

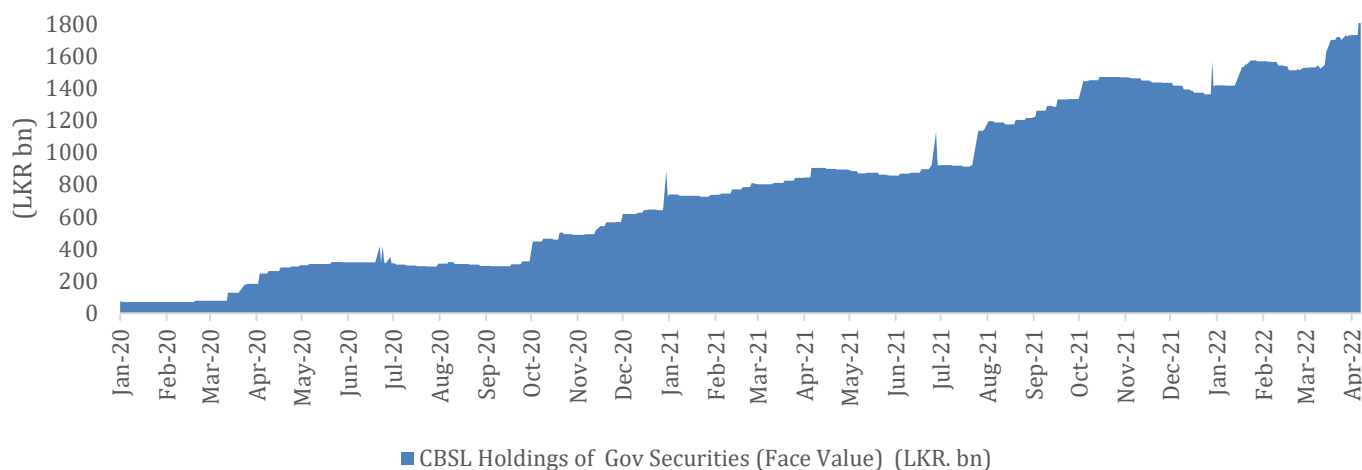
## CBSL tightens monetary policy with a monumental 700bps rate hike, making it the highest rate hike of the 21<sup>st</sup> century

CBSL has decided to increase the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 700 basis points each. The domestic as well as the external instabilities were stated as the reasons for such decisions as a result at this juncture, stability was sighted as the key metric as opposed to growth. Furthermore, credit card and all other interest caps will be removed.

CCPI Inflation continued its upward trend starting April'21, reaching 18.7% in Mar'22 significantly breaching the stipulated "6%" upper bound of the central bank. The increased money supply, currency depreciation, money printing and lower interest rates cumulatively brought on significant inflationary pressure on the economy, far exceeding the CBSL's target. Furthermore, the governor sighted an expectation of forward inflation reaching c. 25% levels as the key reason for the strong upward movement in policy rates.

Whilst completely halting money printing at the moment remains impractical, we view the 700bps rate hike as the first step in rectifying the excessive money printing witnessed over the recent past.

### The CBSL's holding of Government Securities



Source: CBSL, SSB Research

While we believe that tightening rates would somewhat curtail inflationary pressures, it should be noted that if government continues its rate hikes, the resulting decline in private sector credit growth may impact the previous growth oriented approach. Furthermore, these efforts were said to be in close coordination with the fiscal policy which may likely result in an increase of taxes as well as an increase in welfare transfers.

Given the nature of the economic dilemma faced by Sri Lanka, we believe that the interest rate cycle would be relatively shorter compared to previous gradual rate hikes as the current 700bps jump is primarily targeted to regain stability. However, following the achievement of relative stability, more emphasis may be placed on growth once the reigns of inflation are secured.

The Governor highlighted that the technical negotiations with the IMF have started, whilst a broader plan for restructuring the country's upcoming debt obligations remained a priority. However, he was quick to point out that there would be no quick fixes in an economic recovery and that conditions may deteriorate further prior to a recovery.

The Governor further stated that the SL's main crisis was its BOP deficit and as a result at the point of restructuring negotiations that local debt does not need to be restructured. As such, we believe such measures, if accurately implemented would gradually help rebuild Sri Lanka's image and investor confidence in the long run.

**Our take on equity:** We believe with the policy rate hike of 700bps, investors may increasingly shift towards fixed income investments as rates adjust upwards. Fund flows to the equity market may get impacted as margin trading rates may increase going forward. From the perspective of equity valuations, a spike in cost of capital may bring down valuations as increase in discount rates impacts present value of cash flows.

Companies that have higher leverage may see a significant increase in their finance expense impacting their earnings. However, we believe certain sector valuations have dipped drastically and offers value for medium to long term investors. For short term investors, stock picking would be a relatively better strategy than looking at the overall index is our belief.

At this juncture if foreign funds were to consider an investment following the news of fruitful negotiations with the IMF, a couple of key advantages include valuations being at the lowest in Sri Lanka's post-war capital markets, and the major devaluation of the LKR c.f. the USD which has resulted in the ASPI dropping below the covid scare of 2020 in USD terms.

Furthermore, speculative funds may look to capitalize on an overshoot of the exchange rate following the sudden switch from a fixed to a floating rate, which has historically resulted in a major devaluation in the short term followed by a settling of the currency in the medium term (as witnessed in case studies of peer countries).

## Softlogic Stockbrokers (Pvt) Ltd

Level #16, One Galle Face Tower, Colombo 02

Sri Lanka

**Telephone** +94 117 277 000 | **Fax** +94 117 277 099

**E-mail** research@softlogicstockbrokers.lk

### Equity Sales

Dihan Dedigama	dihan@softlogic.lk	+94 11 7277010 / +94 117277955, +94 777689933
Hussain Gani	gani@softlogic.lk	+94 11 7277020 / +94 777992086
Prasanna Chandrasekera	prasanna.chandrasekera@equity.softlogic.lk	+94 11 7277056
Eardley Kern	e.kern@equity.softlogic.lk	+94 11 7277053, +94 777348018
Andre Lowe	andre.lowe@equity.softlogic.lk	+94 11 7277052, +94 777230040
Dilip Fernando	dilip.fernando@equity.softlogic.lk	+94 11 7277000, +94 77 3379730
Dinesh Rupasinghe	dinesh.rupasinghe@equity.softlogic.lk	+94 11 7277059, +94 77 2072397
Tharindu Senadeera	tharindu.senadeera@equity.Softlogic.lk	+ 94 11 7277000, +0773505094
Madushanka Rathnayaka	madushanka.rathnayaka@equity.softlogic.lk	+94 34 7451000, +94 773566465
Gratian Nirmal	gratrain.nirmal@equity.softlogic.lk	+94 774510000/+94 21 7451 000
Krishan Williams	krishan.williams@equity.softlogic.lk	+94 31 7451000, +94 773569827
Lakshan Rathnapala	lakshan.rathnapala@softlogic.lk	+94 11 7277000, 077 8329698
Asitha Bandara	asitha.bandara@softlogic.lk	+ 0718740019

### Equity Research

Mahesh Udugampala

mahesh.udugampala@softlogic.lk

+94 11 7277030, +94 769 637 638

Shadini Silva

shadini.silva@softlogicstockbrokers.lk.lk

+94 11 7277032, + 94 773 627 792

Thuvarakan Senthilmani

thuvarakan.senthilmani@softlogic.lk

+94 11 7277031, +94 77 5015637

Raynal Wickremeratne

raynal.Wickremeratne@softlogicstockbrokers.lk

+94 11 7277034, +94 77 5268282

Nishanthi Hettiarachchi

nisha.hettiarachchi@softlogicstockbrokers.lk

+94 11 7277033, +94 77 1078499

Technical Analyst - Saditha Kaluarachchi

saditha.kaluarachchi@softlogic.lk

+94 11 7277033, +94 77 4244526

### Disclaimer

#### Local & Non-USA based clients

*The information contained in this report is for general information purposes only. This report and its content is a copyright of Softlogic Stockbrokers and all rights reserved. This report- in whole or in part- may not, except with the express written permission of Softlogic Stockbrokers be reproduced or distributed or commercially exploited in any material form by any means whether graphic, electronic, mechanical or any means. Nor may you transmit it or store it in any other website or other form of electronic retrieval system. Any unauthorised use of this report will result in immediate proceedings.*

*The report has been prepared by Softlogic Stockbrokers, Sri Lanka. The information and opinions contained herein has been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. Such information has not been independently verified and no guaranty, representation or warranty, express or implied is made as to its accuracy, completeness or correctness, reliability or suitability. All such information and opinions are subject to change without notice. This document is for information purposes only, descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as, an offer, or solicitation of an offer, to buy or sell any securities or other financial instruments. In no event will Softlogic Stockbrokers be liable for any loss or damage including without limitation, indirect or consequential loss or damage, or any loss or damage whatsoever arising out of, or in connection with the use of this report and any reliance you place on such information is therefore strictly at your own risk.*

*Softlogic Stockbrokers may, to the extent permissible by applicable law or regulation, use the above material, conclusions, research or analysis in which they are based before the material is disseminated to their customers. Not all customers will receive the material at the same time. Softlogic Stockbrokers, their respective directors, officers, representatives, employees, related persons and/or Softlogic Stockbrokers may have a long or short position in any of the securities or other financial instruments mentioned or issuers described herein at any time and may make a purchase and/or sale, or offer to make a purchase and/or sale of any such securities or other financial instruments from time to time in the open market or otherwise, in each case either as principal or agent. Softlogic Stockbrokers may make markets in securities or other financial instruments described in this publication, in securities of issuers described herein or in securities underlying or related to such securities. Softlogic Stockbrokers may have entirely underwritten the securities of an issuer mentioned herein.*