NEWS ROUND UP

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Sri Lanka rupee ends firmer, bond yields stable

Sri Lanka's rupee closed stronger at 174.55/65 the US dollar in the spot market Friday, while the bond market was quiet with yields stable, market participants said.

The rupee closed at 174.60/75 to the US dollar in the spot market on Friday.

Overnight liquidity short was 16.48 billion rupees, stable from Thursday.

The bond market was quiet with stable yields a day before the traditional new year, dealers said.

Twelve-month bills closed at 9.80/95 percent on Friday, unchanged from Thursday's close.

A bond maturing on 15.03.2022 closed at 10.40/48 percent, stable from 10.40/47 percent.

A bond maturing on 15.07.2023 closed at 10.65/70 percent, unchanged from yesterday.

A 5-year bond maturing on 15.03.2024 closed at 10.70/78 percent, flat from Thursday.

A bond maturing on 01.06.2026 closed at 10.95/00 percent, down from 10.97/00 percent.

A bond maturing on 15.01.2027 closed at 11.00/05 percent up from 10.98/02 percent.

A bond maturing on 01.05.2029 closed at 11.15/20 percent, easing from 11.17/22 percent. (EconomyNext)

Sri Lanka private credit barely grows in Feb 2019, currency peg strong

Sri Lanka's private credit barely grew in February 2019, though no longer contracting like in January 2019, while new credit to state enterprises was also small and central bank money printing was negative, official data showed, helping harden a peg with the US dollar.

Central bank credit (printed money) to the banking system contracted 4.8 billion rupees in January, ending a steak of money printing that began from September 2018, involving a complex series of policy errors that triggered a second run on the rupee which ended at 182 to the US dollar by the end of the year.

Weak Private Credit

Private credit grew just 7.6 billion rupees in February to 5,560.7 billion rupees, turning around from a negative 4.3 billion rupees in January.

Private credit can fall because exporters are unwinding dollar positions to pay down packing credit taken during a run on the rupee as credibility on the peg is restored. Government settlement of contractors can also reduce private credit, both of which have no negative effects on growth or employment.

The rupee appreciated from about January as private credit fell and capital flight ended.Up to April the rupee peg has been allowed to rebound to 174 to the US dollar from 182 wtih a strong side convertibilit undertaking deployed to collect forex reserves.

In Febuary the central bank was a net buyer of 29 million US dollars in forex markets. In March net purchases were 86 million dollars.

Credit to government from the banking system was 46.2 billion rupees in February, down from 110.3 billion rupees in January.

Total credit from commercial banks and central bank to all customers was 57.5 billion rupees in February slightly lower than 61 billion rupees a month earlier. In September total credit including CB credit was 278 billion rupees and in October 114 billion, November 135 billion rupees and Demceber 144 billion rupees amid capital flight sterilization.

However January 2019 spike in central bank credit came from a reserve appropriation to part-settle a maturing sovereign bond.

Analysts have pointed out that due to particular method adopted in settling foreign loans with central bank reserve, the effect is monetary policy neutral and does not involve altering the liquidity of multiple banks and has no effect on either inflation or the peg, unlike sterilized currency defence.

In 2018 the central bank generated a first run on the rupee by printing money and halting mopping up operations from February 2018 which sent the rupee reeling from 153 to about 161 to the US dollar by July.

The central bank then created fresh money and a second liquidity shock through unsterilzed dollar purchases as well as so-called Soros swaps with the Treasury which led to the second run. A legacy central bank swap (which is an explicit forward convertibility undertaking) also matured in September, which was then filled with large scale money printing, filling liquidity shorts at multiple banks.

Forward Convertibility Undertakings

Unlike reserve appropriations, forward convertibility undertakings alter reserve money by injecting cash to multiple banks when neutralized with freshly printed money.

To avoid monetary instability in the future EN's economic columnist Bellwether has said that all future swap maturities should be settled in paper with the counterparty bank giving the central bank and equivalent volume of Treasury bills instead of cash to make the transaction monetary policy neutral.

However swap maturities (as well as any other risky open market operations) cause less problems when private credit is weak or and dollar purchases are mopped up steadily to keep the peg on the strong side of its convertibility undertaking.

In September 2018 however credit surged.

Balance of payments troubles are primarily caused by credit, as it is borrowers - mostly large investors and the government - who can spend beyond their means.

Pressure on the rupee is created when new loans are financed by central bank credit from its reverse repo, term reverse repo auctions to sterilize interventions or for any other lender of last resort operation or outright purchases of Treasury bills to manipulate bill auctions or provisional advances given to the Treasury.

Ordinary people outside the central bank have no ability to put pressure on the currency. Even capital flight will simply push up interest rates if unsterilized interventions are made or lead to a very temporary fall in the currency if no intervention is made.

Targeting two impossible variables

Sri Lanka's rupee falls because it is a peg with a series of convertibility undertakings (exchange rate targets) and money is printed to target interest rates after deploying so-called weak side CUs.

Soft-pegged central banks do not seem to realize that deploying a weak side convertibility undertaking and printing money to maintain a base money target (a base or reserve money target is a derivative of an interest rate target) and deploying a strong side convertibility undertaking to contract the reserve money to maintain the target has opposite effects on the rupee.

The central bank seems to believe that its intention in printing money (whether to monetize the debt or engage in LOLR operations to maintain a base money target) could affect the eventual outcomes.

"Reserve Money, which was at Rs. 939.8 billion at end 2017 and at Rs. 1,010.5 billion at end September 2018, was recorded at Rs. 1,020.8 billion on 2 November 2018," the central bank said in November 2018 amid concerns over money printing.

"This is a year-on-year growth in Reserve Money of 11.6 per cent, which is well within the CBSL projections for the year." But a central bank can only control one variable at a time, either the interest rates (through base money) or the exchange rate, and not both simultaneously it is wants to avoid balance of payments troubles.

"...[A] central bank really has only one instrument of policy, i.e base money," Ross McLeod a professor at Crawford School of Public Policy at Australia National University said at the Asian Liberty Forum in Colombo.

"Which says they can only control one nominal variable at once: the exchange rate or the price. Not both simultaneously."

Some economists also call it the impossible trinity of monetary policy objectives because, central banks then impose exchange controls and/or trade controls to be able to keep printing money.

In 2018 the central bank slapped controls on car imports and other items brining the entire free trade strategy of the current administration into disrepute like other soft-peggers before them. Even the US Fed slapped so-called Nixon shock controls as its soft peg collapsed in 1971 following fancy monetary policy incompatible with its gold peg. (EconomyNext)

China's Qindao Huijintong wins Rs6.7bn Sri Lanka power grid deal

China's Qingdao Huijington Power Equipment Company Ltd has won a deal to build a 33KiloWatt transmission line for Sri Lanka's state-run Ceylon Electricity Board.

The deal is part of a 115 million US dollar grid improvement project funded by the Asian Development Bank, the state information office said.

The cabinet of ministers had approved a proposal by Power Minister Ravi Karunanayake to award the construction contract to the Chinese firm.

The firm will build pillars and gantries for the 33kW transmission lines as part of package 4 of the ADB funded project.(EconomyNext)

Sri Lanka forex reserves soar in April to US$7.6bn

Sri Lanka's forex reserves grew by 1.58 billion US dollars to 7,621.9 million US dollars by end March 2019 from 6,035.16 million US dollars, helped by sovereign bond sales and actual mopping up of inflows amid weak credit and better monetary policy.

Gross official reserves are made up of central bank's monetary reserves and fiscal reserves of the Treasury which are borrowed outright.

The central bank also borrows reserves outright from the International Monetary Fund.

It also technically borrows reserves from private or state entities giving explicit forward convertibility undertakings (dollar rupee swaps), which is the most dangerous form of reserve building.

Unwinding of those swaps later will shrink reserve money and when money is printed to stop rates rising, balance of payments trouble develops.

The central bank can also built reserves by permanently mopping up rupees generated from dollar purchases from the interbank market of when credit is weak.

If reserves are mopped up by outright sales of sterilization securities (Treasury bills taken into its balance sheet to generate monetary instability in the country in the past) it will permanently 'purchase' the reserves or its own securities) and the dollars remain locked in its balance sheet.

In the past the central bank sold its own securities when it ran out of Treasury bills to lock up reserves.

A few years ago the central bank stopped selling its own securities, which analysts have identified as one reason for frequent balance of payments crises and monetary instability.

The central bank instead temporarily mopped up reserves by entering into term repo deals, which mature in a few days or weeks releasing the liquidity back to banks who then loans them to generate imports.

Liquidity shocks from term repo terminations were the key driver of the 2012 and 2015 balance of payments crises and also the run on the rupee from April 2018, when term repos which were started in that year itself were released as credit picked up in March.

In December 2019, when the economy was starting to recover analysts warned that it should resume selling to stop another balance of payments crisis from developing because the economy and the credit system was starting to recover from the previous crisis. (Sri Lanka's Central Bank should sell own securities in new credit cycle: Bellwether)

Instead from February it stopped mopping up all reserves and in March terminated term repos and in April cut rates and recklessly injected money in a way that left observers non-plussed. In January 2019 private credit turned negative for the first time in four years ending a run on the rupee and placing Sri Lanka's dollar peg on the strong side of its convertibility undertaking.

In 2019, the central bank has bought dollars on a net basis in February and March deploying a strong side convertibility undertaking of its unstable soft-peg. It kept overnight money markets short.

Its permanent Treasury bill stock, excluding those involved in reserve repo injections which rose to 179 billion rupees in January - partly due to reserves sold to the Treasury to settle foreign loans - has been brought down to 163 billion rupees by April 12.

A central bank that deploys convertibility undertakings (buys or sells dollars for whatever reason in forex markets) make the balance of payments drive the monetary base (reserve money).

If that central bank then resists the natural growth of reserve money by mopping up dollar purchases, it will slow economic activity a little but will build up reserves and keep the currency peg strong. In the process it will keep short term rates slightly above the free market or currency board rate.

If it expands reserve money over what is determined by the balance of payments through open market operations (terminating term repos, engaging in reverse repo deals or buying Treasury bills outright) the central bank will generate a balance of payments crisis and weaken the peg.

Though rates will initially fall, the monetary instability it triggers will generate capital flight and higher interest rates later.

Currency depreciation will also keep nominal interest rates permanently higher than countries with consistent and stable monetary regimes (free floating or currency boards or even tighter-than-currency board like China from 1993 to 2005).

In 2019 monetary policy has been prudent, other than an anomaly where term money is injected at lower rates than the ceiling policy rate. (EconomyNext)

Money, money, money: the tycoon factor in India's election

India's tycoons are playing a pivotal role in the Asian giant's most expensive election ever, from funding campaigns and tacit endorsements to being hot-button issues themselves.

Prime Minister Narendra Modi's re-election bid has received huge financial backing from corporate India, raising fears about the integrity of the world's largest democratic process, experts say.

Meanwhile, Congress party opponent Rahul Gandhi is trying to exploit a fighter jet deal involving industrialist Anil Ambani while fugitive tycoons Vijay Mallya and Nirav Modi loom over the vote from London.

Contesting polls is getting costlier in India and analysts say parties are becoming more reliant on donations from anonymous businessmen, leading to a lack of transparency and worrying conflicts of interest.

"There's a trend towards plutocracy," Niranjan Sahoo, of the Observer Research Foundation (ORF) think-tank, told AFP. "Unbridled corporate influence can have a serious impact on policies," he added.

The New Delhi-based Centre for Media Studies estimates that around $5 billion was spent during the 2014 election that swept Modi's Hindu nationalist Bharatiya Janata Party (BJP) to power -- up from $2 billion in 2009.

The group thinks the 2019 contest could top $7 billion, making it one of the priciest elections globally.

"Elections are getting more expensive for many structural reasons," Milan Vaishnav, a senior fellow at the Carnegie Endowment for International Peace think-tank, told AFP.

"(There is a) growing population, increasing political competition, voter expectations of handouts in the form of cash and other inducements, and technological change, which means greater outlays for media and digital outreach," he added.

Analysts say traditional funding streams, such as party memberships, are declining so parties increasingly rely on wealthy donors to fund campaigns.

Data compiled by the Association for Democratic Reforms (ADR), an election watchdog, showed that in financial year 2017-18 corporates and individuals contributed 12 times more to the BJP than to six other national parties, including Congress, combined.

- 'QUID PRO QUO' -

The BJP received 93 percent of all donations above 20,000 rupees ($290) that year, according to ADR'S analysis. Modi's BJP banked 4.37 billion rupees ($63.3 million); Congress got just 267 million rupees.

"There is a huge funding disparity now. Congress simply doesn't have the money to fight elections. That should worry people," said the ORF's Sahoo.

Modi's government says it has cracked down on so-called "black money" in politics by lowering the amount that can be donated in cash from 20,000 rupees to 2,000 rupees.

Critics, however, say it is now easier for wealthy entities to donate to political parties; corporate funding formed 92 percent of the total donations declared by the BJP in 2017-18, according to ADR.

Detractors point to the government removing a cap on corporate donations two years ago and introducing a scheme whereby donors can give anonymously through "electoral bonds" purchased from a bank.

On Friday India's supreme court ordered parties to reveal the identity of donors after activists challenged the bond system, which the government has defended.

"The lack of transparency allows conflicts of interest and quid pro quos to flourish", said Vaishnav, who suspects that medium-sized businesses requiring permits from the government are more of an issue than India's big oligarchs.

Tycoons do not explicitly endorse candidates for fear of backing the wrong horse but Modi, 68, is seen to be close to several big tycoons.

In 2014 he travelled between rallies in a corporate jet and helicopter owned by billionaire industrialist Gautam Adani, while magnate Ratan Tata praised Modi for carrying out air strikes in Pakistan.

India's richest man Mukesh Ambani -- whose personal net worth has soared from $18.6 billion when Modi came to power to $53 billion today, according to Forbes -- has repeatedly called him "our beloved prime minister" in speeches.

- 'HE'S NOT THE MESSIAH...' -

"If you look at the measure that counts, which is how much money do these guys have, then India's tycoons have done tremendously well under Modi," James Crabtree, author of "The Billionaire Raj", told AFP.

Ambani's oil-to-telecoms conglomerate Reliance Industries and the Adani Group did not respond to requests for comment.

Gandhi, 48, is trying to score political points by accusing Modi and Anil Ambani, Mukesh's younger brother, of dodgy dealings related to the purchase of Rafale jets from France –- allegations both deny.

Congress's leader is also using liquor-baron Mallya and jeweller Nirav Modi to attack the BJP. The government accuses them of massive fraud and is trying to extradite them from Britain.

Modi pledged to crack down on crony capitalism during his tenure so the duo represent a sore point for a man who prides himself on being India's "chowkidar" ("watchman").

"Vijay Mallya and Nirav Modi have become the symbols of a job half done. Nonetheless the noose is tightening on these guys," said Crabtree.

India's business community appears less enthusiastic about Modi this time round after a shock cancellation of high-value banknotes and poorly implemented new tax disrupted economic growth.

But they are set to vote for him overwhelmingly anyway, fearing that a coalition or Gandhi victory could put a halt to much-needed economic reforms.

"He's not the messiah we thought he was but without doubt almost everybody wants Modi to come back with an absolute majority," said a prominent Mumbai-based businessman who asked not to be named.

"Because beyond him there is no alternative," he added. (AFP)