NEWS ROUND UP

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Sri Lanka Central Bank refutes President's bond claims

Sri Lanka's Central Bank Wednesday rejected President Maithripala Sirisena's allegation that over one thousand billion rupees had been stolen through controversial bond sales over a 14-year period ending 2016.

Central Bank of Sri Lanka Senior Deputy Governor Nandalal Weerasinghe said he was at a meeting with President Sirisena on December 21 to discuss progress in investigating the alleged bond scams, but was surprised to read inaccurate media reports of it quoting the President's Media Division.

"I was at this meeting and I can tell you that no one mentioned this figure of 1,000 million rupees," Weerasinghe said clarifying that no one had actually estimated the possible loss or otherwise from disputed bond sales.

He said the Presidential Commission of inquiry (PCI) into bond sales of 2015 and 2016 had ordered several forensic audits for the purpose of establishing if there was any loss to the state, and if so how much. Anything else was mere speculation, he added.

The President's Media Unit statement issued on December 21 shortly after the high-powered meeting at the Presidential Secretariat quoted central bankers as giving the one thousand billion figure for losses from bond sales between 2002 and 2016, a period covering the former Rajapaksa regime too.

Central Bank Governor Indrajith Coomaraswamy said he had sent an interim report on the progress of implementing PCI recommendations to Sirisena on the night of October 26, just as President Sirisena sacked Prime Minister Ranil Wickremesinghe and triggered a power struggle that lasted 51 days.

Sirisena had claimed that one of the main reasons to sack Wickremesinghe and his government was their failure to complete investigations into controversial bond auctions through which the then governor Arjuna Mahendran's son-in-law's company is said to have benefited. Mahendran was accused of passing inside information to his son-in-law.

The Presidential Commission of Inquiry which finalized its report in January last 2018 noted that Mahendran's actions led to an "avoidable loss of 688 million rupees (Rs. 688,762,100)" in the February 2015 bond action.

Coomaraswamy denied any undue delay in carrying out a forensic audit of bond actions. He said they were currently evaluating proposals from international audit firms to carry out six separate audits into bond sales as well as EPF and ETF activities.

He said the selection of auditors required careful vetting. He expected the audits to be completed by the end of this year with several interim reports expected much earlier. (Economy next)

Sri Lanka to be 'brutal' on finance companies that lose capital

Sri Lanka will act fast to resolve finance companies that fall short of capital, Central Bank Governor Indrajit Coomaraswamy said., which had led to large holes in balance sheets and collapses, ending a the practice of procrastination or regulatory forbearance.

Finance companies in future will have to boost capital quickly when required.

"If finance companies don't, we will have to take regulatory action. We will have to be brutal when we apply that," Governor Coomaraswamy told reporters.

In the US, the policymakers took away the discretion and the Federal Deposit Insurance Corporation, a resolution agency now acts quickly, because delays expanded the capital shortage and the gap between deposits and assets widened.

It was easy to find a buyer when the capital shortage was small, and even if there were no takers, the FDIC had to put in only a small amount of cash in a liquidation, when a lender was closed as soon as capital fell below a pre-determined threshold like 200 basis points.

The US has thousands of independent banks, dating back from its free banking era and also when branch banking was prohibited and a number of banks fail each year.

When the housing bubble fired by the Federal Reserve collapsed in 2008/2009, 140 banks coming under FDIC mandate failed, another 157 failed the following year.

At end-September 2018, the ratio of capital held at finance companies in Sri Lanka to cover risks (capital adequacy) fell to 11.1 percent from 13.2 percent a year earlier.

Because finance companies give loans to riskier clients than ordinary banks, they need higher capital buffers, according to some analysts.

Central Bank regulations introduced in July 2018 call for finance companies to have at least 10 percent capital adequacy. By July 2019, capital adequacy has to increase to 10.5 percent, eventually requiring 12.5 percent July 2021 onwards.

Analysts say Sri Lanka will need to legislate a threshold like 8 percent to effectively end regulatory forbearance.

Coomaraswamy said another step existing finance companies could take is to merge with peers to meet the minimum capital levels, since having over 40 finance companies in the country is 'ridiculous', although the central bank will not force firms to take either option.

There was a spurt of new finance company licenses issued during the Rajapaksa regime. Several shadow banking institutions also failed at the time.

The current problems in firms like The Finance and ETI Finance, date back to the forbearance period.

"Non-compliance will result in restrictions on deposit and business expansion and, where necessary, winding up of businesses," Coomaraswamy said.

"Therefore, it will be necessary for finance companies to give priority to capital augmentation plans in the near future," he said.

"The change in the regulatory posture of the central bank will result in early interventions against noncompliant, distressed and high risk finance companies."

Many finance companies have primitive IT systems which are not capable of complex risk management.

Bad loans across finance companies were 7 percent at end-September 2018, up from 5.7 percent a year earlier.

Coomaraswamy's hard hitting stance amidst concerns raised by officials that some that some finance companies are ignoring regulations, rights of depositors and risk management practices to please wishes of shareholders.

Coomaraswamy said central bank officials are closely monitoring and talking with other at-risk finance companies to stabilize them.

He said there is little risk to Sri Lanka's economy if finance companies go bust, as they hold only 7.9 percent of the total assets in the financial sector.

"This long tail of very vulnerable finance companies are in turn a very small part of the total assets," Coomaraswamy said.

"Some larger finance companies are robust, and are as strong as banks."

"Having said that clearly there can be a contagion effect if there is instability in some institutions," he said.

Coomaraswamy said a deposit insurance scheme is settling what the companies owe their depositors. (Economy next)

Sri Lanka expecting US$400mn India swap line shortly: CB Governor

Sri Lanka is expecting to get a 400 million dollars swap line from India shortly, Central Bank Governor Indrajit Coomaraswamy said, as the country has lost 1.1 billion US dollars in forex reserves over three months and money was printed after intervening.

Sri Lanka has been negotiating with the Reserve Bank of India to get a 400 million dollar swap line from a facility made available to countries in the South Asia Association for Regional Co-operation (SAARC).

"We are hoping to get that quickly," Governor Coomaraswamy said.

Minister Harsha de Silva said in a twitter.com message that Sri Lanka was hoping to get up to a billion US dollars in swap lines.

Sri Lanka's is now facing balance of payments trouble after the central bank printed money saying inflation was low in the first quarter of 2018, despite operating a highly unstable soft-peg.

Central Bank swap lines were invented by the US Federal Reserve when it faced pressure on a gold soft-peg.

The soft - gold peg collapsed in 1971 - 73 when then Federal Reserve Chairman Arthur Burns tried to close an 'output gap' by printing money ending the Bretton - Woods system of failed soft-pegs.

The Fed invented swap lines as loose policy led better managed central banks such as Switzerland and Germany, which were driven by Austrian classical economics acquired large dollar balances.

The Fed was driven by Mercantilist-Keynesianism.

The swap lines were at first structured to be for three months (assuming that any pressure on the dollar against gold was temporary) but the lines were extended and losses were palmed off the US Treasury.

The swap lines critics later said, prevented the Fed from practicing more prudent policy, and may be contributed to the collapse of the Bretton Woods system by encouraging bad policy.

At the time it was believed that a central bank could sterilize interventions with impunity on a so-called portfolio-balance channel. However Bretton-Woods collapsed forcing the Fed to float and suspend gold convertibility.

The Fed had also acquired massive liabilities through swap lines by 1978 as the US tried and failed to defend the US dollar. (Carter moves to halt decline of the US dollar).

Fed Governor Paul Volcker later saved the dollar.

There had been concern that swap lines represented a tool through which the Fed avoided congressional approval and took on public liabilities.

Central Banks, especially soft-pegs are poorly understood by the public, politicians and the soft-peggers who run them. (Economy next)

Sri Lanka to tighten ownership limits in banks

Sri Lanka will tighten share ownership limits of Sri Lankan banks along with stricter qualifications for key management positions to improve governance, the Central Bank Governor said.

"We believe that share ownership in banks needs to be broadbased to strengthen corporate governance and to avoid ownership concentration, dominance in the boards, conflict of interest and risks associated with related party transactions," Governor Indrajit Coomaraswamy said delivering a monetary policy road map for 2019.

"Therefore, the existing requirements on share ownership will be reviewed and certain additional measures will be brought in."

At the moment a single individual or company, acting with related parties, can own up to 10 percent a bank, which could be increased to 15 percent with special permission from the Central Bank.

There are also some legacy ownership stakes in some banks.

Coomaraswamy said quality of appointments to banks will be made stricter in the future.

"Fit and proper assessment criteria for appointment of directors, chief executives and key management personnel of banks will be strengthened further to appoint the most suitable and qualified individuals to the top positions in banks," he said.

"Only persons with proven track records of good conduct and financial integrity would be considered for such appointments," he said.

However, the government is the biggest stakeholder of some listed banks, controlling between 10-35 percent of some private banks through state financial institutions and a pension fund.

In the recent past, controversial persons have been appointed to the boards of 'private' commercial banks where state agencies had large stakes.

Sri Lanka Treasuries yields ease at auction

Sri Lanka's Treasury bill yields eased at Wednesday's action with the 12-month yield falling 21 basis points to 10.99 percent, the state debt office said.

The debt office, which is a unit of the Central Bank, offered 7 billion rupees of 60month bills and accepted 4,705 million dollars of bids at a weighted average yield of 9.95 percent down from 9.99 percent on December 19.

The debt office offered 8.5 billion rupees of 12-month bills and accepted 10,795 million rupees of bids.

There were no sales of 3-month bills. (Economy next)

Sri Lanka mulls extending IMF deal amid soft-peg trouble

Sri Lanka may extend an International Monetary Fund program which due to end in the first half of 2019, as the central bank has again enters a period of balance of payments trouble, while operating a highly unstable soft-pegged exchange rate regime.

Sri Lanka is on a reform oriented 3-year extended fund facility (EFF) which was due to end in April 2019.

"There is a provision for the EFF to be extended by a year," Coomaraswamy said.

"The government could negotiate if it wants to."

"It is an option, and what we have to see is how much more money we need and what are the terms and conditions.

Sri Lanka was about to sign the last section of a three year program when President Maithripala Sirisena triggered political crisis by appointing ex-President Mahinda Rajapaksa as Prime Minister and dissolving parliament leading to credit downgrades.

Coomaraswamy said he believed downgrades could have been avoided if a staff level agreement agreed in late October could have been signed.

Now however the administration is in election mode.

"The government can take a decision to make a request," Deputy Governor Nandala Weerasinghe said.

"Based on that request we can negotiate."

Central Bank Governor Indrajit Coomaraswamy said it would be useful to have a program extension.

The IMF forced Sri Lanka to operate a pegged exchange rate regime with a forex reserve target but the central bank was allowed to behave like a monetary authority with a free floating exchange rate rate, involving cutting interest rates when inflation fell.

The IMF program was suspended in September after the central bank failed to collect reserves in 2018 after it started injecting money in to the banking system from March, amid a private credit spike, loosening a peg which was kept tight until the first quarter of 2018 with sterilized purchases.

The central bank then cut rates in April and injected tens of billions of rupees in the banking system in quantity-easing style putting pressure on the rupee and undermining the credibility of the peg.

From May, foreign investor in bonds started to leave.

The central bank was also targeting the exchange rate along a real effective exchange rate index, without having the tool to control the exchange rate, which is a floating policy rate.

Another de facto convertibility undertaking was given in the form of preventing a 'disorderly adjustment' of the exchange rate.

A soft or non-credible peg involves defending an exchange rate and printing large volumes of money to keep interest rates down, which allows bank to give credit preventing an adjustment of the credit system, putting further pressure on the peg.

A float is usually required to re-establish confidence in the exchange rate and prevent further injections of new money (sterilized forex sales).

Sri Lanka had repeatedly gone to the IMF as large volumes of reserves were lost in a short time amid sterilized forex sales in the past half century, since a currency board (hard peg) was abolished in 1951, eliminating a hard budget constraint.

Over the past three months, 1.1 billion US dollars were lost as interventions were followed by money printing. New money was also released into the banking system by cutting a reserve ratio in November.

Sri Lanka and its citizens had paid a heavy price for running a soft-peg in the form of capital controls, trade controls, inflation, export of labour abroad, demand for subsidies and deficit spending.

The current administration's free trade strategy was also torpedoed to try to maintain the peg, which has no credibility.

The administration hopes to make Sri Lanka a financial centre, while the soft-peg has made it difficult for people to even buy a car or three wheeler due to credit and import restrictions.

The soft peg has also kept nominal interest rates high, as investors demanded a premium to account for chronic depreciation, despite partial opening of the capital account. (Economy next)

Tourist arrivals growth higher in 2018 with record haul in December

Tourist arrivals grew at a faster pace in 2018, despite missing the 2.5 million target thanks to a record haul in December, official data released yesterday confirmed.

Sri Lanka ended 2018 with 2.33 million tourists, up by 10.3% over 2017, in which year the increase was only 3.2%. In 2016, arrivals growth was 14%.

Tourist arrivals during December reached a record 253,169, up 3.5% from a year earlier. In terms of arrivals, February, March, June and November recorded the highest growth rates in 2018, while December had the highest number of tourists.

The record haul in December overshadowed industry concerns following the political instability following 26 October, which was a likely cause of the country missing the 2.5 million arrivals target by 166,204 in 2018. However, Sri Lanka has missed original annual targets since 2016.

Sri Lanka recorded its highest growth, 46.1%, in 2010, following the end of the near 30-year-old conflict. Thereafter, the growth trajectory saw a downward trend in 2011 and in 2012, posting a 30.8% and 17.5% growth respectively. However, in 2013, there was a positive growth of 26.7%, which subsequently went on a descending trend for four years.

Tourism Development Minister John Amaratunga said Sri Lanka would have achieved the originally-set target of 2.5 million arrivals target, or surpassed it, if not for the political upheaval in post-26 October 2018.

"A realistic, but ambitious prediction at this juncture is the four million tourist arrivals and $5 billion income this year, with Sri Lanka being declared top destination to travel in 2019 by Lonely Planet. Therefore, we are confident with the ongoing and upcoming promotional activities, Sri Lanka can achieve four million tourist arrivals and $5 billion income by end of this year. I pray and hope we will be able to go forward without any further obstacles or disruption from any quarter," he told Daily FT.

Sri Lanka Tourism's branding and marketing campaign 'So Sri Lanka' debuted at World Travel Mart (WTM) in London last November, and is planned to launch the much-anticipated global tourism promotion campaign as well as the newest logo in March this year at the ITB in Berlin.

The Minister expressed his confidence that the country would continue on the growth trajectory, capitalising on the newest promotional campaigns and initiatives underscored in the 2017-2020 Tourism Strategic Plan (TSP).

Amaratunga also reiterated that there was no other country in the world which could offer a travel experience in a compact island like Sri Lanka.

According to Amaratunga, Colombo has the opportunity to be seen as a hub for entertainment in the future, with the ever-burgeoning investment and development of tourism here.

"Indubitably, Sri Lanka has many diverse attractions that appeals to a wide spectrum of travellers from across the world. While we develop and further sustain the natural resources and attractions that are bountiful from a local standpoint, it is also important to consider expanding the local offering when it comes to the aspect of entertainment," he added.

Amaratunga also said while the Government initiates the policy framework, and provides an advantageous environment for growth, it is the responsibility of all stakeholders to work towards achieving these goals, which will set the pace to bolster Sri Lanka's tourism offerings.

He said they hoped to promote home-stays, where small-scale businesses would receive some share of the benefits from tourism to uplift their livelihood and rural economy.

The Minister also noted that this could mean that tourism will be the number one foreign exchange earner in the near future. (Daily FT)