10 FINANCIAL SECTOR

10.1 Money Supply

Monetary expansion decelerated considerably owing to the continuation of tight monetary policy, a slowing down of economic activity, greater caution exercised by banks in their credit operations, particularly during and in the aftermath of the drought and power cuts, and liquidity constraints faced by banks due to a rise in non-performing loans during the second and third quarters and a reduction in net foreign assets. Weak demand for consumer durables also contributed to slow monetary expansion. Central Bank credit to government, however, increased, reflecting the rediscounting of Treasury bills by commercial banks that faced liquidity constraints, as well as the credit needs of the Government. The sharp reduction in the growth of credit to the private sector moderated the monetary expansion in 1996. The growth of Broad Money (M2) declined to 10.8 per cent on a point to point basis at the end of 1996, compared with 19.2 per cent at the end of 1995. As in the previous year, the Narrow Money supply (M1) grew at a much lower rate of 4.0 per cent in 1996, compared with the growth of Broad Money. The increased sophistication of banking facilities, such as automated teller machines, credit cards and electronic banking, which tend to increase the liquidity of quasi-money, and greater prudence in the use of transaction balances by the public in an environment of high interest rates, were responsible for the slower growth of M1. The liquidity overhang (i.e. the growth of money in excess of the growth of nominal GNP) which arose towards the end of the previous year owing to excessive credit growth, gradually dissipated during the second half and the underlying inflation rate (i.e. the growth of money less the real growth of the economy) dropped to below 10 per cent towards the end of the year.

TABLE 10.1
Summary Monetary Statistics

Amount in Rs Billion

Item	End 1996	Change 1995 Amount	1995 %	1996 Amount	1996 %
Monetary Aggregates:					
Narrow Money Supply (M1)	78.2	4.8	6.7	3.0	4.0
Broad Money Supply (M2)	253.2	36.9	19.2	24.7	10.8
Underlying Factors					
Domestic Credit to :	252.3	50.0	28.8	28.5	12.7(a)
Government (net)	47.5	7.1	25.1	12.3	35.1
Public Corporations	9.9	3.3	65.2	1.4	16.6(a)
Private Sector	194.8	42.9	29.5	14.8	8.2(a)
External Assets (net)	61.9	2.0	3.2	-4.6	-7.0
Other Items (net)	61.0	-15.2	32.6	0.8	1.3(a)
Reserve Money	85.5	10.5	15.5	6.9	8.8

Source: Central Bank of Sri Lanka.

(a) When the effects of the bonds issued by the Treasury in lieu of some former directed credit are removed, the increases were 18.5, 31.5, 14.7 and -19.7 per cent, respectively.

Net domestic assets of the banking system increased by 18.1 per cent in 1996, compared with a much sharper increase of 27.4 per cent in 1995, mainly reflecting the slower growth of private sector credit. Bank credit to the private sector increased by 14.7 per cent, compared with 28.2 per cent in 1995. Increased expenditure on defence and the wheat flour subsidy, together with revenue shortfalls due to lower than expected privatisation proceeds, required the Government to resort to increased bank credit. Despite the increased financing needs, the Government did not raise the existing limit of Rs.125,000 million on the outstanding level of Treasury bills. This, together with improved government cash management and adjustments of wheat flour and petroleum prices in response to rising world market prices, helped to contain the fiscal deficit and bank financing. Nevertheless, net credit to the Government from the banking sector increased by Rs.12,344 million (35.1 per cent) as against an increase of Rs.7,067 million (25.1 per cent) in 1995. Of this increase, Rs.9,873 million came from the Central Bank and Rs.2,471 million from commercial banks. Even with this level of bank financing of the defict, monetary conditions appeared too tight, particularly in a situation where the economy was recovering fast after the setback experienced in mid 1996. This called for some relaxation of monetary controls, which became effective in early 1997.

In October 1996, as indicated in the Budget for 1996, the Government issued bonds worth Rs.19,933 million to the two state banks to compensate them for losses due to defaults on directed credit. This too had an effect on the monetary statistics. Although accounting for these bonds has no impact on overall monetary aggregates, it causes changes in the values of private sector credit, credit to corporations, credit to co-operatives and net other assets. With appropriate adjustments for the bond issues, credit to the private sector has grown by 8.2 per cent in 1996 (14.7 per cent without bonds). Credit to government corporations increased by 16.6 per cent (31.5 per cent without bonds). As a part of the bond issue was in settlement of the loans to the Paddy Marketing Board (PMB), credit to co-operative institutions declined by Rs.2,474 million.

TABLE 10.2
Monetary Aggregates (a)

Amounts in Rs. Million

End of Period	Narrow Money Supply (M1)						Broad Money Supply (M2)					
	1995	1996	Change (%) Point to Point 1995	Point to Point 1996	Moving Average 1995	Moving Average 1996	1995	1996	Change (%) Point to Point 1995	Point to Point 1996	Moving Average 1995	Moving Average 1996
January	69,875	73,783	21.0	5.6	19.3	9.2	193,010	228,090	21.4	18.2	21.2	18.2
February	70,702	77,439	13.4	9.5	18.5	8.9	192,859	234,198	18.2	21.4	20.9	18.5
March	71,335	81,795	13.8	14.7	18.2	9.0	195,370	239,177	17.9	22.4	20.7	18.9
April	68,718	79,478	11.5	15.7	17.8	9.4	195,982	241,894	17.8	23.4	20.7	19.4
May	68,376	76,619	12.4	12.1	17.5	9.4	197,892	242,072	18.9	22.3	20.6	19.7
June	68,714	75,956	10.1	10.5	16.6	9.4	201,170	240,407	17.6	19.5	20.1	19.8
July	68,194	76,109	7.8	11.7	15.6	9.7	202,826	240,083	17.3	18.4	19.7	19.9
August	69,321	76,184	9.1	9.9	14.8	9.8	205,325	240,096	18.1	16.9	19.4	19.7
September	70,306	76,634	6.3	9.0	13.6	10.0	211,009	241,699	18.5	14.5	19.0	19.4
October	71,538	74,003	7.0	3.5	12.4	9.7	215,349	242,845	17.6	12.8	18.6	18.9
November	71,847	75,276	7.7	4.8	11.4	9.4	218,999	245,227	18.8	12.0	18.5	18.3
December	75,217	78,203	6.8	4.0	10.4	9.2	228,536	253,201	19.2	10.8	18.4	17.5
Monthly Average	70,345	76,797	10.4	9.2			204,861	240,749	18.4	17.5		

(a) Monetary data from 1990 have been classified to be consistant with the standard international practice. Please refer notes to Appendix Tables 100, 101 and 105.

Source: Central Bank of Sri Lanka

Following an overall balance of payments deficit for the second successive year, the net foreign asset (NFA) position of the banking sector declined by Rs.4,671 million (7.0 per cent). The major portion of this decline was shown in the NFA position of commercial banks which declined by Rs.4,156 million. Gross foreign liabilities of commercial banks increased by Rs.5,260 million reflecting almost entirely the continued growth of non resident foreign currency (NRFC) deposits. However, gross foreign assets of commercial banks increased only by Rs.1,103 million. The decline in NFA exerted pressure in the exchange market and the rupee depreciated by 5 per cent against the US dollar in 1996.

It is noteworthy that about 50 per cent of the NRFC deposits are in fact held by Sri Lankans who have returned

TABLE 10.3
Monetary Aggregates and Underlying Factors

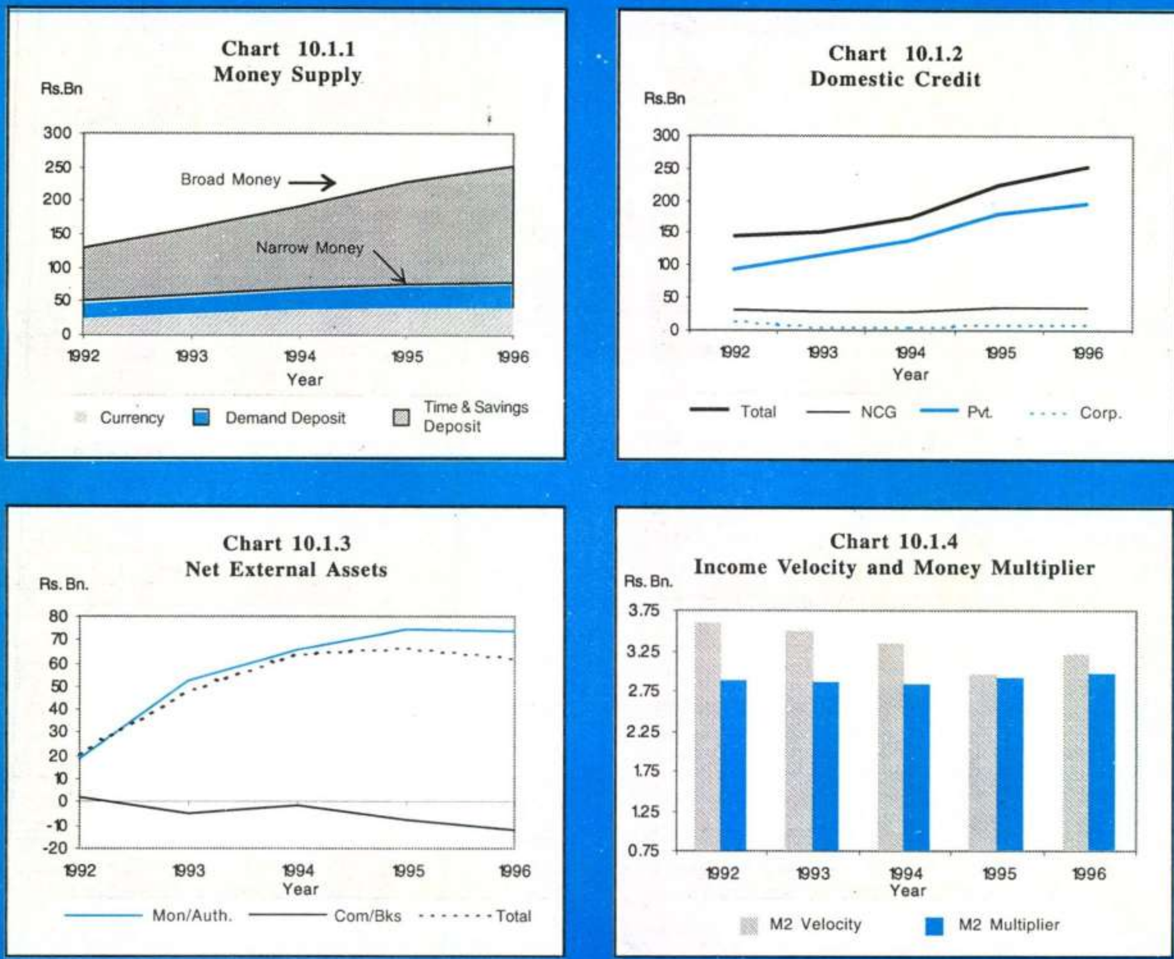
Amounts in Rs. Million

Item	Dec 1994	Dec 1995	Dec 1996	Change 1995 Amount (a)	1995 Percentage	1996 Amount (a)	1996 Percentage
Monetary Aggregates :							
1. Currency held by the Public	38,906	42,198	42,565	3,292	8.5	367	0.9
2. Demand Deposits held by the Public	31,555	33,019	35,638	1,464	4.6	2,619	7.9
Narrow Money Supply (M1)	70,461	75,217	78,203	4,756	6.7	2,986	4.0
3. Time & Savings Deposits of the Private sector held with Com. banks	121,209	153,319	174,998	32,110	26.5	21,679	14.1
Co-operative Institutions	3,781	3,598	3,056	-183	-4.8	-542	-15.1
Government Corporations	13,236	15,888	17,864	2,652	20.0	1,976	12.4
Other Private Sector constituents (b)	104,192	133,833	154,078	29,641	28.4	20,245	15.1
Broad Money Supply (M2)	191,670	228,536	253,201	36,866	19.2	24,665	10.8
Underlying Factors							
1. Domestic Credit	173,794	223,798	252,317	50,004	28.8	28,519	12.7
Net Credit to Government	28,147	35,214	47,558	7,067	25.1	12,344	35.1
Gross Credit to Government	40,250	47,738	63,970	7,488	18.6	16,232	34.0
By Central Bank	19,568	27,458	37,801	7,890	40.3	10,343	37.7
By Commercial Banks	20,682	20,280	26,169	-402	-1.9	5,889	29.0
Govt. deposits and cash balances	12,103	12,524	16,412	421	3.5	3,888	31.0
Gross credit to the private sector	145,647	188,584	204,759	42,937	29.5	16,175	8.6
Co-operative Institutions	2,541	3,939	1,465	1,398	55.0	-2,474	-62.8
Government Corporations	5,163	8,527	9,938	3,364	65.2	1,411	16.5
Other Private Sector constituents	137,943	176,118	193,356	38,175	27.7	17,238	9.8
2. External Banking Assets (net)	64,467	66,532	61,861	2,065	3.2	-4,671	-7.0
Central Bank (net)	65,864	74,301	73,786	8,437	12.8	-515	-0.7
Commercial Banks (net)	-1,397	-7,769	-11,925	-6,372	-456.1	-4,156	-53.5
3. Other Items (net)	-46,590	-61,794	-60,978	-15,204	-32.6	816	1.3
Other liabilities (net) of Central Bank	-39,398	-51,986	-58,476	-12,588	-32.0	-6,490	-12.5
Other liabilities (net) of Commercial Banks	-7,192	-9,808	-2,502	-2,616	-36.4	7,306	74.5

(a) Signs Indicate the effect on M2.
(b) Excludes Non-Resident Foreign Currency Deposits.

Source: Central Bank of Sri Lanka.

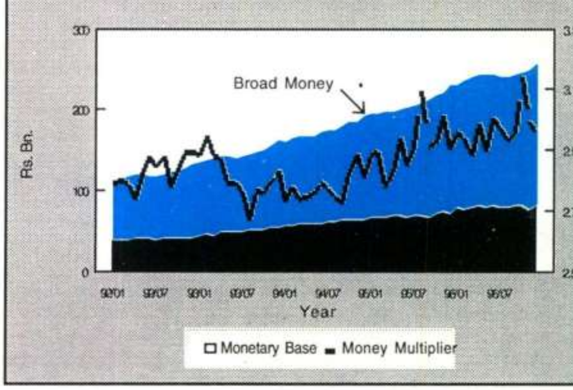
Chart 10.1
Monetary Aggregates, Velocity and Money Multiplier



after employment abroad and now reside in Sri Lanka. This component of foreign currency deposits should be treated as domestic deposit liabilities denominated in foreign currency, but not as bank liabilities to non-residents as presently done. When appropriate adjustments are made, both the net foreign assets of commercial banks and the level of quasi-money will increase, raising the level of broad money (M2). In addition, there is also a need to have a consolidated monetary survey incorporating Foreign Currency Banking Units (FCBUs) as their transactions with domestic customers have increased in the recent past. A technical note on this and the impact of these two types of revisions to the monetary survey are presented in Box 10 with the intention of making the revised format of the monetary survey a regular feature of monetary statistics compiled by the Central Bank.

Reserve money (high powered money or monetary base) increased by Rs.6,922 million or 8.8 per cent in 1996, compared with an increase of Rs.10,532 million or 15.5 per cent in 1995. This slow growth in reserve money led to a significant tightening of liquidity in the presence of an

Chart 10.2
Monetary Base and Money Multiplier



Box 10

Revision of the Monetary Survey to Include FCBUs

At present, the monetary survey is confined to the operations of the Central Bank and the domestic units of commercial banks (DBUs) in Sri Lanka. Two major changes are necessary in the monetary survey to improve the presentation and the coverage of monetary statistics. One relates to the treatment of Foreign Currency Banking Units (FCBUs). The other relates to the treatment of non-resident foreign currency (NRFC) accounts. This technical note explains the required changes and their implications on monetary data.

Treatment of FCBUs

At present, data relating to the operations of FCBUs are not appropriately captured in the monetary survey. FCBUs are regarded as non-resident entities or pure off shore entities and the balances in the domestic balance sheets of the DBUs relating to FCBUs are regarded as foreign assets/liabilities. These balances are included as net foreign assets (NFA) in the monetary survey. This has been the practice since the establishment of the FCBUs.

FCBUs were established under Central Bank Circular No. 380 in mid July 1979 to develop off shore banking activities and to facilitate operations of companies in the Export Processing Zones. FCBU transactions with domestic entities, and hence the impact on domestic monetary developments, were expected to be minimal. However, the importance of FCBUs in the financial system has grown considerably. At end 1996, 26 FCBUs were functioning in the country. These units provide a full range of commercial banking services to their customers. The customer base of the FCBUs can be categorised into three groups, viz., non-residents, residents and banks. The non resident category consists of purely offshore customers. The resident category includes BOI (GCEC) enterprises and other approved customers. FCBUs have become an important source of credit to these resident enterprises. While the total resources of FCBUs, which stood at Rs. 576 million (US dollars 39 million) in 1979, have risen to Rs.81,073 million (US dollars 1,430 million) in 1996, credit granted by FCBUs to their resident customers has increased from Rs.5,050 million in 1982 to Rs.44,572 million in 1996. In view of the decision taken towards the end of 1996 to permit non-BOI exporters to obtain foreign currency loans from FCBUs, the level of transactions is expected to increase still further. In the case of the non-resident category of FCBU customers, the transactions are pure off shore activities and their impact on domestic money supply is minimal. However, FCBU loans to residents have implications on domestic monetary management. These loans will enhance the liquidity in the domestic economy. Considering the magnitude of their influence on the domestic economy, monetary statistics should appropriately capture their operations.

Treatment of NRFC Balances

At present, NRFC deposits are treated as belonging to non-residents and the balances in these accounts are treated as foreign liabilities. It is understood that over 50 per cent of these deposits, in value terms, are held by residents, mainly returnee migrants. Hence, the component of NRFC deposits held by this group should be treated as domestic liabilities to residents, denominated in foreign currencies, and not as foreign liabilities of DBUs. A large part of the funds obtained from NRFC deposits are invested by DBUs in FCBUs, which are in fact resident entities. Therefore, effectively, these are now not foreign but domestic assets. What is relevant from the point of view of the total foreign exposure of the country's banking system is the sum of the net foreign exposures of FCBUs and DBUs to non residents. This total net foreign exposure is not revealed by the current monetary survey as the classification of assets and liabilities relating to NRFC deposits is on the basis of currency denomination, rather than on the standard 'resident - non resident' ownership classification.

In view of these considerations, a revised monetary survey has been prepared.

Monetary Survey Including FCBUs

The current domestic monetary survey (DMS) is based on definitions under which FCBUs are treated as non-resident entities. In incorporating FCBUs into the monetary survey, they will effectively be treated as resident entities. Hence some items relating to

Box 10 (contd.)

TABLE 1
Comparison of Monetary Surveys

Rs. Million

	Current			Proposed		
	1994 Dec	1995 Dec	1996 Dec	1994 Dec	1995 Dec	1996 Dec
Broad Money (M_2^*)	191,672	228,537	253,201	214,306	259,442	288,657
Narrow Money (M1)	70,463	75,218	78,203	70,463	75,218	78,203
Currency	38,906	42,199	42,565	38,906	42,199	42,565
Demand Deposits	31,557	33,019	35,638	31,557	33,019	35,638
Quasi Money (QM)	121,209	153,319	174,998	143,843	184,224	210,454
DBUs	121,209	153,319	174,998	136,734	171,157	195,672
FCBUs				7,109	13,067	14,782
Net Foreign Assets	64,467	66,532	61,861	58,760	64,745	63,319
Monetary Authorities	65,864	74,301	73,786	64,571	73,662	73,786
Commercial Banks	-1,397	-7,769	-11,925	-5,811	-8,917	-10,467
DBUs	-1,397	-7,769	-11,926	393	-3,037	-4,186
FCBUs				-6,204	-5,880	-6,281
Net Domestic Assets	127,205	162,005	191,339	155,546	194,696	225,334
Domestic Credit	173,795	223,799	252,317	206,047	262,670	292,395
Claims on Government (net)	28,148	35,215	47,558	30,882	38,430	46,152
Monetary Authorities	16,756	24,418	34,291	16,756	24,418	34,291
Commercial Banks	11,392	10,797	13,267	14,126	14,012	11,861
DBUs	11,392	10,797	13,267	11,392	10,797	13,267
FCBUs				2,734	3,215	-1,406
Credit to Public Corporations	5,163	8,527	9,938	11,407	13,305	15,491
DBUs	5,163	8,527	9,938	5,163	8,527	9,938
FCBUs				6,244	4,778	5,553
Credit to the Private Sector	140,484	180,057	194,821	163,758	210,935	230,752
DBUs	140,484	180,057	194,821	140,484	180,057	194,821
FCBUs				23,274	30,878	35,931
Other Items (net)	-46,590	-61,794	-60,978	50,501	-67,974	-67,061
DBUs	-46,590	-61,794	-60,978	-31,562	-48,049	-48,043
FCBUs				-18,939	-19,925	-19,018
Memorandum Items:						
Reserve Money	68,055	78,587	85,509	68,055	78,587	85,509
NDA Monetary Authorities	2,191	4,286	11,723	2,191	4,286	11,723
Money Multiplier	2.82	2.91	2.96	3.15	3.30	3.38
Point to Point Change %						
Total Broad Money	19.7	19.2	10.8	18.7	21.1	11.3
Net Foreign Assets	34.0	3.2	-7.0	40.4	10.2	-2.2
Net Domestic Assets	13.6	27.4	18.1	12.2	25.2	15.7
Claims on Government (net)	4.3	5.1	35.1	3.7	24.4	20.1
Claims on Public Corporations	-33.6	65.2	16.5	-26.0	16.6	16.4
Claims on Private Sector	21.2	28.2	8.2	22.0	28.8	9.4
Other Items (net)	-20.5	-32.6	1.3	-24.0	-34.6	1.3

Source: Central Bank of Sri Lanka

domestic units in the DMS would require redefinition. Therefore, the following sub sections of the DMS have been redefined:

Investment in FCBUs by the domestic unit. All commercial banks invest NRFC funds through their FCBUs. In the DMS, these investments are treated as foreign assets. However, with FCBUs being regarded as domestic entities, these investments would be treated as domestic assets denominated in foreign currencies. In order to avoid a double counting of foreign assets, only the final investments made by FCBUs with non-residents should be regarded as foreign assets. The effect of this adjustment is to bring about a reduction in the value of gross foreign assets presently recorded in the DMS.

NRFC deposit balances. At present, NRFC deposit balances are treated as foreign liabilities in the DMS. According to commercial bank sources, around 51 per cent of NRFC deposit holders reside in Sri Lanka. These, in fact, are not foreign liabilities of the domestic economy. Therefore, in the proposed monetary survey, a portion of these NRFC deposit liabilities (50 per cent) is treated as domestic deposits and hence a part of broad money. The balance (i.e., non resident NRFC holders) deposits are treated as foreign liabilities. The effect of this adjustment is to

Box 10 (contd.)

increase broad money and reduce foreign liabilities from the values presently indicated in the DMS.

The consolidated monetary survey has the following main changes from the current monetary survey.

A higher level of broad money. Broad money increases due to the deposits of BOI and Other Approved Customers with FCBUs being included and NRFC deposits being redefined. The growth of broad money at end 1996 will become 11.3 per cent, compared with 10.8 per cent in the present monetary survey.

A more relevant estimate of NFA. The incorporation of FCBU data and the reclassification of parts of the NRFC deposits as domestic liabilities have led to changes in the NFA of commercial banks, which represent a more complete picture of the net foreign asset position of the banking system. The NFA of the banking system declines by 2.2 per cent in 1996, compared with a 7 per cent decline before the revisions.

Increased NDA. The NDA of commercial banks increase due to the inclusion of credit extended by FCBUs to both the public and the private sectors.

Larger Money Multiplier. The proposed monetary survey has a more realistic coverage of the level of financing of economic activities. The money supply indicated by the consolidated survey has expanded the stock of broad money, without changing the conceptual definition of broad money (i.e., even under the revised monetary survey, broad money is defined as the sum of narrow money and time and savings deposits held by the public, though it is now inclusive of deposits of BOI and Other Approved Customers of FCBUs). However, reserve money (base money or high powered money) remains unchanged, thus causing an increase in the money multiplier. Conceptually, this increase is a result of a reduction in the cash to deposits ratio and a reduction in the overall effective SRR (as there are no reserve requirements on FCBU deposits).

overall increase in net domestic assets of the banking system by 18.1 per cent. The liquidity tightness was manifested in a somewhat higher broad money multiplier which remained around 3 during the second half of the year. The income velocity remained around 3 in 1996 as in 1995. On the sources side, the 8.8 per cent increase in reserve money came from increased net credit to the Government of Rs.9,873 million, offset by a decline in net international reserves of the Central Bank. On the use side, this increase was reflected primarily in an increase in currency in circulation by Rs.2,795 million and in commercial bank deposits with the Central Bank by Rs.4,054 million.

10.2 Monetary Policy

The Central Bank had to conduct monetary policy in an environment where the economy was experiencing a temporary downturn in mid 1996. Increased demands for concessional credit were made by firms which were adversely affected by the power cuts and there was a continuation of a significant amount of liquidity overhang from the previous year. The difficulties in implementing monetary policy in such circumstances were reduced by improved fiscal management where measures were put in place to contain the fiscal deficit by raising the administered price of wheat flour, bread and petroleum products, together with measures to reduce non-priority expenditure. The temporary supply dislocations as a consequence of the drought and power cuts tended to raise prices. In view of the continued high rate of monetary expansion, which was above 20 per cent in terms of broad money, and rising prices in the first three quarters of the year, relaxation of monetary controls was not warranted until the underlying inflationary pressure abated.

The high statutory reserve requirements were maintained and moral suasion was used to advise commercial banks to reduce risky lending and consumption oriented credit. At regular monthly meetings with commercial bank managers, the Central Bank emphasised the importance of maintaining sound banking practices to ensure the stability of the financial system. Open market operations constituted the main instrument of monetary policy. When there were increased demands for subsidized credit in mid 1996 by firms which were facing liquidity shortages, the Central Bank used moral suasion to persuade banks to meet the temporary credit needs of their clients on a case by case basis, after rescheduling of such credit where necessary.

The Central Bank purchased a significant amount of Treasury bills at the primary auctions in the early part of the year, in addition to taking up several special issues of

Treasury bills, amounting to Rs. 5,000 million in its efforts to stabilise the money market. These bills were subsequently sold to the market through the secondary window. By the end of the first half of 1996, net credit to the Government from the Central Bank had risen by Rs.2,841 million, reflecting mainly an increase of Rs.3,759 million on account of Provisional Advances. With increased government expenditure and a shortfall in privatization proceeds, the Central Bank had to accommodate part of the financing needs of the Government, and by December, net credit to the Government had risen by Rs.9,873 million. With the outstanding level of Treasury bills reaching the limit of Rs.125,000 million approved by Parliament, direct government borrowing through the issue of new Treasury bills was constrained after August 1996. This limit on Treasury bills imposed some discipline on fiscal management in that it helped to curtail less productive expenditure and contain the fiscal deficit. In addition, it was one of the factors which helped to maintain interest rates on Treasury bills consistently below the levels in 1995. A part of the financing needs of the Government was met through administrative borrowings, i.e. direct use of excess funds of some public sector institutions.

The Central Bank's portfolio of Treasury bills was sufficient for the conduct of open market operations (OMO). Hence, there was no necessity for the Central Bank to issue its own securities. The Central Bank monitored the money market developments continuously and adjusted interest rates applicable for repo and secondary market operations with a view to reducing volatility of call market rates. For purposes of monetary control, the Statutory Reserve Ratio (SRR) was maintained at 15 per cent for all deposits, except foreign currency deposits placed abroad, for which the ratio was lower at 5 per cent. No refinance was granted under the Medium and Long Term Credit Fund (MLCF) or short-term refinance schemes of the Central Bank.

With the reduction in the growth of monetary aggregates towards the end of the year and the gradual decline in price increases, financial and exchange markets became more stable. The volatility of short-term interest rates was considerably reduced. Deposit mobilisation by banks through time and savings deposits increased by 15 per cent. Non-resident foreign currency (NRFC) deposits increased by 16 per cent. As economic activities were recovering towards the latter part of the year and the inflationary pressure had significantly abated, the Bank was considering an appropriate relaxation of monetary policy largely through a reduction of the statutory reserve requirement and permitting non-BOI exporters to obtain foreign currency loans. It was also felt that the progressive reduction of the SRR to a reasonable level could enable the Bank to resort to market related interventions, such as open market operations, to regulate money supply.

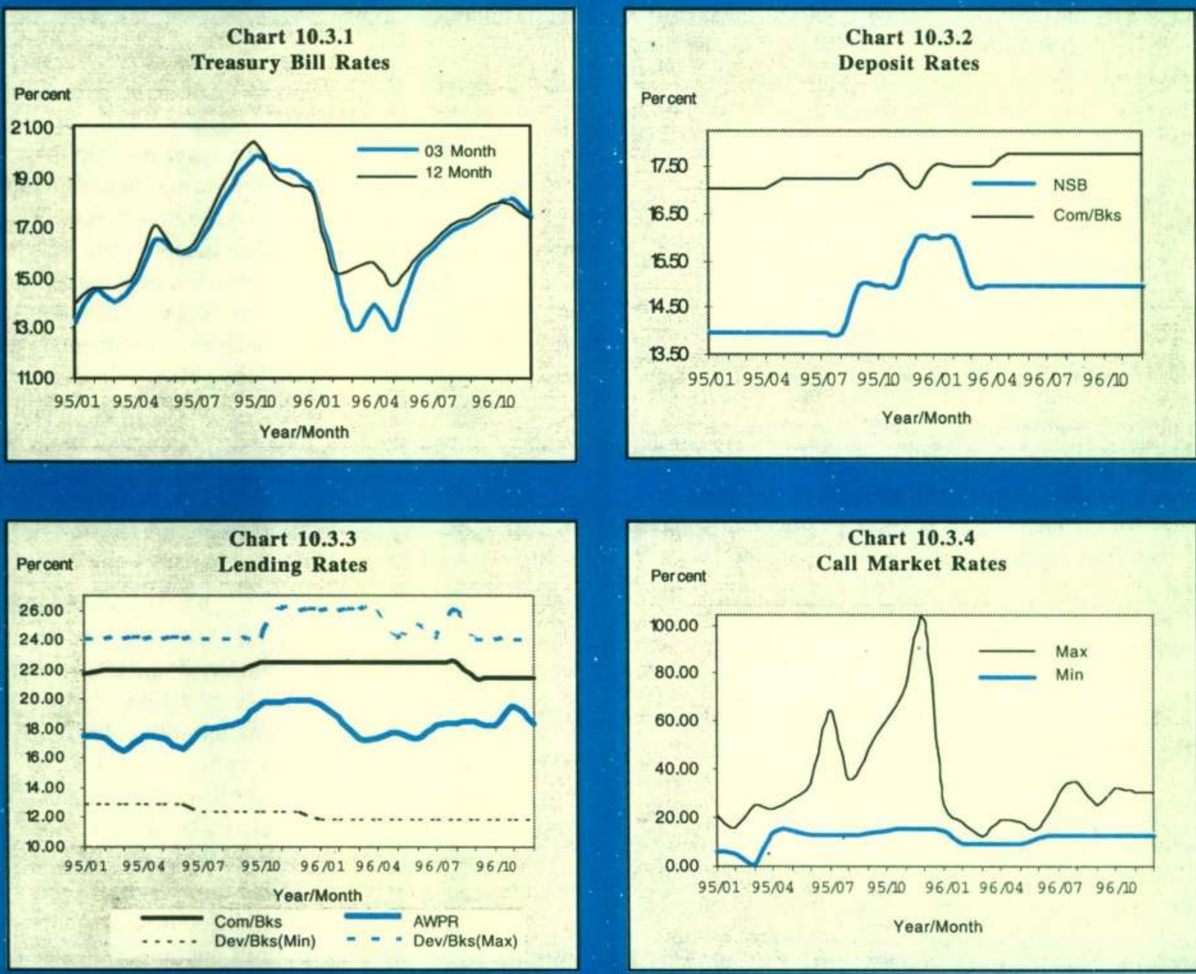
10.3 Interest Rates

Interest rates were generally lower in 1996 than in 1995 with much less volatility. With an injection of liquidity into the system both through government operations and through the net inflow of foreign assets in the first few months, the short-term interest rates declined sharply early in 1996. Thereafter, with increases in government demand for credit and a deficit in the balance of payments, rates gradually picked up until mid November. A decline was again witnessed at the end of the year. Moving with these trends, the medium and long-term rates also remained relatively stable during the year.

Short-Term Rates

In contrast to the very high levels and volatility experienced in the last quarter of 1995, interest rates fell rapidly owing to increased liquidity in the market in the first few months of 1996. This resulted primarily from the seasonal increase in government liquidity in the first two months and the significant surplus in the balance of payments in that period. The injection of rupee funds by the Central Bank, through purchases of foreign exchange from commercial banks, increased Provisional Advances extended to the Government and transfer of its profits to the Government added to market liquidity. Heavy overbidding at the Treasury bill auctions reflected the liquidity in the market. Consequently, the weighted average yield rates on Treasury bills on all maturities declined sharply from a range of 19.26 - 18.97 per cent at end 1995 to a low of 11.98 - 14.40 per cent in March 1996. The decrease was more pronounced in the shorter maturities, reflecting the seasonality observed in the recent past. This decline was reflected in the call market rates as well, which fell even more sharply, from 20.00 - 58.00 per cent at end 1995 to 9.80 - 10.80 per cent at end March. The rates applicable to Central Bank transactions in the repurchase (repo) market and the secondary Treasury bill market declined in line with the trends observed in the primary market rates. The Central Bank continued to determine the overnight rate and the secondary market rates taking into account markèt liquidity conditions and yields in the primary market. Accordingly, the overnight repo rate dropped from 16.50 per cent at end 1995 to 9.50 per cent during the first quarter. Similarly, the discount rate for the 3-month bills declined from 19.01 per cent at end 1995 to 10.98 per cent by mid March 1996.

Chart 10.3
Interest Rates



Dev/Bks(Min) - Refinance rate under SMI scheme

After March, an upward movement of interest rates was evident, mainly attributed to increased government borrowing, market anticipation of an enlarged budget deficit arising from increased defence expenditure, deficits in the balance of payments and additional liquidity needs of the firms affected by the power cuts.

Treasury bill rates rose gradually to a range of 15.21 - 15.66 per cent at end June. In line with this trend, call market rates also increased to a range of 14.00 - 17.50 per cent. Meanwhile, the Central Bank discount and re-discount rates in the secondary Treasury bill market were also permitted to reflect the increases in yields in the primary market. Accordingly, the discount and re-discount yields at end June, on 3-month Treasury bills stood at 14.96 per cent and 17.46 per cent, respectively, at end June. Similarly, the repo rate rose to 11.75 per cent in May and then to 12.75 per cent in June.

In the second half of 1996, the gradual rise in interest rates continued until mid November, but began to decline thereafter. The weighted average yield rate on 3-month bills rose to 18.25 per cent, the highest since January, while the 12-month rate increased to 17.98 per cent. However, Treasury bill rates declined thereafter and came down to a range of 17.45 -17.38 per cent at end 1996. Interest rates in the call money market too tended to be higher in the second half, rising to a range of 12.00-35.00 per cent. As with Treasury bill rates, a downward movement was also seen in call rates in December. At the end of 1996, call rates were in the range 17.50-28.00 per cent.

Moving with other short term rates, the average weighted prime lending (AWPR) rate of commercial banks also declined from 20.1 per cent at end 1995 to 16.9 per cent at end March 1996, before reaching 17.4 per cent at end June. The AWPR stood at 20.2 per cent at end December 1996.

The National Savings Bank (NSB) revised its deposit rates on 12-month deposits downward, from 16.00 per cent at end December 1995 to 15.00 per cent from 1 March 1996, in line with declining short term interest rates.

Long-Term Rates

Government Securities (Rupee Loans) provided some indications of movements in long-term rates, though these are not entirely market determined. Rupee loans with maturities of 4-6 years and 5-7 years carried interest rates of 14 per cent, while those with maturities of 7-8 years were issued with an interest rate of 13 per cent. Responding to market demand, a two year Rupee Loan was floated at 15.00 per cent per annum. Apart from these, the Government issued bonds to the two state banks in lieu of defaulted loans that had arisen from directed credit. These had a maturity of ten years and carried a coupon rate of 14 per cent. The Government also issued similar bonds to the NSB, in respect of past interest subsidies and administrative borrowings, at 14 per cent per annum.

Long-term instruments were also issued by some quoted public companies. The Merchant Bank of Sri Lanka Ltd. issued 4 year debentures with a rate of 17.54 per cent per annum, while Vanik Incorporation Ltd. had a public issue of 3 year debentures at 20 per cent per annum. These high interest rates appeared to reflect partly the non-availability of a medium-term market-determined rate for government debt instruments to be used as reference rates for private sector debt instruments.

People's Bank reduced its lending rate for SMI loans by 2.5 percentage points from 18.5 per cent to 16.0 per cent in March, while the Bank of Ceylon reduced its lending rates for these loans by 1.5 percentage points from 19.0 per cent to 17.5 per cent, in line with declining market rates and to encourage SMI activity.

Lending rates of long-term credit institutions, viz., State Mortgage and Investment Bank (SMIB), Development Finance Corporation of Ceylon (DFCC), National Housing Development Authority (NHDA), National Savings Bank (NSB) and National Development Bank (NDB) also displayed some downward movement, whereas a few others maintained rates at the 1995 level. Lending rates of the SMIB and NSB remained unchanged in the range of 17.00-22.00 per cent and 17.00-20.00 per cent, respectively. Meanwhile, the maximum lending rate of the NHDA was lowered from 20.5 per cent at end 1995 to 15 per cent in January 1996, while the range of lending rates, at 10.00 - 15.00 per cent, remained unchanged throughout the year. The minimum on-lending rate of the DFCC was lowered from 20.00 per cent to 16.00 per cent in 1996. Meanwhile, the lending rates of the NDB were in a range of 11.90 - 26.00 per cent in 1996 in comparison to the range of 12.5 - 26.0 per cent in the previous year.

10.4 Commercial Banking

In a somewhat uncertain situation characterised by the mid term downturn in agricultural and industrial output and tourism and security related uncertainties, commercial banks were more cautious in their lending operations and shifted their asset portfolios to less risky assets such as government and government guaranteed securities, (which showed a growth of 34 per cent during the year) while maintaining overdrafts virtually unchanged (a growth of only 2 per cent). Of the total increase in the assets of the commercial banking system, 26 per cent was allocated to liquid assets compared with 10 per cent in 1995. Total assets of commercial banks increased by 16.2 per cent in 1996 while the investments in Treasury bills increased by Rs.4,066 million, compared with a reduction of Rs.4,186 million in 1995.

Despite the continuation of the tight monetary policy and depressed agricultural and industrial output, total

TABLE 10.4
Selected Assets and Liabilities of Commercial Banks

Amounts in Rs. Million

Item	Change 95 Dec/94 Dec Amount (Rs.Mn.)	Change 95 Dec/94 Dec %	Change 96 Dec/95 Dec Amount (Rs.Mn.)	Change 96 Dec/95 Dec %
Assets Category				
1. Liquid Assets	5,525	7.1	14,059	16.8
Cash on Hand	312	7.5	2,429	54.1
Due from Central Bank	7,180	30.2	3,310	10.7
Foreign Currency on Hand	-2,401	-9.9	411	1.9
Treasury Bills	-3,591	-23.7	3,978	34.4
Commercial Bills	4,025	37.4	3,931	26.6
Local Bills	-17	-7.1	-80	-38.6
Import Bills	3,542	65.3	3,416	38.1
Export Bills	499	9.8	584	10.6
2. Investment	-6,737	-25.9	7,686	39.9
Treasury Bills	-3,591	-23.7	3,978	34.4
Government Securities	-595	-44.2	89	11.7
Other Investment	2,551	-26.8	3,620	52.0
3. Total Loans and Advances	43,772	30.6	15,430	8.3
Loans	21,474	24.9	10,076	9.4
Overdrafts	18,272	39.5	1,424	2.2
Commercial Bills	4,025	37.4	3,931	26.6
4. Fixed and other Assets	7,374	14.7	24,459	42.5
Liability Category				
1. Capital Accounts	5,181	18.3	5,778	17.3
2. Total Deposits	37,642	19.8	33,676	14.8
Demand Deposits	868	2.1	6,291	14.8
Time & Savings Deposits	36,774	24.7	27,384	14.7
3. Borrowings	4,351	34.3	11,152	65.4
Local Borrowings	3,668	34.6	11,949	83.8
Foreign Borrowings	683	32.5	-797	-28.6
4 Other Liabilities	7,272	14.7	3,678	6.5
Total Assets/Liabilities	54,447	19.4	54,283	16.2

Source: Central Bank of Sri Lanka.

assets of commercial banks increased by 16.2 per cent in 1996, compared to a rise of 19 per cent in the previous year. Meanwhile, liquid assets grew by 16.8 per cent, compared to a rise of 7 per cent in 1995. Consequently, the ratio of liquid assets to demand deposits increased from 196 per cent at end 1995 to 200 per cent at end 1996.

Structure of Assets and Liabilities

The total resources of commercial banks rose by Rs.54,283 million (16.2 per cent) during the year compared to an increase of Rs.43,772 million (19 per cent) in 1995. With the slowing down of economic activities in mid 1996, there was a reduction in the expansion of loans and advances. The issue of government bonds to the two state banks, in October 1996, in lieu of defaulted directed credit also had a significient impact on the classification of assets. Consequently, the share of total loans and advances in total resources declined from 56 per cent in 1995 to 51.9 per cent in 1996 (without the bond issue the ratio stood at 56.8 per cent). The total value of loans and advances of commercial banks recorded a moderate increase of Rs.15,430 million (8.3 per cent) in 1996 (without bond issue 18.5 per cent) compared to Rs.43,772 million (31 per cent) in 1995. This included an increase of Rs.3,416 million (38.1 per cent) on account of facilities provided against import bills, Rs.594 million (10.6 per cent) increase in export bill financing and Rs.10,075 million (9.4 per cent) increase in other loans.

On the liabilities side, major increases were recorded in deposit liabilities, domestic inter-bank borrowings, paid up capital, reserves and undistributed profits and other liabilities. Total deposits rose by 14.8 per cent (Rs.33,675 million) in 1996 mainly due to the increases in demand deposits and time and savings deposits by 14.8 per cent (Rs.6,291 million) and 14.7 per cent (Rs.27,384 million), respectively. Total deposits as a percentage of total resources declined from 69 per cent in 1995 to 67 per cent in 1996, reflecting a slight reduction in deposit mobilisation which was evidenty a result of slower growth in income. Banks relied more on the domestic interbank market than on foreign borrowings for their short-term liquidity needs, partly due to the relatively lower call market rates, compared to 1995. Domestic inter-bank borrowings increased by 83.8 per cent (Rs.11,949 million), while foreign borrowings decreased by 28.6 per cent (Rs.797 million) during the year.

Paid up capital, reserve funds and undistributed profits increased by 17.3 per cent (Rs.5,778 million) in 1996, compared to the 18.3 per cent (Rs.5,181 million) increase in 1995. The ratio of capital, reserves and undistributed profits to total assets remained unchanged during the year (around 10 per cent), indicating that banks had increased their reserves to match their assets.

Sources and Users of Funds

Total net availability of funds to commercial banks rose by Rs.20,945 million in 1996, compared to an increase of Rs.13,478 million in 1995. A significant portion of this increase was due to the issue of long-term bonds by the Government to the state banks. Without bonds, the increase in funds amounted to Rs.8,591 million. The major net suppliers of funds to the banking sector in 1996 were the domestic private sector and the foreign sector, while co-operatives and government corporations also supplied a significant amount. The major users of bank resources

TABLE 10.5
Sources and Users of Resources of Commercial Banks

Rs. Million

Category	Change (a) 1995 Sources	1995 Users	1996 Sources	1996 Users
1. Government Sector	**595**			**2,471**
Holdings of Govt Securities	4,186			4,066
Deposits	193		3,419	
Import Bills		2,548		1,631
Short-Term Credit		857		619
Overdrafts		380	427	
2. Central Bank		**4,774**		**5,227**
Borrowings		428	425	
Reserves		7,180		3,310
Investment in Central Bank Securities	3,146		88	
Till Cash		312		2,429
3. Government Corporations	**35**		**383**	
Deposits	3,399		1,794	
Advances		3,363		1,411
4. Co-operatives		**1,832**	**1,639**	
Deposits		434		835
Advances		1,398	2,474	
5. Other Domestic Private Sector		**6,873**	**12,598**	
Deposits (b)	31,303		23,721	
Local Bills		449		1,025
Import Bills		471		693
Overdrafts		15,956		3,483
Loans		20,705		8,329
Investments in Securities & Bonds		595		3,708
Debentures			6,115	
6. Inter-Bank Transactions	**2,005**		**2,169**	
Balance With Domestic Banks		2,090		1,012
Deposits & Borrowings With Domestic Banks	4,095		3,181	
7. Foreign Sector	**6,372**		**4,156**	
Borrowings	683			797
Deposits	3,786		6,057	
Foreign Balances Inculuding Export Bills	1,904			1,103
8. Other Assets & Other Liabilities	**4,471**			**13,248**
Capital & Reserves	5,182		5,778	
Fixed Assets		1,342		1,496
Long Term Govt Bonds Restructuring Bonds				19,392
Other Assets		6,032		3,571
Other Liabilities	6,663		5,433	
Total Net Sources/ Users	13,478	13,478	20,945	20,945

Source: Central Bank of Sri Lanka.

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

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

were the government sector, and the CentralBank which absorbed Funds through and the reserve requirements.

In 1996, the other domestic private sector (i.e., excluding corporations and co-operatives) emerged as a major net source of funds to the banking sector, in contrast to the experience of the past few years, where this sector was a major user of funds. This change has come about primarily as a result of a much lower increase in the funds utilised for loans and overdrafts. Tight monetary policy and increased caution on the part of the banks in their lending operations were the major causal factors for this. The other domestic private sector provided Rs. 12,598 million to the banking sector in 1996, in contrast to its absorption of Rs.6,873 million from the banking sector in 1995.

As in 1995, the foreign sector was a net provider of resources. Net inflows amounted to Rs.4,156 million in 1996 through an increase of foreign deposits with the commercial banks, in comparison to an inflow of Rs.6,372 million in 1995 through deposits and foreign borrowings. However, in 1996, the borrowings and foreign bills including export bills were users of funds in contrast to being suppliers in 1995.

Co-operatives and government corporations also contributed to the net resource build up, providing Rs.1,639 million and Rs.383 million, respectively. Here too the issue of government bonds had an impact on resource availability. The co-operative sector was a net user of commercial bank funds in 1995, with the banks providing credit to finance the paddy purchases of the Paddy Marketing Board (PMB).

On the use side, commercial banks' other assets and other liabilities absorbed Rs.13,248 million during 1996, in contrast to being a source of funds in 1995. The long-term bonds issued to the two state banks in October 1996 against government guaranteed loans led to an increase

Table 10.6
Commercial Banks Advances by Purpose and Maturity (a)

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 1995	58,330	76.0	13,384	17.4	5,034	6.6	76,749	43.7
December 1995	60,946	75.7	14,802	18.4	4,783	5.9	80,530	43.8
September 1996	69,658	78.5	15,089	17.0	3,981	4.5	88,728	43.8
2. Financial								
September 1995	5,428	67.0	2,045	25.2	629	7.8	8,102	4.6
December 1995	3,994	50.5	3,194	40.4	720	9.1	7,908	4.3
September 1996	4,975	58.7	2,709	32.0	793	9.4	8,476	4.2
3. Agricultural								
September 1995	7,248	69.2	2,423	23.1	802	7.7	10,473	6.0
December 1995	7,312	62.9	3,480	30.0	826	7.1	11,618	6.3
September 1996	7,178	65.9	2,753	25.3	959	8.8	10,890	5.4
4. Industrial (b)								
September 1995	17,833	72.9	3,988	16.3	2,639	10.8	24,460	13.9
December 1995	17,145	71.5	4,186	17.5	2,640	11.0	23,971	13.0
September 1996	18,112	65.2	6,508	23.4	3,144	11.3	27,764	13.7
5. Tourism								
September 1995	1,441	50.6	557	19.5	853	29.9	2,851	1.6
December 1995	1,368	48.1	665	23.4	813	28.6	2,846	1.5
September 1996	1,753	54.7	625	19.5	824	25.7	3,202	1.6
6. Housing								
September 1995	4,323	21.2	6,138	30.1	9,899	48.6	20,359	11.6
December 1995	4,688	21.1	7,143	32.2	10,349	46.7	22,180	12.1
September 1996	5,525	21.4	9,507	36.8	10,800	41.8	25,832	12.8
7. Consumption								
September 1995	7,655	57.2	2,959	22.1	2,772	20.7	13,386	7.6
December 1995	8,356	60.3	2,669	19.3	2,822	20.4	13,847	7.5
September 1996	8,847	58.3	3,216	21.2	3,122	20.6	15,184	7.5
8. Other loans								
September 1995	12,379	63.7	5,596	28.8	1,447	7.4	19,422	11.0
December 1995	13,701	65.1	5,758	27.4	1,588	7.5	21,047	11.4
September 1996	14,192	63.6	5,903	26.5	2,210	9.9	22,304	11.0
9. Total								
September 1995	114,637	65.2	37,090	21.1	24,074	13.7	175,800	100.0
December 1995	117,509	63.9	41,897	22.8	24,541	13.3	183,946	100.0
September 1996	130,239	64.4	46,307	22.9	25,833	12.8	202,379	100.0

(a) Advances include loans,overdrafts and bills discounted and exclude cash items in process of collection.. Source: Central Bank of Sri Lanka
(b) Includes advances granted for Engineering and Building Trade, Mining and Fishing.

in other assets of banks. The Central Bank absorbed Rs.3,310 million worth of funds from the commercial banks through statutory reserves. With the increased fiscal deficit, the government sector absorbed commercial bank funds to the value of Rs.5,758 million through government securities, import bills and short-term credit. However, this sector contributed Rs.3,419 million to the banking sector by increasing its deposits. Hence, on a net basis, the government sector absorbed Rs.2,471 million in 1996. In contrast, it had supplied Rs.595 million worth of funds in 1995.

Commercial Bank Loans and Advances[1]

Loans and advances of commercial banks to the private sector, public enterprises and co-operative institutions registered an increase of 15.1 per cent (Rs.26,579 million) for the twelve months ending September 1996, compared to a rise of 23.2 per cent (Rs.33,153 million) during the 12 month period ending September 1995. The share of short and medium term credit in total credit, rose from 86.3 per cent in 1995 to 87.3 per cent (Rs.72,140 million) in 1996, while the share of long-term advances was 12.7 per cent (Rs.25,833 million) at end 1996.

Continuing past trends, the bulk of commercial bank loanable funds was absorbed by trading activities, which took up 44 per cent of the total. Credit in respect of trading activities rose by 15.6 per cent (Rs.11,980 million) during the 12-month period ending September 1996. In conformity with the general nature of commercial bank credit, 78.5 per cent of credit for trading activities was in the form of short-term facilities. Furthermore, the share of medium-term and long-term credit in trading activities declined further during 1996.

Credit for industrial purposes from commercial banks rose by 13.5 per cent (Rs.3,304 million) in the 12-month period ending September 1996, while as a proportion of total credit, it fell marginally from 13.9 per cent (Rs.24,460 million) in September 1995 to 13.7 per cent (Rs.27,764 million) in September 1996. Short-term credit for industrial purposes declined in 1996, while medium-term and long-term credit rose.

Credit to the housing and property development sub sector grew by 27 per cent during the 12 months ending September 1996, as compared to a growth of 4 per cent in the same period of the previous year. The share such credit in total outstanding loans and advances increased from 11.6 per cent at end September 1995 to 12.8 per cent at end September 1996. The major share of credit (42 per cent) in this sector fell into the long-term category.

The growth of credit for consumption purposes declined further in 1996 and grew at a slower pace than of overall credit. Credit to this category rose only by 13.4 per cent in 1996 compared to 22 per cent in 1995. The share of consumption loans in total loans and advances fell from 7.6 per cent at end September 1995 to 7.5 per cent at end September 1996. Meanwhile, credit to the agriculture, financial and tourism sectors increased modestly by 4.0 per cent (Rs.417 million), 4.6 per cent (Rs.374 million) and 12.3 per cent (Rs.351 million), respectively.

TABLE 10.7
Advances by Type of Security (a)

Item	End Sep. 1995		End Dec.1995		End Sep. 1996	
	Amount (Rs. Mn.)	% of Total	Amount (Rs. Mn.)	% of Total	Amount (Rs. Mn.)	% of Total
1. Documentary Bills	5,706	3.2	4,943	2.7	6,038	3.0
2. Government Securities	6,237	3.5	6,809	3.7	9,007	4.5
3. Shares Joint Stock Companies, Bonds, Debentures Sundries including Cash Value of Life Policies	3,162	1.8	3,012	1.6	2,906	1.4
4. Fixed, Saving & Other Cash Deposits and CDs	15,541	8.8	16,067	8.7	18,405	9.1
5. Stocks in Trade	15,140	8.6	14,688	8.0	16,493	8.1
6. Immovable Property, Plant & Machinery	43,180	24.6	45,391	24.7	50,476	24.9
7. Personal Guarantees and Pro Notes	24,680	14.0	27,902	15.2	32,005	15.8
8. Trust Receipts	10,197	5.8	10,240	5.6	10,510	5.2
9. Hire Purchase Agreements	1,051	0.6	2,085	1.1	1,991	1.0
10. Tractor & Motor Vehicles	2,220	1.3	2,495	1.4	2,935	1.5
11. Other Securities	27,417	15.6	26,501	14.4	28,731	14.2
12. Unsecured	21,268	12.1	23,814	12.9	22,880	11.3
TOTAL	175,800	100.0	183,946	100.0	202,379	100.0

(a) Excludes cash items in process of collection and advances granted for financing purposes under the Guaranteed Price Scheme.

Source: Central Bank of Sri Lanka.

1 The analysis is based on data for the first three quarters of 1996.

The average weighted lending rate (AWLR) on all loans and advances rose marginally from 20.7 per cent per annum at end 1995 to 21.0 per cent per annum at end September 1996. Of the total of loans and advances, 36 per cent carried interest rates below 20 per cent, 44 per cent had rates in the range 20-25 per cent, 9 per cent had interest rates above 25 per cent but below 30 per cent and 11 per cent had rates in excess of 30 per cent.

When viewed from the perspective of collatered 89 per cent of the total loans and advances were secured. About 25 per cent of loans were granted against immovable property, plant and machinery, while 16 per cent were covered by personal guarantees and promissory notes.

10.5 Central Banking

Reflecting the overall deficit in the balance of payments, the net international reserves of the Central Bank declined in 1996. However, primarily due to increased government borrowings from the Central Bank, the domestic assets rose, leading to an overall increase of 4.6 per cent in total assets, in comparison to an increase of the 11.3 per cent in 1995. On the liabilities side, the increase was seen in the currency issue, as well as in the deposit liabilities. Reflecting these developments in total resources and the continuation of a relatively tight monetary policy, the base money (reserve or high powered money) increased by 8.8 per cent, in comparison to a rise of 15.5 per cent in 1995.

Structure of Assets and Liabilities

The total resources of the Central Bank at Rs.181,564 million at end December 1996, recorded a moderate increase of 4.6 per cent (Rs.8,053 million) during the year, in comparison to an increase of 11.3 per cent (Rs.17,548 million) in the previous year.

On the assets side, the increase was entirely reflected in domestic assets of the Central Bank, which grew by 15.8 per cent (Rs.10,710 million) in 1996, compared to 12.1 per cent (Rs.7,323 million) in 1995. The growth in domestic assets was largely due to an increase in net credit to the Government, through increases in Treasury bill holdings and loans and advances.

In line with the overall deficit in the balance of payments, the international reserves of the Central Bank declined from Rs.105,896 million in 1995 to Rs.103,244 million in 1996. This reduction was reflected mainly in the decline in cash balances held abroad by 11.7 per cent (Rs.4,689 million).

Viewed from the liabilities side, the currency issue of the Central Bank rose by 6.0 per cent (Rs.2,796 million), while deposit liabilities rose by 2.7 per cent (Rs.2,068 million) in 1996. The increase in deposits with the Central Bank resulted from increases in deposits of commercial banks by 12.7 per cent (Rs.4,054 million), deposits of the Government by 15.5 per cent (Rs.470 million) and deposits of government agencies by 14.9 per cent (Rs.73 million) during the period. This increase was partly offset by declines in deposits of international organisations and other deposits by 3.8 per cent (Rs.1,567 million) and 58.8 per cent (Rs.963 million), respectively.

10.6 Banking Development

Branch Expansion

The total number of commercial banks operating in the country remained at 26 with 8 domestic banks and 18 foreign banks. (In December 1996, licence was issued for the establishment of a branch of a foreign commercial bank, Societe Generale, which commenced business in March 1997). However, the bank branch network continued to expand during the year, particularly in the case of domestic private banks. The total number of bank branches operated by domestic banks increased from 899 to 1,022 in 1996, while foreign bank branches increased by 1 to 38, resulting in the total number of bank branches increasing by 124, to reach 1,060 at end 1996. The National Savings Bank opened 2 branches, while the RRDBs also opened 4 branches during the year, raising the total number of bank branches from 1,202 in 1995 to 1,332 in 1996. These increases in the number of bank branches affected the

TABLE 10.8
Distribution of Bank Branches

Category	1995	1996
1. No. of Institutions	44	44
Commercial Banks	26	26
Domestic Banks	8	8
Foreign Banks	18	18
Savings Banks	1	1
RRDBs (a)	17	17
2. No. of Bank Branches (b)	1,202	1,332
Commercial Bank Branches	936	1,060
Domestic Bank Branches	899	1,022
Main Branches	797	828
ASC Branches	19	17
Kachcheri Branches	23	23
Extension/Pay Offices	41	49
Pawning Centres	15	101
Overseas Branches	4	4
Foreign Bank Branches(c)	37	38
NSB Branches	95	97
RRDB Branches	171	175

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 sub-branches.

banking density, as measured by the total number of bank branches for each 10,000 population, increasing to 0.7251 in 1996.

The total number of bank branches of the People's Bank remained at 325 as in the previous year though it opened 86 of pawning centres. With the upgrading of two Bank of Ceylon Agrarian Service Centre branches (ASC) to main branches and with the amalgamation of 2 of its branches, the total number of main branches of the BoC increased from 273 in 1995 to 274 in 1996. Accordingly, at end 1996, the total branch network of the BoC consisted of 274 main branches, 4 overseas branches, 17 ASC branches, 23 Kachcheri branches, 21 extension offices and 3 pay offices.

Hatton National Bank Ltd. opened 10 new branches and upgraded its Bogawantalawa extension office to a full fledged branch during the year while Commercial Bank of Ceylon Ltd. established five branches. Seylan Bank Ltd. enhanced its branch network by establishing 5 new branches and upgrading two of its mobile banking centres. Sampath Bank Ltd. and Union Bank of Colombo Ltd. opened 3 branches each during the year. Two foreign banks, The Hongkong and Shanghai Banking Corporation Ltd. and Muslim Commercial Bank Ltd. opened a branch each during the year, while the Standard Chartered Bank closed down one of its branches.

The total number of Regional Rural Development Banks (RRDBs) remained unchanged at 17. However, the Kalutara, Matara, Kandy and Gampaha RRDBs opened a new branch each bringing the total number of RRDB branches to 175. The National Savings Bank established 2 new branches thus raising the total number of branches to 97.

Banking Facilities

Banking facilities provided by commercial banks were enhanced during the year with new deposit and credit facilities, together with expanded innovative banking facilities, such as endorsing of commercial paper, installation of Automated Teller Machines (ATMs), leasing, pawn broking and tele banking.

As a part of the deposit mobilisation efforts made by the commercial banks, several commercial banks introduced new products such as children's savings schemes and family savings schemes, to the market, while some have linked deposit schemes with lottery systems, credit facilities, insurance benefits etc. in order to attract deposits. Meanwhile, banks continued to mobilise deposits through various kinds of deposit schemes aimed at particular target groups, such as children, families, Samurdhi beneficiaries, doctors, media personnel, teachers etc.

With a view to developing thrift habits among school children, People's Bank (PB) introduced a new deposit scheme called "Sisu Udana". Students who hold these accounts are entitled to be reimbursed for expenses incurred, up to Rs.200,000 for specific medical purposes and are also entitled to win prizes. Another new deposit scheme, "Suva Sevana", which is linked to a credit facility, was introduced by People's Bank. The target group of the scheme were employees in health services. Bank of Ceylon (BoC) introduced a new family savings scheme named "Ran Kedella", which is associated with a lottery and also entitles the account holder family unit to discounts at certain retail stores.

Hatton National Bank Ltd. (HNB) introduced a new deposit scheme, named "Silver Line" investment scheme, under which depositors are provided with life insurance cover. In addition, HNB introduced a lucky draw, "Pathum Udanaya", to Non Resident Foreign Currency Account (NRFC) and Resident Foreign Currency Account (RFC) holders. Commercial Bank of Ceylon Ltd. introduced a new savings product titled "Progressive Saver Account". Under this scheme, customers are paid a 25 per cent bonus on the interest earned on the savings account if there are no withdrawals. Pan Asia Bank Ltd. launched a new deposit scheme, named "Lama Setha", for children.

PB became a participatory credit institution (PCI) in the Fisheries Sector Community Development Credit Scheme, North Central Province Infrastructure Development Credit Programme and Financing for North Western Province Water Resources Development Project which are funded by the ADB. BoC implemented a fisheries community development loan scheme in 1996 to provide credit for self-employment activities undertaken by fishermen. In addition, BoC launched a pilot project for ornamental fish farming in Padukka.

HNB, BoC and PB commenced mobilising savings from Samurdhi beneficiary families through the Samurdhi Scheme. Under this Scheme, loans were granted to selected "Samurdhi Niyamakas" for on lending to low income people in villages.

These three banks launched the "Surathura" Credit Scheme during the year to grant financial assistance to non-recipients of Samurdhi benefits, who are unemployed and wish to commence or expand income generating economic activity such as small scale agricultural and industrial projects, small scale trading activities etc.

In addition, PB launched two new loan schemes - one for media personnel for the purchase of electronic equipment and the other for dental surgeons who are not attached to government service, to purchase necessary basic equipment for private practice. Further, PB introduced a loan scheme for Grama Niladaris for the purchase of motor cycles at concessionary interest rates. With the help of the Foreign Employment Bureau, PB launched another credit scheme to help youth who go to South Korea for foreign employment. BoC provided cultivation loans to farmers through farmer organisations, while Pan Asia Bank Ltd. implemented three loan schemes; "Pay as You Earn Loan Scheme", "Own a Car Loan Scheme" and "Home Ownership Scheme".

Union Bank of Colombo Ltd. engaged in "Interest Rate Cap Arrangements" and the "Interest Rate Floor and Cap Arrangements" during the year. Several commercial banks acted as bankers to the issuance of commercial paper by their corporate customers. Widening the ATM network, 9 banks installed 26 ATMs in 1996 thus bringing the total number of ATMs operating in the country to 161 at end 1996.

10.7 Credit Information Bureau

The Bureau suffered a major reverse when it was completely engulfed by fire in the aftermath of the bomb explosion in January 1996. However, within one month, the Bureau re-established itself in new premises, purchased new equipment and re-commenced operations from March 1996. Although all records and equipment were destroyed by fire, the credit information database was re-built from data retrieved from back-up tapes.

The Bureau supplied 79,110 reports to its shareholders during the year. The reporting floors remained unchanged at Rs.100,000 for irregular loan accounts and Rs.500,000 for regular loan accounts. The Bureau has always strived to improve the quality of its reports by updating its information database regularly. While the updating of the irregular loan database continued to be done monthly, the regular loans, which had hitherto been updated quarterly, was done monthly in the case of the Western Province. This enabled the Bureau to provide more accurate credit information to an important segment of the banking community. By year end, the database of the Bureau had 72,700 loan accounts.

The Bureau also gave effect to the Credit Information Bureau of Sri Lanka Amendment Act of 1995 by formulating rules to enable prospective borrowers to obtain, on request, credit information relating to them supplied by the Bureau to its shareholders.

During the year, one licensed commercial bank and one finance company were admitted as shareholders of the Bureau, bringing the total number of shareholders to fifty eight.

Table 10.9
Cultivation Loans Granted Under the New Comprehensive Rural Credit Scheme as at end December 1996

Rs. Million

Season	State Banks			Domestic Private Banks (a)			RRDBs			Total Loans (b)		
	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total
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	179	131	310	8	23	31	34	22	56	221	176	397
Cultivation Year 1995	695	313	1,008	26	41	67	71	44	115	792	398	1,190
1995/96 Maha	265	76	341	18	28	46	25	33	58	308	137	445
1996 Yala	71	33	104	3	12	15	14	8	22	88	53	141
Cultivation Year 1996	336	109	445	21	40	61	39	41	80	396	190	586

(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.

Source: Central Bank of Sri Lanka

10.8 Rural Banking and Rural Credit

Rural Credit Policy and Main Developments

A salient feature of the rural credit policy pursued in 1996 was the emphasis given to micro-financing as a method of promoting self-employment among the unemployed, especially the educated youth. While continuing with the policy of relying on donor funded rural credit schemes for delivering credit to specific sectors, two new micro finance schemes were inaugurated with Government funds during the year : Samurdhi Development Loan Scheme or SASANA for Samurdhi beneficiaries and Self-Employment Promotion Through Micro-Enterprises Credit Scheme or 'Surathura Diriya' for non-Samurdhi beneficiaries. The strategy adopted in both schemes was the delivery of credit as a total package covering training, marketing, compulsory savings and sub-contracting with large scale manufacturers. This strategy of credit delivery aims at the creation of an appropriate environment for prospective borrowers to succeed in their ventures.

Financing of the short-term agricultural credit requirements through resources generated from within the banking system with a government subsidy to support interest concessions introduced in 1994, was continued during the year under review. Under this programme, loans were granted for the cultivation of paddy and other subsidiary food crops coming under the New Comprehensive Rural Credit Scheme (NCRCS).

An important landmark during the year under review was the initiative taken to strengthen the Regional Rural Development Bank (RRDB) network by consolidating and integrating the District-based RRDBs operating in a Province into a Province-based Regional Development Bank (RDB). At the same time, several private sector institutions such as the Ceylinco Group and Pramuka Development Bank completed the initial work involved in establishing development and savings banks so as to cater to the development and financing requirements of the rural sector in the country. In the informal sector, the formation of small scale savings and loan associations that mobilise savings from and provide small loans to their membership recorded a phenomenal development during 1996. The entry of such people-based organisations into the rural credit scenario could be viewed as a salutary development for promoting area-based participatory credit activities.

New Comprehensive Rural Credit Scheme (NCRCS)

Credit disbursed by banks under the NCRCS in 1996 amounted to Rs.586 million, recording a decline of 51 per cent over the level achieved in the previous year. Correspondingly, the number of loans granted declined sharply from 82,000 in 1995 to 30,810 in 1996. Several

TABLE 10.10
Deposits and Advances - Rural Sector

Rs. Million.

	Co-operative Rural Banks (CRBs)		Bank of Ceylon Sub- Offices at Agrarian Service Centres		Regional Rural Development Banks		Thrift and Credit Co-operative Societies		Sarvodaya		Janashakthi Bank Hambantota		Samurdhi Scheme	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
1. Total Savings (a)	7,500	7,927	197	234	1,945	2,035	2,038	2,397	100	157	26	29	-	1,366
Savings	-	n.a.	169	194	1,595	1,596	1,049	1,152	73	121	6	8	-	8
Special Savings	-	n.a.	4	5	8	22	509	631	27	36	7	9	-	1,347
Fixed Deposits	-	n.a.	24	35	342	417	178	267	-	-	1	1	-	11
Shares	-	-	-	-	-	-	302	347	-	-	12	13	-	-
2. Total Loans Granted	805	1,067	83	101	2,020	2,284	1,677	1,888	542	753	174	508	-	4
Agriculture	106	94	45	45	321	267	208	259	193	235	108	127	-	n.a.
Animal Husbandry	29	35	1	1	30	24	43	38	22	29	-	-	-	n.a.
Fisheries	-	-	-	-	15	25	-	-	-	3	4	5	-	n.a.
Small Industries	40	43	3	6	130	201	126	99	64	101	12	165	-	n.a.
Housing Electrification and Water Supply	385	584	5	9	-	-	156	179	-	-	4	6	-	n.a.
Projects/ Commerce	104	158	15	24	1,087	1,064	732	649	45	82	36	50	-	n.a.
Others	141	154	14	16	437	714	412	664	218	303	10	155	-	n.a.

(a) Savings as at 31 December 1996
(b) Loans granted during the years 1995 and 1996.

Sources: Bank of Ceylon
People's Bank
Regional Rural Development Banks
Samurdhi Authority of Sri Lanka
SANASA
Sarvodaya
Women's Development Federation-Hambantota

factors contributed to this weak performance of the NCRCS in 1996: a reduction in the extent of area under cultivation on account of the severe drought conditions, the disqualification of many farmers from receiving new credit due to their failure to conform to the conditions of the Government's Relief Package to farmers introduced in 1994 by paying 25 per cent of the loan balances, and the cautious approach of banks to rural lending following the high incidence of default experienced in 1995. Out of disbursements, Maha 1995/96 accounted for Rs.445 million while the balance Rs.141 million was disbursed during Yala 1996. As usual, the major share of credit (68 per cent) was absorbed by paddy, leaving the balance for subsidiary food crops.

Under the interest subsidy scheme for cultivation loans under the NCRCS introduced in 1994, an interest subsidy of 7.5 percentage points per annum on agricultural loans was paid to lending banks for a maximum period of 270 days by the Government. The subsidy enabled the lending banks to provide credit to farmers at 16 per cent per annum, irrespective of their cost of funds. The interest subsidy paid to banks in 1996 on account of cultivation loans disbursed during Yala 1995 and Maha 1995/96 amounted to Rs.14.5 million.

The Government agreed to allow defaulting farmers between Yala 1986 and Maha 1993/94 to avail themselves of relief under the Farmers' Relief Package of 1994, until Yala 1997. The extension of the relief scheme in this manner is expected to bring more defaulting farmers to the institutional sector by offering them an opportunity to have their accounts regularised in a participatory loan write-off scheme. This would make them eligible to obtain fresh loans as borrowers of good standing. The Government's relief package required the Central Bank to relax its credit guarantee rules by way of waiving the requirement that a bank should institute legal action in order to be eligible for the full amount of the credit guarantee. In terms of this waiver, the Central Bank agreed to pay a half of the principal amount in loss remaining after the collection of the advance of 25 per cent from the farmers. For all other NCRCS loans, the general credit guarantee rules continued to apply.

Crop Insurance Schemes

There was an enhancement in the coverage of agricultural insurance schemes offered by the Agricultural Insurance Board (AIB) during the year under review. The new areas of insurance covered by AIB included livestock (except poultry), maize, sugarcane, coconut (up to 4 years) and betel. These new insurance schemes which received a positive response from the farming community were operated on an island-wide basis. Meanwhile, Ceylinco Insurance Company Ltd. (CICL), a private insurer, continued to expand its agricultural insurance activities which had been started in 1995 on a limited scale. The CICL insurance schemes covered paddy, maize, fruits, vegetables, livestock and potatoes and were implelented in selected cultivation districts.

The extent of paddy land insured by the AIB in 1996 was 26,000 hectares recording a sharp decline from prors the 71,000 hectares covered in 1995. This decline is explained by the sharp reduction in the area covered by NCRCS during the year. The private operations of crop insurance could have expanded their scale, had the banks been permitted to accept their policies as collateral for cultivation loans. The premia collected by the AIB in 1996 amounted to Rs.16.1 million, while the indemnities met were recorded at Rs.18.5 million, leaving a shortfall of Rs.2.4 million in its insurance operations. The CICL collected premia amounting to Rs.0.33 million and paid compensation to the value of Rs.0.21 million.

Micro Financing and Savings Schemes

Samurdhi Development Credit Scheme or SASANA Scheme

With a view to raising the income levels and the living standards of the Samurdhi beneficiaries, a new Micro Enterprise Scheme titled SASANA was inaugurated by the Ministry of Youth Affairs, Sports and Rural Development in collaboration with the Bank of Ceylon and the People's Bank using the existing network of Samurdhi animators and managers. Under this scheme, family members of Samurdhi beneficiaries were eligible to raise small loans ranging between Rs.2,500 and Rs.10,000 for the purpose of undertaking new income generating projects or for expanding the existing projects. A pre-requisite for the eligibility for micro finance under this Scheme was a minimum savings of Rs.2,000 in a Samurdhi Bank Society by a Samurdhi family.

In order to inculcate savings habits among Samurdhi beneficiaries, 82 Samurdhi Bank Societies were established in selected districts during the year under review. The beneficiaries were required to invest in shares of these bank societies in addition to placing their voluntary savings with such societies. The value of shares owned by beneficiaries amounted to Rs.107 million, while the savings stood at Rs.8 million at the end of the year. In addition, beneficiaries were required to participate in a compulsory savings scheme under which savings at the rates of Rs.500 and Rs.1,000 per month were collected at source from the beneficiary families at the time of the disbursement of benefits to them. As at the end of 1996, the total compulsory savings mobilised amounted to Rs.1,347.5 million. The Samurdhi Authority had invested the entirety of these savings in Treasury bills and bank deposits pending the preparation of guidelines, rules, terms and conditions for the disbursement of micro credit among the beneficiaries.

Self Employment Promotion through Micro Enterprise Credit or Surathura Diriya

A second Micro Enterprise Credit Scheme targeting the non-Samurdhi beneficiaries was inaugurated by the Government towards the end of 1996. This Scheme, titled 'Surathura Diriya', was implemented by the Central Bank in collaboration with the Bank of Ceylon, People's Bank and Hatton National Bank by using the network of Samurdhi animators and Samurdhi managers. Under this Scheme, educated unemployed youth who were not Samurdhi beneficieries could receive loans upto Rs.50,000 at the rate of 10 per cent per annum for undertaking income generating self employment activities. Credit was delivered to beneficiaries as a comprehensive package under which a wide range of support services by way of training, marketing, linking with large scale manufacturers and traders etc. was provided by the banks to beneficiary groups. At the end of 1996, 2,400 beneficiaries had been granted a sum of Rs.78 million under the Scheme.

Janashakthi Banking Societies in Hambantota

Janashakthi Banking Societies are informal savings and loan associations established by the Women's Development Federation in Hambantota with the objective of mobilising savings and granting small loans to their members. This Scheme is an evolution of an informal savings arrangement into an organised formal voluntary association managed exclusively by women members. The societies have as their objective the holistic development of the members by upgrading their living conditions, social recognition, health and nutritional levels. As at the end of 1996, there were 67 Janashakthi Banking Societies consisting of 26,000 members in the Hambantota district. Savings amounting to Rs.28 million have been mobilised from members upto the end of 1996 in the form of savings and investments in shares in the societies. The total lending which amounted to Rs.217.4 million as at the end of the year had primarily been extended for agriculture, small industries and trading purposes. The major sources of funds were the savings of members and credit obtained from the National Development Trust Fund. The interest rate charged on these loans continued to remain at 36 per cent per annum during 1996.

Sarvodaya Rural Entrepreneurship Project

Under this Scheme, Sarvodaya Shramadana societies have been formed with a view to improving the economic status of the members, inculcating savings habits among them and meeting their small-scale financial requirements. At the end of 1996, about 2000 such societies had been formed in 20 districts. Loans are granted after the members go through a compulsory savings programme for at least 6 months with the society. The maximum amount granted was Rs.30,000 per member. A total of Rs.752.5 million was granted to members as micro enterprise loans under this Project in 1996.

Thrift and Credit Co-operative Societies (TCCS) Micro-Finance Scheme

TCCS or SANASA also provides micro-finance facilities to members to meet their urgent financial requirements, while maintaining the members' savings as deposits with SANASA Primary Societies. These micro-loans are granted to members on very simplified procedures at prevailing market rates. With effective credit supervision, SANASA has been able to maintain a recovery rate of 99 per cent of its micro credit facilities. In 1996, the total amount of such loans granted was Rs.1,888 million.

10.9 Other Financial Institutions

Savings Institutions

The National Savings Bank (NSB) improved its deposit mobilisation in 1996. With the advantage of its wide branch network and by maintaining competitive rates of interest, it was able to raise deposits amounting to Rs.9,080 million during the year in comparison to Rs.4,430 million in 1995, thus bringing total deposits to Rs.66,835 million at end 1996. The Bank mobilised savings through instruments such as Passbook savings, fixed deposits, pension schemes, endowment scheme, premium savings bonds, gift tokens, Savers' Housing Loan Scheme and "Surakum Ginum". Fixed deposits increased by 15 per cent (Rs.5,475 million), while savings deposits increased by 17 per cent (Rs.3,595 million) during the year. Other deposits, including the NSB pension scheme and premium savings bonds, indicated an increase of 10.9 per cent (Rs.10 million). NSB interest rates were revised downward in the early part of the year in keeping with movements in other market rates. Accordingly, interest rates applicable for 3-month fixed deposits were revised downward from 14 per cent to 12 per cent in February 1996. The interest rate on 12-month fixed deposits with interest payable at maturity was reduced from 16 per cent to 15 per cent in 1996. The interest rate on savings deposits remained at 12 per cent throughout the year.

Expanding the facilities provided by the NSB to its clients, a new deposit scheme, named "Surakum Ginum", which is linked to a life insurance benefit scheme was introduced during the year. Under this scheme depositors make an agreed monthly deposit for a period of 66 months and thereafter receive a monthly payment from the bank, equivalent to the monthly deposit.

Total investments of the NSB increased by Rs.7,720 million and stood at Rs.60,220 million at end 1996. The bulk of investments was in the form of Rupee Loans (74 per cent) while investments in Treasury bills accounted for 11 per cent of total investments at end year.

The country's main superannuation fund, the Employees' Provident Fund (EPF), recorded an increase in activities in 1996. A decision was taken by the Ministry of Labour in February 1996 that no new members should be enrolled in the approved private provident funds, hence, some of the new contributions to these funds would also be directed to the EPF. The total contributions received by the EPF amounted to Rs.9,000 million in 1996, compared with Rs.8,154 million received in 1995, while the net benefits paid to members increased from Rs.2,715 million to Rs.3,000 million. These transactions, together with the inflows arising from returns on EPF investments resulted in the members' balances with the Fund increasing from Rs.85,386 million at end 1995, to Rs.102,000 million at end 1996. The total value of EPF investments at end 1996 stood at Rs.116,098 million, clearly the largest single investor Fund in the country. Of its investments 97.7 per cent were in government paper.

The country's second superannuation fund, the Employees' Trust Fund (ETF), also recorded a significant growth in 1996, in total assets as well as contributions. Total assets of the ETF increased by 20 per cent to reach Rs.16,951 million at end 1996. Total contributions received increased from Rs.1,503 million in 1995 to Rs.1,609 million in 1996, while outstanding members' balances rose by 20 per cent to Rs.14,798 million at end 1996. Total investments increased from Rs.13,236 million at end 1995 to Rs.16,040 million at end 1996. The bulk of these investments was in the form of government securities, which accounted for 59 per cent of total investments, as against 68 per cent recorded in 1995. Thus, some diversification in the investment portfolio has taken place with a shift away from government securities. Investments in government securities increased from Rs.8,932 million to Rs.9,521 million during the same period. Investments with commercial banks and the State Mortgage and Investment Bank, which accounted for 10 per cent of total investments in 1996 compared with 6 per cent in 1995, increased substantially from Rs.772 million in 1995 to Rs.1,525 million in 1996. Other investments including debentures, shares, investments in Unit Trusts, commercial paper etc. accounted for 31 per cent of total investments compared to 27 per cent in 1995. Investments in this category increased by 41 per cent to Rs.4,994 million at end 1996.

Long-Term Lending Institutions

Indicating some slowing down in lending activities of the DFCC in 1996, the number of loans approved during the year fell to 878 from 1,248 in 1995, while the amount of total loan approvals also decreased by 28 per cent to Rs.4,259 million. The total amount of loans disbursed amounted to Rs.2,851 million, a decrease of Rs.836 million. However, total loans outstanding increased by 13 per cent to Rs.10,411 million at end 1996. The majority of loans (56 per cent) disbursed during the year were for industrial purposes, as in the previous year. The financial sector including leasing, received 18 per cent, while the tourism and agriculture sector absorbed 11 per cent and 8 per cent, respectively, of total loans disbursed. Loans granted for other purposes including electricity, gas and water, community and social services, transport services etc. decreased from Rs.228 million in 1995 to Rs.225 million in 1996.

Of the total loans outstanding, 64 per cent was medium term, 21 per cent was long term and 15 per cent was short term, reflecting that the main focus of the DFCC is on medium term financing. While 66 per cent of total loans outstanding were loans above Rs.5 million, 58 per cent of total loans outstanding were released against the security of property mortgage. Of the total loans disbursed during the year, 33 per cent were granted at interest rates below 16 per cent, 19 per cent within a range of 17.0-19.5 per cent and 48 per cent at rates of 20 per cent and above.

The DFCC provided Rs.131 million to five companies by way of equity financing, compared to Rs.361 million for 20 companies in 1994. The bulk of equity financing facilities (Rs.108 million) was provided to the industrial sector while Rs.13 million and Rs.10 million were provided to the financial sector and tourism sector, respectively.

The main sources of funds of the DFCC during the year were repayment of loans by customers (Rs.2,889 million), borrowings from the International Development Association (IDA) and the Asian Development Bank (ADB) (Rs.973 million).

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

Rs. Million

Loans	DFCC		NDB(a)		NSB		SMIB		HDFC		NHDA		Total		% of Total	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
1. Agriculture	433	400	651	1.057	-	-	25	26	-	-	-	-	1109	1,483	6	9
2. Industry	3,560	2,223	3,437	3,979	-	-	-	-	-	-	-	-	6,997	6,202	36	36
3. Tourism	1,056	447	11,17	301	-	-	-	-	-	-	-	-	2,173	748	11	4
4. Commercial	-	-	-	-	-	-	-	-	-	-	-	-	-		-	-
5. Financial	434	569	70	35	1,600	999	-	-	-	-	-	-	2,104	1,603	11	9
6. Housing	-	-	91	199	239	1,328	819	1,081	555	544	875	1,276	2,579	4,428	13	26
7. Redemption of Debt	-	-	-	-	-	-	11	-	-	-	-	-	11		-	
8. Other Loans	415	620	1,153	1,831	2,748	78	20	57	-	-	-	-	4,336	2,586	22	15
Total (Approved)	5,898	4,259	6,519	7.402	4,587	2.405	875	1.164	555	544	875	1,276	19,309	17,050	100	100
Loans granted (b)	3687	2.851	4,011	5.537	4,587	2.405	738	1.164	469	468	373	519	13,865	12,944		
Loans granted a % of Total Loans Approved	63	67	62	75	100	100	84	100	85	86	43	41	72	76		

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

Sources: Development Finance Corporation, National Savings Bank, State Mortgage & Investment Bank, Housing Development Finance Corporation, National Development Bank, National Housing Development Authority

The other major long-term lending institution, National Development Bank (NDB) approved Rs.7,401 million worth of credit during the year in respect of 240 loans. The increase in total loan approvals was 14 per cent in 1996 as in 1995. The industrial sector received the largest portion of credit, accounting for 54 per cent of total loans approved during the year. The agricultural sector received Rs.1,057 million (14 pr cent of the total). The other sectors which received significant amounts of credit from the NDB were tourism, financial, housing and property development. The NDB also provided equity finance facilities amounting to Rs.643 million in respect of 12 projects. As in the previous year, the main sources of funds for the NDB were the recovery of loans (55 per cent), borrowing under ADB and IDA credit lines (19 per cent) and borrowings abroad (19 per cent).

The State Mortgage and Investment Bank (SMIB) approved 8,348 loans to the value of Rs.1,164 million during the year. Of this total, 7,986 loans, with a value of Rs.1,081 million were for the housing sector. In keeping with the SMIB's character of being primarily a provider of funds for housing purposes, 93 per cent of total loan approvals in 1996 were for housing, while the balance were for agricultural and industrial purposes. The majority of loans provided by the bank were below 5 million, with long-term loans constituting 94 per cent of the total. The SMIB provided facilities mainly against the security of land and property and EPF balances. Of the total loans granted, 48 per cent were within an interest rate range of 16-18 per cent, while 45 per cent were at rates above 20 per cent. The main sources of funds for the SMIB in 1996 were fixed deposits, debentures, recovery of past loans and ADB and USAID credit lines.

The Housing Development Finance Corporation of Sri Lanka Ltd. (HDFC) approved 4,105 loans to the value of Rs.544 million for housing purposes compared with 4,539 loans with a value of Rs.555 million approved in 1995. The majority of loans (94 per cent) were granted in the interest rate range of 15 - 19 per cent, against a property mortgage. The main sources of funds for the HDFC were the Housing Guarantee Low Income Shelter Programme funded by USAID and administered by the Central Bank, and fixed deposits. The National Housing Development Authority (NHDA) also continued to expand credit facilities for housing activities. The NHDA approved Rs.1,276 million for housing purposes in 1996, of which Rs.519 million was granted within the year. This compared with approvals of loans to the value of Rs.875 million and disbursements worth Rs.373 million in 1995. All these loans were below Rs.25,000 and granted against the security of personal guarantees at rates of 14 and 15 per cent. The sources of funds of the NHDA were government grants, sale of houses and loan recoveries.

Finance Companies

The total number of finance companies operating in the country throughout most of 1996 was 24. In October 1996, registration was granted to one more, bring the total number of finance companies registered with the Central Bank to 25 at end 1996. Total assets and liabilities of finance companies increased from Rs.15,085 million in 1995 to Rs.17,984 million in 1996.

Total loans and advances, which include credit granted for hire purchase and leasing, increased by25 per cent to Rs. 12,086 million. Investments, consisting of investments in government securities, subsidiaries, associate companies and parent companies and other investments, increased by 10 per cent to Rs. 2,161 million. The bulk of these investments was in Treasury bills and shares.

On the liabilities side, deposits with finance companies rose by Rs. 1,975 million in 1996 compared to Rs.1,439 million in 1995. Borrowings of finance companies decreased from Rs.1,812 million in 1995 to Rs.1,454 million in 1996. Meanwhile, capital and reserves of finance companies showed an increase of Rs.279 million during the year.

Interest rates for one year fixed deposits were in the range of 18 to 21 per cent in 1996. In comparison, the lending rates for hire purchase activity were in the range 16 - 30 per cent, with the minimum rate charged by most companies exceeding 21 per cent. Lending rates for other purposes varied within a broader margin.

The relief scheme for depositors of distressed finance companies operated by the Central Bank continued in 1996, with depositors of three failed finance companies receiving relief payments during the year.

TABLE 10.12
Assets and Liabilities of Licensed Finance Companies

Rs. Million

Item	As at 31 December 1995	As at 31 March 1996	As at 31 June 1996	As at 31 September 1996	As at 31 December 1996
Assets					
1 Capital Account	2,326	2,220	2,432	2,533	2,605
2 Deposits	8,227	8,793	9,536	9,876	10,202
3 Borrowings	1,812	1,243	1,124	1,269	1,454
4 Other Liabilities	2,720	3,372	2,961	3,137	3,724
Total	15,085	15,628	16,053	16,815	17,984
Liabilities					
1 Loans and Advances	9,664	10,474	10,763	11,461	12,086
2 Equity Investments	988	1,045	1,019	984	1,036
3 Treasury Bills	976	951	1,080	1,031	1,125
4 Other Assets	3,457	3,158	2,192	3,329	3,737
Total	15,085	15,628	16,053	16,815	17,984
Number of Finance Companies Reporting to the Central Bank	24	24	24	24	24

Source: Central Bank of Sri Lanka

(a) Only finance companies registered with the Central Bank are allowed to undertake finance business. Other existing finance companies have been directed to initiate wind ing-up operations.

10.10 Specialised Financial Institutions

Merchant Banking

As in 1995, there were seven merchant banks in 1996, of which six were in active operation. The year witnessed a large growth in merchant banking activities with a significant improvement in total income and a moderate growth in total assets.

Total assets of merchant banks increased by 6.8 per cent from Rs. 11,342 million in 1995, to Rs. 12,114 million in 1996. Total income of merchant banks increased by 64 per cent to Rs.2,331 million at end 1996. Interest on margin trading, income from leasing, interest from discounting trade bills and profit on investments in shares accounted for 77 per cent of the total income and were the major sources of income of merchant banks in 1996. All these sources recorded enhanced incomes in 1996.

TABLE 10.13
Progress of Activities of Merchant Banks

Rs. Million

		1995	1996(a)
1	Earned income on Leasing	460	559
2	Interest on Discounting Trade Bills	320	374
3	Financial and Marketing Consultancy Services	37	38
4	Underwriting Commissions	23	12
5	Insurance Commissions	3	2
6	Interest on Margin Trading	192	668
7	Profit on Investment in Shares	56	194
8	Interest on Treasury Bills	17	123
9	Other Income	272	350
0	Total Income	1,378	2,331
11	Total Assets	11,342	12,114

(a) Provisional

Source: Central Bank of Sri Lanka.

Leasing Companies

The total assets of the three specilised leasing companies rose from Rs.4,595 million at end 1995 to Rs.5,842 million at end 1996. However, the total new lease finance provided by the companies decreased by 13.6 per cent and stood at Rs.1,921 million at end 1996, primarily due to a reduction in the finance provided for commercial vehicles, which fell by 20 per cent. Total lease finance for commercial vehicles was Rs.1,043 million and it was 53 per cent of total lease finance. An important feature observed in recent years has been the shift in the portfolio of leasing companies from hire purchase to lease financing.

The development of the leasing industry is expected to help long-term capital formation in the country. Hence the Budget for 1997 introduced a proposal to permit the depreciation allowance on leased assets to be set off only against leasing income to help sustain and develop specialised leasing companies.

Venture Capital Companies

The total number of venture capital companies operating in the country in 1996 stood at six. Activities of the venture capital companies increased during the year with total assets growing from Rs.2,076 million at end 1995 to Rs.2,296 million at end 1996. Investments made by venture capital companies in the equity of projects rose by Rs.290 million (47 per cent) in 1996. As in the previous year, the majority of funds provided by venture capital companies (65 per cent) was for the commencement of new operations, while 32 per cent of financing was for the expansion of exiting projects. Equity investments made in the manufacturing sector amounted to Rs.658 million, while projects in the services and agriculture sectors received Rs.239 million and Rs.66 million, respectively.

Insurance Companies

Insurance activities of the country were carried out by six insurance companies in 1996 as in the previous year with these firms conducting aggressive advertising campaigns to popularise insurance. Life insurance activities as well as general insurance activities showed an improvement during the year.

The total life premia collected by the companies increased by 23 per cent to Rs.2,761 million in 1996 compared to a 38 per cent increase in 1995. The total value of life funds of the insurance companies reached Rs.55,281 million, a 10 per cent increase over the previous year. The total number of life policies in force increased by 9 per cent to 708,000.

General insurance consisted of fire, accident, marine and motor insurance. Net premia on general insurance activities rose by 19 per cent in 1996 compared to 32 per cent increase in 1995. Net premia in the motor insurance sector, which was the biggest sector in the general insurance category as in the previous year, increased from Rs.1,452 million in 1995 to Rs.1,589 million in 1996. Net premia of the fire insurance, accident insurance and marine insurance categaries also rose by 5 per cent, 33 per cent, 47 per cent.

10.11 Money Market

Overall Trends

Despite the reduction in the pace of economic activity during the middle of the year, money markets remained active and stable in 1996. Increased liquidity in the market resulted in lower interest rates with less volatility than in 1995. Even in the aftermath of the bomb attack on the Central Bank in January, money markets displayed a reassuring degree of stability, clearly indicating that the Sri Lankan money market and the institutional arrangements had developed to an extent sufficient to withstand serious shocks to the system. Most primary Treasury bill auctions were oversubscribed by the public. Operating through the money markets, the Central Bank employed open market operations as its main instrument of monetary policy. Taking into account domestic market forces, in particular, the relatively high rate of inflation, and the movement in international exchange rates, the Central Bank's middle rate for the US dollar, the intervention currency, depreciated by about 5 per cent during the year.

TABLE 10.14
Money Market Operations

(Amount Rs.Mn.)

Period			Call Money Market		Primary Treasury Bill Market							Secondary Treasury Bill Market		
			Total Lending Borrow ings	Outstand-ing at end of period (a)	Total Outstand-ing	Amount Issued	Amount Accepted (Purchases)					Total Sales	Total Purchases	Outstand-ing at end period
							Central Bank	Commer-cial banks	Others	Total				
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	11,463	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
1996														
	1st	Quarter	217,697	2,390	120,021	52,025	3,560	27,170	21,295	52,025		9,384	795	4,401
	2nd	Quarter	191,406	4,792	122,821	50,009	8,586	27,285	14,138	50,009		1,710	3,871	1,493
	3rd	Quarter	233,790	3,977	124,521	58,819	9,502	33,021	16,296	58,819		1,975	5,854	681
	4th	Quarter	301,921	6,862	124,996	66,027	2,753	42,362	20,912	66,027		3,043	6,301	1,003

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

Source: Central Bank of Sri Lanka

Inter Bank Call Money Market

The call money market continued to expand during 1996. Small foreign banks and non-commercial banks were generally net borrowers, while domestic commercial banks remained the major lenders. The annual turnover rose from Rs.654,000 million in 1995 to Rs.945,000 million in 1996 (an increase of 44.6 per cent). Consequent to the high liquidity that prevailed particularly in the first quarter, call market rates fell sharply from 20.00-58.00 per cent at end 1995 to 9.60-10.80 per cent by end March, before rising to a level of 14.00-17.50 at end June. Thereafter, call money rates varied within a narrow range with slight fluctuations. Call money rates were in a range of 13.30-25.00 per cent in September, while they moved up to a slightly wider range of 13.00-31.00 per cent in December with the end year rates remaining at 17.50-28.00 per cent.

Treasury Bill Market

Primary Market for Treasury Bills

Reflecting the liquidity in the market, heavy overbidding at the Treasury bill auctions and a sharp decline in the discount rate were evident at the beginning of the year. In fact, only a few auctions were undersubscribed during 1996. The total value of Treasury bills offered in the primary market stood at Rs.227,000 million, in comparison to Rs.224,000 million in the previous year. The total outstanding level of Treasury bills rose from Rs.114,000 million at end 1995 to Rs.125,000 million by October 1996, thus reaching the limit on government borrowing through Treasury bills approved by Parliament. This limit prevented further issues of Treasury bills and helped contain yield rates.

The Central Bank purchased Rs.24,000 million of Treasury bills in the primary market in 1996 as against the purchases of Rs.20,000 million in 1995. There were special issues amounting to Rs.6,900 million which were purchased directly by the Central Bank. The major portion of these special issues was taken up by the Central Bank in its efforts to stabilise the market following the bomb blast on 31 January.

Treasury bill rates, which declined in the first few months of 1996 with the infusion of liquidity into the system, gradually rose to a range of 18.25-17.98 per cent by mid November. These rates were approximately 1.5-2.5 percentage points below the corresponding rates in mid November 1995. The rates declined thereafter to a range of 17.45-17.38 per cent at the end of 1996.

Secondary Market for Treasury Bills

The sales (discounting) of Treasury bills from the secondary window of the Central Bank amounted to Rs.16,000 million in 1996 compared with Rs.17,000 million in the preceding year. Meanwhile, purchases (re-discounting) of Treasury bills fell considerably from Rs.35,000 million in 1995 to Rs.17,000 million in 1996, indicating the higher liquidity in the market.

The Central Bank's secondary market discount and re-discount rates moved during 1996 in line with trends witnessed in the primary market rates. The spread between these rates which stood at 1.46 percentage points at end 1995, rose to 2.00 percentage points on 16 February. This spread increased further to 3.00 percentage points in March and after several adjustments, declined to 1.75 percentage points on 26 December. The discount and rediscount rate for 3 month bills fell from 19.01 per cent and 20.47 per cent, respectively, at end 1995 to 17.20 per cent and 18.95 per cent, respectively, at end 1996.

Repurchase Market for Treasury Bills

The sale of Treasury bills under Repurchase Agreements (repos) was introduced by the Central Bank in October 1993, with a view to stabilising the lower end of the call market. The repurchase rate was determined daily by the Central Bank taking into consideration factors such as primary and secondary market rates, call market rates and liquidity, general economic conditions and policy considerations.

The overnight repo rate declined gradually from 16.50 per cent at end December 1995 to 9.50 per cent at end March before being increasing, in keeping with market trends, to 12.75 per cent by June. The repo rate remained unchanged at 12.75 upto mid September, when it rose slightly to 13.00 per cent. It further rose to 13.25 per cent towards the end of November, but with the decline in the Treasury bill rates, declined to 12.75 per cent by end December 1996.

Repo sales amounted to Rs.404,000 million in 1996 in comparison to Rs.198,000 million in 1995, indicating greater participation by investors.

Reverse Repurchase Market for Treasury Bills

The reverse repurchase scheme of the Central Bank was introduced in November 1995, with the intention of stabilising the upper end of the call market interest rates. In view of the continued liquidity in the market during

1996, there was no necessity for the Central Bank to inject funds through its reverse repurchase scheme. Consequently, this scheme was inactive in 1996.

Domestic Foreign Exchange Market

In 1996, the Central Bank continued to facilitate the domestic foreign exchange market by announcing daily spot buying and selling rates for the US dollar, the intervention currency. The spread between spot buying and selling rates, which was increased to 2 per cent from 1 per cent in 1995, was maintained. The Central Bank middle rate stood at Rs.56.7050 per US dollar at the end of 1996 as against Rs.54.0475 per US dollar at the end of 1995, reflecting a depreciation of the rupee against the US dollar. of 4.9 per cent. Purchases by the Central Bank fell from US dollars 202 million in 1995 to US dollars 96 million in 1996, indicating a sharp decline of 52.4 per cent. The purchases were all made in the first eight months of 1996, notably in the immediate aftermath of the attack on the Bank on 31 January. Meanwhile, sales of US dollars by the Central Bank to commercial banks in 1996 amounted to US dollars 198 million, compared by US dollars 7 million in In the previous year. The net purchases of foreign exchange from the Central Bank by commercial banks in 1996 amounted to US dollars 102 million, reflecting the increased foreign exchange needs of commercial banks.

Off-shore Market

Off-shore banking activities of the Foreign Currency Banking Units (FCBUs) of commercial banks, which rose in 1995, recorded a decline in 1996. The total assets/liabilities of the FCBUs declined by 3 per cent (US dollars 46 million) and stood at US dollars 1,430 million at end 1996. This contraction was mainly attributed to the decline in the activities of the non-resident category.

On the asset side, advances to non-residents fell by 12 per cent (US dollars 69 million) to US dollars 504 million at the end of the year, while those to the resident category rose by 3 per cent (US dollars 21 million) to US dollars 856 million at end December 1996. This was reflected primarily in advances extended to exporting enterprises under the purview of the Board of Investment (BOI).

On the liabilities side, deposit liabilities of the non-resident category also dropped by 10 per cent (US dollars 67 million) while those of the residents increased by 3 per cent (US dollars 18 million). The funds obtained from local banks through the placement of their foreign currency deposits also declined. However, large increases in the balances maintained by BOI enterprises, in particular the foreign owned enterprises, and the other approved category resulted in the overall increase in deposit liabilities of the non-resident category.

10.12 Capital Market

The Colombo stock market remained depressed in 1996, though some recovery was seen in the second half of the year with improved investor sentiment. The continued depression in the market was due to poor foreign participation, labour unrest, two incidents of urban terrorism, and the power crisis. Though the activities of non-nationals were low, they were net purchasers, due to reduced sales. Of the four initial public offerings (IPOs) made by non-plantation companies during 1996, three were over-subscribed. In addition, fifty one per cent share parcels of four privatised plantation companies were sold, on an all or nothing basis, to the highest bidder, consequent on a change instituted in the mechanism by which shares of privatised companies were offered to the market.

TABLE 10.15
Share Market Indicators

	1993	1994	1995	1996
1. Market Capitalization (Rs.Mn.)	123,790	143,210	106,869	104,197
2. Number of New Issues (No.)	12	21	17	8
3. Total Number of Shares Issued (Mn.)	42	190	100	64
4. Value of New Shares Issued (Rs.Mn.)	1,051	4,589	2,120	2,178
5. Number of Shares Traded (Mn.)	351	506	315	227
6. Value of Shares Traded (Rs.Mn.)	18,579	34,522	11,249	7,403
7. Price Indices -				
CSE All Share (as at 31 Dec.)	605.3	986.7	663.7	603.0
CSE Sensitive (as at 31 Dec.)	826.5	1,438.8	990.5	897.7

Source: Colombo Stock Exchange

Primary Market

There was a total of eight initial public offerings in 1996 in comparison to seventeen in 1995. Of these, four were non-plantation companies, viz., Lanka Lubricants Ltd., Associated Hotels Company Ltd., Tea Smallholders Factories Ltd., Lion Brewery Ceylon Ltd., while four viz., Agarapatana Plantations Ltd., Hapugastenna Plantations Ltd., Balangoda Plantations Ltd. and Udupussellawa Plantations Ltd. were plantation companies being offered to the market as a part of the Government's ongoing privatisation programme. A change was effected in the mechanism by which the 51 per cent majority shareholding was disposed of, as the previous method had resulted in an under valuation, thereby reducing the receipts to the

Chart 10.4
Share Market Indicators

Chart 10.4.1
Share Price Indices
(1985=100)

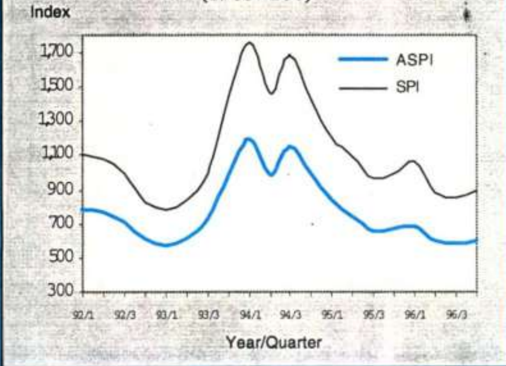


Chart 10.4.2
Stock Market Transactions

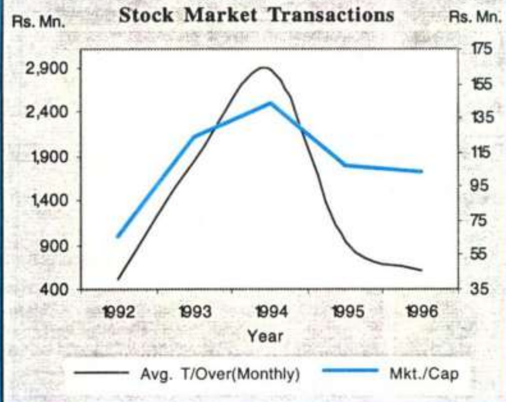
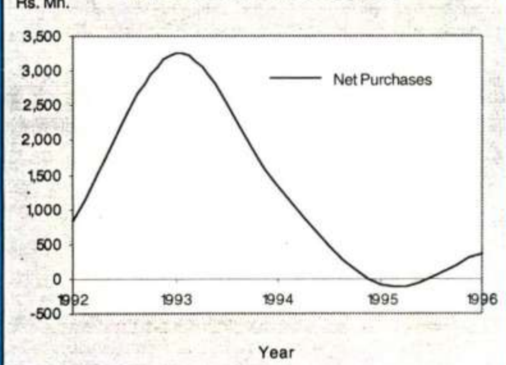


Chart 10.4.3
Non-National Participation



Government. Under the new procedure, the shares continued to be sold on an all or nothing basis but were auctioned. This resulted in the realised price per share being considerably higher than the par value. Of the four initial public offerings made by non-plantation companies during 1996, only Lanka Lubricants Ltd. was under-subscribed. The total market value of the eight IPOs (inclusive of share premium) was Rs.2,178 million. In comparison, 1995 saw a total value of Rs.2,121 million being raised through initial offers, including the amount raised through the sale of 51 per cent share holdings of plantation companies on an "all or nothing" basis.

Secondary Market

The All Share Price Index (ASPI) and CSE Sensitive Price Index (SPI) of the Colombo Stock Exchange (CSE) which started falling in 1994, continued their slide up to July 1996 in spite of the slight upward movement recorded from January to March 1996. An upward movement was seen again in both indices from August to November. The ASPI and SPI that started at 663.7 and 990.5, respectively, at the beginning of the year, ended at 603.0 and 897.7, respectively. As such, the ASPI and SPI depicted overall decreases of 9.2 per cent (60.7 index points) and 9.4 per cent (92.8 index points), respectively, during 1996.

Market capitalization of the CSE, which stood at Rs.106,900 million at the beginning of the year, reached a high of Rs.118,400 million on 15 March, before declining to Rs.92,700 million by end July. It ended December at Rs.104,200 million, reflecting a decrease of Rs.2,700 million

TABLE 10.16
Number of New Share Issues by Type of Investment

Type of Investment	1992	1993	1994	1995	1996
Banks Finance & Insurance	1	3	6	2	-
Beverages Food & Tobacco	2	-	3	-	1
Chemicals & Pharmaceuticals	-	-	-	-	1
Diversified	-	-	-	-	-
Footwear & Textiles	1	-	1	-	-
Hotels & Travels	4	4	-	1	1
Investment Trusts	-	-	-	-	-
Land & Property	-	-	1	-	-
Manufacturing	-	2	4	5	-
Motors	3	1	6	-	-
Oil Palm	-	-	-	-	-
Plantations	-	-	-	9	5
Services	1	-	-	-	-
Store & Supplies	-	-	-	-	-
Trading	3	2	-	-	-
Total	15	12	21	17	8
Number of Shares Offered (Mn.)	78	42	190	100	64
Value of Shares Offered (Rs.Mn.)	1,267	1,050	4,589	2,120	2,178

Source: Colombo Stock Exchange

TABLE 10.17
New Share Issues of Companies during 1996

	Name of Company	No. of Shares on Offer	Par Value Rs.	Premium Rs.	Value of Shares (Rs.Mn)	No. of Shares Subscribed by Public	No. of Shares Taken up by Underwriter
1	Tea Smallholders Factories Ltd.	5,850,000	10	2.00	70	5,850,000	-
2	Lanka Lubricant Ltd.	11,700,000	10	40.00	585	2,048,200	9,651,800
3	Agarapatana Plantations Ltd.	7,599,000	10	25.25	268	7,599,000	-
4	Assosiated Hotels Company Ltd..	1,040,760	10	15.00	26	1,040,760	-
5	Hapugastenne Plantation Ltd.	10,200,000	10	13.75	242	10,200,000	-
6	Balangoda Plantation Ltd.	10,200,000	10	31.25	421	10,200,000	-
7	Udapusselawe Platation Ltd..	4,845,000	10	55.25	316	4,845,000	-
8	The Lion Brewery Ceylon Ltd.	12,500,000	10	10.00	250	12,500,000	-

Source : Colombo Stock Exchange.

(2.5 per cent) during the period under review. Market capitalization in Sri Lanka is heavily influenced by a few prominent stocks, among which financial sector institutions dominate. The two development banks, *i.e.* DFCC and NDB, John Keels Holdings, HNB, Hayleys, Ceylon Tobacco, Commercial Bank, Asian Hotels Corporation, Sampath Bank and Distilleries Company were the largest companies by market capitalization. These ten companies accounted for about 38 per cent of the total market capitalization of the Sri Lanka stock market at the end of 1996. There were five banking institutions among the top 10 companies at the end of the year and these five accounted for 21 per cent of the total market capitalization.

The decreasing trend in trading activities continued to persist in 1996. Even though there are about 2,000 public companies registered in Sri Lanka under the Companies Act, only 235 companies were listed on the Colombo Stock Exchange (CSE) as at end December 1996. Moreover, of these listed companies, only 25-35 companies trade regularly, according to CSE records.

The total turnover in 1996 fell to Rs. 7,400 million from Rs. 11,250 million in 1995 (a fall of 34 percent). The daily turnover declined from Rs. 46.9 million in 1995 to Rs. 30.6 million in 1996. The number of trades declined significantly to 98,191 (47 percent decline) in 1996 from 186,276 in 1995.

TABLE 10.18
Distribution of Shares Traded in the Secondary Share Market in 1996 - by Category

Category of Investment	No. of Transactions	No. of Shares ('000)	Value (Rs. Mn.)
Banks, Finance & Insurance	31,954	52,717	3,269
Beverages, Food & Tobacco	13,176	38,045	529
Construction & Engineering	1,933	9,651	111
Chemicals & Pharmaceuticals	1,353	735	44
Diversified	7,050	3,566	1,720
Footwear & Textiles	2,616	1,952	17
Hotels & Travels	4,497	11,864	158
Investment Trusts	598	398	8
Land & Property	3,830	10,653	79
Manufacturing	26,209	51,742	1,047
Motors	2,033	4,141	146
Oil Palms	13	26	8
Plantations	1,008	5,749	137
Services	590	497	14
Stores & Supplies	105	226	21
Trading	1,226	2,493	78

Source: Colombo Stock Exchange.

The monthly turnover, which was Rs.878 million in January, dropped to Rs.247 million in July before moving up to Rs.782 million in December. During the period under review, the monthly turnover reached its highest level of Rs.941 million in March. The Banks, Finance and Insurance sector accounted for 44 per cent of total turnover, while DFCC, NDB, Sampath Bank, Commercial Bank and HNB had 79 per cent of the share in this sector, with the two development banks accounting for 48 per cent.

Further, the market price earnings ratio (PER) showed a continuous downward trend. The market PER which was 11.2 at the beginning of the year ended at 10.7 on 31 December 1996.

The uncertainty in the economic environment caused by terrorist activities, the ongoing war, labor unrest and power crisis have been cited as the main disincentives to foreign participation in the Colombo Stock Market. Despite the low level of activity however, non-nationals were overall net purchasers to the value of Rs.351.6 million in 1996, in contrast to 1995 when they were net sellers to the value of Rs. 89.7 million.

Compared to 1995 both non-national purchases and sales have declined significantly in 1996. Non-national sales have decreased, perhaps partly reflecting an unwillingness to sell at the currently prevailing low prices. During the period under review, foreign participation accounted for 54.7 percent of the total turnover compared to 59.5 percent in the previous year.

Sectoral Performance

The movements in the sectoral price indices show that seven sectors viz., Beverages, Food and Tobacco, Chemicals and Pharmaceuticals, Construction and Engineering, Diversified, Oil Palms, Plantations and Services, out of a total of 16 sectors, were able to maintain their price levels at end December 1996. The Plantation sector performed successfully with a gain of 125.3 per cent, while Footwear and Textiles was the biggest loser with a 28.1 per cent decrease in price. Investment Trusts, Manufacturing, Hotels and Travels, Motors and Banks, Finance and Insurance were the other sectors adversely affected.

The profitability of the corporate sector showed an improvement towards the end of 1996. The banking sector has, in general, shown greater stability and resilience, than most other sectors. In contrast to other quarters of 1996, profits in the fourth quarter of 1996 of most companies increased due to the absence of power cuts and labour problems.

Regional Stock Markets

Asian Pacific stock markets were about evenly divided between advances and declines during 1996. Taipei was the most successful market while Bangkok was the worst in the Asian-Pacific region. Based on published data the Taipei Weighted Price Index has gained 40.7 per cent, while the Bangkok SET Index lost 42.3 per cent during the 52 week period. Further, while Sydney, Kuala Lumpur, Jakarta, Hongkong, Bombay and Manila markets recorded gains, Karachchi, Seoul, Colombo, Tokyo and Singapore markets recorded losses.

Developments in the Market

The CSE celebrated its one hundredth anniversary in 1996. Despite the reduced level of market activity, further developments were instituted to improve the functioning of the Exchange. The Securities and Exchange Commission (SEC) of Sri Lanka has given approval for the operations of an Over the Counter (OTC) Board on the floor of the CSE. The OTC Board commenced its operations from 1 July 1996. The purpose of the OTC Board is to facilitate securities trading operations of public companies not listed on the CSE. Companies participating in the OTC Board are not considered to be listed companies and they are not bound by the general listing requirements of the CSE. As the listing procedure of the CSE is tedious, time consuming and costly, many small and medium companies that have sold shares to the public to raise funds are reluctant to participate in the formal mechanism of the CSE. The OTC market gives an opportunity to these companies to facilitate secondary trading of their shares. The OTC Board system would be useful for companies with a fairly broadbased ownership. Registering on the OTC Board will not prevent public unlisted companies from undertaking private transactions.

The CSE is in the process of setting up a Debt Securities Board too. The intention of the Debt Securities Board is to popularize a secondary market for debt securities. The SEC and CSE are jointly working out the procedures for this market. However, the secondary market for debt securities in Sri Lanka has yet to pick up.

Action is underway to set up a Rating Agency in Sri Lanka. A Rating Agency is an independent body that rates various financial instruments such as stocks, securities etc., according to internationally accepted rating standards. The rating is not a recommendation, but an indication of the level of risk based on the analysis done by a rating institute. Once set up, the agency will rate companies issuing debt securities so that an investor would be able to invest with greater awareness and confidence in the market.

Unit Trusts

A new unit trust, the Century Growth Fund, was launched in December 1996, increasing the total number of unit trusts (UTs) to five. The combined net asset value (NAV) of UTs declined by 7.6 per cent in 1996, compared to the drop of 27.7 per cent in 1995. The performance of the UTs has to be judged in relation to the performance of the Colombo Stock Market which recorded declines of 32 per cent and 9 per cent in 1995 and 1996, respectively, in the All Share Price Index. The structure of portfolios of UTs at end 1996 was similar to the structure at end 1995. As a proportion of their total net asset value, investment in equities was 60.6 per cent in 1996 as against 61.7 per cent in 1995.

TABLE 10.19
Unit Trusts (a)

	1994	1995	1996 (b)
1 Total Asset -Rs.Mn.	3,982	2,881	2,652
2 Net Assets Value - Rs.Mn.	3,947	2,855	2,637
3 Investments in Equities - Rs.Mn.	2,859	1,762	1,599
4 (3) as a Percentage of (1)	72.4	61.7	60.6
5 Total Unit Holders (No.)	22,286	25,251	26,235

(a) Values are as at 31 December

Source : Unit Trusts

(b) Includes only four Unit Trusts, though Ceybank Century Growth Fund was launched on 3 December 1996.