



MONTHLY ECONOMIC UPDATE | July

Economy at a glance for July 2020

Slack persists with a slower recovery

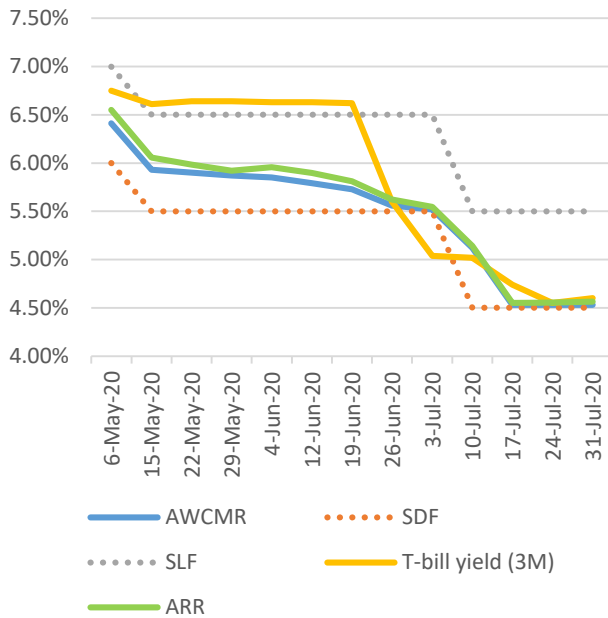
Highlights

- Economic activities, especially the industry and services sector, improved in July as reflected by increased power demand. However, the economy was still operating with a considerable slack.
- Both short-term and long-term interest rates have further eased, helped by the CBSL's monetary easing, while the money market remained flushed with excess liquidity. Interest rates in the Eurodollar market have also further eased, as Fed kept its benchmark policy rates near rock bottom.
- External position of the country improved, but capital continued to flee. Rupee displayed stability and a minor appreciation. Reserves rose by USD 409 Mn in July. The repo facility with the Fed, the currency swap with Reserve Bank of India, and proceeds of SLDB auction helped to reinforce the reserve position.
- Inflation increased to 4.2% (Y-o-Y) mainly as a result of high food inflation (10.9%). Non-food inflation also rose marginally (1.5%).
- ASPI lost 1% in July as market activities turned tepid last few weeks in the run up to the General election. Transport sector shares (i.e. shipping and logistics) saw the biggest gains as global supply chains started to normalize, while Insurance sector shares saw biggest losses.
- Commodity prices started to stabilize as the global economic activities returned to normalcy. Gold rallied amidst low interest rates and global uncertainty.

Interest Rates

Short-term rates

Figure 1: Treasury bill yield and money market rates



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, ARR – simple average of daily repo rates
Source: CBSL

July began with the call and repo rates nearing the lower bound of the policy corridor. Subsequently, the CBSL cut the policy rates by 100 bps on 9th July to allow the said rates to move down before it touched the floor rate once again by around mid-month indicating that the money market was quite saturated with liquidity. The call and repo rates displayed very little volatility and they moved with a tighter spread as repo market volumes greatly outperformed the call market volumes.

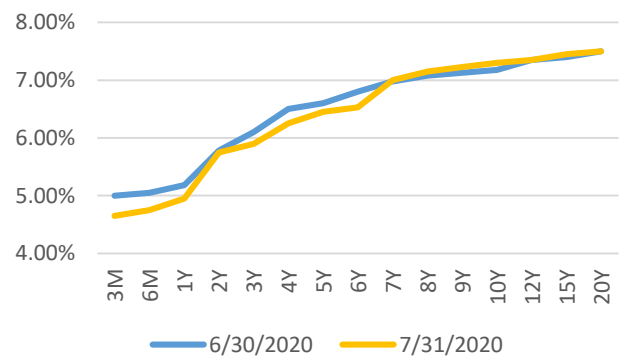
On 20th July, the CBSL sold some of its forex reserves to the government to pay for its foreign currency obligations for the month. Consequently, the excess liquidity dropped sharply by LKR 42 Bn. Towards the end of the month the excess liquidity level somewhat moderated. There were several reverse repos maturing during July which can be traced back to earlier auctions. No open market

operations were carried out for the entire month by the CBSL. Instead, the CBSL unloaded portion of its stock of G-secs at regular intervals throughout the month barring the 31st July where it topped up G-secs in its books by close to LKR 20 Bn just to bring it back closer to the initial level. The reserve money (i.e. currency in circulation and deposits held by the commercial banks) contracted marginally in the last two weeks due to subdued economic activity and increase in the CBSL net foreign assets but broadly remained unchanged with respect to the last week of June.

The policy rate cut delivered about 45-50 bps drop in yields in the primary T-bills, and a slightly weaker 42-43 bps drop in the secondary market by the end of the month. The T-bill yields in the primary and secondary market converged towards the end of the month as secondary market yields started to flatten. The T-bills in the primary market remained overpriced. This is corroborated by the fact that the CBSL only opting to fill the offered amount partially (30%) on the last auction of the month (29th July). On 31st July the CBSL bought over LKR 19 Bn G-secs possibly to drive the secondary market yields lower. The market saw modest volumes during the said period. Bid-ask spread in the secondary market tightened during the month indicating better market liquidity.

Long-term rates

Figure 2: Yield curve of treasuries¹



Source: First Capital Research

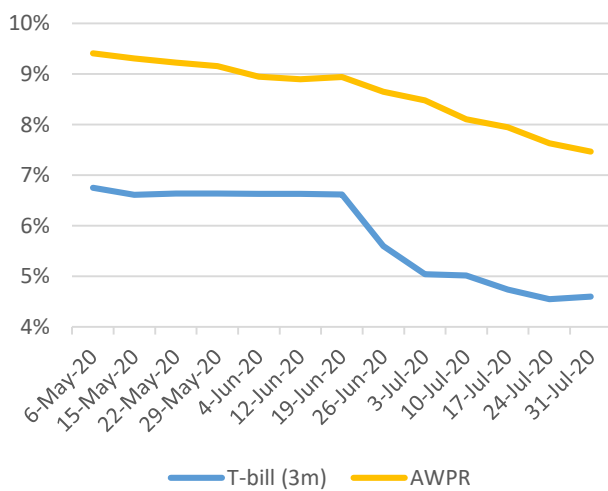
The CBSL held three bond auctions in July and all of them were oversubscribed. However, in the last

¹ Shorter end – less than 2Y, mid/intermediate tenor – 2 to 10Y, longer tenor – above 10Y

two auctions, the CBSL accepted only a fraction of the offered amounts.

The secondary bond market operated with relatively high volumes with 1st and 3rd turnover recording turnovers surpassing LKR 100 Bn. The bid-ask spread narrowed by the end of the month indicating better liquidity. The yield curve slightly steepened as the yields of the tenors below 6 years dipped (~15-35) while the rest remained almost unchanged. A steepening curve typically indicates improving economic activity and rising inflation expectations.

Figure 3: Secondary market T-bill yields and AWPR²



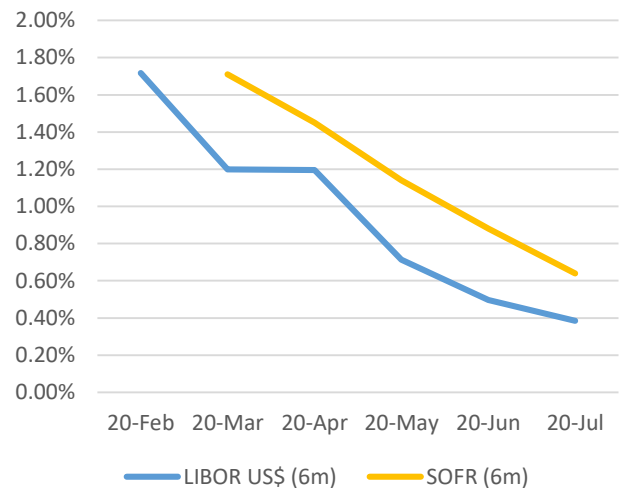
Note: Yield given is for the secondary market
Source: CBSL

Credit to private sector continued to contract in June (LKR 70 Bn) while, credit to government expanded by LKR 134 Bn. The CBSL approved around LKR 12 Bn loans under the *Saubagya* COVID-19 renaissance facility during the period 13-23 July.

AWPR continued to fall gradually (~118 bps) throughout the month. With T-bill yields flattening, the spread between T-bill yield and AWPR narrowed marginally.

Figure 4: Month open international lending rates

² AWPR is calculated based on the submissions made by the commercial banks to the CBSL on the rates offered to customers who borrowed more than LKR 10 Mn for less than three months.
Page | 3



Notes: The SOFR Averages are compounded averages of the SOFR over rolling 180-calendar day periods.

Source: New York Federal Reserve and global-rates.com

US treasury yields declined further in July as investors assessed the progress on the next virus relief package and digested the latest employment data [1] hence the yield differential between US 3m T-bill and LKR 3m T-bill declined significantly.

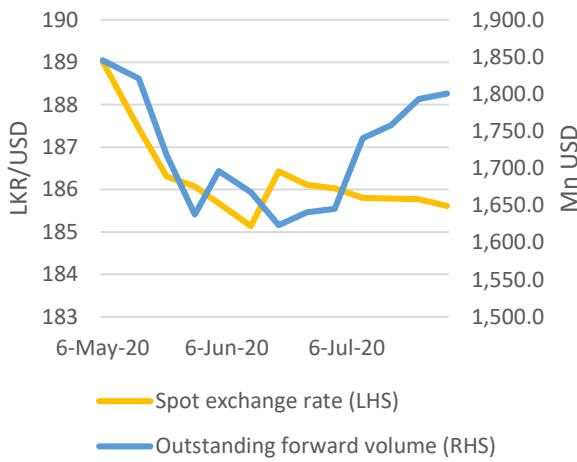
Fed left its key benchmark interest rates unchanged at 0-0.25% in July [2]. With Fed funds rate hitting almost the rock-bottom, LIBOR US\$ rate continued to decline. SOFR, its replacement rate following the LIBOR phase out in 2021, has also declined gradually.

The yields on SLISBs continued to improve in July with the strengthening of the external position of the country. The SLDB auction held during July 22-27 had a notable demand from investors while the CBSL being able to secure better rates than the June auction. However, Floating Rate Notes, which is linked to 6-month LIBOR, had only very little demand from the investors. LIBOR is set to phase out by the end of 2021 and ICRA Lanka previously highlighted the risks of ill prepared transition for Sri Lankan financial sector.

Read report on the [implications of LIBOR transition for Sri Lanka](#).

External Sector

Figure 5: Exchange rate and outstanding forward volume



Source: CBSL

Worker remittances rose to USD 573 Mn in June, a decline of 9% compared to the corresponding month of the previous year but an increase of 33% compared to the month earlier. Exports grew sharper in June. This growth was driven by the performance of apparel & textiles (84%), tea (6%), coconut (26%), and rubber & rubber based products (35%).

In July, the rupee displayed stability and a slight appreciation. However, the forward rates that prevailed by the end of July indicate the market was expecting the rupee to depreciate in next three months. It is reasonable to assume the CBSL was a net buyer of foreign currency during the month, given favourable external position of the country.

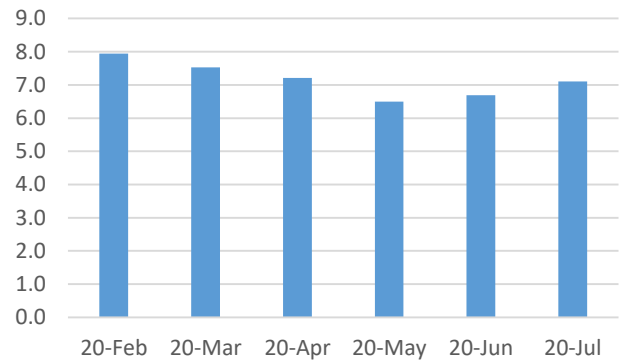
The liquidity in the forward market were seen rising throughout July possibly due to expectation of more external trade in 3Q & 4Q reflected by the consistently modest interbank forex market volumes.

Capital flight continued for yet another month in July as the investors exited the market due to policy rate cut and the stable rupee. By the end of the first week of 2020, foreign investors held over LKR 104 Bn worth G-secs. But overtime, the amount shrunk gradually. By the end of July it stood just around LKR 13 Bn. For the month of July alone over LKR 8 Bn foreign capital flew out of the treasuries. From

equities, over LKR 3 Bn foreign capital flew out for July.

Reserves rose by USD 409 Mn in July. There is reason to believe that the repo facility with the Fed, the currency swap with Reserve Bank of India, and proceeds of SLDB auction helped to reinforce the reserve position. Appreciation of gold prices have also lead to increase in the overall value of reserves during the month. Foreign currency obligation of USD 544 for July was financed using the CBSL reserves. For August and September USD 300 Mn forex obligations are pending.

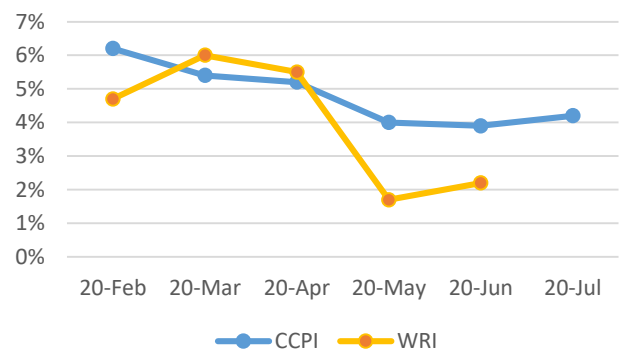
Figure 6: Gross official reserves (Mn USD)



Source: CBSL

Prices & Wages

Figure 7: CCPI and Wage Rate Index of the informal private sector (Y-o-Y)



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

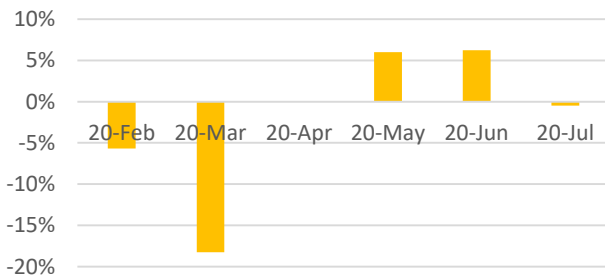
Wage growth was low and remained below the inflation indicating deteriorating purchasing power of consumers for two consecutive months by June. This comes after recently released unemployment data for 1Q 2020 which showed it had risen to its

10-year high. The wage slowdown was mainly witnessed in the industrial sector.

Agricultural producers saw the prices they receive go up by 15% (Y-o-Y) while manufacturers saw the prices go up by 3% in May as per the Producer's Price Index. The inflation increased to 4.2% (Y-o-Y) in July mainly as a result of high food inflation (10.9%). Non-food inflation also rose marginally (1.5%).

Equities

Figure 8: ASPI (M-o-M)



Note: CSE was closed for the whole month of April
Source: CSE

ASPI lost 1% in July as market activities turned tepid last few weeks in the run up to the General election. Foreign investors were net sellers. Transport sector shares (i.e. shipping and logistics) saw the biggest gains as global supply chains started to normalize while Insurance sector shares saw the biggest losses.

Figure 9: ASPI sector performance

Sector	Index Points Gain
Transportation	100.35
Materials	73.42
Automobiles & Components	56.3
Household & Personal Products	37.72
Retailing	35.53
Real Estate	33.25
Utilities	29.94
Consumer Durables & Apparel	19.58
Commercial & Professional Services	16.55
Diversified Financials	15.33
Consumer Services	5.35
Health Care Equipment & Services	4.88
Pharma, Biotech & Life Sciences	0

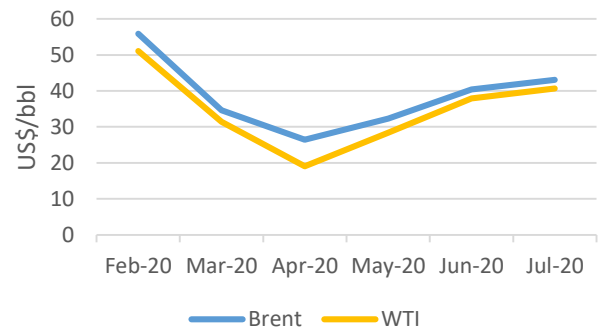
Food, Beverage & Tobacco	-1.17
Food & Staples Retailing	-9.01
Banks	-21.79
Capital Goods	-22.68
Telecommunication Services	-22.74
Energy	-35.33
Insurance	-83.02

Source: CSE

The performance of the key global stock indices was mixed during July as the US-China tension weighed in on the stocks. US stocks rallied on the back of optimism on further development of a COVID vaccine. Emerging market performed well while European indices performance was mixed.

Commodities

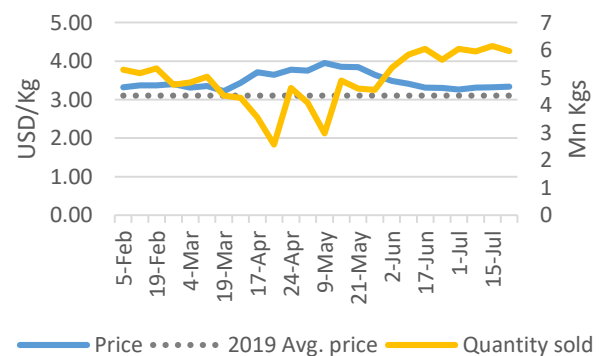
Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

With economies reopening, crude oil prices continued to rise in July.

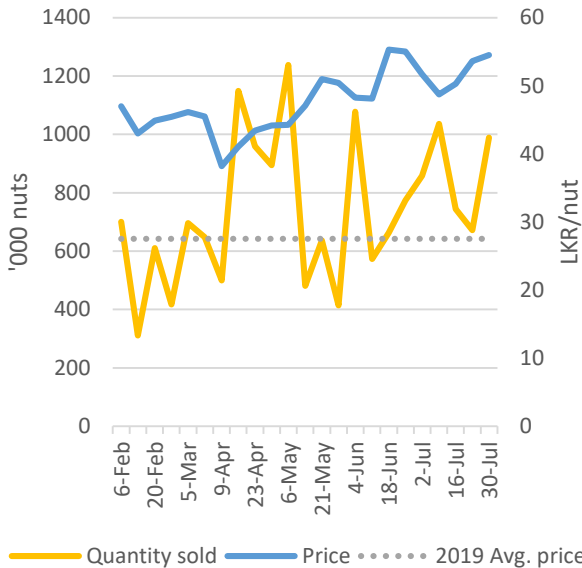
Figure 11: Tea (All Elevations) price and quantity sold at weekly auctions



Source: Forbes & Walker

Tea prices were steady. Floods have damaged tea gardens in the northeastern state of Assam - which accounts for over half of India's production. As a result, the prices are expected to be favourable for countries such as Sri Lanka in coming months [3].

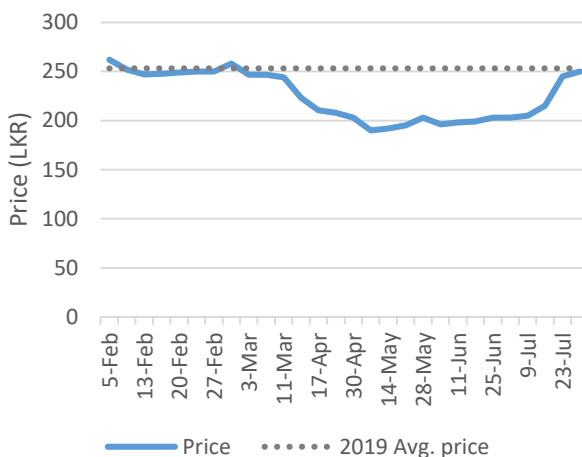
Figure 12: Coconut price and quantity sold at weekly auctions



Source: CDA

Coconut prices remained buoyant amidst volatile demand in the auctions.

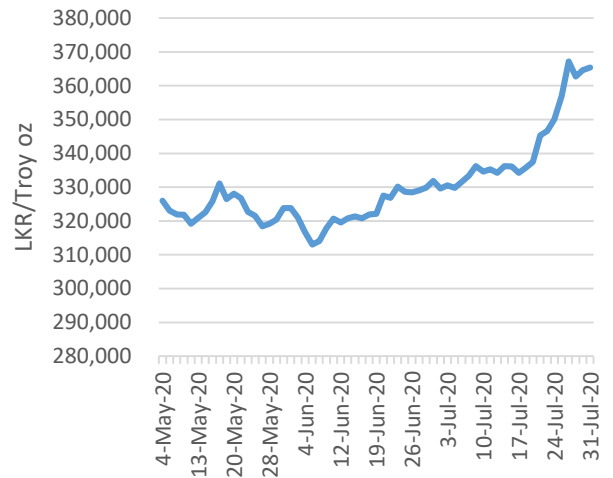
Figure 13: Rubber price weekly auctions



Source: RRISL

Rubber prices plummeted, following COVID breakout as the automotive industry sales slipped sharply. With gradual reopening of economies, the price of rubber recovered to pre-crisis level.

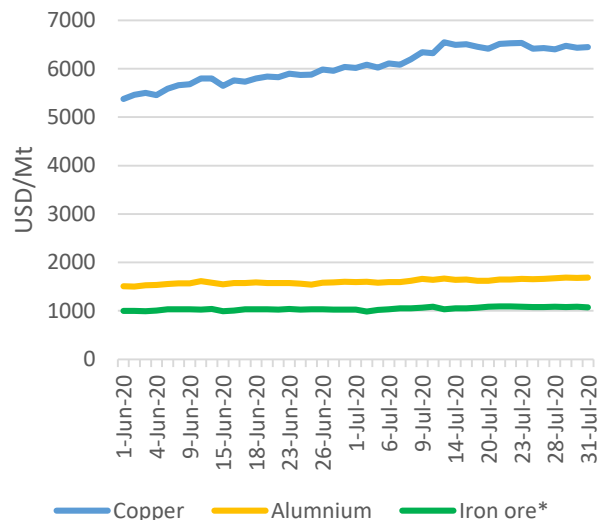
Figure 14: Daily gold price



Source: CBSL

Gold rallied in July as prices rose sharply. Lower interest rates and global uncertainty compelled investors to seek refuge in gold.

Figure 15: Daily key base metal prices



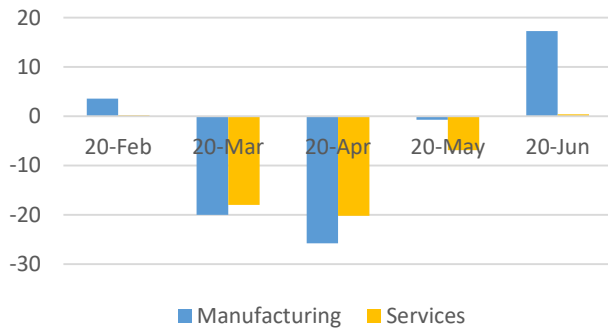
Notes: Iron ore prices are for 10 Mts

Source: dailymetalprices.com

Key base metal prices started to stabilise as the global economy is gradually normalizing.

Real Sector

Figure 16: 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.

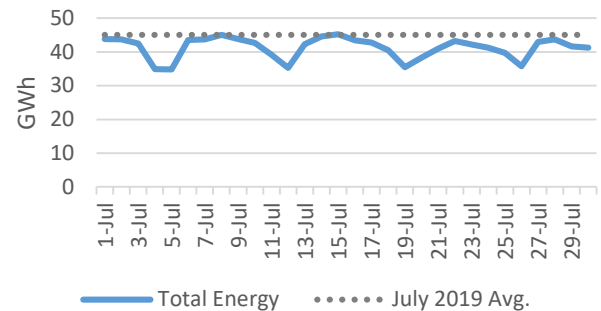
Source: CBSL

Manufacturing sector showed a strong rebound in June with economic activities returning to normalcy. The spike in exports in June also helped to lift the production activities of manufacturers. The new orders and input purchases rose possibly translating to production in coming months. Employment also rose in line with the increase in production and new orders. The supply disruption caused by the COVID pandemic continued to fade out.

Services sector remained neutral in June compared to the month before. The sector saw new businesses and business activity improving marginally amidst improving mobility. Employment in the sector continued to fall.

Economic activities, especially the industry and services sector, improved in July as reflected by increased power demand. However, the economy was still operating with a considerable slack.

Figure 17: Daily power generation



Source: CEB, PUCSL

Outlook for August

Activities in the real economy is expected to improve further. The inflation will remain mild. There is a possibility for the CBSL to consider a rate cut, which may drive the interest rate further down. Rupee will broadly remain stable but, mild depreciation is likely. Wage growth is expected to remain stagnant. Lower volatility in commodity prices is likely.

Rating Actions

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

Issuer	Issue	Action	Previous Rating	Current Rating
Union Bank of Colombo PLC	Issuer Rating	Reaffirmed	[SL]BBB (Stable)	[SL]BBB (Stable)
Ceylon Tea Brokers PLC	Issuer Rating	Reaffirmed	[SL]BBB (Stable)	[SL]BBB (Stable)
Bogawantalawa Tea Estates PLC	Issuer Rating	Reaffirmed	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)
Bogawantalawa Tea Estates PLC	Senior Convertible Unsecured Redeemable Debenture Programme (LKR 850 Mn)	Reaffirmed	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)
National Savings Bank	Issuer Rating	Reaffirmed	[SL]AAA (Stable)	[SL]AAA (Stable)
National Savings Bank	Senior Unsecured Redeemable Debenture Programme (LKR 20,000 Mn)	Reaffirmed	[SL]AAA (Stable)	[SL]AAA (Stable)
National Savings Bank	Subordinated Unsecured Redeemable Debenture Programme (LKR 6,000 Mn)	Reaffirmed	[SL]AAA (Stable)	[SL]AAA (Stable)
Metrocorp (Private) Limited	Issuer Rating	Assigned	N/A	[SL]A+ (Stable)
Rainco (Private) Limited	Issuer Rating	Withdrawn	[SL]D	N/A
Orient Finance PLC	Issuer Rating	Revised	[SL]BB+ (Negative)	[SL]BB (Negative)
Capital Alliance LTD	Capital Alliance Investment Grade Fund	Reaffirmed	[SL]Amfs	[SL]Amfs

Abbreviations

bps	Basis points
CBSL	Central Bank of Sri Lanka
CDA	Coconut Development Authority
CSD	Census and Statistics Department
CPC	Ceylon Petroleum Corporation
GoSL	Government of Sri Lanka
SLDB	Sri Lanka Development Bonds
SLISB	Sri Lanka International Sovereign Bonds
SOFR	Secured Overnight Financing Rate
PMI	Purchasing Managers Index
PUCSL	Public Utilities Commission of Sri Lanka
pps	Percentage points
RRISL	Rubber Research Institute of Sri Lanka

To subscribe to ICRA economic updates, contact
 Lalinda Sugathadasa
 Head of Research & Business Development
 Call: +94 77 478 1343
 Email: research@icralanka.com

Works Cited

- [1] CNBC, "Treasury yields decline slightly as investors weight jobs data, stimulus talks," CNBC, 06 August 2020. [Online]. Available: <https://www.cnbc.com/2020/08/06/treasury-yields-unemployment-data.html?recirc=taboolainternal>.
- [2] CNBC, "Treasury yields fall slightly as Fed begins 2-day meeting," CNBC, 28 July 2020. [Online]. Available: <https://www.cnbc.com/2020/07/28/us-treasury-yields-fed-meeting-july.html>.
- [3] T. E. Times, 22 July 2020. [Online]. Available: <https://economictimes.indiatimes.com/markets/commodities/news/indian-tea-prices-jump-to-record-as-floods-covid-19-slash-output/articleshow/77108650.cms?from=mdr>.

Published date: August 14, 2020
Document #: meuju20

©Copyright, 2020- ICRA Lanka Limited. All Rights Reserved. Contents may be used freely with due acknowledgement to ICRA Lanka. All information contain herein are from sources deemed reliable; however, no representation or warranty is made to the accuracy of thereof.

About ICRA

ICRA Lanka Limited is a credit rating agency licensed by the Securities and Exchange Commission of Sri Lanka (SEC). ICRA Lanka is a fully owned subsidiary of ICRA Limited of India. The company was incorporated in December 2010 and was granted license by the SEC in May 2011.



Subsidiary of
ICRA Limited

CORPORATE OFFICE

Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka
Tel: +94 11 4339907; Fax: +94 11 2333307
Email: info@icralanka.com; Website: www.icralanka.com

Disclaimer

This publication has been prepared by ICRA Lanka solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ICRA Lanka does not represent that it is accurate or complete. ICRA Lanka does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication.

Contacts

W Don Barnabas
Managing Director/CEO
+94-11-4339907
wdbarnabas@icralanka.com

Lalinda Sugathadasa
Head of Research &
Business Development
+94-11-4339907
lalinda@icralanka.com

Danushka Perera
Head of Corporate Sector Ratings
+94-11-4339907
danushka@icralanka.com

Rasanga Weliwatta
Head of Financial Sector Ratings
+94-11-4339907
rasanga@icralanka.com

Access more of our research content at
<https://www.icralanka.com/research/>

Follow us on



IcraLanka



icra-lanka



ICRA Lanka