



# MONTHLY ECONOMIC UPDATE August

Economy at a glance for August 2022

## Economy shows signs of recovery

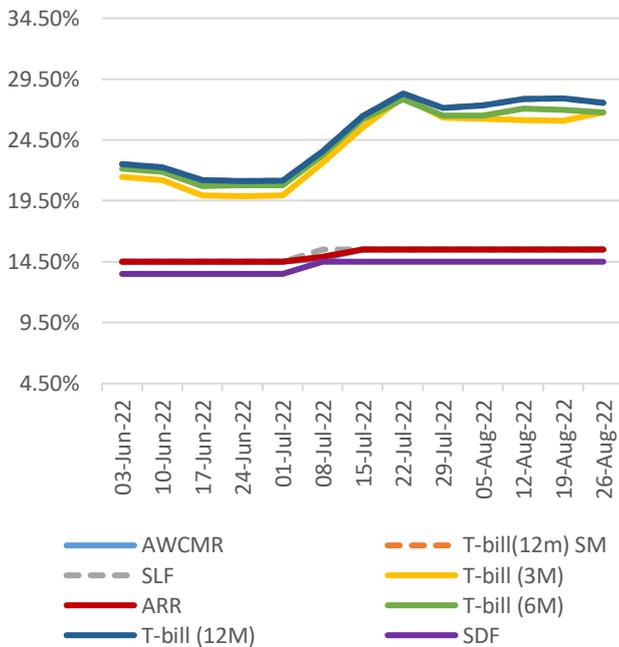
### Highlights

- The Central Bank of Sri Lanka opted to maintain the policy rates at their existing levels as existing contractionary measures was sufficient to curtail inflation without negatively impacting private credit growth and unemployment
- The Primary Bill auction was very active during the month, resulting in a turnover of around LKR 320 Bn which resulted in an increase in 3M yields by around 200 bps.
- Overall private credit growth declined by 41 Bn (M/M) In July as rising market rates coupled with worsening economic situation most likely deterred borrowings.
- Sri Lanka's overall trade deficit in July was USD 123 Mn which is an 80% improvement compared to the same month last year
- Inflation levels rose again in August (Y/Y) as headline inflation increased to 64.3% from 60.8%.
- The stock market made strong gains as markets closed with a 17.33% gain in the ASPI and 19.63% in the S&P20.
- Global Brent crude oil prices which started at around USD 100 per barrel plummeted to their weakest levels since February.
- Gold prices trended upwards during the month and is expected to stay at elevated levels following persistent inflation figures, despite monetary tightening by the Fed.
- The PMI for Manufacturing and Services experienced an expansion during the month as improved fuel availability led to faster delivery times.

## 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

In August, the Central Bank of Sri Lanka opted to maintain the policy rates at their existing levels, since they believed that existing contractionary measures was sufficient to curtail inflation without negatively impacting private credit growth and unemployment. Call and repo volumes declined further to near zero levels.

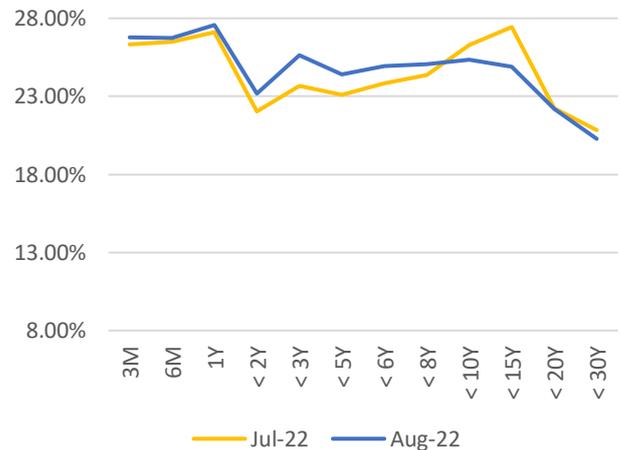
Overnight liquidity deficit levels increased marginally during the month, close to the LKR 500 Bn mark. Heavy borrowings through the Standing Lending Facility increased marginally. The Central Bank stock of Treasury bills declined slightly by LKR 3 Bn in August and there were no short- or long-term repo auctions during the month.

The Primary Bill auction was very active during the month, resulting in a turnover of around LKR 320 Bn which resulted in an increase in 3M yields by around 200 bps. The 3M T-Bills continued to attract the highest demand when compared to 6M and 12M.

Rates in the secondary market also increased marginally.

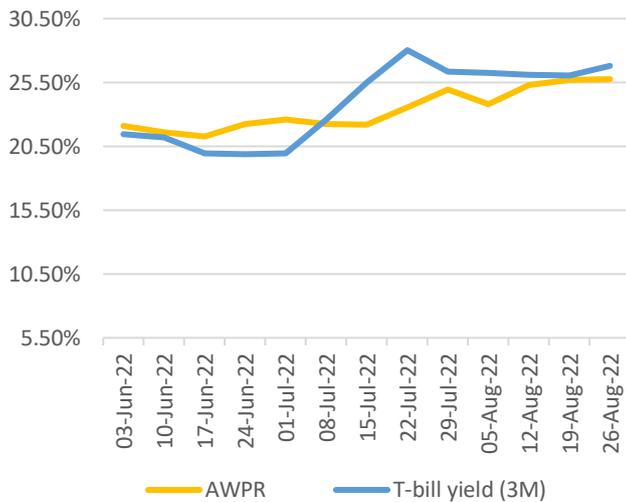
### Long-term rates

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 longer-term maturities declined even further following higher demand for short-termed instruments. The market absorbed around LKR 77 Bn in new Bond issuances while volumes in the secondary market remained high.

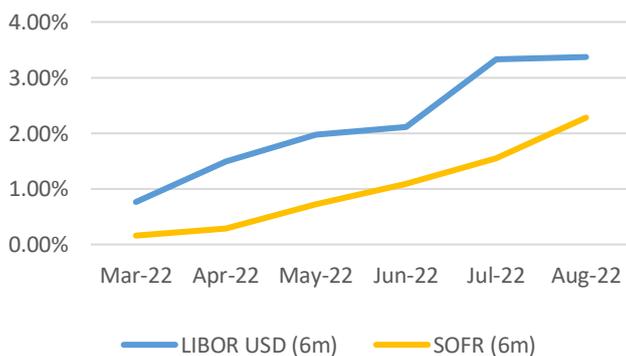
Figure 3: AWPR<sup>1</sup> and 3M T-bill yield


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

Overall private credit growth declined by 41 Bn (M/M) In July as rising market rates coupled with worsening economic situation most likely deterred borrowings. Reserve money contracted by 3.7% and AWPR increased by 82 bps in August following the increase in the lending rates coupled with 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 beginning of August saw Treasury yields falling sharply led by 2- and 3-year notes following a better-than-expected inflation in July of 8.5%, down from

9.1% in the previous month. The main reason for the pullback was due to falling energy prices. Longer term yields shot up following improved inflation sentiment. Towards the middle of the month, latest released data which reflected a slowdown in China's economy caused rising treasury yields to lose momentum. Nevertheless, the Fed indicated that it would take further action as continuously rising yields edged medium term yields to a 2-month high. Rising yields continued towards the end of the month as multiple Fed officials specified the importance of containing inflation as a benefit to the broader economy. The month however ended with the 2-year instrument reaching a 15 year high as markets strongly expect that the Fed would increase policy rates next month.

The USD lined LIBOR increased marginally by 5 bps while the SOFR rose sharply by 133 bps during the month of August.

## External Sector

Sri Lanka's overall trade deficit in July was USD 123 Mn which is a 80% improvement compared to the same month last year. YOY (Year-on-year) overall exports increased by 5.4% mainly due to a 23.6% increase in export of textiles and garments and a 75% increase in exports of gems and precious stones. Overall import bill for the month declined by 24.8% as YOY medical and pharmaceuticals declined by 67.8%, telecommunication devices declined by 96% and machinery and building material declined by around 40%.

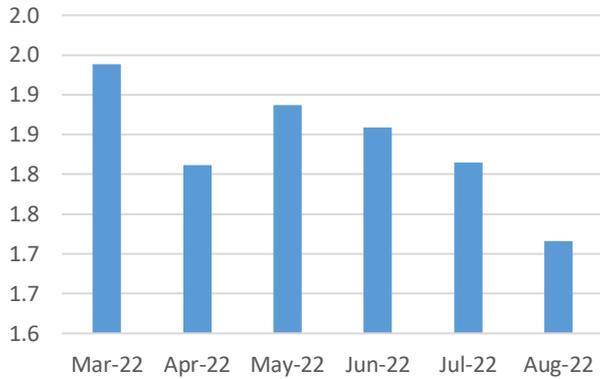
Receipts from tourism (Month-On-Month) increased by 44% compared to the previous month due to an improvement in the fuel ques along with easing of social tensions within the country. As a result tourism figures are expected to pick up over the following months. Worker remittances declined by 38.3% to USD 279 Mn in July (Y/Y).

The yields on ISB's declined marginally across all maturity periods following marginally improved sentiment.

<sup>1</sup> 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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## Prices & Wages

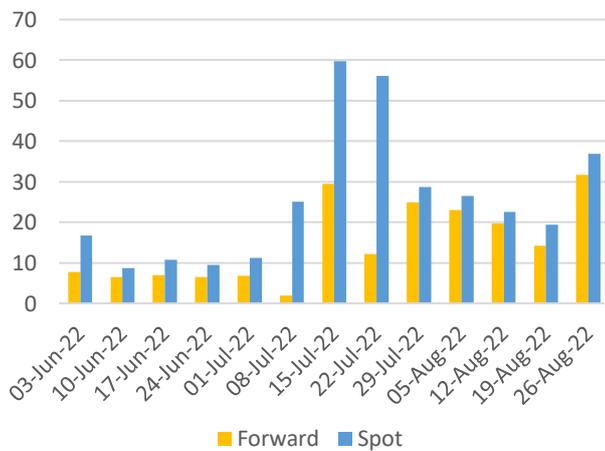
Figure 5: Gross official reserves (Bn USD)



Source: CBSL

Total gross official reserves declined by USD 100 Mn to USD 1.716 Bn towards the end of August, mainly since the CBSL remained a net seller of foreign currency to local banks and financial institutions.

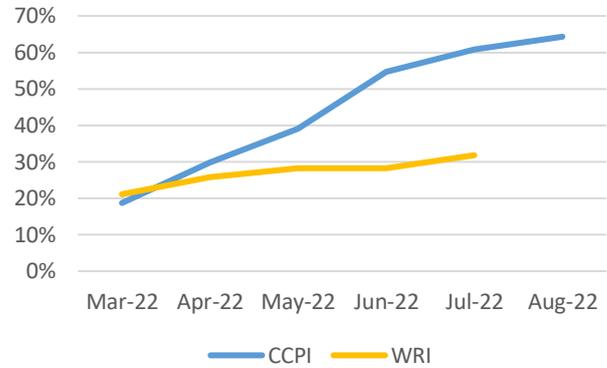
Figure 6: Interbank forex market daily avg. volumes (USD Mn)



Source: CBSL

Interbank spot volumes declined from its peak following the import ban, but remained at elevated levels in August. Business sentiment improved following news regarding reaching of a staff level agreement with the IMF as well as the higher availability of foreign currency in the financial system. Forward volumes also improved during the same time period.

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

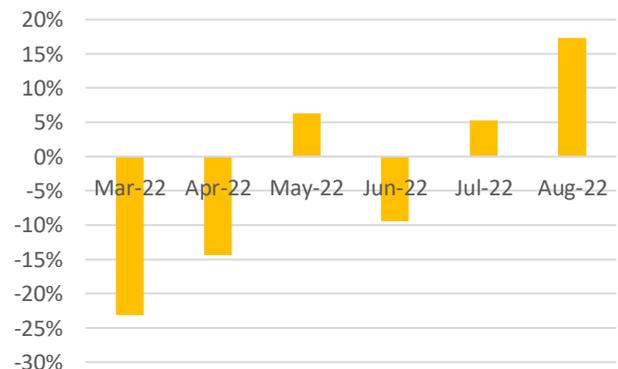
Private Wage growth continued to increase and posted a 31.8% increase (Y/Y) in July, while public sector employees' wages posted a 16.1% growth (Y/Y) during the same period.

Inflation levels rose again in August (Y/Y) as headline inflation increased to 64.3% from 60.8%. Food inflation increased to 93.7% from 90.9% due to rising prices of fresh fish, vegetables, biscuits, eggs, and milk powder. Non-food inflation increased to 50.2% from 46.5% as a result of increased prices of fuel, housing, water, electricity, gas, and electricity.

## Equities

### Domestic Market

Figure 8: ASPI (M/M)



Source: CSE

The stock market made strong gains during August after remaining subdued in the last few months posting strong gains. Hence markets closed with a 17.33% gain in the ASPI and 19.63% in the S&P20. Most sectors made gains with Transportation and Energy being the best performers. Net foreign purchases remained strongly positive and overall PBV (Price-to-Book-Value) rose from 0.83 to 0.96.

Figure 9: GICS sector performance- August

Sector	Index Points Gained
Transportation	6929
Energy	1428
Commercial & Professional Services	890
Household & Personal Products	581
Diversified Financials	387
Materials	314
Automobiles & Components	280
Capital Goods	214
Consumer Services	133
Food, Beverage & Tobacco	132
Food & Staples Retailing	131
Retailing	120
Real Estate	72
Insurance	65
Telecommunication Services	58
Software Services	49
Consumer Durables & Apparel	42
Utilities	33
Banks	-4
Health Care Equipment & Services	-6

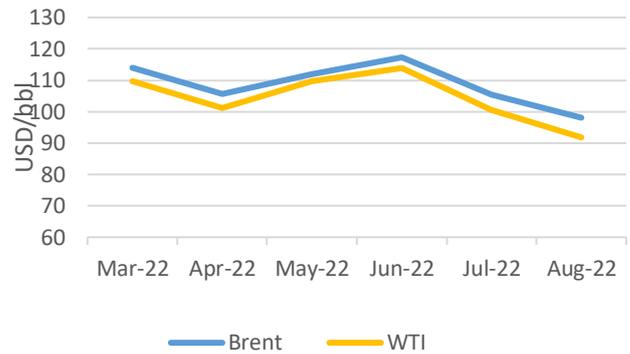
### Global Market

Renewed fears of hiking interest rates and a weakening economy caused stocks prices to dwindle in August. The Dow Jones Industrial Average dropped 4.06%, the S&P 500 Index fell 4.24% and the Nasdaq Composite fell by 4.64%. Despite a strong start to the month, building from the previous month as well as a strong employment report, Fed Chair's comments on their commitment to control inflation caused stock prices to slip towards the end of the month. All sectors apart from Energy and Utilities made losses where Real Estate led the charts. European markets were also down with France, Germany and the UK experiencing

losses. However most Asian markets apart from China made gains during the month.

### Commodities

Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Global Brent crude oil prices which started at around USD 100 per barrel plummeted to their weakest levels since February at the start of the month following an announcement by OPEC+ to increase production. Despite prices rebounding, overall effect was nullified as fears of recessions in China, clouded overall demand outlook. Oil prices edged higher towards the end of the month, as OPEC announced again it would consider cutting output in order to boost prices. However, prices slumped towards the end of the month over falling global stock prices.

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



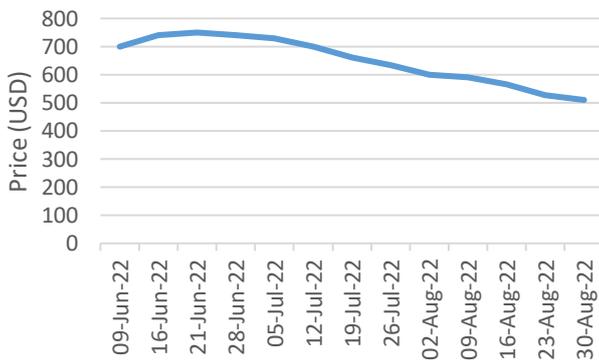
Source: Forbes & Walker

Auction volumes declined sharply during the month following heavy rains while impacted the overall

quality at the offerings. As a result of the short supply, price parity between the better teas and others declined to minimum levels. International auctions performed well with Malawi, Kolkata and Guwahati auctions fetching strong demand.

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 saw prices decline following the continuation of lockdown restrictions, hindering industrial activity in China which is the largest consumer of Natural rubber.

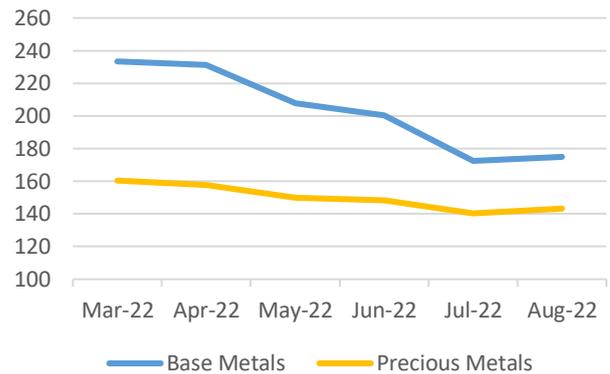
Figure 13: Coconut price weekly auctions



Source: CDA

Coconut supply was volatile following adverse weather conditions which caused prices to increase in the auctions compared to the previous month.

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

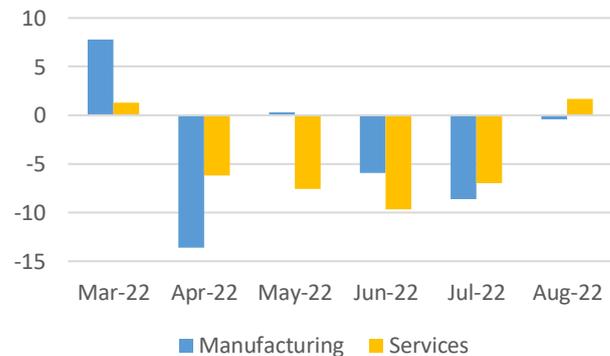
Source: IMF

Gold prices slid at the start of month as investors rallied towards a potential interest rate hike by the Fed Reserve in order to combat rising inflation. However, the potential fear of a global economic slowdown resulting from steep interest rate hikes renewed investors faith in the precious metal towards the tail end of the month. Additionally, prices are expected to stay elevated towards the rest of the year as stagflation is expected to remain.

Overall base metal prices showcased an upward revision during the month compared to the downturn in the previous couple of months. Copper prices saw boost following news of China intending to fuel large infrastructure projects to boost growth. Aluminium prices also spiked following supply concerns as few factories in China shut production.

## 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 recorded an expansion in August 2022, compared to the previous month mainly due to improvements reported in Employment and Stock of Purchases. An improvement in delivery times was also observed as a result of improved fuel availability. As a result, an improvement in production was observed largely within the apparel sector. The PMI for services also expanded during the month resulting from an increase in New Businesses, Business Activity and Expectations. The expansion was observed from within the Financial Services, Real Estate, and Insurance sectors.

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

## Outlook for September-October

In August, the Central Bank opted to maintain the base rates at their current levels, as they believed that existing measures are sufficient to anchor rising inflation figures, while maintaining market rates at a level that would not deter credit expansion in the private 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 which improved in August have increased even further with the 3M T-Bill increasing to over 32% in September

According to the Central Bank Governor, upward pressure on the exchange rate have eased to a certain extent which has resulted in a positive trade balance as exporters are likely to bring down their proceeds through official channels. Furthermore, imports of non-essentials have been curtailed to considerable levels.

Global Brent Crude oil prices have been continuously decreasing for the past couple of month and currently hover around USD 92 per barrel descended from their peak prices and settled below USD 100 which bodes well for struggling emerging economies such as Sri Lanka. However, prices are unlikely to decrease sharply towards the rest of the year.

## Rating Actions

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

Issuer	Issue	Action	Previous Rating	Current Rating
Senfin Money Market Fund	Issuer Rating	Revised	[SL]A+mfs	[SL]AA-mfs
Construction Guarantee Fund	Issuer Rating	Reaffirmed	[SL]A (Stable)	[SL]A (Negative)
Orient Finance	Issuer Rating	Withdrawn	{SL}BB (Stable)	
Union Bank of Colombo	Issuer Rating	Reaffirmed	[SL]BBB (On Watch)	[SL]BBB (Negative)
DFCC Bank	Issuer Rating	Revised	[SL]AA- (On Watch)	[SL]A+ (Negative)
Softlogic Stock Brokers	Issuer Rating	Notice of Withdrawal	[SL]BBB	
Softlogic Life Insurance	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 Authorit
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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