



MONTHLY ECONOMIC UPDATE | November

Economy at a glance for November 2020

Vaccine news ignite optimism.

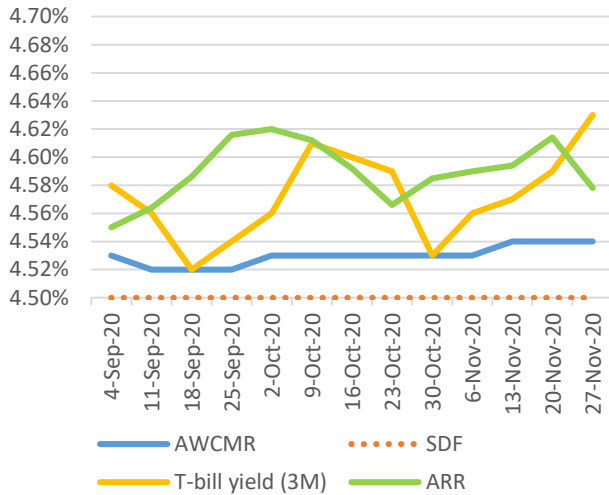
Highlights

- Money market rates indicate rising trend in November despite soaring liquidity levels.
- Economic disruptions caused by the 2nd wave of infections put pressure on the AWPR in early November, but eased off during the second half of the month.
- Yield curve shifted up with a steeper angle indicating future economic activities amidst prospects of viable vaccine.
- Yields on ISBs started to moderate throughout the month as investors reevaluated their initial reaction to the second wave. Bonds with the nearest maturity (27-Jul-21) saw yields dip up by ~2000 bps while longest maturity (28-Mar-30) bonds saw yields decreasing by ~130 bps.
- Foreign capital of over LKR 1.7 Bn (USD 9 Mn) from treasuries and nearly LKR 2.8 Bn (USD 15 Mn) from equities exited from the domestic markets in November.
- USD 580 Mn foreign currency obligations were paid during the month. The gross official reserves further declined to USD 5.5 Bn.
- Inflation rose marginally to 4.1% on account of rise in both food and non-food inflation.
- ASPI gained over 9%, while CSE's liquid S&P gained over 7% in November. CSE rode on the better-than-expected 2Q corporate financials, ending of the lockdown, and vaccine announcement.
- Gold plunged to July levels as investors turned bullish with the vaccine optimism.

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

Money market rates indicated rising trend in November despite soaring liquidity levels. The month opened with a sharp decline in excess liquidity at the end of October, likely as a result of an FX payment. This boosted the interbank call volumes to pre-crisis levels. Repo market also saw modest volumes. The daily excess liquidity levels reverted to LKR 185 Bn with the CBSL injecting close to LKR 80 Bn via purchase of treasuries. In addition, the CBSL injected LKR 30 Bn via term reverse repos.

ICRA Lanka previously suspected (in September issue) asymmetry in liquidity among the market participants and it is now ascertained as per the CBSL’s recent publication [1] that it was indeed the case since September. Accordingly, term reverse repos were employed to provide liquidity to standalone primary dealers.

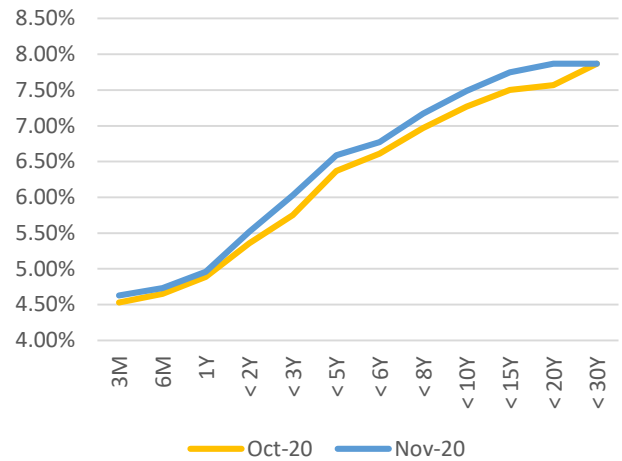
With the recent comments by the CBSL governor on the debt sustainability, ICRA Lanka expects the CBSL actions to have some alignment with key tenets of the Modern Monetary Theory (MMT) [2]. This means that it is likely that the stock of treasury

securities held by the CBSL to expand significantly beyond current levels (LKR ~570 Bn as of end November). In addition, ICRA Lanka expects the CBSL to continue with private placement of treasuries.

Both primary and secondary T-bill yields rose during the month by about 5 -10 bps. All T-bill auctions were oversubscribed but almost all were partially filled. The secondary T-bill market volumes were weak while the bid-ask spreads were steady.

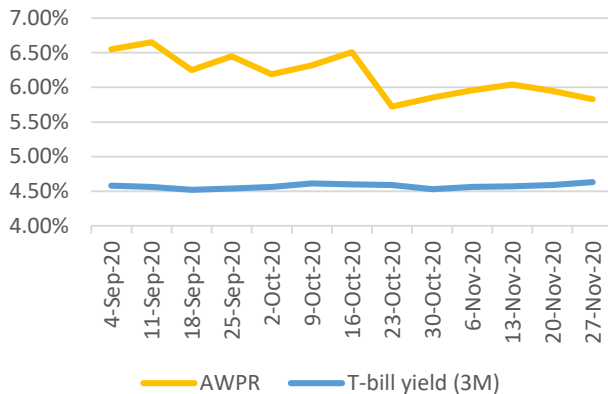
Long-term rates

Figure 2: Yield curve of treasuries



Notes: Yields are based on the weekly average prevailed at the last week of the month, Shorter end – less than 2Y, mid/intermediate tenor – 2 to 10Y, longer tenor – above 10Y, Source: CBSL

Only a fraction of the amount offered was filled by the CBSL during the bond auction held in November. Secondary bond market volumes were also thin and operated with wider bid-ask spreads. Yield curve shifted up with a steeper angle indicating future economic activities amidst prospects of a viable vaccine.

Figure 3: AWPR¹ and 3M T-bill yield


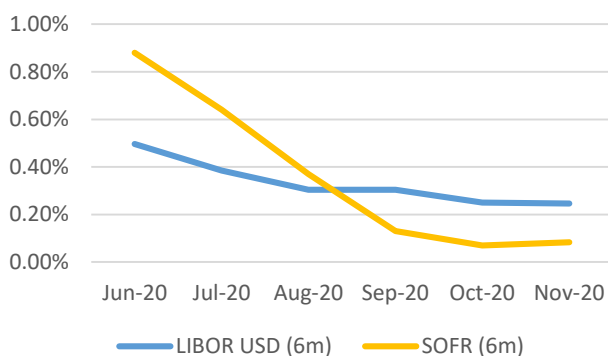
Note: T-bill yield for secondary market
Source: CBSL

Economic disruptions caused by the 2nd wave of infections put pressure on the AWPR in early November, but eased off during the second half of the month. The spread against 3M T-bill yield declined by the month end.

Private sector credit expanded in October in line with ICRA Lanka’s expectation while the government credit continued to accelerate. For November also, we expect the private sector credit to further expand.

International rates

Figure 4: Month open international lending rates



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

Initial bullish reaction to the prospects of a Democratic sweep faded as it became increasingly likely that congress will be divided. US treasuries struggled to find direction as the election results kept the market in suspense. Yields surged after the announcements of Pfizer and Moderna on vaccine success rates but later moderated as the virus cases continued to rise apace in US and Europe. The hopes of Fed tweaking its asset purchase programme to include longer-dated bonds played favourably for treasuries.

Month open 6M LIBOR USD rate fell marginally while its’ replacement rate, SOFR, edged up in November. The LIBOR administrator said it is consulting on plans to extend the retirement date for 3-, 6- and 12-month London interbank offered rates on dollars until late June 2023, although regulators are still pushing for banks to move away from the benchmarks as soon as they can [3].

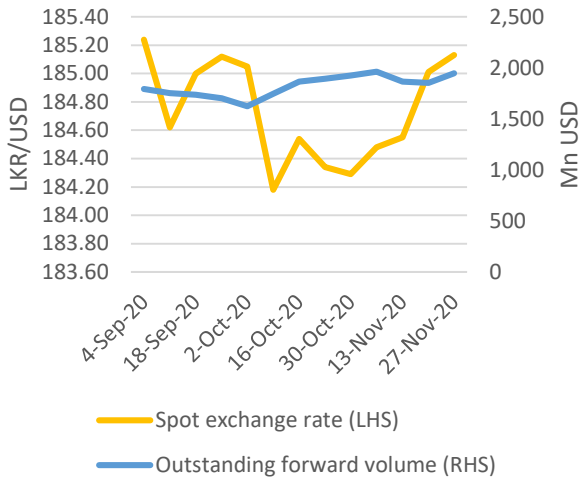
The CBSL offered USD 75 Mn SLDBs in November auction which went undersubscribed (Close to USD 25 Mn were filled). The CBSL in a statement said “Subsequent to the said auction, due to renewed interest/ investor appetite for SLDBs, further investment of USD 62million was raised by close of business today (16th November), at the Weighted Average Fixed Rates determined for respective maturities on offer at the above auction, with settlement of such investments on 18.11.2020”. During this auction the CBSL did not offer floating rate SLDBs which are linked to 6M LIBOR USD. ICRA Lanka has previously highlighted the weaknesses of the SLDB fallback language to handle permanent cessation of LIBOR.

Yields on ISBs started to moderate throughout the month as investors reevaluated their initial reaction to the second wave. Bonds with the nearest maturity (27-Jul-21) saw yields dip up by ~2000 bps while longest maturity (28-Mar-30) bonds saw yields decreasing by ~130 bps.

¹ 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.
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External Sector

Figure 5: Exchange rate and outstanding forward volume



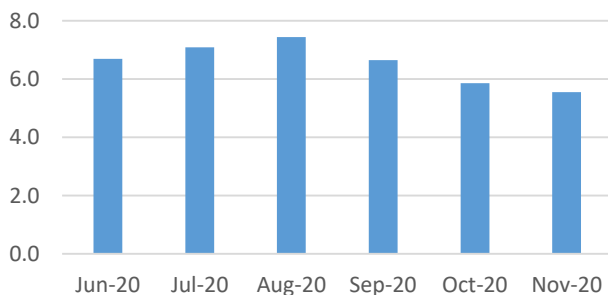
Source: CBSL

Sri Lanka further extended the import restrictions. The measure drew concern from European Union, a key export market, and called to end it.

Foreign capital of over LKR 1.7 Bn (USD 9 Mn) from treasuries and nearly LKR 2.8 Bn (USD 15 Mn) from equities exited from the domestic markets in November. In addition, USD 580 Mn foreign currency obligations were paid down during the month. The CBSL net purchases from the intervention in the FX markets were just USD 2.4 Mn. The gross official reserves further declined to USD 5.5 Bn.

Rupee gradually weakened against greenback during the month. Forward volumes declined gradually but picked up in the last week ahead of holiday season, while spot market volumes were weak.

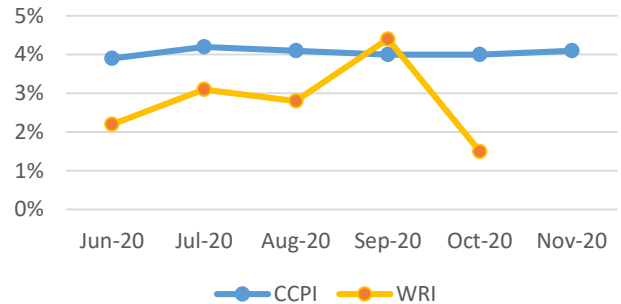
Figure 6: Gross official reserves (Mn USD)



Source: CBSL

Prices & Wages

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



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

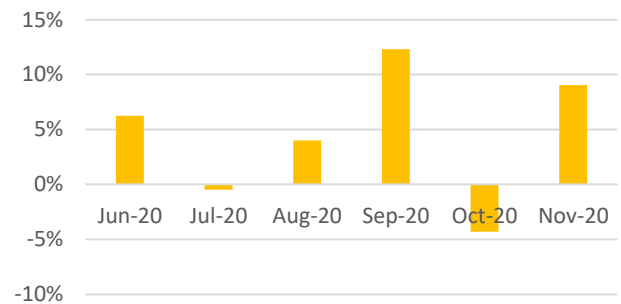
Source: CBSL

Wage growth slipped with the onset of the second wave of infections. Inflation rose marginally to 4.1% on account of rise in both food and non-food inflation. Bus fares were increased on 11th November and contributed to increase in non-food inflation.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

ASPI gained over 9%, while CSE's liquid S&P gained over 7% in November. CSE rode on the better-than-expected 2Q corporate financials, ending of the lockdown, and vaccine optimism. In addition, investors also parsed the 2021 Budget Proposals which has emphasis on certain sectors. Trading continued to be dominated by domestic retail investors while foreigner investors were on the sell-side. Market PBV (Price-to-book value) increased to 1.05 from 0.96.

All GICS sectors recorded gains in November. Transport sector shares recording exceptional performance.

Figure 9: GICS sector performance- November

Sector	Index Points Gain
Transportation	1505.32
Automobiles & Components	189.01
Materials	173.57
Consumer Durables & Apparel	148.66
Capital Goods	140.14
Retailing	129.76
Commercial & Professional Services	113.80
Utilities	82.79
Telecommunication Services	72.38
Household & Personal Products	70.06
Food, Beverage & Tobacco	56.70
Healthcare Equipment & Services	39.60
Insurance	37.48
Diversified Financials	30.08
Real Estate	25.99
Consumer Services	24.50
Energy	20.09
Banks	18.95
Food & Staples Retailing	8.83

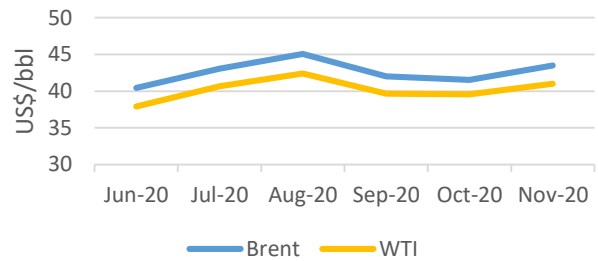
Source: CSE

Global Markets

Early enthusiasm in US equities in the run up to the election diminished following election day as the control of the senate by the Republicans was a possibility which might stall the economic stimulus. But the vaccine announcements gave a nudge to the market. Nevertheless, US indexes gained double digits. European and Emerging markets were broadly higher.

Commodities

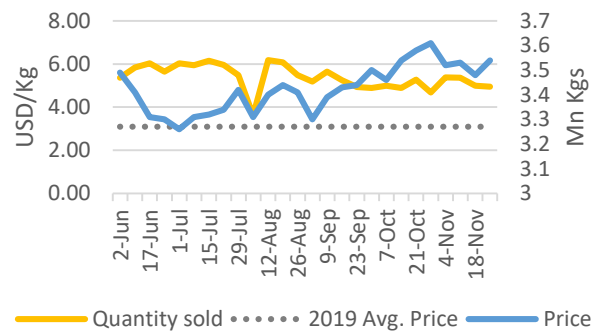
Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Oil prices rebounded as vaccine optimism overwhelmed concerns over lockdowns to contain the virus.

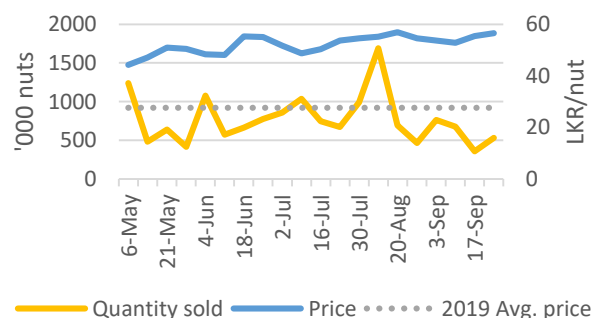
Figure 11: Tea (All Elevations) price and quantity sold at weekly auctions



Source: Forbes & Walker

Tea prices sustained momentum amidst constrained supply. It was proposed to increase the daily wage of plantation workers during the budget speech which if implemented without addressing productivity will have implications for plantation sector viability.

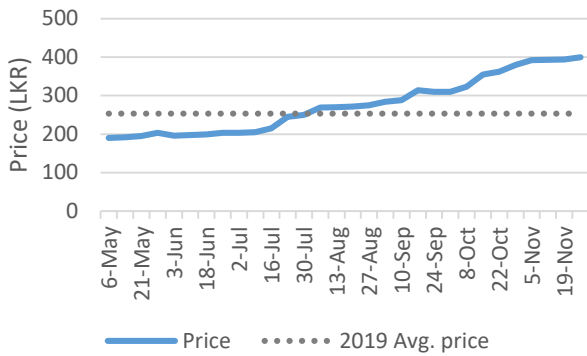
Figure 12: Coconut price and quantity sold at weekly auctions



Source: CDA

CDA suspended coconut auctions from 30th September indefinitely as coconut prices soared due to supply shock.

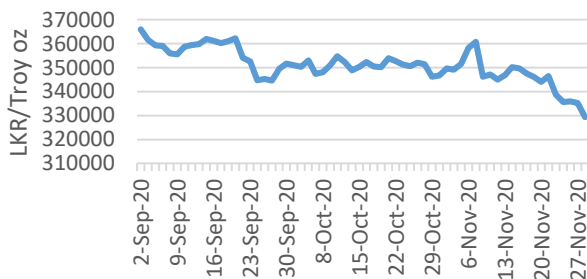
Figure 13: Rubber price weekly auctions



Note: Price of Latex 4X
Source: RRISL

Rubber prices continued to hold firm in November. Demand for surgical gloves and tires drove the rubber prices.

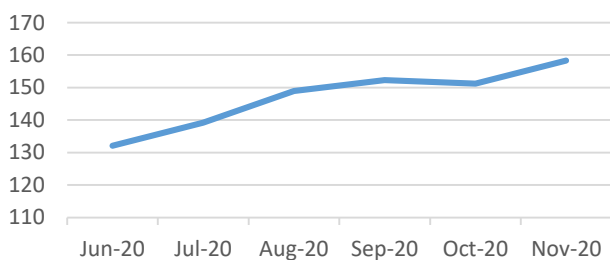
Figure 14: Gold price



Source: CBSL

Gold plunged to July levels as investors turned bullish with the vaccine optimism.

Figure 15: Base metal price index (2016=100)

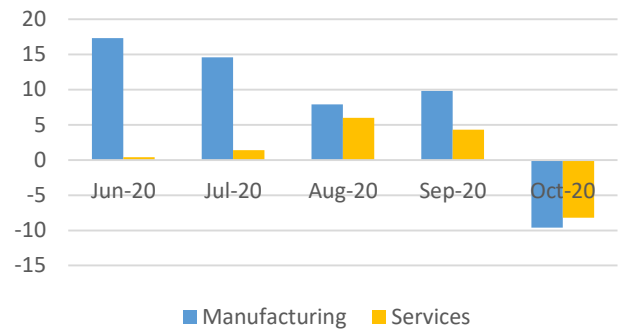


Notes: includes Aluminum, Cobalt, Copper, Iron Ore, Lead, Molybdenum, Nickel, Tin, Uranium, and Zinc
Source: IMF

Base metal prices soared with bets on faster global recovery on the back of vaccine announcements.

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

The resurgence of the second wave and partial lockdowns forced businesses to cut activities. PMI data for October indicated a contraction after 5 months of recovery from the initial lockdown. The contraction was profound in the manufacturing of wearing apparel and food & beverages sectors. Services sector, which was still recovering, also faced a major setback with the second wave. Business activities declined especially in wholesale and retail trade, transportation, and accommodation, food and beverage subsectors. However, in November, the economic activity level seemed to have improved and performed better than what was anticipated earlier. This is in part due to many businesses adopting remote working arrangements and business continuity plans.

ICRA Lanka's nowcasting models show GDP contracted by 17.5% (margin of error = +/- 16%) in 2Q to and by 6.1% (margin of error = +/- 6%) in 3Q. Based on our predictive models we expect the economy to contract by 7.9% (base case) to 17.8% (protracted case) in 4Q.

Read ICRA Lanka's [3Q Economic Update](#) to see a complete list of predictions.

Outlook for December

Economy is expected to operate with a slack. Weaker aggregate demand is likely to keep the inflation in check. Only about USD 8 Mn foreign currency obligations are pending for December, therefore we do not expect significant fluctuations in excess liquidity, hence the money markets may remain broadly stable.

Rating Actions

Following rating actions were taken by ICRA Lanka during the month of **November**.

Visit <https://www.icralanka.com/ratings/> to read the rating rationales.

Issuer	Issue	Action	Previous Rating	Current Rating
Sarvodaya Development Finance Limited	Issuer rating	On Notice of Withdrawal	[SL]B (Negative)	[SL]B (On notice of withdrawal)
Panasian Power PLC	Issuer rating	On Notice of Withdrawal	[SL]A- (Stable)	[SL]A- (On notice of withdrawal)
Lakderana Investments Limited	Issuer rating	Assigned	N/A	[SL]BB- (Stable)
Nation Lanka Finance PLC	Issuer rating	On Watch	[SL]B- (Negative)	[SL]C+ (On Watch)
First Capital Holdings PLC	Issuer rating	Upgraded	[SL]A- (Stable)	[SL]A (Stable)
First Capital Holdings PLC	Commercial Paper Programme (LKR 1,500 Mn)	Upgraded	[SL]A2	[SL]A1
First Capital Holdings PLC	Proposed Senior Unsecured Redeemable Debenture programme (LKR 2,000 Mn)	Assigned	N/A	[SL]A
First Capital Treasuries PLC	Issuer rating	Upgraded	[SL]A- (Stable)	[SL]A (Stable)
First Capital Treasuries PLC	Subordinated Unsecured Redeemable Debenture programme (LKR 750)	Upgraded	[SL]BBB+ (Stable)	[SL]A- (Stable)
First Capital Treasuries PLC	Subordinated Unsecured Redeemable Debenture programme (LKR 500)	Withdrawn	[SL]BBB+ (Stable)	[SL]BBB+ (withdrawn)

Abbreviations

ASPI	All Share Price Index
bps	Basis points
CBSL	Central Bank of Sri Lanka
CDA	Coconut Development Authority
CSD	Census and Statistics Department
CSE	Colombo Stock Exchange
GICS	Global Industry Classification Standard
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
RRISL	Rubber Research Institute of Sri Lanka
YTD	Year-to-date

Works Cited

- [1 CBSL, “Recent Economic Developments Highlights of 2020 and Prospects for 2021,” CBSL, 2020.]
- [2 EconomyNext, “Sri Lanka to cut foreign debt share to 40-pct in 2021, ride Modern Monetary Theory: CB Governor,” 1 December 2020. [Online]. Available: <https://economynext.com/sri-lanka-to-cut-foreign-debt-share-to-40-pct-in-2021-ride-modern-monetary-theory-cb-governor-76479/>.
- [3 W. Shaw, L. McCormick, E. Bolingbroke and C. Torres, “Libor’s Final Retirement Date May Get Delayed Until Mid-2023,” Bloomberg, 30 November 2020. [Online]. Available: <https://www.bloomberg.com/news/articles/2020-11-30/three-month-dollar-libor-may-win-retirement-relieve-to-mid-2023#:~:text=Libor's%20Final%20Retirement%20Date%20May%20Get%20Delayed%20Until%20Mid%202023%20%2D%20Bloomberg.>

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