve Money being the core operational target. The monetary policy department sets a benchmark for monetary growth in line with other macroeconomic indicators to accommodate sustainable economic growth while maintaining price stability. It's also worth mentioning that Da Afghanistan Bank has achieved all its monetary targets during the FY 2023-24.

Major Policy Announcements

- *Relaxation in cash withdrawal limits*

The banking system of Afghanistan survived economic shocks and has been going through a paradigm shift in terms of the tools and services they cater to the market. At the outset of the economic shocks over the past few years, commercial banks in the country faced a liquidity crunch, and therefore, restrictions on cash withdrawals were imposed by the central bank to avoid bank runs and to systematically resolve the issue of liquidity, inevitably adding to the then existing economic woes. In line with the improvement in the banks' liquidity, the central bank of Afghanistan relaxed the limits of weekly and monthly cash withdrawals both in national currency and as well as in foreign currencies.

- *Promoting the use of national currency*

In the bordering provinces of Afghanistan, the use of Afghani in different classes of transactions was limited due to various factors. To fill the void, DAB's leadership has taken active measures by promoting the use of the national currency and imposing a ban on foreign currencies, which resulted in appreciating the value of AFN.

- *Transitioning to Islamic banking*

The banking sector in Afghanistan is passing through a paradigm shift. Conventional banking tools are being replaced by Islamic Banking tools. The Shift on such a scale, and that too in its initial phase, is bound to have a stagnating impact on the credit. It is envisioned that after the rollover of Islamic banking tools, financial markets in Afghanistan will experience a credit boom and eventually play an active role in employment and value generation.

BANGLADESH

Highlights of Major Policies of Bangladesh Bank (BB) during July 2023-September 2024

BB has shifted to interest rate targeting framework from the monetary aggregate targeting framework for formulating and implementing monetary policy since July 2023. Under the new framework, BB has provided unrestricted access to the Standing Deposit Facility (SDF) and Standing Lending Facility (SLF) along with the repo facility for banks and FIs.

To bring all people of the country under the digital payment ecosystem, BB has decided to launch a Mobile Financial Services (MFS) personal account for young people aged between 14 and 18 years.

Aligning with international best practices, the interest rate cap under SMART (Six-Months Moving Average Rate of Treasury Bill) has been withdrawn to move towards a market-based interest rate system. The interest rate of bank loans will now be solely based on banker-customer relationship, taking into account the demand and supply of loanable funds in the banking system.

In order to bolster confidence and increase insurance participation among consumers, commercial banks have been authorized to act as corporate agents of insurance companies, leveraging their extensive networks to augment insurance penetration in Bangladesh.

To facilitate Offshore Banking Operations (OBOs) and keeping their business uninterrupted, OBOs are allowed to borrow funds from their Domestic Banking Units (DBUs) up to 30 percent (including present outstanding) of regulatory capital.

BB adopted a crawling peg exchange rate system since May 2024. This system links the Taka's value to a currency basket with a mid-rate aligned with the Real Effective Exchange Rate (REER) Index, reducing market volatility and narrowing the gap between formal and informal market exchange rates.

BB introduced the Financial Market Infrastructure (FMI) system on 2 June 2024 to further enhance the secondary market for government securities. This system aims to improve monetary policy transmission by offering more efficient liquidity and buy-sell options for primary dealers alongside repo, SDF, and SLF.

To tame inflation, BB has steadily raised the policy rate (repo rate) by a total of 350 basis points since June 2023, bringing it to 9.50 per cent in September FY25. The Standing Lending Facility (SLF) rate has been set at 11.00 percent, while the Standing Deposit Facility (SDF) rate is fixed at 8.00 per cent as of September FY25.

BHUTAN

The primary objective as per RMA Act of Bhutan 2010, is to formulate and implement monetary policy in view of achieving and maintaining price stability. Since in 1974, Ngultrum (BTN) is pegged with Indian Rupee at one-to-one exchange rate system, which is called as conventional peg arrangement. This fixed exchange rate serves as an explicit nominal anchor for maintaining price stability.

Targeting fixed exchange rate has benefited for Bhutan over the years in maintaining low exchange rate volatility, facilitating smooth trade integration, safeguarding competitiveness, bolstering confidence in Ngultrum. However, the challenges continue to remain in terms of independence of monetary policy operation (impossible trinity), with closed capital flows and pegged exchange rate.

Given higher trade integration and peg exchange rate with India, an effective management and monitoring of external reserves remain critical in maintaining the peg exchange rate. In addition, the RMA regulate the flow of credit and money supply in economy to control building pressure on stability of peg regime.

Prior to COVID-19, inflation hovered around 3-4 per cent. However, during the pandemic, inflation raised to 5.63 per cent in 2020 and 7.35 per cent in 2022, contributed by rise in global prices due to supply chain disruptions and geo-political tensions. While inflation stabilize during the post-pandemic, but still remain higher than pre-pandemic levels. As of April 2024, Bhutan's inflation rate recorded at 4.87 per cent.

The Cash Reserve Requirements (CRR) remains only monetary policy instrument used to regulate economic and financial conditions- credit, liquidity and money supply. Based on macroeconomic and liquidity condition in banking sector, CRR are revised accordingly. However, the CRR has its limitation in achieving the policy objective and market based monetary policy operation is warranted. In response to the Covid-19 pandemic, the Royal Monetary Authority (RMA) reduced the CRR from 10 per cent to 7 per cent to ease liquidity pressures on financial institutions. Following the reopening of the economy and borders post-pandemic, the CRR was revised upwards from 7 per cent to 8 per cent.

Additional to CRR the interest rate structure has undergone reforms to adapt to market changes and economic growth. The RMA initially controlled rates, then partially liberalized while keeping interest spread at a maximum of 6 per cent. The Base Rate system in 2012 aimed to improve efficiency, but challenges remained. To address these, the Minimum Lending Rate (MLR) was introduced in 2016, currently estimated at 6.92 per cent. The implementation of MLR has supported the softening of interest rates over the period to promote access to credit.

INDIA

Major Policy Announcements by the Reserve Bank of India (April 2023 – March 2024)

The modified MIFOR (MMIFOR), developed as an alternative to the MIFOR, was notified as a 'significant benchmark', in June 2023. The Mumbai Interbank Forward Outright Rate (MIFOR) has been transformed into the Modified MIFOR using the alternate reference rate, secured overnight financing rate (SOFR) instead of LIBOR in line with the global transition away from the LIBOR. Modified MIFOR is now being used for all new contracts.

In December 2023, securities lending and borrowing in government securities (G-secs) was permitted with the objective of providing investors an avenue to deploy their idle securities to enhance portfolio returns and deepen the G-sec market.

In February 2024, Reserve Bank of India and Nepal Rastra Bank signed and exchanged Terms of Reference for integration of fast payment systems of India and Nepal, viz., UPI of India and National Payments Interface of Nepal, respectively. Further, RuPay cards and UPI connectivity between India and Mauritius, as well as UPI connectivity between India and Sri Lanka was launched.

The Reserve Bank, in consultation with the GoI introduced an ultra-long 50-year paper, in addition to the existing benchmark tenor papers, to cater to the demand from long-term investors.

The scope of Unified Payments Interface (UPI) was expanded in September 2023 by permitting linkage of credit lines to UPI as funding account and enabling transfer to/from pre-sanctioned credit lines at banks.

The Reserve Bank permitted the issuance of RuPay Prepaid Forex cards by banks in India for use at automated teller machines (ATMs), point of sale (PoS) machines and online merchants overseas. (June 2023)

The Reserve Bank announced the development of a Public Tech Platform for Frictionless Credit. The Platform has been developed by the Reserve Bank Innovation Hub (RBIH), a wholly owned subsidiary of the Reserve Bank. The pilot of the platform commenced on 17 August 2023.

To promote the internationalisation of INR and to support to the local currency settlement with partner countries the Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2023 were issued on 21 December 2023.

The Reserve Bank issued a circular (dated 16 November 2023) on regulatory measures towards consumer credit and bank credit to NBFCs to pre-empt build-up of any potential risk from interconnectedness and excessive credit growth in these segments. The measures included higher risk weights for such exposure as also tighter exposure limits.

Framework for acceptance of green deposits for the Regulated Entities (REs) was introduced to encourage REs to offer green deposits to customers, protect interest of the depositors, aid customers to achieve their sustainability agenda, address greenwashing concerns and help augment the flow of credit to green activities/projects. REs shall be allocating the funds raised from green deposits in the sectors adopted from the Government of India's 'Framework for Sovereign Green Bonds'. REs shall issue green deposits as cumulative/non-cumulative deposits and in Indian Rupees only. The framework came into effect from June 1, 2023

The prompt corrective action (PCA) framework for NBFCs was extended to government NBFCs (except those in base layer) vide circular dated October 10, 2023. The objective of the PCA framework is to enable supervisory intervention at appropriate time and require the supervised entity (SE) to initiate and implement remedial measures in a timely manner to restore its financial health.

MALDIVES

Monetary policy stance and announcements in 2023

The MMA's monetary policy framework remained unchanged in 2023, with a focus on sustaining the US dollar peg within the established range of MVR 10.28 to MVR 15.42 for the exchange rate. Accordingly, the MMA continued to bolster the banking system through foreign exchange market intervention and rufiyaa liquidity management. No adjustments were made to monetary policy instruments, with the exception of the MMA commencing renumeration on Islamic MVR MRR at 1 per cent p.a., effective 02 January 2023.

Despite the decrease in global inflationary pressures and oil prices relative to 2022, local demand remained high and foreign currency shortages persisted in the domestic economy. As such, the MMA significantly increased the supply of foreign currency provided to the domestic economy through sale to commercial banks, accommodating the foreign exchange demand of the public and local businesses. The MMA repaid the US dollars 100 million foreign currency swap which was availed in December 2022 from the RBI.

In 2023, there were no additional operational changes to monetary policy instruments, including open market operations and standing facilities. Open market operations have remained suspended since May 2014, and excess liquidity in the banking system continues to be absorbed through the MRR and the overnight deposit facility, which yields 1.5 per cent annually. The overnight Lombard facility also remained available for the commercial banks, to borrow from the MMA at 10% per annum.

NEPAL

The stance of monetary policy for 2024/25 has been continued as cautiously accommodative to support the economic activities given the comfortable level of foreign exchange reserve and lower inflation. For this, both the bank rate (the upper bound of interest rate corridor) and the policy rate has been reduced by 50 basis points to 6.5 per cent and 5.0 per cent respectively whereas the deposit collection rate (lower bound of interest rate corridor) have been kept unchanged at 3.0 per cent. Earlier, the bank rate was reduced from 7.5 per cent to 7.0 per cent, the policy rate was reduced from 6.5 per cent to 5.5 per cent and deposit collection rate was reduced from 4.5 per cent to 3.0 per cent.

The target of the monetary policy is to contain inflation within 6.5 per cent and maintain foreign exchange reserves sufficient to cover the imports of goods and services for at least 7 months.

Nepal Rastra Bank has recently introduced provision of providing standing deposit facility (SDF) at lower bound of interest rate corridor (IRC) for effective implementation of IRC and effective liquidity management.

NFRS 9-Expected Credit Loss Related Guidelines, 2024 has been issued for the implementation of the Expected Credit Loss (ECL) Model which will enhance credit risk management and resilience of banks and financial institutions.

Regulatory measures have also been in place for monitoring large exposure credit, enhancing the effectiveness of regulation and supervision, reducing the over-concentration of the credit, prioritizing small and medium-sized productive loans, and enhancing the quality and access to credit, so as to promote the financial stability.

PAKISTAN

Monetary Policy Stance

Monetary Policy Committee (MPC) of the SBP decides the stance of the monetary policy, which is communicated through the policy rate announcement in Monetary Policy statements. The implementation process involves managing daily liquidity in the money market to keep short-term interest rates stable and close to the policy rate. The SBP releases Monetary Policy Statements eight times a year, detailing the policy rate and providing an analysis of current economic conditions.

In order to achieve the core objective of price stability, the SBP upheld a tight monetary policy stance by maintaining the policy rate at 22 per cent from July-2023 to May-2024 due to high National CPI (NCPI) inflation. During Jul-Jun FY24, NCPI inflation rose to 23.4 per cent, within SBP's revised projection range of 23-25 per cent. However, in June 2024, the SBP lowered the policy rate by 150 basis points to 20.5 per cent, following a significant drop in NCPI inflation in May, supported by favorable domestic and global conditions.

Major Policy Announcements

Followings are the highlights of major policies/ measures taken by SBP since July 2023:

- With a view to further strengthen Shariah compliance framework and harmonize the Shariah practices in Islamic banking industry, SBP adopted further AAOIFI Shariah Standards on (i) Hiring of persons, (ii) Revocation of Contracts, (iii) Settlement of Debts, (iv) Hawalah, (v) Commercial Papers, (vi) Concession Contracts, (vii) Options to Terminate and (viii) Options to Reconsider.
- In pursuance of SBP Vison 2028 and to facilitate banks in their conversion from conventional to Islamic, SBP has developed broad guiding parameters, which will help banks to devise their own conversion plans.
- With the vision to build an innovative and inclusive digital financial ecosystem, SBP introduced a Centralized Foreign Exchange (FX) Trading Platform called 'FX Matching' for interbank FX market. The objective is to provide the interbank market participants a centralized trading platform that offers FX trading on anonymous basis and real time price visibility.
- In order to foster innovation in the payments industry and promote financial inclusion through digital financial services in the country, SBP revised the Regulations for Electronic Money Institutions (EMIs) in light of the indigenous experiences and international best practices.
- With the objective to accelerate the pace of digitization of merchant and business transactions

in Pakistan, SBP launched an interoperable Raast P2M service to facilitate digital payment acceptance for merchants and businesses. The will enable payment acceptance by businesses using Quick Response (QR) Codes, Raast Alias, IBAN and Request to Pay (RTP).

- Considering the critical importance of SMEs in inclusive economic growth and employment creation, SBP implemented measure for the banks to develop Digital Supply Chain Finance (DSCF) in increasing SMEs' access to finance as well as digitization of retail payments.

SRI LANKA

The Central Bank of Sri Lanka continued to maintain an accommodative monetary policy stance since June 2023. As inflationary pressures remained subdued, monetary policy was relaxed further thus far in 2024. The Central Bank significantly lowered its policy interest by a total of 650 basis points since June 2023. In March 2024, policy interest rates were further reduced by an additional 50 basis points amidst subdued aggregate demand conditions, favourable near-term inflation dynamics, well-anchored inflation expectations, as well as the absence of excessive external sector pressures. This policy adjustment warranted a continuous downward adjustment in overall market lending rates. Meanwhile, with the inflation outlook remaining benign, monetary policy was further eased in July 2024 by reducing policy interest rates by 25 basis points with a view to signalling the continuation of the eased monetary policy stance and inducing a further reduction in market lending rates. Accordingly, policy rates have been reduced by a total of 725 basis points thus far during the current monetary policy easing cycle.

Other Major Policy Changes

Financial Stability related

- On 25 March 2024, Banking Act directions were issued on "Large Exposure of Licensed Banks", to be implemented with effect from 01 January 2026 with a view to mitigating the potential credit concentration risks, ensuring safety and soundness of the banking sector.

Table 3.1: Changes in Policy Interest and SRR made since August 2021

Date	SDF Rate (%)	SLF Rate (%)	SRR (%)
19.08.2021	5.00	6.00	2.00
01.09.2021	5.00	6.00	4.00
20.01.2022	5.50	6.50	4.00
04.03.2022	6.50	7.50	4.00
08.04.2022*	13.50	14.50	4.00
07.07.2022	14.50	15.50	4.00
03.03.2023*	15.50	16.50	4.00
01.06.2023	13.00	14.00	4.00
06.07.2023	11.00	12.00	4.00
16.08.2023	11.00	12.00	2.00
05.10.2023	10.00	11.00	2.00
24.11.2023	9.00	10.00	2.00
26.03.2024	8.50	9.50	2.00
24.07.2024	8.25	9.25	2.00

*Close of Business

Note: SDF- Standing Deposit Facility, SLF- Standing Lending Facility

- On 28 March 2024, a circular was issued on "Guidelines for the establishment of Business Revival Units in Licensed Banks" with a view to facilitating the sustainable revival of businesses affected by the extraordinary macroeconomic circumstances and improving the asset quality of Licensed Banks.
- On 13 June 2024, Banking Act determination No. 01 of 2024 was issued, determining every Licensed Commercial Bank (LCB) and Licensed Specialised Bank (LSB) to maintain Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) as the statutory liquidity ratios of such banks, at all times, in accordance with the Basel III framework.
- On 15 June 2024, the Banking (Amendment) Act, No. 24 of 2024 came into effect further strengthening the legal and regulatory framework applicable for LCBs and LSBs to enhance the resilience of the banking sector of Sri Lanka. Further, the Central Bank has issued several new Regulations/instructions to licensed banks to facilitate the effective implementation of the Banking (Amendment) Act.
- With the implementation of the Banking (Amendment) Act, No. 24 of 2024, effective from the appointed date of 15 June 2024, the demarcation of the Domestic Banking Unit and Off-shore Baking Unit is eliminated, and off-shore banking business is identified as a permissible activity that a LCB may carry out.
- On 03 May 2024, CBSL issued directions on Credit Risk Management to every Finance Company (FC) licensed under the Finance Business Act, No. 42 of 2011 outlining the key principles for a sound credit risk management framework.
- The Governing Board of CBSL has approved the comprehensive Resolution Policy, which is in line with Banking (Special Provisions) Act, No.17 of 2023 and serves as a foundational framework that will guide the resolution of both Licensed Banks (LBs) and FCs, on 17 July 2024
- on 30 September 2024 the Central Bank of Sri Lanka issued directions on Corporate Governance for Licensed Banks, with a view to strengthening the corporate governance processes and practices of the licensed commercial banks and licensed specialised banks in Sri Lanka.
- CBSL has developed specific resolution triggers, which define the thresholds and conditions under which an LB will be subject to resolution measures, and are crucial for early intervention and allow CBSL to act swiftly when a financial institution shows signs of distress. In addition, on 29.10.2024, CBSL issued the "Banking (Special Provisions) Act Direction No. 1 of 2024," introducing data templates for resolution planning for LBs, to collect essential information from LBs, which will be instrumental in developing and updating resolution plans.
- The Governing Board of CBSL approved the framework developed for operationalisation of the Financial Stability Fund (FSF), a key component of CBSL's broader financial stability objectives. The FSF has established on 03 October 2024 with the nominal value of Rs.500 million received from Government Treasury. The FSF will be used to support resolution actions and provide financial resources during the resolution of FIs having systemic importance or impact, ensuring that essential financial services remain uninterrupted. This fund will play a critical role in mitigating the systemic risks posed by distressed financial institutions.
- As part of the Financial Sector Safety Net Strengthening Project of the World Bank (WB) and in adherence to international best practices, a new guideline on the reimbursement of insured deposits was introduced with the approval of the Governing Board. This guideline aims to streamline and expedite the claims filing and processing procedures, benefiting insured depositors.

Others

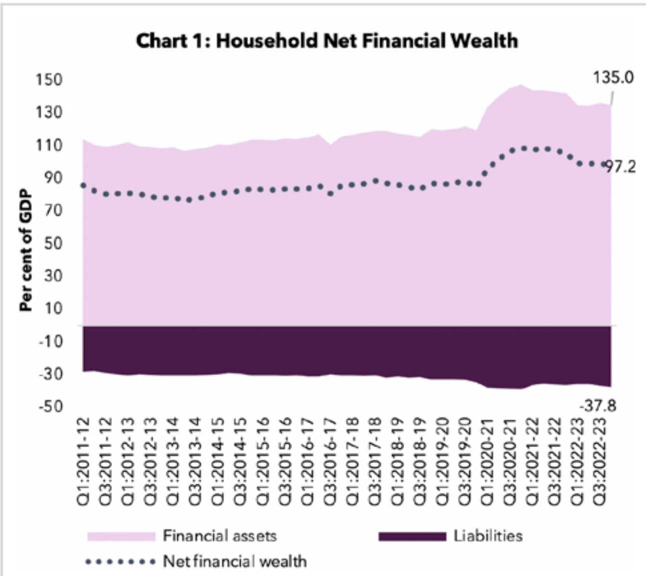
- On 01 February 2024, approval was granted for Lanka Pay (Pvt) Ltd to join with the Nepal Clearing House Ltd for the acceptance of LANKAQR transactions made by Nepali tourists through NEPALPAY QR mobile applications
- On 21 May 2024, the Financial Literacy Roadmap of Sri Lanka (2024-2028) was launched under the National Financial Inclusion Strategy (NFIS) to provide unified policy direction for stakeholders in financial literacy initiatives, aiming to improve the financial behaviour and resilience of Sri Lankans.

SECTION 04
Articles

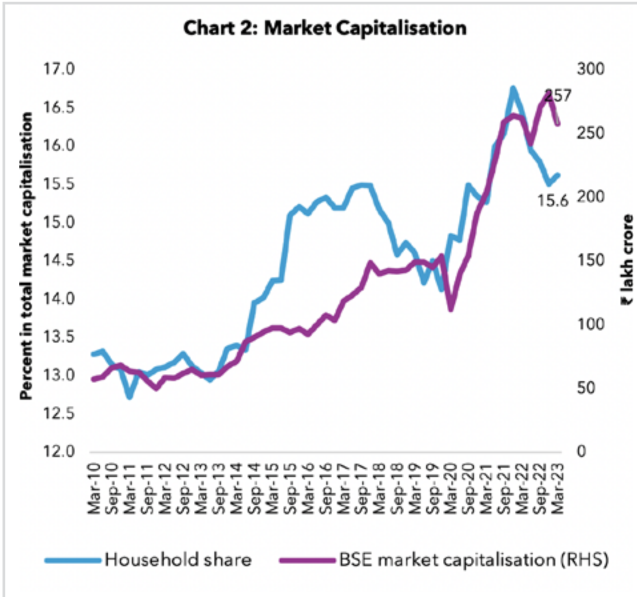
ARTICLE 1: ESTIMATING THE FINANCIAL WEALTH OF INDIAN HOUSEHOLDS[1]

by Anupam Prakash, Suraj S, Ishu Thakur and Mousumi Priyadarshini [2]

Households form the bedrock of any macroeconomic framework as the key drivers of consumption, savings and overall economic activity. Household consumption depends upon their income as well as wealth. Monitoring household financial position can help to understand the evolving private consumption and economic activity for a forward-looking monetary policy (Lettau et al., 2002; Ludwig and Sløk, 2004). This study presents quarterly estimates of financial wealth of Indian households from June 2011 to March 2023, including the investments in listed equity accounting for variations in asset prices[3].



Source: Authors' calculations.



Source: Authors' calculations.

Accordingly, household financial assets stood at 135.0 per cent of GDP while their financial liabilities were 37.8 per cent of GDP as at end-March 2023 and their net financial wealth remained at 97.2 per cent of GDP. The spike in financial assets during the Covid-19 pandemic amidst restrictions on contact-intensive services and subdued growth in liabilities led to an increase of 12.6 percentage points in net financial wealth between end-March 2020 and end-March 2023 (Chart 1).

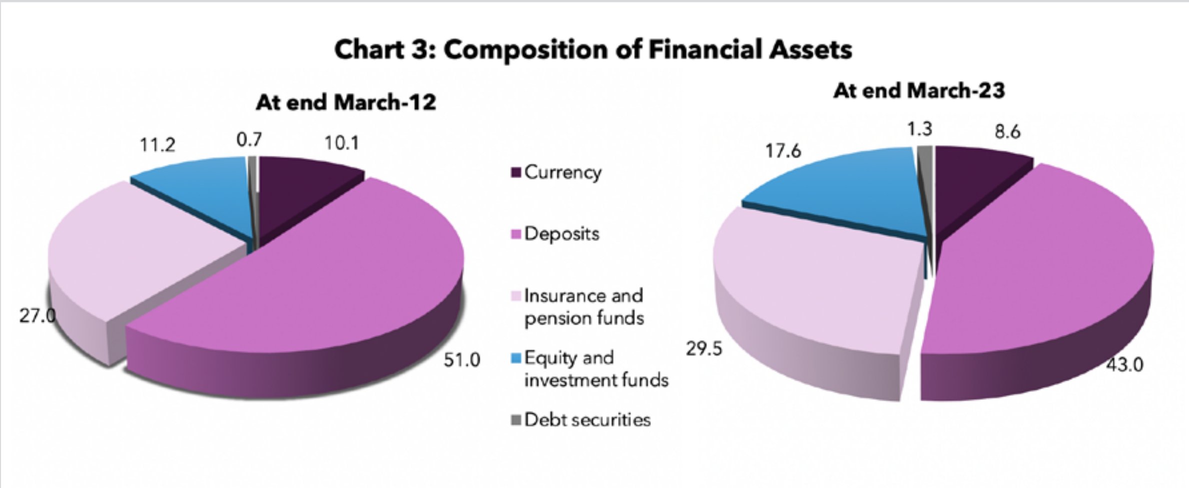
1 Published in the July 2024 Bulletin of the Reserve Bank of India.
2 Dr Anupam Prakash is in Monetary Policy Department, RBI and Suraj S, Ishu Thakur and Mousumi Priyadarshini are from Department of Economic and Policy Research, RBI. The views expressed in this article are those of the authors and do not represent the views of the Reserve Bank of India.
3 Data for the compilation is sourced from counterparty sectors which comprises various agencies/regulators including RBI, Securities and Exchange Board of India (SEBI), Pension Fund Regulatory and Development Authority (PFRDA), Insurance Regulatory and Development Authority of India (IRDAI), Association of Mutual Funds of India (AMFI), Controller General of Accounts (CGA), Employees' Provident Fund Organisation (EPFO), National Housing Bank (NHB), etc.

Equity Wealth

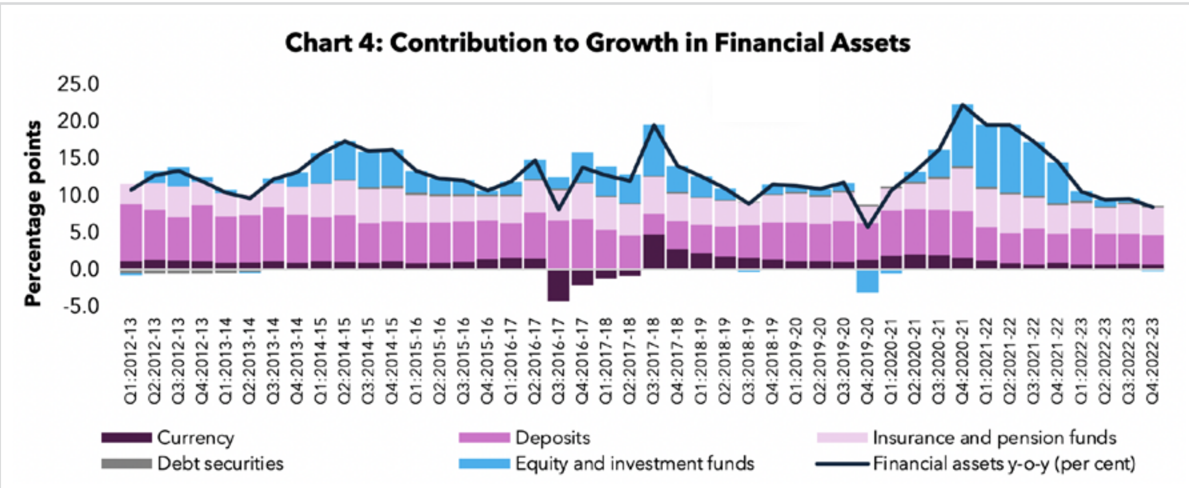
Equity wealth of households is estimated by summing up the market capitalisation as per the shareholding of household categories such as promoter households (Indian promoter individuals and Hindu Undivided Families (HUFs)) and non-promoter households of the listed companies with the Bombay Stock Exchange (BSE)[4]. As per the estimation, equity wealth of households peaked to 19.4 per cent of GDP in Q3:2021-22 from 10.3 per cent of GDP in Q1:2011-12. However, it subsequently moderated to 14.9 per cent of GDP in Q4:2022-23. The post-pandemic stock market recovery coincided with an increase in households' share in the market capitalisation mainly driven by non-promoter households, taking the share of households in total market capitalisation to 15.6 per cent as at end-March 2023 (Chart 2).

Compositional Shifts in Financial Assets

Deposits have sustained their dominance in total financial wealth in the last decade, though with indications of increasing interest towards other instruments, viz., equity and investment funds and insurance and pension funds. The share of equity and investment funds in total financial wealth increased by more than 50 per cent between 2011-12 and 2022-23. With an exponential growth in digital payments, the currency share in household financial assets has moderated. The stock market decline at the onset of the pandemic outbreak pulled down the net financial wealth of households in Q4:2019-20. However, this decline was more than offset by the accumulation of savings and deposits in 2020-21 due to the pandemic-induced restrictions on spending and the subsequent revival of the stock market (Charts 3 and 4).



Source: Authors' calculations.



Source: Authors' calculations.

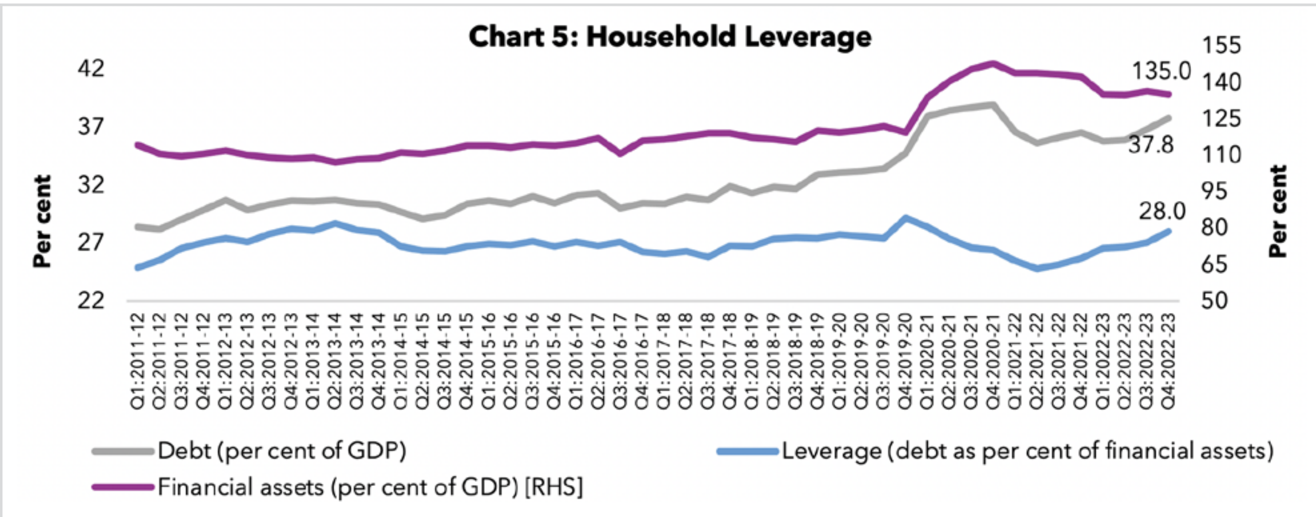
4 Household equity wealth in each listed company is calculated at quarterly level by multiplying the proportion of shares held by the promoter and non-promoter household groups with the total market capitalisation of the company. Accordingly, the total equity wealth is arrived at by aggregating the company level household equity holdings for all the listed companies.

Household Leverage

Mortgages make up the lion's share (more than 50 per cent) of household debt in advanced economies (AEs), while in emerging market economies (EMEs) non-mortgage debt forms at least two-third of the total (IMF, 2017). The latter comprises both secured and unsecured personal loans, viz., vehicle loans, education loans, credit card outstanding, business loans for industry, trade, transport, finance and loans for agriculture. Similar to other EMEs, the banking sector in India dominates as the supplier of credit to the households with almost 80 per cent share in total credit; non-bank entities, i.e., HFCs and NBFCs are also emerging fast as other sources of credit in the recent years. The share of non-bank debt increased by around 7.0 percentage points from end-March 2012 and remains at 20.7 per cent as at end-March 2023.

Adverse income shocks can get amplified in the presence of elevated debt levels (Mian et al., 2017, Zabai, 2017). While the indebtedness of Indian households has been on an upward trajectory reflecting financial deepening, it also needs to be seen in the context of an increase in their financial assets. The household "leverage" ratio - defined as the ratio of household debt to financial assets - has remained largely flat and range-bound since 2011-12 (Chart 5).

The estimation of the household financial wealth in this paper excludes investments, particularly by high-net-worth individuals, in the unlisted corporate sector, due to data constraints. Globally, household financial wealth in unlisted equity holdings exceeds listed equity wealth. In India, there exist 17.1 lakh active unlisted/private limited companies as compared with only 6,658 listed companies as at end-May 2024. The information on household holdings in these unlisted companies and consistency in their valuation would help to strengthen estimates of financial wealth presented in this study. Furthermore, significant household investments in India still flow into non-financial assets such as real estate, gold and precious metals. In this context, regular and comprehensive household wealth surveys can enrich the estimates of household overall wealth, encompassing both financial and physical assets and liabilities.



Source: Authors' calculations.

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ARTICLE 2: INTERNATIONALIZATION OF UNIFIED PAYMENTS INTERFACE (UPI)[1]

by Reserve Bank of India

The Unified Payments Interface (UPI) is a real-time payment system launched in India in April 2016 by the National Payments Corporation of India (NPCI). The UPI is a system that powers multiple bank accounts into a single mobile application (of any participating bank), merging several banking features, seamless fund routing & merchant payments into one hood. It facilitates immediate money transfer through mobile devices round the clock 24*7 and 365 days. It has features like, single click two factor authentication (seamless single click payment), incremental security with the virtual address, no requirement to enter the details such as card number, account number and IFSC and provision for utility bill payments, over the counter and QR code- based payments. While initial participants on the UPI platform were banks, non-bank third party app providers and use of QR codes have all combined in popularising UPI. Over the years, the UPI has emerged as a robust, cost effective and portable retail payment system and is attracting active interest across the globe.

Table 01: Monthly volume of UPI payments in 2024

Month	Avg. Daily Volume (in million)
Jan-24	393.65
Feb-24	417.33
Mar-24	433.55
Apr-24	443.47
May-24	452.77
Jun-24	462.84
Jul-24	465.66
Aug-24*	485.06

Source: National Payments Corporation of India. Note: *data to be updated.

The average daily volume of UPI payments stood at 465.66 million in July 2024, rising from 104.77 million average daily volume of payments in July 2021.

The NPCI has introduced multiple products within the realm of UPI by introducing features to meet specific purposes and to cater to specific category of users. A list of such products is given in the table below.

Table 02: Products within the realm of UPI

Products	Description
UPI 123PAY	Enables safe and secure UPI transactions for feature phones
UPI LITE	UPI LITE is a payment solution to process low value transactions that have been set at below 500.
Credit Card on UPI	Under this, RuPay Credit cards can be linked to a UPI ID.
UPI Circle	UPI Circle is a solution where a payer can extend the authorization to transact from their UPI account to an individual (whom they trust) with required limits.
UPI-ATM	UPI-ATM would allow participating bank's customers who are live on UPI, to withdraw cash from any participating banks' ATMs (enabled for UPI-ATM) without using their card (based on QR code scanning).
UPI ONE WORLD	UPI ONE WORLD is designed for hassle-free and secure digital payments for travellers visiting India.
Hello! UPI	It facilitates payments in Indian regional languages, and this is particularly useful for Indians who are conversant with their mother tongue language.

Source: National Payments Corporation of India. Note: *data to be updated.

1 Entire article is based on data and information from RBI and NPCI.

Internationalization of UPI

Internationalisation of the UPI is one of the visions enshrined in the Reserve Bank of India's Payments Vision 2025 as follows;

"Reserve Bank shall actively support the global outreach initiatives to expand the footprint of domestic payment systems by collaborating with relevant stakeholders (e.g. Central Banks, BIS, World Bank, other institutions, etc.)"

The UPI internationalisation would facilitate in-bound remittances at a lower cost, accelerate growth in trade and commerce and provide seamless payment experience to India's outbound tourists.

The RBI and the NPCI have undertaken various steps to expand the global reach of UPI in recent years. The NPCI International Payments Limited (NIPL), a wholly owned subsidiary of National Payments Corporation India (NPCI), was created in 2020 with a specific goal of deploying RuPay (domestic card scheme) and UPI outside of India.

The NIPL has successfully established partnerships with Discover Financial Services (DFS) USA, Japan Credit Bureau (JCB) Japan, Union Pay International (UPI) China, Royal Monetary Authority (RMA) of Bhutan and Network for Electronic Transfers (NETS), Singapore. NIPL has partnered with the Bank of Namibia and the Central Bank of Peru for the development and deployment of a UPI like payments system.

Currently, UPI is accepted in (select merchant locations) in Bhutan, Nepal, Sri Lanka, Mauritius, UAE, Singapore and France (E-commerce). A snapshot of UPI cooperation with these countries is provided in the table below.

Going forward, the 'new trinity' of Jan Dhan, Aadhaar, and mobile (JAM) -UPI- Unified Lending Interface (ULI) is expected to play a revolutionary role in India's digital revolution. The UPI's global reach and acceptance is definitely an important aspect of this journey in future.

Table 03: Internationalization of UPI

Country	Organization	Partnership
UAE	NEOPAY (payment subsidiary of Mashreq Bank)	Enables Indian travellers in UAE to make payments via UPI powered apps at select merchants
Singapore	Network for Electronic Transfers (NETS)	Enables Indians to make payments via UPI powered apps (and RuPay Cards) at select merchant locations in Singapore.
	Banking Computer Services Private Limited	Users in India and Singapore can conduct convenient, safe, instant, and cost-effective cross border fund-transfer through UPI-PayNow linkage.
Bhutan	Royal Monetary Authority of Bhutan (RMAB)	Select merchant locations in Bhutan now accept UPI powered apps and Rupay Cards because of the partnership
Nepal	Fonepay Payment Service Limited	Indian citizens can seamlessly conduct QR-code-based UPI transactions in Nepal
Sri Lanka	LankaPay Private Limited	This will allow Indian citizens to make QR-code based payments using UPI apps at merchant locations in Sri Lanka
Mauritius	Bank of Mauritius	Enables an Indian traveller to Mauritius to make payments to a merchant using UPI. Similarly, a citizen of Mauritius travelling to India can make payments to a merchant using Instant Payment System (IPS) app of Mauritius
France (E-commerce)	Lyra Group	Indian tourists to the Eiffel Tower can now purchase tickets online through UPI powered apps

ARTICLE 3: RECENT INFLATION TRENDS IN BANGLADESH: CAUSES AND POLICY IMPLICATIONS

by Dr. Imam Abu Sayed, Dr. Ripon Roy, Rifat Ara Bindu and Romana Ferdoush[1]

1. Introduction

Inflation remains a critical macroeconomic issue for Bangladesh, impacting the nation's economic stability and social well-being. Understanding the forces driving inflation is essential for designing effective policy interventions aimed at achieving higher and sustained economic growth and maintaining price stability.

Bangladesh's inflationary trends have evolved over the past few decades, driven by a complex interplay of supply-side shocks, demand-pull factors, inflation expectation and external influences. The inflation rate for consumer prices in Bangladesh is increasing over time. In the past 34 years the inflation rate moved over between 2.0% and 11% (BBS, 2024) . Exchange rate movements, import dependency, and monetary factors, including money supply and interest rates, also significantly contribute to inflationary pressures. Furthermore, the country's rapid urbanization, growing consumer demand, and shifts in global supply chains have exacerbated inflationary pressure.

This study aims to empirically examine the key determinants of inflation in Bangladesh by applying econometric models to analyze both short-term and long-term drivers. By investigating these relationships, the paper seeks to offer valuable insights into the dynamics of inflation and provide evidence-based policy recommendations.

A Brief Overview of the Current Inflation Scenario in Bangladesh

Figure 1: From January 2023 to August 2024, food inflation in Bangladesh remained a major concern, consistently exceeding non-food inflation rates. Supply chain disruptions also played a role in keeping food inflation persistently high. At its peak, food inflation reached 14.10 percent in July 2024, before moderating slightly to 11.36 percent by August 2024.

Non-food inflation in Bangladesh from January 2023 to August 2024 remained significant, though consistently lower than food inflation. It was primarily driven by rising costs in housing, transportation, utilities, and healthcare. Global fuel price hikes, along with the depreciation of the Bangladeshi Taka, led to higher cost for production and transportation, which contributed to rising non-food prices. Peaks in non-food inflation were observed in the first half of 2024, reaching around 10 percent, especially in urban areas where transportation and utility costs are higher.

Figure 2: Rural inflation in Bangladesh from January 2023 to August 2024 was heavily influenced by food inflation, as rural households are more vulnerable to fluctuations in food prices. The rural economy, being highly dependent on agriculture, felt the brunt of rising prices for essential items such as rice, wheat, and vegetables due to poor harvests and global supply disruptions. Urban inflation in Bangladesh

Figure 1: The trend of Inflation (Base Index 2021-22 =100) Food and Non-Food Inflation

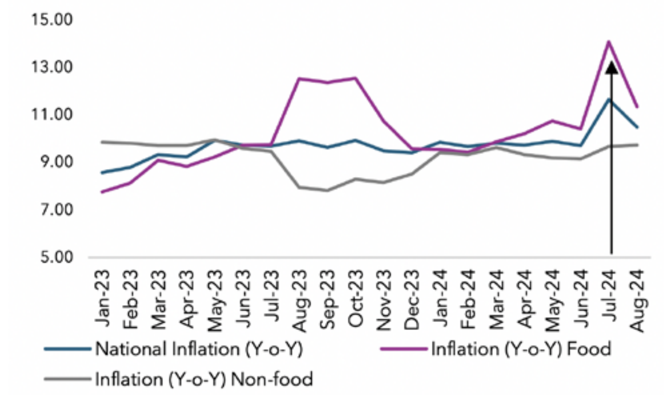
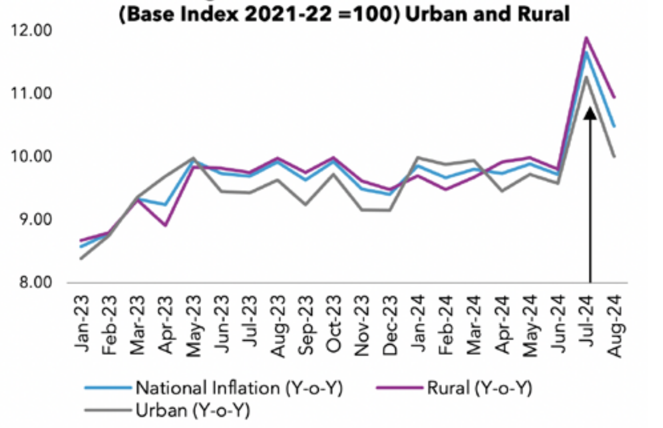


Figure 2: The trend of Inflation (Base Index 2021-22 =100) Urban and Rural



Sources: Bangladesh Bureau of Statistics and Bangladesh Bank

1 Dr. Imam Abu Sayed is Director(Research) of Bangladesh Bank , Dr. Ripon Roy is Additional Director(Research) of Bangladesh Bank and Rifat Ara Bindu and Romana Ferdoush are Assistant Directors (Research) of Bangladesh Bank

from January 2023 to August 2024 remained notably high, driven by increased costs in transportation, housing, and utilities. Rising global fuel prices and the depreciation of the Bangladeshi Taka further compounded these costs, particularly affecting urban dwellers that rely heavily on energy and transportation services. Notably, the trend of rural and urban inflation is going to the same direction along with the overall year on year national inflation rate.

2. Data and Methodology

We collected monthly data from January 2015 to May 2024 on the following variables: The rate of inflation as dependent variables, Industrial Production (Index, 2015-16=100), import (USD million), Inward Remittance (USD million), Foreign Exchange Rate; month end (BDT per U.S. Dollar), and Broad Money Supply (m2). The monthly data were obtained from the Bangladesh Bank (BB) website and the Bangladesh Bureau of statistics (BBS).

All variables, except the rate of inflation, were log-transformed before conducting the econometric analysis. A key prerequisite for time series data analysis is to first assess the stationarity of the data. A common approach using unit root tests, along with other stationarity tests, to examine the stochastic properties of the variables employed in the model.

In this paper, two tests were applied: the Augmented Dickey-Fuller (ADF) test and the Phillips-Perron (PP) test. Before conducting these unit root tests, a correlation matrix test was performed as a standard preliminary check. Subsequently, the long-run relationships and dynamic interactions among the variables of interest were estimated using the bounds testing or ARDL (Auto-Regressive Distributed Lag) procedure developed by Pesaran et al. (2001). The ARDL co-integration method is particularly suitable when the variables are characterized by a mixed order of integration, i.e., I(0) and I(1). The long-run relationship between inflation and its determinants is estimated via the ARDL approach as follows:

$$Infl\_rate = f\,(inf_{t-1}, lipi, limp, lrem, ls, lm2) \ldots\ldots\ldots (1)$$

Where, Infl_rate= Rate of inflation;

inft-1= lag value of rate of inflation;

Lipi= log of Industrial Production;

Limp_usd= log of import;

Lrem= log of Inward Remittance;

Ls= log of Foreign Exchange Rate;

Lm2= log of Broad money supply;

The ARDL equation of this analysis is:

$$\begin{aligned} Inf_t = {} & \delta_0 + \sum\nolimits^{n}_{t=1} \delta_{1i}\, Inf_{t-i} + \sum\nolimits^{n}_{t=0} \delta_{2i}\, Lipi_{t-i} + \\ & \sum\nolimits^{n}_{t=0} \delta_{3i}\, Limp\_u_{t-i} + \sum\nolimits^{n}_{t=0} \delta_{4i}\, Lrem\_u_{t-i} + \\ & \sum\nolimits^{n}_{t=0} \delta_{5i}\, Ls_{t-i} + \sum\nolimits^{n}_{t=0} \delta_{6i}\, Lm2_{t-i} + \\ & \alpha_t,\ t = 1, 2, \ldots, T \ldots\ldots\ldots\ldots\ldots (2) \end{aligned}$$

Where the terms δ1, δ2, δ3,δ4, δ5 represent the long-term coefficients, δ0 the constant, α the error term.

The short-run relationship between inflation and its determinants is estimated via the ARDL approach as follows:

$$\begin{aligned} \Delta Inf_t = {} & \gamma + \sum\nolimits^{n}_{t=1} \emptyset_i\, \Delta Inf_{t-i} + \\ & \sum\nolimits^{n}_{t=0} \beta_i\, \Delta Lipi_{t-i} + \sum\nolimits^{n}_{t=0} g_i\, \Delta Limp\_u_{t-i} + \\ & \sum\nolimits^{n}_{t=0} \mu_i\, \Delta Lrem\_u_{t-i} + \\ & \sum\nolimits^{n}_{t=0} \omega_i\, \Delta Ls_{t-i} + \sum\nolimits^{n}_{t=0} \vartheta_i\, \Delta Lm2_{t-i} + \\ & \not{e}\, ECT_{t-1} + \alpha_t;\ t = 1, 2, \ldots, T \ldots\ldots\ldots\ldots\ldots\ldots (3) \end{aligned}$$

Where the terms $\emptyset, \beta, g, \mu, \omega$ and ϑ are the short-term dynamic coefficients of the model once it has converged to equilibrium. ECTt-1 is the error (or equilibrium) correction term derived from the long-run equilibrium relation, and $\not{e}$ is the coefficient associated with this term that represents the speed of adjustment.

3. Results and Discussion

Correlation matrix

Table-1 shows that the Industrial Production, Import, Exchange Rate, Inward Remittance and M2 are positively correlated with the inflation rate. The correlation between dependent variable and independent variables indicate that any change in independent variables affected the rate of inflation positively. The results correlation matrixes are consistent with initial theoretical expectations.

To start the estimation of the analysis, at first, we examined the stationary test of the variables because a random time series is assumed to be stationary if its mean and variance are time invariant (Gujarti, 1995).

Table 01: Correlation matrix

	INF	LIPI	LIMP_U	LREM_U	LS	LM2
Rate of inflation	1	0.62	0.35	0.46	0.91	0.64
log of Industrial Production	0.62	1	0.82	0.78	0.83	0.96
log of import	0.35	0.82	1	0.59	0.52	0.76
log of Inward Remittance	0.46	0.78	0.59	1	0.62	0.77
log of Exchange Rate	0.91	0.83	0.52	0.62	1	0.85
log of Broad money supply	0.64	0.96	0.76	0.77	0.85	1

Source: Author's own calculation.

First, it can be used irrespective of the order of the stationarity level of the data set, that is ARDL can be applied if the underlying variables are I(0), I(1) or a combination of both (Pesaran & Pesaran, 1997).

At first, to determine whether the variables are stationary, we have done ADF test. ADF is the simple and convenient approach to determine stationarity. Philips-Perrron (PP) unit root tests (Philips-Perrron, 1988) have also been used to test stationarity among the variables. The results of the unit root test are presented in Table-2.

Lag Selection Criteria

For the lag selection criterion, we selected the automatic selection criterion and used Akaike Information criterion (AIC) for choosing the length with a maximum lag of 3. The optimal combination according to Akaike Information criterion (AIC) is ARDL (1, 1, 0, 0, 3, 3). The model selection according to AIC is shown in the Appendix-1.

Table 02: Unit root test

Variables	ADF-test				PP-test			
	At level		At first difference		At level		At first difference	
	t- statistics	p- value	t- statistics	P* - value	Adj.t-statistics	p- value	Adj.t-statistics	P* - value
INF	0.503999	0.9862	-13.39043	0.0000	0.261200	0.9752	-13.27713	0.0000
LIPI	-0.856335	0.7984	-9.399498	0.0000	-1.490781	0.5348	-34.41497	0.0001
LIMP_U	-2.233875	0.1957	-11.01991	0.0000	-2.875657	0.0514*	--	--
LREM_U	-2.028025	0.2746	-16.05525	0.0000	-2.737582	0.0709*	-27.50892	0.0001
LS	2.689664	1.0000	-4.008176	0.0020	3.163882	1.0000	-3.968236	0.0023
LM2	-1.353584	0.6020	-14.50666	0.0001	-2.203394	0.2063	-13.99150	0.0000

Source: Author's own calculation.

Null hypothesis is no unit root presence and * is for statistically significance.

ARDL estimation results

The result of the bound test is presented in Table 3 below, and shows that the Fisher test value (F = 3.44) exceeds the upper limits of the critical values. In this case, we can reject the null hypothesis of no long-term relationship and we can conclude that a long-term relationship exists among the variables in the model.

Table 3: Bounds Test

F-Bounds Test		Null Hypothesis: No levels relationship		
Test Statistic	Value	Signif.	I(0)	I(1)
F-statistic	3.44	10%	2.08	3
k	5	5%	2.39	3.38
		2.5%	2.7	3.73
		1%	3.06	4.15

Source: Author's own calculation.

Estimation of Long Run Relationship

The confirmation of the existence of the long run relationship in the model allows us to estimate the long run form of equation. Using ARDL approach the estimated long-run relationship are described in the table below:

Table 4: Long-run coefficients from the estimated ARDL model

Selected Model: ARDL(1, 1, 0, 0, 3, 3)

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
INF(-1)	0.76	0.061	12.49	0.0000
LIPI	-1.82	0.559	-3.26	0.0015
LIPI(-1)	0.65	0.403	1.61	0.1100
LIMP_U	0.75	0.281	2.68	0.0086
LREM_U	0.29	0.219	1.36	0.1772
LS	7.31	3.537	2.07	0.0414
LS(-1)	-9.43	7.274	-1.29	0.1977
LS(-2)	31.11	9.235	3.37	0.0011
LS(-3)	-24.27	5.306	-4.57	0.0000
LM2	4.99	3.809	1.31	0.1928
LM2(-1)	-7.02	4.203	-1.67	0.0983
LM2(-2)	8.73	4.032	2.16	0.0329
LM2(-3)	-6.95	3.309	-2.09	0.0384
C	-18.40	6.185	-2.98	0.0037
R-squared		0.969674		
Adjusted R-squared		0.965568		

*Note: p-values and any subsequent tests do not account for model selection.

Source: Author's own calculation.

From the table above, lag value or past value of rate of inflation has a positive and significant impact on the current inflation. On the other hand, industrial production has a negative and statistically significant impact on rate of inflation; i.e. if the industrial production increases by 1 percent then the rate of inflation will decrease by 1.8 percent in the long-run while its lag value indicates the statistically insignificant result. Besides, the coefficients of import and exchange rate are showing positive impact on inflation while the past values of exchange rates showed statistical significant result. From this estimation, this is clear that any change in exchange rate previously may influence the current inflation rate in the log-run. Furthermore, the coefficients of inward remittances and broad money supply (m2) are also showing positive impact on inflation though these variables showed statistically insignificant result. However, the lag values of broad money supply (m2) represent negative and statistically significant results. Moreover, the statistical results for R^2 and Adjusted R^2 indicate the model's strong goodness of fit, showing that the independent variables explain around 97% of the variation in the dependent variable.

Error Correction Estimation

The short run dynamics coefficients from the estimated ARDL model are shown in Table- 5, where, the lag is selected by Akaike Information Criteria (AIC). The coefficient of Error Correction Model (ECM) is expected to be negatively significant and ECM indicates the speed of adjustment to long-run equilibrium after a short-run shock. In other words, it measures the rate of convergence toward equilibrium if there is any short-run disequilibrium. Table-4 indicates that the error correction coefficient, estimated to be -0.24 which is statistically significant at the 1% level of significance. The coefficient suggests that the deviation from the

Table 5: ECM Regression: Selected Model: ARDL(1, 1, 0, 0, 3, 3)

Case 2: Restricted Constant and No Trend

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LIPI)	-1.82	0.407	-4.475251	0.0000
D(LS)	7.31	3.188	2.292880	0.0240
D(LS(-1))	-6.84	5.119	-1.335416	0.1849
D(LS(-2))	24.27	4.828	5.026539	0.0000
D(LM2)	4.99	2.829	1.765761	0.0806
D(LM2(-1))	-1.78	2.475	-0.719399	0.4736
D(LM2(-2))	6.95	2.633	2.638868	0.0097
CointEq(-1)*	-0.24	0.047	-5.057401	0.0000
R-squared		0.342686		
Adjusted R-squared		0.297577		

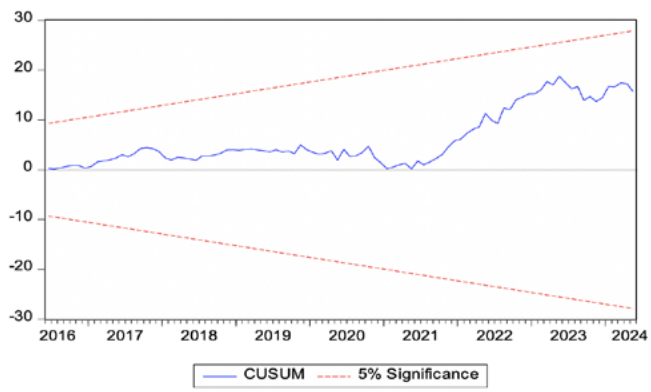
* p-Value incompatible with t-Bounds distribution.

Source: Author's own calculation.

long-run equilibrium level in the current period is corrected by 24.55 percent in the next period to bring back equilibrium.

Stability Test

To ensure the stability of the ARDL model established in this study, Pesaran and Pesaran (1997) suggested using the cumulative sum (CUSUM). The CUSUM is updated recursively and plotted against the break points in figure (3). It can be seen that parametric constancy and model reliability are achieved when the levels of CUSUM remain within the critical 5% range (shown by the red dashed line). The plot of the tests show that there is no root lying outside at the 5 % level of significance. Therefore, our model passes the stability test.



4. Conclusion and Policy Implications

This paper aims to identify the key determinants of inflation in Bangladesh by analyzing monthly data from 2015 to 2024. Using an ARDL approach, we examined the long-run relationship between inflation and several factors highlighted in the literature. After controlling for relevant variables, we found empirical evidence of a co integration relationship between inflation, industrial production, imports, the exchange rate, and money supply. One of our key findings is that a 1 percent increase in industrial production leads to a 1.8 percent decrease in the inflation rate in the long run. However, Bangladesh has been facing inflationary pressures, primarily driven by both supply-side and demand-side factors. Primarily, supply chain disruptions, increased import costs due to currency depreciation, and domestic production shortfalls have added to inflationary pressures. While inflation remains a critical concern for the overall macroeconomic stability of the country, targeted interventions by BB and the government have attempted to alleviate the situation. The following policy proposals can be considered:

1. Inflation in our model is mainly drive by supply side factors like industrial production and imported goods while demand side co-variables like remittance and money supply are insignificant.
2. A deprecation of BDT passes through to inflation by increased import payments which can be referred as imported inflation. Thus, maintaining a more stable exchange rate is crucial. Keeping that in mind, BB adopted a crawling peg exchange rate system to stabilize the BDT/USD exchange rate. This may involve targeted interventions in the foreign exchange market and promoting export growth to mitigate import-related inflation.
3. Our results do not support the hypothesis that remittances create upward risks for inflation raising demand of the recipient household.
4. Finally, implementing a formal inflation-targeting framework could strengthen the credibility of monetary policy and improve the central bank's capacity to effectively manage inflation expectations balancing classical, neoclassical and Keynesian approach.

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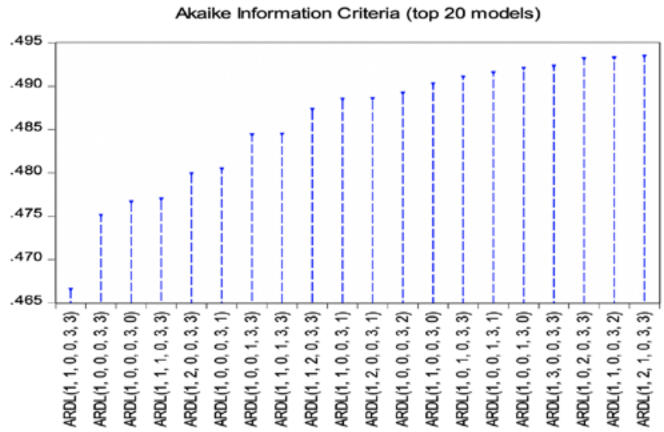
Appendix-1

Model selection summary



ARTICLE 4: LEVERAGING RENEWABLE ENERGY FOR SUSTAINABLE GROWTH

by S.P. Premarathne and K.L.A.K. Sewwandi[1]

Introduction

Energy is a key driver for economic growth, playing an integral role in powering industrial production, transportation, and household consumption. However, the rapid pace of economic development has often been accompanied by unsustainable energy practices, resulting in the depletion of limited energy resources and contributing significantly to climate change through greenhouse gas (GHG) emissions. As countries strive for progress, the growing awareness of environmental and social costs has led to a global push for more sustainable energy solutions. Renewable energy (RE) sources offer a promising alternative by reducing GHG emissions, conserving energy resources, and supporting long-term sustainable development goals. Global commitments such as the Paris Agreement have accelerated efforts to transition from fossil fuels to cleaner energy sources, with nations setting ambitious targets to mitigate the adverse effects of climate change. These commitments have driven a wave of investments in renewable technologies, which now play a pivotal role in shaping economic strategies and driving innovation across various sectors. For developing countries like Sri Lanka, transitioning to RE is critical not only for environmental sustainability but also for enhancing energy security and fostering resilient economic growth.

As a nation that is regularly affected by climate change-induced natural disasters and a country dependent on fossil fuel imports, Sri Lanka needs to leverage RE sources to meet the growing energy demand while ensuring the sustainability of the development process in the medium to long term. In line with its commitments under the Paris Accord, Sri Lanka has made both unconditional and conditional commitments to reduce GHG emissions, focusing on integrating RE into its national energy strategy. The Nationally Determined Contributions (NDCs) underscore the country's commitment to achieving carbon neutrality by 2050 and ensuring that 70 per cent of electricity is generated from renewable sources by 2030. Achieving these goals will require substantial investments in infrastructure, innovative policy frameworks, and international cooperation to support the transition. As Sri Lanka and many other developing countries continue to navigate their development trajectories, leveraging RE will be key to ensure sustainable, inclusive growth while mitigating the negative environmental impacts of traditional energy practices.

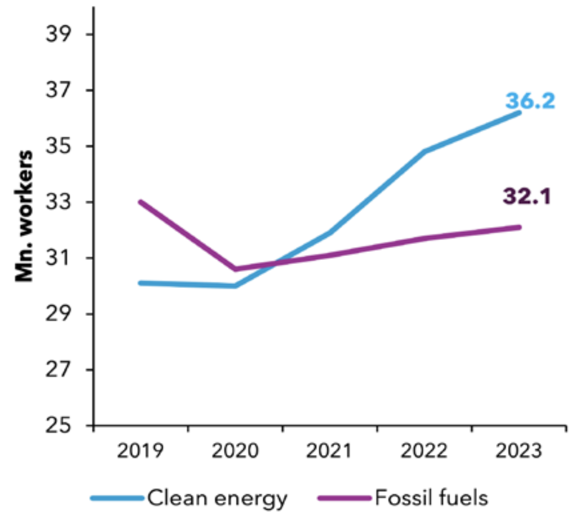
Recent Developments in Global RE Landscape

The transformation in the energy sector over the recent years has largely stemmed from the significant challenges in the global landscape. The disruptions to the global energy demand during the COVID-19 pandemic, followed by the global energy crisis with the regional tensions in Eastern Europe have urged governments to reinforce policies to provide more secure access to energy including financial support to drive the transformation of the energy market. Accordingly, the investments in clean energy have accelerated recording a growth of about 50 per cent over the past three years (IEA, 2024), while employment in the clean energy sector has continued to remain above the employment in fossil fuels since 2021, largely driven by the improvements in the RE sector (IEA, n.d.). These developments led to global annual renewable capacity additions increased by almost 50 per cent to nearly 510 GW in 2023, recording the fastest growth rate in the past two decades (Renewables 2023 – Analysis - IEA, 2024).

The accelerated phase of transition in energy sources has been evident in both power and transport sectors. According to the Renewable Capacity Statistics 2024 report of the International Energy Agency (IEA), renewables accounted for around 85 per cent of global new power generation capacity additions with seeing a peak of 473 GW of new renewable capacity in 2023. Within renewables, solar energy stood as the largest source of renewable capacity at 36.7 per cent followed by hydropower at 32.7 per cent by 2023. With China at the forefront of capacity installations, Asia alone accounted for 69 per cent of the total new RE installations in 2023, registering a growth of 20 per cent (IRENA, 2024). Electric mobility has been the main driver of the transportation sector's accelerated shift towards low emissions. The number of electric

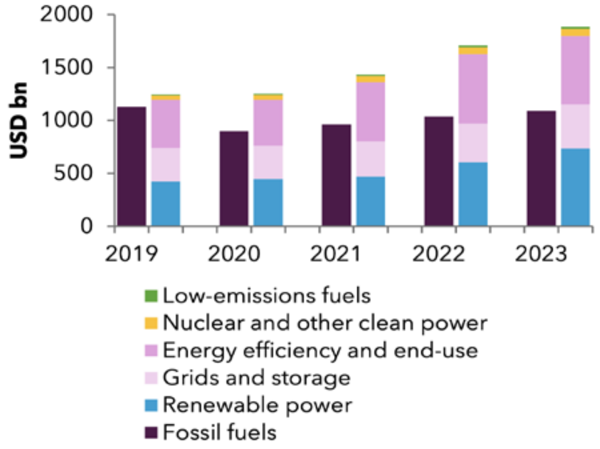
1 S.P. Premarathne and K.L.A.K. Sewwandi are Economists of Central Bank of Sri Lanka, and the views expressed in this article are those of the authors and do not represent the views of the Central Bank of Sri Lanka

Figure 1: Total employment by sector



Source: World Energy Employment-2023, IEA

Figure 2 : Global investment in clean energy and fossil fuels



Source: World Energy Investment-2024, IEA

vehicles reached over 40 million in 2023, making up over 18 per cent of total car sales during the year. However, this accelerated transition remains heavily concentrated in a few major markets, with China, the United States, and Europe alone accounting for approximately 95 per cent of electric car sales in 2023 (IEA, 2024).

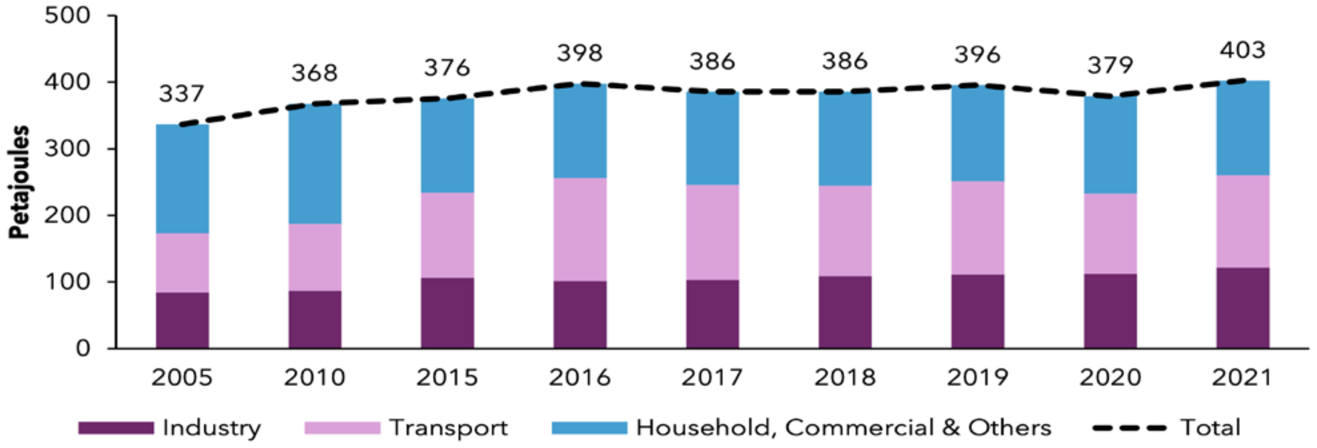
The committed and innovative policy support was a vital part of the major economies' rapid transformation into RE. Incentives from China's Five-Year Plan, along with the ample supply of locally manufactured equipment, have driven the country's rapid solar PV and wind power expansion, positioning China as a leader in global renewable capacity growth. The 'REpowerEU' plan of the European Commission, with a dedicated solar energy strategy and a legally binding solar rooftop initiative is also poised to facilitate EU member countries to reach 45 per cent renewables in the electricity generation mix by 2030. Moreover, the Inflation Reduction Act of the United States which provides targeted incentives to drive investment in clean energy acted as a major driving force for accelerated additions in recent years. (Renewables 2023 – Analysis - IEA, 2024).

While the major economies have made significant progress in RE transformation, the South Asia region presents significant potential for improvement, where approximately two-thirds of energy is imported and fossil fuels comprise around 80 per cent of energy production. However, several South Asian countries are making strides in renewable energy adoption to support economic growth and combat climate change (World Bank, 2023). Leveraging their natural resources, Bhutan and Nepal rely on hydropower as their primary source of electricity generation. India, the fastest-growing renewable energy market among large economies through 2030, is rapidly transforming its energy landscape with extensive developments in solar and wind energy. With the rapid expansion of auctions, support schemes for rooftop PV and stronger financial indicators of utility companies, India targets an additional 500 GW of non-fossil fuel based generation capacity by 2030 (Renewables 2024-IEA, 2024). Meanwhile, other South Asian countries are also progressing with tapping into their potential in renewable energy, though their phase of development is yet to gain momentum.

Transforming Sri Lanka's RE Landscape

Sri Lanka, like many nations globally, is navigating its energy transition amidst rising demand and the urgent need to reduce reliance on fossil fuels, aligning its strategies with global efforts to promote RE and sustainability. As shown in Figure 3, Sri Lanka's total energy demand has steadily increased across industry, transport, household, and commercial sectors, despite some transitory volatilities caused by global and domestic disruptions such as supply issues during the economic crisis and demand drops from the COVID-19 pandemic (Energy Balance 2021 Sri Lanka,

Figure 3: Total Energy Demand by Sector

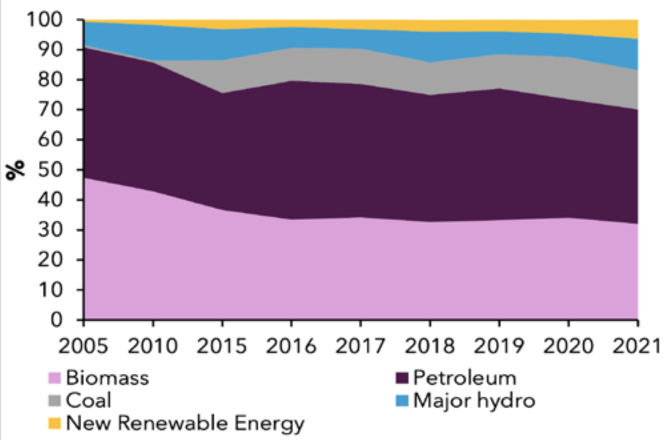


Source: Sri Lanka Energy Balance-2021, SLSEA

n.d.). At the same time, when the energy demand is continuously increasing, the country continues to grapple with reliance on costly imported fossil fuels raising sustainability concerns. From its early years, Sri Lanka's primary energy supply has predominantly depended on biomass and petroleum, along with contributions from coal, hydro, and emerging renewable sources (Figure 4 and Figure 5). Fossil fuels primarily drive the transport and electricity generation sectors in Sri Lanka and the heavy reliance on fossil fuels has also led to an increase in the country's GHG emissions. While Sri Lanka's GHG emissions remain among the lowest in the world and South Asia, these emissions have steadily increased over the past decade, growing from 0.6 mtCO_2e per capita in 2010 to 1.0 mtCO_2e per capita in 2020 (World Bank, 2022).

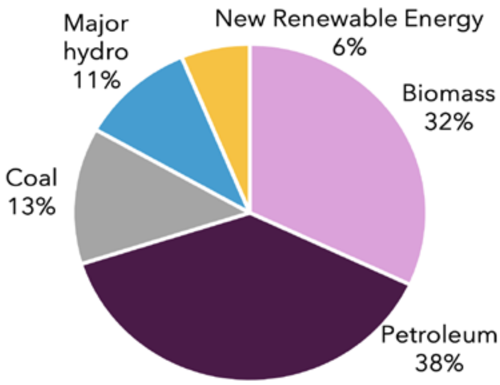
Focusing on ensuring energy security, equity, and sustainability of the energy supply, Sri Lanka's National Energy Policy of 2019 has been formulated in alignment with the country's commitment to achieving carbon neutrality by 2050, NDCs, and Sustainable Development Goals (SDGs) and serves as the cornerstone for the country's energy sector developments. The country's commitment to NZE by 2050 is underpinned by an ambitious target to achieve 70 per cent of its electricity generation from RE sources by 2030. This forms a crucial part of the nation's climate strategy outlined in its updated NDCs in 2021, where Sri Lanka has pledged a total reduction of 14.5 per cent in GHG emissions across key sectors such as power, transport, industry, and waste, as a signatory to the Paris Agreement. This reduction

Figure 4: Percentage Share of Primary Energy Supply by Source



Source: Sri Lanka Energy Balance-2021, SLSEA

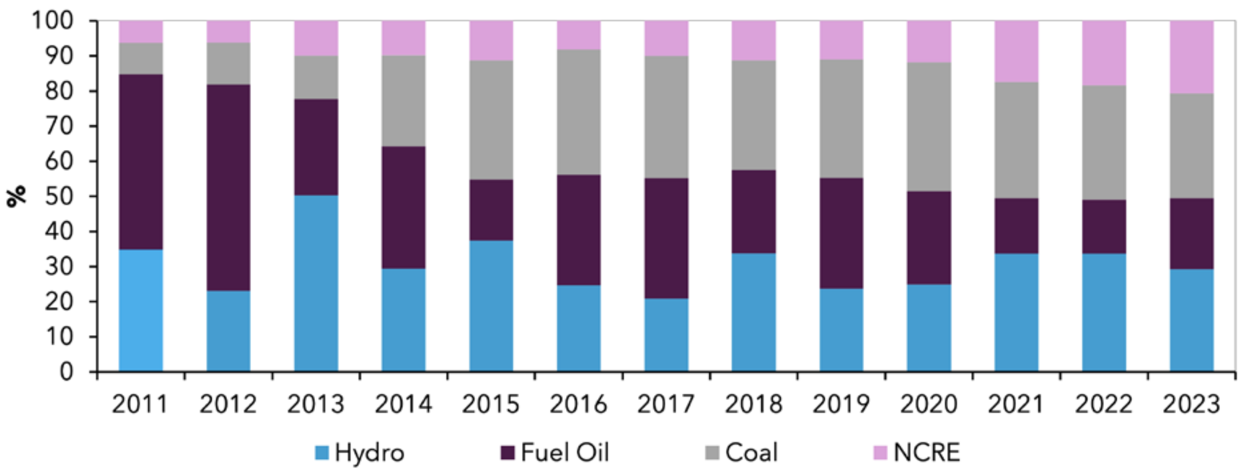
Figure 5: Sri Lanka Primary Energy Mix (2021)



Source: Sri Lanka Energy Balance-2021, SLSEA target, consisting of 4 per cent unconditional and 10.5 per cent conditional emission reduction commitments respective to a business-as-usual (BAU) scenario, is set to be achieved by the end of the decade covering 2021 to 2030 (Sri Lanka Updated Nationally Determined Contributions, 2021).

The power sector is at the forefront of these efforts, representing a large share of the country's emissions reduction potential. In 2023, Sri Lanka had an installed power generation capacity of 4,381 MW, with around 50 per cent share from renewable sources, primarily hydropower (CBSL, 2023). However, hydropower has increasingly become a less reliable energy source due to regular and intense drought periods experienced by the country, resulting in varying the share of RE in the mix and unprecedented surges in fossil fuel-based generation (Figure 6). Despite achieving nearly 100 per cent electrification, the growing demand for electricity, which increases at an annual rate of around 5 per cent, and the country's heavy dependence on fossil fuel and unreliable rainfall patterns in the long patterns, primarily warrants taking several measures to promote RE in Sri Lanka.

Figure 6: Sri Lanka Electricity Generation Mix



Source: CBSL, Ceylon Electricity Board

Sri Lanka's updated NDCs in the electricity sector reflect an ambitious push towards decarbonisation, with a central focus on RE integration. NDC1 aims to enhance the contribution of RE in the electricity generation mix by adding 3,867 MW of capacity from solar PV (rooftop, small-scale, and large-scale), wind, hydro, and sustainable biomass by 2030. Of this total, 2,917 MW is conditional upon external financial and technical support, underlining the importance of international collaboration to achieve these targets. The country's progress is evident, particularly in solar PV rooftop installations, which reached close to 700 MW by the end of 2022, supported by about 47,000 rooftop systems in domestic, commercial, and industrial settings, under the 'Battle for Solar Energy' programme. Through this initiative, Sri Lanka aims to add 1,000 MW of solar electricity by 2025 and 1,500 MW by 2030. NDC5 supports research and development activities for non-conventional renewable energy (NCRE) sources that are not yet commercialised, focusing on developing grid-supporting infrastructure such as storage solutions and smart grid technologies. This is critical for integrating a higher share of intermittent RE sources into the national grid (Ministry of Environment, 2023).

Additionally, Sri Lanka's power sector NDCs include demand-side management (DSM) initiatives aimed at improving energy efficiency through the use of efficient equipment, appliances, and advanced technologies. Accordingly, the ongoing Energy Efficiency Improvement & Conservation (EEI&C) programme in Sri Lanka, which encompasses several DSM initiatives, has made considerable progress through policies, regulations, appliance labeling, and awareness programmes. Transmission and distribution efficiency measures, along with the shift from fuel oil to natural gas, form part of the sector's broader strategy to reduce emissions. The overall target for the power sector is a 25 per cent reduction in GHG emissions compared to a BAU scenario, with 20 per cent of this reduction dependent on external technical and financial support, paving the way for achieving carbon neutrality in the country's electricity sector by 2050 (Ministry of Environment, 2023). Moreover, Sri Lanka's heavy reliance on fuel imports, which accounted for 28 per cent of the total import bill in 2023, could be significantly reduced by transitioning to RE sources, thereby offering a pathway to lower import costs, alleviate the economic burdens associated with fluctuating global fuel prices, enhance energy security, and ultimately create a healthier economy by easing pressure on the balance of payments in the long run (CBSL, 2023).

Policy Priorities for Leveraging RE Transitions

Despite these ambitious pledges and recent advancements in RE, Sri Lanka along with many other developing economies are yet to pick up the phase in RE sector development. Progress in RE expansion in developing economies is often hindered by financial and structural barriers. In the case of Sri Lanka, which is emerging from a sovereign debt crisis, the Government can play only a facilitator role in promoting green energy expansion amidst the ongoing fiscal consolidation efforts. However, the Government continued to pursue structural reforms to promote the transition towards RE. Accordingly, in 2023, the Sri Lankan government introduced a semi-annual cost reflective electricity tariff revision mechanism. that incentivised households and businesses to explore alternative energy sources, particularly rooftop solar energy, thus promoting a shift away from fossil fuels and contributing to the RE transition. This reform paved the way to correct market distortions caused by historically incorrect incentives from electricity subsidies, which encouraged reliance on the national electricity provider, the Ceylon Electricity Board (CEB), and its fuel-based generation. Further, the Sri Lankan Government enacted the Electricity Act No. 36 of 2024, with ongoing discussions on potential amendments, to catalyse necessary restructuring within the sector. The act focuses on several aspects of the power sector including industry regulation, market competition, RE concentration and institutional restructuring marking a shift in the legislative landscape. The country has also made significant advancements in developing policy frameworks for sustainable finance including the Roadmap for Sustainable Finance 2019, the development of the Green Finance Taxonomy and the Green Bond Framework. Such structural reforms backed by necessary policy frameworks and legislative provisioning enable countries to diversify their energy sources and promote RE initiatives, ultimately facilitating private sector investments in large-scale projects like wind and solar farms that aim to reduce GHG emissions and ensure long-term energy security.

Nevertheless, power generation technologies based on RE typically involve higher upfront investment and are often subject to long payback periods. Given the intrinsic connection between the cost of capital and risks, costs tend to be even higher in emerging and developing economies as they are associated with higher risk factors. Therefore, maintaining competitive procurement programmes linked to clear long-term strategies and schedules can create positive investment signals enabling these countries to expand RE segments (IEA, 2024). For instance, India has successfully implemented a competitive bidding process for solar and wind energy projects, which has significantly reduced costs and attracted substantial investment despite the challenges. Additionally, introducing policies and regulations to ensure timely implementation and avoiding retroactive policy changes also remains vital for the expansion of renewables.

Similar to Sri Lanka, the energy market structure of many developing countries consists of a single state-owned entity that buys power from regulators at cost. However, often these utilities are operated at a loss, partly due to non-cost reflective tariffs as well as operational inefficiencies, resulting in RE investors facing risks such as delayed payments and inadequate maintenance in grid infrastructure. Measures aimed at improving collection rates, maintaining cost-reflective tariffs, and setting ceiling prices for competitive auctions can strengthen the financial position of these public off-takers, thereby reducing associated risk for renewable investors. Concurrently, carefully designed derisking and support policies also need to be placed to limit the impact of those measures on households.

Although most developed economies have adopted targeted investment promotion policies for RE expansion efforts, many developing countries continue to rely on generic tax incentives. Profit-based tax incentives such as corporate income tax reductions and tax holidays are particularly popular among developing countries and least developed countries (LDCs) while reduction or exemption of VAT and import duties also remain common as these countries often import capital goods and inputs required to develop RE infrastructure (UNCTAD, 2023). However, for countries like Sri Lanka, offering such tax incentives would add another burden on the already strained fiscal position, as the country is undergoing fiscal consolidation efforts aimed at reducing budget deficits and managing its public debt. Meanwhile, the tax incentives given to RE suppliers are effective in reducing associated financial costs, but these may not directly address the barriers to investment in RE such as access to finance and market and infrastructure risks. Therefore, the adoption of guaranteed schemes, comprising financial guarantee schemes, priority grid access, and industrial guarantees on network availability or spare parts, is also a vital need in the RE expansion policies in developing countries such as Sri Lanka. Further, simplifying registration and licensing processes and providing easier access to land are also areas where many developing countries are lagging in business facilitation towards RE developers compared to developed countries.

The largest growth in renewable electricity has been driven by the variable renewables over the past decade as hydro energy potential in many countries such as Sri Lanka has been largely or fully tapped. However, the integration of intermittent and more decentralised sources of energy, such as wind and solar can be challenging as these require substantial developments in transmission and distribution networks. Introducing appropriate regulations, market rules and technical standards to increase power system flexibility is crucial for accommodating higher variable renewable energy (VRE) penetration. Additionally, the introduction of system-friendly VRE incentives while enacting policies to encourage grid investment around 'green' corridors can also facilitate a swift flow of investments in the RE sector (IEA, 2024).

Conclusion

The global transition towards RE is imperative for sustainable development, offering a pathway to address climate change, enhance energy security, and promote economic resilience. Nations around the world are increasingly recognising the necessity of shifting from traditional non-renewable resources to renewable sources to meet rising energy demands and mitigate environmental impacts. For Sri Lanka, leveraging RE is essential not only for achieving its ambitious targets outlined in its NDCs but also for enhancing energy independence and reducing reliance on costly fossil fuel imports. However, the journey is accompanied by challenges, including the high initial costs of RE technologies, the need for robust infrastructure, and financial barriers, especially in developing economies like Sri Lanka. To successfully navigate this transition, a comprehensive approach is required, focusing on strategic investments in renewable infrastructure, establishing supportive regulatory frameworks, and fostering public-private partnerships that drive innovation and reduce costs. Additionally, enhancing financial mechanisms to facilitate access to capital for renewable projects, coupled with capacity-building initiatives to empower local communities, will be vital. As Sri Lanka and its regional peers work towards a sustainable energy future, a collaborative effort among governments, the private sector, and civil society will be crucial in overcoming existing barriers, unlocking RE potential, and contributing to global sustainability efforts, paving the way for greener economic development.

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SECTION 05

Box Items

BOX 1: FRAMEWORK ON CURRENCY SWAP ARRANGEMENT FOR SAARC COUNTRIES FOR THE PERIOD 2024 TO 2027

by Reserve Bank of India

The Reserve Bank of India with the concurrence of the Government of India has put in place a revised Framework on Currency Swap Arrangement for SAARC countries for the period 2024 to 2027. Under this Framework, the Reserve Bank would enter into bilateral swap agreements with SAARC central banks, who want to avail of the swap facility.

The SAARC Currency Swap Facility came into operation on November 15, 2012, with an intention to provide a backstop line of funding for short term foreign exchange liquidity requirements or balance of payment crises of the SAARC countries till longer term arrangements are made. Swaps are a cornerstone of the financial stability of the region.

Under the Framework for 2024-27, a separate INR Swap Window has been introduced with various concessions for swap support in Indian Rupee with a total corpus of the Rupee support of INR 250 billion. The RBI will continue to offer swap arrangement in US$ and Euro under a separate US Dollar/ Euro Swap Window with an overall corpus of US dollars 2 billion.

BOX 2: BANGLADESH BANK INITIATIVES ON INWARD WAGE REMITTANCES BY MOBILE FINANCIAL SERVICE PROVIDERS

by Dr. Imam Abu Sayed, Md Abdul Karim, Rifat Ara Bindu and Romana Ferdoush[1]

Remittances play a crucial role in promoting economic growth by serving as a key source of foreign exchange reserves and positively influencing the balance of payments and national savings in the economy of Bangladesh. Amid global uncertainties and the dwindling trend of the foreign exchange reserve, remittances play a significant role, with earnings increasing by 10.65 percent to USD 23,912.22 million in FY24. The mobile financial services (MFS) system has played a major role in contributing to financial inclusion for rural people who do not have enough financial literacy. MFS has grown rapidly, with 13 providers now serving over 230 million account holders.

Bangladesh Bank (BB) has implemented numerous initiatives to facilitate inward wage remittances through mobile financial service providers (MFSPs). These efforts aim to make remittances faster, more accessible, ease the repatriation of wage remittances, and secure for migrant workers and their families, while also ensuring that such transfers take place through formal channels and shore up our foreign currency reserves. It will also stop the drainage of wage remittances through unofficial channels. The graph shows monthly inward wage remittance through MFS from June 2021 to June 2024. Overall, the trend shows a consistent rise, reflecting the growing use of MFS channels for receiving inward wage remittances. However, there exists m-o-m volatility in inward wage remittance. For example, remittances through Mobile Financial Services (MFS) saw the highest increase from April to June 2024 over the past three years considering seasonality of festivals. Inward wage remittance increased to Tk 949.01 crore in June 2024 from Tk 635.14 crore in June 2023.

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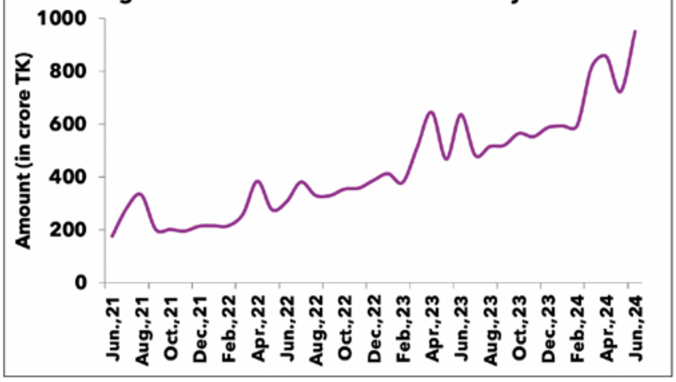


Figure 1: M-o-M Inward Remittances by MFS

Bangladesh Bank (BB) initiatives on Inward Wage Remittances by MFSPs:

1) BB has permitted mobile financial service providers like bKash, Rocket, and Bashundhara Pocket to directly facilitate remittance transfers from Bangladeshi wage earners abroad enhancing digitalization. Authorized dealers (ADs) can make drawing arrangements directly with exchange houses abroad without prior permission from Bangladesh Bank, removing the requirement for reference letters or certificates from Bangladesh's embassies or high commissions.

2) To enhance flexibility, BB has allowed MFS providers to repatriate wage earners' remittances via online payment gateways, banks, digital wallets, and aggregators. This move aims to boost financial inclusion by allowing digital fund transfers. MFS providers will collaborate with foreign PSPs to receive and convert foreign currency, which will be credited to wage earners' accounts in taka. ADs shall transfer the fund, on receipt in their nostro accounts, to settlement accounts in equivalent Taka of MFSPs.

3) As part of BB initiatives, wage earners will have to open mobile financial accounts through proper electronic Know Your Customer (e-KYC) with validated proof of departure from Bangladesh. These accounts can be converted between local and wage earner accounts based on their travel status.

4) In response to widespread adoption, the BB has raised the transaction limit through the MFS account to Tk 2,50,000 (excluding any cash incentives).

6) Recently, BB, in collaboration with the government, has introduced a 2.5 percent incentive for Bangladeshi expatriates who legally transfer compensation funds received from employers or insurance companies for deaths or injuries abroad back to Bangladesh.

7) MFS providers have been instructed to offer competitive rates charges for remittance transfers to discourage informal remittance channels like hundi.

8) BB has issued guidelines to MFS providers and banks for ensuring compliance with anti-money laundering (AML) and counter-terrorist financing (CTF) regulations as well as providing robust technological frameworks to secure transactions.

Challenges:

1) A significant portion of the population, particularly in rural areas, may have limited digital literacy or access to smartphones, hindering their ability to use MFS for receiving remittances efficiently.

2) Cybersecurity risks and fraud prevention are ongoing concerns, as digital platforms are increasingly targeted by cybercriminals.

3) Despite advancements, transaction fees for sending remittances via MFS platforms can remain relatively high, discouraging the use of formal channels.

The initiatives by BB on inward wage remittances through MFSPs have not only simplified the remittance process but also increased the inflow of remittances into Bangladesh. By encouraging remittances through MFS platforms, BB aims to deter the use of informal channels, such as hundi, and boost the country's foreign exchange reserves.

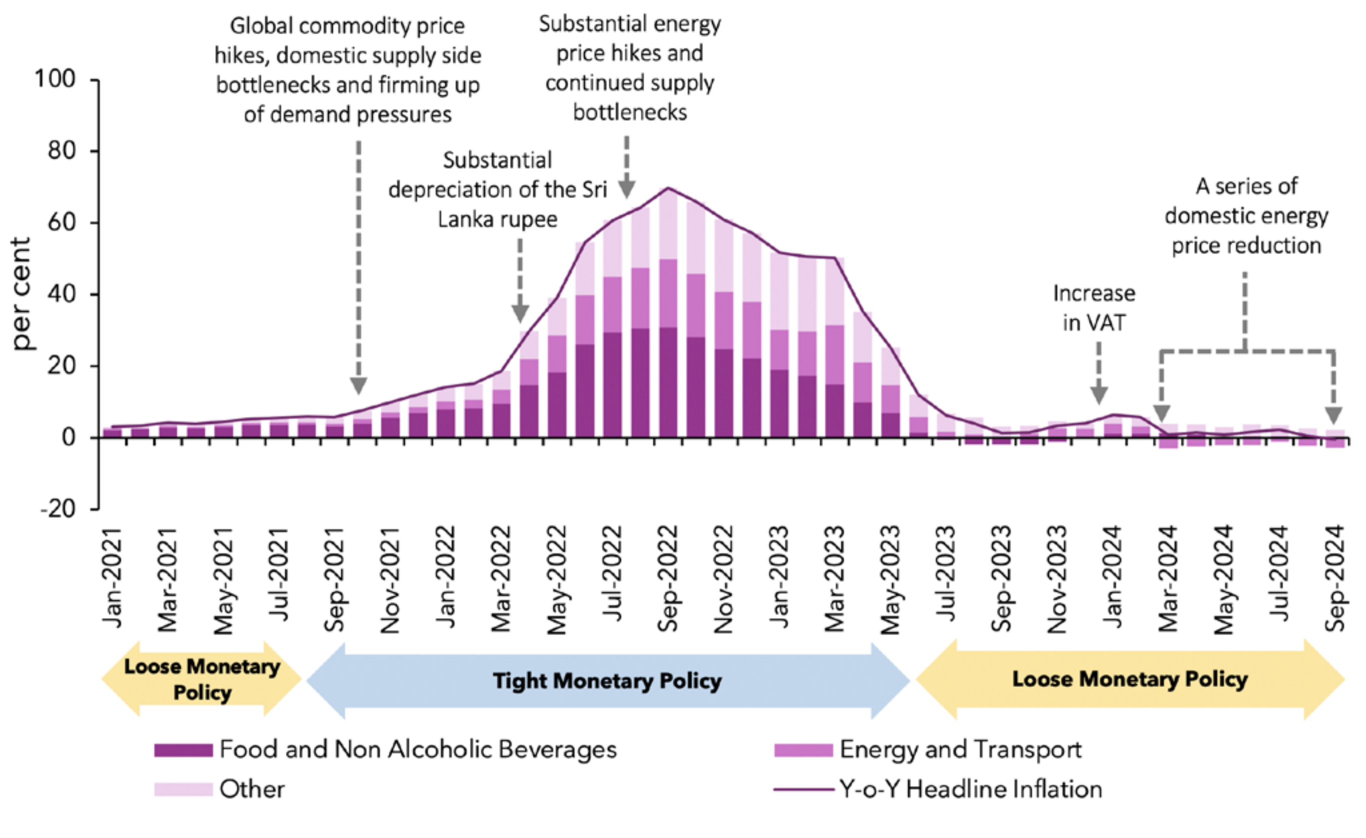
BOX 3: FROM HIGH INFLATION TO PRICE STABILITY: SRI LANKA'S DISINFLATION JOURNEY

By Dr. Vishuddhi Jayawickrema[1]

In 2022, Sri Lanka faced an unprecedented inflationary crisis, marking the highest price level increase in its history since independence in 1948. The country faced supply bottlenecks, foreign exchange liquidity shortages and depreciation of the domestic currency, long-overdue administered price corrections, and policy missteps, all of which exerted significant pressure on prices. Global inflation also accelerated during this period, driven by the lingering effects of ultra-easy monetary and fiscal support following the COVID-19 pandemic and fuel and non-fuel commodity shortages exacerbated by geopolitical conflicts, coupled with capacity constraints and supply chain disruptions intensified by the pandemic. In response to both global and domestic inflation drivers, the Sri Lankan authorities implemented swift and decisive policy measures to curb the acceleration of inflation in early to mid-2022. By late 2022, inflation started moderating from its peak levels, reflecting the early outcomes of these policy measures. This marked the onset of a significant disinflation process, which brought headline inflation closer to its target in less than one year from its peak. This article aims to briefly explore the dynamics of Sri Lanka's high inflation episode, the policy responses by both the Central Bank and the Government to manage inflation and inflation expectations, and the key lessons learnt.

While Sri Lanka successfully maintained single-digit inflation for over 12 years since early 2009, inflation began to rise to double digits in December 2021. This was largely due to the gradual accumulation of underlying aggregate demand pressures in the

Figure 1: Contribution to Headline Inflation (CCPI-based, year-on-year)



Sources: Department of Census and Statistics
Central Bank Staff Judgement

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economy, compounded by the lagged effects of an extended period of relaxed monetary policy following the pandemic and an unprecedented expansion of Central Bank credit to the Government. Additionally, shortages of essential goods, exacerbated by certain abrupt policy decisions, and destabilised inflation expectations also contributed to this. The mispricing of domestic energy products and the maintenance of a non-market-clearing exchange rate further amplified domestic inflationary pressures. The exchange rate, which was held at a non-market-reflective level from mid-2021 to early 2022, was allowed to be determined by market forces in March 2022. Following this policy shift, the exchange rate underwent a sharp correction, triggering a surge in imported inflation. Concurrently, global oil and other commodity prices also rose in 2022. The sharp depreciation of the Sri Lanka rupee, combined with global commodity price hikes and corrections of past mispricing episodes, led to significant increases in domestic petroleum and electricity prices. In addition, frequent and substantial fuel price hikes led to large increases in transport costs due to the second-round effects. Meanwhile, administratively determined prices of imported food items, such as wheat and milk powder, were revised considerably and were subsequently allowed to be market-determined. Food prices at restaurants, including bakery products, rose sharply driven by increased LP gas and wheat flour prices, and higher electricity tariffs. These, coupled with continued shortages of food and non-food items, further escalated inflation to unprecedented levels in 2022. At its peak, headline inflation reached 69.8 per cent in September 2022 (year on year, based on the Colombo Consumer Price Index (CCPI)), while food inflation and inflation in energy and transport-related categories were recorded at even higher levels.

Several policy measures have been implemented by the Central Bank to stabilise the economy and tighten monetary and credit conditions. To counter rising inflationary pressures and anchor inflation expectations, the Central Bank has tightened monetary policy since August 2021, with a substantial increase in policy interest rates in April 2022. Since the beginning of this monetary tightening cycle, the Central Bank's key policy interest rates–Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR)–were raised by 11 percentage points until March 2023. Additionally, during this period, the Central Bank increased the Statutory Reserve Ratio (SRR) by 2 percentage points, while removing several caps on interest rates, allowing for greater upward adjustments in market interest rates. Meanwhile, the high-risk premia attached to government securities on account of the debt restructuring-related uncertainties broadly complemented the monetary policy stance, thereby resulting in a higher spread between the policy interest rates and the market interest rates. The unprecedented increase in policy interest rates helped curb the further accumulation of demand-driven inflationary pressures, pre-empting the escalation of adverse inflation expectations, easing pressure on the external sector, and correcting distortions in the market interest rate structure. In parallel, the Central Bank implemented a series of measures aimed at stabilising the external sector.

The Government also introduced a range of measures to improve domestic supply conditions and implement the necessary reforms to ensure long-term domestic price stability. An Extended Fund Facility (EFF) programme with the International Monetary Fund (IMF) was commenced. This, alongside various bilateral and multilateral arrangements, helped improve the country's foreign exchange liquidity and market confidence. As a result, the supply of imported essential goods gradually normalised, and the availability of agricultural inputs, particularly fertilizer, improved. More importantly, the Government introduced significant policy adjustments to address severe fiscal imbalances.

A revenue-based fiscal consolidation process, aligned with the IMF EFF, was initiated to contain excessive aggregate demand pressures and reduce the reliance on monetary financing of the budget deficit. While implementing decisive measures to strengthen fiscal performance, the Government also introduced initiatives to mitigate the impact of the economic crisis on the poor and vulnerable groups. Additionally, the Government introduced cost-reflective price adjustments for energy, preventing the adverse effects of mispricing. A crucial step toward ensuring long-term price stability was the enactment of the Central Bank of Sri Lanka Act in 2023. Among its key provisions, the new Act established domestic price stability as the Central Bank's primary objective, introduced flexible inflation targeting and a flexible exchange rate policy as the monetary policy framework, prohibited monetary financing of fiscal deficits, and enhanced the Central Bank's transparency and accountability.

The outcomes of the policy efforts discussed above began to materialise in late 2022, with inflation starting to moderate from October 2022. Consequently, from its peak of around 70 per cent, headline inflation decelerated to 57.2 per cent (year-on-year) by December 2022, and further eased to single-digit levels by July 2023. Inflation remained broadly stable around the country's inflation target of 5 per cent from July 2023 to February 2024. However, since March 2024, substantial reductions were introduced to electricity tariffs and domestic petroleum prices. The direct and second-round effects of these adjustments led to a notable reduction in inflation, with the country even starting to experience deflation in September 2024. Overall, Sri Lanka's impressive disinflation process was supported by several factors, including subdued aggregate demand resulting from tight monetary and fiscal policies, improvements in domestic supply conditions, enhanced external sector performance, some normalisation of global commodity prices, and the passthrough of these reductions to domestic prices. Additionally, Sri Lanka's disinflation was bolstered by well-anchored inflation expectations. The proactive implementation of corrective monetary policy measures, combined with an effective and transparent communications strategy, helped anchor medium-term inflation expectations in line with the inflation target of 5 per cent. Regular communication of the estimated short- to medium-term inflation trajectory along with the underlying economic factors and assumptions remained a key component of this strategy. The Central Bank's monthly press release on inflation and the bi-annual Monetary Policy Report that was introduced in July 2023 were instrumental in communicating the inflation outlook and the associated risks to the public.

Sri Lanka's experience with high inflation in 2022 provides valuable lessons for SAARC countries and other emerging economies navigating similar economic challenges. It underscores the importance of timely and effective monetary policy interventions to manage the rapid acceleration of inflation, driven by both global and domestic factors, including policy missteps. Key lessons include the need for early monetary tightening to prevent demand-driven inflation, the dangers of excessive monetisation of budget deficits, the implications of persistent mispricing of essential commodities, and the risks associated with maintaining a non-market-clearing exchange rate at the cost of depleting external buffers. Although actions to control inflation may have dampened near-term growth, the restoration of price stability and the implementation of broader reforms are expected to foster sustained economic growth that benefits all stakeholders in the long run.

The success of Sri Lanka's disinflation process, achieved through a combination of tight monetary policies, fiscal reforms, and external support, underscores the effectiveness of coordinated policy responses. Moreover, it is crucial to maintain strong monetary and fiscal discipline, ensure transparent communication of policy goals, and focus on long-term structural reforms to sustain price stability. Moving forward, the formal adoption of a flexible inflation targeting framework as the monetary policy framework, along with a flexible exchange rate regime, will further strengthen the Central Bank's ability to manage inflation. In addition, greater accountability to meet the inflation target and enhanced Central Bank autonomy, coupled with regular coordination with fiscal authorities, will be pivotal in maintaining domestic price stability. Upholding these policies will enable Sri Lanka to build a resilient economy, well-prepared to face future challenges.

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