



MONTHLY ECONOMIC UPDATE

September

Economy at a glance for September 2021

Economy recovers as Delta subsides

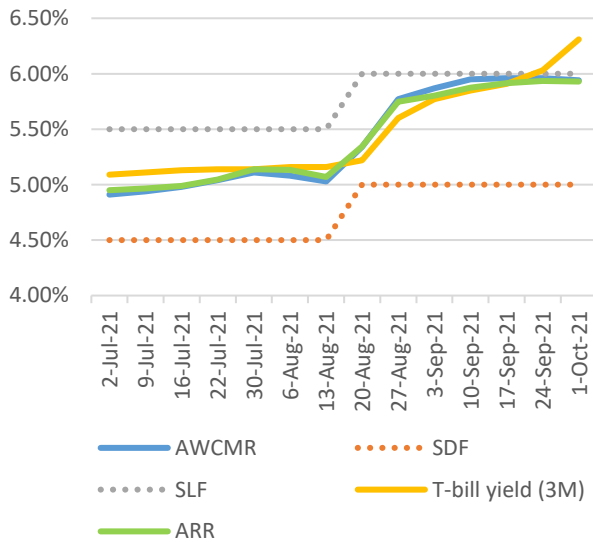
Highlights

- Money market rates adjusted upward in response to the policy rate hike in August.
- The yield curve continued to shift upwards in line with the August policy rate hike.
- The CBSL's holdings of T-bills went up by LKR 111.1 Bn causing the money supply to move up by an equivalent amount
- AWPR rose 52 bps. Surprisingly, private credit jumped by LKR 134 Bn from July, the largest monthly increase since 2015
- The total official reserves fell to USD 2.6 Bn after the settlement of forex debt worth USD 1.4 Bn.
- Activity levels in the interbank spot and forward markets remained subdued,
- Headline inflation decreased to 5.7% (Y/Y) due to the statistical effect of the high base that prevailed last year around the same time.
- The stock market posted over 5% gains in both ASPI and S&P SL20 indices.
- Both manufacturing and services sectors grew as per the PMI.

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 adjusted upward in response to the policy rate hike in August. The call and repo rates converged on the upper bound of the policy corridor, while repo rate remained under the call rate.

Liquidity level was in negative territory and drastically dropped past LKR150 Bn/ day for the most part of the month before improving to LKR120/day, after the CBSL injected LKR 103.5 Bn via a term reverse repo. The interbank call market volumes surged while repo volumes declined. In the meanwhile, heavy borrowing (over LKR 200 Bn/day) via SLF continued throughout the month.

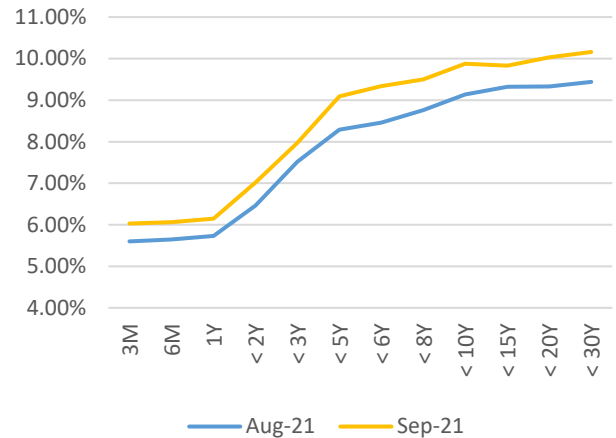
The CBSL's holdings of T-bills went up by LKR 111.1 Bn causing the money supply to move up by an equivalent amount. In addition, forex intervention by the CBSL may have added around LKR 686.1 to the money supply.

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.
Page | 2

T-bill yields in both primary and secondary markets increased by roughly 40 to 50 bps. The offer-to-acceptance ratio continued to suffer for 6M and 12M treasuries in the primary market. The volumes in the secondary market also declined.

Long-term rates

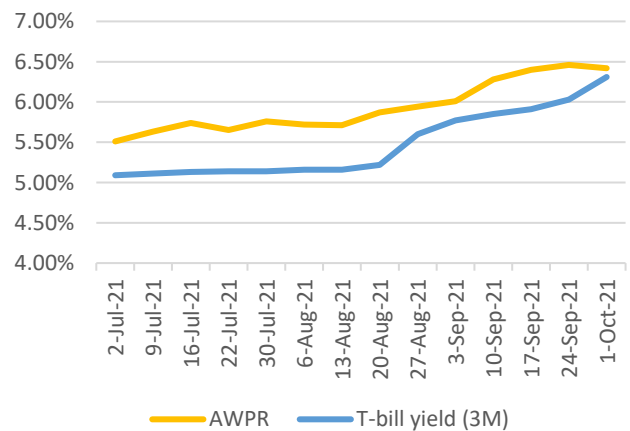
Figure 2: Yield curve of treasuries



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 yield curve continued to shift upwards in line with the August policy rate hike. Two primary auctions were held in September and were supplemented with direct issuances.

Figure 3: AWPR¹ and 3M T-bill yield

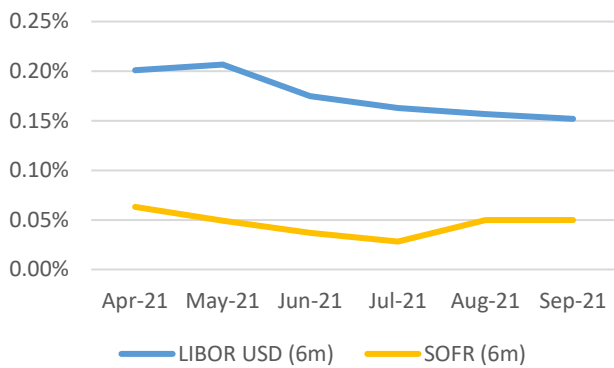


Note: T-bill yield for secondary market, Source: CBSL

AWPR rose 52 bps in September. Surprisingly, private credit jumped by LKR 134 Bn from July, the largest monthly increase since 2015, possibly as a result of businesses rushing to lock-in interest rates before lending rates start to move up. It is likely the trend may have continued through September 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

Moderation of inflation in July boosted the treasury markets. Fear of fallout of Evergrande collapse also drove investors to treasuries helping to ease yields further. However, after the Fed signaled a sooner-than-expected interest rate increase in 2022, yields started to move up. In Eurodollar markets, the spread between SOFR and LIBOR USD declined.

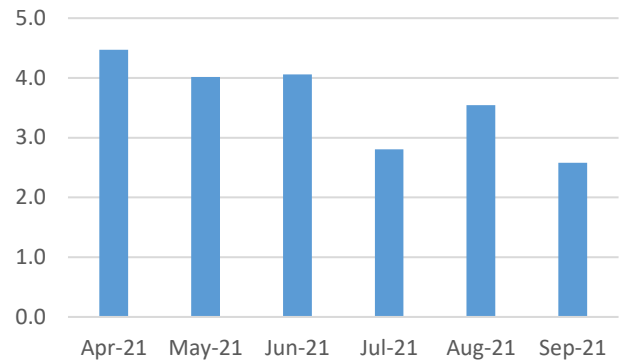
The SLISB yields continued to move up in September. Yields on the Jan-22 ISBs rose by nearly 10 pps.

External Sector

Sri Lanka’s merchandise exports soared to USD 1083.6 Mn (14.4%, Y/Y) in August driven by apparel and key cash crops. However, remittances recorded a 2.8% decline from last year to USD 446 Mn.

Capital flight continued in September. Total foreign capital outflow from the treasuries was just over USD 1 Mn while the same from the equities was about USD 34 Mn.

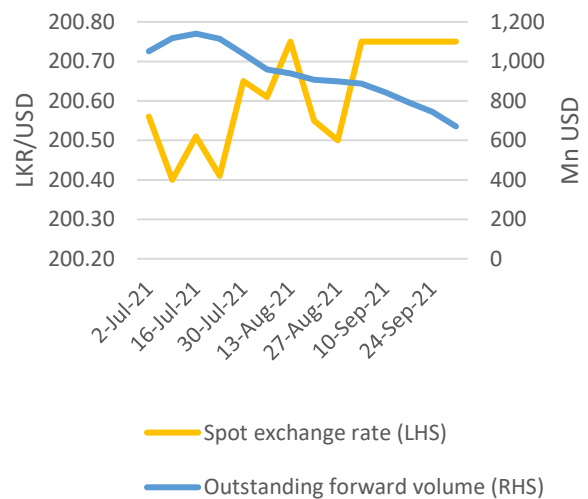
Figure 5: Gross official reserves (Mn USD)



Source: CBSL

The CBSL’s forex intervention caused marginal addition to reserves (USD 3.4 Mn). The total official reserves fell to USD 2.6 Bn after the settlement of forex debt worth USD 1.4 Bn.

Figure 6: Interbank spot market

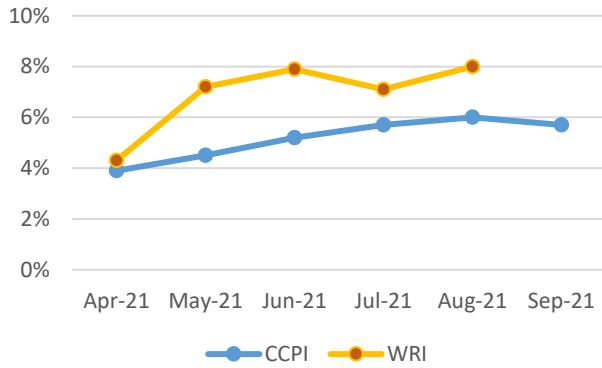


Source: CBSL

Activity levels in the interbank spot and forward markets remained subdued in September. Outstanding forward volume continued to decline during this time.

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

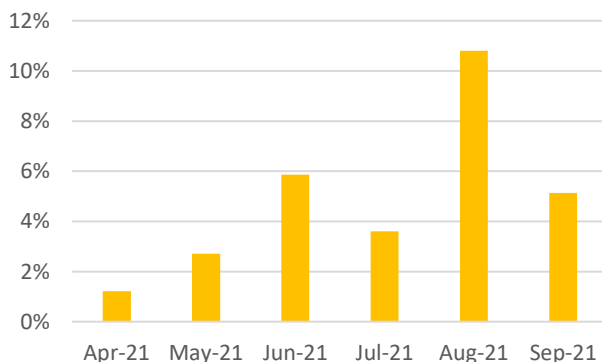
Wage growth recovered and recorded 8% growth (Y/Y) in August.

Headline inflation decreased to 5.7% (Y/Y) due to the statistical effect of the high base that prevailed last year around the same time. Food inflation decreased to 10% from 11.5% while non-food inflation increased to 3.8% from 3.5%.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

The stock market posted over 5% gains in both ASPI and S&P SL20 indices. The month started off with the CSE experiencing the worst fall since February 2021 following the Finance Minister’s debut speech regarding the grim situation of the

economy. However, towards the month end the investors looked past the speech and returned to the market. Foreign investors remained net sellers, and overall PBV (Price-to-Book-Value) increased from 1.26 to 1.32 favouring sellers

Figure 9: GICS sector performance- September

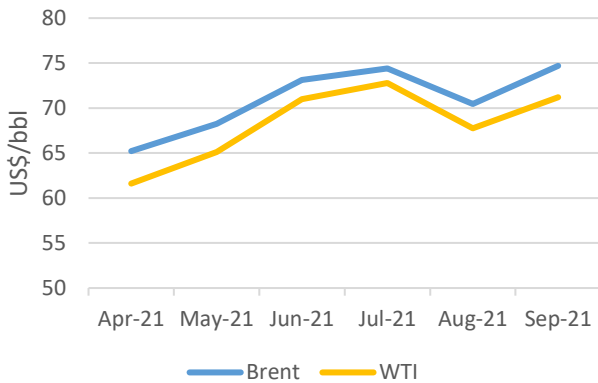
Sector	Index Points Gained
Transportation	5243
Diversified Financials	143
Health Care Equipment & Services	114
Capital Goods	85
Consumer Services	73
Telecommunication Services	44
Insurance	37
Household & Personal Products	32
Energy	31
Utilities	24
Automobiles & Components	21
Retailing	19
Real Estate	12
Food, Beverage & Tobacco	5
Food & Staples Retailing	3
Banks	-2
Commercial & Professional Services	-11
Materials	-46
Consumer Durables & Apparel	-50

Global Markets

The US Equities market slowed down in September as investors turned cautious over the Delta variant infections, slowing economic growth, and ongoing debates regarding potential interest rate hikes. The Dow Jones industrial average fell by 4.29%, S&P 500 index lost 4.76% and the Nasdaq dropped 5.31%. European markets followed suit with Germany, France and the UK equities experiencing losses. Asian Markets displayed mixed sentiments as China and Korea experienced losses while Japan and India recorded gains.

Commodities

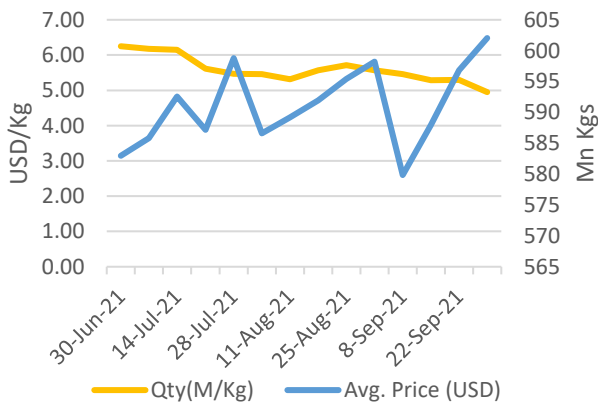
Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Global oil prices rebounded strongly in September after briefly dipping in the previous month. Oil supply tightened when the US offshore oil supply was affected as hurricanes Ida and Nicholas swept through the Gulf of Mexico. As a result, production was shut down for weeks due to damaged pipelines and platforms.

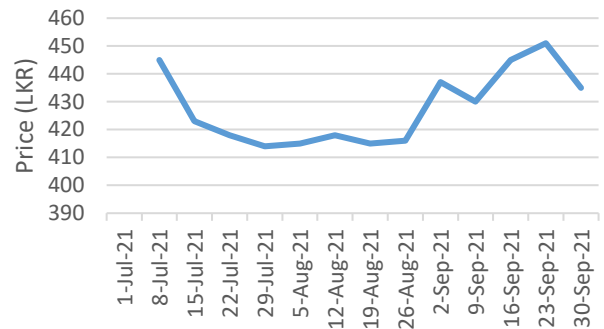
Figure 11: Tea (All Elevations) price and quantity sold at weekly auctions



Source: Forbes & Walker

Tea prices at the Colombo auction rose sharply throughout the month as a result of decreased supply resulting from lockdown measures throughout the country.

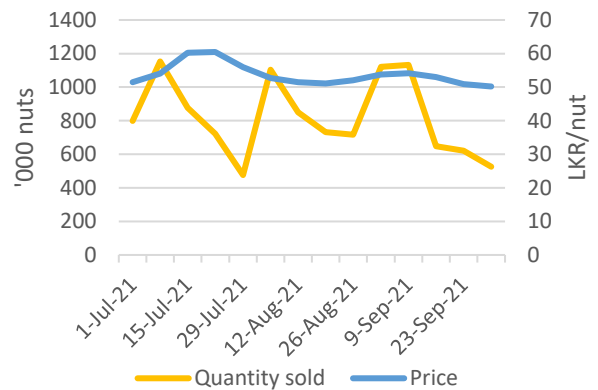
Figure 12: Rubber price weekly auctions



Note: Price of Latex 4X
Source: RRISL

Supply bottlenecks among the natural rubber producing countries lifted rubber price at the Colombo auction. Prices moderated towards the end of the month on the back of improved expectations of global supply recovery over the coming months [1].

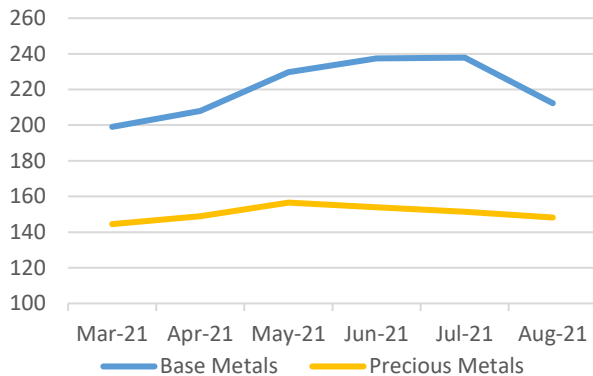
Figure 13: Coconut price weekly auctions



Source: CDA

Poor yield quality drove the coconut prices down while supply remained weak.

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

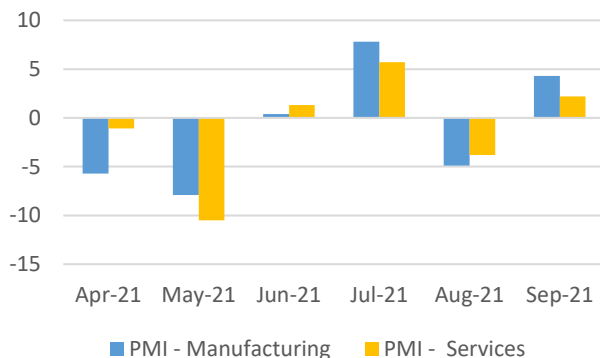
Gold prices slid by around 4% during September as US Treasury yields rose, riding on the expectations of an advanced timeline for a rate hike by the Fed.

Copper and Tin prices rose during the months as demand from China surged due to decreased inventories and low supply in the global market. Aluminum traded at 13-year high as markets expect production cuts in China, leading to shortages in the Global market. Nickel climbed to a 7-year high ahead of Indonesia’s planned tax on exports [2].

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 the 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

Both manufacturing and services sectors grew in September as per the PMI. Manufacturing sector saw new orders improving and expanded their workforce to cope with the demand. But the supply lags continued to prevail. The services sector experienced a rise in new businesses while expecting more business activities in the near-term.

Outlook for October - November

The GoSL lifted the quarantine curfew in early October. 60% of the Sri Lankan population will be fully vaccinated soon reaching a new milestone. We believe the worst of the Delta-variant is behind us. Businesses have learnt to deal and operate amidst the pandemic over time. With this, Sri Lanka is looking at a fairly modest and undisturbed economic performance in 4Q.

Tighter market liquidity will be the new normal moving forward. We may see some levelling off of treasury yields in the next few weeks. Banks may compete for funds pushing deposit rates higher, but we expect lending rates to be slightly stickier in the short term. In this context, private credit is likely to weaken.

Businesses will look forward to National Budget Proposals in November. The total expenditure allocation is slightly less than that of 2021 and signals a conservative fiscal stance in 2022.

Read ICRA Lanka’s [initial observations of the Appropriation Bill.](#)

With price controls on several of the items being removed, inflation will remain elevated for the rest of the year. In its latest Monetary Policy Review, the CBSL acknowledged “headline inflation to deviate somewhat from the targeted levels in the near term” as predicted by ICRA Lanka before.

The CBSL revoked the 100% cash margin deposit requirement on the importation of selected goods

classified 'non-essential' in October. As pointed out by ICRA Lanka last month in this very publication, this would have further dented economic activity and brought about scarcity in the targeted goods. In the 6-month policy Road Map, the CBSL expressed its intention to request the government to tax profits of exporters at 28% instead of 14% where the foreign exchange is not repatriated and converted. We doubt this move will bring about the desired objective and help to establish the credibility of the currency. Given the precarious position on the country's foreign reserves, what is needed is to encourage and provide additional incentives to boost exports, rather than penalizing the sector. The CBSL on the other hand needs to address underlying causes of alleged speculation and focus on a long-term strategy to stabilize the currency.

Rating Actions

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

Issuer	Issue	Action	Previous Rating	Current Rating
National Savings Bank	Issuer Rating	Reaffirmed	[SL]AAA (Stable)	[SL]AAA (Stable)
National Savings Bank	Senior, Unlisted, Rated Redeemable debenture program (LKR 15 Bn)	Assigned	N/A	[SL]AAA (Stable)
National Savings Bank	Senior Unsecured Redeemable Debenture Programme (LKR 20 Bn)	Reaffirmed	[SL] AAA (Stable)	[SL] AAA (Stable)
National Savings Bank	Subordinated Unsecured Redeemable Debenture Programme (LKR 6 Bn)	Reaffirmed	[SL] AA+ (Stable)	[SL] AA+ (Stable)
National Savings Bank	Basel III Compliant Additional Tier 1 Capital Bond Program	Reaffirmed	[SL]AA(hyb) (Stable)	[SL]AA(hyb) (Stable)
Softlogic Life Insurance	Insurance Financial Strength Rating	Reaffirmed	[SL]A (Stable)	[SL]A (Stable)
Softlogic Capital PLC	Senior unsecured Listed Redeemable Debentures (LKR 3.5 Bn)	Assigned	N/A	[SL]BBB + (Stable)
Softlogic Capital PLC	Issuer Rating	Reaffirmed	[SL]BBB + (On Watch)	[SL]BBB + (Stable)
Arpico Finance Company PLC	Issuer Rating	Withdrawn	[SL]B+ (Negative)	N/A
Bank of Ceylon	Issuer Rating	Reaffirmed	[SL]AAA (Negative)	[SL]AAA (Negative)
Bank of Ceylon	Basel III Compliant Additional Tier 1 Capital Bond Program 2020 (LKR 10 Bn)	Reaffirmed	[SL]AA(hyb) (Negative)	[SL]AA(hyb) (Negative)
Bank of Ceylon	Basel III Compliant Additional Tier 1 Capital Bond Program 2021 (LKR 3.35 Bn)	Reaffirmed	[SL]AA(hyb) (Negative)	[SL]AA(hyb) (Negative)
JAT Holdings PLC	Issuer Rating	Reaffirmed	[SL]A+ (Stable)	[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] A. & Kottayam, "The Hindu Business Line," 20 September 2021. [Online]. Available: <https://www.thehindubusinessline.com/markets/commodities/spot-rubber-lost-ground-on-monday/article36572839.ece>.
- [2] J. Roy, P. Ruparelia, R. Ghosh and D. Ghosh, "Indian Iron and Steel Sector Monthly Update," ICRA, August.

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