



# Insights

April 2021

## Low interest rates. Who are the winners and losers?

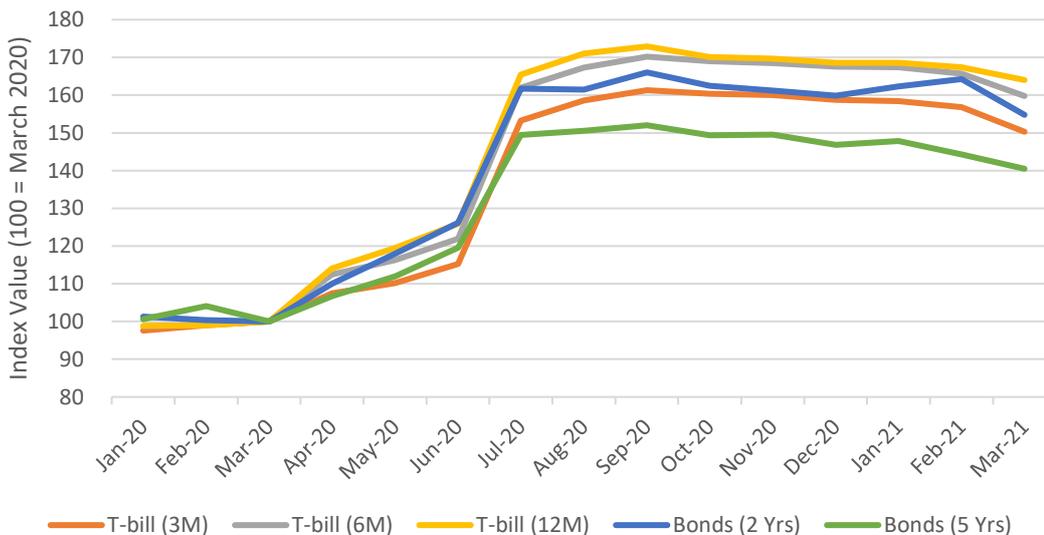
### Key Takeaways

- Price increase in treasuries have helped primary dealers and banks to realize substantial capital gains as much as 40-to-60 percent from March 2020 price levels.
- Equities attracted a large number of local investors, as historically low interest rates on fixed income assets prompted them to seek alternative investments. Investors saw their portfolio valuations growing by at least 90% from the precrisis level by the end of January this year.
- Declining yields on fixed deposits helped mutual funds industry's Asset Under Management (AUM) to grow exponentially to 97% by March this year making it one of the biggest winners from the current low interest rates.
- Share of institutional time deposits have increased as low interest rates have driven retail depositors to higher yielding assets. More risk averse depositors such as retirees have opted to stay put and lower real returns have undoubtedly affected their welfare level.
- Lower interest rates have pushed the demand for housing loans up, resulting in house prices soaring by over 20% from the 2Q 2020 level outpacing apartment and land prices.
- Large corporates and financial intuitions are showing growing interest in issuing debt instruments and locking up their funding needs at the current low interest rates. Roughly LKR 117 Bn debt instruments have been rated between 2Q 2020 to 1Q 2021 period.

When the COVID pandemic engulfed global economies, Central Banks around the world almost universally, brought the interest rates down. The Central Bank of Sri Lanka (CBSL) also followed suit and reduced policy rates in seven steps between March and July last year. This had a major impact on market rates and asset prices creating opportunities and challenges to the various sectors of the economy.

## Treasuries

Figure 1: Price of Government Securities



Price increase in treasuries helped primary dealers and banks to realize substantial capital gains as much as 40-to-60 percent from March 2020 price levels.

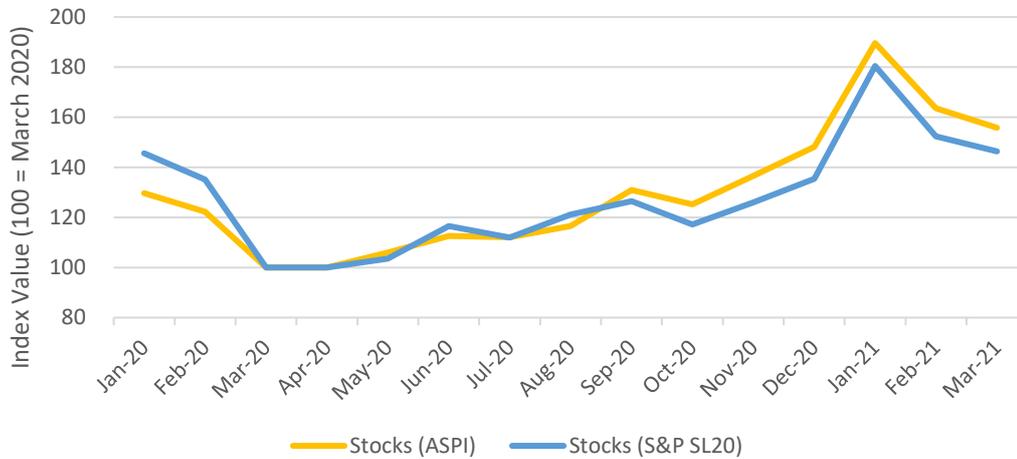
Sources: ICRA Lanka Research, CBSL

During March last year, when the markets grappled with mounting uncertainty, investors sought refuge in the treasury assets propelling the prices up. Subsequent interest rate cuts also gave a nudge to the process. This helped the primary dealers and banks to realize substantial capital gains as much as 40-to-60 percent from March 2020 price levels.

Employees' Provident Fund (EPF), Sri Lanka's largest superannuation fund which holds over 90% of its portfolio in government securities [1] would have been in a position to make considerable capital gains pushing the effective rate of return up in 2020. As at end of 2016, more than 75% of its treasury holdings, which had weighted average yield of 11.26% [2], were expected to mature after 2021. It is not possible to determine the current composition of the maturity profile of the government securities portfolio of the EPF. However, going forward, with the low yields in treasuries, maintaining effective yields at higher level will be challenging while keeping the current risk profile.

## Equities

Figure 2: Movement in Stocks



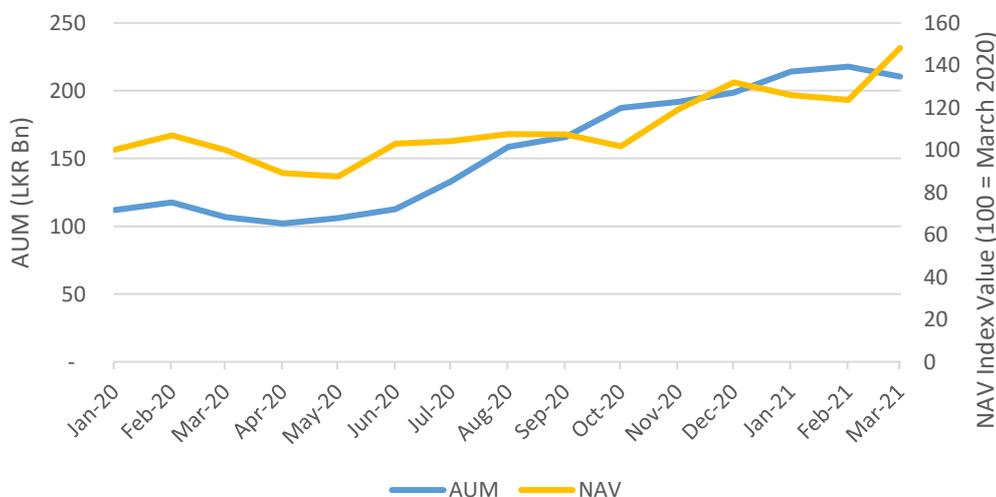
Investors saw their portfolio valuations growing by at least 90% from the precrisis level by the end of January this year.

Sources: ICRA Lanka Research, CSE

Initial panic selling triggered a market collapse in March 2020, followed by a month of closure to prevent a further fall and chaos in the market. However, with easing of the restrictions, the market gained momentum. Equities attracted a large number of local investors as historically low interest rates on fixed income assets prompted them to seek alternative investments. Investors saw their portfolio valuations growing by at least 90% from the precrisis level by the end of January this year. The risk appetite among the investors seemed to have improved overtime especially after 3Q 2020 as indicated by increased demand for non-blue-chip companies.

## Mutual Funds

Figure 3: Industry NAV for Mutual Funds



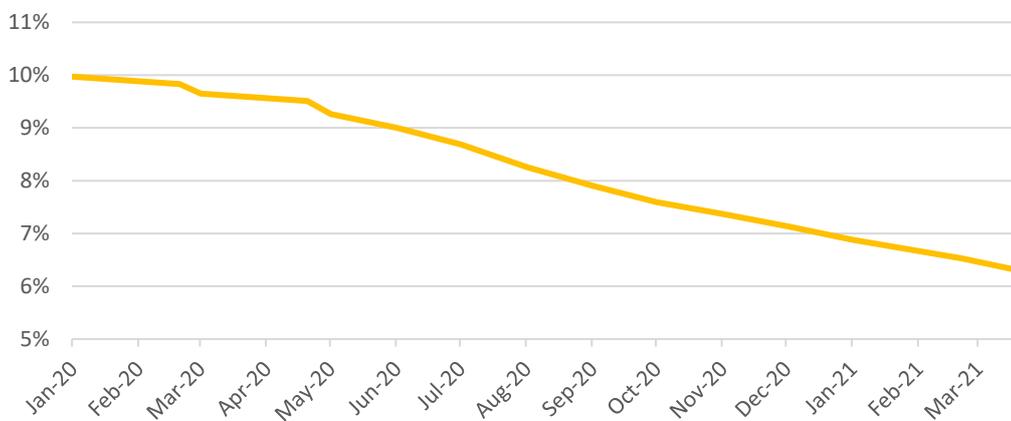
Declining yields on fixed deposits helped mutual funds industry's Asset Under Management (AUM) to grow exponentially to 97% by March this year making it one of the biggest winners from the current low interest rates.

Sources: ICRA Lanka Research, UTASL

March to May last year was quite a turbulent period for financial markets. Mutual funds industry was no exception. The funds saw their respective AUMs (Assets Under Management) shrinking during this period as investors withdrew funds to meet consumption or working capital needs. Concurrently, fall in equities sent NAVs (Net Asset Value) plummeting as much as 12% by the end of the said period. Subsequently, declining yields on fixed deposits helped mutual funds industry's Asset Under Management (AUM) to grow exponentially to 97% by March this year making it one of the biggest winners from the current low interest rates. Industry NAV have grown 48% from the precrisis level by the end of March this year.

## Time Deposits

Figure 4: Weighted Average Fixed Deposit Rate



Share of institutional time deposits have increased as low interest rates have driven retail depositors to higher yielding assets.

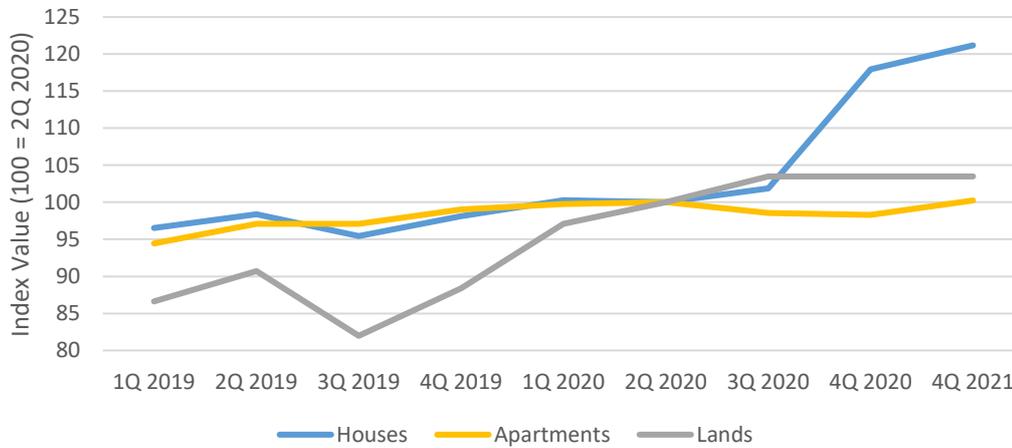
Source: CBSL

Time deposit rates were already coming down before the crisis as the policy rates were cut on numerous occasions between June 2019 and February 2020. Rates continued to decline thereafter with the COVID induced monetary easing. However, year-on-year growth rate of aggregate fixed deposits continued to accelerate throughout 2020 as the share of institutional depositors increased.

Meanwhile, share of retail deposits show a decline possibly as a result of deposit holders switching to riskier but higher yielding assets such as equities. More risk averse depositors such as retirees have opted to stay put and lower real returns have undoubtedly affected their welfare level.

## Real Estate

Figure 5: Price Movement in Properties



Lower interest rates have pushed the demand for housing loans up, resulting in housing prices soaring by over 20% from the 2Q 2020 level which is in stark contrast to apartment and land prices.

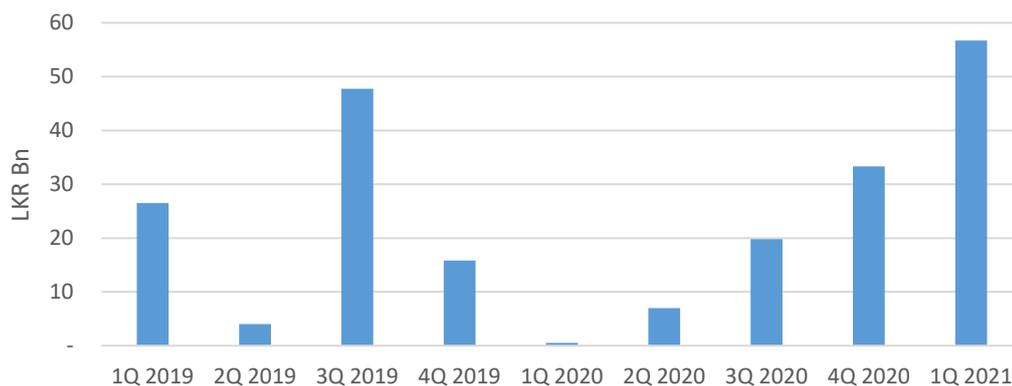
Notes: Average price of a four-bedroom house and three-bedroom apartment.

Source: ICRA Lanka Research, Lankapropertyweb.com

Lower interest rates have pushed the demand for housing loans up, resulting in housing prices soaring by over 20% from the 2Q 2020 level which is in stark contrast to apartment and land prices. Higher cost of construction triggered by the import controls may also be keeping the house prices buoyant.

## Debt Instruments

Figure 6: Amount of Publicly Rated Debt Instruments



Large corporates and financial intuitions are showing growing interest in issuing debt instruments and locking up their funding needs at the current low interest rates.

Source: ICRA Lanka Research estimates

AWPLR, a key benchmark in debt markets, has fallen over 350 bps since March 2020 so far. Reduction in lending rates has helped businesses to reduce interest expenses considerably over the last few quarters. Large corporates and financial intuitions are showing growing interest in issuing debt instruments and locking up their funding needs at the current low interest rates. According to ICRA Lanka estimates roughly LKR 117 Bn debt instruments have been rated between 2Q 2020 to 1Q 2021 period and 1Q

2021 marks the highest amount of debt rated during the last five years. On the demand side, insurance companies and mutual funds stepping forward to buy these instruments increase their effective yields to attract investors from other asset classes.

## Abbreviations

AUM	Assets Under Management
ASPI	All Share Price Index
bps	Basis Points
CBSL	Central Bank of Sri Lanka
CSE	Colombo Stock Exchange
EPF	Employees' Provident Fund
NAV	Net Asset Value
pps	Percentage Points
UTASL	Unit Trust Association of Sri Lanka

## Works Cited

- [1] Employees' Provident Fund, "Financial Highlights," Employees' Provident Fund, Colombo, 2019.
- [2] Employees' Provident Fund, "Annual Report," Employees' Provident Fund, Colombo, 2016.

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

Published date: Apr 27, 2021  
Document #: ins21apr27

©Copyright, 2021- 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 (ICRA Lanka) 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 ("ICRA") of India. The ultimate parent company of the international credit rating agency, Moody's Investors Service, is the indirect majority shareholder of ICRA.



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](mailto:info@icralanka.com); Website: [www.icralanka.com](http://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  
+94-11-773417517  
[wdbarnabas@icralanka.com](mailto:wdbarnabas@icralanka.com)

Lalinda Sugathadasa  
Head of Research &  
Business Development  
+94-11-774781343  
[lalinda@icralanka.com](mailto:lalinda@icralanka.com)

Rasanga Weliwatta  
Head of Financial Sector Ratings  
+94-11-773553564  
[rasanga@icralanka.com](mailto:rasanga@icralanka.com)

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

Follow us on



lcr Lanka



icra-lanka