



MONTHLY ECONOMIC UPDATE February

Economy at a glance for February 2022

Sri Lanka economy suffers under accelerating tensions in Ukraine.

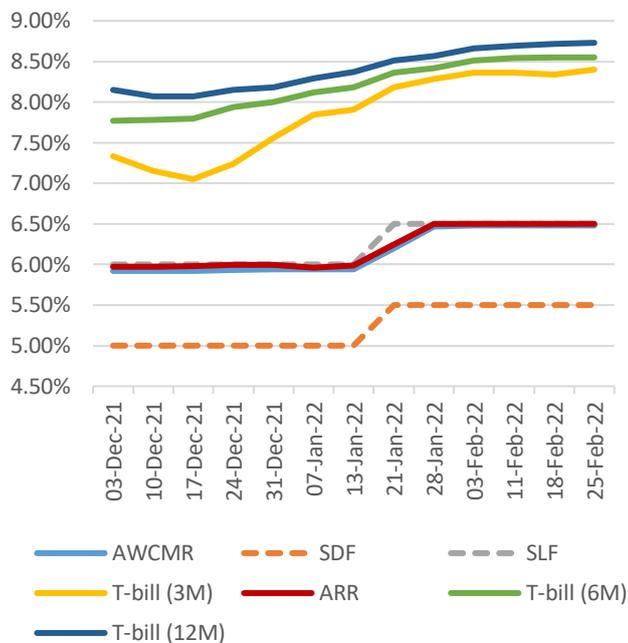
Highlights

- Liquidity deficit in the money market gradually widened and reached a new low of LKR 690 Bn by the end of the month.
- In the primary auctions the 3M bills continue to outperform 6M and 12M, which caused the yield to invert.
- AWPR rose by 50 bps in January following the rate hike and further increased by another 50 bps in February reflecting tightening monetary conditions.
- US inflation figures reached a new 40 year high of 7.5% for the month of February.
- Receipts from tourism increased exponentially generating around USD 314.5 in February.
- Inflation figures continued to rise in February (Y/Y) and reached a new high of 15.1%.
- The CSE collapsed in February with a 11% fall in the ASPI and a 10.48% fall in the S&P SL20.
- Global crude oil price rose sharply and reached a seven year high of USD 94/ barrel following the Russia-Ukraine crisis.
- Gold prices gained 5.5% during the month and reached USD 1900/ ounce

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

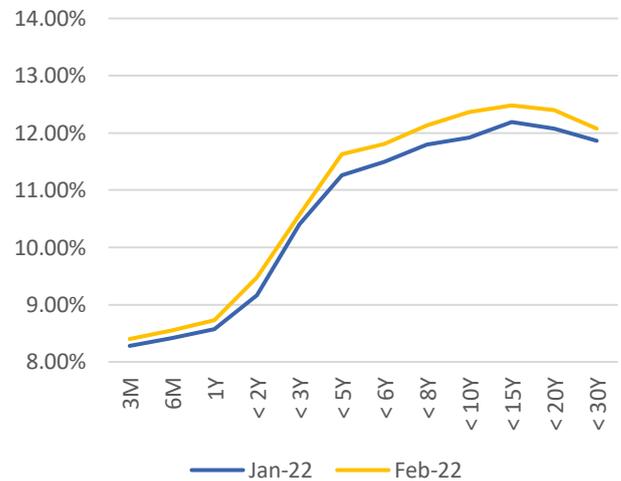
The call and repo rates continued to hover marginally below the newly increased upper bound of the policy corridor. The call market volumes gradually increased during the month while repo volumes remained relatively stable.

Overnight liquidity deficit levels declined further and reached a new low of LKR 628 Bn/day towards the tail end of the month. Heavy borrowing through the Standing Lending facility crossed the LKR 650 Bn/day threshold. The Central Bank absorbed over LKR 700 Bn worth of liquidity through short-term repos. The stock of T-bills held by the CBSL declined by around LKR 40 Bn during the month.

The T-bill yields in the primary auctions remained stable while yields in the secondary market increased. The 3M T-bills continued to outperform 6M and 12M in the primary auctions as investors expect interest rates to increase in the near future. Volumes in the secondary market remained high.

Long-term rates

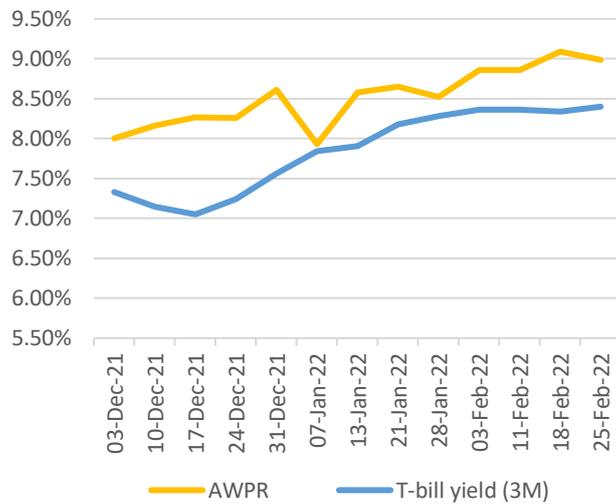
Figure 2: Yield curve of treasuries



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 overall yield curve shifted upwards with longer term maturities recording the highest gains. The market absorbed around LKR 80 Bn in new bond issues, however volumes in the secondary market declined.

Figure 3: AWPR¹ and 3M T-bill yield

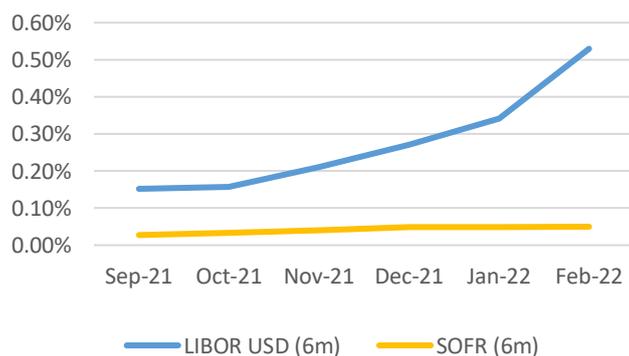


Note: T-bill yield for secondary market, Source: CBSL

Overall credit to the private sector increased by LKR 61 Bn (M/M) in December as a result of increased consumer demand that was evident during the festive season. Reserve money expanded marginally during February. AWPR rose by 50 bps in January following the rate hike and further increased by another 50 bps in February reflecting tightening monetary conditions.

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 month started with the 2- and 10-year rates hitting their highest levels in 2 years following better than expected job growth. A new 40-year high US inflation figure of 7.5% along with expectations of monetary tightening caused yields to reach a new 3-year peak towards the middle of the month. Increasing uncertainty regarding Russia’s invasion of Ukraine caused short term rates to decline towards the end of the month. The short- and medium-term yields saw their largest daily drop in around 2 years at the end of the month as Russia mounts attack on Ukraine.

As expectations of rate hikes increase, the US linked LIBOR rate increased by 19 bps while the SOFR rate remained stable.

The yields on ISB’s increased across all maturity periods.

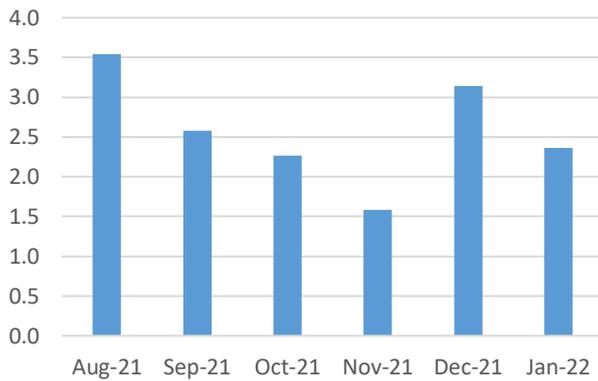
External Sector

Sri Lanka’s trade deficit widened markedly to over USD 1 Bn in December as merchandise imports shot up to around USD 2.2 Bn. Increase in the fuel bill was the main contributor to increased import costs.

Receipts from tourism increased exponentially and generated around USD 314.5 Mn in February. Worker remittances declined by over 60% to USD 259 Mn in January compared to the year before. Treasury instruments held by foreigners remained unchanged for February.

Figure 5: Gross official reserves (Mn USD)

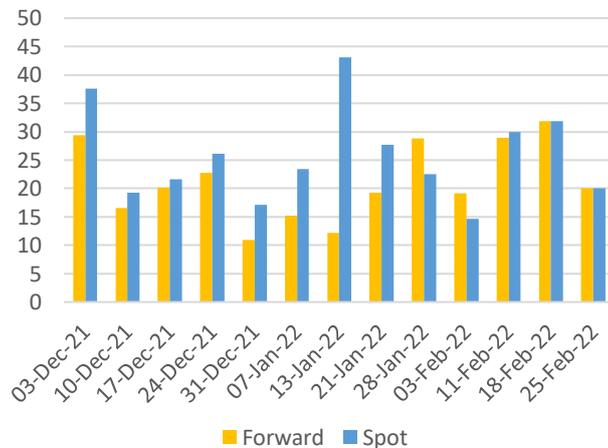
¹ AWPR is calculated based on the submissions made by the commercial banks to the CBSL on the rates offered to customers who borrowed more than LKR 10 Mn for less than three months. Page | 3



Source: CBSL

The CBSL had sold close to USD 600 Mn of gross official reserves in January and February to maintain the currency peg. Around USD 400 Mn forex payments were pending in February. Total official reserves stood at USD 2.3 Bn towards the end of January.

Figure 6: Interbank forex market daily avg. volumes (USD Mn)

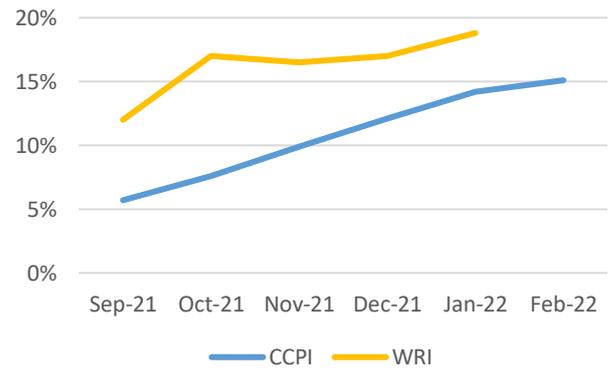


Source: CBSL

The interbank forward volumes increased in February after slowing down in the previous month, while spot volumes stayed high.

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

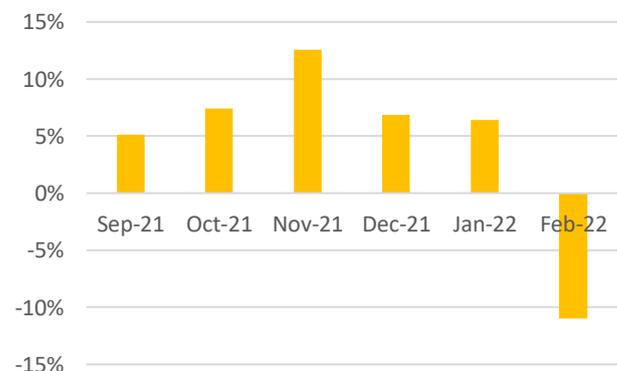
Private Wage growth continued to increase and posted 18.8% growth (Y/Y) in January as economy recovers from the effects of the Omicron variant. Wages of public sector employees posted 16.1% growth (Y/Y) during the same period.

Inflation continued to rise during February (Y/Y) as headline inflation increased to 15.1%. Food inflation rose to 25.7% from 25% due to hikes in prices of milk powder, rice, fresh fruits and bread. Non-food inflation increased to 10.1% from 9.2% due to increase in prices of transport, fuel, gas and housing.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

Enthusiasm among investors evaporated in February as markets closed with a 11% fall in the ASPI and a 10.48% fall in the S&P20. Total market loss for February exceeded LKR 425 Bn, after

making continuous gains in the last 11 months. Continuous nationwide power outages along with the severity of the economic crisis caused investors to lose confidence in the bourse. All sectors were down with the transport sector experiencing highest losses. Overall PBV (Price-to-Book-Value) fell from 1.77 to 1.57 favoring buyers.

Figure 9: GICS sector performance- February

Sector	Index Points Gained
Banks	-11
Telecommunication Services	-22
Consumer Services	-29
Health Care Equipment & Services	-62
Food & Staples Retailing	-73
Real Estate	-88
Utilities	-103
Commercial & Professional Services	-159
Energy	-167
Food, Beverage & Tobacco	-168
Household & Personal Products	-200
Software Services	-243
Capital Goods	-244
Automobiles & Components	-247
Insurance	-280
Materials	-300
Consumer Durables & Apparel	-317
Retailing	-369
Diversified Financials	-432
Transportation	-9881

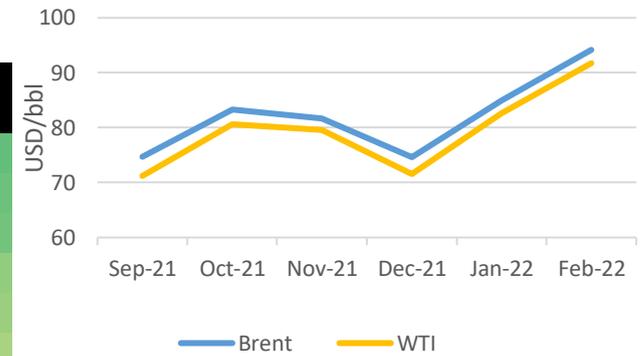
Global Markets

Rising tensions in Eastern Europe intensely impacted markets in February, causing stocks to fall for the second consecutive month. The Dow Jones dropped 3.53%, S&P500 fell 3.14% while Nasdaq lost 3.43%. The Energy sector continued to be the lone gainer for the month while the largest loses were observed in Communication Services, Real Estate and Technology. European markets followed suit with Germany, France and the UK experiencing losses. Asian stocks followed a similar trend with China, Japan and India experiencing losses. With the Omicron variant numbers easing up, investors were looking forward to economic

recovery in 2022, however economic impact of the invasion may dampen those expectations.

Commodities

Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Global oil prices rose sharply during the month and reached a seven year high of USD 94/barrel as supply disruptions resulting from the Russia-Ukraine crisis escalated. Global supply is expected to fall as a result of the sanctions imposed on Russia which is a top oil and gas supplier. However, price hike slowed down towards the end of the month as the OPEC countries announced that they would begin to increase output by April.

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



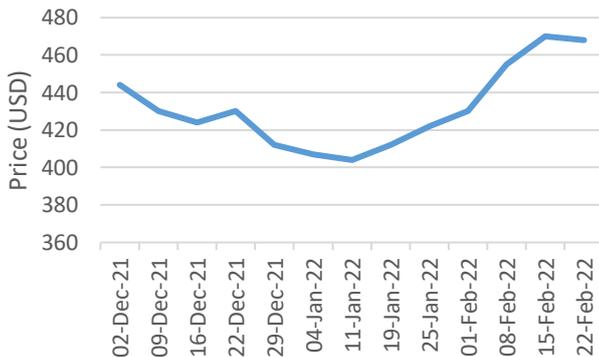
Source: Forbes & Walker

Prices at the Colombo auctions declined marginally as conflicts between Russia and Ukraine continued. Uncertainty in demand as well as volatile prices will definitely be a growing concern for the industry which is already dealing with high logistics rates.

International auctions saw an overall decline in prices.

Read ICRA Lanka's report, [Sri Lanka plantations at a fork in the road, thrive or survive?](#)

Figure 12: Rubber price weekly auctions



Note: Price of Latex 4X
Source: RRISL

Prices at the Colombo auctions saw a rise, supplemented by increasing global prices. The price hikes are a result of Industrial activity which has picked up as Omicron cases have begun to decline. Furthermore, supply from countries like Thailand have been delayed due to heavy rain.

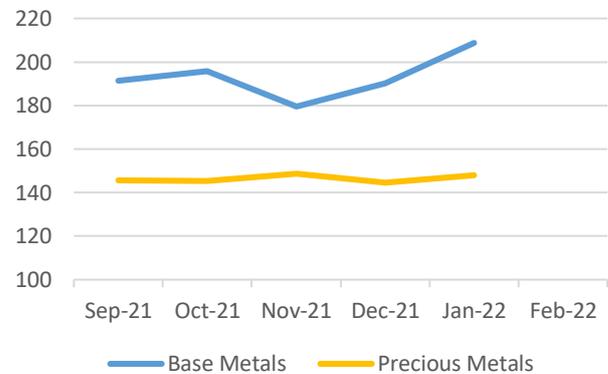
Figure 13: Coconut price weekly auctions



Source: CDA

Overall month of February proved to be a successful one as strong demand caused prices and supply to increase.

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

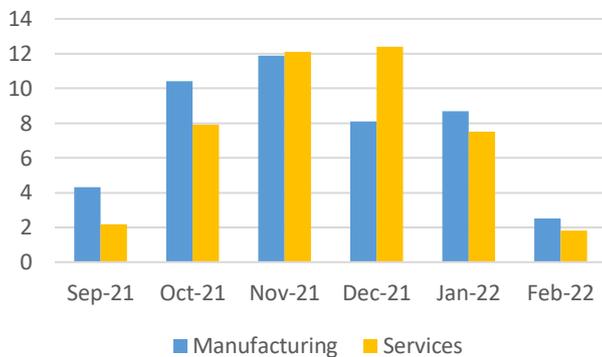
Gold prices gained 5.5% during the month and reached a nine-month high of USD 1900 per ounce as Ukraine tensions heightened causing investors to flock to gold. The gold price hike was also a result of US inflation reaching a new high of 7.9% during the month. Prices are likely to remain high following the international sanctions on Russia.

Base metal prices spiked as geopolitical tensions caused Nickel prices to reach a 11 year high. Aluminum prices also spiked as global sanctions could potentially cut supplies from Russia who is a major supplier. Iron ore prices however declined to a 2 year low following increased supply from China.

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

The PMI index for the manufacturing sector increased in January resulting from improvements in production and employment within industries such as textile and food and beverages. However, PMI for services declined following a decrease in business activity.

The PMI index for manufacturing expanded in February mainly due to the expansion in new orders. However, production declined on a month-on-month basis due to supply side constraints. PMI for services expanded in February underpinned by the increase seen in new businesses, business activities and expectations for activity.

Read ICRA Lanka's take on what lies [beyond the pandemic for Sri Lanka](#)

Outlook for February - March

As predicted by many experts, including ICRA Lanka, Ukraine crisis has taken the center stage in the global arena and sent shockwaves across markets. In this context, timing couldn't be worse for a vulnerable economy like Sri Lanka.

The CBSL finally opted to change its hard stance on the exchange rate and allowed to depreciate – a move ICRA Lanka opined to be prudential for a long time amid severe shortage of forex. This may help ease pressure to some degree.

Read ICRA Lanka's take on [the recent currency devaluation](#)

Key commodity prices have reached multi-year highs fueling inflation globally. Sri Lanka is no exception; the double-digit inflation will accelerate further in the near-term continuing to inflict economic pain on masses for a foreseeable future.

The World Health Organization last week confirmed the emergence of "Deltacron" - a hybrid strain that combines both the delta and omicron variants. Still there's a great deal of debate surrounding how much of a threat it can pose to the global economy.

Interest rates are rising, self-reinforcing as inflation expectations run stronger. Therefore, we can expect tighter credit conditions moving forward. Bleaker economic outlook also discourages any new investments deterring the credit growth.

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
Habib Bank Limited (Sri Lanka)	Issuer Rating	Reaffirmed	[SL]A+ (Stable)	[SL]A+ (Stable)
Sanasa Development Bank PLC	Issuer Rating	Upgraded	[SL]BBB- (Stable)	[SL]BBB (Stable)
Hayleys PLC	Issuer Rating	Upgraded	[SL]AA- (Stable)	[SL]A+ (Stable)
Hayleys PLC	Senior Listed Rated Unsecured Redeemable Debenture Program (issued 08/08/2018) (LKR 3527 Mn)	Upgraded	[SL]AA- (Stable)	[SL]A+ (Stable)
Hayleys PLC	Senior Listed Rated Unsecured Redeemable Debenture (issued 26/08/2019) (LKR 3000 Mn)	Upgraded	[SL]AA- (Stable)	[SL]A+ (Stable)
Hayleys PLC	Proposed Senior Listed Rated Unsecured Redeemable Debentures Program	Assigned		[SL] AA- (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

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Published date: March 16, 2022
Document #: meufeb22

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