NEWS ROUND UP

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IMF team to arrive in mid-Feb

The International Monetary Fund (IMF) will send a team to Colombo in mid-February to resume discussions on the $ 1.5 billion Extended Fund Facility (EFF) program after it was derailed during the 52-day political turmoil last year.

Finance Minister Mangala Samaraweera and IMF Managing Director Christine Lagarde exchange greetings in Washington
IMF Managing Director Christine Lagarde on Tuesday met with Finance Minister Mangala Samaraweera and Central Bank Governor Dr. Indrajit Coomaraswamy in Washington. Following the discussion the IMF released a statement.

"I was pleased to meet with Minister Samaraweera and Governor Coomaraswamy this afternoon. We discussed the challenging economic environment and the policy priorities for the country. The authorities stressed Sri Lanka's continued commitment to their economic reform agenda under the IMF-supported program," Lagarde said in the statement. The IMF and the Sri Lankan Government had reached a staff-level agreement just hours before President Maithripala Sirisena appointed Opposition Leader Mahinda Rajapaksa as Prime Minister on 26 October, triggering a constitutional crisis that also derailed the IMF program. Following the appointment of the new Cabinet, the Central Bank resumed talks with the IMF at the beginning of 2019.

"We agreed that a strong policy mix, with effective implementation of that agenda, is key to strengthening confidence, while putting Sri Lanka on a sustainable, high-quality growth path that would benefit its people."

"The IMF remains ready to support the Sri Lankan authorities in these endeavours and an IMF team is scheduled to visit Colombo in mid-February to resume program discussions."

The Sri Lankan delegation discussed the possibility of resuming the IMF program with a view to stabilising the economy following the disruptions of post 26 October 2018, and stressed on Sri Lanka's commitment to the economic reform agenda, the Finance Ministry said in a separate statement.

The IMF has disbursed over $ 1 billion out of a $ 1.5 billion three-year EFF loan it had agreed in 2016. Central Bank Governor Dr. Indrajit Coomaraswamy in the first week of January said the Sri Lankan Government has to option of extending the three-year program, which is scheduled to end in June by one year and also enhance the funding limit.

Sri Lankan delegation included Non-Cabinet Minister of Public Distribution and Economic Reforms Dr. Harsha de Silva, Treasury Secretary Dr. R.H.S. Samaratunga, Central Bank Governor Dr. Indrajit Coomaraswamy, Central Bank Senior Deputy Governor Dr. N.P. Weerasinghe, Economic Advisor to the Minister of Finance Deshal de Mel and IMF for Sri Lanka Executive Director M. Siriwardena. (Daily FT)

Port City is here for all

The reclamation of the 269 hectares of the Port City was officially completed yesterday, setting the stage for the next phase of seeking investment with officials, saying they would redouble efforts to restart talks stalled during the recent political turmoil to achieve the target of $15 billion infresh ventures.

CHEC Port City Colombo Managing Director Jiang Houliang Pix by Lasantha Kumara

Megapolis and Western Development MinisterPatali Champika Ranawaka, speaking at the ceremony to mark the end of the reclamation, spoke of the master plan set in place for the second step of the project, and said that a clear mechanism is provided for the implementation, directing both public and private sector development with a set of development objectives, definitions, and regulations.

He further said that these regulations, which consist of four volumes covering urban design, utilities, landscape, and sustainability, are to enforce the vision and objectives of the master plan in a transparent manner.

“This project hopes to establish seamless connectivity to the Port City, by introducing a new road and tunnel connecting directly to the Marine Drive in Kollupitiya, and a railway system to run through the Port City, connecting directly to the commercial city surrounding Beira Lake. The Road Development Authority has done a feasibility study and work will start according to its results,” the Minster explained.

The Minister stated that there will be a city park, an international school, an international hospital, and an international conference hall constructed in Port City, along with all other facilities.

Ranawaka also mentioned a feasibility study done for a secondland reclamation venture along the sea between Dehiwala and Kollupitiya,but such a project would only be started at some point in the next decade.

Colombo Port City Project Director Nihal Fernando told Daily FT that several parties have showed interest to invest in the Port City, but talks ran into a roadblock during the constitutional crisis.

“These interested parties have not withdrawn their proposals, so very soon they will restart the negotiations. Currently, there are negotiations going on with a foreign company to invest another $1 billion on three buildings in the Port City. The Government might even announce special concessions for investments, to make them more attractive,” Fernando stated.

The Project Director detailed that the land costing will be established on open market policies, and that the land values might depend on the type of construction demarcated,be it a high-rise building or a two story building. He further stated that special legislationis being drafted by the Government, which is required for the International Financial City.

“Out of the 269 hectares of land that is reclaimed, 62 hectares of land will be leased out by the Government of Sri Lanka, proceeds of which will come to the Government and 91 hectares of common land, such as beaches and green spaces which will not be commercial spaces,will also managed by the Government,”Fernando said.

Speaking to the audience, Chinese Ambassador Cheng Xueyuan, who was present at the ceremony, said that the Port City project symbolises the friendship of China and Sri Lanka.

“China has invested nearly $7 million to promote the relevant industries in Sri Lanka. This project has provided more than 4000 jobs to the locals, benefitting thousands of Sri Lankan families. We are now engaged in surface development and building utilities,” he stated.

Megapolis and Western Development Ministry Secretary Nihal Rupasinghe, Megapolis and Western Development Ministry Senior Advisor Vidya Amarapala, and CHEC Port City Colombo Ltd. Managing Director Jiang Houliang,were also present at the ceremony.
(Daily FT)

Ailing rupee and price controls may lead to a shortage of milk powder

A cup of tea is every Sri Lankan's morning mantra. This might not be the case much longer as Sri Lanka may face a shortage of milk powder as several leading milk powder importers are reported to have taken a collective decision to suspend imports. The recent depreciation of the rupee has caused a significant increase in import costs and importers say they are now unable to sell at the controlled price, hence the decision to suspend imports. The same impact will be felt in other industries subject to price controls. The pharmaceutical industry withdrew eleven drugs from the market citing similar reasons. The currency has depreciated by 10% in the past two months and over 20% in the past year, which will raise landed costs of import products significantly. Importers of goods subject to price controls will continue to be squeezed as their price margins reduce and this will eventually lead to a halt in imports, like in the evident case of milk powder.

Imported milk powder is taxed at a total of 45% in Sri Lanka, with the objective of protecting local farmers and achieving self-sufficiency in milk products. Despite this self-sufficiency goal, local production meets below 40% of the total domestic milk requirement, considerably below 80% levels in the 1970s. Therefore, majority of the demand in milk products is met through imports, mostly from New Zealand and Australia. Over the last decade, in 7 out of 10 years, imports of milk powder has grown at a higher pace than the growth in local production.

Additionally, in May 2018, changes to existing price controls on milk prices have raised the controlled price for milk powder to Rs. 345/400g pack and Rs. 860/1kg pack. This price control was enforced by the Consumer Affairs Authority, despite a rise in the global prices of milk. Global milk powder prices fell in 2015 and 2016 and climbed in 2017 and 2018 and now the cost of one metric ton of milk powder in the world market is $ 3250-3350.

Furthermore, the depreciating rupee, now valued at Rs. 184 to a dollar has only continued to worsen the situation, making it more expensive to import milk powder. "Importers of milk powder are squeezed between the tax (which raises costs), the controlled price which sets a ceiling at which the product retails, and now the depreciating rupee which further raises import costs." says Ravi Ratnasabapathy, Resident Fellow of the Advocata Institute.

The floor price encourages production which the market is sometimes unable to absorb, leading to gluts which cannot be converted to powder (the only long term storage form of milk) due to the controlled price.

A recent report by the Advocata Institute, Price Controls in Sri Lanka, emphasizes the contradictory trajectory of policies in the dairy industry. This tangle of taxes and controls comes at a cost to consumers. Our costs are increasingly becoming apparent by visible shortages of milk powder in the market. (Daily FT)

JKH's Rs. 11 b share buyback offer ends

The Rs. 11 billion worth share buyback offer of John Keells Holdings (JKH) had ended with the move triggering acceptance of only 46% of the offer.

JKH said that its offer to repurchase 69.37 million shares or 5% of shares in issue received acceptances of 32.2 million shares amounting to 46.39% of the offer. However those who accepted had requested for additional repurchase of 68.53 million shares.

The offer was on a pro-rata basis of one share for every 20 shares held at Rs. 160 each.

JKH will complete the offer of 69.37 million by accepting additional applications on pro rata basis as per their shareholding.

Company analysts said the level of acceptance points to majority of shareholders believing JKH share has greater upside going forward.

JKH share closed 2018 at Rs. 159, up 6.9% from the previous year.The 52-week highest share price of JKH in 2018 was Rs. 167 and the lowest was Rs. 126. Yesterday it closed at Rs. 152.10.

Given recent political instability and depressed economic performance, some anticipated foreign shareholders of JKH would accept the buyback offer. However the fact that majority had not, analysts opined, reflects their forward view as well as overall sentiment on emerging/frontier markets.

Foreign shareholding in JKH amounts to 47.6% and has nearly 11,700 shareholders in total.

According to CT CLSA, JKH share was up 1% in the past 12 months, outperforming the market by 8% and trades at 9% discount to its estimates sum of the parts valuation of Rs. 173.

JKH was the most traded stock in 2018 with 318 million shares changing hands for Rs. 47.3 billion accounting for 23.6% of CSE's total as per CT CLSA data. However in terms of market capitalisation JKH's figure of Rs. 220.6 billion is behind number one Ceylon Tobacco'sRs. 268 billion.

In announcing the share buyback, JKH said that the Board was of the view that the share is not reflective of the value of the Company and did not adequately represent the growth prospects. This presented an opportunity for JKH to repurchase its shares. Further, the strength of JKH's Balance Sheet, along with existing cash reserves, was more than adequate to fund the Company's planned investment pipeline while retaining its track record of dividend pay-out.

Investors toasted the announcement on 12 November pushing JKH share price to a high of Rs. 152 before closing up Rs. 6, or 4%.

The pay-out will be from tax-paid dividend reserves hence won't be subject to the Withholding Tax. It was also the first share buyback by JKH after 2008. (Daily FT)

CB buys Rs. 90 b in T-bills

The Central Bank yesterday said it had bought Rs. 90 billion in Treasury Bills in January and would reverse part of the transition next month and eventually offload the rest once the Government's borrowing program is back on track.

The Central Bank subscribed to Treasury bills (T-bills) amounting to Rs. 90 billion in January 2019 at the request of the Treasury to assist financing needs of the Government due to the delay in receiving expected foreign currency financing arrangements as envisaged in the Treasury's cash flow for the month of January 2019, the monetary authority said in a statement.

The Monetary Board has acceded to the Treasury's request in the national interest and under exceptional circumstances.

"Having reviewed the macroeconomic consequences of subscribing to T-bills by the CBSL, the Government has agreed to reverse part of the transaction in February and the balance during the first quarter of 2019 once the Government's borrowing program is brought back on track with realisation of expected financial arrangements," it added. (Daily FT)

Rupee edges lower; stocks slip

Sri Lanka's rupee closed slightly weaker on Wednesday in thin trade due to light dollar demand from banks and importers, while worries over political uncertainty and fiscal slippage weighed on investor sentiment.

The International Monetary Fund (IMF) will resume discussions with Sri Lanka in February for further disbursal of part of a $1.5 billion loan, the lender said, after a political crisis led to talks being delayed by three months.

The rupee ended at 182.30/40 per dollar on Wednesday, compared with 182.15/30 in the previous session, market sources said. Markets were closed on Tuesday for a holiday. On 3 January, the rupee had fallen to an all-time low of 183.00 against the dollar.

The rupee fell 19% in 2018, making it one of the worst-performing currencies in Asia, according to Refinitiv data, due to heavy foreign outflows. The rupee has declined about five percentage points since the political crisis started.

A series of credit rating downgrades have made it harder for Sri Lanka to borrow as it faces record high repayments of $5.9 billion this year, with $2.6 billion of it due in the first three months.

On Tuesday, the island nation's junior Finance Minister, Eran Wickramaratne, told Reuters that Sri Lanka was considering an offer from Bank of China for a loan of $300 million, which could be raised to $1 billion, to help it meet repayments in the coming months.

The Central Bank on 9 January said that the Reserve Bank of India (RBI) had agreed to provide $400 million to it under a regional swap facility and it had also requested a further bilateral swap arrangements of $1 billion.

Sri Lanka's shares closed slightly weaker, near their more than six-week closing low hit on Friday. The Colombo Stock Index ended 0.13 % weaker at 5,973.34, hovering near its lowest close since 26 November hit on Friday. The benchmark stock index lost 5 % in 2018. Turnover was Rs. 950.2 million ($5.22 million), more than last year's daily average of Rs. 834 million. Foreign investors sold a net Rs. 620.6 million worth of shares on Wednesday. They have been net sellers of Rs. 15.3 billion worth of stocks since a political crisis began on 26 October.

The bond market saw outflows of Rs. 77.9 billion between 25 October and 9 January, the latest Central Bank data showed. Foreign investors pulled a net Rs. 22.8 billion out of stocks last year, while they net sold Rs. 159.8 billion from Government securities from January through 26 December Bourse and Central Bank showed data.

Sri Lanka President Maithripala Sirisena appointed a Cabinet of Ministers from his rival party on 21 December after he was forced to reinstate Ranil Wickremesinghe as Prime Minister, 51 days after he was sacked. The crisis is expected to ease, though tense relations between the two men could cause fiscal problems, analysts say.

Sri Lanka plans to increase Government spending by 13.2% from last year to Rs. 4.47 trillion in 2019, the Finance Ministry said last week. (Daily FT)

Value thesis more pronounced in Lankan equities; yet polarised risks make 2019 challenging

Asia Securities Research expects the Sri Lankan stock market to offer pockets of opportunities for investors, in the year ahead, despite expectations that 2019 will in general be a challenging year for equities. The leading stock brokerage firm is recommending that clients take positions in stocks with specific growth opportunities in the current environment.

The Colombo Stock Exchange's All Share Price Index (ASPI) currently trades at 8.5x trailing price-to-earnings (P/E) multiple, down from 10.1x at the beginning of 2018. Furthermore, the ASPI is trading at a 20% discount to the overall MSCI Emerging Markets (EM) index, which is the largest discount seen in the last five years.

As widely understood, the local idiosyncratic risks (largely political and to some extent macroeconomic) led to Rs. 9.6 b (approx. $ 50 m) of foreign fund outflows from the stock market compared to Rs. 28.5 b in inflows in 2017 resulting in the dip in valuations.

EM equities too saw a challenging 2018 as a stronger US economy, rising US rates, and the resulting weakening EM currencies leading to foreign funds exiting the EM asset class. However, the outlook for EMs has improved and is expected to mark a catch-up rally buoyed by an improving macro picture, strengthening currency and lower oil prices with the caveat of easing US-China trade tensions.

However, it is likely that Sri Lanka will not see a significant benefit from this trend in the short run, as the local conditions will keep foreign investors on the sidelines; 1) delayed budget reading that creates uncertainty about fiscal measures, 2) debt maturities of $ 5.9 b exacerbated by credit rating downgrade and the resultant pick up in refinance costs, and 3) uneasy alliance between the president and the UNF government, raising concerns on continuing policy divergence, are the largest residual risks factored in by investors.

In addition, given the current high interest rate environment, the local high net worth and retail investors may favour the fixed income asset class and take a wait-and-see approach toward equities. Overall, these developments will drive soft momentum in 1H CY19.

However, from a macro standpoint, several catalysts could lead to better investor confidence in 2H CY19; 1) re-engaging with funding partners such as the IMF and making progress on other funding lines currently in the pipeline 2) managing the $ 1.5 b sovereign bond repayments in January and April, and 3) presenting the budget with streamlined fiscal policy, while continuing the reforms agenda, are key data points eagerly watched by investors.

In addition, several tailwinds supporting growth momentum can lead to an improved outlook on SL; 1) pickup in agriculture and the related household income, translating to better consumer demand, 2) continued low oil prices and better hydro power generation leading to an improved current account balance, and 3) lower currency depreciation strengthening reserves.

Of the 12 sectors covered by Asia Securities, three are rated positive, with a neutral view on the rest. Banks are expected to see an improvement in earnings with the high impairments seen in 2018 falling away, while the telecommunication sector is expecting a tailwind for voice demand through the reduction of the telco levy.

The consumer segment (FMCG and retail) currently experiencing muted growth should see its earnings recover in 2H CY18. In the manufacturing sector, export-oriented companies will see better results with the lower nominal LKR rates, while Non-Bank Finance sector and Leisure will remain under pressure in 2019, according to Asia Securities.

The top picks selected by Asia Securities Research in 2H CY18 returned 0.8%, outperforming the broader ASPI (-2.1%) and the S&P SL 20 (-7.0%) on a total return basis. The portfolio for 2019 is comprised of seven stocks selected based on specific value drivers, backed by the Asia Securities' bottom-up views on each stock. (Daily FT)