Sri Lanka

Sri Lanka Markets Update

Daily Market Note

Domestic Markets

- **USD/LKR spot closed at 130.20/35 against an opening level of 130.55/75**
- **Spot opened trading today at 130.30/50 and is currently trading at the same level.**
- **Overnight liquidity was a surplus of LKR 93.1 Bio and O/N Money averaged at 5.74%**

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Reuters HSBS

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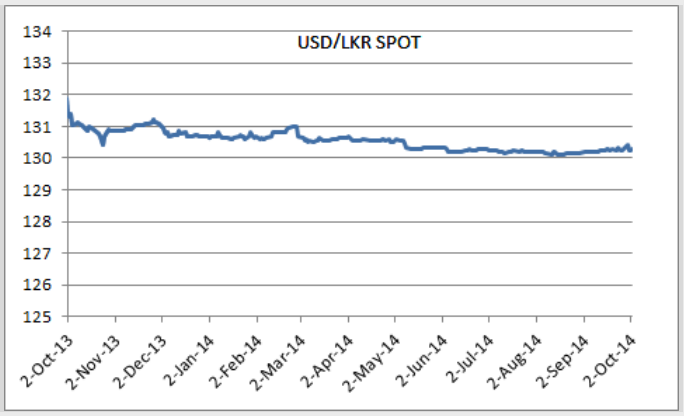
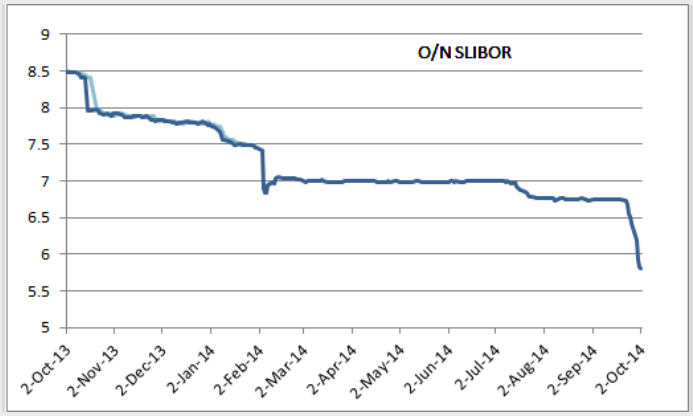
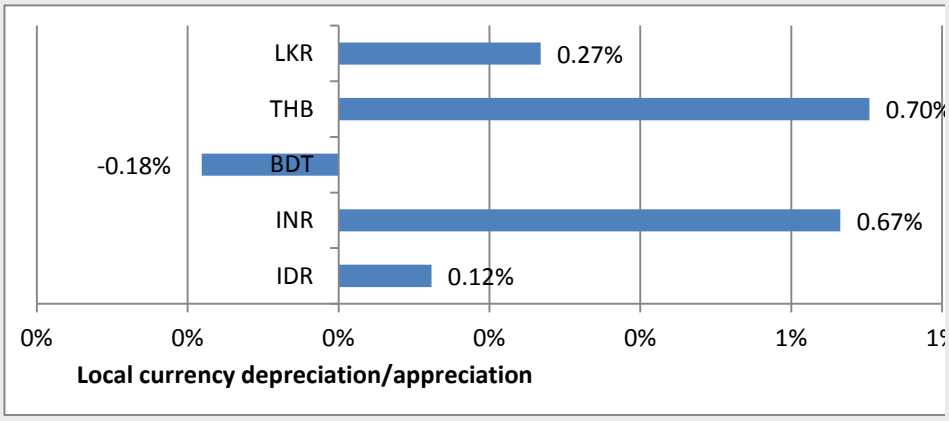


Source : Reuters (02/10/14)



Source : Reuters (02/10/14)

- **Regional Currency Performance against USD**



Source : Reuters (01/01/14 to 02/10/14)

- **Liquid 2016 and 2018 bonds closed at 6.30/6.60 and 6.75/85 respectively.**
- **Equities closed 58 points higher**

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USD/LKR Spot-closing (October 2) 130.30/50 **Inter Bank call money (October 2) 6%-8.5%**

USD/LKR forward Premiums

3 mth	91/121 cents
6 mth	198/238 cents
12 mth	390/450 cents

Treasury Bill Rates – Auction rates - net of tax

3 mth	6.15%
6 mth	6.23%
12 mth	6.26%
USD Sovereign Bond	
2015	3.04%
2020	4.62%

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O/Night	5.81%
1 Month	6.42%
3 Month	6.64%
6 Month	7.86%
12 Month	7.10%

Economic Indicators

All share Price index	7,351.05 (7,293.08)
S&P SL 20 Index	4,107.36 (4,065.11)
Daily Turnover	2.462 Bn (2.654 Bn)
Consumers Price Index	181.9 (September 2014)
Inflation y-o-y %	3.5% (September 2014)
Inflation 12m moving ave	4.2% (September 2014)

CBSL SDFR	6.50% (January 2014)
CBSL SLFR	8.00% (January 2014)
Statutory Reserve Ratio	6.00% (June 2013)
GDP Growth	7.8% (2014 2Q)
Gross Official Reserves	$ 9 Bn (July 2014)
Government Revenue	$ 8.75 Bn (2013 CBSL Annual Report)
Government Expenduture	$ 12.84 Bn (2013 CBSL Annual Report)
Unemployment	4.1% (2014 1Q)
Outstanding External debt	$ 39.7 Bn (2013 CBSL Annual Report)
Exports	$ 6.393 Bn (Jan-July 2014)
Imports	$ 10.830 Bn (Jan-July 2014)
Trade Deficit	$ 4.436 Bn (Jan-July 2014)

Derivatives – IRS (Bid)

	USD	GBP	AUD	EUR
2 Year	0.7690	1.1640	2.7400	0.1838
5 Year	1.8380	1.8790	3.3200	0.4413
10 Year	2.5440	2.3890	3.8150	1.1075

Central Bank rates

NZD	3.50%	AUD	2.50%
GBP	0.50%	USD	0.25%
CAD	1.00%	EUR	0.05%
CHF	0.25%	JPY	0.10%

Stock Markets

DJI (USA)	16,801.05 (-0.02%)
Nikkei 225	15,607.70 (-0.35%)
FTSE 100	6,446.39 (-1.69%)

International Currency Markets

USD/JPY	108.81	JPY/LKR	1.2003
GBP/USD	1.6129	GBP/LKR	211.53
EUR/USD	1.2653	EUR/LKR	164.96
AUD/USD	0.8789	AUD/LKR	114.71
USD/CAD	1.1171	CAD/LKR	117.58

Commodity Markets

Gold	$ 1,212.44
IPE brent	$ 91.03
WTI	$ 90.97

LIBOR - USD

3 mth	0.231%
6 mth	0.324%
12mth	0.568%

US Treasuries

5 yr	1.70%
10yr	2.440%
30yr	3.150%

Asian Currencies

USD/IDR	12,145
USD/INR	61.53
USD/THB	32.45

Source: Reuters/Daily FT

*All rates above are for indicative purposes only.

FX Edge

USD-JPY slippage; near-term USD risks versus medium-term bullishness

USD-JPY's pullback is consistent with increased "risk off" bias. Japanese investment flows in Q3 show more consistent investment abroad. The USD more broadly has retraced as most other G10 currencies have corrected higher and as front-end US yields have eased from this week's highs. There may be further near-term risks of USD slippage if Friday's US jobs data disappoints, but those short term risks do not change our medium-term expectations for further USD gains, which we reaffirm in a new Currency Special report and revised forecasts.

Risk-off can still matter

The wave of "risk off" bias that developed Wednesday has left some funding currencies, such as the JPY, at markedly higher levels. The USD has moved off its recent highs, commensurate with the gains in most other G10 currencies as well as with the drop in US yields that has accompanied the risk off bias. We view the latest shift in currencies as corrective rather than representing a structural/sustainable trend change, given that the underlying conditions that have driven financial markets in recent months remain very much in place--primarily relative central bank policy operations and expectations, and the accompanying growth/inflation dynamics behind them. However, that does not mean the current pullback in the USD and gains in other currencies cannot continue in the short-term, given the unpredictability of swings in risk appetite, as well as the scope for even some modest scaling back of the considerable short positions that have been built up in currencies such as the EUR and JPY.

USD-JPY's decline has concurred has concurred with the slide in US and Japanese equities, after the S&P 500 dropped 1.4% Wednesday and the Nikkei-225 fell 2.6% overnight. In addition, markets will also be tempted to relate the drop in the currency pair to the relatively steep drop in the US Treasury 10-year note yield, which fell 9bp Wednesday to 2.39% and is down 20bp from its recent closing high of 2.61%. Although we would not dismiss impact of the drop in the 10-year yield on USD-JPY, we would note that the correlation between the two has not been so strong in the past two months. That said, we do think the drop in shorter-term US yields is a factor in the broader USD pullback, and would note that 2-year USD swap yields have fallen to 0.78% today from Tuesday's intraday peak of 0.84%.

Japanese capital outflows evident

Also in Japan, domestic investors continued to allocate funds abroad and last week purchased JPY184bn in foreign bonds and JPY393bn in foreign equities. The timing, for the week ended September 26, coincides with Japan's fiscal half-year end and suggests that previous patterns (or at least expected patterns) of capital repatriation back into Japan at such "book closing" periods are not evident in the way they may have been historically. In fact, the flow data for calendar Q3 shows pretty consistent outflows from Japanese investors, as they purchased a net JPY3,259bn in foreign bonds and JPY2,134bn in foreign equities over the period. That should not automatically be assumed to correlate with or generate JPY declines, in part because it does not take into consideration any currency hedging that might accompany the deployment of capital abroad and also because foreign investor purchases of Japanese bonds and stocks over the same period (JPY5,077bn) nearly matched the amount of Japanese capital outflows. Nonetheless, markets continue to speculate that reforms at Japan's large pension funds, led by the government's GPIF, will result in both higher allocations of funds abroad and as well as into domestic equities, both of which would imply downward pressure on the JPY. And the cross border flow data over Q3 indicate that capital outflows have picked up in advance of the anticipated GPIF reform announcements.

US data focus

We mentioned that the drop in front-end US yields in the past day is a contributor to--or at least consistent with--the pullback in the USD. Although some considerable element of the yield drop has been related to the "risk off" bias evident in equities, softer readings on some of the economic data may also be a factor. The September ISM Manufacturing Index fell to 56.6 from 59.0 in August and while still well above the 50% break-even level, it was two points weaker than expected. August construction spending fell 0.8% m/m versus an expected gain of 0.5%, and the July figures were revised down to a 1.2% gain from 1.8%. And September vehicle sales were also lower than expected, coming in at a 16.3m annual rate, down from a 17.4m pace in August and versus an expected rate of 16.8m.

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Short-term risks versus medium-term opportunities

We mention those reports in the context of the upcoming US employment data due Friday and the potential impact it will have on Fed policy expectations and front-end US yields. In simple terms, two-year USD swap yields have risen notably over the summer (notwithstanding the 6bp pullback from this week's high at 0.84%) and that has concurred with the USD's gain over that period, with the Dollar Index (DXY) up over 7% since the beginning of July. We view the rise in both yields and the USD as closely related to the realization that Fed rate hikes are likely to start within the next year. If Friday's jobs data disappoints, it may not ultimately impact the actual timing and pace of eventual Fed tightening. However, it could indeed impact the market's perceived risk of the timing and scope of rate hikes. The higher level of yields and the USD in recent months suggest the shorter term risks lie more with a weaker report than a stronger one, as weaker data may argue for a more dovish policy path, while the Fed policy implications of a stronger report are seemingly better reflected in the current, higher levels of the USD and short term yields. We highlight these risks from a shorter-term, tactical perspective, rather than from our medium-term strategic outlook, where expect the USD will continue to move higher into 2015. Indeed, we have just updated our USD forecasts and have the currency moving higher versus all other G10 and most EM currencies in the coming year, and detail those views in our new Currency Special, "Can a strong USD save the world?". And if in fact upcoming data/events result in some deeper pullback/correction in the USD, we would most likely view it as an opportunity to establish or add to medium-term long USD positions.

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