

**(E) CENTRAL BANKING**

The Central Bank's assets/liabilities increased by Rs. 441.2 million or 17.5 per cent during the year review. The expansion in assets consisted of an increase of Rs. 466.0 million in domestic assets offset to the extent of Rs. 24.9 million by the decline in the international reserve. On the liabilities side, a rise of Rs. 149.5 million in deposits of international organisations, foreign government and foreign banking institutions offset by a decline of Rs. 28.6 million in borrowings from banks abroad resulted in a net increase of Rs. 120.9 million in external liabilities. The currency issue of the Central Bank rose by Rs. 109.1 million. Deposits of the Government increased by Rs. 42.4 million, while deposits of commercial banks decreased by Rs. 4.5 million.

The expansion of the domestic assets of the Central Bank was mainly on account of an expansion of credit to the Government. There was a rise of Rs. 37.5 million in advances to the Government in addition to the increase of Rs. 269.4 million in the Central Bank's holdings of government and government guaranteed securities. Advances to commercial banks declined by Rs. 12.8 million.

**Credit Policy**

With the objective of curbing the emergence of inflationary pressures, the Central Bank has been following a credit policy which was generally restrictive in regard to overall monetary expansion but suitably modified so as to permit the flow of credit to essential and productive sectors of the economy. The need to keep inflationary pressures in check was even greater in 1968 in view of the record increase in bank credit to the private sector during the year. Monetary policy had to be reoriented to the needs of the monetary situation that was developing after the devaluation of November 1967 and the subsequent measures of exchange reform introduced in May 1968. The Central Bank therefore found it necessary to continue and, in certain respects, strengthen the restrictive policy which was already in force.

During the first five months of the year commercial bank credit to the private sector increased by an amount which was equal in magnitude to the increase in each of the two previous years. Although part of this increase was seasonal or temporary and was expected to be reversed within the next few months, an underlying longer-term trend of an expansionary character was also discernible. On the 6th May, therefore, when the Foreign exchange Entitlement Certificate Scheme was introduced, the Bank Rate was raised from 5 per cent to  $5\frac{1}{2}$  per cent. A resurgence of credit expansion was expected towards the end of the year. The Central Bank did not consider it necessary to resort to new methods of control but to redefine the ceilings on commercial bank credit with reference to a more realistic base date.

The Central Bank therefore fixed new ceilings limiting the increase in specified forms of commercial bank advances to 8 per per cent of their level at the end of August or September according to whichever was higher. This ceiling was to be effective initially from the beginning of October to the end of December and

applied to loans, overdrafts, import bills and local bills, but excluded export bills, loans under the new Agricultural Credit Scheme, advances to government corporations and loans under the tea factory modernisation project. Banks were also allowed to increase pre-shipment credits for exports by a further 7 per cent over the total credit as at the base date. Up to the end of December, banks as a whole were in a position to keep credit expansion within the prescribed limits.\*

### Medium and Long-term Credit Fund

The Medium and Long-term Credit Fund created by the Central Bank in 1965 was augmented by a credit of Rs. 20 million in the course of the year under review. The total of refinance loans granted from this Fund during the year, at Rs. 5.2 million, was somewhat higher than in the previous year. Refinance facilities availed of by commercial banks were much larger than in earlier years; they amounted to Rs. 2.3 million and were entirely in respect of loans granted for tea factory development. Other credit institutions obtained less re-finance loans than in the previous year. These were in respect of loans to the private sector industries and amounted to Rs. 3.0 million.

The outstanding amount of refinance loans so far granted under the scheme was Rs. 9.6 million at the end of December, 1968.

### Banking Development

Reference was made in the Annual Report for 1967 to the need to reorganise the institutional framework for mobilising savings, and in that connection it was mentioned that proposals were under consideration for the establishment of a National Savings Bank. The proposals were finalised in the course of 1968 and the draft Bill is now under consideration by the Government.

Further progress was made in regard to the proposals to reorganise the Government-owned long-term finance institutions the Ceylon State Mortgage Bank and the Agricultural & Industrial Credit Corporation. These proposals were intended to enlarge the scope of activities of these two institutions and to enable them to obtain refinance facilities from the Central Bank, so as to equip them to meet the increasing needs of development. With regard to the State Mortgage Bank, the amendments proposed by the Central Bank have already been passed by Parliament in 1968 (Act No. 33 of 1968).

Further steps were taken to amend the People's Bank Act consequent on the recommendations of the People's Bank Commission. It is intended to widen the scope of activities of the Bank in certain fields so as to enable it to participate more effectively in economic development.

The proposal made by the Central Bank in 1967 for the introduction of a scheme of deposit insurance was taken up with the Ministry of Finance. The scheme as originally proposed was to be a compulsory one so as to spread the

\* In January 1969 the operation of the ceilings was extended for a further period of six months with certain modifications

risks on as wide a basis as possible; but in view of representations made to the Ministry of Finance, it was modified to give banks the option of joining the scheme. In view of the possibility of using the People's Bank's branch expansion programme and its rural banking scheme for the rapid mobilisation of rural savings, steps are being taken to finalise this scheme at an early date.

In 1968 the Central Bank had under active consideration a proposal to establish a development bank as subsidiary of the Central Bank. This bank is expected to supplement the operations of the existing long-term financial institutions by providing promotional services and financial assistance where other institutions are unable to give the necessary assistance due to such factors as the size of a project or the risks involved in the period of gestation. This proposal has now been approved in principle by the Government.