



MONTHLY ECONOMIC UPDATE June

Economy at a glance for June 2022

Economy at a standstill

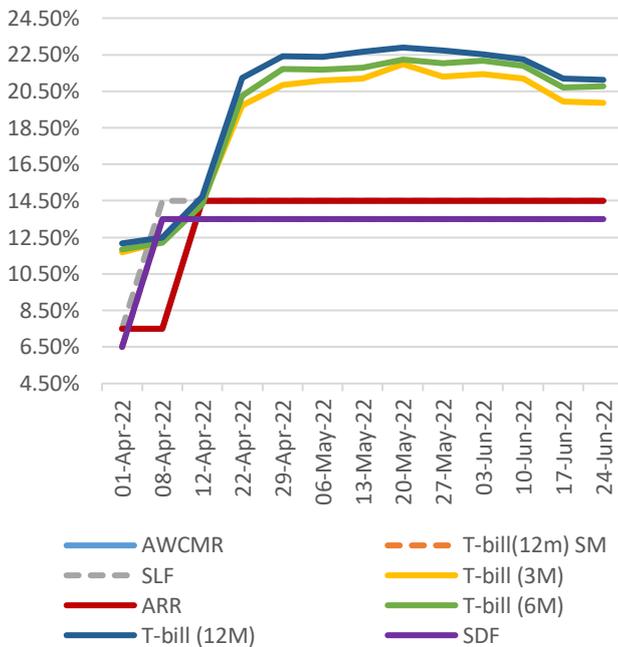
Highlights

- The Central Bank absorbed around LKR 317 Bn in short term treasury bills during the month, however the repo market remained inactive during that time.
- Yields in the primary market declined by around 180 bps during the month, possibly as investor sentiment improved due to ongoing debt restructuring talks with the IMF.
- Overall private credit growth expanded by LKR 223 Bn (M/M) in April while reserve money contracted by 1.3% and AWPR increased by 100 bps in June reflecting tightening monetary conditions
- Sri Lanka's trade deficit for May was USD 404 Mn which is a 43.5% improvement compared to the same month last year.
- Inflation levels rose sharply during June (Y/Y) as headline inflation increased to 54.6% while food inflation increased to 80.1% and non-food inflation increased to 42.4%.
- The stock market suffered as markets closed with a 9.44% fall in the ASPI and a 12.88% fall in the S&P20.
- Global Brent crude oil prices rose during the first half of the month, reaching a 3-month high of USD 122 a barrel following EU leaders' collective decision to cut oil imports from Russia.
- Overall base metal prices showed a strong decline following rising fuel and energy prices causing industrial activity in Europe to take a dip
- PMI for manufacturing continued to contract in May 2022, and was mainly witnessed in the food and beverage sector. Services PMI for May declined due to decreased overall demand for accommodation, food & beverages, wholesale, retail and real estate.

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 money market rates continued to remain at the same level during the month as call and repo rates continued to hover at the upper bound of the policy corridor. Call and repo volumes continued to remain at near zero levels.

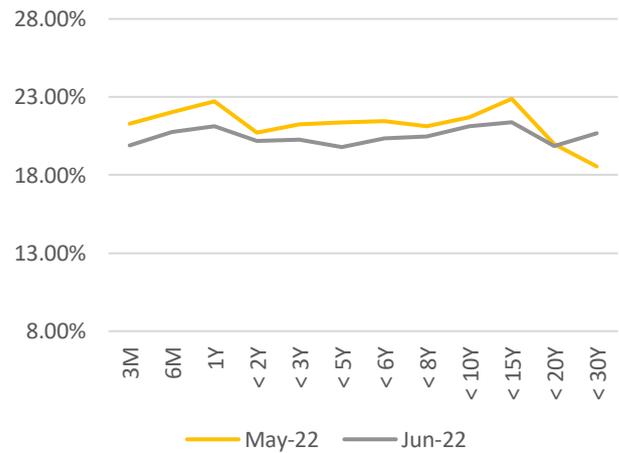
Overnight liquidity deficit levels continued to remain at around the LKR 500 Bn level. Borrowings through the Standing Lending Facility remained at elevated levels, although showed improvement towards the end of June. The Central Bank absorbed around LKR 317 Bn in short term treasury bills during the month. There were neither short-term nor long-term repo absorptions during the month. The CBSL stock of treasury bills also increased by LKR 115 Bn in June to surpassed the LKR 2 Tn mark.

Yields in the primary market declined by around 180 bps during the month, possibly as investor sentiment improved due to ongoing debt

restructuring talks with the IMF. The 3M T-bills continued to attract high demand over 6M and 12M. Rates in the Secondary market saw a similar drop, which resulted in high volumes in the secondary market.

Long-term rates

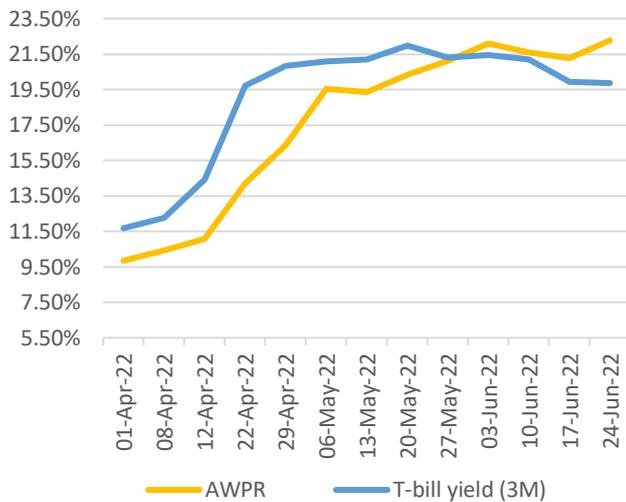
Figure 2: Yield curve of treasuries



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 also declined marginally during the month with short-term maturities experiencing the sharpest contractions. The Market absorbed around LKR 90 Bn in new bond issuances and volumes in the secondary market rose sharply.

Figure 3: AWPR¹ and 3M T-bill yield

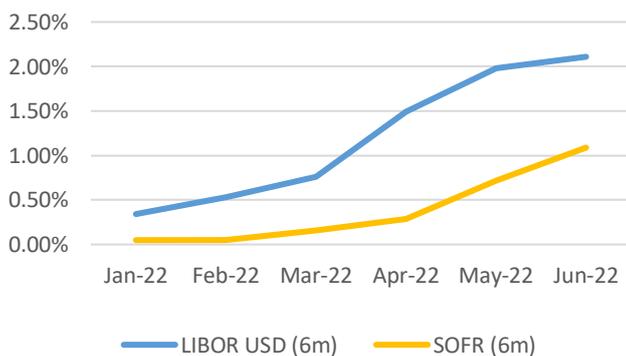


Note: T-bill yield for secondary market, Source: CBSL

Overall private credit growth expanded by LKR 223 Bn (M/M) in April and by another LKR 2 Bn (M/M) in May as rising rates coupled with worsening economic situation most likely deterred borrowings. Reserve money contracted by 1.3% and AWPR increased by 100 bps in June 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

Treasury yields rose sharply during the start of the month pushing short term rates to near 3-year highs as investors expect Federal Reserve to

tighten monetary policy in the upcoming months. The yield curve also grew flatter as the spread between 5- and 30-year bonds shrank to as little as 9.6 bps. Short and Medium rates reached their peak in over a decade as a result of US inflation rising to 8.6% exceeding investor expectations in May. This jump sparked market fears of a potential inverted yield curve which could result in recessionary pressures. Short-term rates declined on the 15th as Fed reserve increases policy rates by 75 bps, which is the biggest magnitude in almost 28 years. Investors flocked to bond market thereafter as a result of a stock selloff causing short- and medium-term yields to decline. Yields fell further towards the end of the month following a decline in consumer sentiment.

Following a 75 bps rate hike by the Fed Reserve, the USD linked LIBOR increased by around 15 bps and SOFR rose by 37 bps

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

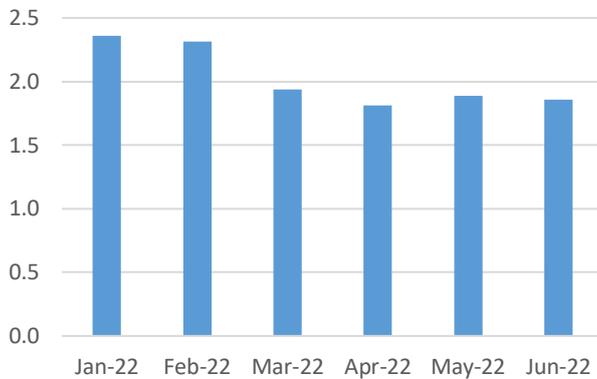
External Sector

Sri Lanka's trade deficit for May was USD 404 Mn which is a 43.5% improvement compared to the same month last year. Overall exports increased by 17.5%. YOY (year-on-year) industrial exports expanded by 24.2% due to increased export of textiles, garments and gems. Import expenditure declined by 9.7% due to reduction in imports of machinery and equipment, chemical products and other 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 34% to USD 304 Mn in May (Y/Y) and declined by 42.6% in June (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

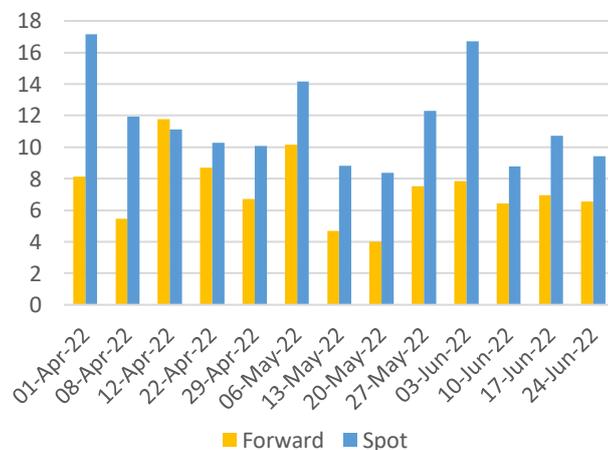
Figure 5: Gross official reserves (Mn USD)



Source: CBSL

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. Overall official reserves slid by a further USD 28 Mn in June as overall imports managed to remain at low levels.

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

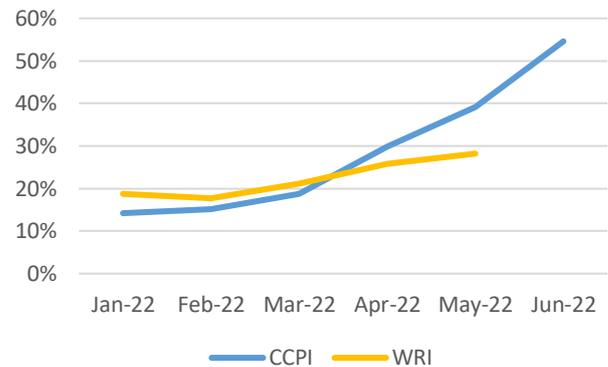


Source: CBSL

Interbank spot volumes showed marginal increase during the month, as business sentiment improved following beginning of IMF discussions. Forwards volumes however stayed low as a result of the prevailing dollar and fuel shortage in the country.

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

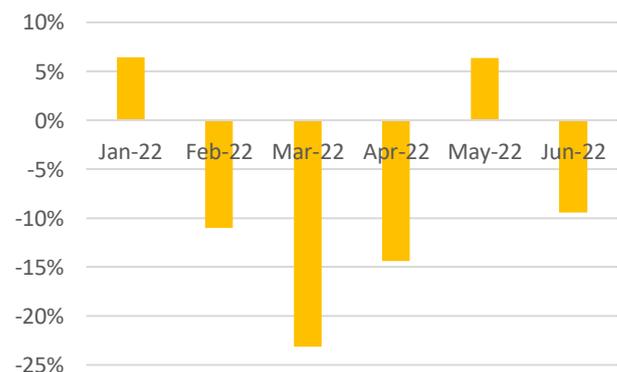
Private Wage growth continued to increase and posted a 28.2% increase (Y/Y) in May, while public sector employees' wages posted a 16.1% growth (Y/Y) during the same period.

Inflation levels rose sharply during June (Y/Y) as headline inflation increased to 54.6% from 39.1% in March. Food inflation increased to 80.1% from 57.4% due to rising prices of fresh fish, vegetables, bread, rice and milk powder. Non-food inflation increased to 42.4% from 30.6% as a result of increased prices of fuel, housing, water, education, gas and electricity.

Equities

Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

The stock market ended the month with a negative sentiment following high inflation followed by record high market rates. Markets closed with a 9.44% fall in the ASPI and a 12.88% fall in the S&P20. Energy and commercial services were the only gainers while Transportation accumulated highest losses. Net foreign purchases were slightly negative and overall PBV (Price-to-Book-Value) fell from 0.98 to 0.80 favoring buyers.

Figure 9: GICS sector performance- June

Sector	Index Points Gained
Energy	213
Commercial & Professional Services	75
Consumer Services	-18
Utilities	-23
Banks	-29
Software Services	-31
Retailing	-48
Real Estate	-49
Food & Staples Retailing	-50
Capital Goods	-51
Automobiles & Components	-75
Telecommunication Services	-81
Household & Personal Products	-81
Health Care Equipment & Services	-90
Insurance	-91
Materials	-93
Food, Beverage & Tobacco	-95
Consumer Durables & Apparel	-98
Diversified Financials	-421
Transportation	-7252

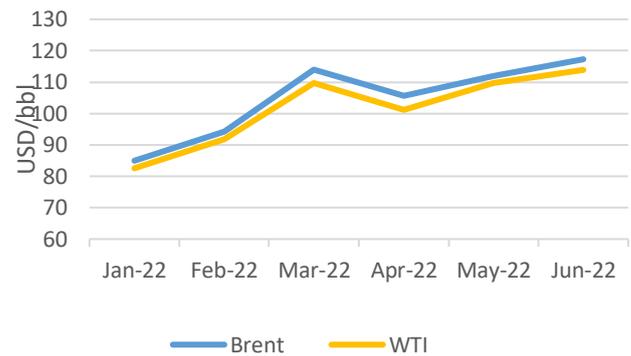
Global Market

Unexpected inflation coupled with further monetary tightening by the Fed caused the stock market to experience large losses during the month of June. Overall inflation comprised of a 34.6% increase in energy prices and a 10.1% increase in food prices. The Fed however assured congress that they were committed to combatting inflation. The Dow Jones Industrial Average lost 6.7%, S&P's 500 index fell 8.39% while the Nasdaq dropped 8.71%. All sectors made losses with Energy and materials

showing worst performance. European markets were also under pressure with Italy, Germany, Spain and UK experiencing losses. Asian markets were mostly down with China being the exception.

Commodities

Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Global Brent crude oil prices rose during the first half of the month, reaching a 3-month high of USD 122 a barrel following EU leaders' collective decision to cut oil imports from Russia. The price rise was also supplemented by OPEC's inability to fully deliver on the pledged output increase. Momentum eventually subsided and prices started to decline as worries regarding inflation caused major central banks to increase interest rates, thereby cutting demand for energy.

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

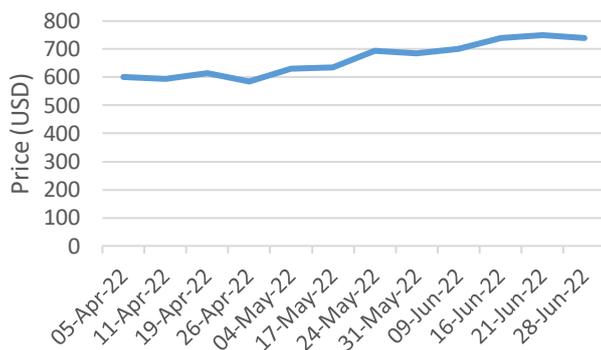


Source: Forbes & Walker

Good weather in the highlands as well as other areas resulted in good demand as well as high output resulting in increased prices. International auctions performed well with Bangladesh, Malawi and Kolkata auctions fetching high 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 June 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.

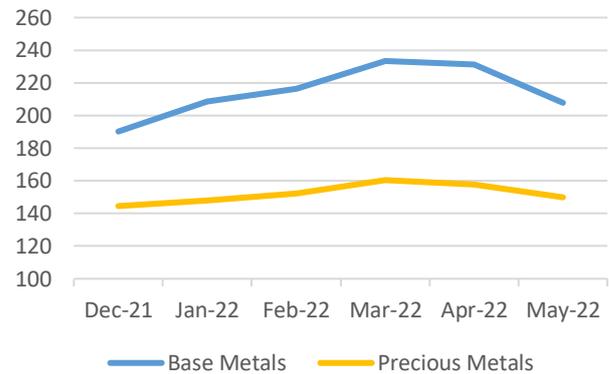
Figure 13: Coconut price weekly auctions



Source: CDA

Coconut supply declined sharply in June 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)



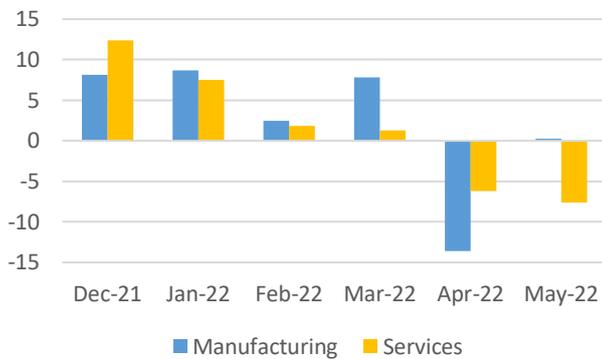
Notes: Base metals index includes Aluminum, Cobalt, Copper, Iron Ore, Molybdenum, Nickel, Tin, Uranium, and Zinc, precious metals index includes Gold, Silver, Palladium, and Platinum
Source: IMF

Gold prices edged higher at the start of June, backed by high inflation figures in the US. A strong job market also pushed gold prices higher. Prices retreated thereafter reaching the USD 1800/ounce mark following the Fed Reserve's 75 bps increase in the policy rates. Specialists say that gold prices will be stationary in the near term as it is being pulled in two directions as hawkish Fed regime clashes with recessionary fears.

Overall base metal prices showed a strong decline following rising fuel and energy prices causing industrial activity in Europe to take a dip. However industrial activity has picked up in China which has led to a record increase in aluminium production. Other metals such as copper, nickel and tin dove as investors expect high inflationary expectations and tightening monetary conditions to curb demand.

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.

The PMI for manufacturing continued to contract in May 2022, however showed a gain from the seasonally low value of April. New orders, production and stock o purchases remained contracted on a month-on-month basis was mainly witnessed in the food and beverage sector. Services PMI for May declined due to decreased overall demand for accommodation, food & beverages, wholesale, retail and real estate.

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

Outlook for July-August

In July, the central bank decided to increase base rates by 100 bps due to expected escalation along with persistence of high inflation in the periods ahead. However, over tightening of monetary conditions is bound to negatively impact any signs of economic growth including the SME sector.

Following IMF discussions, it was stated that critical reforms such as the Central Bank independence, strong anti-corruption measures and promotion of the rule of law were necessary in order to ensure a successful debt restructuring program. Treasury bill rates skyrocketed as a result and have now exceeded the 30% mark for a 3M instrument.

New PMI data released for June shows a sharp decline in business activity in both manufacturing and service sectors due to the economic crunch resulting in hyperinflation as well as fuel and gas shortages.

Global oil prices have descended from their peak prices and settled at around USD 100 a barrel following recessionary fears, which bodes well for struggling emerging economies such as Sri Lanka. However, prices are expected to persist at higher levels for the remainder of the year.

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
Sri Lanka Savings Bank	Issuer Rating	Reaffirmed	[SL]BBB- (Stable)	[SL]BBB- (Stable)
Merchant Bank of Sri Lanka & Finance PLC	Issue Rating (Subordinated Unsecured Redeemable Debenture Program) – LKR 2000 Mn	Withdrawn	[SL]BBB (Stable)	
Vidullanka PLC	Issuer Rating	Reaffirmed	[SL]A- (Stable)	[SL]A- (Stable)
Vidullanka PLC	Issue Rating (Commercial Paper Program) – LKR 200 Mn	Reaffirmed	[SL]A2+	[SL]A2+
Janashakthi Limited	Issuer Rating	Reaffirmed	[SL]BB+ (Negative)	[SL]BB+ (Negative)
LOLC Ceylon Holdings Limited	Issue Rating (Guaranteed Redeemable Debentures Program) – LKR 1000 Mn	Reaffirmed	[SL]A(CE)	[SL]A(CE)
LOLC Holdings PLC	Issuer Rating	Reaffirmed	[SL]A (Stable)	[SL]A (Stable)
LOLC Holdings PLC	Issue Rating (Listed Senior Unsecured Redeemable Debenture Program) – LKR 7000 Mn	Reaffirmed	[SL]A (Stable)	[SL]A (Stable)
LOLC Holdings PLC	Issue Rating (Commercial Paper Program) – LKR 3000	Reaffirmed	[SL]A1	[SL]A1
LOLC Holdings PLC	Issue Rating (Senior Unsecured Unlisted Rated Redeemable Debenture Program)	Reaffirmed	[SL]A (Stable)	[SL]A (Stable)
Commercial Leasing and Finance PLC	Issue Rating =	Withdrawn	[SL]A (Stable)	
LOLC Development Finance PLC	Issuer Rating	Reaffirmed	[SL]A- (Stable)	[SL]A- (Stable)
LOLC Finance PLC	Issuer Rating	Reaffirmed	[SL]A (Stable)	[SL]A (Stable)
Lanka Credit and Business Finance PLC	Issuer Rating	Reaffirmed	[SL]B+ (Stable)	[SL]B+ (Stable)
Prime Finance PLC	Issuer Rating	Withdrawn	[SL]BBB- (On watch)	

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

To subscribe to ICRA economic updates, contact

Shevinda Thilakaratne

Analyst

Call: +94 77 406 6764

Email: research@icralanka.com

Published date: July 18, 2022

Document #: meujun22

©Copyright, 2022- 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 thereof.

Page | 9

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; Website: 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

Viruba Nagulan
Acting CEO
+94-774780366
viruba@icralanka.com

Rasanga Weliwatte
Head of Ratings
+94-773553564
rasanga@icralanka.com

Shevinda Thilakaratne
Analyst
+94-774066764
shevinda@icralanka.com

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

Follow us on



IcraLanka



icra-lanka