



First Capital

First Capital Research

Pre-Policy Analysis

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ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 7

Policy Expectation

With the issuance of USD 2.5Bn Sovereign Bond, Sri Lanka's forex reserve assets spiked to USD 9.9Bn in Apr 2018, above the 4 months import bill value of USD 7.4Bn.

Changes took place during the period;

The issuance of much anticipated USD 2.5Bn Sovereign Bond while extending the closing date of Foreign Currency Term Financing Facility coupled with continuous widening of trade deficit and CBSL continue to offer and accept lower than maturity of SLDBs

USD 2.5Bn Sovereign Bond issue improved the forex reserve position considerably, increasing it to LKR 9.9Bn above the minimum level, which is 4 months of import, thus significantly lowering the economic risk profile of the country while foreign currency maturities during the next 2 months amounting to appr. USD 500-600Mn.

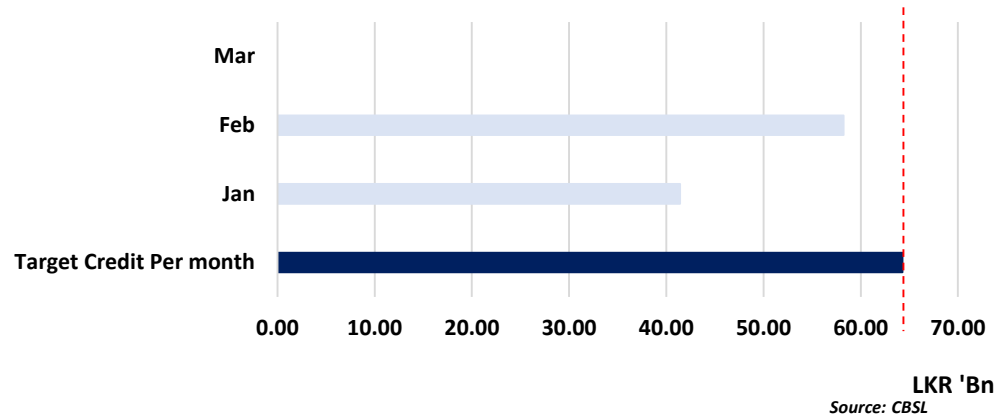
However, private sector credit growth continues to be sluggish with no signs of acceleration and inflation (even if a fuel price hike is incorporated) is expected to be within the bands of 4%-6% while REER is moving further towards the fair value in Mar 2018 from 103.35 in Jan 2018 is likely to maintain at fair value.

On previous pre-policy issue First Capital Research highlighted a low but increased probability of a rate hike where probability of a rate hike was raised to 10% in Apr 2018 from 0% in Feb 2018, which was in line with the increase in the risk profile of the country. However, with the issuance of much anticipated Sovereign Bond which completely wipes out the possibility of a rate hike that was required to improve the reserve position. The considerably slow GDP growth level that is prevailing in the country, lower inflation and improved REER is expected to significantly reduce probability of a rate hike.

Therefore despite the recent developments considering the slow economic conditions First Capital Research believe **current monetary policy is appropriate and no change is required.**

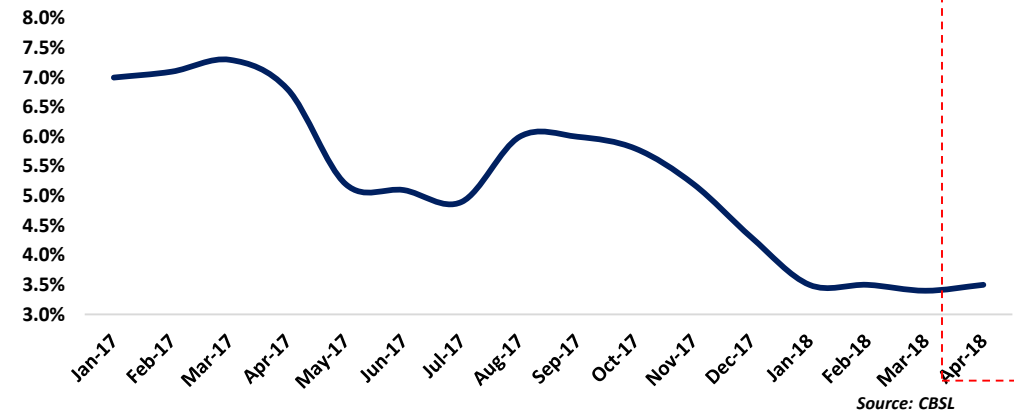
Graph 1 : Credit Growth remains slow

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



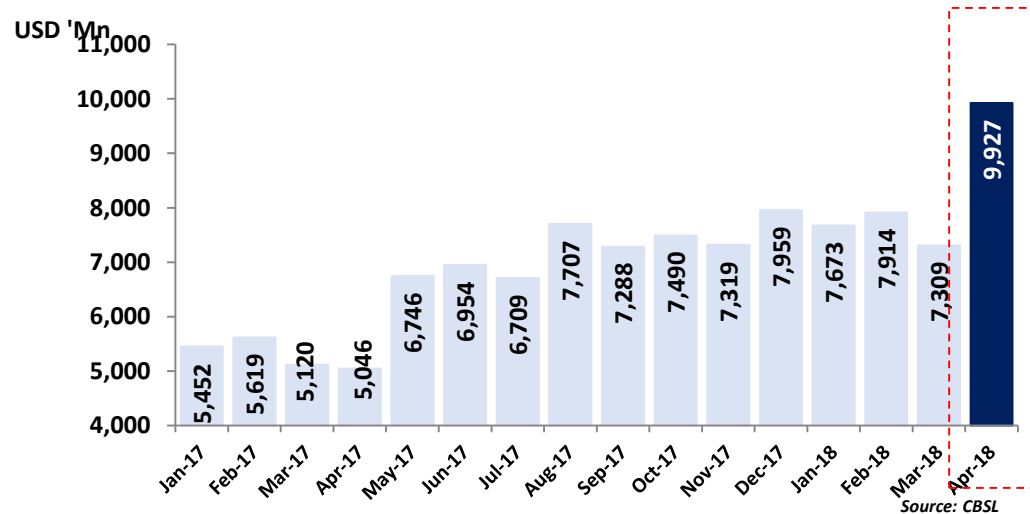
Graph 2 : Core Inflation remains below par at 3.5% in Mar 2018

Core inflation is expected to remain under control over the next 1-2 months while there could be some upward pressure towards end of 3Q2018 but likely to remain within 4-6%.



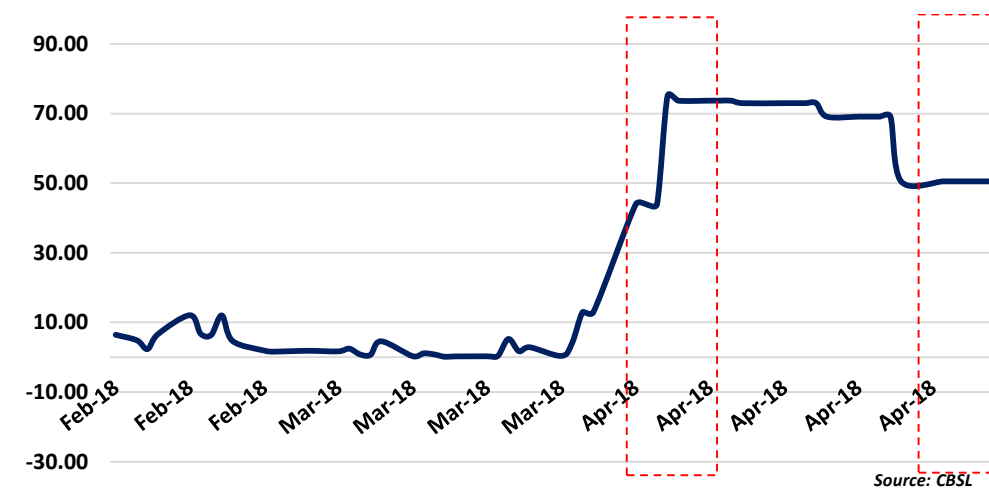
Graph 3 : Official Reserves increases to USD 9.93Bn in Apr 2018

We expect the reserve position to improve to USD 11Bn with the foreign funding facility, H'tota port payment coming in over the next 2 weeks.



Graph 4 : CBSL holding in Gov Sec maintained above LKR 43Bn


CBSL holding in Government Securities increased to LKR 75Bn on 7th Apr 2018 prior to gradually decline prior to stabilize at LKR 50Bn in May 2018.



Expected Monetary Policy Stance

With the issuance of Sovereign bond leading to an improved reserve position has reduced the risk considerably. However, considering the fact of overly slow GDP growth and appropriate levels of other economic indicators (inflation, REER, credit growth, CBSL holding) we believe current monetary policy is appropriate and no change is required.

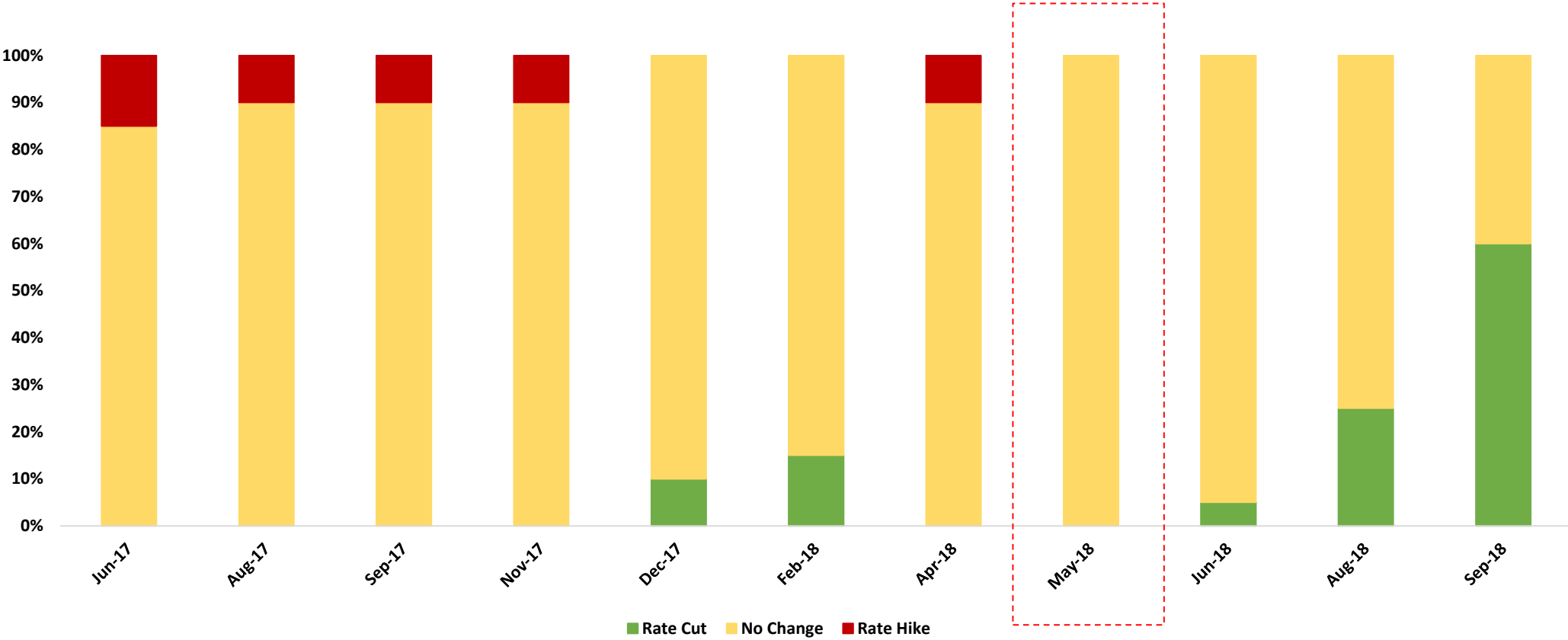
Expected Monetary Policy Stance by CBSL	Probability
Raising Policy Rates by 50bps	0%
Raising Policy Rates by 25bps	0%
Policy Rates to remain unchanged	100%
Cutting Policy Rates by 25bps	0%
Cutting Policy Rates by 50bps	0%

 Probability decreased to 0% from 10% in Apr 2018

Current Policy Rates	
Standing Deposit Facility Rate (SDFR)	7.25%
Standing Lending Facility Rate (SLFR)	8.75%
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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