NEWS ROUND UP

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Crux of currency crisis!

Central Bank Governor Dr. Indrajit Coomaraswamy yesterday declared the rupee was under pressure more due to exogenous factors, but reassured it would ease as a follow up to ongoing stabilisation measures whilst being wary of overly aggressive propping up, saying past exercises led to doublewhammies.

The reassurances on the currency as well as insights to the challenges faced were shared by the Governor during his speech at the inaugural session of the Daily FT co-hosted 6th annual Cyber Security Summit yesterday at the Cinnamon Grand with over 400 participants from private and public sectors.

Dr. Coomaraswamy opted to comment on the recent dip of the rupee as the FT Summit was the first public event he was addressing since the currency had come under increased pressure.

He said the rupee's dip was largely driven by three external developments whilst some of the characteristics of the domestic economy also contributed although the economy had been stabilising considerably.

One is the increase in US interest rates on a sustained basis following three revisions so far and fourth one anticipated in December. This the Governor said had resulted in large capital outflows from emerging markets back to the US, reversing the inflows out of the US experienced earlier due to low interest rates there and attractive options elsewhere.

However, he noted Sri Lanka hadn't seen a major outflow though foreign investments had relinquished some of their positions from Government Securities and listed equity raising the demand for US dollars from the market as against the weak supply.

The second exogenous factor listed by Dr. Coomaraswamy was more geopolitical. One is the trade war between the major economies, US and China, with the former slapping higher tariff on $ 200 billion worth of more Chinese imports and the latter countering with a similar move on $ 60 billion worth of imports from US. The other is the tensions between US-Iran and within the Middle East.

"Due to the elevated uncertainty at global level, money and investors shift to safer havens i.e. US Dollar, the currency of the reserve of the international financial system, thereby strengthening the currency," the Governor explained at the FT Cyber Security Summit, co-hosted by CICRA Holdings Ltd.

The third external factor is the rise in oil prices and since Sri Lanka is a net importer, there is pressure on reserves and exchange rate. "These are the three major reasons for the pressure on the rupee," he added.

"Though Sri Lanka has made progress in terms of stabilising the economy, the external factors are too powerful and we don't have the capacity to withstand without experiencing some pressure on reserves and exchange rate leading to depreciation," Governor added.

It was also pointed out that countries with current account deficit in the balance of payments such as Sri Lanka are most vulnerable to these external shocks.

"The deficit aspects is our own doing due to wrong economic policies of the past which saw exports as a percentage of GDP shrinking to 12.4% by 2015 from 33% in 2000 and heavy foreign borrowings some in commercial terms and funding projects with low or no return," Dr. Coomaraswamy recalled.

The Governor also strongly responded to queries as to why the Central Bank is not defending the falling rupee more aggressively. He revealed that past exercises of defending the rupee had disastrous effect and must remember the lessons.

According to him, in 2011/12 the then Central Bank administration spent a staggering $ 4.2 billion (current reserves are at $ 8 billion) to defend the rupee yet eventually the currency depreciated by 13.5%. Then in 2015 around $ 1.2 billion was spent but that failed to prevent the rupee from depreciating by 9%.

“So trying to spend large amount of our reserves to defend a particular (exchange) rate, in the end you up with a doublewhammy – depleting the reserves and eventually ending up with a depreciating rupee,”he added.

Dr. Coomaraswamy said that in that context, the Central Bank had of late been pursuing a flexible exchange policy with the rate more determined by the market and intervened selectively to smoothen out any sharp volatility and if necessary will get aggressively but not overly.

“We also haven’t been just sitting back but have taken a few more remedial measures,” he added.

Additionally, the Central Bank addressed the loss of foreign exchange due to the excessive import of duty free gold only to be smuggled to India where a 15% duty applies. He said gold imports which were around $ 250 million had ballooned to $ 600 million in 2017 and in early this year it was growing at a rate by which we would have ended with nearly $ 1 billion spent by end 2018. This prompted the Government to impose a 15% tax as a counter measure as gold smugglers were arbitraging with Indian situation.

The Governor also said that motor vehicles import was another big challenge on the reserves as they accounted for the two-thirds of trade deficit increase from $ 5.3 billion from last year to $ 6.4 billion this year. Duty on small vehicles was hiked and as a further measure the Central Bank on Tuesday imposed 100% Letters of Credit margins deposit requirement on vehicle imports.

“In our toolkit we have several other options too, such as changing the duration for repatriation of export proceeds and revision of the interest rates to even out the differences between US rates and Sri Lanka. However the Monetary Board is reluctant to increase the interest rates as of now because the growth of the economy is subdued though there is an uptick witnessed in the second quarter,” Dr. Coomaraswamy pointed out.

“If necessary we have that tool (adjusting the interest rate) but as I said earlier that is the option we are reluctant to take because we don’t want to slow the economy at this point of time,” he reiterated.

“For Sri Lanka the best buffer and resilience is develop exports to boost reserves and attracting Foreign Direct Investment,” added the Central Bank Chief during his speech at the FT-CICRA Cyber Security Summit yesterday where 17 experts, foreign and local, shared key insights to latest threats and solutions for cyber security. (Daily FT)

Mangala responds to concerns over state of Lankan economy

The Government said that it has thus far been successful in curbing excess import growth and controlling the depreciation of the Sri Lankan rupee, which had started to hit record lows during the last few days.

According to Finance and Mass MediaMinister Mangala Samaraweera, Sri Lanka has been less affected than many other countries with economies of different sizes and stability.

“Between 1 January and 18 September 2018, the Sri Lankan rupee has depreciated by approximately 7.4%. During the same period the Indian rupee has depreciated by 13.5%, the Pakistanrupee by 12.1%, the Indonesian rupiah by 9.5%, the Russian ruble by 18.2% and the Brazilian real by 24.8%. We are expecting further depreciations in the coming weeks.

There are countries worse than these. In Turkey the lira depreciation is 68% and in Argentina the depreciation is 112%. But I think the wrong economic decisions of the past have led these two countries toward this devastation,” he said.

The Minister, revealing his contingency plan to respond to the Sri Lankan rupee depreciation which is expected to go forward during the coming weeks, said: “What should our policy be in response? It is imperative that we build up the safeguards and resilience to be able to meet up with such volatility while further consolidating macroeconomic stability to provide confidence to global capital markets. Towards this end the Government has taken appropriate steps to build safeguards. Throughout 2017 the Central Bank made a conscious effort to build up foreign exchange reserves purchased from the market instead of the old practice of borrowed reserves. Accordingly, the reserves reached a record level of $9.9 billion. Today this has come down to $ 8.2 billion, having had to do some debt servicing by the end of August 2018.

“In recent months there has been much talk about the depreciation of the Sri Lankan rupee. I would like to shed some light on the exchange policy of ours. Some try to identify the depreciation of the Sri Lankan rupee as the fall of the economy. If that were the case Vietnam, where one US dollar can buy 33,300 dong, should be in the doldrums. But in 2017, Vietnam attracted $ 36 billion worth of foreign investment while exports reached $ 250 billion. Indonesia, where their rupiah is still depreciating at a much faster and higher rate than Sri Lanka, one US dollar buys 15,000 rupiah. According to our economic pundits, Indonesia should also be a basket case. But as we know, in 2017 Indonesia’s GDP reached $ 1 trillion and real GDP growth stood at 5%,” he added.

Currently, the value of the rupee is determined by the foreign exchange market. The primary determinants for currency are the exports and imports of goods and services and the net capital flows to any country. According to the Minister, in Sri Lanka these basic indicators are positive and the country was moving in the correct direction.

“We saw that our growth rate has gone up from 3.1% to 3.7% during the second quarter last year. Exports have reached $11.3 billion. With everything else taken into consideration we have exceeded $15 billion in exports last year. Import growth was seen with motor vehicles and small-sized cars, which were under-priced in local markets. The Government took action to control this situation. From the last Budget we took a decision to tax based on the engine capacity of the vehicles. This helped to stop corruption with vehicle imports but we saw a vehicle tsunami heading this way,especially small cars with a capacityless than 1,000cc. During 1Q 2018, we have imported over 25,000 small cars. So it had to be taxed to stop the flow of our foreign reserves. But still these vehicles are priced less than what they were during the previous regime,” said Minister Samaraweera.

On Wednesday, the Central Bank imposed a 100% cash margin on the requirement for a Letter of Credit on non-commercial motor vehicles with immediate effect.

“We have taken action to reduce foreign currency outflow. In India they are facing this depreciation worse than us. They have imposed this cash margin also for non-essential luxury items. As the country develops and integrates with the global economy there is greater exposure to global capital markets. Sri Lanka has seen an increase in foreign investment in the stock market and government securities in recent years. However, such investments are volatile in nature and are determined more by global factors rather than local issues. The normalisation of US monetary policy has been a major factor affecting global financial markets," he explained.

According to Minister Samaraweera, it is important to understand recent history.

"After the financial crisis of 2008, US interest rates dropped to record lows where the investor capital left the US in search of higher returns in high-risk frontier markets. However, with the recovery of the US economy the Federal Reserve has been increasing US interest rates which has caused global investments to uplift capital from emerging markets like Sri Lanka and return to the US. Naturally this has caused capital movement out of many emerging economies, putting pressure on their balance of payment and causing currency depreciation. Sri Lanka too has experienced foreign investments in government securities moving out and foreign capital leaving the equity market. Similar trends were seen in all emerging and frontier market economies," he said. (Daily FT)

Govt. cannot release foreign reserves to manage rupee depreciation: Harsha

As the rupee depreciates daily to new lows, National Policies and Economic Affairs State Minister Dr. Harsha Silva yesterday defended the Government's stance to refrain from artificially managing the value of the currency, warning of the negative impact an interference may bring.

"As a responsible government we have to come to an agreement and face reality, to ensure the continuity of a stable economic environment we can't intervene to stabilise the rupee," he said, speaking at a special press briefing held in Parliament.

The rupee has depreciated by 7.4 % against the US dollar he said, highlighting that the rate was lower than most other currencies in the region including the Indian rupee.

The State Minister of National Policies and Economic Affairs stressed that even if the Government decided to release foreign reserves currently held by the Central Bank, it would not deliver the desired results due to a lack of confidence in Sri Lanka.

"If we release the $9 billion held as reserves the market will not believe that we can do it. The reason is that there is a huge loan burden as never seen before in in Sri Lanka's history, payable in the future. We have to pay the $4billion taken as international sovereign bonds. This loan is not like earlier debt with long payment periods and low interest rates; these have bullet payments, we have to pay large sums of money and high interest rates," he claimed.

As a responsible government we cannot release the dollars as we have to repay over $15 billion in the coming years.

The net absorption in the country has improved during the last two years, he claimed. According to him, under the new Central Bank, along with IMF reforms, Sri Lanka has retained reserves from the market as never before, recording a positive net absorption rate of $1,664 million in 2017 from the previous year's negative $768 million and in 2016, Silva said while quoting figures.

In 2010 the absorption rate was at a negative $ 67 million, in 2011 the absorption rate was a negative $2,840 million while in 2012 the figure remained a negative $1,166 million, which caused the IMF to raise concerns, the Deputy Minister said. In 2013 the figure turned a positive $ 436 million and continued to maintain a positive figure of $ 545million. However, the absorption rate turned a negative $3,250 million in 2015 and continued to be a negative $ 768 million in 2016, he said.

Staunchly defending the Government's decision not to manage the currency value through the release of foreign reserves, he accepted that there would be challenges in the cost of living and salaries which the country's economy would have to face.

However, the State Minister explained that the worst was yet to come with upcoming elections in the United States and the trade wars US president Trump had started with economic giants such as China and Europe, but said the crisis may settle with the November elections.

The State Minister also warned that if the country did not take long-term corrective actionsto increase exports, which are currently at 12% of GDP compared to 35% of GDP in 2000, the repercussions would be far worse.

"This is the fundamental issue. We can manage in the short term but if we don't increase exports then we are not going to make a sustainable recovery," he said, adding that engaging in cheap politics would not help in the long term. (Daily FT)

Lankan who solved maths problem for Jeff Bezos and gave world Amazon

Yasantha Rajakarunanayake is surprised Amazon CEO Jeff Bezos, the world's richest man, remembers him three decades after they lost touch.

The Sri Lankan scientist, now based in the US, was Bezos' classmate at Princeton University in the 1980s.

Speaking at The Economic Club of Washington, a non-profit that holds discussions on important issues of the day, Bezos described Yasantha as the "smartest guy at Princeton".

It was Yasantha's mastery of math that convinced him to abandon his dream of becoming a theoretical physicist, Bezos added in the 13 September talk.

Soon afterwards, the part of his speech about Yasantha went viral, and set the internet on the trail of the islander who, inadvertently, helped change the way the world shops.

Talking to ThePrint, the scientist said the surge of emails that followed Bezos' speech first gave him the impression that he had been hacked.

"I think Jeff had done the interview on 13 September, and by 15, I was getting spam in my LinkedIn inbox," said Yasantha. "Several people were asking me, 'are you Jeff Bezos' Yoshanta?' I thought someone had hacked my Linkedin, and was quite worried. They had misspelled my name as well."

By 18 September, Yasantha, 55, had seen the video, and acknowledged it in a tweet.

"To hear him mention me by name, and include anecdotes about me on national (US) television as his Sri Lankan friend," he told ThePrint, "It was a pleasant surprise."

"It is not every day that the world's richest guy calls you the smartest person he ever met in Princeton. I am thankful," he added.

According to Yasantha, he and Bezos were at Princeton together between 1982 and 1985, and "shared some academic interests".

In the video, Bezos animatedly described an anecdote from their days at the University, when he and a roommate failed to solve a math problem despite wracking their heads over it for hours. He was then an aspiring theoretical physicist.

When they couldn't, both Bezos and his roommate screamed in unison "Yasantha", because they knew the Sri Lankan would help them out. When they went to his room, according to Bezos, Yasantha stared at the problem for a while and then gave them the answer.

Taken aback by the promptness, Bezos asked him, "Did you just do that in your head?"

"No, that would be impossible," Yasantha said, adding that he only knew the answer because he had solved a "very similar problem three years ago".

"I was able to map this problem on to that problem, and the answer was immediately obvious," he added.

"That was an important moment for me," the Amazon Founder said, "because that was the very moment I realised I was never going to be a great theoretical physicist."

Yasantha said he didn't remember the incident as clearly as Bezos did, but added that it happened around 1984.

"I think it was in 1984 that he asked me for the solution to the math problem he mentioned in his video," he told ThePrint. "It was a pivotal moment for him to decide to give up his initial dream of becoming a theoretical physicist. I don't recall the incidents as vividly as he does, but it is quite true."

The two haven't kept in touch since 1985, but clearly share a mutual admiration.

"Jeff was an excellent student, and a very persistent, tenacious one," said Yasantha, "That is unique to him."

Yasantha described how students once dared each other to complete a computer science assignment in a single line of coding.

"Finally, I gave up and did this in 10 or so lines of code," he added, "But I remember Jeff working through all night, in pursuit of the most compact solution, and turned in a two-line solution that was probably the shortest anyone could do."

"It goes to prove that Jeff is tenacious, and will not give up like most of us would when presented with a challenge," he said. (Daily FT)

National cyber security policy in the offing: Defence Secretary

Defence Secretary Kapila Waidyaratne PC yesterday revealed that Sri Lanka is presently working on drafting a national policy on cybersecurity.

"The country which is in the process of drafting a cybersecurity policy; Sri Lanka needs to identify mechanisms for the implementation or a body that it will monitor," Waidyaratne as the Chief Guest told the inauguration ceremony the 6th Annual Daily FT-CICRA Cyber Security Summit 2018 titled 'Towards a secure digital future'.

A report titled 'Information and Cyber Security Strategy of Sri Lanka 2018-2023' by the Sri Lanka Computer Emergency Readiness Team | Coordination Centre (Sri Lanka CERT|CC) states, "As the complexity of the cyber security ecosystem increases, the government of Sri Lanka recognises the necessity of introducing a National Information and Cyber Security Strategy to cope with emerging threats."

The proposed strategy, which is going to be implemented over a period of five years (2018-2023), will be a high-level top-down approach to information and cyber security that establishes a range of national objectives and priorities that should be achieved in a specific timeframe.

The report further states, "To further strengthen our regulatory framework to effectively battle emerging cybercrimes, gaps in the existing policies and laws will be identified, and new legislation, policies, and standards will be drafted and implemented to create a secure cyberspace for individuals and organisations."

In line with the strategy, a National Information and Cyber Security Agency (NICSA) will also be established. "The Agency will be responsible for overseeing the implementation of the cyber security strategy, setting national polices, facilitating the protection of critical national infrastructure, educating citizens, building a pioneering technology competent workforce, and promoting industry development," further states the report.

Speaking further at the Daily FT-CICRA Cyber Security Summit with over 400 participants from private and public sectors, Waidyaratne mentioned that the Government of Sri Lanka has taken a number of steps to mitigate cyber threats over the last few years by enacting relevant legislation such as the Electronic Transactions Act No. 19 of 2006, Payment Devices Frauds Act No 30 of 2006, the Intellectual Property Rights Acts, and Computer Crimes Act No 24 of 2007. Sri Lanka ratified the Budapest Convention on Cybercrime in 2015 and became the first country in South Asia to join this convention.

However, Waidyaratne believes that Sri Lanka needs to improve the legislation to implement the international treaties which it is signatory as well as to empower intelligent services and military forces of Sri Lanka.

"By doing so, they will be capable of assessing threats in the cyber domain and countering them in a digital future," Waidyaratne opined.

Pointing out that cybercrimes are growing beyond geographical and jurisdictional boundaries apart from growing economic losses, Waidyaratne said it poses huge threats for the national security.

"We are aware that the cyber terror attacks can cripple military, financial and services sectors of advanced economies. Therefore, global community as a whole has a significant responsibility to safeguard national and global sensitive information against cyber-attacks. More importantly, wise and strong achievements, investments in the cyber security and defences are more required in the most wild and the complicated 21st century," said Waidyaratne.

Apart from national security, Waidyaratne said that cybercrimes have already been a severe threat to the development in the current world. "Therefore, it is crucial to discuss the cyber security threats domestically as well as internationally. Cybersecurity corporations between partnering countries is essential," he mentioned at the forum.

Among the 193 ITU (international Telecommunication Union) member countries, Sri Lanka is ranked 72 in the Global Cybersecurity Index (GCI) in the year 20166. GCI assesses a country's overall commitment towards cyber security in relation to five different dimensions, namely legal, technical, capacity building, organisational, and cooperation dimensions. Sri Lanka's performance in each dimension is assessed and rated either as initiating, maturing, or leading. Sri Lanka's overall performance is rated as maturing.

The Daily FT-CICRA Cyber Security Summit focussed on four core sessions: mitigating cyber risks in financial services, security in the IOT Era, prevention of data leakage, and digital forensic dynamics.

It featured 17 speakers and panellists creating awareness on the importance of cyber security among top officers in the Government, corporates and IT professionals. It also showcased best practices to participants in acquiring, implementing, managing and measuring information security postures of their organisations and countermeasures.

The summit also highlighted latest flaws in information security that affects the global community including corporations and governments. Discussions and presentations revolved around some of the most malicious attacks and potential threats surrounding the security field.

Participants got a better understanding of the need for proactive strategies for corporate IT infrastructure through these demonstrations.

The day conference of the summit was followed by Hangout with Hackers (Night Hack) – an evening edutainment meet-up where ethical hackers conducted demonstrations and engage with the audience to showcase the latest skills.

Visa Inc., US, Director (Risk Services, India and South Asia)Lakshmi Ramakrishnan delivered the keynote address at the session on 'Mitigating risks in financial services', while Central Bank Governor Dr. Coomaraswamy was the Guest Speaker. Commercial Bank of Ceylon COO/Executive Director Sanath Manatunge, LankaClear DGM (IT and Operations)Dinuka Perera and Central Bank Head of IT Wasantha de Alwis figured in the panel discussion.

The second session, titled 'Security in the IOT Era' had CISCO USA Cyber Security Regional Manager (India and SAARC)Vivek Srivastava delivering the keynote while Dialog Axiata Chief Operating OfficerDr. Rainer Deutschmann was the Guest Speaker. Duo World Inc. CEO and Chief Architect MuhunthanCanagey and Dialog Axiata M2M/IoT Strategy Development and Partner Management Head Dr. Indika Samarakoon participated in the panel.

InfoWatch Russia Senior Manager Nikita Zaychikov delivered the keynote at the third session, titled 'Prevention of data leakage', while Cisco Inc. US Cyber Security Director (India and SAARC)Vishak Raman was the Guest Speaker. Hatton National Bank Deputy General Manager (Risk/CRO/CISO)DamithPallewatta and BDO Sri Lanka and the Maldives Partner (Risk, Forensic and IT Advisory Service)AshaneJayasekara were the panellists of the session.

Digital Intelligence and Investigation Solutions, Cellebrite, Israel Vice President (APAC)Terry Loo delivered the keynote for the fourth session titled 'Digital Forensic Dynamics'. AppKnox, Singapore Co-Founder/CTOSubhoHalder was the Guest Speaker of the session while the panellists were Sri Lanka Police STF CommandantSenior DIG M.R. Latiff and Sri Lanka CERT|CC Principal Information Security EngineerRoshan Chandragupta.

The Summit which was followed by a CEO Forum on Wednesday was supported by Cisco as the Principal Sponsor, Visa as the Strategic Partner and Infowatch and Tufin as Co-Sponsors. LankaPay is the Official Payment Partner while Dialog is the Telecommunication Partner. Sri Lanka Insurance is the Insurance Partner. The Ministry of Telecommunication and Digital Infrastructure and ICT Agency of Sri Lanka have endorsed the event. Cinnamon Grand is the Hospitality Partner of the summit while Triad is the Creative Partner. The Electronic Media Partners of the event are TV Derana, FM Derana, Ada Derana and Derana24X7.

The Summit saw the participation of over 60 deserving university students sponsored by the National Savings Bank; Carson Management Services; John Keells Holdings PLC; Lanka Orix Leasing PLC; Vallibel PLC; Siam City Cement; 99X; AIA; Expolanka Holdings PLC; PAYable; BDO Partners/Lanka Holdings; Nature Beauty Creation; Overseas Reality Ceylon; and Sunshine Holdings.

The universities represented wereUniversity of Moratuwa; University of Peradeniya; University of Jaffna; University of Colombo; University of Sri Jayewardenepura; University of Kelaniya; Sabaragamuwa University of Sri Lanka; Uva Wellassa University of Sri Lanka; and Open University of Sri Lanka. . (Daily FT)

Sri Lanka rupee falls to new low below 168 to US dollar; cash injected to keep rates down

Sri Lanka's rupee closed at around 168.65/169.00 levels the US dollar Thursday down from 167.10/30 levels a day earlier, as the central bank injected cash to keep interest rates below the policy corridor ceiling.

The central bank injected 10 billion rupees overnight at 8.06 percent and 5 billion rupees for 5 days through a term repo auction at 8.15 percent higher than the 8.11 percent, a day earlier.

The central bank can allow rates to go up to 8.50 percent without a formal rate hike to reduce pressure on the rupee.

During the first run the rupee earlier this year, the central bank allowed rates to go up from June 06, to 8.50 percent to help end a run on the rupee which was triggered by tens of billions of rupees injected to the banking system during late March and April coinciding with a so-called 'buffer' strategy to repay bonds.

During the current run on the rupee, which coincided with tens of billions of rupee injected to the banking system from a currency swap, the rates had been held down at 8.0 percent pushing the rupee down faster.

The central bank also cut net open dollar positions (NOP) of banks, which analysts had earlier warned will worsen volatility of the rupee based on the experience of past episodes. (What Sri Lanka can do to improve the credibility of its soft-dollar peg: Bellwether). The rupee fell faster as expected after NOPs were cut.

A false narrative had been floated in recent years that Sri Lanka's currency collapses come from time to time because it had been held fixed for a long time, though EN's economic columnists had pointed out that the rupee will fall at time when money is printed to keep rate down against the market rate when credit picks up, regardless of past behavior.

In the current run on the rupee, tens of billions of rupees were printed through a currency swap.

"When a central bank engages in swaps, it is effectively providing a convertibility undertaking, and is pegging," explains EN's economic columnist Bellwether. "Unless policy consistent with the peg is followed the rupee will fall."

If dollars are printed through an unsterilized action via an outright purchase, or the spot leg of a swap, the central bank has to either follow through with unsterilized dollar sales, or the new liquidity has to be killed (sterilized) to prevent it hitting the forex markets.

In the current run on the rupee, there is now a big liquidity shortage also due to other swap reversals (forward leg).

The central bank is now injecting tens of billions of rupees to sterilize the liquidity shortage and keep rates down.

"In sharp contrast to the rush to sterilize the shortage at 8.0 percent now with new money there was no rush to sterilize (mop up) liquidity in August when the liquidity shock hit the system," Bellwether says.

Both actions are against the stability of the currency.

The first term repo auction to mop up cash did not start until August 13, when overnight excess liquidity hit 57 billion rupees. No money was sterilized through a sell-down of bills either.

Bellwether had pointed out that it is easy to undermine the credibility of the peg by cutting rates and printing money and panic exporters but it is difficult to restore confidence.

In Sri Lanka the situation is further complicated because except in 2009, the rupee is not allowed to bounce back after currency pressure ends, which makes market participants desperate.

Analysts have pointed out that there are two problems with Sri Lanka's central bank. One is common to all soft-pegs where an exchange and interest rate is targeted (by printing money) at the same time, which cannot be done in practice.

But in Sri Lanka there are additional inconsistencies.

While claiming to operate a flexible exchange rate (whatever that means) reserves are collected, or swaps are executed.

After printing money in emulating peg behavior, Sri Lanka then switches to a floating regime, sometime with tens of billions of rupees of excess liquidity remaining in the banking system. For a float to take hold quickly money markets have to be kept short.

In the current run on the rupee, money markets have been kept flushed with excess liquidity until September 14, except for one other day. Only in the last four days have money markets been consistent with a float.

This week the central bank rejected a 17.5 billion rupee bill auction which may end up as a permanent liquidity injection.

Due to the large liquidity shortfall that developed this week coinciding with the reversal of a 2013 swap with a state bank, a much bigger permanent shortfall had developed in the banking system. Any defense of the currency by the central bank then expands the shortfall.

It is not clear whether coupled with term auctions earlier this week, the money markets will again become flushed with excess liquidity overnight by the end of the week, putting further pressure on the rupee and undermining any float.

On Thursday the overnight shortfall fell to 18.25 billion rupees from 22.86 billion rupees a day earlier.

However some term reverse repo deals through which money was printed this week will expire next week. Analysts say it is important to keep the markets short by 20 billion rupees or more overnight.

Sri Lanka has a policy rate far in excess of the US Fed, which analysts say would allow the country to maintain a very strong peg with the US dollar, if the tendency to pump tens of billions of rupees through 'quantity easing' style exercises suddenly to give shocks to the system can be stopped. (Economy Next)

Sri Lanka to fast-track visas for tech industry expansion

Sri Lanka is proposing to fast-track visas for migrant tech professionals amidst a talent crunch and changes to its higher-education laws to develop local talent and attract foreign universities to set up campuses in the island.

"In order to stimulate and enable sustainable growth in the IT-BPM industry, a number of regulatory amendments need to be implemented," the government's National Export Strategy 2018-2022: Information Technology Strategy policy document published in 2018 notes.

Among the key regulatory reforms is the need to fast-track the current approval process for tech companies to hire foreign professionals, "by introducing necessary procedural reforms for visas at the Department of Immigration and Emigration.

"Initiate a programme similar to the French Tech Visa, a simplified, fast-track procedure for three types of international start-up founders, employees and investors," suggests the policy document.

La French Tech was launched in 2013. The following year 1.5 billion US dollars was raised from 177 deals. In 2017, tech funding was estimated to reach 4.1 billion US dollars from 716 deals, according to CB Insights.

There are other examples that Sri Lanka is trying to follow.

Chile launched a startup programme in 2010 to attract foreign professionals raising valuations totalling 1.4 billion US dollars by 2018. The programme has also seen a surge in higher education enrollment in the Andean nation. Nearly 90 percent of Chilean high school students gain admission to university, compared to less than 20% in Sri Lanka.

Sri Lanka's trade agreements with India and Singapore will ease some restrictions of professional migrants from those countries tied to investments here. Ironically, a vocal protectionist body within the tech industry is opposing these and any relaxation of migrant restrictions. But others see value in being more open (https://echelon.lk/home/wanted-skilled-migrants/).

-Talent crunch-

Sri Lanka's tech industry is expected to generate 5 billion US dollars in exports by 2020, up from 1.2 billion US dollars in 2017, employing 200,000 people (up from 80,000 in 2017) and launching 1,000 start-ups.

However, several challenges limit growth, including a talent crunch.

"During sector consultations, industry players noted that as many as 18,000 new IT graduates would be needed annually," the National Export Strategy policy document published in 2018 said.

In the midst of a brain drain Sri Lanka's education system also doesn't have the capacity to produce enough IT professionals and collaboration with the private sector is limited.

"Graduates have good technical skills, but often are missing soft skills and practical experience.

"Some internship opportunities are provided to students, but state universities favour full-time, lecture-mode education and do not promote working experience during university years.

"This creates a problem with workforce conversion and bringing graduates into the industry," the tech export strategy document notes.

The NES is seeking to address these gaps by proposing changes to the Universities Act of 1978.

"Allow universities to establish companies and start-ups independently and facilitate those companies in individually applying for bids and contracts and in leveraging their research through commercialization and entrepreneurship," it proposes.

The government is also proposing to build regional tech research centres beginning with the universities at Moratuwa, Kandy and Jaffna.

Foreign universities will be allowed to set up satellite campuses in Sri Lanka to enhance advanced skill levels and local research and development capability.

"Universities such as the Carnegie Mellon University and the Massachusetts Institute of Technology can be targeted through public-private efforts." . (Economy Next)

Sri Lanka reluctant to hike rates to fix currency pressure: report

Sri Lanka's central bank is reluctant to hike interest rates to defend the currency as it may hurt an economic recovery, while an option remained to tighten exporter repatriations, a media report quoted Central Bank Governor Indrajit Coomarwasamy as saying.

"In our tool we have several other options too, such as changing the duration of repatriations of export proceeds and revision of interest rates to even out the differences between US rates are Sri Lanka," Sri Lanka's Daily FT newspaper quoted Coomaraswamy as saying.

"However the monetary board is reluctant to increase the interest rates as of now because the growth of the economy is subdued though there is an uptick witnessed in the quarter."

A meeting of the rate setting monetary board has been put off to October 02, from September 28. The rupee touched 169 to the US dollar in the spot market Thursday.

Coomaraswamy had said there was no point in defending a particular exchange rate as experience in the past has shown that it does not work, the newspaper reported.

"So trying to spend a large amount of reserves to defend a particular rate, you end up with as double whammy - depleting the reserves and eventually ending up depreciating the rupee."

There is a however a difference between defending a currency when there is excess liquidity (unsterilized defence) which tends to tighten the system and sterilized sales (defending a currency and then printing money to keep rates down) which does not help.

Most analysts agree that volumes of reserves can be lost through sterilized forex sales with no useful outcome, once the credibility of the peg had been lost.

Sri Lanka's banking system is now facing severe liquidity shortages partly due to swap operations, which makes further defence of the currency less effective.

However analysts have pointed out that the central bank can allow interbank rates to go up to 8.50 percent without a formal rate hike and the central bank has printed money below that rate to sterilize liqudity shortfalls which may delay the stabilization of the currency.

Keeping overnight money markets short by about 20 to 30 billion rupees and forcing banks to borrow about that volume through the overnight window will also help a float take hold faster, analysts say.

Any overnight excess liquidity will not help the rupee, analysts have warned.

The central bank has been injecting cash through term reverse repo deals of up to two weeks to sterilize the liquidity shortage that has emerged. Term reverse repo deals analysts have said are better than permanent injections of cash.

When a currency panic develops, exporters will try to hold back dollars and fund daily operations with overdrafts. If money markets are kept tight, banks will have to stop other credit and fund exporters only.

If liquidity (printed money) is pumped in to maintain excess money in the banking system, banks can fund exporters and also other creditors as well, fueling pressure on the currency.

As long as exporters take loans, displacing other credit, there is no pressure on the currency, only on interest rates.

Banks also do not like to borrow large amount of money overnight and lend as there is a mismatch in their books, which is analyst say forcing banks to borrow about 20 to 30 billion rupees overnight will help a float take hold.

Coomaraswamy had said that external factors such as rising US interest rates are also impacting Sri Lanka. Though some foreign investors have sold bond and stocks, there not been a 'major outflow' the newspaper report said.

Sri Lanka had already restricted vehicle imports and put taxes on gold.

Sri Lanka's currency instability comes from operating a so-called soft-peg where a central bank tries to target both the exchange rate and interest rates (by printing money) which cannot be done in practice especially when credit picks up.

Analysts economists have called for the soft-peg to be abolished and go back to a hard peg (currency board) or at least take measures to improve the credibility of the peg.

Fixing the peg will also help Sri Lanka follow a free trade regime. (Economy Next)

Sri Lanka sees more FDI firms exiting than entering: study

Many firms registered with the Board of Investment which regulated foreign investments have exited Sri Lanka, especially after a civil war ended, amid rising labour costs, incentive shopping, and ad-hoc changes to policies including land, a research study said.

Since 2009, when a war ended and Sri Lanka's economy expanded rapidly, 410 firms registered with the Board of Investment (BOI) had exited, while 202 new firms have entered, a report by Colombo-based Institute of Policy Studies, a think tank said.

"The number of firms that exited Sri Lanka between 2002 and 2016, and between 2009 and 2016, is nearly twice as many as those entering into the economy," the report 'Firm-Level Analysis of Manufacturing Sector Investment in Sri Lanka' by researchers Kithmina Hewage and Harini Weerasekara said.

The exits were mainly from the apparel sector, while food and beverage and other manufacturing industries also saw a large number of investments pulling out.

"Notably, there appear to be few entrants into the manufacturing sector since 2009, a time period during which Sri Lanka was expected to benefit from a peace dividend and attract higher rates of private investment."

It was not clear what role information technology and service firms are playing in Sri Lanka, which are growth areas with high paying jobs, some of which are small start-ups and tend to operate outside the tax incentive system which is mostly for larger firms with capital investment.

Some IT firms are started in Sri Lanka with support from friends and relatives in Australia, the US and UK.

The IPS report said local policy inconsistencies had also hurt investment.

"While the three-decade long civil war hampered the realisation of the country's investment potential, the country appears to have fallen short of expectations even in a post-conflict environment – largely owing to inconsistencies in the policy regime."

It said ad-hoc policy changes related to land and public enterprises undermine investment security.

Sri Lanka had restricted land ownership of foreign companies and expropriated several private entities through force.

The post-war boom was mainly led by the state investing in debt-funded public infrastructure projects, with less importance given to the tradable sector.

The report said that even when taking a longer time period into account, 665 firms exited between 2002 and 2016, with only 469 entering.

Of the 933 firms that were in operation in 2002, only 408 were in business in 2016. In the post conflict period, of 930 firms that were in operation in 2009, only 675 firms have continued till 2016.

"While protectionist economic policies could possibly result in low entries, the consistently high rates of firm exits across the time period under analysis appear to be linked with the type of investment prominent in Sri Lanka," the report said.

It said the types of FDIs in Sri Lanka which exited were seeking incentives instead of efficiency.

A complicated tax regime had enabled some investors to gain more incentives than others even if they didn't end up fully committing funds required to gain the benefits under an agreement.

FDI inflows to Sri Lanka have been severely hampered by policies that allow for 'incentive shopping'," the research said.

A new Inland Revenue Act which came into force in 2018 has closed all loopholes, instead allowing for capital allowances for the amounts actually invested.

Further, labour cost increases had also prompted some apparel investments to exit, IPS said.

Sri Lankans are now favouring high paying and flexible service sector jobs over working in factories, industrialists complained last week at an economic forum organized by Sri Lanka's Ceylon Chamber of Commerce.

The number of firms registered with BOI fell to 877 in 2016, from 930 from 2009, the research said.

It said that in 2016, foreign owned companies with the BOI fell to 274 from 304 in 2009, while joint ventures between local and foreign parties fell to 172 in 2016 from 278 in 2009.

Local firms registered with the BOI grew to 431 in 2016 from 348 in 2009.

"Such a shift in the composition of firms away from joint ventures towards local ownership is discouraging," the report said.

"There are many benefits that joint ventures bring to the table, such as technology upgrading and transfers and providing links to global value chains that Sri Lankan firms will potentially lose out on."

"The decline in foreign and joint ownership and the resulting decline in FDI are particularly worrisome for a small developing economy such as Sri Lanka, since it depends on foreign capital to compensate for inadequate domestic savings," IPS said.

It said that inefficiencies of the investment facilitator also contributed to lower FDIs to Sri Lanka, and recommended improving the investor climate to attract efficiency seeking FDIs. (Economy Next)