AMBEON SECURITIES

Central Bank of Sri Lanka relaxes restrictions on standing facility for LCBs

Key highlights

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The Central Bank of Sri Lanka has relaxed restrictions on Licensed Commercial Banks (LCBs) on the Standing Facilities under Open Market Operations (OMOs) in an effort to bring down market interest rates. Despite previous reductions in the central bank's policy rates, market rates have not fallen proportionally. The relaxation is aimed at accelerating the decline in market interest rates. The changes involve removing restrictions on the Standing Lending Facility (SLF) and easing restrictions on the Standing Deposit Facility (SDF) from five times (5x) to ten times (10x) per calendar month, starting from February 16, 2024.

The Central Bank's assessment indicates positive outcomes from the restrictions, such as reactivating the domestic money market, curbing excessive competition for deposit mobilization, and moderating the market interest rate structure. Overall, the move is expected to align with the Central Bank's monetary policy direction and contribute to the stability of financial institutions and the financial system in Sri Lanka. See below the impact of this decision on various economic aspects.

Increased Access to Standing Facilities

LCBs will now have increased access to the Standing Facilities, specifically the Standing Lending Facility (SLF) and the Standing Deposit Facility (SDF). The removal of restrictions on SLF and the easing of limits on SDF mean that LCBs can engage more freely in these facilities, providing them with additional liquidity support from the Central Bank.

Cost of Funds

With easier access to the Standing Facilities, LCBs may experience a reduction in their cost of funds. This can positively impact their profitability as they can obtain funds at a lower cost, which may, in turn, influence the interest rates they offer to customers.

Market Interest Rates to Decline

The central objective of the relaxation is to accelerate the fall of market interest rates. LCBs are likely to benefit from lower market interest rates, which can positively impact their borrowing and lending activities. This, in turn, can stimulate economic activities and credit expansion.

Downward Pressure on Bond Yields

The primary aim of the relaxation is to accelerate the fall of market interest rates. As LCBs gain easier access to the Standing Facilities, particularly the Standing Lending Facility (SLF), they may have increased liquidity. This influx of liquidity, combined with the overall policy direction to lower market rates, could exert downward pressure on bond yields.

Increased Liquidity for LCBs

The eased restrictions provide LCBs with greater access to Standing Facilities, such as the Standing Lending Facility (SLF). This increased liquidity can enable LCBs to expand their lending activities, including providing more credit to private borrowers.

Private sector credit growth

The combination of increased liquidity and lower interest rates creates a more favorable environment for borrowers. This could lead to a higher demand for credit from private individuals and businesses looking to finance various activities, such as investments, expansions, or working capital needs.

Enhanced Market Participation

The increased flexibility in accessing Standing Facilities may encourage LCBs to actively participate in the market, contributing to the overall liquidity and efficiency of the domestic money market.

Investor Confidence

A more accommodative monetary policy, as reflected in the relaxation of restrictions, could enhance investor confidence in the domestic market. Positive investor sentiment may attract foreign capital, potentially affecting the exchange rate.

Source: CBSL, Press Releases

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