

Pre-Policy Analysis

2ND NOVEMBER 2017

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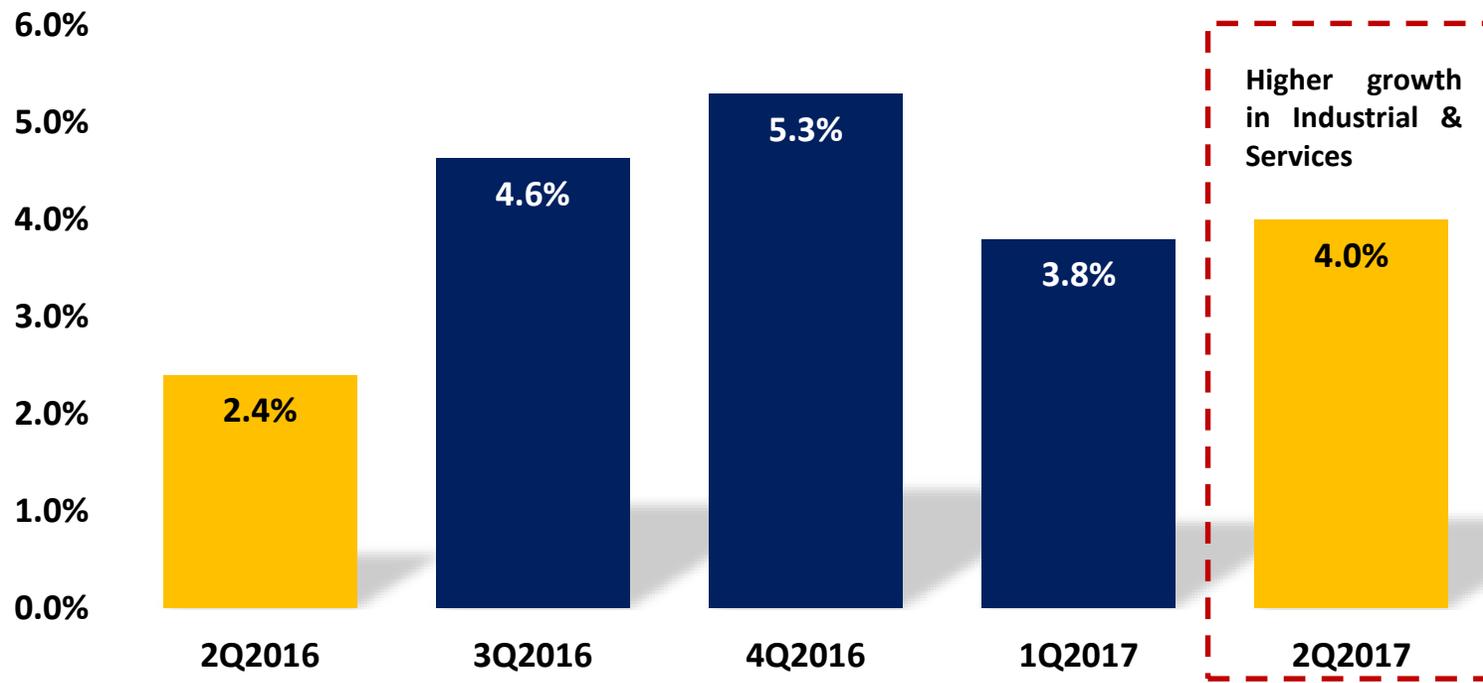
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GDP Growth

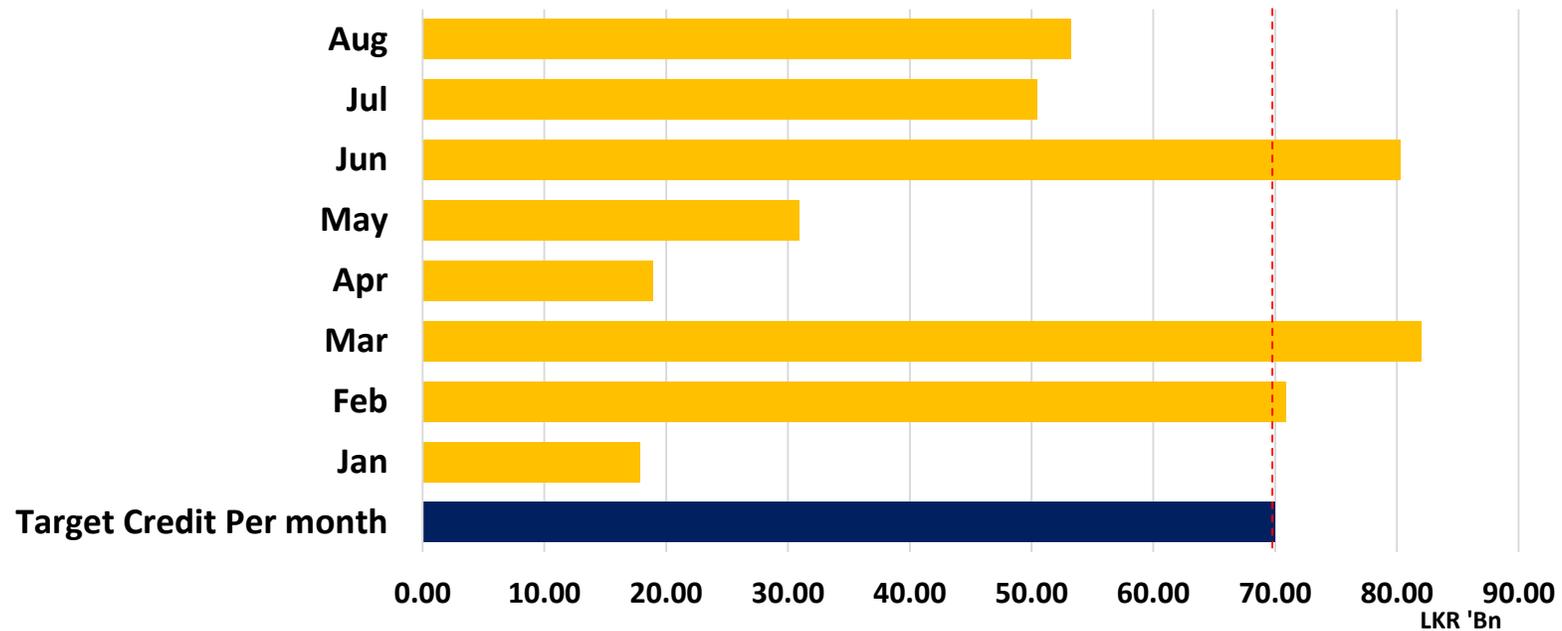
GDP growth for 2Q 2017 was better than expected, grew by 4.0%YoY in the 2Q2017 with the industrial and the services activities recorded higher growth rates of 5.2%YoY and 4.5%YoY respectively.



Source: CBSL

CREDIT GROWTH

FC Research upgrades private sector credit growth for 2017E to 16% from 14% amidst a possible pickup towards year end. Private sector credit figure saw an increase to LKR 53Bn in August 2017 despite slowdown in the credit in July, we believe overall credit is likely to continue to remain under control.



INFLATION

CCPI based headline inflation, accelerated on a YOY basis to 7.8% in Oct 2017 from 7.1% in Sep 2017. NCPI based inflation also accelerated on a YOY basis to 8.6% in Aug 2017 from 8.6% in Sep 2017.

However Core inflation remained under check decelerating to 5.8% in Oct 2017 from 6.0% in Sep 2017.

FC Research forecast Nov 2017 CCPI headline inflation to be at 7.0% and CCPI core inflation at 4.7%.

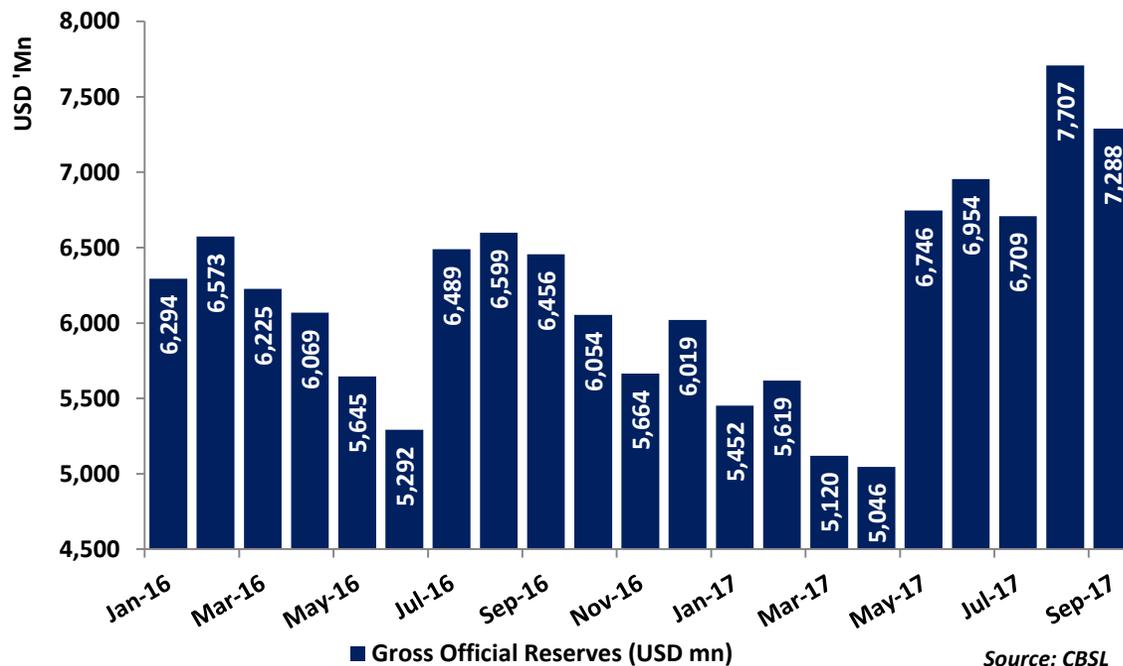
FC Research View

We believe point to point inflation will be dip beyond Nov 2017 despite food shortages due to higher base effect as increased VAT was implemented on Nov 2016. Further, Core inflation going forward is likely to be around the 5.0% mark over the next few months

Official Reserves

Sri Lanka's forex reserves assets dropped by USD 418Mn to USD 7.29Bn in September which was equivalent to about 4.5 months of imports from USD 6.0Bn reserve at end 2016. The CBSL had net purchased USD 1.2Bn on a net basis from currency markets so far this year.

FC Research View: FC Research believe Foreign Reserves are now at comfortable levels and likely to end the year around the USD 7.0Bn mark.

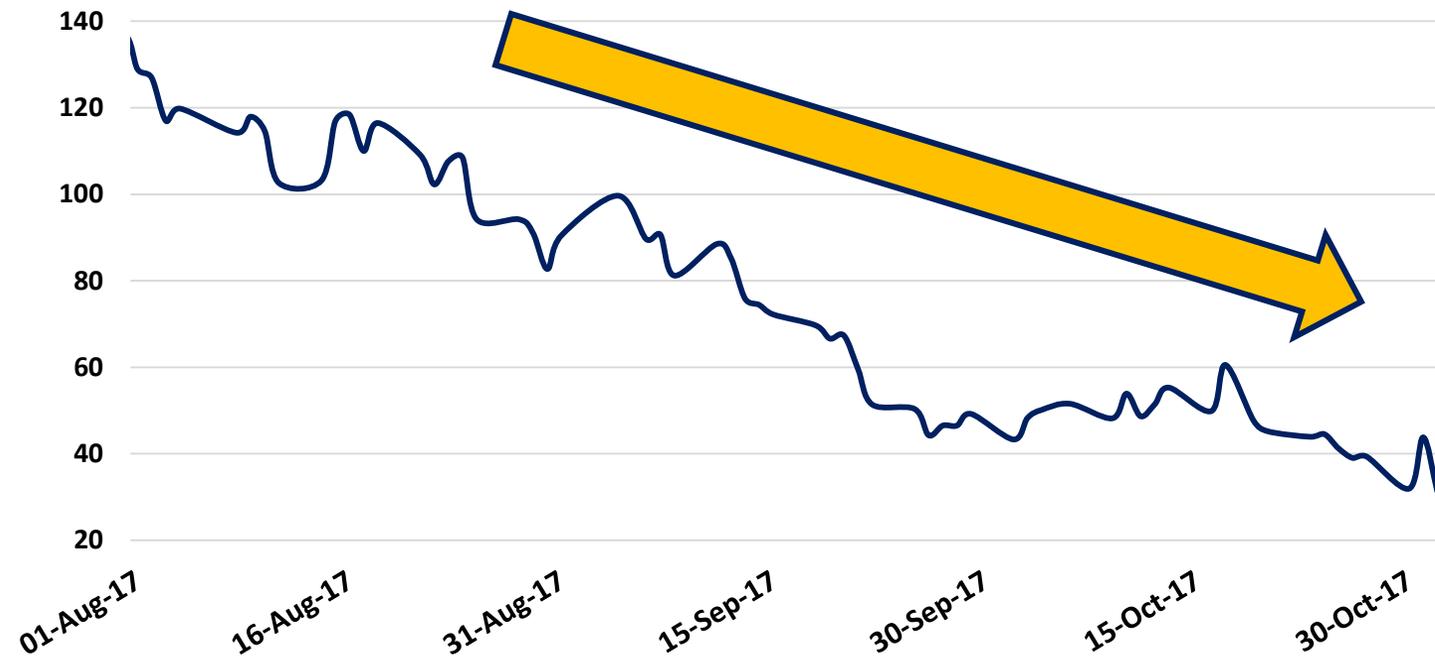


Central Bank purchases and sales (USD Mn)

	Purchase	Sales
Jan-17	64.66	204.50
Feb-17	145.09	297.25
Mar-17	192.23	13.00
Apr-17	257.92	-
May-17	183.47	35.00
Jun-17	136.00	-
Jul-17	344.75	-
Aug-17	200.00	-
Sep-17	186.50	-

CBSL HOLDINGS

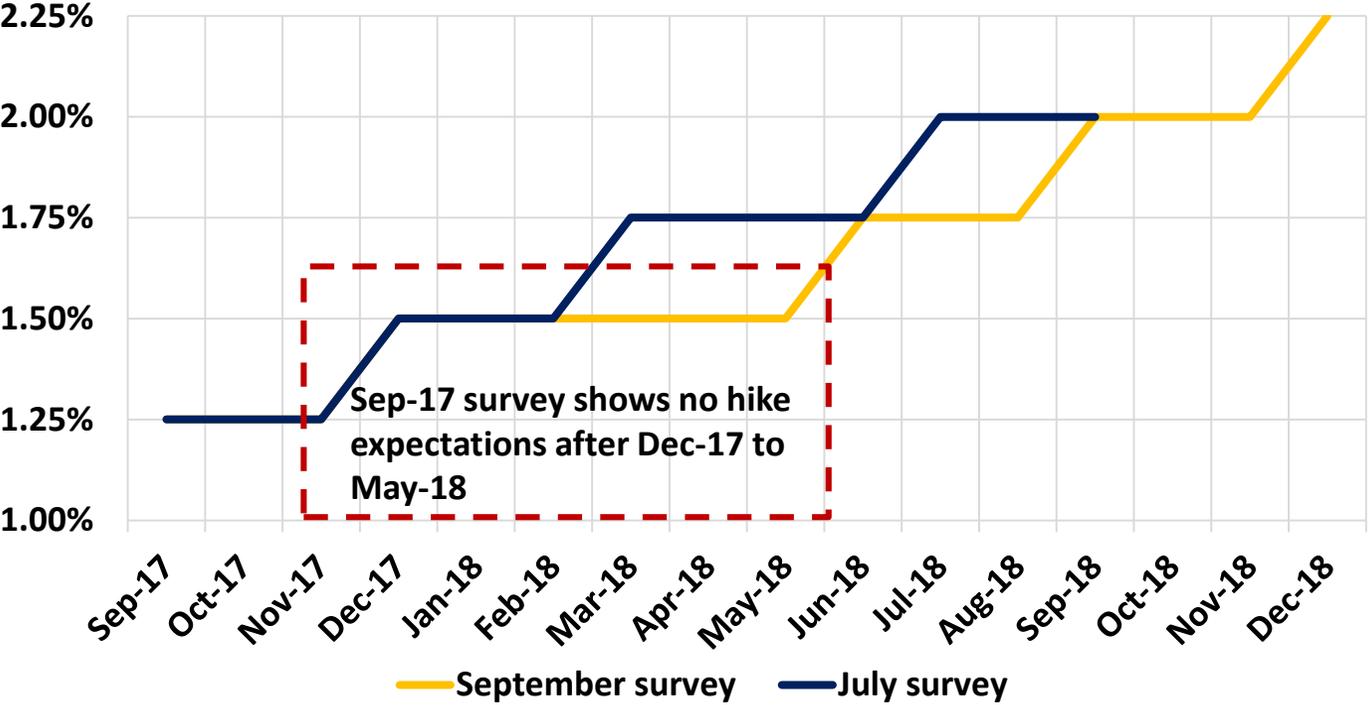
During last two months CBSL bought down its holding in Government Securities from LKR 130Bn to below LKR 31Bn as at 1st Nov 2017.



Source: CBSL

Fed Rate Hike Expectations

Economists said the Fed will still pencil in three hikes for 2018, but with the first of those not projected until June, versus March in the Fed's previous set of forecasts. Sep-17 survey shows Fed expects to raise policy rates in Dec-17 and no further hikes are expected after Dec-17 until after May-18.



Source: Bloomberg surveys

Expected Monetary Policy Stance

FC Research believes that considering the current economic conditions with better than expected GDP growth level and the considerable improvement in the Economic Health the **current monetary policy is appropriate and no change is required**

Expected Monetary Policy Stance by CBSL	Probability	Current Policy Rates	
Raising Policy Rates by 50bps	0%	Standing Deposit Facility Rate (SDFR)	7.25%
Raising Policy Rates by 25bps	10%	Standing Lending Facility Rate (SLFR)	8.75%
Policy Rates to remain unchanged	90%	Statutory Reserve Ratio (SRR)	7.50%
Cutting Policy Rates by 25bps	0%		
Cutting Policy Rates by 50bps	0%		

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

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