NEWS ROUND UP

Friday,October 12th, 2018

Contents

Sri Lanka stocks end 0.57-pct lower, rupee weakens marginally

Sri Lanka stocks closed 0.57 percent lower on Thursday amidst foreign selling in Ceylon Tobacco while the rupee weakened marginally to a new low of 171.35/45 rupees against the US dollar and gilt yields increased sharply, market participants said.

Colombo's All Share index fell 0.57 percent, to end 33.54 points lower on Thursday at 5,838.48 amidst low volumes and the S&P SL20 index of more liquid stocks closed a sharp 1.14 percent lower, down 34.34 points to 2,965.82.

Market turnover was 301.7 million rupees as 83 stocks declined during the day against 33 that gained.

John Keells Holdings (down 1.90 rupees to 130 rupees), Sampath Bank (down 7.90 rupees to 228 rupees) and Ceylon Cold Stores (down 18.10 rupees to 752 rupees) contributed to the benchmark index decline.

Net foreign selling was 50.1 million rupees, compared to buying of 15.9 million rupees the previous day.

Foreign selling in Ceylon Tobacco was 33 million rupees, followed by 23 million rupees in Sampath Bank,.

Ceylon Tobacco closed unchanged at 1,375 rupees.

There was one crossing, or off-market negotiated trade, in Ceylon Tobacco for 32.7 million rupees.

The Sri Lanka rupee weakened to a new low of 171.35/45 rupees against the US dollars in the spot market, down from the previous close of 171.20/40 rupees.

The currency traded at an intraday low of 171.45 rupees against the greenback, market participants said.

Sri Lanka had widened dollar trading positions of some banks, which were recently slashed amid a run on the rupee.

Gilt yields edged higher in the secondary market.

A three-year bond maturing in 2021 ended at 11.40/75 percent in two-way quotes, up sharply from 11.10/30 percent the previous day.

A five-year bond maturing in 2023 closed at 11.85/95 percent, up from the previous closing of 11.35/45 percent. (EconomyNext)

Sri Lanka makes second forced bond sale, yields up

Sri Lanka has made the second coercive bond sale with gilt dealers being forced to 5-year bonds based on a cut-off decided by the authorities during a 40 billion rupee bond sale.

Sri Lanka has sold 20 billion rupees of bond maturing on 15 July 2023 at an average yield of 11.69 percent of which about 4.0 billion rupees were estimated to have been forced on buyers at the weighted average yield.

The bond was quoted in the secondary market at yields around 11.85/95 percent generating losses for holders. The cut-off is estimated to have been around 12.00 percent, market sources said.

A 15 October 2021 bond forced on buyers at 10.03 percent at the last auction is now trading around 11.50/75 percent with holders now in losses.

Sri Lanka's interest rates have been rising amid a liquidity shortage generated by a maturing central bank swap and interventions made after the exchange rate came under pressure from excess liquidity and low rates.

Critics say the coercive bond sales are a point of vulnerability both to the financial system and the economy in general, especially when the exchange rate is under pressure.

An offer of 20-billion rupees of 14-year 3-month bond maturing on 15 January 2033 was fully take up at a weighted average yield of 11.90 percent. It was quoted around 11.70/95 percent.

The longer term yield curve is flat in the belief that interest rate spike is temporary with some insurance firms in particular willing to buy the bonds.

Rates could come down after credibility returns to the exchange rate peg, market analysts say. (EconomyNext)

Sri Lanka widens bank dollar trading positions

Sri Lanka has widened dollar trading positions of some banks, market participants said, which were recently slashed amid a run on the rupee triggered by a spike in unsterilized excess liquidity.

Cuts in the so-called NOPs (net open positions) have led to heightened volatility of the rupee in the past, according analysts who have closely studied policy errors of the central bank.

A wider NOP allow foreign exchange flows from day-to-day to be matched without altering the monetary base, making Sri Lanka's credit system behave like a floating regime.

A narrower NOP requires greater central bank intervention to keep a currency stable. Intervention by the central bank alters the monetary base, making the exchange regime behave like a peg.

But dollar purchases by the central bank at current rates will inject permanent liquidity, peg the currency and undermine a float.

Though the credit system now has a large liquidity shortage which can absorb some injections, the actual damage of central bank dollar purchases in the market will be done by creating an opinion among exporters an opinion that the current exchange is justified and is not an overshoot.

Analysts have also said that NOPs can be linked to liquidity positions of banks on the basis that banks that borrow printed money from the central bank, should not be entitled to hold dollars with such money.

This will encourage banks to run plus liquidity positions in the long term and not fund credit with window money.

However the current large liquidity shortage is coming from a policy error of the central bank involving a hedging deal on a loan taken by National Savings Bank in 2013.

The monetary policy of the central bank is now supportive of the rupee. Overnight interest rates are near the 8.50 percent ceiling policy rate.

On Wednesday 3-month Treasury bill yields rose sharply to 9.38 percent.

In the past, the central bank has made currency pressure turn into full-blown balance of payments crisis by injecting 3-month printed money at subsidized rates into the banks, by intervening in bill auctions which can be loaned customers to generate more pressure on the rupee.

Analysts say laws should be brought to prohibit the central bank from injecting money below the Sri Lanka Interbank Offered Rate of that tenor to maintain economic stability and preserve the welfare of the people, especially when the rupee is under pressure.

Sri Lanka's rupee is unstable due to the lack of a consistent or market based operating regime, involving targeting either the interest rate (floating rate) or the exchange rate (peg) consistently. (EconomyNext)

Trillions in US net worth vulnerable to recession: IMF

A severe recession would slash US public wealth by about $5 trillion, causing vastly more damage to Washington's finances than just an increase in debt and deficits, the IMF warned Tuesday.

Yet governments around the world, many of which face similar dangers, do not clearly publicize their overall net worths, the International Monetary Fund said in a new report.

This creates a potential blind spot for policymakers who could use this knowledge to head off economic risks, it said.

The global crisis lender, which in Indonesia this week is staging its annual meetings with the World Bank, cut its outlook for global GDP on Monday by two tenths to 3.7 percent through next year.

The fund pointed to rising trade tensions as a cause for worry and also predicted slower growth in the United States next year and beyond.

Economists now say the chances of a recession in the United States are growing due to several factors, including trade tensions and mounting interest rates.

Beyond tax revenues and sovereign debts, a government's balance sheet contains a range of other assets and liabilities, such as the state enterprises, land and natural resources it owns as well as the money it has to pay to fund public-sector employee pensions.

The difference between the two sides of the ledger is a country's net worth.

"The scars from the global financial crisis are still evident on public wealth a decade later," the report said, adding that the net worth of 17 advanced economies together was now $11 trillion lower than it had been prior to the crisis.

- Wall Street, pensions and debt -

Countries that take such a broad approach to their finances may face lower borrowing costs and see higher revenues, making them more resilient in a downturn, the report said.

But after a decade of recovery, the net worths of most Group of Seven economies are now negative, it said.

China's net worth has deteriorated to eight percent of GDP because of off-budget borrowing by local authorities and poor returns from powerful government-run businesses, the IMF found.

Meanwhile, the net worth of the United States has been in decline for nearly four decades. Worsening notably due to the global financial crisis, it had sunk by 2016 to negative 17 percent as a share of GDP, the report said.

The federal mortgage giants Fannie Mae and Freddie Mac, which the government took over during the crisis, have lent a staggering amount -- 44 percent of GDP -- to the private sector.

But the biggest source of risk comes from state and local government retirement pensions, which can lose money when Wall Street sinks -- meaning the shortfall has to come out of local government budgets.

Towns and states then have to cut spending elsewhere, creating a drag on the economy.

Nationwide, such pension funds are already underfunded by about eight percent of GDP.

Using a hypothetical "stress test" scenario developed by the US Federal Reserve for banking regulation, the IMF found a severe recession would cut the value of America's publicly held assets by an amount equal to 26 percent of GDP by 2020.

At current levels, that would amount to about $5 trillion.

The scenario, which imagines a deep global recession, rising interest rates but collapsing stock and real estate prices, would see sovereign debt balloon by nine percent but net worth dive by another 17 percent, mainly because falling real estate prices would drag down the value of publicly owned structures.

Defaults on mortgages and student loans as well as pension fund shortfalls would all jump sharply, the report found.(AFP)

Another wild sell off: Dow sinks 546 points

The Dow tumbled 546 points, or 2.1%, on Thursday following another rollercoaster session. The index briefly turned positive during morning trading before succumbing to heavy selling pressure. At one point the Dow was down 699 points. The Dow has shed 1,378 points over the past two days.

The mood on Wall Street was only slightly calmer than Wednesday's 832-point nosedive.

The S&P 500 closed down 2.1%, notching its sixth-straight losing session. It's the longest slump for the broad index since just prior to President Donald Trump's election more than two years ago.

The Nasdaq briefly tumbled into a correction, signaling a 10% decline from previous highs. But the index climbed out of correction territory and closed down 1.3%.

All three major indexes have lost more than 5% this week. That hasn't happened since March.

"This kind of washout doesn't get accomplished in a day. Even though yesterday felt traumatic, it tends to be a three-day process," said Art Hogan, chief market strategist at B. Riley FBR.

The VIX volatility index touched its highest level since February.

One positive is that unlike on Wednesday, the market did not close on the lows of the day. The rebound was helped by fresh reports that President Donald Trump and Chinese leader Xi Jinping have agreed to meet next month at the G-20 summit. Such a meeting could ease fears that the US-China trade war will hurt corporate profits and slow the US economy.

Tech stocks have come under fire because they are some of the riskiest and most expensive parts of the market. Investors fear how these momentum names will hold up in a downturn, particularly as interest rates spike. A proxy for the tech sector had its sharpest plunge in seven years on Wednesday.

"Halloween started early this month for investors," Ed Yardeni, president of investment advisory firm Yardeni Research, wrote to clients.

The afternoon sell-off comes even though a new report showed that consumer prices rose less than expected in September.

Stocks have turned sharply south in large part because investors are concerned about rising interest rates. As the Federal Reserve raises rates to prevent runaway inflation, investors have been getting out of bonds, driving down their price and driving up their yields. Suddenly, the return on bonds has become competitive with some stocks — particularly risky tech stocks.

Rising interest rates also increase borrowing costs for households and businesses, eating into corporate profits.

Some US companies have recently warned about pain from rising costs. Paint company PPG Industries (PPG) spooked investors on Tuesday by saying it's paying more for chemicals, oil and shipping. Fastenal (FAST), another industrial company, suffered a surprise decline in margins due to spiking freight costs. And the company warned of potential trouble from the US tariffs on China.

Wall Street is getting increasingly nervous about the ongoing trade war between the United States and China. While US growth has remained on track, China's economy is showing signs of a slowdown. Citing the trade fight, the IMF on Monday lowered its 2019 growth projections for both the US and China.

"The downgrade from the IMF underscores this is a very real threat. It's really a gamechanger," said Kristina Hooper, global market strategist at Invesco.

If Trump and Xi officially announce a meeting at the G20 summit, it could help tamp down market fears about the trade war.

Hogan said the problem is that investors "don't see an exit on the trade war highway. We're escalating our rhetoric with China."

Global markets lost ground overnight. Stock indexes in the United Kingdom, Germany and France all fall by more than 1%. Benchmark indexes in Shanghai and Tokyo closed down 5.2% and almost 4%, respectively. Hong Kong's market was down over 3%.

There were plenty of other jitters. Gold, which often rises during times of stress, climbed nearly 3%. That hasn't happened since June 2016. The Fear & Greed Index, a CNN Business gauge of market sentiment, is flashing "extreme fear." Just a month ago the index was comfortably in "greed" territory.

However, Yardeni is optimistic the market will rebound because corporate profits are robust and no recession is in sight.

"We remain bullish on the outlook for earnings, and expect the market to recover and make new highs going into next year," Yardeni wrote. (CNN)