

Monthly Economic Update (MEU)

September 2023

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



**The
Ceylon
Chamber of
Commerce**

EIU

Highlights

Sri Lankan Economy

Economy Contracted by 3.1% in Q2-2023

Sri Lankan economy recorded a contraction of 3.1% during the Q2-2023 due to the subdued performance of the Industry and Services activities. As the Q1-2023 recorded a contraction of 11.5%, this quarter signals strong rebound in economic recovery. Considering the 1st half (1H) of 2023, the economy registered a contraction of 7.9% on a y-o-y basis. Considering the near term outlook, economic activities may negatively affected by weather related disruptions and modest external demand conditions.

Disinflation Trend Continuing: at single digit level for the second month in line

Consumer price inflation measured based on the CCPI and the NCPI continuing the disinflation trend and reached to the single digit level in August 2023 for the first time since November 2021. The same trend is continuing with mid-single digit inflationary rates in September 2023.

The External Sector Remains Resilient

The deficit in trade account declined remarkably during the first seven months of 2023 on a Y-o-Y basis, owing to significantly declined imports, despite the decline in exports. Earnings from tourism and inflows of workers' remittances performed well during the period under concern and expected to improve further during the period ahead.

Persistent Downward Adjustment of Market Interest Rates

The implementation of monetary policy easing measures since June 2023, coupled with the announcement of the domestic debt optimization (DDO) operation, has led to a reduction in market interest rates up to some extent.

Global Economy

Oil Prices Hit 10-Month Highs on Extended Production Cuts

In mid-September, oil prices surged to their highest levels in 10 months, driven by extended production cuts from major players Saudi Arabia and Russia. Brent crude futures reached \$94.34 per barrel, while U.S. WTI crude futures hit \$91.20.

ECB Takes Bold Step: Raises Interest Rates to Historic Heights

In a decisive move, the European Central Bank (ECB) has increased interest rates by 25 percentage points, reaffirming its determination to tackle the ongoing inflationary pressures. This resolute action comes amid apprehensions regarding its potential implications on the economic growth within the eurozone. The surging energy and food costs, primarily attributed to Russia's invasion of Ukraine, have left the eurozone contending with elevated inflation and a more sluggish growth trajectory in contrast to the United States.

WTO Trade Barometer: June 2023 Update

The current reading of 99.1 on the World Trade Barometer index marks an improvement from the previous reading of 95.6 in May and is close to the baseline value of 100. This suggests that merchandise trade volume rebounded in Q2 after two quarters of decline, although it still slightly lags behind the trend. The sustainability of the recovery in Q3 and beyond remains uncertain, particularly due to the export orders component of the barometer (based on purchasing managers' indices), which continues to show weakness.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

-3.1% in Q2-2023

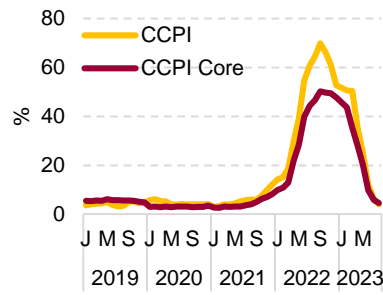
Movement of Purchasing Managers' Index-Aug 2023

Manufacturing PMI **49.3**
Services PMI **57.6**

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

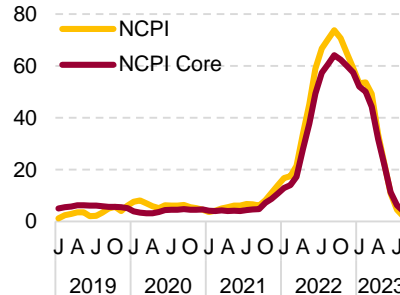
Inflation

CCPI Inflation (%) - Base 2021



Aug. 2023
Headline **4.0%**
Core **4.6%**

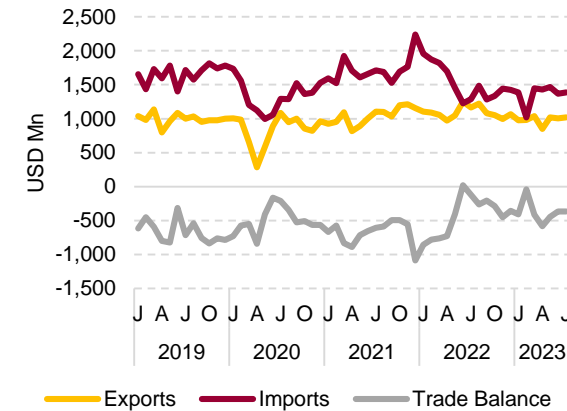
NCPI Inflation (%) - Base 2021



Aug. 2023
Headline **2.1%**
Core **4.1%**

External Sector

Merchandise Trade



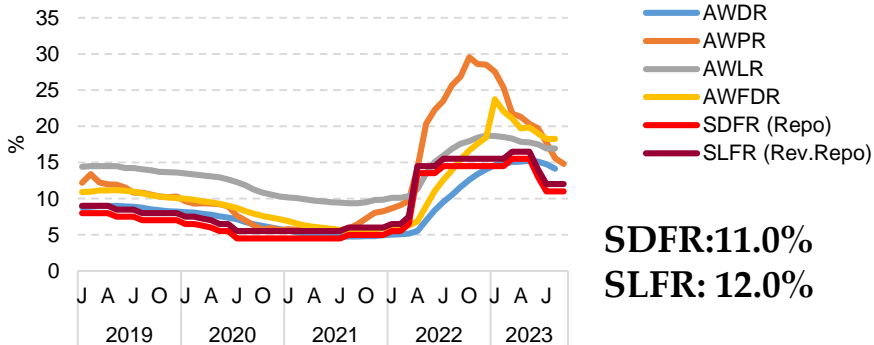
Tourism

Jul. 2023 Exports **12%** ↓
Aug. 2023 Arrivals **261%** ↑
Imports **8%** ↑
Earnings **210%** ↑

Workers' Remittances

53% ↑

Interest Rates

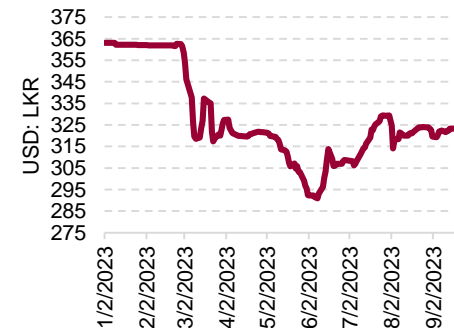


SDFR: **11.0%**
SLFR: **12.0%**

Growth in Credit to Private Sector

July 2023
7.6% ↓

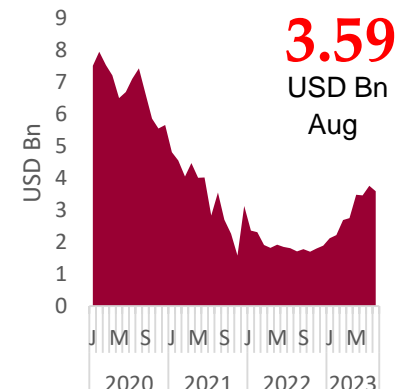
Exchange Rate



Appreciation of LKR thus far 2023 (Jan-Sep)

11.9%

Official Reserves



3.59
USD Bn
Aug

KEY INSIGHTS

Sri Lankan Economy

Economy Contracted by 3.1% during Q2-2023; However signals a strong rebound.

Sri Lankan economy recorded a contraction of 3.1% during the Q2-2023 due to the subdued performance of the Industry and Services activities. The Agriculture sector registered an expansion. As the Q1-2023 recorded a contraction of 11.5%, this quarter signals strong rebound in economic recovery.

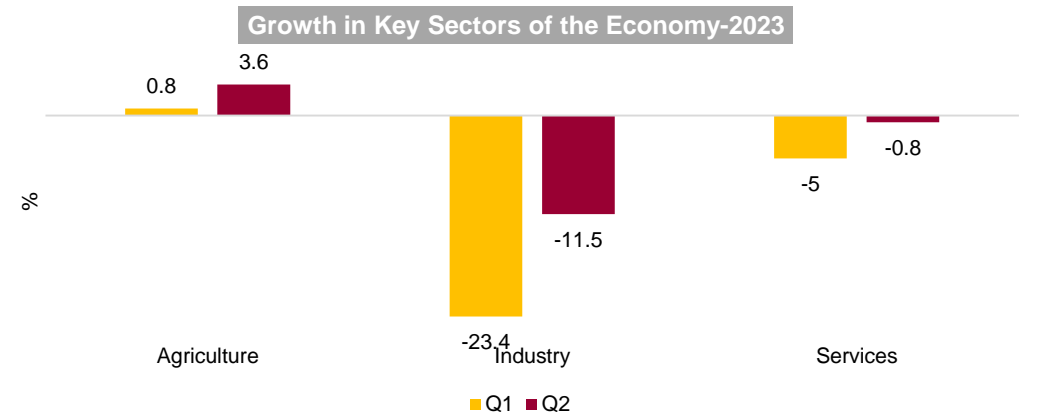
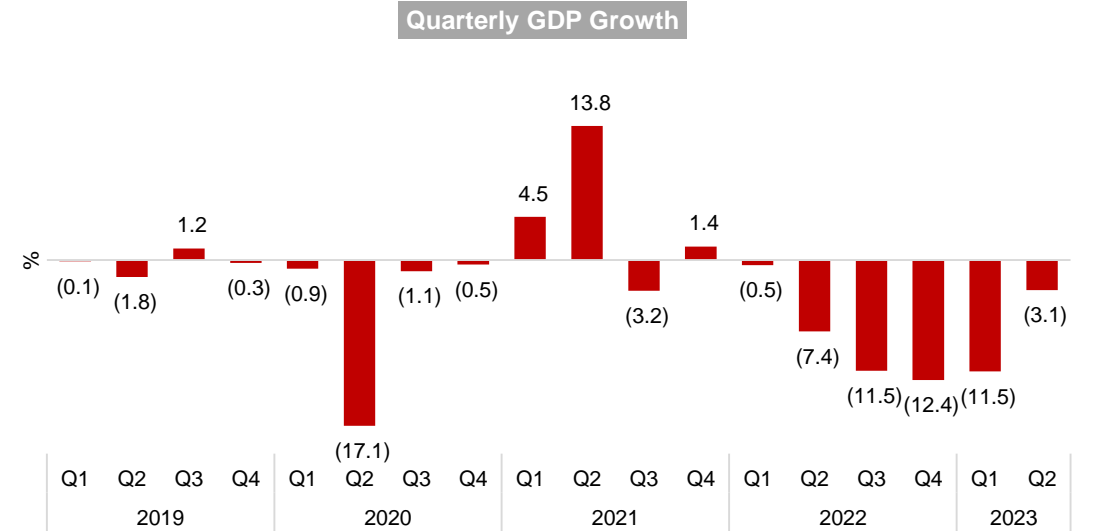
During the Q2-2023, the pressure on short term and long term investments caused by high interest rates in the economy remained in force. Along with that the consumption patterns of general public was limited to consume mainly for the consumer goods due to the reduction of real income. Further, the expectations of domestic producer's on the economy were at a lower level and continued to grow slowly and this was specially affected by the uncertain situation related to exchange rate. High input costs have led to the deterioration of international competitiveness in terms of exports and as a result a decreased export volumes.

In this backdrop, the Industry activities contracted by 11.5%, mainly driven by contraction of construction activities (23%), mining and quarrying (24.3%) and overall manufacturing activity (5.1%).

Services sector performance has declined by 0.8% during the period in concern, where the highest contraction recorded by the financial services (18.8%), followed by professional services (9.8%) and IT programming, consultancy and related services (8.5%).

However, the agriculture sector recorded an expansion of 3.6% mainly due to the growth in growing cereals (44.4%).

Considering the 1st half (1H) of 2023, the Sri Lankan economy registered a contraction of 7.9% on a y-o-y basis.



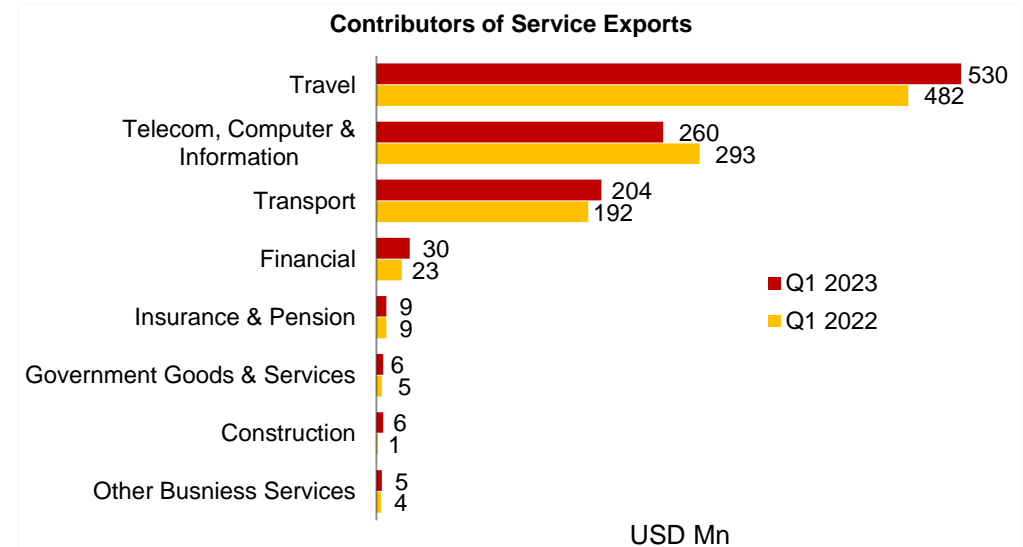
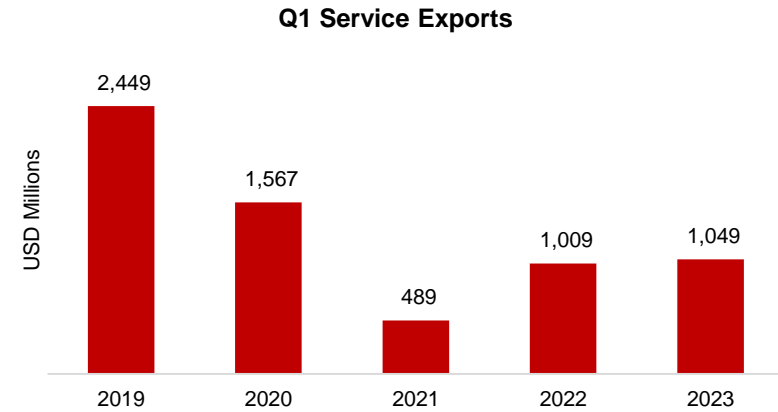
KEY INSIGHTS

Sri Lankan Economy

Service Export Shows Signs of Improvement

In the first quarter of 2023, service export trade recorded a marginal year-on-year increase of 3.96%. This uptick can be primarily attributed to the performance of major service trade sectors. The most pronounced decline was observed in the travel sector which saw an increase from USD 482 million to USD 530 million during this period. Similarly, the export of transport service rose from USD 192 million to USD 204 million in the same period in 2022. Service exports in financial, construction, insurance & pension and government goods & services also experienced improvement in their respective exports, although these changes are relatively insignificant. The only sector that had a decrease in exports was the telecommunication, computer, and information segment, which experienced a notable drop from USD 293 million to USD 260 million.

While service exports in 2023 continue to exhibit a year-on-year increase, albeit modest, they offer promising signs of post-pandemic recovery. It is essential to acknowledge that despite this gradual progress, service exports remain notably below the pre-pandemic levels witnessed in 2019. Notably, the Export Development Board (EDB) has adjusted their forecast for service exports in 2023, projecting a total value of USD 2.58 billion. While strides have been made in recuperating from the pandemic-induced economic downturn, there is still a substantial gap to bridge to reach the levels observed before the global health crisis. The EDB's forecast serves as a guiding target, emphasizing the importance of continued efforts to bolster service trade and pave the way for further growth and recovery in the coming years.



KEY INSIGHTS

Global Economy

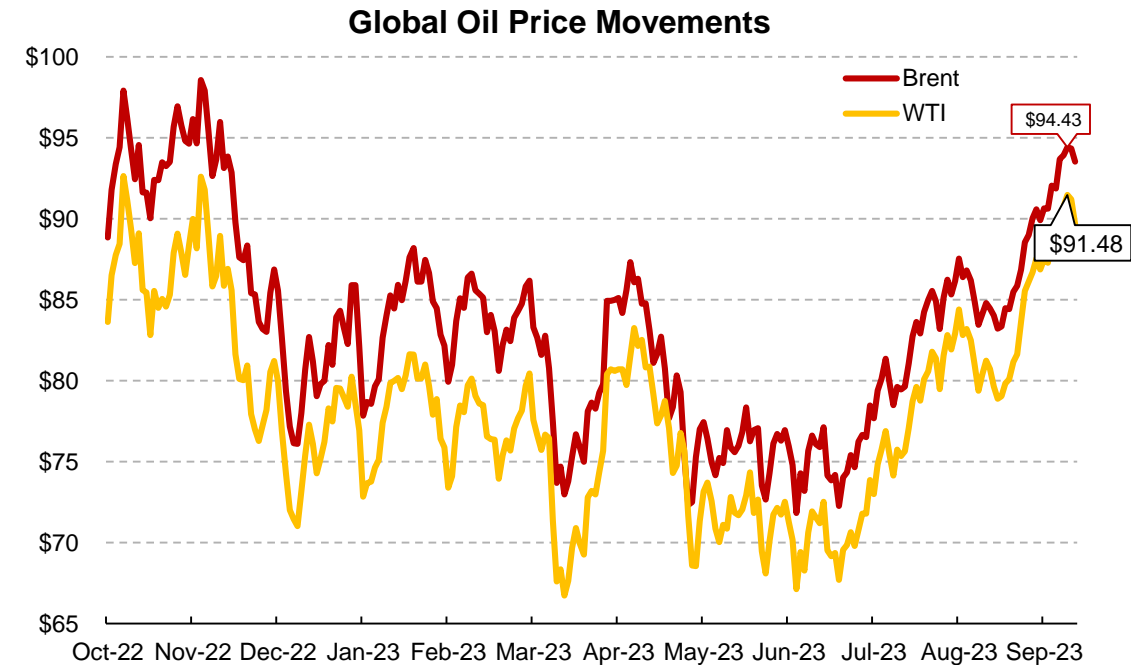
Supply Squeeze Drives Oil Prices to 10-Month Highs

Oil prices surged to 10-month highs on September 18th, driven by extended production cuts from major players Saudi Arabia and Russia. The global benchmark, Brent crude futures, ultimately settled at \$94.34 per barrel after hitting a session peak of \$95.96 per barrel, the highest since November 2022. Similarly, U.S. West Texas Intermediate crude futures reached \$93.74 a barrel before settling at \$91.20, also marking the highest level since November.

Saudi Arabia, initially implementing a temporary cut of 1 million barrels per day from the global market in July, has since extended this measure. According to Saudi Arabia's Ministry of Energy, the kingdom intends to maintain its production cut until the end of December. Russia has added its own voluntary export cuts in recent months and Deputy Prime Minister Alexander Novak confirmed that Russia's 300,000-barrel-per-day export reduction would persist through the year-end.

On the 21st of September, Russia has indefinitely banned exports of petrol and diesel to all countries except the members of the Moscow-led Eurasian Economic Union, due to inter-governmental agreements, in order to stabilise the domestic market. Russia has faced recent challenges with shortages of petrol and diesel, leading to spikes in wholesale fuel prices. However, retail prices remain capped as an attempt to align with official inflation targets.

Saudi Arabia and Russia's decision to reduce supplies despite rising prices has raised tensions with developed economies, with the International Energy Agency warning last week they were "locking world oil markets into substantial deficit. However, Saudi Arabia's Energy Minister, Prince Abdulaziz bin Salman, has defended the OPEC+ cuts as necessary for stabilizing energy markets. He emphasized the importance of light-handed regulation to limit volatility, all while warning that the global economic recovery spurred by increased oil demand remains uncertain.



KEY INSIGHTS

Global Economy

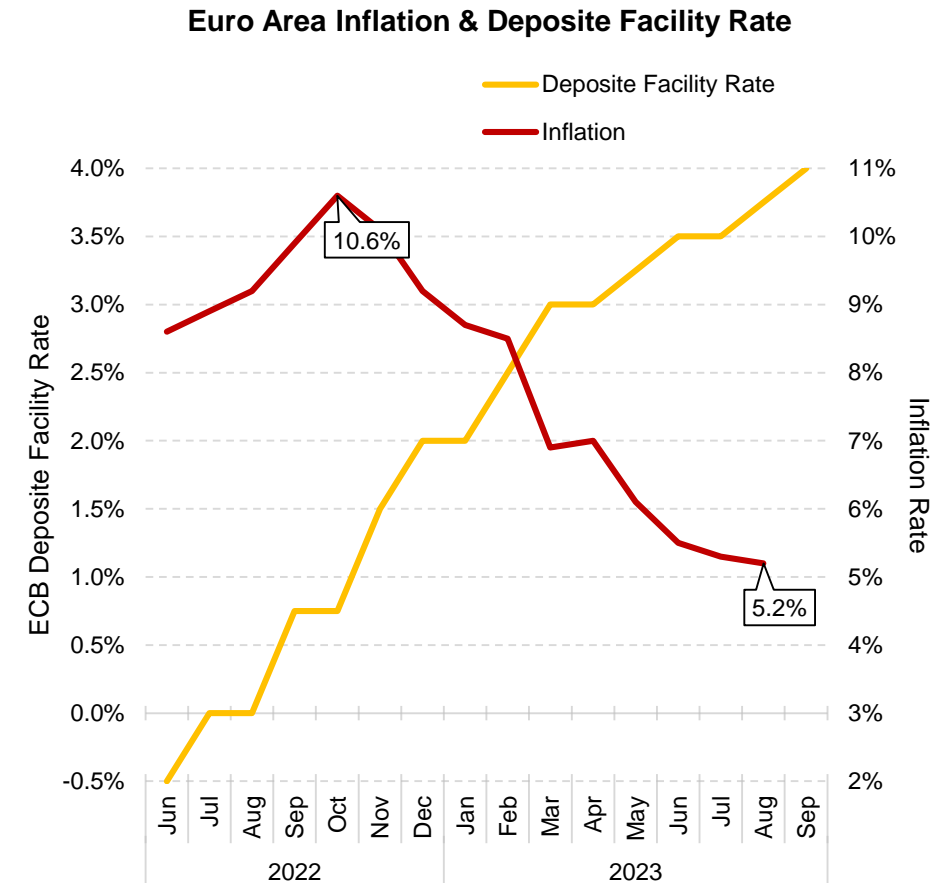
ECB Raises Interest Rates to a Record High

The European Central Bank (ECB) has raised interest rates by 25 percentage points, underscoring its commitment to combat persistent inflation despite concerns about the potential impact on the eurozone's economic growth. Soaring energy and food prices triggered by Russia's invasion of Ukraine, had left the eurozone grappling with higher inflation and weaker growth compared to the United States. Notably, this interest rate hike marks the ECB's 10th consecutive increase, elevating its Deposit Facility Rate from negative territory last year to a record-high of 4%.

In conjunction with this decision, the ECB also revised its economic projections, reducing expectations for economic growth while revising upward its inflation forecasts. The recalibrated trajectory now anticipates a slower descent of inflation toward the coveted 2% target. For 2023, the Euro Area is expected to witness an average inflation rate of 5.6%, followed by 3.2% in 2024 and 2.1% in 2025. The upward adjustments to inflation expectations in 2023 and 2024 are primarily attributed to the elevated path of energy prices.

The ECB has expressed its belief that maintaining a higher key interest rate over an extended period will play a significant role in steering inflation back within target boundaries. Furthermore, the ECB has not ruled out the possibility of further rate hikes, as it adopts a data-dependent approach to gauge the appropriate level and duration of these measures. Decisions regarding interest rates will hinge on an analysis of the inflation outlook as revealed by incoming economic and financial data, the underlying inflation dynamics, and the effectiveness of monetary policy transmission.

In explaining this course of action, ECB President Christine Lagarde emphasized that the rate increases are intended to safeguard price stability for the benefit of the public, with no intention of inducing a recession but rather as a means to expedite the return to the inflation target of 2%.



KEY INSIGHTS

Global Economy

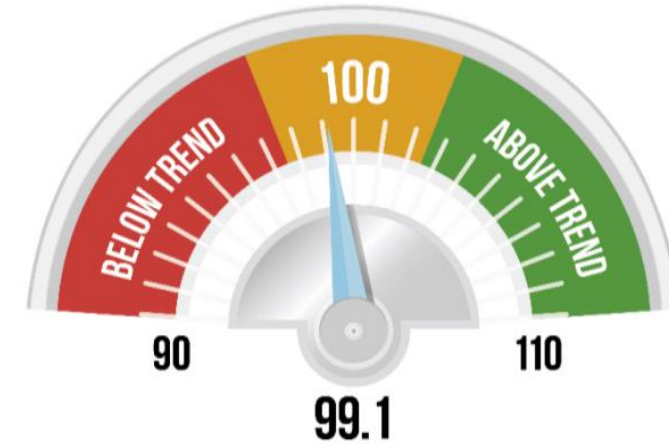
WTO Trade Barometer: June 2023 Update

The current reading of 99.1 on the barometer index marks an improvement from the previous reading of 95.6 in May and is close to the baseline value of 100. This suggests that merchandise trade volume rebounded in Q2 after two quarters of decline, although it still slightly lags behind the trend. The sustainability of the recovery in Q3 and beyond remains uncertain, particularly due to the export orders component of the barometer (based on purchasing managers' indices), which continues to show weakness.

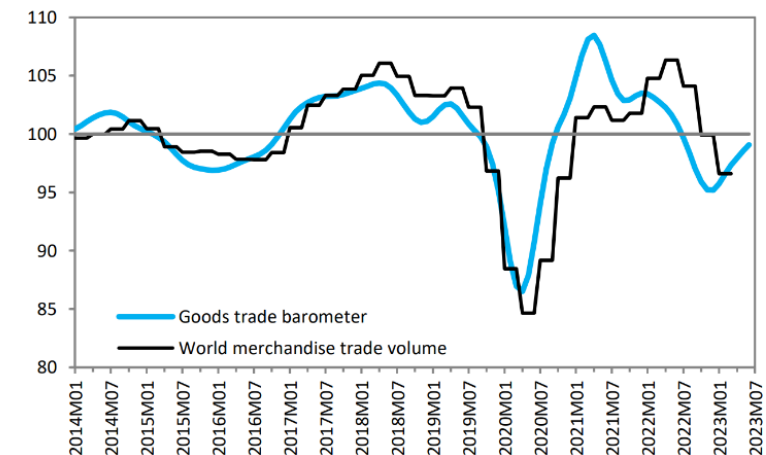
In the first quarter of 2023, the volume of merchandise trade experienced a year-on-year decline of 1.0% and a quarter-on-quarter decrease of 0.3%, extending a downturn that began in the fourth quarter of 2022. This decline can be attributed to various factors, including elevated food and energy prices linked to the conflict in Ukraine and the implementation of tighter monetary policies in advanced economies to combat inflation. Global import demand remains subdued, largely impacted by sluggish economic growth in the European Union and China. These developments are somewhat weaker than the WTO's trade forecast from April, which predicted a 1.7% increase in merchandise trade volume for 2023. However, this target remains attainable if trade picks up in the expected manner during the second half of the year.

The majority of the barometer's component indices currently register slightly below trend readings. These indices include the export orders index (97.6), the container shipping index (99.5), the air freight index (97.5), and the raw materials index (99.2). Notable exceptions are the automotive products index (110.8), which has surpassed trend levels, and the electronic components index (91.5), which has fallen below trend. The robust increase in automotive product exports has significantly contributed to stronger-than-anticipated GDP growth in Japan during the first half of 2023. Moreover, vehicle exports have served as a rare source of economic strength for China, which has encountered challenges in regaining momentum in recent months.

Index value, June 2023 = 99.1



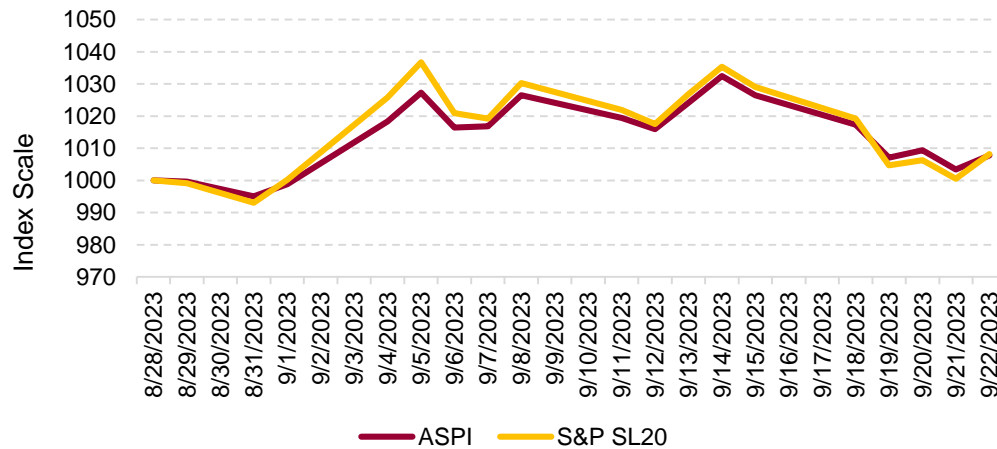
Index history, trend = 100



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.

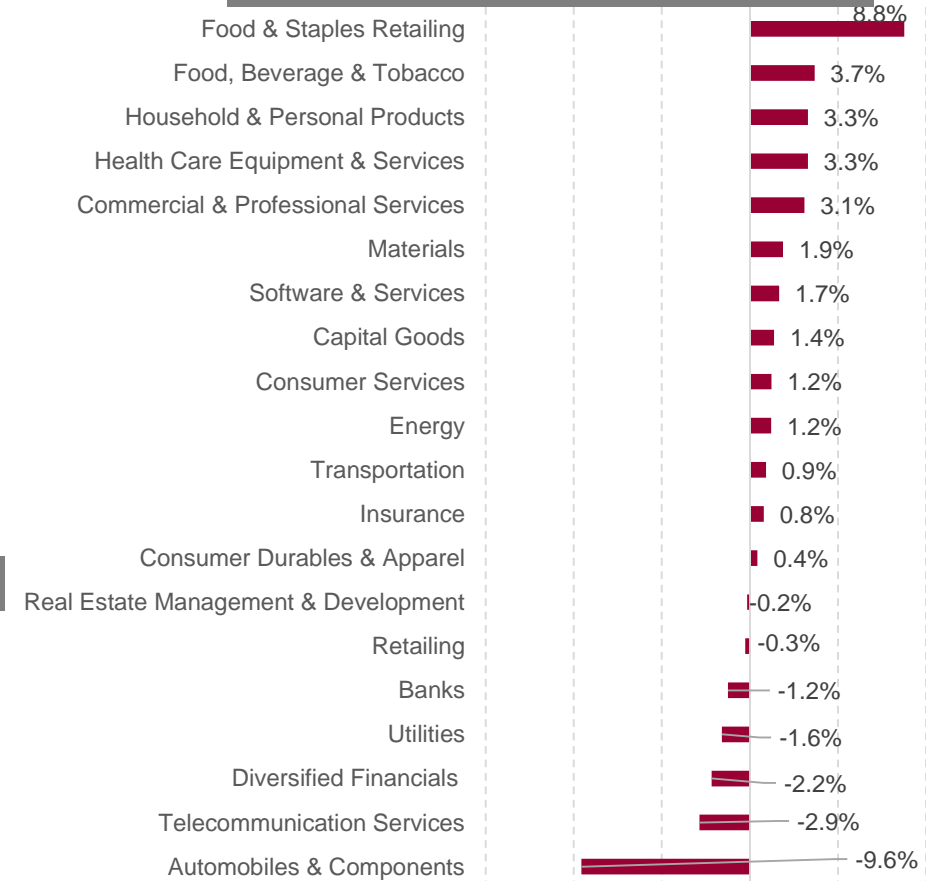
Index Performance



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 28/08/2023-22/09/2023



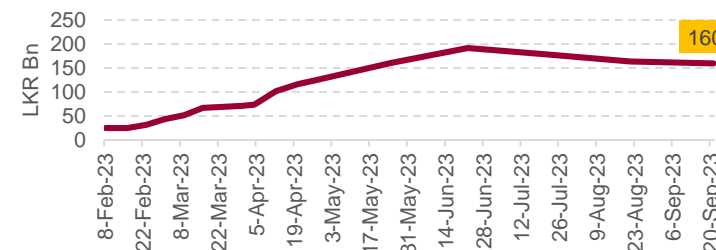
*GICS: Global Industry Classification Standards

Foreign Inflows (Rs Mn) YTD* (22/09/23)

Foreign Inflow	31,913.67
Foreign Outflow	28,072.57
Net Foreign Inflow/(Outflow)	3,841.10

*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

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.

Critical Mineral Diversification

Introduction

An energy system powered by clean technologies represents a significant departure from one fuelled by traditional hydrocarbon resources. Critical minerals, including copper, lithium, nickel, cobalt, and rare earth elements, play indispensable roles in many of today's rapidly expanding clean energy technologies, ranging from wind turbines and electricity networks to Electric Vehicles (EVs). The demand for critical minerals in the clean energy sector is projected to surge by up to three and a half times by 2030 as the world undergoes a transformative shift towards cleaner energy sources.

China currently occupies a dominant position in both the production and processing of critical minerals, serving as the largest supplier of these essential materials to the US and the EU. Nevertheless, the escalating tensions between China and Western democracies have spurred efforts to diversify away from China. Recent export restrictions imposed by China on vital materials such as gallium and germanium, crucial components in semiconductors and renewable energy technologies, have only intensified this trend. These restrictions may ultimately incentivise Western economies to reduce their reliance on China.

Opportunities for Sri Lanka

Given the nations' endowment, Sri Lanka contribute to this global rise in demand for critical minerals through the export of graphite. Remarkably, Sri Lanka is the sole nation worldwide with commercially viable deposits of highly crystalline graphite. The vein graphite produced in Sri Lanka distinguishes itself through exceptional purity, a flawless crystal structure, and robust electrical conductivity, rendering it suitable for a diverse range of commercial applications. Natural graphite is cheaper and less energy intensive to produce compared to its synthetic counterpart. Currently, Sri Lanka's graphite production hovers around 5,000 metric tons. Thanks to technological development, the reliability of natural graphite quality has been improving over the past few years. The IEA the market share of natural graphite is expected to increase in the coming years. Graphite, a crucial component in the core anodes of lithium-ion batteries used in EVs, is poised for unprecedented growth. The International Energy Agency predicts that by 2030, EVs will comprise more than 60% of the total vehicles sold worldwide. In 2022, the Biden Administration's Inflation Reduction Act excluded EV batteries containing graphite of Chinese origin from federal subsidies. These underscore the tremendous opportunities that Sri Lanka can harness in the graphite export sector. Both Australian and Chinese firms have expressed keen interest in investing in Sri Lanka's mineral industry.

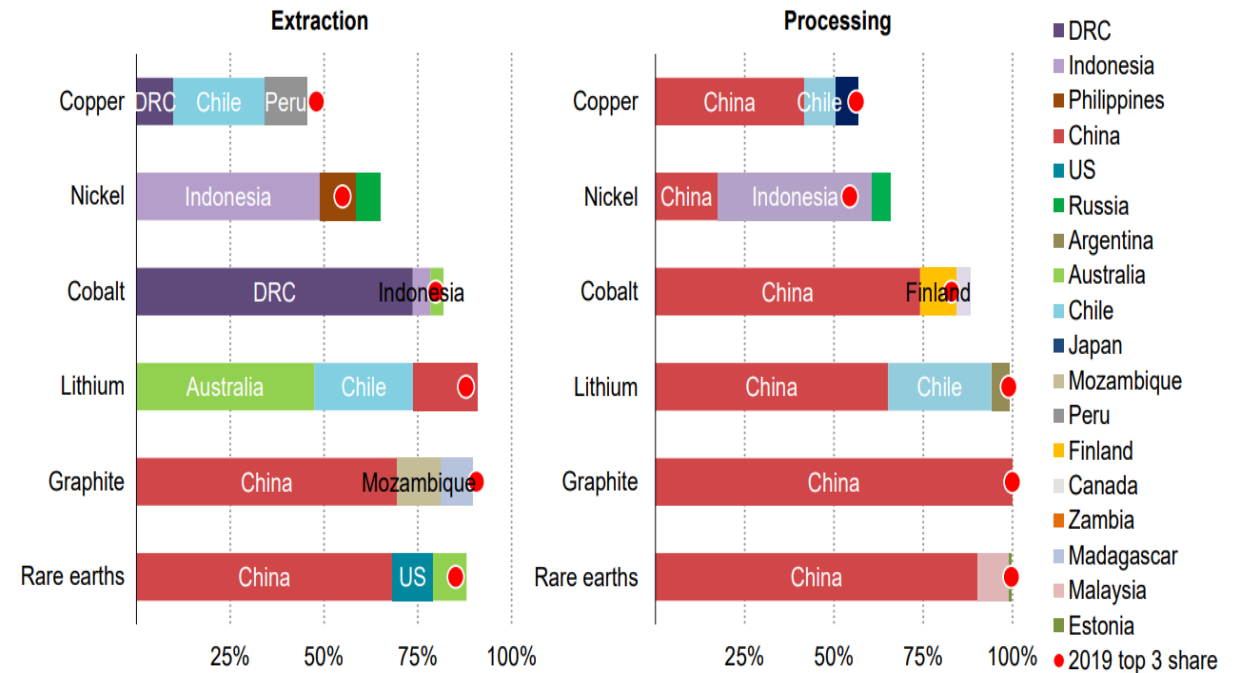
Evolving Landscape cont'd

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Beyond Mining-Maximising Resource Potential

Sri Lanka has a unique opportunity to advance beyond the extraction of critical minerals and engage in value-added processing. Presently, much of the value addition in the processing of raw materials occurs in China, which also stands as the foremost processor of graphite, for instance. However, as geopolitical tensions persist, several emerging economies have begun diversifying their exports away from China, historically the primary importer of critical minerals from these emerging markets. Countries such as Indonesia, Namibia, and Zimbabwe have recently prohibited the export of unprocessed critical minerals to promote higher value-added domestic processing. Sri Lanka, too, can follow suit by ascending the value chain. Instead of merely exporting raw graphite, the nation could consider exporting processed graphite in the form of electrodes or anodes. Additionally, there's a potential to export lithium-ion cells or even entire battery packs to key players in the EV manufacturing production network, including the US, Japan, South Korea, and the EU. This strategic shift toward value-added processing not only enhances the country's economic prospects but also aligns with the evolving dynamics of the global critical minerals market.

Share of top three producing countries in total production for selected resources and minerals, 2022



Datasheet

Latest Available data

External Trade (USD Mn)	July-2023	Month Ago	Year Ago
Exports	1,020	1,005	1,164
Agricultural Exports	231	226	228
Industrial Exports	786	791	933
Imports	1,388	1,369	1,287
Consumer Goods	267	252	184
Intermediate Goods	882	875	889
Investment Goods	237	240	214
Trade Balance	-367	-364	-122
Tourist Arrivals (No.)	136,405 (Aug)	143,039	37,740
Tourism Earnings	211 (Aug)	219	68
Workers' Remittances	499 (Aug)	541	325
Inflation (%)	Aug-2023	Month Ago	
CCPI (2021 base)			
Headline	4.0	6.3	
Core	4.6	6.1	
NCPI (2021 base)			
Headline	2.1	4.6	
Core	4.1	6.3	
Interest Rates (%)		Month Ago	Year Ago
AWPR	14.81 (Sep)	15.59	26.89
AWLR	16.90 (Aug)	16.90	16.86
AWDR	14.15 (Aug)	14.76	10.49
AWFDR	18.26 (Aug)	18.26	13.09
SDFR	11.00	11.00	14.50
SLFR	12.00	12.00	15.50
Growth in Credit to Private Sector	-7.6 (Jul)	-8.2	15.2
Fiscal Sector (LKR Bn)		2023 (Jan-Jun)	Year Ago
Revenue and Grants		1,317	919
Expenditure and Net Lending		2,560	1,822

EIU

Economic Intelligence Unit
of The Ceylon Chamber
of Commerce

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

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- ▶ 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



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