P Nandalal Weerasinghe: Monetary and financial sector policies for 2024 and beyond

Annual policy statement by Dr P Nandalal Weerasinghe, Governor of the Central Bank of Sri Lanka, Colombo, 10 January 2024.

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1. Economic Performance in 2023

The Sri Lankan economy started showing signs of gradual recovery during the latter part of 2023. Positive economic growth was recorded by the Sri Lankan economy in the third quarter of 2023, following consecutive contractions since the first quarter of 2022. Leading economic indicators signal the continuation of the strong pace of activity during the last quarter of 2023.

Inflation, which accelerated to unprecedented levels in 2022, was brought down to single-digit levels within a period of one year. Despite the historically high level of inflation in September 2022, the price escalation was quickly reined in and entered an impressive disinflation path thereafter, eventually bringing inflation down to the targeted levels within a period of one year. Sri Lanka's swift disinflationary process was supported by an array of policy measures implemented by both the Central Bank and the Government. Meanwhile, core inflation, which reflects the underlying demand pressures in the economy, also recorded steady disinflation during 2023.

Inflation expectations have been anchored around the targeted levels. Extensive policy measures aimed at restoring confidence and stability in the economy, though painful in the near term, have helped stabilise inflation expectations, which remained largely de-anchored during 2022.

The credible deceleration of inflation and well-anchored inflation expectations within the targeted range allowed the Central Bank to begin its monetary policy easing cycle in mid 2023. The Central Bank commenced the relaxing of its monetary policy stance in June 2023 in view of the deceleration of inflation, benign inflation expectations, stable inflation outlook, and improvements observed in the external sector. As a result of the monetary policy easing measures and administrative measures, market interest rates declined significantly, particularly deposit interest rates. Market lending interest rates also declined, albeit at a slower pace, partly contributed by the rigidity in the yields on government securities amidst the high risk premia.