10. FINANCIAL SECTOR

10.1 Monetary Policy

Monetary policy in 1998 focussed on making further progress towards achieving financial market stability and price stability. The policy had to be conducted in a highly unstable external environment. The world banking industry and financial markets had been experiencing tremendous instability since mid 1997. The East Asian financial market turmoil had immediate contagion effects and more lasting adverse repercussions on world financial and commodity markets. The subsequent eruption of the payments crisis in Russia and the economic problems in Brazil and Japan intensified the instability. In addition, there were concerns about the stability of some financial institutions western countries due to their large exposures to countries in financial distress. The stability of financial institutions in many countries was threatened by the weaknesses of their own corporate governance and regulatory framework and supervisory standards. Many financial institutions in crisis countries were closed down. Financial flows to developing countries slowed down significantly, and financial policies were tightened, initially raising interest rates to stabilise exchange rates. There were speculations about whether China would be compelled to devalue its currency to restore competitiveness. While market confidence in some of the Asian crisis hit countries was being slowly restored, interest rates of western industrial countries, as well as many other countries were adjusted downwards to avoid a sharper economic depression. With this instability in world financial markets, the directions of exchange rate movements were not clear and the high volatility of exchange rates among key currencies, particularly the yen/US dollar rate, made it a challenging task to co-ordinate exchange rate and monetary policies for relatively more open and small economies like Sri Lanka. Despite these difficulties, and a constraint created by a larger than expected domestic fiscal deficit, monetary controls and a flexibly managed exchange rate helped to maintain domestic financial market stability in 1998.

The above background constrained the ability of the Central Bank to continue the relaxation of monetary policy, begun in 1997, to permit a further reduction of interest rates. The uncertainty in regional financial markets and somewhat higher domestic inflation at the beginning of 1998 required tightening of the policy stance in the first few months of the year. Although a slight relaxation was effected in the second quarter, renewed volatility in the foreign exchange market required a further tightening of policy. This stance was maintained until the last quarter, when a reduction in inflationary pressures and the emergence of relative stability in the exchange markets permitted some easing of policy. Open market operations continued to be the primary instrument of monetary policy, with the repo rate serving as the main signalling mechanism. From May onwards, commercial banks were permitted to include their holdings of Treasury bonds as a part of their liquid assets. In November, an overnight reverse repurchase facility was reintroduced. With the Central Bank now providing both an overnight repo facility and an overnight reverse repo facility, volatility in the call market would be restrained, thus bringing about greater stability in the money market.

The developments in the latter part of 1997 and in 1998 clearly demonstrated the links between external events and domestic markets, and the need to maintain consistent exchange and monetary policies. The East Asian financial crisis and the resultant volatility in international currency markets in the second half of 1997 also led to uncertainty in the domestic foreign exchange market. This continued into 1998 with the market speculating that a large depreciation of the rupee would be effected. The Central Bank indicated clearly that no such depreciation of the rupee was envisaged. Further, in order to discourage the use of relatively inexpensive call market funds for speculative purchases of foreign currency, the repo rate was raised by 200 basis points in December 1997 and by a further 100 basis points in January 1998. Adjustments were also made in the Central Bank's discount and rediscount rates and the margin between these rates to support this tightening of the policy stance. These measures, together with some progress towards financial market and exchange rate stability in East Asia, were successful in reducing the speculative pressures. In fact, commercial banks sold US dollars 54 million to the Central Bank in March and April. This permitted a slight relaxation in policy and the overnight repo rate was gradually reduced from 12.00 per cent to 11.65 per cent by end April. However, a resurgence of international volatility and associated domestic speculative activity thereafter, prompted the Central Bank to tighten policy again by raising the repo rate to 12.00 per cent, by mid May.

The repo rate was maintained at around 12 per cent until the last quarter of 1998, in which period some relaxation was possible. A significant deceleration in inflation was seen in the second half of the year. The East Asian crisis also eased, reducing the uncertainty in the exchange market. The Central Bank was therefore able to relax the monetary policy stance somewhat, without inducing further instability, by reducing the overnight repo rate in several steps to 11.25 per cent by the end of December 1998.

From 18 May 1998 onwards, commercial banks were permitted to include their holdings of Treasury bonds as part of their liquid assets, even though the remaining time to maturity of the bonds exceeded one year. They were also permitted to use these bonds for repurchase, discount and rediscount transactions at the Central Bank's secondary window. Several reasons underlay this decision. It helps to make medium-term government bonds more marketable, it provides additional interest bearing instruments that commercial banks could hold as liquid assets and finally it would enhance the ability of the Central Bank to use these bonds for open market operations.

From 06 November 1998, an overnight reverse repo facility was reintroduced by the Central Bank. The Bank first introduced a reverse repurchase facility on a limited scale in 1995, when a shortage of market liquidity had created a tendency for call money rates to rise to unacceptably high levels. However, due to the limited amounts of funds offered and certain structural weaknesses in the market, this facility did not achieve its objective of stabilising the upper end of the interest rates in the call money market. Its use was discontinued in January 1996. The new facility introduced in November 1998 differs from the initial facility in several respects. It is limited, at present, to overnight transactions. It is open not only to commercial banks, but also to institutions which are not commercial banks but are Primary Dealers for Treasury bonds and bills. The major difference is that an unlimited volume of funds is available at a fixed rate, provided that the specified collateral, viz., Treasury bills or bonds, could be provided. Moreover, unlike in 1995 when the facility was created in conditions of a severe liquidity shortage, the market was quite liquid in 1998 and hence, the facility was not utilised very often. Its introduction was more in the nature of an assurance to market players that stability in interest rates would be preserved, rather than a means of injecting liquidity into the system immediately.

The Central Bank's own Securities continued to be available on tap throughout the year for mopping up operations. The Securities offered had a maturity of 7 days and carried a yield equal to the 7-day repo rate. However, this facility was rarely resorted to as the portfolio of Treasury bills in the Central Bank was sufficient for its open market operations in 1998.

The Central Bank continued its policy of not granting refinance under the Medium and Long-Term Credit Facility (MLCF) or any short-term facility. The outstanding level of refinance granted in the past declined from Rs.1,692 million at the end of 1997 to Rs.1,122 million at the end of 1998, due to continuation of repayments to the Central Bank without new refinancing.

10.2 Money Supply

The growth of money supply continued to decline in 1998. A significant reduction in net foreign inflows and slow

TABLE 10.1
Summary Monetary Statistics

Item	End 1998	Change			
		1997		1998	
	Rs.Bn.	Amount Rs.Bn.	%	Amount Rs.Bn.	%
Monetary Aggregates:					
Narrow Money Supply (M1)	96.3	7.6	9.8	10.4	12.1
Broad Money Supply (M2)	316.2	35.1	13.8	27.9	9.7
Consolidated Broad Money Supply (M2b)	377.7	45.0	15.6	44.1	13.2
Underlying Factors (a)					
Domestic Credit to :	369.5	30.7	10.5	46.5	14.4
Government (net)	64.6	-1.9	-4.0	19.4	42.8
Public Corporations	10.8	-0.8	-5.4	-3.8	-26.1
Private Sector	294.1	33.4	14.5	30.9	11.8
External Assets (net)	105.6	27.4	43.5	15.2	16.7
Other Items (net)	-97.4	-13.1	-19.5	-17.5	-22.0
Reserve Money	92.9	-1.8	-2.1	9.1	10.9

Source: Central Bank of Sri Lanka

(a) In relation to M_{2b}

Chart 10.1
Monetary Expansion

Chart 10.1.1
Monetary Growth - Moving Average

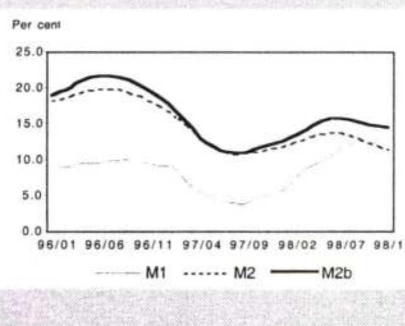


Chart 10.1.2
Monetary Growth - Point to Point

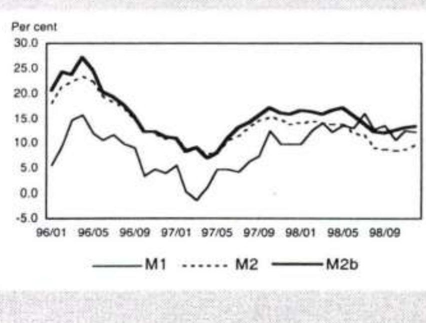


TABLE 10.2
Monetary Aggregates 1997 - 1998(a)

Rs Million

End of Period	Narrow Money Supply (M_1)						Broad Money Supply (M_2)						Consolidated Broad Money Supply (M_{2b})					
	1997	1998	Percentage Change				1997	1998	Percentage Change				1997	1998	Percentage Change			
			Point to Point		Moving Average				Point to Point		Moving Average				Point to Point		Moving Average	
			1997	1998	1997	1998			1997	1998	1997	1998			1997	1998	1997	1998
January	77,889	85,527	5.6	9.8	9.2	5.8	253,157	289,017	11.0	14.2	16.9	11.9	288,640	335,827	10.8	16.3	17.8	12.5
February	77,597	87,262	0.2	12.5	8.3	6.8	254,967	291,450	8.9	14.3	15.8	12.3	291,487	338,718	8.2	16.2	16.5	13.2
March	80,828	92,194	(1.2)	14.1	6.9	8.2	260,657	297,205	9.0	14.0	14.6	12.7	296,908	343,609	8.9	15.7	15.2	13.8
April	80,583	90,436	1.4	12.2	5.7	9.1	261,357	297,152	8.0	13.7	13.4	13.2	297,972	346,676	7.0	16.3	13.6	14.6
May	80,240	91,177	4.7	13.6	5.1	9.8	262,188	298,472	8.3	13.8	12.3	13.6	299,265	349,938	7.9	16.9	12.3	15.3
June	79,670	90,126	4.9	13.1	4.7	10.5	265,104	296,943	10.3	12.0	11.5	13.8	302,031	348,566	10.9	15.4	11.5	15.7
July	79,535	92,264	4.4	16.0	4.1	11.5	267,601	298,677	11.5	11.6	11.0	13.8	307,086	349,416	12.9	13.8	11.1	15.7
August	81,068	91,389	6.4	12.7	3.9	12.0	271,989	296,505	13.3	9.0	10.8	13.4	311,192	349,499	14.0	12.3	10.9	15.5
September	82,287	93,463	7.4	13.6	3.8	12.5	276,994	301,678	14.6	8.9	10.8	12.9	317,668	355,707	15.5	12.0	11.0	15.2
October	83,300	92,240	12.6	10.7	4.5	12.4	279,577	303,514	15.1	8.6	11.1	12.3	322,404	362,633	16.9	12.5	11.4	14.9
November	82,708	92,975	9.9	12.4	4.9	12.6	281,697	306,637	14.9	8.9	11.3	11.8	323,583	366,114	15.9	13.1	11.7	14.6
December	85,851	96,268	9.8	12.1	5.4	12.7	288,258	316,174	13.8	9.7	11.6	11.5	333,668	377,740	15.6	13.2	12.1	14.4
Monthly Average	80,963	91,277	5.5	12.7			268,629	299,452	11.6	11.6			307,659	352,037	12.0	14.5		

(a) Monetary data from 1990 have been reclassified to be consistent with the standard international practice. Please refer notes to Appendix Tables 104,105 and 109.

Source: Central Bank of Sri Lanka

TABLE 10.3
Monetary Aggregates and Underlying Factors 1996 - 1998 (a)

Rs. Million

Item	Dec. 1996	Dec. 1997	Dec. 1998	Change			
				1997		1998	
				Amount	Percentage	Amount	Percentage
Monetary Aggregates							
Currency held by the Public	42,565	45,680	51,767	3,115	7.3	6,087	13.3
Demand Deposits held by the Public	35,638	40,172	44,501	4,534	12.7	4,330	10.8
Narrow Money Supply (M1)	78,203	85,852	96,268	7,649	9.8	10,417	12.1
Time & Savings Deposits of the Private Sector held with Commercial Banks	210,454	247,816	281,473	37,362	17.8	33,657	13.6
DBUs	195,672	227,963	257,995	32,291	16.5	30,032	13.2
FCBUs	14,782	19,853	23,478	5,071	34.3	3,625	18.3
Consolidated Broad Money Supply (M2b)	288,657	333,668	377,741	45,011	15.6	44,074	13.2
Underlying Factors							
Net Foreign Assets	63,074	90,501	105,648	27,427	43.5	15,147	16.7
Monetary Authorities	73,541	89,936	101,744	16,395	22.3	11,808	13.1
Commercial Banks	-10.467	565	3,904	11,032	105.4	3,339	591.0
DBUs	-4,186	2,095	1,141	6,281	150.0	-954	-45.5
FCBUs	-6,281	-1,530	2,763	4,751	75.6	4,293	280.6
Net Domestic Assets	225,582	243,172	272,091	17,590	7.8	28,919	11.9
Domestic Credit	292,395	323,046	369,517	30,651	10.5	46,471	14.4
Claims on Government (net)	47,131	45,250	64,618	-1,881	-4.0	19,368	42.8
Monetary Authorities	34,291	20,300	25,909	-13,991	-40.8	5,609	27.6
Commercial Banks	12,840	24,950	38,709	12,110	94.3	13,759	55.1
DBUs	14,246	26,065	32,682	11,819	83.0	6,617	25.4
FCBUs	-1,406	-1,115	6,027	291	20.7	7,142	640.5
Credit to Public Corporations	15,491	14,658	10,835	-833	-5.4	-3,823	-26.1
DBUs	9,938	10,338	9,485	400	4.0	-853	-8.3
FCBUs	5,553	4,320	1,350	-1,233	-22.2	-2,970	-68.8
Credit to the Private Sector	229,773	263,138	294,064	33,365	14.5	30,926	11.8
DBUs	193,842	216,030	243,549	22,188	11.4	27,519	12.7
FCBUs	35,931	47,108	50,515	11,177	31.1	3,407	7.2
Other Items (net)	-66,813	-79,874	-97,426	-13,061	-19.5	-17,552	-22.0
DBUs	-47,798	-50,944	-60,248	-3,146	-6.6	-9,304	-18.3
FCBUs	-19,015	-28,930	-37,178	-9,915	-52.1	-8,248	-28.5

(a) Signs indicate the effect on M2b .

Source: Central Bank of Sri Lanka

growth in credit to the private sector served to offset an enhancement in credit to the government and dampen the expansion of broad money. In contrast to the developments in 1996 and 1997, the rate of narrow money growth was comparatively high. Reflecting the slower growth, consolidated broad money (M2b), which includes both domestic banking units and Foreign Currency Banking Units (FCBUs), increased by 13.2 per cent in 1998, in comparison to a rate of 15.6 per cent in 1997. This slower growth in money supply, together with supply side developments, helped to reduce inflationary pressure.

The external sector developments had a lower expansionary impact on money supply as the balance of payments showed a lower overall surplus (US dollars 37 million) in 1998 compared to 1997 (US dollars 163 million). The net external assets of the banking system increased by 16.7 per cent in 1998 compared to 44 per cent in 1997. External assets contributed to one third of the growth of broad money, in comparison to 60 per cent in 1997. The net foreign assets of the monetary authorities improved by Rs. 11,808 million. The net foreign assets of commercial banks also increased by Rs.3,339 million, entirely due to an improvement in the net foreign assets of FCBUs. This reflected mainly a sharp reduction in net exposure to the foreign sector.

An increase in net domestic assets was the main causal factor for the growth in monetary aggregates in 1998. Although credit to the private sector grew at a lower rate than in 1997 and credit to government corporations in fact showed a contraction, a surge in credit to the government resulted in a 14.4 per cent increase in domestic credit in 1998, in comparison to a growth of only 10.5 per cent in 1997. The slower growth in economic activity in the country in 1998 and the significant deceleration in the growth of

Chart 10.2
Monetary Aggregates, Velocity and Money Multiplier

Chart 10.2.1
Money Supply

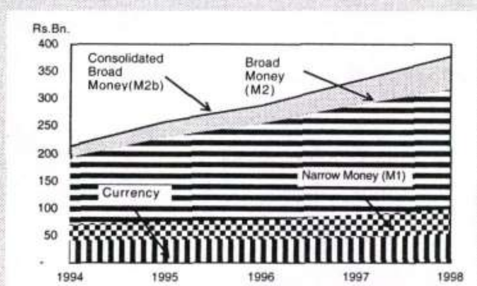


Chart 10.2.2
Domestic Credit

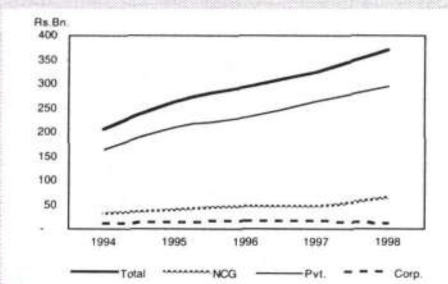


Chart 10.2.3
Net External Assets

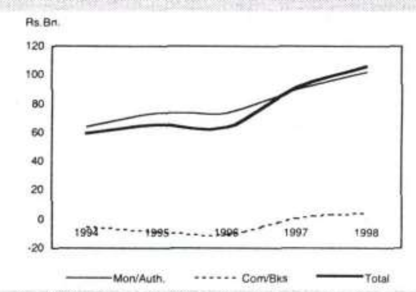
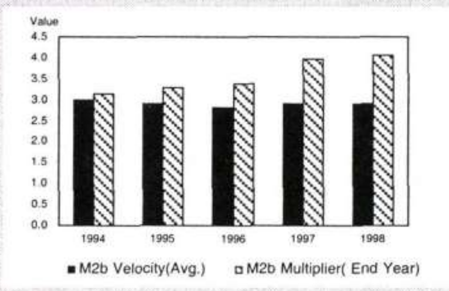


Chart 10.2.4
Income Velocity and Money Multiplier



exports and imports held down the growth in private sector credit to 11.8 per cent in 1998, in comparison to a growth of 14.5 per cent in 1997. This deceleration was more pronounced in the case of credit from the FCBUs, where credit growth fell from 31 per cent in 1997 to 7 per cent in 1998. Several factors operated to reduce credit growth from the FCBUs. The continuing uncertainty in foreign financial markets both led to a contraction in the absolute level of activity of the FCBUs and discouraged them from increasing their net foreign exposure. The volatility in the foreign exchange markets and the comparatively low domestic interest rates made borrowing from the FCBUs less attractive to domestic enterprises. In addition, the FCBUs used some of their funds to provide a syndicated loan of US dollars 100 million to the Government of Sri Lanka. Credit from the domestic units grew at a faster rate, i.e., at 12.7 per cent in 1998 compared with 11.4 per cent in 1997, partly to compensate for the decline in the growth of FCBU credit. The credit growth came from the domestic commercial banks, rather than the foreign banks.

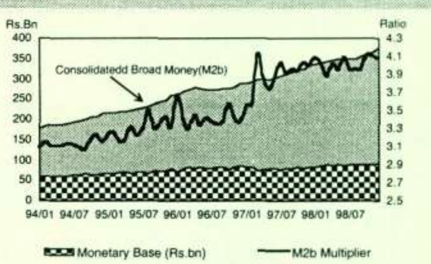
Credit to public corporations declined by 26.1 per cent in 1998, following a decline of 5.4 per cent in 1997. However, unlike in 1997 where the decline was in credit from FCBUs, in 1998, credit declines were seen in both FCBUs and domestic units. Lower international prices for petroleum products and wheat enabled the Ceylon Petroleum Corporation (CPC) and the Co-operative Wholesale Establishment (CWE) to record improved performances and thus reduce their liabilities to the banking sector.

In distinct contrast to 1997, credit to the government increased significantly in 1998. In 1997, large inflows of proceeds from privatisation enabled the government to reduce its liabilities to the banking system. In 1998, however, inflows from privatisation were much lower. Furthermore, government revenue was less than anticipated in the Budget, whereas expenditure increased, compelling the government to increase its borrowings. This led to a 42.8 per cent (Rs.19,368 million) increase in net credit to the government from the banking sector, including the US dollar 100 million syndicated loan from FCBUs. In 1997, credit to the government from the banking sector had declined by 4 per cent (Rs.1,881 million).

Reserve Money

Reserve money (high powered money or base money) increased by 10.9 per cent (Rs.9,130 million), as against a decline of 2.1 per cent (Rs.1,773 million) in 1997. The decline in 1997 was due to the government using proceeds from the privatisation of state owned enterprises to repay debt owed to the Central Bank. The Central Bank continued to use reserve money as an important intermediate target in implementing monetary policy. Policies were directed at preventing an excessive expansion in reserve money, which would lead to the build up of inflationary pressure in the economy, while at the same time providing sufficient liquidity to the market to ensure that economic activity took place unhindered by liquidity constraints. Reserve money growth occurred mainly through the increase in net external assets of the Central Bank. As reserve money grew at a slightly lower rate than consolidated broad money (M2b), the consolidated broad money multiplier increased marginally from 3.98 at the end of 1997, to 4.07 at the end of 1998, reflecting the slight tightening of monetary policy in 1998. The average income velocity of money remained relatively stable at 2.9 in 1998.

Chart 10.3
Monetary Base and Money Multiplier



10.3 Interest Rates

Interest rates were generally stable in 1998, though the tightened monetary policy stance caused rates to rise by 1-2 percentage points over the rates that prevailed at the end of 1997. Several factors helped to maintain reduced interest rate volatility. The growth of private sector credit was relatively low, thus avoiding any excessive demand pressure. The government obtained a syndicated loan of US dollars 100 million from the FCBUs in the latter part of the year, thus reducing the demand for domestic rupee funds. Meanwhile, the Central Bank reintroduced an overnight reverse repurchase facility with the objective of stabilising the upper end of the call money market rates.

Short-Term Interest Rates

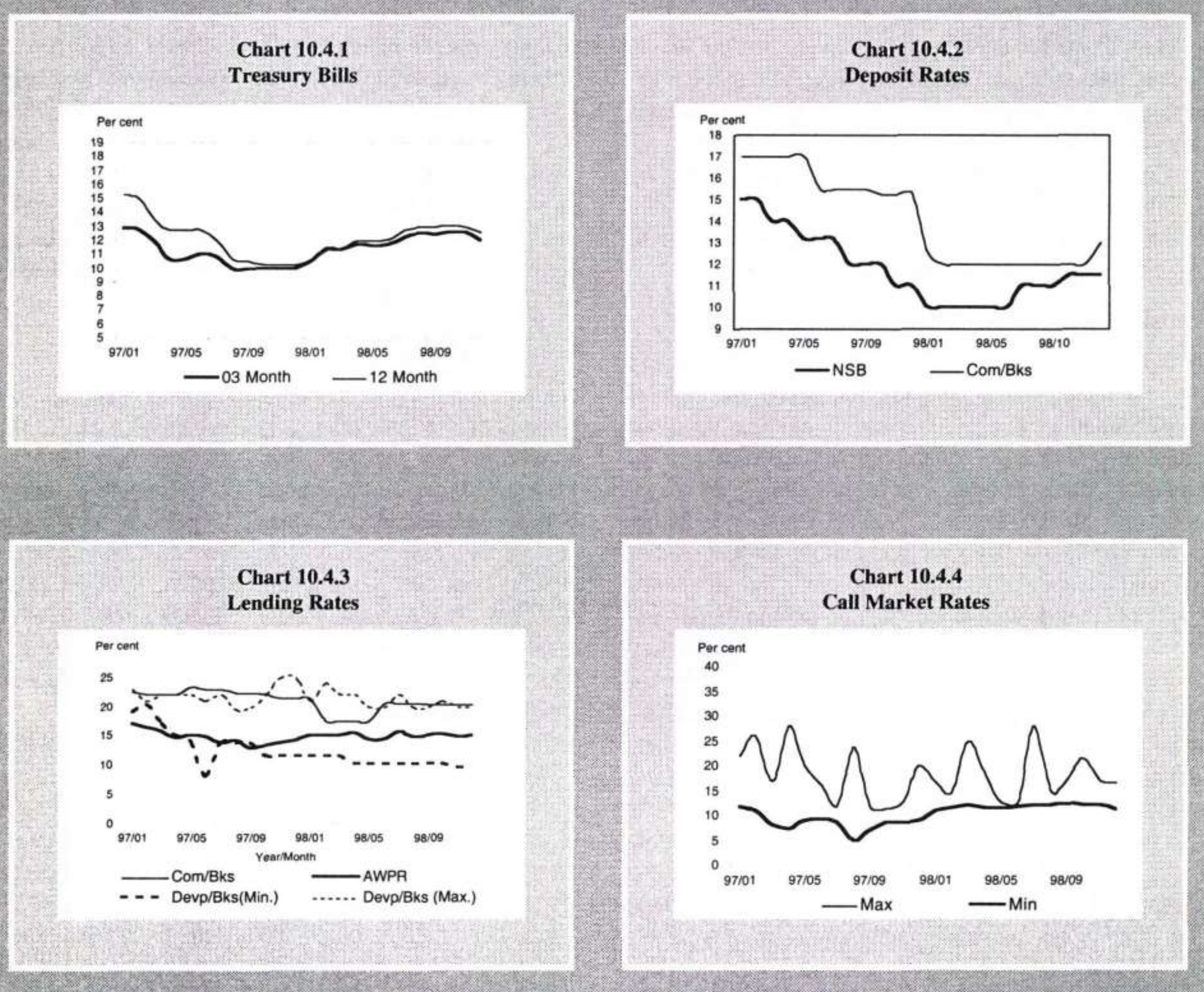
Primary market yield rates on Treasury bills increased gradually throughout the year but showed a decline in December following inflows of liquidity into the market. The yield on 3-month Treasury bills, which was at 9.97 per cent at the beginning of the year, increased to 11.00 per cent in February 1998 and remained around this level until end July 1998. Thereafter, the rate stabilised around 12 per cent. A similar movement was seen in 6-month Treasury bill rates and 12-month Treasury bill rates. The weighted average yield rate for 6-month Treasury bills, which was 9.95 per cent at the beginning of the year, ended the year at 12.34 per cent.

The 12-month Treasury bill rate increased from 10.24 per cent at the beginning of the year to 13.06 per cent at end October 1998 and then decreased marginally to 12.59 per cent at the end of the year.

Following the same trend as the primary Treasury bill market, other short-term rates, i.e., the discount rate, rediscount rate and repo rate moved slightly upward during the year. The 3-month discount rate, which was 9.72 per cent at the beginning of the year, increased gradually to 12.50 per cent by mid November and then decreased to 11.86 per cent at the end of the year, while the 3-month rediscount rate, which was 12.97 per cent at the beginning of the year, increased to 15.65 per cent by mid November and came down to 15.01 per cent at the end of 1998. The 12-month discount rate increased from 9.99 per cent at the beginning of the year to 12.39 per cent at end December but with a peak of 12.91 per cent at end October 1998. The rediscount rate for 12-month Treasury bills increased from 13.24 per cent to 16.39 per cent at the beginning of August, before declining to 15.54 per cent at the end of the year.

The overnight repo rate, first introduced in 1993, serves as the primary signalling mechanism for interest rates and is a very important tool of monetary policy. It also serves to stabilise the lower end of the call money market. In the final month of 1997 and in early 1998, the overnight repo rate was gradually increased as the monetary policy stance was tightened somewhat. The overnight repo rate, which was 11.00 per cent at the end of 1997, was increased to 12.00 per cent in January and maintained at this level until end March, whereafter, with some easing of pressure in the foreign exchange market, it was reduced to 11.65 per cent in April. In May, following further volatility in exchange markets, it was raised again to 12.15 per cent and maintained at slightly over 12.00 per cent until October. Greater stability

Chart 10.4
Interest Rates



in the exchange market and a reduction in inflation in the latter part of 1998, enabled the gradual reduction of the overnight repo rate to 11.25 per cent by end 1998.

Call market rates showed comparatively little volatility during the year. They were in the range of 13.00-14.00 per cent at the end of 1998 compared to the range of 12.00-20.00 per cent at the end 1997. The lower end of the call market rates is greatly affected by changes in the repo rate. Call market rates moved to somewhat higher levels in March, July and October with a relatively higher spread between the maximum and minimum rates, reflecting temporarily liquidity shortages in the market. A peak of 28.00 per cent was experienced in July.

The Central Bank reintroduced a reverse repurchase facility in November 1998 with a view to further stabilising the short-term rates in the money market by creating stability at the upper end of the call market interest rate range as well. The reverse repo rate, which is determined by the Central Bank on a daily basis, is currently equivalent to the overnight discount rate at the Bank's secondary window. The reverse repo rate was 15.45 per cent when the facility was first reintroduced in November and was maintained at the same level throughout the rest of 1998.

The call market rates showed a lower volatility during the year due to repo market and reverse repo market activities of the Central Bank and also owing to the increases in liquidity particularly during the later part of the year.

Central Bank Securities, with 7-day maturity, were also available to the market. The interest rates on these were equal to the 7-day repo rate. The rates were in the range of 11.93-12.06 per cent per annum during the year.

Deposit Rates

Although deposit rates of commercial banks did not strictly follow the same trend as Treasury bill yields, deposit rates of commercial banks remained low throughout the year. Savings deposit rates of commercial banks, which were in the range of 3.00-11.00 per cent at end 1997, came down slightly to 3.00-10.00 per cent by end February and further to a range of 2.00 – 10.00 per cent and were maintained in this range during the rest of the period. One year fixed deposit rates, which were in the range of 8.50-15.25 per cent at end 1997, decreased to 8.50-12.5 per cent in January 1998. They showed a further slight reduction to a range of 8.50-12.00 per cent by February 1998 and remained approximately at the same level until December when they increased to a range of 9.00-13.00 per cent. The Weighted Average Deposit Rate (AWDR), which is computed monthly and is based on the interest rates paid on all interest bearing deposits of commercial banks, decreased gradually from 10.0 per cent in December 1997 to 9.2 per cent in December 1998. The Average Weighted Fixed Deposit Rate (AWFDR) also decreased from 11.5 per cent in December 1997 to 10.7 per cent in December 1998.

Interest rates on foreign currency savings deposits showed some variation during the year, following international developments. Savings deposits denominated in US dollars were in the range of 2.50 – 5.50 per cent at the beginning of the year and rose to a range of 3.00-6.25 per cent in July, before declining to a range of 2.75-6.25 per cent in September with the reduction in international rates. Sterling deposits obtained slightly higher rates, lying in a range of 3.00-8.00 per cent per annum at the beginning of 1998. The rates narrowed to a range of 4.50-6.00 per cent by end 1998. Similar trends were seen in the case of fixed deposits. US dollar 1-year fixed deposit rates, which were in a range of 5.20-6.00 per cent per annum in January 1998, moved to a range of 4.00-6.25 per cent by the end of the year. The rates on 1-year fixed deposits denominated in sterling pounds moved from a range of 5.75-7.00 per cent per annum to 4.65-6.63 per cent during the same period. Meanwhile, the rates offered by FCBUs on US dollar deposits were generally in a range of 4.00-6.00 per cent and on deposits in sterling pounds in a range of 5.25-7.00 per cent at the end of the year.

The savings deposit rate offered by the NSB, which influences many other rates in the market, was reduced from 10.8 per cent per annum at the end of 1997, to 9.6 per cent in January and maintained at this rate until end June, when it was raised to 10.5 per cent, the rate which prevailed until end December 1998. The rate on 1-year fixed deposits followed a similar pattern. The rate was reduced from 11.00 per cent at end 1997 to 10.00 per cent in January 1998. It was raised to 11.00 per cent in July, and unlike the savings deposit rate, was raised again to 11.50 per cent in October, and maintained at that level until end 1998.

Lending Rates

The Average Weighted Prime Lending Rate (AWPR), which is based on the rates offered by commercial banks to their prime customers, increased from 14.2 per cent in December 1997 to 15.0 per cent in January 1998. Throughout most of 1998 the AWPR hovered around 15 per cent with a peak of 15.8 per cent in July. The AWPR showed a slight increase form 14.5 per cent at end 1997 to 14.9 per cent at end 1998. The Average Weighted Lending Rate (AWLR), based on the Quarterly Survey of Bank Advances, decreased from 20.5 per cent at end September 1997 to 19.6 per cent at end September 1998.

Interest rates charged by FCBUs are generally based on the London Inter Bank Offered Rate (LIBOR). Lending rates in US dollars were in the range of 3.50-8.75 per cent. Interest rates on foreign currency lending to non-BOI exporters were in the range of 6.18-10.50 per cent in 1998.

Rates on commercial paper, which is a corporate debt instrument used in raising short-term funds, also saw a decline, and were in the range of 11.00–18.00 per cent during the year compared to the range of 10.00-27.60 per cent in the pervious year. Meanwhile, interest rates charged by commercial banks for payments through credit cards were in the range of 20.00-33.00 per cent as in the previous year.

The Legal Rate of interest and the Market Rate of interest, which are published by the Central Bank under the Civil Procedure Code (Amendment) Act No.6 of 1990 and in terms of Section 23 of the Debt Recovery (Special Provision) Act No.2 of 1990, respectively, were both 11.5 per cent per annum for the year 1998. They were both 12.7 per cent in the previous year.

Long-Term Rates

Long-term rates include interest rates on rupee securities, yield rates on Treasury bonds, lending rates of long-term credit institutions and debentures. Rupee loans with maturities of 4-5 years, 5 years, 5-6 years, 6-7 years, and 9-10 years were issued during the year. The associated interest rates, which are administratively determined, were in the range of 11.0-12.25 per cent, with the longer maturity loans having higher rates. Most of the issues were of maturities with 6-7 years. The rate offered on Rupee loans was higher in 1998 than in 1997. Rupee loans with 6-7 year maturities were issued at the rate of 12.25 per cent at end December 1998, compared to the rate of 11.75 per cent on Rupee loans with the same maturity issued in September 1997.

The Central Bank issued Treasury bonds with maturities of 2 years, 3 years and 4 years. These bonds both have a coupon (interest paid half yearly) and are auctioned. Treasury bonds with a 2-year maturity carried a coupon rate of 11.00 per cent, while the auction determined weighted average yield rate was 10.81-13.94 per cent during the year. The 3-year Treasury bonds carried a coupon rate of 11.50 per cent, while the weighted average yield rate was in the range of 12.44-13.93 per cent. Treasury bonds with maturities of 4 years were issued with a coupon rate of 12 per cent and had yield rates in the range of 12.93-13.94 per cent during the year.

Interest rates charged by long-term credit institutions decreased slightly in 1998. The State Mortgage and Investment Bank (SMIB) reduced its lending rates by 2 percentage points during the year. The SMIB rates were in the range of 15.00-18.00 per cent at the end of the period. DFCC Bank reduced its lending rates from a range of 13.0-22.0 per cent at end 1997 to 13.0-20.5 per cent at end 1998. Following the same trend, the National Development Bank (NDB) reduced its lending rates to 9.6-20.0 per cent from 11.5 -25.0 per cent at the end of the previous year. The lending rate of the National Housing Development Authority was in the range of 10.0-16.0 per cent compared to a range of 10.0-15.0 per cent during 1997. The lending rates of the National Savings Bank decreased by 1.5 percentage points and were in the range of 14.0-15.0 per cent at end 1998.

A new phenomenon in the market was the increased issue of listed debentures. During the year, three domestic private banks issued debentures which had maturities of 5 years. There were four issues. Two of these carried fixed rates, (13.5 per cent per annum, payable quarterly), one had a floating rate fixed at the 3-month Treasury bill rate plus 1 percentage point and the other had an option of either a fixed rate or a floating rate fixed at the 1-year Treasury bill rate plus 1 percentage point. Three other listed companies also issued listed debentures with fixed rates in the range of 15.00-18.00 per cent per annum.

10.4 Commercial Banking

The domestic units of commercial banks showed a moderate growth while the activities of Foreign Currency Banking Units (FCBUs) slowed down during the year. A decline in domestic economic growth and a reduction in the growth of imports and exports constrained the growth in the banking sector. In addition, uncertainty in international financial markets and the comparatively low domestic interest rates which made borrowing in foreign currency less attractive, tended to lead to a contraction in the activities of the FCBUs. The total assets of the domestic units of commercial banks grew nearly at the same level in the previous year (13 per cent). Total assets of FCBUs declined by 9 per cent, in contrast to the significant growth of 17.6 per cent in 1997. A noteworthy feature was the reduction in the FCBU exposure to the domestic sector. The net foreign asset position of the FCBUs improved in 1998, despite the extension of a syndicated loan of US dollars 100 million to the Government of Sri Lanka. Meanwhile, net foreign assets of the domestic banking units deteriorated mainly due to increases in foreign liabilities. A substantial increase in foreign currency deposits was the main reason for the higher level of foreign liabilities. This appeared to reflect a desire on the part of residents to maintain their deposits in foreign currency in the context of volatile international foreign exchange markets and an expected large depreciation of the rupee.

With the yield rates on government debt instruments rising by about two percentage points, no appreciable decrease was seen in the general lending rates of commercial banks. Deposit rates stayed unchanged or declined in some instances. Thus, the margins of banks increased and several banks have reported growth rates in profits exceeding the growth rate in turnover. However, reflecting the preference shown by depositors to hold foreign currency denominated deposits and the slowing down of economic activities, the growth rate of rupee deposits, both demand deposits and time and savings deposits in domestic banking units, declined during the year. In contrast, foreign currency deposits with the domestic units showed a sharp increase (41 per cent in 1998, in comparison to 22 per cent in 1997). Meanwhile, credit to the private sector from domestic units of commercial banks increased by a slightly higher rate in comparison to last year, partly reflecting the slower growth in credit from the FCBUs. The domestic banks accounted for the major portion of the increase in credit. Reflecting the reduced attractiveness of obtaining credit in foreign currency, the foreign currency loans extended by commercial banks to non-BOI exporters decreased from US dollars 254 million in 1997 to US dollars 177 million in 1998.

Towards the end of the year, the government obtained a syndicated loan of US dollars 100 million from FCBUs, which helped to reduce the pressure on the domestic market interest rates.

Structure of Assets and Liabilities of Commercial Banks

The total resources of domestic units of commercial banks increased by Rs.58,892 million or by 13.3 per cent in 1998, in comparison to the Rs.52,994 million (13.6 per cent) registered in 1997. The low growth in imports and exports was reflected in a slower growth in credit. Total loans and advances including commercial bills expanded by 14.6 per cent and contributed 57 per cent of the total growth of commercial banks assets. Reflecting the substantial decline in receipts from external activities, the increase in foreign assets of the commercial banks contributed only 18 per cent of the growth in total assets, in comparison to 36 per cent recorded in 1997. This, and a decline in investment in Treasury bills, resulted in a slower growth in the liquid assets of commercial banks during the year. Thus, the change in overall liquid assets (including investments in Treasury bonds, which were considered as a liquid asset with effect from 18 May 1998) to the change in total assets ratio decreased from 40 per cent in 1997 to 33 per cent in 1998.

Holdings of commercial bills, which consist of export bills, import bills and local bills, grew at a higher rate of 36.4 per cent in 1998 compared to 9.5 per cent in 1997. The growth was entirely reflected in the holdings of import bills.

TABLE 10.4
Selected Items of Assets and Liabilities of Commercial Banks

Item	Change			
	97 Dec/96 Dec		98 Dec/97 Dec	
	Amount (Rs. Mn.)	%	Amount (Rs. Mn.)	%
Asset Category				
1. Liquid Assets	21,428	21.9	19,306	16.2
Cash on Hand	540	7.8	865	11.6
Due from Central Bank	-5,228	-15.3	2,303	7.9
Foreign Currency on Hand	19,385	87.1	10,596	25.5
Treasury Bills	4,960	31.9	-6,938	-33.9
Treasury Bonds (a)			6,008	
Commercial Bills	1,771	9.5	7,472	36.4
Local Bills	-61	-44.4	-66	-85.6
Import Bills	1,072	8.7	7,687	57.1
Export Bills	760	12.2	-150	-2.1
2. Investment	8,454	31.4	-3,193	-9.0
Treasury Bills	4,960	31.9	-6,938	-33.9
Government Securities	1,776	211.3	2,733	104.5
Other Investment	1,718	16.2	1,012	8.2
3. Total Loans and Advances	27,766	13.7	33,588	14.6
Loans	19,968	17.0	15,869	11.5
Overdrafts	6,027	9.1	10,247	14.2
Commercial Bills	1,771	9.5	7,472	36.4
4. Fixed and Other Assets	2,937	3.6	8,786	10.3
Liability Category				
1. Capital Accounts	5,131	13.1	5,851	13.2
2. Total Deposits	40,340	15.4	37,214	12.3
Demand Deposits	3,837	7.9	4,528	8.6
Time and Savings Deposits	36,502	17.1	32,686	13.1
3. Borrowings	-786	-2.8	4,630	16.9
Local Borrowings	-2,037	-7.8	4,242	17.6
Foreign Borrowings	1,251	63.0	388	12.0
4 Other Liabilities	8,310	13.7	11,197	16.3
Total Assets/Liabilities	52,994	13.6	58,892	13.3

(a) With effect from 18 May 1998 Treasury bonds are considered as part of liquid assets of commercial banks.

Source: Central Bank of Sri Lanka

Investments in export bills declined by 2.1 per cent in 1998 in comparison to a 12.2 per cent growth in 1997, which was a reflection of a decrease in export growth during the year.

Matching the slower growth in assets, the liabilities of domestic commercial bank units also grew more slowly in 1998 relative to 1997. Total deposit liabilities grew by 12.3 per cent in comparison to a 15.4 per cent growth recorded in 1997. Meanwhile, interbank borrowings increased by 17.6 per cent, in contrast to the 7.8 per cent decline shown last year. Following these developments, interest rates rose to a slightly higher level in comparison to the previous year.

The balances in the capital account improved by 13.2 per cent (Rs.5,851 million) in 1998, compared to the 13.1 per cent (Rs.5,131 million) increase in 1997. The banks continued to maintain shareholders' funds to total assets at an unchanged rate of 10 per cent as in 1997.

With the decline in foreign inflows, foreign assets of the domestic units grew by a lower rate of 21.5 per cent in 1998, compared with a 70.2 per cent growth in 1997. Assets with banks abroad increased by approximately 25 per cent to Rs.22,760 million at end 1998. In comparison, these assets increased by 109 per cent during 1997. Placements with FCBUs increased approximately by 27 per cent to Rs.28,927 million at end 1998. Foreign liabilities of the domestic units of commercial banks, of which about 81 per cent is accounted for by Non Resident Foreign Currency (NRFC), Resident Non National Foreign Currency (RNNFC) and Resident Foreign Currency (RFC) deposits, increased by 34.0 per cent to Rs. 54,409 million in 1998, in comparison to an 18.7 per cent growth in 1997. Thus, the net foreign asset position of domestic units deteriorated.

Twenty six FCBUs continued to operate in 1998. However, unlike in 1997 when they expanded significantly (by 26 per cent), the FCBUs contracted in 1998, with total assets/liabilities decreasing by US dollars 155 million (9 per cent). The major sources of funds of FCBUs are resident sources, mainly foreign currency deposits with domestic banking units and deposits by BOI enterprises. Investments with non resident enterprises and loans and advances to BOI enterprises were the main areas where FCBU funds were deployed. Reflecting partly the decline in export growth and partly a reduction in the attractiveness of foreign currency borrowing, credit extended by FCBUs to BOI enterprises declined by 3 per cent in 1998, in contrast to a growth of 20 per cent in 1997. The FCBUs of four domestic banks and a foreign bank formed a syndicate to provide US dollars 100 million as a loan to the government in November 1998. The FCBUs, whose net foreign asset position at the end of 1997 amounted to a net deficit of US dollars 25 million, improved their position to record a net surplus of US dollars 41 million at the end of 1998. Although both foreign assets and foreign liabilities declined, liabilities declined at a much faster rate, leading to the net improvement.

Total gross assets of FCBUs decreased by 9 per cent in 1998 to US dollars 1,526.5 million at the end of the year. This was a result of a decline in claims on non residents by 30 per cent and an increase in claims on residents by 8 per cent. Placements with banks abroad declined by 35 per cent, while claims on non-banks increased by 5 per cent. Total lending to the private sector by FCBUs amounted to US dollars 745.3 million at the end of 1998, a 3 per cent decline in comparison to the previous year. However, in rupee terms an increase of Rs.3,407 million was seen between the two years. Of the total FCBU credit to the private sector, two thirds are provided by FCBUs of domestic banks.

One of the main purposes of establishing FCBUs was the provision of credit facilities to BOI enterprises. Fulfilling this purpose, such credit constituted the largest portion of FCBU assets. However, reflecting the slower growth of Sri Lankan exports, the credit granted to BOI enterprises declined by 3 per cent in 1998 in comparison to an increase of 20 per cent during the previous year. Meanwhile, credit to other residents (excluding the US dollar 100 million loan given to the government), decreased by 46 per cent. The decline was mainly reflected in credit granted to public corporations, which declined by US dollars 50 million during the year. This reduction was primarily due to the Ceylon Petroleum Corporation (CPC) and the Co-operative Wholesale Establishment (CWE) reducing their liabilities to the banks.

In the case of the special facility too, under which commercial banks were permitted to extend credit to non-BOI exporters either through their domestic units or through their FCBUs, a decline in credit extended was seen. A sum of US dollars 177 million was granted in 1998, as against a sum of US dollars 254 million in 1997. About 95 per cent of the loans under this facility, however, were extended through the domestic units, rather than through FCBUs.

On the liabilities side of the FCBUs, the decline was a combined outcome of a decline in non resident liabilities by US dollars 269 million, an increase in resident liabilities by US dollars 105 million and an increase in internal accounts by US dollars 9 million. The major portion of resident liabilities was from placements of funds by domestic units.

Sources and Users of Funds of Domestic Units of Commercial Banks

The slowing down of economic activities during the year was reflected in the total net availability of resources to the commercial banks, which increased by Rs.15,830 million in 1998 in comparison to an increase of Rs.30,074 million in 1997. In contrast to the experience in 1997 where the private sector was the major net source of funds, in 1998, the foreign sector and the other assets and other liabilities sectors accounted for about 92 per cent of the net increase in funds. The domestic private sector, which contributed over 50 per cent of the net funds in 1997, contributed only 8 per cent of net funds in 1998. The government sector was the sector

TABLE 10.5
Sources and Users of Resources of Commercial Banks

Rs. Million

Category	Change (a)			
	1997		1998	
	Sources	Users	Sources	Users
1. Government Sector		**12,797**		**6,618**
Holdings of Government Securities		6,736	4,205	
Deposits	827			2,083
Import Bills		1,920		9,414
Short-Term Credit		406		901
Overdrafts		4,562	1,576	
2. Central Bank	**5,413**			**3,129**
Borrowings	725		39	
Reserves	5,228			2,303
Investment in Central Bank Securities				
Till Cash		540		865
3. Government Corporations		**973**		**4,301**
Deposits		573		5,153
Advances		400	853	
4. Co-operatives	**425**			**482**
Deposits	621			332
Advances		196		150
5. Other Domestic Private Sector	**15,081**		**1,229**	
Deposits (b)	32,455		27,667	
Local Bills	248		383	
Import Bills		490	1,460	
Overdrafts		1,731		10,966
Loans		17,323		17,234
Investments in Securities and Bonds		1,718		1,013
Debentures	3,640		930	
6. Inter-Bank Transactions		**5,023**		**1,300**
Balance With Domestic Banks	535			5,291
Deposits & Borrowings With Domestic Banks		5,558	3,991	
7. Foreign Sector		**11,281**	**7,376**	
Borrowings	1,251		388	
Deposits	7,515		17,434	
Foreign Balances Including Export Bills		20,047		10,447
8. Other Assets & Other Liabilities	**9,155**		**7,225**	
Capital & Reserves	5,131		5,851	
Fixed Assets		1,436		1,821
Long-Term Government Bonds	1,000			
Restructuring Bonds				
Other Assets		2,501		6,965
Other Liabilities	6,962		10,160	
Total Net Sources/ Users	**30,074**	**30,074**	**15,830**	**15,830**

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 special savings schemes.

which absorbed the largest proportion of the funds (42 per cent), while the Central Bank absorbed 20 per cent of the funds.

In contrast to the previous year, the foreign sector became the major source of funds during the year. Foreign inflows into the commercial banks increased mainly due to an increase in resident and non-resident foreign currency deposits, including compensation paid to Kuwaiti workers affected by the Gulf war. The total net receipts from foreign deposits and borrowings amounted to Rs.7,376 million in 1998. However, foreign balances including export bills, which are major users of funds, also reflected a decline in absorption from Rs.20,047 million in 1997 to Rs.10,447 million in 1998.

The other assets and liabilities sector was a net provider of funds, as in 1997. Commercial banks increased their capital and reserves, thus improving the stability of the banking system. In addition, other liabilities too were a source of funds, partly due to the inflows from the debentures issued by the banks. The domestic private sector became less important as a source of funds mainly due to the decrease in deposits and the increase in overdrafts during the year. This sector provided only a net sum of Rs.1,229 million compared to the Rs.15,081 million provided in 1997.

The government and the Central Bank were major users of funds. Unlike in 1997, holdings of government securities became a source of funds during the year as the commercial banks reduced their holdings. However, increases in government import bills discounted, provision of short-term credit and a decline in government deposits resulted in the government becoming a major user of funds, absorbing 42 per cent of the total increase in commercial bank resources in 1998. The Central Bank was a large user of funds in 1998 through the absorption of Rs.2,303 million as statutory reserves.

Commercial Bank Loans and Advances[1]

According to the Quarterly Survey of Commercial Banks Advances and Deposits, the shares of loans and advances given to trading and industrial sectors in total credit recorded decreases, while the major increases were recorded in loans to the consumption and housing sectors. The decline in the share to the trading and industrial sectors was a result of the slowing down of the growth of imports and exports. All the other sectors indicated marginal improvements in their shares of total credit. In terms of the relative importance in sectoral credit growth, major increases have been recorded in consumption, housing, tourism, financial, agricultural and other sectors.

As in the past, the trading sector absorbed the largest amount of bank credit during 1998. Its contribution to total

1 The description in this section depends on the information obtained through the Quarterly Survey of Bank Advances and Deposits and is based on domestic banking unit data upto end September 1998.

TABLE 10.6

Commercial Bank Advances by Purpose and Maturity (a)

Category		Short-Term (1) Amount Rs. Mn.	Short-Term (2) (1) as % of (7)	Medium-Term (3) Amount Rs. Mn.	Medium-Term (4) (3) as % of (7)	Long-Term (5) Amount Rs. Mn.	Long-Term (6) (5) as % of (7)	Total (7) Amount Rs. Mn.	Total (8) (7) as % of Grand Total
1. Trading									
1997	September	70,429	75.7	17,839	19.2	4,708	5.1	92,976	45.1
1997	December	73,364	74.0	20,682	20.9	5,126	5.2	99,172	45.8
1998	September	73,453	73.6	21,204	21.2	5,142	5.2	99,799	43.1
2. Financial									
1997	September	4,346	57.5	2,563	33.9	655	8.7	7,563	3.7
1997	December	4,059	53.3	2,711	35.6	844	11.1	7,614	3.5
1998	September	5,878	67.2	1,894	21.7	974	11.1	8,745	3.8
3. Agricultural									
1997	September	6,974	64.7	2,808	26.1	996	9.2	10,778	5.2
1997	December	7,668	65.2	3,085	26.2	1,001	8.5	11,755	5.4
1998	September	7,811	64.0	3,257	26.7	1,144	9.4	12,211	5.3
4. Industrial (b)									
1997	September	18,333	72.0	4,407	17.3	2,706	10.6	25,445	12.3
1997	December	18,508	73.1	4,796	18.9	2,022	8.0	25,326	11.7
1998	September	19,245	72.0	5,401	20.2	2,080	7.8	26,725	11.6
5. Tourism									
1997	September	1,470	45.0	663	20.3	1,131	34.7	3,264	1.6
1997	December	1,650	49.7	695	21.0	973	29.3	3,319	1.5
1998	September	1,563	40.5	830	21.5	1,462	37.9	3,855	1.7
6. Housing									
1997	September	6,498	25.3	10,014	39.0	9,159	35.7	25,671	12.4
1997	December	6,260	24.9	10,614	42.3	8,225	32.8	25,099	11.6
1998	September	7,820	25.3	10,951	35.5	12,095	39.2	30,866	13.3
7. Consumption									
1997	September	11,483	62.9	3,631	19.9	3,140	17.2	18,254	8.8
1997	December	12,414	63.7	4,126	21.2	2,945	15.1	19,484	9.0
1998	September	14,977	64.2	4,678	20.0	3,685	15.8	23,340	10.1
8. Other Loans									
1997	September	15,037	67.1	4,828	21.5	2,558	11.4	22,423	10.9
1997	December	14,510	58.1	5,043	20.2	5,404	21.7	24,957	11.5
1998	September	17,397	67.5	5,615	21.8	2,768	10.7	25,780	11.1
9. Total									
1997	September	134,570	65.2	46,753	22.7	25,052	12.1	206,375	100.0
1997	December	138,432	63.9	51,752	23.9	26,540	12.2	216,724	100.0
1998	September	148,142	64.0	53,829	23.3	29,350	12.7	231,321	100.0

Source: Central Bank of Sri Lanka

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

credit outstanding at the end of September was 43 per cent, in comparison to 45 per cent at the end of the previous year. Meanwhile, credit granted to this sector increased by 7 per cent.

The housing and property development sector was the second largest absorber of total credit, taking 13 per cent of total credit, while credit granted to this sector increased by 20 per cent. The growth in credit to the housing sector, which was also seen in the credit given by finance companies, may warrant caution to avoid any excessive exposure to this sector, which could result in asset price bubbles and a possible maturity mismatch on the part of institutions whose liabilities are essentially short-term.

The importance of industrial credit in commercial bank credits, which was 12 per cent at end September 1997, remained at around the same level at end September 1998.

Credit to tourism, financial, agriculture and other categories increased by 18.1 per cent, 15.6 per cent, 13.3 per

TABLE 10.7
Advances by Type of Security (a)
September 1997 - September 1998

Security	30 Sep. 1997		31 Dec. 1998		30 Sep. 1998	
	Amount Rs. Mn.	% of Total	Amount Rs. Mn.	% of Total	Amount Rs. Mn.	% of Total
1. Documentary Bills	6,032	2.9	6,186	2.9	6,398	2.8
2. Government Securities	2,684	1.3	2,560	1.2	3,608	1.6
3. Shares of Joint Stock Companies, Bonds, Debentures and Sundries including Cash Value of Life Policies	2,139	1.0	2,763	1.3	3,448	1.5
4. Fixed, Saving and Other Cash Deposits and CDs	20,860	10.1	21,705	10.0	24,974	10.8
5. Stocks in Trade	16,597	8.0	18,546	8.6	17,494	7.6
6. Immovable Property, Plant and Machinery	52,384	25.4	55,748	25.7	60,522	26.2
7. Personal Guarantees and Pro Notes	31,543	15.3	34,389	15.9	37,874	16.4
8. Trust Receipts	11,407	5.5	12,092	5.6	10,585	4.6
9. Hire Purchase Agreements	1,301	0.6	876	0.4	1,118	0.5
10. Tractors and Motor Vehicles	2,791	1.4	2,563	1.2	2,798	1.2
11. Other Securities	32,046	15.5	31,777	14.7	35,621	15.4
12. Unsecured	26,591	12.9	27,518	12.7	26,881	11.6
TOTAL	206,375	100.0	216,724	100.0	231,321	100.0

Source: Central Bank of Sri Lanka

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

cent and 14.9 per cent, respectively, while the combined share of these sectors in total credit was 21.9 per cent in 1998, in comparison to 21.4 per cent recorded in 1997. Consumption credit has increased by 28 per cent, while its share in total credit increased from approximately 9 per cent in 1997 to 10 per cent in 1998.

With regard to collateral, 88 per cent of the loans were secured, while 26 per cent of the total loans were issued against immovable property, plant and machinery. About 16 per cent of the loans were covered by personal guarantees and promissory notes.

The maturity structure reflected a slight decline in short-term credit (under one year) from approximately 65 per cent in 1997 to 64 per cent in 1998. The proportion of medium-term credit and long-term credit rose from 22.7 per cent to 23.3 per cent and 12.1 per cent to 12.7 per cent, respectively.

10.5 Central Banking

The Central Bank used a somewhat contractionary policy in order to maintain a tighter monetary policy stance in 1998. The repo rate was the main instrument used for this purpose. Interest rates remained at a slightly higher level, and helped to avoid excessive portfolio shifts to foreign assets during the year. As a further step towards maintaining market stability, the Central Bank reintroduced a reverse repo facility. The Central Bank's foreign assets position improved mainly through its earnings from investments, the sale to the Central Bank by government of the foreign exchange receipts of the loan of US dollars 100 million from FCBUs and sale by DFCC Bank of the proceeds of US dollars 65 million received from the issue of Floating Rate Notes. Although the Central Bank took up about Rs.25,999 million worth of Treasury bills at the primary auctions, most of this was subsequently disposed of in the secondary market. As a result, the Bank's holdings of Treasury bills increased only by Rs.1,016 million in 1998.

Structure of Assets and Liabilities

The total resources of the Central Bank increased by 2.6 per cent (Rs.4,774 million) to Rs.188,673 million during 1998 compared to a 1.3 per cent (Rs.2,332 million) growth in 1997. A significant portion of this has come about through the increase in the rupee value of net foreign assets.

When the assets side is taken into consideration, the increase was entirely due to improvements in the foreign assets of the Central Bank. The total foreign assets of the Central Bank reached Rs.127,177 million recording a 6.9 per cent (Rs.8,178 million) increase during the year. Reflecting this, a surplus of US dollars 37 million in the balance of payments was recorded in 1998. In comparison, foreign assets in 1997 increased by 15 per cent (Rs.15,755 million).

Meanwhile, the domestic assets of the Central Bank decreased by Rs.3,401 million (5 per cent) in comparison to the Rs.13,423 million (17 per cent) decrease recorded in 1997. Loans and advances to the government through the revolving credit facility increased by Rs.1,885 million (7 per cent). The Treasury bill holdings of the Central Bank increased by Rs.1,016 million (14 per cent) to Rs.8,238 million, in contrast to the decrease in the Central Bank's Treasury bills holdings by 58 per cent in 1997, mainly due to the retirement of Rs.10,000 million worth of Treasury bills by the government using the proceeds from privatisation.

On the liabilities side, total deposit liabilities of the Central Bank declined by 5 per cent (Rs.3,701 million), when compared with the decline of 4 per cent (Rs.3,277 million) in 1997. This was mainly attributed to the decline in government deposits by 52 per cent (Rs.3,367 million) in 1998. Deposits of commercial banks with the Central Bank increased by 7 per cent when compared with 1997, where a 15 per cent decline was experienced due to the reduction of the statutory reserve ratio.

The total currency issue by the Bank during the year increased by 13.1 per cent (Rs.6,952 million) compared to a 7.4 per cent increase recorded last year. The issue of currency notes increased by 13.1 per cent in 1998 compared to the 7.4 per cent increase recorded in the previous year, while the issue of coins recorded an increase of 12.3 per cent in 1998 in comparison to 7.8 per cent in 1997.

10.6 Banking Development

The total number of commercial banks operating in the country remained unchanged at 26 during the year. Of these, 8 were domestic banks and 18 were foreign banks. An important development that took place in the year 1998 was the commencement of the restructuring of Regional Rural Development Banks (RRDBs) by setting up Regional Development Banks (RDBs). A RDB is to be established in each province. This will take over the business of existing RRDBs in that province. This would ensure that each province in the country would have a development bank which would provide banking facilities in that area. As a first step towards implementing the restructuring programme, in terms of the provisions of the Regional Development Banks Act No.6 of 1997, a RDB named Ruhuna Development Bank was established by amalgamating the RRDBs of Galle, Matara and Hambantota. Subsequently, two more RDBs were set up in 1998, viz., the Kandurata Development Bank and the Rajarata Development Bank. This resulted in reducing the total number of RRDBs from 17 at end 1997 to 9 at end 1998. These RDBs have been issued licences to function as specialised banks under the Banking Act.

Branch Expansion

The total number of commercial bank branches including main branches (excluding 185 pawning centres), Agrarian Service Centres (ASC) branches, Kachcheri branches, extension offices and overseas branches, increased to 1,037 at end 1998 from 998 at the end of the previous year. Of the increase, 37 were branches of domestic banks and 2 of foreign banks. Commercial Bank of Ceylon Ltd. and Hatton National Bank Ltd. (HNB) opened 12 and 10 new branches, respectively, during the year, while Sampath Bank Ltd., Union Bank Ltd. and Pan Asia Bank Ltd. opened 3 branches each. In addition, eight extension offices were opened by domestic banks, while 2 ASC branches of BOC were upgraded to main branches. The number of branches of domestic banks increased from 956 to 993 at end 1998. The total number of foreign bank branches increased by 2 with the setting up of a branch each by Muslim Commercial Bank Ltd. and The Hongkong & Shanghai Banking Corporation Ltd. In addition, People's Bank opened 18 pawning centres and 3 service centres during the year. This increase in the number of branches improved the provision of banking services and reduced the number of persons served by a commercial bank branch (excluding pawning centres) from 18,589 persons in 1997 to 18,104 persons in 1998. With the amalgamation of some RRDBs into RDBs, the total number of RRDB branches decreased from 176 at end 1997 to 96 at end 1998. Correspondingly, the total number of RDB branches stood at 80 at end 1998. The National Savings Bank expanded its branch network to 100 during the year.

TABLE 10.8

Distribution of Bank Branches

Category	1996	1997	1998(a)
1. No. of Institutions	44	44	39
Commercial Banks	26	26	26
Domestic Banks	8	8	8
Foreign Banks	18	18	18
Savings Banks	1	1	1
RRDBs (b)	17	17	9
RDBs (c)	-	-	3
2. No. of Bank Branches (d)	1,230	1,273	1,313
Commercial Banks	958	998	1,037
Domestic Banks	919	956	993
Main Branches	828	858	889
ASC Branches	17	14	12
Kachcheri Branches	23	23	23
Extension/Pay Offices	47	57	65
Overseas Branches	4	4	4
Foreign Bank Branches (e)	39	42	44
Pawning Centres	101	167	185
NSB Branches	97	99	100
RRDB Branches	175	176	96
RDB Branches	-	-	80

Source: Central Bank of Sri Lanka

(a) Provisional
(b) Regional Rural Development Banks established under the RRDB Act No.15 of 1985.
(c) Rural Development Banks established under the RDB Act No. 6 of 1997.
(d) Includes Head Offices
(e) Includes Sub-branches.

Banking Facilities

With the expansion in the economy and the increased complexity in the financial sector, the activities of commercial banks also have expanded in a competitive environment. Rapid advances in telecommunications and

Box 11

The Use of Credit Cards in Sri Lanka

Following the technological advances throughout the world and also the gradual deregulation of financial sector activities starting from late 1977, Sri Lanka has taken many steps to create a more dynamic and innovative banking industry. One such step was the introduction of credit cards which marked Sri Lanka's first move towards a cashless society. There are four parties involved in credit card operations, viz., the credit card company which owns the trademark of the card, the bank which issues the card, the merchant and the cardholder. When issuing a credit card, the issuing bank and the card applicant enter into an agreement which includes terms and conditions relating to credit card operations. A cardholder need not necessarily be a bank's account holder.

Credit cards were introduced for the first time in Sri Lanka in the early 1980s, by a private company. The card was named the 'Golden Key Credit Card'. Its usage was initially limited due to the limited recognition of the card, difficulties in convincing customers and merchants of the benefits of using plastic money and also the lack of awareness of people about credit cards. However, over the years the acceptance of the card increased. Commercial banks began issuing credit cards in the 1980s, along with the introduction of a range of new financial instruments. These were initially for local transactions only. With the liberalisation of the current account following the acceptance of Article VIII status of the IMF by Sri Lanka in 1994, banks began to issue global access credit cards as well. The popularity of credit cards with the public has increased rapidly with greater awareness of their advantages. Various facilities and benefits offered by the card issuing banks, together with aggressive advertising campaigns, have also helped to popularise credit cards.

In Sri Lanka, six domestic banks and three foreign banks presently issue credit cards, and such issues are made under famous international trade names, such as VISA and MasterCard. At present, there are several types of cards issued by these banks e.g., 'Classic' cards, 'Gold' cards and 'Business' cards. Some of these cards are valid internationally as well as locally, while some are valid only for local transactions.

Greater use of credit cards may reduce the conventional demand for credit from the banking sector. Greater use of credit cards could also lead to a faster growth of private sector credit. Those credits, which are used and settled within the month, will not be reflected in the balance sheets of the commercial banks. In addition, cash holdings of the public could decrease as people would need less cash for transactions. The decline in cash holdings by the public would increase the money multiplier. Further, the acceptability of credit cards in many countries of the world ensures a great degree of convenience to travellers.

Credit Cards Issued by Commercial Banks

	1997	1998(a)	% Change
Total number of credit cards issued	52,882	85,964	63
Local	29,985	59,043	97
Global	22,897	26,921	18
Outstanding credit at end of year (Rs. Mn.)	874	1,482	70
Local	358	317	-11
Global	516	1,165	126
Overdues (as % of outstanding credit)	9	19	-
Pastdues (as % of outstanding credit)	21	7	-
Interest Rate (%)	20-33	20-33	-
Commission from Dealers (%)	0.2-5.0	0.2-5.0	-

(a) Provisional Sources: Relevant Institutions

The use of credit cards is becoming popular in Sri Lanka. While there are many advantages associated with the use of these cards, there are also disadvantages, such as card users becoming excessively indebted and thereby facing financial distress. The most recent information indicates that past dues (over 3 months in arrears) amount to about 7 per cent of outstanding credit card balances, while overdues (one to three months in arrears) amount to about 19 per cent. Fraudulent use of credit cards is also a possibility if cardholders do not exercise sufficient caution in the use of credit cards.

computer technology have further expanded the automation in the banking industry, with most commercial banks computerising a large part of their activities. Several banks have linked their branches through a computer network. The services available to customers have been improved by providing them with telephone banking facilities or by permitting them to access their accounts at any time through their personal computers.

People's Bank introduced a form of plastic money, viz., Smart Card, sometimes called an electronic purse, in mid-1998, for the first time in Sri Lanka. This card is a multi scheme card which allows a holder to use it as a multiple electronic purse, credit card and ATM card. Smart Cards can also maintain savings deposits in an electronic purse residing in its chip. A customer can deposit or withdraw cash from the electronic purse at any of the Smart Card merchant outlets or bank branches. In addition, Smart Card users have the benefit of reloading electronic money from their accounts at reloading stations. Meanwhile, Sampath Bank Ltd. continued issuing debit cards with the SET/CIRRUS/MAESTRO facility. In 1998, 11 commercial banks installed 68 Automated Teller Machines (ATMs), raising the total number of ATMs to 270 at end 1998. Nine commercial banks continued to provide credit card facilities. There were approximately 85,964 credit cards issued at end December 1998.

People's Bank (PB) introduced two new deposit schemes. One was the 'Swarna Prasada' Investment Account, which could be opened either with in initial lump sum deposit or by making monthly payments. The second was named 'Isuru Udana' and is aimed at minors. PB also launched several new loan schemes to grant loans for agriculture, rural development, small and medium projects, self employment, consumption etc.

Bank of Ceylon (BoC) introduced several new credit schemes during the year to promote the tea smallholder sector and the fishing industry. BoC also acted as a participating credit institution under the Rural Development Project funded by the Asian Development Bank (ADB) and the Rural Development Project funded by the International Fund for Agricultural Development (IFAD) and Swedish International Development Agency. Both PB and BoC granted credit under the Coconut Development Credit Programme and the Food and Nutrition Promotion Scheme.

Hatton National Bank (HNB) introduced a 'Gold Investment Account' Scheme, under which an individual is able to buy gold and hold it in an account. The depositor is entitled to withdraw the accumulated gold lying in the account and has the option of selling the gold back to the HNB. A gold account holder is also allowed to obtain loan facilities against the balance in the Gold Investment Account. In addition, HNB introduced a personal loan scheme for executives for vehicle leasing, purchase of consumer durables and also for education and purchase of property. It also introduced a phone banking facility. It was the first commercial bank in Sri Lanka to raise funds through the issue of debentures in 1998.

Commercial Bank of Ceylon Ltd. introduced new deposit schemes during the year, namely, the 'Arunalu' Minors' Savings Account Scheme, the 'Isuru-2' Minors' Savings and the Lump Sum Deposit Scheme. Commercial Bank of Ceylon also began keeping one branch open for business on holidays and weekends to provide limited services such as acceptance of deposits, opening of accounts, issue and encashment of travellers' cheques, foreign currency notes, drafts and pay orders and for the settlement of utility bills. It also made two issues of debentures for Rs.250 million each.

Seylan Bank Ltd. introduced a new loan scheme named 'Piyasa Velenda Nivasa', an extension of its existing 'Piyasa' Housing Loan Scheme, to provide facilities to customers who wish to own a business premises and residence in a single unit. This scheme enables customers to borrow Rs.50,000 - Rs.10 million, with a pay back period of 6-25 years. The loans have a maximum grace period of 4 years, at a concessionary interest rate. The interest rate during the grace period is 16.2 per cent and is 19 per cent thereafter. Seylan Bank also introduced another loan scheme for farmers in the Kirindi Oya Settlements who have not been able to cultivate paddy for two consecutive seasons, to divert part of their paddy lands for the cultivation of bananas. Under this scheme, Rs.6.9 million has been approved for 258 customers. The rate of interest is 22 per cent per year. Seylan Bank also raised funds through an issue of debentures to meet its medium and long-term lending requirements.

Pan Asia Bank Ltd. introduced a new deposit product, called the 'Poorna Monthly Income Planner' which carries an interest rate of 10.75 - 13.50 per cent per year, depending on the maturity and amount of the deposit. Pan Asia Bank also commenced pawning business during the year. Meanwhile, Union Bank introduced a Children's Education Savings Account Scheme.

10.7 Credit Information Bureau of Sri Lanka

The Credit Information Bureau of Sri Lanka (CRIB), which was established by the Credit Information Bureau of Sri Lanka Act No. 18 of 1990, completed its eighth successful year of operation in 1998. The Bureau, as empowered by the incorporating Act, continues to collect and collate credit, trade and financial information on borrowers and prospective borrowers of lending institutions and to provide such information to lending institutions that are shareholders of the CRIB.

The Bureau presently collects information on irregular loans of Rs.100,000 and over and regular loans of Rs.500,000 and over. Thereafter, the Bureau updates the information on irregular loans of all lending institutions and regular loans of Western Province state banks monthly, and information on the regular loans of other lending institutions quarterly. The CRIB is increasing the coverage and enhancing the quality of its credit reports with a view to providing an up-to-date credit information service.

A substantial increase in the demand for credit reports from lending institutions has been observed. The Bureau issued 125,928 credit reports during the year 1998, a 23 per cent increase compared to 102,175 credit reports issued in 1997. As a result, income from credit reports in 1998 increased by 33 per cent. Although the Bureau has gained a profit of Rs.3.7 million, it is still operationally running at a loss. During the year 1998, one Regional Development Bank and one licensed finance company were enrolled as shareholders of the Bureau. Presently, the shareholders of the Bureau are the Central Bank of Sri Lanka, commercial banks, licensed specialised banks and finance companies.

10.8 Rural Banking and Credit

Overall Trends and Developments

The policy of encouraging the establishment of a widespread rural banking network at the grassroots levels as a measure to make rural credit more accessible to the rural people was pursued vigorously during 1998. This policy, being a continuation of the steps taken in this direction in the preceding year, included the following: the formation of people-based micro-finance organisations; encouragement of the private sector to set up development and savings banks and the establishment of Regional Development Banks (RDBs) on a province-basis under the restructuring and amalgamation of the district-based Regional Rural Development Banks (RRDBs).

In the area of promoting people based organisations, the setting up of Samurdhi Bank Societies (SBS) and Isuru Development Societies (IDS) was continued, in geographical areas that had not been covered in the previous programmes. Private development and savings banks, viz., the Sanasa Development and Savings Bank, Pramuka Development and Savings Bank and the Ceylinco Development Bank, continued to open new branches outside Colombo. In addition, the National Development Bank and the DFCC Bank too continued their regional branch expansion programmes, thereby making their services accessible to people living in remote parts of the country. The RRDBs are being restructured to form Regional Development Banks (RDBs). Three such RDBs had commenced operations by end 1998. In the new RDBs the capital base was enhanced, diversifying the ownership among the two state banks, the National Savings Bank and the Employees' Provident Fund, in addition to the share ownership of the Central Bank. Further, RDB management was professionalised by making provisions for the appointment of a professional as the General Manager who will function as the Chief Executive Officer of the RDB.

The existing agricultural credit scheme, i.e., the New Comprehensive Rural Credit Scheme (NCRCS), which covers the paddy and subsidiary food crop sectors, continued to be funded by lending banks with an interest support from the government. A similar interest subsidy was provided by the government to lending banks in respect of Phase II of the self employment oriented micro-credit scheme titled 'Surathura' (Phase II). Three major policy changes were made during the year under review in the area of agricultural credit. First, the on-lending interest rate under the NCRCS, which had been fixed at 16 per cent per annum since 1991, was reduced to 12 per cent per annum from Yala 1998 to be in line with the general reduction in interest rates on development credit granted by commercial banks. Second, the interest subsidy on agricultural loans was raised by the government from 7.5 percentage points to 10 percentage points to facilitate the lending banks to cover a part of the cost of funds. Third, an Agricultural Credit Guarantee Fund was established with funding by the government to replace the then existing Central Bank Credit Guarantee Scheme. The new Fund will provide an indemnity of upto 60 per cent for loan losses of lending banks under the NCRCS and other agricultural credit schemes operated by the Central Bank.

The Isuru Development Societies in the districts of Puttalam, Galle and Matara, which had been registered as limited liability corporate bodies under the Societies Ordinance, took steps to form District Federations in the respective districts during the year under review. The objective of this step was to strengthen them financially on the one hand, and to enable them to grow as viable institutions in their role as linkage agencies, on the other. This exercise has proved that, if the poor are appropriately motivated, they could collectively achieve goals which permit them to advance their living conditions and get out of the poverty trap.

New Comprehensive Rural Credit Scheme (NCRCS)

The New Comprehensive Rural Credit Scheme (NCRCS) continued to fund small farmers island-wide by providing short-term cultivation loans for the cultivation of paddy and other subsidiary food crops. Loans granted during 1998 amounted to Rs.442 million in respect of 10,343 farmers. The Participating Credit Institutions (PCIs), which grant loans out of their own funds to prospective eligible farmers, are provided with an interest subsidy of 10 percentage points to enable them to lend to farmers at 12 per cent per annum. During the year under review, an interest subsidy amounting to Rs.24.7 million was paid by the government in respect of loans amounting to Rs.1,849 million that had been granted by PCIs in the six consecutive cultivation seasons from 1994/95 Maha to 1998 Yala.

The Farmers' Relief Scheme, introduced by the government in 1994, was also in operation during the year under review, as the termination date of the scheme was extended by a further six months from June 1998 to December 1998. Under this facility, relief was provided to defaulting farmers for credit obtained from 1978 to Maha 1993/94 by way of loan forgiveness, provided that they paid 25 per cent of the loan amount outstanding in their name to the lending bank concerned. In such cases, the balance

Box 12

Isuru Project: An Experiment in Poverty Alleviation through Micro Financing and the Credit Plus Approach

A generally accepted view by formal lending banks is that the poorest of the poor, the lowest stratum in the poverty pyramid, are not bankable or creditworthy. They are considered unbankable because they are not familiar with the lending and recovery procedures adopted by formal banks. They are considered uncreditworthy because they do not have a credit discipline and cannot provide the necessary collateral which lending banks normally insist on. As a result, the financial requirements of this category of people are not normally met by formal lending banks, but by the informal sector. Another reason for the aversion of the lending banks to providing credit facilities to this group is the high administration costs involved in maintaining a large portfolio of small loans.

In the late 1970s, the attention of international lending organisations that are geared to poverty alleviation was drawn to the need for developing a suitable credit system in which this group of borrowers could be provided with the necessary financial facilities through the formal banking system. The International Fund for Agricultural Development (IFAD) and the Asia Pacific Rural and Agricultural Credit Association (APRACA) took the lead in developing such a system. Around this time, acting independently, the Grameen Bank of Bangladesh headed by Professor Mohammed Yunus, managed to perfect a system to address this social issue. All these attempts, at a subsequent stage, converged to the development of what is today known as the *Credit Plus Approach*, as an effective micro finance system for poverty alleviation.

This approach was attempted in Sri Lanka in the late 1980s on an experimental basis by a partnership of the IFAD, Canadian International Development Agency (CIDA), the Government of Sri Lanka (GOSL) and the Central Bank of Sri Lanka (CBSL). The result was the implementation of a special poverty alleviation project titled ***"Small Farmers and the Landless Credit Project"*** (SFLCP), dubbed the ***"ISURU"*** Project in vernacular language, in four selected districts in which the incidence of poverty was concentrated in large pockets as a chronic and acute problem. The selected districts were Kandy, Puttalam (funded by IFAD) and Galle and Matara (funded by CIDA). A loan agreement signed in 1988 between the GOSL and the IFAD facilitated the implementation of the Project through a joint funding of IFAD, CIDA and CBSL on behalf of the GOSL. The Project was implemented on behalf of the GOSL by the CBSL through its Rural Credit Department. The need for such a poverty alleviation project arose from the failure of some individuals in the rural population to improve their economic conditions by successfully integrating with the free market economy system that was introduced to Sri Lanka in 1977. Hence, leading such population towards eventual economic advancement through a concerted effort was considered necessary. All the agencies involved in the Project agreed that the ground situation in Sri Lanka provided a good opportunity for testing the credit plus approach, which had been developed, to some extent, in other countries in the region at that time. This approach essentially consisted of extending micro credit, associated with the provision of a host of support services to back it.

The strategy adopted by the Project in realising its objectives consisted of an entry by a change agent to the village and encouraging the target beneficiaries to form themselves into small self help groups (SHGs) of people in identical poverty situations. These group members were then taken through a social mobilisation programme, which covered areas such as the creation of an awareness of the reason for poverty, the way to get out of the poverty trap, the power and the value of the synergical force that are unleashed through group action, inculcation of thrift and savings habits, credit discipline, participation in group voluntary activities, development of occupational skills, leadership competence and basic entrepreneurial skills such as accounting, law and marketing. These SHGs also served to reduce the administration costs of banks and overcome the problem of lack of collateral through an inter-se guarantee that provided a mutual guarantee by other group members.

The Project work was carried out by the Central Bank with the Director/Rural Credit as the Project Director, and by setting up a Project Central Office headed by a Project Manager and supported by a Project District Co-ordinator in each of the four districts covered by the Project. The Project was inaugurated in 1989 and continued till the end of 1997. The Financing Plan of the Project envisaged a total expenditure of US dollars 17.9 million over the project period by IFAD (a soft loan of US dollars 6.7 million), CIDA (a grant of US dollars 6.6 million), CBSL (local expenditure amounting to US dollars 4.1 million) and the beneficiaries (an equity participation and savings

Box 12 (contd.)

generation amounting to US dollars 0.5 million). In the implementation of the Project, a large number of Non Governmental Organisations (NGOs) were admitted as Participating Agencies (PAs) to assist in social mobilisation and/or retail lending. The engagement of NGOs in this role was guided by their lower administration costs, their familiarity with lending and engaging in rural development work, the expertise they had acquired over time as effective social mobilisers and the widespread grassroots level network with which they were equipped to function as effective change agents at the entry points. The main NGOs so admitted in the Isuru Project were national NGOs such as SANASA, Sarvodaya, the Women's Bureau, Lanka Mahila Samithi and regional NGOs such as Gami Seva Sevana, Coconut Triangle Milk Producers' Co-operative, etc. The Regional Rural Development Bank (RRDB) in each of the districts covered by the Project functioned as the banker to the Project.

The target group of the Project was selected on the basis of an income criterion linked to the basic food needs of a family. Accordingly, at the outset, the income level for identifying the poorest of the poor was fixed at Rs.3,360 per head per annum. This was the income that was considered necessary to acquire the daily requirement of 2,200 calories by an individual.

TABLE 1

Isuru Project: Achievements Over the Project Period 1989 - 97

Description	Kandy	Puttalam	Galle	Matara	Total
No. of Villages surveyed	851	352	662	447	2312
No. of SHGs formed	3327	2253	1537	1605	5580
No. of beneficiaries Covered	19,895	12,668	9,953	10,477	52,993
No. of women Beneficiaries	11,702	8,740	7,448	7,821	35,711
Savings mobilised as group savings (Rs. million)	20.7	14.1	11.0	15.6	61.4
Total amount of loans (Rs. million)	144.0	120.0	59.3	92.2	415.6
Average Size of a Loan (Rs)	8785	10039	7591	10392	9228
Cumulative recovery rate	96.4%	96.2%	85.4%	92.6%	94.0%

Source: Rural Credit Department, Central Bank of Sri Lanka

With the increase in price levels over the years, this income level was revised upward from time to time. Accordingly, at end 1997, it stood at Rs.7,200 per head per annum.

The achievements of the project over the project period have been rated as remarkable by the donors. Table 1 presents the cumulative achievements as at end December 1998.

With the supply of foreign funds for the Project ceasing at the end of 1997, the Central Bank took upon itself the task of continuing the project activities as per the original loan agreement by re-cycling the recoveries of the Project that had been accumulated in a revolving fund. In 1998, steps were taken to ensure the sustainability of the project activities by clustering the small self help groups of project beneficiaries into viable entities. Accordingly, action was taken to set up formal beneficiary organisations by registering them as Isuru Development Societies with the Registrar of Companies under the Societies Ordinance. These Development Societies, which are limited liability corporate bodies, are in a position to raise funds by issuing shares and mobilising savings from members and to provide micro loans to members. In addition, they can also function as retail loan disbursement institutions by linking with a formal bank which would grant a block loan to such Development Societies. Table 2 presents the status of the formation of Isuru Development Societies at end 1998.

With the success of the SFLCP in achieving its objectives, donor attention was paid to a possible replication of the experience in other parts of the country as well as other countries in the region. The IFAD uses

TABLE 2

The Status of the Formation of Isuru Development Societies as at end 1998

Particulars	Kandy	Puttalam	Galle	Matara	Total
No. of Development Societies	24	43	47	54	168
No. of embers	867	1535	2043	1729	6174
Value of the share capital (Rs. thousand)	288.3	786.0	884.2	911.8	2870.3
Compulsory Savings (Rs. thousand)	46.4	224.0	561.0	544.0	1375.4
Voluntary Savings (Rs. thousand)	199.9	392.9	nil	385.2	978.0
No. of loans	1,115	2,897	5,761	3,397	13,170
Value of loans (Rs. thousand)	1,190	1,293	1,690	1,854	6,027

Source: Rural Credit Department, Central Bank of Sri Lanka

the experience to promote similar projects in other countries. In Sri Lanka, the Overseas Economic Co-operation Fund (OECF) of Japan has agreed to fund a further poverty alleviation project as a way to replicate the SFLCP in six more districts in the country.

TABLE 10.9

Cultivation Loans Granted Under the New Comprehensive Rural Credit Scheme (Position as at 31 December 1998)

Rs. Million

Season	State Banks			Domestic Private Banks (a)			Regional Rural Dev. Banks (b)			Total Loans		
	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total	Paddy	Subsidiary Food Crops	Total Loans Under NCRCS
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
1996/97 Maha	233	59	292	18	28	46	24	36	60	275	123	398
1997 Yala	72	35	107	20	32	52	16	13	29	108	80	188
Cultivation Year 1997	305	94	399	38	60	98	40	49	89	383	203	586
1997/98 Maha (d)	145	37	182	14	22	36	19	37	56	178	96	274
1998 Yala (d)	69	32	101	16	25	41	14	12	26	99	69	168
Cultivation Year 1998 (d)	214	69	283	30	47	77	33	49	82	277	165	442

(a) Hatton National Bank, Commercial Bank and Seylan Bank only.
(b) Data from RDBs are also included in 1998 figures.
(c) The Refinance Scheme was withdrawn in April 1994 and replaced by an Interest Subsidy Scheme.
(d) Provisional.

Source: Central Bank of Sri Lanka

75 per cent was written off with the Central Bank (a share of 37.5 per cent), the government (a share of 18.75 per cent) and the lending bank (a share of 18.75 per cent) taking up the losses. As at the end of 1998, a cumulative number of 32,359 farmers had benefited from the Farmers' Relief Scheme.

In the implementation of the scheme in 1998, a sum of Rs. 9 million was paid by the government, while Rs.5.8 million was met by the Central Bank under the provisions of its Credit Guarantee Scheme. Thus, the cumulative payments by the government and the Central Bank upto the end of 1998 amounted to Rs. 42 million and Rs. 83 million, respectively.

Crop Insurance Schemes

During the year under review, the Agriculture Insurance Board (AIB) continued to provide agricultural insurance coverage for paddy, subsidiary food crops and livestock. A special insurance scheme was also designed and implemented for 11 perennial fruit crops for which credit facilities are to be provided under the Second Perennial Crop Development Project funded by the Asian Development Bank. A similar scheme has also been introduced in respect of crops being funded under a credit scheme implemented by the Department of Export Agriculture. The AIB has introduced an agricultural insurance scheme on an experimental basis for maize in collaboration with the Southern Development Authority in the Southern Region and will extend the scheme to other parts of the country in the future. In the meantime, preliminary steps were also taken by the AIB to design an insurance scheme for tea growers in consultation with the Tea Research Institute and the Tea Small Holder Development Authority. The Ceylinco Insurance Company Ltd (CICL), which is the only private insurer operating in this field, also expanded its insurance services to cover paddy, soya bean, chillies, banana and sugar cane. As a part of expanding its services, preliminary work was also completed by CICL to cover many perennial crops and fruit crops in their agricultural insurance scheme.

The extent of paddy land insured by the AIB in 1998 amounted to 14,000 hectares in comparison to 21,000 hectares covered in 1997. A gradual decline in the area covered by agricultural insurance has been reported since 1996, due to a fall in the credit levels granted under the NCRCS after the withdrawal of the Central Bank's re-finance scheme and the AIB of insurance coverage in respect of rain-fed paddy cultivation in certain parts of the country. The insurance premia collected under paddy amounted to Rs. 9.25 million as against an indemnity payment of Rs. 1.55 million during 1998. The area insured under other crops was 1,713 hectares and the premia collected on such insurance amounted to Rs. 0.64 million. The CICL insured an extent of 1,000 hectares of paddy land and collected premia to a value of Rs. 0.74 million. The payment of indemnity against

TABLE 10.10

Deposits and Advances - Selected Rural Sector Institutions

Rs. Million

	Co-operative Rural Banks (CRBs)		Bank of Ceylon Sub-Offices at Agrarian Services Centres		Regional Rural Development Banks (a)		Thrift and Credit Co-operative Societies (SANASA)		Sarvodaya		Janashakthi Bank Hambantota		Samurdhi Banking Socities		SANASA Development Bank	
	1997 (b)	1998 (c)	1997 (b)	1998 (c)	1997	1998 (c)	1997	1998 (c)	1997	1998 (c)	1997	1998 (c)	1997	1998 (c)	1997	1998 (c)
Total Savings (d)	9,871	10,518	305	316	2,504	7,827	3,895	3,506	206	293	14	43	132	458	386	678
Savings	7,343	9,093	257	256	1,612	1,881	1,715	1,543	159	227	11	13	24	-	18	115
Special Savings	-	-	10	29	118	111	847	762	47	65	3	15	25	194	-	1
Fixed Deposits	2,528	2,445	37	32	773	5,835	493	443	-	-	1	1	-	-	231	410
Shares	-	-	-	-	1	1	840	756	-	-	-	15	83	263	138	151
Total Loans Granted (e)	3,363	3,907	151	170	3,929	9,194	2,335	1,868	1,010	1,352	313	58	27	827	20	339
Agriculture	879	341	14	16	662	4,156	290	232	290	319	170	29	6	57	1	10
Animal Husbandry	489	149	1	1	49	155	46	36	37	48	32	13	-	1	-	1
Fisheries	98		-	-	31	20	-	-	-	-	8	3	-	177	-	-
Small Industries	130	213	2	3	356	644	93	74	81	89	70	4	-	-	2	99
Building Construction, Electrification and Water Supply	1,358	2,011	3	3	134	179	253	202	-	-	14	6	-	-	-	32
Projects/Commerce	209	406	56	70	705	1,152	511	409	77	98	-	-	21	-	11	155
Others	199	787	75	77	1,992	2,887	1,143	914	525	798	19	3	-	593	6	43

(a) Data from RDBs are also included in 1998 figures.
(b) Revised.
(c) Provisional data
(d) Savings as at the end of the years 1997 and 1998
(e) Loans granted during the years 1997 and 1998

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

crop failure under paddy by CICL was Rs. 0.6 million. The CICL also insured an area of 653 hectares for other crops. The premia collected on such insurance amounted to Rs. 0.72 million as against an indemnity payment of Rs. 0.56 million.

Both the AIB and the CICL continued to provide insurance coverage for livestock during 1998. The total premia collected by the AIB on this insurance amounted to Rs. 2.6 million, while the indemnities paid were Rs. 1.05 million. As for the CICL, the amount collected as premia on livestock insurance was Rs. 0.7 million, while the claims paid amounted to Rs. 0.22 million.

Agricultural insurance has expanded in the coverage of different products and crops in the recent past. Yet, its outreach, compensation levels and viability fall far short of the desired levels. The major agricultural insurer, the AIB, still depends on state funds for determining the coverage and compensation levels of its crop insurance schemes. This situation, which is a persistent feature, has raised serious issues about its viability and ability to serve the farming community. The private insurers, on the other hand, are reluctant to enter the crop insurance business mainly due to the statutory monopoly position vested with the AIB. Hence, the farming community will benefit more if competition is promoted in the provision of agricultural insurance, since this may lead to a reduction in premium rates and an enhancement of compensation levels.

Micro Finance and Savings Schemes

Self-Employment Promotion through Micro-Enterprise Credit (Surathura Scheme)

The Surathura Phase II in which the lending banks, viz., Bank of Ceylon, People's Bank and Hatton National Bank, provide micro loans to the unemployed out of their own funds, continued to be in operation during 1998. This was an extension of Phase I of the Scheme in which the necessary funds were provided by the government by way of re-finance to the three lending banks. In order to maintain an on-lending rate of 10 per cent per annum, an interest subsidy of 10 percentage points was paid by the government in respect of performing loans under the Surathura Phase II.

TABLE 10.11
Surathura Scheme Progress as at end 1998

	Phase I			Phase II		
	No. of Loans	Value (Rs. Mn.)	Recovery Rate (%) (a)	No. of Loans	Value (Rs. Mn.)	Recovery Rate (%) (a)
Bank of Ceylon	3,740	150	69	5,050	221	65
People's Bank	4,042	150	59	9,759	341	67
Hatton National Bank	1,257	50	89	307	13	45
Total	9,039	350		15,116	575	

(a) Position as at 30.06.1998 Source: Central Bank of Sri Lanka

Samurdhi Development Credit Schemes

The Samurdhi Bank Societies (SBS), which were set up as an integral part of the Samurdhi Movement under the Sri Lanka Samurdhi Authority Act, continued to focus on mobilising savings from Samurdhi members, who have been organised into Self Help Groups (SHGs), and to grant them loans for undertaking income generating activities. At end 1998, 639,106 shares of SBS to a value of Rs. 263 million had been issued to members. The total deposits of SBS, including the value of shares issued, stood at Rs.458 million as at that date. With regard to loan disbursements, 68,474 micro loans to a value of Rs.238 million had been disbursed to members in respect of agriculture, small trading, fisheries, consumption and to a lesser extent, distress relief purposes. This reflects an average loan size of Rs.3,471, a very small micro-finance facility. The overall recovery rate maintained by the SBS has been reported at 96 percent. In addition, loans were also disbursed under the Samurdhi Development Credit Programme (SASANA) and the Samurdhi Enterprise Credit Programme (SAVANA) through the two state banks during the year under review. The total number of loans granted under both schemes stood at 82,725, while the value was Rs. 589 million. A recovery rate of 66 per cent has been reported in the SASANA Scheme and 98 per cent in the SAVANA Scheme as at end December 1998.

Two more loan schemes for the benefit of Samurdhi animators and Samurdhi beneficiaries were also introduced under the Samurdhi Scheme during 1998. The first scheme, which was operated as a Revolving Fund Scheme, was implemented to meet the urgent and small loan requirements of animators and beneficiaries. By end 1998, a total of 94,917 loans to a value of Rs.78 million had been granted under this scheme. The other loan scheme was for providing the animators and beneficiaries with equipment and vehicles such as water pumps, three-wheelers and two-wheel tractors, under a special leasing facility. A sum of Rs. 122 million, under 508 loans, had been provided up to end 1998. In addition, as at end 1998, the compulsory savings by 897,803 Samurdhi beneficiaries stood at Rs. 3,818 million, of which Rs.2,909 million was maintained in special savings accounts with the two state banks. This records an increase of Rs. 1,094 million or 40 per cent over the level that prevailed at end 1997. During the year under review, 20,233 beneficiaries moved out of the Samurdhi scheme, after improving their economic conditions.

Gami Pubuduwa Scheme (GPS)

The Gami Pubuduwa Scheme (GPS), which is an innovative linkage banking scheme introduced by the Hatton National Bank, completed its ninth year of operations in 1998. Up to the end of 1998, a sum of Rs.876 million had been granted under the scheme for 27,500 small and micro projects. Most of these loans were fully re-paid by the respective borrowers on the due dates. Accordingly, the amount outstanding at end 1998 stood at Rs. 277 million, spread over 10,900 small projects. The scheme is implemented by 99 delivery units staffed by 114 field officers who carry out credit delivery and recovery activities. The GPS has continuously managed to maintain a collection ratio of 97.2 per cent, which is a very satisfactory record for a high risk micro finance scheme. In an attempt to further expand the GPS, Hatton National Bank has also initiated a financial assistance programme for educated rural youth, particularly school leavers and university undergraduates.

Thrift and Credit Co-operative Societies (TCCS) Credit Schemes

The TCCS credit schemes were operated during 1998 by both the Sanasa Development Bank (SDB) and the TCCS District and Primary Societies. The SDB is a specialised bank set up in August 1997 with a vision to raise the income levels of the low income groups through co-operative and development oriented financial services. The SDB grants loans to borrowers both directly and through the TCCS District Unions and Primary Societies.

Accordingly, several loan schemes targetting specific categories of borrowers were introduced by the SDB during 1998. These loan schemes were operated in selected areas of the country. At the end of 1998, 1,516 micro loans amounting to Rs. 21.2 million had been granted by the SDB under its micro credit schemes.

In the case of TCCSs, deposits mobilised and loans granted to members stood at Rs. 3,505 million and Rs. 1,868 million, respectively, at end 1998.

Janashakthi Banking Societies in Hambantota

Janashakthi Banking Societies (JBS) were first set up in 1989 as informal savings and loan associations by the Women's Development Federation (WDF) in the Hambantota District, with a vision to empower the women in poor families in the area to become both socially and economically self-reliant. The WDF continued to conduct awareness programmes on health, nutrition, thrift and viable economic activities for the target group. During 1998, 807 new members were registered with the existing 67 societies in 463 villages, increasing the total membership to 26,807. The total deposits mobilised from the members at end December 1998 stood at Rs.43 million. The outstanding loans to members as at the same date, granted for agriculture, animal husbandry, fisheries, small trading and housing, amounted to Rs. 58 million. Further, the JBS managed to maintain its recovery rate at 95 per cent.

Sarvodaya Economic Enterprise Development Services (SEEDS)

The Sarvodaya Economic Enterprise Development Services (SEEDS), which functioned as a branch of the main Sarvodaya Movement, was established as a limited liability company by guarantee in 1998 so as to build up its own identity and cater to micro and small scale borrowers. The mandate of the new company has been to formulate and implement a five year working plan covering mobilisation of savings and extension of credit as a package service to target groups. The new company also functions as a participating lending NGO under a number of foreign funded credit schemes. It has also introduced its own micro loan products under such names as 'Saubhagya', 'SEFE' 'Sirikatha' and 'Sithum-Pathum', targetting specifically the rural poor. During 1998, SEEDS had disbursed 99,741 loans to a value of Rs.1,352 million, maintaining a recovery rate of 90 per cent.

Tea Shakthi Movement(TSM)

The Tea Shakthi Movement (TSM), which was introduced in February 1997 with a view to organising tea smallholders into self reliant and sustainable entrepreneurs and raising the fund base of tea smallholder societies, expanded its activities during the year under review. The savings of members, together with interest earned on investments, stood at Rs. 82 million at end 1998. The savings so mobilised were utilised to grant loans to Tea Small Holder Societies for the acquisition of vehicles and other types of investments. In addition, the TSM paid compensation to members under its insurance scheme for natural and accidental death, permanent incapacitation and heart surgery, amounting to Rs. 6.3 million in respect of 205 cases during 1998.

10.9 Other Financial Institutions

Savings Institutions

The National Savings Bank (NSB), strengthened its activities during the year. The total resources of the NSB rose by approximately 9 per cent, mainly through the growth of deposits. The introduction of several new savings schemes and a widespread advertising campaign helped to mobilise deposits. Interest rates paid by the NSB, which have a significant influence on deposit rates elsewhere, were reduced in the first half of the year, but rose in the second half. Diversification of the NSB's investment portfolio continued with an increase in the holdings of market based instruments. New savings deposit schemes for children named 'Punchi Hapan' and 'Hapan' were introduced during the year. Savings deposits increased by 16 per cent, fixed deposits by 4 per cent and other deposits, including National Savings Certificates, Savings Certificates, Premium Savings Bonds and the NSB Pension Scheme, by 23 per cent. Total deposits of the NSB increased by 9 per cent in 1998 to reach Rs.84,280 million, in comparison to a 13 per cent increase in the savings and fixed deposits of commercial banks, to Rs. 287,929 million.

The interest rates offered by the NSB were revised several times during the year. The savings deposit rate and one year fixed deposit rate, which stood at 10.8 per cent and the 11.0 per cent, respectively, at end December 1997, were revised downward to 9.6 per cent and 10.0 per cent, respectively, in January 1998. In line with market trends, these rates were revised upward again at the beginning of the second quarter of the year. The savings deposit rate was raised to 10.5 per cent and the one year fixed deposit rate to 11.00 per cent with effect from 1 July 1998. While savings deposit rates remained at 10.5 per cent throughout the rest of the year, the one year fixed deposit rate was increased to 11.50 per cent in October 1998.

Similarly, the lending rates of the NSB were also adjusted several times during 1998. Interest rates on loans granted for housing purposes, which were in the range of 15.50 - 16.50 per cent, at end 1997, were reduced to a range of 15.00-16.00 per cent in January 1998 and prevailed at the same rate through January to July. Thereafter, these rates were further reduced to a range of 14.00-15.00 per cent in August and remained at the same level throughout the rest of 1998.

Total investments of the NSB increased by 9 per cent and stood at Rs.80,502 million at end 1998. A noteworthy feature in the investment portfolio of the NSB is the move towards investment in more market oriented government instruments which is, in fact, a reflection of the government itself moving towards more market oriented debt instruments. The share of investments in Treasury bills and Treasury bonds increased from 10 per cent at end 1997 to 21 per cent at end 1998. Investments in Treasury bills rose by 12 per cent during the year, while investments in Treasury bonds rose over sixfold from Rs.1,609 million to Rs.10,177 million at end 1998. Correspondingly, the share of investments in government Rupee securities fell from 75 per cent of total investments in 1997 to 62 per cent in 1998. Investments in debentures, Unit Trusts and shares also increased by 61 per cent and 18 per cent, respectively. Investments in government and government guaranteed securities continued to dominate the investment portfolio, accounting for 83 per cent of total investments of the NSB as at end 1998. The NSB Act requires the NSB to maintain at least 60 per cent of its investments in government and government guaranteed securities.

Chart 10.5
Employees' Provident Fund

Chart 10.5.1
Contributions and Refunds

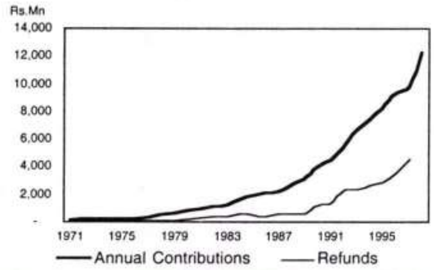
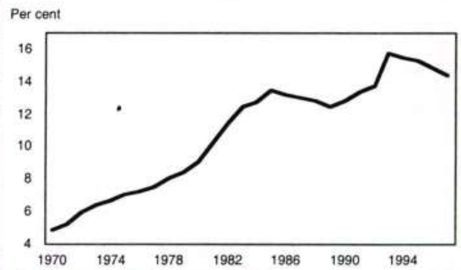


Chart 10.5.2
Rate of Return on Investments



The Employees' Provident Fund (EPF), the government's main compulsory savings institution and superannuation fund for corporation and mercantile sector employees, remains the largest single investment fund in the country. Contributions to the EPF have risen over the years, recording approximately Rs.12,300 million in 1998, an increase of 13 per cent over the level in the previous year. The refunds paid to members amounted to Rs.6,000 million compared to Rs.4,775 million in 1997. The total member balance of the EPF increased by 13 per cent to reach approximately Rs.144,000 million at end 1998. The Fund invested mainly in government and government guaranteed securities as in the previous years. Total investments of the Fund amounted to Rs.162,000 million. Of this amount 98 per cent had been invested in government paper. As the EPF is gradually being permitted to increase its investments in non-governmental securities, its holdings of such investments have increased by Rs.741 million during the year, to reach a total value of Rs.3,267 million at end 1998.

The Employees' Trust Fund (ETF), the country's second superannuation fund, also recorded increased inflows. The total assets of the Fund increased by 16 per cent in 1998 compared to the growth of 15 per cent in the previous year. Total contributions received increased by Rs.254 million to reach Rs.2,234 million in 1998. Total investments increased by Rs.3,242 million and stood at Rs.21,940 million at end 1998. Unlike the EPF, the ETF has greater flexibility in the composition of its investment portfolio. Consequently, at end 1998, it had 29 per cent of its portfolio in non-government securities. However, with the depressed conditions in the stock market, the bulk of its investments in 1998 was in government paper. At end 1998, its investments in Treasury bonds increased to Rs.571 million, investments in Treasury bills to Rs.10,054 million, and investments in Rupee Securities to Rs.4,881 million. Other investments including investments in debentures, shares, Unit Trusts, commercial paper and asset backed notes increased marginally during the year.

Long-Term Lending Institutions

DFCC Bank expanded its activities during the year, while increasing its funds for future lending through the successful issue of Float Rate Notes (FRN) in the international market in December 1998. The FRN raised US dollars 65 million. During 1998, 1,418 loans worth a total of Rs.8,478 million were approved, compared with 1,066 loan approvals to the value of Rs.6,631 million in the previous year. The total amount of loans disbursed during the year was Rs.4,277 million, an increase of 16 per cent. As a result, total loans outstanding increased by 20 per cent and stood at Rs.13,513 million at end 1998. As in the previous year, the major share of loans disbursed during the year was for industrial purposes (55 per cent). The commercial sector received 12 per cent, mainly for wholesale and retail trading, while the agricultural sector and financial sector absorbed 11 per cent and 8 per cent, respectively. Loans granted to the tourism sector amounted to only 2 per cent of the total loans granted. Loans for other purposes, which include community and social services, electricity, gas and water, and transport services, accounted for 13 per cent of total disbursements. DFCC Bank provided Rs.45 million in 1998 by way of equity finance, compared to Rs.1,454 million in the previous year.

As in the past, the main focus of DFCC Bank was on medium and long-term financing. Of the total loans outstanding, 57 per cent were medium-term, 34 per cent were long-term and 8 per cent short-term. Given its emphasis on project lending, 89 per cent of the total loans outstanding were above Rs.1 million, while the majority of loans had

TABLE 10.12

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

Rs. Million

Purpose	DFCC		NDB(a)		NSB		SMIB		HDFC		NHDA		PSDBs (b)		Total		% of Total Loans Approved	
	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998
Agriculture	1,122	1,153	815	2,864	-	-	13	14	-	-	-	-	2	44	1,952	4,075	7.0	8.9
Industry	3,806	5,114	6,679	15,035	-	-	-	-	-	-	-	-	19	283	10,504	20,432	37.8	44.5
Tourism	181	126	307	782	-	-	-	-	-	-	-	-	59	10	547	918	1.9	2.0
Commercial	888	591	-	1,429	-	-	-	-	-	-	-	-	353	1,082	1,241	3,102	4.5	6.8
Financial	320	766	569	340	-	5,240	-	-	-	-	-	-	16	21	905	6,367	3.2	13.8
Housing	-	-	-	275	1,812	679	1,329	1,540	484	684	1,463	1,911	5	152	5,093	5,241	18.3	11.4
Redemption of Debt	-	-	-	-	-	59	17	17	-	-	-	-	2	19	19	95	0.1	0.2
Other Loans	314	728	3,276	1,177	3,808	3,286		19	-	-	-	-	161	478	7,559	5,688	27.2	12.4
Total (Approved)	6,631	8,478	11,646	21,902	5,620	9,264	1,359	1,590	484	684	1,463	1,911	617	2,089	27,820	45,918	100	100
Loans Granted (c)	3,684	4,277	4,674	14,536	5,167	7,960	1,359	1,248	362	530	670	887	449	2,081	16,365	31,519		
Loans Granted as a percentage of total loans approved	56	50	40	66	92	86	100	78	75	77	46	46	73	100	59	69		

(a) Including refinance and equity investments
(b) PSDB-Private Savings and Development Banks.
(c) Includes loans approved in previous years and disbursed during the period under review.

Sources: DFCC Bank Ltd.
National Development Bank Ltd. (NDB)
National Savings Bank (NSB)
State Mortgage and Investment Bank (SMIB)
Sanasa Development Bank Ltd.
Pramuka Savings and Development Bank Ltd.
Housing Development Finance Corporation (HDFC)
National Housing Development Authority (NHDA)

been granted against property mortgages. The lending rates of DFCC Bank came down slightly from a range of 13.50-21.00 per cent at the beginning of the year to a range of 13.00-20.50 per cent at the end of the year. Of the total disbursements, 52 per cent had interest rates in the range of 14.00-19.00 per cent. The main sources of funds of the DFCC Bank were borrowings from the International Development Association (IDA) and the Asian Development Bank (ADB) (36 per cent), repayment of loans by customers (29 per cent) and issue of debentures (11 per cent).

The National Development Bank (NDB), which raised foreign loans in 1997 to fund its credit activity, approved loans to the value of Rs.21,902 million in 1998 compared to the total approvals of Rs.11,646 million in the previous year. The total number of loans also increased substantially from 733 to 1,224 in 1998. Of the total approvals Rs.14,536 million has been granted during the year. Total loans outstanding stood at Rs.21,883 million at end 1988. The bulk of loan approvals (69 per cent) by the NDB was for the industrial sector. Approvals to the industrial sector more than doubled during the year. Loan approvals to the agriculture sector, which stood at 13 per cent of total approvals, increased significantly from Rs.815 million to Rs.2,864 million at end 1998. The NDB concentrated on lending to the commercial sector, including financing for foreign trade, and the housing sector. The commercial sector received 7 per cent of total approvals in 1998, while loan approvals for housing purposes was Rs.275 million. Loans received by the tourism sector more than doubled in 1998 compared to the previous year. Loan facilities enjoyed by the financial sector and other sectors, which includes property development, decreased by 40 per cent and 64 per cent, respectively, during the year. The majority of loans granted by the NDB were over Rs.25 million in value, were for a period of 1-5 years and carried an interest rate of 14-19 per cent. The main sources of funds of the NDB in 1998 were repayments of loans by customers, issue of debentures, issue of commercial paper and borrowings from the National Savings Bank.

The State Mortgage and Investment Bank (SMIB) approved 8,913 loans to the value of Rs.1,590 million, an

TABLE 10.13
Assets and Liabilities of Licensed Finance Companies

Rs. Million

Item	As at 31 December 1997	As at 31 March 1998	As at 30 June 1998	As at 30 September 1998(a)	As at 31 December 1998(a)
Assets					
1.Loans and Advances	14,544	15,385	14,921	16,399	17,175
1.1 Hire Purhcase	2,619	2,741	2,345	2,445	2,355
1.2 Leasing	7,772	8,140	8,339	8,977	9,807
1.3 Real Estate	1,605	1,666	1,681	2,082	2,151
2.Equity Investments	1,697	2,227	1,936	1,905	1,875
3.Treasury Bills	1,534	1,159	1,848	1,688	1,949
4.Fixed Assets	1,664	2,126	2,196	2,209	2,288
5.Other Assets	2,856	2,736	2,576	2,827	2,802
Total	22,295	23,633	23,477	25,028	26,069
Liabilities					
1.Capital Account	3,124	3,585	3,629	3,620	3,769
2.Fixed Deposits	13,495	14,046	14,186	14,733	15,195
3.Certificate of Deposits	542	736	792	846	881
4.Borrowings	558	480	643	1,312	1,910
5.Provisions	1,385	1,471	1,054	1,263	1,059
6.Other Liabilities	3,191	3,315	3,173	3,254	3,275
Total	22,295	23,633	23,477	25,028	26,089
No. of Finance Companies reporting to the Central Bank	25	25	25	25	25

(a) Provisional

Source: Central Bank of Sri Lanka

increase of approximately 17 per cent during the year. As it is primarily a provider of funds for housing purposes, 97 per cent of total loan approvals in 1998 were for housing, while the balance was for the purchase of land for agricultural purposes, for the transport sector and for community and social services. The total value of loans disbursed during 1998 was Rs.1,248 million, a decrease of 8 per cent over the previous year. The term structure of loans indicates that 87 per cent of total loan approvals were long-term, while 12 per cent were medium-term. Most loan approvals (85 per cent) were for loans above Rs.100,000 and were secured by property or EPF balances. Total deposits mobilised by the SMIB decreased by 5 per cent during the year. Total assets of the SMIB increased by 4 per cent and reached Rs.6,627 million at end 1998. The main sources of funds were repayments of loans by customers and borrowings under a USAID credit line.

The SMIB revised its deposit rates several times during the year following competition in the market. Although deposit rates were decreased by 1 percentage point in January, the revision was reversed subsequently in September. Lending rates, which were in a range of 17.00 - 20.00 per cent at end 1997, were revised downward to a range of 15.00 - 18.00 per cent in January 1998.

Loans approved by the two private savings and development banks (PSDBs) increased substantially from Rs.617 million at end 1997, to Rs.2,088 million at end 1988. Credit was granted mainly to the commercial sector (52 per cent), industrial sector (14 per cent), housing sector (7 per cent) and agriculture sector (2 per cent). More than 77 per cent of the loans were over Rs.1.0 million, while 81 per cent of loans carried an interest rate exceeding 20 per cent. Of the total loans outstanding, 64 per cent were medium-term, 22 per cent were short-term and 14 per cent were long-term loans. The main sources of funds of the PSDBs were deposits and repayments of loans by customers.

The Housing Development Finance Corporation (HDFC) and National Housing Development Authority (NHDA) increased their lending for housing purposes. The HDFC approved Rs.684 million in respect of 4,908 loans during the year. This was an increase of 41 per cent over the previous year's approvals. Total loans disbursed rose from Rs.362 million to Rs.530 million. The majority of loans were long-term and secured by mortgages over property. All these loans were below Rs.1 million and the majority of loans carried an interest rate of 16.00-19.00 per cent. The main sources of funds of the HDFC were repayments of loans by customers and borrowings from international financial agencies.

The NHDA generally granted small size loans for housing. In 1998, Rs.1,911 million was approved for 65,318 borrowers, compared to Rs.1,463 million in respect of 32,520 borrowers in 1997. Of the total approvals, Rs.887 million has been granted during the year. This is an increase of 32 per cent over 1997. All the loans granted were less than Rs.25,000. They carried a rate of interest in the range 11.0-16.0 per cent per annum.

Finance Companies

The total number of Finance Companies (FCs) operating remained unchanged at 25, while the number of branches was 46 at end December 1998. Their total assets/liabilities increased by 17 per cent in comparison to a 24 per cent growth recorded in 1997 and reached Rs.26,089 million by end December 1998. This is equal to 6 per cent of the assets of the domestic units of commercial banks. In comparison, total assets of commercial banks moved up by 13 per cent in 1998 and 14 per cent in 1997. Total credit granted by FCs grew relatively slowly as was the case with commercial banks. Meanwhile, the deposit growth of FCs was relatively higher than the deposit growth of commercial banks in 1998.

Loans and advances continued to be the major category of assets of FCs, accounting for almost two thirds of total assets. The growth rate of loans and advances, however, slowed down slightly to 18 per cent in 1998, from 20 per cent in 1997. In comparison, loans and advances of commercial banks grew by 15 per cent in 1998 and 14 per cent in 1997. Within loans and advances, leasing (57 per cent), hire purchase (14 per cent) and real estate (13 per cent) were the main components. Advances to the real estate sector showed the fastest growth, at 34 per cent in 1998. In view of potential asset price bubbles, it may be advisable to view this with some caution. Credit for leasing activity increased by 26 per cent, while credit for hire purchase activity actually declined by 10 per cent.

The investment component of FC assets amounted to 15 per cent, with one half of the investments being in government securities, primarily Treasury bills. Amongst other assets, the holdings of cash and bank balances fell by 22 per cent, while fixed assets rose by 38 per cent.

From the perspective of liabilities, the major component was deposits, accounting for 62 per cent of total liabilities (fixed deposits - 58 per cent, certificates of deposit (CDs) - 4 per cent). Total deposits of FCs increased by 15 per cent in 1998 (38 per cent in 1997), in comparison to an increase of 7 per cent in rupee deposits of commercial banks (14 per cent in 1997). A noteworthy development was that CDs grew by 62 per cent.

The dependence of FCs on borrowings as a source of funds increased, with a three fold growth in the outstanding borrowings in 1998 compared to a decline of 62 per cent in 1997. This increased dependence on borrowings may be due to the slower growth of deposits of FCs in 1998. The drop in provision for bad and doubtful debt in 1998 was mainly the result of the writing off of approximately Rs.480 million of bad loans by one FC in June 1998. Other liabilities of FCs fell by 5 per cent in 1998, in comparison to an increase of 23 per cent in 1997.

A further reduction in deposit rates as well as lending rates was seen in 1998. Interest rates on fixed deposits maturing in one year came down to a range of 10.00 - 20.00 per cent per annum in 1998 from a range of 14.00 - 21.00 per cent in 1997, while lending rates on hire purchase financing were reduced to a range of 10.00-27.00 per cent per annum in 1998 from a range of 11.00-30.00 per cent per annum in 1997. Similarly, the interest rates on leasing were reduced to a range of 10.00-27.00 per cent per annum in 1998 in comparison to a range of 13.00-30.00 per cent per annum in 1997.

10.10 Specialised Financial Institutions

Merchant Banking

The total number of merchant banks operating in Sri Lanka remained at 10 in 1998. Total assets of merchant banks decreased slightly by 2 per cent in 1998. Total pre-tax profits were negative in 1998 too, though the loss has come down significantly compared to 1997. The total income of merchant banks increased by 3 per cent to reach Rs.2,008 million at end 1998. Major income sources were leasing (23 per cent), loans (14 per cent) and discounting trade bills (13 per cent). Profits on investment in shares and income from financial and marketing consultancy services decreased significantly.

TABLE 10.14

Progress of Activities of Merchant Banks 1997-1998

Rs. Million

	1997	1998(a)
1. Earned Income on Leasing	473.8	471.1
2. Interest on Discounting Trade Bills	332.8	256.0
3. Financial and Marketing Consultancy Services	203.9	111.3
4. Underwriting Commissions	0.8	-
5. Insurance Commissions	2.0	2.5
6. Interest on Margin Trading	30.9	24.0
7. Profit on Investment in Shares	229.8	25.0
8. Interest on Treasury Bills	91.8	94.7
9. Interest on Loans	305.1	272.4
10. Dividends	61.6	179.6
11. Other Income	224.9	571.0
12. Total Income	**1,957.4**	**2,007.6**
13. Pre Tax Profit	-135.1	-58.6
14. Total Assets	19,802.4	19,388.2
No. of Merchant banks reporting	10	10

(a) Provisional Source: Central Bank of Sri Lanka

Leasing Companies

There were 5 specialised leasing companies, of which 3 were subsidiaries of commercial banks operating in Sri Lanka, in 1998. In addition, a number of other financial institutions such as commercial banks, development banks, finance companies and merchant banks engaged in leasing business in Sri Lanka. In the midst of intense competition, the activities of these companies increased during the year. The total assets of the 5 leasing companies increased from Rs.7,538 million at end 1997 to Rs. 10,013 million at end 1998. The total value of new lease finance provided by these companies increased by 60 per cent in 1998 compared to 63 per cent in the previous year. As in the previous year, lease finance was mainly for commercial vehicles (55 per cent), passenger vehicles (15 per cent), plant and machinery (12 per cent) and office equipment (11 per cent). In terms of sectors, the trading sector received 32 per cent of the total lease finance, while the services sector and the transportation sector received 22 per cent and 21 per cent, respectively. In addition, the industrial sector (16 per cent), the construction sector (4 per cent) and the agriculture sector (3 per cent) also received significant levels of finance. Leasing companies indicated that they were affected by competition from other financial institutions and by the GST imposed on leases. Another constraint faced by most leasing companies was the difficulty in obtaining long-term funds for financing leases.

Venture Capital Companies

Venture Capital Companies (VCCs) continued to provide long-term capital for commencement of new business, expansion of existing ventures, acquisitions and buyouts, in addition to investing in listed shares and other financial instruments. Of the total investment in equity, the majority (64 per cent) was for commencement of operations, though financing for this purpose was lower than in 1997. Financing for expansion of ventures stood at Rs. 313 million, an increase of 4 per cent over the previous year. Meanwhile, provision of funds for acquisitions, buyouts and investment in quoted companies dropped during the year. VCCs invested in 135 projects in 1998, compared to 161 projects in the previous year. In terms of the sectors that received funds, the services sector was the largest recipient of funds (60 per cent), absorbing Rs. 1,390 million, an inecrease of 17 per cent over the previous year. The VCCs provided 34 per cent and 6 per cent of total equity financing to the manufacturing sector and the agriculture sector, respectively. Total assets of the VCCs grew by 1 per cent during the year.

Insurance Companies

The insurance industry has grown in 1998, in terms of both the total asset base and profits. Total assets of 7 insurance companies reached Rs.23,805 million, an increase of 5 per cent during the year. Net profit before tax also increased by 10 per cent in 1998. This growth was accompanied by an increase in employment in the insurance sector from 6,244 to 6,511. The total branch network increased to 268 at end 1998 from 262 at end 1997.

The growth in the insurance industry was seen in both life insurance and general insurance activities. The total value of life assurance fund was Rs.16,107 million, an increase of 19 per cent over the previous year. The total premium collected with respect to business in force increased by 18 per cent during the year, while the total sum insured rose by 11 per cent compared to the previous year. The total number of policies in force also increased by 5 per cent in 1998. Total benefit payments on maturity, death and disability and surrender increased by 17 per cent during the year.

General insurance activities, except marine insurance, showed an improvement during the year. Net premia for policies in force increased by 10 per cent and stood at Rs.4,607 million at end 1998. Net premia in the motor insurance sector, which is the biggest in the general insurance category, increased by 18 per cent during the year. Net premia in fire insurance and general accident insurance increased by 9 per cent and 5 per cent, respectively. Meanwhile, net premia in marine insurance dropped marginally during the year.

10.11 Money Market

Overall Trends

In view of continued uncertainty in the external environment and somewhat high domestic inflation early in 1998, policy measures were focussed on making progress towards monetary and price stability. This resulted in a relatively stable money market with less volatile call market interest rates, and slightly higher repo rates and Treasury bill rates. The market was generally liquid, partly due to the slower growth in credit and the inflow of foreign funds in the second half of 1998. Reflecting this availability of liquidity, most primary Treasury bill auctions were over-subscribed by the public. The resumption of the Central Bank's reverse repurchase facility in November also helped to stabilise the market and arrest any undue rise in interest rates. Open market operations continued to be the mechanism for liquidity management, with the repo rate and the rediscount rates being used as the main means of influencing the market. Although the Central Bank's own Securities, with a maturity of seven days, were available, use of the facility by commercial banks was minimal. In the domestic foreign exchange market, the Central Bank's middle rate for transactions with commercial banks depreciated by about 10 per cent. The slightly higher repo rates in 1998 than in 1997, served to contain the demand for funds from the call market for the purchase of foreign exchange.

Inter Bank Call Money Market

Activity in the call money market was somewhat less in 1998 than in 1997, with the total turnover falling from Rs.1,015,457 million to Rs.880,566 million. There was also less volatility in call market rates. The slight tightening of the monetary policy stance, effected through increases in the repo rate, led to an increase in the lower end of the call market interest rates. Reflecting higher liquidity in the market in the early part of the year, call market rates declined to a

TABLE 10.15
Money Market Operations 1996-1998

Rs. Million

Period		Call Money Market		Primary Treasury Bill Market						Secondary Treasury Bill Market (Central Bank)	
						Amount Accepted (Purchases)					
		Total Lending/ Borrowings	Outstanding at end period	Total Outstanding	Amount Issued	Central Bank	Commercial Banks	Others	Total	Total Sales	Total Purchases
1996											
1st	Quarter	217,697	2,390	120,021	52,025	3,560	27,170	21,295	52,025	9,384	795
2nd	Quarter	191,406	4,792	122,821	50,009	8,586	27,285	14,138	50,009	1,710	3,871
3rd	Quarter	233,790	3,977	124,521	58,819	9,502	33,021	16,296	58,819	1,975	5,854
4th	Quarter	301,921	6,862	124,996	66,027	2,753	42,362	20,912	66,027	3,043	6,301
1997											
1st	Quarter	303,208	4,811	124,996	56,629	9,304	30,179	17,146	56,629	7,222	4,027
2nd	Quarter	275,508	5,830	124,996	38,609	7,863	22,452	8,294	38,609	4,373	4,433
3rd	Quarter	224,566	1,853	114,996	46,676	3,886	25,776	17,014	46,676	5,936	1,563
4th	Quarter	212,175	3,599	114,996	68,973	4,245	44,906	19,822	68,973	1,289	7,197
1998											
1st	Quarter	210,509	4,141	112,996	56,717	7,175	32,321	17,221	56,717	2,218	10,491
2nd	Quarter	196,668	2,734	114,996	50,086	6,398	28,254	15,434	50,086	4,062	4,143
3rd	Quarter	241,206	5,759	117,996	53,542	6,924	32,825	13,793	53,542	3,373	123
4th	Quarter	232,184	4,272	119,996	70,338	5,502	44,740	20,096	70,338	1,738	105

Source: Central Bank of Sri Lanka

lower and narrower range of 11.00-16.50 per cent in the first two months of 1998 compared to a range of 12.00-20.00 per cent at end December 1997, and stood at a level of 12.0-12.75 per cent by end March 1998. In the second quarter, call money rates fluctuated within a narrow range with slight fluctuations and were in a range of 12.13-12.75 per cent at end June 1998. A temporary shortage of liquidity in the market in July saw the rates move to a peak of 28.00 per cent on 30 July, which was the highest recorded in 1998. Thereafter, the rates declined to a range of 12.25-17.25 per cent during September. The inflow of foreign funds into the market in the latter part of 1998 caused the rates to decline to a range of 11.25-16.50 per cent in December. The end year rates remained in a very narrow range of 13.00-14.00 per cent.

Primary Treasury Bill Market

In contrast to the declining trend observed in Treasury bill yield rates, particularly in the second half of 1997, yield rates tended to rise slightly in 1998. However, as the market was generally liquid, most primary Treasury bill auctions were oversubscribed. The yield rates on 3-month and 12-month Treasury bills, which stood at 9.97 per cent and 10.21 per cent, respectively, at the last auction in 1997, rose gradually to 11.75 per cent and 12.09 per cent, respectively, by end June. The yield rates increased further to stand at 12.01 per cent and 12.59 per cent, respectively, at the last auction in 1998. The rise in yield rates can be partly attributed to the maintenance of a higher overnight repo rate. In addition, the increase in inflation in the early part of the year would have contributed to the increase in yield rates. The difference between the yields on shorter maturity Treasury bills and the longer maturity Treasury bills was small, resulting in a flat yield curve throughout most of the year. Following the retirement of Rs.10,000 million worth of Treasury bills in 1997 using the proceeds from privatisation, a further Rs.2,000 million worth of Treasury bills were retired in March 1998. However, government expenditure increased and revenues were less than budgeted, partly due to the GST rate being lower than the revenue neutral rate. This led to an additional financing requirement. Hence, the government reissued this Rs.2,000 million of Treasury bills and a further Rs.5,000 million, from the bills retired in 1997. In order to avoid disrupting the market through these issues, they were taken up by the Central Bank. These developments in the primary Treasury bill market led to the rise in the total outstanding level of Treasury bills from Rs.114,996 million at end 1997 to Rs.119,996 million at end 1998.

With a view to maintaining stability in the money market rates, the Central Bank purchased bills amounting to Rs.25,999 million in the primary market, including Rs.11,660 million worth of Treasury bills reserved for the Central Bank from the reissues of Treasury bills prior to the Primary Treasury bill auctions. These purchases were, however, almost entirely divested to the market subsequently, and the book value of the Central Bank's holdings of Treasury bills stood at Rs.8,233 million at end 1998, compared to Rs.6,691 million at end 1997. The total value of Treasury bills offered in the primary market in 1998 was Rs.217,022 million as against the Rs.194,866 million in the previous year.

Central Bank Secondary Market for Treasury Bills

The sales (discounting) of Treasury bills from the secondary window of the Central Bank amounted to Rs.11,390 million in 1998, in comparison to Rs.18,821 million in the previous year (a decline of 39.5 per cent). Meanwhile, purchases (rediscounting) of Treasury bills also fell from Rs.17,220 million in 1997 to Rs.14,862 million in 1998.

As in the past, the Central Bank's discount and rediscount rates were important signalling instruments on short-term interest rates. In addition, the spread between the Central Bank's 3-month discount and rediscount rates for Treasury bills was also adjusted to influence the liquidity conditions in the market. The margin was raised in two steps, from 3.25 to 4.25 percentage points, in January, to tighten monetary conditions and discourage commercial banks from selling Treasury bills to the Central Bank to obtain low cost liquidity for speculative activity in a volatile foreign exchange market. Some improvement in stability in the foreign exchange market was seen in February. Commercial banks stopped buying foreign currency from the Central Bank and the inter-bank exchange rate for the dollar appreciated in the first few weeks in February. The margin between the discount rate and rediscount rate was therefore reduced to 4.00 percentage points on 20 February. The margin was adjusted several times during the year and stood at 3.15 percentage points from mid August to end December 1998. When the year is considered as a whole, the general increase in interest rates of about 2 percentage points can be seen in the Central Bank's secondary window too. The discount and rediscount rates for 3-month bills rose to 11.86 per cent and 15.01 per cent, respectively, at end 1998 from 9.72 per cent and 12.97 per cent, respectively, at end 1997.

Central Bank Repurchase (Repo) Market for Treasury Bills

The overnight repo rate continued to be one of the major instruments used by the Central Bank for liquidity management in 1998. The Central Bank engaged in repurchase transactions, to stabilise call market rates, particularly the lower end of the rates. The considerable uncertainty created in the foreign exchange market due to the crisis in East Asia in the latter half of 1997, continued into 1998, leading to speculative activity in the Sri Lanka foreign exchange markets. In order to discourage this, and in view of the increase in inflation early in 1998, the overnight repo rate was raised from 11.0 per cent at end 1997 to 12.00 per cent in January and kept at a relatively high level throughout most of the year, to avoid portfolio shifts from domestic assets to foreign assets. Towards the end of the year, a reduction of pressure on the exchange rate and a decline in domestic inflationary pressure permitted a lowering of the repo rate. The Central Bank was able to reduce the overnight repo rate in several steps to 11.25 per cent by end December. Repo sales by the Central Bank rose to Rs.728,335 million in 1998 from Rs.446,423 million in 1997.

Central Bank Reverse Repurchase (Reverse Repo) Market for Treasury Bills

With a view to creating stability at the upper end of the call market interest rate range, the Central Bank introduced a reverse repurchase facility in November 1995. Structural weaknesses in the market and limits on the amount of liquidity provided made this facility less effective than envisaged. Its use was gradually abandoned and the facility was not offered in 1996 or in 1997. In fact, the availability of liquidity in the market in 1997 obviated the need for such a facility. The Central Bank reintroduced the reverse repurchase facility with effect from 09 November 1998, in order to stabilise the short-term rates in the money market. All commercial banks and non commercial bank Primary Dealers for government securities are eligible to make use of this facility. At present, only overnight funds are provided under this facility. There is no limit on the amount of liquidity that can be obtained, but such funds are provided only against the collateral of Treasury bills or Treasury bonds. The reverse repo rate is determined by the Bank on a daily basis and is announced to the market. Currently, this rate is equivalent to the rediscount rate at the Bank's secondary window. There were only two reverse repurchase transactions recorded, i.e., on 27 November and 01 December, amounting to Rs.731 million and Rs.334 million, respectively, at the rate of 15.45 per cent.

Domestic Foreign Exchange Market

The US dollar continued to be the intervention currency, and the Central Bank announced daily spot buying and selling rates for the dollar for transactions with commercial banks. The spread between the spot buying and selling rate has stood at 2 per cent from 1995. The Central Bank's middle rate was Rs.67.7800 per US dollars at end 1998 as against Rs.61.2850 per US dollars at end 1997, a depreciation of 9.6 per cent.

Purchases of US dollars by the Central Bank from commercial banks fell from US dollars 137 million in 1997 to US dollars 61 million in 1998. Meanwhile, sales of US dollars by the Central Bank to commercial banks in 1998 amounted to US dollars 215 million, as against US dollars 155 million in 1997. Accordingly, the net purchases of foreign exchange from the Central Bank by commercial banks in 1998 amounted to US dollars 154 million, as against net purchases of US dollars 18 million in 1997. Total inter-bank turnover, which stood at US dollars 3,881 million in 1997, rose to US dollars 4,409 million in 1998. However, the forward transactions decreased from US dollars 1,606 million in 1997 to US dollars 696 million in 1998.

The scheme to permit commercial banks to grant foreign currency loans to non-BOI exporters either from their domestic units or from their FCBUs, introduced in January 1997, continued in 1998. However, due to the continuing volatility in foreign exchange markets and the comparatively low domestic interest rates that prevailed, non-BOI exporters made less use of this facility than in 1997. A sum of US dollars 177 million (approximately Rs.11,425 million) was granted as credit under this scheme in 1998, as against US dollars 254 million (approximately Rs.15,017 million) in 1997. Thus, under this scheme, a gross sum of US dollars 431 million had been granted upto end December 1998. The outstanding level of credit at end December 1998 was US dollars 44 million.

Central Bank Securities

Central Bank Securities were available on tap to commercial banks and Primary Dealers throughout the year. The securities offered were short-term, with maturities of 7 days. However, there was very little demand for these securities and the total issues amounted only to Rs.40 million in 1998, as against Rs.7,835 million issued in 1997. The securities were sold at par with an interest rate equal to the prevailing rate for 7 day repos. The interest rates were in the range of 11.93 - 12.06 per cent per annum in 1998.

Commercial Paper (CP)

Commercial paper has become a popular instrument in the corporate sector in Sri Lanka, since their first issue in 1993. The popularity is attributed to their ability to meet the short-term liquidity requirements of corporate entities at attractive rates of interest. Listed companies as well as merchant banks issue commercial papers with maturity periods of 3-6 months. Such paper can be supported by commercial banks, subject to the guidelines issued by the Central Bank.

The gross issues of commercial paper, including reissues, in 1998 stood at Rs.16,457 million. (This value relates only to CP issued with the involvement of either commercial banks or merchant banks.) During 1998 merchant banks made their own issues amounting to Rs.1,702 million, while they supported companies to issue commercial paper totalling Rs.2,446 million. However, the bulk of commercial paper, amounting to Rs.12,309 million, was issued with the support of the commercial banks. The outstanding value of commercial paper at end 1998 was Rs.4,286 million. During the year, the yield on commercial paper varied within a range of 11.00-18.02 per cent per annum.

10.12 Capital Market

Although the Colombo share market recovered somewhat in the first few months of 1998, the year as a whole saw a continuation of the downward trend in market activity and share prices. This was mainly attributed to the continuation of adverse economic and financial conditions, particularly in the Asian region. The impact of the East Asian crisis, which started in July 1997, continued during 1998 and had a dampening effect on the regional stock markets including Colombo, as foreign investors reduced their exposure to the entire region. Secondly, the nuclear tests carried out by India and Pakistan in May 1998 led to negative foreign investor sentiment, with a resulting pullout of investments from South Asian markets. In addition, the Russian financial crisis which started in August 1998, resulted in a moratorium on debt repayments by Russia and reduced tea imports from Sri Lanka, adversely affected prices in the plantation companies. The All Share Price Index (ASPI) fell by 15 per cent, while the Sensitive Price Index (SPI) declined by 13 per cent in 1998, in contrast to the increases of 16 per cent and 19 per cent, respectively, in 1997. Foreign investors were net sellers with net outflows amounting to approximately US dollars 24 million. Market capitalisation also decreased by 10 per cent. The total number of companies listed on the Colombo Stock Exchange (CSE) had a net increase of one in 1998. Five plantation companies offered shares for sale to the public and a company in the hotel sector had an Initial Public Offer (IPO) during the year. Indicating the continued interest of the public in investing in plantation company shares, all the offers for sale were over-subscribed. The IPO of the company in the hotel sector was also over-subscribed.

TABLE 10.16

Share Market Indicators

	1996	1997	1998
1. Market Capitalisation (Rs.Mn.)	104,197	129,428	116,660
2. Number of New Issues (No.)	8	5	6
3. Total Number of Shares Issued (Mn.)	64	50	28
4. Value of New Shares Issued (Rs.Mn.)	2,178	456	349
5. Number of Shares Traded (Mn.)	227	515	634
6. Value of Shares Traded (Rs.Mn.)	7,403	18,315	18,130
7. Price Indices - CSE All Share (as at 31st Dec.)	603.0	702.2	597.3
- CSE Sensitive (as at 31st Dec.)	897.7	1,068.0	923.0

Source : Colombo Stock Exchange

An additional encouraging feature was the gradual development of the corporate debt market. Three commercial banks and three private companies together made seven debenture issues to the public and those were listed on the CSE. By end 1998, the total value of listed corporate debt amounted to Rs.3,703 million. In many well developed financial markets, the value of debt instruments exceeds the value of equity. The development in the Colombo market is

Chart 10.6
Share Market Indicators

Chart 10.6.1
Share Price Indices
(1985 = 100)

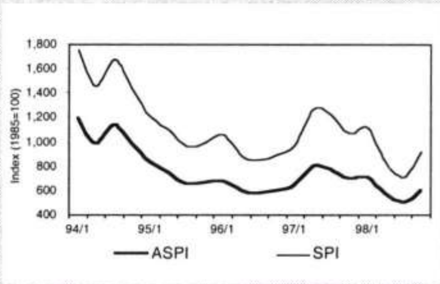


Chart 10.6.2
Stock Market Transactions

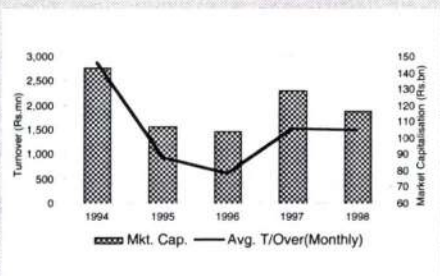
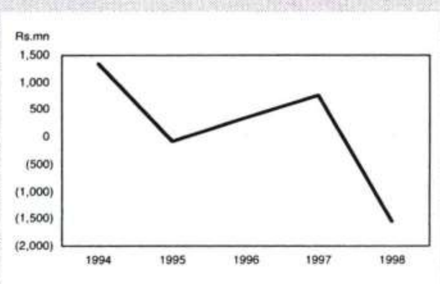


Chart 10.6.3
Non-National Participation



a healthy sign as this broadens the financial market and provides new avenues of investments to savers and new means of raising funds to companies.

A third positive feature was the continued expansion in market based government bonds. The issue of market oriented Treasury bonds commenced in 1997, in which year the total issue amounted to Rs.10,000 million. In 1998, the total value of Treasury bonds issued rose to Rs.38,915 million. These bonds, which carry a coupon rate and are sold by auction, had maturities of 2, 3 and 4 years.

Internationally, one Sri Lankan company made a global placement of shares, while another had a Floating Rate Note issue. Both offers were over-subscribed.

Primary Market

An IPO was made by a hotel sector company, i.e., Royal Palm Beach Hotel Ltd., during 1998. Five offers for sale of shares were made by plantation companies, viz., Hapugastenna Plantations Ltd., Udapussellawa Plantations Ltd., Balangoda Plantations Ltd., Madulsima Plantations Ltd. and Kahawatta Plantations Ltd. during the year. The total market value of all these share issues (inclusive of share premium) was Rs.349 million, compared with the market value of Rs.583 million of five share issues made in 1997. The total value of rights issues made during 1998 was Rs.1,960 million compared with Rs.1,078 million during 1997.

Two international placements viz., the Floating Rate Notes (FRN) issue of DFCC Bank and a global placement of shares by Aitken Spence Company Ltd. were made during the year. Both issues were over-subscribed despite the regional decline, indicating the confidence placed by international investors in these institutions. The FRN issue

TABLE 10.17
Number of New Share Issues by Type of Investment

Type of Investments	1996	1997	1998
Banks Finance & Insurance	-	1	-
Beverages Food & Tobacco	1	-	-
Chemicals & Pharmaceuticals	1	-	-
Constructions & Engineering	-	-	-
Diversified	-	-	-
Footwear & Textile	-	-	-
Hotels & Travels	1	2	1
Investment Trusts	-	-	-
Land & Property	-	-	-
Manufacturing	-	-	-
Motors	-	-	-
Oil Palm	-	-	-
Plantations	5	2	5
Services	-	-	-
Store & Supplies	-	-	-
Trading	-	-	-
Total	8	5	6
Number of shares offered (Mn.)	64	50	28
Value of shares offered (Rs. Mn)	2,178	583	349

Source: Colombo Stock Exchange

TABLE 10.18
New Share Issues of Companies during 1998

Name of Company	Date of Opening List	No. of Shares (Thousands)	Par Value (Rs.)	Premium (Rs.)	Value of Shares on Offer (Rs. Mn.)	No. of Shares Applied for by Public (Thousands)	No. of Shares Taken up by Underwriters (Thousands)
1. Hapugastenne Plantations Ltd.	22.01.98	4,000	10	–	40	4,000	Nil
2. Udapussaellawa Plantations Ltd.	13.02.98	1,900	10	–	19	1,900	Nil
3. Royal Palm Beach Hotels Ltd	26.03.98	10,000	10	1	110	10,000	Nil
4. Balangoda Plantations Ltd.	26.03.98	4,000	10	10	80	4,000	Nil
5. Madulsima Plantations Ltd.	29.04.98	4,000	10	5	60	4,000	Nil
6. Kahawatte Plantations Ltd.	08.10.98	4,000	10	–	40	4,000	Nil

Source: Colombo Stock Exchange

of DFCC Bank amounted to US dollars 65 million (about Rs.4.3 billion). These were 10 year bonds with a floating rate equivalent to 6-month US dollar LIBOR plus 2 per cent. The capital repayment of the FRN is guaranteed by the Asian Development Bank (ADB) while the interest payment is guaranteed by the Government of Sri Lanka. These bonds are listed on the Luxembourg Stock Exchange. Aitken Spence Company Ltd. made a global placement of 7 million shares at Rs.105 per share each. The Commonwealth Development Corporation and the International Finance Corporation were major institutional investors. A notable development in the debt securities market was seen during the year. There were seven debenture issues by 6 companies viz., Ceylinco Securities and Financial Services Ltd., Hatton National Bank Ltd., Commercial Bank of Ceylon Ltd. (two issues), Ceylon Glass Co. Ltd., Seylan Bank Ltd. and Vanik Incorporation Ltd. The maturity period of these issues varied from 3-5 years, while they carried interest rates ranging from 13.5 per cent to 17.5 per cent. Although most issues had fixed rates of interest, two were offered with floating rates. However, interest rate variability has been limited by prescribing a minimum interest rate of 12.74 per cent per annum and a maximum interest rate of 16 per cent per annum. All the issues were over-subscribed and the total amount raised through these issues was Rs.2,668 million. The issues have been listed on the Colombo Stock Exchange. Meanwhile, the National Savings Bank (NSB) and Bank of Ceylon (BoC) entered into an agreement during December 1998 under which BoC issued ten-year debentures worth Rs.1 billion to the NSB.

Secondary Market

The declining trend seen in the All Share Price Index and the Sensitive Price Index since July 1997 continued into January 1998. Although some improvement in prices was seen from February to April, prices fell substantially thereafter, and in August, reached their lowest recorded since May 1991. An increase in economic volatility in East Asia, aggravated by the impact of the nuclear tests conducted by India and Pakistan, contributed significantly to this drop in prices. By end August, the ASPI had decreased by 206 index points (34 per cent) and SPI decreased by 367 index points (34 per cent), reaching 496 and 701 respectively. From September to December, some positive movements in prices were seen, though they remained below the levels at end December 1997. The year ended with an overall decline in the ASPI by 105 index points (15 per cent) and the SPI by 145 index points (13 per cent), which reached 597 and 923, respectively, at the end of 1998.

Market capitalisation of the CSE fluctuated during the year reflecting the behaviour of share prices. The highest level of market capitalisation during the year was Rs.147,900 million in April, at which point it showed a 14 per cent increase over the Rs.129,400 million recorded at end December 1997. Thereafter, market capitalisation fell to a low of Rs.96,100 million at end August. However, it improved gradually during the last four months of the year. When the year is considered as a whole, market capitalisation declined by 10 per cent and stood at

TABLE 10.19
Category-wise Distribution of Shares Traded in the Secondary Share Market in 1998

Category of Investment	No of Transactions	No. of Shares ('000)	Value (Rs. Mn.)
Banks, Finance & Insurance	52,407	136,122	4,572
Beverages, Food & Tobacco	18,971	65,432	1,347
Construction & Engineering	7,810	20,847	343
Chemicals & Pharmaceuticals	3,071	3,011	85
Diversified	8,641	21,686	3,638
Footwear & Textiles	4,170	14,197	32
Hotels & Travels	11,127	160,007	1,122
Investment Trusts	1,015	3,107	210
Land & Property	3,685	14,065	86
Manufacturing	39,089	100,610	2,846
Motors	1,613	3,993	142
Oil Palms	14	3	1
Plantations	173,518	85,829	3,301
Services	1,584	1,195	43
Stores & Supplies	290	790	29
Trading	2,063	3,240	98

Source : Colombo Stock Exchange

Rs.116,700 million at the end of December 1998. Nearly forty per cent of the total value of market capitalisation in Sri Lanka comes from 10 institutions. John Keells Holdings, HNB, DFCC Bank, NDB, Hayleys, Ceylon Tobacco, Commercial Bank, Nestle Lanka, Aitken Spence and Pure Beverages are the top ten institutions by market capitalisation. Four of these are financial institutions, including two development banks.

The total turnover decreased by 1 per cent from Rs.18,315 million in 1997 to Rs.18,130 million in 1998. The average daily turnover decreased from Rs.76.0 million to Rs.75.5 million between the two years. The highest turnover amounting to Rs.2,800 million was recorded in May 1998 while the lowest turnover of Rs.688 million was recorded in December 1998. The largest share of the total turnover was from the Banks, Finance and Insurance sector while NDB, DFCC Bank and Sampath Bank accounted for 59 per cent of the share of this sector.

The market price earning ratio (PER) moved with the price indices, rising from 12.5 at the end of 1997 to 14.3 at the end of April 1998. Thereafter, it declined gradually to reach a level of 8.2 at end August 1998, but improved to 9.0 at end December 1998.

Foreign investor participation at the Colombo stock market continued to be adversely affected during the year, as in the entire Asian region. Overall, foreign transactions during the year recorded a net outflow of Rs.1,560 million (US dollars 24 million) against Rs.716 million of net foreign inflows recorded in 1997. During the period under review, foreign participation accounted for 35 per cent of the total turnover compared to 43 per cent in the previous year.

Sectoral Performance

Price movements in most sectors were not attractive in 1998. Of the 16 sectors, price decreases were recorded in 12. The Plantation sector was the biggest loser as prices decreased by 45.6 per cent. This was mainly attributed to the Russian crisis. Among the other sectors which had significant decreases in prices were Footwear and Textiles, Investment Trusts, Banks, Finance and Insurance, Chemical and Pharmaceuticals, Motors and Manufacturing. The Stores and Supplies sector achieved the highest growth in prices, recording an increase of 31.7 per cent. The Oil Palms, Services and Beverage, Food and Tobacco sectors also recorded decreases in prices during the year.

TABLE 10.20
Listed Debenture Issues During 1998

	Issuer	Date	Maturity Period	Type of Debenture	No. of Debentures	Price per Debenture	Amount Rs. (Mn.)	Interest Rate	Over subscribed/ Under subscribed
1	Ceylinco Securities & Financial Services Ltd	19.03.98	4 yr	Unsecured redeemable (Put option at the end of 3rd year)	1,000,000 182,550	100 100	100 18	17.5 p.a. (payable half yearly)	Over subscribed
2	Hatton National Bank Ltd	24.06.98	5 yr	Unsecured, subordinated redeemable.	10,000,000	100	1000	13.5 p.a. (payable quarterly)	Over subscribed
3	Commercial Bank Of Ceylon Ltd.	06.07.98	5 yr	Unsecured, subordinated redeemable.	250,000	1000	250	13.5 p.a. (payable quarterly)	Over subscribed
4	Ceylon Glass Company Ltd.	10.07.98	3 yr	Redeemable guaranteed by DFCC Bank	500,000	100	50	13.5 p.a. (payable half yearly)	Over subscribed
5	Commercial Bank Of Ceylon Ltd.	28.09.98	5 yr	Unsecured, subordinated redeemable.	250,000	1000	250	Floating rate (payable quarterly) linked to 3 month TB rate+1%	Over subscribed
6	Seylan Bank Ltd	30.09.98	5 yr	Unsecured, subordinated redeemable.	3,000,000 3,000,0000	100 100	300 300	13.5 p.a., (payable monthly) or 14.37 p.a. (payable annually) or floating tate .Linked to 1 year TB rate + 1%	Over subscribed
7	Vanik Incorporation Ltd	11.12.98	5 yr	Capital guaranteed redeemable.	4,000,000	100	400	15 p.a (payable annualy) 14.2 p.a (payable quarterly)	Over subscribed
	Total				22,182,550		2,668		

Source: Colombo Stock Exchange

Regional and Major International Stock Markets

Most Asian and emerging markets performed poorly, although the well developed Western stock markets performed relatively well. In the region, the worst affected market was Karachchi which had a 44 per cent decline in prices in 1998. Among other markets, Colombo (15 per cent), Bombay (18 per cent), Taipei (13 per cent), Singapore (12 per cent), Tokyo (5 per cent), Hong Kong (4 per cent), Kuala Lumpur (3 per cent), Manila (3 per cent) and Bangkok (2 per cent) recorded decreases in prices during the year. Meanwhile, increases in prices were recorded in Seoul (54 per cent), Sydney (5 per cent) and Jakarta (1 per cent). A welcome feature was that South East Asian markets achieved some stability by the end of the year. This was mainly attributed to their efforts to stabilise their economies through necessary policy actions, including exchange rate stability.

In the Western markets, the Dow Jones Industrial Average for the New York Stock Exchange recorded a 15 per cent growth, while the Financial Times Stock Exchange Index for London grew by 11 per cent.

Developments in the Market

The Colombo Stock Exchange (CSE) became the 52nd member of the International Federation of Stock Exchanges (FIBV) on 26 October 1998. The objective of the FIBV is to contribute to the development, support and promotion of organised and regulated securities markets to meet the needs of the world's capital markets in the best interests of their users. The FIBV has 52 full members, which include the world's leading and developed stock exchanges, 14 affiliate members and 32 emerging markets.

The fully automated trading system introduced in 1997 at the CSE has established a wide area network which connects all brokers' offices via a radio link to the stock exchange. This system has assisted brokering firms to open branches outside Colombo and to have access to a wider range of market information.

The CSE and the Securities and Exchange Commission (SEC) expect to introduce short selling and stock lending in a move to increase the sophistication of Colombo's equity market. A study in this regard will be carried out examining the practices and conventions followed in Malaysia. The United States Agency for International Development (USAID) is expected to fund the study.

Several steps were taken in the 1998 Budget to encourage the listing of companies on the CSE and widen the investor base. A waiver of the tax on capital gains of unquoted companies was granted in the 1998 Budget proposals, provided that such a company seeks a listing on the CSE on or before 31 March 1999. In the 1999 Budget proposals, this concession was extended until 31 March 2000. With the objective of developing the debt market, the 1998 Budget exempted from income tax, the capital gains and profits on the sale of listed debentures. Proposals were made in the 1999 Budget to develop the secondary market for debt in order to give both listed companies and investors sufficient manoeuvrability to hedge their positions and encourage market development. Proposals were made to remove the withholding tax of 10 per cent levied on interest paid on listed debentures and debt securities and the stamp duty on the issue of listed debt instruments such as debentures and promissory notes. The removal of capital gains tax on share warrants and derivative instruments has also been proposed.

Chart 10.7
Stock Prices

Chart 10.7.1
Comparison with Major International Markets
(97 Dec=100)

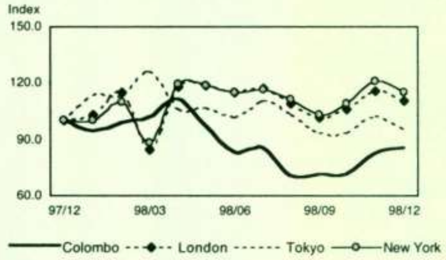
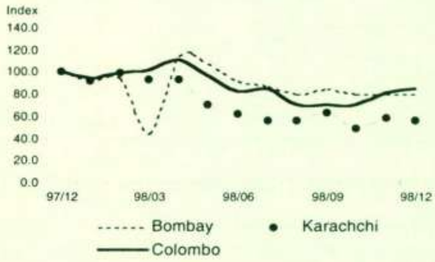


Chart 10.7.2
Comparison with South Asian Markets
(97 Dec=100)



As proposed in the 1998 Budget, the SEC, in collaboration with the CSE, established a Settlement Guarantee Fund to further enhance investor confidence and stabilise the Colombo stock market. The Fund would guarantee the settlement of share trades between the clearing members (stock brokers) of the Central Depository System of the CSE. According to current SEC regulations, the buyer is required to make payment before the sixth day after the transaction and the seller's dues will be settled before seven days. In case a broker fails to pay the dues, the Fund will clear the defaulted trade. The defaulting broker will be suspended from business until he clears the amount paid by the Fund, together with any penalties. The government has allocated Rs.150 million as initial capital for the Fund while technical assistance has been provided by the USAID.

The CSE advanced the forced sale date from trading day plus 15 market days to trading day plus 8 days, with effect from 8 June 1998. According to the previous rules, when a client purchased securities through a broker, his dues were to be settled by trading day plus 5 days while a further grace period of 10 days was allowed, during which period an interest charge of 0.1 per cent per day was imposed. Therefore, the settlement period was effectively trading day plus 15 market days. According to the new directives, the grace period has been reduced to 3 days and the settlement period is equal to the trading day plus 8 days. If the buyer had not paid for his shares by the eighth day, the brokers are required to sell these shares compulsorily at whatever price they could obtain.

Medium and Long-Term Government Securities

Treasury Bonds

The issue of medium-term Treasury bonds, begun in March 1997, was expanded in 1998. These Treasury bonds have now become popular in the market and provide the private sector with medium-term bench mark interest rates and a risk free yield curve beyond one year. The acceptance of these bonds increased with the decision made by the Central Bank on 18 May 1998 to consider all Treasury bonds issued in terms of the Registered Stock and Securities Ordinance as part of liquid assets of commercial banks and licensed specialised banks.

TABLE 10.21
Treasury Bond Issues during 1998

Maturity Period	Coupon Rate (% per year)	Weighted Average Yield to Maturity	Outstanding Amount at end Year (Rs. Million)
2 Years	11.00	10.81-13.94	25,065
3 Years	11.50	12.44-13.93	9,450
4 Years	12.00	12.93-13.94	4,400
Total			38,915

Source: Central Bank of Sri Lanka

With a view to increasing the liquidity of these bonds and promoting the market in Treasury bonds, the Central Bank also decided to make them eligible for transactions at the secondary window of the Central Bank as in the case of Treasury bills. Accordingly, the Central Bank permitted the use of Treasury bonds for repurchase agreements (repos) and outright buying and outright selling at its secondary window from 21 May 1998.

At several Treasury bond auctions in 1998, blocks of Treasury bonds with different maturities were offered, to provide a greater choice to the market. Another major development in the Treasury bond market was the introduction of "Jumbo" issues at the Treasury bond auctions with a view to building up a large securities reserve, creating a highly liquid secondary market and lowering the government's borrowing cost. In these 'Jumbo' issues, a decision is taken to issue a large block of bonds of a specific series; smaller portions of this block are offered to the market at various auctions, subject to the government's borrowing requirements and liquidity situation in the market. There were 17 series of bonds, comprising 11 series for 2-year bonds (29 issues), 4 series for 3-year bonds (14 issues) and 2 series for 4-year bonds (9 issues) during the year. The coupon rates for maturities of 2-year, 3-year and 4-year Treasury bonds were 11.00 per cent per annum, 11.50 per cent per annum and 12.00 per cent per annum, respectively. All auctions were fully subscribed. As with other interest rates, an upward movement was also seen in Treasury bond yields.

The last auction in December 1997, at which Rs.1,000 million 2-year Treasury bonds with a coupon rate of 11 per cent were offered, was heavily oversubscribed with bids received at a premium, resulting in the weighted average yield falling to 10.81 per cent. With the gradual increase in short-term rates, some uncertainty was generated in the market, leading to a decline in the degree of over-subscription and a rise in yield rates. Investors showed some caution in investing in medium-term bonds, despite there being liquidity in the market. However, all auctions were fully subscribed. The degree of over-subscription increased towards the end of the year, particularly in the last two months of 1998, reflecting improved liquidity during the period.

The weighted average yields for 2-year, 3-year and 4-year Treasury bonds were in the ranges of 10.81-13.94 per cent, 12.44-13.93 per cent and 12.93-13.94 per cent, respectively, during the year.

Rupee Loans

With a view to obtaining medium and long-term funds to finance the government expenditure, borrowing through the Rupee Loans Programme continued in 1998. These loans are sold at par and carry a fixed rate of interest. Subscriptions of Rs.52,299 million were received in 1998 as against receipts of Rs.48,500 million in 1997. These loans carried interest rates ranging from 11.00 to 12.25 per cent while the maturity period varied in the range of 4-10 years. The major subscribers to the Rupee Loans Programme were the Employees' Provident Fund (EPF), the National Savings Bank (NSB) and the Employees' Trust Fund Board.

TABLE 10.22

Rupee Loans Floated during 1998

Maturities (Years)	Volume (Rs. Million)	Interest Rates
4-5 years	5,500	11.50
5 years	10,000	11.00
5-6 years	6,000	12.00
6-7 years	29,300	11.25-12.25
9-10 years	1,500	11.50
Total	52,300	11.00-12.25

Source: Central Bank of Sri Lanka

Unit Trusts

The total number of (Unit Trusts) UTs remained unchanged at ten in 1998. A downturn was recorded in the activities of UTs in 1998, in contrast to the upsurge in 1997. A decline was seen in the total Net Asset Value (NAV) of most UTs, except income funds and a few growth funds. However, the number of Unit holders and the number of Units in issue increased.

The downturn in the activities of UTs was mainly due to the setback in the stock market. A setback in the stock market strongly affects the activities of UTs, since two thirds of the investment portfolios of UTs are in equities, although a decline was seen investments in equities in 1998.

The combined NAV of UTs dropped by 13 per cent in 1998 compared to an increase of 17 per cent in 1997. Investments in equities declined by 21 per cent in 1998, compared to an increase of 40 per cent in 1997.

TABLE 10.23

Unit Trusts (a)

	1995	1996	1997	1998(b)
1. Total Assets - Rs. Mn.	2,881	2,652	3,097	2,687
2. Net Assets Value - Rs. Mn.	2,855	2,637	3,072	2,675
3. Investments in Equities - Rs. Mn.	1,762	1,599	2,244	1,773
4. (3) as a percentage of (2)	61.7	60.6	73	66.3
5. Total Unit Holders	22,251	25,240	26,441	27,709
6. No. of Unit Trusts	4	5	10	10

Source : Unit Trusts

(a) Values are as at 31 December
(b) Provisional

In the case of UTs that specialised in certain areas of investment, the performance was different. Growth funds, whose main areas of investment were Banking and Finance, Manufacturing, Diversified holdings and the Plantation sector, faced a decline in their NAV as these sectors did not perform well. However, income funds, who had a mixture of fixed income securities such as government paper, debentures and commercial paper, saw their NAV increase.

Despite the declining trend in stock market activities, the number of unit holders increased by 5 per cent in 1998, as was the case in 1997, while the number of units in issue rose by 4 per cent during 1998. Meanwhile, the combined Net Asset Value per unit was in the range of Rs.5.18-11.14 at end December 1998, in comparison to a range of Rs.6.03-10.52 at end December 1997.