NEWS ROUND UP

Monday,02nd September, 2019

Contents

Foreign investors exit Sri Lanka rupee bonds for second week

Foreign investors have sold down 12 billion rupees of government bonds in the week to August 28, after selling over 13 billion rupees of bonds in the previous week.

Foreign investors started selling bonds shortly before a rate cut in August, as the rupee started to fall after large volumes of money was printed apparently to force down a call money rate.

The gap in yields between Sri Lanka dollar and rupee bonds have narrowed in recent months, while depreciation has also worsened in recent years.

Sri Lanka's rupee has collapsed from 131 to 182 since 2015, with the operation of a 'flexible exchange rate' involving printing money to keep rates down artificially while trying to defend a peg and collect forex reserves.

Until August the central bank was buying dollars and steadily mopping up inflows amid weak bank credit, keeping an exchange rate peg stable, despite some selling by bond holders

But the central bank suddenly stopped mopping up inflows around in late July, and started printing money actively in August.

After keeping unsterilized excess liquidity from the acquisition of foreign assets for an extended period of time, the central bank then started printing money. Then the exchange rate was let go without taking away the excess liquidity.

The central bank also engaged in a disruptive sell down of its domestic assets around August 16, printing money before and after the transaction, in a move that puzzled outside observers.

On August 29, all excess liquidity went out of the interbank system. By August 31, 15 billion rupees was injected overnight at 7.40 percent, still far below the 8.0 percent ceiling policy rate, while other banks borrowed 14 billion rupees overnight.

The injected volumes rise when interventions are made in the forex market (sterilized forex sales). The central bank is also terminating term reverse repo deals made in August, widening the gap.

Sri Lanka has seen monetary instability due to targeting an exchange rate and suppressing short term interest rate spikes with large volumes of cash injections.

In 2019 however bank credit has been weak or negative weak, indicating that the credit system can absorb some levels of bond sales if money was not printed. (EconomyNext)

Sinhaputhra Finance in talks with investors after Sri Lanka regulatory warning

Sri Lanka's Sinhaputhra Finance Plc, said it was in talks with an investors for new capital after the central bank, which regulates non-bank lenders, warned that it may cancel its finance company license.

"..[A] comprehensive capital plan backed by an investor who has demonstrated financial credibility of meeting the regulatory capital requirement was submitted to the monetary board of the central bank and the company is awaiting their response," the firm said in a stock exchange filing.

The central bank in a letter to the Securities and Exchange Commission, published on the stock exchange website said it had given notice of cancellation of the finance company license to Sinhaputhra.

The company has then filed objections as provided by law, saying they were in talks with an investor.

"As per the provisions in the law, the Monetary Board will have to consider the objections tendered by the Company and determine whether to withdraw the notice or cancel the license," the central bank said.

According to CSE data the stock has last traded at 8.20 rupees. (EconomyNext)

Sri Lanka bank profitability under pressure: Moody's

Sri Lankan banks' profitability is under pressure with an uptick in bad loans, Moody's rating agency said in a new report which notes its negative outlook for the banking system is driven by slow economic growth.

"weakening asset quality is keeping credit costs high, in turn pressuring profitability," said the report.

Moody's expects the government's capacity to support banks will be limited given its large amounts of external debt and contingent liabilities.

Fundamental risks to Sri Lanka's economy remain significant, given its twin trade and budget deficits and the government's high reliance on external debt, Moody's Investors Service said in the new report.

It projects Sri Lanka's economic growth will slow to 2.6 percent in 2019 from 3.2 percent in 2018 on declining tourist arrivals,

"Asset quality will weaken amid sluggish economic conditions," Moody's said.

The slow recovery in the tourism and related sectors after April's suicide bombings is resulting in subdued economic growth.

"Tourist arrivals declined sharply following the Easter Sunday attacks in Sri Lanka, but have started recovering and should support an improvement in GDP growth in 2020," said Tengfu Li, a Moody's analyst.

Political risks could also resurface, with presidential and parliamentary elections scheduled for late 2019 and 2020, the report noted.

Previous bouts of political instability having triggered significant capital outflows and currency depreciation.

"Weak economic growth will in turn result in deteriorating asset quality, also on the back of excessive credit growth in recent years," said Li.

However, bank loan growth has moderated, which should help keep capitalization stable and also ease funding pressure. (EconomyNext)

Sri Lanka's Colombo bursting with tourists in August

Sri Lanka's capital Colombo is fully booked with a convention involving a Bora religious dignitary and arrivals may top 170,000 in August, or 15 percent below last year's level, officials said.

"Most hotels in formal and informal sector are fully booked," Tourism Minister John Amaratunga said.

"Apartment have been booked."

Minister Amaratunga said about 30,000 Bora tourists wanted to come but Colombo and environs did not have enough rooms.

"Some have fallen back. Definitely 20,000 to 25,000 are to come."

Sri Lanka's tourism sector was hit by Easter Sunday attacks by an extremist organization, most of whose members have now been arrested.

Key Western nations, whose intelligence officials were working with Sri Lanka's authorities rapidly withdrew travel advisories as the network was shutdown within weeks. In May arrivals dropped 60 percent.

Chairman Sri Lanka Tourism Development Authority Johanne Jayaratne said he expected arrivals to top 170,000 in August.

Last year Sri Lanka got about 200,000 visitors, indicating that the August arrivals would only be about 10 percent below 2018.

Jayaratne said he expected tourist arrivals to reach last year's levels by October.

The winter season beach tourism season involving Sri Lanka's Western and Southern coasts starts in October after monsoons end. Until about September Sri Lanka's East Coast is sunny.

Jayaratne said Sri Lanka is now projecting about 2.1 million tourists to arrive in 2018, down from 2.3 million last year, or 10 percent down.

"Sri Lanka is recovering faster than other countries that have experienced similar events,"Amaratunga said.

"I am thankful fo the armed forces, police and intelligence and all those involved."

Sri Lanka's hotels slashed prices to draw visitors. Jayaratne said total earnings would be more than 10 percent down due to price cuts.

Sri Lanka is now more attractive and comparable to some East Asian destinations after price cuts.

Politically influential hoteliers in the capital kept prices high for for Colombo city hotels until last year making the city compare unfavourably with some East Asian destinations with better service. (EconomyNext)

Markets sag as hope fades for trade war détente

Investors' souring hopes for detente in the US-China trade war dragged stocks lower on Tuesday, putting a dent in the relief rally that started the week.

An inverted yield curve and worrisome economic data out of Germany also helped wipe away Wall Street's early gains, while results in Europe and Asia were mixed.

US President Donald Trump's repeated assertions that Beijing wants to make a deal to end the two countries' year-long trade war had cheered markets on Monday. But the optimism was short-lived, since Chinese officials did not confirm any new talks.

In Frankfurt and Paris, shares advanced solidly but London dipped as Brexit-weary British investors played catch-up after a three-day holiday weekend.

US Treasurys continued to fall, deepening the inversion of the curve between yields on the 2-year and the 10-year notes, a widely accepted sign a recession is likely.

China's beleaguered yuan nosedived to 7.1722 yuan to the dollar — a level not seen since 2008.

The currency had plunged Monday on last week's news that Washington would hike tariffs on more than half-a-trillion dollars of Chinese imports, after Beijing unveiled levies on tens of billions of dollars of US goods.

– Grim news from Germany –

Chris Low of FTN Financial said investors were absorbing the reality that, despite Trump's rosy forecasts on Monday about the chances for a trade deal, the two sides were in fact no closer to an agreement.

"We've been barraged by comments from the Chinese side that nothing has changed," he told AFP.

He also pointed to unhappy economic news out of Germany, which recorded negative growth in the second quarter.

The news prompted fresh talk of a recession, with many saying growth could easily be negative again in the third quarter.

"Given that other data points for Germany in Q3 have been weak, there's every chance that we see another contraction and satisfy the definition of a technical recession," said David Cheetham at XTB.

Charles Schwab analysts said "early gains that came amid cooled trade tensions between the US and China fell victim to worries surrounding the persistent decline in bond rates, with the inversion between the 2-year and 10-year Treasury notes widening to heighten recession concerns."

In commodities, oil prices rose after Trump said he was prepared to meet Iran's Hassan Rouhani in the next few weeks, following talks over Tehran's nuclear program at the G7 summit.

"Expectations are… rising that tensions in the Gulf can be de-escalated following President Macron's overtures to broker a meeting between Donald Trump and his Iranian counterpart," noted AxiTrader analyst James Hughes.

– Key figures around 2100 GMT –

New York – Dow: DOWN 0.5 percent at 25,777.90 (close)

New York – S&P 500: DOWN 0.3 percent at 2,869.16 (close)

New York – Nasdaq: DOWN 0.3 percent at 7,826.95(close)

London – FTSE 100: DOWN 0.1 percent at 7,089.58 points (close)

Frankfurt – DAX 30: UP 0.6 percent at 11,730.02 (close)

Paris – CAC 40: UP 0.7 percent at 5,387.09 (close)

EURO STOXX 50: UP 0.7 percent at 3,370.47 (close)

Tokyo – Nikkei 225: UP 1.0 percent at 20,456.08 (close)

Hong Kong – Hang Seng: DOWN 0.1 percent at 25,664.07 (close)

Shanghai – Composite: UP 1.4 percent at 2,902.19 (close)

Euro/dollar: DOWN at $1.1083 from $1.1102

Dollar/yen: DOWN at 105.77 yen from 106.12 yen

Pound/dollar: UP at $1.2288 from $1.2217

Euro/pound: DOWN at 90.25 pence from 90.87 pence

Brent North Sea crude: UP 81 cents at $59.51 per barrel

West Texas Intermediate: UP $1.29 at $54.93 (AFP)