



MONTHLY ECONOMIC UPDATE | January

Economy at a glance for January 2021

Equities remain bullish despite sluggish economy

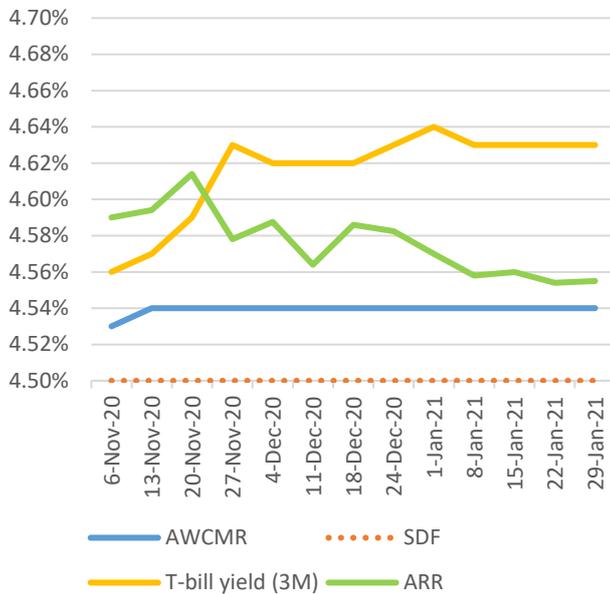
Highlights

- Interbank call market activity rose markedly to pre-crisis levels during January barring 3rd week. High excess market liquidity (above LKR 200 Bn) that prevailed during the first half of the month, gradually slid in the later weeks.
- Heavy buying interest was witnessed in the early treasury auctions as there was high anticipation for a rate cut in the first monetary policy review for the year. However, the CBSL held the policy rates unchanged during the meeting and in the subsequent auction, buying interest declined.
- Merchandise exports fell just USD 36 Mn short of USD 1 Bn mark in December – a 3.5% dip compared to the same month the year before. Worker remittances was up by 22.2% (Y/Y). Imports declined by 14.4% (Y/Y). As a result, the trade deficit remained around USD 563 Mn.
- Rupee came under pressure in the second half of January. The CBSL sold over USD 72 Mn in the forex market in an attempt to prevent further depreciation. In addition, the CBSL informed commercial banks to refrain from entering into forward contracts of foreign exchange for a period of three months. As a result, forward volumes further contracted.
- CSE opened 2021 with a record all-time-high performance in January with the ASPI gaining over 25% while S&P 20 gaining around 30% making it one of the best performing market in the world.
- Early January, oil topped to pre-crisis level following Saudi output cut but failed to maintain momentum as the broader global economic recovery still remained largely uncertain.

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

Interbank call market activity rose markedly to pre-crisis levels during January barring 3rd week. Repo volumes were modest and were up after thin volumes in December. Call rates were flat while repo rates went down.

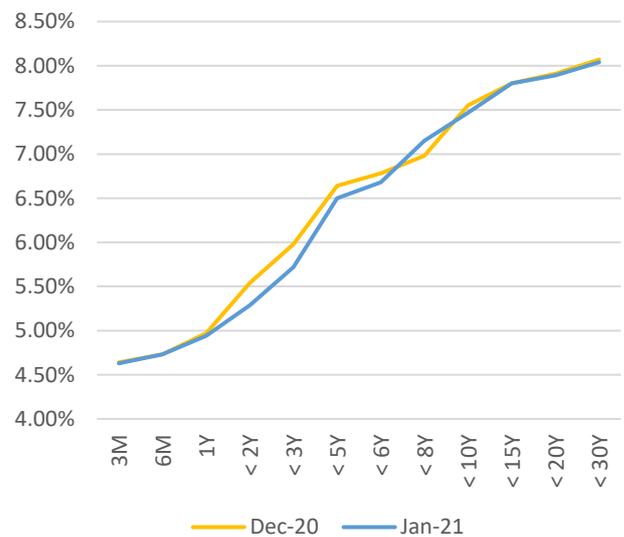
High excess market liquidity (above LKR 200 Bn) that prevailed during the first half of the month, gradually slid in the later weeks. The CBSL sold down some of its treasury holdings on several occasions during the month just before buying LKR 12 Bn treasuries on the last working day of January. The CBSL did not conduct any OMO auctions in January. The intervention in the forex market removed over LKR 14 Bn from the market. In addition, over USD 970 Mn forex obligations were pending for January and these payments would also have removed substantial amount reserve money from circulation.

Heavy buying interest was witnessed in the early treasury auctions as there was high anticipation for

a rate cut in the first monetary policy review for the year. Accordingly, yields in the primary T-bills market were seen falling. The CBSL held the policy rates unchanged during the meeting and in the subsequent auction, buying interest declined. Yields in the secondary market were steady apart from 12Ms which moved down by ~3 bps amidst record selloff as investors eyed on absorbing fresh debt issuances ahead of monetary policy review.

Long-term rates

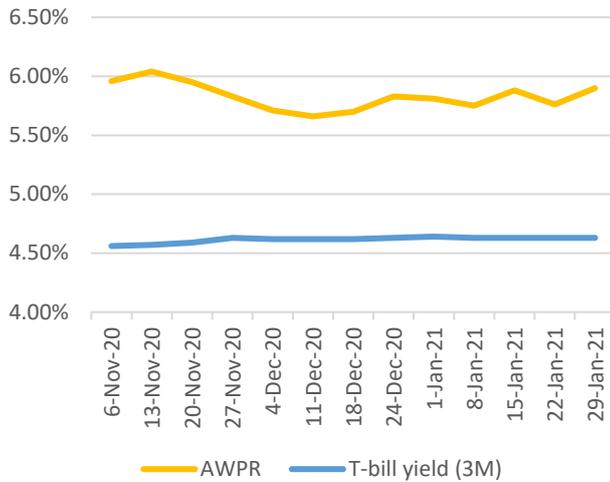
Figure 2: Yield curve of treasuries



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

The CBSL held two bond auctions in January which absorbed over LKR 155 Bn from the market. The market activity in the secondary market was modest. Yields of mid-tenor securities declined 10-to-25 bps while the long end of the yield curve was mixed.

Figure 3: AWPR¹ and 3M T-bill yield



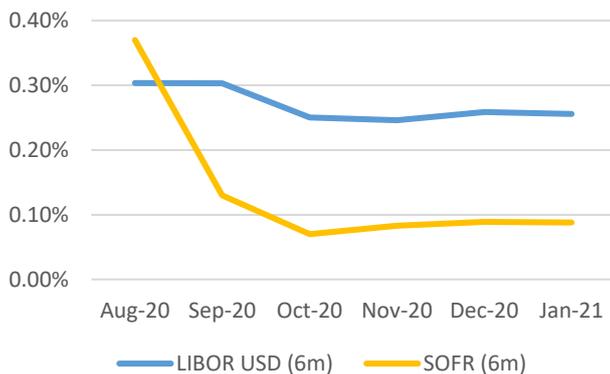
Note: T-bill yield for secondary market
Source: CBSL

AWPR was volatile and generally remained above December level. Consequently, the AWPR and 3M T-bill spread widened.

Bank credit to private sector continued to expand in December. However, we expect the credit to slow down in January.

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

Key highlights for US treasuries centered around the additional fiscal stimulus, speculation about

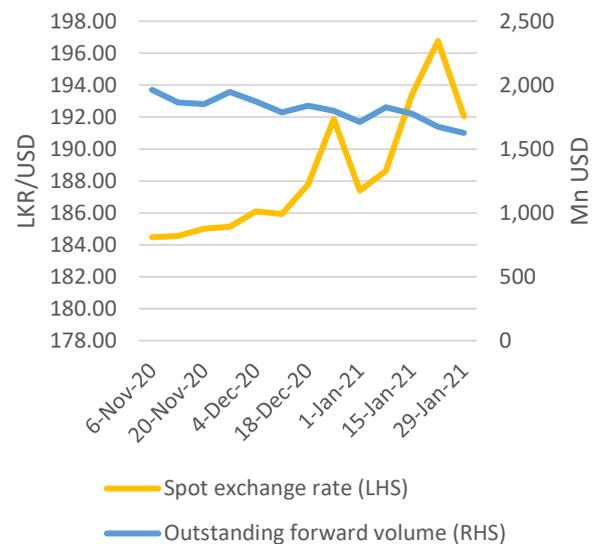
Fed's QE programme, and ECBs announcement of its asset purchasing programme. Disappointing economic data, both US and Europe bolstered demand for treasuries. Treasuries gained further traction as equities came under pressure towards the tail end of the month.

Vaccine rollout in major economies sparked confidence among lenders and helped to ease Eurodollar rates.

SLISBs with the nearest maturity (27-Jul-21) saw yields moderating to 23.66% by end January while ISBs maturing in 2022-24 saw yields rising further by over 150 bps.

External Sector

Figure 5: Exchange rate and outstanding forward volume



Source: CBSL

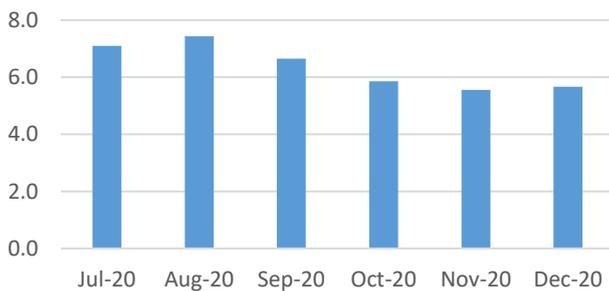
Merchandise exports fell just USD 36 Mn short of USD 1 Bn mark in December – a 3.5% dip compared to same month the year before. Worker remittances was up by 22.2% (Y/Y). Imports declined by 14.4% (Y/Y). As a result, the trade deficit remained around USD 563 Mn.

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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Foreign investors sold around USD 16 Mn equities by taking advantage of the strong domestic buying interest in January. Capital flight from treasuries was around USD 10 Mn. The CBSL restricted outward remittances on capital transactions for six months. During the SLDB auction held in January, the CBSL accepted USD 44 Mn. By January, the reserves fell to USD 4.8 Bn [1]. Total forex payments for January were over USD 970 Mn which may have been drawn out of reserves.

Interbank forex market operated with weaker volumes. Rupee came under pressure in the second half of January. The CBSL sold over USD 72 Mn in the forex market in an attempt to prevent further depreciation. In addition, the CBSL requested commercial banks to refrain from entering into forward contracts of foreign exchange for a period of three months. As a result, forward volume further contracted.

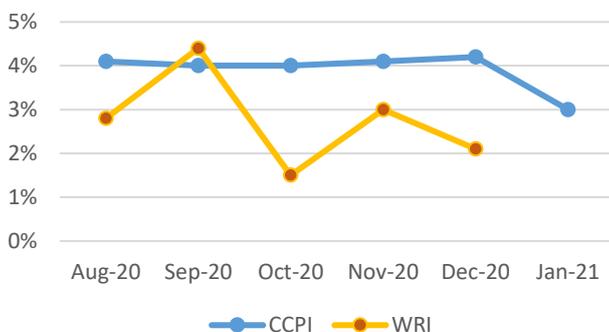
Figure 6: Gross official reserves (Mn USD)



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)

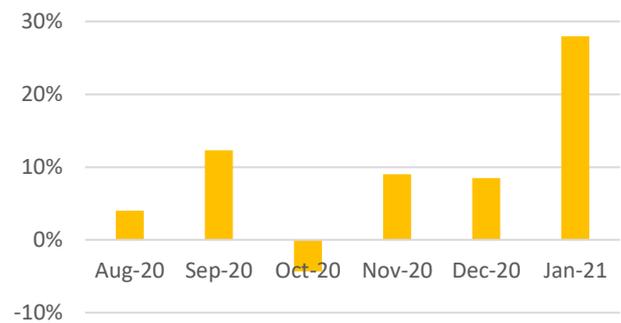
Source: CBSL

Wage growth continued to be sluggish in December trailing behind inflation. Food inflation eased in January to 6.8%(Y/Y) while non-food inflation also slid to 1.4% (Y/Y).

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

CSE opened 2021 with a record all-time-high performance in January with the ASPI gaining over 25% while S&P 20 gaining around 30%. CSE was among the best performing markets of the world. Market PBV increased from 1.13 to 1.44 favouring sellers. Domestic buying interest was high.

Transport sector shares continued to perform well in January. Healthcare and Consumer service sectors which had a good run in December lost some of the gains.

Figure 9: GICS sector performance- January

Sector	Index Points Gain
Transportation	3599
Diversified Financials	808
Materials	517
Capital Goods	413
Food & Staples Retailing	190
Consumer Durables & Apparel	184
Banks	155
Food, Beverage & Tobacco	125
Real Estate	124
Automobiles & Components	103
Energy	85

Retailing	77
Telecommunication Services	72
Insurance	52
Commercial & Professional Services	24
Household & Personal Products	16
Utilities	10
Consumer Services	-1
Healthcare Equipment & Services	-148

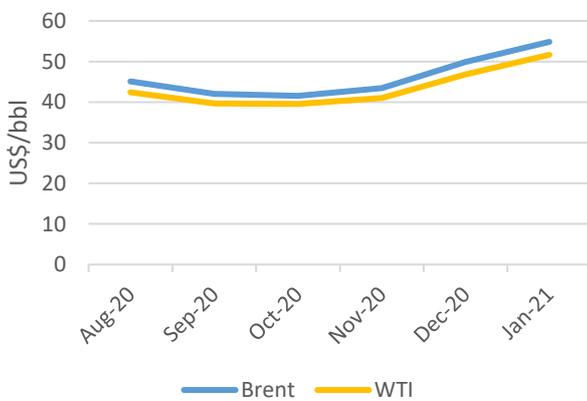
Source: CSE

Global Markets

Performance of the US equities was mixed in January due to slower pace of vaccine distribution. A short squeeze of GameStop stocks took the spotlight. European markets were down with the exception of Germany's DAX. Emerging markets were also mixed with Hang Seng (Hong Kong), Kospi (Korea), and Nikkei (Japan) recording gains.

Commodities

Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Early January, oil topped to pre-crisis level following Saudi output cut but failed to maintain momentum as the broader global economic recovery still remained largely uncertain.

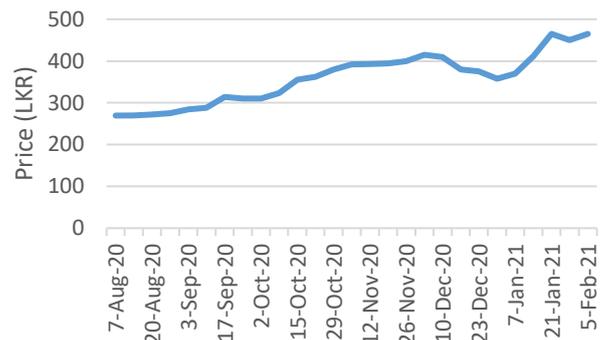
Figure 11: Tea (All Elevations) price and quantity sold at weekly auctions



Source: Forbes & Walker

Tea prices opened on a high note in the first auction of January before taking a dip in the later auctions amidst record supply.

Figure 12: Rubber price weekly auctions



Note: Price of Latex 4X

Source: RRISL

Rubber bounced back from December slump in January. News with regard to opening of South Asia's largest tyre manufacturing plant in Sri Lanka may have given a boost to prices.

Figure 13: Gold price



Source: CBSL

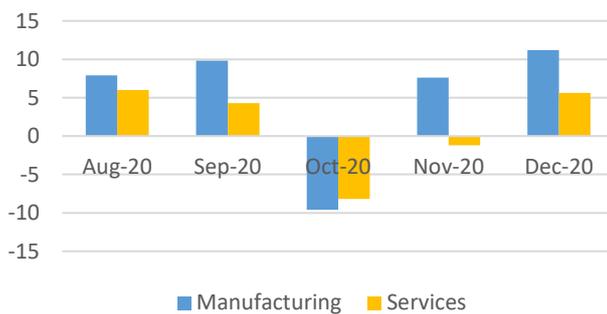
Gold gained in January over weaker real yields in US treasuries. US fiscal stimulus hopes also compelled investors to park their wealth in gold in expectation of inflation.

Base metals were buoyant, driven by expectation of further expansion in industrial activities.

prices weigh down on the import bill. Bilateral loans may help to restore reserves which are worryingly low at the moment. It is likely that the credit grew slowly in January hence the Central Bank may eye on keeping the credit flow smooth and consistent moving into March to end 1Q stronger.

Real Sector

Figure 14: 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

PMI data for December showed improving performance of manufacturing and services sector indices. Manufacturers were seen receiving new orders, expanding production and stocks, and recruiting staff. However, the delivery lag continued to persist.

Services sector, which contracted for two months since the beginning of the second wave, managed to record an expansion in January. Service establishments saw new business coming in while business activities improving. However, the employment in the sector was still weak.

Outlook for February

Pressure for inflation to rise will remain mild as demand is fairly subdued for the time being. But import restrictions have already found their way to some sections of the economy by way of supply shocks. Sri Lanka's external sector troubles are far from over as commodity prices, especially oil,

Rating Actions

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

Issuer	Issue	Action	Previous Rating	Current Rating
MCB Bank Limited (Sri Lanka Branch)	Issuer Rating	Reaffirmed	[SL]A+ (Stable)	[SL]A+ (Stable)
Alliance Finance Company PLC	Issuer Rating	Reaffirmed	[SL]BBB- (Negative)	[SL]BBB- (Negative)
Construction Guarantee Fund	Issuer Rating	Revised	[SL]A- (Stable)	[SL]A (Stable)
JB Vantage Money Market Fund	Mutual Fund Rating	Assigned	N/A	[SL]A+mfs
LOLC Holdings PLC	Proposed Senior Redeemable Debentures (LKR 10,000 Mn)	Assigned	N/A	[SL]A (Stable)

Abbreviations

ASPI	All Share Price Index
bps	Basis points
CBSL	Central Bank of Sri Lanka
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
RRISL	Rubber Research Institute of Sri Lanka
YTD	Year-to-date

Works Cited

- [1] Newsfirst, "Sri Lanka's reserves decline : CBSL," 12 January 2021. [Online]. Available: <https://www.newsfirst.lk/2021/02/12/sri-lankas-reserves-decline-cbsl/>.

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