NEWS ROUND UP

Monday,October 22nd, 2018

Contents

Sri Lanka's Chemanex Plc, to exit closed export unit

Sri Lanka's Chemanex Plc, said it was selling a 70 percent stak in an export unit for 20 million rupees to the other shareholders.

Chemanex said the unit, Cal Exports Lanka (Pvt) Ltd, will reduce its capital and from 42 million rupees to 18.7 million and return 9.2421 rupees per share on 2.52 million shares.

The firm was set up to manufacture industrial powder and adhesives.

The firm had said earlier, it was closing the business as it was found to be unviable. (EconomyNext)

Merchandise export made little contribution to Sri Lanka's growth

Sri Lanka's industrial production barely grew in the second quarter of 2018 with exports contributing little to growth and recent import tariff hikes counter-productive to increasing competitiveness, a new World Bank report said.

Growth is strong in South Asia, but not driven by exports or manufacturing, the bank said in its South Asia 'Economic Focus'.

"Domestic consumption has been the main contributor to economic growth across the region, with exports or investment being remarkably subdued," the report said.

In India and Sri Lanka, the contribution of investment is projected to be relatively more important in 2018.

But even there, the World Bank said, the main driver remains domestic consumption.

"In both countries exports contribute relatively little to growth," it said.

The World Bank's Spring 2017 edition of the report had argued that South Asia's benefits from trade diversion may be small but that they increase with the elasticity of domestic supply and the extent of export diversification.

It is not clear what contribution the export of services is doing to the economy. Services which includes, information technology, tourism and even exports of labour. Capital will generally flow to where returns are high, and access to resources including workers is easier.

To benefit from the opportunities offered by strong import demand in the US and Europe, South

Asian countries need to improve logistics, reduce red tape, and enhance competitiveness, it said.

"Unfortunately," the latest report said, "some of the policy measures recently adopted in the region to address widening current account deficits go in the opposite direction.

"Regulatory duties have been increased in Pakistan; import tariffs on vehicles have been raised in Sri Lanka; and India did the same on 19 products worth 13 billion dollars in imports."

Industrial production in South Asia is holding well, but it grows slower than GDP in most countries.

South Asia's industrial production grew by only 5.4 percent in the second quarter of 2018, slightly lower than a quarter before.

In India it grew by 5 percent, in Pakistan by 4.5 percent, and in Sri Lanka by only 0.6 percent, the report said. (EconomyNext)

India's Modi concerned over excessive delays in Sri Lanka joint projects

India's Prime Minister Narenda Modi has expressed concern over excessive delays in joint venture projects with Sri Lanka, at a meeting with Prime Minister Ranil Wickremesinghe.

Prime Minister Modi has requested that projects on which memoranda of understanding had been signed be fast-tracked at a meeting in New Delhi.

Prime Minister Modi had said that spent the most amount of time on diplomatic efforts with Sri Lanka, but he was saddened at the response by Sri Lanka.

If there was any doubt or suspicion about these projects, Sri Lanka was requested to discuss any such concerns.

Prime Minister Wickremesinghe had said that there was no suspicion or misunderstanding on his part of the people of Sri Lanka and he regretted any mis-understanding on this matter.

Wickremesinghe had promised to expedite agreed projects.

Sri Lanka was expected to build a container terminal with an international shipping firm in which both an Indian firm and Sri Lanka Ports Authority would have a stake. President Sirisena reportedly opposed the deal.

Sri Lanka was also expected to build a joint venture liquid natural gas power plant after President Maithripala Sirisena halted a coal plant with India, which was just about to start construction.

There is an ongoing deal to jointly manage an Airport in Matttal in Southern Sri Lanka. (EconomyNext)

Top Sri Lanka economist urges free trade amid soft-peg failure

A top Sri Lankan economist renewed calls for freer trade as the country slammed import controls as a soft-peg with the US dollar failed for the second time in 2018, sending the rupee sliding, and President Maithripala Sirisena called for a report on new imports that can be controlled.

"If you liberalise imports, it creates a real bang in the economy and it creates competition and people have to work very hard to survive," Sarath Rajapatirana, an economic advisor to President Sirisena said.

"Reduce the protection. You have to introduce reforms to increase competition."

Rajapatirana was speaking at an economic forum at the Colombo-based think tank Institute of Policy Studies earlier this week.

Days later President Sirisena at a meeting of an economic council convened by him had called for a report on new 'non-essential' items that can be controlled while promoting import substitutes.

Import substitution involves giving extra profits to crony businessmen by blocking the ability of consumers - especially the poor - to purchase competing good with high import duties.

Over the last decade, businessmen that are now called 'oligarchs' had been created through a series of import duties, especially by taxing items like building materials. Food is also taxed, and farming is inefficient and is not export competitive either in quality or price.

Monetary Instability

The failure of Sri Lanka's soft-peg with the US dollar, which is called a 'flexible exchange rate' has strengthened the case of import the anti-free trade lobby, leaving the case for free trade in tatters.

The 'flexible exchange rate' has turned out to be an unusually unstable soft-peg where the anchor swings suddenly from de facto external (reserve collecting peg) with a convertibility undertaking loosely defined in terms of a real effective exchange rate index and volatility, to supposedly domestic (floating rate with a wide near-double digit inflation target) with unsterilized liquidity collected from the pegged period intact, sending the rupee sliding down.

Sri Lanka's rupee fell from around 161 to 171 to the US dollar over the last few weeks after the central bank built up unsterilized excess liquidity through a peg with the US dollar in July and

August as well as Soros-style inshore currency swaps. At the time the rupee had barely recovered from the first run.

The situation had been further complicated by maturing legacy currency swaps dating back from 2013, which generated liquidity shortages. Monetary policy is now more supportive of the rupee.

Analysts have traced the origins of the first run on reserves to the failure to mop up (sterilize(inflows in the first quarter 2018 with so-called term repo auctions failing, pushing the de facto peg to its 'weak side', followed by active money printing in April following a rate cut.

Until the first quarter the de facto peg has been kept on its 'strong side' with steady selling down of down central-bank-held securities throughout 2017 allowing the central bank to build reserves.

Analysts and economists have called for abolishing the soft-pegged central bank in favour of a Hong Kong style orthodox currency board, or a Singapore style modified currency board, to help protect the poor and take Sri Lanka forward and end the monetary instability that started shortly after setting up of the soft peg in 1950. Exchange controls came less than two years later.

But Rajapatirana said trade unions would oppose a currency board.

"Currency board requires very free adjustment of relative prices," Rajapatirana said.

"So when we have trade unions and other organisations and institutions we cannot work a currency board like these countries' (Hong Kong and Singapore) economies have done."

"We don't have the tradition. I also like that Stanley Fischer, the famous professor, whenever there was a monetary problem, he says 'how would a currency board deal with it?' It's just a way of thinking about it."

"But we don't have the freedom to have fixed exchange rate forever and allow other adjustments to take place around it. We don't have the freedom. I think that is a good thing. The idea is to keep the exchange rate corridor without having to deal with large disruptive shocks."

Fischer, who was a senior official of the International Monetary Fund during the Asian Financial Crisis when soft-pegs were targeted and broken by speculators but they were unable to break Hong Kong, has said that all intermediate regimes are vulnerable to failure, while free floats and currency boards have consistent policy. (Exchange Rate Regimes: Is the Bipolar View Correct?).

He has also questioned widely held beliefs about dollarization, which operates for purposes of balance of payments in the same way as a currency board, showing that he may be one of the few people in existence who understands how pegs work.

Dollarization and currency boards have been effectively used to tame both runaway central banks and high spending politicians. Ecuador dollarized in 2000 and has avoided massive output and inflation shocks found in the rest of Latin America despite having relatively bad socialist policies.

"There is much food for thought in the story of Ecuadorian dollarization—not least, that the early success of what was a desperation move, taken in haste, without most of what were thought of as the necessary preconditions being in place, requires us to reconsider the conditions under which such a switch in the monetary system will succeed," Fischer said later.

Efforts by politicians to end dollarization has ended in failure so far. Most cases of dollarization (Zimababwe is one example) has taken place by the people with authorities giving support later by relazing legal tender laws and other rules by which people are forced to use bad central bank money.

Dollarized Panama (with a chronic persistent current account deficit) is also a sea of stability in the region, and is held out as an example to follow in Sri Lanka like Singapore or Hong Kong.

Currency boards in the past have set a strong foundation for economies to grow generating labour shortages triggering imports of workers. Sri Lanka (then Ceylon) also imported labour during its currency board period.

Middle Eastern nations like Dubai, which have currency board like systems, (pegs with a high degree of credibility) also import labour, while other central banks in the region such as Iran operate regularly collapsing soft-pegs.

Analysts had already warned that Sri Lanka has to restrain the central bank to make free trade possible. (Sri Lanka central bank has to be restrained for free trade to succeed).

Sri Lanka now has one of the most restrictive trade regimes in the world. Exchange controls and trade restriction began shortly after the soft-peg was created and the entire economy was closed in the early 1970s, when the Bretton Woods system of soft-pegs failed.

Wartime Tariffs

In 2016, following the increases in multiple import levies called 'para-tariffs' over the past decade, the World Bank described Sri Lanka's import regime as 'one of the most complex and protectionist in the world'.

Rajapatirana said that it was misleading to call policy changes done in 2010 as trade reforms.

"We said in 2010 we did trade reforms," he said. "No. In 2010 we increased the effective rates of protection."

Taxation of raw materials and inputs make exports of final goods uncompetitive as margins are eaten up by taxes.

In Sri Lanka energy is also taxed with excise and non-recoverable taxes, not value-added tax.

Rajapatirana said Sri Lanka should learn from Vietnam, which has liberalised its economy, increasing productivity which has boosted its exports.

"Vietnam is one of the most liberal economies I have seen. If you want to buy a shirt in Hanoi, four people will come and offer you a good price," Rajapathirana said.

"So it is important that we continue to liberalise the economy. We have absolutely no other way to do it."

"We need to lower tariffs and move towards a system where people can choose where they want to invest, except where intervention is needed for public goods. That is the way to increase productivity. I see no other way than that," he said.

"We can get stuck here if we don't look out and address these issues."

The State Bank of Vietnam also runs a soft-peg, but more successfully than Sri Lanka's central bank. The Vietnam dong held around 15,000 to 16,000 to the US dollar for around a decade until 2008, giving a stable foundation for the country to grow.

The peg failed spectacularly in 2008 after credit growth rocketed amid higher US interest rates and the state misguidedly engaged in 'stimulus'. The dong crashed to around 22,000 to the US dollar.

However, with credit growth at some banks rising over 20 percent, and rising US interest rates, analysts say Vietnam is also sitting on a powder keg, unless the State Bank of Vietnam takes action. So far, action has been limited to selective credit curbs.

National Policies and Economic Affairs State Minister Harsha de Silva said sections of the ruling coalition was inward looking, though his United National Party (UNP) was for liberalising markets.

He said that the economic policy clashes within the coalition government may cause Sri Lanka to 'miss the bus again'.

The 2018 budget, mainly a product of the UNP, had called for liberalising imports with the removal of so-called para-tariffs.

Rajapatirana said that paratariffs were a legacy of the civil war, which are no longer needed.

"We have done something in the last budget on paratariffs. They were needed at that time to finance part of the war, but there's no need to have it now and the more you keep it, the longer the public gets misallocated resources," he said.

However analysts say the administration will have a hard time convincing the ordinary people, after slapping taxes and trade restrictions on imports over the last month to compensate for monetary instability. (EconomyNext)

Europeans want Iran bank connected to world: French senator

European nations are seeking to ensure at least one Iranian bank stays connected to the world after the US imposed new sanctions against the country, a French senator said in Tehran on Sunday.

The United States pulled out of a landmark 2015 nuclear deal with Iran in May and has been reimposing punishing sanctions on the Islamic republic, targeting in particular its financial system.

The European efforts to help Iranians benefit from the nuclear deal despite the US sanctions is "difficult but it's possible", said French Senator Philippe Bonnecarrere.

One way was "to have at least one Iranian bank remain connected to the international banking system through SWIFT to keep up commercial relations on goods or services that are not subject to sanctions," he added.

Bonnecarrere, who heads the France-Iran friendship group in the upper house of parliament, made the remarks during a news conference with French and Iranian counterparts.

The 2015 nuclear deal was agreed between Iran and the so-called 5+1 group -- UN Security Council permanent members Britain, China, France, Russia and the United States, plus Germany.

Bonnecarrere was in Iran with six other members of the French parliament.

The visit was a sign of "all the determination and all the will of France to keep alive the nuclear agreement," said Delphine O, one of lawmakers. (AFP)

Saudi Arabia tries to salvage its investment conference after A-listers pull out

Saudi Arabia's investment conference this week was until recently the hottest ticket in business and finance.

Now the program has been stripped of names and a guest list, once a who's who of global business, was removed from the conference website.

Most of the top global CEOs and finance officials who were due to participate in the Future Investment Initiative, dubbed "Davos in the desert," pulled out in the last 10 days following the disappearance of Jamal Khashoggi at the Saudi consulate in Istanbul, Turkey, on October 2.

Saudi Arabia initially denied any knowledge of what happened to him, but late on Friday admitted that the Washington Post columnist died inside the consulate. Members of Crown Prince Mohammed bin Salman's inner circle have been blamed for his death.

Conference organizers insist it will be business as usual when the event starts on Tuesday. Early Monday, the website of the Future Investment Initiative was promising that a detailed program for the three-day event would be "released shortly."

"[The conference] will immerse thousands of delegates from all over the world in a rich agenda comprised of more than 40 individual plenaries, summits, open discussions and taskforce sessions," the Future Investment Initiative said in a statement last week.

Bin Salman is due to host the conference. But if he attends, he'll be rubbing shoulders with a much less famous crowd than this time last year, when he used the conference to promote his Vision 2030 plan to wean Saudi Arabia's economy off oil.

Among the A-list executives who have pulled out are JPMorgan (JPM) CEO Jamie Dimon, HSBC (HSBC) CEO John Flint, Blackrock (BLK) CEO Larry Fink and Uber CEO Dara Khosrowshahi. US Treasury Secretary Steven Mnuchin and IMF managing director Christine Lagarde are also skipping the event.

"The Khashoggi story has damaged the reputation of the kingdom and has increased political uncertainty," said Garbis Iradian, the chief economist for Middle East and North Africa at the Institute of International Finance. "[Businesses] may postpone or reduce doing business dealings in the kingdom and adopt a wait and see attitude," he added.

But the absence of top names won't put a halt to discussions about future business opportunities. Some companies are sending less senior executives or bankers. Others, such as Airbus (EADSF) — which has 1,000 employees in the kingdom — want to keep channels of communication open despite pulling top executives.

Officials from regional governments such as the United Arab Emirates will also be present. Many of them have expressed solidarity with Saudi Arabia's stance on Khashoggi's death.

The Russian Direct Investment Fund -— a sovereign wealth fund — will lead a delegation including more than 30 Russian entrepreneurs, executives and officials.

"We appreciate the constructive dialogue and are happy to share experiences, identify new joint projects and discuss promising areas for the development of comprehensive cooperation between a wide range of partners from Russia, Saudi Arabia and other countries," RDIF CEO Kirill Dmitriev said in a statement on Friday.

And the United States and the United Kingdom have indicated they have no intention of disrupting lucrative arms sales to Saudi Arabia. Defense contractors from both countries are likely to attend.

UK government minister Dominic Raab said on Sunday that Britain isn't going to "terminate" its relationship with Saudi Arabia, not just because of the "huge number of British jobs" that depend on the relationship but because to "exert influence over your partners you need to be able to talk to them."

But the kingdom's budding relationship with the global tech world is coming under pressure, and could be damaged.

At the conference a year ago, SoftBank (SFTBF) CEO Masayoshi Son sat alongside bin Salman as the prince announced plans for a $500 billion futuristic city, NEOM.

Son has also launched a $93 billion mega tech fund with nearly half the money coming from the Saudi government. It has already made big investments in dozens of startups such as WeWork and Slack. Son was already planning for a second such fund. Now, that looks unlikely to happen.

SoftBank has remained silent over whether Son and other top executives still plan to attend the FII. The company declined to comment on the matter Friday.

The kingdom urgently needs to reverse a decline in foreign investment to diversify its economy and end what the crown prince once called an "addiction" to oil. Under Vision 2030, bin Salman wants to grow the private sector, boost tourism and reduce unemployment over the next decade.

The plan caught the imagination of many international players, including billionaire Richard Branson, who jumped on opportunities for two tourism projects and was in talks for a $1 billion investment in his space company.

But Branson was one of the first to suspend his links with Saudi Arabia following Khashoggi's disappearance, and he has questioned whether anyone in the West can continue to do business there.

Many international investors were convinced this time last year that Saudi Arabia was open for business. It will be a much harder sell this time around. (CNN)