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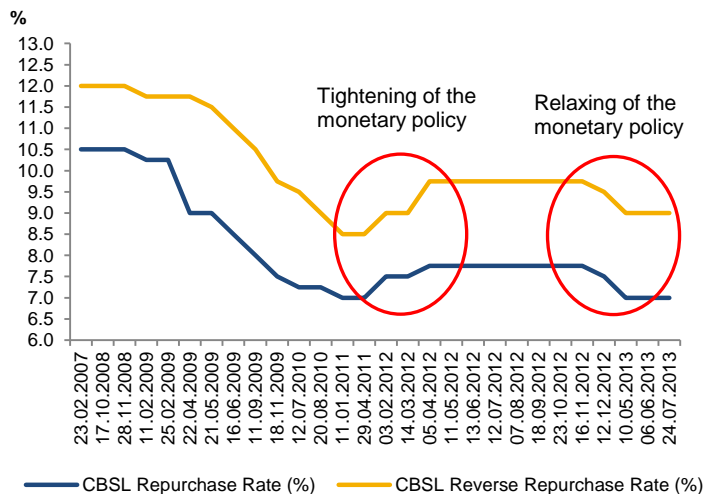
## WOULD INTEREST RATES DECLINE???

Subsequent to the tightening of the monetary stance (*figure i*) in early 2012, saw the interest rates rise and credit growth (9.3% YoY in May 2013) slow down. However in a low inflationary environment the CBSL decided to ease the monetary policy by cutting the policy rates by 25 bps in December 2012 and 50 bps in May 2013 (*figure i*) in order to kick start the economy. To further infuse liquidity into the system and to reduce the interest spreads, the regulator decided to cut the Statutory Reserve Ratio (SRR) by 200 bps to 6% in June 2013. Further CBSL also directed the banks to cut down the credit card interest rates from 28% to 24% and in July 2013 imposed a cap on penal interest rates charged on Loans and Advances by Banks, Finance and Leasing Companies (2.0% p.a. for banks and 3.0% p.a. for finance and leasing companies).

However apart from all these policy measures the fall in market interest rates (*figure iv*) are still very slow and the credit growth is rather subdued (*figure vi*). We believe significant government borrowing from the private sector (crowding out effect) and weakening of the exchange rate (*figure vii*) is holding up the interest rates. Therefore credit demand would not pick up this year as expected but we anticipate the market interest rates to gradually ease off towards the end of the year.

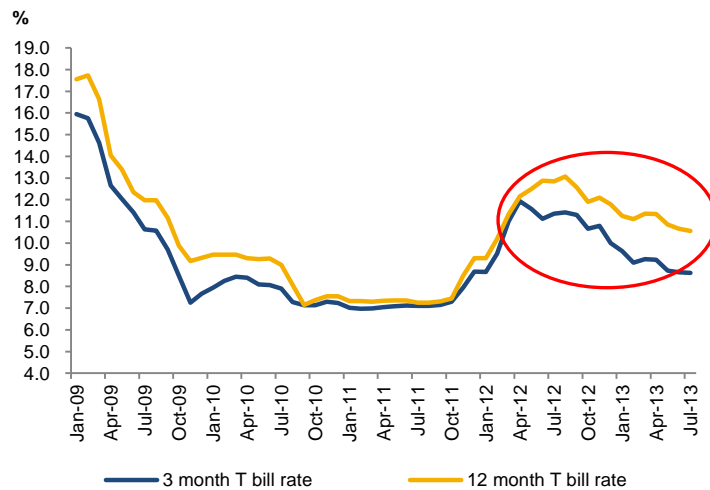
We forecast banking sector credit expansion to be c.15.0% (3.0% cut from the original 18.0% target) in 2013E largely due to slower decline in market lending rates and rather slow economic activity levels. However we remain bullish on the sector with its, interest spreads in-tact, sound credit quality, healthy capitalization levels, etc.. and we maintain our BUY recommendations on **Commercial Bank** (COMB.N:LKR119.30, COMB.X:LKR94.80), **Hatton National Bank** (HNB.N:LKR153.00, HNB.X:LKR110.60), **Sampath Bank** (SAMP:LKR196.20), **NDB Bank** (NDB:LKR163.10) and **Seylan Bank** (SEYB.N:LKR61.00, SEYB.X:LKR34.70).

Figure i : Policy Rates



Source : CBSL/ TKS Research

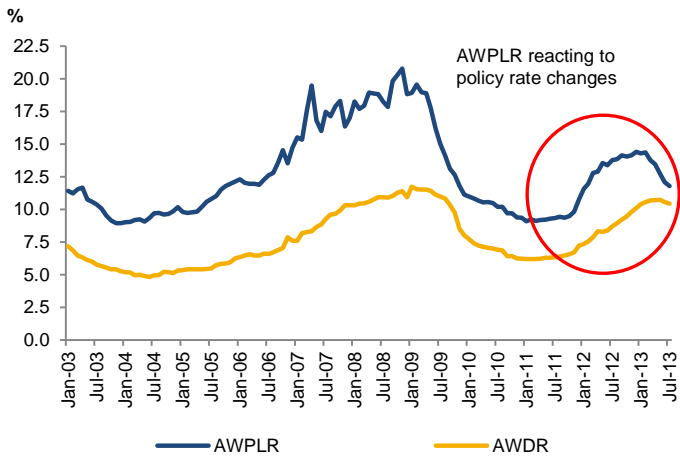
Figure ii : Rates on Government Securities



Source : CBSL/ TKS Research

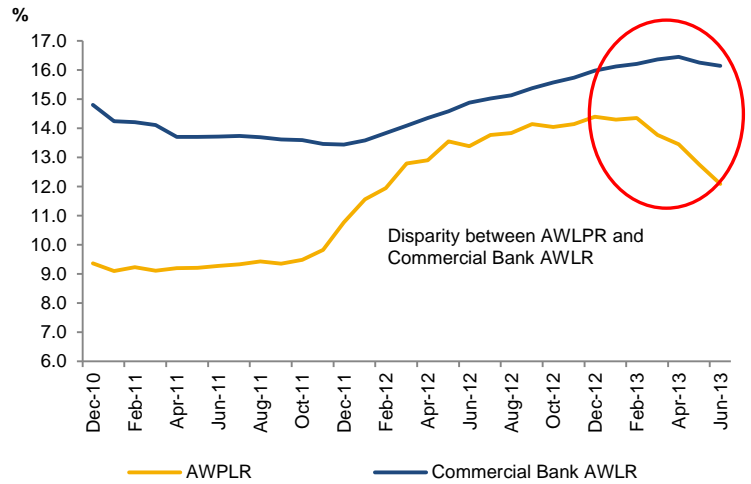
# SRI LANKA BANKING UPDATE

Figure iii : AWPLR Vs AWDR



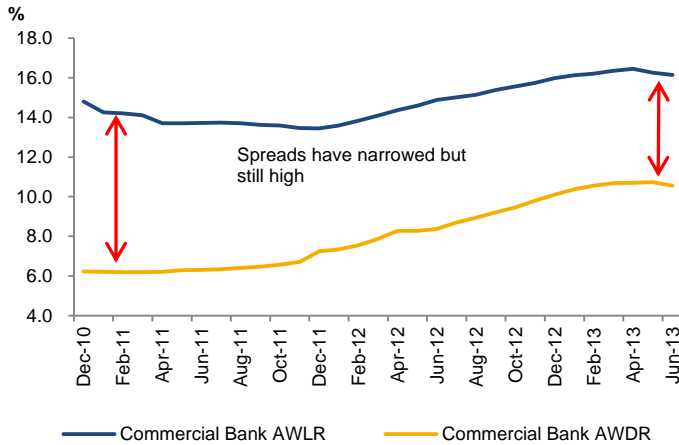
Source : CBSL/ TKS Research

Figure iv : AWPLR Vs Commercial Bank Rates



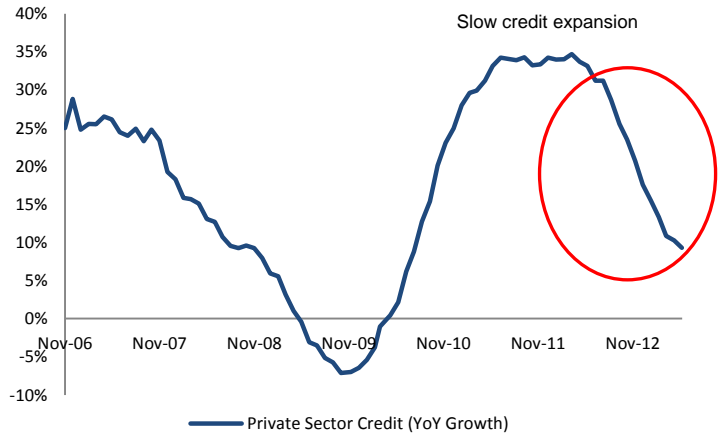
Source : CBSL/ TKS Research

Figure v : Commercial Bank Spreads



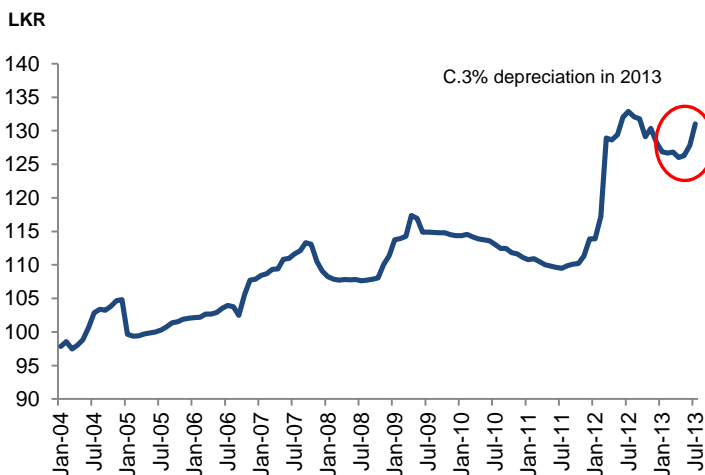
Source : CBSL/ TKS Research

Figure vi : Private Sector Credit Growth



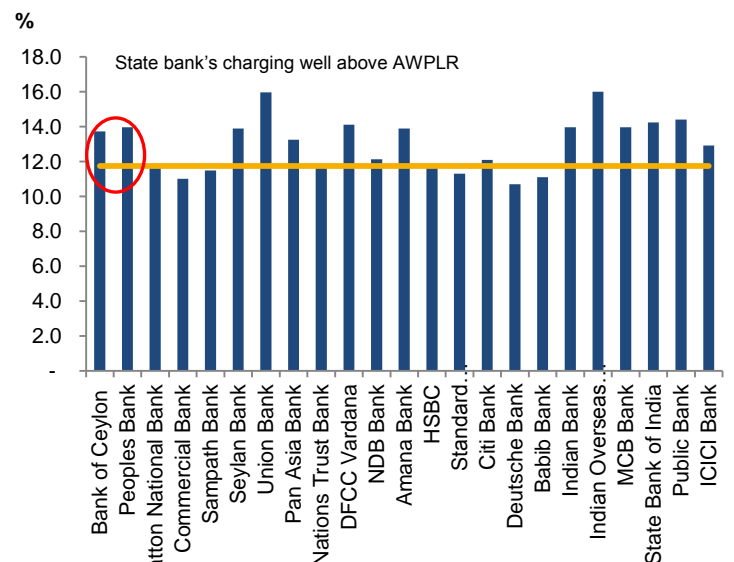
Source : CBSL/ TKS Research

Figure vii : Exchange Rate



Source : CBSL/ TKS Research

Figure viii : AWPLR Vs Individual Bank Rates



Source : CBSL/ TKS Research

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