NEWS ROUND UP

Wednesday, 25th September, 2019

Contents

Sri Lanka stocks close 0.57-pct lower

Sri Lanka stocks closed 0.57 percent lower on Tuesday, dragged down by losses in Cargills (Ceylon) PLC, provisional data showed.

Colombo's All Share Price Index was down 32.94 points to 5,743.54 and the S&P SL20 of more liquid stocks fell 0.48 percent or 13.19 points to 2,746.56.

The market turnover was 260 million rupees with 30 stocks gaining and 102 falling.

Two crossing in John Keells Holdings contributed 66.6 million rupees to the market turnover, and the stock closed 1.10 rupees up at 152.90 rupees a share.

Cargills (Ceylon) PLC closed 8.00 rupees down at 185.00 rupees a share, Browns Investment fell 40 cents to 4.20 rupees a share and LOLC Holdings was down 2.80 rupees at 122.20 rupees a share contributing to the decline of the ASPI. (EconomyNext)

Sri Lanka rupee ends firmer, gilt yields stable

The Sri Lanka rupee closed stronger at 181.10/30 to the US dollar in the spot market on Tuesday, while bonds yields were steady, dealers said.

The rupee closed at 181.50/60 against the greenback in the spot market on Monday.

Liquidity in the overnight money market was 19.76 billion rupees, up from 12.90 billion rupees at Monday's close. Banks deposited 24.60 billion rupees through the excess liquidity window, up from 21.40 billion rupees.

There were no repo or reverse repo auction for the day.

In the secondary bond market, gilt yields remained unchanged in an inactive market with no trades, dealers said.

A bond maturing on 15.12.2021 closed at 8.88/93 percent on Monday, down from 8.90/98 percent from Monday's close.

A bond maturing 15.07.2023 closed at 9.85/93 percent, stable from 9.85/95 percent.

A bond maturing on 15.09.2024 closed at 10.26/30 percent slightly down from Monday, 10.27/32 percent.

A 15-year bond maturing on 15.09.2034 which was sold at the last auction closed 10.87/90 percent, down from 10.88/93. (EconomyNext)

Sri Lanka orders 200bp cut in lending rates in new price controls

Sri Lanka's central bank has slapped price controls on commercial banks loans, as credit contracted and bad loans soared after the agency generated monetary instability by controlling the exchange rate while printing money to simultaneously control interest rates in 2018.

Sri Lanka has elevated interest rates due to conflicts between money and exchange policies which have led to permanent depreciation of the currency, critics have said.

The central bank has ordered banks to cut lending rates by 200 basis points from October 15, 2015, from rates charged on April 2019 'subject to certain exclusions'.

Each licensed commercial bank has been ordered to cut its its Average Weighted Prime Lending Rate (AWPR) by 250 basis points by 27 December 2019 from the rate published by the central bank on April 2019.

"By 01 November 2019, each LCB's AWPR must be at least 150 basis points lower than its AWPR as at 26 April 2019,"the central bank said.

Rates on credit cards which are not settled on the settlement day, will be controlled at 24 percent.

Penal rates on banks have been controlled at 400 basis points.

The central bank earlier slapped price controls on deposits

The current administration started in 2015 with then finance minister Ravi Karunanayake announcing a raft of price controls including in milk tea, which has now been extended to banks.

With Easter Sunday attacks adding to monetary instability growth fell to 1.6 percent in the the June 2019 quarter.

The 2018 monetary instability came with barely a year of monetary stability in 2017, which ended with cash injections that began around March 2018.

Over the past eleven months, the Central Bank of Sri Lanka has taken a number of monetary and regulatory policy measures to induce a reduction in market lending rates. These measures include the reduction of the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 100 basis points in two steps, the reduction of the Statutory Reserve Ratio (SRR) applicable on rupee deposit liabilities of Licensed Commercial Banks (LCBs) by 2.50 percentage points that released around Rs. 150 billion of additional liquidity to the financial market, and the imposition of caps on rupee deposit interest rates offered by licensed financial institutions that enabled them to reduce the cost of mobilising funds from the general public.

The Central Bank has taken these measures with a view to supporting economic activity, given well contained inflation and inflation expectations. Further slowdown observed in the economy following the Easter Sunday attacks has intensified the need for lower market lending rates.

Meanwhile, the growth of credit extended to the private sector has decelerated sharply since the beginning of this year, and the non-performing advances (NPAs) have grown due to various factors.

The Central Bank is of the view that, among these, excessively high nominal and real lending rates are a key reason for slowing credit expansion and rising NPAs.

In fact, Sri Lanka’s real lending rates are unacceptably high compared to its peer economies, and are not consistent either with the low inflation regime experienced by the country over the past 10 years and the expectations of 4-6 per cent level of inflation envisaged under the proposed flexible inflation targeting framework.

Accordingly, the Monetary Board decided to order the Licensed Banks under Section 104(1)(b) of the Monetary Law Act, No. 58 of 1949, as amended, to reduce interest rates applicable on all rupee denominated loans and advances by at least 200 basis points by 15 October 2019, in comparison to the interest rates applicable as at 30 April 2019, subject to certain exclusions.

With effect from 01 November 2019, in the case of credit card advances, the maximum interest rate applicable will be 28 per cent per annum, while in the case of pre-arranged temporary overdrafts, the maximum interest rates applicable will be 24 per cent per annum.

Penal interest rates added to loans and advances have been capped at 400 basis points per annum, for the amount in excess of an approved limit or in arrears, during the overdue period, with effect from 15 October 2019.

Each LCB is also expected to reduce its Average Weighted Prime Lending Rate (AWPR) by 250 basis points by 27 December 2019 compared to its AWPR as published by the Central Bank as at 26 April 2019. By 01 November 2019, each LCB’s AWPR must be at least 150 basis points lower than its AWPR as at 26 April 2019.

The Central Bank will continue to closely monitor the movements in market lending rates to ensure a more effective transmission of monetary policy through the financial system. The Central Bank also expects to review this Order at end March 2020. (EconomyNext)

Sri Lanka misses IMF targets with ‘flexible exchange rate’; new deal on way

Sri Lanka has missed targets in a deal with the International Monetary Fund as it operated controversial ‘flexible exchange rate’ with contradictory policy for most in 2018, but a new deal was on and the country was hit Islamist bomb blasts.

Sri Lanka’s central bank started to print money and generate excess liquidity through multiple lender of last resort windows in March/April and July/August 2018 despite having a forex reserve target, leading to a collapse of the currency from 153 to 182 to the US dollar.

Thought tight liquidity after triggering currency pressure, prevented a total Indonesia or Argentina style meltdown analysts say trade restrictions and a credit contraction led to a fall in revenues and an output shock, which led to missing budget targets, analysts say.

Printing money generates a deficit in the balance of payments with excess demand, as well as spooking foreign investors, importers and exporters, automatically leading to a fall in forex reserves, missing any IMF forex reserve targets.

As Sri Lanka’s was recovering from currency collapses, in April 2019 on Easter Sunday several churches and hotels in Sri Lanka were hit by Islamist bomb attacks, for which Islamic-state claimed responsibility, generating widespread sympathy in the West.

Though Sri Lanka had missed targets in the program a new deal has been reached, pending prior actions, the IMF said.

“The team reached understandings at the staff level with the Sri Lankan authorities on the sixth review of the EFF-supported program,” IMF Mission chief to Sri Lanka Manuela Goretti said in a statement.

“The authorities are taking steps to complete all the pending actions and structural benchmarks for this review over the next few weeks.

“The team welcomed the authorities’ efforts to normalize the security situation in the country after the tragic terrorist attacks in April and mitigate the impact of the shock on the economy.”

The monetary instability from the pursuit of a ‘flexible exchange rate’ where interest rates and exchange rates are targeted simultaneously came despite political difficult tax hikes and market pricing of fuel.

“While the program targets agreed at the time of the fifth review are no longer within reach, the authorities are committed to achieve a primary fiscal surplus of 0.2 percent of GDP in 2019, through implementation of remaining revenue measures in the 2019 budget and prudent expenditure management,” the IMF said in a statement.

The petroleum utility also borrowed dollars running losses in excess of 100 billion rupees, despite having a price formula for reasons which are not clear, raising questions whether agency was mis-used in a failed bid to control the exchange rate through Mercantilist means.

Critics had pointed out that the collapse of the currency and unhedged forex risk taken on by the Ceylon Petroleum Corporation had wiped out any gains from tax hikes as dollar debt expanded taking away any gains from 'revenue based fiscal consolidation'.

However after October 2018, when President Maithripala Sirisena triggered a political crisis by violating the constitution analysts say the central bank was put in a difficult position and had managed as best as it could.

Analysts and warned at the inception of the program given Sri Lanka's past tendency to print money and generate currency pressure even within IMF deals, missing reserve targets, the central bank should have been restrained with tight ceilings on domestic assets.

The monetary instability and credit contraction coupled with bomb blast cut growth to 1.6 percent in the June 2018 quarter.

IMF said it expected growth of 2.7 percent in 2019, improving to 3.5 percent in 2020.

The IMF urged Sri Lanka to pass changes to a monetary law, amid concerns that the law may give more room for bureaucratic discretion to generate monetary instability though contradictory money and exchange policies.

Concerns are also rising that the new law will also help the central bank avoid inflation targeting with genuine float by getting legal authority to practice discretionary 'flexible' inflation targeting with a highly unstable soft-peg with little or no credibility.

Sri Lanka has to peg (buy dollars and inject base money) to meet IMF reserve targets and insistence by IMF among others, that there has to be a 'reserve buffer'.

Analysts who have tried to decipher the policy behind the 'flexible exchange rate' have identified the latest re-incarnation as having a convertibility undertaking of delaying interventions until there is a 'disorderly fall' but buying dollars at market rates with no 'disorderly gain' especially from the Treasury.

Base money injected from dollar purchase are also kept as excess liquidity for a extended periods of time but, any liquidity contraction from defence after the disorderly fall is injected overnight, making for hopelessly skewed policy that pushes the currency down even when credit is weak.

The full statement is reproduced below:

International Monetary Fund
Washington, D.C. 20431 USA

We welcome the authorities' commitment to fiscal discipline and institutional reforms to anchor debt sustainability, while providing space to support the ongoing recovery and social goals.

• The new Central Bank Act will be a landmark reform in the roadmap towards flexible inflation targeting, strengthening the Central Bank of Sri Lanka's mandate, governance, accountability, and transparency, in line with international best practice.

• Trade and investment liberalization, SOE reforms, and stepped-up anti-corruption efforts will be important to bolster Sri Lanka's competitiveness and medium-term growth.

A staff team from the International Monetary Fund (IMF) led by Manuela Goretti visited Colombo during September 10-25, 2019 to conduct the sixth review under Sri Lanka's economic reform program supported by a four-year Extended Fund Facility (EFF) arrangement. At the end of the visit, Ms. Goretti made the following statement:

"The team reached understandings at the staff level with the Sri Lankan authorities on the sixth review of the EFF-supported program. The authorities are taking steps to complete all the pending actions and structural benchmarks for this review over the next few weeks.

"The team welcomed the authorities' efforts to normalize the security situation in the country after the tragic terrorist attacks in April and mitigate the impact of the shock on the economy. Real GDP growth was revised to 2.7 percent in 2019 and is projected to improve to 3.5 percent in 2020, as tourist arrivals and related activities gradually recover. Inflation is expected to remain stable at around 4.5 percent during 2019-20.

Despite the recent fall in tourist arrivals and remittances, the current account balance is projected to improve to 2.6 percent of GDP in 2019 on the back of lower imports and stronger exports supported by the exchange rate correction in late 2018.

"Sustaining prudent policies and implementing institutional reforms remain critical to preserve macroeconomic stability, given the weak global outlook and Sri Lanka's sizable public debt.

"The protracted impact of the 2018 political crisis and the Easter attacks are significantly impacting fiscal performance. The end-June fiscal target was missed by a large margin, due to frontloading of spending from the clearing of arrears and externally-financed capital projects carried over from 2018 as well as a sharp fall in indirect revenues following the terrorist attacks.

While the program targets agreed at the time of the fifth review are no longer within reach, the authorities are committed to achieve a primary fiscal surplus of 0.2 percent of GDP in 2019, through implementation of remaining revenue measures in the 2019 budget and prudent expenditure management.

"The mission welcomed the authorities' commitment to advance revenue-based fiscal consolidation in 2020 and over the medium term to preserve the gains achieved under the program, put the high public debt on a downward path, and provide space for better-targeted social and capital spending.

Sustained efforts are needed to mobilize revenues, by broadening the tax base and enforcing compliance, and strengthen spending efficiency. To anchor public debt sustainability, the mission welcomed the authorities’ plans to revamp fiscal rules and establish an independent public debt management agency over the medium term, in line with international best practice.

Improving the financial performance of SriLankan Airlines and advancing energy sector reforms, including by tackling cost inefficiencies and subsidies in the electricity sector, remain critical steps to reduce fiscal risks.

“The mission supported the Central Bank of Sri Lanka (CBSL)’s prudent and data-dependent monetary policy approach and their renewed commitment to strengthen reserve buffers in line with program understandings.

The CBSL should continue to allow for exchange rate flexibility and limit FX intervention to smooth excess volatility, in the event pressures from tighter global financial conditions were to intensify.

The new Central Bank Act will be a landmark reform in the roadmap towards flexible inflation targeting by strengthening the CBSL’s mandate, governance, accountability, and transparency, in line with international best practice.

“The CBSL adopted temporary measures to support the tourism sector and ease credit conditions in the aftermath of the terrorist attacks, including a debt service moratorium and caps on bank interest rates. These exceptional measures should be lifted as soon as credit conditions stabilize to avoid distortions to the financial system, amid weaker credit quality and falling profitability. The mission welcomed the ongoing efforts to strengthen the regulatory and supervisory regime for banks and non-bank financial institutions.

The CBSL’s plans to enhance the macroprudential policy framework and stress testing capabilities and to upgrade the contingency framework would also contribute to financial stability. The authorities have made progress in strengthening the Anti-Money Laundering and Countering the Financing of Terrorism regime.

“The mission welcomed the authorities’ ongoing plans to bolster competitiveness and medium-term growth by gradually liberalizing the trade and investment regimes, while addressing any potential revenue impact. These plans would need to be supported by an unwavering commitment to strengthen governance and transparency, notably in state-owned enterprises, and tackle corruption as well as stepped-up efforts to promote women’s economic empowerment and targeting social transfers to those who need it the most.”

The team met with Prime Minister Wickremesinghe, Minister of Finance Samaraweera, State Minister of Finance Wickramaratne, Governor of the Central Bank of Sri Lanka Coomaraswamy, Secretary to the Treasury Samaratunga, Senior Deputy Governor Weerasinghe, other public officials, representatives of the Parliamentary Opposition, business community, civil society, and international partners. (EconomyNext)

China is sending government officials into companies like Alibaba and Geely

China is sending officials into some of the country's biggest private companies in a move it says is designed to bolster high-tech manufacturing.

Officials in the city of Hangzhou, a center of private enterprise in China's Zhejiang province, will be dispatched to 100 companies in the region, including e-commerce giant Alibaba (BABA) and automaker Geely (GELYF), the local government said in a statement at the weekend.

The role of the "government affairs representatives" is to foster communication and help businesses carry forward key projects, it added. It's part of China's ambition to become a tech superpower by moving its huge manufacturing industry up the value chain.

But the announcement triggered a backlash on Chinese social media, with many users expressing concern about the growing role of the state in business. It's also unlikely to reassure foreign governments worried about the independence of private companies such as Huawei.

The Chinese technology and telecommunications giant has struggled to fight off claims that it could spy on behalf of Beijing. And reducing the role of the state in China's economy is a key demand set out by the United States for resolving the trade war.

"The government wants more control of the economy, especially at this tough time. The trade war is escalating and Washington is putting more pressure on Beijing. The economy also keeps getting worse," said Ronald Wan, chief executive for Partners Capital International in Hong Kong.

It was understandable that the government wants to enhance communication with private companies during tough economic times, Wan said, but even a limited role for officials would be symbolic, because Hangzhou is home to some of China's biggest private enterprises.

"The government could also be sending a signal to private companies: move closer to the government and listen," he added.

Beijing has strengthened the Communist Party's involvement in the corporate sector since late last year. A directive issued by the central government in November requires all companies, including private and foreign firms, to set up party committees if more than three of their employees are party members.

Party committee at companies in the private sector should act as supervisors to ensure companies strictly obey Chinese laws and regulations, according to the directive. At state-owned enterprises, they participate in decision making.

"The move by Hangzhou government could just be the beginning. It may be copied by other local governments," Wan said.

Alibaba said the initiative was about fostering "a better business environment" to support companies based in Hangzhou.

"The government representative will function as a bridge to the private sector, and will not interfere with the company's operations," the company said in a statement emailed to CNN Business.

Geely didn't immediately respond to a request for comment.

The statement from the Zhejiang provincial government didn't contain a full list of the 100 companies that will be assigned officials. But Meng Xinzhe, vice chairman for the local industry association, uploaded a government document Monday on his Weibo account which listed a number of top financial and tech firms, including online payment company Ant Financial, internet and entertainment conglomerate NetEase (NTES), surveillance camera maker Hikvision, and rival Dahua Technology.

The Zhejiang provincial government responded to concerns about the future of the market economy in an opinion piece posted on its website on Sunday, saying the representatives would not interfere in decisions made by the companies and were only there to help resolve issues concerning government-related issues.

The officials would be supervised by the city government and their appointments would last a year, it added. (CNN)