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## Monetary Policy Review: No. 05 - July 2021

### The Central Bank of Sri Lanka maintains policy interest rates at their current levels

The Monetary Board of the Central Bank of Sri Lanka, at its meeting held on 07 July 2021, decided to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at their current levels of 4.50 per cent and 5.50 per cent, respectively. The Board arrived at this decision after carefully considering the macroeconomic conditions and expected developments on the domestic and global fronts.

### The Sri Lankan economy is likely to have recorded a higher than expected growth rate in the first quarter of 2021

Although GDP estimates for the first quarter of 2021 have not been released by the Department of Census and Statistics, indicators for several key sectors of the economy point towards a stronger than expected recovery during the quarter. Disturbances to domestic economic activity due to the third wave of the COVID-19 pandemic and related preventive measures weakened the recovery somewhat, in the second quarter of 2021. Nevertheless, the ongoing vaccination drive throughout the country and the likely removal of mobility restrictions are expected to ease the impact of the current wave of COVID-19 on overall economic activity, thereby facilitating a sustained economic recovery towards achieving a GDP growth rate of around 5 per cent in 2021. Along with the expected recovery in the global economy and the improvements on the domestic front, the upward momentum of economic activity is envisaged to sustain over the medium term.

### The external sector is expected to gradually recover in the period ahead

In spite of the resilience shown by merchandise exports, the trade deficit widened during the period from January to May 2021, over the same period last year. Challenges emanating from multiple waves of COVID-19 globally and domestically continued to stifle the recovery of the tourism industry. On the other hand, the notable improvement in workers' remittances continued to provide support for the external current account. While the measures introduced to address challenges in the external sector have helped ease the domestic foreign exchange market conditions to some extent, speculative behaviour and frontloading of imports have caused undue pressures in the market. The exchange rate has recorded a depreciation of 6.7 per cent against the US dollar thus far during the year. As of end June 2021, the gross official reserves were estimated at US dollars 4.0 billion (equivalent to 2.7 months of imports). This does not include the bilateral currency swap facility with the People's Bank of China (PBoC) of CNY 10 billion (equivalent to approximately US dollars 1.5 billion). Although the level of foreign reserves could experience some variations in the period ahead, such developments are expected to be temporary, with the adequate financing strategies lined up to

maintain reserves at sufficient levels and to meet all maturing debt servicing obligations of the Government on time.

### **Market interest rates remain low, facilitating increased credit flows to the private sector**

In response to the monetary policy easing measures adopted by the Central Bank, most market deposit and lending interest rates have declined to their historic low levels. Prevailing low interest rates and the surplus rupee liquidity in the domestic money market enabled the flow of low cost credit to the economy, thus supporting the revival of economic activity. Accordingly, credit extended to the private sector expanded notably during the period from January to May 2021, and this momentum is expected to sustain through 2021. The Central Bank expects domestic investors to make use of the low interest rate environment to expand their productive economic activities and explore new opportunities that are being created in the economy aimed at local and international markets. Meanwhile, credit obtained by the public sector from the banking system, particularly the Government, also increased notably, amidst the impact of the pandemic on government revenue and recurrent expenditure. With the significant expansion in domestic credit, the growth of broad money ( $M_{2b}$ ) remained elevated by end May 2021.

### **Any buildup of sustained inflationary pressures will be addressed through appropriate measures over the medium term**

Inflation remains moderate, given the subdued aggregate demand conditions, although food inflation has accelerated due to supply-side disruptions. Inflation is expected to remain broadly within the desired 4-6 per cent range during the remainder of 2021. The envisaged improvements in aggregate demand conditions stemming from the effects of the stimulus measures adopted by the Central Bank and the Government and the likely increases in global commodity prices, may generate some inflationary pressures over the medium term. Such pressures will be mitigated through timely policy intervention by the Central Bank, thereby ensuring the maintenance of inflation in mid-single digit levels over the medium term.

### **Policy rates are maintained at current levels**

In consideration of the current and expected macroeconomic developments highlighted above, the Monetary Board decided to maintain the policy interest rates, i.e., Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank, at their current levels of 4.50 per cent and 5.50 per cent, respectively. The Central Bank will continue to monitor domestic and global macroeconomic and financial market developments and stand ready to take appropriate measures, as and when necessary, with the aim of maintaining inflation in the targeted 4-6 per cent range under the flexible inflation targeting framework in the medium term, while supporting sustained economic recovery.

#### **Monetary Policy Decision: Policy rates and SRR unchanged**

Standing Deposit Facility Rate (SDFR)	4.50%
Standing Lending Facility Rate (SLFR)	5.50%
Bank Rate	8.50%
Statutory Reserve Ratio (SRR)	2.00%

**INFORMATION NOTE:**

The virtual monetary policy press conference will be held on 08 July 2021 at 11.00 a.m. via Zoom and will be livestreamed on Facebook.

The release of the next regular statement on monetary policy will be on 19 August 2021.

## Annexure I

**Table 01: Inflation**

Month		Nov 20	Dec 20	Jan 21	Feb 21	Mar 21	Apr 21	May 21	Jun 21
Headline Inflation (Year on year % change)	CCPI (2013=100)	4.1	4.2	3.0	3.3	4.1	3.9	4.5	5.2
	NCPI (2013=100)	5.2	4.6	3.7	4.2	5.1	5.5	6.1	-
Core Inflation (Year on year % change)	CCPI (2013=100)	3.0	3.5	2.7	2.6	3.1	3.0	3.2	3.2
	NCPI (2013=100)	4.5	4.7	4.2	4.1	4.3	4.1	4.2	-

Source: Department of Census and Statistics

**Table 02: Monetary Sector Developments (Provisional)**

Indicator	Outstanding Amount (Rs. billion)					Year-on-Year % Change				
	Jan 21	Feb 21	Mar 21	Apr 21	May 21	Jan 21	Feb 21	Mar 21	Apr 21	May 21
Reserve Money	976	978	1,029	1,031	1,036	4.3	1.5	1.5	0.9	4.0
Broad Money (M <sub>2b</sub> )	9,533	9,651	9,839	9,947	10,033	23.7	23.8	21.5	20.4	21.0
Net Foreign Assets (NFA)	(321)	(386)	(430)	(431)	(429)	-458.9	-496.1	-1,629.0	-615.8	-778.2
Net Domestic Assets (NDA)	9,854	10,037	10,269	10,378	10,462	29.4	30.4	27.2	26.9	25.4
Net Credit to the Government (NCG)	4,758	4,793	5,005	4,965	5,024	63.1	61.9	54.7	50.4	45.0
Credit to Public Corporations	1,058	1,080	1,098	1,093	1,113	29.0	29.7	26.5	17.1	16.8
Credit to the Private Sector	6,197	6,276	6,388	6,446	6,501	6.9	7.8	7.5	8.2	10.5
Broad Money (M <sub>4</sub> )	11,643	11,790	12,010	12,154	12,265	21.6	21.9	20.4	19.6	20.2

Source: Central Bank of Sri Lanka

**Table 03: Interest Rates**

Interest Rate (%)	End Jan 21	End Feb 21	End Mar 21	End Apr 21	End May 21	End Jun 21	As at 07 July 21
<b>Policy Rates of the Central Bank</b>							
Standing Deposit Facility Rate	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Standing Lending Facility Rate	5.50	5.50	5.50	5.50	5.50	5.50	5.50
<b>Average Weighted Call Money Rate (AWCMR)</b>	4.55	4.55	4.62	4.64	4.66	4.93	4.93
<b>Treasury bill yields (Primary market)</b>							
91-day	4.69	4.90	5.05	5.11	5.13	5.18	5.19
182-day	4.75	4.99	5.10	5.14	5.14	5.19	5.19
364-day	4.98	5.09	5.11	5.18	5.18	5.23	5.23
<b>Lending Rates</b>							
Average Weighted Prime Lending Rate (Weekly)	5.90	5.76	5.78	5.86	5.65	5.51	-
Average Weighted Lending Rate (AWLR)	10.17	10.08	9.91	9.73	9.64	-	-
Average Weighted New Lending Rate (AWNLR)	8.37	8.26	8.28	7.95	7.74	-	-
<b>Deposit Rates</b>							
Average Weighted Deposit Rate (AWDR)	5.58	5.36	5.20	5.07	4.97	4.87	-
Average Weighted Fixed Deposit Rate (AWFDR)	6.88	6.53	6.29	6.09	5.94	5.82	-
Average Weighted New Deposit Rate (AWNDR)	5.19	4.96	4.86	4.77	4.77	-	-
Average Weighted New Fixed Deposit Rate (AWNFR)	5.30	5.09	4.99	4.92	4.90	-	-

Source: Central Bank of Sri Lanka