

Monthly Economic Update (MEU)

October 2023

**Economic Intelligence Unit
The Ceylon Chamber of Commerce**



EIU

Highlights

Sri Lankan Economy

Progress of the IMF Programme

The International Monetary Fund (IMF) has announced that they, in collaboration with Sri Lankan authorities, have successfully reached a staff-level agreement for the initial review of the 48-month Extended Fund Facility (EFF)-supported program. Following approval, Sri Lanka may gain access to approximately US\$330 million.

Mixed Performance in PMI-September

Purchasing Managers' Index for September 2023 indicated a contraction in manufacturing activities, but an expansion in services activities. However, outlook for both manufacturing and services activities in next three months remained positive, mainly due to upcoming festive season.

CBSL Eases the Monetary Policy Further

In the recent Monetary Policy Review, the Central Bank (CBSL) lowers Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) by 100 Basis points each, now set at 10% and 11%. The core objective of this adjustment is to promote inflation stability, with a clear aim to reach the desired 5% level in the medium term.

Inflation Declined further in September

In September, the headline and core inflation, as measured by the NCPI, were reported at 0.8% and 1.7%, respectively. Meanwhile, the CCPI-based headline and core inflation rates stood at a modest 1.3% and 1.9% for the same month. The slowdown in inflation can be attributed to a decrease in both food and non-food inflation.

Global Economy

IMF Anticipates a Decline in Global Growth

The expected trend for global economic growth indicates a gradual decline, moving from 3.5% in 2022 to 3.0% in 2023 and subsequently diminishing to 2.9% in 2024, as the World Economic Outlook-October 2023 update of the IMF.

Oil Price on Rise owing to Israel-Hamas conflict

Global oil market prices have surged over the past two weeks following the attack by Hamas on Israeli civilians on October 7th. This offensive, marked by its tragic consequences, sent shockwaves through the oil markets, resulting in prices soaring to USD 94 per barrel.

Bond Yields on the Rise: Global Trend in Advanced Economies

Long-term bond yields are rising in advanced economies, causing a decline in equity prices. This surge in bond yields could have far-reaching effects on business investment, Merges and acquisition activity, the housing market, and asset prices, as well as potentially reducing perceived wealth, impacting consumer spending.

WTO Revised Trade Growth Forecasts Downward for 2023

The World Trade Organization has revised down its 2023 world merchandise trade volume growth forecast to 0.8% from previously forecasted 1.7% in April. Trade growth is anticipated to rebound to 3.3% in 2024, nearly unchanged from previous estimate of 3.2%.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

-3.1% in Q2-2023

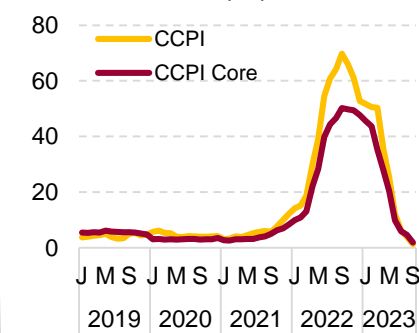
Movement of Purchasing Managers' Index-Sep 2023

Manufacturing PMI **45.7**
Services PMI **54.7**

PMI recorded an expansion in Services activities and softening the contraction in Manufacturing activities.

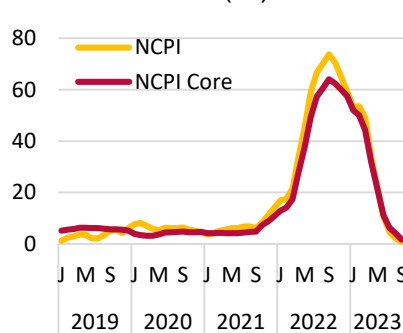
Inflation

CCPI Inflation (%) - Base 2021



Sep. 2023
Headline **1.3%**
Core **1.9%**

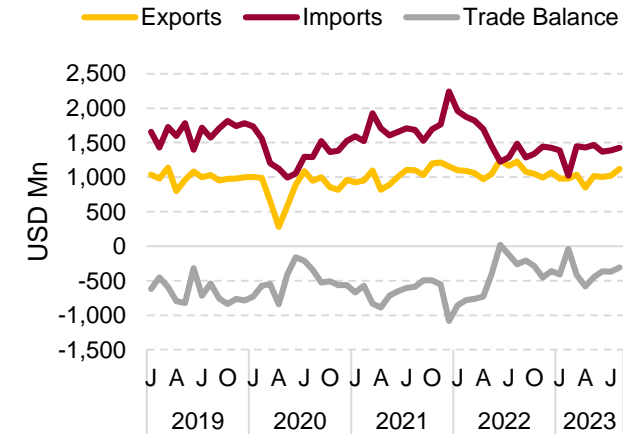
NCPI Inflation (%) - Base 2021



Sep. 2023
Headline **0.8%**
Core **1.7%**

External Sector

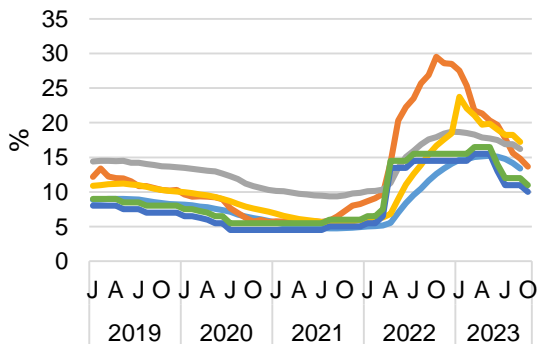
Merchandise Trade



Tourism

Aug. 2023
Arrivals **276%** ↑
Earnings **184%** ↑
Workers' Remittances **34%** ↑
Exports **8.7%** ↓
Imports **4%** ↓

Interest Rates



AWDR
AWPR
AWLR
AWFDR
SDFR (Repo)
SLFR (Rev.Repo)

SDFR: 10.0%
SLFR: 11.0%

Growth in Credit to Private Sector

Aug 2023
6.8% ↓

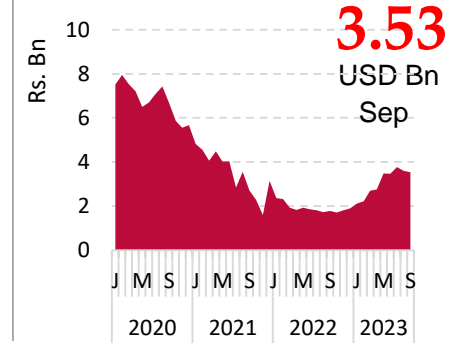
Exchange Rate



Appreciation of LKR thus far 2023 (Jan-Oct)

11.7%

Official Reserves



3.53
USD Bn
Sep

KEY INSIGHTS

Sri Lankan Economy

Sri Lanka's Economic Reform Progress: IMF's First Review of the EFF

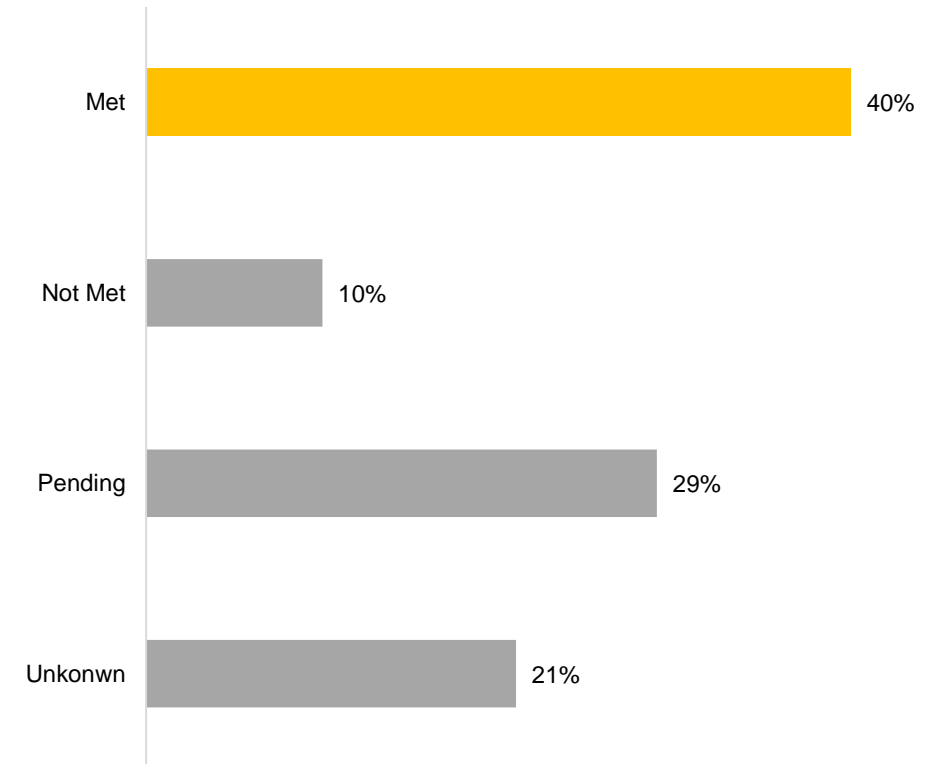
The IMF team has successfully reached a staff-level agreement with the Sri Lankan authorities regarding the first review within the framework of a 48-month Extended Fund Facility (EFF) arrangement, designed to support economic reform. It's important to note that the staff-level agreement remains contingent on two key factors: (i) the authorities' diligent execution of all prior actions, and (ii) the successful completion of financing assurances reviews.

The Sri Lankan authorities have maintained a steadfast commitment to their ambitious reform agenda under the EFF, and their reform endeavours are highly commendable. Notable achievements include a rapid reduction in inflation and a significant fiscal adjustment anticipated by year-end. In particular, the inflation rate has declined from a peak of 70% in September 2022 to a mere 1.3% by September 2023. Additionally, the nation's gross international reserves have surged by USD 1.5 billion during the March-June period of the current year, significantly alleviating shortages of essential commodities.

Assessment of program performance at the end of June reveals positive results, with all quantitative performance criteria for that period met, except for the one concerning expenditure arrears. Furthermore, most indicative targets were achieved, although there was a minor deviation in tax revenues, which is an area of ongoing focus. Additionally, a majority of structural benchmarks were either met or implemented, albeit with some delays, by the conclusion of September 2023.

Pending approval by the IMF Executive Board, Sri Lanka stands to gain access to SDR 254 million (equivalent to approximately USD 330 million), thereby raising the total IMF financial support disbursed under this arrangement to SDR 508 million (roughly USD 660 million). This development marks a significant milestone in Sri Lanka's ongoing economic reform journey

Progress on government commitments in Sri Lanka's
2023 IMF Programme



KEY INSIGHTS

Sri Lankan Economy

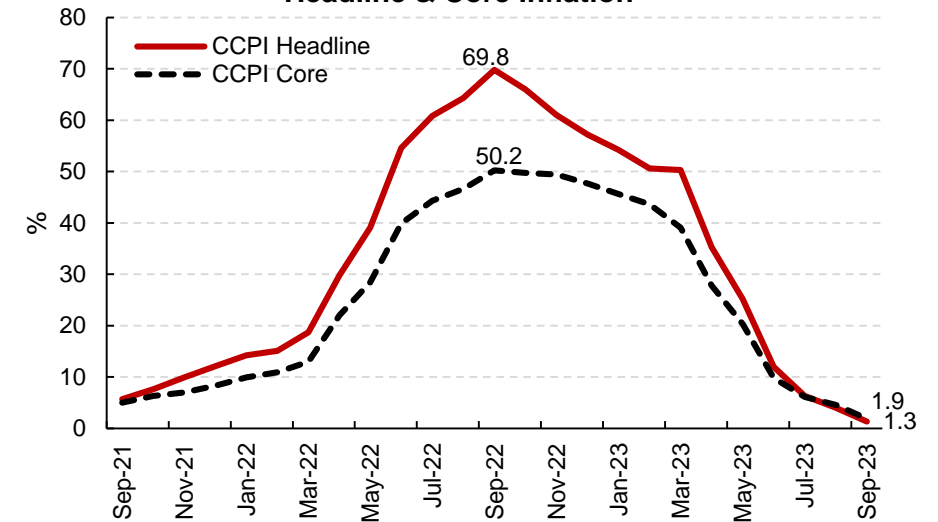
Sri Lanka's Disinflation Process: A Turning Point in 2023

In a recent monetary policy review, the Monetary Policy Board made a significant decision to reduce both the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 100 basis points, adjusting them to 10% and 11%, respectively. This move was a result of a thorough analysis of present and anticipated economic developments, which included the presence of low inflation and sanguine inflation expectations within the domestic economy. The core objective of this adjustment is to promote inflation stability, with a clear aim to reach the desired 5% level in the medium term. This is particularly pertinent in light of the current inflation metrics, with September's headline and core inflation rates standing at a mere 1.3% and 1.9%, respectively. This approach is pivotal in enabling the economy to attain its full potential for growth.

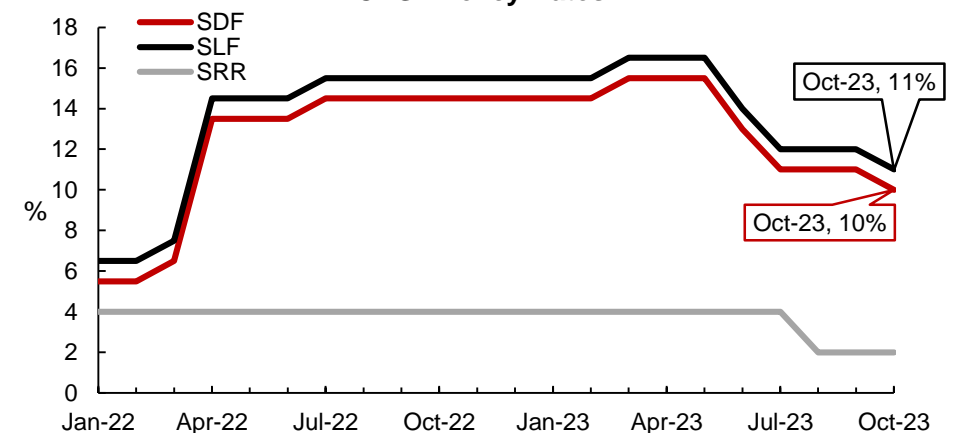
The deceleration in inflation can be attributed to a decline in food inflation, non-food inflation, the moderation of core inflation, and the firmly anchored inflation expectations. Furthermore, the disinflation process is projected to shift course starting in the third quarter of 2023, subsequently stabilizing around the 5% target level over the medium term.

The financial sector plays a pivotal role in this strategy, and it is strongly encouraged to promptly and effectively pass on the benefits arising from the ongoing relaxation of monetary conditions to both individuals and businesses. This support will be instrumental in facilitating the envisioned economic rebound, thereby contributing to the nation's economic resurgence.

Headline & Core Inflation



CBSL Policy Rates



KEY INSIGHTS

Global Economy

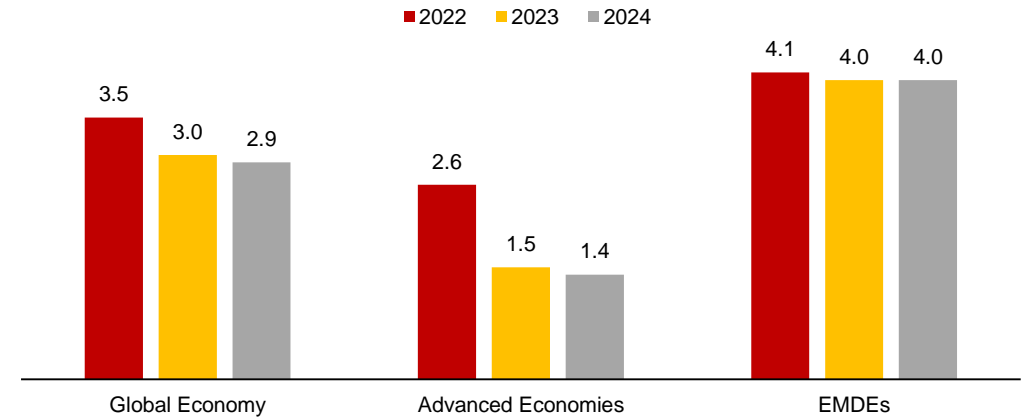
IMF Anticipates a Decline in Global Growth

The International Monetary Fund (IMF) recently released its World Economic Outlook, unveiling the revised growth forecasts for the global economy. The global growth trajectory is anticipated to decline, transitioning from 3.5% in 2022 to 3.0% in 2023 and further to 2.9% in 2024. In this updated projection, there's a marginal downward revision of 0.1 percentage point for 2024 in comparison to the July 2023 WEO Update. The deceleration in annual average growth from 2022 to 2023 is predominantly steered by advanced economies.

The IMF is forecasting a decrease from 2.6% in 2022 to 1.5% in 2023 and a further dip to 1.4% in 2024 for advanced economies. This shift is particularly pronounced due to stronger-than-expected momentum in the United States and weaker-than-expected growth within the euro area. Notably, nearly 90% of advanced economies are expected to witness reduced growth in 2023. Among advanced economies, the United States has been subject to an upward revision, driven by resilient consumption and investment. Conversely, the euro area has experienced a downward revision, influenced by tighter monetary policy and the energy crisis, which have collectively taken a toll. With the projected slowdown in advanced economies, there is an estimated average increase of 0.1 percentage point in annual unemployment over the period spanning 2022 to 2024.

Simultaneously, EMDEs are projected to undergo a modest growth reduction, slipping from 4.1% in 2022 to 4.0% in both 2023 and 2024, reflecting a marginal 0.1 percentage point downward revision for 2024 when compared to the July 2023 WEO Update. However, this overarching trajectory masks regional disparities, with growth in two out of the five primary geographic regions exhibiting an increase in 2023, followed by a decline in 2024.

Global Growth Forecasts by the IMF



	Projections		
	2022	2023	2024
Advanced economies	2.6	1.5	1.4
United States	2.1	2.1	1.5
United Kingdom	4.1	0.5	0.6
Japan	1.0	2.0	1.0
Canada	3.4	1.3	1.6
Germany	1.8	-0.5	0.9
France	2.5	1.0	1.3
Italy	3.7	0.7	0.7
EMDEs	4.1	4.0	4.0
China	3.0	5.0	4.2
India	7.2	6.3	6.3
Russia	-2.1	2.2	1.1
Brazil	2.9	3.1	1.5
Mexico	3.9	3.2	2.1
Saudi Arabia	8.7	0.8	4.0

KEY INSIGHTS

Global Economy

Bond Yields on the Rise: Global Trend in Advanced Economies

In most advanced economies, there is a noticeable uptick in long term bond yields. For instance, the United States witnessed the 10-year government bond yield reaching 4.98% last week, marking the highest level since 2007. Similarly, Germany's 10-year bond yield rose to 2.95%, the highest it's been since 2011, and Italy experienced a yield of 4.95%, the highest since 2012. Similar trends have been observed in other countries as well. This shift likely reflects the growing optimism surrounding economic growth, driven by better-than-expected economic data, notably in the United States. Additionally, it can be attributed to major central banks' decisions to maintain elevated interest rates for a longer duration than previously anticipated.

The escalating bond yields are contributing to a weakening of equity prices. If this surge in bond yields persists, it has the potential to significantly impact various aspects, including business investment, Mergers & Acquisitions transaction volumes, housing market activity, and asset prices. Moreover, it could lead to a reduction in perceived wealth, potentially impacting consumer spending.

The IMF has raised concerns regarding the recent rapid increase in bond yields, highlighting the potential threat to financial market stability. Higher bond yields could pose challenges for medium-sized commercial banks, potentially requiring asset value downgrades due to mark-to-market requirements. Furthermore, these elevated yields may lead to an increase in defaults on commercial property mortgages, further affecting some banks. The IMF has sounded the alarm that these developments could set off an "adverse feedback loop," in which declining asset values trigger a freeze in credit markets.

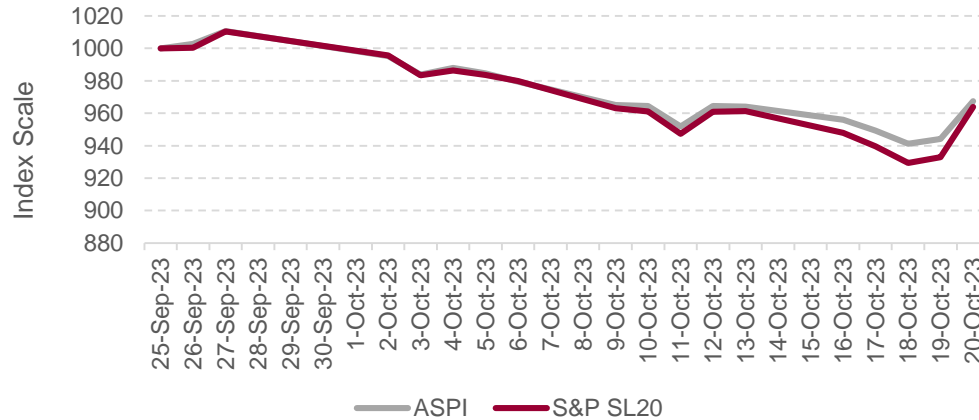
US 10 Year Treasury Bond Note Yield



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 25/09/2023-20/10/2023



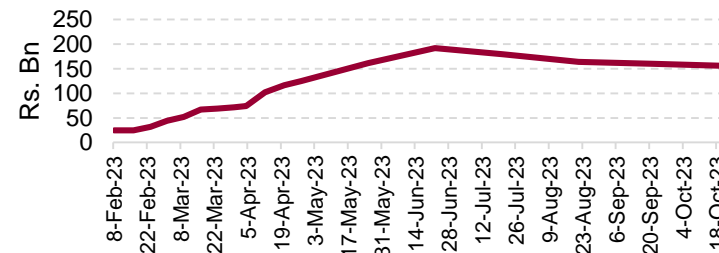
*GICS: Global Industry Classification Standards

Foreign Inflows (Rs Mn) YTD* (20/10/23)

Foreign Inflow	34,331.16
Foreign Outflow	30,445.43
Net Foreign Inflow/(Outflow)	3,885.73

*YTD: Year to Date

Foreign Holdings in Government Securities



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.

Israel-Hamas War: A Threat to Global Oil Prices

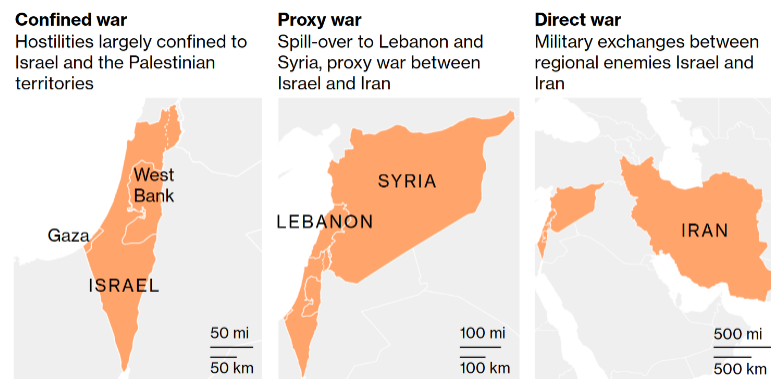
The recent eruption of conflict between Israel and Hamas carries the potential to not only disrupt the world economy but also, if more nations become entangled, to push it perilously close to recession. The looming threat of escalation is real as Israel's military prepares for a potential invasion of Gaza in response to a militant group's attack, with concerns extending to the likelihood of militias in Lebanon and Syria, supporters of Hamas, joining the conflict. A steeper escalation of the conflict could thrust Israel into direct confrontation with Iran, a significant provider of arms and financial support to Hamas—identified as a terrorist group by the US and the European Union.

Notably, Iran's oil exports have risen in recent years, stepping in to fill a void left by Russia's invasion of Ukraine. If Iran's oil supply were to be disrupted, a critical question emerges: might Saudi Arabia come forward to bridge the gap? Saudi Arabia, a pivotal producer and member of the OPEC oil-producing nations, reduced its daily production by 1 million barrels earlier this year. Furthermore, Iran itself holds the capacity to disrupt the flow of oil through the strategically vital Strait of Hormuz, a narrow passage that separates the Persian Gulf from the Arabian Sea, through which approximately 20% of the world's oil is transported.

History attests that conflict in the Middle East can send shockwaves throughout the world. Recall the Arab-Israeli war of 1973, which led to an oil embargo and several years of stagflation in industrialized economies. The present global economy is in a precarious state, still recovering from the inflationary pressures exacerbated by Russia's invasion of Ukraine last year. Another conflict in an energy-producing region has the potential to reignite inflationary pressures. Broader consequences could extend from, renewed turmoil in the Arab world to influences on next year's presidential elections in Sri Lanka and the United States, where gasoline prices may hold sway over voter sentiment.

How the Israel–Hamas's conflict could evolve

The prospect of direct conflict between Iran and Israel, while considered a low probability scenario, remains inherently perilous. In the event of an open conflict, oil prices could surge to an alarming USD 150 per barrel. Bloomberg Economics' predictive model foresees a substantial 1 percentage point drop in global growth, which would push the growth projection for 2024 down to a mere 1.7%. Such a decline signifies a recessionary downturn that extracts roughly \$1 trillion from the global economic output.



Source: Bloomberg Economics

Scenario	Details	Impact on oil prices and VIX*	Impact on global GDP and inflation**
Confined war	- Ground invasion of Gaza - Limited broader regional conflict - Lower Iranian crude output	Oil: +\$4/barrel VIX: No impact	GDP: -0.1 ppts. Inflation: +0.1 ppts.
Proxy war	- Multifront war in Gaza, West Bank, Lebanon, Syria - Unrest in wider Middle East	Oil: +\$8/barrel VIX: +8 points	GDP: -0.3 ppts. Inflation: +0.2 ppts.
Direct war	- Israel and Iran in direct conflict - Unrest in wider Middle East	Oil: +\$64/barrel VIX: +16 points	GDP: -1.0 ppts. Inflation: +1.2 ppts.

Source: Bloomberg Economics

*Impact calibrated based on 2014 Gaza War, 2006 Israel–Lebanon War, and 1990–1991 Gulf War.

**Impact on year on year change in global GDP and inflation for 2024, estimated using Bayesian Global VAR

Evolving Landscape cont'd

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.

Implications for Sri Lanka

Higher fuel prices pose a significant concern for the Sri Lankan economy, particularly in the wake of a substantial fuel price surge following the fuel shortage and has already put a strain on consumer budgets. Additional fuel price increases would prove detrimental to consumers, especially if global prices reach USD 150 per barrel.

The Government of Sri Lanka has initiated a stringent management approach for its current fuel stocks, responding to the mounting uncertainty surrounding global fuel supplies. The president has taken a proactive approach by issuing directives to the Ceylon Petroleum Corporation and the Ceylon Petroleum Storage Terminals Limited, emphasizing the need for an enhanced system to manage the existing fuel reserves more effectively.

Concurrently, discussions have been set in motion between the Ministry of Power and Energy and the CPC to strategize the future course of action regarding the preservation of current fuel stocks over the next two months. These discussions have prominently considered the potential re-implementation of the QR code system or a comparable fuel sales management system should a fuel crisis reemerge.

Datasheet

Latest Available data

External Trade (USD Mn)	Aug-2023	Month Ago	Year Ago
Exports	1,119	1,020	1,225
Agricultural Exports	243	231	254
Industrial Exports	872	786	966
Imports	1,426	1,388	1,486
Consumer Goods	268	267	231
Intermediate Goods	857	882	1037
Investment Goods	299	237	213
Trade Balance	-307	-367	-260
Tourist Arrivals (No.)	111,938	136,405	29,802
Tourism Earnings	152	211	41
Workers' Remittances	482	499	359
Inflation (%)	Sep-2023	Month Ago	
CCPI (2021 base)			
Headline	1.3	4.0	
Core	1.9	4.6	
NCPI (2021 base)			
Headline	0.8	2.1	
Core	1.7	4.1	
Interest Rates (%)		Month Ago	Year Ago
AWPR	13.68 (Oct)	14.81	29.51
AWLR	16.20 (Sep)	16.90	17.58
AWDR	13.39 (Sep)	14.15	11.63
AWFDR	17.24 (Sep)	18.26	15.41
SDFR	10.00	11.00	14.50
SLFR	11.00	12.00	15.50
Growth in Credit to Private Sector	-6.8 (Aug)	-7.6	12.1
Fiscal Sector (LKR Bn)		2023 (Jan-Jul)	Year Ago
Revenue and Grants		1,517	1,093
Expenditure and Net Lending		2,103	2,988

EIU

Economic Intelligence Unit
of The Ceylon Chamber
of Commerce

Make Better Informed Strategic Decisions.

Leverage the wide business network of The Ceylon Chamber of Commerce to gain a more comprehensive understanding of the Sri Lankan economy.

Our Services Include:

- ▶ Policy Advocacy
- ▶ Macroeconomic and Sector Reports/Presentations
- ▶ Curated Trade and Sector Data Analysis and Updates
- ▶ Bilateral / Regional Trade and Investment Reports
- ▶ Industry and Sector Surveys
- ▶ Consultancy for Donor/Development Agency Related Projects
- ▶ Economic Business Consultancy Services



Reach us at +94 11 558 8809 | ei@chamber.lk

THANK YOU

DISCLAIMER:

All information collected and analyzed is derived from sources, which we consider reliable and a sincere effort is made to report accurate information. The EIU does not warrant the completeness or accuracy of information derived from secondary sources. Details published herein are intended for information purposes only.



EIU



Unlock the power of foresight for your firm's success.

When it comes to navigating the ever-changing landscape of economic indicators, including currency and interest rates, look no further than our expert services. Experience the difference with our meticulously crafted presentations and reports, tailored exclusively for your business needs. Don't miss out on the invaluable insights that could shape your strategic decisions.

**Reach out to us
and embark on a journey towards informed,
data-driven decision making.**



ei@chamber.lk



011-55 888 09/68/83/96