NEWS ROUND UP

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Contents

Sri Lanka rupee weakens; stocks rally slows

The Sri Lanka rupee weakened sharply to end Tuesday at around 174.50/80 rupees against the US dollar in the spot market while the equities rally of the last two slowed though stocks closed 0.34 percent higher, market participants said.

The currency traded at an intraday low of 174.75 rupees against the greenback, market participants said, as the country is locked in political crisis.

The rupee closed Monday at around 173.80/174.00 rupees against the greenback.

Sri Lanka stocks ended 0.34 percent higher on Tuesday, but weakened from intra-day highs at close.

Colombo's All Share index closed 20.14 points higher at 5,964.32, slipping from an intraday high of 6,000.19 earlier in the day.

The benchmark index had gained 1.1 percent on Friday and surged 1.9 percent Monday – the highest gain in four years – and rose 0.94 percent in early trading Tuesday before losing momentum.

The S&P SL20 of more liquid stocks ended at 3,083.20 points, up a sharp 0.80 percent, or 24.61 points.

Market turnover was 981.4 million rupees, with 95 stocks gaining while 67 declined.

John Keells Holdings made the largest contribution to the benchmark index gain. The stock ended 6 rupees higher at 147.90 rupees.

Construction stocks were the most traded stocks.

Access Engineering saw over 2 million shares change hands and closed unchanged at 15.80 rupees, while a little more than 6.5 million Tokyo Cement shares were traded. The stock gained 40 cents to 25.10 rupees.

Net foreign selling was 155.3 million rupees, down from 3.06 billion the previous day.

Foreign selling in Tokyo Cement was 149 million rupees, according to Asia Securities.

Crossings, or off-market negotiated trades, amounted to 210.4 million rupees, accounting for 21.4 percent of the day's turnover.

There were two crossings in Tokyo Cement for 64.6 million rupees, two in John Keells Holdings for 50.2 million rupees and one each in Commercial Bank for 50.2 million and Hatton National Bank for 45.4 million rupees.

Commercial Bank closed unchanged at 114 rupees and Hatton National Bank gained 1.40 rupees to 211.40 rupees.

Gilt yields edged lower in the secondary market.

A three-year bond maturing in 2021 closed at 10.90/11.20 percent in two-way quotes, down from Monday's closing of 11.20/30 rupees.

A five-year bond maturing in 2023 ended at 11.32/40 percent, from the previous day's 11.40/60 percent closing. (EconomyNext)

Sri Lanka political crisis hikes debt rollover risk

Sri Lanka's political crisis triggered by appointing Mahinda Rajapaksa as Prime Minister would make it more difficult for the island to refinance foreign debt, Fitch Ratings said.

"Prolonged political upheaval accompanied by deterioration of policy continuity could undermine investor confidence and make it more challenging for the government to meet its large external financing needs in 2019-2022," Fitch said

"The outcome of the power struggle and possible implications for the sovereign rating (B+/Stable) remain uncertain."

Sri Lanka's budgets which had improved recently may be hit whatever the outcome of the crisis.

"..[T]he newly appointed Prime Minister Mahinda Rajapaksa, who served as president from 2005-2015, oversaw an aggressive Chinese-financed infrastructure drive and sharp increase in public debt during his second term from 2010-2015," he said.

"His return to prominence could pose risks to fiscal consolidation, although he has yet to state his policy priorities.

"Wickramasinghe, if he hangs on, might also be tempted to adopt a more populist fiscal stance, given the political pressure he has faced since the ruling coalition suffered heavy losses in local government elections in February."

The full statement is reproduced below:

Fitch Ratings: Sri Lanka's Political Standoff Lifts Refinancing Risk

Fitch Ratings-Hong Kong/Singapore-30 October 2018: The Sri Lankan president's sudden replacement of the prime minister on 26 October highlights tensions within the coalition government and creates uncertainty over further progress on reform and fiscal consolidation, says Fitch Ratings.

Prolonged political upheaval accompanied by deterioration of policy continuity could undermine investor confidence and make it more challenging for the government to meet its large external financing needs in 2019-2022.

The outcome of the power struggle and possible implications for the sovereign rating (B+/Stable) remain uncertain.

Ranil Wickramasinghe, who was sacked as prime minister, has called for a parliamentary vote to demonstrate his support, while members of his party have said they will consider impeachment proceedings against President Maithripala Sirisena on grounds that he exceeded his constitutional authority in replacing the prime minister.

The president has responded by suspending parliament until 16 November and, in the meantime, appears set to name a new cabinet. The ultimate shape of the government and its policy stance may not crystallise until parliament resumes.

We last affirmed Sri Lanka's sovereign rating in February 2018. At the time, we noted that potential negative rating sensitivities included deterioration of policy coherence and credibility, a derailment of the IMF support programme or a reversal of fiscal improvements leading to a failure to stabilise government debt ratios.

The IMF-led programme might help to anchor policy if there is a change in leadership, while the benefits of some recent structural reforms are likely to persist. For example, a VAT hike has pushed up the revenue-to-GDP ratio and narrowed the fiscal deficit, while the Inland Revenue Act, implemented from April 2018, is likely to increase revenue further.

Moreover, there is no indication that the central bank's autonomy will be undermined by the political upheaval. The central bank has been key to improved economic management under the IMF programme, with greater currency flexibility supporting foreign-currency reserves.

However, the newly appointed Prime Minister Mahinda Rajapaksa, who served as president from 2005-2015, oversaw an aggressive Chinese-financed infrastructure drive and sharp increase in public debt during his second term from 2010-2015.

His return to prominence could pose risks to fiscal consolidation, although he has yet to state his policy priorities.

Wickramasinghe, if he hangs on, might also be tempted to adopt a more populist fiscal stance, given the political pressure he has faced since the ruling coalition suffered heavy losses in local government elections in February.

Sri Lanka's public debt-to-GDP ratio is already 77.6%, which is well above the 62.9% median for sovereigns rated 'B' or lower.

The next test of the government's commitment to the targets set out under its IMF programme will be the 2019 budget, which is due to be delivered on 5 November.

A delay to the budget or slippage on targets could further undermine near-term investor sentiment, and might also jeopardise compliance with IMF targets under the IMF-supported programme, which is in any case due to expire in mid-2019.

The government is also behind schedule on introducing automatic electricity pricing - a structural benchmark under the IMF programme - which could see continued delays under the political upheaval.

Policy decisions that derail the IMF programme or lead to a loss of investor confidence could increase external financing challenges.

The external debt stock is equivalent to around 60% of GDP, and almost 30% of this (around USD15 billion) matures in 2019-2022. Moreover, almost half of public debt is denominated in foreign currency, which may create pressure if the rupee continues to weaken; it has lost 12% against the US dollar this year. (EconomyNext)

Postponing reforms will make Sri Lanka lag behind peers, central bank warns

Postponing planned economic reforms will make Sri Lanka more vulnerable to external and internal shocks and stall growth, causing the island to lag behind regional peers, the central bank has warned.

“It is important to facilitate private sector led growth with prudent, consistent and far reaching reforms that support increased productivity in the economy,” it said in its half yearly report on recent economic developments and prospects for 2019.

This was in the backdrop of tightening policy spaces in the monetary, fiscal and external fronts amid subdued economic performance, the central bank said.

“Recent experience has once again displayed the importance of strengthening the economy through structural transformation, while improving the country’s macroeconomic fundamentals,” it said.

“The postponement of much needed structural reforms will only lead to the Sri Lankan economy lagging behind its regional peers, amidst increased vulnerability to internal and external disturbances.”

Therefore, the central bank said, it is essential that such reforms are expeditiously implemented within a transparent framework for Sri Lanka to progress as an upper middle income economy where its human and physical resources are fully utilised in a more productive manner. (EconomyNext)

Big Tech's next European nightmare: A tax on revenues

Big tech companies are bracing for new taxes in Europe that could cost them billions.

Policymakers across Europe are developing rules that would force tech companies to pay taxes on revenue generated in the region, rather than on profits. Tech companies are lobbying hard against the changes.

"It is a pretty big departure from the general understanding of how you apply tax on multinationals," said Daniel Bunn, director of global projects at US think tank The Tax Foundation.

The tax initiative is the latest in a series of European regulatory and legal efforts to target tech companies. The European Union has imposed tough new data privacy rules, and hit tech companies such as Google (GOOGL) with major antitrust fines.

The changes to the tax system are being championed by French President Emmanuel Macron, who has thrown his weight behind a European Commission plan for a 3% tax on sales of select online services. It could take effect as early as 2020.

The levy would apply to companies with annual global revenue of at least €750 million ($851 million) and online sales of €50 million ($56.8 million) in the European Union. Google, Amazon (AMZN), Facebook (FB) and Apple (APPL) would be top targets.

Calls to tax big tech have been fueled by the relatively small amounts paid in Europe by tech companies, some of which route profits to low-tax countries in the region. Tech companies fear the rules could set a precedent that would be followed by governments elsewhere.

"The digital economy is new, and the existing tax laws on the books really aren't prepared for it," said Channing Flynn, an international tax partner at EY. "This is a way to begin reforming the tax law."

The Organisation for Economic Cooperation and Development is pushing to agree global standards among the richest economies of the world, but a final proposal is not expected until at least 2020, and even more time will be required for any changes to be implemented.

Europe doesn't want to wait that long. The Commission has billed its 3% tax as a temporary solution, with the ultimate goal being the ability to tax tech companies on profit generated in specific countries in Europe.

The United Kingdom, which is scheduled to leave the European Union in March 2019, is moving even more quickly. It broke ranks with its peers on Monday, announcing a 2% levy on sales of digital services in the United Kingdom. The new tax will take effect from April 2020.

The British government estimates that its plan will generate £400 million ($510 million) a year in revenue, while the European Union expects its tax will raise €5 billion ($6.4 billion).

Tech companies are fighting back hard.

Digital Europe, which represents the industry in the region, said the Commission's proposal would undermine existing tax treaties and effectively tax them twice on the same sales.

"To safeguard the principles of fairness and integrity in tax policy, any tax on the activities of corporations should be linked to profit, not revenues," the group said in a letter to European ministers earlier this month. Its members include Apple, Amazon, Google, IBM (IBM) and Microsoft (MSFT).

Some see the tax changes as part of an effort to boost local companies at the expense of Silicon Valley giants.

Leaders of the US Senate Committee on Finance said in a letter to the Commission earlier this month that the rules "discriminate against US companies" and create "a significant new trans-Atlantic trade barrier."

"There is a political edge to it. The big companies have been dominant and this is a political effort to allow some UK or European companies to compete," said EY's Flynn.

But some European tech companies have also spoken out against the proposed overhaul.

"Taxing revenues, as opposed to profits, will also impose a significant compliance cost, requiring new processes and infrastructure to be established," a coalition of European tech firms that includes Spotify (SPOT), Booking.com (BKNG) and Rovio told European finance ministers in a letter.

Katie O'Donovan, Google's UK public policy manager, told British lawmakers on Tuesday that her company would prefer one set of global rules.

"A multilateral, international solution is one that will be really meaningful," she said. "We look forward to continue and supporting an international resolution."(CNN)

China's currency just hit its lowest level in a decade. What's next?

China's battered currency is trading at its lowest point since the global financial crisis, leaving investors asking how much farther it might fall.

The yuan sank past 6.97 to the dollar in Tuesday morning trading in Asia, its weakest level since May 2008. The currency has now slumped more than 9% against the greenback since January, dragged down by interest rate hikes in the United States, fears over the health of China's economy and the trade war between the two countries.

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Beijing wants "to avoid provoking the United States" ahead of Xi's expected meeting with Trump at the G20 summit next month, the analysts wrote in a note to clients Monday.

Trump has accused China of deliberately devaluing its currency as the trade conflict between the two countries has escalated — claims Beijing has repeatedly rejected.

The Chinese government on Friday issued a warning to speculators betting against the yuan, which is also known as the renminbi.

"For those who are trying to short the renminbi, we fought hand to hand a few years ago, so we are very familiar with each other," said Pan Gongsheng, deputy governor of the People's Bank of China, in Beijing on Friday. "I think it's still fresh in our memory."

China does have tools it can use to counter the currency's decline, including selling some of its huge war chest of US dollars.

The central bank "is likely to intervene to keep the pace of depreciation gradual," the Capital Economics analysts said. But they predicted the yuan would slip past 7 to the dollar soon, a level not seen since May 2008.

Other economists said they expect the yuan to touch the 7 mark several times before it clearly moves past it, allowing investors to get more comfortable. That way, "it will not create any surprise to the market when it happens," said Iris Pang, a China economist at Dutch bank ING. (CNN)