NEWS ROUND UP

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Sri Lanka rupee ends weaker, stocks down 0.03-pct

The Sri Lanka rupee closed weaker Thursday at 172.75/90 rupees against the US dollar in the spot market, while stocks ended a marginal 0.03 percent lower on selling interest in banking stocks, market participants said.

The rupee had traded at an intraday low of 172.90 rupees against the greenback.

The rupee ended Tuesday at around 172.50/70 rupees against the greenback, recovering from an intraday low of 173 rupees, but weaker from Monday's closing of 172.30/60 rupees, market participants said. Markets were closed Wednesday for Poya.

In equities, Colombo's All Share index fell 0.03 percent, down 1.98 points to 5,768.54, and the S&P SL20 of more liquid stocks ended 0.19 percent lower, down 5.54 points to 2,926.69.

Market turnover was about 1.3 billion rupees as 43 stocks gained during the day against 61 that declined.

Hatton National Bank (down 3 rupees to 205 rupees), Commercial Bank (down 70 cents to 107.80 rupees) and DFCC Bank (down 2.20 rupees to 87 rupees) weighed down the benchmark index.

Sampath Bank closed 1.60 rupees lower at 222.50 rupees and Nations Trust Bank was down 1.90 rupees to 85.10 rupees.

NDB Bank fell 20 cents to 99 rupees while Seylan Bank shed 1.30 rupees to close at 66.50 rupees.

Union Bank had gained 40 cents to 11.40 rupees.

Super market chain Cargills ended 5 rupees lower at 195 rupees.

John Keells Holdings gained 2.20 rupees to 135.50 rupees and Ceylon Tobacco ended 4.80 rupees higher at 1,385 rupees.

Net foreign selling was 277.5 million rupees, up from 59.3 million rupees the previous day.

Foreign selling in John Keells Holdings was 313 million rupees, according to Asia Securities, a Colombo-based stock brokerage.

Foreign investors were net buyers of small parcels in banking stocks: 13 million rupees in Sampath Bank and 11 million rupees in Commercial Bank.

There were eleven off-market negotiated deals, or crossings, in John Keells Holdings totalling 1.06 billion rupees, accounting for 85 percent of market turnover.

Gilt yields were mostly unchanged in lacklustre secondary market trading.

A three-year bond maturing in 2021 ended at 10.85/95 percent in two-way quotes, unchanged from Tuesday's closing.

A five-year bond maturing in 2023 closed at 11.33/38 percent, edging lower from 11.34/42 percent the previous day. (EconomyNext)

Sri Lanka banks in 'perfect storm', buying opportunity

Sri Lanka's banking sector is caught in a 'perfect storm' with margins expected to tighten due to weak credit growth, rising non-performing loans, increasing regulatory costs and higher taxes, an equities research report said.

"On one hand, weak economic growth and austerity measures enforced by the government have led to a moderation of credit growth, while opex headwinds and rising impairment cost due to elevated non-performing loans will bear down on industry profitability," Asia Securities, a Colombo based brokerage said in a banking sector report.

But depressed prices show a buying opportunity, with larger banks, such as Commercial Bank, Sampath bank and Hatton National Bank, likely to see the first investor interest after negative sentiment clears, the report said.

"Here's a fact, Sri Lanka's banking sector is forecast to generate the highest returns on equity of all the comparable banking sector's in the in the region," Asia Securities chief Dumith Fernando said at an investor forum organised by Asia Securities.

"Here's another fact, Sri Lanka's banking sector as measured by price to book, price to earnings multiples, is the cheapest sector of all the regions, trading at the lowest valuations since the end of the war," he said.

According to Asia Securities, implementation of Basel III capital requirements and increasing provisioning for non-performing loans under IFRS 9 are expected to slow-down growth for Sri Lankan banks.

"We believe the dip in asset quality will run its course until the second half of 2019, but take comfort in the fact that the banks have taken prudent measures to arrest the situation," Asia Securities said.

However, the higher capital and liquidity requirements from Basel III will leave the industry more stable and sturdier to weather future credit events, it said.

"One risk to our view, and an important one for investors, is the impact of government policy on the industry."

"The debt repayment levy, for example will lead to an 8.5 percent drop in profitability across our covered banks, if implemented in the current form, and was partially the reason for the dip in industry valuations since August 2018," Asia Securities said.

Excerpts of Asia Securities' banking sector report are as follows:

Asset quality deterioration is a cyclical trend; systemic risks not seen: Credit cycles typically have a strong linkage with economic cycles, and the Sri Lankan services sector (both banks and non-bank financial institutions) is currently in the midst of a cyclical asset quality deterioration phase. However, the current phase is less intense than the last one in 2013/14.

Banks are seen taking a more prudent approach to manage the situation, and with tighter capital and liquidity regulations being implemented, there does not seem to be a major risk to the system. In the short run, however, this would create earnings headwinds in the next few quarters.

Loan growth to moderate to about 15 percent in 2018-2020: Following three years of strong credit growth which averaged 18.8 percent, licensed commercial banks are expected to enter into an era of structurally low credit growth as credit supply tightens and demand weakens.

On one hand, higher capital requirements from the last Basel III implementation would encourage banks to be more measured in lending.

Alongside this, the implementation of IFRS 9 (locally enacted as SLFRS 9) would lead to higher impairment books for each loan disbursed (given the shift to an 'expected credit loss' model).

As a result, banks are expected to be more cautious on managing lending exposure, further slowing down credit disbursement.

On top of this, sluggish economic growth momentum courtesy of high oil prices, a weakening currency and large government debt repayments falling due in 2019-21 are expected to moderate credit demand to some extent.

On the other hand, private banks are expected to take up a higher share of the lending from the undercapitalized state banks.

"While tightening regulatory conditions seem to constrict growth, we strongly believe that the banking system will emerge more stable as a result," Asia Securities said.

SME lending remains a key opportunity; retail lending to be sluggish until 2019: SMEs remain the backbone of the economy, contributing to about 52 percent of GDP growth according to the Ministry of Finance.

Unsurprisingly, banks have been heavily focusing on this segment for the past few years. With more upside left to fill SME lending penetration, banks would continue to focus on this segment. However, SMEs are more susceptible to economic cycles than their larger counterparts, the corporate sector.

A large part of the of the non-performing loans increases this year was driven by cash flow stresses in the SME segment, and his would lead the banks to step up their risk-assessment with SME lending.

"Consumer loan-affordability remains weak, on the back of austerity measures implemented by the government, and we argue that the key consumer-related products (housing loans, vehicle

loans and credit cards) would not see material growth until the second half of 2019" Asia Securities said.

Interest rates show upward bias, but signs of liquidity pressure weighing on NIMs (net interest margins): The central bank in April 2018 signaled the end of (the) policy tightening era with a 25bps cut in the Standard Lending Facility Rate (SLFR).

However, the six months that followed saw a strengthening US dollar and subsequent capital outflow from government securities and the equity market, rising LIBOR pushing up government refinancing cost and elevated oil prices burdening the trade balance.

"Consequently, we see upward pressure on policy rates, but consider this likely in the first half of 2019, if the negative externalities intensify," the report said.

While rising interest rates generally bode well for banks given the asset-liability structure, there is some pressure on deposit rates in the market as the cost of borrowing (both locally and internationally)—a sizeable source of funding for local banks—is increasing.

"We do not see significant pressure on lending rates, and on balance, see signs of NIMs trending down, albeit modestly".

Profitability face short term headwinds; large banks better positioned to take the hit: Asia Securities said it sees the largest impact coming from high impairment charges, which saw a surge of 144 percent from a year earlier during the first half of 2018.

While this figure includes some prudential-impairments taken by the banks, the continued tepid economic conditions would lead to elevated credit costs in in 2018 (forecast at about 80bps).

In addition, IFRS 9 implementation is expected to push up credit costs structurally to about 50bps per annum in 2019-2021, versus an average of 40bps 2015-17.

Market has aggressively discounted the sector; key picks are COMB, HNB, SAMP and NTB: Within the listed licensed commercial banks, our coverage of nine banks has seen their stock prices decline by about 20 percent on average.

Following this, the sector now trades at a price to book value multiple of 0.7x estimated for 2018 and 0.6x estimated for 2019, with the valuation overhang bearing down on the more stable banks as well.

"We believe COMB (0.8x book value estimated for 2019), HNB (0.7x) and SAMP (0.6x) offer more attractive entry points at these levels, and once the negative sentiment clears, will see first-investor interest as they offer better liquidity and stable fundamentals in the long run," Asia Securities said. (EconomyNext)

Land prices in Sri Lanka's Colombo district up 16-pct in first half

Land prices in Sri Lanka's Colombo district, where the capital is, rose over 16 percent in the first half of 2018 from a year ago, led by commercial properties and appear to be picking up again.

The Central Bank said its Land Price Index (LPI), compiled biannually covering the Colombo District, rose 16.3 per cent in the half-year ending June 2018, faster than in the previous six months.

The rebased Land Price Index for the Colombo District reached 116.3 during the first half of 2018, recording an increase of 16.3 percent compared to the first half of 2017, a statement said.

"All sub-indices of LPI, namely Residential LPI, Commercial LPI and Industrial LPI contributed to this increase."

The highest increase was in the Commercial LIP, which rose 16.8 percent, followed by residential land which rose 16.5 percent and industrial land which rose 15.8 percent.

The central bank said that with the increasing importance of monitoring land prices due to recent developments in the real estate sector, the geographical coverage of LPI was expanded to 82 centers covering all DS divisions in the Colombo District.

The bank also revised its base period from 1998 to first half of 2017 to accommodate this expansion.

Residential land prices had risen 9.7 percent, Commercial 11.2 percent and Industrial land 10.1 percent in the half year to December 2017.

The data up to December 2017 showed land price inflation slowing in the previous three six-month periods with the LPI itself having risen 12.8 percent up to end-December 2016, and slowing to 12.6 percent in the six months to June 2017. (EconomyNext)

Sri Lanka plantation industry says wage model unsustainable

Sri Lanka's 150-year-old plantations industry model, where resident workers are paid daily wages, is not sustainable and a more entrepreneur-type, productivity-linked system is the way forward, officials said.

Regional plantations companies (RPCs), which have reached deadlock with unions on a pay hike, propose the industry shift entirely to a productivity-based wage model as the only way to

meet union demands to double daily basic pay to 1,000 rupees.

The RPCs are offering to pay 46 rupees for every kilo of tea harvested, where resident labour remains on company payroll with the same benefits like housing and medical care but responsible for plucking tea bushes in demarcated plots.

Workers now get a basic pay of 500 rupees along with incentive payments amounting to a total daily wage of 805 rupees.

Additionally, tea harvesters who are able to bring in harvests above the norm of 16-18 kilos are entitled to 'over-kilo' pay of 28.75 rupees for every kilo in excess of the plucking norm.

RPCs propose raising the basic wage by 20 percent to 600 rupees from 500 rupees and other increases that take the maximum total daily wage to 940 rupees.

"The current model is not sustainable," Sunil Poholiyadde, chairman of The Planters' Association of Ceylon, told a news conference.

"It is essential that the wage is linked to productivity for the sustainability of the industry and the national economy as whole."

Sri Lanka suffers from the highest cost of production among tea producers with the largest contributing factor being low labour productivity.

"RPC's are not denying a wage increase; however there must be consideration for financial viability," Poholiyadde said.

"Current market dictates and prices at the Colombo auctions have shown a downward trend. Raising productivity is an absolute must which the trade unions accepted at the last negotiations with the inclusion of a productivity incentive in the wage package."

A PA statement said RPC workers are paid more than the tea smallholder sector and garment industry with 67 percent of the cost of production of tea going to workers.

The tea smallholder sector, accounting for 76 percent of national green leaf production, offers a minimum of 26 rupees a kilo of green-leaf.

That's without EPF, ETF, maternity benefits, gratuity, holiday pay, attendance bonus pay, profit share, total maternal care, day care and all the other benefits offered by RPCs to their workers.

And that's in addition to the compulsory 300 days of work offered a year irrespective of the output of the workers, weather conditions, crop availability and the viability of the estates, the PA said.

Rajadurai said there are 420,000 smallholders and their productivity is better. The number of workers on RPC estates had fallen to 150,000 from 350,000 at the time of privatisation.

“Smallholders pluck 30-40 kilos a day and earn over 1,000 rupees,” he said.

“We offered 46 rupees per kilo. If an RPC worker plucks 22 kilos, he has got his 1,000 rupees. The RPCs have already offered workers a mechanism to earn 1,000 and more. They have the potential. We want to encourage the more productive workers.

“If the plantations industry is to continue we should change the model and for workers to be entrepreneurs. Otherwise we have this deadlock every two years.” (EconomyNext)

Stock markets rebound after dramatic tumble

Stocks attempted a comeback on Thursday as Europe and Wall Street rallied, reversing some of Wednesday's bruising losses after a string of rosy earnings reports.

Wall Street notched solid gains as investors bought shares at reduced prices -- even though all three major indices were still down sharply for the week.

In Europe, all major markets closed solidly in the black but London's FTSE index underperformed, held back by a steady pound and a weak sales outlook from advertiser WPP.

"After a severe sell-off it's perfectly normal to see the market rebound," analyst Adam Sarhan said. "The key question: Is it a one-or two-day rally or is it a new trend?"

Capital Economics analyst Oliver Jones also said that the rebound in US markets was unlikely to last.

"We think that the bounce in the S&P 500 today after its slump on Wednesday will prove temporary, as investors become even more worried about the outlook for the US economy in the next few quarters," he said.

Earlier, the European Central Bank's monthly monetary policy meeting contained no surprises, with the bank leaving interest rates and its exit calendar from mass bond-buying untouched.

ECB chief Mario Draghi said risks to the eurozone growth outlook were "broadly balanced", citing protectionism, vulnerabilities in emerging markets and financial market volatility as prominent downside risks.

"Not sexy, but highly effective," is how Carsten Brzeski, chief economist at ING Germany, described the ECB's determination to end the bond purchases, also known as quantitative easing (QE).

The ECB, he said, was on "autopilot" as far as the policy's implementation was concerned.

"It would require a severe downturn of the economy, not only weaker momentum, in the coming six weeks for the ECB to alter its course," Brzeski said.

- ROUGH DAY IN ASIA -

Earlier, the closely-watched Ifo survey of businesses in Germany showed falling confidence as the eurozone's largest economy faces gathering clouds over the single currency area.

Shares in AB InBev slumped after the Belgian-Brazilian beer giant slashed its dividend following a slide in quarterly profits for the brewer of Budweiser.

Earlier Thursday, Asian stock markets closed sharply lower, tracking Wednesday's plunge on Wall Street, with trading floors awash with negativity on geopolitical concerns and following weak US economic and earnings data.

Global equities have been pummeled this year by a wave of problems led by the China-US trade war and rising Federal Reserve interest rates.

Among the strongest headwinds in recent weeks has been a brewing nuclear standoff between the United States and Russia, the high-profile killing of a Saudi journalist, Brexit, and Italy's budget row with the European Union.

- KEY FIGURES AROUND 2100 GMT -

New York - Dow: UP 1.6 percent at 24,984.55 (close)

New York - S&P 500: UP 1.9 percent at 2,705.57 (close)

New York - Nasdaq: UP 3 percent at 7,318.34 (close)

London - FTSE 100: UP 0.6 percent at 7,004.10 points (close)

Frankfurt - DAX 30: UP 1.0 percent at 11,307.12 (close)

Paris - CAC 40: UP 1.6 percent at 5,032.30 (close)

Milan - FTSE MIB: UP 1.8 percent at 18,815.32 (close)

EURO STOXX 50: UP 1.1 percent at 3,164.80 (close)

Tokyo - Nikkei 225: DOWN 3.7 percent at 21,268.73 (close)

Hong Kong - Hang Seng: DOWN 1.0 percent at 24,994.46 (close)

Shanghai - Composite: FLAT at 2,603.80 (close)

Euro/dollar: DOWN at $1.1375 from $1.1393 at 2100 GMT

Pound/dollar: DOWN at $1.2817 from $1.2881

Dollar/yen: UP at 112.37 from 112.19 yen

Oil - Brent Crude: UP 72 cents at $76.89 per barrel

Oil - West Texas Intermediate: UP 51 cents at $67.33 (EconomyNext)

Europe's economy is getting hit from all sides

Europe's economy turned in its best performance in decades in 2017. There won't be a repeat anytime soon.

Growth is expected to slow dramatically this year as Europe grapples with new trade barriers, uncertainty over Brexit and political spats that undermine confidence in the euro and put banks under stress.

"The ever strengthening cocktail of risks stemming largely from elsewhere has been a source of increasing concern," said Florian Hense, an economist at Berenberg bank.

The European Central Bank estimates that eurozone growth will slow to 2% this year, compared to 2.5% in 2017. Europe, which had been growing more quickly than the United States as recently as last year, is falling behind again.

Business is already feeling the chill.

A survey of purchasing managers published Wednesday by IHS Markit indicated that the eurozone economy grew at its slowest rate in over two years in October. The survey suggests global trade conflicts are reducing demand for European exports.

Even more ominous, expectations for future growth hit their lowest level in four years.

"It does not take much more uncertainty across the globe to cause a further major drop in sentiment and a delay of investment decisions," said Stephen Brown, a senior economist at Capital Economics.

The European Central Bank said Thursday that the data wasn't gloomy enough for it to reconsider plans to end its massive stimulus program in December. The bank will have effectively added €2.7 trillion ($3.1 trillion) to the economy since 2015 by buying government bonds.

"Yes, there is a weaker momentum ... but is this enough of a change to make us change the baseline scenario? The answer is no," bank president Mario Draghi told reporters. "We are talking about weaker momentum, not a downturn," he added.

The United States has hit Europe with new tariffs on steel and aluminum. But European companies are also being caught in the crossfire of a bigger trade conflict between the United States and China.

"Many firms will be selling parts that are used as inputs for production or selling general investment goods, so trade tensions can have an indirect effect," said Brown.

The biggest problem is in Germany, an export powerhouse that has seen a particularly sharp drop in activity.

The German Chamber of Industry and Commerce has downgraded its forecast for economic growth to 1.8% in 2018, down from an earlier estimate of 2.7%.

IHS Markit's survey showed a pullback in orders from abroad, and weakness in Germany's car industry.

German automakers are being hard hit by global trade tensions, continued fallout from diesel scandals and delays sparked by a new vehicle certification system in Europe.

BMW issued a profit warning in September, blaming in part "continuing international trade conflicts." On Thursday, Mercedes Benz owner Daimler (DDAIF) reported a sharp drop in third quarter profits.

"The automotive industry and thus also Daimler are still in a very challenging environment," CEO Dieter Zetsche said in a statement.

Another major risk looms: President Donald Trump has repeatedly threatened tariffs on cars assembled in Europe if the European Union doesn't move to reduce trade barriers.

The United Kingdom is scheduled to leave the European Union in March 2019. But companies in mainland Europe and the United Kingdom are still in the dark about what that means for their ability to do business across the new border.

Fears are rising that the United Kingdom may depart with a deal so vague that it gives companies and investors no greater clarity on the future than they had in June 2016, when voters backed Brexit in a referendum.

A so-called "blind Brexit" may be even worse for some companies than a scenario where the United Kingdom leaves in March without an agreement on access to Europe's vast markets.

BMW (BMWYY) will shut its Mini factory in England for one month of maintenance immediately after Brexit because it can't be sure of getting parts. Jaguar has cited uncertainty over Brexit as one reason for putting 1,000 workers on a three-day work week until Christmas.

Airlines could face major disruption to their business, while retailers are being advised to stockpile food and medicines.

European politics is also threatening economic stability.The European Commission rebuked Italy earlier this week over a draft budget that calls for a sharp spending increase in violation of EU rules. Italy will have to back down or face fines.

Investors worry that the conflict between Rome and Brussels could escalate further and put Italy's fragile banking sector under more pressure. That in turn would weigh heavily on Italy's stuttering economy."Italy is the third largest economy in the eurozone, so its financial fate is important for the entire bloc," said Kathleen Brooks, research director at Capital Index. (CNN)