NEWS ROUND UP

Thusday, 21st March, 2019

Contents

Sri Lanka rupee falls at close, stocks retreat

Sri Lanka's rupee closed weaker at 178.40/45 to the US dollar on Tuesday, while bond yields fell and stocks retreated 0.42 percent on foreign selling, brokers and dealers said.

The rupee closed at 178.25/35 to the US dollar in the spot market on Monday, gaining from Friday.

Dealers said the bond market was quiet Tuesday morning, and some activity was seen in the afternoon session following a bills auction.

The state debt office had accepted 24 billion rupees in bills on Tuesday, with auction weighted average yields falling.

In the secondary market, Twelve month bills closed at 10.42/50 percent on Tuesday, down from 10.47/55 percent at Monday's close.

A bond maturing on 01.08.2021 closed at 10.72/75 percent today, falling from the previous close of 10.75/82 percent.

A bond maturing on 15.07.2023 closed at 10.90/00 percent on Tuesday, down from Monday's close of 10.95/05 percent.

A new 5-year bond closed at 15.03.2024 closed at 11.05/08 percent today, easing from 11.08/10 percent at Monday's close.

A bond maturing on 01.08.2026 closed at 11.15/25 percent on Monday, stable from 11.15/30 percent at the previous close.

A bond maturing on 15.06.2027, closed at 11.25/35 percent on Tuesday, falling from 11.28/38 percent at Monday's close.

A bond maturing on 01.09.2028, closed at 11.33/43 percent on Tuesday, down from the previous close of 11.35/43 percent.

A newly-issued bond maturing on 01.05.2029 closed at 11.42/48 percent today, stable from Monday's close of 11.45/52 percent.

At the Colombo Stock Exchange, the All Share Price Index dipped below 5,600.

The market closed 23.31 points lower at 5,591.67 after reaching an intraday high of 5,620 in the first few minutes of trading, First Capital Research said.

The more liquid S&P SL20 Index closed 8.65 points lower at 2,752.35.

Market turnover was 291.3 million rupees, driven by foreign selling, with 182.6 million rupees in net outflows from the market.

Distilleries Company of Sri Lanka contributed most to the All Share's fall, with the share ending 80 cents lower at 14 rupees.

Trading was centred on Hemas Holdings, which contributed 52 percent to turnover, and closed 1 rupee lower at 75 rupees per share.

Meanwhile, John Keells Holdings closed 1 rupee higher at 151.50 rupees per share.

Share prices of 38 firms gained on Tuesday, while 81 fell. (EconomyNext)

Sri Lanka manufacturing, services sector growth slows in Feb

Sri Lanka's manufacturing and services sector growth slowed down in February from January, state data showed.

The Sri Lanka Purchasing Managers' Index (PMI) compiled by the central bank fell 3.8 index points to 50.6 points in February for the manufacturing sector.

An index value over 50 signifies an increase compared to the previous month.

"Manufacturing activities increased at a slower rate in February 2019 compared to January 2019, mainly driven by the decrease in new orders and production, especially in manufacturing of textiles, wearing apparels, leather and related activities," the central bank said.

The new orders sub-index fell to 48.5 points in February from 54 points in January while production fell to 48 points from 55.5 points.

"This decline was mainly due to the lesser number of working days in February," the central bank said.

"Stock of purchases also decreased during the month in line with the decrease in new orders and production."

Employment was seen increasing in February due to the upcoming festive season in April, while raw material supply time lengthened over the Chinese New Year holiday season, the central bank said.

The global manufacturing PMI also recorded a 50.6 value in February, falling 0.1 points from January.

Manufacturing in Eurozone, UK, USA, Singapore and Russia slowed down, while China and India recorded growth, the central bank said.

The services sector PMI in Sri Lanka fell 2.8 points to 53 points in February, reversing a trend seen over two consecutive months.

The new business sub-index slowed down to 55.3 points in February from 57.7 points in January, while expectations for activity decelerated to 60.5 points from 64.4 points.

"Both new businesses and expectations for activities slowed down due to many people taking a wait and see approach as there is an uncertainty in the business climate," the central bank said.

"Expectations in the wholesale and retail trade sub sector deteriorated due to new vehicle duty reforms introduced in the Budget 2019."

The business activity sub-index fell to 54.7 points from 56.7 points, but expansions were seen in financial and transportation industries due to technology based improvements and export growth, the central bank said.

Employment was seen slowing down to 51.1 points from 57.4 points, as many are focusing on business process automation and artificial intelligence, the central bank said.

"Prices charged in the services sector increased at a slower rate while the expected labour cost in the services sector also increased at a slower pace."

Globally, the services sector PMI grew to 53.3 points in February, recovering from a 28-month low 52.6 points in January, accelerating a 115-month growth trend.

Services sectors of Japan, China, UK, India and USA recorded growths in February. (EconomyNext)

Sri Lanka GDP grows 3.2-pct in 2018

Sri Lanka's gross domestic product was estimated to have grown 3.2 percent in 2018, data from the state statistics office showed amid monetary instability triggered by money printing and real effective exchange rate targeting as well as a political crisis.

GDP growth slowed from 3.4 percent a year earlier.

Agriculture grew 4.8 percent after a drought ended, industry grew 0.9 percent and services grew 4.7 percent.

In the fourth quarter growth was estimated at 1.8 percent, amid steep collapse in the currency and a political crisis, down from 3.7 percent a year earlier.

The statistics office said agriculture grew 4.5 percent, services grew 4.3 percent and industrial activity contracted 3.6 percent in the quarter.

The appointment of Mahinda Rajapaksa as Prime Minister by President Maithripala Sirisena, worsened capital flight which had already begun by September following a second monetary policy error.

The credit system was hit by monetary instability from March after the central bank released liquidity and printed money activity to enforce a rate cut in April triggering monetary instability and capital flight.

Monetary instability worsened in August with the rupee ultimately falling to 182 to the US dollar by then end of 2018.

Capital flight and exporter hold backs, overcame any benefit to the credit system from reductions in the budget deficit.

Liquidity shortages emerged as the central bank enforced shifting convertibility undertakings, which were shifted downwards.

Severe monetary instability can shrink growth as estimated in national income accounts. In 2001, GDP contracted 1.5 percent, on top of a civil war when the rupee fell from 75 to 95 to the US dollar.

Inflation was contained at about 4.3 percent in 2018. Inflation can go up as the price structure adjusts to the fallen currency as monetary instability recedes. Currency depreciation also keeps nominal interest at high levels even if the capital account is free. (EconomyNext)

Sri Lanka per capita GDP edges lower amid soft-peg collapse

Sri Lanka's gross domestic product edged marginally lower to 4,102 dollars per person in 2018 from a revised 4,104 dollars in 2017 amid a collapse in the currency from operating a soft-pegged exchange rate.

Sri Lanka's central bank has an explicit strategy of targeting a real effective exchange rate index but does not have a floating policy rate to enforce it, generating balance of payments troubles.

The central banks also cuts rates and prints money when inflation falls (independent monetary policy) effectively operating a de facto inflation targeting regime with a exchange rate peg, generating balance of payments troubles through what economists call the impossible trinity of monetary policy objectives.

Last year the central bank also brought in Nixon-shock style trade restrictions to cover its monetary policy errors, shattering a key plank of the current administration's economic strategy.

Sri Lanka has seen back-to-back balance of payments troubles since 2015, with monetary stability only maintained by the central bank in 2017.

In 2017 also the rupee was permanently depreciated despite the central bank generating a balance of payments surplus by mopping up inflows, to ostensibly target a real effective exchange rate index.

According to revised data released by the statistics office, per capita GDP grew from 3,821 dollars in 2014 to 3,842 in 2015 and to 3,886 dollars in 2016, when the rupee fell from 131 to 150 to the US dollar.

In 2017 per capita GDP rose faster to 4,102 dollar from 3,886 with some monetary stability returning.

In 2018 per capita GDP edged down to 4,102 dollars from 4,104 with the rupee collapsing first to 161 and then to 180 in two episodes of instability. The census department is using an average exchange rate of 163 rupees for 2018.

Sri Lanka's per capita GDP fell 869 dollars to 838 dollars in 2001 and the economy contracted 1.5 percent, after a case of severe monetary instability and currency collapse in the midst of a war.

Sri Lanka's growth has flagged in recent years after spiking with the end of a war in 2009, partly as GDP computation changed but also due to lack of liberalization to spur growth, combined with monetary instability, analysts say.

For about a decade Sri Lanka pursued a strategy of crony protectionism, expropriation and building loss-making state enterprises mis-allocating resources, which hurt long term growth prospects reducing the usage of infrastructure built with state borrowings.

Monetary instability had worsened since 2015. Monetary instability has been a key constraint on the economy and people's freedoms since a soft-pegged central bank was set up in 1950 leading to draconian exchange and trade controls.

Currency depreciation and unsound money in general destroys real wages and also destroys real capital available to invest and increase labour productivity and cut slashes the economic foundations of a family.

From 2015 Sri Lanka tried to implement ' a social market economy' in without the fundamental building block - central bank reform - as Germany did for its own social market economy, while Britain which won World War II regressed with monetary instability and currency collapsed (Sterling crises) as it pursued Keynesian economics.

"Stability may not be everything," said Karl Schiller, one time economy and finance minister of Germany. "But without stability everything is nothing."

Sri Lanka is planning to move from a second class (soft-pegged) exchange rate regime which is called a 'flexible exchange rate' to a second class (flexible) inflation targeting regime. (EconomyNext)

US Fed now expects no rate hikes in 2019

The Federal Reserve sent a strong signal the US economy is slowing, indicating Wednesday it will not raise the benchmark lending rate again this year amid a drop in spending and broader global uncertainty.

It was an aggressive downshift that came as a shock to many economists, since as recently as September the Fed expected to raise rates three times in 2019.

"It may be some time before the outlook for jobs and inflation calls clearly for a change in policy," Federal Reserve Chairman Jerome Powell told reporters following the announcement.

And he said global growth which had been a tailwind to the US economy, had begun to slow -- notably in Europe and China where tariffs and Brexit are weighing.

The Fed's surprising change of direction follows the four rate increases last year, frequently in the face of vociferous antagonism from President Donald Trump, who called the central bank "crazy" for tightening monetary policy as the economy grew.

The change could prompt speculation that the most recent hike in December, implemented despite a Wall Street sell-off and signs of weakening economic activity, was aimed at demonstrating the central bank's independence from Trump.

The shift in the closely-watched forecast released meant nine of the 17 members of the policy-setting Federal Open Market Committee lowered their projection for this year.

But the forecast Wednesday also confirms the next move is still expected to be an increase in the key policy interest rate, though that is not now expected to come until sometime in 2020.

The explanation can be found in the stark change in language in the statement from FOMC, which voted unanimously to keep the key rate unchanged at 2.25 to 2.5 percent.

In its second meeting of the year, the committee said "growth of economic activity has slowed from its solid rate in the fourth quarter," as household and business spending is expected to drop off and annual inflation has declined.

In contrast, in January, the FOMC said economic activity was growing at a "strong rate" and household spending continued to "grow strongly."

- ABOUT-FACE -

Powell explained the about-face, saying that, while fiscal stimulus boosted the economy in 2018, there had been "data arriving since September suggesting that growth is slowing somewhat more than expected."

But while "developments at home and around the world that bear close attention," Powell told reporters the Fed's outlook "is a positive one."

The committee members forecast a median federal funds rate this year of 2.4 percent -- the current level -- down from the 2.9 percent forecast in December, and 3.1 percent in September.

Central bankers also cut their median forecast for economic growth this year to 2.1 percent, from 2.3 percent in December. That is a sharp contrast to the expectation of more than three percent this year, forecast by the White House Council of Economic Advisers.

Wall Street fell following the announcement, with the Dow losing 0.5 percent and the broader S&P 500 dropping 0.3 percent.

Economists warned that a forecast of zero hikes could encourage markets to expect and demand a rate cut, and they warned of the potential for rising wages.

But Ian Shepherdson of Pantheon Macroeconomics called the dovish stance an "accident waiting to happen."

It was "an unnecessarily bold move... and it runs the risk of the Fed having to reverse course in the summer," when wage pressures could pick up.

The FOMC also decided to slow the shrinking of its securities holdings -- including Treasury notes and mortgage-backed securities -- which were built up to $4.5 trillion in the years after the 2008 global financial crisis.

Starting in May, the Fed will reduce the balance sheet by $45 billion a month, down from $50 billion previously.

But from October, it will no longer reduce its Treasury holdings, while continuing to runoff $20 billion a month of MBS, the Fed said in a separate statement.

Powell said the total holdings will fall to a bit above $3.5 trillion.

The central bank in January pledged to revisit the process after financial markets late last year were thrown into turmoil in part because of concerns the Fed was too rigid in the "balance sheet normalization" plan.

Powell also said Wednesday he did not see major risks to the financial system that could lead to another financial crisis.

"I would say overall, we don't see financial stability vulnerabilities as high," he told reporters. (AFP)