

Pre-Policy Analysis

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Lead Analyst: Amanda Lokugamage
Secondary Analysts: Dimantha Mathew
Atchuthan Srirangan

**ANALYST CERTIFICATIONS AND REQUIRED
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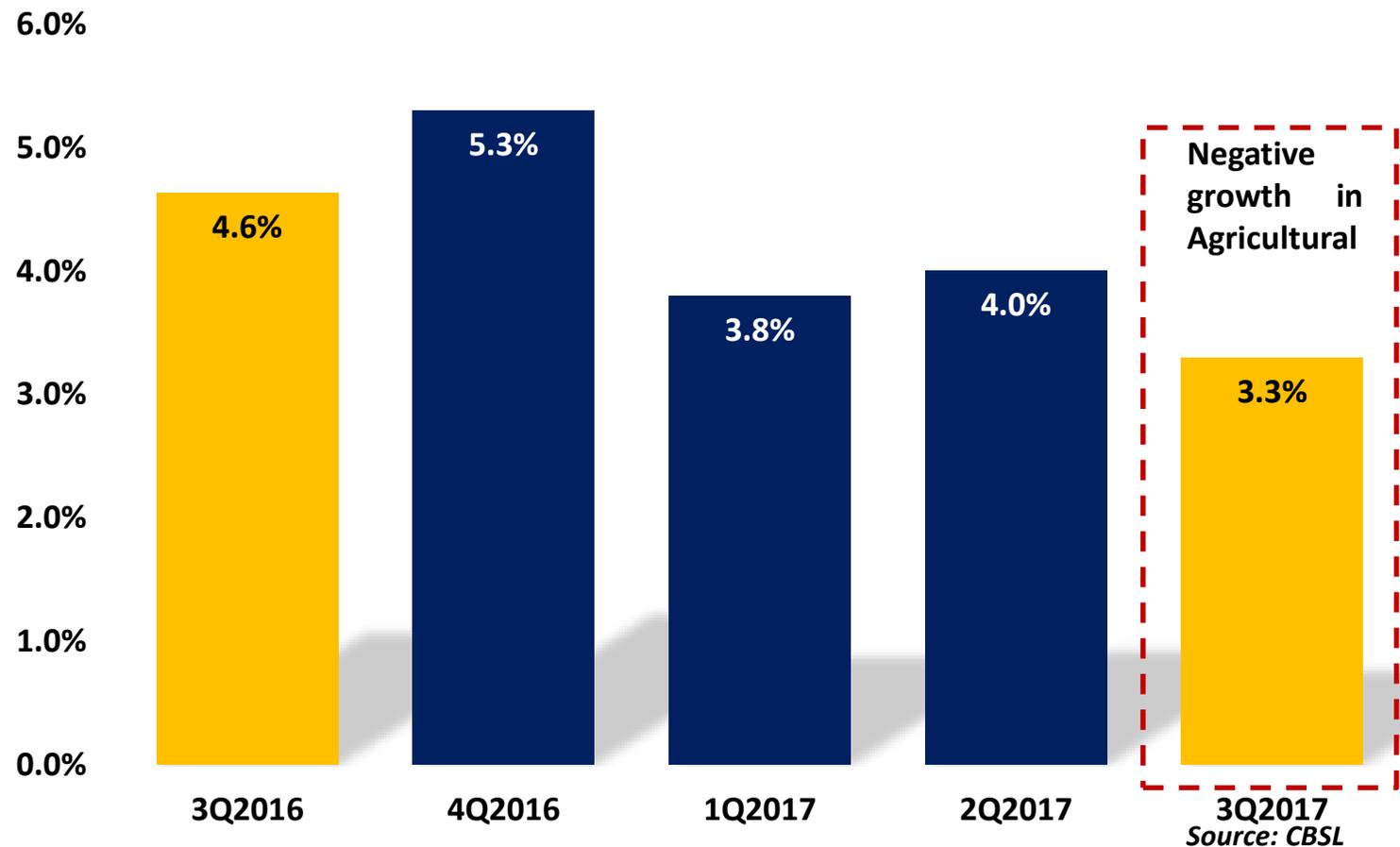


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GDP Growth below expectations

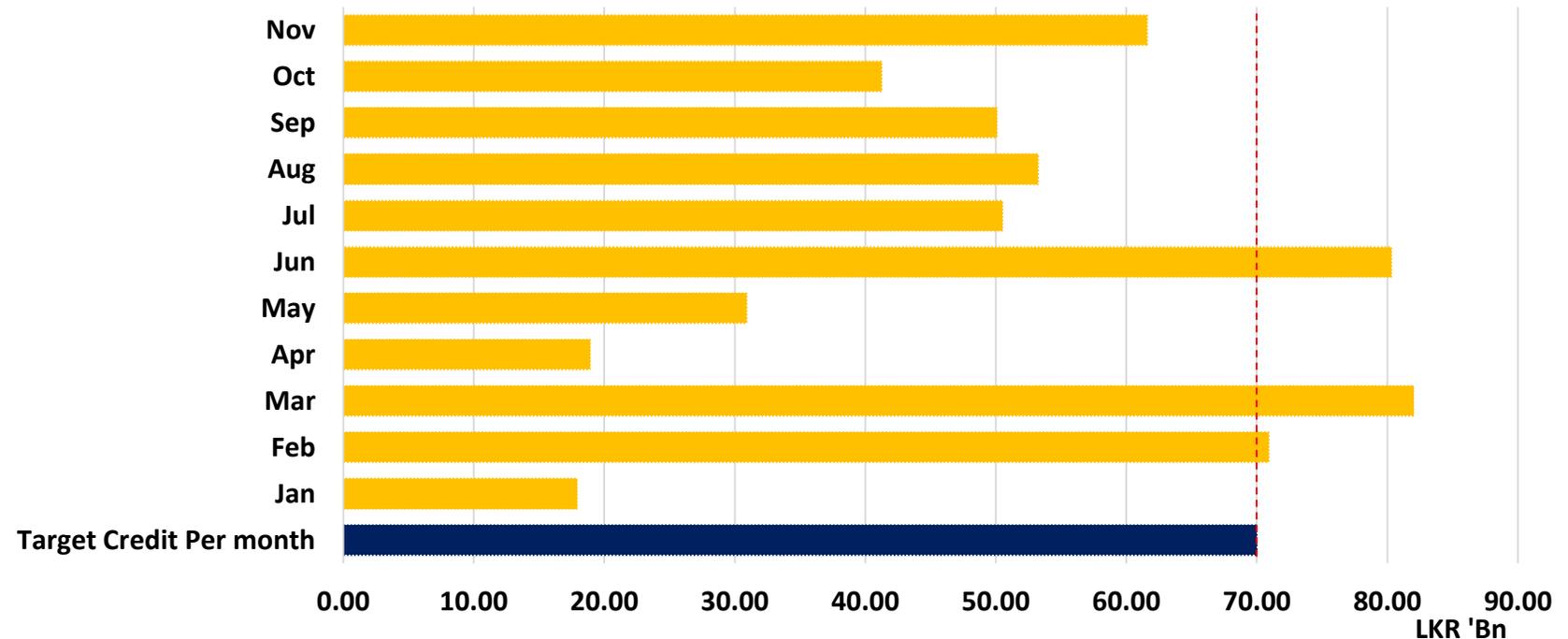
GDP growth for 3Q2017 was lower than expected, grew by 3.3%YoY in the with overall agricultural activities reporting a negative growth mainly due to the unfavorable weather conditions (severe drought as well as heavy rainfalls) that prevailed during the last 2 years in many districts of the country.

During the third quarter of 2017, the 'Services activities' continued to expand further by 4.3%, while 'Industrial Activities' recording a marginal growth rate of 1.9%.



Credit Growth Increases

First Capital Research upgraded private sector credit growth for 2017E to 16% in Aug 2017 from 14% amidst a likely increase towards the end of the year. Private sector credit figure saw decelerated to LKR 41Bn in October 2017 prior to pick up by LKR 61.6Bn in November 2017, we believe overall credit is likely to continue to remain under check.



Inflation continues to slow down

CCPI based headline inflation, decelerated on a YoY basis to 5.8% in Jan 2018 (below the First Capital Research estimate of 6.7%) from 7.1% in Dec 2017. NCPI based inflation accelerated on a YoY basis to 7.7% Dec 2017 from 7.5% Nov 2017 .

However, Core inflation remained under check decelerating to 3.5% in Jan 2018 from 4.3% in Dec 2017.

First Capital Research View

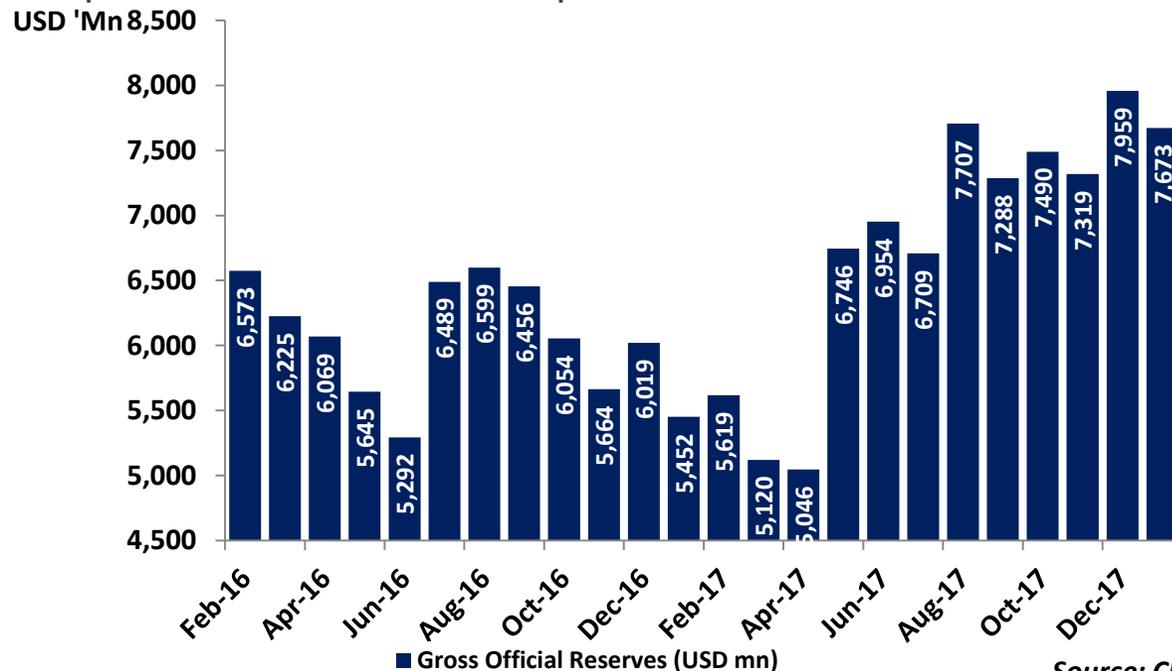
First Capital Research forecast Feb 2018 CCPI headline inflation to be at 5.1%

We believe inflation will be under control over the next 2-3 months while there could be some upward pressure towards 2Q2018.

Official Reserves remains above USD 7 Bn

Sri Lanka's forex reserves assets decreased by USD 286Mn to USD 7.67Bn in January 2018 which was equivalent to about 4.5 months of imports, from USD 7.96Bn in December 2017. The CBSL had net purchased USD 191Mn from currency markets so far during 2018.

First Capital Research View: First Capital Research expects foreign reserves to maintain at USD 7.0Bn which is equivalent to 4 months import bill value.



Source: CBSL

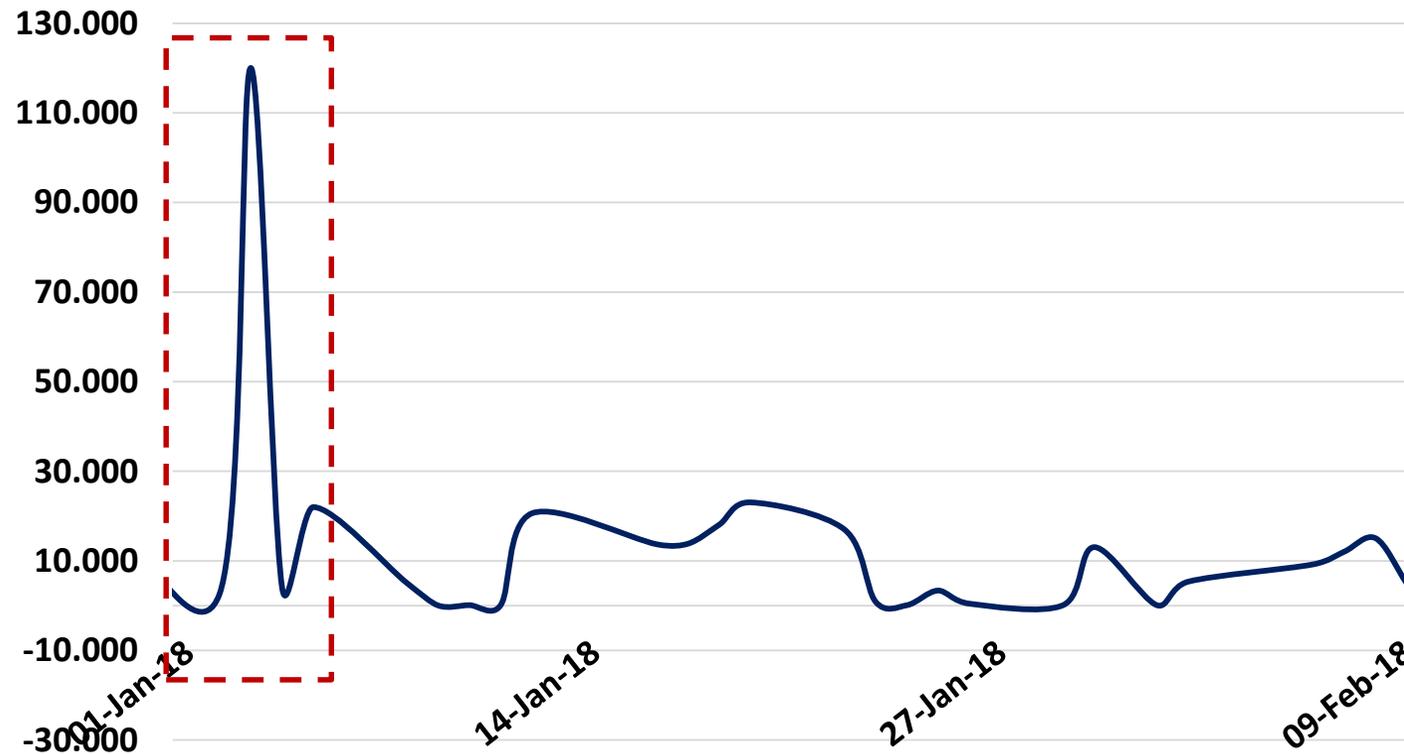
Central Bank purchases and sales (USD Mn)

	Purchase	Sales
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	-
Oct-17	97.00	-
Nov-17	206.00	-
Dec-17	200.50	-
Jan-18	191.00	-

Source: CBSL

CBSL Holdings brought down to Zero

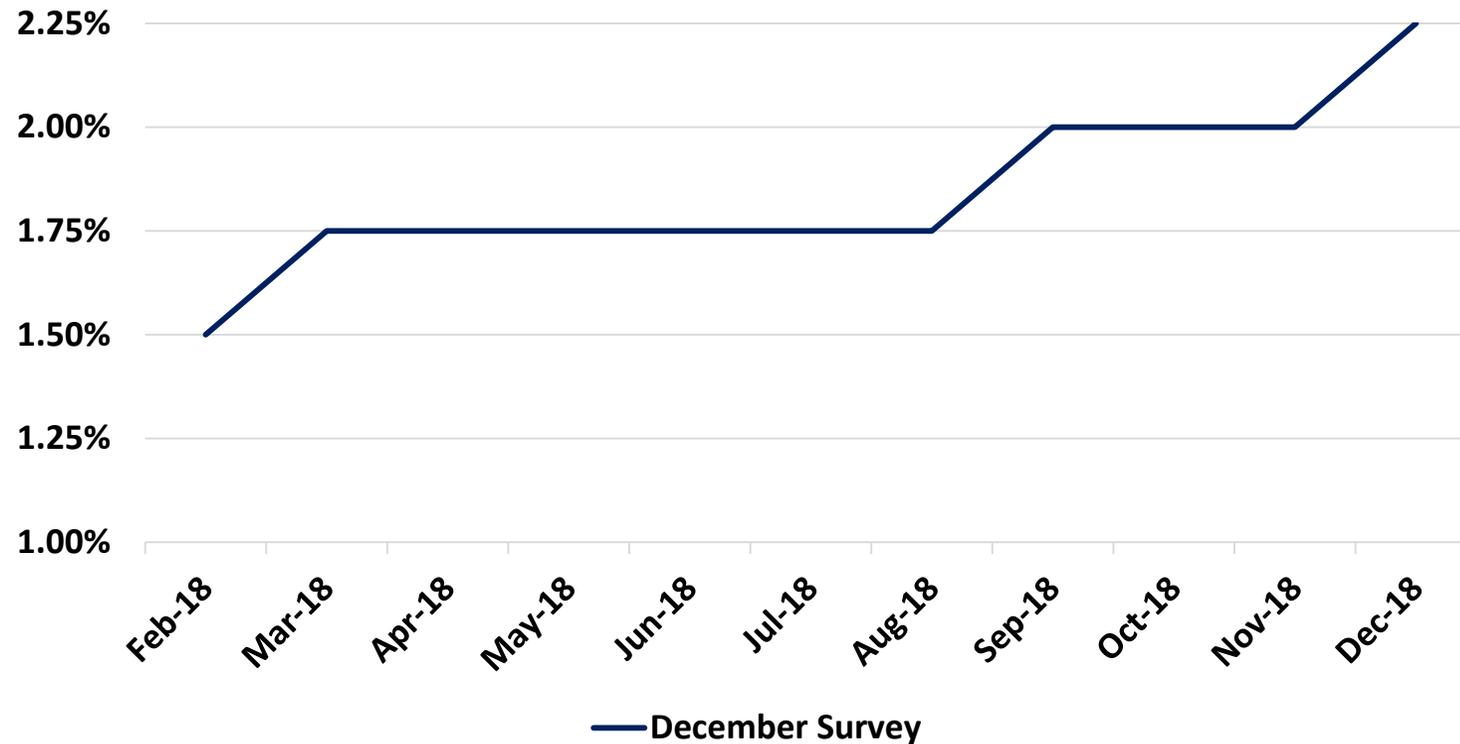
YTD CBSL increased its holding in Government Securities marginally from LKR 2.55Bn in Jan 2018 to LKR 4.92Bn as at 12th Feb 2018. However, on 03rd Jan 2018 CBSL holdings was seen increased to LKR 120.05Bn prior to settling at LKR 4.23Bn the following day.



Source: CBSL

Fed Rate Hike Expectations

Economists said the Fed will still pencil in three hikes for 2018 (March 2018, June 2018 and December 2018), but moved forward one of those projected moves to March 2018 from June 2018.



Source: Bloomberg Surveys

Expected Monetary Policy Stance

First Capital Research believes inflation rate to moderate, foreign reserve position to be maintained above LKR 7.0Bn levels, improve in credit growth and likely increase in GDP growth in 2018E. Consideration of above favourable macroeconomic environment **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	0%	Standing Lending Facility Rate (SLFR)	8.75%
Policy Rates to remain unchanged	85%	Statutory Reserve Ratio (SRR)	7.50%
Cutting Policy Rates by 25bps	15%		
Cutting Policy Rates by 50bps	0%		

Probability increased to 15% from 10% at December 2017

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

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CONTACT US



First Capital

Dimantha Mathew +94 11 2639 853

Amanda Lokugamage +94 11 2639 868

Atchuthan Srirangan +94 11 2639 863

Nisansala Kuruppumudali +94 11 2639 866

Hansinee Beddage +94 11 2639 864