



First Capital

First Capital Research

Pre-Policy Analysis

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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 decreased the probability of a rate hike to 0% from previous 10% while increasing the probability of an unchanged policy stance to 100% in Apr 2018. **In line with First Capital Research expectation, CBSL announced continuation of the monetary stance in May 2018.**

❑ Changes took place during the period;

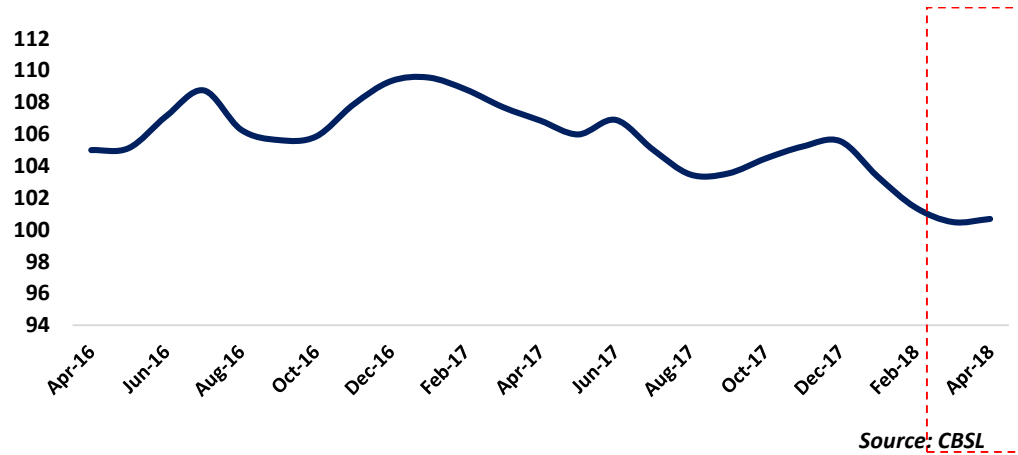
- 1Q2018 GDP continued to remain low at 3.2%, LKR depreciating to all time low of LKR/USD 159.72, inflation remained low but stable, Foreign reserve position dipping to USD 8.77Bn amidst increased foreign outflow from debt and equity markets, continuous widening of trade deficit and CBSL continuing to offer and accept lower than maturity of SLDBs

❑ Private sector credit growth continues to be sluggish with no signs of acceleration while country's GDP growth remains considerably slow. These factors are increasing the probability of a rate cut. However, with high foreign outflows 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.

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

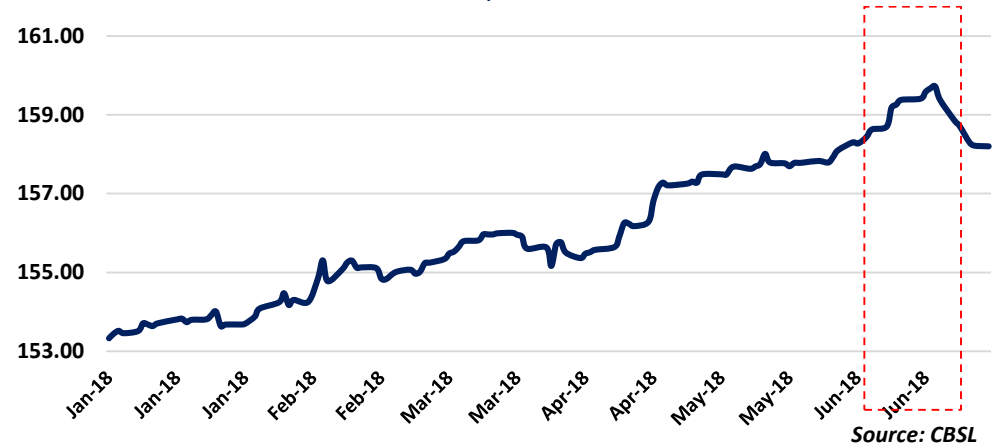
Graph 5 : Real Effective Exchange Rate remains at 100.7 in Apr 2018

REER was supported by currency depreciation witnessed in Feb to Apr 2018 coupled with USD strengthening during Apr 2018



Graph 6 : LKR weakens against strengthened USD

LKR was seen depreciating to all time lows of LKR/USD 159.72 in Jun 2018 on the back of increased and continued pressure on the LKR.



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.

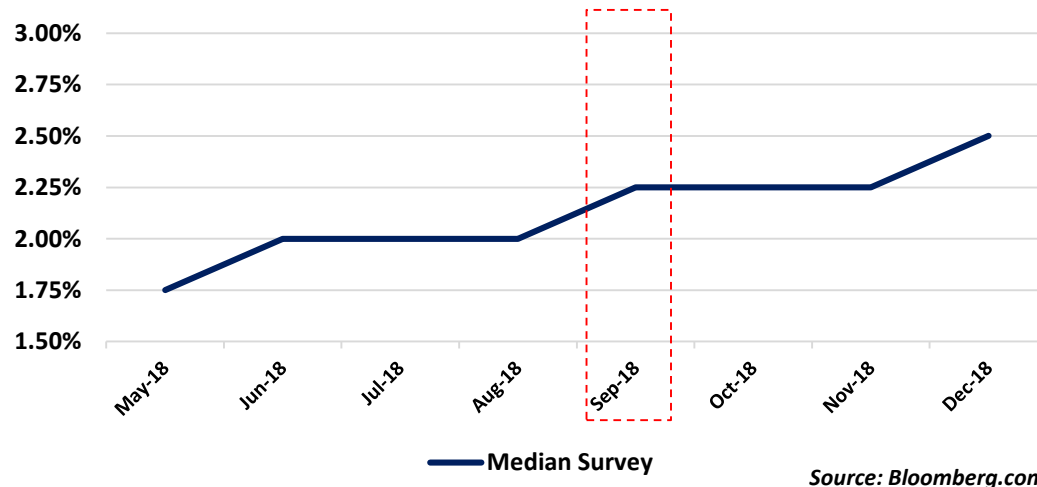


Table 1 : Bond Maturities – 2H2018

ISIN	Series	Issue Date	Maturity Date	Outstanding (LKR) Mn
LKB01518G152	08 50 2018 B	15-07-03	15-07-18	90,716
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

Overly slow (1Q2018 GDP growth of 3.2%) warrants a rate cut while continuous heavy 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.

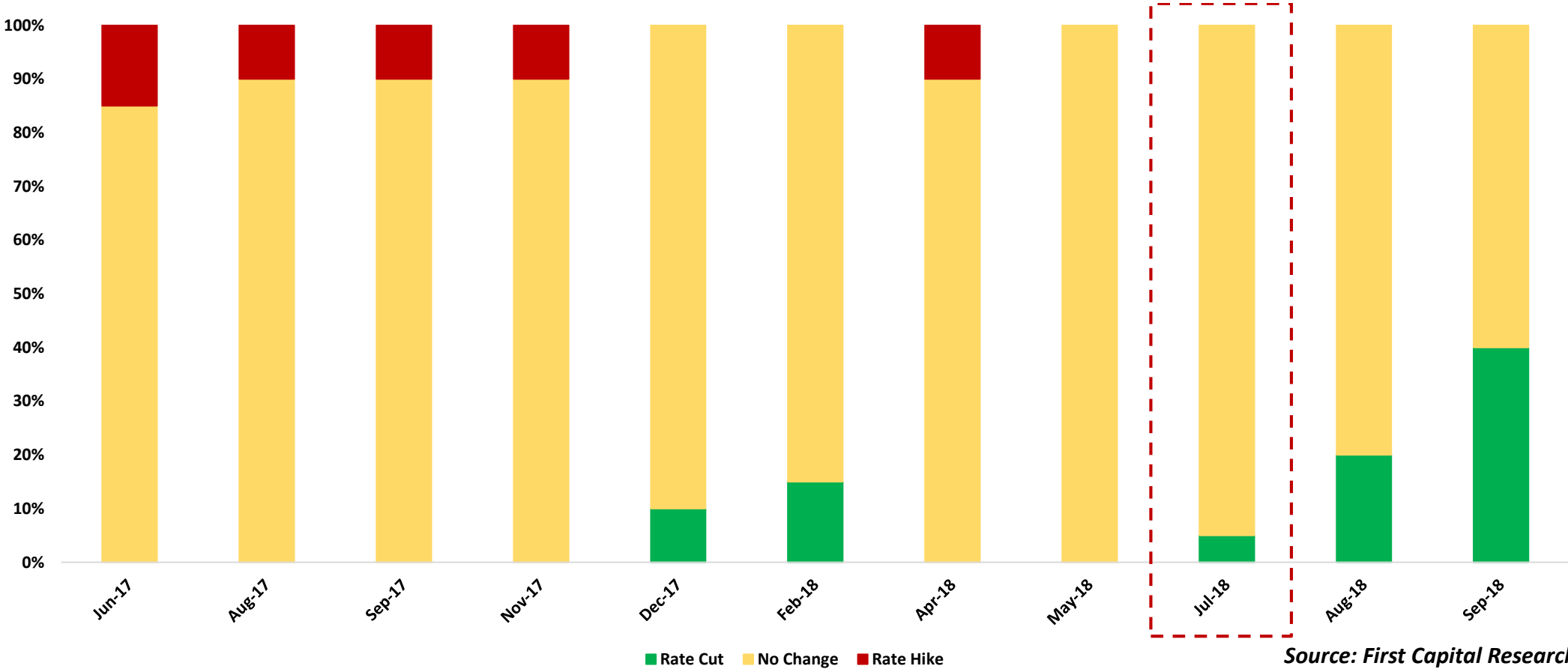
Expected Monetary Policy Stance by CBSL	Probability
Raising Policy Rates by 50bps	0%
Raising Policy Rates by 25bps	0%
Policy Rates to remain unchanged	95%
Cutting Policy Rates by 25bps	5%
Cutting Policy Rates by 50bps	0%

Probability increased to 5% from 0% in May 2018

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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