PRESS RELEASE

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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Monetary Policy Review: No. 06 – November 2024

The Central Bank of Sri Lanka introduces the Overnight Policy Rate and further eases its monetary policy stance

The Monetary Policy Board of the Central Bank of Sri Lanka, at its meeting held on 26 November 2024, decided to further ease the monetary policy stance and set the newly introduced Overnight Policy Rate (OPR) at 8.00 per cent. With this change, the effective reduction in the policy interest rate would be around 50 basis points from the current level of the Average Weighted Call Money Rate (AWCMR), which continues to serve as the operating target of the Flexible Inflation Targeting (FIT) framework.

The Board arrived at the decision to ease the monetary policy stance following a comprehensive assessment of current and expected domestic and international economic developments, including risks and uncertainties, to ensure that inflation treads towards the inflation target of 5 per cent, while supporting the economy to reach its full capacity. In particular, with the latest available incoming data, the critical factors that convinced the Board to further ease monetary policy were the deeper-than-expected deflation conditions in the near term with further moderation of underlying inflationary pressures and inflation expectations, better-than-expected developments on the external front, and the lack of further space available for a reduction in market lending rates.

Introduction of Overnight Policy Rate (OPR)

Effective 27 November 2024, the Central Bank also moved to a single policy interest rate mechanism from its dual policy interest rate mechanism. Accordingly, the Overnight Policy Rate (OPR), set at 8.00 per cent, will serve as the primary monetary policy tool of the Central Bank to signal and operationalise its monetary policy stance henceforth. Moreover, with this transition to the single policy interest rate mechanism, the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) will no longer be considered policy interest rates of the Central Bank.[1]

[1] For more details on this transition, refer the Press Release on *"The Central Bank of Sri Lanka moves to a Single Policy Interest Rate Mechanism by Introducing the Overnight Policy Rate"* and the underlying Concept Note, which can be accessed on https://www.cbsl.gov.lk/sites/default/files/concept_note_on_opr_e.pdf

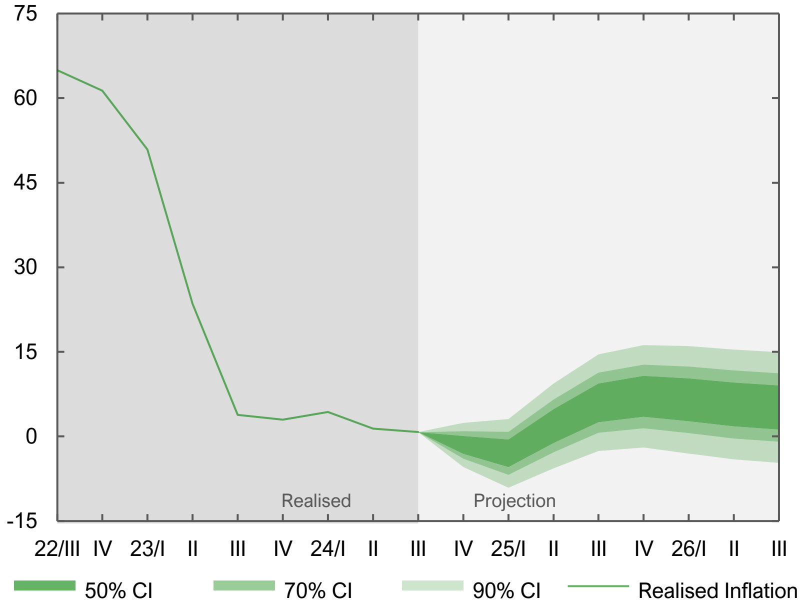
SDFR and SLFR, the rates applicable for standing facilities that will continue to be available for participatory institutions for overnight transactions with the Central Bank, are linked to the OPR with a margin of ± 50 basis points. Accordingly, SDFR and SLFR will be 7.50 per cent and 8.50 per cent, respectively.

Headline inflation is projected to remain negative in the near term

Headline inflation, as measured by the year-on-year change in the Colombo Consumer Price Index (CCPI), which turned negative in September, remained in the negative territory in October 2024. This was driven by the previous downward revisions to electricity tariffs and domestic fuel prices, and the softening of volatile food prices, amid subdued demand pressures. Core inflation,

Headline Inflation Projections*: (Quarterly, CCPI, Y-o-Y, %)

Based on the Projections during the November 2024 Monetary Policy Round



Source: *Central Bank Staff Projections*

* 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).

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 November 2024. They are conditional on the forecasts of global energy and food prices; the expected growth trajectory 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 possible upward pressures on global food and energy prices amidst geopolitical uncertainty; possible realisation of demand for higher wages; possible adverse weather conditions affecting agricultural production; any deviation from the envisaged fiscal consolidation path; possible rupee depreciation at higher levels; and possible sticky global inflation due to the policy changes in the USA. Meanwhile, downside risks to inflation projections include, among others, the possible price reductions of essentials; the sustained impact of diminished purchasing power of people.

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.

which reflects underlying demand conditions in the economy, also moderated. Latest projections reveal that headline inflation will remain negative in the forthcoming months, deeper than previously projected, mainly due to the effects of larger downward adjustments in fuel prices and transport costs and the reduction in volatile food prices. However, inflation is expected to turn positive from mid-2025 and gradually converge towards the targeted level of 5 per cent over the medium term, supported by appropriate policy adjustments. While core inflation is projected to slow further over the next few months, a reversal of this trend is expected with core inflation stabilising over the medium term. Meanwhile, inflation expectations appear to have further moderated since the previous monetary policy review.

Market interest rates have declined and broadly stabilised

Market interest rates, which declined over time in response to the accommodative monetary policy stance, have largely stabilised. Supported by reduced market lending interest rates, credit extended to the private sector by Licensed Commercial Banks (LCBs) continued to expand notably since May 2024. Sectoral data for Q3-2024 on credit to the private sector also display broad-based growth across all major economic sectors. The expansionary momentum of credit to the private sector is expected to continue, underpinned by favourable market lending interest rates, the anticipated expansion of domestic economic activity and improving sentiments. Meanwhile, the pressure observed in yields on government securities has also eased to some extent owing to improved fiscal performance, benign inflation outlook, and overall stable economic conditions.

The external sector outlook turned more favourable

A larger expansion in import expenditure relative to export earnings drove the merchandise trade deficit to widen in the nine months ending September 2024 compared to the same period in 2023. However, improvements in earnings from tourism and workers' remittances during this period, contributed positively to the external current account. The Sri Lanka rupee recorded a year-to-date appreciation of around 11.0 per cent against the US dollar. With significant purchase of foreign exchange from the domestic market by the Central Bank and multilateral fund inflows, Gross Official Reserves (GOR) stood at US dollars 6.5 billion (including the swap facility from the People's Bank of China) as of end October 2024. Meanwhile, the Sri Lankan authorities reached a staff-level agreement on the third review of the Extended Fund Facility with the International Monetary Fund (IMF-EFF). The continuation of the IMF-EFF programme, the expected finalisation of the debt restructuring process and continued financial support from multilateral and bilateral development partners will further enhance external sector resilience and investor confidence, amidst the country's attempts to enhance non-debt creating inflows.

The monetary policy stance is eased further to induce additional impetus to domestic economic activity

In consideration of the current and expected macroeconomic developments including those highlighted above, the Monetary Policy Board of the Central Bank of Sri Lanka, at its meeting held on 26 November 2024, decided to ease the monetary policy stance further and set the Overnight Policy Rate (OPR) at 8.00 per cent, compared to the current level of AWCMR around 8.50 per cent. While the Board is satisfied with the outcomes of accommodative monetary policy measures adopted thus far, the stabilisation of market lending interest rates at current levels amidst a deflationary environment presents the Central Bank with the opportunity to carefully effect further policy easing. This could stimulate demand, support domestic economic activity and help retrace inflation towards its target over the medium term. The decision to ease the monetary policy stance further is also supported by improving external sector resilience, while the Board also took comfort in the continuation of fiscal consolidation. That said, the Board will continue to closely monitor the macroeconomic developments and adopt a data-driven approach to ensure that it stays on course to achieve the inflation target of 5 per cent over the medium term, while supporting the economy to reach its potential.

Monetary Policy Decision	**Overnight Policy Rate (OPR)**	**8.00%**
	Statutory Reserve Ratio (SRR)	*2.00%*

INFORMATION NOTE:

A press conference, chaired by Governor Dr. P Nandalal Weerasinghe, will be held on 27 November 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, which will be the first review for the year 2025, will be announced in due course.

* **Data Annexure** is accessible at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/mpr06_2024_e.pdf