



First Capital

First Capital Research

Pre-Policy Analysis

01ST AUGUST 2018

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ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 7

Policy Expectation

❑ Previous pre-policy issue:

- Based on the economic developments and outlook for key macroeconomic variables leading to a stable economic front, First Capital Research increased the probability of a rate cut to 5% from previous 0% while decreasing the probability of an unchanged policy stance to 95%, in Jul 2018. **In line with First Capital Research expectation, CBSL announced continuation of the monetary stance in July 2018.**

❑ Changes took place during the period;

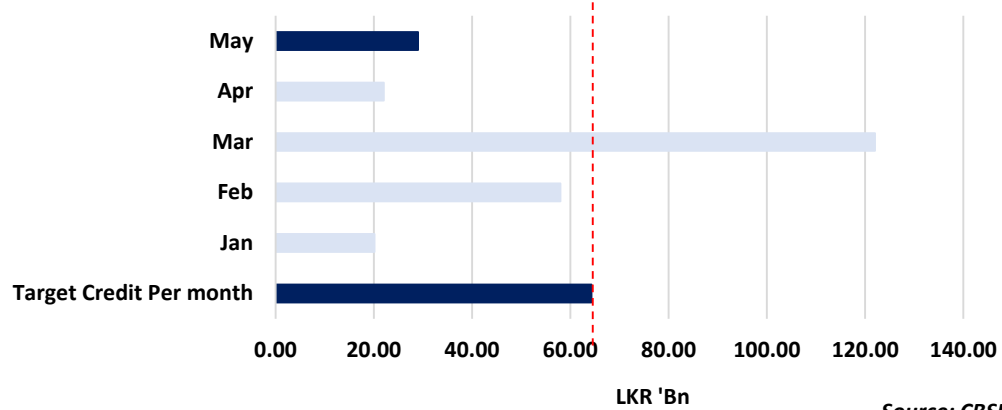
- Lower credit growth, LKR showing signs of stabilization at LKR/USD 159-160 levels, inflation continuing to remain low, increase in foreign reserve position to USD 9.25Bn, continuous foreign outflow from debt and equity markets and widening trade deficit

❑ Continuous foreign outflow witness in both debt and equity market, rules out the possibility of a rate cut as it would further aggravate the outflows thus increasing the pressure on LKR. We decrease the probability of a rate cut from previous expectation of 20% and maintain at 5%, same as July 2018 thus deferring the rate cut to Q4 from previous expectation of Q3.

❑ Considering the current economic conditions of the country, First Capital Research believe current monetary policy is appropriate and no change is required.

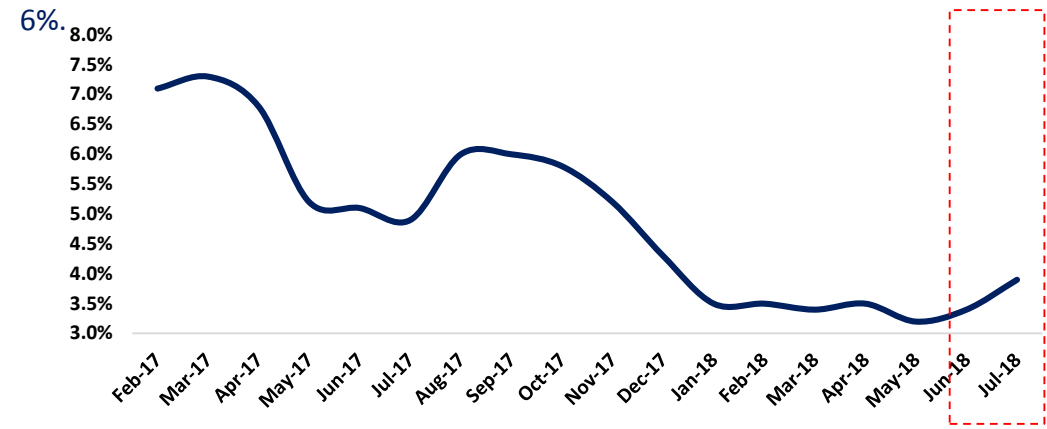
Graph 1 : Credit Growth remains slow at 5%YTD

Credit growth remains sluggish at 5%YTD, below First Capital Research target of 16%, private sector credit growth is expected to pick up towards 2H2018.



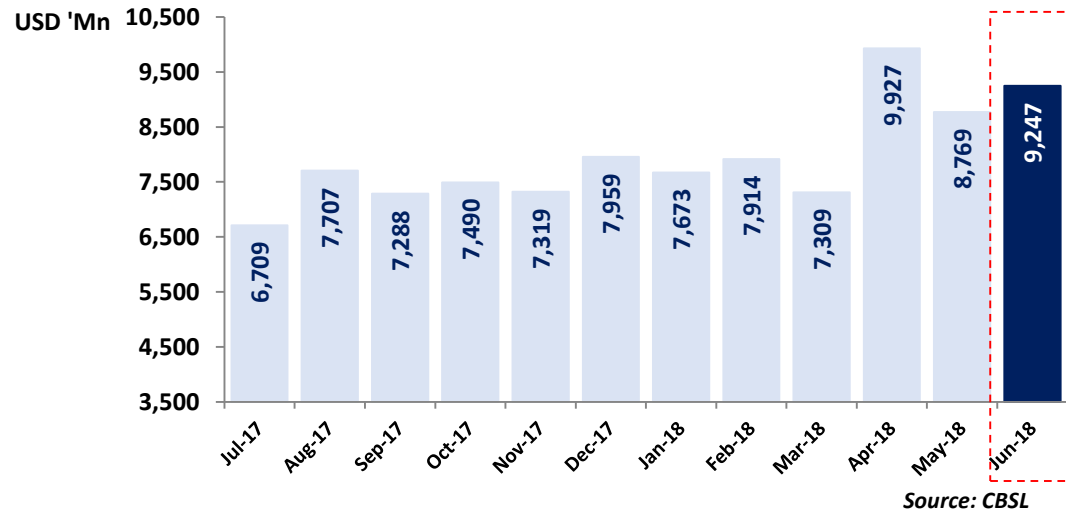
Graph 2 : Core Inflation spikes but remains below par at 3.9% in July 2018

Core inflation is expected to increase with the implementation of pricing formula and off season food shortage but to remain under control within 4%-6%.



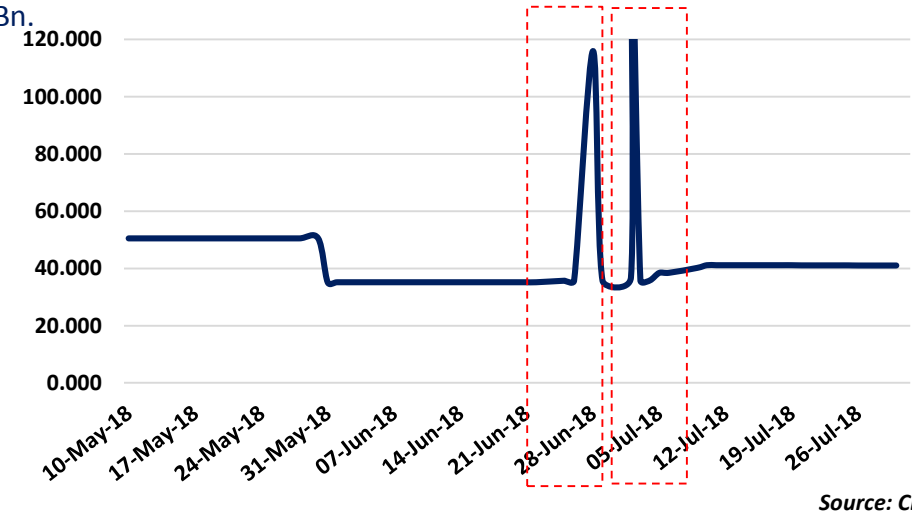
Graph 3 : Official Reserves increase to USD 9.2Bn in June 2018

Reserves increased to LKR 9.2Bn in June 2018 with the receipt of LKR 584Mn, the final payment of the Hambantota Port sale.



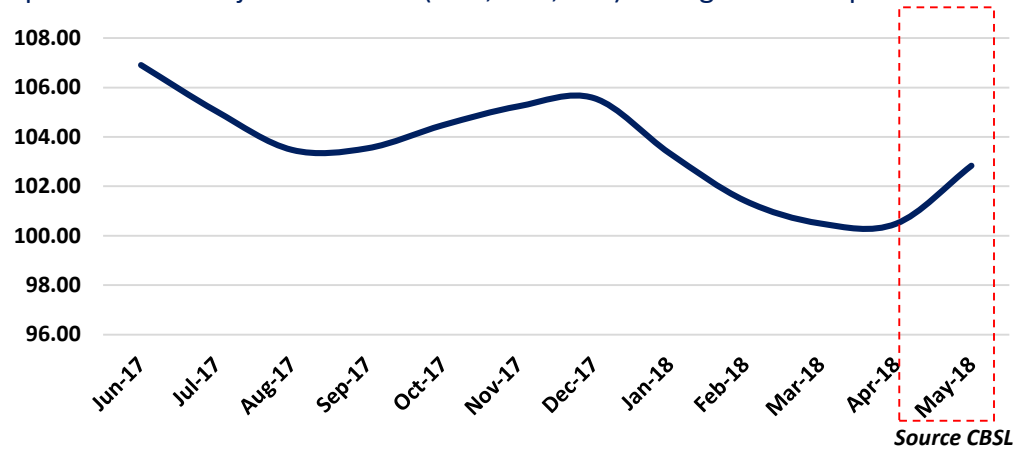
Graph 4 : CBSL holding in Gov Sec maintained above LKR 41Bn

CBSL holding in Government Securities increased to LKR 172Bn on 02 Jul 2018 prior to dip to LKR 36Bn on 03 Jul 2018 and stabilize and maintain above LKR 40Bn.



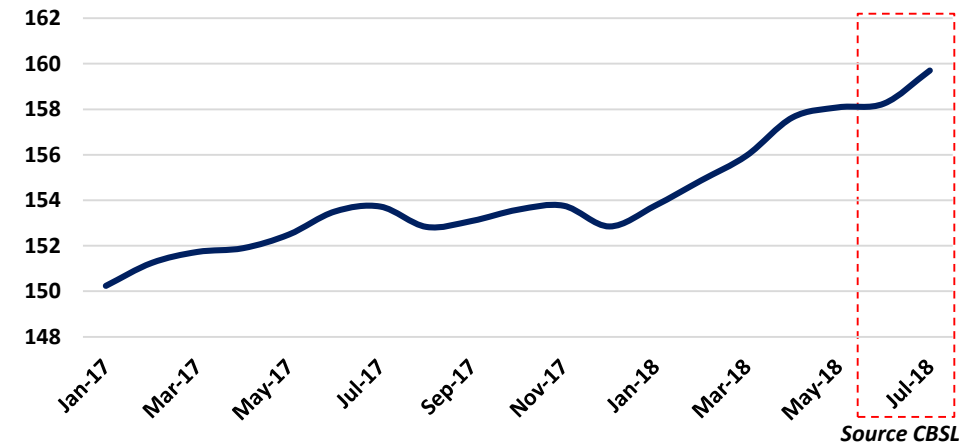
Graph 5 : Real Effective Exchange Rate remains at 100.7 in Apr 2018

REER was supported by decrease in core inflation in May 2018 coupled with depreciation of major currencies (USD, GBP, INR) during the same period.



Graph 6 : LKR weakens against strengthened USD

LKR was seen stabilizing around LKR/USD 159-160 levels in May - Jun 2018 amidst CSBL selling USD in the market.



Graph 7 : Fed Rate Hike Expectations - 2018

Surveys conducted in Dec 2017 and in Feb 2018 indicated two rate hikes (Sep and Dec) for 2018.

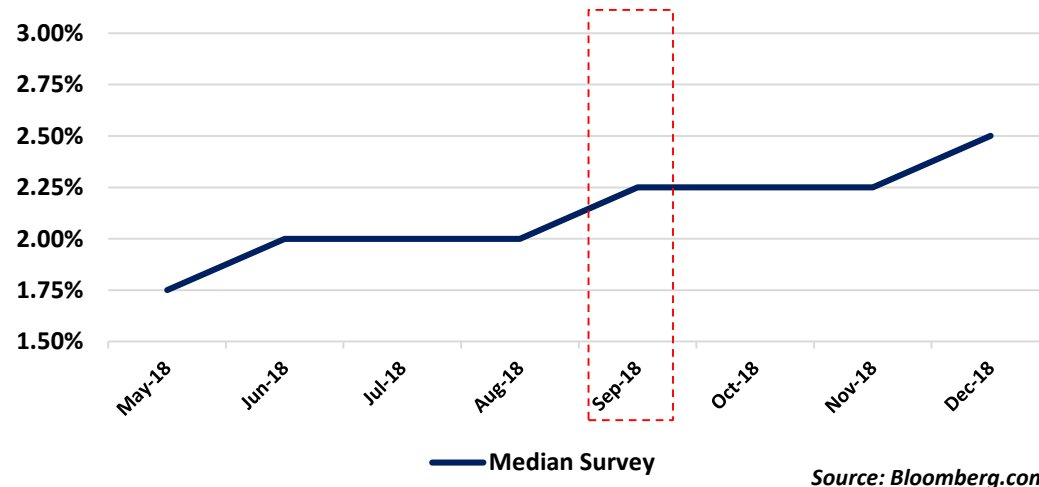


Table 1 : Bond Maturities – 2H2018

ISIN	Series	Issue Date	Maturity Date	Outstanding (LKR) Mn
LKB01518H150	07 50 2018 A	15-08-03	15-08-18	97,846
LKB00418J150	08 75 2018 A	15-10-14	15-10-18	36,532
LKB00718K151	08 00 2018 A	15-11-11	15-11-18	102,691

Series	ISIN	Maturity Date	Outstanding (USD)
SLDB2018B	LKG00518I188	17-09-18	375

Source CBSL

Expected Monetary Policy Stance

Subdued credit growth and slow GDP growth warrant a rate cut, while continuous foreign outflow from both debt and equity markets dissent it as it would aggravate the foreign outflows thus increasing pressure on LKR. Therefore, we believe a continuation of the current monetary policy stance.

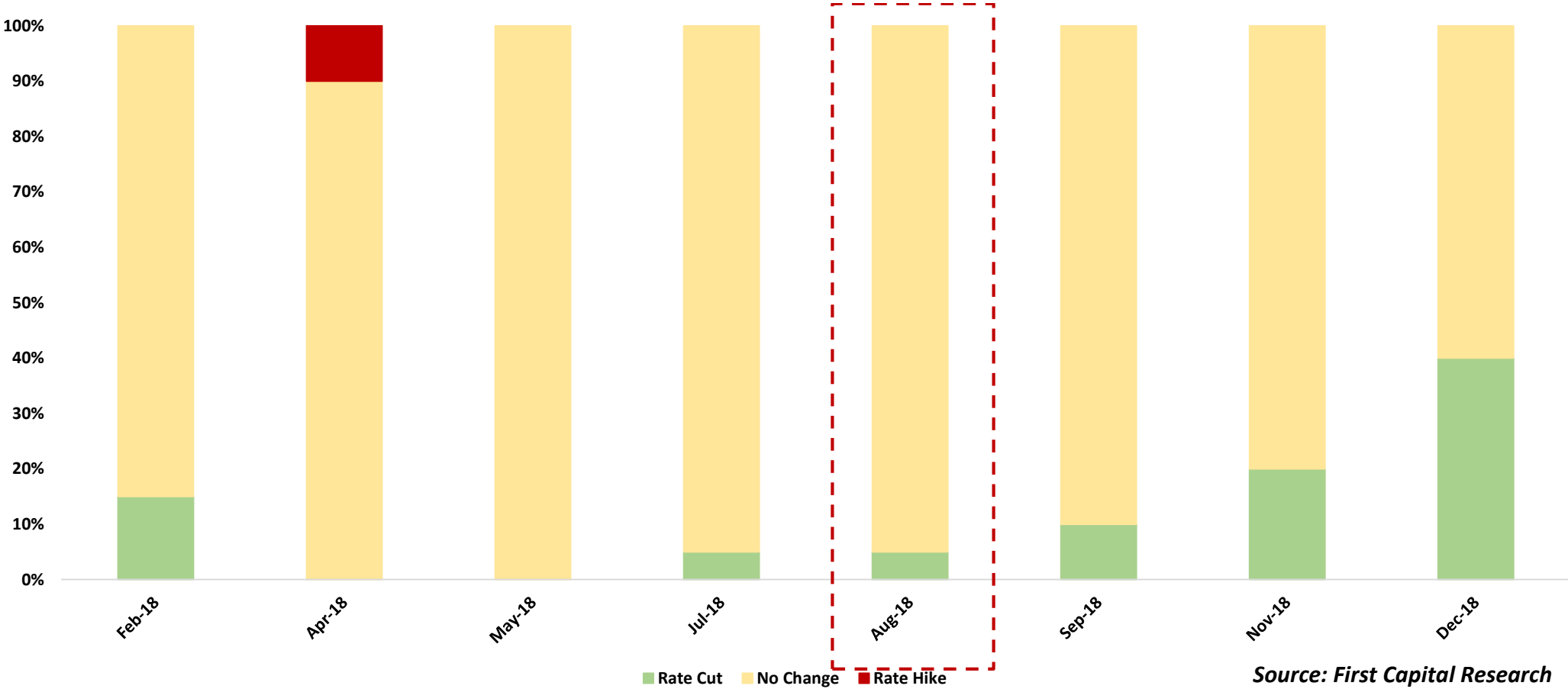
Expected Monetary Policy Stance by CBSL	Probability
Raising Policy Rates by 50bps	0%
Raising Policy Rates by 25bps	0%
Policy Rates to remain unchanged	95%
Cutting Policy Rates by 25bps	5%
Cutting Policy Rates by 50bps	0%

Probability remains at 5%, same as July 2018 levels.

Current Policy Rates	
Standing Deposit Facility Rate (SDFR)	7.25%
Standing Lending Facility Rate (SLFR)	8.50%
Statutory Reserve Ratio (SRR)	7.50%

We expect the CBSL to keep Statutory Reserve Ratio (SRR) unchanged at 7.50%

First Capital Expectations



Source: First Capital Research

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