Resource Untapped

T Tyron Devotta

The focus in the weeks past was mainly on the South East Asian Region with various sectors of the Sri Lankan economy keenly looking at how they could take advantage of this untapped resource for the benefit of the nation and its partners.

TOURISM MINISTERS MEET

The SAARC Tourism Ministers’ Meeting on the 23rd and 24th September took the limelight when Tourism Ministers from Bangladesh, Bhutan, Pakistan, Maldives, Nepal and India along with their delegates met at the BMICH in Colombo to discuss policy decisions relating to Tourism in the SAARC region. Some of the policy decisions taken up at this meeting were Simplifying visa related procedures and documentation for nationals of SAARC countries, Establishment of direct air links between SAARC capitals, Introduction of special air fare within the region, Exploring the possibility of the convertibility of SAARC currencies within the region, Customs formalities from and to SAARC countries, Human Resource Development Program pertaining to Tourism, Strategies to be adopted in promoting South Asia as a multi destination, Development of Intra-regional Tourism and Establishment of an implementing mechanism for the SAARC Technical Committee on Tourism.

Forex Dealers’ Congress

Meanwhile the Forex Association is preparing itself for the South Asian Forex Dealers’ Congress to be held in November. Association sources say that South Asia as a region is lately attracting the attention of many potential investors. ‘With numerous fund managers looking to spread their portfolios to include direct investment in the South Asian region, it is our firm belief that it is time to heighten awareness of this region worldwide, especially considering the potential benefits foreign investment would bring to a country such as ours. The current emphasis on emerging markets is a welcome one for our part of the world, and it is imperative that we take every advantage of the prevailing interest to propel this region into the limelight at this opportune moment’ they say.

It has been a long awaited dream of the Association to host an international congress where they would have a platform to intimate dealers from other centers into all that Sri Lanka has to offer both as a venue and a vehicle of investment. They say that of prime significance among the requisites for achieving the status of a regional financial center, is a healthy, stable and sophisticated financial services and banking sector. ‘It is this need that we propose to address through organizing a regional conference of dealers. In the country’s endeavors to attract potential investors from offshore, time and again the urgent need has arisen for a financial sector that is trained, experienced and speedily reformed into an advanced center with products such as derivatives and hedge instruments on offer. However, any such attainment of excellence would primarily depend upon a clear understanding of regional economic and financial needs, and the convergence of national socioeconomic policies and the need for capital for development within the region.’

It is also proposed to discuss the possibility of formulating a Regional Action Committee at this forum to jointly study regulatory issues and trade and service incentives within the region and to make recommendations to the lawmakers of the respective countries.

AN OPERATIONAL MERGER

The Development Finance Corporation of Ceylon (DFCC) which in a recent amendment to its Act changed its name to DFCC Bank, purchased 7,375,000 shares of Commercial Bank for a price of Rs 1.003 billion. ‘DFCC Bank is certainly not envisaging a hands off investment through this transaction. but to form a strategic partnership and an operational rationalization between two strong financial entities to generate a high level of synergy through the combination of complementary institutional strengths and skills. The strategic alliance is one aimed at the objective of consolidating the gains and opportunities in the areas in which the two institutions have clear and competitive advantages’ bank sources said.

Banking and financial services sectors in Sri Lanka will in the future need to gear up for different roles from that of the past. Financing of large industrial and infrastructure projects will need larger and financially stronger institutions with large equity bases and market capitalization to muster the required long-term resources. Today Sri Lanka is gearing itself to meet the challenges as well as profit from the globalization, privatization and deregulatory trends around the world. Today and particularly tomorrow will not be an era conducive to the proliferation of small banks and duplication of banking skills. The need of the future will be growth oriented strong and diversified financial conglomerates based on consolidating and optimizing existing institutional structures, different skills and technology as well as financial strengths.

The two banks in partnership will be in a position to offer almost all the financial facilities and services needed by small and large businesses, entrepreneurs and the public in a manner of a one-stop-shop. The alliance has the potential to evolve into a financial powerhouse which can contribute greatly to the national development of the country.

The Rs 4.3 billion equity base of the DFCC Bank and the Rs 3.2 billion equity of Commercial Bank gives the partnership adequate strengths to generate a high level of investor confidence and be a force in large scale resource mobilization both within the country and overseas.

ADB GUARANTEES LOAN TO SRI LANKA

The National Development Bank(NDB) has successfully borrowed a US850 million loan on a 10 year bullet repayment from a syndication of Japanese financial institutions. The two lead managers of the issue are Nippon Life Insurance and the Industrial Bank of Japan.

The unique feature of the loan is that ADB has guaranteed a principal payment at maturity under its partial credit guarantees scheme by the co-financing unit of the ADB, while the government of Sri Lanka guaranteed the interest payments. The guarantee from the ADB, a multilateral regional development bank with an AAA rating was instrumental in mitigating sovereign risk of Sri Lanka and extended the maturity significantly in addition to obtaining competitive prices.

The significance of the deal as far as the NDB is concerned is its entry into the International Capital Markets and also the tremendous response it has had from its syndicated lenders in order to enter into new transactions of this nature in the future.

The Bank has also secured a further US$5 million from the ADB and together these new credit lines made available to industry will now be called Small and Medium Enterprise Assistance Projects.

A STRATEGIC ALLIANCE

CTC Eagle Insurance Company and NDB, two gi ants in the financial market, have signed a Memoran- dum of Understanding(MOU) which will in effect merge two subsidiary companies, CTC Eagle Fund Management Company and CKN Fund Management Company. The newly formed Eagle NDB Fund Management Company, will manage funds of about Rs 4 billion, making them twice as large as their nearest competitor.

Under the terms of the strategic alliance, CKN Fund Management, a subsidiary of NDB, has invested Rs 17.15 million for 49% of the shares of CTC Eagle's hitherto fully owned subsidiary CTC Eagle Fund Management Company. CTC Eagle will takeover all funds currently under the management of CKN, its assets and human resources. They will takeover the management of the Pyramid Unit Trust which has a net asset value of Rs 290 million and an investor base of over 3000 unit holders.

Chairman of CTC Eagle, Gottfried Thoma said 'This is an exciting development, with two strong players in the Sri Lankan financial services arena joining together, providing an impetus to the country's capital market'. Director/General Ranjith Fernando, added that this alliance provides NDB an opportunity to strengthen its presence in fund management in line with NDB's new positioning as a universal bank.

FISCAL AND PRICE INDICATORS

Meanwhile a special report by Jardine Fleming says that the government is aggressively addressing the Budget deficit through a combination of supply- and-demand-side measures. On the demand side, subsidies on items such as wheat flour, electricity, transport and fuel have been pruned; the estimated savings amount to about 5% of total spending (around Rs 10 billion) in 1996-1997. Moreover, interest payment on the domestic debt which forms 18% of total spending – will come down with falling interest rates, further easing pressure on the Budget. Defence spending, now the single largest item of spending, will be less easy to tackle, and is likely to remain at about 20% of spending (5% of GDP).

Jardine Fleming reports that privatization has brought in a pot of gold, with the privatizations of the state telecommunications company, a host of plantation companies and the sale of government debentures in a development bank. Year-to-date, they have raked in more that Rs 21 billion. Measures to broaden the tax collections base, such as a VAT system, have also been brought in. 'Despite a high, but stable, defense bill, we see the budget deficit falling to a forecast 7.2% of GDP in 1997, thanks to the fiscal reforms under way. We see continued progress in 1998, with the deficit falling to 6.7% of GDP as privatization continues to benefit government coffers and tax collections increase thanks to a stronger economy,' says Jardine Fleming.

INFLATION

According to stock market analysts, inflation is on a downward trend since peaking at a six-year high of 15.9% in 1996.

Jardine Fleming forecasts 'While subsidies continue to come off this year (such as those for bread and electricity), the high base last year will mean a lower YoY increase. Moreover, with the arrival of the monsoons, food prices have also stabilized. Annual average inflation stood at 12.9% in August, and we expect this to come down further to 10.0% by end-1997. Fears that the looser monetary policies will have an inflationary impact are not warranted, since inflation in Sri Lanka is largely a cost-push phenomena. High interest rates, in themselves, were a major contributor to high costs. The 11% increase in electricity tariffs in September will exert some pressure on the index this month; however, for the reasons outlined above, the YoY increase will still be subdued. We see inflation remaining flat in 1998 at a forecast 10.8%. The implementation of the VAT and further expected price rises will prevent a substantial reduction in inflation next year.'

FINANCE-INTEREST RATES

It is reported that the cut in the statutory reserve requirement (SRR) by 3% to 12% early this year has had a dramatic impact on interest rates. The bench- mark 12-month T-bill rate (TBR) has fallen around 600 bp year-to-date to 10.5%, while the PLR has fallen 700 bp year-to-date to a 12%.

'Thanks to the foreign funds inflow from Sri Lanka Telecom and National Development Bank together with a lower public borrowing requirement there is abundant liquidity in the market, making for lower interest rates. This means the traditional cyclical pressure on interest rates in the 4th quarter of 97 will not be evident this year. When these factors combine with the lower inflationary outlook, prospects for interest rates staying low have never been brighter. With inflation stabilizing around 10% this year, and lending rates falling to around 14%, we see real interest rates falling to around 4% – 5% on an annual average basis, from heights of 10% -11%. Their forecast for 1997 average is 13.7% for the 12-month TBR and 14.83% for the PLR. Our 1998 forecasts have also been revised down to

12.4% for the TBR and 14.23% for the PLR.'

Since the reduction of the SRR, lending rates have fallen rapidly, led by foreign commercial banks who take their cue from the call market rates. Currently, PLRs are the lowest in two years. In a bid to preserve spreads, the banks have lowered deposit rates to a two year low. Because of volatile lending rates and government-controlled deposit rates, the banks have traditionally enjoyed high margins. However, after the rationalization of interest rates, the era of abnormally high spreads is fast coming to an end' says Jardine Fleming research.

'We expect average spreads to stabilize between 3% and 4% in the long run. Banks which historically maintained profitability on high spreads, will in the future have to rely on higher business volumes and new products,' these analysts forecast.

GOOD PERFORMANCE FROM EXPORTS

Exports suffered last year as power cuts disrupted industrial production and hit the garment sector, which account for 45% of total exports. At the same time, a poor retail environment in the US, the largest market for garments, added to the slowdown. Thankfully, tea exports came to the rescue, with both production and output reaching record highs.

Jardine Fleming forecast says "Tea prices have continued to be firm year-to-date, further buoying exports. With the industrial sector back on its feet, industrial exports have also recovered, rising 14% in 1997. Overall exports were up 12% YoY in 1997. We see exports rising 10% YoY in 1997 and 11.1% YoY in 1998.

ECONOMY IMPORTS ON THE RISE

Import growth is strongly related to exports, given the low-value-added nature of the primary export – garments. Hence, import growth slowed to just 2% YoY in 1996 – a historic low. At the same time, the economic recession hit consumer and investment imports, contributing to the slowdown.

According to these analysts 'With both the economy and industrial exports back on their feet this year, import growth will rise to keep pace. All categories of imports have shown strong growth in 1997, particularly investment and consumer imports. Imports were up 10.5% YoY in 1997, and we see overall growth at 9% YoY for 1997.

FOREX

According to Jardine Fleming, with forex reserves under pressure from two consecutive BoP deficits in 1995-1996, the rupee has depreciated 5% year-to-date against the USS. Inflationary pressures in 1996 limited the depreciation in 1996 to just 4.7% YoY. Historically, steep depreciation has had a substantial impact on domestic inflation. Hence, the exchange rate is frequently used to ward off imported inflation. The relatively steep depreciation of the currency this year has corrected some of the real appreciation in the past year.

They forecast ‘Given a closed capital accounts, Sri Lanka is shielded from the speculative attacks taking place on South East Asian currencies. However, the need to maintain the external competitiveness of the rupee vis-a-vis these currencies will place additional pressure on the currency this year. Added pressure will come if India and Pakistan devalue their currency significantly. Nevertheless, we do not expect the ru pee to depreciate more than 3.5% over the remainder of 1997. This is particularly so given our outlook for a BoP surplus which will boost foreign reserves to a com- fortable 5-6 months of imports by end-1997. We see the currency depreciation stabilizing to around 5% in 1998 on expectations of continued BoP surplus and falling inflation.”