PRESS RELEASE
Communications Department, 30, Janadhipathi Mawatha, Colombo 01, Sri Lanka
+94 11 2477424 / +94 11 2477669 +94 11 2346304
communications@cbsl.lk / dcommunications@cbsl.lk www.cbsl.gov.lk

ශ්‍රී ලංකා මහ බැංකුව
இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

Issued By Economic Research Department
Date 28 May 2024

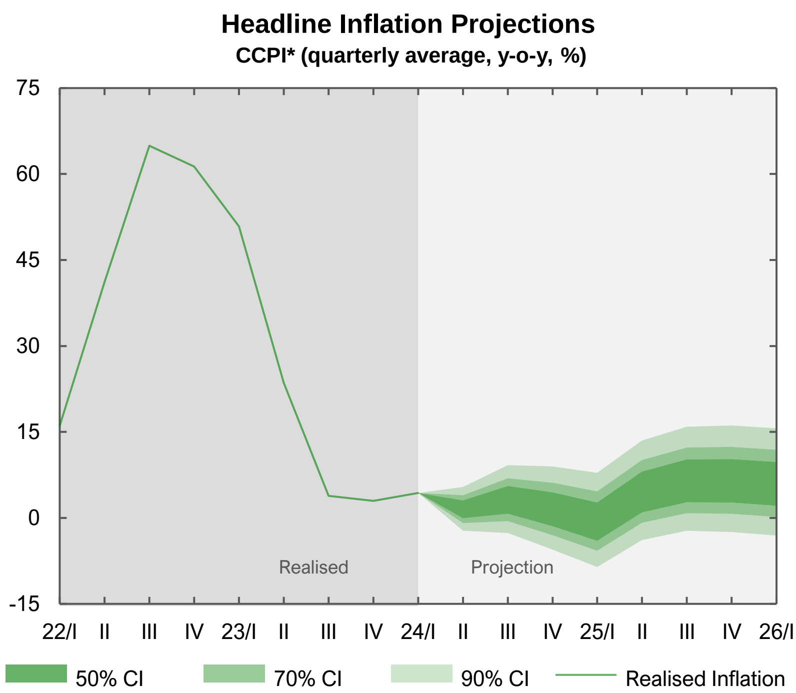
Monetary Policy Review: No. 03 - May 2024

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

The Monetary Policy Board of the Central Bank of Sri Lanka, at its meeting held on 27 May 2024, 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 8.50 per cent and 9.50 per cent, respectively. The Board arrived at this decision after carefully assessing the current and expected macroeconomic developments and possible risks on the domestic and global fronts with a view to maintaining inflation at the targeted level of 5 per cent over the medium term while supporting the economy to reach its potential. While the medium term inflation outlook remains compatible with the current level of policy interest rates and inflation expectations are well anchored, the Board observed the need for a further reduction in market lending interest rates in line with policy interest rates and other benchmark interest rates, which is imperative for the easing of domestic monetary conditions and domestic economic recovery.

Headline inflation is expected to converge to the targeted level over the medium term, despite transitory volatilities

Headline inflation, as measured by the year-on-year change in the Colombo Consumer Price Index (CCPI, 2021=100), showed some uptick to record 1.5 per cent in April 2024 compared to 0.9 per cent in March 2024, mainly due to an acceleration in non-food inflation. However, on a month-on-month basis, both food and non-food prices declined. Recent movements in inflation indicate that the uptick in inflation driven by the Value Added Tax (VAT) amendments in January 2024 has been partly offset by the latest price developments underpinned by the downward revisions to the electricity tariff, and fuel and LP gas prices. In addition, the moderation in food prices and the muted demand conditions also contributed to the low level of inflation. Meanwhile, core inflation, which reflects underlying demand pressures in the economy, also remained at subdued levels reflecting low demand pressures in the economy. Incoming data suggests that headline inflation is likely to be below the targeted level of 5 per cent in the upcoming months due to the combined impact of the administered price adjustments and eased food prices, although some upside risks remain. However, inflation is expected to eventually align with and remain around the target level over the medium term, supported by appropriate policy measures.



Source: *Central Bank Staff Projections*

* Realised data up to Q4 2022 shown in the fan chart are based on CCPI (2013=100, seasonally adjusted), while data after this period are based on CCPI (2021=100, seasonally adjusted). Projections are based on all available data at the forecast round in May 2024.

Note: 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 May 2024. 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 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.

There are upside risks to inflation projections stemming from factors such as the impact of possible upward pressures on global energy prices amidst uncertainty; the impact of adverse weather on agricultural production and in turn on food prices; possible upward revisions to electricity tariff; and any exchange rate depreciation more than the levels considered in the projections. Meanwhile, downside risks to inflation projections include the sustained impact of the diminished purchasing power of the public and the further easing of supply conditions.

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.

A further decline in market lending interest rates is warranted

The overall market interest rate structure has adjusted downwards in response to the monetary policy easing measures implemented thus far. The yields on government securities continued to decline, further aligning with the current level of policy interest rates. With the decline in average deposit interest rates in the banking sector in recent months along with the moderation of benchmark interest rates, further space has been created for overall lending interest rates to adjust downwards in the period ahead. Moreover, elevated interest rates on selected loan products are yet to be adjusted downwards in line with the overall interest rate structure. Flows of credit to the private sector have only recorded a marginal expansion thus far during the year, in spite of the notable monetary policy easing and the improvement in overall liquidity conditions. A further reduction in retail lending interest rates could facilitate the pickup in private sector credit, thereby supporting the ongoing recovery of economic activity.

The external sector strengthened further

As domestic economic activity gathered momentum in recent months, the cumulative merchandise trade deficit is expected to have widened during the four months ending April 2024 compared to the same period in 2023. Buttressed by tourism related inflows, the services sector recorded a notable net inflow in recent months, while workers' remittances remained elevated. Gross official reserves increased notably to US dollars 5.5 billion (including the PBOC[1] swap) by end April 2024, supported by considerable net purchases by the Central Bank from the domestic foreign exchange market amidst increased foreign currency inflows. Meanwhile, the Sri Lanka rupee recorded an overall appreciation of around 8.0 per cent against the US dollar thus far in 2024.

Policy interest rates are maintained at their current levels

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 27 May 2024, was of the view that it is appropriate to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank at their current levels of 8.50 per cent and 9.50 per cent, respectively. The Board noted that there remains space for market lending interest rates to decline further given the prevailing accommodative monetary policy stance and the continued decline in the cost of funds of financial institutions. The Board re-emphasised the need to pass the benefits of eased monetary conditions to the borrowers without further delay. The Monetary Policy Board will continue to observe incoming data and assess

[1] People's Bank of China

risks to the inflation outlook, 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 and SRR unchanged**	
	Standing Deposit Facility Rate (SDFR)	8.50%
	Standing Lending Facility Rate (SLFR)	9.50%
	Statutory Reserve Ratio (SRR)	2.00%

INFORMATION NOTE:

A press conference, chaired by Governor Dr. P Nandalal Weerasinghe, will be held on 28 May 2024 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 on 24 July 2024.

* **Data Annexure** is accessible at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/mpr03_2024_e.pdf