NEWS ROUND UP

Monday, January 14, 2018

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Sri Lanka busts US$1.2bn on soft-peg in late 2018, exceeds IMF receipts

Sri Lanka's busted 1,229 million US dollars over the past four months, to operate a highly unstable soft-pegged monetary regime, exceeding the total receipts from the International Monetary Fund under program started after a 2015 collapse of the soft-peg.

By June 2018, the IMF had disbursed 715.23 million Special Drawing Rights (a denominator currency used by the IMF), which it said was equal to 1,014 million US dollars.

The full program is 1.1 billion SDR or about 1.5bn US dollars at the time the program was approved.

Defending and Printing

In December the central bank spent 122 million US dollars defending a soft-peg, a monetary arrangement where money is printed after intervention (sterilized) to stop the money supply from adjusting (mis-targeting real money demand) to the balance of payments.

In December the central bank had also bought 2.71 million dollars to prevent the rupee from appreciating, amid pressure on the peg, the data shows.

In November the central bank spent 519.23 million US dollars defending a peg, amid a political crisis and uncertainty triggered by President Maithripala Sirisena.

In that month, about 90 billion rupees of money was released to finally sterilize interventions by cutting the reserve ratio.

Unlike in previous balance of payments crises where Treasury bills were bought outright to print money and finally sterilize interventions, the central bank has injected more money on term and overnight basis, putting more pressure on banks to slow credit.

In October the central bank had spent 303.55 million US dollars defending the soft-peg and also bought 7 million dollars to prevent its appreciation.

Mish-mash of convertibility undertakings

Severe pressure began on the currency in September after an August incident of mis-targeting real money demand where excess liquidity in money markets were pushed up to 55 billion rupees by the central bank, including through a type of currency swap that speculators usually use to attack soft-pegs.

In September the central bank spent 297.5 million dollars to defend the peg (and also spent 3 million dollars to stop its appreciation) when a (weak side) convertibility undertaking in the form of an exchange guarantee in forward markets matured.

Sri Lanka operates a pegged exchange rate system with multiple convertibility undertakings (a real effective exchange rate index, forward exchange cover or currency swaps, and an undertaking to prevent a disorderly adjustment of the exchange rate).

But there is monetary policy to make the peg work in the form of a floating interest rate.

The dollar purchases in December, October and September in the midst of currency trouble also shows that a convertibility undertaking is in operation on the strong side of the peg, where the rule is unclear to outside observers.

But the IMF through a forex reserve collection target in its deal had de facto imposed a strong-side convertibility undertaking on the soft peg but with no complementary restrictions on domestic assets acquisitions to make it work.

The mish-mash of convertibility undertakings are labeled a 'flexible exchange rate'.

Monetary Politics

Sri Lanka runs into frequent balance of payments crisis primarily by mis-targeting real money demand by sterilizing forex sales to maintain soft-pegged exchange rate regime, which results in a loss of credibility of the peg followed by exporter hold back and capital flight.

To regain credibility of the soft-peg rates have to rise, the exchange rate has to fall or trade or exchange controls have to be imposed.

"Sterilized intervention enables the central bank to leave unchanged its issue of local currency even when losses of foreign reserves signal lower demand for local currency," economist Kurt Schuler, an expert on pegs once explained to the US congress (Why Currency Crises Happen).

"However, if the central bank persists in refusing to reduce its issue of local currency, it will eventually lose all its foreign reserves.

"It must choose among abandoning the exchange rate, restricting convertibility by imposing exchange controls, or giving up independence in monetary policy by allowing the money supply to shrink.

"Politically, devaluation is usually easiest because it can be done fastest and can be blamed on external forces."

Sri Lanka's central bank depreciated the rupee from 153 to 182 to the US dollar so far in 2018 and blamed external forces as soft-peggers are wont to do.

An April mis-targeting of reserve money to enforce a rate cut despite rising US rates, where an expansion in real demand for money was exceeded by 44 billion rupees left the exchange rate at 161 to the US dollar.

What are now called developed countries adopted floating exchange rates after the Bretton-Woods soft-pegs collapsed. Sri Lanka closed her entire economy at the time.

Despite knowing that soft-pegs do not work, developed countries again tried to re-establish soft-pegs through the European Exchange Rate Mechanism amid warnings from classical economists like Alan Walters who called it 'half-baked'.

The ERM collapsed in 1992, about 20 years after Bretton Woods, leading to a loss of credibility on the economic policy making of UK's Conservative Party in particular.

So far calls to reform the peg have been resisted in Sri Lanka at an enormous cost to the country and its peoples and the credibility of the politicians of the day.

Sri Lanka's United National Party has also suffered a hit on the credibility of economic policy making due to the soft-peg with its entire free trade strategy being torpedoed by the peg. (Colombo/Jan11/2018)
(Economynext)

Bond market closes on positive mode

The bond market opened the week ending 11 January 2019 on a bearish mode but returned to a positive mode by the latter part of the week on the back of the primary auction outcomes.

Firstly, the weighted average on the 364 day bill decreased by 14 basis points to 10.85% at the weekly Treasury bill auction. Secondly, The Treasury bond auctions conducted Friday recorded impressive outcomes as the weighted averages on the 4 year and 11 month maturity of 15.12.2023 and the 9 year and 8 month maturity of 01.09.2028 recorded 11.58% and 11.73% respectively with the exact offered total amount of Rs. 98 billion been fully accepted at the phase I stage. The bid to offer ratio stood at 2.44:1.

In the secondary bond market, the liquid maturities of 01.05.20, two 2021's (i.e. 01.03.21 and 15.12.21), 15.12.23, 15.03.25, 01.06.26 and 01.09.28 were seen dipping to weekly lows of 10.85%, 11.15%, 11.20%, 11.44%, 11.60%, 11.67% and 11.60% respectively following the bond auction outcomes from its highs of 11.00%, 11.25%, 11.38%, 11.50%, 11.80%, 11.85% and 11.70% respectively. Activity picked up by the end of the week with considerable volumes commencing to change hands. In addition, the 364 day bill was seen changing hands at 10.79% and 10.80% as well in the secondary market.

Nevertheless, the foreign holding in rupee bonds was seen decreasing further for a nineteenth consecutive week to record an outflow of Rs. 3.6 billion for the week ending 9 January. The daily secondary market Treasury bond/bill transacted volume for the first four days of the week averaged Rs. 9.95 billion.

In the money market, the overnight call money and repo rates averaged 9% during the week as the average net overnight liquidity shortfall in the system decreased to Rs. 84.96 billion for the week against its previous week of Rs. 113.20 billion. The OMO (Open Market Operation) Department of Central Bank continued to inject liquidity during the week on an overnight and term (i.e. six and seven days) basis at weighted averages ranging from 8.99% to 9.00%. Interestingly, the 11 October 2019 bill maturity (273 days) was purchased at a weighted average yield of 10.10% at an OMO auction for outright purchase of Treasury bills.

Rupee appreciates further

The USD/LKR rate on spot contracts appreciated further during the week to close the week at Rs. 181.90/10 against its previous weeks closing levels of Rs. 182.65/75 on the back of bank selling interest and export conversions following the agreement with the Reserve Bank of India to provide a $ 400 million SWAP facility to the Central Bank of Sri Lanka (CBSL).

The daily USD/LKR average traded volume for the first four days of the week stood at $ 82.14 million.

Some of the forward dollar rates that prevailed in the market were one month – 182.80/20; three months – 184.60/00 and six months – 187.55/95.
(Dailyft)

Indian rupee seen facing more punishment, but no new record low: Reuters poll

The battered Indian rupee will take another bruising this year, despite a recent revival, weighed down by uncertainty around national elections in May and an expected economic slowdown, a Reuters poll found.

While the currency recovered nearly 6% after touching a record low of 74.485 per dollar on 11 October, the 2-8 January poll of more than 65 analysts showed the rupee will weaken again. However, fewer than 20% of contributors in the latest poll expected the rupee to breach that all-time low in the next 12 months, compared to nearly 50% in a November survey and about one-third in December.

After falling about 9% in 2018 – its biggest decline since Prime Minister Narendra Modi took office in 2014 – the Indian currency was forecast to weaken 1.9% to 71.50 per dollar in a year, from about 70.20 on Tuesday.

Two-thirds of those who gave a year-ahead forecast predicted the currency to be weaker – trading at more than 70 per dollar, with the most pessimistic call at 80. The others either had it around where it is now or a touch stronger. “Overall there’s nothing to be greatly optimistic about the rupee. There are lots of uncertainties, both on economic and political fronts lingering as we enter into 2019,” said Prakash Sakpal, Asia Economist at ING, adding that elections and political uncertainty pose “the biggest risk”.

“Things could go either way. We might see the BJP (Bharatiya Janata Party) retaining its power by a very thin margin. On the other extreme, there could be a coalition. This would obviously not be viewed by the international community positively, which of course is going to be bad for the currency,” Sakpal said.

A deep sell-off in emerging market currencies last year was triggered by a resurgent dollar and the US-China trade war, making the rupee the worst-performing major Asian currency in 2018.

In recent weeks, the dollar has lost momentum on economic growth worries in the US and a dialing back of rate hike expectations, benefiting emerging market currencies – with the MSCI emerging market currency index rising to levels last seen in late July. But growth conditions in most emerging economies aren’t much to write home about either, potentially limiting the upside for those currencies.

The rupee’s path this year will largely be determined by the results of national elections in May, oil price moves and the Reserve Bank of India’s policy.

With foreign outflows from Asian equities the biggest in at least seven years in 2018, the U.S.-China trade war and a widening Indian fiscal deficit at a time of slowing economic growth globally, the rupee is not likely to rise. India’s government is expected to miss its deficit target of 3.3% of gross domestic product this fiscal year as data showed the April-November deficit was already 115% of the budgeted target. That poses a big threat to economic expansion. India’s annual economic growth fell to a worse-than-expected 7.1% in the July-September quarter.

“Slowdown will become a trend this year, especially as external demand will remain on a weakening path, whereas without much downside in oil prices, imports will remain elevated, so we should see a bigger hit to GDP growth from continued widening in the trade deficit this year,” added ING’s Sakpal. But not everyone was convinced about a weaker rupee, as expectations of fewer US Federal Reserve rate hikes are likely to restrain the dollar from making further gains. “We see the retreat in global oil prices and a pause in the Federal Reserve hiking cycle outweighing domestic concerns,” said Rini Sen, FX strategist at ANZ. “This will see the rupee regain lost momentum, but much of this reversal is expected to come post the general elections in mid-2019.” (Dailyft)

Kekulawala joins Softlogic Holdings Board

Ex-banker Nihal Kekulawala has joined the Board of Softlofic Holdings PLC as an Independent Director.

He also currently serves on the Boards of Pan Asia Banking Corporation, AMW Capital Leasing and Finance, Lanka Walltiles, Lanka Ceramics, Lanka Ventures, LVL Energy Fund and Continental Insurance Lanka Ltd.

Kekulawala counts over 30 years of result-oriented financial management experience in the financial services industry. He has worked as a consultant who was responsible for setting up Pan Oceanic Bank in Solomon Islands and functioned as its Director/CEO for three years until 2016. Prior to that he held senior management positions at the Hatton National Bank Plc and at the time of retirement in December 2012 he was the Senior Deputy General Manager of Strategy and Compliance.

He is a Fellow of the Institute of Chartered Accountants of Sri Lanka, Institute of Chartered Accountants in England and Wales. He is also a Fellow of the Chartered Institute of Bankers in England. He holds a Master of Business Administration degree from the University of Manchester, England. He has also undergone extensive management and leadership development studies at Stanford University in USA, Institute of Management Development in Lausanne, Switzerland, University of Melbourne in Australia and Asian Institute of Management in the Philippines.

He is a Past President of the Association of Professional Bankers in Sri Lanka.

With the latest appointment, the Board of Softlogic Holdings comprisesChairman and Managing Director Ashok Pathirage, H. Gunawardena, H. Kaimal, R. Perera, R. Rasool, S. Selliah, P.L. De Alwis, G.L.H. Premaratne, A.S. Dharmasiri, A.R. Davidson, S. Saraf (C.K. Gupta as his alternate) and J.D.N. Kekulawala. (Dailyft)

China says will reduce foreign investment curbs; 2018 FDI up 3% to $ 135 b

China will reduce restrictions on foreign investment and address difficulties facing foreign companies investing in the country, the Commerce Minister said, according to a transcript of an interview he gave to state media.

Commerce Minister Zhong Shan said China would allow full foreign ownership of companies in more areas of the economy and would reduce the number of industries in which foreign investment was restricted or barred, according to the transcript posted on the Ministry of Commerce's website yesterday.

The comments appeared to be largely reiterations of past pledges by Chinese officials for further market opening.

Foreign direct investment (FDI) into China rose by 3% year-on-year to $ 135 billion in 2018, Zhong said.

That would mark a slowdown from growth rates of 7.9% in 2017 and 4.1% in 2016.

But Zhong said China had maintained stable FDI growth "against a gloomy global climate", noting that total FDI around the world had slumped by 41% in the first half of last year.

China has been pushing to broaden opportunities for private firms and foreign investors to stimulate an economy that is slowing on the back of weakening domestic demand and a trade war with the United States.

Zhong said “properly handling” trade frictions with the United States was a major task for the Ministry in 2019.

The Ministry would “conscientiously implement” the consensus to work toward a resolution of the trade row reached by Chinese President Xi Jinping and US counterpart Donald Trump in Argentina late last year, he added.

The two sides held three days of trade talks at a vice-ministerial level in Beijing last week. Zhong said the Commerce Ministry would push for the introduction of a foreign investment law as soon as possible, improve the handling of complaints from foreign firms, and encourage foreign investment in manufacturing and high tech.

The Ministry would also encourage foreigners to invest in central and western China, he said.

(Dailyft)

U.S. Equity Futures, Asian Shares Drop; Yuan Gains: Markets Wrap

U.S. equity futures declined with Asian stocks on Monday as a January rally in risk assets showed signs of abating. The yuan extended recent gains.

Shares in Hong Kong and Seoul retreated and gains in Australia fizzled. Futures on the S&P 500 dropped after the index Friday closed flat and the yield on 10-year Treasuries declined. Japan is closed for a holiday, so Treasuries won’t trade until the London open, though futures indicated a decline in yields.

Signs of progress in U.S.-China trade talks and dovish commentary from Federal Reserve officials have buoyed a rally in global equities in January. The next hurdle to clear will be a slew of U.S. bank profit reports and an earnings season, amid worries global growth is slowing. Also weighing on sentiment is the partial U.S government shutdown that’s entered its fourth week.

Elsewhere, oil headed toward $52 a barrel and the yen strengthened. The pound gained ahead of Tuesday’s crucial vote on Brexit, with Prime Minister Theresa May appearing no closer to getting the backing she needs.

USD Will Remain Strong This Year, Says DBS Bank's Wee
Philip Wee, senior currency economist at DBS Bank, discusses Fed policy and the U.S. dollar.
Here are some important events coming up:

Some of the world’s biggest banks announce earnings, including Citigroup, JPMorgan, Bank of America, Wells Fargo, Morgan Stanley and Goldman Sachs. Alcoa, Indian IT company Mindtree, Netflix, Taiwan Semiconductor, American Express and BlackRock also post results.
U.K. Parliament will vote on the Brexit deal.
These are the main moves in markets:

Stocks

- The MSCI Asia Pacific Index fell 0.3 percent as of 10:02 a.m. Hong Kong time, after last week’s 4.1 percent advance.
- Hong Kong’s Hang Seng slid 1.2 percent.
- Australia’s S&P/ASX 200 Index was flat.
- Futures on the S&P 500 slid 0.7 percent. The S&P 500 Index ended Friday little changed.

Currencies

- The yen rose 0.2 percent to 108.23 per dollar.

- The offshore yuan rose 0.2 percent to 6.7464 per dollar.
- The euro held at $1.1477.
- The British pound added 0.1 percent to $1.2859.

Bonds

- The yield on 10-year Treasuries fell four basis points to 2.70 percent on Friday.
- Australia's 10-year bond yield dipped about one basis point to 2.30 percent.

Commodities

- The Bloomberg Commodity Index added 0.2 percent on Friday.
- West Texas Intermediate crude rose 0.3 percent to $51.43 a barrel.
- Gold climbed 0.1 percent to $1,292.06 an ounce.

(Bloomberg)