NEWS ROUND UP

Monday, December 31st, 2018

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Sri Lankan stocks down, foreign inflow for the week

Sri Lankan stocks ended weaker Friday in thin trade with continued foreign selling in John Keells Holdings, although there was a net foreign inflow of funds for the week, brokers said.

The All Share Price Index closed at 6,015.23, down 2.96 points (0.05 percent) while the more liquid SP SL20 index closed at 3,115.42, down 1.48 points (0.05 percent).

Crossings or negotiated block deals accounted for 24 percent of the day's turnover of 389 million rupees with one crossing each in JKH and Melstacorp, Asia Securities said.

Estimated net foreign buying topped in Softlogic Holdings while net foreign selling was mainly in in JKH.

There was a net foreign inflow of 264 million rupees for the week, breaking the trend of net foreign sales.

Negotiated deals contributed 60 percent of the week's turnover with foreign activity skewed towards the buying side, they said.

JKH and Hemas Holdings saw the highest foreign outflows for the week while Melstacorp attracted the highest foreign inflows. (EconomyNext)

Sri Lanka holds rates; credit up amid sterilized forex interventions

Sri Lanka's central bank held rates in December at 9.0 percent, while credit to the state and private sector accelerated amid money printed to enforce fixed interest rates after intervening in forex markets to maintain a soft-pegged exchange rate.

"In spite of the increased cost of funds and tight liquidity conditions, the year-on-year growth of credit to the private sector accelerated since September 2018, partly reflecting the private sector advancing its activities in anticipation of measures by the government and the Central Bank to curb excessive import growth," the soft-pegged central bank said in its December monetary policy statement.

Liquidity runs short when the central bank intervenes in forex markets to defend a peg when a run is triggered on the rupee.

In a soft-peg the central bank then prints money to fill the liquidity shortage (sterilize the intervention) and stop rates from going up and slowing credit, triggering 'balance of payments' pressure.

Private credit had expanded by 79 billion rupees to 5,509 billion rupees in November, growing at an annual rate of 16.2 percent, up from 16.1 percent a month earlier.

In November the central bank also dumped tens of billions of rupees in the banking system through a reserve ratio cut and expanded the ability of banks to give loans from future deposits.

A soft-pegged central bank's monetary operations may appear as credit to government because Treasuries are used to print money into the banking system, despite budget deficits falling or not expanding.

Net credit to government from the banking system accelerated at an annual rate of 9.2 percent in October to 14 percent in November, data showed.

The SRR cut dumped 90 billion rupees in to the banking system in November to sterilize earlier interventions.

But interventions in the forex markets continued generating more shortages.

"The reduction of the Statutory Reserve Ratio (SRR) at the last monetary policy review in November 2018 released around Rs. 90 billion of rupee liquidity to the banking system," the monetary authority said.

"However, the liquidity deficit has widened thereafter, and the Central Bank continued its open market operations (OMOs) cautiously to manage liquidity on overnight, short term and long term basis as appropriate."

The central bank which was injecting printed money into banks at rates around 8.47 percent in the first week of November, injected new money at rates as low as 8.35 percent after a 50 basis point 'rate hike' to 9.0 percent from 8.50 percent and a cut in the reserve ration which dumped 90 billion rupees of liquidity in to the banking system.

Sri Lanka operates a highly unstable foreign reserve collecting soft-peg with the US dollar, involving a de facto external anchor with a shifting convertibility undertaking.

The regime suddenly shifts to a floating rate with a domestic anchor made up of a wide near-double-digit inflation target with unsterilized excess liquidity collected during the pegging period intact, sending the rupee sliding down forcing currency defence.

The central bank lost control of the peg in the first quarter of 2018, when the economy recovered, as it failed to mop up inflows (sterilize dollar purchases) and injected cash to generate excess liquidity in April.

Though the peg stabilized around July and August after falling sharply, unsterilized excess liquidity was against built up including through rupee dollar swaps, triggering a renewed period of pressure. The rupee has since fallen to 180 to the US dollar.

In November interventions topped 500 million dollars, amid a political crisis, which added to uncertainty.

When a soft-pegged central bank mops up inflows (liquidity from dollar purchases), the peg strengthens by squeezing credit and outflows.

But when it injects cash through open market operations, credit expands and imports grow beyond dollar inflows generating balance of payments pressure and forcing the currency down.

There have been calls to reform the central bank's open market operations to make it more difficult for the central bank to generate monetary instability.

Critics have pointed out that the central bank cannot take the risks it did 15 or 20 years ago because Sri Lanka is now more exposed to international capital markets, and monetary instability is amplified by panicking foreign bond holders and credit downgrades, making it more difficult to recover from such periods. (EconomyNext)

Sri Lanka fuel prices fall 17.9-pct, regulated bus fares down 4.2-pct

Sri Lanka bus fares which were raised by state regulation three times this year have come down by 6 percent after a fuel prices were cut by 17.9 percent, while the minimum fare is up 33 percent over the year, official data shows.

Since May when fuel prices were raised by formula, bus fares were raised twice amid allegations that a part of the price increase was politically motivated.

Since montly formula pricing began, Lanka Auto Diesel has fallen from a peak of 123 rupees a litre to 101 rupees or 17.9 percent.

The National Transport Commission which regulates prices cut the price of fares by about 4.2 percent.

With the latest price cut, diesel prices are up 6.3 percent after a fuel pricing formula was started in May, from 95 rupees to 101 rupees a litre while fares are up an average of 17 percent.

But the minimum fare is up from 9 rupees to 12 rupees or 33 percent.

Earlier in the year the National Transport Commission, then under Minister Nimal Siripala de Silva raised the minimum fare to 12 rupees from 10 rupees despite Lanka Private Bus Owners Association chief Gemunu Wijeratne saying it was not required.

However following threat of a strike by All Ceylon Private Bus Owners' Federation, the Transport ministry had raised the minimum fare.

The LPBOA had asked for a 10 percent increase but the Transport Ministry had agreed to a 12.5

percent increase, The Island newspaper reported.

http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=184748

Wijeratne said he did not want the minimum fare raised because it would drive more people towards three wheelers.

The NTC has kept the minimum fare at 12 rupees.

Three wheeler prices are not regulated by the state and are subject to free market competition.

There is no strong three wheeler associations to drive price collusion and taxi app firms like PickMe, which have boosted productivity of have kept prices down.

Even before taxi apps came, call centre taxis were boosting productivity.

Under state regulation, there is no competition and room for innovation is also limited, leading to a wide gap between regulated buses and the free market especially in quality.

Reports said several three wheeler association have reduced the minimum fare back to 50 rupees from 60 rupees, with 92 Octane petrol falling 19 percent to 125 rupees from a peak of 155 rupees.

In the free market, where there are no government license to stop competition, prices do not go up in line with fuel prices.

Under Nimal Siripala de Silva there were several attempts to regulate three wheelers including banning entry to younger drivers, but Finance Minister Mangala Samaraweera shot it down. (EconomyNext)

What oil's plunge says about the global economy in 2019

The forces that pushed oil sharply lower at the end of 2018 aren't going away.

US crude prices have crashed 40% since hitting four-year highs above $76 a barrel in October. Brent crude, the global benchmark, slumped this week to its lowest level since August 2017.

Oil is an important bellwether of future economic growth, and wild price swings in recent days mirror those of global stocks.

Sustained downward pressure on oil prices reflects concerns about surging US production and a weaker global economy. Not even output cuts by OPEC and its partner states have been able to reverse the trend.

The dynamic could make for a wild 2019.

International Monetary Fund economists expect global growth to slow to 2.5% next year from 2.9% in 2018. Reduced economic activity means less demand for energy products.

The International Energy Agency has warned of "relatively weak" demand in Europe and developed Asian countries. It also flagged a "slowdown" in demand in India, Brazil and Argentina caused in part by weak currencies.

OPEC warned this month that demand for its oil next year would be about 1 million barrels a day less than in 2018.

"The dominant factor on the demand side will be the economic outlook," said Robin Mills, CEO of energy consulting firm Qamar Energy. "It will receive some support from lower oil prices but overall the global economy appears likely to slow."

OPEC and its allies agreed earlier in December to remove 1.2 million barrels a day from world markets.

Members of the cartel pledged to reduce their production by 800,000 barrels per day for six months beginning in January. Russia and other partners promised to slash an additional 400,000 barrels per day.

Reaching a deal caused prices to shoot higher, but the effect wore off within days.

The price of oil could determine what happens when the agreement expires in June.

"If it remains below $60 a barrel you would expect OPEC to look to extend the December agreement," said Russ Mould of online investment platform AJ Bell. "If it has surged back toward say $80 a barrel it may then look to increase output once more."

The United States surprised investors in November when it granted eight countries temporary sanctions waivers that allow them to buy from Iran without fear of punishment.

The waivers expire in May, and it's unclear whether they'll be extended.

What happens next is "very difficult to predict, because the United States just did an almost complete about-turn on Iran policy," said Spencer Welch, oil markets executive director at IHS Markit.

"The United States does not want the gasoline price to go to high, so it is likely that US policy will be influenced by what the market is doing, which will be influenced by how effective the OPEC cut is," he added.

The United States became the world's largest producer of crude oil in September, overtaking Russia and Saudi Arabia for the first time since 1973.

The feat demonstrates how the US shale oil boom has reshaped the global energy landscape. American oil output has more than doubled over the past decade.

It has even raised questions about OPEC's ability to influence prices.

"One of the drivers behind the change in dynamics that has resulted in OPEC losing influence over the oil industry is the emergence of the capability of outsiders to produce oil," said Jameel Ahmad, global head of currency strategy and market research at FXTM.

"None have been more prominent in this arena in recent years than the United States," Ahmad said.

Matt Egan contributed to this report. (CNN)

China's economy had a tough 2018. Next year will be worse

China's economy is entering uncharted territory, and that could spell trouble for the rest of the world.

After decades of sharp expansion, the Chinese economy is slowing down. Growth in 2018 is set to be the weakest since 1990. And 2019 looks even worse.

The world's second largest economy is feeling the effects of a darkening trade outlook and government attempts to rein in risky lending after a rapid rise in debt levels.

"The drivers of China's slowdown have yet to have their full impact on the economy, and the combination of both is unprecedented," analysts at Moody's wrote in a research note this month. "This creates a high degree of uncertainty and risk."

What happens in China matters for businesses and markets across the globe. It's the world's largest exporter of goods, sucking in materials from other countries in order to ship out iPhones, laptops, bulldozers and tons of other products.

The country's rapidly expanding middle-class has turned it into the biggest market on the planet for consumer goods like cars, smartphones and beer, generating billions in profits for companies like General Motors (GM) and Apple (AAPL).

"China has become the world's largest growth engine," said Rajiv Biswas, chief Asia-Pacific economist at research firm IHS Markit.

Fears about China's economic health have already rippled through financial markets. The country's benchmark stock index plunged into a bear market in June and is down 25% since the start of the year. The jitters have also affected markets in Europe and the United States.

What remains uncertain is the severity of the slowdown and how far the Chinese government will go in trying to soften its impact.

The big wild card is how the trade war between the United States and China, which began this year, will play out in 2019.

After imposing heavy new tariffs on hundreds of billions of dollars of goods, the two sides are now trying to negotiate a deal by the end of February. If they fail, tariffs are set to rise further.

Meanwhile, the economic hit from the trade war is expected to become more pronounced in China in the coming months, hurting exports and companies' profits.

"Export growth will come under pressure even if a further escalation in tariffs is avoided," Julian Evans-Pritchard, senior China economist at research firm Capital Economics, wrote in a note to clients this month.

Opinion is divided on whether the two governments will reach a lasting agreement in the next two months. Their expanding conflict is about far more than just trade. It spans China's stance on technology, intellectual property, investment, industrial policy and access to its markets.

Besides imposing tariffs, the US government has this year prevented two major Chinese tech firms from buying important American-made parts, stepped up scrutiny of foreign investments and sought the extradition of a top executive at Huawei, the Chinese company expected to lead the roll-out of 5G technology around the world.

"The path to an eventual truce between the two economic superpowers is likely to be bumpy and prolonged," analysts at investment firm Vanguard said in a report this month.

Along the way, they could do plenty more economic damage to one another.

"The trade war has the potential to hit growth significantly," said Gerard Burg, China economist at National Australia Bank. "But it all depends on how far both sides are willing to push."

The renewed negotiations show China's need "to achieve some sort of deal with the United States to buy badly-needed breathing space in a toughening economic climate," Diana Choyleva, chief economist at research firm Enodo Economics, wrote in a note to clients this month.

A crucial question for China is how its consumers respond to the uncertainty.

The country's extraordinary economic transformation in recent decades has pulled hundreds of millions of people out of poverty fueled a spending boom.

"Household consumption is what has driven the structural growth story in China," said Edmund Goh, a portfolio manager at Aberdeen Standard Investments in Shanghai. "It has defied a lot of the slowdown"

But cracks are starting to show.

Car sales have tanked in recent months, dealing a blow to global automakers like Volkswagen (VLKAF) and Ford (F). And retail spending in general has been slowing, according to official data.

Debt levels among Chinese consumers have been rising quickly, which could add to their reluctance to spend, Goh said.

China is likely to meet the difficulties facing the economy with its trademark approach: juicing activity through government stimulus.

It has already resorted to tax cuts, investments in infrastructure and looser monetary policy this year. Analysts expect more measures in 2019.

Officials could loosen restrictions on the country's red-hot real estate market to encourage developers to ramp up building activity, economists suggest.

But more stimulus measures risk undermining Beijing's efforts to address the deeper problems in the economy, including curbing the huge amounts of debt in the financial system, according to Iris Pang, China economist at investment bank ING.

"The government has shelved reform," she said, and will instead "focus on pro-growth measures."

The US Labor Department will release its December jobs report on Friday. Economists expect the report to show that the American economy added 178,000 jobs, according to a survey conducted by Refinitiv. The unemployment rate is forecast to remain at 3.7% — a near-50-year low. And paychecks are expected to grow by 3%.

The American labor market is strong. Employers list more job openings than there are people to fill them. But economists predict economic growth will slow in 2019 as the effects of tax cuts and government spending wear off.

The stock market is on track for the worst December since 1931. Stocks have one more day left to make up some lost ground.

Stocks often finish December with rallies, but this isn't a typical December. Huge swings in both directions have sent investors' heads spinning. The Dow had its worst-ever Christmas Eve on Monday, only to post its best-ever point gain when trading resumed on Wednesday. Stocks were sharply lower for most of Thursday before roaring back at the close to finish the day in positive territory.

The partial government shutdown means businesses and investors could miss some important economic data reports.

The Department of Labor is funded through September 2019, so the monthly jobs report scheduled for Friday will remain on time. But both the Bureau of Economic Analysis and the Census Bureau, which belong to the Department of Commerce, have ceased providing updates and can only resume after Congress and the White House agree on a deal. The same is true of the Department of Agriculture, which produces data on crop production, prices and sales.

No major reports are due next week, but international trade figures for November are scheduled to be released on January 8. The Census Bureau had been planning to report on public pensions for the third quarter and residential home sales, as well as more international trade data. (CNN)