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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: No. 08 - November 2023

The Central Bank of Sri Lanka further reduces policy interest rates

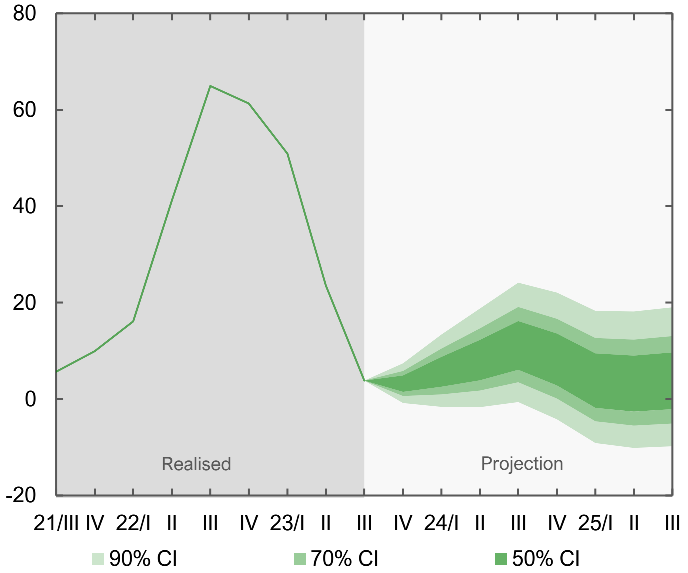
The Monetary Policy Board of the Central Bank of Sri Lanka, at its meeting held on 23 November 2023, decided to reduce the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 100 basis points (bps) to 9.00 per cent and 10.00 per cent, respectively. The Board arrived at this decision following a careful analysis of the current and expected developments in the domestic and global economy, with the aim of achieving and maintaining inflation at the targeted level of 5 per cent over the medium term, while enabling the economy to reach and stabilise at the potential level. The Board took note of possible upside risks to inflation projections in the near term due to supply-side factors stemming from the expected developments domestically and globally. However, the Board viewed that such near-term risks would not materially change the medium-term inflation outlook, as inflation expectations of the public remain anchored and economic activity is projected to remain below par in the near to medium term. Further, the Board viewed that with this reduction of policy interest rates, along with the monetary policy measures carried out since June 2023, sufficient monetary easing has been effected in order to stabilise inflation over the medium term. Hence, the Monetary Policy Board underscored the need for a swift and full passthrough of monetary easing measures to market interest rates, particularly lending rates, by the financial institutions, thereby accelerating the normalisation of market interest rates in the period ahead.

Headline inflation continues to remain low, reflecting subdued demand conditions. Headline inflation, as measured by the year-on-year change in the Colombo Consumer Price Index (CCPI, 2021=100), was recorded at 1.5 per cent in October 2023, compared to 1.3 per cent in September 2023. Food inflation continued to be negative (year-on-year) for the fourth consecutive month in October 2023. The National Consumer Price Index (NCPI, 2021=100) based headline inflation (year-on-year) was recorded at 1.0 per cent in October 2023, compared to 0.8 per cent in September 2023. Both CCPI and NCPI based core inflation (year-on-year), which reflects underlying demand pressures in the economy, moderated further in October 2023, reflecting the subdued demand pressures in the economy. A one-off upward movement in inflation is expected in the near term, driven mainly by the changes to the Value Added Tax (VAT) proposed by the

Government effective January 2024. The spillover effects of tax measures and other developments are likely to be muted due to subdued underlying demand pressures; hence, this rise in inflation is expected to be transitory. Accordingly, headline inflation over the medium term is expected to converge towards the targeted level of 5 per cent, supported by appropriate policy measures.

Headline Inflation Projections

CCPI* (quarterly average, y-o-y, %)



***Note:** Realised data up to Q4 2022 shown in the fan chart are based on the CCPI (2013=100, seasonally adjusted), while data after this period are based on the CCPI (2021=100, seasonally adjusted). Projections are based on all available data.

***Source:** Central Bank Staff Projections*

The fan chart illustrates the uncertainty surrounding the baseline projection path using confidence bands of gradually fading colours. The confidence intervals (CI) shown on the chart indicate the ranges of values within which inflation may fluctuate over the medium term. For example, the thick green shaded area represents the 50 per cent confidence interval, implying that there is a 50 per cent probability that the actual inflation outcome will be within this interval. The confidence bands show the increasing uncertainty in forecasting inflation over a longer horizon.

Note: A forecast is neither a promise nor a commitment.

The projections reflect the available data, assumptions and judgements made at the forecast round in November 2023. They are conditional on the forecasts of global energy and food prices; gradual growth recovery of Sri Lanka's major trading partners; the anticipated domestic fiscal path in line with the IMF-EFF projections under the debt restructuring scenario and key changes proposed in the Government Budget Speech – 2024; and global financial conditions implied by the monetary policy stance of the USA. Further, the projections are conditional on the model-consistent interest rate path and the resulting macroeconomic responses. Any notable change in these assumptions could lead to the realised inflation path deviating from the projected path.

Given the prevailing domestic and global economic uncertainties, adverse weather conditions and geopolitical tensions, the risks associated with the current projections are higher than in normal times. These risks arise due to the possibility of various factors deviating from the levels already internalised in projections, either explicitly or implicitly. In particular, there are upside risks to inflation projections stemming from factors such as the possibility of increased taxes and related second-round impacts, possible wage hikes, large increases in energy prices, any larger than expected exchange rate depreciation amidst relaxed import restrictions, the impact of possible adverse weather on agricultural production and in turn on food inflation, etc. Meanwhile, downside risks to inflation projections include the possibility of a faster recovery of supply conditions and the sustained impact of diminished purchasing power of the public.

The Central Bank remains committed to communicating any changes to the inflation outlook to the public on a regular basis, enabling the public to make informed decisions.

Market interest rates are expected to normalise in the period ahead. Market interest rates continued to adjust downwards, and most benchmark interest rates have declined significantly. Meanwhile, the yields on government securities are also adjusting downwards with falling risk premia. The reduction of policy interest rates by 100 bps in this monetary policy review is expected to create further space for market interest rates to adjust downward and normalise in the period ahead. Reflecting the transmission of the relaxed monetary policy stance, outstanding credit to the private sector by the banking sector expanded on a monthly basis in September as well as in October 2023 based on provisional data. With the moderation of market lending interest rates, credit to the private sector is expected to increase further in the period ahead, thereby supporting the envisaged rebound of domestic economic activity.

Policy interest rates are further reduced in view of the stable inflation outlook over the medium term and subdued demand pressures

In consideration of the current and expected macroeconomic developments highlighted above, the Monetary Policy Board of the Central Bank of Sri Lanka, at its meeting held on 23 November 2023, decided to reduce the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 100 bps to 9.00 per cent and 10.00 per cent, respectively. The Board viewed that, with this reduction of policy interest rates and based on the available information, further monetary policy easing will be paused in the near term, given the space for market interest rates to adjust downwards in line with the current and past monetary policy easing measures. The Board anticipates a swift, sizeable and broad-based reduction in overall market lending interest rates in line with the monetary policy easing measures effected since June 2023. Such adjustment in interest rates is imperative to ease the domestic monetary conditions further. The Board stressed the need for all licensed banks to take swift measures to reduce market lending interest rates to ensure that the benefits of the series of monetary policy easing measures are adequately passed on to businesses and households.

The Monetary Policy Board will continue to assess risks to inflation projections, among others, and stand ready to take appropriate measures to maintain domestic price stability in the period ahead while supporting the economy to reach its potential.

Monetary Policy Decision	**Policy interest rates reduced**	
	Standing Deposit Facility Rate (SDFR)	9.00%
	Standing Lending Facility Rate (SLFR)	10.00%
	Statutory Reserve Ratio (SRR) *remains unchanged*	2.00%

INFORMATION NOTE:

A press conference, chaired by Governor Dr. P Nandalal Weerasinghe, will be held on 24 November 2023 at 11.30 am at the Atrium of the Central Bank of Sri Lanka, and proceedings will be livestreamed on Facebook and YouTube.

The release of the next regular statement on monetary policy review will be announced in due course.

Annexure I

Table 01: Inflation

Month		Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23	Oct 23
Headline Inflation (Year-on-Year % change)	CCPI (2021=100)	51.7	50.6	50.3	35.3	25.2	12.0	6.3	4.0	1.3	1.5
	NCPI (2021=100)	53.2	53.6	49.2	33.6	22.1	10.8	4.6	2.1	0.8	1.0
Core Inflation (Year-on-Year % change)	CCPI (2021=100)	45.6	43.6	39.1	27.8	20.3	9.8	5.9	4.6	1.9	1.2
	NCPI (2021=100)	52.0	50.1	44.2	31.8	21.6	11.3	6.3	4.1	1.7	0.6

Source: Department of Census and Statistics

Table 02: Monetary Sector Developments (Provisional)

Indicator	Outstanding Amount (Rs. billion) (a)								
	Jan 23	Feb 23	Mar 23	Apr 23	May 23	Jun 23	Jul 23	Aug 23	Sep 23
Reserve Money	1,590	1,505	1,424	1,417	1,559	1,436	1,374	1,407	1,244
Broad Money (M_{2b})	12,322	12,346	12,293	12,387	12,307	12,517	12,726	12,698	12,806
Net Foreign Assets (NFA)	(1,573)	(1,434)	(1,174)	(1,039)	(838)	(808)	(707)	(612)	(560)
Net Domestic Assets (NDA)	13,895	13,780	13,467	13,426	13,144	13,325	13,433	13,309	13,366
Net Credit to the Government (NCG)	7,612	7,471	7,568	8,091(b)	8,111	8,261	8,549	8,465	8,204
Credit to Public Corporations / SOBEs	1,748	1,712	1,605	1,147(b)	1,084	1,096	1,097	1,091	1,099
Credit to the Private Sector	7,318	7,260	7,141	7,093	7,004	7,080	7,093	7,098	7,168
Broad Money (M_4)	14,891	14,906	14,868	14,981	14,885	15,093	15,335	15,330	15,446

(a) Valuation changes arising from changes in the exchange rate have led to significant changes in monetary and credit aggregates during the period starting from March 2022.

(b) With the approval of the Cabinet of Ministers at its meeting held on 30 January 2023, the outstanding foreign currency guaranteed debt of the Ceylon Petroleum Corporation (CPC) was absorbed into central government debt with effect from December 2022, in line with the actions agreed under the IMF-EFF arrangement to restructure the balance sheets of selected State Owned Business Enterprises (SOBEs). Accordingly, a part of this adjustment was effected in April 2023, hence, was reflected in the balance sheet of the particular state-owned commercial bank, which caused a reduction in credit to public corporations/ SOBEs and an expansion in net credit to the government (NCG).

Source: Central Bank of Sri Lanka

Table 03: Interest Rates

Interest Rate (%)	End May 23	End Jun 23	End Jul 23	End Aug 23	End Sep 23	End Oct 23	As at 23 Nov 2023
Key Policy Interest Rates of the Central Bank							
Standing Deposit Facility Rate	15.50	13.00	11.00	11.00	11.00	10.00	10.00
Standing Lending Facility Rate	16.50	14.00	12.00	12.00	12.00	11.00	11.00
Average Weighted Call Money Rate (AWCMR)	16.50	13.85	11.50	11.50	11.66	10.29	10.25
Treasury Bill Yields (Primary market)							
91-day	25.65	23.00	19.96	18.48	17.42	16.10	15.29 (a)
182-day	25.29	19.49	17.69	15.36	15.13	14.93	14.75 (a)
364-day	22.91	16.99	14.29	13.58	13.30	13.02	12.94 (a)
Lending Rates							
Average Weighted Prime Lending Rate (Weekly)	20.29	19.47	17.18	15.29	14.67	13.88	13.14 (b)
Average Weighted Lending Rate (AWLR)	17.75	17.51	16.90	16.20	15.62	15.18	-
Average Weighted New Lending Rate (AWNLR)	22.39	21.51	19.30	17.89	16.57	15.98	-
Deposit Rates							
Average Weighted Deposit Rate (AWDR)	15.23	15.09	14.76	14.15	13.39	12.75	12.11
Average Weighted Fixed Deposit Rate (AWFDR)	19.84	19.70	19.02	18.26	17.24	16.34	15.54
Average Weighted New Deposit Rate (AWNDR)	18.85	14.98	12.45	11.46	11.47	11.51	-
Average Weighted New Fixed Deposit Rate (AWNFDR)	19.19	15.49	12.76	11.81	11.82	11.78	-

(a) Rate at the auction held on 22 November 2023
(b) For the week ending 17 November 2023

Source: Central Bank of Sri Lanka