Monthly Economic Update (MEU)

July 2023

Economic Intelligence Unit
The Ceylon Chamber of Commerce

Highlights

Sri Lankan Economy

LKR Depreciated against the USD during July

The LKR recorded a depreciation of 6% during the month of July. As at 26th July, the USD/LKR spot rate was reported at LKR 329.41 as per the CBSL. However, considering the period thus far 2023, the LKR has appreciated by 10.4%.

Decline in Market Interest rates

In response to the policy measures taken up by the CBSL to ease monetary conditions of the economy and announcement of the domestic debt optimization plan resulted in decline in market interest rates in July. The CBSL is expecting a sizeable decline of interest rates in the near term.

External Sector Resilience continues to Improve

During the first five months of 2023, the trade deficit decreased notably as merchandise imports declined, partly due to a moderation in global demand, despite some setbacks in merchandise exports.

In recent months, the liquidity situation in the domestic foreign exchange market has been steadily improving, primarily driven by a rise in foreign exchange inflows. Inflows of remittances and tourism earnings recorded a significant improvement during the 1H of 2023 on a y-o-y basis.

Progress of the IMF Programme

As of the end of June, Sri Lanka has been able to verifiably achieve 33% of the 100 targets that are captured by the IMF tracker which were set forth by the IMF program. Out of the 55 commitments due by June, Sri Lanka has only accomplished 33, while 8 conditions have not been met and 14 lack publicly verifiable information.

Global Economy

A Mixed Picture on Global Economic Outlook

As per the latest update of the World Economic Outlook of the IMF, the agency is expecting a 3% global economic growth in 2023 and 2024, which was at 3.5% in 2022. The increase in central bank policy rates to fight inflation continues to weigh on economic activity, Global headline inflation is expected to fall from 8.7% recorded in 2022 to 6.8% in 2023 and 5.2% in 2024. Most of the risks to the outlook are predominantly tilted towards the downside.

China’s Exports record Biggest Decline in more than 3 years

China's exports have faced a challenging period, declining for the second consecutive month and experiencing the largest drop since February 2020 in June. This downturn comes as overseas economies grapple with inflation and rising interest rates, impacting demand for Chinese goods in international markets.

IMF Approves Bailout Programme for Pakistan

Recently the IMF Board approved a significant USD 3 billion bailout programme for Pakistan, providing much-needed financial assistance to address the country's severe economic crisis. The approval came after reaching a staff level agreement last month and is designed as a 9-month Stand-by Arrangement, aimed at supporting Pakistan's economic stabilization programme

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

-11.5% in Q1-2023

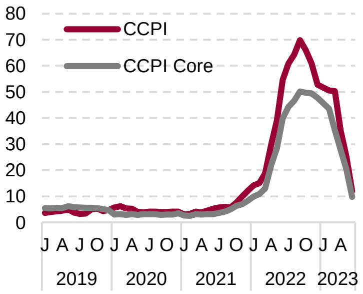
Movement of Purchasing Managers' Index-June 2023

Manufacturing PMI	43.7
Services PMI	56.7

Services activities expanded, Manufacturing activities contracted.

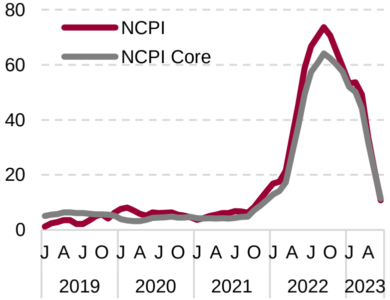
Inflation

CCPI Inflation (%)-*Base 2021*



June. 2023	Headline	Core
	12.0%	9.8%

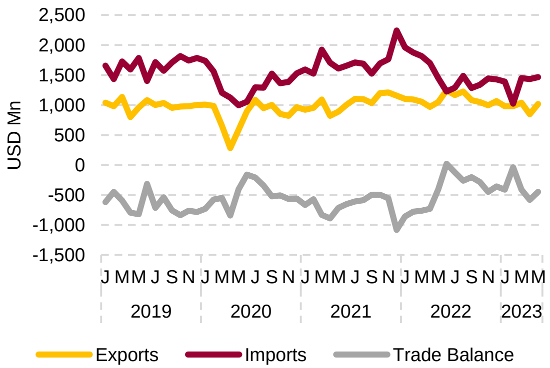
NCPI Inflation (%)-*Base 2021*



June. 2023	Headline	Core
	10.8%	11.0%

External Sector

Merchandise Trade



May. 2023

Exports **2.7%**

Imports **1.0%**

Trade Deficit **11.0%**

Tourism

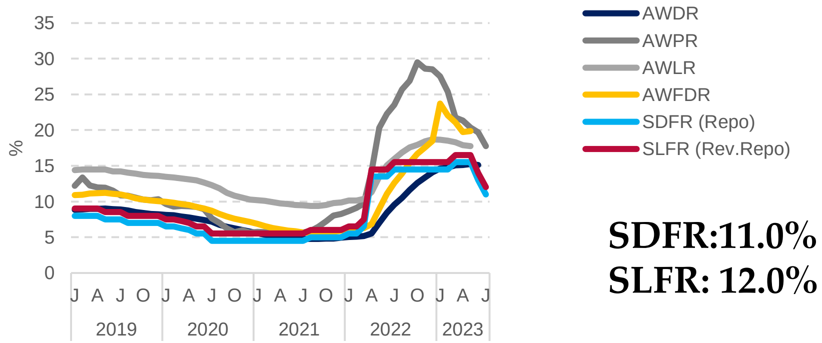
June. 2023

Arrivals **206%**

Earnings **168%**

Workers' Remittances **73%**

Interest Rates



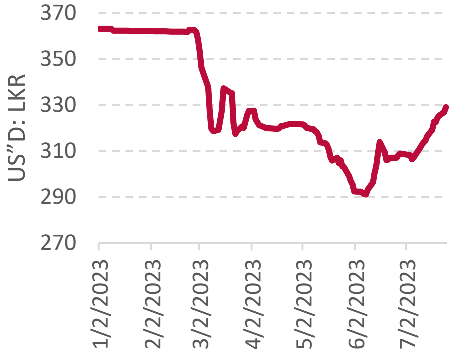
SDFR:11.0%
SLFR: 12.0%

Growth in Credit to Private Sector

May 2023

9.5%

Exchange Rate

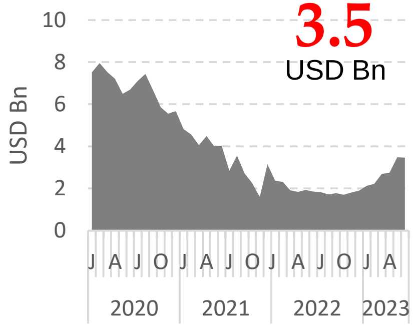


Appreciation of LKR thus far 2023 (Jan-Jul)

10.4%

Official Reserves

3.5 USD Bn



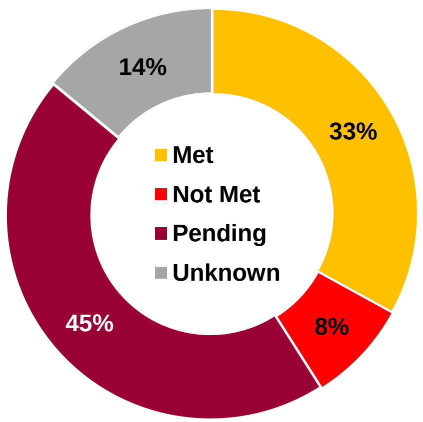
KEY INSIGHTS
Sri Lankan Economy

Sri Lanka's Progress in Achieving IMF Programme Targets

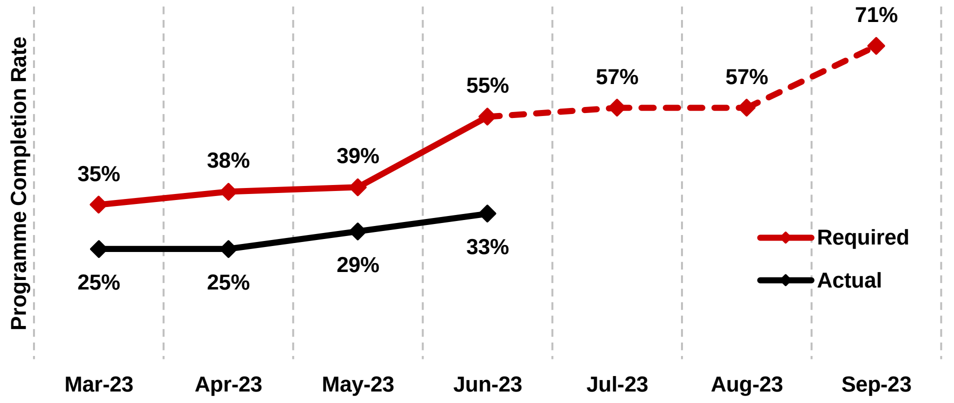
As of the end of June, Sri Lanka has been able to verifiably achieve 33% of the 100 targets that are captured by the IMF tracker* which were set forth by the IMF programme. Out of the 55 commitments due by June, Sri Lanka has only accomplished 33, while 8 conditions have not been met and 14 lack publicly verifiable information. The areas where Sri Lanka has fallen short primarily involve the passage of legislation and information dissemination. The country is committed to enact three significant laws: a revision of betting and gaming levies, enactment of the Central Bank of Sri Lanka Act and a new Anti-Corruption Act. The drafts of these bills are still pending parliamentary approval and enactment, delaying their implementation. Information dissemination pertains to the publication of annual reports for all 52 major SOEs up to 2022 and preparing a plan to phase out import restrictions during the period of the programme. As of now, only 11 out of the 52 key SOEs have published their annual reports up to 2022. Other commitments include; bringing tax revenue to 2.1% of GDP by March 2023, creating an online fiscal transparency platform and cabinet approval on restructuring plan for key SOEs.
Updates in July show that the new Central Bank Act and the Anti-Corruption Bill got parliamentary approval and the Ministry of Finance has published annual reports of 52 major SOEs. However, overall Sri Lanka has failed to meet the intended completion rate for its commitments and it raises concerns about the country's ability to achieve its economic goals. Therefore, unless significant progress being made in meeting its commitments in the upcoming months, it would be difficult securing the second tranche of funds from the IMF by September.

** IMF Tracker is an online tool that tracks the progress on government commitments in Sri Lanka's 2023 IMF Programme and this tool is run by Verité Research (Pvt) Ltd.*

Progress of the IMF Programme-SL (as of 30th June 2023)



SL Actual vs Expected Progress on the IMF Program (as of 30th June)



Data Sources:Manthri.lk, Publicfinance.lk

KEY INSIGHTS
Sri Lankan Economy

Update: Domestic Debt Optimization

Sri Lanka's Domestic Debt Optimization plan involves several key steps:

1. Converting certain Treasury Bonds into new ones to help eligible holders, specifically superannuation funds, avoid a 30% tax rate on income from Treasury bond investments. This applies mostly to bonds maturing between 2024 and 2032.
2. Converting Treasury Bills held by the Central Bank of Sri Lanka into Treasury Bonds.
3. Converting provisional advances made by the Central Bank to the Sri Lankan Government into Treasury Bonds.
4. Exchanging outstanding Sri Lanka Development Bonds (SLDBs) for Treasury Bonds denominated in USD or Sri Lankan Rupees.
5. Restructuring local law foreign currency-denominated bank loans of the Government.

The Gazette notification, ‘Registered stock and securities (Conversion of securities) Regulations, No. 02 of 2023’, issued by Sri Lanka's President and Minister of Finance, outlines steps for domestic public debt optimization to ensure economic recovery and sustainable growth. The key points include:

1. The option for holders of any stocks or securities to convert or exchange their holdings into Treasury Bonds.
   The authority given to the Secretary of Ministry of Finance to specify the terms for interest payments and conditions for such conversions or exchanges.
2. Authorization to create and issue Treasury Bonds necessary for the conversion or exchange of securities.
   Ensuring all privileges, exemptions, and immunities of the original stocks or securities apply to the new ones.
3. Authorization to create and issue Treasury Bonds to cover any expenses incurred in this process.

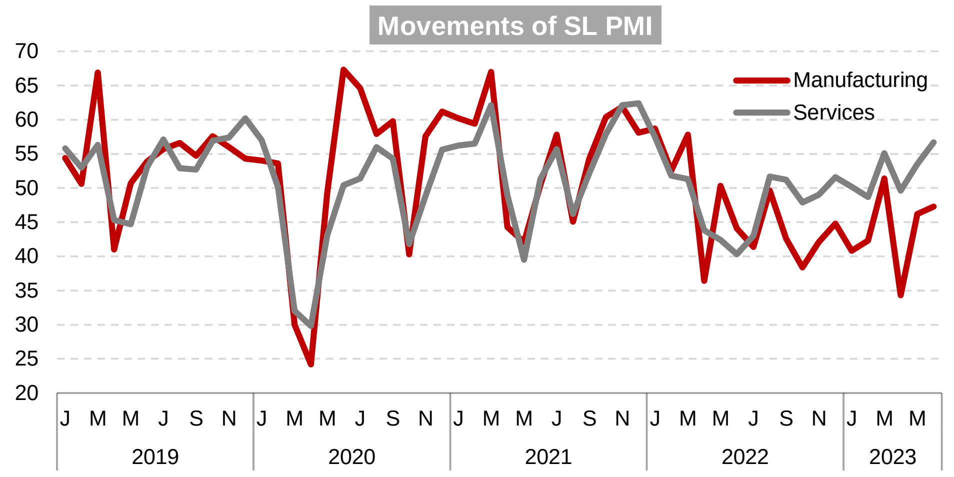
Deadline Extensions:

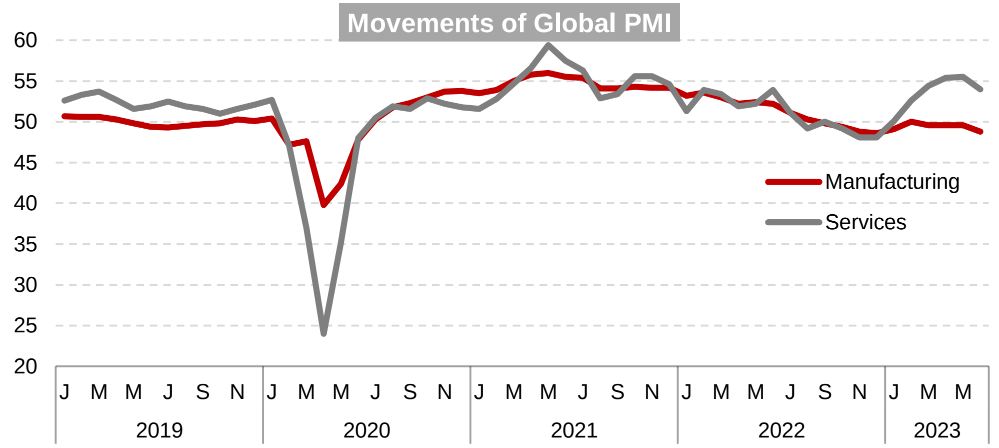
The new deadline for eligible holders to submit offers for the exchange of existing Treasury Bonds for new ones is now set for August 11, 2023, at 4:00 p.m. IST.
The Sri Lankan government has extended the deadline for the exchange of Sri Lanka Development Bonds for new Treasury Bonds, with the new deadline set for July 25, 2023, at 4:00 p.m. IST, which has passed at the time of writing this.

KEY INSIGHTS
Sri Lankan Economy

Manufacturing Sector Contracts; Services Show Growth in June: PMI

The latest data from the Purchasing Manager's Index (PMI) in June presents a mixed picture for Sri Lanka's economy. The manufacturing sector recorded a contraction with a PMI value of 47.3, although it showed some improvement compared to May's index of 46.2. The decline was primarily driven by reduced production and new orders in the textile and apparel sector, mainly due to subdued global demand. However, there were positive signs in the food and beverage industry, where select manufacturers reduced prices to stimulate demand, leading to some improvement. Expectations for manufacturing activities for the next three months indicated an improvement, anticipating a gradual recovery in economic conditions.
The services sector displayed a more positive trend, registering a PMI value of 56.7, surpassing the threshold and reaching its highest level since January 2022. This expansion was fueled by increased new businesses, business activities, and optimistic expectations for future activity. The outlook for services over the next three months remains positive, with anticipated improvements in economic conditions attributed to various factors, including policy rate cuts, a strengthening Sri Lankan Rupee, relaxation of import restrictions, and a moderation of inflationary pressures.
The global manufacturing and services PMIs stood at 48.8 and 54.0, respectively. While both indices experienced a relative drop compared to May figures (49.6 and 55.5), the main driving force behind lower production was the continued contraction in new order intakes, which have declined for the 12th consecutive month. Additionally, international trade flows remained weak, as new export business contracted for the 16th successive month.





Data Sources: CBSL

KEY INSIGHTS
Global Economy

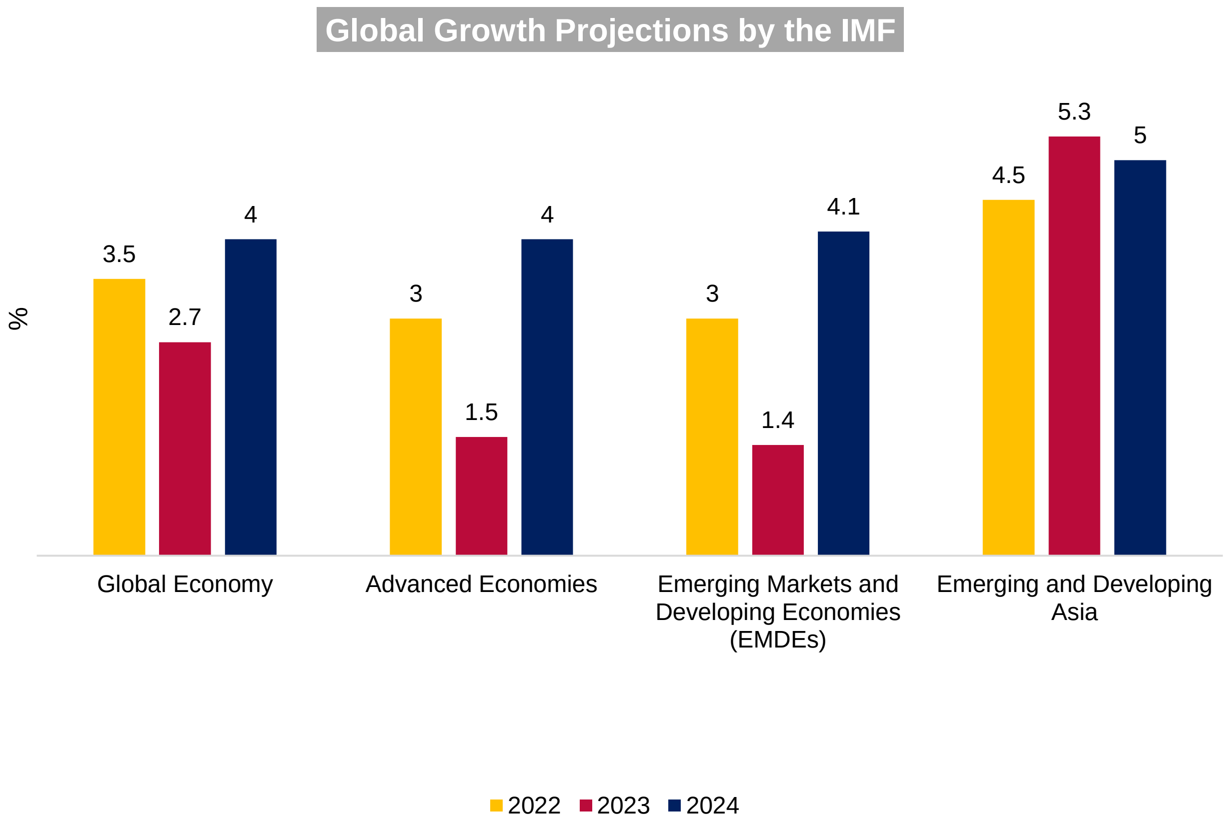
Global Economic Recovery Slows amidst Widening Divergence among Sectors and Regions

The IMF is expecting a 3% global economic growth in 2023 and 2024, which was at 3.5% in 2022. The increase in central bank policy rates to fight inflation continues to weigh on economic activity, the latest update of the World Economic Outlook report of the IMF, says.

Global headline inflation is expected to fall from 8.7% recorded in 2022 to 6.8% in 2023 and 5.2% in 2024. Core inflation is expected to decline more gradually, and forecasts for inflation in 2024 have been revised upward.

The recent resolution of the US debt ceiling standoff, coupled with robust measures taken earlier this year by authorities to control turbulence in US and Swiss banking has mitigated the imminent dangers of financial sector turmoil. This moderated adverse risks to the outlook. However, the balance of risks to global growth remains tilted to the downside. Inflation is expected to remain high and even rise if further shocks occur, including those from an intensification of the war in Ukraine and extreme-weather related event, triggering more restrictive monetary policy, the report stated.

Financial sector turbulence could resume as markets adjust to further policy tightening by central banks. China's recovery could slow, in part as a result of unresolved real estate problems, with negative cross-border spillovers. Sovereign debt distress could fall faster than expected, reducing the need for tight monetary policy, and domestic demand could again prove more resilient.



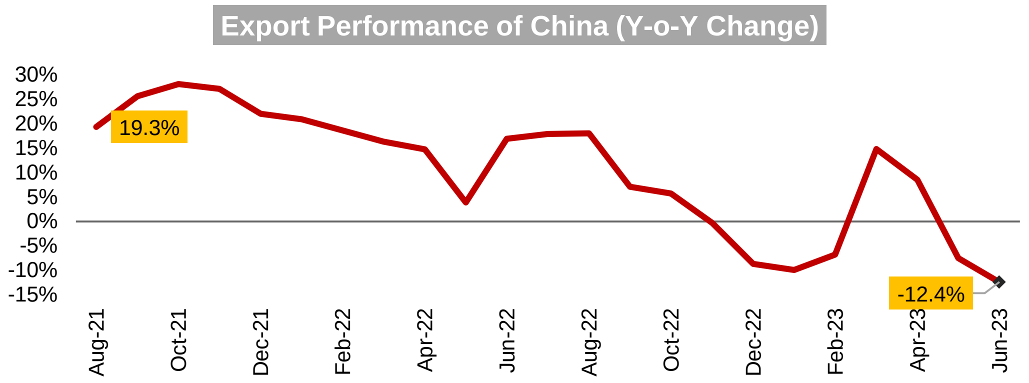
Data Sources: IMF

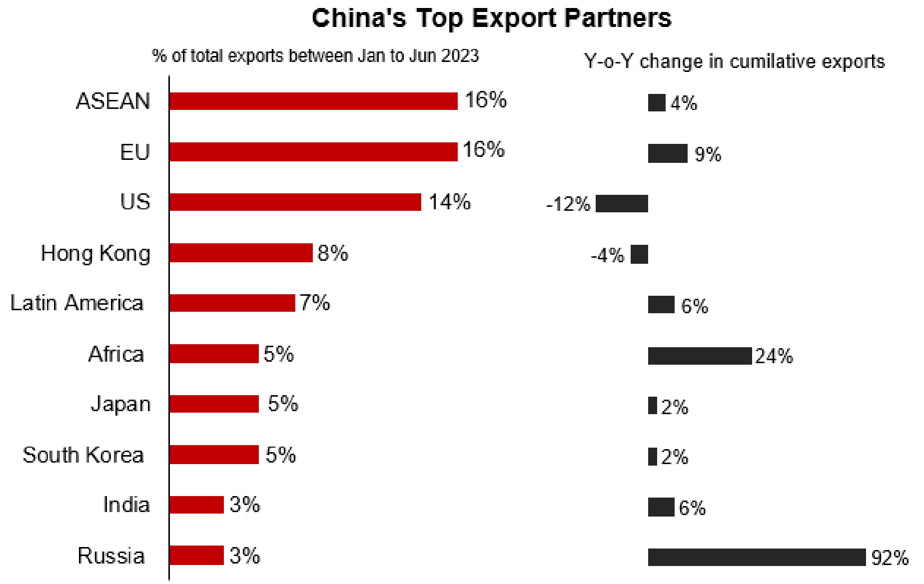
China’s Exports record Biggest Decline in more than 3 years

China's exports have faced a challenging period, declining for the second consecutive month and experiencing the largest drop since February 2020 in June. This downturn comes as overseas economies grapple with inflation and rising interest rates, impacting demand for Chinese goods in international markets. Notably, the economy recorded a worse-than-expected decline of 12.4% year-on-year in June, following a drop of 7.5% in May. A closer look at the data reveals significant variations in China's trade performance with different regions. In June, exports to the United States witnessed a substantial plunge of 24% year-on-year, while exports to the 10-member ASEAN bloc declined by 17% year-on-year.

While year-on-year growth may appear slow, there is an encouraging month-on-month progression. Additionally, imports have declined 6.8%, in June from a year ago, also worse than expectations for a 4% decline and the 4.5% annual decline in May.

In the first half of the year ASEAN was recorded as the largest trading partner of China. Exports to the United States have fallen the most among its major trading partners over the first half of the year, as diplomatic tensions mount over chip technology and other issues, while exports to Russia have risen sharply. One notable and interesting trend is the growing divergence in China's trade performance between different regions. Specifically, trade with economies in Southeast Asia and its ‘Belt and Road’ partners has been outperforming trade with the United States and the European Union in the recent months.





Data Source: Reuters, CNBC, State Council Information Office

KEY INSIGHTS
Global Economy

IMF Approves Bailout Programme for Pakistan amidst challenging times

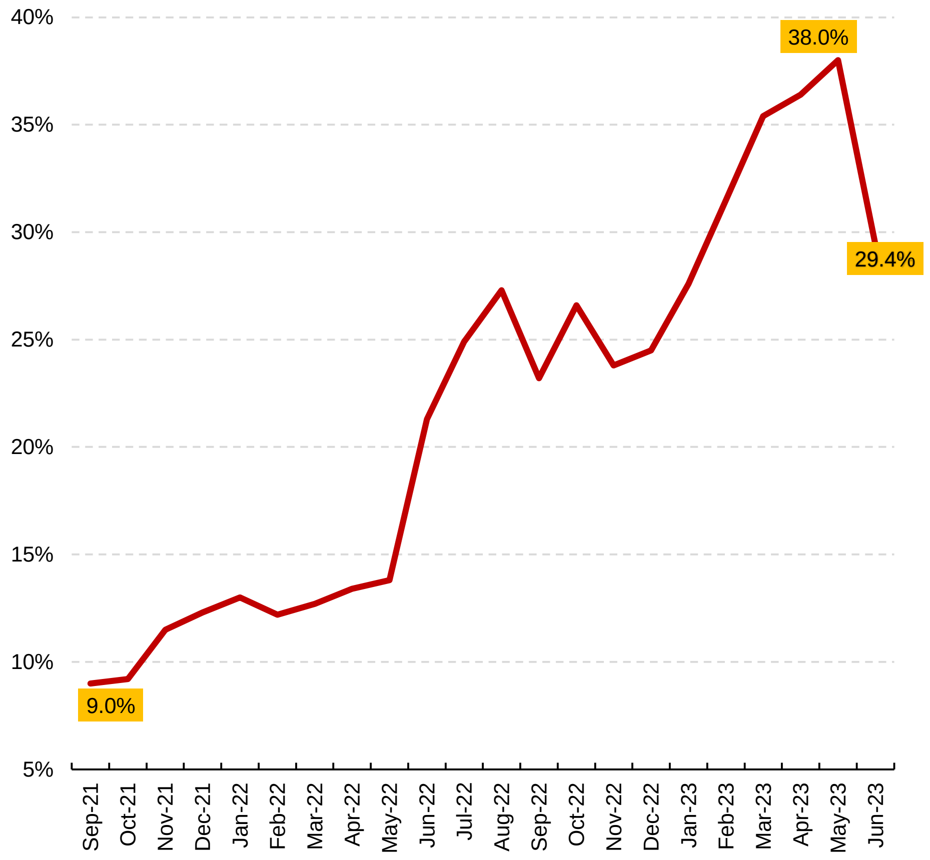
On July 12th, the IMF Board approved a significant USD 3 billion bailout programme for Pakistan, providing much-needed financial assistance to address the country's severe economic crisis. The approval came after reaching a staff level agreement last month and is designed as a 9-month Stand-by Arrangement, aimed at supporting Pakistan's economic stabilization program. The approval will immediately disburse about USD 1.2 billion to help stabilize the economy. The remaining amount will be phased over the programme's duration, subject to two quarterly reviews.

The programme will focus on,

- Implementation of the FY24 budget to facilitate Pakistan's needed fiscal adjustment and ensure debt sustainability, while protecting critical social spending
- A return to a market-determined exchange rate and proper foreign exchange market functioning to absorb external shocks and eliminate foreign exchange shortages
- An appropriately tight monetary policy aimed at disinflation
- Further progress on structural reforms, particularly with regard to energy sector viability, SOE governance, and climate resilience.

Pakistan's economy, which was already struggling after years of financial mismanagement, however, several external shocks have further exacerbated the situation. The spike in commodity and energy prices following Russia- Ukraine crisis has put immense pressure on prices. Additionally, the devastating floods in 2022 have caused a total economic loss of around USD 15.2 billion. These floods significantly impacted the country's agricultural sector, leading to a projected contraction of 0.9% of GDP and potentially pushing millions more people below the poverty line. Furthermore, internal political instability has added to the uncertainty. Deadly clashes between supporters of Pakistan's former prime minister Imran Khan and law enforcement agencies have rattled financial markets.

Y-o-Y Inflation of Pakistan: Consumer Price Inflation (CPI) based

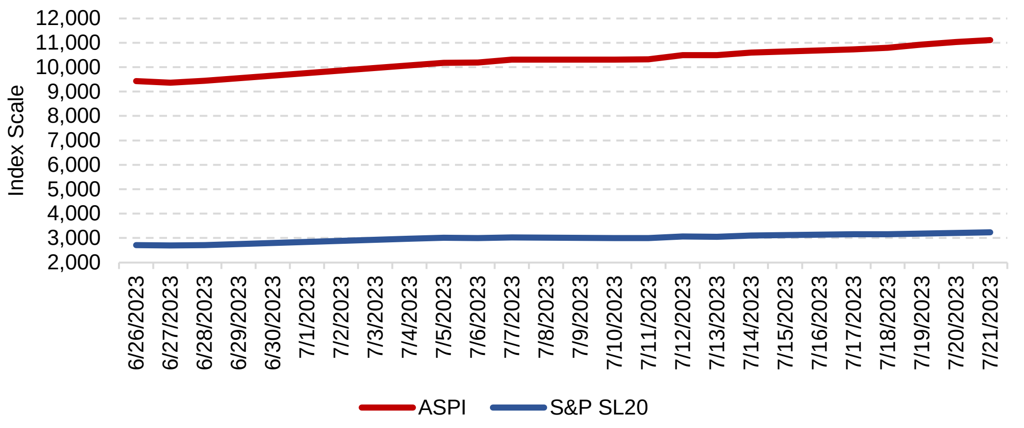


Data Source: IMF, World Bank, Pakistan Bureau of Statistics

Equity and Debt Market Performance

In order to provide our members with a concise update on the equity market performance of the month, the EIU is collaborating with the Colombo Stock Exchange (CSE) to introduce a new section in the MEU. This addition aims to deliver a formal and succinct overview of the equity market's performance.

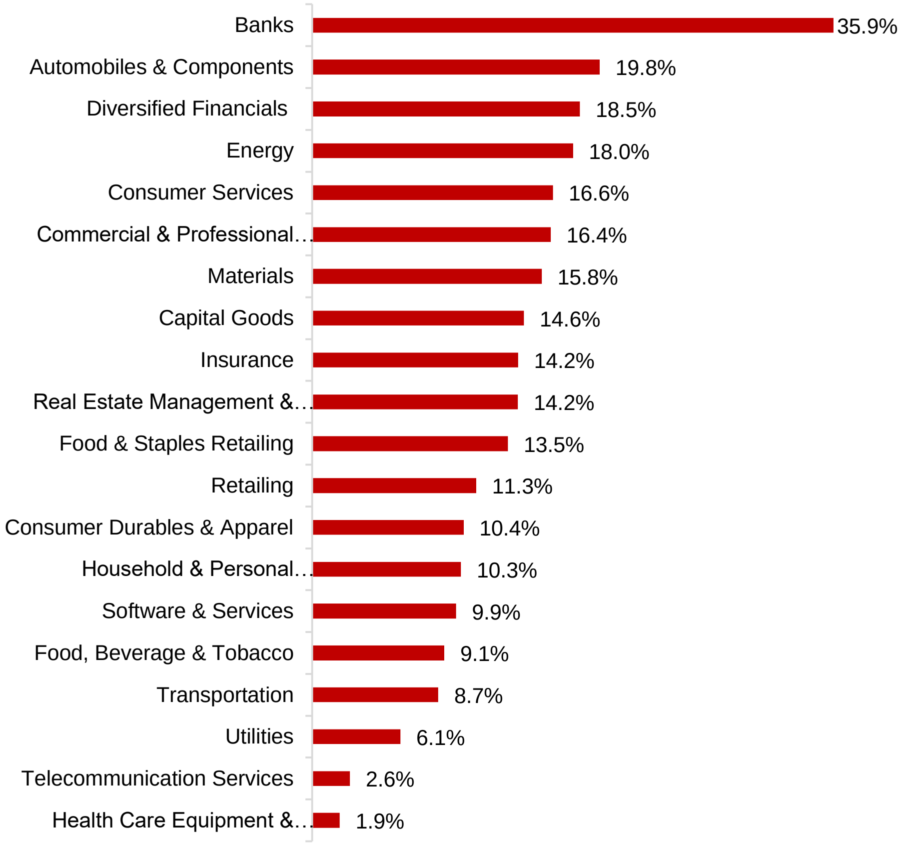
Index Performance



All Share Price Index (ASPI) is the benchmark index of the Colombo Stock Exchange (CSE). This is based on the float adjusted market capitalization.

S&P Sri Lanka 20 Index (S&P SL20) is the blue-chip index of the CSE and it includes the largest most liquid and profitable 20 companies as index constituents.

Market Cap Changes of GICS* Industry Groups (26/06/2023-21/07/2023)



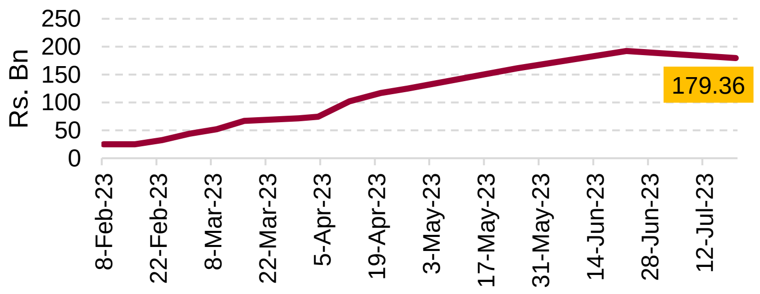
*GICS: Global Industry Classification Standards

Foreign Inflows (Rs Mn) YTD* (21/07/23)

Foreign Inflow	21,484.45
Foreign Outflow	18,934.69
Net Foreign Inflow/(Outflow)	2,549.76

*YTD: Year to Date

Foreign Holdings in Government Securities



The detailed report could be accessed via https://drive.google.com/drive/folders/1TXMS-z9GEO5vmAJ00IOZtJ5_rYvyDpd_

Data Source: CSE

Evolving Landscape

With the aim of keeping our members updated on latest global trends, especially those influencing Sri Lanka, 'Evolving Landscape' section was added to the MEU. This section guide our members in strategic planning, innovation and competitiveness and helping them identify sector-specific opportunities and challenges.

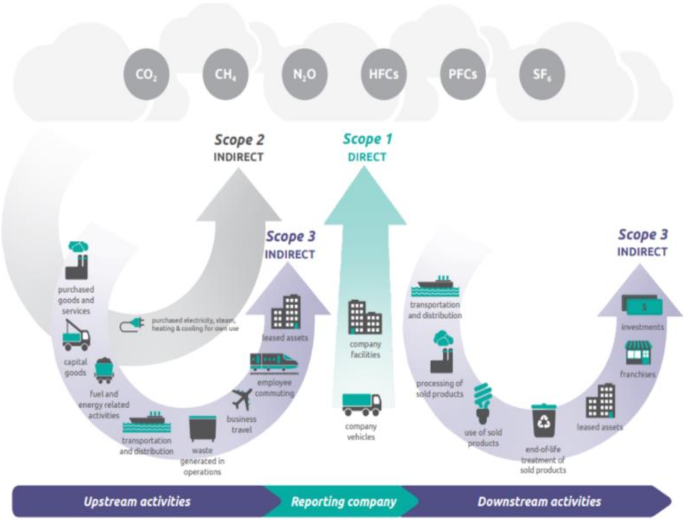
Decarbonizing the Value Chain

Corporate Responsibility & GHG Emissions

Growing corporate responsibility to combat climate change, reducing greenhouse gas (GHG) emissions as a key commitment since the Paris Agreement.

Emissions Scopes explained:
Scope 1: Direct emissions from company operations (e.g., manufacturing, vehicle operation).
Scope 2: Indirect emissions from energy consumed by the company.
Scope 3: Indirect emissions linked to the company's supply/value chain, such as procurement, transportation, product use, and end-of-life management.

Emphasis on Scope 3 emissions, accounting for up to 80% total emissions. Scope 3 further categorized into upstream (e.g., raw material procurement) and downstream (e.g., product distribution) activities.
Various approaches to calculate and report Scope 3 emissions, often based on supplier-specific calculations or company expenditures and national industry averages.



Importance and Management of Scope 3 Emission

Importance of Scope 3 reporting:
Provides an accurate emissions profile, identifies associated risks, informs investment decisions, tracks GHG performance over time, enhances engagement with partners, demonstrates sustainability commitment, and provides a competitive edge.

Key strategies for managing Scope 3 emissions:
- Selecting suppliers and customers based on carbon emissions.
- Revising product specifications to reduce resource demand, developing lower-emission products.
- Forming partnerships for low-carbon product lines and innovative technology.
- Implementing end-of-life recycling strategies and securing low-carbon raw materials.
- Building or transitioning into green-business segments.
- Integrating upstream or downstream into the value chain for better emissions control.

The need for proactive management: Increasing pressure for mandatory Scope 3 disclosures, attracting environmentally conscious investors, and avoiding reputational risks and financial implications. Adherence to regulations such as the EU's Corporate Sustainability Reporting Directive (CSRD) is critical for sustainable future growth.

Data Source: McKinsey & Company

Datasheet

Latest Available data

External Trade (USD Mn)	May-2023	Month Ago	Year Ago
Exports	1,019.5	849	1,048.3
Agricultural Exports	225.7	184	190.9
Industrial Exports	789.7	661	854.2
Imports	1,466.3	1,431	1,451.5
Consumer Goods	292.9	262	177.1
Intermediate Goods	970.5	985	1,306.1
Investment Goods	201.5	180	238.2
Trade Balance	-447.0	-583	-403
Tourist Arrivals (No.)	100,388 (Jun)	83,309	32,856
Tourism Earnings	158.4 (Jun)	132	45
Workers' Remittances	475.7 (Jun)	498	274.3

Inflation (%)	Jun-2023	Month Ago	
CCPI (2021 base)			
Headline	12.0	25.2	
Core	9.8	20.3	
NCPI (2021 base)			
Headline	10.8	22.1	
Core	11.3	21.6	

Interest Rates (%)		Month Ago	Year Ago
AWPR	17.76 (Jul)	19.69	23.53
AWLR	17.75 (May)	17.87	13.46
AWDR	15.09 (Jun)	15.23	8.41
AWFDR	19.70 (Jun)	19.84	11.06
SDFR	11.00 (Jul)	13.00	14.50
SLFR	12.00 (Jul)	14.00	15.50
Growth in Credit to Private Sector	-9.5 (May)	-8.3	19.3

Fiscal Sector (LKR Bn)		2023 (Jan-Apr)	Year Ago
Revenue and Grants		821.35	631.13
Expenditure and Net Lending		1,645.60	1,155.23

Data Sources: CBSL, Department of Census and Statistics, Sri Lanka Tourism development Authority

EIU

Economic Intelligence Unit of The Ceylon Chamber of Commerce

The Ceylon Chamber of Commerce

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