



MONTHLY ECONOMIC UPDATE

September

Economy at a glance for September 2022

Economy in need of essential reforms

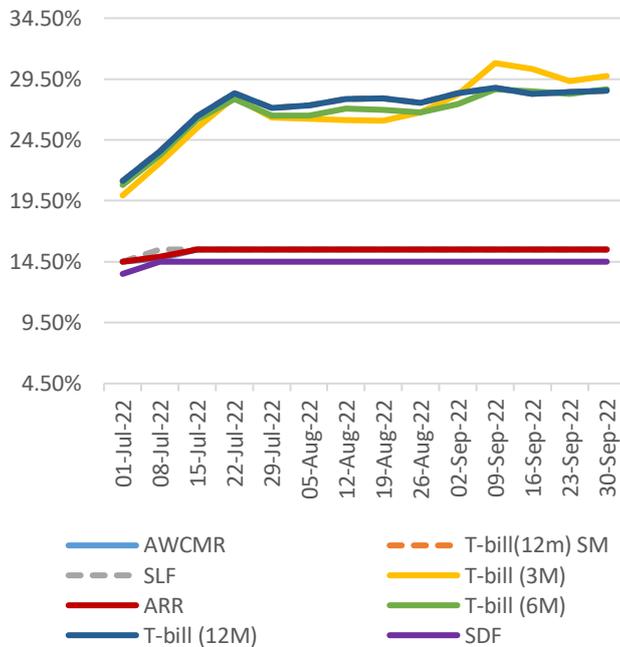
Highlights

- In September, the Central Bank of Sri Lanka opted to maintain the policy rates at their current levels, since they believed that existing contractionary measures was sufficient to curtail inflation without negatively impacting private credit growth
- The Primary Bill auction was active during the month, however declined compared to the previous month resulting in a turnover of around LKR 236 Bn.
- Sri Lankas overall trade balance showed a considerable improvement of 55% compared to the same month last year. Overall exports improved by 11.2% while the import bill declined by close to 12%.
- Inflation levels rose again in August (Y/Y) as headline inflation increased to 69.8% from 64.3%. Food inflation increased to 94.9% from 93.7% and non-food inflation increased to 57.6% from 50.2%.
- Receipts from tourism (Month-On-Month) fell by around 20% compared to the previous month in August due to a decrease in overall tourist arrivals.
- The stock market continued to make gains in September despite the worsening economic situation as markets closed with a 9.48% gain the ASPI and an 8.07% gain in the S&P SL20.
- Global oil prices declined in September as weakening economic outlook resulting from increased global inflation followed by tightening of interest rates by the Fed Reserve and Bank of England slumped overall demand.
- The PMI for manufacturing recorded a reduction in September 2022, compared to the previous month mainly due to a decrease in New Orders and Stock of purchases. The PMI for services also contracted during the month resulting from a decrease in New Businesses and Employment.

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 September, the Central Bank of Sri Lanka opted to maintain the policy rates at their current 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.

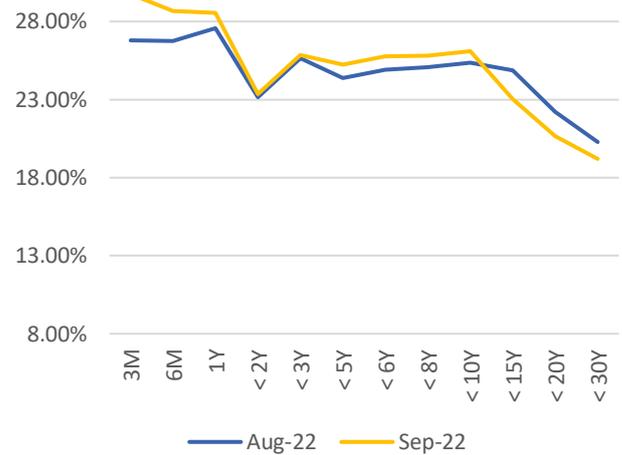
The overnight liquidity deficit improved during the month, even reducing below the LKR 400 Bn mark towards the end of the month. Borrowings through the standing lending facility improved in September compared to the previous month, but remained at elevated levels. The Central Bank stock of treasury bills increased by LKR 62 Bn during the month and there were no short- or long-term repo auctions in September.

The Primary Bill auction was active during the month, however declined compared to the previous month resulting in a turnover of around LKR 236 Bn which

resulted in an increase in 3M yields by around 100 - 150 bps. The 3M T-Bills continued to attract the highest demand when compared to 6M and 12M. Rates in the secondary market short term instruments increased by around 30 bps.

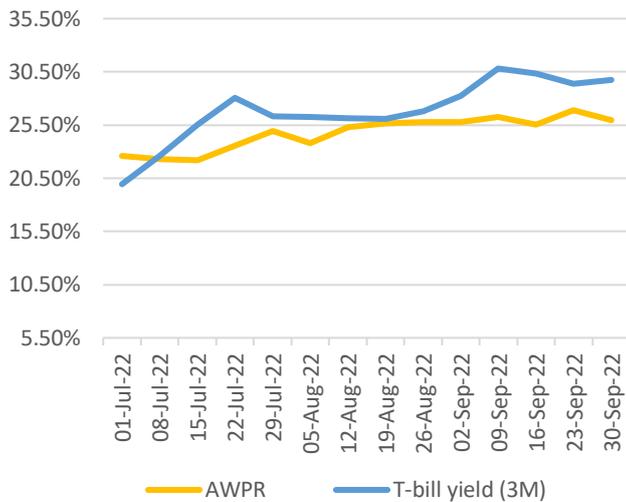
Long-term rates

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 marginally following higher demand for short-term instruments. The market absorbed around LKR 106 Bn in new Bond issuances while volumes in the secondary market remained high.

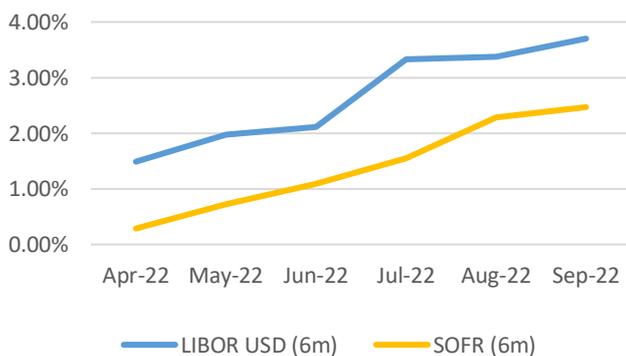
Figure 3: AWPR¹ and 3M T-bill yield


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

Overall private credit growth declined by 59 Bn (M/M) In August as rising market rates coupled with worsening economic situation most likely deterred borrowings. Reserve money contracted by 2.8% and AWPR increased by 20 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

Bond prices which were increasing during the start of September turned around following a 75-bps hike in the policy rates by the European Central Bank due

to rapidly rising inflation in the region. The yields of the inverted yield curve begun to narrow following another potential interest rate hike by the Fed, and latest inflation data which showed August inflation to be around 8.3% affirming market expectations. This caused to 2-year treasury instruments to reach a 15 year high, thereby inverting the yield curve even further. Towards the tail end of the month, the 10-year instruments reached a new 11 year high after the Federal Reserve decided on another 75-bps interest rate hike which raised the Fed-funds range to 3% - 3.25%. Yields across all maturities continued to ascend towards the end of the month expecting further action from the Fed. Treasuries rallied further after the Bank of England stepped in to buy gilts which plummeted sharply after the new budget proposal by the new UK Finance Minister.

The USD linked LIBOR increased by 33 bps while the SOFR rose marginally by 19 bps during the month of August.

External Sector

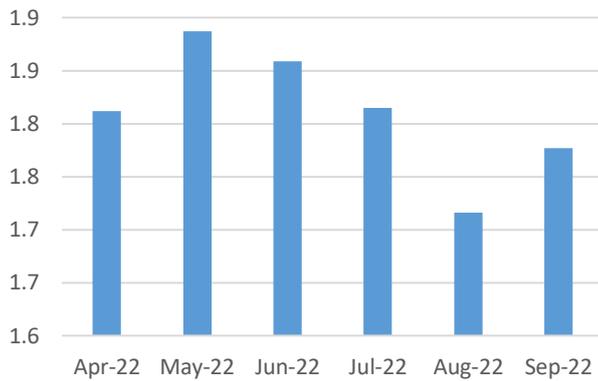
Sri Lankas overall trade balance showed a considerable improvement of 55% compared to the same month last year. YOY (Year-on-year) overall exports improved by 11.2% during the month mainly due to increased exports of garments, precious stones, machinery, and animal products. YOY overall import bill declined by close to 12% due to decreased imports of pharmaceuticals, machinery, equipment and building materials.

Receipts from tourism (Month-On-Month) fell by around 20% compared to the previous month in August due to a decrease in overall tourist arrivals. However, tourism figures are expected to pick up over the following months following resumed flights from Russia. Worker remittances declined by 27.2% to USD 325 Mn in August (Y/Y).

The yields on ISB's declined across all maturity periods following worsening market expectations.

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.
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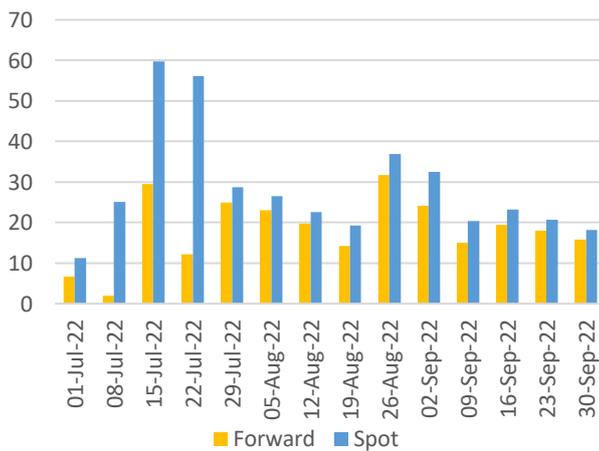
Figure 5: Gross official reserves (Bn USD)



Source: CBSL

Total gross official reserves increased by USD 61 Mn to USD 1.777 Bn towards the end of September, mainly due to the current account surplus following reduced overall imports

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

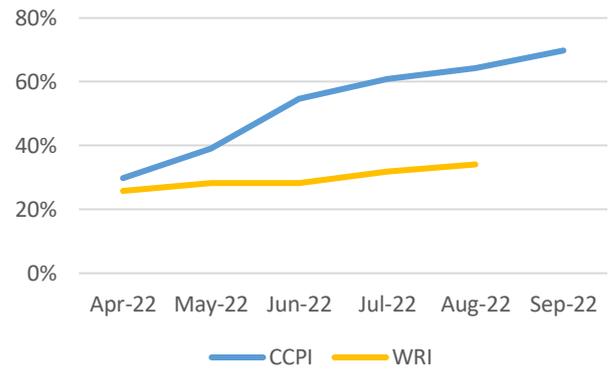


Source: CBSL

Interbank spot volumes declined from its peak following the import ban, and continued to descend in September. 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 due to trade surplus. Forward volumes also stayed low during the same time period.

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

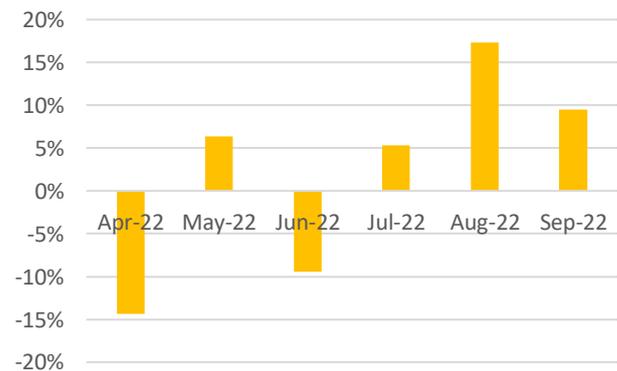
Private Wage growth continued to increase and posted a 31.8% increase (Y/Y) in July, while public sector employees' wages posted a 16.1% growth (Y/Y) during the same period.

Inflation levels rose again in August (Y/Y) as headline inflation increased to 69.8% from 64.3%. Food inflation increased to 94.9% from 93.7% due to rising prices of fruits, chicken, and wheat flour. Non-food inflation increased to 57.6% from 50.2% 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 continued to make gains in September despite the worsening economic situation as markets closed with a 9.48% gain the ASPI and a 8.07% gain in the S&P SL20. Most sectors made gains with Energy. Commercial & Professional Services and Materials making largest

gains. Net foreign purchases rose exponentially during the month due to large scale investments by international institutions and market PBV (Price-to-Book-Value) rose from 0.96 to 1.03 favoring sellers.

Figure 9: GICS sector performance- September

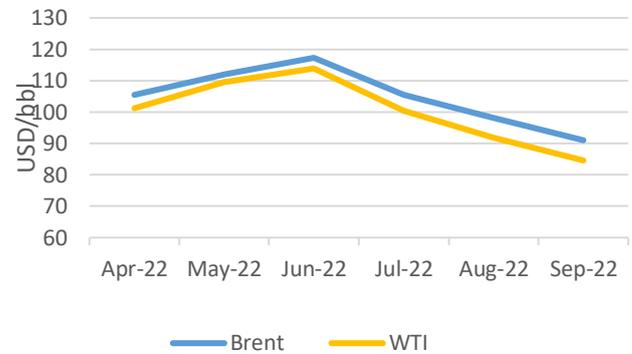
Sector	Index Points Gained
Energy	1806
Commercial & Professional Services	352
Materials	246
Food & Staples Retailing	172
Capital Goods	151
Retailing	132
Transportation	126
Software Services	76
Banks	56
Food, Beverage & Tobacco	44
Utilities	39
Diversified Financials	32
Insurance	16
Real Estate	14
Consumer Services	13
Automobiles & Components	-7
Telecommunication Services	-17
Health Care Equipment & Services	-37
Consumer Durables & Apparel	-105
Household & Personal Products	-273

Global Market

Stocks saw a brief upturn at the start, but lost momentum thereafter as the Fed announced its third consecutive 75 bps hike of the year. Hence markets were mainly down as the Nasdaq dropped 10.5% and the S&P500 dropped 9.34% in September. In the following month, markets will mainly be concerned regarding China which is planning to hold its 5-year economic framework and foreign policy. Furthermore, economic conditions are likely to worsen in the upcoming months following accelerated inflation and strained supply chains. Additionally European and Asian markets were down during the month.

Commodities

Figure 10: Crude oil price



Source: Bloomberg quoted in CBSL

Global oil prices declined in September as weakening economic outlook resulting from increased global inflation followed by tightening of interest rates by the Fed Reserve and Bank of England slumped overall demand. Towards the end of the month, prices slide further to end at 9-month lows, following the appreciation of the dollar followed by further anticipated rate hikes by the Fed. However, prices are unlikely to decline much further as the OPEC has announced further cuts to production.

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

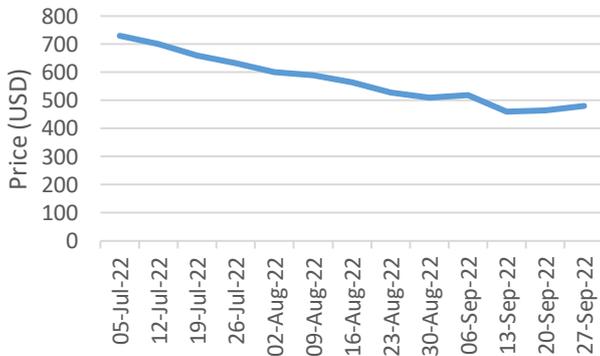


Source: Forbes & Walker

Auction volumes increased sharply during the month of September as clear weather was reported in all regions of the country. Prices also rose during the month following an improvement in overall quality. International auctions performed well with Bangladesh, 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.

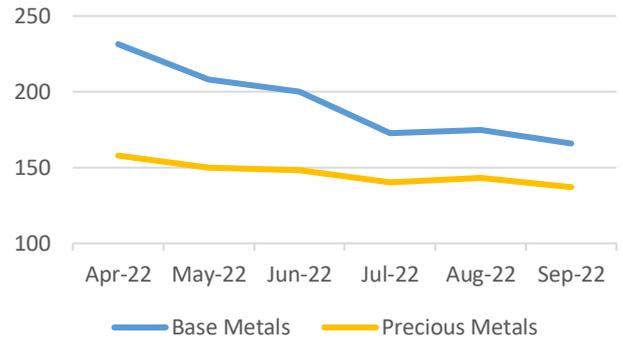
Figure 13: Coconut price weekly auctions



Source: CDA

Coconut supply was volatile in September with supply spiking towards the start of the month and declining towards the latter stages which caused prices to decline marginally

Figure 14: Metal price index (2016=100)



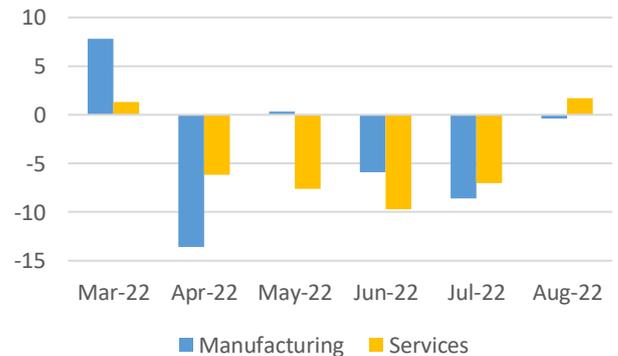
Notes: Base metals index includes Aluminum, Cobalt, Copper, Iron Ore, Molybdenum, Nickel, Tin, Uranium, and Zinc, precious metals index includes Gold, Silver, Palladium, and Platinum
Source: IMF

Gold prices stayed strong at the start of September on hopes that the Fed Reserve might potentially slow the pace of interest rate hikes following latest data which showed moderate wage growth. However, a 75-bps rate hike by the Federal Reserve caused prices to sink continuously for the next couple of weeks reaching a new 2 year low. However, prices reverted towards the end of the month on the back of increased demand from India

Global base metal prices rose at the start of the month supported by energy-related supply concerns. Aluminium and Copper prices were amongst the highest gainers. However, prices slipped toward the middle of the month following worries that the global economic slowdown would curb demand. Prices continued to fall towards the end of the month as the dollar hit a 2-decade peak.

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 a reduction in September 2022, compared to the previous month mainly due to a decrease in New Orders and Stock of purchases. An improvement in delivery times was also observed as a result of improved fuel availability. A decline in production was mainly observed in the food & beverages and apparel sectors following weaker demand from domestic and well as international market. The PMI for services also contracted during the month resulting from a decrease in New Businesses and Employment. Employment was mainly affected due to increasing resignations and retirements. However, expectations for Business Activity for the next 3 months is expected to improve with the upcoming festive season.

Outlook for October – November

The meeting held in October, the CBSL decided to maintain interest rates at current levels as they expect inflation levels to decelerate in the upcoming months. However as per the IMF, Sri Lanka is expected to suffer a GDP contraction of around 9.2% in 2022. Hence while controlling inflation levels are unquestionably important, it is important to note that sustained high interest rates are likely to dampen further economic growth.

Following IMF discussions, it was stated that critical reforms such as the Central Bank independence, strong anti-corruption measures, privatization of State-Owned Enterprises and promotion of the rule of law were necessary in order to ensure a successful debt restructuring program. Treasury bill rates have increased even further with the 3M T-Bill increasing to over 33% 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.

The newly proposed income tax reforms are being implemented at a time when consumers and businesses have already experienced many difficulties due to price hikes and increasing expenses. Hence it is imperative that the new tax reforms be coupled with a reduction in unnecessary government expenditure in order to reduce the overall strain to the economy.

Global Brent Crude oil prices which rose at the start of October have been on a downward trend over the past two weeks reaching a price USD 92 per barrel which bodes well for struggling emerging economies such as Sri Lanka. However, prices are expected to increase in future months as OPEC+ nations have agreed to restrict supply in order to increase price.

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
Metrocorp (Pvt) Limited	Issuer Rating	Reaffirmed	[SL] A+ (Stable)	[SL] A+ (Stable)
Access Engineering PLC	Issuer Rating	Revised	[SL] A+ (Negative)	[SL] A (Negative)
Access Engineering PLC	Senior Unsecured Redeemable Listed Debenture Program (LKR 5000 Mn)	Revised	[SL] A+ (Negative)	[SL] A (Negative)
Softlogic Stockbrokers (Pvt) Ltd	Issuer Rating	Withdrawn	[SL] BBB (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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