



MONTHLY ECONOMIC UPDATE

June

Economy at a glance for June 2021

A month of stagnation with tightening liquidity.

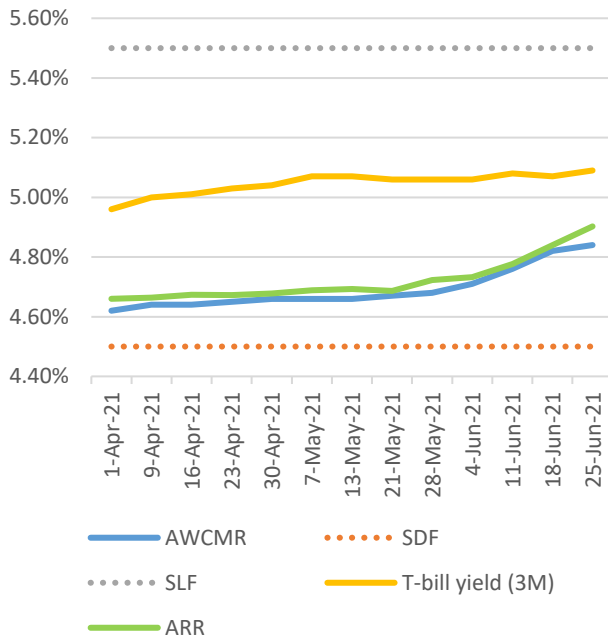
Highlights

- Driven by the uncertainty of the third wave of the pandemic, call and repo rates rose up over 20 bps during the course of the month amid tightening liquidity.
- The shorter-end and belly of the yield curve shifted up marginally (3-4 bps).
- With tightening liquidity in the money markets, the AWPLR was seen rising during June by about 20 bps.
- The CBSL allowed the banks to buy SLISBs with fresh funds on 16th June. Yields on SLISBs jumped over 9 pps in the last week of June.
- The reserve position essentially remained flat at USD 4 Bn in June.
- Both interbank spot and forward markets were dull. Outstanding forward volumes declined. Forward premiums remained inverted during the month.
- Headline inflation increased to 5.2% in June, biggest jump since the beginning of the pandemic last year.
- The performance of the CSE was mixed in general during the month of June as the market closed with a 5.87% gain in the ASPI and a 0.35% loss in the S&P20.
- PMI for both services and manufacturing sectors showed more or less a continuation of the impact of the pandemic for another month.

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

Driven by the uncertainty of the third wave of the pandemic, call and repo rates rose up over 20 bps during the course of the month amid tightening liquidity. The market volumes remained elevated. The CBSL regularly added liquidity via purchasing treasuries at the primary auctions. In addition, it added over LKR 200 Bn (which claimed to be a provisional advance) towards the tail-end of the month before withdrawing the next day. The open market purchases of forex by the CBSL have also injected close to LKR 7 Bn (USD 33 Mn). Standing Lending Facility (SLF) was seen being utilized more intensely averaging around LKR 40 Bn a day during the month.

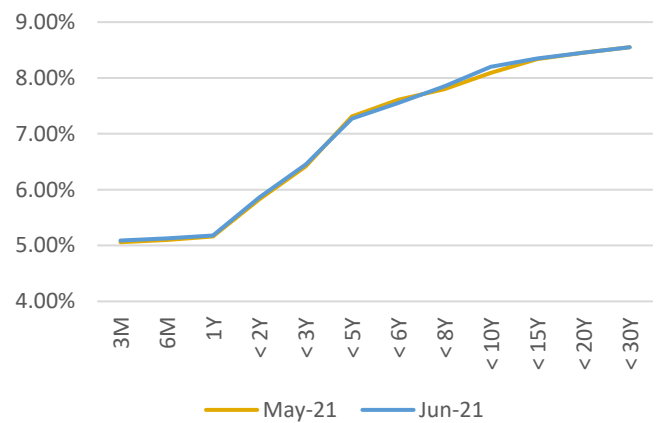
The T-bill yields in both primary and secondary markets edged up during June with secondary market recording moderate volumes. The CBSL

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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continued to maintain the yield cap on one-year notes but relaxed the same to 5.23% during the last auction of the month. Bid acceptance ratios for 6M and 12M notes were strikingly low.

Long-term rates

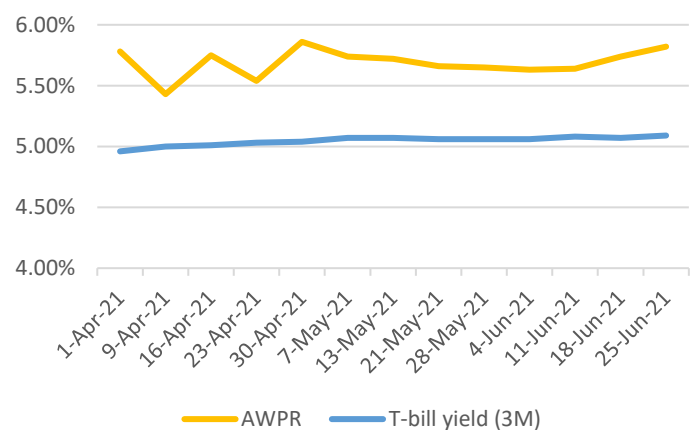
Figure 2: Yield curve of treasuries



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

Healthy demand was observed for fresh bond issues during the month. The volumes in the secondary market were moderate. In the meanwhile, the shorter-end and belly of the yield curve shifted up marginally.

Figure 3: AWPR¹ and 3M T-bill yield



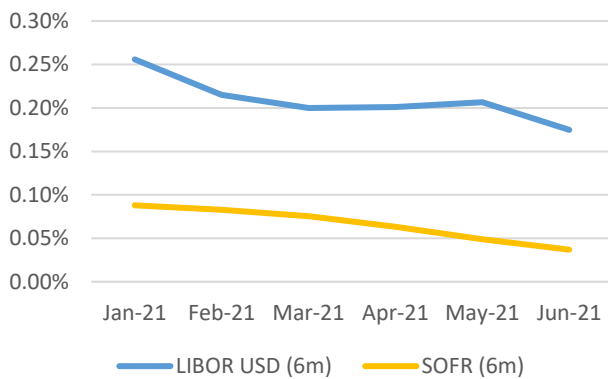
Note: T-bill yield for secondary market, Source: CBSL

With tightening liquidity in the money markets, the AWPLR was seen rising during June by about 20 bps.

Private credit growth was moderate in May expanding by over LKR 55 Bn possibly as a result of the rapid escalation of the pandemic situation in the country. The reserve money grew stronger in the last two weeks of June likely due to expansion in the money in circulation. Therefore, we expect the moderation in private credit to have continued through June 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

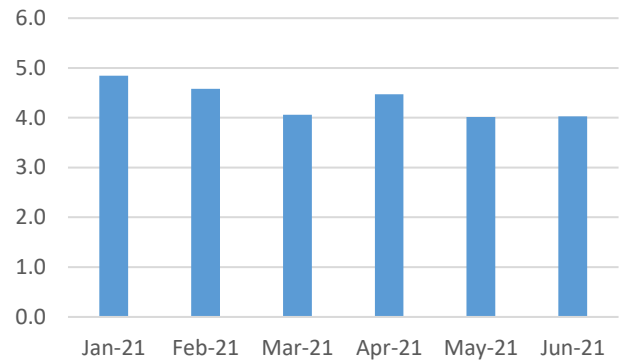
The US treasury market was rattled when the Fed announced that they are forecasting hikes in 2023 – a move which the Fed initially said would not initiate until at least 2024. However, the Fed’s reassurance that it would be patient before tapering the QE programme helped to keep the market liquid. Eurodollar rates slid in June.

The CBSL allowed the banks to buy SLISBs with fresh funds on 16th June. Yields on SLISBs jumped over 9 pps in the last week of June compared to end May.

External Sector

Exports marginally went up to USD 892 Mn while imports dropped to USD 1.7 Bn from the month-ago levels in May. Concurrently, workers’ remittances grew by 6.5% to USD 460mn (Y/Y).

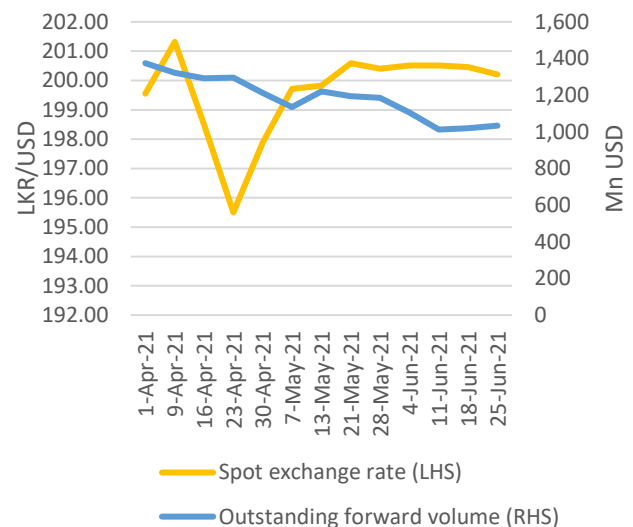
Figure 5: Gross official reserves (Mn USD)



Source: CBSL

The CBSL offered USD 100 Mn during the SLDB auction held in June, but investors showed lackluster buying interest. The CBSL bought USD 33 Mn forex from the open market. The reserve position essentially remained flat in June compared to May.

Figure 6: Exchange rate and outstanding forward volume

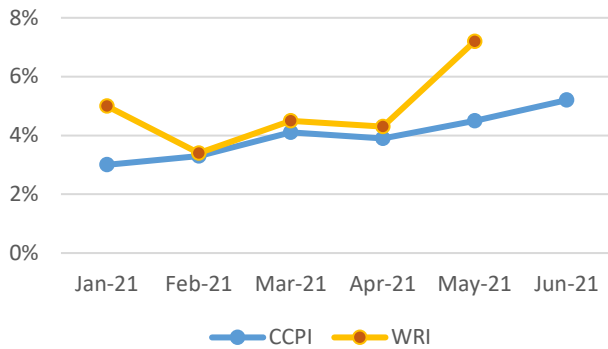


Source: CBSL

Both interbank spot and forward markets were dull. Outstanding forward volumes declined. Forward premiums remained inverted during the month.

Prices & Wages

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



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

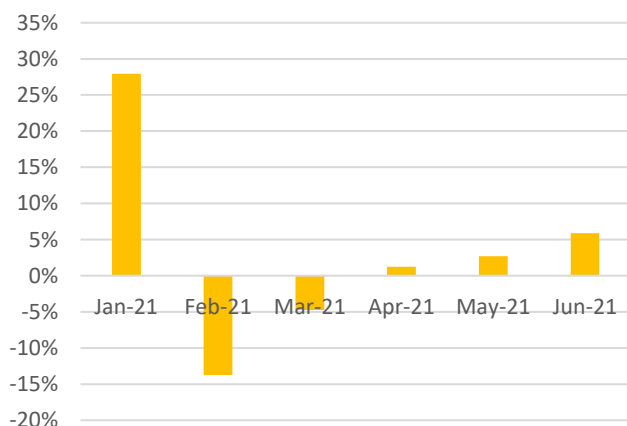
Wage growth jumped to 7.2% in May as a result of the lower base that prevailed around the same time last year. This is driven by the recovery in services and industrial sector wages.

Headline inflation increased to 5.2% in June, biggest jump since the beginning of the pandemic last year. The increase is due to the hike in fuel prices which has caused a broad-based increase in prices of both food and non-food items.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

The performance of the CSE was mixed in general during the month of June as the market closed with a 5.87% gain in the ASPI and a 0.35% loss in the S&P20. Foreign investors were net sellers, however the overall net outflow decreased substantially to LKR 1.16 Bn from LKR 3.8 Bn. Majority of GICS sectors were able to record gains with the best performing sectors being transportation and Diversified Financials. Overall PBV (Price-to-Book-Value) decreased from 1.14 to 1.12 favoring buyers.

Figure 9: GICS sector performance- June

| Sector | Index Points Gained |
|------------------------------------|---------------------|
| Transportation | 713 |
| Diversified Financials | 512 |
| Household & Personal Products | 121 |
| Commercial & Professional Services | 57 |
| Real Estate | 33 |
| Food, Beverage & Tobacco | 24 |
| Food & Staples Retailing | 21 |
| Materials | 9 |
| Consumer Services | 6 |
| Retailing | 5 |
| Banks | 3 |
| Energy | 3 |
| Insurance | -3 |
| Utilities | -9 |
| Automobiles & Components | -9 |
| Consumer Durables & Apparel | -17 |
| Capital Goods | -36 |
| Telecommunication Services | -43 |
| Health Care Equipment & Services | -101 |

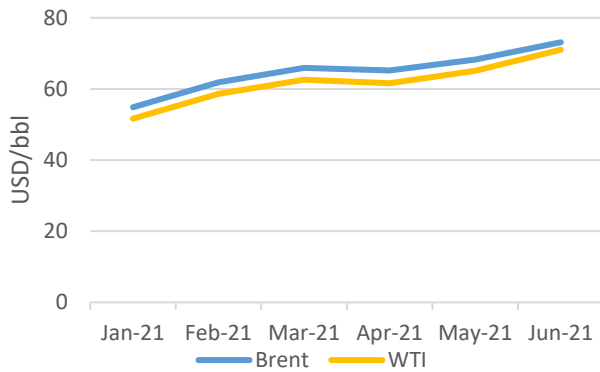
Source: CSE

Global Markets

US stock markets remained upbeat regardless of rising inflation and the Fed being more 'hawkish' on inflation. While majority of the sectors experienced gains in June, anticipation regarding second-quarter corporate earnings is expected to drive prices further up. European markets edged higher with France, Germany and UK being the top performers.

Commodities

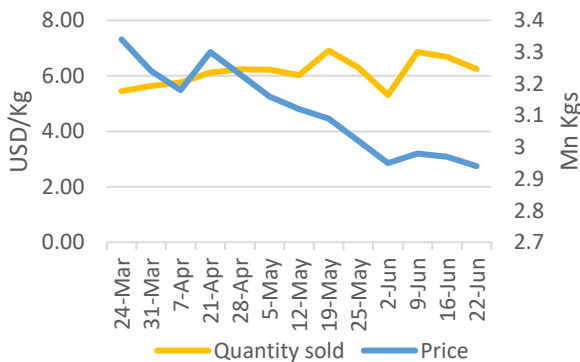
Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Global Brent crude oil continued to maintain a strong upward momentum throughout the month of June as it reached three-year high. The prices continue to be influenced by strong demand from USA, Europe and China. However, disagreement among OPEC+ countries regarding increasing supply has been the main reason behind the rising oil prices.

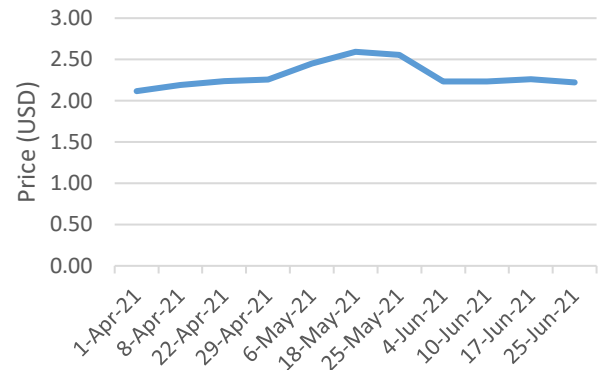
Figure 11: Tea (All Elevations) price and quantity sold at weekly auctions



Source: Forbes & Walker

Tea prices continued to fall in June. Market sources informed ICRA Lanka that, the buyers are in a strong footing to negotiate the prices down as the global supply soars with the recovery in production activities in key source markets.

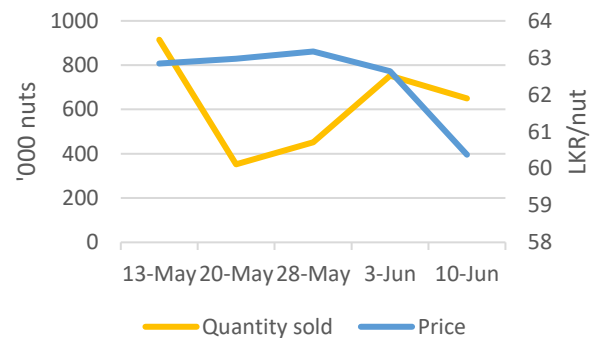
Figure 12: Rubber price weekly auctions



Note: Price of Latex 4X
Source: RRISL

Prices in the Colombo auction remained flat in June. Global rubber prices lost momentum largely due to lack of demand from India and China which are the largest consumers. However, demand is expected to pick up in the upcoming months as global economies return to normalcy.

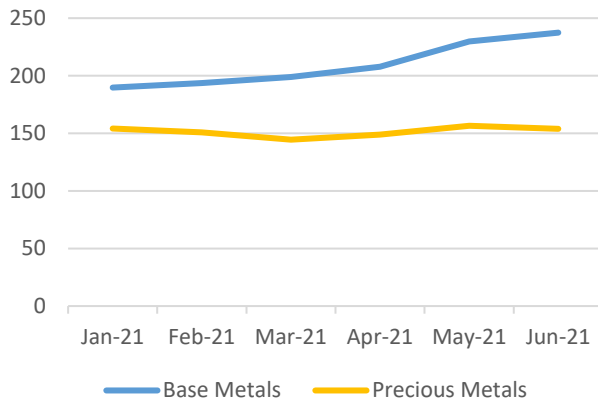
Figure 13: Coconut price weekly auctions



Source: CDA

Coconut prices plummeted in the Sri Lankan auctions likely as a result of drop in nut quality owing to adverse weather conditions.

Figure 14: Metal price index (2016=100)



Notes: Base metals index includes Aluminum, Cobalt, Copper, Iron Ore, Molybdenum, Nickel, Tin, Uranium, and Zinc, precious metals index includes Gold, Silver, Palladium, and Platinum

Source: IMF

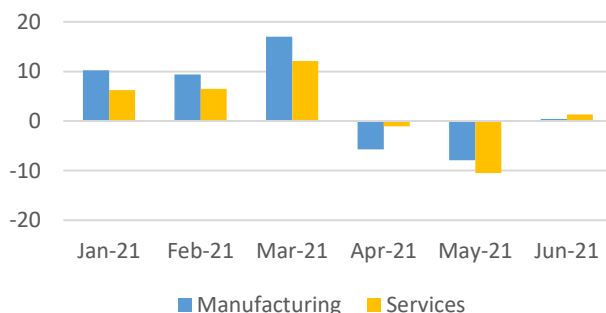
Gold prices which have been gaining momentum in the last few months, slipped 7% in June after the Federal Reserve's indication of twin interest rate hikes by 2023.

Global base metal prices continued to rise in June fueled by the post-pandemic recovery. Markets cooled after China announced that it is planning to release its copper, aluminum, and zinc reserves [1].

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

Real Sector

Figure 15: 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 for both services and manufacturing sectors showed more or less a continuation of the impact of the pandemic for another month. Logistical delays in securing supplies were persistent. However, the relaxation of the lockdown measures helped the services sector activities to marginally improve.

Outlook for July-August

Current vaccination drive is likely to speed up the recovery in the real sector. Therefore, higher economic activity levels are expected for July/August.

We expect moderate level of inflation in July as well with the increase in fuel prices working its way into more sectors of the economy.

The vaccination rollout is likely to give a boost to the business sentiment and the consumer confidence and hence private credit in July may expand slightly faster on month-on-month basis than in June.

Falling prices of Sri Lanka's key export commodities and increasing industrial input prices will continue to pose a significant challenge to the external sector.

Rating Actions

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

| Issuer | Issue | Action | Previous Rating | Current Rating |
|----------------|---|------------|-----------------|-----------------|
| Vidullanka PLC | Issuer Rating | Reaffirmed | [SL]A-(Stable) | [SL] A-(Stable) |
| Vidullanka PLC | Commercial Paper Program (COR/IR/15/08) (LKR 100 Mn) | Reaffirmed | [SL]A2+ | [SL]A2+ |
| Vidullanka PLC | Commercial Paper Program (COR/IR/20/01) (LKR 100 Mn) | Reaffirmed | [SL]A2+ | [SL]A2+ |
| LOLC Holdings | Proposed Senior Unsecured Unlisted Rated Redeemable Debenture Programme (LKR 2000 Mn) | Assigned | N/A | [SL]A (Stable) |

Abbreviations

| | |
|-------|---|
| ASPI | All Share Price Index |
| bps | Basis points |
| pps | Percentage 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 |
| RRISL | Rubber Research Institute of Sri Lanka |
| YTD | Year-to-date |

References

- [1] Reuters, "China to release copper, aluminium and zinc reserves to stabilise prices," 16 June 2021. [Online]. Available: <https://www.reuters.com/world/china/china-release-copper-aluminium-zinc-reserves-stabilise-commodity-prices-2021-06-16/>.

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