

MARKET UPDATE

10.10.2024

AN APPRECIATING LKR, ENHANCED DEMAND, DECREASING INTEREST RATES & FAVORABLE COMMODITY PRICES, SET TO FAVORABLY IMPACT BUSINESSES



Appreciating LKR

A stronger LKR offers multiple benefits for companies, especially in sectors that rely on imports. Lower input costs for raw materials lead to improved profit margins for manufacturers, pharmaceuticals, and construction firms, as the cost of imported goods declines. Additionally, reduced prices from imports can stimulate consumer demand, further boosting revenues. Moreover, companies with significant foreign loan exposure benefit from reduced debt servicing costs.



Declining Interest Rates

Falling interest rates are expected to reduce borrowing costs, which will help cushion profit margins and free up cash for investments and debt repayments. This environment may also encourage companies to take on more debt, potentially boosting demand in sectors such as retail and real estate, as businesses leverage cheaper financing options for expansion and growth.

AN APPRECIATING LKR, ENHANCED DEMAND, DECREASING INTEREST RATES & FAVORABLE COMMODITY PRICES, SET TO POSITIVELY IMPACT BUSINESSES



Recovering Retail Demand

Sri Lanka's ongoing economic stabilization, marked by slowing inflation and a stabilizing local currency, is expected to boost consumer purchasing power. Additionally, lower interest rates should make loans more affordable, encouraging spending on non-essential goods and services. Declining global commodity prices further help reduce costs, which can stimulate demand as consumers benefit from lower prices across sectors. These factors collectively position the economy for a potential recovery in consumer demand in our view benefiting the listed counters.



Declining/Stable Commodity Prices

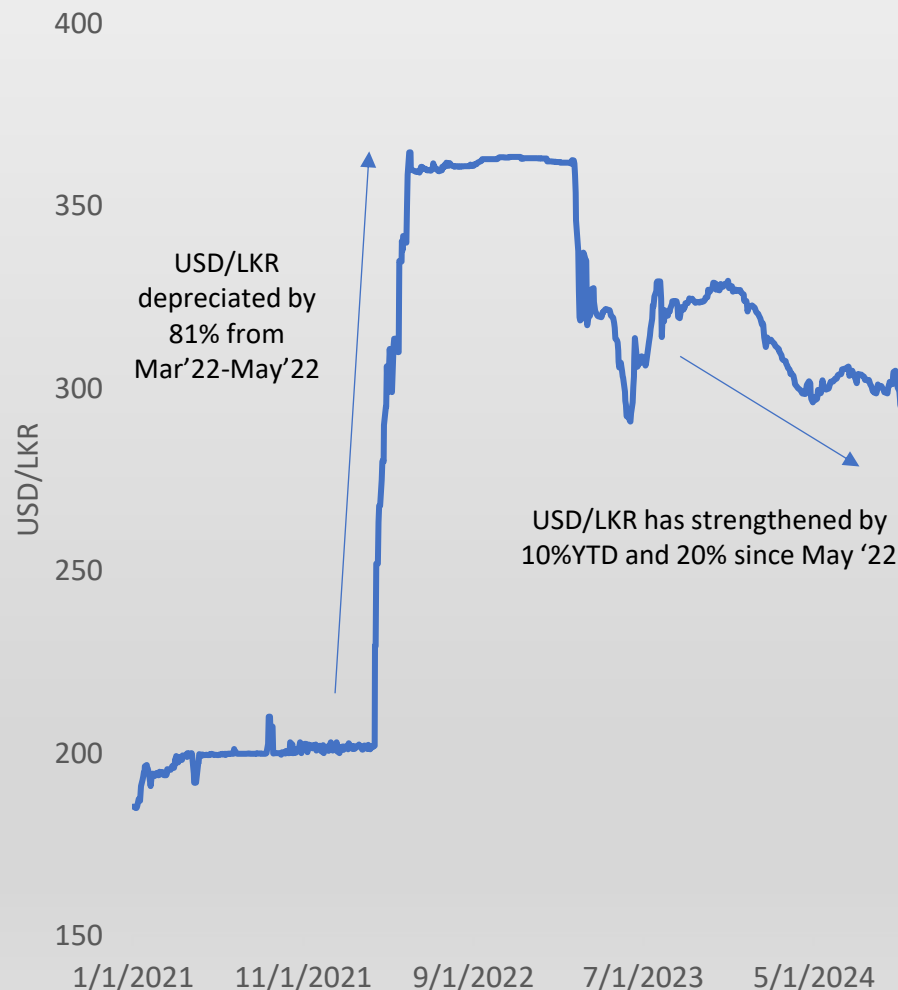
Decline in overall commodity prices presents a favorable scenario for many businesses specially with many companies expected to benefit from lower input cost, leading to enhanced profitability. Companies that strategically utilize the decrease in commodity prices can position themselves more effectively in competitive market landscape



Appreciating LKR

STRONGER CURRENCY LEADS TO IMPROVED PROFITABILITY

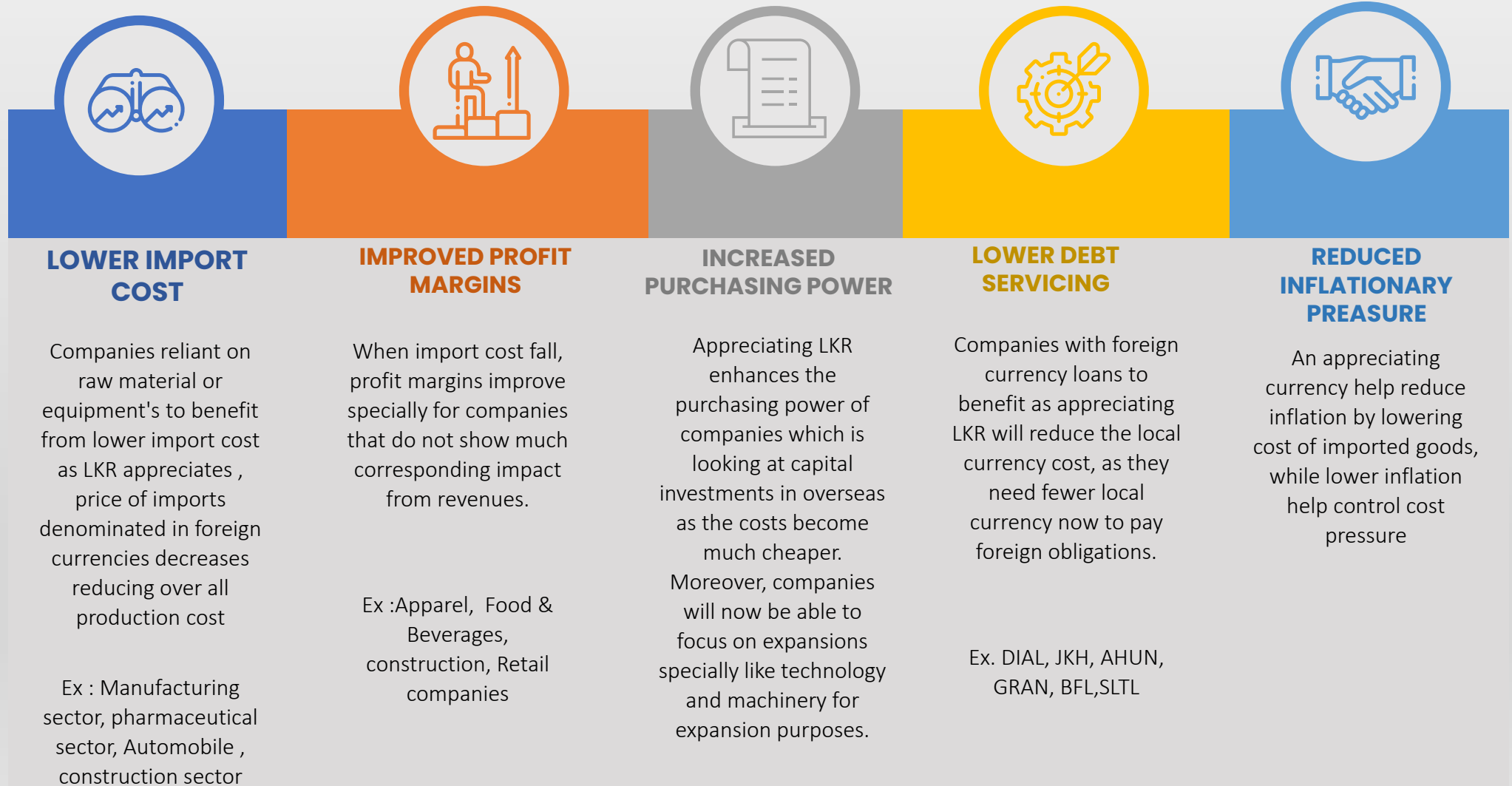
USD/LKR COULD STABILIZE IF OVERALL POSITIVE OUTLOOK PERSIST



- LKR has appreciated by 9.6% YTD and 20% from the all-time high levels in May '22 (Spot rate of LKR to USD is at LKR 292.91 as at 10/10/2024, appreciated from LKR 323.99 as at 01/01/2024 and LKR 364.76 in May'22)
- We anticipate the exchange rate to stabilize despite temporary uptick during upcoming festive season, driven by strong remittance inflows, which have increased by 11% YoY from January to August, along with a robust rise in tourism revenue, up 66% during the same period. Additionally, the narrowing trade deficit (narrowed by 29%MoM to USD 429Mn in Aug'24) and an overall positive outlook are contributing to improved sentiment, further supporting the stabilization of the local currency.

COMPANIES TO SEE PROFITS SURGE AMID LOWER IMPORT COSTS

REDUCED INFLATIONARY PRESSURE , IMPROVED PROFIT MARGINS , INCREASED PURCHASING POWER TO FOLLOW

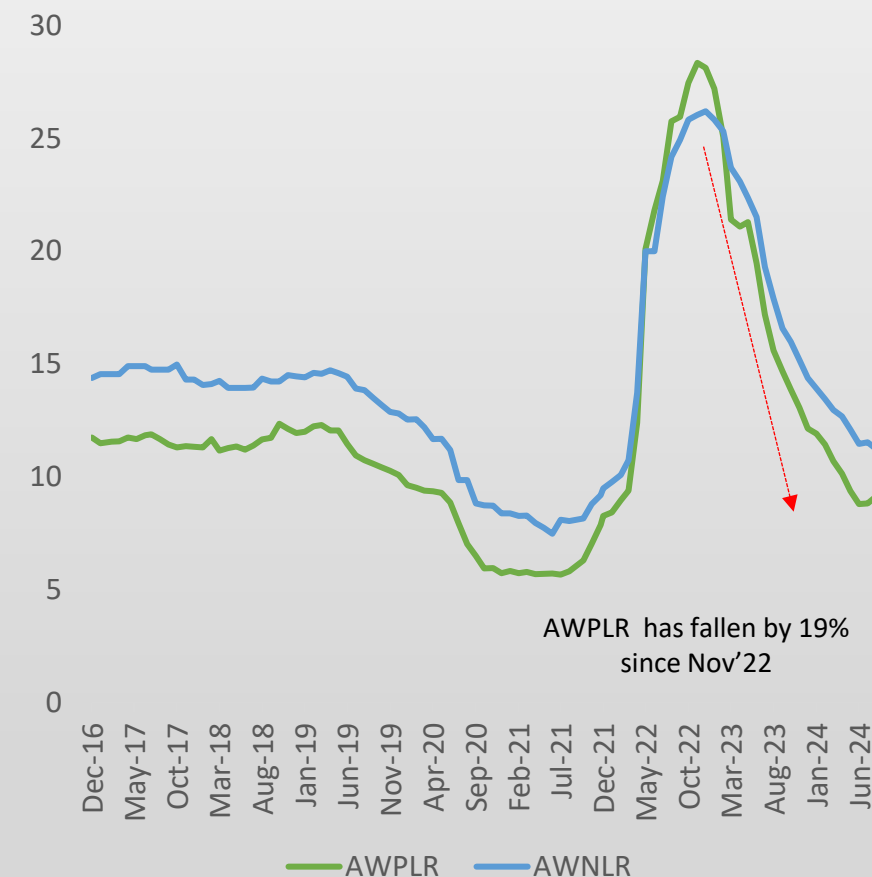




Declining Rates

LOWER RATES TO SUPPORT BOTTOM LINES OF LISTED ENTITIES

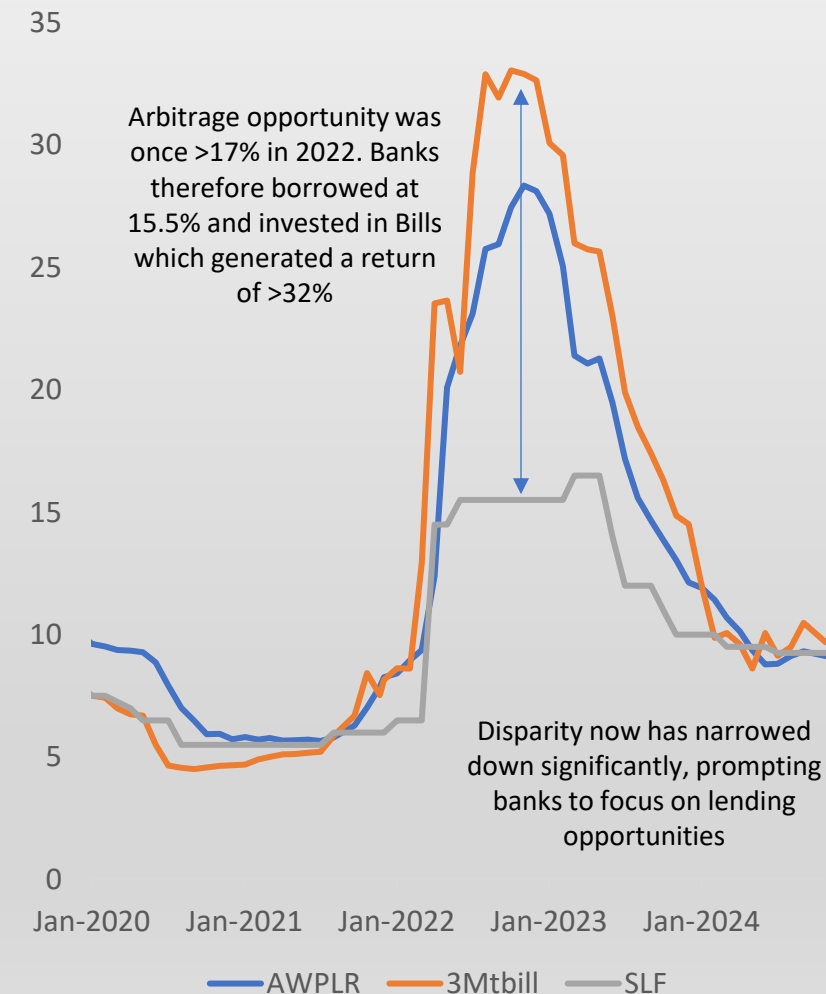
COMPANIES TO FURTHER BENEFIT WITH POTENTIAL DECLINE IN RATES



- Over the past two years, Sri Lanka's interest rates have seen significant fluctuations, driven by efforts to manage the economic crisis and curb high inflation. Rates which were hovering around 28% levels now have dropped down to 9.31% due to strict policy measures implements to tame the inflation.
- This has resulted in lower interest burden specially for companies with high gearing ratios resulting in enhance cashflows and stronger financial stability
- We expect the interest rates to fall even further, specially on the back of low inflation where CBSL could pivot toward a more accommodative monetary policy by reducing rates further. We expect highly geared counters like SINS, HAYL, DIAL,AHUN,CCS,DIMO,KHL,SHL to benefit.

BANKS COULD DIVERSIFY THEIR PORTFOLIO FROM T-BILLS TO LOANS

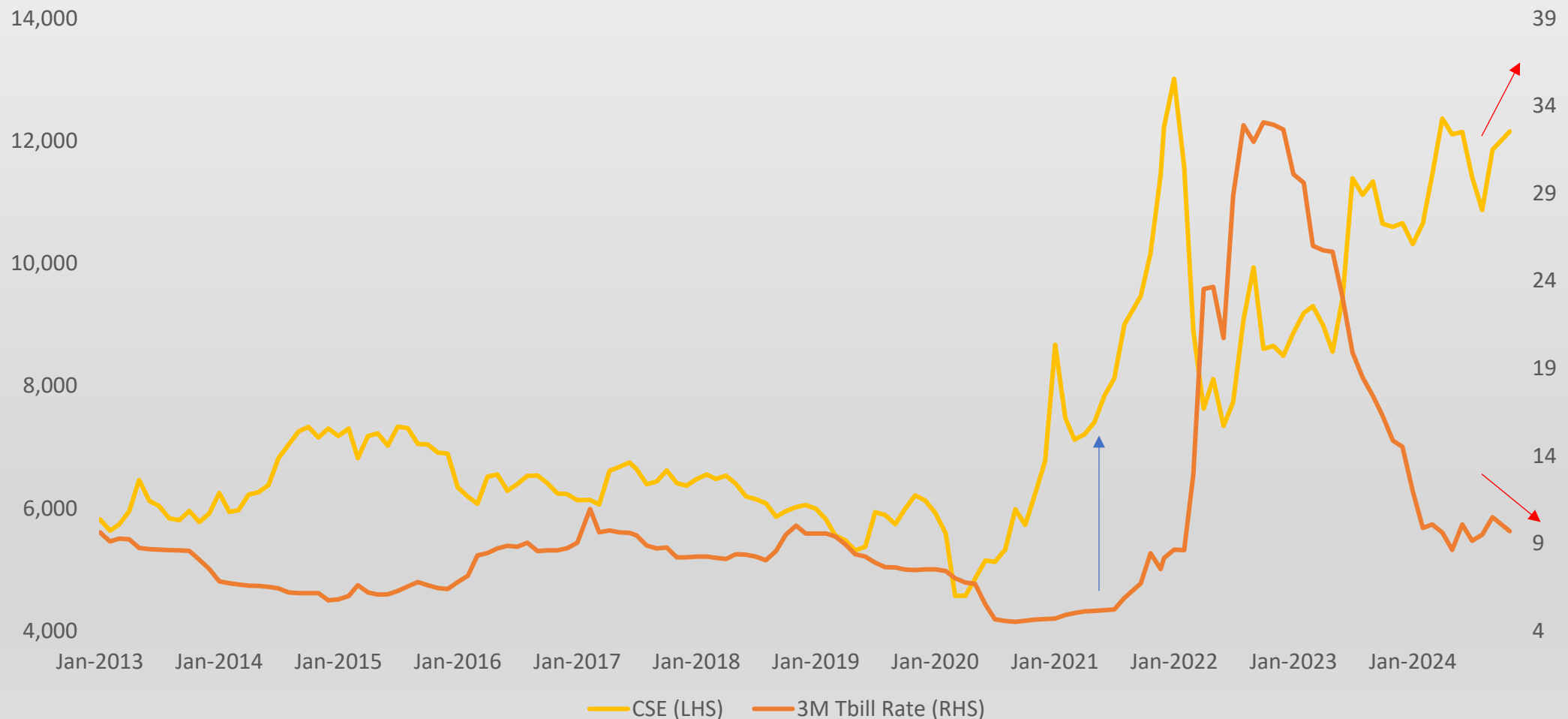
ARBITRAGE OPPORTUNITY HAS NARROWED DOWN BETWEEN BILLS AND POLICY RATES



- The arbitrage between Treasury bill (T-bill) rates and policy rates had previously been significantly high, encouraged banks to invest in government securities after borrowing from central banks at lower rates. For instance, when the policy rates were at 15.5% in Aug'22, 3-month T-bill rates hovered around 33% where banks had an arbitrage opportunity to park their excess liquidity in the form of government bonds and bills after borrowing from CBSL at a lower rate.
- However, recent developments indicate that this gap is narrowing. T-bill rates have fallen below 10% levels when the policy rates are now at 9.25%, suggesting banks may now be more inclined to allocate their funds towards loan disbursements rather than government securities, potentially leading to lower borrowing costs and stimulating investments in the economy.
- This realignment could enhance liquidity in the market, making financing more accessible and fostering economic growth.

A STRONG CASE FOR EQUITY MARKET RECOVERY & EXPANSION

MARKETS POISED TO REACH HIGHER DRIVEN BY EXPECTED DROP-IN RATES, LOW VALUATIONS, AND POSITIVE ECONOMIC OUTLOOK.





**Recovering
Consumer Demand**

CONSUMER DEMAND IS ALREADY PICKING UP

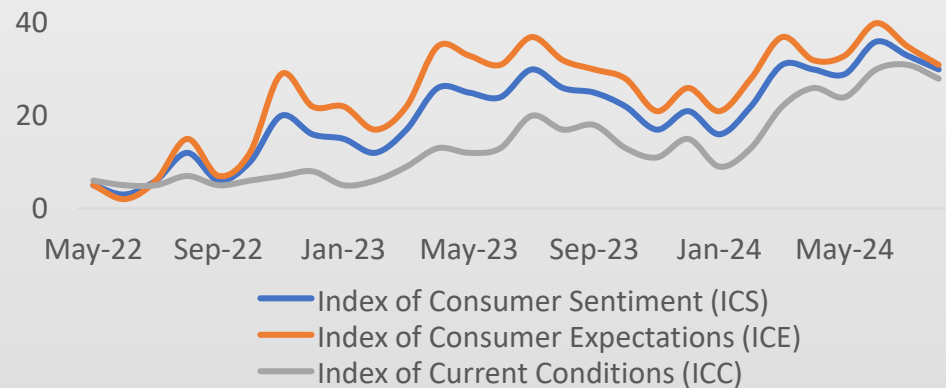
HIGHER DISPOSABLE INCOME BACKED BY INCREASED SALARIES FOR GOVERNMENT EMPLOYEES AND LOWER INCOME TAX TO FURTHER STIMULATE DEMAND. LOW-INTEREST RATE ENVIRONMENT TO SUPPORT

- Consumer demand in Sri Lanka has shown notable signs of recovery, supported by various key indicators. Electricity consumption for instance has been on the rise, reflecting improved household and business activities. Cement sales have also picked up signaling a rebound in construction and infrastructure activities. Additionally, credit card usage and foot fall in supermarkets have also surged indicating strong retail demand and higher spending on both essential and nonessential goods.
- The real estate market, particularly condominium sales, has showed renewed interest, where prices and new projects rising in the recent past suggesting confidence in long term investments. Looking ahead, government policies as such as expected salary increase for public sector employees and potential reduction in personal income taxes are poised to boost disposable income, further stimulating consumer demand. Together with low interest rate environment, which is making borrowing more affordable, these factors are set to support and accelerate consumer demand in the coming years.
- These developments in our view reflect growing optimism in Sri Lanka's economic recovery, which is likely to translate in to more robust retail and investment landscape.

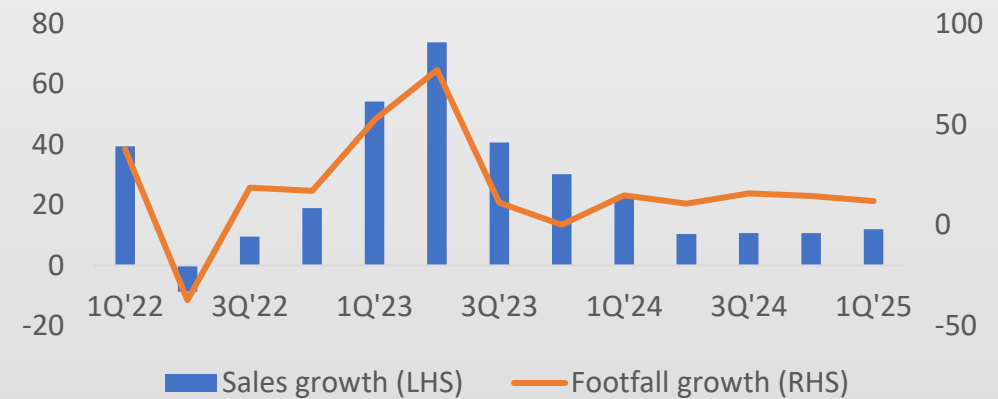
CONSUMER CONFIDENCE IS GRADUALLY GAINING MOMENTUM

HIGHER FOOT FALL IN MODERN TRADE, HIGHER CEMENT PRODUCTION IMPLY ECONOMIC RECOVERY

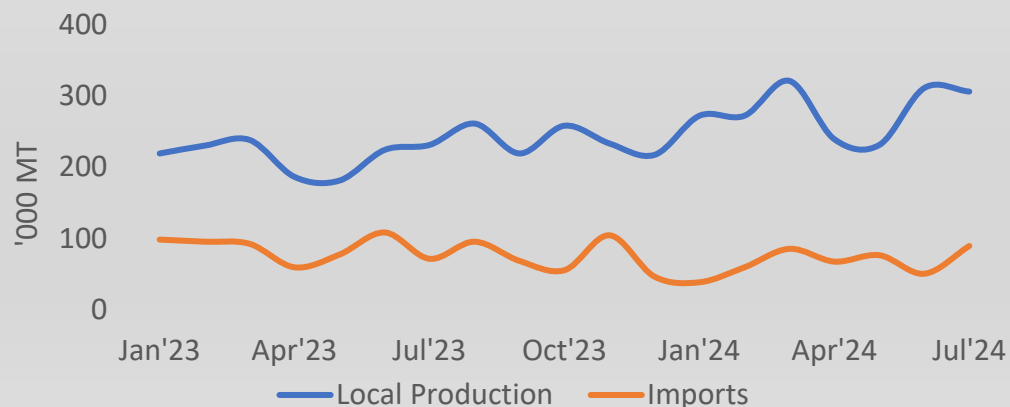
Consumer Confidence is gradually strengthening



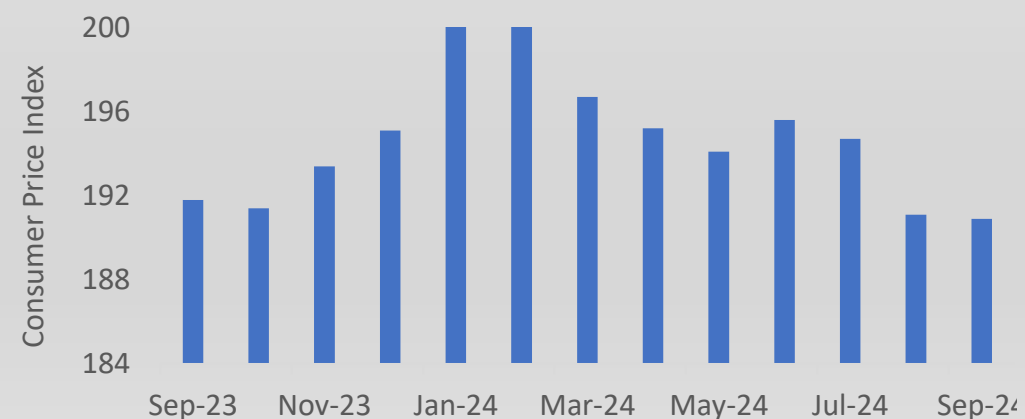
Growing footfall to boost sales



Cement production and imports are on the rise



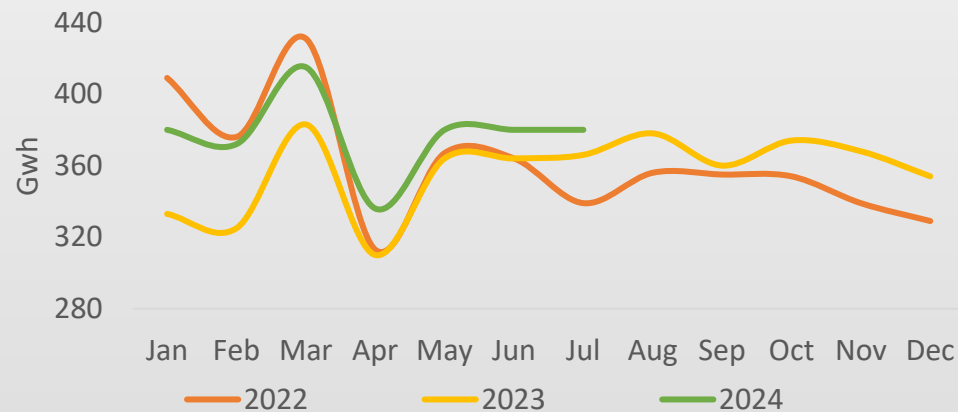
Falling CPI to drive up consumer purchasing power



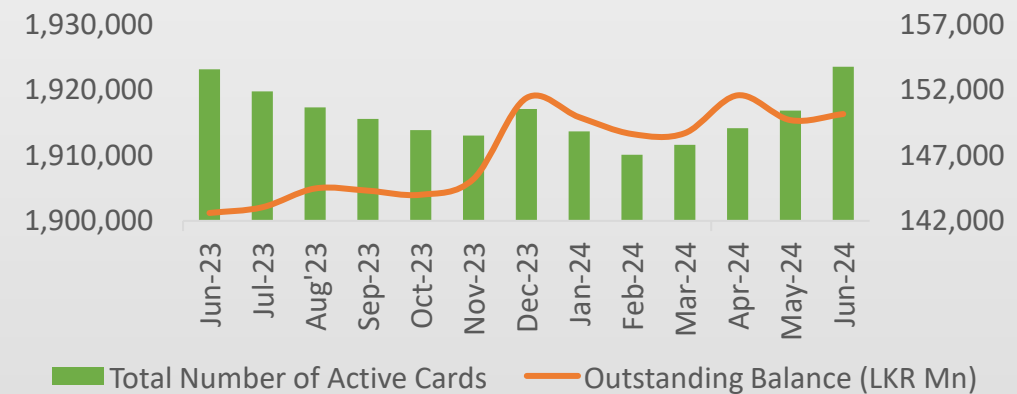
CREDIT CARD USAGE IS PICKING UP ALONG WITH ELECTRICITY CONSUMPTION

CONDOMINIUM PRICES ARE PICKING UP AFTER MANY DULL QUARTERS

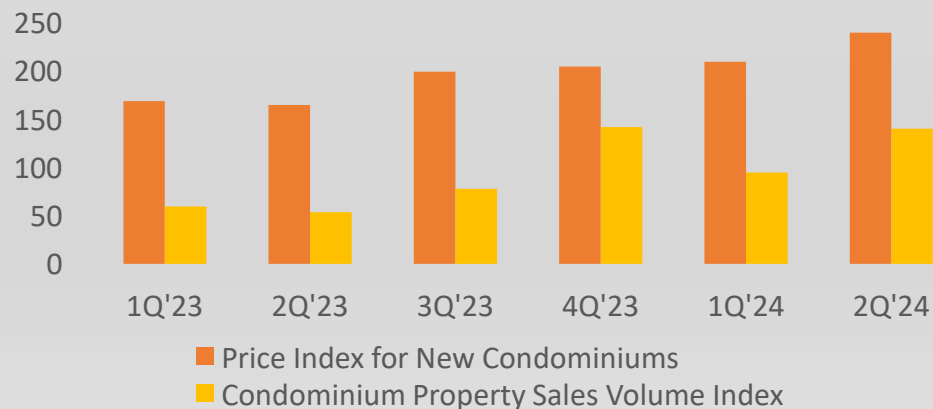
Electricity usage picking up indicating higher activities



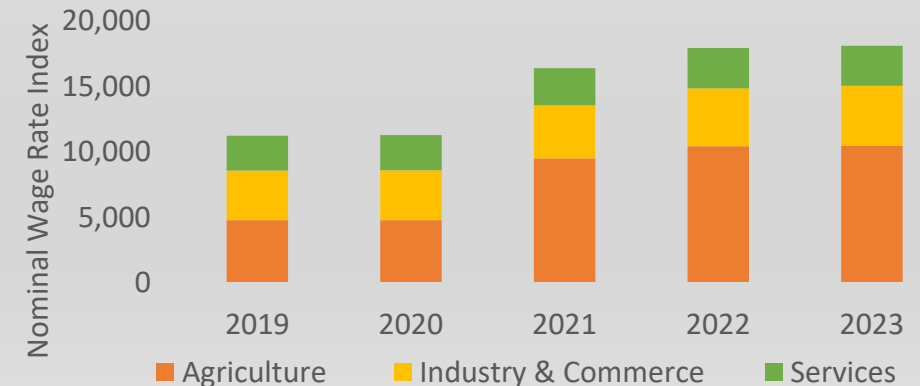
Rising credit card usage signals economic upturn



New project launches are driving up condominium prices



Rising wage rates to boost consumer demand

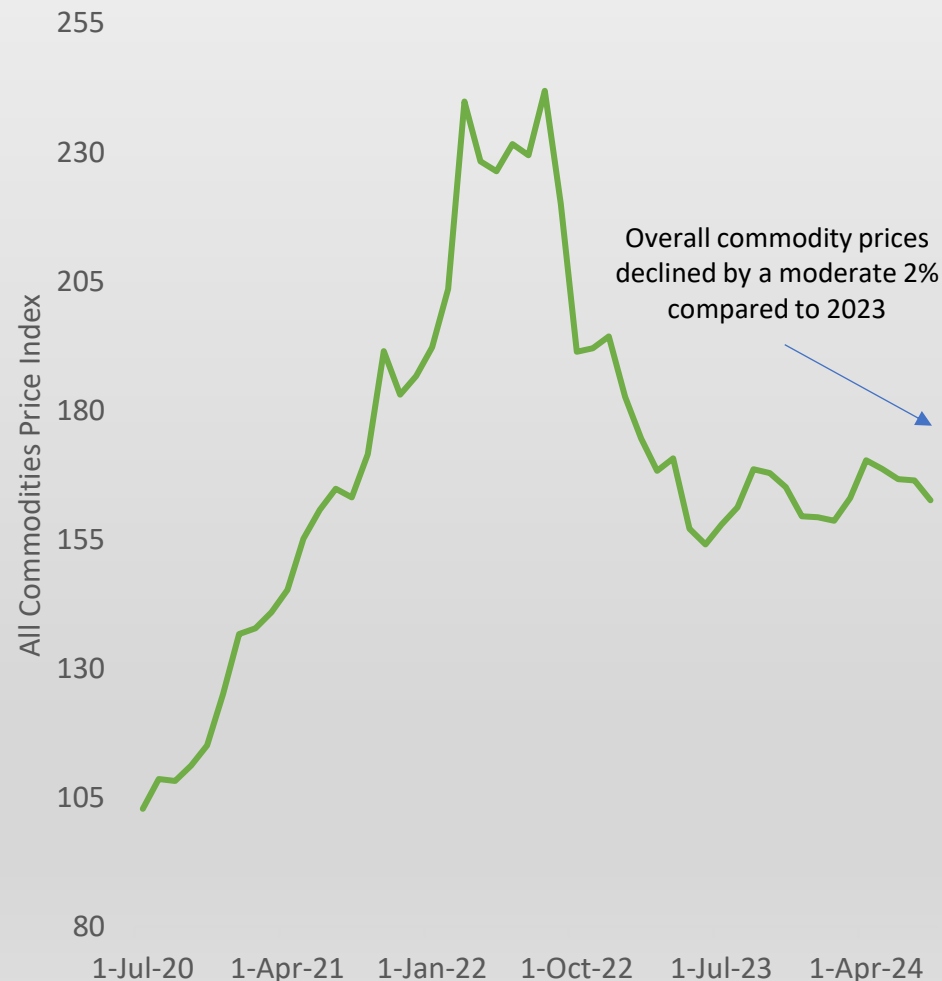




**Stable Commodity
Prices**

OVERALL COMMODITY PRICES ARE TRENDING DOWN HELPING COMPANIES

WE REMAIN CAUTIOUS ON POSSIBLE INCREASE IN PRICES , HOWEVER STRONGER LKR COULD MITIGATE THE IMPACT



- Global commodity price index signals a drop in global commodity prices compared to 2023. Though oil prices fluctuated due to geopolitical tensions, overall commodity prices saw modest decrease due to lower natural gas and coal costs. Agricultural prices remained largely stable with changes in food and fertilizer prices while metals too saw minimal volatility.
- These falling commodity prices can benefit companies by reducing input cost, leading to improved margins (despite some companies which are export oriented facing some challenges).
- However, we remain cautious on possible increase in prices driven by rising demand from China's recovery, impending Fed rate cuts and heightened tensions in red sea due to ongoing conflicts. However, these price increases could be temporary as improvements in supply could offset demand. A stronger LKR meanwhile should also compensate the impact to a greater extent in our view. .

FALLING COMMODITY PRICES TO BOOST OVERALL ECONOMY

FALLING COMMODITY PRICES, COUPLED WITH STRONG LKR, TO BOOST CORPORATE MARGINS

Commodity	Unit	Avg prices 2023	Avg prices 2024	Prices as at Sep'24	Price changes against 2023	Impact on CSE	Comment
Brent oil	USD/Bbl	82.6	82.7	74.3	-10%	LIOC	Reduction in brent prices will have positive impact on the overall economy given that SL heavily depend on oil imports helping to reduce the import bill, reduce inflation and boost consumer demand. Though there could be pressure on the margins for LIOC due to fuel price formula, we expect the impact to be largely offset by strong consumer demand.
Diesel	USD/Gallon	4.21	3.83	3.54	-16%		
Cotton	USD/Kg	2.09	1.95	1.82	-13%	TJL, MGT, HELA	Reduction in global cotton prices to benefit the apparel sector, lowering production cost.
Wheat	USD/MT	340	272	270	-21%	BFL, GRAN, TAFL	Feed cost reduction and lower input cost to benefit the industry
Maize	USD/MT	253	188	185	-27%		
Fertilizer (urea)	USD/Tonne	358	331	338	-6%	CIC, AGST	Declining fertilizer prices together with rising fertilizer subsidies to increase production volumes
Sugar (U.S)	USD/Kg	0.89	0.85	0.80	-10%	CCS, COCO, SUN	The companies involved in food and beverage production, including confectionary that use sugar as one of key ingredient could boost profitability with lower production costs due to the decline in sugar prices.

RIISING DEMAND COULD HOWEVER INCREASE PRICES

HOWEVER HIGHER SUPPLY AND STRONGER LKR COULD MITIGATE THE IMPACT

Commodity	Unit	Avg prices 2023	Avg prices 2024	Prices as at Sep'24	Price changes against 2023	Impact on CSE	Comment
Jet Fuel	USD/Gallon	2.70	2.42	1.99	-26%	Tourism Industry	Positive for tourism industry and trade balance as a whole
Barely	USD/MT	167	141	138	-17%	LION, BREW	Companies engaged in producing beer and alcoholic beverages that use barely as one of their key ingredients to benefit
Rice, Thailand	USD/MT	529	589	555	5%		
Aluminum	USD/Tonne	2,256	2,367	2,450	9%	ACL, ALUM, LALU, SIRA	Aluminum and Copper prices have risen compared to 2023, as prices experienced a significant decline during that year. However, YTD prices are gradually declining.
Copper	USD/Tonne	8,490	9,131	9,237	9%		
Palm Oil	USD/MT	886	903	983	11%	SUN, WATA	SL is considering lifting the ban on palm oil cultivation, given that high import prices could create an opportunity for local companies
Coal, Australia	USD/MT	188	142	149	-21%		Beneficial for the country as a whole as coal is one of the main sources of electricity generation

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