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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Press Release

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Monetary Policy Review: No. 2 – 2017

As per the provisional estimates of the Department of Census and Statistics (DCS), the Sri Lankan economy grew by 4.4 per cent in real terms during 2016 compared to the growth of 4.8 per cent in 2015. Within this annual growth, Industry related activities grew notably by 6.7 per cent driven by construction related activities, while Services related activities grew by 4.2 per cent mainly with the expansion of financial services, insurance and telecommunications. However, Agriculture related activities contracted by 4.2 per cent in 2016, impacted by supply side disruptions on account of floods in the second quarter and drought conditions during the final quarter of 2016. In spite of challenging external factors such as adverse weather conditions and global developments, an acceleration of growth was observed towards end 2016 with the last quarter of 2016 recording a growth of 5.3 per cent, partly supported by the base effect.

In the meantime, headline inflation, as measured by the year-on-year change in the Colombo Consumers’ Price Index (CCPI, 2013=100), accelerated to 6.8 per cent in February 2017 from 5.5 per cent in January 2017. A similar trend was observed in the National Consumer Price Index (NCPI, 2013=100) based headline inflation, which rose to 8.2 per cent (year-on-year) in February 2017 from 6.5 per cent in January 2017. Year-on-year core inflation based on both CCPI and NCPI also remained high at 7.1 per cent in February 2017. The recent acceleration in inflation is largely due to the impact of prevailing drought conditions and adjustments to the tax structure, and it is projected that inflation would revert to the desired mid single digit levels in the period ahead and stabilise thereafter, unless disrupted by adverse inflation expectations.

The earlier tightening of monetary policy and monetary conditions by the Central Bank and the resultant increase in market interest rates are likely to have impacted the growth of credit to the private sector by commercial banks to some extent. Accordingly, the year-on-year growth of private sector credit decelerated further to 20.9 per cent in January 2017 from 21.9 per cent at end 2016. Meanwhile, credit to the public sector increased noticeably, causing year-on-year broad money (M_{2b}) growth to remain high at 17.7 per cent in January 2017, although this was a deceleration compared to 18.4 per cent in December 2016. Nevertheless, the deceleration in monetary and credit aggregates has been slower than expected.

On the external front, the deficit in the trade account of the balance of payments (BOP) was recorded at US dollars 9.1 billion in 2016 compared to US dollars 8.4 billion in 2015, with expenditure on imports increasing by 2.5 per cent and earnings from exports contracting by 2.2 per cent during the year. Provisional data for January 2017 also indicated a widening of the trade deficit. Earnings from tourism and workers' remittances continued to cushion the adverse impact of the trade deficit on the BOP. In the meantime, outflows of foreign investments from the government securities market observed in early 2017 appear to have subsided, and marginal inflows have been experienced in spite of the increase in policy interest rates in the United States. Gross official reserves were estimated at US dollars 5.6 billion at end February 2017 compared to US dollars 6.0 billion at end 2016, while the Sri Lankan rupee depreciated by 1.2 per cent against the US dollar during the year up to 22 March 2017.

Considering the above developments, the Monetary Board, at its meeting held on 23 March 2017, was of the view that further tightening of monetary policy is necessary as a precautionary measure, in order to contain the build-up of adverse inflation expectations and the possible acceleration of demand side inflationary pressures through excessive monetary and credit expansion. The Monetary Board also took into account the notable improvements in fiscal operations, which have resulted in the overall budget deficit in 2016 declining to envisaged levels. The Board was of the view that these improvements, together with the substantial upward movements already observed in market interest rates, have reduced the required adjustment in policy interest rates. Accordingly, the Monetary Board decided to increase the key policy interest rates of the Central Bank, namely the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by 25 basis points each, to 7.25 per cent and 8.75 per cent, respectively, with effect from 24 March 2017.

Monetary Policy Decision:	**Policy rates increased**
Standing Deposit Facility Rate (SDFR)	7.25%
Standing Lending Facility Rate (SLFR)	8.75%
Statutory Reserve Ratio (SRR)	7.50%