

# Review of the Monetary Policy Stance

**No. 02 of 2019**

**08 April 2019**



**Economic Research Department  
Central Bank of Sri Lanka**

# Monetary Policy Decision:

Review No. 02 of 2019

**Maintain policy interest rates at their current levels**

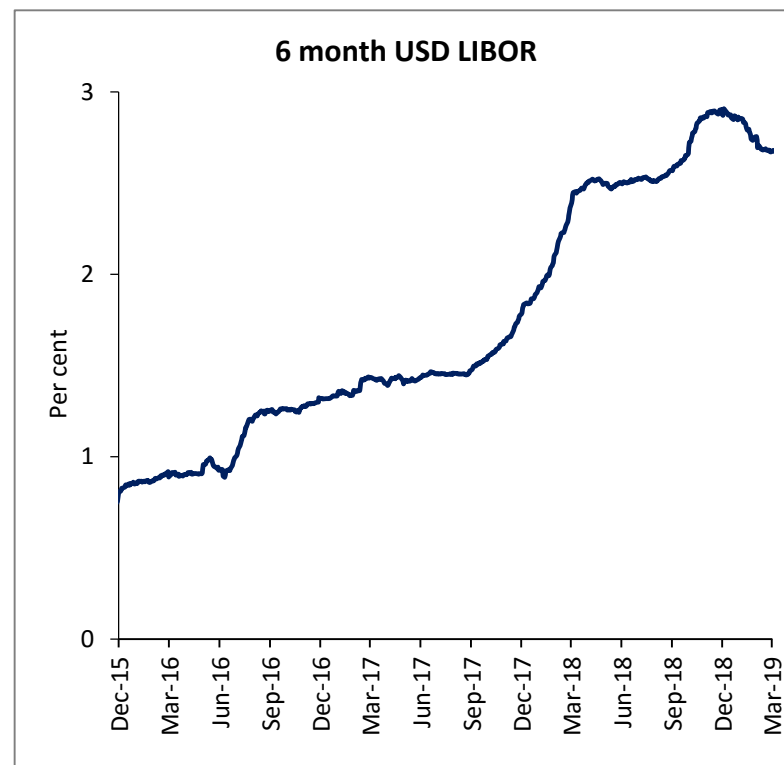
<b>Standing Deposit Facility Rate (SDFR)</b>	<b>8.00%</b>
<b>Standing Lending Facility Rate (SLFR)</b>	<b>9.00%</b>
<b>Statutory Reserve Ratio (SRR)</b>	<b>5.00%</b>

- In the meantime, the Central Bank will consider and implement mechanisms for more effective transmission of the recent decline of the benchmark rates to other market interest rates
- The Board was also of the view that, if the current trends in global financial markets, trade balance, and credit growth continue, policy interest rates could be reduced in the period ahead, given well anchored inflation and inflation expectations

# Global monetary policy tightening put on hold

Recent developments in global growth and inflation dynamics have led key advanced economies and EMEs to shift their monetary policy stance from cautious to dovish

- **FED:** signaled a dovish approach and decided to maintain the target rate at the current level, citing muted inflation pressures and subdued economic activity
- **BOE:** Maintain the current monetary policy stance while signaling possible accommodation to support Brexit-hit domestic growth
- **ECB:** Ended its asset purchase program in December 2018 and decided to delay the policy rate hike until 2020
- **RBI:** reduced the repo rate by 25 basis points to 6.00% in April 2019 for the second consecutive time in 2019

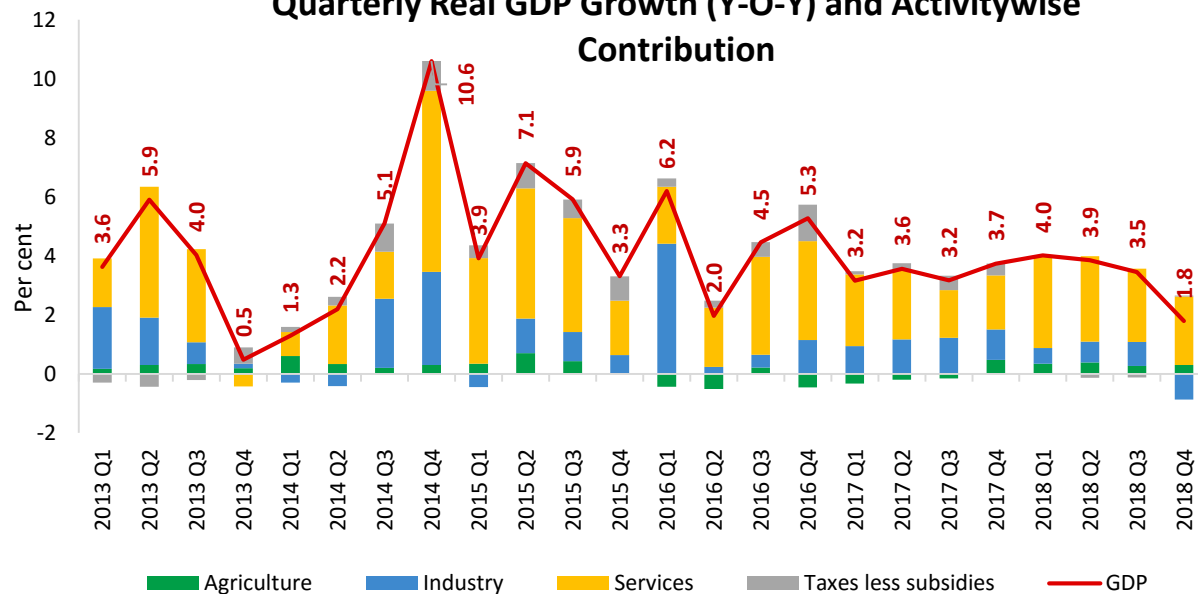


The perceived delay in further rate hikes by the FED has triggered some foreign investment inflows to emerging market economies

# Subpar economic growth

Real GDP growth for 2018 was recorded at 3.2% in 2018, following an upward revised 3.4% growth in 2017...

Quarterly Real GDP Growth (Y-O-Y) and Activitywise Contribution



	2017	2018
GDP % Growth at Constant Prices	3.4	3.2
GDP at Current Prices Rs. bn	13,418	14,450
GDP % Change at Current Prices	11.9	7.7
GDP Deflator (% Change)	8.2	4.3
GDP in USD bn	88.0	88.9
Per Capita GDP in USD	4,104	4,102

Economic Activity	Growth Rates (%)									
	2017					2018				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
Agriculture, Forestry and Fishing	-4.4	-2.6	-2.0	7.2	-0.4	5.1	5.6	4.0	4.5	4.8
Industries	2.9	4.7	4.7	4.3	4.1	1.7	2.8	3.1	-3.6	0.9
Services	4.4	3.9	2.8	3.4	3.6	5.5	4.8	4.3	4.3	4.7
Taxes less subsidies	2.3	3.4	5.5	2.5	3.3	1.1	-1.7	-1.3	0.2	-0.4
GDP	3.2	3.6	3.2	3.7	3.4	4.0	3.9	3.5	1.8	3.2

# Subdued inflation and inflation expectations

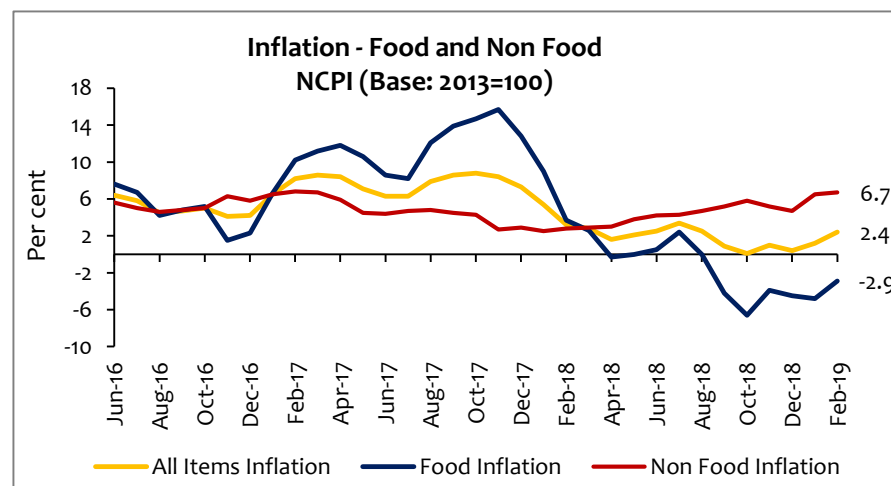
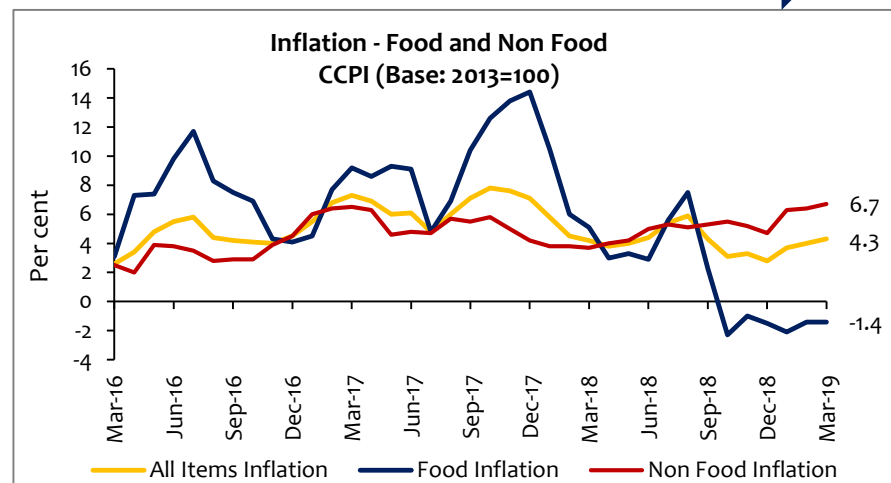
Inflation edged up during the first three months of 2019, mainly due to the increase in non-food inflation

## Headline inflation (%)

	Dec-16	Dec-17	Dec-18	Jan - 19	Feb-19	Mar-19
<b>based on CCPI (2013=100)</b>						
Y-o-Y	4.5	7.1	2.8	3.7	4.0	4.3
Annual average	4.0	6.6	4.3	4.1	4.1	4.1
<b>based on NCPI (2013=100)</b>						
Y-o-Y	4.2	7.3	0.4	1.2	2.4	
Annual average	4.0	7.7	2.1	1.8	1.7	

## Core inflation (%)

	Dec-16	Dec-17	Dec-18	Jan - 19	Feb-19	Mar-19
<b>based on CCPI (2013=100)</b>						
Y-o-Y	5.8	4.3	3.1	5.5	5.4	5.6
Annual average	4.4	5.9	3.5	3.7	3.8	4.0
<b>based on NCPI (2013=100)</b>						
Y-o-Y	6.7	2.7	3.1	5.1	5.5	
Annual average	5.9	4.9	2.4	2.7	3.0	

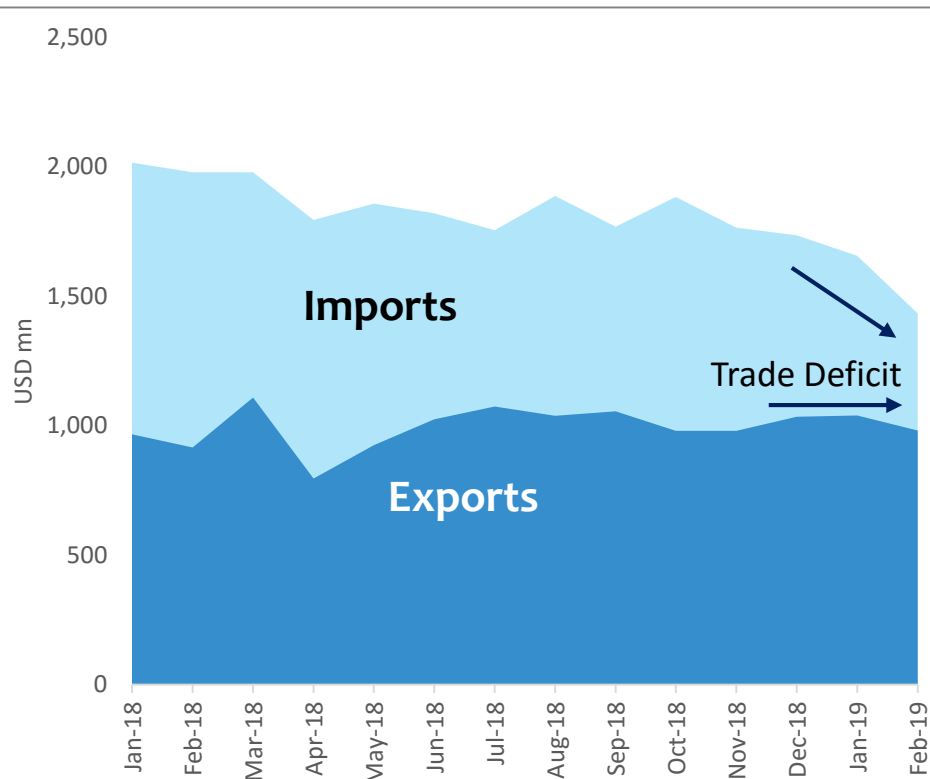


Inflation is expected to remain generally below 5% in 2019, and in the 4-6% range in the medium term

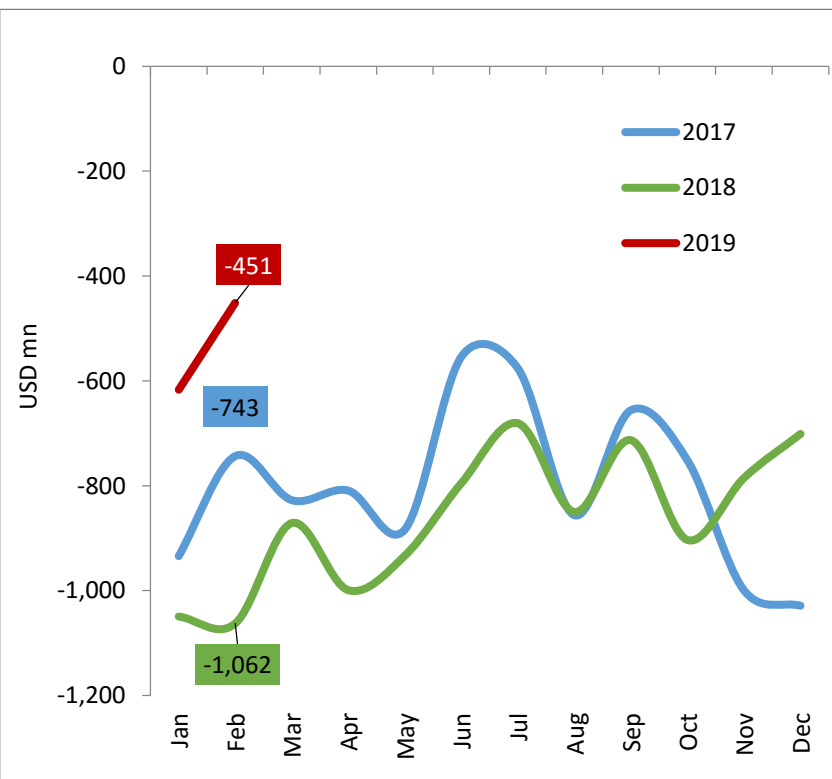
# Easing trade deficit

- In February 2019 (Provisional), trade deficit contracted significantly to USD 451 mn (the lowest since October 2013) from USD 1,062 mn in February 2018
- During the first 2 months of 2019, trade deficit contracted to USD 1,069 mn (Provisional) from USD 2,111 mn during the corresponding period of 2018

Monthly Trade Deficit



Monthly Trade Deficit 2017-2018



# Import expenditure decreased significantly from November 2018...

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Import expenditure declined by 27.6% in February 2019

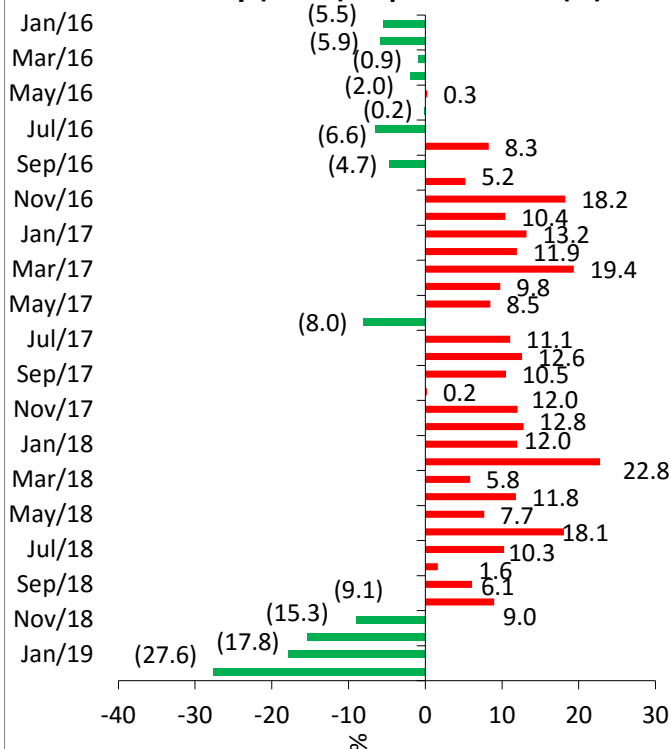
• Significant reductions were recorded in:

- Fuel (-10.6%)
- Personal vehicles (-57.7%)
- Fertiliser (-73.8%)
- Gold (-99.3%)
- Textiles and textile articles (-14.2%)

• Increases were led by:

- Base metals (24.1%)

Monthly (Y-o-Y) Import Growth (%)



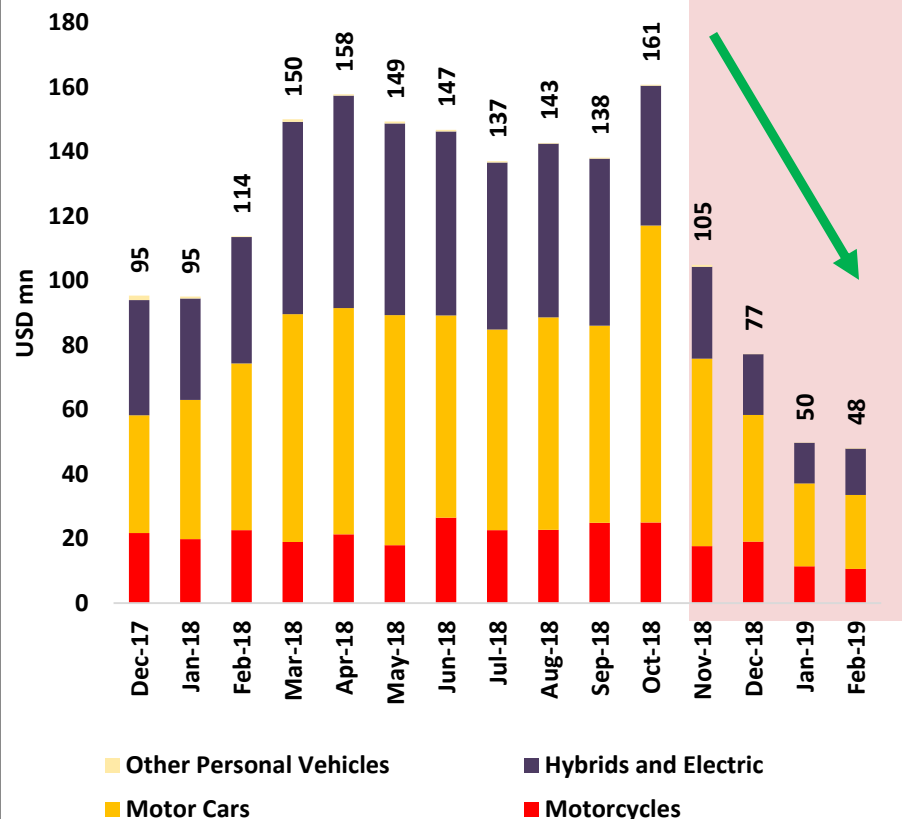
Category	2018		USD mn (%)			USD mn (%)		
	USD mn	Y-O-Y Change	Feb		Y-O-Y Change	Jan-Feb		Y-O-Y Change
			2018	2019		2018	2019	
<b>Total imports</b>	<b>22,232.7</b>	<b>6.0</b>	<b>1,978.0</b>	<b>1,432.4</b>	<b>-27.6</b>	<b>3,992.5</b>	<b>3,087.9</b>	<b>-22.7</b>
<b>Non-fuel imports</b>	<b>18,080.8</b>	<b>3.0</b>	<b>1,662.8</b>	<b>1,150.6</b>	<b>-30.8</b>	<b>3,315.3</b>	<b>2,477.1</b>	<b>-25.3</b>
<b>Intermediate goods</b>	<b>12,488.0</b>	<b>9.2</b>	<b>1,096.3</b>	<b>831.0</b>	<b>-24.2</b>	<b>2,229.7</b>	<b>1,787.1</b>	<b>-19.8</b>
o/w Textiles and textile articles	2,858.5	4.9	247.3	212.2	-14.2	492.5	474.7	-3.6
Fuel	4,151.9	21.1	315.2	281.8	-10.6	677.2	610.8	-9.8
Plastic and articles thereof	697.4	10.2	56.9	43.3	-23.8	111.6	96.3	-13.7
Chemical products	904.2	8.4	75.0	60.3	-19.7	149.5	136.4	-8.7
Fertiliser	261.6	154.4	20.3	5.3	-73.8	62.7	9.1	-85.5
Wheat and maize	373.5	4.7	43.7	26.7	-38.9	74.8	41.2	-44.9
Gold	438.7	-32.5	111.9	0.7	-99.3	205.7	0.8	-99.6
Base metals	682.8	8.6	47.9	59.4	24.1	107.5	106.1	-1.2
<b>Consumer goods</b>	<b>4,979.7</b>	<b>10.6</b>	<b>441.8</b>	<b>259.9</b>	<b>-41.2</b>	<b>883.3</b>	<b>560.4</b>	<b>-36.6</b>
o/w Personal vehicles	1,573.5	103.6	113.7	48.1	-57.7	208.8	97.7	-53.2
Dairy products	332.3	5.2	26.9	6.1	-77.3	58.8	24.0	-59.2
Sugar and confectionery	249.7	-3.2	31.0	13.9	-55.2	58.7	28.9	-50.8
Rice	106.8	-64.5	23.5	1.0	-95.7	54.8	3.3	-93.9
<b>Investment and other goods</b>	<b>4,690.4</b>	<b>-4.2</b>	<b>439.8</b>	<b>341.5</b>	<b>-22.4</b>	<b>879.5</b>	<b>740.3</b>	<b>-15.8</b>
o/w Machinery and equipment	2,491.6	-4.9	200.4	193.9	-3.2	440.7	425.1	-3.5
Building material	1,524.5	-4.2	123.0	108.8	-11.6	266.1	240.8	-9.5
Transport equipment	668.1	-1.0	56.2	38.0	-32.4	108.9	72.8	-33.2

# Policy measures yielded expected results...

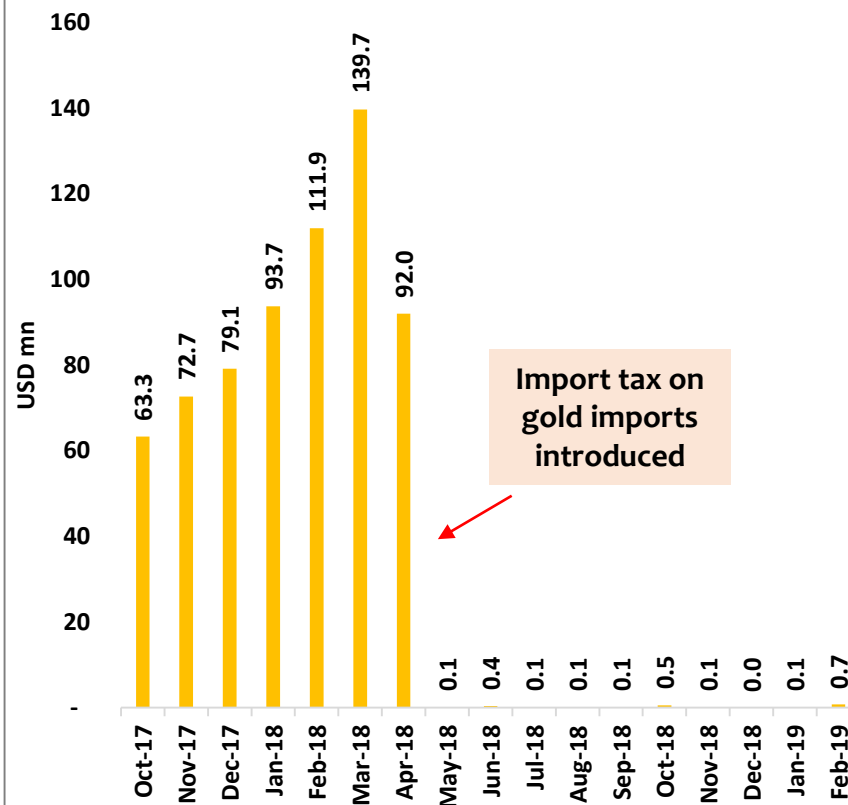
- Vehicle imports have declined by 58% in February 2019 (Y-o-Y)  
(USD 727.7 mn in 2017 and USD 1,573.5 mn in 2018)

- Gold imports have declined to negligible levels with the imposition of 15% custom duty  
(USD 649.8 mn in 2017 and USD 438.7 mn in 2018)

### Expenditure on Personal Vehicles



### Gold Imports





# Export earnings grew by 7.2% (Y-o-Y) to USD 981 mn in Feb 2019...

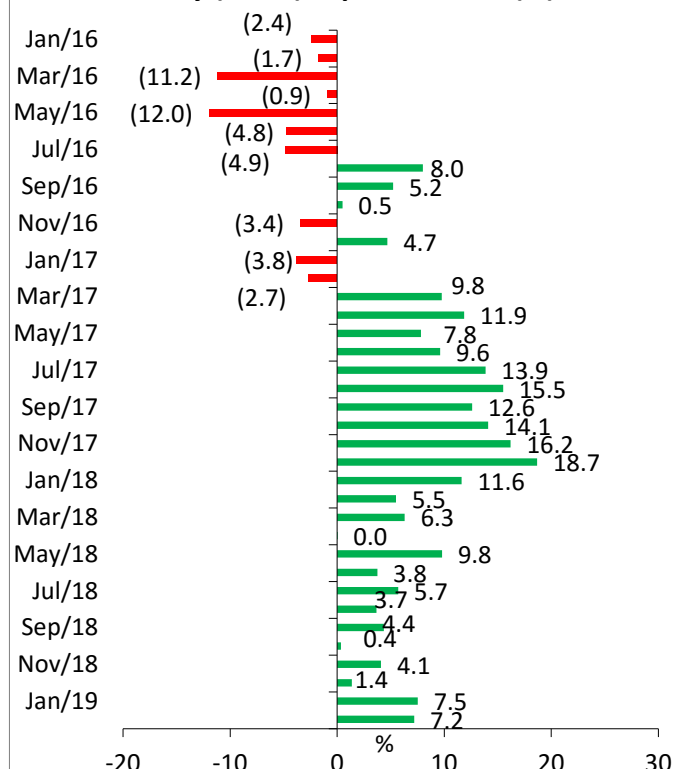
## • Increase was mainly driven by:

- Textiles and garments (14.4%)
- Food, beverages and tobacco (19.9%)
- Seafood (29.9%)
- Spices (16.0%)
- Gems, diamonds and jewellery (17.5%)

## • Significant reductions were recorded in:

- Tea (-6.4%)
- Petroleum products (-15.2%)
- Leather, travel goods, footwear (-28.5%)

### Monthly (Y-o-Y) Export Growth (%)



Category	2018		USD mn (%)			USD mn (%)		
	USD mn	Y-O-Y Change	Feb 2018	Feb 2019	Y-O-Y Change	Jan-Feb 2018	Jan-Feb 2019	Y-O-Y Change
<b>Total exports</b>	<b>11,889.6</b>	<b>4.7</b>	<b>915.7</b>	<b>981.1</b>	<b>7.2</b>	<b>1,881.0</b>	<b>2,019.3</b>	<b>7.3</b>
<b>Agricultural exports</b>	<b>2,579.3</b>	<b>-6.8</b>	<b>206.1</b>	<b>207.8</b>	<b>0.8</b>	<b>410.2</b>	<b>415.4</b>	<b>1.3</b>
o/w Tea	1428.5	-6.6	118.2	110.6	-6.4	230.0	221.4	-3.8
Unmanufactured tobacco	35.6	-2.5	3.6	1.9	-48.7	5.4	4.0	-25.9
Seafood	265.8	10.5	19.5	25.3	29.9	42.4	52.7	24.2
Rubber	31.6	-18.8	4.1	2.3	-42.9	8.1	5.1	-37.0
<b>Industrial exports</b>	<b>9,258.2</b>	<b>8.4</b>	<b>703.2</b>	<b>769.5</b>	<b>9.4</b>	<b>1,460.9</b>	<b>1,595.9</b>	<b>9.2</b>
o/w Textiles and garments	5,317.7	5.7	407.0	465.6	14.4	841.8	941.5	11.8
Rubber products	875.3	4.8	68.3	69.7	2.0	139.4	150.3	7.9
Petroleum products	622.1	43.2	45.5	38.6	-15.2	98.2	76.0	-22.6
Leather, travel goods and footwear	147.7	-6.8	14.8	10.6	-28.5	27.8	23.7	-14.8
Food beverages and tobacco	462.3	17.7	29.6	35.5	19.9	77.8	88.6	13.9
Gems, diamonds and jewellery	278.0	8.0	23.1	27.1	17.5	50.6	51.2	1.3
Base metals and articles	165.4	42.8	11.2	15.2	36.4	23.3	29.3	26.0
Machinery and mechanical appliances	434.8	17.3	31.4	32.2	2.7	61.1	69.1	13.0
<b>Mineral and Other Exports</b>	<b>52.2</b>	<b>1.6</b>	<b>6.3</b>	<b>3.8</b>	<b>-39.4</b>	<b>9.9</b>	<b>7.9</b>	<b>-20.1</b>

Sources: Sri Lanka Customs, Ceylon Petroleum Corporation and other exporters of petroleum, National Gem and Jewellery Authority, Central Bank of Sri Lanka

# Tourist earnings showed an increase, while workers' remittances declined thus far during 2019...

## Tourist Arrivals and Earnings

- Arrivals March 2019:
  - Increased by 4.7% (y-o-y) to 244,328
  - (2,333,796 in 2018)
- Earnings March 2019:
  - Estimated at USD 458.6 mn
  - Cumulative earnings in first three months: USD 1,390 mn
  - (USD 4,381 mn in 2018)

### Tourist Arrivals (2016-2019 March)

	2016	2017	2018	2019
Cumulative	2,050,832	2,116,407	2,333,796	740,600*
March	192,841	188,076	233,382	244,328
Monthly Avg	170,903	176,367	194,483	246,867*

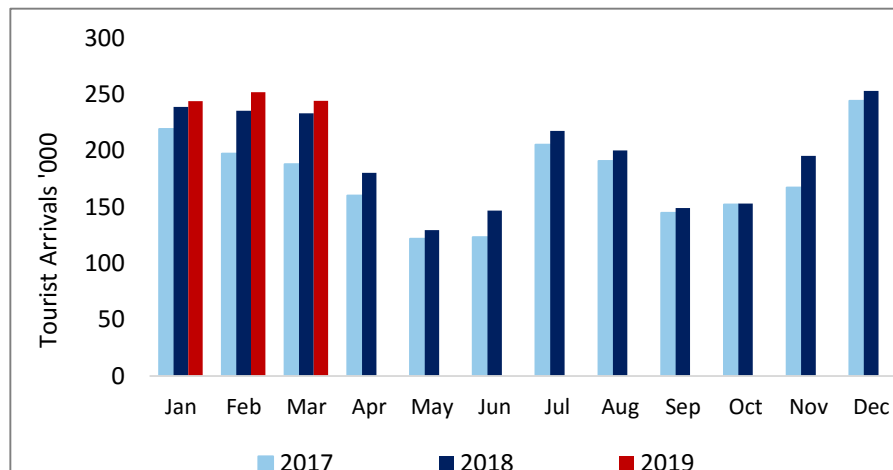
\*Jan - Mar 2019

## Workers' Remittances

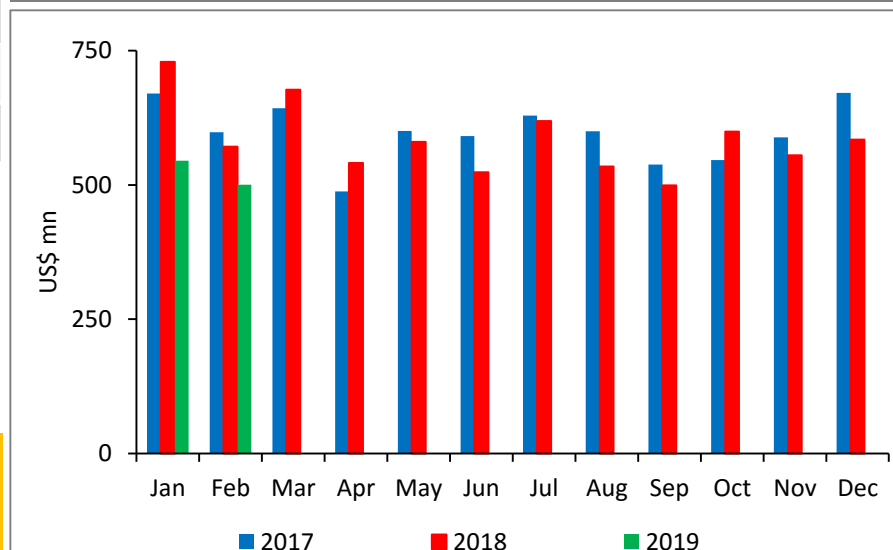
- Feb 2019: decreased by 12.4% (y-o-y) to USD 500.5 mn
- Cumulative during first two months: USD 1,045.8 mn (USD 7,015 mn in 2018)

**The estimated current account deficit could be lower than earlier projections**

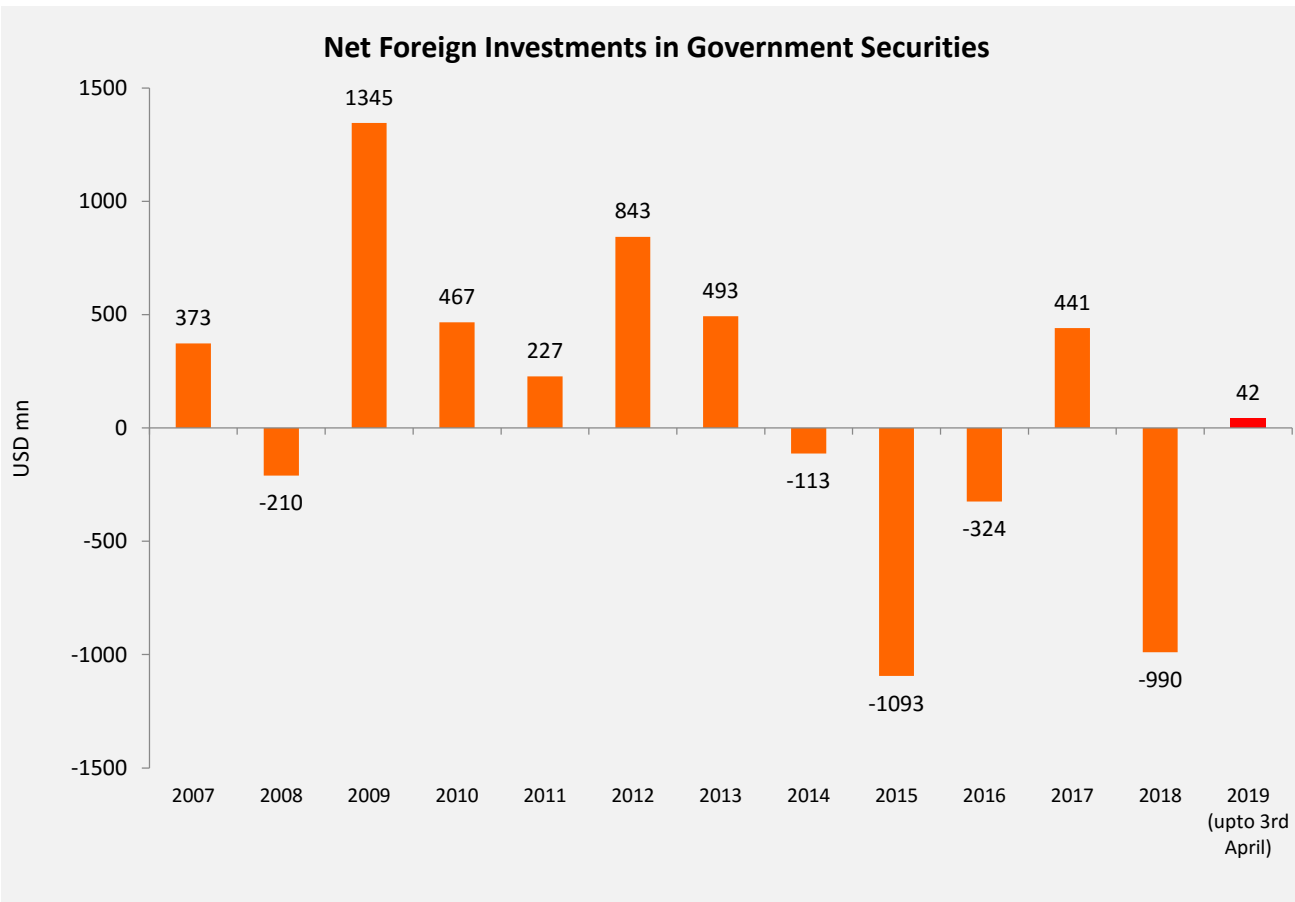
### Tourist Arrivals



### Workers' Remittances



# There had been inflows to the Government securities market, although CSE recorded outflows..



- Increased inflows to the Government securities market were observed (USD 239 mn) in 2019 (net inflow of USD 42 mn up to 03 Apr 2019)
- Foreign investments in the secondary market of CSE recorded a net outflow of USD 33.5 mn up to 5 April 2019

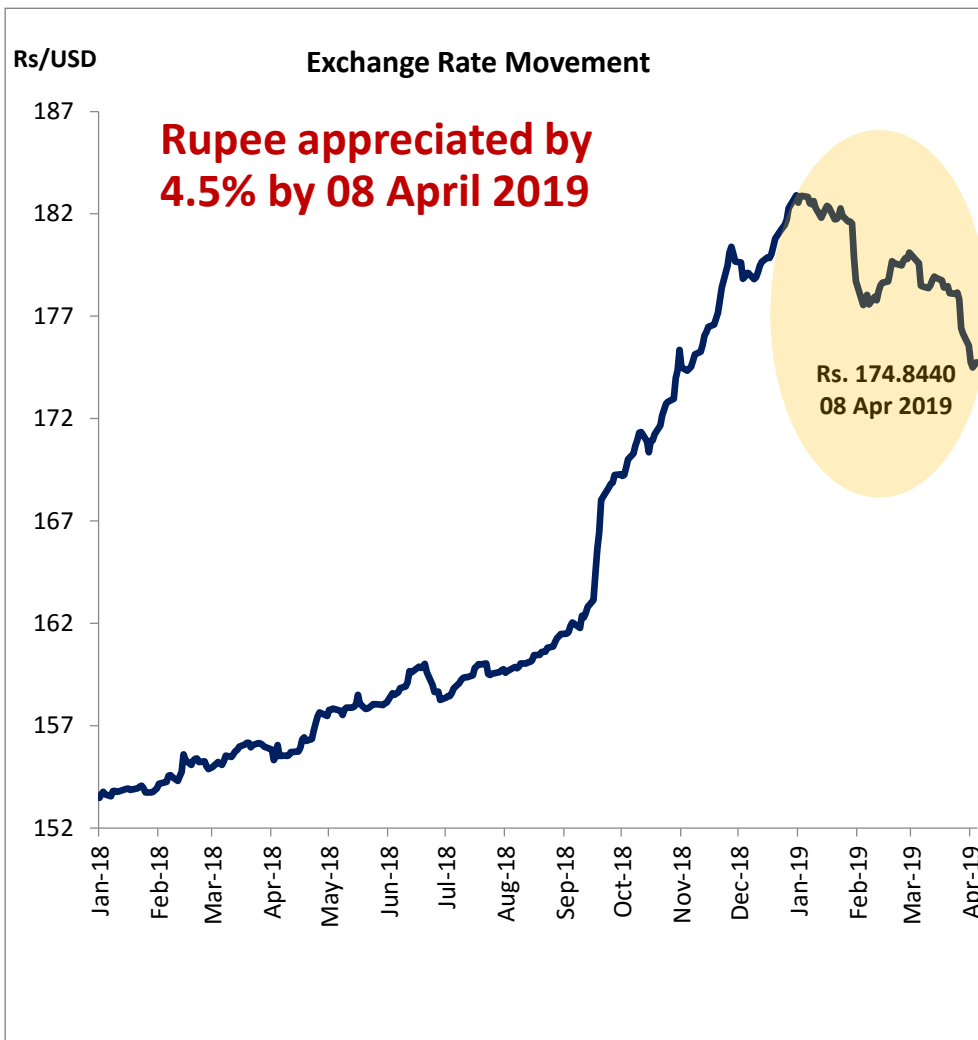
- The Central Bank purchased foreign exchange over USD 150 mn on a net basis so far in 2019 (2018: net sales of USD 1,120 mn)
- Gross Official Reserves, recorded at USD 6.0 bn at end Feb 2019, are estimated to have increased to USD 7.6 bn (end March 2019) with the ISB issuance and purchases from the market

Easing trade deficit

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Pressure on the Exchange rate has subsided

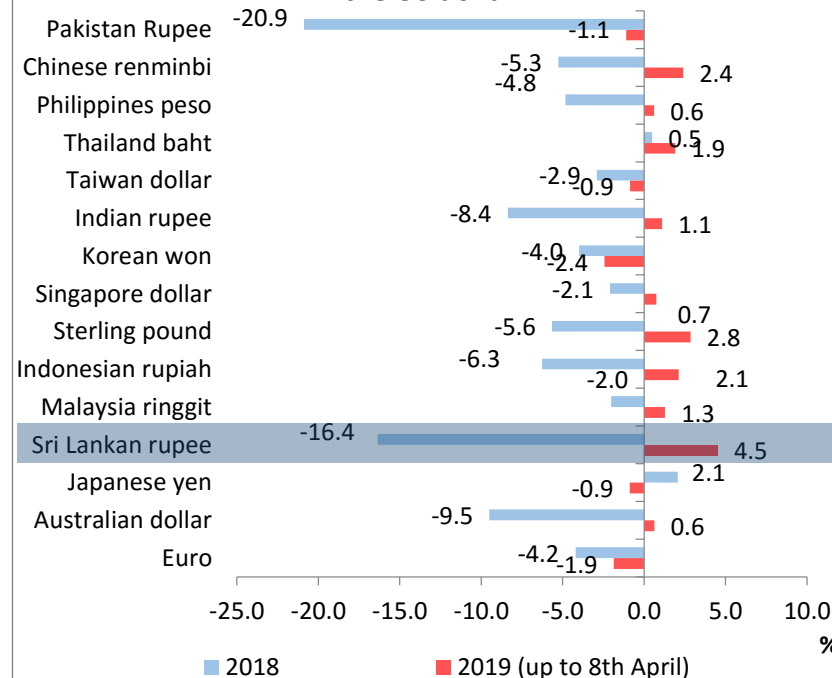
Global monetary Policy tightening put on hold



#### Movement of LKR against Major Currencies

Currency	2018 App(+)/Dep(-)	up to 08 Apr 19 App(+)/Dep(-)
US dollar	-16.4%	4.5%
Pound sterling	-11.4%	1.6%
Euro	-12.7%	6.5%
Japanese yen	-18.1%	5.5%
Indian rupee	-8.7%	3.4%

#### Movement of International Currencies against the US dollar

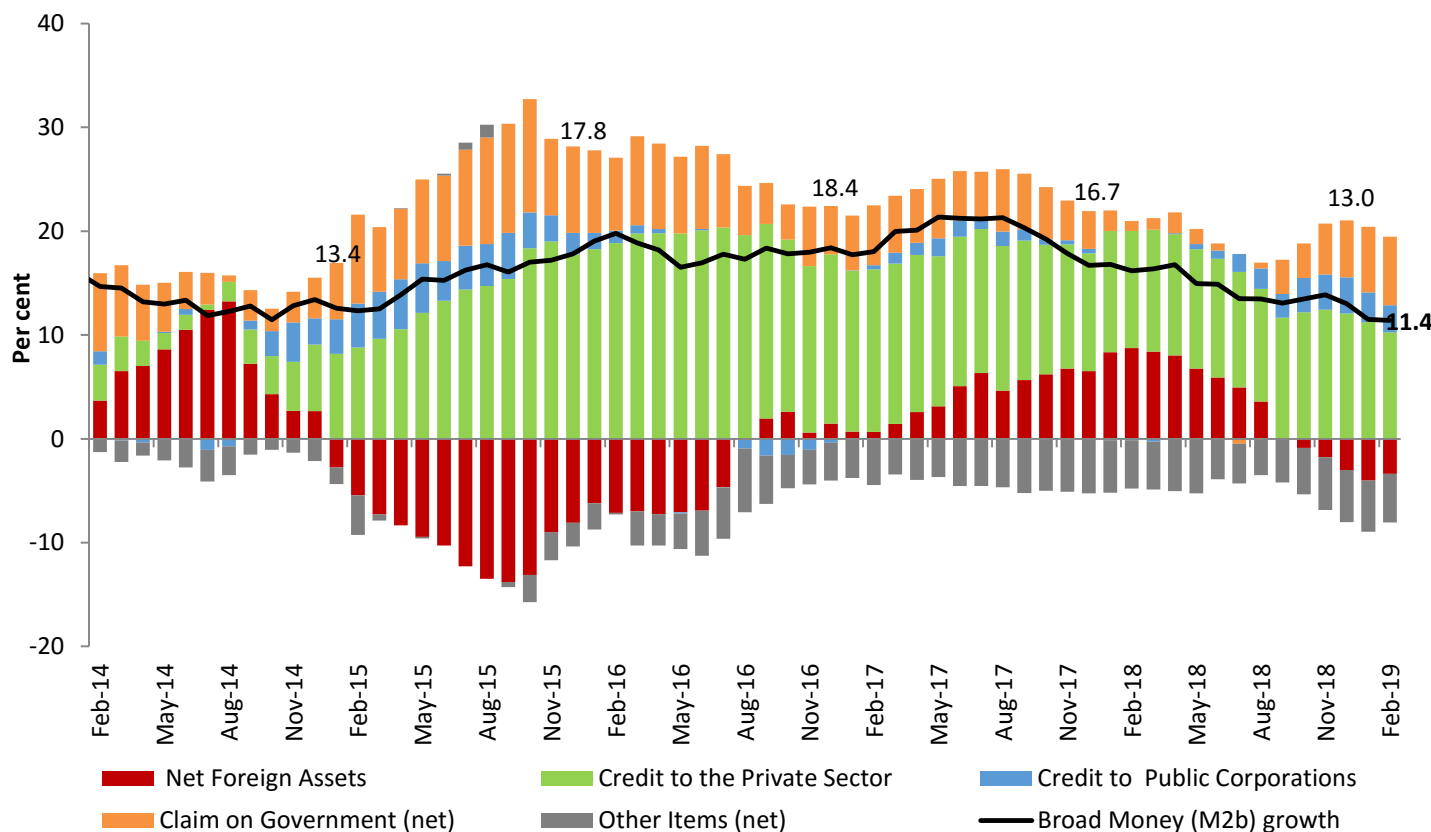


REER indices have moving upwards with the current appreciation of the rupee

# Growth of monetary and credit aggregates decelerated

- Broad money ( $M_{2b}$ ) growth decelerated to 11.4% (y-o-y) in Feb 2019 (11.5% in Jan 2019) from 13.0% in Dec 2018 with the contraction in NFA of the banking sector as well as the decline in credit to the private sector

Contribution to Year-on-year growth of Broad Money ( $M_{2b}$ )

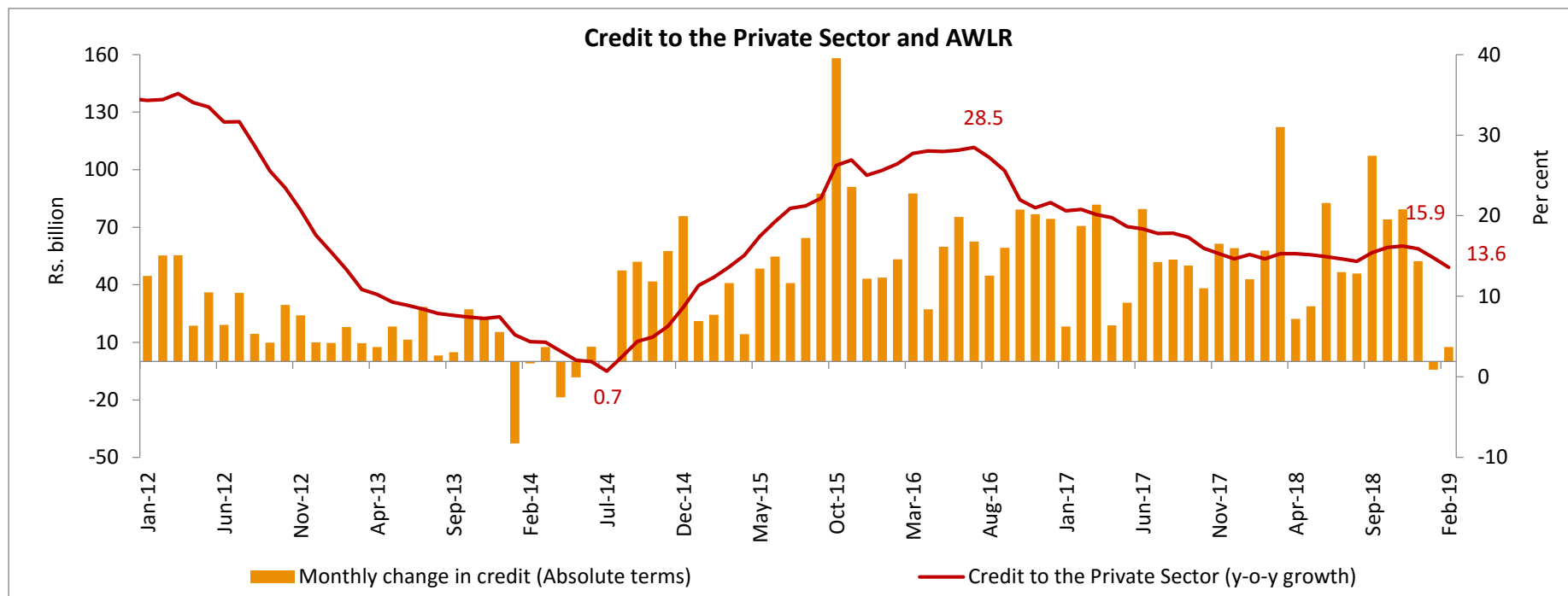


- Net Credit to the Government increased by Rs 156 bn during the first two months of 2019
- Credit to public corporations decreased by Rs. 40.6 bn during the first two months of 2019

**Broad money growth is expected to be around 12.0% in 2019**

# Amidst high market interest rates, growth of credit extended to the private sector decelerated during the first two months of 2019...

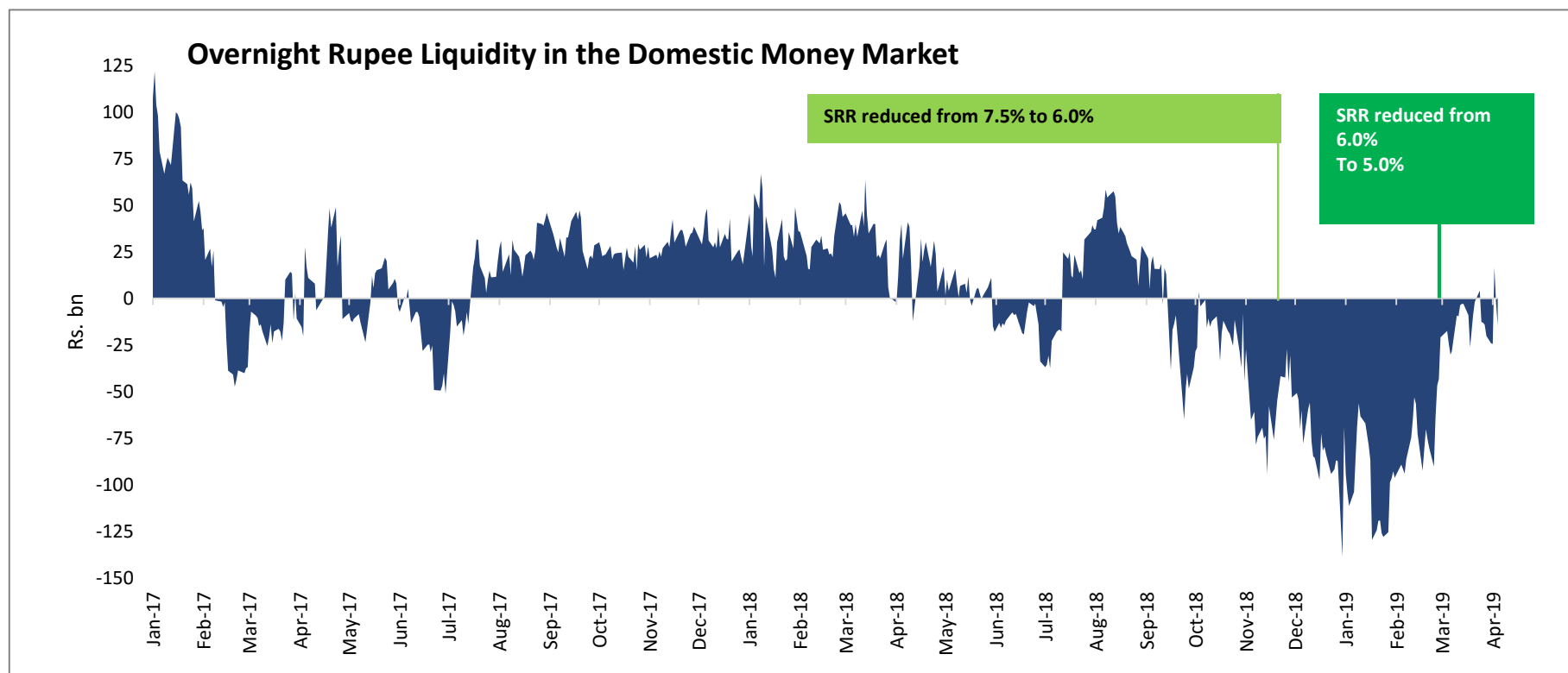
- Private sector credit recorded a repayment of Rs. 4.3 bn in Jan 2019 followed by a marginal increase of around Rs. 7.6 billion in February 2019
- Private sector credit grew by 13.6% (y-o-y) in Feb 2019 in comparison to 14.8% (y-o-y) in Jan 2019



- Credit to the private sector is expected to increase by around 13.5% in 2019 (an increase of around Rs. 750 bn during the year)

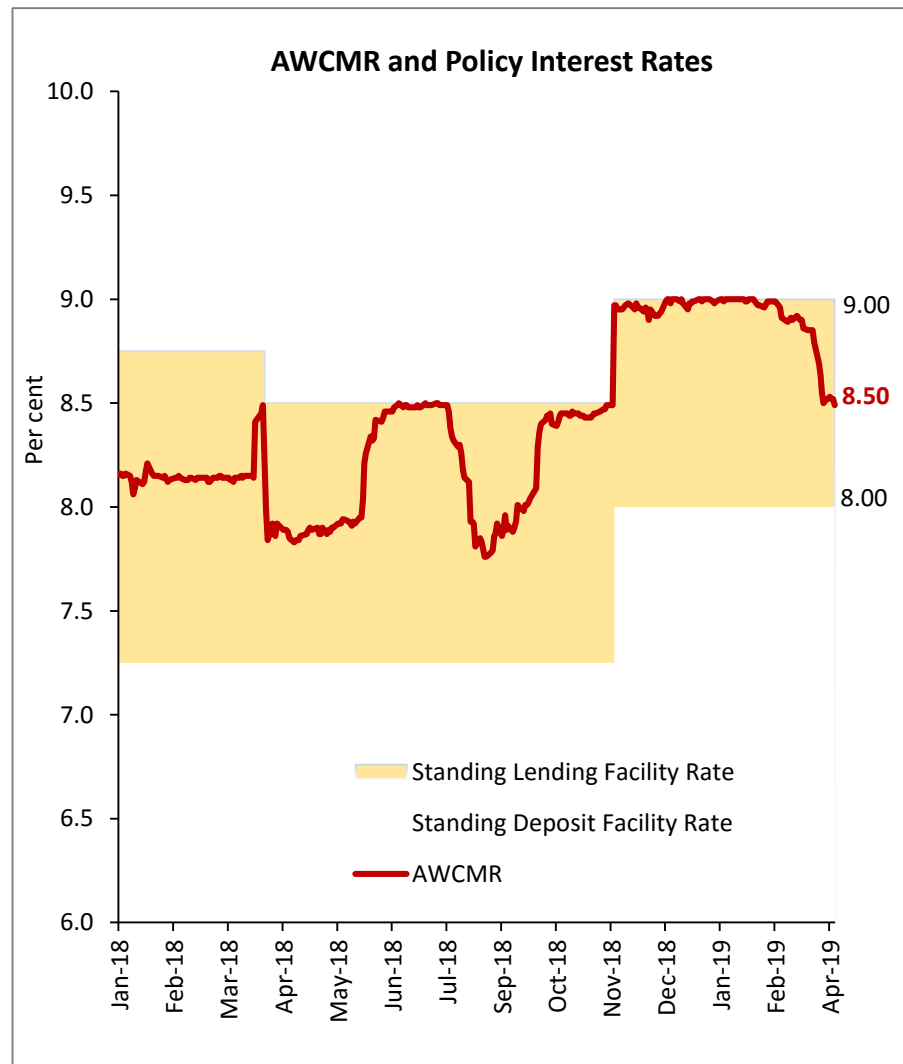
# Overnight rupee liquidity in the domestic money market that was in deficit since mid-Sep 2018 is currently at a balance level on average..

- SRR reductions in Nov 2018 and Mar 2019 released around Rs. 150 bn liquidity to the market on a permanent basis

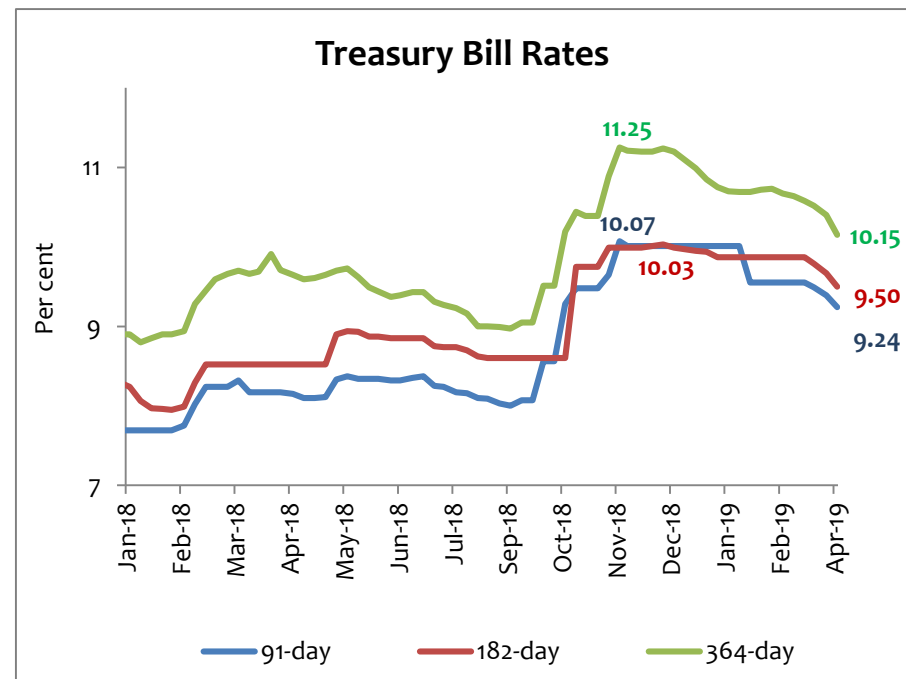


**Operationally, the Central Bank continued to provide required liquidity to the market on overnight, short term and long term bases**

# AWCMR has declined from the upper bound to the middle of the policy rate corridor, which is a 50bps reduction in overnight rates...



**With favorable market sentiments amidst the settlement of the matured ISB in January 2019, receipt of the ISB proceeds in March 2019, and improving liquidity, yields on government securities also declined notably so far in 2019**

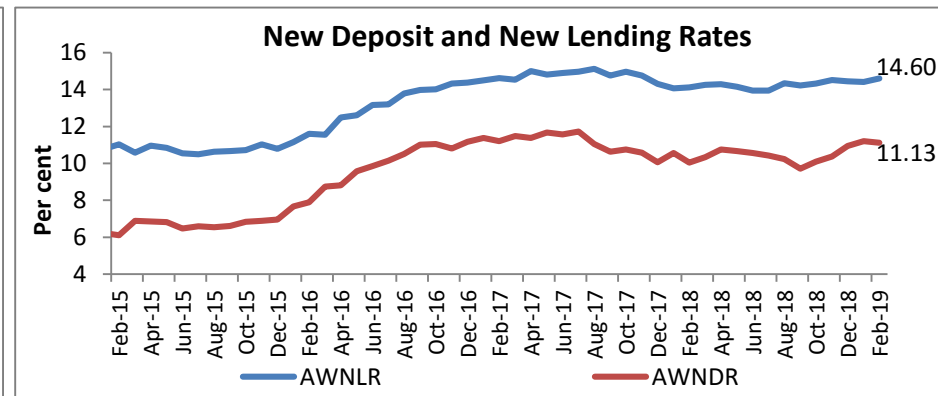
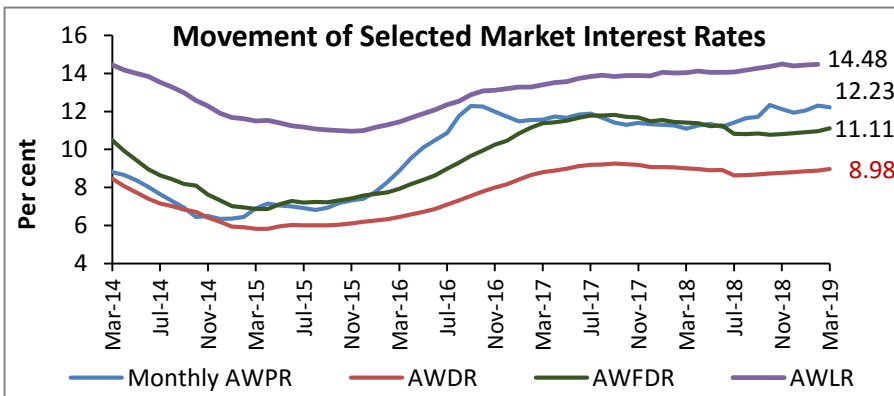
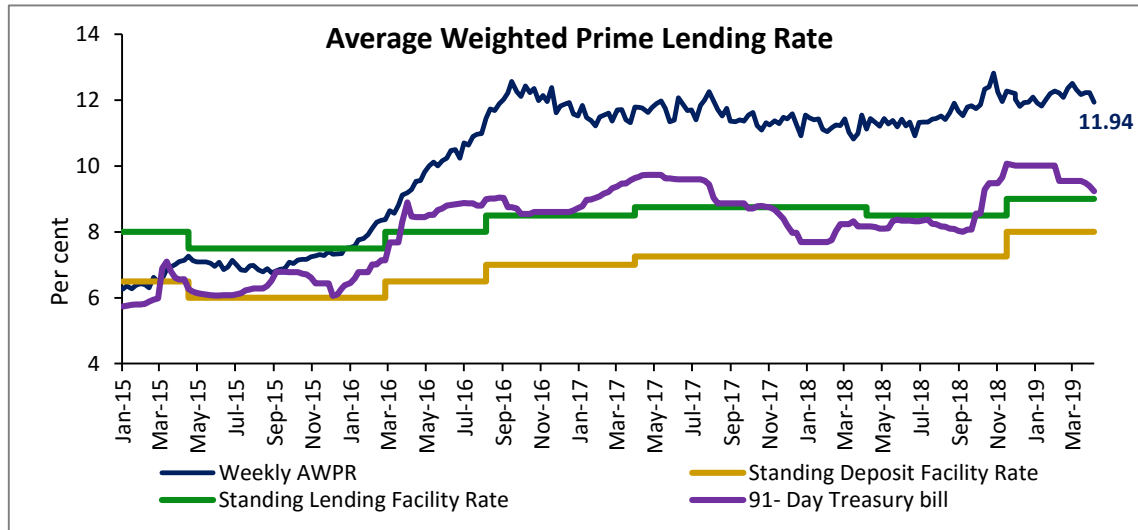




# Other market interest rates are yet to respond to the sizable liquidity injections and the reduction in AWCMR...

Adjustments in Interest Rates		
Interest Rate	2018	So far in 2019
	bps Change	bps Change
AWCMR	80	-45
91-day T-bill	232	-77
182-day T-bill	169	-49
364-day T-bill	230	-105
Weekly AWPR	54	-15
Monthly AWPR	61	29
AWLR	52	8
AWNLR	13	16
AWDR	-26	17
AWNDR	88	19
AWFDR	-63	26

However, AWPR declined by 29bps during the week ending 05 April 2019



With inflation being contained below 5%, real interest rates are also at substantially high levels

# Summary

- With recent monetary policy and operational actions, there is space for market interest rates to reduce
- The reduced short term rate structure must get transmitted to other market interest rates
- In this context, the Central Bank will consider and implement mechanisms for more effective transmission of the recent decline of the benchmark rates to other market interest rates

**In view of the above the Monetary Board decided to maintain policy interest rates at their current levels.**

**The Board was also of the view that, if the current trends in the global financial markets, trade balance, and credit growth continue, policy interest rates could be reduced in the period ahead, given well anchored inflation and inflation expectations**

**Thank you**