



MONTHLY ECONOMIC UPDATE | February

Economy at a glance for February 2021

Treasury yields up, equities down

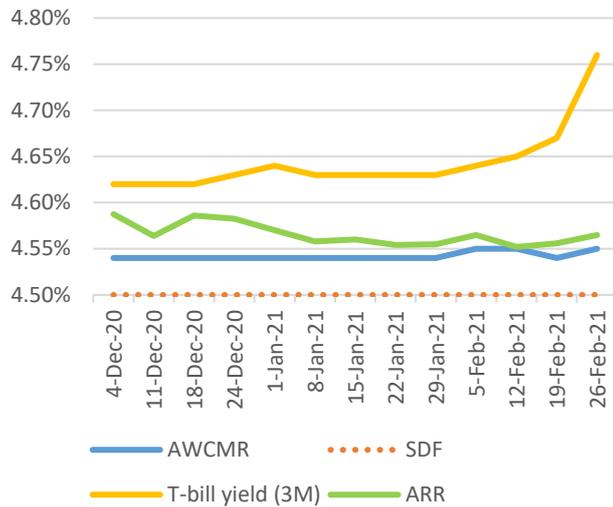
Highlights

- T-bill yields in the secondary market saw ~10 bps hike as the CBSL relaxed yield caps during the primary auctions. ICRA Lanka notes a similar rise in US treasuries as well.
- AWPR broadly remained around 5.75% apart from the 2nd week of February where the rate dipped sharply to 5.59%.
- Yields on SLISBs rose with the nearest maturity (27-Jul-21) increasing by about 12 pps and tapering towards the longer end.
- Capital flight continued but to a lesser degree than in January. Foreigners sold over USD 25 Mn equities and nearly USD 1 Mn treasuries during the month on net basis.
- Gross official reserves slid to USD 4.5 Bn by the end of the month.
- Rupee depreciated by nearly three rupees during the first week of February amid heavy dollar purchases by the banks. In the subsequent weeks as the interbank forex volumes moderated, the rupee stabilized around 194 LKR/USD.
- Inflation fell below 4% (i.e. lower bound of the CBSL's inflation target) for the second straight month due to the higher base that prevailed around the same time last year.
- Enthusiasm among the domestic investors evaporated as the markets closed with a 13.75% fall in the ASPI and a 15.6% fall in the S&P SL20.

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

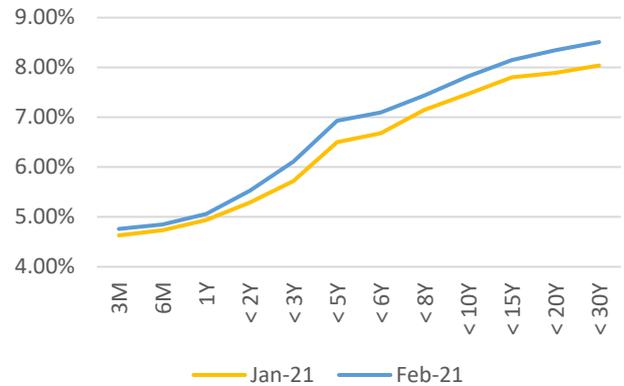
Call and repo rates were steady but the volumes moderated in February. T-bill yields in the secondary market saw ~10 bps hike as the CBSL relaxed yield caps during the primary auctions (Yield caps for 3M and 6M securities were absent since the second auction for February).

There was no auction based open market operations during the month. Despite adequate bid volumes, in all the primary auctions in February, the market failed to absorb intended treasury stocks. The CBSL stepped in and bought over LKR 73 Bn T-bills to its books over the course of the month. In the meanwhile, the net effect of payment of foreign currency obligations (USD 102 Mn) and the purchase of forex from the market by the CBSL (USD 72 Mn) may have drained over LKR 15 Bn from the money supply. As a result, the excess liquidity gradually reverted back to above LKR 150 Bn mark.

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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Long-term rates

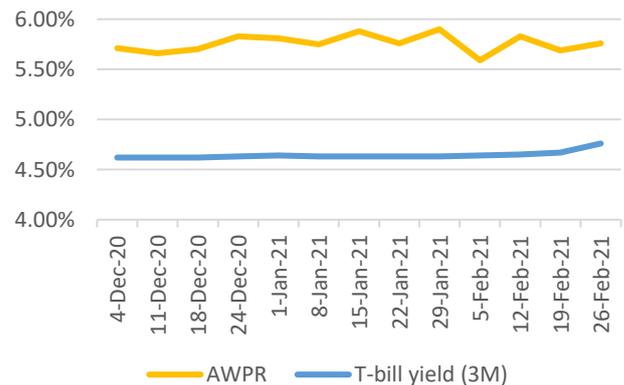
Figure 2: Yield curve of treasuries



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 market showed interest in the fresh bond issue for the month. The CBSL offered LKR 125 Bn and accepted nearly LKR 100 Bn during the primary auctions. Secondary market bond yields rose 25-50 bps. ICRA Lanka observes that recent surge in treasury yields has been a global phenomenon. Many analysts attribute the rising inflation expectation as a key cause of this increase.

Figure 3: AWPR¹ and 3M T-bill yield



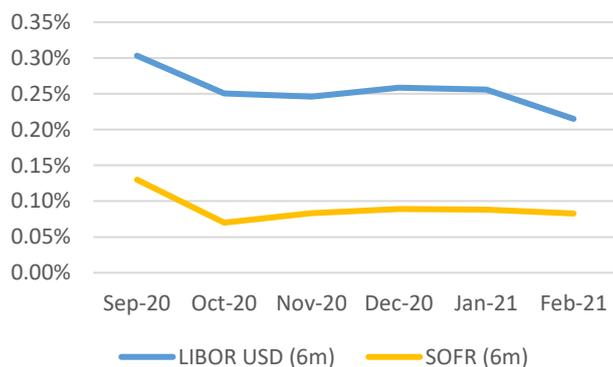
Note: T-bill yield for secondary market
Source: CBSL

AWPR broadly remained around 5.75% in February except in the 2nd week where the rate dipped sharply to 5.59%.

In line with ICRA Lanka's previous expectation, the private credit slowed down in January. The credit grew only by LKR 26 Bn with respect to December 2020, lowest month-on-month increase since July last year. Private credit generally tends to falter whenever the reserve money growth slows down. Hence, we expect the private credit to have grown slowly in February as well.

International rates

Figure 4: Month open international lending rates



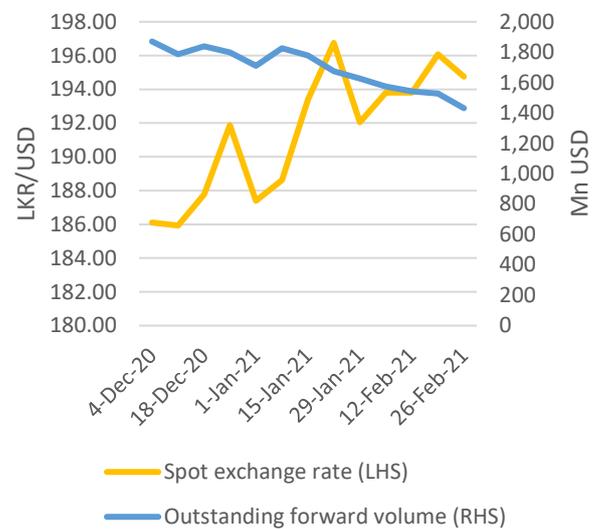
Notes: The SOFR Averages are compounded averages of the SOFR over rolling 180-calendar day periods.
Source: New York Federal Reserve and global-rates.com

In the US, declining COVID cases and deaths and expedited vaccines rollout programme caused the US treasury yields to shoot-up. Falling unemployment and energy prices have also fed into the inflation expectations. Consequently, the yield curve, especially the mid-tenor securities, were seen steepening. But the yields moderated towards the month end as the Fed reassured its commitment to the bond buying programme (i.e. Quantitative Easing).

Yields on SLISBs rose in February with the nearest maturity (27-Jul-21) increasing by about 12 pps and tapering towards the longer end. ISBs that matures early next year also saw yields soaring by nearly 12 pps.

External Sector

Figure 5: Exchange rate and outstanding forward volume



Source: CBSL

Merchandise exports fell 8.1% (Y/Y) in January to USD 924 Mn which while imports declined by 8.3% to USD 1.6 Bn. As a result, the trade deficit reduced by 8.5%. Worker remittances recorded a 16% increase to USD 675 Mn.

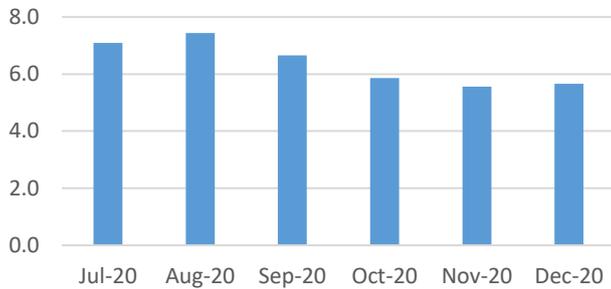
In January, The CBSL restricted outward remittances on capital transactions for six months in order to combat depreciation of the rupee. Capital flight continued in February but to a lesser extent than in January. Foreigners sold over USD 25 Mn equities and nearly USD 1 Mn treasuries during the month.

Total forex loans and interest due was around USD 102 Mn for February. The CBSL also announced that it has settled a USD 400 Mn swap with Reserve Bank of India. In addition, the CBSL bought over USD 27 Mn worth of forex from the market. This comes after the CBSL made it mandatory for commercial banks to sell 10% of the forex remittances to the CBSL. In this context, the reserves slid to USD 4.5 Bn by the end of the month.

Rupee depreciated by nearly three rupees during the first week of February amid heavy dollar purchases by the banks. In the subsequent weeks as the interbank forex volumes moderated, the rupee stabilized around 194 LKR/USD. In the

meanwhile, interbank forward volumes continued to decline.

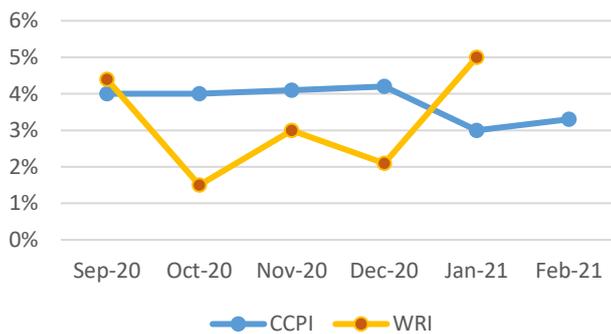
Figure 6: Gross official reserves (Mn USD)



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

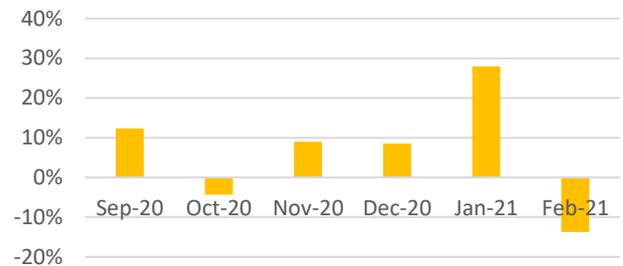
Wages grew stronger above inflation in January on account of continued recovery of services and industrial sectors.

Inflation fell below 4% (i.e. lower bound of the CBSL's inflation target) for the second straight month in February due to the higher base that prevailed around the same time last year. Inflation surpassed 6% in February last year as a result of an increase in prices of food.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

Enthusiasm among the domestic investors evaporated as the markets closed with a 13.75% fall in the ASPI and a 15.6% in the S&P SL20. Plunge in equities was board based, a likely market correction, wiping out nearly LKR 520 Bn value from the market after making back-to-back steep gains in previous weeks. The CSE crashed several times after stocks saw sharp intra-day falls. During February, market PBV (Price-to-Book-Value) decreased from 1.44 to 1.22 favouring buyers.

Figure 9: GICS sector performance- February

Sector	Index Points Gain
Consumer Services	-25
Telecommunication Services	-44
Food & Staples Retailing	-55
Insurance	-69
Commercial & Professional Services	-89
Healthcare Equipment & Services	-93
Household & Personal Products	-97
Utilities	-97
Banks	-109
Food, Beverage & Tobacco	-114
Real Estate	-121
Energy	-166
Consumer Durables & Apparel	-167
Retailing	-169
Automobiles & Components	-205
Capital Goods	-252
Materials	-277
Diversified Financials	-368
Transportation	-674

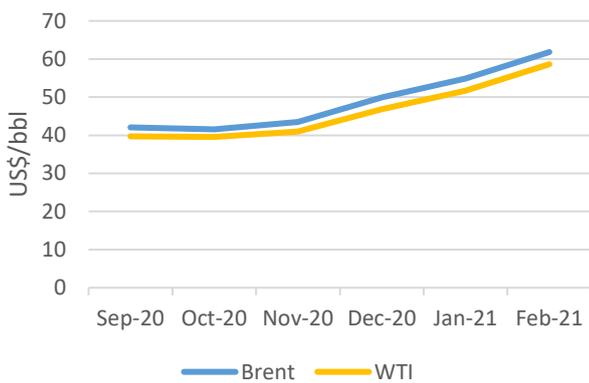
Source: CSE

Global Markets

US markets rode on the prospects of economic recovery and decreasing number of COVID cases. Europe and emerging markets were also upbeat, recording solid gains sharing optimism over global recovery from the plight of COVID pandemic.

Commodities

Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Oil prices surged above USD 60 a barrel for the first time since January 2020 after Saudi Arabia cut oil production.

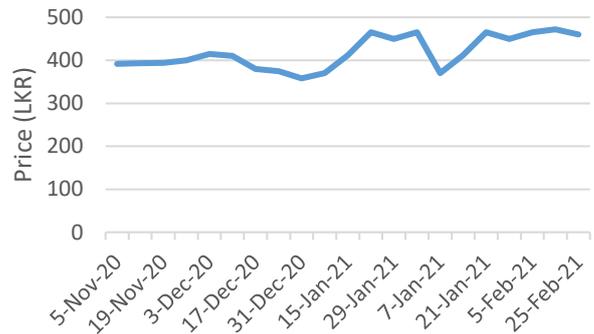
Figure 11: Tea (All Elevations) price and quantity sold at weekly auctions



Source: Forbes & Walker

Tea prices continued to recover in February while the production declined gradually.

Figure 12: Rubber price weekly auctions



Note: Price of Latex 4X

Source: RRISL

Rubber price was steady in February in the domestic auctions while spot prices in the global markets rose driven by soaring crude oil prices.

Figure 13: Gold price



Source: CBSL

Gold fell during February as investors were attracted to high yields of US treasuries. In addition, bullish equities drove investors away from gold.

Read ICRA Lanka's report on the [implications of rising commodity prices for Sri Lanka](#).

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

Manufacturing sector continued to expand in January and February months as seen from the latest PMI data. New orders have slowed down while employment rose at a higher rate. The supplier delivery times continued to lengthen as a result of lower inbound ship traffic triggered by the import controls.

Services sector expanded and expectations for business activity enhanced as the mobility improved with individuals adapting to new normal. However, the employment continued to contract.

Read ICRA Lanka's report on [the outlook for Sri Lankan economy - 2021](#).

Outlook for March

Over 500,000 people in Sri Lanka have been vaccinated against the COVID-19 virus by early March [1]. Early success in the vaccine rollout is crucial as this will be closely monitored by the international investors and the recovery of the real economy hinges on this.

It is unclear whether pressure for treasury yields to go up is triggered by inflation expectations or the prospects of economic recovery or both. In any case, it is important to keep the yields in check to drive the lending rates down. In this context, if the

credit growth becomes weak in Q1, the CBSL will be on the spotlight as markets may anticipate some policy action in the next Monetary Policy Committee meeting early April.

China approved USD 1.5 Bn currency swap with Sri Lanka last week. This may help to restore confidence in the rupee and the SLISBs in the near-term.

There is no immediate sign of inflation taking off, but rising commodity prices and import restrictions may push up prices in certain sectors.

Rating Actions

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

Issuer	Issue	Action	Previous Rating	Current Rating
Oxford College of Business (Pvt) Ltd	Issuer Rating	Assigned	N/A	[SL]BBB (Stable)
Multi Finance PLC	Issuer Rating	Revised	[SL]B- (Negative)	[SL] C+
Softlogic Finance PLC	Issuer Rating	Reaffirmed	[SL]BB- (On Watch)	[SL]BB- (On Watch)
Commercial Credit and Finance PLC	Guaranteed Redeemable Debentures Programme (LKR 2,000 Mn)	Assigned	N/A	[SL]AA(CE)
Commercial Credit and Finance PLC	Listed Guaranteed Subordinated Redeemable Debentures Programme (LKR 2,000 Mn)	Withdrawn	[SL]A+ (SO)	N/A
Windforce (Pvt) Ltd.	Issuer Rating	Assigned	N/A	[SL]AA- (Stable)
Softlogic Capital PLC	Issuer rating	Reaffirmed	[SL]BBB+ (On Watch)	[SL]BBB+ (On Watch)
Softlogic Capital PLC	Senior, unsecured, listed redeemable, debentures (LKR 1,500 Mn)	Reaffirmed	[SL]BBB+ (On Watch)	[SL]BBB+ (On Watch)

Abbreviations

ASPI	All Share Price Index
bps	Basis points
pps	Percentage 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] Xinhua Net, "Over 500,000 people vaccinated against COVID-19 in Sri Lanka," 02 March 2020. [Online]. Available: http://www.xinhuanet.com/english/asiapacific/2021-03/02/c_139778159.htm.

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