10. FINANCIAL SECTOR

10.1 Money supply

Monetary expansion continued to remain high primarily owing to a significant acceleration of bank credit to the private sector. This took place in the context of a sharp drying up of foreign capital inflows which depressed the domestic capital market. The Government and public corporations resorted to increased bank credit. As a result, the money supply measured in terms of Broad Money (M_2) expanded by 19.2 per cent in 1995. This was a high rate of monetary growth considered in the context of 19.7 per cent in 1994 and higher growth during the previous years. However, it is significant that Narrow Money supply (M_1) grew only by 6.7 per cent in 1995, compared with 18.7 per cent in the previous year. The faster growth in M_2 than in M_1 was a result of a shift of public preference for interest bearing assets at a time of high interest rates. New financial instruments and services such as teller card facilities, the growing popularity of credit cards and the intensification of deposit mobilisation efforts by commercial banks helped the process. Also contributing was a slow growth of new deposits in the National Savings Bank due to a delay in responding to rising interest rates, and a shift of investments by the public from a depressed stock market to the banking sector.

TABLE 10.1
Summary Monetary Statistics

Item	End 1995	Change 1994		Change 1995	
	Rs.Bn.	Amount Rs.Bn.	%	Amount Rs.Bn.	%
Monetary Aggregates :					
Narrow Money Supply (M_1)	75.2	11.1	18.7	4.8	6.7
Broad Money Supply (M_2)	228.5	31.5	19.7	36.9	19.2
Underlying Factors					
Domestic Credit to :	223.8	23.1	15.3	50.0	28.8
Government (net)	35.2	1.2	4.3	7.1	25.1
Public Corporations	8.5	-2.6	-33.6	3.3	65.2
Private Sector	180.1	21.9	17.7	42.9	29.5
External Assets (net)	66.5	16.3	34.0	2.0	3.2
Other Items (net)	-61.8	-7.9	20.5	-15.2	32.6

Source: Central Bank of Sri Lanka

Net domestic assets of the banking system increased sharply by 27 per cent as the banks accommodated increased credit demand by both the private sector and the public sector through economising on reserves, aggressive banking practices to mobilise new deposits in a more competitive banking environment and reducing foreign held balances. Despite high and rising interest rates, the demand for credit by the private sector remained high owing to a drying up of capital inflows from abroad, a reduction in funds obtainable through a depressed share market and liquidity problems faced by business enterprises as a result of lower than usual turnover, towards the end of the year. Thus, credit to the private sector rose by Rs.42,937 million (29.5 per cent) in 1995 compared with an increase of Rs.21,943 million (17.7 per cent) in 1994. This expansion was fuelled by increased bank borrowings by the Government towards end 1995 due to a widening fiscal deficit on account of enhanced expenses on defence and subsidies. The Government contributed to this credit expansion by borrowing Rs.7,067 million in 1995, as against Rs. 1,154 million in the previous year.

Almost the entirety of growth in credit to the Government from the banking system took place during the second half of 1995 as there was no serious imbalance in the government cashflow during early 1995. The adverse monetary implications of escalating defence and welfare expenditure were seen during the second half of the year when there were heavy claims on domestic financial resources by the Government. However, as lending to the private sector was more attractive to commercial banks, their credit to the Government declined marginally by end 1995. Consequently, net credit to the Government from the Central Bank rose by Rs.7,662 million, if not for which interest rates in the market would have risen higher.

Bank credit to public corporations increased notably by Rs.3,364 million (65.2 per cent) in 1995, in contrast to a sharp decline during the previous two years. This reflected higher borrowings by the Ceylon Petroleum Corporation (CPC) following the damage to its oil storage facilities (Rs.1,297 million) and the Co-operative Wholesale Establishment (CWE) owing to escalating world wheat prices (Rs.644 million). Total bank credit to co-operative institutions increased by Rs.1,398 million in 1995 as against Rs.638 million in 1994, primarily due to an increase in credit to the Paddy Marketing Board for purchases during a record crop year (Rs. 1,458 million) .

Unlike during the last five years, where a major expansionary impact was brought about by large overall surpluses in the balance of payments, net foreign assets (NFA) of the banking system reflected only a marginal increase of 3.2 per cent in 1995. As there was an overall deficit in the balance of payments in 1995, this increase was

TABLE 10.2
Monetary Aggregates 1993 - 1995

Rs Million

End of Period	Narrow Money Supply (M_1) 1993	1994	1995	Percentage Change 1993	1994	1995	Broad Money Supply (M_2) 1993	1994	1995	Percentage Change 1993	1994	1995
January	51,195	57,772	69,875	15.5	12.8	20.9	132,393	159,015	193,010	19.6	20.1	21.4
February	51,148	62,351	70,702	11.8	21.9	13.4	134,235	163,175	192,859	19.4	21.6	18.2
March	53,444	62,708	71,335	11.6	17.3	13.8	138,994	165,703	195,370	20.8	19.2	17.9
April	53,528	61,611	68,718	11.3	15.1	11.5	141,079	166,336	195,982	20.2	17.9	17.8
May	52,573	60,856	68,376	12.1	15.8	12.4	139,761	166,380	197,892	19.4	19.0	18.9
June	51,992	62,417	68,714	11.6	20.1	10.1	138,412	171,035	201,170	19.0	23.6	17.6
July	52,976	63,275	68,194	15.5	19.4	7.8	140,920	172,890	202,826	21.3	22.7	17.3
August	53,524	63,571	69,321	15.6	18.8	9.0	142,007	173,931	205,325	20.1	22.5	18.0
September	54,640	66,119	70,306	16.5	21.0	6.3	145,299	178,121	211,009	21.6	22.6	18.5
October	55,159	66,873	71,538	18.9	21.2	7.0	148,535	183,127	215,349	21.7	23.3	17.6
November	55,296	66,693	71,847	18.1	20.6	7.7	152,863	184,359	218,999	22.9	20.6	18.8
December	59,355	70,461	75,217	18.6	18.7	6.7	160,136	191,670	228,536	23.4	19.7	19.2
Monthly Average	53,736	63,726	70,345	14.8	18.6	10.4	142,886	172,979	204,861	20.8	21.1	18.4

Source: Central Bank of Sri Lanka

Note: Monetary data from 1990 have been reclassified to be consistent with the standard international practice. Please refer notes to Appendix Tables 82, 83 and 87.

TABLE 10.3
Monetary Aggregates and Underlying Factors 1993 - 1995

Rs. Million

	Dec. 1993	Dec. 1994	Dec. 1995	Change 1994 Amount	Change 1994 Percentage	Change 1995 Amount	Change 1995 Percentage
Monetary Aggregates :							
1. Currency held by the Public	32,133	38,906	42,198	6,773	21.1	3,292	8.5
2 Demand Deposits held by the Public	27,222	31,555	33,019	4,333	15.9	1,464	4.6
Narrow Money Supply (M_1)	59,355	70,461	75,217	11,106	18.7	4,756	6.7
3. Time and Savings Deposits of the Private Sector held with Commercial Banks	100,781	121,209	153,319	20,428	20.3	32,110	26.5
Co-operative Institutions	3,287	3,781	3,598	494	15.0	-183	-4.8
Government Corporations	10,287	13,236	15,888	2,949	28.7	2,652	20.0
Other Private Sector Constituents (a)	87,207	104,192	133,833	16,985	19.5	29,641	28.4
Broad Money Supply (M_2)	160,136	191,670	228,536	31,534	19.7	36,866	19.2
Underlying Factors							
1. Domestic Credit	150,697	173,794	223,798	23,097	15.3	50,004	28.8
Net Credit to Government	26,993	28,147	35,214	1,154	4.3	7,067	25.1
Gross Credit to Government	35,098	40,250	47,738	5,152	14.7	7,488	18.6
By Central Bank	16,797	19,568	27,458	2,771	16.5	7,890	40.3
By Commercial Banks	18,301	20,682	20,280	2,381	13.0	-402	-1.9
Govt. Deposits and Cash Balances	8,105	12,103	12,524	3,998	49.3	421	3.5
Gross Credit to the Private Sector	123,704	145,647	188,584	21,943	17.7	42,937	29.5
Co-operative Institutions	1,903	2,541	3,939	638	33.5	1,398	55.0
Government Corporations	7,775	5,163	8,527	-2,612	-33.6	3,364	65.2
Other Private Sector Constituents	114,026	137,943	176,118	23,917	21.0	38,175	27.7
2. External Banking Assets (net)	48,119	64,467	66,532	16,348	34.0	2,065	3.2
Central Bank (net)	52,980	65,864	74,301	12,884	24.3	8,437	12.8
Commercial Banks (net)	-4,861	-1,397	-7,769	3,464	71.3	-6,372	-456.1
3. Other Items (net)	-38,679	-46,590	-61,794	-7,911	-20.5	-15,204	-32.6
Other Liabilities (net) of Central Bank	-31,975	-39,398	-51,986	-7,423	-23.2	-12,588	-32.0
Other Liabilities (net) of Commercial Banks	-6,704	-7,192	-9,808	-488	-7.3	-2,616	-36.4
Broad Money Supply (M_2)	160,136	191,670	228,536	31,534	19.7	36,866	19.2

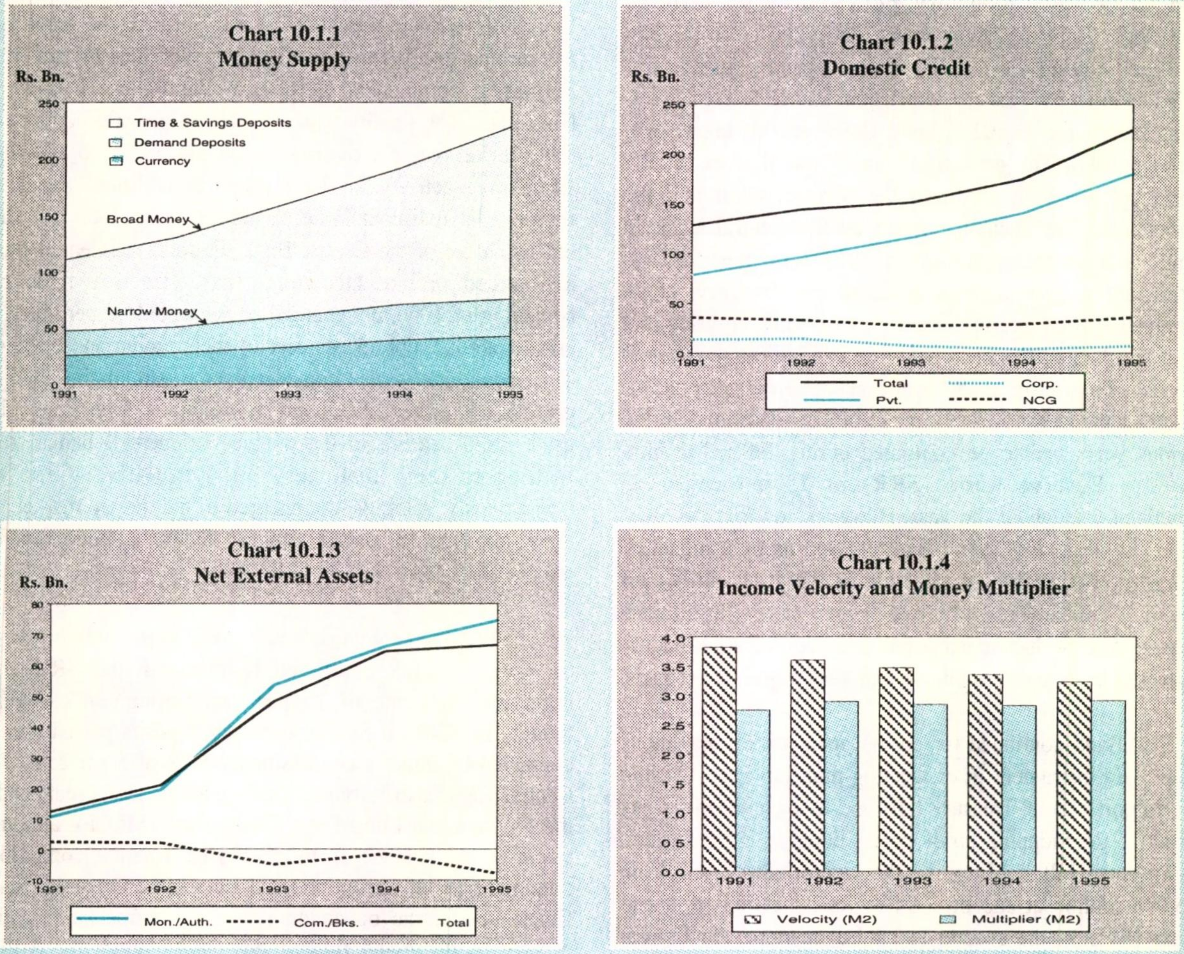
(a) Excludes Non-Resident Foreign Currency Deposits.

Source: Central Bank of Sri Lanka

Notes: *Signs indicate the effect on M_2.*
Monetary data have been reclassified to be consistent with the standard international practice.
Please refer notes to Appendix Tables 82, 83 and 87.

Chart 10.1

Monetary Aggregates, Velocity and Money Multiplier



entirely the result of the depreciation of the exchange rate. Net foreign assets of the Central Bank increased by Rs.8,437 million (12.8 per cent) in 1995, following an increase of Rs.12,884 million or 24.3 per cent in 1994, whereas those of commercial banks fell by Rs.6,372 million, which was reflected in an accumulation of external liabilities in the form of non-resident foreign currency deposits without a corresponding increase in foreign assets.

Gross foreign assets of commercial banks fell by Rs.1,902 million, reflecting a reduction in deposits with FCBUs and balances with banks abroad as the banks shifted their portfolio from less attractive foreign assets to more attractive domestic assets due to a widening of the interest rate differential between foreign currency deposits and domestic financial assets. Meanwhile, gross foreign liabilities of commercial banks rose by Rs.4,470 million (14.5 per cent) mainly due to an increase in NRFC, RFC and RNNFC deposits.

Reserve money (high powered money or the monetary base) increased by Rs.10,532 million or 15.5 per cent in 1995 as compared with Rs.11,587 million or 20.5 per cent in 1994. From the source side, the expansion of net credit to the Government contributed to the growth in reserve money. This was reflected in an increase in currency in circulation and commercial bank deposits. Almost sixty per cent of the growth in reserve money occurred in December, reflecting increased availability of Central Bank funds to the Government for settlement of large payments during the month. The money multiplier remained stable at around 2.9. Following the trend observed in the past few years, the income velocity of money continued to decline reflecting reduced inflationary expectations and the increased attractiveness of the banking sector.

10.2 Monetary Policy

The environment in which the Central Bank was called upon to conduct monetary policy in 1995 differed significantly from the environment that prevailed in the past five years. During the last five years monetary growth was fuelled mainly by a sharp expansion in net foreign assets arising from large capital inflows. However, this impact was absent in 1995. The growth in money was thus essentially caused by a rise in credit to the private sector and the Government. The challenge faced by the Central Bank in formulating monetary policy in 1995 was, therefore, to contain credit growth, thus avoiding the ill-effects of an unacceptably high rate of money growth, while ensuring that the system had sufficient liquidity to avoid stifling economic activity. Thus, the tight monetary policy adopted to counteract the expansionary impact of capital inflows in the previous years had to be continued during 1995. The high Statutory Reserve Ratio (SRR) of 15 per cent was maintained throughout the year. However, towards the latter part of the year, the Central Bank relaxed its tight monetary policy somewhat by purchasing of Treasury bills and permitting limited foreign borrowing by financial institutions to ensure that productive economic activities were not unduly suppressed by liquidity tightness and very high interest rates.

The Bank continued to rely on open market operations as the main instrument in conducting monetary policy, using both its portfolio of Treasury bills and its own securities. As a result of the mopping up of excess liquidity in the system, the Treasury bill holdings of the Central Bank fell from Rs.5,093 million at end of 1994 to Rs.2,991 million at end March 1995. In the second and third quarters, the Central Bank issued its own 3-month securities in order to contain the growth of money. The average yield on these was in the range 14.08-18.10 per cent per annum.

Despite the high growth in money supply, the slowing down of foreign capital inflows and increased domestic demand for funds led to a shortage of liquid funds and a corresponding rise in interest rates towards the end of the year. There was increased demand for credit by the Government on account of the higher than anticipated defence and welfare expenditure, following the breakdown of the peace talks in April and the rise in wheat prices. Reduced inflows from abroad, the inability to raise funds in a sluggish stock market, inflationary expectations and cash flow problems of the corporate sector all contributed to a heightened demand for bank credit from the private sector. These factors led to an increase in Treasury bill yields from 14.34 per cent in March to 18.68 per cent in December. Meanwhile, call money rates rose from 18 - 25 per cent in March to 20 - 58 per cent by end December. Also, reflecting speculative behaviour, the money market displayed extraordinary volatility in the movement of daily call money rates.

To ease the tightness in the money market, the Central Bank intervened to purchase Treasury bills in the secondary market and decided to retire its own securities on maturity. Further, it commenced a Reverse Repurchase Facility in November. The facility was expected to provide liquidity to the market on an overnight basis and also dampen speculative activity in the market. In addition, the Bank reduced the rediscount rate, which is charged on Treasury bill purchases of the Central Bank. Further, the Central Bank announced in late December that, effective from the beginning of 1996, commercial banks would be permitted to borrow abroad, upto 5 per cent of their capital and reserves. This measure was also considered as a part of the ongoing process of further liberalising transactions. The Bank also used moral suasion to discourage commercial banks from lending to their customers for speculative purposes. Consequently, stability was restored to the money market. At the same time, enhanced liquidity led to a moderation in interest rates from very high levels.

In order to contain domestic credit expansion, however, the Central Bank continued to maintain the SRR at a relatively high rate of 15 per cent throughout the year, though the SRR on foreign currency deposits placed abroad continued to attract a concessionary SRR of 5 per cent. The Central Bank also refrained from granting new credit under the Medium and Long Term Credit Fund (MLCF), although requests for finance from distressed finance companies continued to be accommodated on a case by case basis. Consequently, the outstanding level of refinance facilities granted to distressed finance companies under the MLCF increased from Rs.2,304 million at end 1994 to Rs.2,473 million at end 1995. In keeping with the current policies to minimise refinance, the overall outstanding refinance under both short-term facilities and the MLCF, net of provisions for loan losses, was reduced from Rs.3,376 million at end 1994 to Rs.2,800 million at end 1995.

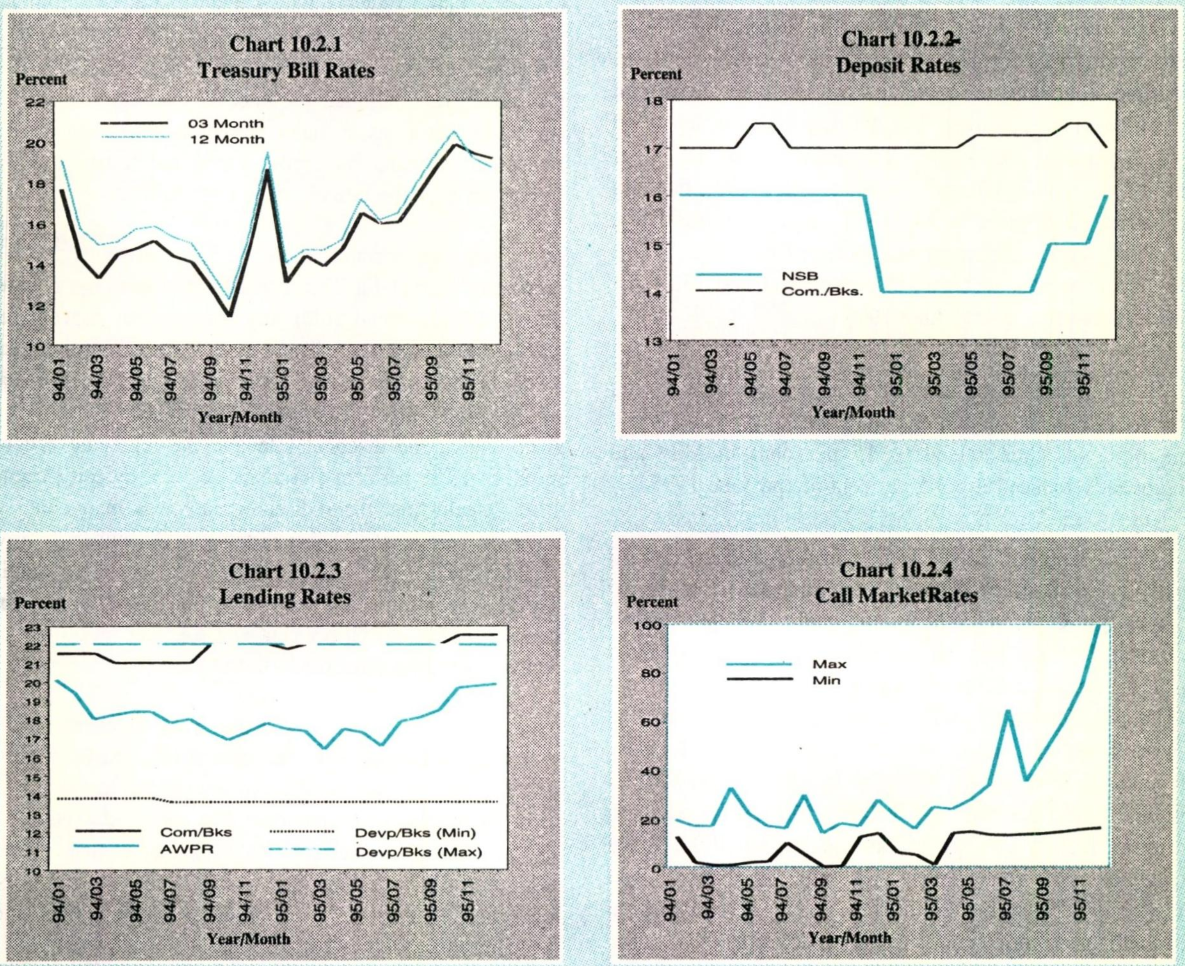
10.3 Interest Rates

Short-term interest rates dropped in early 1995, reflecting a significant easing of liquidity mainly due to the retirement of Central Bank securities, increased provisional advances to the Government and transfer of Central Bank profits to the Government. This trend reversed drastically from the second quarter of the year with a tightening of the liquidity caused by reduced foreign inflows, increased government borrowing and a continued rise in utilisation of bank credit by the private sector. The average yield rate on 12-month Treasury bills, which declined from 19.43 per cent at end 1994 to 14.00 per cent in February 1995, progressively rose to a peak level of 20.5 per cent by mid-October. Thereafter, the rates dropped slightly until end 1995, but remained above 18 per cent. Call money market rates followed the same trend with a high volatility during the second half of 1995. The medium and long-term rates recorded some fluctuations during the year.

Short Term Interest Rates

With the increase in liquidity, short-term interest rates reflected a downward trend during the first two months of 1995. Treasury bill yield rates remained somewhat stable in March. From April onwards, Treasury bill yield rates moved in a steady upward direction as the market experienced a tight liquidity situation. Call money market rates followed suit with wide fluctuations on a few occasions in the second half of the year. In the last quarter of the year, call money market rates rose to very high levels with high volatility. Increased demand for funds by non-commercial bank participants such as development banks and merchant banks and a shortage of short-term funds with the state banks due to cash flow problems experienced by the Government were mainly responsible for the excessive rise in interest rates during this period. With a view to stabilising call money market rates, the Central Bank introduced a reverse repurchase scheme in Treasury bills in November 1995 under which short-term funds were provided to eligible borrowers. This scheme had its limitations in influencing short-term interest rates as it was confined to commercial banks which were approved dealers in Treasury bills and the amounts offered were relatively small compared to the increased demand for short-term liquidity, and due to market imperfections.

Chart 10.2
Interest Rates



The average yield rates on Treasury bills declined from a range of 18.75 - 19.43 per cent at end December 1994 to a range of 13.24 - 14.00 per cent in the first week of February, reflecting normal seasonality. Treasury bill primary auctions were heavily oversubscribed during this period. The Central Bank continued its open market operations to mop up excess liquidity. Accordingly, the Central Bank's holdings of Treasury bills declined from Rs.5,093 million at end 1994 to Rs.492 million by mid-February 1995. The Treasury bill yield rates were on an upward direction particularly from April and reached 16.36 - 16.47 per cent by end June. Call money market rates, which dropped to a range of 6.00-14.00 per cent in the third week of January from a range between 20.00-23.00 per cent at end 1994, rose to 23.00-34.00 per cent by end June. Several developments such as reduced foreign inflows, a weakening in the Government's cash position and mopping up operations of the Central Bank, which absorbed Rs.1,670 million through the issue of its own securities during March to May, were responsible for a tight liquidity situation in the market.

During the first half of 1995, the yield rates on the Central Bank's sales (discounting) and purchases (rediscounting) of Treasury bills in the secondary market fluctuated, following the general trends in other short-term rates in the money market. The discount rates, which stood at 18.48 per cent for 3-month Treasury bills and 19.18 per cent for 12-month Treasury bills at end 1994, gradually dropped to 12.99 per cent and 13.75 per cent, respectively, in the first week of February and increased thereafter, in line with market trends, to reach 15.53 per cent and 15.84 per cent, respectively, by end June 1995.

The repo rate was reduced from 20 per cent at end 1994 to 12.00 per cent in the third week of March 1995. This rate was then raised to 15 per cent in May and subsequently reduced to 13.5 per cent at end June 1995.

The second half of the year witnessed a sharp upward movement in short-term interest rates due to a tightening of the liquidity situation as mentioned earlier. Yield rates on 12-month Treasury bills at the primary auctions rose from 16.47 per cent at end June to a peak level of 20.54 per cent in October. Thereafter, with an injection of funds by the Central Bank, as evident from the increase in its Treasury bill holdings from Rs.9.1 billion at end October to Rs.12.5 billion by end December, the Treasury bill rates indicated a marginal decline during the last quarter of 1995. From November 1995, the average yield rates on 3-month and 6-month bills were higher than the average yield rate on 12-month bills, reflecting a market perception of a future drop in interest rates.

Call market rates rose to unprecedentedly high levels in July 1995 and in the last quarter. During the last quarter, a reduction in the supply of funds to the call money market by the two state banks due to delays in settlement of obligations by the Government, an increased demand for funds by non-commercial bank participants and greater reliance on call market funds by other financial institutions including merchant banks exerted pressure on interest rates. Under the impetus of these factors, despite the injection of funds by the Central Bank through its activities in the primary and secondary markets for Treasury bills and reverse repo transactions, call money market rates fluctuated between 16.00 - 102 per cent in December. The reverse repo scheme was not effective enough in containing call money market rates when pressures for funds originated from institutions which were not eligible to be covered by the scheme. In addition, structural weaknesses in the financial system constrained the effective use of the reverse repo scheme to stabilise short-term interest rates at reasonably low levels. However, in mid-December, market liquidity improved to some extent after a special issue of Treasury bills and the receipt of privatisation proceeds on account of the sale of Colombo Gas Company which enabled the Government to settle part of its obligations to the state banks. At end December, call money rates were in a range of 20.00 - 58.00 per cent. The continued presence of non-commercial bank financial institutions as major borrowers and seasonally high transaction demand for credit during the festive season in December kept the interest rates from falling.

During the second half of 1995, the discount rate in the secondary market for Treasury bills and the repo rate were on an upward trend following the general movement in short-term interest rates. These rates were raised to attractive levels in the last quarter of the year to encourage purchases of Treasury bills from the Central Bank's portfolio. Accordingly, the discount rate and the repo rate had been raised to 19.01 per cent and 16.50 per cent by end December 1995. Meanwhile, the rediscount rate was maintained at a relatively low level (20.47 per cent) in December to provide liquidity to the market at a reasonable rate. The weighted average yield rate on reverse repo transactions varied between 22.60 - 50.00 per cent in December reflecting heavy demand for short-term funds in the market.

The coupon rate on Central Bank Securities, which remained unchanged at 13 per cent at the first twelve issues in 1995, was raised to 15.5 per cent at the last two issues, made in August and September. The weighted average yield rate on these securities rose to 14.08 per cent at the issue made on 24 March 1995 and to 16.60 per cent at the issue made on 28 June 1995. Thereafter, with minor fluctuations, the yield rate rose to 18.6 per cent at the 6 September 1995 issue, which was the last issue for the year.

The weighted average lending rate of commercial banks declined from 18.5 per cent at the end of 1994 to 16.4 per cent by end March 1995, conforming to the general trends in other short-term interest rates. The rate then rose to 20.0 per cent by end June 1995 and further to 20.5 per cent at end September. Meanwhile, the weekly Average Weighted Prime Lending Rate (AWPR) declined from 18.5 per cent at end December 1994 to 16.2 per cent by end March 1995 before rising to 16.9 per cent at end June. Thereafter, the AWPR indicated a clear upward trend, reaching 20.1 per cent at end December 1995.

In view of the rising trend in interest rates and the slowing down in the growth of its deposits, the National Savings Bank (NSB) twice raised its interest rate on fixed deposits. The rate was raised from 14 per cent per annum to 15 per cent per annum, with effect from 01 September 1995 and to 16 per cent with effect from 15 December. However, its savings deposit rates remained at 12 per cent throughout the year.

Long Term Rates

Some fluctuations were observed in long-term rates in 1995. The interest rate on government securities with 5 - 7 year maturities was 14 per cent in 1995 compared with 14 - 16 per cent for securities with 3 - 5 year maturities in 1994.

The minimum lending rate of the State Mortgage and Investment Bank (SMIB) declined from 18 per cent at end 1994 to 17 per cent in January 1995. The lending rates of the National Savings Bank (NSB) declined from a range of 18 - 21 per cent at end 1994 to a range between 17 - 20 per cent in May 1995. In contrast, the lending rates of the Development Finance Corporation of Ceylon (DFCC) increased from a range of 18 - 22 per cent to a range between 20 - 24 per cent from January 1995. Meanwhile, the lending rates of the National Development Bank (NDB), which ranged between 16.5 - 22.0 per cent at end 1994, rose to a range of 19.5 - 26 per cent. The refinance rate under the Small and Medium Scale Industries (SMI)-IV Scheme, which is fixed on the basis of the AWDR of commercial banks, was reduced from 13.6 per cent at end 1994 to 12.5 per cent by end 1995.

10.4 Commercial Banking

In the context of a tight monetary policy, high interest rates and expanding credit demand by the private sector, liquid assets of commercial banks increased at a slower pace of 7 per cent (Rs.5,526 million) in 1995 compared to a rise of 19 per cent (Rs.12,204 million) in the previous year. Consequently, the ratio of liquid assets to total deposits fell from 40 per cent at end 1994 to 36 per cent at end 1995.

Structure of Assets and Liabilities

The total assets/liabilities of commercial banks rose by 19 per cent during the year, in comparison to an increase of 14 per cent in nominal GDP, indicating a further deepening of banking activity. The share of total loans and advances in total assets increased from 51 per cent in 1994 to 56 per cent in 1995, reflecting high credit demand. During the year, total loans and advances increased by 31 per cent (Rs.43,772 million) mainly on account of increases in overdraft facilities by 40 per cent (Rs.18,272 million) and loans by 25 per cent (Rs.21,474 million).

On the liabilities side, major increases were recorded in total domestic deposits, paid up capital and reserves and foreign currency liabilities with correspondent banks. Total deposits increased by 20 per cent (Rs.38,247 million) during the year on account of increases in time and savings deposits by 24 per cent (Rs.37,337 million) and demand deposits by 2 per cent (Rs.870 million). Total deposits as a percentage of total assets remained around 69 per cent as in the previous year. Domestic inter-bank borrowings increased by 35 per cent (Rs.3,668 million), while foreign borrowings also increased by 33 per cent (Rs.683 million) during the year, reflecting a high credit demand which was not matched by a corresponding increase in deposits.

Paid up capital and reserves increased by 18.3 per cent (Rs.5,181 million) during the year, partly due to the commencement of operations by three new banks, while the ratio of capital and reserves to total assets remained around 10 per cent in 1995 as in the previous year.

Sources and Uses of Funds

For the year as a whole, the foreign sector, inter-bank transactions, other liabilities including the capital and reserve base of commercial banks, the government sector and government corporations were net providers of resources to commercial banks, while the other domestic private sector, the Central Bank and co-operatives absorbed resources from commercial banks. Total net availability of funds increased by Rs.13,478 million in 1995, in comparison to an increase of Rs.15,765 million in 1994.

The foreign sector emerged as a major source of funds for commercial banks in the form of borrowings, deposits and foreign balances in 1995, providing a sum of Rs.6,372 million. In contrast, this sector was a net user of commercial bank funds during the previous two years.

The government sector contributed a net resource build up of Rs.595 million in comparison to an amount of Rs.605 million provided in the previous year. This was mainly due to an increase in government deposits by Rs.193 million and a decrease in investments in Treasury bills by Rs.4,186

TABLE 10.4

Selected Items of Assets Liabilities of Commercial Banks 1994-1995

Rs. Million

Item	Average of Monthly Values		End of Period	
	1994	1995	1994	1995
Cash on Hand and Deposits at Central Bank (inclusive of Statutory Reserve Requirements)	25,844	29,724	27,957	35,449
Foreign Balances	19,873	22,748	24,236	21,835
Treasury Bills	13,957	12,592	15,143	11,552
Bills Discounted	10,904	13,434	10,773	14,799
Total Liquid Assets	70,578	78,498	78,109	83,635
Total Investments (a)	8,531	8,033	10,861	7,715
Total Loans and Overdrafts (b)	123,808	150,484	132,447	172,194
Demand Deposits (c)	37,377	39,848	41,678	42,548
Time and Savings Deposits (d)	138,600	168,327	152,601	189,978
Total Deposits	175,977	208,175	194,279	232,526
Ratio of:	%	%	%	%
Cash to Demand Deposits	69.1	74.6	67.1	83.3
Cash to Total Deposits	14.7	14.3	14.4	15.2
Foreign Balances to Total Deposits	11.3	10.9	12.5	9.4
Treasury Bills to Total Deposits	7.9	6.0	7.8	5.0
Commercial Bills Discounted to Total Deposits	6.2	6.5	5.5	6.4
Liquid Assets to Demand Deposits	188.8	197.0	187.4	196.6
Liquid Assets to Total Deposits	40.1	37.7	40.2	36.0
Investments to Total Deposits	4.8	3.9	5.6	3.3
Loans and Overdrafts to Total Deposits	70.4	72.3	68.2	74.1

Source : Central Bank of Sri Lanka

(a) Government and government guaranteed securities,Central Bank securities and private securities and excluding Treasury bills.
(b) Excluding bills discounted.
(c) Excludes domestic inter-bank deposits.
(d) Includes sums of Rs 3,719 million and Rs. 4,322 million being long-term deposits mobilised by the state banks under special savings schemes in 1994 and 1995, respectively.

Note: The discrepancies between the figures given here and similar figures given elsewhere in this Report are due to differences in definition.

million during the year. Meanwhile, the government sector absorbed commercial bank funds through enhanced import bills, short-term credit and overdraft facilities to the value of Rs.3,785 million. Government corporations became a marginal net supplier of funds, providing Rs.35 million in 1995, as compared to Rs.6,343 million supplied in 1994. This change was largely due to increased borrowings by three major corporations - the Ceylon Petroleum Corporation, the Co-operative Wholesale Establishment and the Ceylon Electricity Board.

An enhanced capital and reserve base brought in Rs.5,182 million to the banking system. This was partly on account of three new commercial banks entering the Sri Lankan banking system during the latter part of 1995. In addition, inter-bank transactions were a source of funds on a net basis as in the previous year, providing Rs.2,005 million to the commercial banks' resource base.

The other domestic private sector emerged as a major user of commercial bank funds in 1995. It utilised a sum of Rs. 6,873 million on a net basis, as compared with Rs. 3,192 million in the previous year. This increase corresponds to the increase in credit to the private sector, where the annual growth rose from 21.2 per cent in 1994 to 28.2 per cent in 1995. Commercial banks provided funds to the domestic private sector mainly through enhanced overdrafts and new loan facilities to the extent of Rs.36,661 million. Meanwhile, deposit mobilisation efforts taken by the commercial banks through new products and schemes in a competitive environment enabled them to mobilise additional deposits to the value of Rs.31,303 million.

The Central Bank absorbed Rs.4,774 million worth of funds from the commercial banking system through the placements of funds by banks on account of reserve requirements. An increase in commercial bank reserves held with the Central Bank by Rs.7,180 million in respect of the increased deposit base was partly offset by a large decrease in investments in Central Bank securities by Rs.3,146 million during the year. Meanwhile, the use of funds by co-operatives amounted to Rs.1,832 million during the year. This was by way of increased advances amounting to Rs.1,398 million and a draw-down of Rs.434 million in deposits.

Commercial Bank Loans and Advances*

Commercial banks increased their lending to all sectors of the economy. The bulk of loans and advances was of a short-term nature and was for trading purposes. Short-term advances accounted for 65 per cent (Rs.114,637 million) of total advances, while the relative shares of medium-term and long-term advances were 21 per cent (Rs.37,090 million) and 14 per cent (Rs.24,074 million), respectively.

Trading activities continued to be the most attractive area for lending operations for commercial banks. Nearly 44 per cent of total loans and advances were channelled to finance trading activities, consisting of exports, imports and domestic trade. Such loans and advances rose by 23 per cent during the twelve months ending September 1995. Most of this credit was for working capital requirements.

The second most important area of commercial bank lending was the industrial sector. Industrial credit grew by 25 per cent during the 12 month period ending September 1995, as compared to a growth of 14 per cent in the corresponding period in 1994, while its share of total loans remained at 14 per cent. This was partly due to the re-entry of the two state banks into the SMI scheme. Even in this sector, the major portion of credit outstanding fell into the short-term category. The share of short-term credits in this sector increased from 70 per cent of the total credit to the sector at end September 1994 to 73 per cent at end September 1995.

Credit to the agricultural sector, which includes tea, rubber, coconut, paddy, livestock and dairy farming, grew by 4 per cent during the 12 months ending September 1995 as compared to a growth of 10 per cent at end September 1994. The share of agricultural credit in total outstanding loans and advances was 6 per cent at end September 1995.

Outstanding bank credit in respect of housing and property development accounted for 12 per cent of the total outstanding credit at end September 1995. As the activities in this sector remained sluggish, bank credit to this sector registered a moderate growth of 5 per cent during the period under review. The major share of advances for housing and property development fell into the long-term category (49 per cent). Meanwhile, credit to the financial sector, amounting to Rs.8,102 million, accounted for 5 per cent of the total outstanding credit and showed an increase of 29 per cent at end September 1995.

Despite the relatively high growth in overall credit from the banking sector, the growth of credit for consumption purposes declined significantly in 1995. Credit to this category, which includes consumer durables and other personal needs, rose by only 22 per cent compared to an 87

* The analysis is based on data for the first three quarters of 1995.

TABLE 10.5

Sources and Uses of Resources of Commercial Banks 1993 - 1995

Rs. Million

Category	Change			
	1994		1995	
	Sources	Uses	Sources	Uses
1 . Government Sector	**605**		**595**	
Holdings of Govt. Securities		1,411	4,186	-
Deposits	2,986		193	-
Import Bills		398		2,548
Short-Term Credit		605		857
Overdrafts	32			380
2 . Central Bank		**9,107**		**4,774**
Borrowings		1,789	-	428
Reserves		3,725	-	7,180
Investments in Central Bank Securities		3,234	3,146	-
Till Cash		359	-	312
3 . Government Corporations	**6,343**		**35**	
Deposits	3,732		3,399	-
Advances	2,611			3,363
4 . Co- operatives	**127**			**1,832**
Deposits	764			434
Advances		638		1,398
5 . Other Domestic Private Sector		**3,192**	-	**6,873**
Deposits (a)	20,724		31,303	-
Local Bills	129		-	449
Import Bills	333			471
Overdrafts		7,067	-	15,956
Loans		13,789	-	20,705
Investments in Securities & Bonds		3,522	-	595
6 . Inter-Bank Transactions	**2,025**		**2,005**	
Balances with Domestic Banks		1,180	-	2,090
Deposits & Borrowings with Domestic Banks	3,204		4,095	
7. Foreign Sector		**3,466**	**6,372**	-
Borrowings	17		683	-
Deposits	3,609		3,786	-
Foreign Balances including Export Bills		7,092	1,904	-
8. Other Assets & Other Liabilities	**6,666**		**4,471**	
Capital & Reserves	6,427		5,182	-
Fixed & Other Assets	2,753			7,374
Other Liabilities		2,514	6,663	
Total Net Sources/ Uses	**15,765**		**13,478**	

Source : Central Bank of Sri Lanka

(a) Includes long-term deposits mobilised by the two state banks under the special savings schemes.

Note: The bold figures indicate whether each sector is a net source or a net user of resources.

TABLE 10.6
Commercial Bank Advances by Purpose and Maturity (a)
1994 – 1995

Category	Short Term		Medium Term		Long Term		Total	
	(1) Amount Rs. Mn.	(2) (1) as % of (7)	(3) Amount Rs. Mn.	(4) (3) as % of (7)	(5) Amount Rs. Mn.	(6) (5) as % of (7)	(7) Amount Rs. Mn.	(8) (7) as % of Grand Total
1. Trading								
September 1994	45,453	72.6	11,835	18.9	5,293	8.5	62,580	43.9
December 1994	49,336	76.4	11,648	18.0	3,566	5.5	64,550	43.6
September 1995	58,330	76.0	13,384	17.4	5,034	6.6	76,749	43.7
2. Financial								
September 1994	3,422	54.5	2,245	35.7	617	9.8	6,284	4.4
December 1994	3,623	55.6	2,266	34.8	629	9.6	6,518	4.4
September 1995	5,428	67.0	2,045	25.2	629	7.8	8,102	4.6
3. Agricultural								
September 1994	6,991	69.4	1,913	19.0	1,175	11.7	10,079	7.1
December 1994	6,974	66.3	2,862	27.2	681	6.5	10,517	7.1
September 1995	7,248	69.2	2,423	23.1	802	7.7	10,473	6.0
4. Industrial (b)								
September 1994	13,552	69.5	3,469	17.8	2,488	12.8	19,509	13.7
December 1994	13,321	68.3	3,561	18.3	2,618	13.4	19,501	13.2
September 1995	17,833	72.9	3,988	16.3	2,639	10.8	24,460	13.9
5. Tourism								
September 1994	998	50.2	467	23.5	524	26.4	1,989	1.4
December 1994	1,149	49.0	477	20.3	721	30.7	2,346	1.6
September 1995	1,441	50.6	557	19.5	853	29.9	2,851	1.6
6. Housing								
September 1994	3,622	18.6	4,429	22.8	11,383	58.6	19,435	13.6
December 1994	3,778	19.3	6,689	34.2	9,073	46.4	19,539	13.2
September 1995	4,323	21.2	6,138	30.1	9,899	48.6	20,359	11.6
7. Consumption								
September 1994	7,677	70.0	1,611	14.7	1,678	15.3	10,965	7.7
December 1994	6,701	61.1	1,808	16.5	2,451	22.4	10,961	7.4
September 1995	7,655	57.2	2,959	22.1	2,772	20.7	13,386	7.6
8. Other Loans								
September 1994	7,459	63.2	3,062	25.9	1,284	10.9	11,806	8.3
December 1994	8,284	59.0	4,466	31.8	1,282	9.1	14,033	9.5
September 1995	12,379	63.7	5,596	28.8	1,447	7.4	19,422	11.0
9. Total								
September 1994	89,174	62.5	29,030	20.4	24,442	17.1	142,647	100.0
December 1994	93,166	63.0	33,778	22.8	21,021	14.2	147,965	100.0
September 1995	114,637	65.2	37,090	21.1	24,074	13.7	175,800	100.0

Source: Central Bank of Sri Lanka

(a) Advances include loans,overdrafts and bills discounted and exclude cash items in process of collection.
(b) Includes advances granted to the Engineering and Building Trade, Mining and Fishing.

per cent rise in the previous year, and remained at 8 per cent of the total credit outstanding at the end of September 1995.

Banks increased the interest rates charged on loans and advances, following the trend observed in other interest rates in the market. The weighted average interest rate on all loans and advances rose from 19.7 per cent at end December 1994 to 20.5 per cent at end September 1995. As at end September 1995, 35 per cent of commercial bank loans and advances carried interest rates in the range of 21-25 per cent, a similar proportion to that which prevailed at end September 1994. Meanwhile, 22 per cent of loans and advances had interest rates in the range of 18-29 per cent. The share of loans and advances earning interest rates within a range of 26-29 per cent was 10 per cent in 1995 compared to 19 per cent in 1994.

TABLE 10.7
Advances by Type of Security (a)
December 1994- September 1995

Security	30 Sep. 1994		31 Dec. 1994		30 Sep. 1995	
	Amount Rs. Mn.	% of Total	Amount Rs. Mn.	% of Total	Amount Rs. Mn.	% of Total
1. Documentary Bills	7,831	5.5	6,426	4.3	5,706	3.2
2. Government Securities	6,426	4.5	7,520	5.1	6,237	3.5
3. Shares of Joint Stock Companies, Bonds, Debentures and Sundries including Cash Value of Life Policies	4,634	3.2	2,734	1.8	3,162	1.8
4. Fixed, Savings & Other Cash Deposits and CDs	43,364	9.4	16,220	11.0	15,541	8.8
5. Stocks in Trade	42,634	8.9	12,164	8.2	15,140	8.6
6. Immoveable Property, Plant & Machinery	35,017	24.5	38,586	26.1	43,180	24.6
7. Personal Guarantees and Pro Notes	23,405	16.4	22,275	15.1	24,680	14.0
8. Trust Receipts	5,485	3.8	7,510	5.1	10,197	5.8
9. Purchase Agreements	1,776	1.2	945	0.6	1,051	0.6
10. Tractors & Motor Vehicles	2,155	1.5	2,096	1.4	2,220	1.3
11. Other Securities	18,698	13.1	17,178	11.6	27,417	15.6
12. Unsecured	11,222	7.9	14,311	9.7	21,268	12.1
TOTAL	142,646	100.0	147,965	100.0	175,800	100.0

Source: Central Bank of Sri Lanka

(a) Excludes cash items in the process of collection and advances granted for financing purposes under the guaranteed price scheme.

10.5 Central Banking

In the context of tight monetary policy, the monetary base expanded at a slower rate of 15.5 per cent, to Rs. 78,587 million in 1995, compared to a growth rate of 20.5 per cent in 1994. There was no significant externally induced growth in reserve money unlike in the previous year. However, the sale of foreign exchange by commercial banks contributed to the expansion in the monetary base of Rs. 10,198 million. The increase in net credit to the government by the Central Bank (by Rs.7,662 million) was the major contributory factor for the growth of the monetary base in 1995.

Structure of Assets and Liabilities

The total assets/liabilities of the Central Bank expanded by 11.3 per cent (Rs.17,548 million) and stood at Rs.173,506 million at end 1995. The growth in total assets/liabilities in the previous year was 16.7 per cent (Rs.22,324 million).

On the assets side, the increase was the combined outcome of an increase in domestic assets of the Central Bank by 12.1 per cent (Rs.7,323 million) and international reserve by 10.7 per cent (Rs.10,225 million). The growth in domestic assets was mainly due to a large increase in Treasury bill holdings and loans and advances to Government.

Despite the overall deficit in the balance of payments, the international reserve of the Central Bank increased from Rs.95,671 million in 1994 to Rs.105,896 million in 1995 due to the sale of foreign exchange by commercial banks, foreign investment income accruing to the Central Bank and the revaluation effects related to exchange rate variations.

Deposit liabilities of the Central Bank increased by Rs.13,074 million, owing to an increase in deposits of commercial banks by Rs.7,021 million corresponding to the increased reserve requirement on the increased deposit base, while deposits of international organisations increased by Rs.5,089 million. Currency issues (notes and coins) of the Central Bank in 1995 increased by Rs.3,603 million compared with an increase of Rs.7,132 million in 1994, indirectly reflecting the impact of tight monetary policy.

10.6 Banking Development

Branch Expansion

The competitiveness and dynamism in the financial sector were further enhanced in 1995 by the commencement of operations of three new commercial banks, bringing the total number of comercial banks in operation to 26 by the end of the year. Two domestic private commercial banks, namely, Pan Asia Bank Ltd. and Union Bank of Colombo

TABLE 10.8
Distribution of Bank Branches 1993-1995

Category	1993	1994	1995*
1. No. of Institutions	40	40	43
Commercial Banks	23	23	26
Domestic Banks	6	6	8
Foreign Banks	17	17	18
RRDBs (a)	17	17	17
2. No. of Branches (b)	1,093	1,135	1,168
Commercial Bank Branches	845	876	901
Domestic Bank Branches (c)	812	840	864
ASC Branches	29	28	19
Foreign Bank Branches (d)	33	36	37
RRDB Branches	163	169	171
NSB Branches	85	90	96

* Provisional Source: Central Bank of Sri Lanka

(a) Regional Rural Development Banks established under the RRDB Act. No.15 of 1985.
(b) Includes Head Offices.
(c) Includes extension offices, Kachcheri branches, pay offices, ASC branches and overseas branches.
(d) Includes sub-branches.

Ltd., were opened during the year, thus raising the total number of domestic banks to eight. A well reputed Korean commercial bank, Korea Exchange Bank Ltd., also established a branch in Colombo bringing the number of foreign banks operating in Sri Lanka to 18.

The bank branch network also continued to increase during the year with a consequent expansion in banking services. An important development in bank branch expansion in 1995 was the opening of branches in India and Pakistan by Bank of Ceylon, facilitating Sri Lanka's transactions with these two countries. Domestic commercial banks opened 24 branches in 1995 (of which six were opened by the two state banks) as compared to 27 new branches operated in the preceding year. The total number of branches opened by foreign commercial banks increased to 37 with the opening of a branch by the Korea Exchange Bank Ltd. Therefore, the total number of commercial bank branches rose to 901 by end 1995, from 876 at end 1994. With the increase in the branch network of the National Savings Bank (NSB) by six and RRDB branches by two, the total number of bank branches rose to 1,168. Accordingly, banking density, as measured by the total number of bank branches for each 10,000 population, increased from 0.6349 in 1994 to 0.6403 in 1995.

The branch network of People's Bank increased to 325 by end 1995 with the opening of a new branch and the reopening of a branch that had been previously closed. Bank of Ceylon (BOC) opened two new domestic branches and two overseas branches, in Madras and Karachchi, while upgrading nine of its Agrarian Service Centre (ASC) branches to fully fledged bank branches, thus raising its total number of main branches from 262 at end 1994 to 273 at end 1995. Accordingly, the branch network of BOC consisted of 273 main branches, 19 ASC branches, 23 Kachcheri branches, 18 extension offices, three pay offices and four overseas branches.

Hatton National Bank Ltd. opened seven new branches, while Commercial Bank of Ceylon Ltd. established two new branches during the year. Seylan Bank Ltd. expanded its branch network by opening seven new branches. Meanwhile, Sampath Bank Ltd. opened three new branches.

The National Savings Bank (NSB) established six new branches, expanding its branch network to 96. Though the total number of RRDBs remained at 17 during the year, the Gampaha and Kandy RRDBs opened one branch each, bringing the total number of RRDB branches (including Head Office branches) operating in the country to 171 at end 1995.

Agency Banking

As in the previous year, the two state banks engaged in agency banking activities through the Praja Naya Niyamaka (PNN) Scheme. However, activities of the PNN Scheme were at a much slower pace than in the previous year. The total number of PNNs operating was 9,248 compared to 10,376 in 1994. No new PNNs were appointed during the year. However, Rs.3 million was granted under this Scheme during the year while total outstanding loans stood at Rs.389 million at end 1995. Meanwhile, the total outstanding loans granted by Sampath Bank Ltd. under its Sampath Seva Sanyojaka (SSS) Scheme was Rs. 9 million, with Rs.1 million being granted during the year. The total number of active Sampath Seva Sanyojakas was 10 at end 1995.

Banking Facilities

The highly competitive environment in the banking sector led commercial banks to expand their customer service facilities further during the year through a number of innovative products. Such facilities provided by the commercial banks during the year included new deposit and loan schemes, installation of additional Automated Teller Machines (ATMs) and electronic money transfer facilities.

The Direct Debit Transfer Scheme of the Sri Lanka Inter-Bank Payment System (SLIPS) was introduced in

February 1995. This scheme facilitates the transfer of funds from an account of a customer of one bank to an account of a customer of another bank through a direct debit order.

People's Bank launched a new deposit-cum-loan scheme, named 'Gurusetha', under which loans are granted to teachers. Bank of Ceylon launched a credit scheme called 'Ran Govi Upahara Programme' to provide credit facilities to farmers who have a satisfactory record in repaying agricultural loans. Hatton National Bank Ltd. (HNB) introduced a new deposit scheme especially designed for women, called 'Pragathi Kantha' current accounts. Women entrepreneurs who hold current accounts under this scheme were given facilities such as a free standing order service, free cheque books and concessions on the issue of drafts and traveller's cheques, in addition to guidance, support and assistance from the bank. HNB also introduced a new credit facility under which franchise holders of the Co-operative Wholesale Establishment (CWE) were granted credit facilities. Standard Chartered Bank Ltd. launched a new savings deposit scheme which included an entitlement to a lucky draw.

Free life insurance cover was provided by Pan Asia Bank Ltd. to its fixed deposit holders who have a minimum deposit of Rs.25,000 and by the HNB to its current account holders who have maintained a minimum balance of Rs.25,000.

HNB and Sampath Bank Ltd. became participatory credit institutions (PCIs) under the Fisheries Sector Community Development Credit Scheme (FSCDCS) funded by the Asian Development Bank (ADB) during the year. In addition, these two banks, together with Commercial Bank of Ceylon Ltd., became PCIs for the Pollution Control and Abatement Fund (PCAF) which was established to provide financial assistance at low cost to industrial enterprises for waste minimisation, resource recovery, pollution control and abatement. Bank of Ceylon and People's Bank were re-admitted as participatory lending institutions under the SMI-IV after satisfactory fulfilment of capital adequacy ratios and audit requirements. The entry of the two state banks accelerated the utilisation of fund available under the SMI-IV, exhausting almost all the funds at end 1995.

During 1995, 25 Automated Teller Machines (ATMs) were installed by seven banks, thus bringing the total number of ATMs to 135 at end year. Hatton National Bank Ltd. permitted withdrawals from NRFC accounts through ATMs.

10.7 Credit Information Bureau

During 1995 the Credit Information Bureau of Sri Lanka maintained its services to the shareholder lending institutions by the performance of its principal activities of collecting credit information, developing the data base on borrowers and supplying credit reports on borrowers.

The Bureau was able to improve the quality of its reports by progressively accelerating the updating of the database thereby ensuring the supply of a more accurate and up-to-date report. While the updating of the 'irregular' loan database was reduced to monthly intervals a major portion of the 'regular' loan database continued to be updated at quarterly intervals. The reporting floors remained at Rs.100,000 for 'irregular' loan accounts and Rs.500,000 for 'regular' loan accounts.

By end 1995 the database of the Bureau had a store of 65,931 loan accounts. The Bureau supplied 98,282 credit reports in 1995, as against 71,623 in 1994 and 58,657 in 1993. The credit reports supplied by the Bureau continued to carry a broad coverage of information including direct advances, indirect advances and other relevant ancillary information.

During 1995, the Credit Information Bureau Act was amended to permit merchant banks and other institutions engaged in leasing activities to have access to the information maintained by the Bureau.

10.8 Rural Banking and Rural Credit

Rural Credit Policy

There were no changes to rural credit policy in 1995. Bank lending to the agriculture sector under the New Comprehensive Rural Credit Scheme (NCRCS) was out of their own funds supported by an interest subsidy paid by the Government so as to maintain the lending rates to farmers at a relatively low level. The Central Bank's involvement in the area of rural credit remained unchanged, except for the provision of refinance. The Bank continued to provide a credit guarantee cover for loans granted under the NCRCS, co-ordinated and directed rural credit policy, effected the payment of the interest subsidy to lending banks and continued to monitor and supervise loan recovery and other rural credit schemes. The termination of the Central Bank's refinance scheme restricted the resource-poor Regional Rural Development Banks (RRDBs) in their lending to the agriculture sector; but commercial banks, especially the two state banks, stepped up their lending to this sector, off-setting the reduced operations of the RRDBs. The new policy demonstrated that lending banks were in a position to supply the funds needed by the rural sector out of their own resources, provided proper incentives were offered.

TABLE 10.9

Cultivation Loans Granted Under the New Comprehensive Rural Credit Scheme (Position as at 31 December 1995)

Rs. Million

Season	State Banks			Domestic Private Banks (a)			Regional Rural Dev. Banks			Total Loans (b)		
	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total Loans Under NCRCS
1991/92 Maha	365	94	459	18	5	23	100	49	149	484	148	632
1992 Yala	96	57	153	1	4	5	38	38	76	134	99	233
Cultivation Year 1992	461	151	612	19	10	29	138	87	225	618	247	865
1992/93 Maha	315	89	404	17	15	32	87	81	168	418	185	603
1993 Yala	140	76	216	2	6	8	43	51	94	185	132	317
Cultivation Year 1993	455	165	620	19	21	40	130	132	262	603	317	920
1993/94 Maha	308	85	393	23	22	45	122	73	195	453	180	633
1994 Yala (c)	136	64	200	8	35	43	62	38	100	207	136	343
Cultivation Year 1994	444	149	593	31	57	88	184	111	295	660	316	976
1994/95 Maha	516	182	698	18	18	36	37	22	59	571	222	793
1995 Yala	167	78	245	9	40	49	60	36	96	236	154	390
Cultivation Year 1995	683	260	943	27	58	85	97	58	155	807	376	1,183

Source: Central Bank of Sri Lanka

(a) Hatton National Bank, Commercial Bank and Seylan Bank only.
(b) The total for 1992 includes a small amount of credit granted by Multi Purpose Co-operative Societies.
(c) The Refinance Scheme was withdrawn in April 1994 and replaced by an Interest Subsidy Scheme.

The relief package announced by the Government in 1994 came into operation in 1995 and was continued during the year. The Central Bank, on behalf of the Government, co-ordinated the loan write-off scheme by issuing necessary instructions to lending banks. About 35,000 farmers took advantage of the relief scheme to have their past-due loans written off by lending banks by paying 25 per cent of the principal sum in default. The Scheme had an adverse impact on loan recovery; the recovery rates fell from a normal level of 75 - 85 per cent, to a much lower level of 45 - 50 per cent during the year under review.

The Central Bank continued to function as the executing agency for a number of foreign funded credit schemes in 1995, supporting the lending operations of participating credit institutions (PCIs) with refinance drawn under various lines of credit. Unlike the schemes funded by the Central Bank's own refinance, these foreign funded schemes were not considered to interfere unduly with the Bank's monetary policy stance. In the case of ADB funded loan schemes, the lending rate and the Central Bank's refinance rate were reduced by 2 percentage points to 14 per cent and 6 per cent per annum, respectively. This downward revision in the interest rates was required to eliminate the disparity created by the reduction of lending rates by the two state banks for agriculture, exports and industry in late 1994 in an effort to promote growth and employment in the economy.

New Comprehensive Rural Credit Scheme (NCRCS)

The total value of credit disbursed by banks out of their own funds under the NCRCS in 1995 amounted to Rs.1,180 million, reflecting an increase of 21 per cent over the previous year's disbursement. Further, the total number of loans granted under the NCRCS during the year increased from 58,836 in 1994 to 82,000 in 1995. This sharp improvement in the performance of the NCRCS during the year under reference was mainly due to many farmers becoming eligible, despite their previous loan defaults, to obtain fresh loans under the relief package announced by the Government in 1994. Of the total amount of credit disbursed under the NCRCS, Maha 1994/95 accounted for Rs.791 million, while Yala 1995 accounted for the balance. The major share of loans granted under the NCRCS was for cultivation of paddy, accounting for 70 per cent of the credit disbursed in 1995, while the balance 30 per cent was for the cultivation of subsidiary food crops.

The interest subsidy scheme for cultivation loans introduced by the Government in 1994 continued without change during 1995. Under this facility, an interest subsidy of 7.5 percentage points per annum on the amount of loans granted by banks for a maximum period of 270 days was made available to banks by the Government to enable them to lend to farmers at 16 per cent per annum. In practice, however, many farmers tend to repay their loans in a much shorter period than 270 days and the draw-down on the interest subsidy funds was less than originally anticipated. The total value of the interest subsidy paid to banks in 1995 on account of cultivation loans disbursed during Yala 1994 amounted to Rs.14 million. The Government agreed to extend the relief scheme announced in 1994 to defaulting farmers until Yala 1997. The extension of the relief scheme would help more farmers to have their defaulted loans written-off by banks on payment of 25 per cent of the principal. Further, this would make them eligible to obtain fresh loans as borrowers in good standing. The Government's relief package required the Central Bank to relax its credit guarantee rules, necessitating the waiver of the condition requiring institution of legal action by PCIs to qualify to receive the full amount of the credit guarantee. In terms of this waiver, the Bank underwrites 50 per cent of the principal amount in loss remaining after the payment of 25 per cent by farmers. The general credit guarantee rules will continue to apply to new loans granted under the NCRCS. Representing a further relaxation of general conditions governing the credit guarantee scheme, the Bank made an advance payment of 25 per cent of the estimated total liability on defaulted loans to help RRDBs adversely affected by the Relief Package. Total advance payments to RRDBs upto end 1995 amounted to Rs.60 million.

The normal indemnity paid by the Central Bank under the credit guarantee scheme in respect of non-recoverable NCRCS loans amounted to Rs.6 million in 1995, raising the total indemnity so paid to Rs.144 million as at end year. This compares with a total premium collection of Rs.28 million under the credit guarantee scheme for the NCRCS by the Bank upto the end of 1995.

Crop Insurance Schemes

Crop insurance was provided by the Agricultural Insurance Board (AIB) on an island-wide basis and Ceylinco Insurance Company Ltd. (CICL) in selected areas during 1995. In 1995, the total extent of paddy land insured by the AIB under its schemes stood at 71,000 hectares, while that by CICL amounted to 349 hectares. The AIB collected premia amounting to Rs.40 million as against indemnity payments of Rs.25 million. CICL, which collected premia amounting to Rs.0.25 million, made indemnity payments of Rs.0.12 million. A salient feature in crop insurance schemes has been the continuous increase in the area insured and the indemnity payments. The introduction of private crop insurance, though on a negligible scale, could be viewed as a salutary development, since the AIB is unable to cater to the entire crop insurance needs of the country in view of its limited resources. However, legal constraints stand in the way of private insurers penetrating the market on an appreciable scale, since the AIB Act provides a virtual monopoly on crop insurance to the AIB. In view of the need for privatising crop insurance business in Sri Lanka, it is necessary to consider amending the AIB Act to make crop insurance optional and to permit state sector banks to accept private crop insurance policies as collateral for loans.

TABLE 10.10

Deposits and Advances - Rural Sector (a)

Rs. Million

	Co-operative Rural Banks (CRBs)		Bank of Ceylon Sub-Offices at Agrarian Services Centres		Regional Rural Development Banks		Thrift and Credit Co-operative Societies	
	1994	1995(b)	1994	1995	1994	1995(c)	1994	1995
1. Total Savings (d)	6,359	7,173	366	471	1,481	615	1,736	1,996
Savings	5,552	n.a.	n.a.	n.a.	1,254	438	924	1,063
Special Savings	-	n.a.	n.a.	n.a.	-	55	683	786
Fixed Deposits	808	n.a.	n.a.	n.a.	228	122	128	147
2. Total Loans Granted (e)	536	805	258	246	1,118	364	1,270	1,524
Agriculture	80	106	108	103	379	92	114	137
Animal Husbandry	18	28	2	2	25	6	28	34
Fisheries	-	-	..	..	29	1	-	-
Small Industries	21	40	2	2	102	27	77	93
Housing, Electrification and Water Supply	261	385	13	12	-	31	112	134
Projects/Commerce	74	104	88	84	216	60	683	820
Others	82	141	45	43	367	147	256	307

(a) Excluding the position of the branches of People's Bank and Bank of Ceylon in rural areas.
(b) Position as at 30 September 1995.
(c) Incomplete data.
(d) Total value of savings as at 31 December.
(e) Total value of loans granted during the year.

Sources: People's Bank
Bank of Ceylon
Regional Rural Development Banks
Thrift and Credit Co-operative Societies

Credit Facilities to the Rural Sector

Credit to the rural sector in Sri Lanka during 1995 was channelled mainly through the Regional Rural Development Banks (RRDBs), Co-operative Rural Banks (CRBs), People's Bank outstation branches, Bank of Ceylon sub-offices at Agrarian Services Centres (ASCs) and Thrift & Credit Co-operative Societies (TCCSs). The total quantum of loans disbursed by Bank of Ceylon and TCCSs to the rural sector in 1995 amounted to Rs.246 million and Rs.1,525 million, respectively. This compares with Rs.258 million and Rs.1,270 million disbursed to the rural sector by the respective institutions during the previous year.

Mobilisation of Rural Savings

As the rural sector is important in the economy, mobilisation of rural savings will generate a significant flow of resources for investment. Hence, effective measures to mobilise rural savings should constitute an essential component in any strategy to develop a viable rural financial market. In Sri Lanka, the savings of the rural sector are primarily mobilised by the CRBs, RRDBs and TCCSs. The total savings mobilised from the rural sector, other than by RRDBs, stood at Rs.9.6 billion at end 1995 compared to Rs.8.5 billion at end 1994, indicating an increase of 11.4 per cent.

10.9 Other Financial Institutions

Savings Institutions

The National Savings Bank (NSB), the premier savings institution in the country, continued to expand its deposit base during 1995. The expansion was at a much slower pace than in 1994, due to a delayed response to rising interest rates elsewhere in the market. Total deposits rose by 8 per cent (Rs.4,430 million) to Rs.57,756 million, compared with an increase of 27 per cent (Rs.11,169 million) in the previous year. Of the total increase in the deposit base, the increase in fixed deposits accounted for 77 per cent (Rs.3,414 million), and the increase in savings deposits for 22 per cent (Rs.975 million). Meanwhile, deposits under the NSB pension scheme and premium savings bonds showed some increase during the year.

Interest rates on savings deposits, which were reduced by 2 per cent to 12 per cent at the beginning of the year, remained at this level throughout the year. Interest rates on 12-month fixed deposits, which had been reduced from 16 per cent to 14 per cent in December 1994 in line with falling market rates, remained at this level throughout much of the year, despite a rise in interest rates elsewhere, notably on Treasury bills. However, although delayed, a response was made to rising interest rates in the Treasury bill market, with the interest rate on one year fixed deposits being revised upward in September 1995 from 14 per cent to 15 per cent and further increased to 16 per cent in December 1995. The interest rate in respect of one year deposits on which interest was paid monthly was also increased from 13.2 per cent to 13.8 per cent in September and to 14.4 per cent in December 1995.

Total investments increased by 8.4 per cent (Rs.4,091 million) to Rs.52,535 million at the end of the year. Investments in rupee securities and debentures increased by 13.5 per cent (Rs.4,155 million) and 143 per cent (Rs.1,840 million), respectively, while investments in Treasury bills decreased by 12.5 per cent (Rs.1,679 million) in 1995.

Activities of the Employees' Trust Fund (ETF) expanded slightly during 1995. Total contributions received by the Fund during the year were Rs.1,500 million, compared to receipts amounting to Rs.1,457 million in 1994. The total outstanding value of members' balance increased by 24 per cent to Rs.12,315 million. The bulk of ETF resources was invested in government securities. Investments in government securities accounted for 66 per cent of total investments, compared to 62 per cent recorded in the previous year. Equity investments by the Fund increased by 17.8 per cent to Rs.1,384 million at end 1995.

According to provisional data, the total members' balance of the Employees' Provident Fund (EPF) increased by 8 per cent, to Rs. 82 billion, at end 1995. Total contributions received by the Fund also expanded from Rs. 7.4 billion in 1994 to 8.2 billion in 1995. With the investment of these contributions and the income from investments already made, net of the benefits paid to members (amounting to Rs. 2.7 billion), EPF investments rose by Rs. 19 billion, to Rs. 100 billion at end 1995. This makes the EPF by far the largest single investor in the domestic market.

Long Term Lending Institutions

The Development Finance Corporation of Sri Lanka Ltd. (DFCC) was able to expand its long-term lending activities further during 1995. The number of loans approved during the year increased substantially from 678 in 1994 to 1,248 in 1995. Of the total number of loans approved, 527 loans were for the industrial sector, 341 loans were for the agricultural sector and 268 loans were disbursed to the tourism sector. The total outstanding value of loans was Rs.9,184 million at the end of the year compared to Rs.7,223 million at the end of the previous year. The total value of loans disbursed by the DFCC amounted to Rs.3,687 million

TABLE 10.11
Loans Approved and Granted by Long-Term Credit Institutions by Purpose

Rs. Million

Purpose	DFCC		NDB(a)		NSB		SMIB		HDFC		NHDA		Total		% of Total Loans Approved	
	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995	1994	1995
Agriculture	308	433	324	651	-	-	12	25	-	-	-	-	644	1,109	4.4	5.7
Industry	2,718	3,560	2,510	3,437	-	-	-	-	-	-	-	-	5,228	6,997	35.9	36.2
Tourism	694	1,056	505	1,117	-	-	-	-	-	-	-	-	1,199	2,173	8.2	11.3
Commercial	-	-	1,312	-	-	-	-	-	-	-	-	-	1,312	0	9.0	0.0
Financial	181	434	70	70	470	1,600	-	-	-	-	-	-	721	2,104	5.0	10.9
Housing	-	-	-	91	236	239	670	819	291	555	547	875	1,744	2,579	12.0	13.4
Redemption of Debt	-	-	-	-	-	-	11	11	-	-	-	-	11	11	0.1	0.1
Other Loans	657	415	979	1,153	2,028	2,748	31	20	-	-	-	-	3,695	4,336	25.4	22.5
Total (approved)	4,558	5,898	5,700	6,519	2,734	4,587	724	875	291	555	547	875	14,554	19,309	100	100
Loans granted (b)	2,748	3,687	5,418	4,011	2,734	4,587	635	738	255	469	454	373	12,244	9,854		
Loans granted as a percentage of total loans approved	60	63	95	62	100	100	88	84	88	85	83	43	84	51		

(a) Including refinance loans and equity investments
(b) Includes loans approved in previous years and disbursed during the period under review.

Sources: Development Finance Corporation of Ceylon (DFCC)
National Savings Bank (NSB)
State Mortgage and Investment Bank (SMIB)
Housing Development Finance Corporation (HDFC)
National Development Bank (NDB)
National Housing Development Authority (NHDA)

as compared to Rs.2,748 million in the previous year. The bulk of loans (57 per cent) disbursed during the period was for industrial purposes, while Rs.724 million (20 per cent) was granted to the tourism sector for construction of tourist hotels. The agricultural sector (Rs.269 million) and the financial sector (Rs.351 million) were other major recipients of credit during the year. The DFCC provided Rs.361 million by way of equity finance to 20 companies. Equity finance facilities amounting to Rs.142 million and Rs.111 million were provided to nine companies in the financial sector and eight companies in the manufacturing sector. The main sources of funds of the DFCC during the year were repayment of loans by customers, issue of debentures and borrowings from the International Development Association (IDA) and the Asian Development Bank (ADB). A sum of Rs.2,471 million was raised through the issue of debentures, while Rs.2,481 million and Rs.1,147 million were obtained by way of recoveries of loans and borrowings from IDA and ADB, respectively.

The National Development Bank (NDB) also expanded its activities in 1995. Total loans approved by the NDB increased by 14 per cent to Rs.6,519 million at end 1995. Of the total loan approvals, 53 per cent (Rs.3,437 million) was for the industrial sector, with the total number of loan approvals for this sector being 258. Meanwhile, Rs.1,117 million and Rs.1,153 million were approved for the tourism sector and property development, respectively. The NDB also provided equity finance facilities totalling Rs.477 million to 10 companies in the industrial, tourism and financial sectors. Of the total equity financing, Rs.249 million was provided to three companies in the tourism sector, while Rs.198 million financed six companies in the industrial sector. The main sources of funds were recovery of loans (Rs.3,414 million), loans under ADB and IDA credit lines (Rs.1,815 million) and borrowings abroad (Rs.222 million).

As in the past, the State Mortgage and Investment Bank (SMIB) engaged in long-term lending activities primarily for housing purposes. The total number of loans approved during the year was 4,862, with a value of Rs.875 million. The bulk of the loans given by the Bank was for housing purposes. According to provisional figures, the number of housing loans approved during the year was 4,567, with a value of Rs.818 million, compared to Rs.887 million in the previous year. Of the total value of housing loans approved in 1995, Rs.294 million was in respect of low income housing projects under the ADB and the USAID programmes. During the period, the SMIB approved loans for agricultural purposes, including purchase of agricultural land, machinery and tractors, to the value of Rs.25 million. Meanwhile, Rs.738 million was disbursed during the year. The total value of housing loans disbursed during 1995 was Rs.687 million.

TABLE 10.12

Sources and Uses of Resources of Licensed Finance Companies

Rs. Million

Item	As at 31 December 1994	As at 31 March 1995	As at 30 June 1995	As at 30 September 1995*	As at 31 December 1995*
Sources					
1. Capital Account	2,184	2,160	2,051	2,234	2,326
2. Deposits	6,788	7,129	7,341	7,832	8,227
3. Borrowings	1,335	1,470	1,718	1,744	1,812
4. Other Liabilities	1,566	1,848	2,031	2,633	2,720
Total	11,874	12,607	13,140	14,443	15,085
Uses					
1. Hire Purchase Business	2,219	2,235	2,187	2,508	2,639
2. Loans Outstanding	4,273	5,020	5,468	6,615	7,025
3. Investments	1,865	1,865	1,903	1,040	988
4. Other Assets	3,517	3,487	3,582	4,280	4,433
Total	11,874	12,607	13,140	14,443	15,085
Number of Finance Companies reporting to the Central Bank	24	24	24	24	24

* Provisional

Source: Central Bank of Sri Lanka

Note: Only finance companies registered with the Central Bank are allowed to undertake finance business. Other existing finance companies have been directed to initiate winding-up operations.

The main sources of funds of the SMIB in 1995 were fixed deposits (Rs.1,067 million), recovery of loans (Rs.980 million), issue of debentures (Rs.500 million) and ADB and USAID loans (Rs.76 million).

Both the National Housing Development Authority (NHDA) and Housing Development Finance Corporation of Sri Lanka Ltd. (HDFC) concentrated their lending activities on credit for housing purposes. The NHDA approved 26,851 loans to the value of Rs.875 million in 1995, of which Rs.373 million was disbursed during the year. This compared with approvals of loans to the value of Rs.547 million and disbursements of Rs.454 million in the previous year. The HDFC approved Rs.555 million in 1995, while Rs. 469 million was disbursed during the period under review as against total loan approvals of Rs.291 million and total disbursements of Rs.255 million in 1994.

Finance Companies

The total number of finance companies licensed with the Central Bank continued to remain at 24 during 1995. Total resources (assets/liabilities) of the finance companies amounted to Rs.15,085 million at end 1995, recording an increase of Rs.3,211 million (27 per cent). Investor confidence in finance companies appeared to be restored to a great extent. The growth in 1995 followed the growth in operations in 1994, when total assets/liabilities grew by 32 per cent. The current decline in the share market and attractive interest rates offered by finance companies are important factors that have contributed to this growth.

Reflecting a similar trend as in 1994, total loans outstanding showed a significant increase of Rs.2,752 million (64 per cent). In 1995, hire purchase financing expanded by Rs.420 million as against an increase of Rs.78 million in the previous year. Meanwhile, investments, which include investments in government securities, investments in subsidiaries, associate companies and parent companies, and other investments, decreased by Rs.877 million.

On the liabilities side, capital and reserves of finance companies rose by Rs.142 million (7 per cent). Deposits with finance companies increased by Rs.1,439 million (21 per cent) to Rs.8,227 million at end 1995. Borrowings, which include loans from commercial banks, shareholders and directors and other borrowings increased by Rs.477 million (36 per cent).

Relief payments to failed finance companies continued to be made under the MLCF. A net sum of Rs.169 million was provided during 1995, a reduction from the Rs.259 million granted in 1994. Accordingly, the outstanding refinance facilities provided by the Central Bank rose from Rs.2,304 million to Rs.2,473 million by end 1995.

10.10 Specialised Financial Institutions

Merchant Banking

The total income of merchant banks increased by 39 per cent (Rs.474 million) to Rs.1,689 million in 1995. The improved income of the industry was attributed mainly to improvement in income from leasing (Rs.157 million) and discounting trade bills (Rs.40 million). Total assets increased by 62 per cent to Rs.12,481 million at the end of the year.

TABLE 10.13
Progress of Activities of Merchant Banks 1994-1995

Rs. Million

	1994	1995*
1. Earned Income on Leasing	293	450
2. Interest on Discounting Trade Bills	281	321
3. Financial and Marketing Consultancy Services	9	37
4. Underwriting Commissions	18	23
5. Insurance Commissions	2	2
6. Interest on Margin Trading	71	116
7. Profit on Investment in Shares	144	60
8. Interest on Treasury Bills	31	94
9. Other Income	366	586
10. Total Income	1,215	1,689

* Provisional Source: Central Bank of Sri Lanka

Leasing Companies

As in 1994, there were three companies, namely, Lanka Orix Leasing Co. Ltd., Commercial Leasing Co. Ltd. and Mercantile Leasing Co. Ltd., which engaged primarily in leasing activities in 1995. The total assets of these companies rose from Rs.2,956 million at end 1994 to Rs.3,631 million at end 1995. Total lease finance provided by the companies grew by Rs.295 million to Rs.2,213 million at end 1995.

In terms of lease finance by type of equipment, 57 per cent of total lease finance was for commercial vehicles. Meanwhile, on a sectoral basis, the trading sector received 47 per cent of lease finance, while the industrial sector received 18 per cent.

Venture Capital Companies

Activities of the venture capital companies continued to expand during the year. According to provisional data, the total resource base of venture capital companies increased from Rs.990 million in 1994 to Rs.1,446 million in 1995. Investments made by venture capital companies in the equity of projects rose from Rs.435 million in 1994 to Rs.589 million in 1995. Of the total investment, 63 per cent were allocated for the commencement of new operations, while 31 per cent were for the expansion of existing projects. The bulk of the investment (62 per cent or Rs.365 million) was in the manufacturing sector, while 30 per cent and 8 per cent of total investments were in the services sector and agricultural sector, respectively.

Insurance Companies

As in 1994, six insurance companies conducted operations in 1995. Of these, five undertook both life and general insurance, while one confined its activities to life insurance. As a result of increased marketing activity by these firms and growing awareness of the advantages of obtaining insurance cover, the insurance industry has tended to grow in recent years. This trend continued in 1995, with expansions in life insurance activity, as well as in general insurance activity, which includes fire, accident, marine and motor insurance.

The total life premia collected grew by 38 per cent to Rs. 2,816 million in 1995. The total value of life funds of the insurance companies rose from Rs. 6,749 million at end 1994 to Rs. 8,598 million at end 1995, while the total number of life policies in force rose from 558,000 to 723,000

Net premia on account of general insurance rose by 26 per cent to Rs. 2,834 million in 1995. Net premia in the motor insurance sector, which was the biggest sector in the general insurance category, increased from Rs. 1,195 million in 1994 to Rs. 1,460 million in 1995. Net premia of fire insurance, accident insurance and marine insurance also rose by 12 per cent, (Rs. 29 million), 28 per cent, (Rs. 175 million) and 67 per cent (Rs. 124 million), respectively.

10.11 Money Market

Overall Trends

With continuing development in the financial sector, money market activity expanded in 1995. Macro economic developments, such as the widening fiscal deficit and reduced inflows from abroad, which led to a general reduction in liquidity in the latter half of the year, had their repercussions on the money market. The yield rates determined at the weekly Treasury bill auctions served as benchmark rates in the determination of other interest rates. Increased liquidity in the market in the early part of the year, supported by the retiring of maturing Treasury bills in January, caused yield rates of Treasury bills to fall in the first quarter. Increased borrowing by the Government and reduced foreign inflows however, led to a shortage in liquidity in the market and a consequent rise in interest rates thereafter. The liquidity shortage, especially in the short-term market, was most acute in the last quarter and pushed up call market rates to unprecedentedly high levels. The Central Bank introduced a new facility, the Reverse Repurchase Facility, in November, to inject liquidity into the market and hence to dampen the rise in interest rates.

TABLE 10.14
Money Market Operations 1993-1995

Rs. Million

Period	Call Money Market			Primary Treasury Bill Market					Secondary Treasury Bill Market		
	Total Lending/ Borrowings	Outstanding at end period (a)	Total Outstanding	Amount Issued	Amount Accepted (Purchases) Central Bank	Commercial Banks	Others	Total	Total Sales	Total Purchases	Outstanding at end period
1993											
1st Quarter	78,122	1,059	88,096	35,632	11,120	13,749	10,763	35,632	27,670	16,565	3,285
2nd Quarter	100,584	1,571	92,496	50,736	16,611	20,467	13,658	50,736	27,026	13,000	3,962
3rd Quarter	98,377	1,004	94,496	42,029	14,076	12,897	15,056	42,029	27,377	8,150	5,742
4th Quarter	97,907	1,192	97,196	30,459	6,394	17,622	6,443	30,459	12,690	9,136	2,777
1994											
1st Quarter	126,036	1,125	97,996	29,302	3,601	13,550	12,151	29,302	6,948	2,506	1,560
2nd Quarter	88,612	2,144	98,096	36,152	4,147	22,885	9,119	36,152	5,546	5,192	2,688
3rd Quarter	114,341	1,811	95,396	45,660	4,475	29,702	11,483	45,660	5,485	2,070	2,939
4th Quarter	139,475	1,242	98,896	57,255	7,881	35,812	13,562	57,255	3,208	9,097	1,415
1995											
1st Quarter	121,859	3,308	98,546	57,166	1,028	36,946	19,192	57,166	5,867	2,977	3,683
2nd Quarter	145,655	2,301	100,396	56,577	4,770	35,085	16,723	56,577	3,534	6,542	2,822
3rd Quarter	166,686	2,942	107,671	55,445	5,882	33,507	16,057	55,445	2,696	12,358	1,914
4th Quarter	219,416	8,078	113,771	54,823	8,237	31,425	15,161	54,823	4,947	13,451	1,728

Source: Central Bank of Sri Lanka

(a) The outstanding amount at the end of the last week for each quarter.

Inter-Bank Call Money Market

Call market transaction volumes were high, following the trend seen in the past two years. The annual turnover increased by 40 per cent (to Rs.654 billion), with some commercial banks and non-bank financial institutions resorting to the call market to obtain funds for their short to medium-term operations. Following an initial decline in rates from a range of 20.00 - 23.00 per cent at end 1994 to a range of 15.00 - 16.00 per cent at end May 1995, rates began moving in an upward direction and rose to a range of 40.00 - 65.00 per cent by mid-July. Although rates declined somewhat thereafter, they began rising steeply once again in the last quarter. By early December, rates had risen to unprecedented heights, with a peak of 102 per cent on 7 December. Large injections of liquidity caused the rates to fall thereafter, though the level at the end of the year was still high, in the range 20.00 - 58.00 per cent.

Treasury Bill Market

Primary Treasury Bill Market

The year commenced with increased liquidity and a consequent demand for Treasury bills, with an associated reduction in yield rates. A retirement of Rs.1,600 million worth of maturing Treasury bills, an increase in provisional advances from the Central Bank to the Government and the transfer of Central Bank profits to the Government added to the liquidity. Despite new issues of Treasury bills and continued open market operations by the Central Bank to mop up excess liquidity, primary auctions were oversubscribed and yield rates fell in the first quarter of 1995. At the last primary auction in March, 3-month bills had an average weighted yield of 14.03 per cent, in comparison to a yield of 18.73 per cent at the last auction in 1994. Correspondingly, the 12-month yield rate fell from 19.43 per cent to 14.61 per cent. Thereafter however, with reduced liquidity and increased recourse to credit by the Government, yield rates rose. In addition, the last two auctions were significantly undersubscribed by the public. The yield rates at the last auction were 19.26 per cent on 3-month bills and 18.97 per cent on 12-month bills. From the middle of November however, auction bids resulted in an inverted yield curve with 3-month rates exceeding 12-month rates, indicating a market perception that interest rates would decline in the future. For the year as a whole, Rs. 16,475 million worth of new Treasury bills were issued, while Rs.1,600 million worth of bills were retired. Of these new issues, Rs.4,350 million were special issues, taken up directly by the Central Bank.

Central Bank Secondary Treasury Bill Market

The Central Bank continued to use the secondary Treasury bill market for its open market operations, both to absorb excess liquidity in the early part of the year and to inject liquidity in the latter part. Central Bank sales (discounting) in the secondary market amounted to Rs.17 billion in 1995, in comparison to sales worth Rs.21.2 billion in 1994, while purchases (rediscounting) in 1995 amounted to Rs.35.3 billion in comparison to purchases of Rs.18.9 billion in 1994. On a net basis therefore, the Central Bank injected liquidity amounting to Rs.18.3 billion through its secondary market operations. The Central Bank's discounting and rediscounting rates continued to be linked to the yield on Treasury bills in the primary market. The spread between these rates, which stood at 4.5 percentage points at the beginning of 1995, was reduced to 4.25 percentage points in February, increased to the initial level at the end of March and further increased to 4.75 percentage points in April, in order to contain the growth of monetary aggregates. In view of the reduced liquidity in the market, the spread was reduced again to 4.5 percentage points in August. From November onwards the spread was further reduced in steps to enable banks to obtain liquidity at reasonable rates and stood at 1.46 percentage points at end 1995.

Central Bank Repurchase Market for Treasury Bills

The Central Bank further used its sales of Treasury bills with repurchase agreements (repos) in 1995 to stabilise the call market. Through this mechanism, the Bank was able to prevent call market rates from falling to very low levels, as long as it had a portfolio of Treasury bills. However, its efforts in this regard were sometimes hampered in the early part of the year by a depletion of its holdings of Treasury bills.

Repo sales by the Central Bank in 1995 amounted to Rs.198 billion, in comparison to sales of Rs.230.9 billion in 1994. Repurchase agreements could have a duration ranging from one day (overnight) to 91 days. However, in practice, repos are usually for less than a week, with the bulk being overnight repos. The overnight repo rate is determined daily by the Central Bank, based on market developments. At the end of 1994, the repo rate was 20.00 per cent. This was gradually reduced to 12 per cent by mid-March, to be in line with market liquidity and other interest rates. Thereafter, it was increased, with some fluctuations, in keeping with other interest rates and stood at 16.50 per cent at end 1995.

Central Bank Reverse Repurchase Market for Treasury Bills

The introduction of the repo facility by the Central Bank helped to stabilise the lower end of the call market. However, no similar mechanism existed to stabilise the upper end of the market, and hence call market rates rose to very high levels in 1995. In order to create some stability at the upper end of the interest rate range, the Central Bank introduced a reverse repurchase facility in November 1995,

Chart 10.3
Share Market Indicators

Chart 10.3.1
Share Price Indices
(1985 = 100)

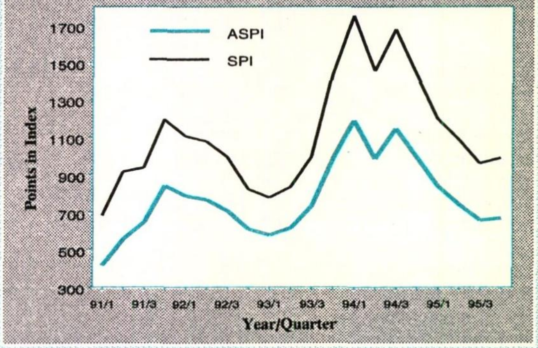


Chart 10.3.2
Stock Market Transactions

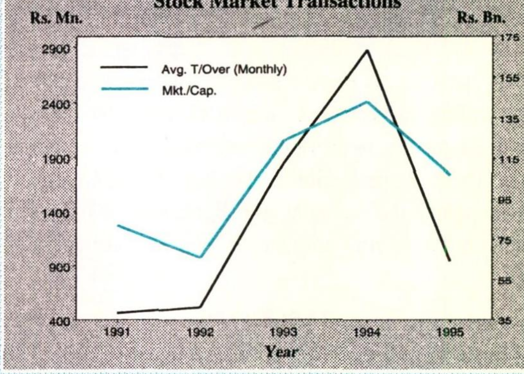
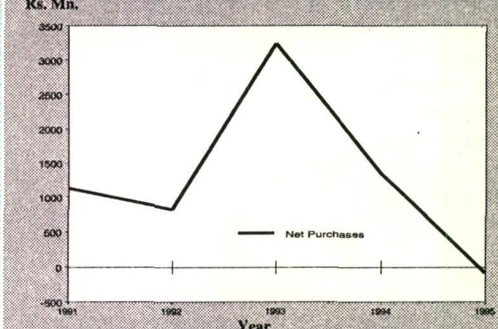


Chart 10.3.3
Non-National Participation



which would enable commercial banks which were approved primary dealers in Treasury bills to obtain temporary liquidity. The facility was limited to overnight agreements.

TABLE 10.15
Share Market Indicators 1992-1995

	1992	1993	1994	1995
1. Market Capitalisation (Rs.Mn.)	66,200	123,790	143,210	106,869
2. Number of New Issues (No.)	15	12	21	14
3. Total Number of Shares Issued (Mn.)	78	42	190	69
4. Value of Shares Issued (Rs.Mn.)	1,267	1,051	4,589	1,814
5. Number of Shares Traded (Mn.)	88	351	506	320
6. Value of Shares Traded (Rs.Mn.)	4,969	18,579	34,522	11,249
7. Price Indices -				
CSE All Share (as at end Dec.)	605.31	978.97	986.73	663.70
CSE Sensitive (as at end Dec.)	826.57	1,442.44	1,438.82	990.50

Source : Colombo Stock Exchange

Initially, the Central Bank announced the quantum of funds it was willing to provide to the market and let the rate be determined on the basis of bids received. Subsequently, in order to increase the flexibility available to the Central Bank in its monetary management, the Bank invited bids without announcing the overall amount offered. The average amount of liquidity offered per day from 10 November to 11 December 1995 was Rs.495 million, with the maximum being Rs.1,450 million. Bids received were in the range 18.00 - 50.00 per cent, while the weighted average ranged from 22.50 per cent to 50.00 per cent. Although the repo facility did reduce the call market rates to some extent, it was not entirely successful in limiting the upper end of the interest range, as indicated earlier. After 11 December, with an increase of liquidity in the market, the Bank intervened in the market through the reverse repo facility only twice.

TABLE 10.16
Number of New Share Issues during 1992-1995 by Type of Investment

Type of Investments	1992	1993	1994	1995
Banks, Finance & Insurance	1	3	6	2
Beverages, Food & Tobacco	2	-	4	-
Chemicals & Pharmaceuticals	-	-	-	-
Diversified	-	-	-	-
Footwear & Textiles	1	-	1	-
Hotels & Travel	4	4	1	1
Investment Trusts	-	-	-	-
Land & Property	-	-	2	-
Manufacturing	-	2	6	5
Motors	3	1	-	-
Oil Palm	-	-	-	-
Plantations	-	-	-	6
Services	1	-	-	-
Stores & Supplies	-	-	-	-
Trading	3	2	1	-
Total	15	12	21	14
Number of Shares Offered (Mn.)	78	42	190	69
Value of Shares Offered (Rs.Mn.)	1,267	1,050	4,589	1,814

Source: Colombo Stock Exchange

Internal Foreign Exchange Market

The US dollar was maintained as the intervention currency by the the Central Bank and the Bank continued to announce daily spot buying and selling rates for the dollar. In the first part of the year, a spread of 1 per cent was maintained between the buying and selling rates. In pursuance of the policies to make the exchange rate more market determined, this spread was increased to 2 per cent with effect from 20 March 1995, in order to provide a greater flexibility to commercial banks in determining their rates for transactions. As a consequence of the reduced inflow of foreign funds into the country, purchases of dollars by the Central Bank fell from US dollars 652 million in 1994 to US dollars 202 million in 1995. There were no sales of US dollars from the Central Bank to commercial banks in 1995. In 1994, such sales had amounted to US dollars 72 million.

Off Shore Market

The assets/liabilities of Foreign Currency Banking Units (FCBUs) rose by 13 per cent in 1995 following the 15 per cent increase in 1994. Total assets/liabilities rose from US dollars 1,304 million at end 1994 to US dollars 1,476 million at end 1995. On the liabilities side, the lower rate of growth was primarily due to the slower growth in the deposits of non-residents, which rose only by 3 per cent (from US dollars 665 million to US dollars 682 million), in contrast to an increase of 11 per cent in 1994. The factors which affected foreign investment in the share market also had a similar impact on the placement of foreign deposits with FCBUs.

Deposits of residents increased by 23 per cent to US dollars 659 million at end 1995 from US dollars 537 million at end 1994, in comparison to a 23 per cent increase in 1994. On the assets side, loans and advances to non-residents increased by only 6 per cent, rising from US dollars 540 million to US dollars 574 million, in comparison to an increase of 18 per cent in 1994. Loans and advances to the resident category however increased by 15 per cent, from US dollars 725 million to US dollars 835 million (the increase

TABLE 10.17
New Share Issues of Companies during 1995

	Name of Company	No. of Shares on Offer (Thousands)	Par Value (Rs.)	Premium (Rs.)	Value of Shares (Rs. Mn.)	No. of Shares Applied for by Public (Thousands)	No. of Shares Taken up by Underwriters (Thousands)
1.	Elastometric Engineering	2,500	10	40	125	3,231	-
2.	ACL Plastics Ltd.	1,400	10	30	56	830	570
3.	Metal Recyclers Colombo Ltd.	3,033	10	35	137	400	2,633
4.	Print Care (Ceylon) Ltd.	4,000	10	35	180	205	3,795
5.	Metalix Engineering Co. Ltd.	1,000	10	45	55	29	971
6.	Lanka Venture Ltd.	14,488	10	10	290	6,745	7,743
7.	Connaisance De Ceylan Ltd.	8,300	10	30	332	34	8,266
8.	Capital Development & Investments Co. Ltd.	10,000	10	30	400	280	9,720
9.	Bogawantalawa Plantations Ltd.	4,000	10	-	40	446	3,554
10.	Kotagala Plantations Ltd.	4,000	10	-	40	206	3,794
11.	Agalawatta Plantations Ltd.	4,000	10	-	40	37	3,963
12.	Kegalle Plantations Ltd.	4,000	10	-	40	767	3,233
13.	Horana Plantations Ltd.	4,000	10	-	40	68	N.A
14.	Kelani Valley Plantations Ltd.	4,000	10	-	40	796	3,204

Source: Colombo Stock Exchange

Notes:
1. New share issues are recorded on the basis of the date of opening of public issue for public subscription.
2. In 1995, 51 per cent of the share capital of three plantation companies, viz., Watawala Plantation Co. Ltd., Maskeliya Plantation Co. Ltd. and Madulsima Plantation Co. Ltd. were offered for sale by the Government on an 'All or Nothing' basis. The value of these three offers amounted to Rs.306 million (30.6 million shares).
3. N.A. - Not Available.

in 1994 being 15 per cent). Clearly, the higher interest rates applicable on loans to residents was encouraging a shift in investments. Loans to BOI enterprises increased by 23 per cent to US dollars 565 million from US dollars 459 million, while loans to other approved residents decreased by 17 per cent, from US dollars 186 million to US dollars 154 million.

Bank of Ceylon made an issue of US dollars 12 million worth of Floating Rate Notes (FRNs) in international capital markets, which was fully subscribed. The funds thus received were to be used to reduce the mismatch in the maturity in their FCBU portfolio.

10.12 Capital Market

Activities in the Colombo stock market in 1995 were characterised by general sluggishness and a bearish sentiment. Investors, both domestic and foreign, tended to avoid making major investments. The market decline, which began in late 1994, was further aggravated in early 1995 by labour unrest and by the breakdown in the peace talks. Share prices continued to fall, although a brief rally was seen around June and July. The All Share Price Index declined by 33 per cent during the year, while the Sensitive Price Index declined by 31 per cent. Foreign participation, usually the cause of a boom in the stock market, was low. Non-nationals were net sellers in the market during the first five months of the year, though significantly, they become net purchasers thereafter, indicating a resurgence in foreign investor confidence in the Colombo stock market. In December however, a reversal occurred once again, and for the year as a whole, non-nationals were net sellers. Primary issues in the market were not very successful, with only one of the 14 new public issues opened in 1995 being fully subscribed by the public. The Government indicated its continued commitment to the privatisation process by placing the shares of six plantation companies for sale in the market.

Primary Market

In 1995, the number of new primary issues opened for subscription remained high, partly due to seven issues being offered under the privatisation programme. However, the number of rights issues fell sharply and the total funds raised in the capital market declined from Rs. 11,331 million in 1994 to Rs. 4,038 million in 1995. Fourteen primary issues were opened to the public for subscription in 1995, all these being initial public offerings (IPO). Six of these were plantation companies being offered for sale by the Government as a part of its ongoing privatisation programme. In comparison, 21 new issues were opened for subscription in 1994. In addition, the Government also offered for sale, on an 'all or nothing' basis, blocks of 51 per cent of the shares in three other plantation management companies. These were taken up by the present managing companies. Of the 14 new primary issues, 13 were undersubscribed. Underwriters to these issues had to take up over 80 per cent

TABLE 10.18
Distribution of Shares Traded In the Secondary Share Market In 1995 - by Category

Category of Investment	No of Transactions	No. of Shares (Thousands)	Value (Rs. Mn.)
Banks, Finance & Insurance	78,235	136,520	5,305.1
Beverages, Food & Tobacco	16,906	48,811	568.2
Construction & Engineering	3,155	6,448	110.6
Chemicals & Pharmaceuticals	1,828	3,236	229.7
Diversified	-	-	-
Footwear & Textiles	8,958	13,106	225.1
Hotels & Travels	10,657	23,019	448.8
Investment Trusts	3,348	4,861	772.8
Land & Property	12,177	14,826	186.3
Manufacturing	41,534	50,689	1,793.0
Motors	2,553	3,966	179.1
Oil Palms	34	45	14.7
Plantations	1	-	-
Services	1,814	4,676	683.2
Stores & Supplies	171	176	19.4
Trading	4,904	5,545	681.7

Source : Colombo Stock Exchange

Note: *Excludes transactions which involve less than 100 shares.*

of the total shares offered, at an approximate cost of Rs.1,457 million. Public investment in the plantation companies was low with only an average of 10 per cent of the offers being subscribed. The total value of the market offer of the 14 companies (inclusive of share premium) was Rs.1,814 million. In comparison, 1994 saw a total market offer of Rs.4,587 million.

A significant decline was also experienced in the funds obtained by companies through rights issues. In comparison to Rs.7,800 million raised through 29 rights issues in 1994, only Rs.1,166 million was raised through 15 rights issues in 1995.

Secondary Market

Continuing the trend which began in 1994, share price indices fell in the current year too, reflecting the impact of a market correction, high interest rates and weakened non-national participation. From December 1994 to end May 1995, the All Share Price Index (ASPI) fell from 986.7 to 693.8 (a 30 per cent reduction), while the Sensitive Price Index (SPI) fell from 1438.8 to 988.4 (a 31 per cent reduction). Share prices increased briefly in June and July, but declined once more thereafter. By end December 1995, the All Share Price Index had dropped to 663.7 (a fall of 33 per cent for the year), while the Sensitive Price Index dropped to 990.5 (a fall of 31 per cent for the year). With the fall in share prices, market capitalisation also declined from Rs.143.2 billion at the end of 1994 to Rs.106.9 billion at end 1995.

The level of activity in the market was very low. Daily turnover declined from an average of Rs.148 million in 1994 to Rs.47 million in 1995 (a decline of 68 per cent) while the total number of shares transacted fell from 506 million to 320 million (a fall of 37 per cent). The fall in investment activities of domestic investors was more pronounced than of non-national investors. Domestic investors, who accounted for 60 per cent of the turnover in 1994, reduced their activities by 78 per cent and accounted only for 41 per cent of the turnover in 1995. Non-national turnover fell by 52 per cent. Purchases by non-nationals declined from Rs.14,473 million in 1994 to Rs.5,389 million in 1995, while sales fell from Rs.13,139 million to Rs.5,479 million in 1995. For the year as a whole, non-nationals were net sellers to the extent of Rs.90 million, in contrast to the last three years when they were large net buyers. The lack of foreign interest in the Colombo stock market was attributed mainly to the labour unrest in the latter part of 1994 and early part of 1995 and the breakdown of the peace negotiations. In addition, high interest rates in the United States and the cautious attitude of many Western investors to investment in emerging markets following the Mexican crisis in 1994 led to investments being focussed on markets in the established financial centres.

Unit Trusts

As in 1994, four Unit Trusts (UTs) operated in 1995. Reflecting the decline in the share market, the combined net asset value (NAV) of these four UTs declined from Rs.3,947 million at end 1994 to Rs.2,889 million in 1995, a decline of 26.8 per cent. In contrast, the NAV of the UTs increased by 10.7 per cent in 1994. The average investment in equities by the UTs declined from 64 per cent of their total net asset value in 1994, to 61.4 per cent in 1995. This overall shift in the structure of their portfolios in part enabled the UTs as a group to limit the decline in their NAV to 26.8 per cent, in comparison to a fall of 32.7 per cent in the All Share Price Index of the Colombo Stock Exchange in 1995.

10.13 Financial Sector Reforms

Important legislative amendments were introduced in 1995 as a part of the ongoing process of developing the financial market. The Credit Information Bureau (CIB) Act, the Banking Act, the National Savings Bank (NSB) Act, the Monetary Law Act (MLA), the Registered Stocks and Securities Ordinance (RSSO) and the Local Treasury Bills Ordinance (LTBO) were all amended.

The CIB Act was amended to permit merchant banks and other institutions engaged in leasing activities to have access to the Credit Information Bureau. Amendments to the NSB Act were designed to restructure the capital base of the NSB and permit its operations to be more market-oriented. With a view to improving the regulatory framework and thus the stability of the financial system, the Banking Act was amended to bring the NSB, the DFCC, the NDB and the SMIB under the regular supervision of the Central Bank and to permit closer Central Bank supervision of prudential guidelines for Foreign Currency Banking Units (FCBUS) of commercial banks operating in Sri Lanka.

Amendments were introduced to the MLA, the RSSO and the LTBO to promote the establishment of a scripless government securities trading system in Sri Lanka, which would be beneficial in the expansion of the primary market and the development of an active secondary market in government securities. Provision was also made through these amendments for the issue of a new type of scripless government security transferable by endorsement, viz. Treasury Bonds, which would have a maturity of over one year and would carry a coupon rate of interest, in addition to being sold at an auction.