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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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An Explanatory Note on Central Bank of Sri Lanka's Open Market Operations (OMOs) and Money Printing

There have been recent claims in the media that the Central Bank of Sri Lanka (CBSL) has "printed" Rs. 100 billion on 25 October 2024, through its Open Market Operations (OMOs). It is important to clarify that these claims are not accurate and are baseless. The liquidity (money) injected through OMOs is a routine central banking function aimed at managing adequate liquidity in the banking system for the purpose of stabilizing the short-term interest rates in the economy and ensuring price stability, and hence it should not be grossly misinterpreted as "money printing."

What is Money Printing?

“Money printing” generally means issuing new money to the economy and in economic terms, new money issued by a central bank is known as ‘reserve money’ or ‘base money’. Reserve money is also called the ‘monetary base’ of the country (or high-powered money), as the commercial banks can create more money based on the money issued by the central bank. Reserve money is also treated as the monetary liabilities of a central bank and this is reflected in the liability side of the central bank balance sheet, which includes total currency issued by the central bank and the commercial banks' deposits with the central bank. During 2024, reserve money issued by the CBSL has only increased by about Rs. 147 billion, which is an adequate amount to facilitate transactions in the economy. During 2024, reserve money increase was an outcome of significant purchases of foreign currency by the CBSL, while there has been a reduction in the stock of government securities held by the CBSL.

One of the determining factors of new money issued to the economy by the CBSL in the past was purchasing Treasury bills by the CBSL directly from the primary market. However, with the introduction of the Central Bank of Sri Lanka Act, No. 16 of 2023, which came into effect in September 2023, the CBSL is now prohibited from printing money through the purchase of government securities in the primary market to fund the government.

Purpose of OMOs:

The main objective of the CBSL is to maintain domestic price stability, which means keeping inflation low and stable. Monetary policy, which is the strategy that a central bank manages interest rates and the money supply, is used to maintain price stability. The OMOs are a key instrument of monetary policy of a central bank. Currently, the CBSL relies on market-based policy instruments to implement monetary policy effectively, and hence one of the primary tools used in this process is the OMOs.

Under the OMOs, the CBSL provides liquidity to the commercial banks for the purpose of preventing sudden changes in the interest rates that can destabilize the economy.

Therefore, OMOs are a tool used by the CBSL to maintain stability in short-term interest rates, specifically the interbank call money rates. The CBSL conducts market operations to manage liquidity to ensure stability in the short-term interest rates.

OMOs are carried out through auctions involving the purchase or sale of government securities on either a temporary or permanent basis from the secondary market. Therefore, OMOs are predominantly short-term operations that help in managing liquidity imbalances in the banking system. During 2024, the liquidity injections by the CBSL are mostly overnight (1 day) or for 7 days. These operations were used as temporary liquidity injecting measures aimed at stabilizing the financial system by managing upward pressure on interest rates, and thereby ensuring smooth functioning of the economy and cannot merely be interpreted as money printing.

Furthermore, central banks worldwide regularly conduct similar operations to manage liquidity conditions. These are routine and standard actions carried out by central banks in liquidity management under monetary policy implementation.

Current Context:

During 2024, the CBSL has conducted frequent liquidity injections due to persistent liquidity asymmetries, despite the prevailing surplus in the banking system. Although the money market operates with surplus liquidity, this surplus is unevenly distributed among commercial banks, creating liquidity needs for domestic banks, for their day to day operations, including lending to the customers. Certain commercial banks have faced severe liquidity shortfalls due to stricter exposure limits for interbank transactions following the sovereign credit rating downgrade. Money market lending by the foreign banks operating in Sri Lanka has remained limited, despite their significant liquidity surplus, due to the strict exposure limits. Hence, the CBSL’s liquidity injections have addressed these shortfalls, ensuring that short-term interest rates, especially the call money rates remain stable.

Without such interventions by the CBSL, short-term interest rates could have increased sharply, disrupting the broader economy and affecting the CBSL's ability to meet its inflation target.

Conclusion:

The above-mentioned media reports have misinterpreted the auctions and monetary operations conducted by CBSL as a part of its regular Open Market Operations. There has been no “money printing” or issuance of liquidity to finance the government’s budget by the CBSL. These actions are part of the standard process of monetary operations aimed at achieving the CBSL’s objective of price stability.