NEWS ROUND UP

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The Vote on Account (VOA), which will set public finances for the first three months of next year, seeks to access a total of Rs. 1, 735 billion from the Consolidated Fund, a top official said yesterday.

The VOA, which was approved by the President Maithripala Sirisena-appointed Cabinet this week.

It includes Rs. 760 billion for public services, Rs. 970 billion for expenditure previously authorised by different laws, and Rs. 5 billion for the Government advance account, MP Mahinda Samarasinghe told reporters.

President Maithripala Sirisena appointed the Cabinet led by MP Mahinda Rajapaksa, who was appointed Prime Minister following the sudden removal of sitting Prime Minister Ranil Wickremesinghe on 26 October.

MP Rajapaksa, who was appointed the Finance Minister by President Maithripala Sirisena, also presented a note on the country's economy at the meeting to update those present on the current situation, Samarasinghe said. A special meeting has been summoned by Sirisena to discuss economic issues faced by the country, he added.

Both Samarasinghe and MP Dayasiri Jayasekara noted efforts would be made to give maximum relief to people, while still managing the fiscal deficit.

The parties opposing President Sirisena's decision moved two votes of No Confidence in Parliament. The House is set to take another vote today, to block the Prime Minister's office from accessing funds, citing the No Confidence Motions that were passed earlier this month.

However, it is not clear if the United People's Freedom Alliance, supporting Mahinda Rajapaksa as Prime Minister, will boycott the vote. A decision is to be taken at the UPFA Parliamentary group meeting to be held this morning.

Both Samarasinghe and Jayasekara, who was also present at the media briefing, were confident of passing the Vote on Account if presented in Parliament, despite not having a clear majority.

"We will need a majority, but we don't expect it to be a problem. We will look at that when the time comes," he said. The VOA will be presented to Parliament only if the Supreme Court decides that the Gazette issued by President Sirisena dissolving Parliament was done by overstepping his powers as set out in the Constitution.

If the President's order is upheld in the courts, Parliament stands dissolved, which then allows the President to gazette the VOA following a Proclamation, Samarasinghe said. (Dailyft)

Rupee hits low on political uncertainty; ends higher on bank dollar sales

The rupee hit a record low for a sixth straight session on Wednesday as investors dumped rupee-denominated assets after a credit rating downgrade and a delay in an IMF loan discussion in the wake of a political crisis.

It ended firmer due to Central Bank greenback selling to prop up the currency.

The rupee hit a fresh low of 180.85 per dollar, surpassing its previous low of 180.50 hit on Tuesday. It ended at 180.50/90 per dollar on Wednesday, compared with 180.40/90 in the previous session.

It has weakened around 3.6% since the political crisis began on 26 October and 17% so far this year.

Moody's downgraded Sri Lanka last week for the first time since it started rating the country in 2010, blaming the political turmoil for aggravating its already problematic finances.

The downgrade coincided with a decision by the International Monetary Fund to delay discussions on its loan tranche to Sri Lanka.

The political standoff took another turn on Friday when the lawmakers who back the disputed Prime Minister Mahinda Rajapaksa – who has refused to resign despite losing two confidence votes in Parliament – walked out of the Chamber in the face of another defeat there.

On Monday, lawmakers who back Rajapaksa boycotted the Parliament session. Rajapaksa and the new Government have not been recognised by any foreign countries because they have not proven their Parliament majority.

The political paralysis remains the main concern of investors. While Rajapaksa and President Maithripala Sirisena have failed to win support in Parliament for their new Government, deposed Prime Minister Ranil Wickremesinghe's coalition, which claims it does have majority support in Parliament, has not been allowed to try to form a Government.

The political impasse could be set to drag on longer after President Sirisena said on Sunday he would not reinstate Wickremesinghe as Prime Minister even if he was able to prove his majority in Parliament.

The Central Bank on 14 November unexpectedly raised its main interest rates to defend the rupee, which has faltered as foreign capital outflows pick up due to the domestic crisis as well as rising US interest rates.

Foreigners sold a net Rs. 201.9 million ($ 1.13 million) worth of stocks on Tuesday, and they have been net sellers of Rs. 7.9 billion since the political crisis started. The bond market saw outflows of about Rs. 29 billion between 25 October and 21 November, Central Bank data showed.

This year, there have been Rs. 17.3 billion of outflows from stocks and Rs. 118.8 billion from Government securities, the latest data from the bourse and Central Bank data showed.

Five-year Government bond yields have risen 70 basis points since the crisis unfolded on 26 October.

The Colombo stock index rose 0.16% to 5,981.16 on Wednesday. It declined 0.41% last week following a 0.39% fall previous week. It has fallen 6.1% so far this year.

Stock market turnover was Rs. 409.3 million on Wednesday, less than half of this year's daily average of Rs. 831.6 million. (Dailyft)

Softlogic Life amongst top ranked brands at Asia Insurance Industry Awards 2018

Sri Lanka's number one health insurance company Softlogic Life made it to the top three insurance companies in the prestigious 'Life Insurance Company of the Year' category at the 22nd Asia Insurance Industry Awards 2018. Softlogic Life was the only South Asian Insurance Brand to be shortlisted as a finalist in the above category at this year's edition.

Organized by Asia Insurance Review Magazine, Softlogic Life was shortlisted for this coveted accolade for encouraging the growth of life insurance as a core component of the financial industry while showcasing leadership, product innovation and excellent customer service through different service channels.

Now in its 22nd year, the Asia Insurance Industry Awards has become a much sought-after mark of excellence and peer group endorsement for insurance players and professionals in the market. The Awards have been hosted annually since 1997 by Asia Insurance Review— the voice of the insurance industry of Asia for the past 27 years. Forty-seven insurers, brokers, risk managers, service providers and industry leaders from the region made it to the list of the top finalists of this year's edition under 15 categories.

Being shortlisted for the 'Life Insurance Company of the Year' award, the Asia Insurance Industry Awards recognised Softlogic Life's track record in innovation and growth, leadership in product portfolio, a broad strategic vision, a high level of employee satisfaction and a strong commitment to meet customer demands. As the fastest-growing life insurance company in Sri Lanka, Softlogic Life was the quickest in the sector to reach a revenue of Rs. 7.5 billion.

Over the last few years, the company has actively embraced creativity and disruptive innovation such as its Life Up smart application, One Day Claim Settlement initiative, Digital Branch concept, Medicine to Door Step service, Express Digital Policy Issuance, Per Day Insurance and a bundle of digital-first initiatives to elevate the standards of Sri Lankans by bringing together world-class solutions that enhances quality of life of their customers. Recently, Softlogic Life unveiled 'Softlogic Life Premier Health Benefit', the country's largest health insurance benefit to date, offering a cover up to Rs. 50 million a year. The latest insurance offering provides a number of 'industry- first' health care benefits for individuals and their families, opening up the best of medical care the world has to offer. A worldwide hospitalisation cover and cashless claim settlement service that serves as a financial relief particularly in the case of an emergency while travelling abroad are core features of this product. Softlogic Life Insurance PLC is a subsidiary of Softlogic Capital PLC and is part of the Softlogic Group, which is recognised as one of Sri Lanka's most diversified and fastest-growing conglomerates, with interests in Healthcare, Retail, ICT, Leisure, Automobiles and Financial Services. Significant stakeholders in the company also include FMO and DEG, who are rated 'AAA' Development Financial Institutions from the Netherlands and Germany, respectively. (Dailyft)

364-day bill weighted avenge dips for a second consecutive week

The downward trend in the weekly weighted average yields continued for a second consecutive week at its weekly Treasury bill auction held yesterday as the 364-day maturity was seen decreasing by one basis point to 11.20%.

The total offered amount of Rs. 18 billion was solely accepted on the 364 day maturity, rejecting all bids for the 182-day maturity. The bids to offer ratio increased to a five week high of 3.22:1.

In the secondary bond market, yields were seen decreasing further mainly on the liquid maturities of the 15.12.21, 01.08.26 and 15.06.27 to lows of 11.85% and 12.30% each against its previous day's closing levels of 11.90/95, 12.25/35 and 12.35/43. In addition, activity was witnessed on the 15.05.23 and 01.09.28 maturities at 12.00% to 12.10% and 12.45% to 12.50% respectively as well.

In the money market, the OMO department of Central Bank infused liquidity for durations of overnight and seven days for successful amount of Rs. 25.15 billion and Rs. 14 billion at weighted averages of 8.50% and 8.54% respectively as the net liquidity shortfall stood at Rs. 55.49 billion yesterday.

However the attempt to infuse liquidity for 14 days was not successful as no bids were received. The overnight call money and repo rates averaged 8.98% and 8.80% respectively.

Rupee appreciates to trade below Rs.180

The USD/LKR rate on spot contracts appreciated above the Rs. 180 psychological level to close the day at Rs. 179.60/90 against its previous day's closing of Rs. 180.50/90 on the back of selling interest by banks.

The total USD/LKR traded volume for 27 November was $ 49.00 million.

Some of the forward USD/LKR rates that prevailed in the market were: one month – 180.65/15; three months – 182.70/20; and six months – 185.70/20. (Dailyft)

Consumers rear-ended by REER depreciation?

www.advocata.org: What really is driving the currency weakness? The Central Bank must consider both fundamentals and monetary factors.

Sri Lanka's currency has fallen rapidly over the last two months, raising fears of yet another crisis. Sri Lanka's Rupee depreciation over the past six months against the US Dollar is at a much higher rate than the historic annual average of around 10% over the last couple of decades. A stable exchange rate reduces transaction costs and uncertainty in international trade, thereby stimulating trade. It is one of the most important macroeconomic variables in the economy; it affects inflation, exports, imports and economic activity. Budget deficits are the source of much instability. The painful tax increases that addressed this issue were expected to result in stabilisation of interest rates, exchange rates and infla-tion. The recent depreciation of the currency is therefore puzzling and worrying.

The problem seems to be in the new inflation targeting regime based on the Real Effective Exchange Rate (REER). What this means is that Sri Lanka will target an inflation-adjusted exchange rate index relative to competitors to keep the Rupee competitive. It appears that the depreciation of other currencies has led the Central Bank to loosen monetary policy, causing the currency to fall. What are the implications of such a policy?

Export growth is correctly identified as critical for development, and the Central Bank objective seems to be to keep the exchange rate competitive; but is this necessary? Previously, competitive exchange rates were seen to be crucial for exports, but a recent paper published by the World Bank in 2015 (Depreciation without Exports? Global Value Chains and the Exchange Rate Elasticity of Exports) suggests this is changing (although the view is not universal; other studies seem to contradict this).

The paper finds that the emergence of global value chains (GVCs) has resulted in a decline in the ef-fect of real exchange rates on export performance. This has been linked with the emergence of GVCs through the following three mechanisms:

1. Firms need to import to be able to export; therefore, their exports contain not just domestic but also foreign inputs.

2. Stable supplier-buyer links are valuable, so the cost of switching suppliers in case of a real ex-change rate change in a given partner's country becomes non-negligible.
3. Large leading firms account for an increasingly larger portion of world trade, and these firms may find it easier to hedge against real exchange rate changes along their production network.
The study finds that when firms' share of imported intermediates is greater than 30%, the effect of real exchange rates on export participation fades. Thus, as countries become more integrated in global production processes, currency depreciation only improves the competitiveness of a fraction of the value of final goods exports. The objective of Sri Lanka's new export strategy is to integrate to GVC. If this paper is correct, the currency may not play a significant role in improving our entry into GVCs.
As yet, Sri Lanka is not well integrated into global value chains; so does the currency depreciation help existing exports? This does not appear to be the case.
A Central Bank staff research paper by U P Alawattage in 2005, titled Exchange Rate, Competitiveness and Balance of Payment Performance, examined the effectiveness of the exchange rate policy in Sri Lanka in achieving external competitiveness since the liberalisation of the economy in 1977. It analyses quarterly data covering the period of 1978:1 to 2000:4 and finds that the Real Effective Exchange Rate (REER) does not have a significant impact on improving the trade balance, particularly in the short term.
The other major concern is the impact of the currency on domestic prices and confidence. For small economies, changes in the exchange rate can have an important influence on prices. It not only affects prices of imports but also import-competing goods, and local goods that are tradable internationally. When the currency depreciates, local prices of these goods and services tend to rise quite quickly, and by a similar amount as the depreciation of the exchange rate.
When import prices rise, demand is driven towards domestically produced goods and services. In the absence of offsetting factors, this results in more pressure on local production capacity and a bidding up of prices. This leads to increased demand for labour and capital pushing wages and interest rates.
The direct effect of the currency depreciation will generally contribute to an overall price level increase in proportion to the share of tradable goods and services in GDP. Published as a Central Bank study in 2017, a paper by S M Wimalasuriya, titled Exchange Rate Pass-Through: To what extent do prices change in Sri Lanka?, suggests that the exchange rate pass-through into import prices is around 50%; that is, import prices increase by about 0.5% (and those of other consumer prices by 0.3%) as a result of a 1% depreciation of the Nominal Effective Exchange Rate.
Therefore, the overall cost of living will rise further. Tax increases – VAT from 11% to 15%, PAL from 5% to 7.5% – and the currency depreciation over the last couple of years has already added significant costs to household budgets. Add to this increases in fuel, gas – all necessary due to increases in global prices – and the combined burden is huge. To add even further inflation through currency deprecia-tion will impoverish many and increase popular discontent. Pursuing unpopular policies is sometimes necessary but the combination of depreciation amid fiscal tightening looks dangerous and perhaps even unnecessary.
Exchange rates can move for a range of reasons, which can be simplified into two categories: "real" factors, or in other words, changes in relative fundamentals; and "monetary" factors. "Fundamentals" would, for example, include changes in the terms of trade and productivity, while "Monetary" factors are changes in the money supply.
In practice, policymakers may find it difficult to distinguish how much of a movement in the exchange rate is due to changes in the fundamentals and how much may be inflationary (or deflationary), alt-hough in the current situation, monetary factors seem to be the cause.
Thus, in Sri Lanka, where inflation expectations are not well anchored, the prudent monetary policy response would be to tighten rates, at least until there are grounds for being more confident that it was the fundamentals that had changed. The immediate political considerations suggest the same ac-tion.
A currency's exchange rate contains important information about the country's monetary position and the credibility of domestic monetary policy. The popular perception of the current stance is that it is either weak or out of control. For businesses, it is creating a new level of uncertainty, which is not be-ing helped by ad hoc administrative measures (increasing LC margins on cars for example) to arrest some of the effects. For consumers, it fuels inflation, adding to the woes of fiscal tightening.

The Central Bank should revisit its inflation-targeting regime and tighten rates to stabilise the currency. (Dailyft)

Stock Rally Eases in Asia as G-20 Eyed Post Powell: Markets Wrap

An equity rally that spread into Asia from the U.S. after a dovish tone from the Federal Reserve chairman lost some steam as investors turned their attention to a crucial meeting of the world's largest economies that will tackle trade issues. The dollar held losses.

Gains from Sydney to Tokyo were more muted than the stellar rally in the S&P 500 Index, which surged the most since March. Hong Kong stocks erased gains as U.S. futures slipped. Emerging-market equities climbed to the highest level since early October and earlier the Nasdaq 100 jumped 3.2 percent after Fed Chairman Jerome Powell fueled speculation the central bank may pause lifting interest rates next year. The Bloomberg Dollar Index held steady after sinking the most in two weeks, when two-year Treasury yields dipped.

Powell's comment that interest rates are "just below" a range of estimates of the so-called neutral level tempered remarks made last month that markets read as a signal of more aggressive monetary policy tightening. Investors are now betting the Fed is nearing a pause in hikes and eurodollar futures show the market pricing for just 25 basis points, the equivalent of one Fed increase, next year.

"He's taking away the concern about aggressive interest-rate increases, which resolves one of the issues that hung over the markets during the last couple of months," Bob Phillips, managing principal at Spectrum Management Group, said in an interview. "We still have the trade war issue with China and we'll see how that works out this week. If that comes out positive, we'll have a decent rally at the end of the year."

With Powell now out of the way, the market is looking for any hopeful signals on trade from a meeting between the U.S. and Chinese presidents that will take place at the Group of 20 summit in Buenos Aires this weekend. U.S. President Donald Trump has threatened tariffs on $200 billion of Chinese goods unless they can strike a deal on revised terms of trade. Global economic growth may be slowing more than expected, the IMF warned. Recent data suggest the situation has only worsened since the fund trimmed its world GDP forecast last month, according to a report prepared for the G-20 meetings.

"The next catalyst will be the G-20 meeting between Trump and Xi; we believe risk assets will tactically trade in the green following a tariff cease-fire," said Eleanor Creagh, a strategist at Saxo Capital Markets in Sydney. "A tradable risk bounce on a paper deal at G-20 will be unlikely to reverse sentiment structurally as the underlying U.S.-China relationship is still deteriorating."
Pimco Says Fed May Need Tight Policy for Above Potential Economy

Pimco's Tony Crescenzi comments on Fed policy in relation to U.S. economic and financial conditions.
Source: Bloomberg

Elsewhere, the pound held gains after reversing losses sparked by the Bank of England's warning that a no-deal Brexit could spark a recession. Oil recovered some of its losses after an unexpectedly large increase in U.S. crude inventories spurred declines Wednesday, adding to worries about a supply glut ahead of a meeting between top exporters Russia and Saudi Arabia.

Coming Up

- Trump and Chinese President Xi Jinping plan to meet at the G-20 meeting of world leaders in Argentina that kicks off on Friday.

- Thursday sees the release of the minutes from the Federal Open Market Committee's November meeting.

These are the main moves in markets:
Stocks

- Japan's Topix index climbed 0.8 percent as off the break in Tokyo.
- South Korea's Kospi index rose 0.5 percent.
- Hong Kong's Hang Seng Index fell 0.2 percent.
- The Shanghai Composite gained 0.1 percent.
- Australia's S&P/ASX 200 Index advanced 0.4 percent.
- Futures on the S&P 500 fell 0.2 percent, which gained 2.3 percent Wednesday and the Nasdaq 100 rose 3.2 percent.
- The MSCI Asia Pacific Index rose 0.8 percent.

Currencies

- The yen added 0.2 percent to 113.43 per dollar.
- The offshore yuan was steady at 6.9409 per dollar.
- The Bloomberg Dollar Spot Index was flat after falling 0.6 percent.
- The euro bought $1.1374, up 0.1 percent.
- The British pound rose 0.1 percent to $1.2833

Bonds

- The yield on 10-year Treasuries dipped two basis point to 3.04 percent.
- Australia's 10-year bond yield held at 2.62 percent.

Commodities

- West Texas Intermediate crude gained 0.6 percent to $50.59 a barrel.
- Gold rose 0.2 percent to $1,223.66 an ounce.

(Bloomberg)