

Impact of Central Bank Repurchase and Reverse Repurchase Rates Changes on Inter-bank Call Money Market in Sri Lanka

S. N. B. M. W. Narayana¹ and Y. K. Weerakoon Banda²

The Central Bank of Sri Lanka is responsible for monetary management of the country so as to achieve its basic objectives. In order to do so, the Central Bank formulates and executes monetary policy. Monetary policy involves policies that affect the cost and availability of money. The Central Bank possess a wide range of tools to be used as instruments of monetary policy. Open Market Operations are one such among many others. Under open market operations, the Central Bank may purchase or sell government or government guaranteed securities in the open market to control the market liquidity.

In order to develop open market operations and to stabilize the highly volatility in call market rates, the Central Bank introduced the sale of Treasury bills under Repurchase Agreements (Repos) and Reverse Repurchase Agreements (Reverse Repos) for secondary market transactions and those rates (Policy Rates) have become more important as these rates are more easily controlled by the Central Bank on a daily basis. Inter-bank call money market participants are the immediate respondents to the Open Market Operations (OMO) and accordingly, the participants in call money market adjust their rates on the announcement of the Repo and Reverse Repo rate announcements, which lead to a change in interest rate scenario in the market.

The objectives of the study are, to examine whether the monetary policy of CBSL is efficiently implemented by using the CBSL instruments like Repo and Reverse Repo rates (Policy Rate), and to check whether the changes in the Repo and Reverse Repo rates have an effect upon the inter-bank call money market behavior and study the relationship between them. The study is significant as to the extent of the validity of the signaling mechanism of the CBSL. To examine the effects on the call money market upon the changes in the CBSL Repo and Reverse Repo announcements, the Event Study methodology has been employed and to test significance of the results (changes in interest rates) T test has been employed. In collocating data, the Repo announcements have been collected from the CBSL and the inter-bank call money rates have been collected from dealers of various commercial bank treasuries.

The results conclude that the announcements of Repo and Reverse Repo rates changes affect call money market rates and these changes appear to signal unanticipated changes in future monetary policy of the country. But the Reverse Repo facility operates in the opposite manner, which indicates a further examination is required. In general the findings support the conclusion that the inter-bank call money market adjust rapidly to information contained in the CBSL official rates changes and 10th ICSSL – Financial Management and New Trend in Sri Lanka

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¹ E-mail: wnarayana@sltnet.lk

² Department of Finance, University of Sri Jasyewardenepura, Sri Lanka Email: weerakon@sjp.ac.lk