Moving Forward



Ajith Nivard Cabraal, the Governor of the Central Bank of Sri Lanka addresses the 2nd Key Person's Forum on 'Lessons Learnt from the Global Financial Crisis.'

The President, your Excellencies, Deputy Governor, captains of industry and my dear friends, first of all I must say that I'm honoured to be invited today, to speak to you at your key person's forum and I do hope that I'd be able to shed some light into how the lessons which we have learnt and use it as a case study as my friend Keith Bernard did using his annual report, so that perhaps we can look at our future with a little more certainty.

The world has been unforgiving during the past few years and it has been a trauma for economic planners and economic managers because we have found that

everyday conditions change so rapidly. What is supposed to be stable, what is supposed to be the framework, has gotten disturbed, what is considered to benchmark, has changed dramatically. So, in that scenario, it's not very easy for people to manage anything, and especially an economy when you have so many different features that move continuously, sometimes for you and sometimes against you.

What I'm going to do today is share with you a few of the thoughts which helped us through this crisis, which enabled us to ensure that our economy stayed stable, stayed in such away that the shock was not transmitted to the people, stayed in a resilient manner so that people who dealt with Sri Lankan did not feel that there was something that they should be very concerned about. So, I hope to do that in a 'lesson one lesson two' kind of way.

The first lesson in that is to strengthen yourself in good times, I always think of it like having to wear a life vest when the storm is coming, when your on the deck of a cruise vessel, and you find that there is a storm brewing, you have to wear your vest before the storm hits you. After the storm hits you and you fall into the water, even though the next person is your dearest friend, he is not going to remove his life jacket and give it to you. So your vest is yours, you've got to wear your vest before you get thrown overboard. We did that. I remember we carefully managed our banks by providing with some space, which they had to prepare themselves, so that when the onslaught came they were ready. I remember we brought in a one percent provision. We followed the Indian RB Act, we brought in a one percent general provision for all the banks and the next day the headlines that went in some of the newspapers was that, "Cabraal delivered the kidney punch to the bank!" But that was what saved the bank. The bank has a space when the problem hits the bank. So, you have to prepare yourself before the crisis comes to you. You also have to practice the initiative that you put in motion when you get into trouble.

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As the central bank we did a scenario analysis for many things including the takeover of the bank. We knew exactly what steps we had to take in case we have to face a crisis. We knew exactly what steps we had to take face crisis in the finance companies. So that is why when it did happen we were ready. We were able to take

the steps. Many thought that it was a meager reaction because it happened suddenly. No it didn't! It happened because we had rehearsed, we had prepared and we had got our overall strategy in place so that we could meet that. We also know that when you do certain things, the equilibrium changes. When you disturb one element in a process that is in equilibrium you will find that it will change, but when it changes it will always go into a new equilibrium. So, you should not worry too much about something changing and there is another repercussion following as a result of that. So we prepared ourselves in the good times and that was the first good lesson for us.

The second is to develop the ability to move quickly and decisively. What saved the day for Sri Lanka was that we gave very clear signals there was nothing vague about what we did, there was nothing wishy-washy. We told exactly what we were going to do and the whole country knew what path we were taking and that was important because without us being very clear and strong and being definite, sometimes we may be wrong, but that doesn't matter because people knew that this is the path that we were travelling on, which is important. You have to be able to back up your statements with your quick action. If you say something today, you can not wait till three weeks later to start with the action for that, it has to be immediate, especially in times of turmoil. That is something that we practice and we followed, which held us in good state.

The third is to read the signs of vulnerability even in the most advanced economy because all these economies are today fully intertwined, not one can function without the other. All are collected. I think of it like the swine flu. I remember those days if someone got the flu, in the 1920's, it would have taken one year to come from one continent to another continent, because by the time these things travelled through people, the virus itself would have taken a long time. It is not so today; if something happens in Brazil it will impact Indonesia, if something happens in Holland it will impact Sydney, Australia. So quickly it changes, it travels and so is the case with economic positions as well. We need to be sure that we watch everywhere; we must know what is happening all over. Greece can have an impact on Sri Lanka. Earlier, we would have thought, no it cannot, but today it will and it does, so we have to be aware as to what is happening all over the world. We were aware, I remember the Central Bank, we kept a tab on all economies, we knew exactly what was happening anywhere. Even in the case of Lehman Brothers, two

weeks before Lehman Brothers crashed, we had 92 million dollars, which we pulled out so we didn't loose. I'm proud to say that because our department watched the signs very carefully because things happen so quickly. Unless you read the signs, if you only rely upon rating agencies and others, you may miss out on the trick and then you're in trouble.

Fourth lesson: practice long-term views, not short-term. If you take your decisions based on the market today and you change your structure, you're in trouble. We took long-term positions, we looked five years ahead and even when things started happening in turmoil, we knew that it would stabilise at some stage, we knew that it would be stable in that particular period after the turmoil has hit. We took a long-term view. Many of our positions that we've taken, especially in our investment as well as some of the steps that we have taken, in relation to bringing stability to the economy was because we took long term positions and worked on those positions.

If you look at national economies, if you look at international economies, short-term and you're only guided by Bloomberg or guided by the Reuters, those are excellent news agencies, no doubt, but you've got to use it in a wise manner, not only be taking your long-term decisions based on the short-term data that you receive. The long-term trends are very important.

Lesson five: deal with Prophets of Doom quickly, clearly and decisively. Many people will say lots of things, which can sometimes destabilise your economy – you've got to take them head on. If you just let it drift the cacophony will become too loud and your story gets drowned out. We took up the position whenever anyone says anything against our economy, which went against the grain of the trend of our economy, we took it on. We said what we had to say and we let the people, the investors decide and we did well.

The first time when we went to the market, and there was a cacophony, no doubt, we've raised 500 million dollars, but even through the din we were able to see that it was oversubscribed three and a half times. That was our first effort. The second effort was when we went even though there was a great shouting we were oversubscribed thirteen times, that is because we went, we told our story we convinced people of the entire picture. And we handled even the difficult parts and

we told what was difficult, a threat, a risk, but yet we shared it and we were able to give the whole picture and people responded to that.

Don’t ignore bad stories, you’ve got to deal with it and if we do that you will be able to overcome many of the bad publicities that you receive. You’ve got to do it regularly, it’s not a ‘one off ‘ that suddenly you get up Thursday morning only and do it. If it happens everyday, you’ve got to deal with it everyday. It is important lessons all round because it is important to maintain the credibility for our economy.

Number six: use several policy initiatives at the same time and do not depend on only one instrument. If you want to attack a certain problem or you want to deal with a certain bridge you should not have only one quality instrument to deal with, you’ve got to have several because sometimes in turmoil situations some don’t work. Some will work but it will work weakly, so you’ve got have all working at the same time because if one fails you have another working at the same time.

If you don’t have the support of the political infrastructure – the political leadership, you’re in trouble.

We have a plan A and a plan B. I remember when we wanted to recapitalise Seylan Bank – we had plan A in place. Plan A didn’t work very well. Some people thought that we were bluffing – they thought that the Governor has only one plan. They thought if that doesn’t work they’d be compelled to come and still deal with us. I told them at that time, don’t make a mistake; we have plan B as well as plan C. Plan B was, in fact, in retrospect better than plan A. I’m glad that it happened with plan B, but you got to be ready with plan A, B and C. If you have that, then you will find that you will never be without space. You’ve got to create spaces for yourself. I remember at the time I became Governor of Central Bank, we had very high inflation, we were moving towards that, our interests rates were high, we had very little space for borrowing, our Debt-to-GDP ratio was 100 percent or close to that; we had very small reserves and reserves were always two and a half months to three months struggling, but we created the spaces. I remember first time when I mentioned to the Central Bank authorities that we are looking at having reserves of six billion dollars when we were having reserves of two billion, I saw some of them looking down and smiling. Let them smile, but I knew that if you had reserves of two billion dollars you are eternally struggling, you cannot eternally struggle; you’ve got

to take a few steps, which will give you the space so that you have additional space to maneuver and space to deal with other people and that is important. So we created policy instruments to go to those places and today we have sufficient space on almost every macro economic fundamental. We can move, we are not hitting the ropes, as it were in the boxing ring – we have space to move and that is important to create the spaces with policy instruments.

Lesson number seven: Work closely with political authorities. The worse thing that can happen to you in a crisis is to have a fight in public. If you don't have the support of the political infrastructure – the political leadership, you're in trouble. I remember at the time when the finance companies were having difficulty, we had to come up with a plan, where we were going to commit four and a half billion Rupees for the sector. I remember talking to the president about it and I was able to convince him so that the government would allocate that fund to the Central Bank if necessary for us to use. We took one hour over that discussion and I was able to convince the president because he was able to see the entire picture and in no small measure, it was due to the confidence that was built up as well. It's the political authorities and the banks, the Central Banks especially do not have a very close – link you will find that it is not possible to deliver instruments of that nature. Some of these things you cannot deliver two weeks later, if the finance companies are in trouble and you wanted an instrument today, that instrument has to be prepared created and brought to the market within a day. If you don't bring it within the day, the next day you'll find that the queue is forming outside and you have confidence eroded. So you have to have a very close relationship.

Seylan Bank was another case study because of the fact that we had that confidence built up and the government was also confident of the ability as well as the stance of the Central Bank – we were able to convince the authorities that we need this support and it was forthcoming. Even at the time when we had a reduction in our reserve you had to have a political support for your decisions to hold because unless you have that you'll find that you're unable to go out there to meet with investors confidently and deal with the situation.

Lesson number 8: remember that Central Bank not only have to be lenders of last resort in your own currency you have to sometimes be lenders of last resort foreign currency as well. Many Central Banks of today have begun to realise that not only

should you be equipped with your own currency you've got to have foreign currency as well. We did not have as much as we would've liked but in a very short time we created stocks, we created other instruments, we raised foreign currency so that we have the ability to deal with situations as and when it arises. Many Central Banks in then Asian region have today built up that capacity, so if there is a huge demand for foreign currency, for it to go out of your system you've got to be able to deliver that because if you let the market only decide that, the market will prove to be very volatile and that can be very dangerous for your economy. You have to prepare yourself in good times and that's what we did. Sometimes you need to have facets in intrinsic value, which even in times of crisis will have value. India as well as Sri Lanka, both, moved to some extent, towards having some portion of our reserves in gold because we believe if you have a certain portion in gold you have an anchor which will hold you in good state even in tough times.

Lesson number 9: Be conscience of the law of unintended consequences. Sometimes we do some really good things but then you find that after some time, it is going wrong. You never thought of certain things; we impose the tax on gold at one time in 2008 – we had 14 billion Rupees worth of gold being imported into the country. In 2009, after the tax was imposed, we had only 259 million Rupees worth of gold being imported into the country. I don't think any of you believe that. So what happened to the rest of the gold? The rest of the gold did come in, but it did not come in to the white economy, it came to a different source. So we changed that. Sometimes even if you believe that something's are good, you find that it doesn't work that way in practice. People find different ways to make it difficult, then we'll move in another direction. So the law of unintended consequences is very important and you've got to do a scenario analysis and not only watch the areas, which you have been normally, and traditionally watching but you find that it happens in other areas as well. That is something we believe that is a good lesson for us, and it has held us in good stead.

The last one: Global problems need global responses. I remember as soon as the global crisis struck, I met with some of the key officials in world bank as well as the IMF and we suggested to them, not only should you treat the ones that are in difficulty but you've got treat the ones who are well as well. It's something like an epidemic where you vaccinate not only the people who are sick, you vaccinate everybody. You've got to vaccinate everyone because then only you will deal with

each other. Because if I am fighting that my neighbour is affected by the epidemic, I'll be reluctant to deal with him. So you've got to vaccinate everyone, even in a financial crisis you've got to ensure that not only do you ensure that it goes to our sick, our treated, you must see that the well are also vaccinated so that they don't get sick and that is important to do. That is why the IMF started the additional facility where the SDR allocation that was increased was an extremely good initiative. It should have come earlier but it came late, nevertheless it has come, which is very important because then everyone knows that the others also have money, people will deal with you only if you have money, however good your friend is, the moment he does not have enough money in his pocket the friendship also reduces a little bit. The less the money the less the friendship in most instances, especially in the case of the bank. So you've got to understand that, so you always have to ensure that you enable everyone to have the funds, and that it is given on an overall basis. It was done in times of tsunamis; it was done in times of earthquakes so that you ensure that economies are able to sustain themselves even in times of difficulty so that they can overall be strong enough to stand any difficulty.

My dear friends, I thought I'd just share these 10 thoughts with you. I'm sure that there will be many more but these held us in good state and we are able to come before you and say that we've been able to deliver value even through difficult times we are able to come back strongly and that was because many people supported us, many helped us, many advised us, many pushed us and all that was helpful. I believe that the business sector has shown a tremendous resilience in ensuring that the country will survive these difficulties and I think it's a tribute to all of you having been able to have the strength, the courage and the conviction to come through and I know that Sri Lanka is on a growth path, which is unstoppable.

We have an exciting future ahead of us, at the time that the war ended; the macroeconomic fundamentals were also brought into place so that they are also benign. What if the war ended, but we had inflation at 40 percent, what if the war ended and the interest rates were at 35 percent? None of you would have been happy, you wouldn't have been able to use that benefit to your advantage. But today you have that so today the places are open, you have a great opportunity and I believe it's time to make use of it.

Thank you very much.