

Monthly Economic Update

Know the pulse of the Economy, Market, and Industry

March 2020

Overview

In March the manufacturing and services sectors underwent a record contraction as the country went into a lockdown. The tourism industry grounded to halt as travel restrictions were imposed. Trade sector was also affected due to import restrictions and exchange rate depreciation.

Rising fears and global economic shutdown due to the economic impact of COVID-19 drove the global stock markets off the cliff in March. CSE crashed several times during the month and ASPI lost about 18% on a M-o-M basis. Significant deterioration in value was observed in Transportation, Consumer Durables & Apparel, Telco, and Insurance sector shares.

Continued capital flight triggered the rupee to depreciate by about 4% and lose over USD 400 Mn reserves. The CBSL took several measures to slow down the worsening external position. As investors were rushing to exit, the SLISB prices plummeted. The SLDBs auctions also went massively undersubscribed.

The CBSLs policy cut drove the call rates down by 30bps, and T-bill yields in the primary market by over 40bps. Overnight liquidity peaked around mid-month to about LKR120 Bn and remained above LKR 60 Bn for the most part of the remainder. AWPR fell close to 20 basis points to 9.29% in March amidst loosening monetary policy.

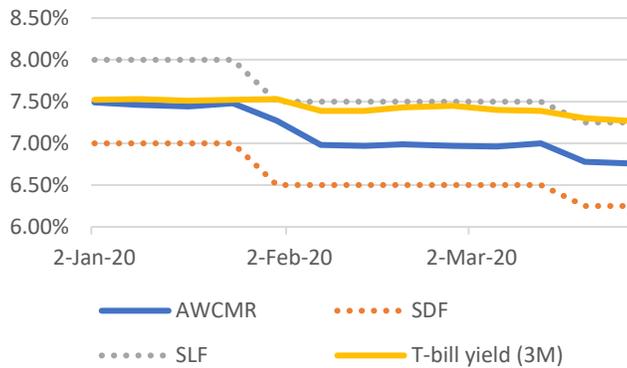
Interest Rates

Short-term rates

The CBSL absorbed close to LKR 55 Bn from the money markets through repos as the call market rates were tending towards 7%. However, following the policy rate cut towards mid-month, the call rates stumbled 30 bps. Overnight liquidity peaked around the same time to about LKR120 Bn and remained above LKR 60 Bn for the most part of the remainder of the month. The interbank market was inactive for a week between 20th and 27th and the CBSL bought over LKR 50 Bn worth government securities during this time. In the previous week the CBSL mopped up LKR 157 Bn through repos. The call and repo volumes remained subdued in the last 3 days of the month. In the meanwhile, the differential between the call and repo rate widened by over 10 bps.

LKR 115 Bn worth T-bills were issued during the month. Yields in the primary market fell significantly following the policy rate cut (3 months -41bps, 6 months- 74bps, and 1 year - 96bps). However, corresponding yields in the secondary market did not fall commensurately (13bps, 22bps, and 18bps). The yield differential between US 3m T-bill and LKR 3m T-bill widened as the US treasury yields fell to near zero. But the mid-month policy rate cut brought the rate differential back to month open level.

Figure 1: Treasury bill yield and call money rate



Notes: AWCMR- Average Weighted Call Money Rate, SDFR- Standing Deposit Facility Rate, SLFR- Standing Lending Facility Rate, T-bill yields are for the secondary market.

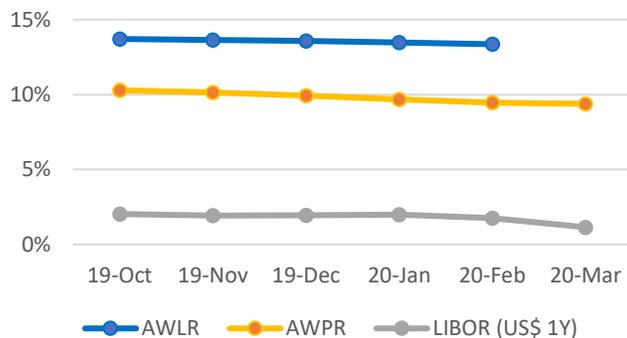
Source: CBSL

Long-term rates

LIBOR (USD 1 Y) rate fell significantly amidst the weakening global economy and rate cuts by Fed. No bids received for floating rate SLDBs in both auctions in March is likely due to market participant's expectation of a further decline in LIBOR in time to come.

AWLR dropped about 10bps in February. AWPR fell close to 20 basis points to 9.29% in March amidst loosening monetary policy.

Figure 2: Local and international lending rates

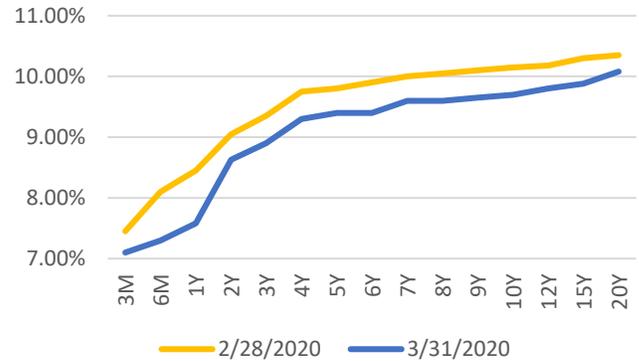


Notes: AWPR- Average Weighted Prime Lending Rate month average, AWLR, Average Weighted Lending Rate. LIBOR is the month open rate.

Source: CBSL and global-rates.com

Secondary bond market remained active in March characterized by significant reduction in foreign ownership of government securities especially in the last two weeks following the rate cut. On net basis, the foreign ownership of the government securities declined by about LKR 50 Bn.

Figure 3: Yield curve of government securities



Source: First Capital Research

With the policy rate cut, the yield curve shifted down uniformly by about 40-50 bps except for some shorter tenor securities.

External Sector

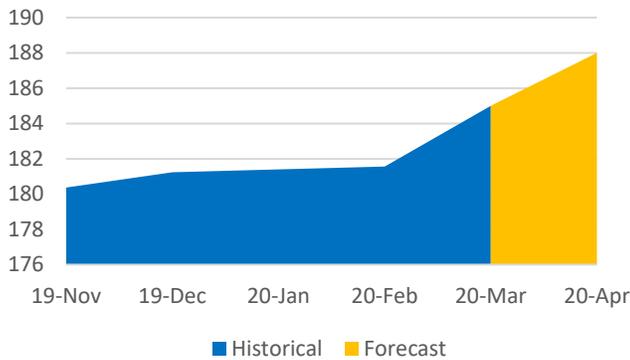
Rupee depreciated by about 4% in March and it accelerated in the last 2 weeks of the month due to capital flight. Outstanding forward volume was seen rising over the weeks as importers rushed to counter further depreciation. Further depreciation is likely in the month ahead as forecasted by the forward rates.

The reserve position deteriorated by USD 422 Mn. The CBSL took several measures to slow down the worsening external position (i.e. suspending importation of vehicles and non-essential goods, and suspending purchase of SLISBs by banks). Furthermore, the CBSL sold down USD 174 Mn forex reserves.

As investors were rushing to exit, the SLISB prices plummeted. In the meanwhile, the CBSL issued SLDBs in two occasions during March (USD 200 Mn & 220 Mn), which went massively undersubscribed

(bids fell short of USD 55 Mn & 198 Mn from the amount offered).

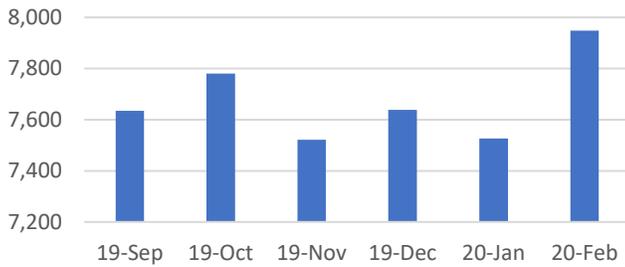
Figure 4: Exchange rate (US\$/LKR)



Note: Forecast is based on the forward rates prevailed during the month end.

Source: CBSL

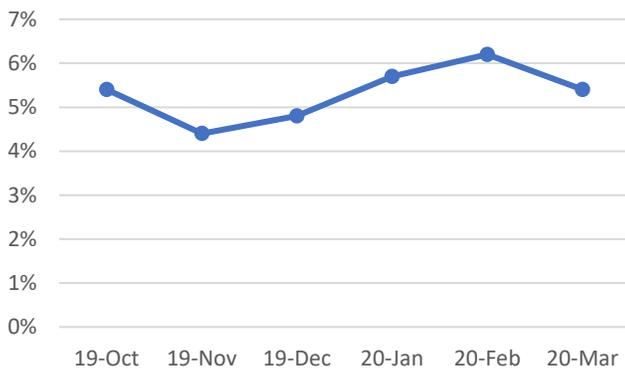
Figure 5: Gross official reserves (Mn US\$)



Source: CBSL

Prices

Figure 6: CCPI (Y-o-Y)



Notes: WRI (100=2012), CCPI (100=2013)

Source: CBSL

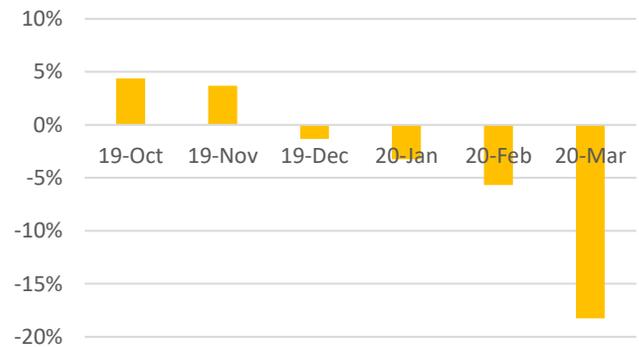
Data indicates the inflation declined to 5.4% in March. However, CSD notes that it carried out fieldwork to collect data only up to the 3rd week of March. ICRA Lanka expects, with vendors adding transport cost to goods, the general price level may remain elevated throughout the confinement period.

Stock Market

Rising fears and global economic meltdown due to the economic impact of COVID-19 drove the global stock markets off the cliff in March.

The trading at the CSE was suspended several times during the month. ASPI lost about 18% on M-o-M basis, the largest drop so far for the year. Foreigners sold over LKR 1 Bn on a net basis in March. All sectors in the ASPI lost value during the month. Significant deterioration in value was observed in Transportation, Consumer Durables & Apparel, Telco, and Insurance sector shares.

Figure 7: ASPI (M-o-M)



Source: CSE

Figure 8: ASPI sector performance

Sector	Index Points Gain
Transportation	-301.06
Consumer Durables & Apparel	-248.05
Telco	-234.01
Insurance	-200.47
Household & Personal Products	-172.45
Capital Goods	-171.16
Banks	-165.86

Diversified Financials	-158.46
Materials	-150.69
Utilities	-143.92
Food, Beverage & Tobacco	-134.93
Retailing	-128.38
Health Care	-125.60
Real Estate	-96.28
Food & Staples Retailing	-74.80
Commercial & Prof. Services	-67.18
Energy	-61.73
Automobiles	-61.66
Consumer Services	-39.31
Pharma	0.00

Source: CSE

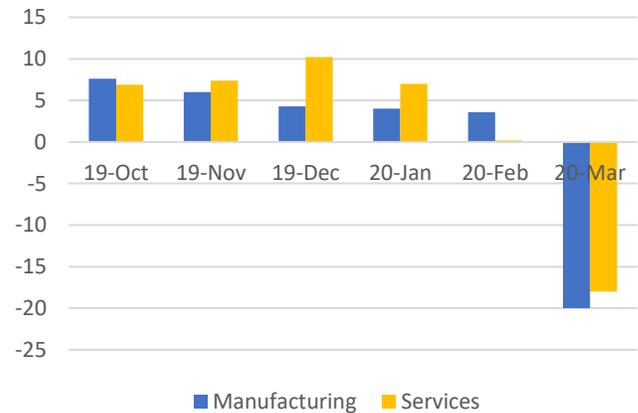
Real Sector

Agriculture production in January fell as production of commercial crops (i.e. tea, rubber, coconut) fell across the board.

Manufacturing sector continued its slow expansion in February mainly due to the slowdown in new orders and employment. Textile and apparel sector cut production as the export demand started to slow down. Supply disruption also impeded production. In March the sector underwent a record contraction as the country went into a lockdown.

Services sector expansion in February was at its lowest level since May last year. Business activities in accommodation, food and beverage, trade and transportation subsectors shrunk. In March services PMI contracted significantly recording the lowest index value since May 2015. The tourism industry grounded to a halt as travel restrictions were imposed. Trade sector was also affected due to import restrictions and exchange rate depreciation. In addition, the disruption to delivery and distribution channels also affected the trade sector.

Figure 9: PMI deviation from point of neutrality (Index points)



Notes- negative values indicate sector is generally contracting on a month-on-month basis while positive values indicate the sector is expanding. The strength of contraction or expansion is manifested by the magnitude of the figure.

Source: CBSL

Outlook for April

There is a great deal of uncertainty surrounding how COVID crisis will evolve in the next few months, however the overall outlook remains gloomy. ICRA Lanka does not expect the activities in the real economy to improve significantly in April. Both short and long-term interest rates are likely to remain low. Further depreciation of rupee is likely as forecasted by the forward rates. Inflation is likely to edge up as a supply disruption may force prices to go up.

Rating Actions

Following rating actions were taken by ICRA Lanka during the month of **March**.
Visit <https://www.icralanka.com/ratings/> to read the rating rationales

Issuer	Issue	Action	Previous Rating	Current Rating
Janashakthi PLC	Issuer Rating	Reaffirmed	BBB- (Negative)	BBB- (Negative)
Alliance Finance	LKR 800Mn senior unsecured debenture	Withdrawal	BBB- (Negative)	BBB- (Negative) Withdrawn
People's Merchant Finance	Issuer rating	Reaffirmed	B (On Watch)	B (On Watch)
Prime Finance PLC	Issuer Rating	Reaffirmed	BBB- (Stable)	BBB- (Stable)
CDB	Issuer Rating	Reaffirmed	BBB+ (Negative)	BBB+ (Negative)
CDB	LKR 1,075 Mn subordinate debenture	Reaffirmed	BBB (Negative)	BBB (Negative)
CDB	LKR 928 Mn subordinate debenture	Reaffirmed	BBB (Negative)	BBB (Negative)
CDB	LKR 2,000 Mn subordinate debenture	Reaffirmed	BBB (Negative)	BBB (Negative)
CDB	LKR 1,000 Mn subordinated guaranteed debenture	Reaffirmed	A- (SO) (Stable)	A- (SO) (Stable)
CDB	LKR 628Mn trust certificate	Reaffirmed	A- (SO) (Negative)	A- (SO) (Negative)
MCB Bank	Issuer rating	Reaffirmed	A+ (Stable)	A+ (Stable)
Vidullanka	Issuer rating	Reaffirmed	A- (Stable)	A- (Stable)
Vidullanka	LKR 100Mn commercial paper program	Reaffirmed	A2+	A2+
Vidullanka	LKR 100Mn commercial paper program	Assigned	NA	A2+

Abbreviations

bps	Basis points
CBSL	Central Bank of Sri Lanka
CSD	Census and Statistics Department
SLDB	Sri Lanka Development Bonds
SLISB	Sri Lanka International Sovereign Bonds
PMI	Purchasing Managers Index

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