



MONTHLY ECONOMIC UPDATE **May**

Economy at a glance for May 2022

Long queues hinder critical productivity

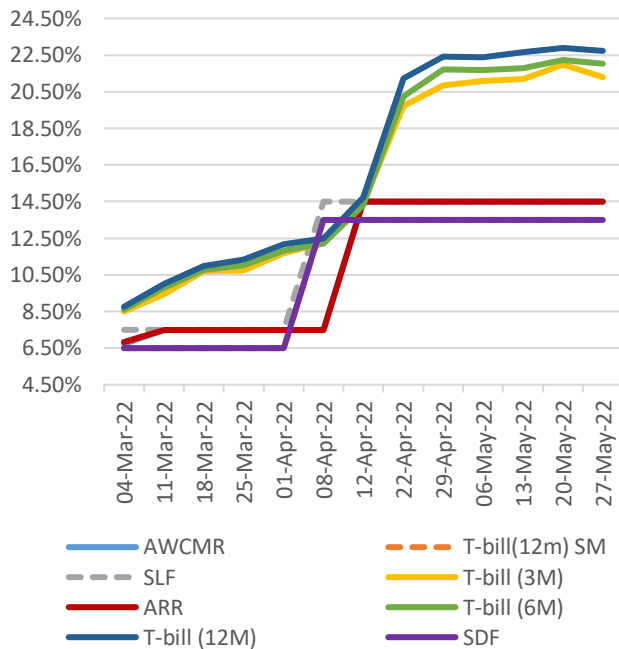
Highlights

- The Central Bank opted to retain policy rates at existing levels stating that current levels stating that “measures to stem the firm up of aggregate demand pressures, are expected to contain any further buildup of inflationary expectations.”
- Overnight liquidity deficit level improved during the month, reaching a new high of LKR 475 Bn.
- Overall private credit growth expanded by LKR 478 Bn (M/M) in March which is a substantial increase compared to the previous months and AWPR increased by 474 bps in May
- Sri Lanka’s trade deficit improved compared to previous months as industrial exports increased by 18.5% in April as result of increased exports of textiles, garments, foods and beverages.
- Tourism figures increased exponentially compared to last year, however worker remittances declined by 52% over the same time period.
- Total gross official reserves increased by USD 100 Mn to USD 1.92 Bn towards the end of May, mainly due to the CBSL’s increased borrowings from the Reserve Bank of India
- Inflation levels rose sharply during April (Y/Y) as headline inflation increased to 39.1% in April
- Brent crude oil prices rose in May, reaching a two-month high of USD 120/ barrel towards the end of the month
- Prices of gold along with base metals (copper, aluminum etc.) fell marginally, following the 50-bps hike in policy rates by the Fed Reserve.

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

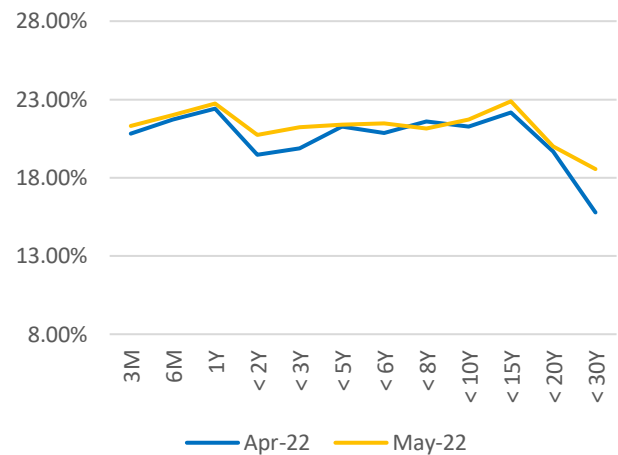
During the month, the Central Bank opted to retain policy rates at existing levels stating that current “measures to stem the firm up of aggregate demand pressures, are expected to contain any further buildup of inflationary expectations.” The call and repo rates continued to hover at the upper bound of the policy corridor of 14.5%. Call and repo volumes declined to near zero levels.

Overnight liquidity deficit level improved during the month, reaching a new high of LKR 475 Bn while consistently staying below the LKR 600 Bn/day levels. Borrowings through the Standing Lending Facility remained at elevated levels, although showed improvement compared to April. The Central Bank absorbed around LKR 130 Bn in long term repos and its stock of treasury bills increased by LKR 107 Bn during the month.

Yields in the primary auctions rose marginally with short term instruments rising by around 20 bps. The 3M T-Bill continued to be in high demand over 6M and 12M, however overall volumes in the primary and secondary markets improved compared to previous months.

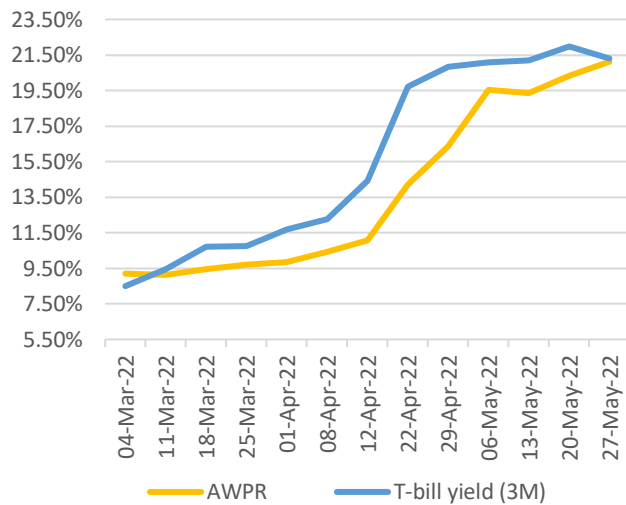
Long-term rates

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

Yields of long-term maturities showed an overall increase during the month, with short-term maturities increasing marginally. The market absorbed around LKR 60 Bn in new bond issuances while volumes in the secondary market increased substantially.

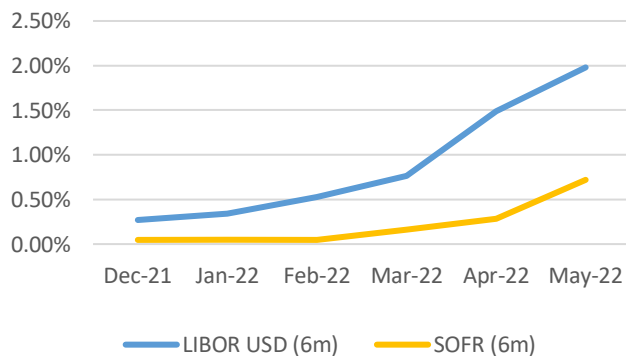
Figure 3: AWPR¹ and 3M T-bill yield


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

Overall private credit growth expanded by LKR 478 Bn (M/M) in March which is a substantial increase compared to the previous months. Reserve money experienced a contraction of 2.7% and AWPR increased by 474 bps in May 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 of May started with yields of medium- and long-term instruments rising above 3% as investors seemed concerned regarding the inflation outlook despite strong US jobs data in April.

However, the market picked up momentum thereafter as buyers returned, causing a decrease in yields of longer-term maturities. Yields continued to fall in the subsequent days as new inflation data showed that inflation levels had decreased less than expected. Furthermore, food and energy inflation had increased over the same time period. Bond yields fell across the board as losses arising from the stock market caused investors to move towards safer assets. However, the total impact was cushioned, as yields rose marginally backed by a strong growth in US retail sales. Towards the tail end of the month, yields of longer-term maturities declined as strong stock selloff continued following fears of stagflation.

Following the 50-bps rate hike by the Federal Reserve the US linked LIBOR increased by close to 50 bps while the SOFR rate rose by around 43 bps.

The yields on ISB's increased across all maturity periods following the worsening of the economic situation in the country.

External Sector

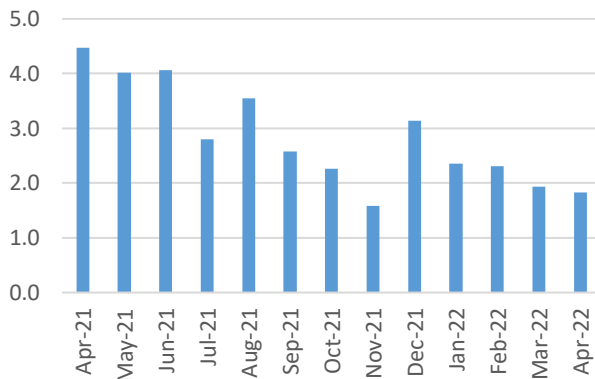
Sri Lanka's trade deficit for April 2022 was USD 729 Mn which is an 18% improvement compared to the same month last year. YOY (year-on-year) industrial exports increased by 18.5% in April as a result of increased exports of textiles, garments, foods, beverages and petroleum products. Import expenditure decreased marginally over the same time period due to decreased imports of various non-food consumer goods.

Receipts from tourism increased exponentially compared to the same month last year generating around USD 113 Mn in April 2022. However, M/M tourism revenue for 2022 has consistently decreased, as latest May 2022 figures shows earnings from tourism to be USD 54 Mn. Worker remittances has declined by 52% to USD 249 Mn in April (Y/Y) and has declined by 34% to USD 304 Mn in May (Y/Y).

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

Prices & Wages

Figure 5: Gross official reserves (Mn USD)

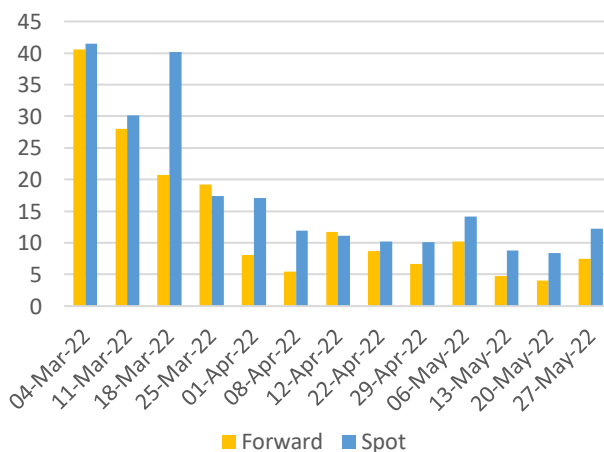


Source: CBSL

Total gross official reserves slid down by USD 90 Mn to USD 1.8 Bn towards the end of April. Outstanding foreign obligations remained at existing levels as the newly appointed CBSL governor ordered the suspension of foreign debt repayments.

Total gross official reserves increased by USD 100 Mn to USD 1.92 Bn towards the end of May, mainly due to the CBSL's increased borrowings from the Reserve Bank of India.

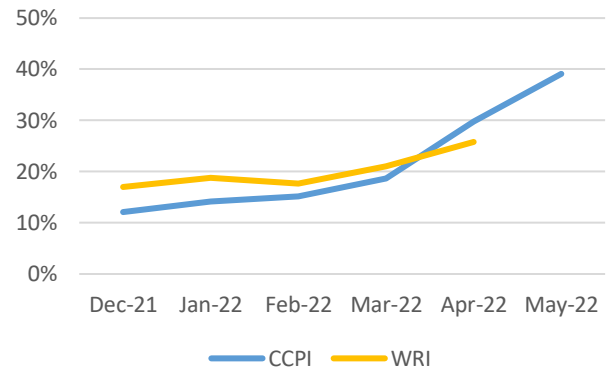
Figure 6: Interbank forex market daily avg. volumes (USD Mn)



Source: CBSL

Interbank spot and forward volumes continued to decline during the month as a result of the prevailing dollar and fuel shortage in the country.

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

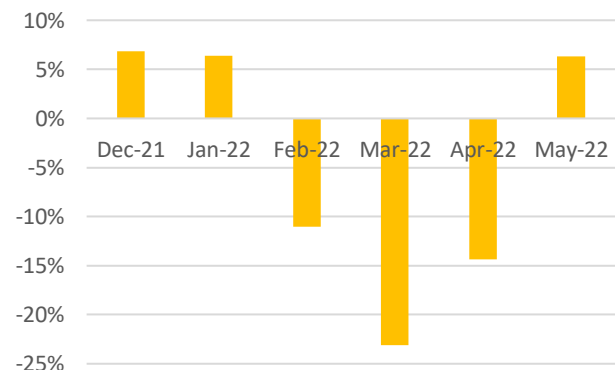
Private Wage growth continued to increase and posted a 16.1% increase (Y/Y) in April, while public sector employees' wages posted a 25.8% growth (Y/Y) during the same period.

Inflation levels rose sharply during April (Y/Y) as headline inflation increased to 39.1% in April from 29.8% in March. Food inflation increased to 57.4% from 46.6% due to rising prices of fresh fish, dried fish, rice, bread and dhal. Non-food inflation increased to 30.6% from 22% as a result of increased prices of fuel, housing, water, gas and electricity.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

The stock market ended on an overall positive sentiment in May after experiencing continuous losses over the past 3 months. Markets closed with a 6.35% gain in the ASPI and a 6.78% gain in the S&P SL20. Transportation sector ended up being the largest gainer while utility and banking sectors made losses. Net foreign purchases remained positive and overall PBV (Price-to-Book-Value) rose from 0.92 to 0.98 favoring sellers.

Figure 9: GICS sector performance- May

Sector	Index Points Gained
Transportation	7788
Energy	561
Diversified Financials	292
Household & Personal Products	134
Food, Beverage & Tobacco	99
Insurance	84
Commercial & Professional Services	78
Food & Staples Retailing	73
Automobiles & Components	71
Consumer Durables & Apparel	46
Materials	42
Capital Goods	28
Software Services	23
Health Care Equipment & Services	21
Real Estate	14
Retailing	8
Consumer Services	5
Telecommunication Services	4
Banks	-18
Utilities	-32

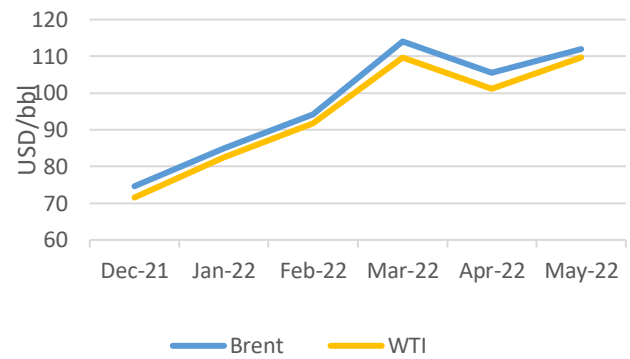
Global Market

Overall stock market performance in May was mixed as a large rally in the final week helped recuperate heavy losses made during the month. The Dow Jones Industrial Average picked up 0,04% while the S&P 500 Index added 0.01%. The Nasdaq however fell 2.05%. Despite looming levels of inflation, the market was relieved to hear the Fed officials indicate that any further rate hikes would slow down after expected hikes in June and July. The energy sector experienced the largest gains whilst consumer discretionary and real estate were the largest losers. European markets remained

positive with Spain, Germany and UK making losses, while Asian markets remained mixed.

Commodities

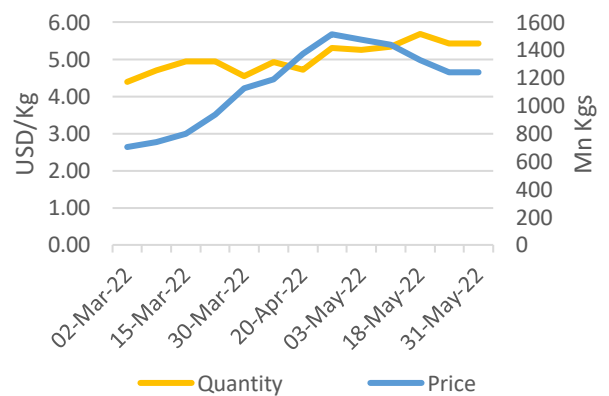
Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Brent crude oil prices rose in May, reaching a two-month high of USD 120/ barrel towards the end of the month. A mix of factors which included the European Union's impending sanctions on Russian oil coupled with China's gradual demand recovery from risen Covid cases, gave way for prices to rebound after decreasing the previous month. Furthermore, prices are expected to remain at elevated levels over the next few months, following OPEC+'s decision to not raise production immediately.

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

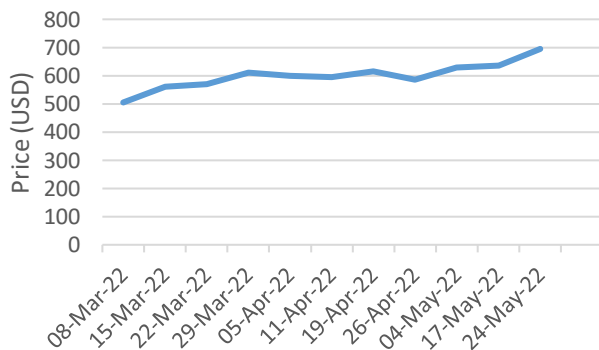


Source: Forbes & Walker

Auction prices were seen decreasing at the start of the month following factors like increasing volumes, lower quality and the appreciation of the rupee. Prices continued to fall throughout the month following diminished quality, Supply from international markets such as Kenya and Bangladesh increased resulting in the fall of global prices.

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

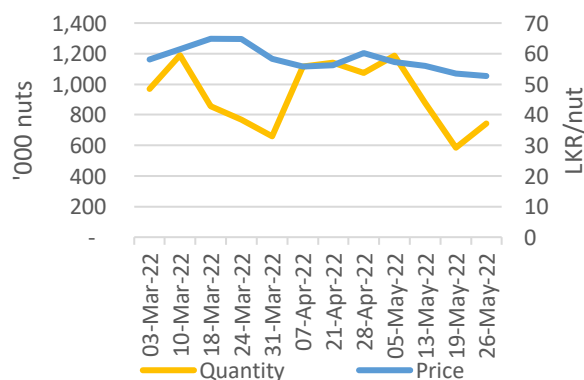
Figure 12: Rubber price weekly auctions



Note: Price of Latex 4X
Source: RRISL

Prices at the Colombo rubber auctions increased in May compared to previous months. Rising local prices is attributable to decreased supply in the market resulting from continuous power cuts along with the fuel shortage.

Figure 13: Coconut price weekly auctions

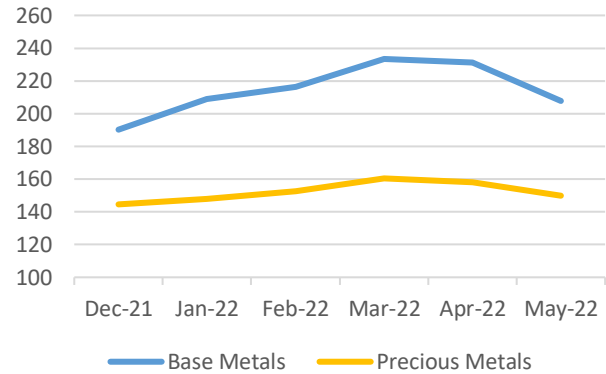


Source: CDA

Coconut supply declined sharply in May following continuous power outages affecting factories and fuel shortages which affect transportation services.

Furthermore, quality also dropped as a result of adverse weather conditions.

Figure 14: Metal price index (2016=100)



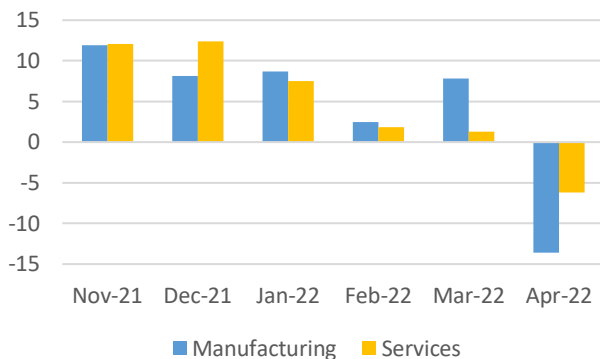
Notes: Base metals index includes Aluminum, Cobalt, Copper, Iron Ore, Molybdenum, Nickel, Tin, Uranium, and Zinc, precious metals index includes Gold, Silver, Palladium, and Platinum
Source: IMF

Gold prices were seen edging up at the start of May as stagflation fears in the US pushed bond prices higher. However, prices fell thereafter when the Federal Reserve reaffirmed the upcoming interest rate hike in June/July. Prices continued to fall as strong retail sales in the US supplemented investor confidence that the economy was bouncing back. As a result, gold prices ended the month at USD 1850/ ounce

Overall base metal prices fell during the month, following strong appreciation of the dollar. Furthermore, copper prices declined as demand from Europe fell due to continued conflicts in Ukraine. Aluminum prices reached four-month lows as a result of slowdown in manufacturing activity in China which is the world's top consumer. Nevertheless, Nickel prices picked up on account of expected rise in production of electric vehicles during the year.

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 for manufacturing contracted sharply in April 2022, as a result of significant decreases reported in production, new orders, stock of purchases and employment. Decreased production figures were mainly owing to the effects of power outages, fuel shortages and difficulties in opening letters of credit. Service sector PMI also deteriorated following high inflation levels, decreased tourist arrivals and continuous power outages

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

Outlook for June-July

Sri Lanka's economic situation continues to worsen as short supply of essential goods such as fuel, cooking gas and medicines have resulted in citizens having to spend increasingly more time in queues. As a result, the country is likely to experience disruptions in economic productivity leading to further recessionary pressures.

Food inflation is likely to increase as a result of unsuccessful government policies which resulted in decreased crop yield specially in the tea and paddy sectors. Furthermore, fuel shortages would mean difficulties in transporting food items within the

country leading to higher prices and more wastages.

The CBSL is likely to retain policy rates at high levels in an effort to curb inflationary pressures as well as reduce the liquidity deficit within the banking system. However sustained high interest rates over long periods are likely to hinder growth prospects discouraging new investments, deterring credit growth.

This week the Federal Reserve increased its policy rates by 75 bps as a measure to control high inflation levels in the US. This is likely to result in further pressure for LKR to depreciate. Hence the CBSL may have to tighten monetary policy further to control the currency rate.

Key commodity prices have reached multi-year highs fueling inflation globally. Oil prices have settled at USD 120 / barrel as supply concerns take effect, and is likely to remain high during the rest of the year.

Rating Actions

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

Issuer	Issue	Action	Previous Rating	Current Rating
Bank of Ceylon	Issuer Rating	Revised	[SL]AAA (Negative)	[SL]AAA (On watch)
People's Bank	Issuer Rating	Revised	[SL]AAA (Stable)	[SL]AAA (On watch)
DFCC Bank	Issuer Rating	Revised	[SL]AA- (Negative)	[SL]AA- (On watch)
Union Bank	Issuer Rating	Revised	[SL]BBB (Stable)	[SL]BBB (On watch)
Sanasa Life Insurance Company	Issuer Rating	Reaffirmed	[SL]BBB (Stable)	[SL]BBB (Stable)
Sanasa Life Insurance Company	Issue Rating (Proposed Senior Unsecured Redeemable Debenture Program – LKR 200 Mn)	Reaffirmed	[SL]BBB (Stable)	[SL]BBB (Stable)
Merchant Bank of Sri Lanka & Finance PLC	Issue Rating (Proposed Subordinated Unsecured Redeemable Debenture Program) – LKR 1000 Mn	Assigned		[SL]BBB (Stable)
First Capital Holdings PLC	Issue Rating (Proposed Subordinated Unsecured Redeemable Debenture Program) – LKR 2000 Mn	Reaffirmed	[SL]BBB (Stable)	[SL]BBB (Stable)
First Capital Holdings PLC	Issue Rating (Commercial Paper Program) – LKR 2500 Mn	Assigned		[SL] A1
Softlogic Holdings PLC	Issuer Rating	Revised	[SL]BBB (Negative)	[SL]BBB- (Negative)
Softlogic Holdings PLC	Issue Rating (Commercial Paper Program) – LKR 2000 Mn	Reaffirmed	[SL] A3	[SL] A3
Janashakthi Limited	Issuer Rating	Suspended	[SL]BB+ (Negative)	
Windforce PLC	Issuer Rating	Reaffirmed	[SL]AA- (Stable)	[SL]AA- (Stable)
Oxford College of Business Pvt Ltd.	Issuer Rating	Revised	[SL]BBB (Stable)	[SL]BBB- (Negative)

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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