

MONTHLY ECONOMIC UPDATE

March 2022

EIU



3
KEY INSIGHTS

Economy Expanded by 1.8% in Q4 and 3.7% for the full year in 2021

Policy rate hike in March as currency allowed to float with steep depreciation

Gold Prices are expected to hit USD 2,500/oz by Year-end over Russia-Ukraine conflict

SRI LANKAN ECONOMY

Economy Expanded by 3.7% in 2021: In Q4 2021, the economy grew marginally by 1.8% to reach an annual growth of 3.7%. Services is the only sector that recorded a growth in Q4 2021 with 3.8% increase Y-o-Y basis while Agriculture and Industrial sectors showed contractions of 4.9% and 0.2% respectively.

CBSL Hiked Policy Rates; Sharpest Increase since 2001: The Central Bank tightened monetary policy further by hiking its policy rates by 1% on 4th March 2022. This can be identified as the sharpest increase since 18th January 2001, where CBSL hiked its policy rates by 3%. Since the end of February, the Average Prime Lending Rate has risen from 9% to 9.9% while the 12 Month-Treasury Bill has increased from 8.5% to 12.2%.

Free-Float of the LKR: After more than six months of fixed-USD exchange control, the CBSL decided to allow the free float of USD exchange rate in early March, which drove a steep depreciation of the currency of around 52% from around LKR 200 to around LKR 306 within a few weeks.

Inflation Surges: The trend of double-digit inflation which started in Nov 2021 continued in Jan and Feb, recording a 16.8% and 17.5% respectively. Food Inflation continued to drive the overall figure reaching to around 25% by the end of Feb.

Growth in Tourists Arrivals Continues: During the period of Jan to 20th of March 2022, 250,881 tourists arrived, which was more than the total figure for 2021. Feb 2022 recorded the highest number of arrivals in the post-pandemic period with 96,507.

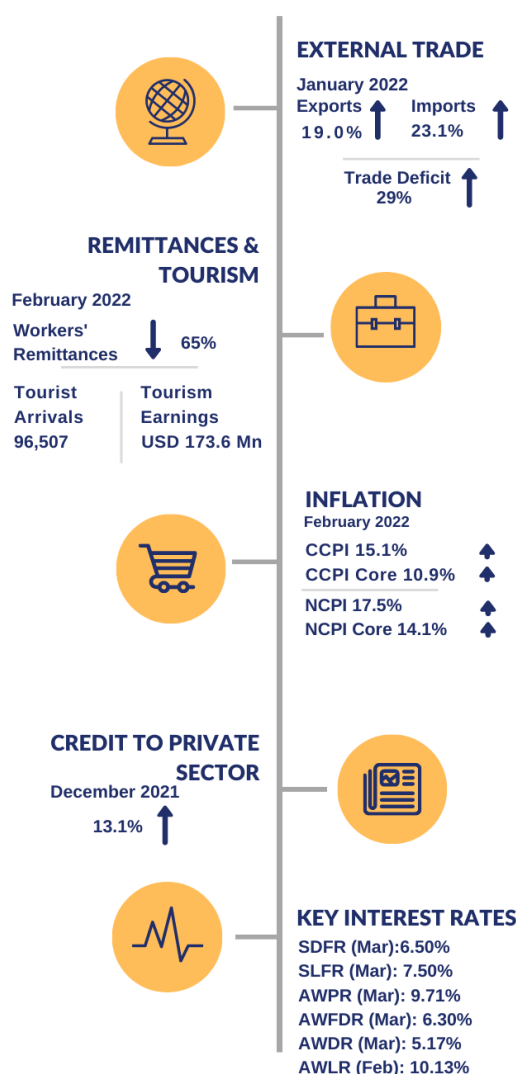
GLOBAL ECONOMY

WTO Goods Barometer Signals possible turning point for trade as supply pressure ease: Supply disruptions have dampened the strength of the rebound in global merchandise trade, but this could be starting to change as supply chain pressure show some signs of easing, according to the latest Goods Trade Barometer of the WTO.

Gold Prices are expected to hit USD 2,500/oz by Year-end: Gold prices have surged nearly 18% thus far 2022 to around USD 2,050/oz in the backdrop of the ongoing Russia-Ukraine conflict and there is more headroom over next few months, says Goldman Sachs. They expect the prices to rise another 25% to USD 2,500/oz by the year-end.

MACROECONOMIC SNAPSHOT

Y-O-Y CHANGES



Data Sources: Central Bank, Sri Lanka
Department of Census and Statistics, Sri Lanka
Tourism Development Authority, Sri Lanka

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FURTHER INSIGHTS- SRI LANKAN ECONOMY

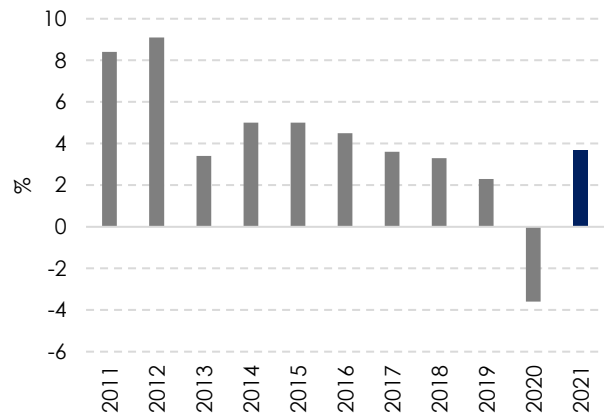
Economy Expanded by 3.7% in 2021

Considering the first nine-months of 2021, the economy recorded a growth of 4.4% on a Y-o-Y basis. In the Q4 2021, the economy grew marginally by 1.8% to reach an annual growth of 3.7%. Services is the only sector that recorded a growth in the Q4 2021 with 3.8% increase Y-o-Y basis while Agriculture and Industrial sectors showed contractions of 4.9% and 0.2% respectively. Specifically, Industrial sector recorded a contraction for the 2nd time in the year, following the Q3 2021 contraction. Annual growth rates of Agriculture, Industry and Service sectors recorded as 2%, 5.3% and 3% respectively, mainly driven by the significant growth in Q2 2021.

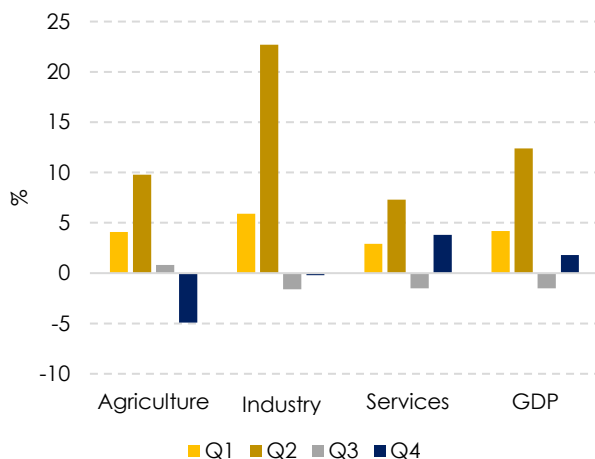
Share of the three sectors of the Economy decreased during Q4 2021, while the share of the Taxes on Products almost doubled during the same period. Overall, the share of value added in each sector for the year decreased from the levels seen in 2020. The adverse effects on the sectors are expected to remain in 2022, with the disruption due to further import restrictions, energy shortages, depreciation of the LKR and the added cost. Industrial and Services sectors may get impacted the most as compared to the Agriculture sector, which would slow down the economic growth further.

EIU expected a 3.8% growth for 2021, while CBSL, WB and the IMF expected 4%, 3.3% and 3.6% growth for Sri Lanka in 2021.

GDP Growth of Last Decade



Quarterly Growth of Key Sectors of the Economy



Data Source: Department of Census and Statistics

Latest Growth Projections for Sri Lanka

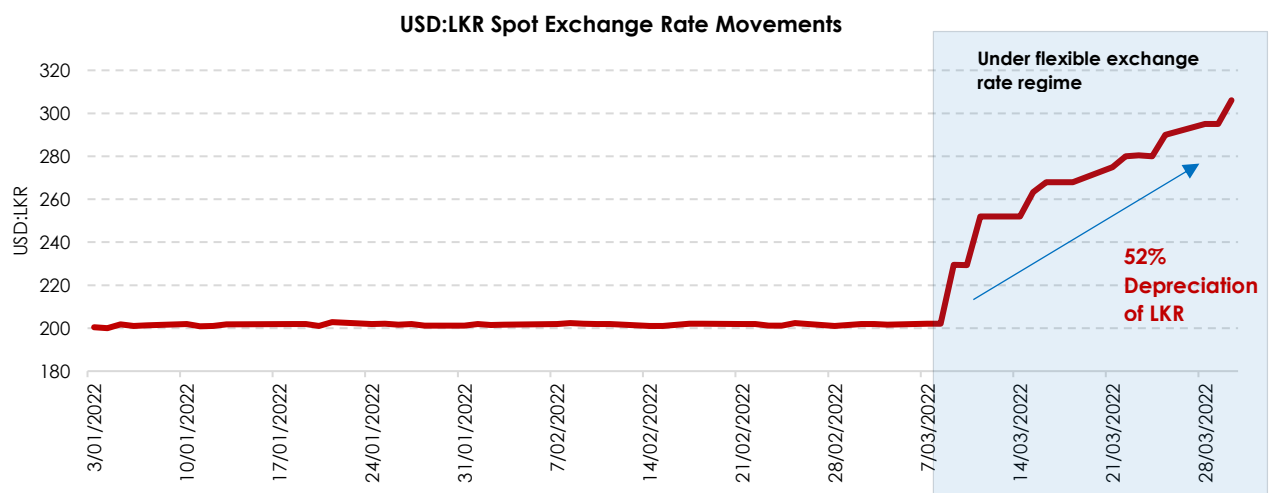
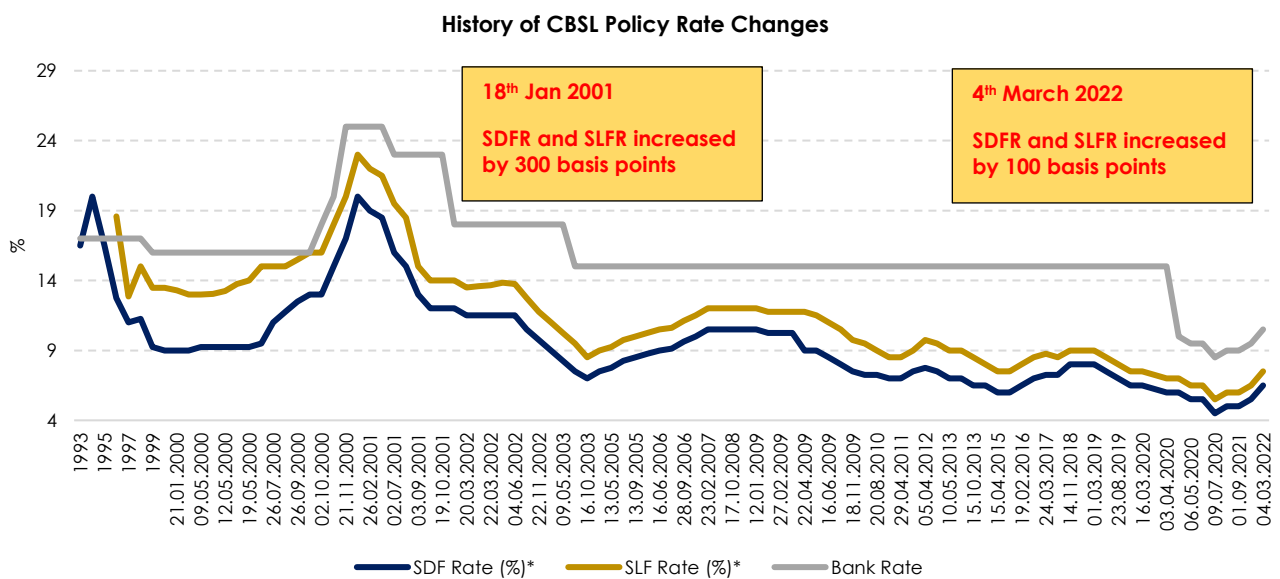
	2021	2022
THE WORLD BANK	3.3%	2.1%
INTERNATIONAL MONETARY FUND	3.6%	3.3%
CENTRAL BANK OF SRI LANKA	4.0%	N/A
ASIAN DEVELOPMENT BANK	3.4%	3.4%
EIU	3.8%	3.0%

CBSL Policy Rates were hiked: Sharpest Increase since 2001

The Central Bank of Sri Lanka was seen tightening their Monetary Policy stance by hiking its policy rates by 100 basis points on 4th March 2022. This can be identified as the sharpest increase since 18th January 2001, where CBSL hiked its policy rates by 300 basis points. Accordingly, Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) were increased to 6.50% and 7.50% respectively.

Looking at the historical movements of CBSL policy rates, Increase in Government's conflict related borrowings and large deficits in the BoP led frequent rate revisions since May 2000. The 300 basis points increase of policy rates in January 2001, led the SDFR and SLFR to 20% and 23% respectively. However, with the introduction of the independent float of the LKR and reductions in interest rates in major international market caused the gradual decrease in rates especially during the 2H of 2001.

Along with the policy rate hike in March 2022, the CBSL announced that it will allow a greater flexibility in the exchange rate for US Dollar, but not more than Rs. 230 per Dollar. However, the USD: LKR exchange rate picked up to LKR 280 per Dollar at the time of writing this.

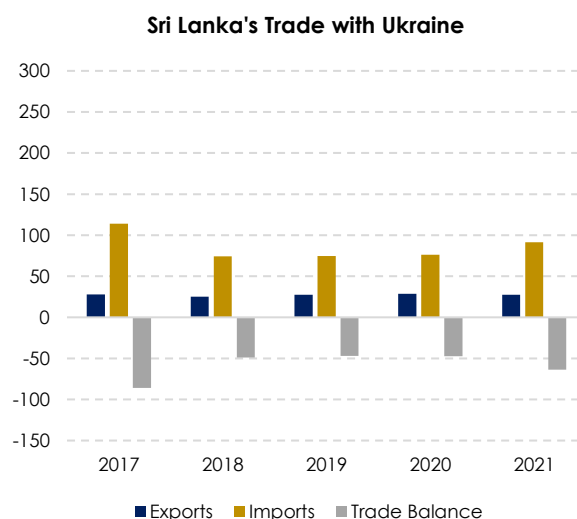
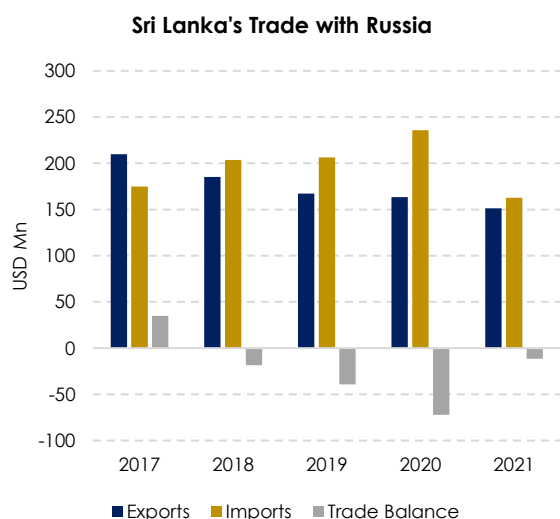


Data Sources: Central Bank of Sri Lanka

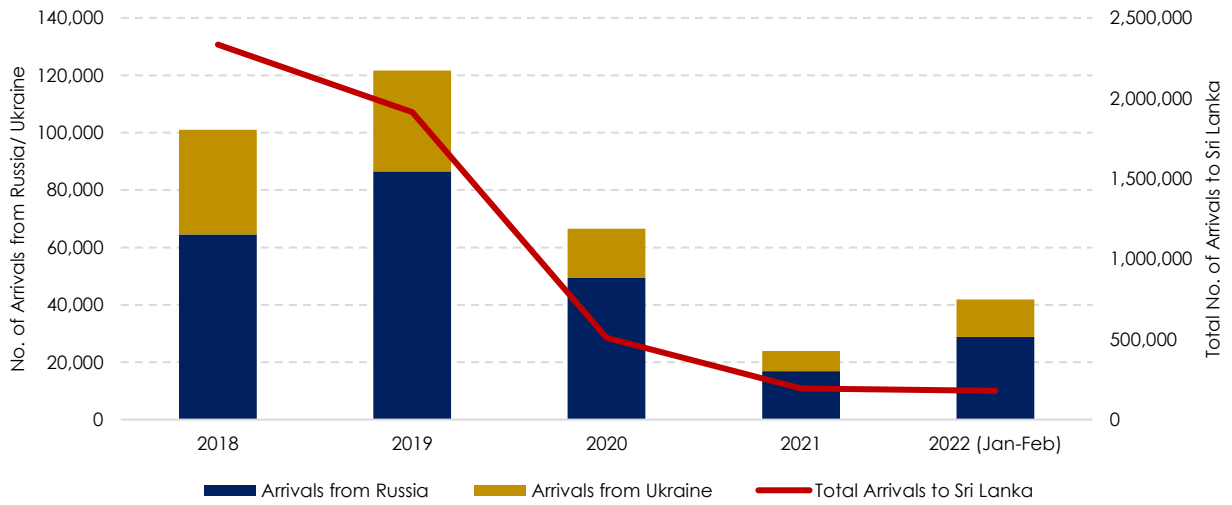
Russia-Ukraine War- Analysis on Economic Impacts of Sri Lanka

There are few looming threats for the Sri Lankan economy and private sector:

- With around 20% of the total Imports represented by Fuel, Sri Lanka is highly exposed to the volatility in the Energy and Oil prices that would occur because of the ongoing War.
- Rising energy prices are likely to worsen Sri Lanka's macro outlook putting further pressure on the Balance of payment and the already fragile exchange rate. Russia is the third largest oil producer in the world with a share of 11%. In addition, the higher fuel costs will impact the freight prices and as a result overall import costs will increase while impacting negatively in the export shipments, by reducing their profitability as well. Overall higher fuel costs will not only affect the Energy sector of the country, but the wider ripple effects will be witnessed in other sectors such as Transportation.
- Settlement of trade transactions is going to be the biggest difficulty in the wake of new sanctions. With the US and EU decision to ban Russia from SWIFT, the key global interbank payments system, payment settlements have halted across the globe. This is a big concern for traders and Sri Lanka will face a similar situation it had with trading with Iran few years back.
- Another sector that will have a negative impact is Tourism. Since following the ease of pandemic pressures, the revival of tourist inflows to the country was mostly led by the tourists from the two countries and the Europe region which represented over 60% of the incoming tourists. Sri Lanka has seen an increase in the inflow of tourists from Russia and Ukraine, both been ranked in the top 5 source markets in December 2021 and January 2022. Therefore, overall, Sri Lanka will also be exposed to the major global risks that were mentioned in the beginning, which would have serious implications given the already high double-digit inflation and the foreign exchange shortage.



Importance of Russia and Ukraine in terms of Tourist Arrivals to Sri Lanka



Data Sources: CBSL, ITC Trade Map, Sri Lanka Customs, SLTDA

Condominium Sales Picked up Significantly in Q4-2021, amidst High Inflation

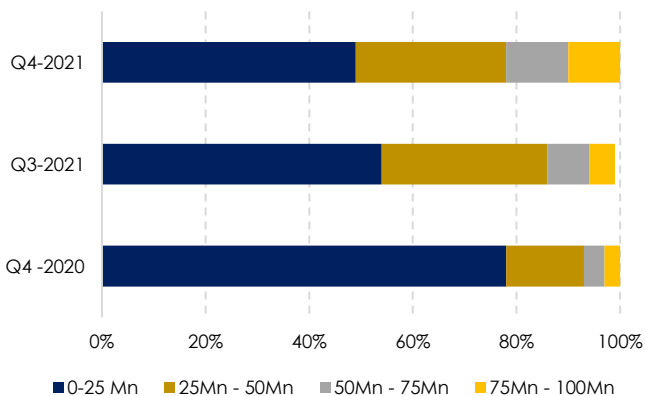
Condominium sales transactions during Q4-2021 have recorded a significant pick up of 49%, compared to a year ago as well as compared to the previous quarter, according to the Condominium Market Survey findings of the Central Bank of Sri Lanka.

In the backdrop of inflationary pressure and the relatively low levels of return earned on traditional investment avenues, investors are moving toward non-traditional investment avenues, among which investment on apartments is becoming increasingly popular. Further, an observable shift is seen in the price categories of transactions. While 77% of transactions were priced below Rs. 25 mn a year ago, it has reduced to 49% in Q4, 2021. Moreover, the Single Condominium projects in the Colombo district remain to be the most preferred category in Q4, 2021, the CBSL stated.

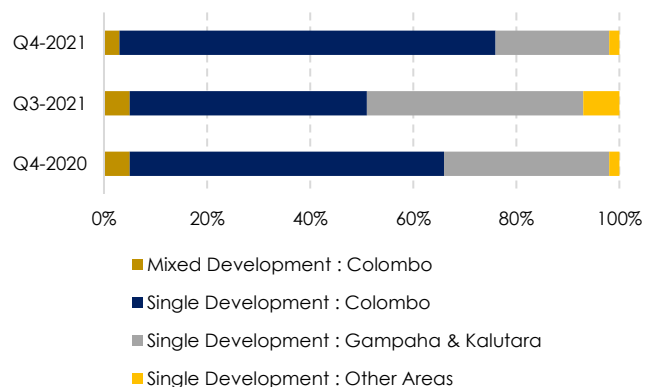
Pre-sale deposits, bank loans and equity were the three key funding sources for condominium developments. The proportion of bank loans have increased marginally over the last year. Most condominium buyers were Sri Lankan residents and only a few condominiums were purchased by dual citizens and foreigners. Purchase of condominiums for investment purposes and for future living has increased during the period under concern, while the proportion of purchases for immediate living for rent have reduced significantly.

The prime source of funding used for condominium purchasing remained to be buyers' own fund, while on average 27% of buyers have obtained bank loans during Q4 of 2021, the CBSL stated in its report.

% of Sales Price Categories



% of Sales by Property Categories



Data Sources: Central Bank of Sri Lanka

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FURTHER INSIGHTS- GLOBAL ECONOMY

WTO Goods Barometer Signals Possible Turning Point for Trade as Supply Pressure Ease

Supply disruptions have dampened the strength of the rebound in global merchandise trade, but this could be starting to change as supply chain pressure show some signs of easing, the latest Goods Trade Barometer of the World Trade Organisation (WTO) shows.

The latest reading of 98.7 is below the barometer's baseline value of 100 and went down slightly from the reading of last November which was 99.5, reflecting a loss of momentum in trade at the start of 2022 following 2021's strong rebound in trade volumes. However, the index also shows signs of bottoming out, suggesting that merchandise trade may turn up soon even if it remain below trend in the near term. In addition to the ongoing supply chain disruptions, the barometer's weakness is partly explained by the introduction of health restrictions to combat the Omicron wave of COVID-19, which some countries are now scrapping since the new variant's health impact has turned out to be relatively mild. Relaxing these measures could boost trade in the coming months, though future variants of COVID-19 continue to present risks to economic activity and trade, the WTO stated.

Most of the barometer's component indices were close to their baseline value of 100 indicating on trend growth, the main exceptions being automotive products (92) and container shipping (97.2). The automotive products index has actually improved compared to recent months due to the gradual increase in availability of semiconductors, which are used extensively in vehicle production. This increased availability is reflected in the electronic components index (98.6), which is close to trend, according to the WTO.



Source: World Trade Organisation (WTO)

Goldman Sachs sees Gold Prices Hitting USD 2,500/oz by Year-end

Gold prices have surged nearly 18% thus far in 2022 to around USD 2,050/oz in the backdrop of the ongoing Russia-Ukraine conflict and there is more headroom over next few months, says Goldman Sachs. They expect the prices to rise another 25% to USD 2,500/oz by the year-end.

“Gold Exchange Traded Funds (ETFs), are building aggressively for the first time since 2020. This momentum is only set to accelerate as our Strategists think the market has not yet priced in a US growth slowdown, which our economists believe is needed to curb inflation” Goldman Sachs says.

In the 2H of 2022, gold demand by Central banks are expected to reach its historical high levels as they globally have both strong diversification and geopolitical reasons to shift reserves into gold. Goldman Sachs expects that by the 2H of 2023, global central bank demand will hit a record 750 tons annual rate vs 450 tons in 2021.

Besides the Central bank demand, Goldman Sachs expects the retail demand, too, to remain robust across Asia going ahead in the backdrop of a strong economic recovery and lack of investment options.

In the second half of 2022, for the first time, we could see major buyers driven simultaneously by diversification and geopolitical motives

Gold CB purchases		
	2021	2017-2019 average
Thailand	90	1
Japan	81	0
India	77	26
Hungary	63	11
Brazil	62	0
2021 leaders	374	37
Russia	3	219
Turkey	0	88
China	0	35
2017-19 leaders	3	342
The rest	44	93

Source: World Gold Council, Goldman Sachs Global Investment Research

Movements of Gold Prices



Data Source: Goldman Sachs

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DASHBOARD

EXTERNAL SECTOR PERFORMANCE-DECEMBER 2021

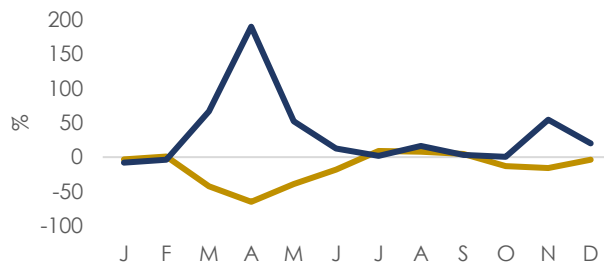
Legend: ■ 2020 ■ 2021 All the numbers are in USD Mn unless otherwise specified.

EXPORTS

EXPORTS INCREASED BY 19.9% Y-O-Y



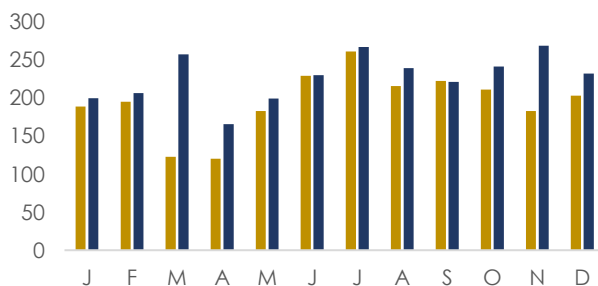
YoY % CHANGE IN EXPORTS



INDUSTRIAL EXPORTS PICKED UP BY 21.3% Y-O-Y

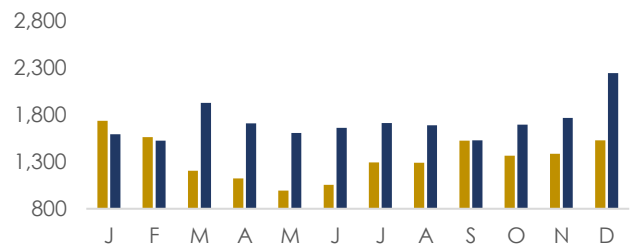


AGRICULTURAL EXPORTS INCREASED BY 14.3% Y-O-Y

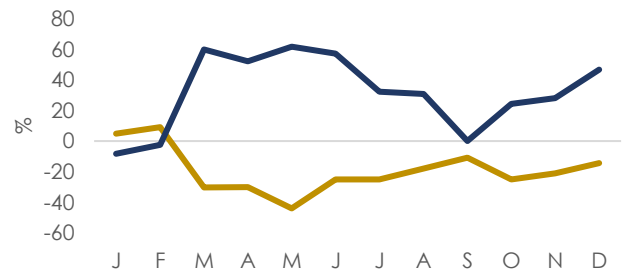


IMPORTS

IMPORTS INCREASED BY 46.8% Y-O-Y



Y-o-Y % CHANGE IN IMPORTS



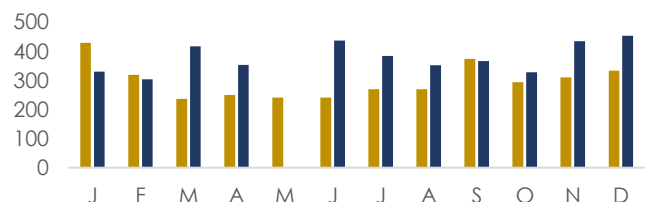
CONSUMER GOODS IMPORTS UP BY 27.9% Y-O-Y



INTERMEDIATE GOODS ROSE BY 58.2% Y-O-Y



INVESTMENT GOODS IMPORTS INCREASED BY 36.1% Y-O-Y



TRADE BALANCE WIDENED BY 29% Y-o-Y (Jan-2022)

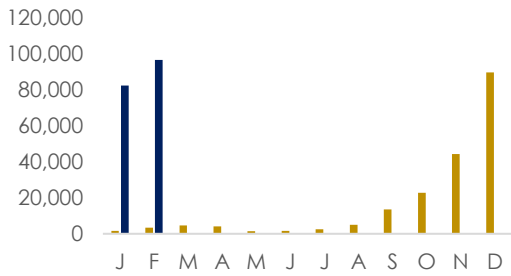


WORKERS' REMITTANCES SLIPPED BY 65% Y-o-Y (Feb-2022)



10%
of the total import bill covered by Remittances (Jan 2022)

96,507 TOURISTS WERE VISITED IN FEBRUARY 2022



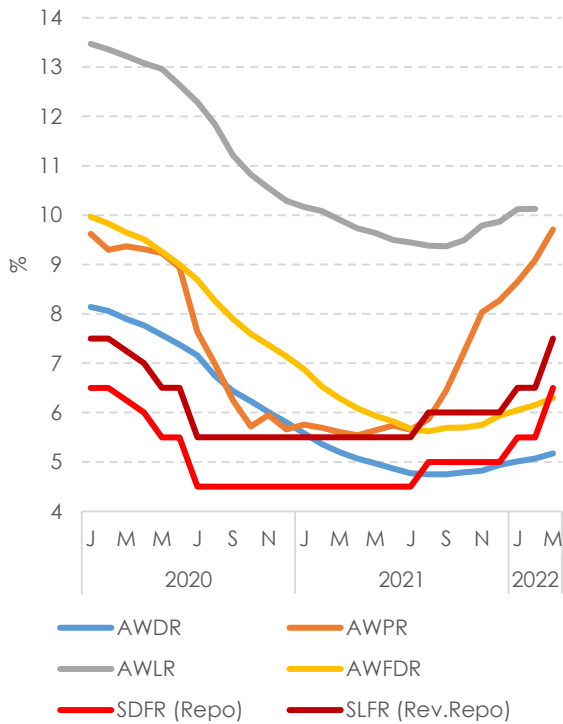
USD 173.6 MN EARNED IN FEBRUARY 2022



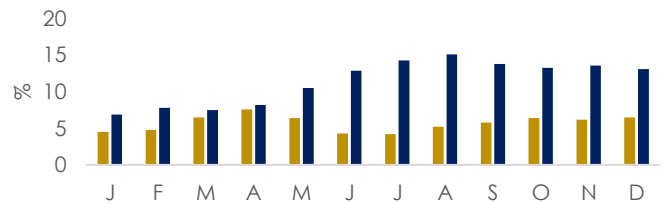
KEY INTEREST RATE INDICATORS

INTEREST RATES

Policy Rates increased to,
Standing Deposit Facility Rate (SDFR): 6.50%
Standing Lending Facility Rate (SLFR): 7.50%

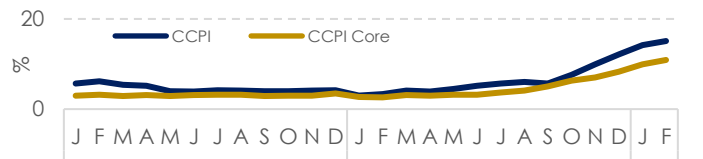


PRIVATE SECTOR CREDIT GROWTH



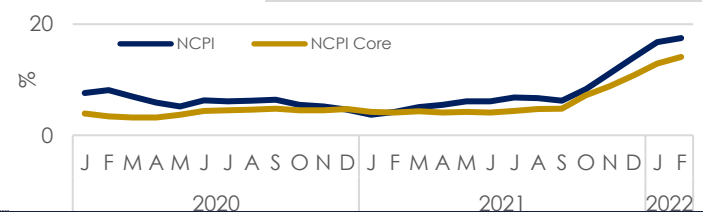
INFLATION: CCPI (BASE 2013) Y-o-Y

	Feb '22	Jan '22
CCPI:	15.1	12.2
CCPI Core:	10.9	9.9



INFLATION: NCPI (BASE 2013) Y-o-Y

	Feb '22	Jan '22
NCPI:	17.5	14.0
NCPI Core:	14.1	10.8



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