10. FINANCIAL SECTOR

10.1 Monetary Policy

Given the pressure on interest rates from increased public sector borrowing and the pressure on the exchange rate from a wider balance of payments deficit, monetary policy in 2000 focused attention on maintaining stability in money and foreign exchange markets and on preventing the build up of demand fuelled inflationary pressure. Increased borrowing by the government and public corporations to finance a larger budget deficit and operational losses, respectively, competed for the financial resources in the domestic market, pushing up interest rates. Meanwhile, adverse developments in the external sector, which exerted pressure in the foreign exchange market, had considerable influence on the conduct of monetary policy in the second half of the year. Consequently, the monetary policy stance, particularly in the second half of the year, was one of tightness. The Central Bank raised its main interest rates, viz., the Bank Rate, the repurchase rate, and the reverse repurchase rate on several occasions during that period.

The framework for the conduct of monetary policy was based on monetary targeting with reserve money as an intermediate target. The Bank continued to rely on several measures in assessing the tightness of the policy stance, including growth in monetary aggregates, monetary conditions index (MCI) and interest rates. Open market operations (OMO) continued to be the major policy instrument. The repurchase rate and the reverse repurchase rate were used to signal the direction of the policy stance.

At the beginning of the year, there was some improvement in the liquidity situation following the re-flow of currency that had been withdrawn by the public towards the end of 1999 due to market uncertainties generated by the Presidential Election, the Year 2000 issue and seasonal factors. As market liquidity improved and the declining trend in inflation continued, the repurchase rate was reduced by 25 basis points to 9.00 per cent in January 2000. In order to assist mopping up of excess liquidity, the Bank temporarily reduced the margin between the primary market yield on Treasury bills and its discount rates from 15 basis points to 5 basis points on 13 January 2000. This was reversed on 18 January following the successful absorption of liquidity. Until May, interest rates in many market segments tended to decline owing to some improvement in the liquidity conditions.

With the country placed on a war footing in May 2000, government borrowings increased, causing interest rates to rise. A deterioration in the balance of payments, and a consequential decrease in domestic rupee liquidity, also exerted pressure on interest rates. The large deficit in the balance of payments generated pressure in the foreign exchange market, leading the Central Bank to increase its interest rates to stabilise this market. The Central Bank raised its rates on several occasions from May. The repurchase rate, which is the rate at which licensed commercial banks and primary dealers can invest their surplus rupee funds in Treasury bonds and Treasury bills held by the Central Bank, was increased progressively from 9.50 per cent at end June to 17.00 per cent at end December. Similarly, the reverse repurchase rate, which is the rate at which licensed commercial banks and primary dealers can obtain rupee funds from the Central Bank against the collateral of Treasury bills and bonds, increased by 500 basis points from end June to December, to end the year at 20.00 per cent. The Bank Rate, which is more an indicative rate of Central Bank policy direction than an operational rate, was also increased on three occasions, by 200 basis points each on 02 October and 08 November and another 500 basis points on 21 November 2000, to a level of 25.00 per cent at the end of the year.

The Statutory Reserve Ratio (SRR) in respect of rupee deposit liabilities remained unchanged at 11 per cent. However, the SRR on foreign currency deposits not placed abroad, which stood at 11 per cent, was removed with effect from 04 August 2000. The removal of the SRR on foreign currency deposits was intended to improve the foreign currency liquidity of commercial banks and reduce their intermediation costs. It may also have assisted in attracting foreign currency deposits by enabling banks to pay more attractive rates.

The Bank continued to provide liquidity to the market through its reverse repurchase window. Commercial banks and primary dealers had heavy recourse to this facility following the shortage in market liquidity, particularly in the second half of the year.

In view of the market distortionary nature of Central Bank refinance, the Bank continued to refrain from granting refinance under the Medium and Long Term Credit Fund (MLCF). Total refinance outstanding under the MLCF declined from Rs.2,929 million at end 1999 to Rs.2,863 million at end 2000. However, refinance granted to failed finance companies increased by Rs.50 million with the settlement of a claim related to a previous year.

10.2 Money Supply

Monetary growth has been stable, at around 13 per cent, despite growth in domestic credit, due to the reduction in net foreign assets of the banking system. The annual growth rate of consolidated broad money (M_{2b}), which includes

Box 9

Reforms for Financial Sector Stability and Efficiency

A large number of countries have been reforming their financial sectors in recent years. The theoretical basis for those reforms originated with the financial liberalisation paradigm introduced by Mckinnon and Shaw (1973), who argued that financial repression in developing countries had retarded economic growth by reducing efficiency in resources allocation. Hence, financial reforms in emerging economies have focussed mainly on relaxing administrative controls, moving towards more market oriented systems that are considered to be more efficient, and strengthening stability in the financial system. The results of the reforms have not been uniform. Some countries have had reform programmes which have been successful in removing the elements of financial repression; several have suffered financial distress; and the rest have had mixed results. Success has been uneven, depending upon policy consistency, strengths in the implementation process and real sector situations. One clear lesson that has been learnt is that reforms are not a one time event but are an ongoing process.

Economic stagnation, together with a repressed financial sector, were causal factors in the move towards market oriented policy reforms in Sri Lanka in 1977. For over two decades prior to that change, financial repression and policy distortions obstructed the emergence of efficient domestic financial markets. Excessive government intervention impeded the development of an efficient and a viable financial system in the country. Financial reforms implemented in Sri Lanka during the past two decades were intended to create an efficient, competitive and developed financial system, while strengthening financial sector stability. The track record is encouraging, despite slow progress in some areas and a few setbacks due to civil strife and external events. During the late 1970s and early 1980s, the pace of reforms was rapid. However, after 1983 some slowdown was evident as domestic unrest compelled the government to shift the focus of attention away from economic reforms, including financial reforms. In the latter part of the 1990s policy makers, both in Sri Lanka and in the rest of the world, became more cautious in further liberalising capital markets, learning from adverse developments in the East Asian crisis. However, one of the fastest growing segments in Sri Lanka's economy in recent years has been the financial sector. This is manifest in developments in money and capital markets, where the volume of transactions has expanded considerable and degree of sophistication has grown markedly.

The most significant features of the comprehensive financial reforms that have been introduced since the latter part of 1977 have been to open to private sector participation areas that had been closed to them, encourage competition, free interest rates from administrative control, relax exchange controls, implement institutional reforms, place greater emphasis on market orientation in monetary management and credit allocation and strengthen the legal, accounting and regulatory frameworks for financial institutions.

In the first phase, interest rates were allowed to be determined by market forces. Interest rates offered by the National Savings Bank (NSB) had been the main determinants of market rates. These rates, which were heavily influenced by government and kept at relatively low levels, were permitted to increase. Interest rates in the primary Treasury bill market were made market based by auctioning bills, beginning late 1980s. As a result, yield rates on Treasury bills became a leading indicator for changes in the interest rate structure of the country. Refinance facilities from the Central Bank were phased out gradually, while interest rates applicable to such facilities from other sources moved towards market rates.

The exchange rate regime moved from a fixed exchange rate to a managed floating rate system, with market forces being allowed a gradually increasing role in determining exchange rates. Exchange control regulations were relaxed to a large extent. Trade and payments systems were liberalised. The relaxation in exchange controls on trade and services culminated in Sri Lanka accepting obligations under Article VIII of the IMF Articles of Agreements in March 1994. At present, not only is the current account fully liberalised, but many capital account transactions have also been deregulated. Rules governing foreign ownership of financial institutions have been greatly liberalised.

The banking sector, which had been rigidly controlled, was liberalised. Foreign banks were encouraged to enter the Sri Lankan market and were permitted to open branches in Sri Lanka. In addition, the domestic private sector was also allowed to engage in commercial banking. New types of financial institutions,

Box 9 (Contd.)

e.g. money brokers, venture capital companies, merchant banks and unit trusts, were permitted to commence operations. In view of their impact on the stability of the financial sector, certain large financial institutions, which undertook some banking functions, were given the special designation of Licensed Specialised Banks and brought under the regulatory and supervisory authority of the Central Bank. The removal of barriers to entry broadened the financial market, and increased efficiency through competition.

The two state banks were recapitalised and granted greater autonomy in their commercial operations in order to restore their financial viability and profitability. The activities of the National Savings Bank were made more market oriented and its capital base was restructured. The National Development Bank (NDB) was privatised and government share ownership in the two development financial institutions, i.e., NDB and DFCC Bank, was sold to the public.

The vital importance of stability in the financial sector has been well understood. With the relaxation of controls in the sector, the regulatory framework has been strengthened to be compatible with international standards. New regulatory standards based on guidelines provided by the Basle Agreements were introduced into the banking sector. Prudential guidelines were introduced in the areas of capital adequacy, liquid assets, loan loss provisioning, and single borrower limits. The regulatory and supervisory functions of the Central Bank of Sri Lanka were strengthened by giving it legal powers under banking sector legislation to carry out its functions effectively. An extremely important legislative enactment in this regard was the Banking Act, which consolidated other legislation and put in place a legal framework for the banking sector. The Banking Act provided for the introduction and operation of procedures for the licensing of persons carrying on banking business, for the regulation and control of matters relating to the banking business and for other matters connected with the banking business. In view of the need to ensure the smooth functioning of the financial system, as well as to safeguard the interests of depositors, a legal framework for regulating finance companies was formed and legislative enactments introduced giving powers to the Central Bank of Sri Lanka to regulate and supervise finance companies. Legislation was also passed to facilitate debt recovery procedures of commercial banks. Moreover, a Credit Information Bureau and a Credit Rating Agency were established. These were expected to help market participants to take better informed decisions, thereby improving the stability in the market.

Another area in which significant reforms took place was in the implementation of monetary policy. The Central Bank reduced reliance on direct intervention policy instruments and placed more emphasis on indirect market based policy instruments in monetary management. The primary and secondary markets in government debt have been developed, enabling the Central Bank to adopt open market operations as its primary tool of monetary policy. Reliance on the statutory reserve requirement for monetary management was gradually reduced. Directed credit allocation, which prevailed for a long period, was replaced with market based credit allocations. Banks became free to determine their lending portfolios. Subsidised credit facilities were phased out by reducing the amounts provided under refinance facilities and by raising the applicable interest rates to take account of costs in financial markets.

Legislative provisions were made to improve the government debt securities markets. The Monetary Law Act, Registered Stock and Securities Ordinance and Local Treasury Bills Ordinance were amended to promote the establishment of a scripless government securities system, to create more market oriented Treasury bonds and to increase the efficiency of the secondary market in government securities. A system of dedicated Primary Dealers was established to promote the market. Many measures were been taken to develop the equity market. Non-nationals were permitted to invest freely in the Colombo stock market through Share Investment External Rupee Accounts (SIERA). Repatriation of dividends, capital gains and sales proceeds were freed of controls. The capital gains tax on share investments was abolished. Foreign ownership of licensed stock broking firms, commercial banks and insurance companies was permitted upto 100 per cent, 60 per cent and 90 per cent of issued share capital, respectively. The trading and payments system in the Colombo Stock Exchange (CSE) is now fully automated. The introduction of an Over the Counter Market and a Debt Securities Board at the CSE is designed to further strengthen its activities. The CSE recently introduced a number of changes to existing listing rules in order to encourage the listing of companies.

Reforms are a continuous process. Although the financial sector in Sri Lanka has undergone significant reform in the past two decades or so, as conditions change and the domestic and international environment

Box 9 (Contd.)

evolve, reforms will continue. Similarly, existing high ratios of non-performing loans and the continuation of high financial intermediation cost clearly indicate the necessity for further reforms. Hence, these are being considered in many areas.

To re-inforce the stability of commercial banks, the regulatory system is being improved. The risk weighted capital adequacy ratio has been raised from 8 per cent to 9 per cent and is to be increased to 10 per cent in 2002. Approval has been granted to domestic commercial banks to issue debentures to augment the capital base of domestic banks. The focus of supervision is changing from the traditional methods to risk based analyses. Amendments are proposed to the Banking Act to make it more effective by providing for the enforcement of the core principles formulated by the Bank for International Settlements in Basle. An Insurance Law was recently enacted to provide for the establishment of a Statuary Insurance Board with powers to register insurance companies and brokers for the purpose of developing, supervising and regulating the insurance industry. The Finance Leasing Act was passed recently to give powers to the Central Bank of Sri Lanka to regulate and supervise finance leasing institutions. The regulatory system for other financial institutions, such as merchant banks, is also being strengthened and brought in line with international standards. The Monetary Law Act (MLA) will be amended to make price stability and financial system stability the Central Bank's primary objectives. Additionally, the proposed amendments to the MLA will give greater flexibility to the Monetary Board in monetary operations and management to adopt to changing conditions.

A further area requiring continuing reform would be the state commercial banks. As these two banks still account for over 50 per cent of assets in the commercial banking sector, their operations have a significant impact on the stability and efficiency of the sector. Steps in this direction have already been taken with the revitalisation of their operations and the recruitment of highly experienced senior management. The Central Bank is also in the process of being re-organised to concentrate its operations on the core objectives and increase efficiency.

These measures are expected to go a long way towards promoting a robust financial system and vibrant economy, while helping the Sri Lankan financial sector to keep abreast of changes in global financial conditions. However, it should be borne in mind that reforms are a process, and as conditions change, further reforms would be called for.

TABLE 1

Selected Indicators of Financial Depth in Sri Lanka

Year	Narrow Money (M_1) as a % of GDP	Broad Money (M_2) as a % of GDP	Financial Sector Contribution to GDP (%)	Total Financial Sector Assets as a % of GDP
1950	20.6	22.1	0.9	39.1
1960	15.7	20.5	0.7	37.0
1970	14.0	22.1	1.1	61.6
1980	13.4	28.2	3.0	96.2
1990	12.3	28.1	4.6	111.2
2000 (a)	9.4	32.0	7.6	129.0

(a) Provisional Source : Central Bank of Sri Lanka.

operations of domestic banking units (DBUs) and foreign currency banking units (FCBUs) declined slightly from 13.4 per cent in 1999 to 12.9 per cent in 2000. A gradual decline was also observed in the moving average of the rate of growth in M_{2b}, which declined from 14 per cent in January to 12 per cent in December. The growth rate in narrow money (M_1), which fluctuated within a range of 4.0-11.7 per cent, recorded a growth of 9.1 per cent at end December.

The major contributory factor for moderation in monetary growth was the decline in net foreign assets (NFA) of the banking system. Reflecting the significant deficit in the balance of payments, NFA of the banking system declined from Rs.102.1 billion to Rs.69.5 billion from December 1999 to December 2000. Net foreign assets of the monetary authorities declined sharply by Rs.31 billion, largely due to the sale of foreign exchange to commercial banks and the settlement of foreign public debt. Meanwhile, the NFA of commercial banks declined by Rs.1.2 billion. Net foreign assets of DBUs of commercial banks increased, while those of FCBUs declined. The increase in NFA of domestic units was due to increased investments with banks abroad. Net foreign assets of FCBUs decreased, partly due to the obtaining of a foreign syndicated loan of US dollars 100 million, which was subsequently on lent to the government.

Domestic credit expanded substantially, recording a growth of 27 per cent. Credit to all sectors, viz., government, public corporations and the private sector, increased, with particularly high growth in credit to the public sector. Credit to government from the banking system increased significantly as revenue receipts were less than expected, the privatisation process was delayed, increased defence expenditure was incurred and interest costs rose. Net credit to government (NCG) from the Central Bank and commercial banks rose by Rs.53 billion.

TABLE 10.1
Summary Monetary Statistics

Item	End 2000	Change 1999		Change 2000	
	Rs.bn.	Amount Rs.bn.	%	Amount Rs.bn.	%
Monetary aggregates:					
Narrow money supply (M_1)	118.5	12.3	12.8	9.9	9.1
Broad money supply (M_2)	404.7	41.9	13.3	46.6	13.0
Consolidated broad money supply (M_{2b})	483.4	50.6	13.4	55.1	12.9
Underlying factors (a)					
Domestic credit to :	549.9	63.4	17.1	117.0	27.0
Government (net)	147.3	29.3	45.3	53.4	56.8
Public corporations	38.3	3.0	30.1	25.2	193.2
Private sector	364.4	31.1	10.5	38.4	11.8
External assets (net)	69.5	-3.6	-3.4	-32.6	-31.9
Other items (net)	-136.0	-9.2	-9.5	-29.4	-27.5
Reserve money	105.2	7.6	8.2	4.7	4.7

Source: Central Bank of Sri Lanka.

(a) In relation to M_{2b}

NCG from the Central Bank amounted to Rs.45 billion and was reflected in an increase in the Bank's holdings of government securities and increased provisional advances. The Central Bank's holdings of Treasury bills and bonds increased by Rs.42 billion. Increases in loans, overdraft balances and import bills discounted were the main components of the increase in NCG from commercial banks. The government obtained a foreign currency loan of US dollars 100 million from FCBUs, while repaying US dollars 42 million of the syndicated loan of US dollars 100 million obtained in 1998.

Credit extended to public corporations increased by Rs.25 billion during the year in comparison to the increase in credit to corporations by Rs.3.0 billion during 1999. Credit obtained by three major public corporations, *i.e.*, the Ceylon Petroleum Corporation (CPC), the Ceylon Electricity Board (CEB) and the Co-operative Wholesale Establishment (CWE), accounted for the bulk of the increase in bank credit to this sector. Large increases in international prices for petroleum products and wheat, increased use of thermal power in place of deficient hydro power and inadequate and delayed adjustment in domestic prices were factors that led to public corporations increasing their bank borrowings. Thus, public sector borrowing (i.e., government and public corporation borrowings) rose by Rs.78 billion (73 per cent), amounting to 142 per cent of the monetary expansion in 2000.

Credit to the private sector increased by Rs.38 billion from December 1999 to December 2000, a growth of 12 per cent as against 11 per cent in 1999. In contrast to 1999 when credit from FCBUs declined, credit extended by both domestic banking units and FCBUs to the private sector increased in 2000. The increase in credit was mainly to the services, commercial and manufacturing sectors. Higher domestic lending rates, with the rise in interest rates in international markets and volatility in the domestic foreign exchange market, dampened the demand for foreign currency credit towards the latter part of the year.

Reserve money increased by Rs.4.7 billion (4.7 per cent) during 2000 in comparison with an increase of Rs.7.6 billion (8.2 per cent) in 1999. Although Central Bank holdings of government securities increased substantially by

Chart 10.1
Monetary Expansion

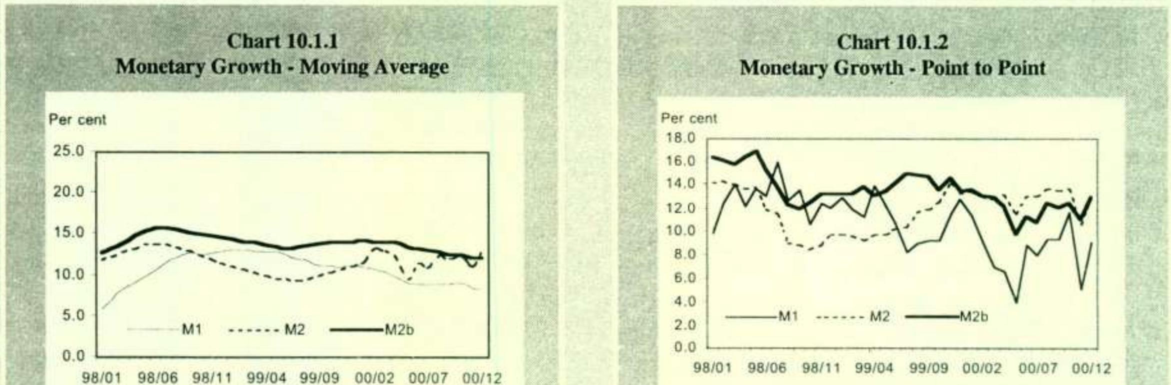


TABLE 10.2

Monetary Aggregates 1999 - 2000 (a)

Rs.Million

End of Period	Narrow Money Supply (M_1)						Broad Money Supply (M_2)						Consolidated Broad Money Supply (M_{2b})					
	1999	2000	Percentage Change				1999	2000	Percentage Change				1999	2000	Percentage Change			
			Point to Point		Moving Average				Point to Point		Moving Average				Point to Point		Moving Average	
			1999	2000	1999	2000			1999	2000	1999	2000			1999	2000	1999	2000
January	96,525	107,630	12.9	11.5	13.0	11.0	317,257	359,623	9.8	13.4	11.1	11.4	380,300	432,181	13.2	13.6	14.2	14.0
February	97,692	106,723	12.0	9.2	12.9	10.8	319,410	361,256	9.6	13.1	10.7	13.1	383,479	433,556	13.2	13.1	13.9	13.9
March	102,616	109,780	11.3	7.0	12.7	10.4	324,606	366,263	9.2	12.8	10.3	13.0	390,991	441,841	13.8	13.0	13.8	13.9
April	103,000	109,871	13.9	6.7	12.8	9.8	326,329	369,479	9.8	13.2	10.0	12.2	392,014	439,970	13.1	12.2	13.5	13.8
May	102,311	106,417	12.2	4.0	12.7	9.1	327,371	365,197	9.7	11.6	9.7	9.7	397,191	435,694	13.5	9.7	13.3	13.4
June	99,890	108,760	10.8	8.9	12.5	8.9	327,709	370,625	10.4	13.1	9.6	11.4	397,565	442,828	14.1	11.4	13.2	13.2
July	99,942	107,910	8.3	8.0	11.9	8.9	330,177	373,504	10.5	13.1	9.5	10.9	402,317	445,990	15.1	10.9	13.3	12.9
August	99,591	108,968	9.0	9.4	11.6	8.9	331,125	376,499	11.7	13.7	9.7	12.4	401,416	451,219	14.9	12.4	13.5	12.7
September	102,070	111,688	9.2	9.4	11.2	8.9	337,568	383,562	11.9	13.6	10.0	12.1	408,341	457,596	14.8	12.1	13.7	12.5
October	100,831	112,639	9.3	11.7	11.1	9.1	341,900	388,701	12.6	13.7	10.3	12.4	412,128	463,258	13.6	12.4	13.8	12.4
November	103,749	108,961	11.6	5.0	11.0	8.6	350,033	387,452	14.2	10.7	10.8	11.1	419,281	465,737	14.5	11.1	13.9	12.1
December	108,554	118,477	12.8	9.1	11.1	8.3	358,076	404,669	13.3	13.0	11.1	12.9	428,319	483,421	13.4	12.9	13.9	12.0
Monthly average	101,398	109,819	11.1	8.3			332,630	378,569	11.0	12.9			401,112	449,441	13.9	12.1		

Source: Central Bank of Sri Lanka

(a) Monetary data from 1990 have been classified to be consistant with standard international practice.
Please refer notes to Appendix tables 105, 106 and 110.

TABLE 10.3

Monetary Aggregates and Underlying Factors 1998 - 2000 (a)

Rs.Million

Item	Dec. 1998	Dec. 1999	Dec. 2000	Change			
				1999		2000	
				Amount (a)	Percentage	Amount(a)	Percentage
Monetary aggregates							
Currency held by the public	51,767	58,481	62,647	6,714	13.0	4,166	7.1
Demand deposits held by the public	44,501	50,073	55,830	5,572	12.5	5,757	11.5
Narrow money supply (M_1)	96,268	108,554	118,477	12,286	12.8	9,923	9.1
Time and savings deposits of the private sector held with com. banks	281,473	319,765	364,944	38,292	13.6	45,179	14.1
DBUs	257,995	298,158	341,776	40,163	15.6	43,618	14.6
FCBUs	23,478	21,607	23,168	-1,871	-8.0	1,561	7.2
Consolidated broad money supply (M_{2b})	377,741	428,319	483,421	50,578	13.4	55,102	12.9
Underlying factors							
Net foreign assets	105,648	102,092	69,529	-3,556	-3.4	-32,563	-31.9
Monetary authorities	101,744	89,287	57,947	-12,457	-12.2	-31,340	-35.1
Commercial banks	*3,904*	*12,805*	11,582	8,901	228.0	-1,223	-9.6
DBUs	1,141	3,235	11,629	2,094	183.5	8,394	259.5
FCBUs	2,763	9,570	-47	6,807	246.4	-9,617	-100.5
Net domestic assets	272,091	326,228	413,892	54,137	19.9	87,664	26.9
Domestic credit	369,517	432,888	549,927	63,371	17.1	117,039	27.0
Claims on government (net)	64,618	93,915	147,304	29,297	45.3	53,389	56.8
Monetary authorities	25,909	46,716	91,556	20,807	80.3	44,840	96.0
Commercial banks	38,709	47,199	55,748	8,490	21.9	8,549	18.1
DBUs	32,682	39,166	42,928	6,484	19.8	3,762	9.6
FCBUs	6,027	8,033	12,820	2,006	33.3	4,787	59.6
Credit to public corporations (b)	10,031	13,046	38,254	3,015	30.1	25,208	193.2
DBUs	8,681	12,707	26,986	4,026	46.4	14,279	112.4
FCBUs	1,350	339	11,268	-1,011	-74.9	10,929	3,223.9
Credit to the private sector (b)	294,868	325,927	364,369	31,059	10.5	38,442	11.8
DBUs	244,353	275,532	307,613	31,179	12.8	32,081	11.6
FCBUs	50,515	50,395	56,756	-120	-0.2	6,361	12.6
Other items (net)	-97,426	-106,660	-136,035	-9,234	-9.5	-29,375	-27.5
DBUs	-60,248	-59,930	-78,406	318	0.5	-18,476	-30.8
FCBUs	-37,178	-46,730	-57,629	-9,552	-25.7	-10,899	-23.3

Source: Central Bank of Sri Lanka.

(a) Signs indicate the effect on M_{2b}.
(b) Credit given to Sri Lanka Telecom has been excluded from public corporations and included *under private* sector from December 1998.

Rs.41 billion and provisional advances rose by Rs.4 billion, reserve money increased only modestly, mainly on account of the sharp decline in NFA of the monetary authorities by Rs.31 billion. A major component of the monetary liabilities of the Central Bank, currency in circulation, increased by Rs.3 billion in 2000 as against Rs.10 billion in 1999 and Rs.7 billion in 1998.

The money multiplier, which was 4.26 per cent in December 1999, increased to 4.60 per cent in December 2000. The increase was mainly due to the removal of the SRR on foreign currency deposits referred to above, and the decline in the currency to deposits ratio. The velocity of money increased marginally from 2.59 per cent in 1999 to 2.60 per cent in 2000.

10.3 Financial Survey

Beginning from 1999, the Central Bank has commenced compiling a financial survey on an experimental basis. This covers not only licensed commercial banks, but also licensed specialised banks and finance companies. With the expansion of the financial sector, the impact of the operations of financial institutions other than licensed commercial banks on the economy increases. Thus, it becomes necessary to broaden the definition of money to encompass these activities as well. The financial survey, therefore, defines a broader concept of money (M_4) than the consolidated broad money (M_{2b}) derived from the monetary survey. Based on the financial survey, the broad monetary aggregate (M_4), which includes consolidated broad

Chart 10.2
Monetary Aggregates, Velocity and Money Multiplier

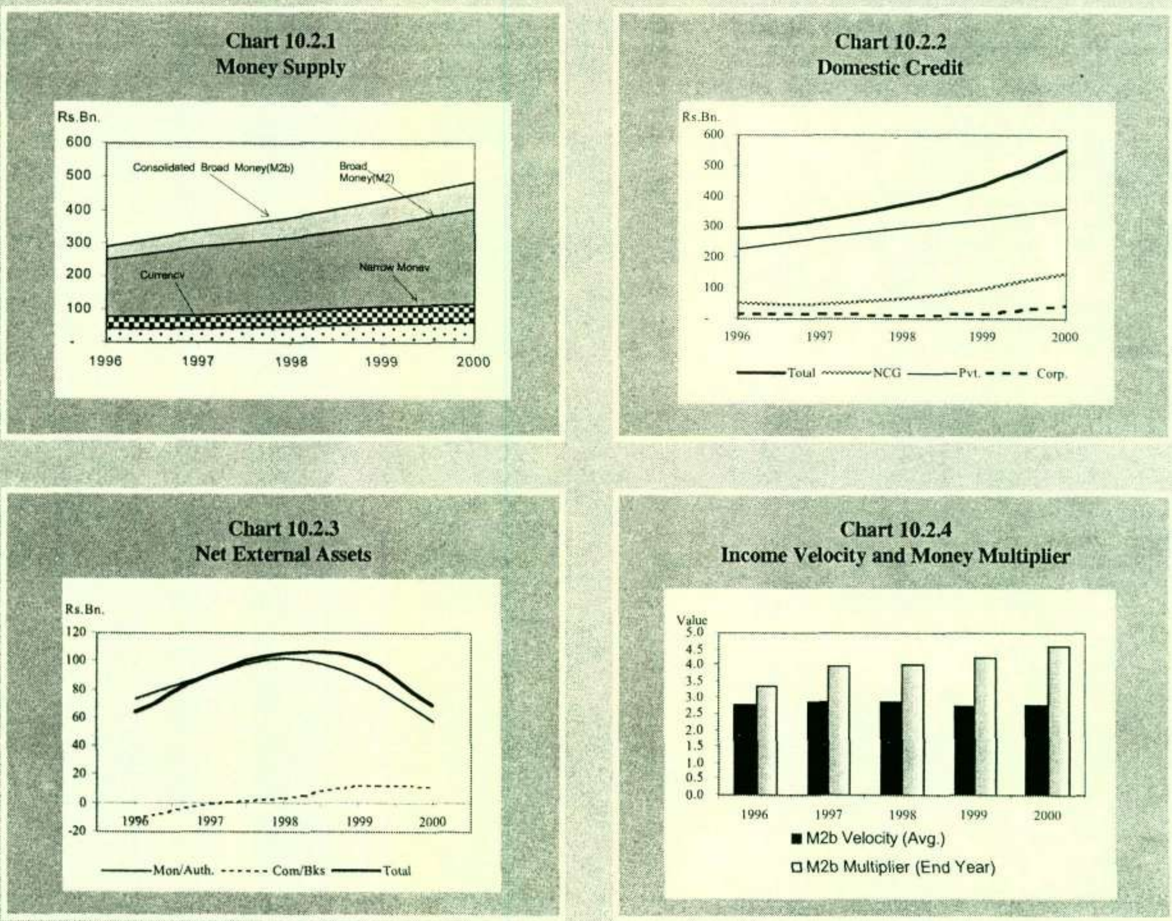


TABLE 10.4

Financial Survey

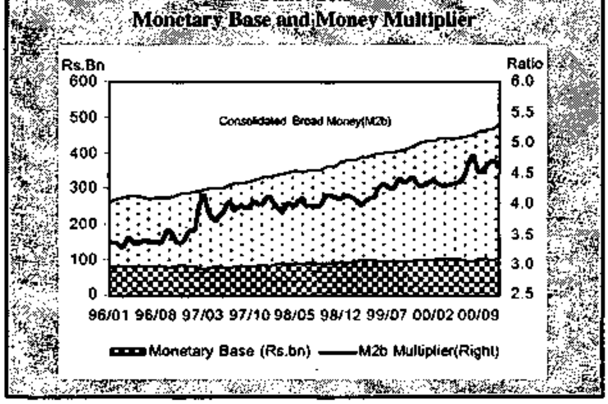
Rs. Million

Item	1997 Dec	1998 Dec(a)	1999 Dec(a)	2000 Dec(b)
Broad money (M_4)	428,617	486,313	549,519	620,160
Consolidated broad money (M_{2b})	333,668	377,741	428,319	483,421
Broad money (M_2)	288,258	316,174	358,076	404,669
Narrow money (M_1)	85,027	95,979	106,696	117,918
Currency	44,853	51,407	56,623	62,088
Demand deposits	40,173	44,572	50,073	55,830
Quasi-money (Total)	343,590	390,334	442,824	502,242
Quasi-money (DBUs)	227,963	257,995	298,158	341,776
Quasi-money (FCBUs)	19,853	23,478	21,607	23,168
Quasi-money (LSBs)	81,769	92,799	103,968	116,507
Quasi-money (FINCOs)	14,006	16,061	19,091	20,791
Net foreign assets	81,106	92,487	89,407	57,902
Monetary authorities	89,930	101,744	89,287	57,947
Commercial banks (DBUs & FCBUs)	565	3,904	12,805	11,582
LSBs and FINCOs	-9,389	-13,161	-12,685	-11,627
Net domestic assets	347,510	393,824	460,114	562,258
Domestic credit	447,267	516,862	600,894	735,623
Public sector	113,304	134,966	173,178	260,171
Claims on government (net)	98,705	124,530	159,132	220,917
Monetary authorities	20,300	25,909	46,716	91,556
Commercial banks (DBUs)	26,065	32,682	39,166	42,928
Commercial banks (FCBUs)	-1,115	6,027	8,033	12,820
Claims on government (LSBs)	51,867	57,902	62,919	70,837
Claims on government (FINCOs)	1,587	2,011	2,298	2,776
Claims on public corporations	14,599	10,435	14,046	39,254
Claims on pub. corp. (DBUs &FCBUs)	14,598	10,031	13,046	38,254
Claims on pub. corp. (LSBs & FINCOs)	1	404	1,000	1,00
Claims on private sector	333,963	381,896	427,716	475,452
Claims on private sector (DBUs)	216,090	244,353	275,532	307,613
Claims on private sector (FCBUs)	47,108	50,515	50,395	56,756
Claims on private sector (LSBs)	55,775	69,110	80,885	88,230
Claims on private sector (FINCOs)	14,990	17,918	20,904	22,853
Other items (net)	-99,757	-123,039	-140,780	-173,365

Source: Central Bank of Sri Lanka

(a) Revised
(b) Provisional
DBUs - Domestic Banking Units
FCBUs - Foreign Currency Banking Units
LSBs - Licensed Specialised Banks
FINCOs - Finance Companies

Chart 10.3
Monetary Base and Money Multiplier



money supply (M_{2b}) and activities of other financial institutions (OFIs), (i.e., Licensed Specialised Banks and finance companies) indicated a point to point expansion of 12.9 per cent at end December 2000, a marginal reduction from the growth of 13.0 per cent recorded at end December 1999. The monthly point to point increases in M_4 were in a range of 11.0-13.3 per cent during 2000. As in the case of consolidated broad money (M_{2b}), the reduction in the value of net foreign assets offset the expansionary effect of the growth in domestic credit and dampened the growth in money supply.

A substantial growth was seen in net credit to the government. In addition to the net credit extended by the monetary authorities and commercial banks, credit from licensed specialised banks and finance companies increased by about 13 per cent as these institutions increased their holdings of government securities in view of the high return on these. Credit to public corporations too increased significantly. However, the increase in credit came entirely from the commercial banking sector.

The point to point growth in private sector credit in the financial survey was moderate, at 11.2 per cent at end December 2000, slightly lower than the private sector credit growth in the consolidated monetary survey (11.8 per cent). The corresponding growth rates at end 1999 were 12.0 per cent and 10.5 per cent, respectively. The slower growth in private sector credit in the financial survey was attributed to the slower growth of credit from licensed specialised banks, particularly the two development financial institutions viz., National Development Bank (NDB) and DFCC Bank.

10.4 Interest Rates

A general rise in the interest rate structure was observed, particularly after the first quarter of 2000, in contrast to a downward movement with reduced volatility in 1999. The main causes were increased public sector borrowings, a reduction in rupee liquidity consequent upon a significant deficit in the balance of payments and tightening of the monetary policy to contain pressure on the exchange rate. As nominal interest rates rose, real interest rates increased towards the latter part of the year, as inflation continued to be relatively low. Despite over-subscriptions at most auctions in government securities, yields on Treasury bills and bonds tended to rise, partly reflecting higher inflation expectations.

Short-term Interest Rates

The gradual increase in the interest rates during the year was clearly reflected in the interest rates in the call market. In the first few weeks of the year, an inflow of liquidity was seen as the market settled down following the uncertainties in December 1999 associated with the Presidential Elections and the Y2K problem, together with

Box 10

Chronology of Changes in Interest Rates and SRR

Date of Announcement 2000		Repo Rate	Reverse Repo Rate	SRR	Bank Rate
January	05	9.00	13.48		
	14	30 day maturity discontinued	30 day maturity discontinued		
	21	9.00	13.30		
April	06	9.00	13.00		
May	09	9.25	13.00		
	11	9.25	13.04		
	12	9.25	13.25		
	16	9.25	13.75		
	19	9.25	14.00		
June	01		Re-repo extended to 7 days		
	08	9.50	15.00		
	23		Re-Repo maturity extended to 30 days		
July	26	11.00	15.00		
	26	Repo maturity reduced to 7 days	Re-repo maturity reduced to 7 days		
August	04			SRR on foreign currency deposits invested domestically withdrawn	
	31	11.75	15.00		
September	19	11.75	Re-repo maturity reduced to overnight		
	26	12.50	15.50		
	29	13.00	16.00		
October	02				Increased from 16.00 to 18.00.
November	08	15.00	18.00		Increased from 18.00 to 20.00
	21	17.00	20.00		Increased from 20.00 to 25.00

the usual seasonal inflow in January. This caused a reduction in call market rates in January. Further, liquidity was added to the market with the increase in provisional advances from the Central Bank to the government and the transfer of Central Bank profits to the government in January and February. Call market rates increased slightly towards the end of March as the New Year season approached, and fluctuated within a range of 9.00-14.50 per cent in the first quarter of 2000.

Thereafter, rates began to rise faster, with the usual seasonal increase in April, increased public sector borrowing, reduction in liquidity consequent upon the deficit in the balance of payments and tightened monetary policy. Call rates moved in a range of 9.50 per cent to 16.75 per cent in the second quarter and in a range of 10.00 per cent to 15.87 per cent in the third. Rates were highest in the fourth quarter, varying between 14.50 per cent and 32.00 per cent.

Repo and reverse repo rates, which are the Central Bank's signalling mechanism to indicate the expected direction of interest rates in the market, continued to influence market rates, particularly in containing the lower and upper ends of call market rates. With continued low inflation and a stable exchange rate at the beginning of 2000, the overnight repo rate was reduced by 25 basis points in January, and maintained at that level until May. Similarly, the reverse repo rate was reduced by 18 basis points in January and 30 basis points in April, following the downward trend in inflation and interest rates in the government debt securities market. After May, however, with the market interest rates rising to reflect increased public sector credit demand, and the Central Bank

Chart 10.4
Interest Rates

Chart 10.4.1
Treasury Bills

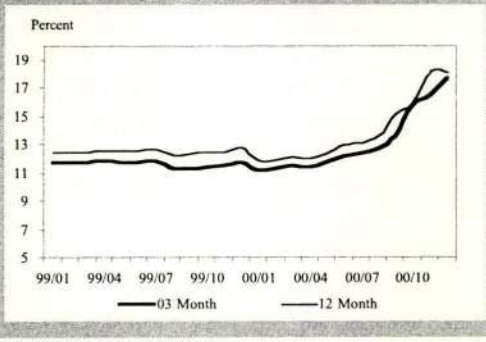


Chart 10.4.2
Deposit Rates

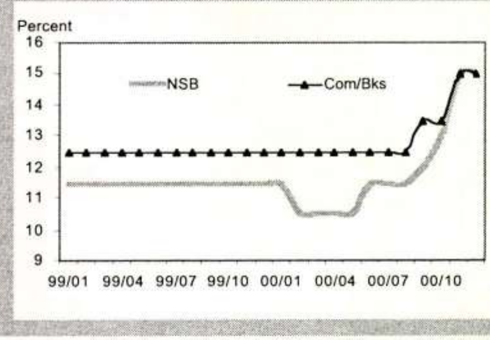


Chart 10.4.3
Lending Rates

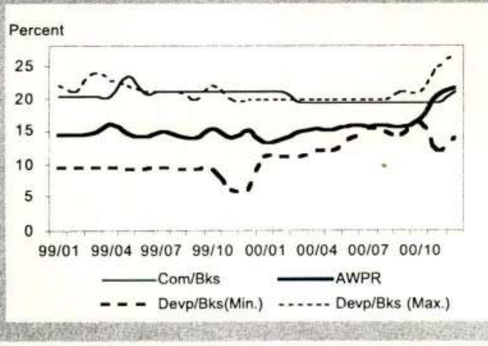
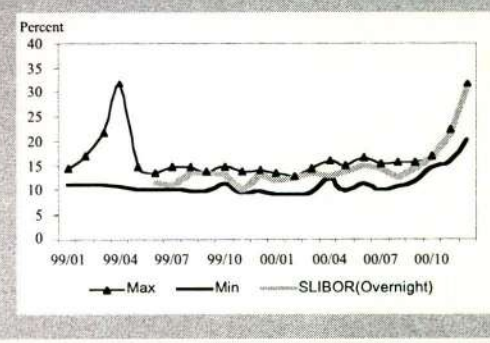


Chart 10.4.4
Call Market Rates



tightening monetary policy to stabilise the foreign exchange market, both the repo rate and the reverse repo rate gradually rose. By end December, the repo rate had risen by 800 basis points to 17.00 per cent and the reverse repo rate by 700 basis points to 20.00 per cent.

Following the usual seasonal pattern, yields on Treasury bills declined at the beginning of 2000. The yield on 91-day Treasury bills, which was 11.79 per cent at end 1999, fell to 11.26 per cent in January, its lowest level in 2000. Similarly, the yield on 364-day bills fell from 12.29 per cent at end 1999 to 11.93 per cent in March 2000. Rates began to rise thereafter with a particularly sharp increase in the second half. Yields on 91-day bills increased by 42 basis points in the first half and 556 basis points in the second half to end the year at 17.77 per cent. Yields on 364-day bills increased by 24 basis points in the first half and 521 basis points in the second half, to end the year at 18.22 per cent.

The Central Bank's discount and rediscount rates moved with market rates. Accordingly, the 91-day discount rate rose from 11.64 per cent at end 1999 to 17.72 per cent at end 2000, while the 91-day rediscount rate increased from 14.29 per cent to 21.27 per cent during the same period. The Central Bank also adjusted the margin between its discount rate and rediscount rates to assist its open market operations. In order to mop up excess liquidity in January, the margin between the primary market yield on Treasury bills and the discount rate was reduced temporarily from 15 basis points to 5 basis points on 13 January 2000. After mopping up liquidity, the margin was restored to 15 basis points on 18 January 2000 to avoid exerting upward pressure on call market rates. The margin was brought back to 5 basis points on 08 February 2000. The spread between the discount rate and rediscount rate was raised by 100 basis points, to 3.55 per cent on 08 June, to discourage discounting through the Bank's secondary window.

The coverage of the Sri Lanka Inter Bank Offered Rate (SLIBOR), which is based on the rates offered for rupee transactions by 12 commercial banks, was extended in 2000. The Central Bank commenced publishing 3-month, 6-month and 1-year values for SLIBOR with effect from 17 July 2000, on a daily basis, in addition to the values previously published for 1-day, 7-days and 1-month. These longer-term values are expected to provide useful indicators of current market perceptions on future interest rates. These rates moved in line with call market rates. During the year, shorter-term values varied within a wider range than longer term values. The highest SLIBOR values were in December 2000. Overnight SLIBOR values in 2000 varied within a range of 9.19-31.50 per cent, 7-day values in a range of 10.09-30.33 per cent, 1-month in a range of 11.10-29.00 per cent, 3-month in a range of 14.67-26.75 per cent, 6-month rate in a range of 14.83-25.42 per cent and 1-year rate in a range of 14.88-24.42 per cent. These rates at end 2000 stood at 31.50 per cent, 26.00 per cent, 25.33 per cent, 24.00 per cent, 23.25 per cent, and 22.67 per cent, respectively.

Deposit Rates

In contrast to a marginal decline in commercial bank rupee deposit rates in 1999, rates rose in 2000, particularly in the second half of the year. Banks faced strong competition from government securities in the latter part of the year and were compelled to increase their deposit rates to retain deposits. The increase was more pronounced in fixed deposit rates. A notable feature was that short-term rates rose faster, resulting in an inverted yield curve for deposits. This indicated a market perception that the prevailing high rates on government securities were a short-term phenomenon. Savings deposits of commercial banks, which were in the range of 2.00-10.00 per cent in 1999, moved to a slightly wider range of 2.00-11.00 per cent in August 2000 and thereafter remained unchanged during the rest of the year 2000; 3-month fixed deposit rates, which stood at 7.50-11.50 per cent at end December 1999, were maintained in this range until May 2000, before the maximum rate was increased to 17.00 per cent in the latter part of 2000. Similarly, the maximum rate on 6-month deposits increased from 11.75 per cent at end 1999 to 15.00 per cent in November 2000, while the maximum rate on 12-month deposits moved up from 12.50 per cent to 15.00 per cent. The Average Weighted Deposit Rate (AWDR), which is computed monthly, based on interest rates paid on all interest bearing deposits of commercial banks, rose from 9.1 per cent in December 1999 to 9.9 per cent in December 2000. However, the Average Weighted Fixed Deposit Rate (AWFDR) indicated a sharper increase from 10.7 per cent to 12.9 per cent during the year.

Following the increase in international rates, commercial banks adjusted their interest rates on foreign currency deposits upwards, particularly in the second half. Rates on savings deposits denominated in US dollars were in the range of 2.50-5.25 per cent per annum at end 1999 and moved up to a slightly wider range of 2.50-5.90 per cent per annum at end 2000. Sterling deposits, which were in a higher range than deposits denominated in US dollars, varied within a range of 3.00-7.25 per cent per annum during 2000. Following the trend in term rupee deposits, fixed deposit rates on foreign currency moved up by a higher margin than savings deposit rates. US dollar 1-year fixed deposit rates increased from a range of 5.50-6.00 per cent per annum at end 1999 to 6.00-7.00 per cent per annum at end 2000. Similarly, rates on 1-year fixed deposits denominated in sterling rose from a range of 3.50-6.75 per cent per annum to 4.40-7.75 per cent per annum during the same period. Moreover, rates offered by FCBUs on US dollar deposits stood within a range of 4.75-6.75 per cent and for deposits in sterling pounds within a range of 5.25-7.25 per cent per annum at end 2000.

The National Savings Bank (NSB) increased its rates with the rising trend in yields on government securities and increases in interest rates offered by commercial banks to depositors. Initially, the rate on savings deposits of NSB was reduced from 9.2 per cent to 8.4 per cent and the rate on 12-month deposits from 11.5 per cent to 10.5 per cent in February 2000. Thereafter, the rate on 6-month fixed deposits was raised to 10.5 per cent in June, 11.00 per cent in September and to 12.00 per cent in October 2000. Similarly, rates on 12-month and 24-month fixed deposits rose to 15.00 per cent and 13.8 per cent, respectively, at end 2000, from 11.5 per cent and 12.00 per cent, respectively, at end 1999.

Lending Rates

With the rising trend in the market rates, a general upward movement of lending rates was observed in the financial system. Many commercial banks revised their lending rates upward by 2-3 percentage points. With tight liquidity conditions in the market and the rise in yield on government securities, the Averaged Weighted Prime Lending Rate (AWPLR), which is based on the rates offered by commercial banks to their prime customers, increased by about 5 percentage points during the year, from 15.90 per cent at end 1999 to 21.46 per cent at end 2000. The increase was most sharp in the fourth quarter. The Average Weighted Lending Rate (AWLR), which is based on the Quarterly Survey of Bank Advances, declined slightly from 18.9 per cent at end December 1999 to 18.5 per cent at end September 2000, owing to a substantial increase in the outstanding amount of credit granted against immovable property at a slightly lower rate than the rates charged in the comparable period in 1999.

The Bank Rate, the interest rate at which the Central Bank grants advances to licensed commercial banks for temporary liquidity purposes, was revised three times during the year. The Bank Rate, which was 16.00 per cent at end 1999, was raised to 18.00 per cent on 02 October 2000, 20.00 per cent on 08 November 2000 and to 25.00 per cent with effect from 21 November 2000.

Rates on commercial paper, which are used by the corporate sector and financial institutions to raise short-term funds followed market trends, fluctuating within a range of 12.00-27.00 per cent in 2000, compared to the range of 11.50-18.00 per cent in the preceding year. Interest charged by commercial banks for payments through credit cards varied within a range of 24.00-38.40 per cent during the year, when compared with 20.00-30.00 per cent in 1999.

The Legal Rate and the Market Rate, 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 Provisions) Act, No.2 of 1990, respectively, declined slightly from 9.7 per cent in 1999 to 9.1 per cent in 2000.

Interest rates charged by FCBUs are generally based on the London Inter Bank Offered Rate (LIBOR). FCBU lending rates to domestic customers were in a range of 4.50-10.00 per cent in 2000 compared to 4.00-9.00 per cent in 1999. In the case of the foreign currency loan facilities to non-BOI exporters, lending rates varied within a range of 6.69-11.70 per cent, slightly higher than the 6.01-10.50 per cent range in 1999.

Long-term Rates

Long-term rates include interest rates on Rupee loans of the government, yield rates on Treasury bonds, lending rates of long-term credit institutions including licensed specialised banks and debentures. The interest rates on government securities (Rupee loans) are administratively determined. Rupee loans with maturity periods ranging from one year to 8-10 years were issued during 2000. These loans were issued at par and the interest rate varied within a range of 11.00-12.00 per cent.

With high liquidity in the market and the continued decline in inflation at the beginning of the year, coupon rates on Treasury bonds were lowered by 25 basis points, from the beginning of 2000. Accordingly, the coupon rates for issues of 2-year, 3-year, 4-year, 5-year and 6-year were 10.75 per cent, 11.00 per cent, 11.25 per cent, 11.50 per cent and 11.75 per cent, respectively. These bonds provide risk free medium-term investment opportunities and are sold by auction, depending on government borrowing requirements. During the year, Treasury bonds with maturities of 2-6 years were issued. Mixed movements were witnessed in yields on all maturities of Treasury bonds in the first half of 2000, but yields tended to rise in the second half of 2000. Yields on 2-year bonds declined gradually from 12.88 per cent in December 1999 to 12.00 per cent in May before reaching 13.11 per cent at the end of the first half in 2000. Yields on 3-year Treasury bonds followed the same pattern. Yields on 4-year bonds fell from 13.21 per cent to 13.05 per cent, the 5-year bonds from 13.30 to 12.94 per cent, and on 6-year bonds from 13.65 per cent to 12.53 per cent in the first half. With the rise in interest rates, only short maturities (2-year and 3-year) Treasury bonds were issued in the second half of 2000.

During the second half of 2000, the yield on 2-year bonds rose from 13.63 per cent to 22.21 per cent and on 3-year bonds from 13.94 per cent to 18.71 per cent. A new instrument, 2-year callable Treasury bonds, was issued for the first time in November 2000. The new instrument provides the government an option to redeem it after the first year of issue, on a date prior to maturity. The two auctions held on 27 and 30 November 2000 recorded yield rates of 20.62 per cent and 22.00 per cent, respectively, lower than the yields on plain 2-year Treasury bonds recorded at the auctions held on the same day.

Interest rates charged by licensed specialised banks and other long-term lending institutions also moved up, following the rise in short-term interest rates in 2000. The increases were seen particularly in the second half of 2000. DFCC Bank's interest rates, which stood within a range of 10.00-19.00 per cent at end 1999, rose to a range of 12.00-21.00 per cent at end 2000. Lending rates of NDB also rose from 6.3 - 20.0 per cent to 14.00 - 26.50 per cent during the period under review. Rates offered by NSB increased from 14.0-15.0 per cent at the end 1999 to 16.0-17.5 per cent at end 2000. The long-term lending rates of the State Mortgage and Investment Bank (SMIB), which were in a range of 15.00 - 18.00 per cent at end 1999, were maintained until September and then increased to 16.00 - 18.00 per cent. The National Housing Development Authority (NHDA) rates, remained unchanged in the ranges of 15.0-18.0 per cent and 10.0-16.00 per cent, respectively, as in the previous year.

These private firms, Sri Lanka Telecom Ltd., Eagle Insurance Co., Ltd. and Suntel Ltd., issued listed debentures during the year. All issues were over-subscribed. In March 2000, Sri Lanka Telecom issued 5-year unsecured redeemable debentures with several interest rate options. These debentures carried an optional coupon rate; 14.5 per cent interest payable annually or 14.0 per cent interest payable quarterly or a floating rate linked to the average 6-month (182 days) Treasury bill yield at the previous four primary auctions plus 1.25 per cent payable semi-annually (subject to a floor of 13.0 per cent and a cap of 16.0 per cent). In March 2000, Eagle Insurance Co. Ltd. issued 3-year secured redeemable debentures as dividend payments to its shareholders, with an interest rate of 14.5 per cent per annum, payable bi-annually. In December 2000, Suntel issued guaranteed redeemable debentures with tenors of five years, six years and seven years. These debentures had a bi-annual coupon and were issued on a fixed rate basis. The coupon on debentures was determined using the weighted average yield of the 3-year Treasury bond auction held immediately preceding the issue. The 5-year debenture carried a coupon which was 80 basis points higher than the rate for the 3-year bonds, while the 6-year and 7-year debentures carried coupons which were 105 and 130 basis points, respectively, higher than this rate.

10.5 Commercial Banking

The number of licensed commercial banks operating in the country increased from 25 at end 1999 to 26 at end 2000. Total assets/liabilities of the domestic units of commercial banks and those of foreign currency banking units (FCBUs) increased during the year. Relatively higher economic growth, improved performance in international trade and increased demand for credit, particularly from the public sector, due to increased fuel prices and defence related imports were mainly responsible for this growth. Total assets of the domestic units grew by 18.7 per cent as compared with 13.8 per cent in the previous year. In contrast to the decline in total assets of FCBUs by 3.5 per cent in 1999, they increased by 27.5 per cent during the year. A part of this was, however, a valuation adjustment due to the depreciation of the rupee, as the assets/liabilities of FCBUs are denominated in foreign currency.

As indicated earlier, credit from domestic banking units, particularly to government and public corporations, rose sharply. The credit to deposit ratio of commercial banks increased as a result of higher growth in advances (17.6 per cent) than in deposits (14.2 per cent).

Credit extended by FCBUs to public corporations and the private sector increased during the year in contrast to net repayments recorded last year. Credit to government increased as FCBUs provided a loan of US dollars 100 million. FCBUs obtained a syndicated foreign loan to meet this credit requirement, thus increasing their foreign liabilities. Meanwhile, the government repaid US dollars 42 million of a previous syndicated loan of US dollars 100 million obtained from FCBUs in 1998. Foreign currency credit granted by commercial banks to non-BOI exporters amounted to US dollars 128 million, an increase of about US dollars 4 million when compared to 1999. These loans were all granted by domestic units during the year. The net foreign asset position of domestic banking units improved while that of FCBUs declined, resulting in a decline in NFA of the commercial banking system.

The rise in market interest rates due to increased government borrowing and tightened monetary policy led banks to increase both deposit and lending rates for rupee funds. A notable feature of the deposit interest rate structure in the latter part of the year was that the rates on short-term maturities were higher than on long-term maturities, indicating an expectation of a decline in rates in the medium-term. There were shifts from demand deposits to interest bearing time and savings deposits as well as from bank deposits to government securities, which had attractive rates, particularly during the second half of the year. Even though the inflation rate was higher in 2000, depositors benefited from a substantially high positive real interest rate. Following increases in international rates in 1999 and early 2000, banks also raised interest rates paid to foreign currency deposits towards the latter part of the year. However, in general, deposit rates recorded lower increases compared with changes in lending rates resulting in increased interest spreads in the banking sector.

Structure of Assets and Liabilities of Commercial Banks

Total resources of DBUs of commercial banks increased by Rs.106,826 million (18.7 per cent) in 2000 which was significant when compared with the Rs.69,173 million (13.8 per cent) increase in 1999. On the assets side, this was reflected mainly in an increase in credit extended and in foreign assets. Total loans and advances, which include loans, overdrafts facilities and purchase of commercial bills, increased by 17 per cent and contributed 48 per cent to the total growth of commercial bank assets. Holdings of commercial bills, both local and export, increased substantially in response to the improvements in international trade and rise in public corporation borrowings particularly deferring of CPC loans. A significant increase in overdrafts provided to government, private sector and public corporations was recorded. The increase in foreign assets of commercial banks contributed 18 per cent of the growth in total assets, in comparison to 25 per cent growth in 1999. Cash and balances with banks and fixed and other assets contributed about 20 per cent and 16 per cent, respectively, of the growth in assets in 2000.

In the investment category, investment in government securities declined substantially. This was a result of commercial banks using government paper continuously to obtain funds from the Central Bank under the overnight reverse repurchase facility to ease the liquidity constraint in the money market. However, other investments of commercial banks increased substantially in comparison to 1999.

Within the liquid assets category, cash holdings of commercial banks declined by 9 per cent, in comparison

TABLE 10.5

Selected Items of Assets and Liabilities of Commercial Banks (a)

Item	Change			
	99 Dec / 98 Dec		00 Dec / 99 Dec	
	Amount (Rs.mn.)	%	Amount (Rs.mn.)	%
Assets category				
1. Liquid assets	19,261	13.9	15,552	9.9
Cash on hand	3,409	41.0	-1,060	-9.0
Due from Central Bank	-2,966	-9.5	492	1.7
Foreign currency on hand	17,626	33.7	19,179	27.5
Treasury bills	-1,925	-14.2	-4,225	-38.3
Treasury bonds (b)	2,495	49.8	-260	-3.5
Commercial bills	622	2.2	1,426	5.0
Local bills	-3	-25.5	8	93.3
Import bills	977	4.6	-906	-4.1
Export bills	-352	-5.2	2,325	36.0
2. Investments	559	1.7	-2,396	-7.3
Treasury bills	-1,925	-14.2	-4,225	-36.3
Other government securities	2,243	41.9	-260	-3.4
Other investment	241	1.8	2,069	15.4
3. Total loans and advances	41,039	15.6	51,848	17.0
Loans	30,685	20.0	22,702	12.3
Overdrafts	9,733	11.8	27,720	30.1
Commercial bills	622	2.2	1,426	5.0
4. Fixed and other assets	5,957	6.4	16,753	16.8
Liability category				
1. Capital accounts	1,351	2.7	237	0.5
2. Total deposits	50,242	14.8	55,963	14.4
Demand deposits	6,901	12.1	6,309	9.8
Time and savings deposits	43,342	15.4	49,654	15.3
3. Borrowings	5,175	16.2	35,381	95.1
Local borrowings	4,420	15.6	33,810	103.0
Foreign borrowings	755	20.8	1,571	35.9
4 Other liabilities	12,404	15.5	15,245	16.5
Total assets/liabilities	69,173	13.8	106,826	18.7

Source: Central Bank of Sri Lanka.

(a) Includes only the operations of domestic banking units .
(b) With effect from 18 May 1998, Treasury bonds are considered as part of liquid assets of commercial banks.

to a 41 per cent growth in 1999, when the banks kept additional cash at the end of 1999 as a precaution against uncertainties relating to the Y2K problem. In contrast to the decline in cash holdings, deposits with the Central Bank and commercial bills increased in 2000. The ratio of total liquid assets to total assets decreased from 28 per cent in 1999 to 25 per cent in 2000.

Within the liabilities category, deposit liabilities, which grew by 14.4 per cent, contributed 52 per cent of the increase in total liabilities in 2000 in comparison to 73 per cent in 1999.

Even though growth in both demand deposits and time and savings deposits was slow, the slowdown in the growth in demand deposit balances was greater. Time and savings deposits grew by 15.3 per cent whereas demand deposits grew by 9.8 per cent. This could be attributed to depositors switching from demand deposits to government securities and fixed deposits responding to rising opportunity costs of holding non-interest bearing deposits. Reflecting a shortage of liquidity in some banks, inter-bank borrowing grew by 103 per cent when compared to a 15.6 per cent growth in 1999. Meanwhile, foreign borrowings of commercial banks grew by 36 per cent compared to 21 per cent in 1999.

Balances in the capital account grew marginally by 0.5 per cent (Rs.237 million) in 2000, compared to a 2.7 per cent (Rs.1,351 million) increase in 1999.

As the capital adequacy ratio (CAR) applicable to total capital (Tier 1 plus Tier II) was to be raised from 8 to 9 per cent and the CAR on Tier I capital from 4 to 4.5 per cent from January 2001, some banks made debenture issues during 1999 and 2000 to comply with the enhanced capital requirement.

Net foreign assets of DBUs of commercial banks improved substantially in 2000 compared to 1999 as foreign currency exposure was reduced due to uncertainties in the foreign exchange market and expectations of a steep depreciation of the rupee. Both foreign assets and foreign liabilities grew during the year while the faster growth in assets led to an improvement in the net assets position. Foreign assets grew by 28.2 per cent in comparison to 29.2 per cent in 1999. Within these assets, deposits with banks abroad grew by 44.5 per cent (28.8 per cent during 1999) while placements with FCBUs and other foreign assets grew by 13.6 per cent and 43.1 per cent, respectively, (38.3 per cent increase and 4.8 per cent decline, respectively, in 1999). A larger portion of other assets consisted of discounted export bills.

Over 90 per cent of the foreign liabilities of domestic banking units arise from foreign currency deposits in the non-resident foreign currency (NRFC) accounts, resident non-national foreign currency (RNNFC) accounts, resident foreign currency (RFC) accounts and foreign currency deposit accounts of exporters. Balances in these accounts grew by 17 per cent in 2000 compared to 22 per cent in 1999. The higher growth in 1999 was mainly attributed to the relatively large amount of compensation payments received by Sri Lankan workers who were displaced during the Gulf War.

The number of FCBUs operating in 2000 increased to 26 from 25 in 1999 as a new commercial bank entered the banking business. Total assets/liabilities of FCBUs increased by US dollars 206 million (15 per cent) in contrast to the decrease of US dollars 143 million (9 per cent) in 1999. More than 50 per cent of the resources of FCBUs came through DBU placements of foreign currency deposits and deposits by BOI enterprises. Resources from non-national sources accounted for around 27 per cent of total resources. In comparison to 1999, resources from both resident and non-resident categories increased during 2000. Investments with non-resident enterprises and loans and advances to BOI enterprises were the main areas where FCBU funds were utilised. Credit extended to BOI enterprises increased from US dollars 680 million in 1999 to US dollars 690 million in 2000, reflecting the growth in exports and increase in domestic interest rates during the year. FCBUs lent a net amount of US dollars 58 million to the government in 2000. In contrast to the net improvement in foreign assets of DBUs, net foreign assets of FCBUs decreased during the year.

The FCBUs extended a significant amount of credit to public corporations and to the private sector. Credit to public corporations increased by US dollars 134 million mainly due to credit to the CPC. Meanwhile, credit to the private sector, which includes BOI enterprises, increased by US dollars 10 million to reach US dollars 709 million. On the liabilities side, the increase was a combined outcome of an increase in non resident liabilities (US dollars 123 million), particularly due to the US dollars 100 million loan, increase in resident liabilities (US dollars 36 million) and increase in internal accounts (US dollars 47 million). About 62 per cent of resident liabilities was through placements of funds by domestic units.

Credit extend under the special facility to non-BOI exporters increased only slightly during the year. A sum of US dollars 128 million was granted in 2000, as against a sum of US dollars 124 million in 1999. In comparison to US dollars 25 million which was granted by FCBUs under this facility in 1999, all credit granted in 2000 came from DBUs.

Sources and Uses of Funds of Domestic Units of Commercial Banks

In line with the higher rate of growth in assets and liabilities in 2000, resources available to commercial banks increased significantly. The total net availability of resources to commercial banks grew by 71 per cent to

TABLE 10.6

Sources and Uses of Resources of Commercial Banks (a)

(Rs. Million)

Category	Change (b) 1999 Sources	1999 Uses	2000 Sources	2000 Uses
1. Government sector		**6,483**		**3,763**
Holdings of govt. securities		318	4,485	
Deposits	1,021		490	
Import bills		1,429	3,695	
Short-term credit		214		1,842
Overdrafts		5,542		10,591
2. Central Bank		**86**	**1,284**	
Borrowings	358		715	
Reserves	2,966			492
Investment in Central Bank securities				
Till cash		3,409	1,060	
3. Government corporations (c)		**6,415**		**14,549**
Deposits		2,389		270
Advances		4,026		14,279
4. Co-operatives	**184**		**68**	
Deposits		20	129	
Advances	204			61
5. Other domestic private sector(c)	**6,664**		**10,739**	
Deposits (d)	37,831		42,760	
Local bills		450		1,360
Import bills	212			1,763
Overdrafts		4,352		13,894
Loans		26,551		12,916
Investments in securities and bonds		241		2,089
Debentures	215			
6. Inter-bank transactions	**1,523**		**14,607**	
Balance with domestic banks		2,790		18,524
Deposits and borrowings with domestic banks	4,313		33,130	
7. Foreign sector		**2,625**		**6,897**
Borrowings	755		1,571	
Deposits	13,894		13,037	
Foreign balances including export bills		17,274		21,504
8. Other assets & other liabilities	**7,238**			**1,489**
Capital and Reserves	1,351		237	
Fixed assets		2,047		984
Long term govt. bonds	1,000			
Restructuring bonds				
Other assets		4,910		15,769
Other liabilities	11,844		15,027	
Total net sources/ uses	**15,609**	**15,609**	**26,697**	**26,697**

Source : Central Bank of Sri Lanka

(a) Includes only the operations of domestic banking units.
(b) The bold figures indicate whether each sector is a net source or a net user of resources.
(c) Credit to Sri Lanka Telecom has been excluded from government corporation and included in the private sector from December 1998.
(d) Includes longterm deposits mobilised by the two state banks under special savings schemes.

Rs.26,697 million in 2000. In comparison, it increased by 3 per cent in 1999. On a net basis, other banks, the private sector and the Central Bank were major sources of funds (approximately 99.7 per cent of the total), while government corporations, the foreign sector, the government and other assets and other liabilities were the major users of funds.

The biggest single source of funds for commercial banks in 2000 on a net basis was the borrowings from domestic banks which contributed about 55 per cent of required funds on a net basis, reflecting the tight liquidity condition in some banks. In comparison, only 9 per cent of resources were provided from this source in 1999. Reverse repurchase agreements with the Central Bank, which do not explicitly appear in this classification of sources and uses, were a large source of funds to commercial banks, providing around Rs.30,426 million in 2000 in comparison to Rs.513 million in 1999. The private sector, the second largest net source of funds, contributed about 40 per cent to the total.

In contrast to the previous year, the Central Bank became a net provider of funds by providing about 5 per cent of the increase in resources of commercial banks in 2000. This was mainly due to the elimination of the statutory reserve requirement on foreign currency deposits.

Public corporations and the government absorbed about 54 per cent and 14 per cent, respectively, of the funds. Meanwhile, showing a further increase from the previous year, the foreign sector became a net user of funds as the domestic units of commercial banks built up their net foreign asset position.

In contrast to the trend observed in previous years, the other assets and liabilities category was a net user of funds. In this category the increase in capital and reserves was lower than in 1999 while the increase in other assets exceeded the increase in other liabilities.

Commercial Banks' Loans and Advances[1]

Based on the Quarterly Survey of commercial banks' loans and advances, the outstanding amount of total loans and advances granted to the non-government sector (public corporations and private sector) by commercial banks registered a point to point growth of 15.9 per cent at end September 2000, as against a 12.4 per cent growth in the 12-months ending September 1999.

Among the sectors, services, industry and housing and property development and commerce recorded high rates of growth. The total outstanding amount of credit in the services sector grew by 32 per cent, absorbing 6 per cent of the total credit outstanding. The housing and property

1 Based on the Quarterly Survey of Commercial Banks' Loans and Advances as at end September 2000.

TABLE 10.7
Commercial Bank Loans and Advances by Purpose and Maturity (a)

Category	Short-Term		Medium-Term		Long-Term		Total	
	(1) Amount Rs. mn.	(2) (1) as % of (7)	(3) Amount Rs. mn.	(4) (3) as % of (7)	(5) Amount Rs. mn.	(6) (5) as % of (7)	(7) Amount Rs. mn.	(8) (7) as % of Grand Total
Trading								
1999 September	80,252	74.5	21,490	20.0	5,923	5.5	107,665	41.4
1999 December	79,863	72.8	22,855	20.8	7,031	6.4	109,749	39.9
2000 September	96,308	75.6	24,385	19.1	6,763	5.3	127,456	46.3
Financial								
1999 September	8,652	68.6	2,668	21.2	1,291	10.2	12,611	4.8
1999 December	8,446	70.7	2,191	18.3	1,316	11.0	11,953	4.3
2000 September	9,346	71.9	2,295	17.7	1,360	10.5	13,001	4.7
Agricultural								
1999 September	9,006	63.5	3,667	25.9	1,505	10.6	14,177	5.5
1999 December	11,111	66.6	3,856	23.1	1,709	10.2	16,676	6.1
2000 September	8,915	58.2	3,830	25.0	2,586	16.9	15,332	5.6
Industrial (b)								
1999 September	19,698	68.7	5,952	20.8	3,025	10.5	28,675	11.0
1999 December	23,423	70.3	6,668	20.0	3,223	9.7	33,315	12.1
2000 September	22,845	66.3	7,484	21.7	4,124	12.0	34,454	12.5
Tourism								
1999 September	1,746	41.6	880	21.0	1,573	37.5	4,198	1.6
1999 December	1,959	43.6	1,006	22.4	1,533	34.1	4,498	1.6
2000 September	1,581	38.5	1,026	25.0	1,495	36.5	4,102	1.5
Housing								
1999 September	7,870	23.5	11,982	35.8	13,608	40.7	33,460	12.9
1999 December	7,450	20.9	12,435	34.8	15,822	44.3	35,707	13.0
2000 September	7,731	19.3	13,026	32.4	19,390	48.3	40,147	14.6
Consumption								
1999 September	18,720	64.1	5,540	19.0	4,950	16.9	29,209	11.2
1999 December	17,932	61.8	6,088	21.0	4,979	17.2	28,999	10.5
2000 September	20,417	64.1	6,774	21.3	4,673	14.7	31,864	11.6
Other Loans								
1999 September	20,456	68.0	7,010	23.3	2,626	8.7	30,092	11.6
1999 December	23,328	68.1	7,679	22.4	3,246	9.5	34,254	12.4
2000 September	21,988	62.7	9,245	26.4	3,834	10.9	35,068	12.7
Grand Total								
1999 September	166,400	64.0	59,188	22.8	34,500	13.3	260,087	100.0
1999 December	173,512	63.1	62,778	22.8	38,861	14.1	275,150	100.0
2000 September	189,132	62.7	68,065	22.6	44,226	14.7	301,423	100.0

Source: Central Bank of Sri Lanka

(a) Advances include loans, overdrafts and bills discounted and exclude cash items in process of collection.
(b) Includes advances granted for engineering and building trade, mining and fishing.

development and industrial sectors grew by 20 per cent each and absorbed 13 per cent and 11 per cent, respectively, of total credit outstanding at end September 2000. The growth in credit to the services sector and industrial sector was in line with the improved performances of these sectors in GDP, where the services sector grew by 6.9 per cent and the industry sector by 10.2 per cent in the third quarter of 2000.

The commercial sector, which accounted for the largest portion (42 per cent) of credit outstanding, recorded a moderate growth in credit (18 per cent from end September 1999 to end September 2000). Credit extended to the commercial sector increased in line with the growth in some categories of exports, i.e., garments and fabrics, processed tea and minor export crops and some categories of imports, i.e., pharmaceuticals and petroleum products. Among the other sub categories in the commercial sector, wholesale and retail trade, which absorbed 11 per cent of total outstanding credit, recorded a 10 per cent growth in credit at end September 2000.

The consumption category, which absorbed 11 per cent of total credit outstanding, recorded a 9 per cent growth in credit. In this category, a large portion (79 per cent) of credit was absorbed by individuals for their personal needs.

Meanwhile, credit provided through credit cards, though absorbing only 0.5 per cent of total credit, grew by 41 per cent reflecting growth in the use of credit cards.

Of the total credit extended by commercial banks, financial, agricultural and other sectors absorbed 4 per cent, 5 per cent and 6 per cent, respectively, at end September 2000. Fifty per cent of credit outstanding in the financial sector was absorbed by financial institutions and leasing companies, while out of the total credit outstanding in the agricultural sector, one third was absorbed by the tea sector.

The tourism sector, which absorbed only 1 per cent of credit, recorded a further drop in credit at end September 2000 in line with slowing down in the tourist industry during the first nine months of 2000.

In terms of the maturity pattern, a large portion of credit to the non-government sector by commercial banks continued to be in the form of short-term credit. At end September 2000, short-term credit (less than one year) accounted for 63 per cent of total credit, while the share of medium-term (2-5 years) and long-term (over 5 years) credit were 22 per cent and 15 per cent, respectively. This pattern held for all sectors, except housing and property development and tourism. In the case of credit to the housing and property development sector, 48 per cent was in the form of long-term credit while medium-term and short-term credit were 33 per cent and 19 per cent, respectively.

The share of credit given against various types of security remained relatively stable in 2000. Slight changes were seen in credit against government securities, immovable property, plant and machinery and personal guarantees and promissory notes. Credit extended against government securities increased from 1 per cent at end September 1999 to 3 per cent at end September 2000. This can be attributed to incentives to hold government paper, following higher yield rates. Credit against immovable property, and plant and machinery increased from 26 per cent to 28 per cent during the same period, while the relative importance of credit against personal guarantees and promissory notes dropped by 2 percentage points to reach 14 per cent at end September 2000. Fixed, savings and other deposits (10 per cent) was the other important form of security. Unsecured credit accounted for 14 per cent of total credit.

The proportion of credit provided at higher rates of interests by commercial banks continued to decline. The percentage share of total credit given at interest rates over 25 per cent declined by about 2 percentage points from the level at end September 1999, while the percentage share of credit given at interest rates ranging between 21 and 25 per cent dropped by 3 percentage points. The proportion of total outstanding credit granted at interest rates ranging between 16 and 20 per cent rose from 34 per cent at end September 1999 to 38 per cent at end September 2000.

TABLE 10.8

Advances by Type of Security (a)
September 1999 - September 2000

Category	30 September 1999		31 December 1999		30 September 2000	
	Amount (Rs. mn.)	% of Total	Amount (Rs. mn.)	% of Total	Amount (Rs. mn.)	% of Total
1. Documentary bills	7,176	2.8	6,299	2.3	7,594	2.5
2. Government securities	3,943	1.5	4,200	1.5	10,388	3.4
3. Shares joint stock companies, bonds, debentures Sundries including cash value of life policies	3,147	1.2	4,377	1.6	4,413	1.5
4. Fixed, saving & other cash deposits and CDs	26,429	10.2	27,324	9.9	29,574	9.8
5. Stocks in trade	17,353	6.7	19,129	7.0	18,639	6.2
6. Immovable property, plant and machinery	68,038	26.2	73,905	26.9	83,707	27.8
7. Personal guarantees and pro notes	40,844	15.7	40,239	14.6	42,069	14.0
8. Trust receipts	6,974	2.7	6,878	2.5	7,667	2.5
9. Hire purchase agreements	2,137	0.8	2,515	0.9	2,739	0.9
10. Tractor and motor vehicles	3,372	1.3	2,986	1.1	4,294	1.4
11. Other securities	43,270	16.6	45,930	16.7	47,713	15.8
12. Unsecured	37,404	14.4	41,370	15.0	42,626	14.1
Total	260,087	100.0	275,150	100.0	301,423	100.0

Source : Central Bank of Sri Lanka

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

Box 11

Real Time Gross Settlement (RTGS) Systems

Rapid technological developments in the financial sector and increased competition among market players have called upon the payment and settlement systems to play a very dynamic and challenging role. As described in a BIS publication[a], a payment system consists of 'a set of instruments, banking procedures and typically, inter-bank funds transfer system that ensure the circulation of money. The funds transfer system or the settlement system is the core of any payment system, which typically involves an agreement among a defined group of participants in the system and the system's operator, specifying rules and procedures related to the transfer of funds among the participants.

There are two major types of payment settlement systems:

- Designated Time (or Deferred) Net Settlement System (DNS)
- Real Time Gross Settlement Systems (RTGS)

The main distinction between RTGS and DNS concerns the form and timing of settlement. DNS systems can handle payment messages in real time but they settle in batches on a net basis at designated times which could be during the operating day or, more typically, at the end of the day. On the other hand, RTGS systems settle payments on a transaction-by-transaction basis as soon as they are accepted by the system.

As the funds transfer is carried out at a designated time in the DNS systems, it causes the system's participants to be exposed to financial risks for the period during which the settlement is deferred. If not sufficiently controlled, these risks can affect not only the direct counter-parties but also other participants, because one participant's inability to settle could cause the positions of other participants to change, opening up the possibility that they too might fail to meet their obligations. RTGS systems, however, do not create credit risk for the receiving participant because they settle each payment individually, as soon as it is accepted by the system for settlement.

The Central Bank of Sri Lanka is currently examining the prospects of setting up an RTGS System. RTGS systems may require relatively large amounts of intra-day liquidity, because participants need sufficient liquidity to cover their outgoing gross payments. Liquidity can come from various sources including opening balances or reserve balances at the central bank, incoming payments and intra-day credit. Adequate liquidity, relative to the value and distribution of payments, makes a smooth flow of payments possible through such systems, helping to avoid delays in individual payments and minimising liquidity risks. There are many variants in the design and operation of RTGS systems, notably in respect of operating arrangements and the use of intra-day credit to provide liquidity.

RTGS systems are operative in many developed countries, specifically in most of the G-10 countries. The Fedwire in the United States (1970), FA in the Netherlands (1985), RIX in Sweden (1986), SIC (Swiss Inter-Bank Clearing) in Switzerland (1987), ELS (Euro Link System) in Germany (1987), BOJ-NET (Bank of Japan Financial Network System) in Japan (1988), BISS in Italy (1989), CHAPS (Clearing House Automated Payment System) in the United Kingdom (1996) and ELLIPS (Electronic Large Value system, Inter-Bank Payment system) in Belgium (1996) are some of the RTGS systems that are currently in operation. The ECB TARGET (Trans –European Real Time Gross Settlement Express Transfer) in Europe is a multi-country payment system, which links the RTGS systems of the central bank members in the European Union. RTGS systems are also in operation in Hong Kong since 1996 and in Australia since 1998. Many other central banks outside the G-10 countries have started to introduce RTGS systems for making wholesale payments or are seeking to enhance their current systems to provide for RTGS to achieve safe and sound payment systems.

However, poorly designed payment systems may lead to systemic crises if risks are not adequately contained as financial shocks can be passed from one participant to another. The effects of such disruption could extend beyond the system and its participants, threatening the stability of money markets and of other domestic and international financial markets. In order to ensure safety in a payment system, it is necessary first to identify and understand how risks of various types may arise or be transmitted within the system and to determine where they are borne. Once these risks are properly analysed and assessed, appropriate and effective mechanisms must be devised to monitor, manage and control them.

(a) Consultative Report of the Task Force on Payment System Principles & Practices, Bank for International Settlements.

Box 11 (Contd.)

Payment systems can be subject to a range of risks, including:

- Credit risk - the risk that a party within the system will be unable to fully meet its financial obligations within the system currently or at any time in the future;
- Liquidity risk - the risk that a party within the system will have insufficient funds to meet financial obligations within the system as and when required, although it may be able to do so at some time in the future;
- Legal risk - the risk that a poor legal framework or legal uncertainties will cause or exacerbate credit or liquidity risks;
- Operational risk - the risk that operational factors such as technical malfunctions or operational mistakes will cause or exacerbate credit or liquidity risks;
- Systemic risk - in the context of payment systems, this risk is the inability of one of the participants to meet its obligations, or possibility that a disruption in the system itself could result in the inability of other system participants or financial institutions in other parts of the financial system to meet their obligations as they become due. Such a failure could cause widespread liquidity or credit problems and, as a result, could threaten the stability of the system or of financial markets.

Central banks play a leading role in the development of payment settlement systems, particularly because of their strong interest in financial stability. Their role in providing settlement accounts for payment system participants, their concerns with the functioning of money markets for the implementation of monetary policy and with maintaining confidence in the domestic currency both in normal circumstances and in a crisis are also contributory factors for their significant involvement in the development of these systems.

The CBSL is currently in the process of obtaining consultancy support to prepare the groundwork towards setting up an RTGS system. The development of this RTGS System is a component of a broader project to develop a payment settlement system in the country.

Preliminary work on this project, i.e., setting up an in-house Scripless Securities Trading System (SSTS) and an Electronic Funds Transfer (EFT) system, has already commenced. The SSTS, inclusive of the Central Depository System (CDS), has been developed by the Information Technology Department and the Public Debt Department for the use of primary auctions of government securities.

10.6 Central Banking

Central Bank operations during 2000 focused on maintaining stability in the foreign exchange and money markets while ensuring the availability of adequate rupee liquidity to facilitate economic activity. The Bank Rate, repo rate and reverse repo rate were raised, particularly in the second half of the year as a contractionary monetary policy stance was adopted. However, demand for funds under the reverse repo facility remained high reflecting the tight liquidity situation in the money market. Consequently, the Central Bank provided substantial amounts of rupee liquidity to the market through its reverse repo window. The margin between the Central Bank's buying and selling rates for the US dollar was widened from 2 per cent to 8 per cent during the year to provide greater flexibility to the market and reduce pressure on external reserves.

Structure of Assets and Liabilities

The total assets and liabilities of the Central Bank increased by 8.3 per cent (Rs.16,605 million) to Rs.217,191 million in 2000 compared to a 6.3 per cent (Rs.11,913 million) growth in 1999.

On the assets side, the increase was entirely due to the increase in domestic assets of the Central Bank which more than offset the decline in foreign assets. Total international reserves of the Central Bank declined by 28.7 per cent (Rs.31,030 million) reflecting the increased deficit in the BOP in 2000. In comparison, foreign assets declined by 14.9 per cent (Rs.18,954 million) in 1999. Repayment of foreign public debt and sales of foreign exchange to commercial banks were the main factors leading to the outflow.

In contrast to the decline in foreign assets, domestic assets of the Central Bank increased significantly by Rs.47,635 million (52 per cent) compared to the Rs.30,886 million (50.2 per cent) in 1999. Loans and advances to the government through the revolving credit facility increased by Rs.4,200 million (11.8 per cent), while holdings of Treasury bills and Treasury bonds increased by Rs.41,329 million (161 per cent). The increase in the holdings of government paper by the Central Bank was a result of the injection of liquidity to the market through its primary and secondary market operations to offset the shortage of rupee liquidity in the market. The total outstanding amount of

Treasury bill and Treasury bond holdings of the Central Bank increased by Rs.41,329 million in 2000 to a value of Rs.66,952 million (Treasury bills Rs.37,898 million, Treasury bonds, Rs.29,054 million) at the end of the year. Out of these total holdings, Rs.30,426 million was on account of reverse repurchase transactions (Treasury bills Rs.1,372 million, Treasury bonds Rs.29,054 million). In comparison, the value of reverse repurchase transactions at end 1999 amounted to Rs.630 million.

On the liabilities side, the total currency issue of the Bank increased by 4.4 per cent (Rs.3,106 million) during the year. Issue of currency notes increased by 4.1 per cent while the issue of coins increased by 12.5 per cent. The currency issue during the year reflected the usual growth, in contrast to 1999 which had a substantial increase of 16.8 per cent as holdings of cash increased for precautionary purposes due to Y2K related problems at the end of 1999. Deposit liabilities of the Central Bank declined by Rs.261 million (0.4 per cent). This was entirely due to a decline in deposits of international organisations by Rs.2,577 million (6.9 per cent) in comparison to Rs.1,229 million (3 per cent) increase during 1999. Meanwhile, deposits with the government increased by Rs.689 million (28 per cent) and deposits of commercial banks increased by Rs.1,585 million (5.2 per cent).

TABLE 10.9

Distribution of Bank Branches

Category	1998	1999	2000 (a)
1. Licensed commercial banks			
I. Total no.of commercial banks	**26**	**25**	**26**
Domestic Banks	8	9	10
Foreign Banks	18	16	16
II. Total no.of commercial bank branches (b)	**1,038**	**1,055**	**1,090**
Domestic bank branches	993	1,013	1,045
Main branches	889	908	931
ASC branches	12	11	11
Kachcheri branches	23	23	23
Extension/pay offices	65	67	76
Overseas branches	4	4	4
Foreign bank branches (c)	45	42	45
Pawning centres	185	186	186
2. Licensed specialised banks (d)			
I. Total no. of licensed specialised banks	**9**	**12**	**12**
Regional Development Banks	3	6	6
National Savings Bank	1	1	1
Long-term lending institutions	2	2	2
Housing finance institutions	1	1	1
Private savings and development banks (e)	2	2	2
II. Total no. of licensed specialised bank branches	**210**	**311**	**315**
Regional Development Banks	80	177	181
National Savings Bank	100	100	100
Long-term lending Institutions	18	20	20
Housing finance institutions	2	3	3
Private savings and development banks (e)	10	11	11

Source: Central Bank of Sri Lanka.

(a) Provisional
(b) Includes head offices. Excludes pawning centres
(c) Includes extension offices and sub branches
(d) Includes financial institutions which have been issued with a licence under the Banking Act to operate as a Licensed Specialised Bank (LSB).
(e) Excluding Ceylinco Savings Bank which did not commence business in 2000 though a banking licence has been issued.

10.7 Banking Development

The total number of commercial banks operating in the country at end 2000 was 26, consisting of 2 state banks, 8 domestic private banks and 16 foreign banks. The domestic private banks included the National Mercantile Bank Ltd., which commenced operations as a new private bank during the year. ANZ Grindlays Bank Ltd., a branch of a foreign bank was renamed as Standard Chartered Grindlays Bank Ltd. consequent on the acquisition abroad of ANZ Grindlays Bank by Standard Chartered Bank Ltd. A licence was issued to Ceylinco Savings Bank Ltd. (though it did not commence business in 2000) to operate as a Licensed Specialised Bank (LSB), thereby increasing the total number of LSBs to 13. This includes 6 Regional Development Banks (RDBs), National Savings Bank, the State Mortgage and Investment Bank, 2 long-term lending institutions, and three private savings and development banks. An important development in banking policy in 2000 was the further liberalisation of foreign ownership of licensed banks. The Budget 2000 announced a proposal permitting the increase of foreign ownership of licensed banks from 49 per cent to 60 per cent of the issued share capital.

Branch Network

The network of bank branches expanded further in 2000. The total number of commercial bank branches, including main branches, Agrarian Services Centre (ASC) branches, Kachcheri branches, extension offices and overseas branches (excluding 186 pawning centres), increased to 1,090 in 2000 from 1,055 at end 1999. The increase in the branch network came mainly through the opening of 32 branches by domestic private banks. Commercial Bank of Ceylon Ltd. and Pan Asia Bank Ltd. opened five branches each, while Hatton National Bank (HNB) Ltd. and Sampath Bank Ltd. established four branches each during the year. Nations Trust Bank Ltd. and Seylan Bank Ltd. set up three branches and one branch, respectively. The total number of extension offices/pay offices increased by nine, while the number of ASC branches and Kachcheri branches of Bank of Ceylon remained unchanged. The branch network of the two state banks also remained unchanged. These developments, together with the establishment of National Mercantile Bank Ltd., resulted in expanding the total branch network of domestic banks by 32 to reach 1,045 at end 2000. In addition, HNB formed thirty four student units in schools.

Box 12

Money Laundering - Its Economic Consequences

What is money laundering?

Money laundering, in simple terms, is the process by which 'illegal' or 'dirty' money is converted into respectable assets. One technical definition of this is 'the process of converting cash, or other property which is derived from criminal activity, so as to give it the appearance of having been obtained from a legitimate source'[1]

The problem of money laundering is not new. However, several factors have tended to exacerbate the problem in the last few decades. Chief among these factors are economic globalisation that has strengthened economic interacsions among nations; the relaxation of controls on capital flows, particularly the removal of exchange controls that has encouraged the flow of funds from one country to another; the emergence of new countries seeking international funds for economic development; the large scale sale of state owned enterprises by many countries, these sales often taking place in international markets; technological developments facilitating transfer of funds; and the development of new financial instruments that have facilitated the anonymous transfer of funds.

Magnitude of the problem

In addition, the magnitude of the flows makes it a matter of serious concern. Although the very nature of these transactions makes measurement difficult, it has been estimated that the annual turnover of the illegal drug industry alone was around US dollars 400 billion, or 8 per cent of all global trade, in 1997. As money laundering involves not only drug trafficking, but also arms dealing, gambling and other such activity, the actual sums involved would be much greater. This sheer magnitude of the problem is one of the reasons that has compelled international groups such as the Financial Actions Task Force set up by the Group of 10 and the UN International Drug Control Programme to address themselves to combating the problem of money laundering.

Economic concerns

Money laundering concerns not only law agencies and tax authorities, but also those responsible for economic development policy. The focus of this box article is on these economic consequences, which are described below.

a. Breakdown of market mechanisms

Money laundering presents a classic case where private benefits and social benefits do not match, thereby resulting in a breakdown of the mechanism underlying the normal free market system. Individuals or organisations, which engage in money laundering, gain substantial benefits by doing so, whereas the process is detrimental to the well being of society as a whole. This breakdown in the market mechanism requires direct intervention by the government.

b. Flows of funds are not based on returns to investment

The general free market principle is that resources would be used in a manner that they would yield optimal returns. However, those who wish to launder money are more concerned with 'cleaning' their funds than in obtaining the best returns. Thus, they would even invest in enterprises with sub optimal returns so long as their funds could be laundered. On a macro scale, this would be reflected in large flows of money to countries which had lax regulations with regard to money laundering, even if such countries had unsatisfactory macroeconomic conditions, such as an over valued exchange rate, high fiscal and trade deficits and high inflation. Thus, the normal market forces, which would encourage the development of efficient organisations and the maintenance of viable macroeconomic conditions in countries, would no longer operate. The signals emanating from the market would appear to reward weak economic policies. Hence, the primary advantage of a free market, viz., the efficient use of resources, would be lost.

c. Demand for money would not reflect economic activity

Many policy decisions in a modern economy are based on functional relationships between economic activity and the demand for money. However, money laundering, and the associated existence of black money, can cause significant distortions in the demand for money, resulting in difficulties in monetary management.

1 McDonnell R. (1997) An Overview of the Global Money Laundering Problem, International Anti-Money Laundering Standards and the Work of the Financial Actions Task Force, in *Global Drug Laws*, New Delhi.

Box 12 (Contd.)

d. Distortion of taxes

Money laundering is inextricably linked with illegal activity and thus tax evasion. If money laundering takes place in significant volumes, the tax base of the country can be affected, significantly eroding tax revenues.

e. Asset price bubbles

It has been noted that money laundering often results in inflows of funds to certain economic assets, e.g., real estate, stocks, bonds. These inflows, which are often large and occur within short periods, tend to drive up the prices of these assets far beyond the levels justified by economic fundamentals. As a result, 'asset price bubbles' develop. Outflows of funds can also be rapid, causing these bubbles to burst, with disastrous consequences for other sectors in the economy. For instance, a sudden drop in real estate prices can cause immense harm to the entire banking sector if a large amount of credit had been granted with real estate as collateral.

f. Economic instability and loss of confidence

As the aim of money laundering is to clean money rather than to invest, laundered funds tend to move swiftly from one investment to another and from one location to another. This volatile movement of large sums of money leads to destabilisation of sectors affected and can effect entire economies.

Thus, these movements of funds have an adverse impact on economic development.

Moreover, money laundering activity has the effect of destroying confidence in the underlying system. A modern economy, in particular the financial sector, is based on confidence. If, however, certain crucial segments of the economy are found to be seriously affected by illegal activity, then, people lose faith in the system and economic activity and development suffers.

Dealing with the problem

Clearly, money laundering has become a major problem in international economics. Although a few countries may benefit by permitting their territories to be used for money laundering, the world economy as a whole suffers. It is also evident that a few countries alone cannot address the problem. Only the entire international community acting in concert can deal with the problem effectively. It is this awareness that has led to the current situation where a number of international organisations are focussing their attention on dealing with the problem. Sri Lanka too, is a part of this international effort to combat money laundering. The banking sector in Sri Lanka has been made aware of the problem and precautions are being taken. The facility of maintaining secret numbered accounts introduced in the past has been eliminated. Formal legislation to address the problem, by way of a Money Laundering Act, is being prepared.

The total number of foreign bank branches including extension/sub offices increased from 42 to 45 at end 2000, resulting in the total number of commercial bank branches increasing to 1,090 at end 2000. With the expansion in the branch network, the number of persons served by a commercial bank branch (excluding pawning centres) declined from 18,050 at end 1999 to 17,761 at end 2000.

The total number of branches of twelve LSBs increased by four and stood at 315, consisting mainly of 181 branches of RDBs and 100 branches of the National Savings Bank.

Banking Facilities

Facilities provided by commercial banks expanded in an intensely competitive environment to cater to the growing needs of customers. Banking products such as automated teller machines (ATMs), credit cards, electronic funds transfer facilities, internet banking, phone banking, on line services and extended banking hours are among the services provided by commercial banks, apart from traditional banking services. Commercial banks have introduced several new deposit and loan products, and some other services during the year, while applying technological advances in banking facilities.

Commercial banks installed 57 ATMs during the period, thus raising the total number of commercial bank ATMs operating in the country to 373. The use of credit cards continued to grow. The total number of cards (net of cancellations) issued increased from approximately 143,000 at end 1999 to approximately 205,000 at end 2000. Of the total cards issued, 52,000 were local cards, while 153,000 were global cards. Global cards can be used for both international transactions and local transactions. The outstanding credit balance increased by 58 per cent to Rs.3,738 million.

In addition to commercial banks, LSBs also expanded facilities during the year with the introduction of new deposit and loan schemes.

TABLE 10.10

New Commercial Banking Facilities - 2000

Bank	New Deposit Schemes	New Lending Schemes	Other Services Introduced
People's Bank	'Jana Jaya' Accounts; a savings scheme linked to a loan scheme.	A long-term facility for industries and services (EASI Scheme).	
		Small sector development loan scheme (fisheries and goat farming).	
		Cultivation loan scheme (pears and strawberry farming).	
		Consumption loan scheme to purchase consumer durables from specified traders.	
		'Govi Sahanaya'; a credit scheme for trading in agricultural commodities through forward sales contracts.	
Bank of Ceylon		'Govi Sahanaya'; a credit scheme for trading in agricultural commodities through forward sales contracts.	
Commercial Bank of Ceylon Ltd.	'Dot. com' deposit scheme for teenagers.	Development loan scheme (Diribala); a long-term facility to provide credit assistance to small and medium-sector industries.	Internet banking.
Hatton National Bank Ltd.	Three year fixed deposit scheme.	'Singithi Setha'; special education loan scheme for minors.	
	One month fixed deposit scheme.	Personal loan scheme (Sabasiri).	
Sampath Bank Ltd.	'Sampath Sanhinda'; deposit scheme for the elderly.	'Sahanmini'; credit scheme to purchase consumer durables under an easy payment system.	'Sampath Thilina'; a gift voucher scheme.
	'Sampath X Set'; savings scheme for youth.		Internet banking.
	'Sampath Udana'; savings certificate scheme.		Call bank (banking through mobile phones).
Seylan Bank Ltd.	'Seylan Shakthi'; 4 year fixed deposit scheme.	Seylan SMILE loan scheme; a long-term loan facility for manufacturing and service oriented industries.	
Nations Trust Bank Ltd.	Cash Manager; deposit accounts through which cash management is done by the bank on behalf of the customer.	Personal loan scheme; to provide facilities for investment and consumption purposes.	Internet banking
			Phone banking
	Investment Planner; deposit scheme with monthly installments for a specified time period.	Housing loan scheme	
		Leasing	
	Flexi-Fixed deposit; a fixed deposit scheme which allows partial withdrawals after a specified period.		
	Kidz Account for minors.		
National Mercantile Bank Ltd.	Merc Float (floating rate savings accounts)		ATM facility.
	Merc Mega (a savings scheme)		
Standard Chartered Grindlays Bank Ltd.	'Early Bird' deposit scheme . for minors	'Overnite loans';an express loan scheme for individuals who earn a monthly salary	
Pan Asia Bank Ltd.	Fixed deposit shemes Fortune 3, Fortune 4 and Fortune Flash)		

TABLE 10.11
Credit Cards Issued by Commercial Banks

	1999(a)	2000(b)	% Change
Total number of credit cards issued	143,124	205,324	43.5
Local	49,781	51,727	3.9
Global	93,343	153,597	64.6
Outstanding Credit at end year (Rs.mn.)	2,365	3,738	58.0
Local	358	403	13.0
Global	2,007	3,335	66.2
Commission from dealers (%)	0.25-4.5	0.25-4.5	–

(a) Revised
(b) Provisional

Source : Relevant Institutions

10.8 Credit Information Bureau of Sri Lanka

The Credit Information Bureau of Sri Lanka, established under the Credit Information Bureau of Sri Lanka Act, No.18 of 1990 as amended by Act, No.8 of 1995, completed its tenth year of operations in May 2000. The primary objectives of the Bureau are to collect and collate information on borrowers and furnish credit information to lending institutions that are shareholders of the Bureau. The major shareholders of the Bureau are the Central Bank of Sri Lanka, commercial banks, and six licensed specialised banks. In addition, registered finance companies, regional development banks and some leasing companies and merchant banks are also shareholders.

It is envisaged that at least 12 more institutions will become members of the Bureau in 2001, when leasing companies are registered as leasing establishments under the Finance Leasing Act.

Presently, major concerns of the Bureau are the coverage and the quality of information. Accordingly, during the year, the Bureau was able to increase its database to 172,099 borrowers, whose borrowings consist of 66,476 regular advances and 37,869 irregular advances.

The number of credit reports issued by the Bureau during the year increased by 9 per cent to 169,088 from the 155,243 reports issued in 1999. As a result, total revenue from credit reports increased to Rs.9.4 million compared to Rs.7.9 million in 1999. The net profit of the Bureau increased to Rs.6.5 million, a 20 per cent increase over the net profit of Rs.5.4 million in 1999. Accordingly, the Board of Directors of the Bureau, for the first time, declared a dividend of 10 per cent to the shareholders from the profit of 1999. Further, the Board declared a 12 per cent dividend from the profits for 2000.

10.9 Rural Banking and Credit

Overall Trends and Developments

The system of forward sales contracts for agricultural commodities, introduced by the Central Bank in 1999 on a trial basis to ensure stable prices for farmers, was vigorously promoted by the Bank in 2000. The policy strategy mainly concentrated on promoting this concept among rural producers, with banking institutions acting as facilitators for making such contracts between the farmers and the buyers. The scheme was promoted in rural areas with the assistance of lending banks, the Ministry of Agriculture, the Department of Agriculture, the Agricultural and Agrarian Insurance Board, the co-operative sector, private sector establishments and NGOs. The forward sales mechanism is intended to moderate sharp price fluctuations between cropping seasons and off-seasons by facilitating farmers to enter into agreements with selected buyers for sale of their produce in advance at a pre-determined price. The scheme is gaining popularity among farmers and many institutions including banks in the rural sector.

Several policy measures were taken during the year to support the marketing of agricultural produce at reasonable prices. Among them was the expansion of the scope of the New Comprehensive Rural Credit Scheme to include pre-harvest and post-harvest handling and processing activities. In the past, the Scheme provided financing facilities only for the cultivation of paddy and subsidiary food crops. Under this new arrangement, farmers, farmer organisations, traders and people based companies who entered into forward sales agreements became eligible to obtain loans under the extended scheme on the same terms and conditions as cultivators. The NCRCS continued to provide loans for paddy and subsidiary food crops utilising funds of the participating credit institutions, backed by an interest subsidy from the government. The interest rate applicable to on-lending under the scheme remained at 12 per cent per annum in spite of the increasing interest rates in other sectors of the economy. The Agricultural and Agrarian Insurance Board offered an insurance package to farmers who enter into forward sales contracts to cover the total loan amount obtained and the total income expected from cultivation of covered crops such as paddy, other food crops, fruits, flowers and coconut.

The Credit Guarantee Scheme, which has been in operation with government funds since 1998, continued to provide credit guarantee cover for NCRCS loans. For loans granted for post-harvest handling and processing activities, the credit guarantee coverage was enhanced to Rs.2.7 million, while the maximum indemnity payment was increased to Rs.1.6 million.

The Poverty Alleviation Microfinance Projects continued to be in operation during the year. The activities of the Small Farmers and the Landless Credit Project (SFLCP), continued in four districts and created opportunities for the rural poor to organise themselves into people based societies by building social capital as a safety net for development. The project, which is in operation in the Kandy, Puttalam, Galle and Matara districts, will be

TABLE 10.12

Cultivation Loans Granted Under the New Comprehensive Rural Credit Scheme (Position as at 31 December, 2000)

Rs. Million

Season	State Banks			Domestic Private Banks (a)			Regional Dev. Banks			Total Loans		
	Paddy	Subsidi-ary Food Crops	Total	Paddy	Subsidi-ary Food Crops	Total	Paddy	Subsidi-ary Food Crops	Total	-Paddy	Subsidi-ary Food Crops	Total Loans granted under NCRCS
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	177	24	201	21	20	41	32	13	45	230	57	287
1998 Yala	74	24	98	12	30	42	24	17	41	110	71	181
Cultivation year 1998	251	48	299	33	50	83	56	30	86	340	128	468
1998/99 Maha	149	24	173	30	22	52	29	27	56	208	73	281
1999 Yala	75	23	98	10	29	39	25	20	45	110	72	182
Cultivation year 1999	224	47	271	40	51	91	54	47	101	318	145	463
1999/2000 Maha	159	41	200	39	27	66	58	46	104	256	114	370
2000 Yala (b)	42	22	64	33	46	79	43	38	81	118	106	224
Cultivation year 2000 (b)	201	63	264	72	73	145	101	84	185	374	220	594

Source: Central Bank of Sri Lanka

(a) Hatton National Bank, Seylan Bank and Sampath Bank only.
(b) Provisional

TABLE 10.13

Deposits and Advances - Selected Rural Sector Institutions

Rs. Million

	Co-operative Rural Banks (CRBs)		Bank of Ceylon Sub-offices at Agrarian Service Centres		Regional Development Banks		Thrift and Credit Co-operative Societies (SANASA)		Sarvodaya (SEEDS)		Janashakthi Bank Hambantota		SANASA Development Bank	
	1999	2000 (a)	1999	2000 (a)	1999	2000 (a)	1999	2000 (a)	1999	2000 (a)	1999	2000 (a)	1999	2000 (a)
Total savings (b)	12,915	14,807	281	353	3,568	4,995	4,238	1,235	425	626	34	46	966	1,178
Savings	9,546	10,870	227	284	2,319	2,731	1,757	490	329	488	17	21	169	194
Special savings	-	-	22	23	285	305	902	252	96	138	1	7	10	12
Fixed deposits	3,369	3,937	32	46	814	899	739	206	-	-	1	1	627	810
Shares	-	-	-	-	151	1,060	841	287	-	-	16	17	160	161
Total loans granted (c)	3,496	3,612	114	159	3,346	4,043	2,483	2,235	504	749	1,025	1,199	325	387
Agriculture	269	450	34	31	346	408	447	402	83	87	795	963	6	4
Animal husbandry	619	491	1	8	37	46	113	102	10	14	-	-	1	0
Fisheries	117	60	-	-	23	26	-	-	-	-	41	41	1	0
Small industries	49	74	19	12	274	294	245	221	15	31	117	111	92	10
Building construction, Electrification and Water supply	1,014	1,091	2	6	44	165	694	625	-	-	68	79	23	14
Projects/commerce	233	182	20	44	525	446	458	412	30	94	-	-	117	139
Others	1,196	1,265	38	58	2,098	2,658	525	473	366	522	3	6	85	220

(a) All figures for 2000 are provisional.
(b) Total Savings at end 2000.
(c) Total Loans granted during the year 2000.

Source: Bank of Ceylon
Co-operative Development Department
Regional Development Banks
SANASA Federation
Sarvodaya (SEEDS)
Women's Development Federation -Hambantota

replicated in six other districts, viz., Kurunegala, Matale, Nuwara Eliya, Badulla, Kalutara and Hambantota, with funds made available by the Japanese Bank for International Co-operation (JBIC). The expansion of the SFLCP is an endorsement of the concept of poverty alleviation by improving the status of women through promoting their full participation in contributing to the overall development of society. This approach to credit disbursement has been very successful, particularly in areas where the incidence of poverty was significantly high, as it contributed to reducing the high cost of borrowing by members of those societies and to increasing their living standards.

The regional branch expansion programme of private banks has continued, thereby making their services more accessible to people living in remote areas. For the first time, a credit card system was introduced to the agricultural sector with the Seylan Bank introducing a credit card called 'Govi Sarupatha'. This system is intended to reduce the transaction costs involved in obtaining credit facilities by farmers from the formal banking system and to build up farmers' self esteem. This special credit card facility was given to those farmers who were eligible to obtain loans under the NCRCS. The programme was launched in the Bakamuna area in the Polonnaruwa District during the year under review and is expected to be extended to other regions in the future.

The participation of RDBs in rural lending activities expanded during the year. The RDBs, which were established by amalgamating the district-based Regional Rural Development Banks, showed progress after the restructuring process by becoming eligible to participate in several foreign funded credit schemes. The Kandurata Development Bank (KDB), having satisfied the eligibility criteria for participation under the ADB projects, was admitted as a participating financial institution (PFI) under the Perennial Crops Development Project (PCDP) and the Tea Development Project (TDP).

Forward Sales Contract System (Govi Sahanaya Scheme)

As a first step in launching the forward sales contract (FSC) scheme, action was taken to popularise the scheme among farming communities, traders, farmer organisations and bankers through meetings and the media. As a second step, programmes were conducted for government and non-governmental organisations, private sector firms and farmer organisations to make them aware of the method of determining forward prices for agricultural commodities such as paddy, maize, sesame, onion, green gram and black gram. The total number of programmes conducted during the year under review was 443, with a participation of about 17,000. Among the participants, 15,379 were farmers, while the rest were bankers and agents from government and non-governmental agencies.

TABLE 10.14

Forward Contracts - 2000

Crop	No. of Agreements	No. of Farmers Benefited	Forward Price Determined
Maize	521	2,400	Rs.10 per kg.
Paddy	1,905	1,905	Rs.12 to Rs.14 per kg.
Sesame	850	850	Rs.35 per kg.
Vegetables	33	33	Rs.14 to Rs.22 per kg.
Other Crops	258	258	Rs.25 to Rs.350 per kg
Total	**3,567**	**5,446**	

Source : Central Bank of Sri Lanka

Progress made in 2000 in respect of entering into FSCs with the assistance of the facilitating banks and the other institutions is given below.

By the end of the year, some farmer groups who cultivated a number of other crops, e.g., soya bean, red onion, and big onion, showed interest in joining the FSC system. Buyers in both private and state sectors have responded favourably to entering into forward contracts with farmers, farmer organisations, collectors etc. as the quality of produce was guaranteed by the Department of Agriculture. In the implementation process, it has been observed that the FSC mechanism encouraged farmers to increase yields and improve quality, which ensures a satisfactory income, while large scale buyers were also encouraged to purchase directly from the local farmers or collectors subject to the maintenance of the required quality in each crop.

The Dambulla wholesale market, which was developed by the government in 1999, continued to operate as the largest fruit and vegetable market in Sri Lanka. This market, named the Dambulla Dedicated Economic Centre (DDEC), provides infrastructure facilities for wholesale marketing of fruits and vegetables. This Centre has become a distribution centre for both locally grown and imported fruits and vegetables. The Centre is managed jointly by the government and the traders involved, and has emerged as an easily accessible centre to market agricultural produce at reasonable prices. The DDEC is being developed by the government on a pilot basis and it is expected to set up similar markets in other parts of the country and for other agricultural commodities. These facilities would assist agricultural producers to market their output and obtain stable prices while enabling consumers to obtain quality produce at a lower cost.

New Comprehensive Rural Credit Scheme (NCRCS)

The New Comprehensive Rural Credit Scheme (NCRCS) continued to operate throughout the country, providing short-term cultivation loans for paddy and other subsidiary food crops. The total value of credit disbursed

Box 13

Building 'Social Capital': Sri Lanka's Experience through the Small Farmers and the Landless Credit Project

'Social capital' or the force that emerges through the synergic power of a group of people has recently been identified as an integral element of sustainable social and economic development. Social capital refers to the interactions, norms and behavioural ethics among individuals who establish self-help groups, networks and organisations to achieve goals, which are of mutual benefit to them. Social capital is not just the sum of the institutions that underpin a society, but the glue that holds them together. It emerges through association of people, i.e., family members, relatives, neighbours, friends, peer groups and members of social and professional associations. This social binding has an effect on community productivity and its well being. Hence, social capital does not exist when individuals are taken separately, but exists when individuals strive hard as a team with trust and mutual understanding towards achieving a common goal. Social capital, therefore, shapes the quality and quantity of social interactions, thereby enabling people, especially poor people, to survive day to day hardships when they are unable to do so individually. In essence, social capital, which refers to the norms and networks that enable people to act collectively, has of late risen to prominence as an effective tool of social and economic development. (see Das Gupta, P. and Seragildin, I.,1999). However, not all economists agree on the usefulness of the concept.

The importance of social capital can be viewed from different angles. From the viewpoint of a community, social capital tightens social units, thereby reducing costs of family businesses and increasing family incomes to a certain extent. It adds more value to education, health, sanitation, sports, entertainment, social virtues and cultural practices. Social capital and poverty alleviation programmes also have a close relationship with each other. The higher the incidence of poverty, the higher the necessity for building social capital. In such situations, social capital acts as a safety net and the voice of the poor communities. Social capital, in turn, creates synergic power among groups of people who attempt to achieve common goals by forming firms, associations, networks, societies (death benefit societies, co-operative societies, thrift and credit societies, farmers' societies, women's societies etc.). It is therefore a factor contributing to economic development, whilst reducing the imbalance between the rich and the poor. However, the of impact of social capital depends upon the economic, social and political environment of a country.

The importance of social capital has not been recognised or measured, and perhaps has been underestimated in many theories of 'economic development'. Mainstream economics usually emphasises the possibility of increasing productivity of human capital through division of labour and specialisation, but does not recognise the positive aspects of social interactions. Instead, social capital is often viewed as exploitative, burdensome, anti-systemic and therefore irrelevant, looking only at the negative aspects of social interactions. However, it has been proven through experience of programmes implemented in developing countries that social capital is more crucial and closely connected to poverty reduction programmes. It has further been observed that such programmes are far more successful with social capital at grassroots level than programmes without social capital and with a top-down approach.

Social capital, though it is not very familiar in everyday language, is not a new ideology for Sri Lanka, as it is inherent in the culture of Sri Lankans with extended family systems and community based economic activities. Even today, social capital is extensively used in agricultural activities and other social events at village level. This feature is known as 'reciprocity'or mutual-aid in farming and other social activities. As reciprocity supplements human capital and physical capital, many development programmes have included it as an integral element in achieving their targets.

Following these considerations, in the late 1970s, emphasis was given by many international donor organisations to poverty alleviation throughout the developing nations and Sri Lanka was not an exception. During that period, successive governments and non-governmental organisations (NGOs) in Sri Lanka were given funds for launching poverty alleviation programmes. A leading NGO, the Sarvodaya Movement, under its Village Adoption Programme extensively used social capital to combat poverty in areas where poverty was an acute problem. Subsequently, various NGOs conducted similar programmes with local and international funds for the supply of credit and other services. As the sustainability of donor funded programmes depends on the availability of financial resources, the necessity arose for developing a suitable sustainable poverty alleviation programme with special emphasis on providing credit facilities to the poor through the formal banking system. Building up social

Box 13 (Contd.)

capital was hence considered essential for the sustainability and success of such programmes. The Central Bank experimented with this concept in one of its development credit programmes, viz. the Small Farmers and the Landless Credit Project, called the 'Isuru' Project in Sinhala.

Mechanism used in the ISURU Project in building Social Capital

The mechanism adopted in building social capital in the Isuru Project involved going through five steps. The first step was to identify villages based on a survey conducted by a change agent and announce the programme objectives and concepts at meetings with people of the village, called 'Janahamuwa'. The second step was to encourage target beneficiaries to form themselves into small Self Help Groups (SHGs), of people in identical poverty situations and other similar interests. The group members were taken through a series of social mobilisation programmes where they were given the opportunity to identify the strengths, weaknesses and opportunities they have and threats they face. The social mobilisation programmes covered areas such as the creation of awareness of the reasons for poverty, the way to get out of the poverty trap using existing opportunities and strengths, the power of social capital or synergic force of a group of people in realising objectives and facing common problems, the value of thrift and savings habits and credit discipline, participation in group voluntary activities and the strength of women's participation in income generating activities.

As the third step, savings habits and thrift were inculcated among the SHG members. The Project promoted savings through compulsory group savings and voluntary group savings, such as rotational savings called 'Seettu' and collective purchase of raw materials, consumer goods, fertiliser and pesticides at wholesale prices. The total group savings of the SHG members as at end 2000, stood at Rs78.4 million. The exchange of labour ('aththam') fostered among the beneficiaries, helped them to build social capital and reduce the cost of their day to day business. When the SHGs were firmly formed, members were given training in different areas such as development of basic entrepreneurial skills, accounting, leadership and marketing. At end 2000, 10,280 SHGs had been established with 61,752 members in four districts, of whom 42,867 were women. The group members, in the meantime, could obtain loans from group savings as well as from participating banks through the Project. The total amount of loans granted to members stood at Rs.594 million at end 2000. The cumulative recovery ratio was 97 per cent. The problem of lack of collateral for obtaining loans from the formal banking system had been overcome through an inter-se guarantee provided by other group members.

As the fourth step, SHGs were converted into formal community based organisations as limited liability Isuru Development Societies (IDSs) by registering them with the Registrar of Companies. This enabled them to function as 'Beneficiary NGOs' with a wide array of tasks and functions assigned to them. These include functioning as link agencies relating to credit, mobilising savings from members, investing excess funds, issuing shares, extending micro loans and representing Isuru beneficiaries at various fora. These societies were formed after funding agencies terminated their fund flow in December 1997. At end 2000, 187 such IDSs had been set up. The value of shares issued to shareholders amounted to Rs.5.8 million whereas normal savings and compulsory savings amounted to Rs.2.4 million and Rs.4.3 million, respectively. The IDSs thus contributed to strengthen the grassroot level community based organisational infrastructure of the country.

As the fifth step, IDSs were federated to form Isuru Development District Unions (IDDUs) in order to continue with Project activities. The IDDUs have organised fund raising campaigns for awarding scholarships to children in member families, conducted trade fairs, hosted sports meets, performed cultural shows and engaged in other community based events. These activities have enabled members of IDSs to increase their family incomes, enhance their children's education and bring out their hidden talents.

Both IDSs and IDDUs have established a viable network of members enabling them to harness the synergic strength of group action. The democratic process of elections, good governance and transparency in operations have bound the members together so that the IDSs can now successfully face challenges that are posed to them by external forces and ensure sustainable development.

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by participatory credit institutions (PCIs) in 2000 out of their own funds under the NCRCS amounted to Rs.594 million, an increase of Rs.131 million (28.2 percent) over the previous year's disbursements. Of the total credit disbursed, a sum of Rs.370 million was in respect of Maha 1999/2000, while the balance Rs.224 million was in respect of Yala 2000. The total number of loans granted under the NCRCS increased from 23,271 in 1999 to 32,339 in 2000. This substantial improvement was mainly due to many farmers' becoming eligible to obtain loans under the NCRCS due to the continuation of the Farmer's Relief Scheme, which was introduced by the government in 1994. Under this relief scheme, farmers who had defaulted repayment of cultivation loans were given the opportunity to repay 25 per cent of the amount outstanding in default and become eligible to obtain a fresh loan for the ensuing cultivation season. The balance 75 per cent was written-off. Further, the on-lending interest rate under the NCRCS, which was 12 per cent per annum, attracted farmers as the rate was lower than other rates in the market. Paddy continued to be the main crop financed under NCRCS, accounting for 70 per cent of the credit disbursed in 2000, while the balance 30 per cent was for the cultivation of subsidiary food crops.

The interest subsidy provided by the government for NCRCS loans since 1994 continued. PCIs grant loans to farmers out of their own funds and receive an interest subsidy of 10 percentage points from the Treasury in order to maintain the lending rate at 12 per cent per annum, which has prevailed since Yala 1998.

In view of the short production cycle, the maximum period given to farmers for repayment of NCRCS loans was 270 days and PCIs were eligible to claim the interest subsidy to cover up to that period. During the year under review an interest subsidy amounting to Rs.40.3 million was paid by the government in respect of loans amounting to Rs.1,736 million that had been granted by PCIs in six consecutive cultivation seasons from 1996/97 Maha to 1999 Yala.

Relief Package to Farmers

The Farmers' Relief Scheme introduced by the government in 1994 was also in operation during the year under review. The government extended the termination date of the scheme by a further six months, from June 1999 to December 1999, and PCIs were requested to submit their claims on or before 31 March 2000.

Under the scheme, farmers have their defaulted loans, including accumulated interest, written-off by banks on payment of 25 per cent of the principal. The balance 75 per cent is shared by the Central Bank (37.5 per cent), lending banks (18.75 per cent), and the government (18.75 percent). Further, this package made them eligible to obtain fresh loans as borrowers in good standing. The government's relief package required the Central Bank to relax its credit guarantee rules by way of waiving the requirement that a lending bank should institute legal action in order to be eligible for the full amount of the credit guarantee. In terms of this waiver, the Central Bank agreed to pay half of the principal amount in loss remaining after the down payment of 25 per cent by the farmer.

The total liability of the Central Bank under this scheme up to the end of 2000 was Rs. 333 million, while the liability of the government was Rs. 235 million.

Expansion of the Scope of the NCRCS

During the year under review, the scope of the NCRCS was expanded by including pre-harvest and post cultivation activities as eligible activities for financing under the NCRCS. These activities included the production of seed and planting material on a commercial scale, purchase and storage of paddy and other agricultural produce by private organisations, farmer organisations and traders, and the purchase of agricultural produce by private traders and companies under the FSC system introduced by the Central Bank.

Under the extended scope of the NCRCS, the maximum loan guarantee cover has been enhanced to Rs.2.7 million, whilst the maximum indemnity payable under the credit guarantee cover was raised to Rs.1.6 million. The indemnity amounts to 60 per cent of the loan in loss or the amount guaranteed, whichever is lower. The premium rate payable for the credit guarantee cover is 2.0 per cent per annum on the amount of the loan granted.

Rescheduling Facilities to Small Scale Potato Farmers

In view of the difficulties experienced by small scale farmers who borrowed from banks for the cultivation of potatoes in the Nuwara Eliya and Badulla districts during the period 1995/96 Maha to 1997/98 Maha, a package of relief measures was introduced by the government.

Accordingly, PCIs were requested to extend rescheduling facilities to loans that had been defaulted by farmers during the period 1995/96 Maha to 1997/98 Maha. This facility was expected to enable farmers to repay the outstanding principal balances within a period of four consecutive cultivation seasons. The Treasury agreed to reimburse the banks (PCIs) 100 per cent of the accumulated interest waived up to the date of rescheduling. Suspension of legal action for the recovery of loans granted for potato cultivation during 1995/96 Maha to 1997/98 Maha in respect of non-wilful defaulters and the availability of an interest subsidy of 10 per cent per annum for loans rescheduled, by the Treasury, and granting limited credit facilities under the NCRCS for those who agreed to reschedule the defaulted loans were the other relief measures provided under the scheme.

A total sum of Rs.13.6 million was reimbursed to the PCIs in 2000 by the Treasury on account of waiver of accumulated interest. Of this, the interest payable on loans under the NCRCS amounted to Rs.8.3 million, while the balance Rs.5.3 million was on account of interest payable on loans outside the NCRCS. The Treasury made available a total of Rs.54.8 million for this purpose.

Subsequent to the above interest waiver, a further relief measure was introduced by the government for potato farmers who had defaulted loan repayment during the period 1994 Yala to 1997/98 Maha. The government decided to write off all loans below Rs.60,000 granted during this period for potato cultivation and still outstanding. In terms of this scheme, the defaulting farmers were required to make a down payment of 25 per cent of the principal in default, while the balance 75 per cent was to be written off. This facility was to be implemented by all banks, while the amounts written off by Kandurata Development Bank and Uva Development Bank were to be absorbed by the government.

In the case of potato cultivation loans over Rs.60,000, all banks were instructed to reschedule the capital of such loans to be repayable over a maximum period of 36 months at an interest rate of 8 per cent per annum. The accumulated interest that was written off was to be reimbursed by the Treasury.

Crop Insurance Scheme

The Agricultural and Agrarian Insurance Board (AAIB) and Ceylinco Insurance Company Ltd. (CICL) continued to provide agricultural insurance cover for paddy, subsidiary food crops, livestock, etc. during the year under review. AAIB introduced new insurance schemes for (i) tobacco cultivation under the Ceylon Tobacco Corporation, (ii) agricultural projects under FSC system, (iii) seed paddy and model farming, (iv) tea nurseries and plants under the Tea Research Institute and the Tea Small Holding Authority and, (v) the scheme for sesame, kurakkan and maize crops. AAIB continued the insurance schemes for export agriculture crops and perennial crops. AIB broadened its scope by introducing a technical method of loss assessment for crops such as onion and ground nut. Action has been taken to introduce new insurance schemes for foliage and cut flowers, medicinal plants, storage of agricultural products and medicinal products and a scheme for insuring agricultural machinery. CICL, which is the only private insurer operating in this field, expanded its services to various new sectors under the Agricultural and Agrarian Insurance Act, No.20 of 1999.

The extent of paddy land insured by AAIB in 2000 amounted to 7,000 hectares (about 2 per cent of the total cultivated area) when compared to 11,000 hectares in 1999. This reduction was mainly due to limiting paddy insurance operations to seed paddy and model farming systems in the wet zone districts and the total suspension of operations in Mannar, Mullaitivu, Kilinochchi and un-cleared areas of the Jaffna and Vavuniya districts. The insurance premia collected during Yala 2000 and 2000/2001 Maha and indemnities paid under paddy stood at Rs.3.7 million and Rs.0.6 million (for Yala 2000) respectively. The area insured under other crops by the AAIB stood at 1,077 hectares. The premia collected and indemnities paid in this sector amounted to Rs.2.3 million and Rs.0.1 million. CICL insured an extent of 2,255 hectares of paddy land in Yala 2000 and collected premia to a value of Rs.2 million. Indemnity payments made by CICL stood at Rs.1.1 million. CICL also insured other crops collecting premia of Rs.1.5 million and paying claims to a value of Rs.0.5 million. Both CICL and AAIB continued providing insurance coverage for livestock.

Microfinance and Savings Schemes

Samurdhi Development Credit Schemes

Samurdhi Banking Societies (SBSs), which are the ground level credit and savings associations of the Samurdhi Movement, continued their activities of mobilising savings, granting loans and providing other services to Samurdhi members. At end 2000, 940 SBSs had been set up under the Samurdhi Act in 252 Divisional Secretariat divisions, an increase of 75 during the year. An important feature of SBSs is the active participation of women in the development process. At end 2000, 65 per cent of the chairpersons of SBSs were women.

The total number of shareholders of SBSs stood at 1,571,200 at end 2000, an increase of 21.5 per cent during the year. The value of paid-up capital of SBSs amounted to Rs.983 million, while member and non-member savings (including compulsory savings of Samurdhi beneficiaries) stood at Rs.3,011 million. Almost two thirds (61 per cent) of the total fund base of SBSs has been invested, while the

TABLE 10.15

Samurdhi Credit Programmes (a)

Name of Programme	Number of Loans	Amount Rs.Mn.	Recovery Rate %
Loans granted by SBSs	480,643	2,783	107
SASANA	84,160	513	79
SAVANA	13,112	321	70
Leasing	721	167	51
Associated Samurdhi Animators Credit Programmes	180,572	159	99
PANA	175	52	99
SABADA	71	9	92
Total	**759,454**	**4,004**	

(a) at end 2000. Source : Samurdhi Authority of Sri Lanka balance 39 per cent has been granted as loans to members. The outstanding loan amounts granted under the SBSs stood at Rs.1,359 million showing an on-time recovery rate of 107 per cent as some borrowers had repaid more than the amount that they required to pay as at the end of 2000. Close monitoring by the animators and peer pressure within the groups to maintain a good repayment record has enabled the achievement of this high rate of recovery. These loans have been granted to members for starting small-scale businesses in agriculture, agro processing, small scale trading, fisheries and for meeting consumption requirements.

Under the Samurdhi Programme, other loan schemes, namely, Samurdhi Development Credit Scheme (SASANA), Samurdhi Animators' Credit Programme, Refinance Credit Programme (PANA), and Samurdhi Leasing Programmes, were also in operation in 2000. In addition, the Samurdhi movement introduced a new development programme called the 'Samurdhi Task Force' for community development activities. Funds for this programme had been allocated under the Samurdhi Programme.

Gami Pubuduwa Scheme (GPS)

The GPS, a rural financial scheme of HNB that aimed at uplifting the living standards of the rural and semi urban population, completed its eleventh year of operation in 2000. This scheme operates through its wide branch network of 106 delivery units located in both rural and semi-urban areas. Financial support has been provided for establishing over 36,700 self employment projects during the project period. The cumulative value of loans granted stood at Rs.1.4 billion at end 2000, while the amount outstanding stood at Rs.380 million, covering over 10,000 current projects. A special feature of this scheme is that each unit is assigned a field officer (Gami Pubuduwa Upadeshaka) who is the link between the borrower and the bank. Each such field officer has to serve an average clientele of 100. Under this process, Rs.850 million had been mobilised as savings deposits up to the end of 2000. HNB maintained an average recovery rate of 97 per cent throughout the project period, proving that close supervision, and follow up can minimise risks in recovering loans granted in this sector. The scheme also serves the poor who would otherwise have never entered the mainstream of the financial sector.

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

TCCS and SANASA Development Bank (SDB) continued to mobilise savings from and grant loans to their members and customers. TCCS, through their large branch network, mobilised a sum of Rs.948 million from members, while granting loans to a value of Rs.2,235 to their members. The value of issued shares stood at Rs.287 million at end 2000. SDB mobilised savings from its members and customers to a value of Rs.1,017 million and issued shares to members to a value of Rs.161 million as at end December, 2000. Both TCCSs and SDB have provided credit for agriculture, animal husbandry, small industries, rural electrification, trade and commerce.

Sarvodaya Economic Enterprise Development Services (SEEDS)

SEEDS, which is the enterprise arm of the Sarvodaya Movement, continued to provide services to its members through different types of micro type financial products. As its main functions, SEEDS engaged in providing credit facilities to members of Sarvodaya Sramadana Societies for establishing small and micro enterprises, in operating a loan scheme for low income families to purchase solar power systems (funded by the World Bank), and operating special credit schemes funded by donor agencies. SEEDS has been functioning as a participating agency in the Small Farmers and Landless Credit Project and Poverty Alleviation Micro-finance Project. SEEDS aims at establishing 1,000 Sarvodaya Development Bank branches in rural areas by 2003. At end 2000, 393 such development bank branches had been established. SEEDS had disbursed Rs.748 million worth of loans as micro-credit and provided 2,078 loans to members to purchase solar power systems as at end December 2000. SEEDS had mobilised Rs.626 million as savings. The recovery rate on loans granted under SEEDS credit schemes stood at 94 percent at end December 2000.

Farmers' Banking Societies (FBSs)

Farmers' Banking Societies called 'Govi Jana Banku' (GJB) in Sinhala, were established by the Ministry of Agriculture and Lands. Their objective was providing funds for farm requirements and services including good quality seed, fertiliser, agro-chemicals, agro-technology, and support services and financial assistance for small farmers, who form 40 per cent of the total farming community. FBSs are expected to improve the living standards of the target groups by increasing farm income and encouraging the savings habit among the farmers. As at end 2000, 452 FBSs had been established at Agrarian Services Centres (Govi Jana Kendra) with 160,172 shareholder farmers, who were required to buy at least 1 share of Rs.100 in FBSs. The share capital of FBSs stood at Rs.16 million as at end December 2000. Savings of the individual farmers stood at Rs.24.5 million, out of which Rs.18 million was mobilised during the year under review. During 1999/2000 Maha and 2000 Yala seasons, loans to the value of Rs.49.2 million and Rs.41.2 million, respectively, were disbursed for paddy and cash crops. FBSs intend to expand credit facilities to other sectors such as livestock, inland fisheries, food processing and marketing of agricultural products.

Credit and Savings Schemes for Women in Micro-Enterprise Development

Kantha Ran Divimaga

The 'Kantha Ran Divimaga' Scheme was launched by Bank of Ceylon in August 1997, in collaboration with the Women's Bureau of Sri Lanka (WBSL) with the objective of uplifting socio-economic standards and raising income levels of women. The target group of the scheme were members of women's societies who were registered with the WBSL. The project covers the entire island excluding the Northern Province, since women's societies have not been established in that region. The Project provides credit, with a maximum of Rs.100,000 per individual at an interest rate of 13.5 per cent per annum, for establishing small scale industries, trade and business, services, animal husbandry, agriculture and other income generating activities. Under the Project, WBSL recommends prospective borrowers to the Bank. The scheme is also linked to a special savings scheme called 'Kantha Ran Ginum', which requires borrowers to make compulsory savings. As at end December 2000, Rs.18.2 million has been granted to 1,008 members to establish income generating projects.

Janashakthi Banking Societies in Hambantota

Janashakthi Banking Societies (JBSs), which were set up under the Women's Development Federation (WDF) in the Hambantota District, completed the eleventh year of operations in 2000. The objective of the scheme was to empower rural women in the Hambantota District by providing credit and other related services, inculcating savings habits and banking practices, developing sanitation and nourishment practices among them and training for skill development. The main programme includes a wide array of sub-programmes which contribute to achieving the objectives of the programme. The target group of the scheme were women in poor families where the monthly income was less than Rs.1,500. At end 2000, there were 67 JBSs, comprising 28,168 members, spread out in the area of Suriyawewa, Katuwana, Tissamaharama, Hambantota and Tangalle. The amount deposited by members by way of normal deposits, special deposits and fixed deposits was Rs.29 million. The value of issued shares to the members stood at Rs.17 million. Total loans granted to members during the year under review was Rs.34 million.

Delivery of Rural Credit through the Co-operative Movement

Co-operative Rural Banks (CRBs), which are the banking arms of Multi Purpose Co-operative Societies (MPCSs), continued their financial functions and other activities under the Co-operative Development Department (CDD). The main functions of CRBs include mobilisation of savings, extension of credit to their member borrowers for agriculture and allied activities, fisheries, animal husbandry, trade and commerce, provision of credit for pawning activities, collection of utility bills and payment of pensions to farmers. At the end of 2000, 300 CRBs were in operation throughout the country with a branch network of 1,476. During the 2000, the value of loans granted by CRBs amounted to Rs.3,612 million. The deposit level of CRBs stood at Rs.14,806 million at end 2000.

Meanwhile, the District Co-operative Rural Banking Unions (DCRBUs), which were set up as apex bodies of MPCSs under the CDD, continued their functions of accepting deposits of MPCSs, investing excess funds mobilised by MPCSs through CRBs and providing working capital loans for MPCSs. By end 2000, 14 DCRBUs had been set up, representing 240 MPCSs.

10.10 Other Financial Institutions

Savings Institutions

National Savings Bank (NSB), the premier savings institution in Sri Lanka, strengthened its activities by widening the scope of its activities in a competitive banking environment. Its activities have become more market oriented. The total resources of NSB increased by 14 per cent to reach Rs.115,102 million at end 2000, reflecting primarily growth in deposits.

The total deposits of NSB rose by 13 per cent to Rs.105,045 million at end 2000. In comparison, savings and fixed deposits of commercial banks increased by 15 per cent in 2000. Savings deposits and fixed deposits of the NSB grew by 2 per cent and 19 per cent, respectively. Meanwhile, other deposits including National Savings Certificates, Premium Savings Bonds and the NSB Pension Scheme, rose by 19 per cent during the year. The implementation of deposit schemes targeting different groups in society (e.g., minors, youth), focussing on customer oriented banking, and opening savings shops, together with widespread advertising campaigns, frequent adjustment of interest rates in line with market trends and increased automation in the bank helped to build up a strong deposit base. In order to encourage and facilitate savings mobilisation, the NSB introduced a new concept of 'banking at leisure', and extended banking hours at its three savings shops.

NSB adjusted its interest rates several times during the year in line with market trends. The savings deposit rates, which was 9.2 per cent in January, was reduced to 8.4 per cent in February and remained at that level through the rest of the year. The rate on 12-month fixed deposits, which was at 11.5 per cent in January was decreased to 10.5 per cent in February, and again increased to 11.5 per cent in June. Thereafter, one year fixed deposit rates were increased gradually to a level of 15 per cent by November 2000.

Chart 10.5
Employees' Provident Fund

Chart 10.5.1
EPF Contributions and Refunds

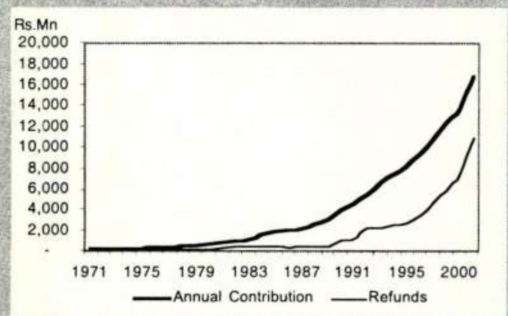
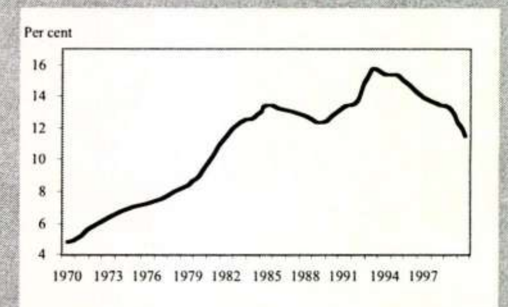


Chart 10.5.2
Rate of Return on Investment



NSB launched a personal loan scheme and a housing loan scheme. In addition, the Bank introduced a privilege card for its 'Ithuru Mithuru' Account holders, who are youth. The privilege card is a plastic card which enables a card holder to obtain discounts from commercial and service institutions specified by the Bank. With the installation of two ATMs during the year, the total number of NSB ATMs increased to three at end 2000. More than half of its branch network has been automated.

The diversification of the NSB's investment portfolio continued with an increase in the holdings of market based instruments. Total investments of the NSB increased by 13 per cent and stood at Rs.100,853 million at end 2000. The share of investment in Treasury bills and Treasury bonds increased from 30 per cent at end 1999 to 38 per cent of total investments at end 2000. Investments in Treasury bills and Treasury bonds increased by 85 per cent and 25 per cent, respectively. The share of investments in government Rupee loans has gradually declined over the past few years. The share of investments in Rupee loans fell from 56 per cent in 1999 to 46 per cent of total investments in 2000, a reflection of a move towards more market oriented instruments. Investments in debentures, commercial paper and in shares and Units Trusts increased during the year.

The country's main superannuation fund, the Employees' Provident Fund (EPF), continued to grow in 2000. The growth of activities of the Fund was accompanied by increases in total contributions, member accounts, total refunds and outstanding member balances. The total contributions received by EPF amounted to Rs.17,009 million, a 24 per cent increase in 2000. This, however, included a large sum received as a payment of arrears. The refunds paid to members rose from Rs.7,691 million to Rs.10,573 million at end 2000. These resulted in increasing the total member balances, after crediting annual interest, by Rs.29,154 million. Being the largest single investor in the country, the total value of investments at end 2000 was Rs.215 billion, an increase of 16 per cent during the year. It has invested a major share of its funds in government paper.

The Employees' Trust Fund (ETF), the country's second superannuation fund, also showed an increase in its activities. The total contributions received in 2000 was Rs.2,928 million compared to Rs.2,665 million in 1999. The superannuation benefits paid to members during the year was Rs.1,483 million, an increase of Rs 61 million over the previous year. The outstanding members' balance in the ETF was Rs.28,023 million, an increase of 10 per cent over the previous year. Total investments at end 2000 was Rs.29,221 million compared to Rs.25,243 million at end 1999. A major share of investments were in government paper. The investments in government paper increased from Rs.17,621 million to Rs.22,476 million at end 2000. Total assets of the ETF amounted to Rs.29,813 million, an increase of 17 per cent over the previous year.

Long-term Lending Institutions

DFCC Bank, a Licensed Specialised Bank, continued its lending activities during the year. Total loans approved by DFCC Bank amounted to Rs.8,074 million, an increase of 15 per cent over the previous year. The increase was mainly to agricultural, commercial and financial sectors. However, the total value of loans disbursed decreased by 12 per cent during the year. The decrease was seen in loan disbursements to most sectors.

TABLE 10.16

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

Rs. Million

Purpose	DFCC Bank		NDB(a)		NSB		SMIB		PSDBs(b)		HDFC		NHDA		Total		% of Total Loans Approved	
	1999	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999	2000	1999	2000(c)	1999	2000
Agriculture	714	826	490	931	-		9	4	37	134	-	-	-		1,250	1,895	4	6
Industry	4,564	3,637	8,381	6,857	-		-	-	211	140	-		-		13,156	11,561	42	36
Tourism	61	68	668	128	-		-		49	42	-		-		778	231	3	1
Commercial	-	669	1,788	666	-		-		938	783	-		-		2,726	1,449	9	5
Financial	1,345	1,531	70	264	1,120	1,383	-		28	235	-		-		2,563	3,028	8	9
Housing	149	93	828	853	1,584	1,248	1,598	1,496	70	85	540	472	2,140	3,580	6,909	7,884	22	25
Redemption of debt			-	-	32	24	18	15	1		-	7	-		50	45	0	0
Other Loans	172	1,250	217	378	2,975	4,444	54	7	386	702	-	170	-		3,804	5,872	12	18
Total (approved)	7,005	8,074	12,442	10,077	5,711	7,099	1,679	1,522	1,720	1,921	540	649	2,140	3,580	31,236	31,963	100	100
Loans granted (d)	5,571	4,909	11,791	6,826	5,587	7,091	1,736	1,376	1,720	1,814	525	558	1,116	1,403	28,046	23,977		
Loans granted as a percentage of total loans approved	80	61	95	68	98	100	103	90	100	94	97	86	52	39	90	75		

(a) Includes refinance and equity investments. Data given in Table 4.12 of the Annual Report do not match the data given under this column due to definitional differences.
(b) PSDBs-Private Savings and Development Banks.
(c) Provisional
(d) Includes loans approved in previous years and disbursed during the period under review.

Sources: DFCC Bank Ltd.
National Development Bank
National Savings Bank
State Mortgage and Investment Bank
SANASA Development Bank Ltd.
Pramuka Savings and Delopment Bank Ltd.
Housing Development Finance Corporation of Sri Lanka
National Housing Development Authority

The majority of the loans disbursed during the year were to the industrial sector (36 per cent of total loans), though the loan disbursements to the industrial sector slowed down during the year. The second major category that received financing from DFCC Bank was the financial sector (24 per cent of total loans). However, loan disbursements to the financial sector decreased by 52 per cent during the year. Total loans granted to the agriculture sector, which holds 8 per cent of total loans granted, decreased by Rs.139 million to Rs.410 million in 2000. DFCC Bank provided 11 per cent of total loans amounting to Rs. 525 million to the commercial sector to finance wholesale and retail trading. Finance facilities provided to the other sectors (19 per cent of total loans), which included community and social services, and electricity, gas and water, increased from Rs.96 million in 1999 to Rs.934 million in 2000.

The total value of loans outstanding increased from Rs.15,054 million to Rs.16,759 million at end 2000. The majority of loans (53 per cent) were medium-term. Of the total loans outstanding, about 36 per cent were long-term, while 11 per cent were short-term. The majority of loans (91 per cent) were secured and over Rs.5 million in size. The bulk of loans and advances had been granted at an interest rate in the range of 14.0 per cent to 19.0 per cent.

The main sources of funds of DFCC Bank during the year were repayment of loans by customers (53 per cent), term borrowings (15 per cent) and lease amortisation (10 per cent). The total asset base of DFCC Bank stood at Rs.24,966 million at end 2000.

National Development Bank, the other major development finance institution, continued to engage in long-term lending activities. However, the lending activities in terms of total loans approved and granted, decreased from the previous year. The total volume of loans approved dropped from Rs.12,442 million at end 1999 to Rs.10,077 million at end 2000. Following the same trend, total loans disbursed came down by 42 per cent to Rs.6,826 million in 2000. The decrease was reflected in decreases in credit to industrial, commercial and tourism sectors while there were increases in credit to agriculture, financial, housing and other sectors. Credit to the industrial sector stood at 68 per cent of total loans and advances approved. Total loans approved to this sector decreased from Rs.8,381 million in 1999 to Rs.6,857 million in 2000. Loan approvals to the commercial sector decreased by Rs.1,122 million, while loans to the tourism sector dropped by Rs.540 million. Loans to the agricultural, financial and housing sectors increased by Rs.441 million, Rs.194 million and Rs.25 million, respectively.

Of the total loans, the majority (49 per cent) were medium-term, 36 per cent were short-term and 15 per cent were long-term. The main sources of funds of NDB were repayment of loans by customers (64 per cent of funds), international credit lines (16 per cent of funds) and issue of debentures (11 per cent of funds). The total assets of the bank increased by 12 per cent to reach Rs.41,545 million at end 2000.

Lending activities of the State Mortgage and Investment Bank (SMIB), the leading housing finance institution in Sri Lanka, also showed a downturn during 2000. Total loan approvals decreased from Rs.1,679 million in 1999 to Rs.1,522 million in 2000. Following a similar trend, loans extended during the year also dropped by 21 per cent to Rs.1,376 million. The total loan approvals to the housing sector, which accounted for 98 per cent of total loan approvals, decreased by Rs.102 million during the year. Of the total loan approvals, 86 per cent of loans were long-term, and 13 per cent were medium-term. The majority of loan approvals were secured against property mortgages, fixed deposits and balances in the Employee's Provident Fund. The majority of loans were approved at interest rates of 16.00-18.00 per cent. SMIB revised its lending rates upward in the latter part of the year in line with market trends. The lending rates for the housing sector, which were in the range of 15.00 - 17.00 per cent at the beginning of the year, increased to 16.00 - 18.00 per cent, in December 2000.

The total deposits mobilised by SMIB stood at Rs.3,430 million, an increase of 11 per cent during the year. Interest rates on deposits were gradually revised upward several times during the year. The one year fixed deposit rate, which was 11.50 per cent in February, was increased to 15.00 per cent in November in several steps. The main sources of funds of SMIB were repayment of loans by customers (83 per cent) and fixed deposits (15 per cent). The total assets of SMIB increased to Rs.8,089 million from Rs.7,447 million at end 1999.

Total loans approved by the two private savings and development banks increased from Rs.1,720 million in 1999 to Rs.1,921 million in 2000. Loans to the agricultural, housing, financial, and other sectors showed an improvement, while loans to industrial, commercial and tourism sectors showed a decline during the year. Loans to the agriculture sector increased from Rs.37 million to Rs.134 million. Loans to the financial and housing sectors rose by 25 per cent and 21 per cent, respectively. Loans to the commercial sector, which holds a share of 41 per cent of total loans, decreased by Rs.155 million during the year. Loans to the industrial sector also decreased to Rs.140 million from Rs.211 million in 1999. The major sources of funds of the two banks in 2000 were deposits, borrowings and issue of debentures. Total assets of the two banks increased to Rs.5,082 million, an increase of 14 per cent during the year.

The Housing Development Finance Corporation of Sri Lanka (HDFC) continued to lend to the housing sector. Total loans approved stood at Rs.649 million in respect of 2,245 loans, compared to Rs.540 million on account of 3,115 loans in the previous year. The amount of loans disbursed rose by 6 per cent to Rs.558 million. Of the total loans approved, 93 per cent were long-term. The majority of loans were in the range of Rs.100,000-Rs.400,000 and were secured against land and property. The major share of loans carried an interest rate in the range of 15.00-19.00 per cent. The major source of funds for HDFC were repayment of loans by customers (75 per cent). The National Housing Development Authority (NHDA) also extended credit facilities to housing sector. NHDA approved Rs.3,580 million in 2000 compared to Rs.2,140 million in the previous year, while total loan disbursements increased by 26 per cent and stood at Rs.1,403 million in 2000. The total number of recipients of loans were 33,000 and all the loans were below Rs.25,000 with interest rates of 12.00-16.00 per cent.

Finance Companies

The total assets and liabilities of finance companies (FCs) expanded at a slower rate in 2000 (9.3 per cent) than in 1999 (17.7 per cent). In comparison, total assets of commercial banks rose by 18.7 per cent in 2000 and 13.8 per cent in 1999. Finance company assets amounted to around 5 per cent of the assets of the domestic banking units of commercial banks. The growth rate of deposits of FCs was also lower (9 per cent) than that of commercial banks (14 per cent) in 2000. The slower expansion of assets/ liabilities of FCs may be attributed to the decline in fixed deposits of FCs by 5 per cent from October 2000 to December 2000. The high rates offered on risk free government securities would have contributed significantly to this development. Total outstanding credit extended by FCs also grew at a lower rate (11 per cent) than the rate of commercial banks (17 per cent) in 2000.

Loans and advances continued to be the major category of assets of FCs, accounting for almost two thirds of total assets, followed by investments (14 per cent) and fixed assets (8 per cent). The growth rate of loans and advances was 11 per cent in 2000 compared to a growth rate of 17

TABLE 10.17

Assets and Liabilities of Licensed Finance Companies

Rs. Million

Item	As at 31 December 1999	As at 31 March 2000	As at 30 June 2000	As at 30 September 2000(a)	As at 31 December 2000(a)
Assets					
1. Loans & advances	20,041	20,803	21,472	22,067	22,306
1.1 Hire purhcase	1,807	2,694	2,684	2,690	1,762
1.2 Leasing	12,187	12,456	12,731	12,929	13,718
1.3 Real estate	2,157	604	686	691	2,108
2. Equity investments	2,043	1,960	1,872	1,991	2,038
3. Treasury bills	2,242	2,370	2,518	2,560	2,605
4. Cash and bank balances	939	1,035	824	814	706
4. Fixed assets	2,501	2,632	2,664	2,697	2,738
5. Other assets	2,942	2,977	3,229	3,172	3,173
Total	**30,708**	**31,777**	**32,579**	**33,301**	**33,566**
Liabilities					
1. Capital account	4,700	4,890	4,870	4,878	4,947
2. Fixed deposits	18,124	18,970	19,299	19,587	18,619
3. Certificate of deposits	986	1,011	1,104	1,139	2,194
4. Borrowings	2,008	2,011	2,134	2,281	2,433
5. Provisions	1,143	1,378	1,510	1,574	1,576
6. Other liabilities	3,747	3,517	3,662	3,842	3,797
Total	**30,708**	**31,777**	**32,579**	**33,301**	**33,566**
No. of finance companies reporting to the Central Bank	25	25	25	25	25

(a) Provisional

Source: Central Bank of Sri Lanka

per cent in 1999. By way of comparison, the outstanding amount of loans and advances of domestic banking units of commercial banks grew by 17 per cent in 2000 and 16 per cent in 1999. Within loans and advances, leasing (61 per cent), real estate (9 per cent) and hire purchase (8 per cent) were the main components. Credit for leasing activities increased by 13 per cent, while credit for hire purchase and real estate development dropped by 2 per cent each in 2000.

The investment component of FC assets amounted to 14 per cent, with 60 per cent of the investments being in government securities, primarily in Treasury bills. Investments in Treasury bills increased by 16 per cent. Amongst the other assets, the holdings of cash and bank balances dropped by 25 per cent, while fixed assets rose by 9 per cent.

From the perspective of liabilities, the major component was deposits, accounting for 62 per cent of total liabilities, while capital and reserves provided 15 per cent, other liabilities 11 per cent and borrowings accounted for 7 per cent. Total deposits of FCs increased by 9 per cent in 2000 (19 per cent in 1999), in comparison to an increase of 13 per cent in rupee deposits of commercial banks (13 per cent in 1999). The dependence on borrowings by FCs moved up by 21 per cent (5 per cent in 1999). The increase in the exposure to borrowings may be attributed to the slow down in the growth in deposits. Meanwhile, provisions for bad and doubtful debt of the total liabilities of FCs was 4 per cent at end 2000 (3 per cent in 1999).

10.11 Specialised Financial Institutions

Merchant Banking

Information was obtained from 13 specialised institutions undertaking merchant banking activity in 2000. As in the previous year, the activities of these institutions slowed down during the year. Total assets of the institutions decreased by 25 per cent and stood at Rs.18,289 million at end 2000. The industry as a whole suffered a loss of Rs.1,761 million during the year mainly because of heavy losses incurred by a few institutions. The total income of merchant banks decreased from Rs.2,288 million to Rs.1,938 million in 2000. Major income sources were leasing, loans and investments in government securities.

TABLE 10.18

Progress of Activities of Merchant Banks 1999-2000

Rs. Million

		1999 (a)	2000 (b)
1	Earned income on leasing	692.2	689.5
2	Interest on discounting trade bills	213.3	67.9
3	Financial and marketing consultancy services	57.5	68.5
4	Underwriting commissions	1.8	0.4
5	Insurance commissions	3.3	4.4
6	Interest on margin trading	32.2	36.3
7	Profit /loss on investment in shares	-35.0	-0.1
8	Interest on treasury bills	271.0	241.9
9	Interest on loans	435.9	398.5
10	Dividends	79.8	74.5
11	Other income	536.4	358.3
12	**Total income**	**2,288.4**	**1,938.1**
13	Pre tax profits/loss	-941.3-	1,761.0
14	Total assets	24,540.7	16,288.6
No. of merchant banks reporting		13	13

Source: Central Bank of Sri Lanka

(a) 1999 data have been revised according to new information received from merchant banks
(b) Provisional

Income from leasing, which accounted for 36 per cent of the total income, decreased marginally during the year. Interest income on Treasury bills and loans, which accounted for 12 per cent and 21 per cent of total income, respectively, decreased by Rs.29 million and Rs.37 million, respectively. Meanwhile, income received from financial and marketing services and margin trading showed some improvement during the year.

Leasing Companies

There are five specialised leasing companies engaged in leasing business in Sri Lanka. In addition to specialised leasing companies, many commercial banks and other financial institutions such as licensed specialised banks, finance companies and merchant banks also engaged in leasing activities, indicating a widened scope for leasing activities in Sri Lanka. A noteworthy development relating to the leasing industry that took place in 2000 was the establishment of a regulatory framework for the leasing industry, a long felt need. The Finance Leasing Act, No.56 of 2000 was passed in August 2000 giving powers to the Central Bank of Sri Lanka to regulate and supervise finance leasing institutions. Under the new Act, licensed finance institutions and public companies incorporated under the Companies Act, with a minimum issued share or paid up capital as stipulated by the Central Bank, will be able to engage in leasing after obtaining Central Bank approval.

The activities of leasing institutions increased during the year. The total assets of the five specialised leasing companies increased by Rs.1,848 million to reach Rs.14,168 million at end 2000. Total lease finance provided by the companies increased from Rs.4,912 million in 1999 to Rs.5,327 million in 2000. The major portion of lease finance was for commercial vehicles (60 per cent) and passenger vehicles (19 per cent). Financing facilities to these two categories increased by 9 per cent and 20 per cent, respectively, in 2000. Financing for plant and machinery also increased, while a decrease was recorded in financing for office equipment.

With regard to the sectors that received financing, the trading sector, which held a share of 37 per cent of total financing, received an increase of Rs.190 million during the year. Finance facilities to the transport sector (20 per cent of total finance) and services sector (20 per cent of total finance) increased by Rs.164 million and Rs.27 million, respectively, during the year. Funds received by the agriculture sector increased by Rs.101 million. However, leasing facilities enjoyed by the industrial sector and the construction sector slowed down during the year.

The high cost of funds, increased overdues and competition from other financial institutions were some constraints faced by the specialised leasing companies during the year.

Venture Capital Companies

The total number of venture capital companies (VCCs) operating in the country remained at seven during the year. The total assets of VCCs stood at Rs.2,918 million, showing a marginal increase during the year. As in the past, VCCs continued to provide long-term funds for the commencement of new businesses, expansion of existing ventures, acquisitions and buyouts. The total funds invested in 2000 was Rs.1,705 million, an increase of 9 per cent over the previous year. Investments in equity for commencement of businesses, which accounted for 47 per cent of total financing, rose by 3 per cent during the year. A 38 per cent growth was seen in financing for expansion of ventures. However, funds for acquisition of ventures and buyouts decreased from Rs.162 million to Rs.140 million in 2000. The total number of projects assisted in 2000 was 471, which includes a considerable number of self employment projects.

Insurance Companies

A new Insurance Act was passed in 2000 to establish a new regulatory framework for the insurance industry. The Regulation of the Insurance Industry Act, No.43 of 2000 provides for the establishment of the Sri Lanka Insurance Board for the purpose of developing, supervising and regulating the insurance industry. The new Act also provides a greater autonomy to the Insurance Board for investment decisions. Under the new Act, a mandatory minimum of 30 per cent and 20 per cent of the life and general reserves, respectively, need to be invested in government securities. However, the Board is given powers to take investment decisions with regard to the rest of the funds. Another major development that took place in the insurance industry was relaxing of restrictions on foreign equity holdings by allowing foreign ownership in insurance companies upto 90 per cent of share capital.

The insurance industry remained competitive during the year. The total number of insurance institutions in operation was nine. A new insurance company, Hayleys AIG Insurance Co. Ltd., which is a foreign collaboration, was established in 2000, while Janashakthi Life Insurance Co. Ltd. and Janashakthi General Insurance Co. Ltd. merged during the year to form the Janashakthi Insurance Co. Ltd. The total branch network of insurance companies increased from 285 in 1999 to 293 in 2000. Net profit before tax of the companies increased by Rs.40 million during the year, while total assets rose by 4 per cent to reach Rs.29,817 million at end 2000. A growth was seen in both life insurance activities and general insurance activities.

The total value of life assurance funds rose by 22 per cent to Rs.23,799 million at end 2000. The total premium collected in respect of new business rose by Rs.260 million during the year. The sums insured on new businesses increased by 2 per cent and stood at Rs.26,911 million at end 2000. The total sums insured and total premium collected in respect of business in force increased by 12 per cent and 20 per cent, respectively. Total benefit payments on maturity, death and disability, surrender and other increased by 8 per cent to Rs.1,585 million in 2000.

General insurance activities, which include fire insurance, general accident insurance, marine insurance and motor insurance, showed an improvement during the year. Net premia for policies in force with regard to general insurance rose from Rs.5,126 million to Rs.6,147 million. As in the past, motor insurance and general accident insurance were the biggest sectors in the general insurance category. Net premia for policies in force in the motor insurance category and general accident insurance category rose by Rs.171 million and Rs.141 million, respectively. Meanwhile, net premia on fire insurance and marine insurance rose by 33 per cent and 24 per cent, respectively.

10.12 Money Market

Overall Trends

An improvement in the rupee liquidity situation was seen at the beginning of the year 2000, following the reflow of currency withdrawn by the public towards the end of 1999 due to market uncertainties generated by elections, Y2K issue and seasonal factors. However, with increased public sector borrowing and outflows on account of the balance of payments deficit, a shortage of rupee liquidity in the market was seen throughout the year. The Central Bank took necessary steps to bridge the gap in credit to prevent a liquidity crunch in the market by injecting liquidity through reverse repurchase transactions and the purchase of Treasury bills at primary auctions. The statutory reserve requirement in respect of foreign currency deposits not placed abroad was also removed in August, partly to

TABLE 10.19

Money Market Operations 1998 - 2000

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
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
1999										
1st Quarter	226,659	3,025	121,996	48,714	5,193	30,684	12,837	48,714	2,141	318
2nd Quarter	228,935	3,811	123,996	54,103	10,886	30,482	12,735	54,103	1,581	490
3rd Quarter	244,090	6,131	123,996	54,272	10,682	29,447	14,143	54,272	2,184	593
4th Quarter	255,370	6,520	124,996	57,201	12,964	33,877	10,360	57,201	920	25
2000 1st Quarter	336,470	6,045	124,996	49,269	7,440	32,052	9,777	49,269	6,268	333
2nd Quarter	281,150	10,465	124,996	43,799	16,089	18,209	9,501	43,799	3,536	200
3rd Quarter	409,241	11,743	131,996	48,548	23,176	14,381	10,991	48,548	1,409	103
4th Quarter	338,358	30,339	134,996	40,428	6,724	19,138	14,566	40,428	3,734	1,429

Source: Central Bank of Sri Lanka

increase liquidity in the foreign exchange market. This released US dollars 61 million into the market.

Inter Bank Call Money Market

The shortage of rupee liquidity in the market, particularly concentrated in some banks, resulted in an increase in borrowings from the call money market, particularly in the second half of the year. The total turnover in the call market increased substantially from Rs.955 billion in 1999 to Rs.1,365 billion in 2000. Call market rates were generally around 15 per cent in the first five months of 2000, but increased thereafter as borrowings increased and monetary policy was tightened, and was 26 per cent at end 2000.

Primary Treasury Bill Market

Despite the decline in the yields on Treasury bills at the beginning of 2000, the yields rose sharply in the rest of the year, particularly in the second half, following increased government borrowing and tightened monetary policy. Although there was a shortage of rupee liquidity in the market, only a few auctions were under-subscribed as the high yield rates with zero risk attracted investors. The total value of Treasury bills offered in the primary market stood at Rs.152,293 million in 2000 compared to Rs.186,490 million in 1999.

The limit to Treasury bills issues, which is authorised by Parliament, was increased from Rs.125,000 million in 1999 to Rs.135,000 million in May 2000. Total Treasury bills outstanding moved up to Rs.134,996 million at end 2000 from Rs.124,996 million at end 1999. There were seven new issues amounting to Rs.13,000 million and five retirements worth Rs.3,000 million during the year.

With a view to maintaining the stability of the money market rates, the Central Bank intervened in the primary market for Treasury bills by purchasing bills at the auction and making reservations from the reissue of bills at primary auctions. Accordingly, the total amount of Treasury bills purchased by the Central Bank during the year was Rs.53,429 million, accounting for 29.3 per cent of total issues, compared to Rs.34,725 million in 1999. Out of these purchases, Treasury bills reserved for the Central Bank amounted to Rs.25,725 million in 2000 when compared to Rs.22,800 million in 1999. However, much of this was subsequently sold in the secondary market. The book value of the Central Bank holdings of Treasury bills (excluding reverse repo transactions) stood at Rs.36,517 million at end 2000 rising from Rs.24,987 million at end 1999.

Central Bank Secondary Market for Treasury Bills

The sales (discounting) of Treasury bills from the secondary window of the Central Bank amounted to Rs.14,948 million in 2000, a substantial increase of Rs.8,122 million compared to the previous year. Similarly, purchases of (rediscounting) of Treasury bills also rose, though by a smaller magnitude, from Rs.1,426 million in 1999 to Rs.2,065 million in 2000. The discount rates, the rediscount rates and the margins were changed to assist policy, as described in the section on interest rates.

Central Bank Repurchase (Repo) Market

The repo and reverse repo windows are the main means by which the Central Bank conducts its open market operations. With the decline in rupee liquidity in the market, the absorption of liquidity through the repo window declined and the volume of transactions was low. Repo sales during the year declined to Rs.110,407 million, when compared with Rs.307,636 million in 1999. Although the repo rate was reduced marginally in the early part of the year, with the tightening of policy it was raised several times during the year, to end the year at 17.00 per cent. In comparison, the repo rate at end 1999 was 9.25 per cent.

Central Bank Reverse Repurchase (Reverse Repo) Market

In contrast to the repo market, the reverse repo market was very active in 2000, as the Central Bank injected substantial amounts of rupee liquidity to the market. The reverse repo facility is open ended, with the reverse repo rate being determined by the Central Bank and used as an active instrument for open market operations. Funds are provided to commercial banks and Primary Dealers on the security of Treasury bills and Treasury bonds. The usual tenor of a reverse repo transaction with the Central Bank is overnight. However, the bank varies this as a policy tool. In June, the tenor was extended to one month to provide greater stability to the market. However, by 19 September the tenor had been reduced to overnight once again. The total value of reverse repo sales was Rs.1,717,191 million in 2000, in comparison to Rs.200,590 million in 1999. Of this liquidity injection in 2000, Rs.1,276,654 million was in the second half. However, Treasury bills tended to be replaced by Treasury bonds as security for obtaining liquidity.

Domestic Foreign Exchange Market

The floating of the exchange rate, which began in 1977 with the move away from a fixed exchange rate regime to a managed float, evolved further in 2000. (More details on historical developments are given in Box 1). With a view to providing greater flexibility to the market in the determination of the exchange rate, and to reduce pressure in the exchange market, the Central Bank widened the margin between its buying and selling rates for the US dollar several times during 2000. As a result of these developments, the Central Bank middle rate (i.e. the average of its buying and selling rates) stood at Rs.80.0598 per US dollar at the end of 2000 as against Rs.72.1150 at end 1999, a depreciation of 9.9 per cent of the rupee against the US dollar for the year.

A marginal increase in purchases of US dollars by the Central Bank from commercial banks was observed with the purchases increasing from US dollars 0.4 million in 1999 to US dollars 2.0 million in 2000. Reflecting the substantial demand for foreign currency by commercial banks resulting mainly from the increase in the import cost of fuel and security related items, commercial banks purchased US dollars 304 million from the Central Bank in 2000, compared to purchases of US dollars 58 million in 1999. The majority of the purchases were made in the latter part of 2000. Total inter-bank turnover, which stood at US dollars 2,382 million in the previous year, increased to US dollars 2,711 million in 2000. Forward transactions also rose from US dollars 458 million in 1999 to US dollars 620 million in 2000, responding partly to the increase in imports and partly to greater uncertainty in the foreign exchange market. Pressure in the exchange market was reduced to some extent by the removal of the SRR on foreign currency deposits with commercial banks, which released around US dollars Rs.61 million held by the Central Bank

Commercial Paper (CP)

Listed companies and other financial institutions such as merchant banks issue commercial paper with a maturity period of 3-6 months to obtain short-term funds. They are usually underwritten, endorsed or guaranteed by a commercial bank or a merchant bank. These are unsecured notes and have become popular since their introduction in 1993 as a source of funds in the private sector. The high interest rates that prevailed in the market for traditional credit through commercial banks also encouraged the raising of funds through CPs.

During 2000, total gross issues of CPs, including reissues, amounted to Rs.14,145 million compared to Rs.16,203 million in 1999. Merchant banks issued their own paper amounting to Rs.1,040 million and Rs.1,200 million on behalf of their clients. Commercial banks supported CPs issues amounting to Rs.11,905 million, accounting for 84 per cent of total issues. The bulk of these issues were 3-month bills. The outstanding value of commercial paper supported by commercial banks stood at Rs.3,963 million at end 2000 compared with Rs.4,356 million at end 1999. The yields on commercial paper were in the range of 12.00-27.00 per cent per annum in comparison with 11.50-18.00 per cent per annum in 1999.

10.13 Capital Market

Although the share price indices of the Colombo Stock Exchange (CSE) indicated an improvement during the period from May to June 2000, the year as a whole saw an overall decline in share prices. Asian as well as major international markets also declined during the year. Two main factors had an adverse effect on markets globally. The first was a fall in the price of technology stocks from March 2000, as investors began to sell these stocks considering them to be overvalued. The second was the oil price hike, which investors feared would cut into company profits. The decline in share prices at the CSE could be attributed mainly to the political uncertainty that prevailed as a result of the general elections held in October, the uncertainty among market participants regarding the extent of depreciation of the Sri Lanka rupee, and the high interest rates on fixed income securities. Of the 16 sectors, two sectors showed a marginal improvement in prices over the year, while the others declined. The decline in both the Milanka Price Index (MPI) and the All Share Price Index (ASPI) was sharper than in 1999. The MPI declined by 25 per cent, to close the year at 698.5, while the ASPI declined by 22 per cent to reach 447.6 by the end of the year. Foreign investors continued to be net sellers in the market in 2000. Total purchases by foreign investors during 2000 amounted to US dollars 19 million, while total sales by foreign investors amounted to US dollars 63 million, resulting in a net outflow of US dollars 44 million. The number of companies listed on the CSE increased from 237 at the end of 1999 to 239 at the end of 2000, with 5 new listings and 3 delistings during the year. There were two public issues of shares during the year, by a plantation sector company which made an offer for sale and an insurance company which made an initial public offer (IPO). Both issues were under-subscribed. There were also three public issues of debentures.

The issue of market based government bonds further expanded during 2000. The total outstanding amount of Treasury bonds increased from Rs. 104,867 million at the end of 1999 to Rs.204,124 million at end 2000, with total new issues during the year amounting to Rs. 125,322 million. These Treasury bonds had maturities varying from 2 to 6 years.

Primary Market

There was one IPO during the year, made by Asian Alliance Insurance Co. Ltd., where two million shares were offered at a par value of Rs. 10 each. Meanwhile, an offer for sale of shares was made by Malwatte Plantations Ltd. for four million shares at a par value of Rs. 10 each. Nine companies made rights issues during the year, while fourteen companies made bonus issues. The total value of bonus issues during the year was Rs. 2,541 million, compared with Rs. 858 million in 1999. The total value of rights issues during the year was Rs. 713 million, compared with Rs. 1,008 million in 1999.

TABLE 10.20
Share Market Indicators

		1998	1999	2000
1. Market capitalisation (Rs. mn.) (a)		116,600	112,800	88,830
2. Number of new issues (No.)		6	5	2
3. Total number of shares issued (mn.)		28	38	6
4. Value of new shares issued (Rs. mn.)		349	537	60
5. Number of shares traded (mn.)		634	486	449
6. Value of shares traded (Rs. mn.)		18,130	14,293	10,624
7. Price indices (a)	- CSE All Share	597	573	448
	- CSE Sensitive	923	-	
	- Milanka	1,000	938	699

Source : Colombo Stock Exchange

(a) End of the year

The debt securities market expanded further during the year. While Sri Lanka Telecom and Suntel raised funds by way of debenture issues, Eagle Insurance issued dividend debentures in March. However, the issue of one million Rs.1,000 debentures in December 2000 by Suntel Ltd. was not listed during the year. The issue of one and a half million Rs.1,000 debentures in March by Sri Lanka Telecom was the single largest issue of debt on the CSE. There was a significant increase in the market capitalisation of listed debentures on the CSE, from Rs. 4.6 billion at the end of 1999 to Rs. 5.8 billion at the end of 2000. The maturity period of these debentures varied from 3 to 7 years, while they carried interest rates ranging from 13 to 22.5 per cent per annum. A parcel of 11,980 debentures issued by Sri Lanka Telecom carried a floating rate of interest which was linked to the 6 month Treasury bill rate. The total amount of debt raised through debenture issues on the CSE during the year was Rs. 2.9 billion, while the total value of debentures listed on the CSE during the year was Rs. 2.1 billion.

TABLE 10.21
Number of New Share Issues by Type of Investment

Type of Investments	1998	1999	2000
Banks, finance & insurance	-	1	1
Beverages, food & tobacco	-	-	
Chemicals & pharmaceuticals	-	-	
Constructions & engineering	-	-	
Diversified	-	-	
Footwear & textile	-	-	
Hotels & travels	1	1	
nvestment trusts	-	-	
Land & property	-	-	
Manufacturing	-	-	
Motors	-	-	
Oil palms	-	-	
Plantations	5	3	1
Services	-	-	
Store & supplies	-	-	
Trading	-	-	
Total	**6**	**5**	**2**
Number of shares offered (mn.)	28	38	6
Value of shares offered (Rs. mn.)	349	537	560

Source: Colombo Stock Exchange

Secondary Market

The decline in share prices was sharper in 2000 in comparison to 1999. The ASPI recorded a decline of 21.8 per cent and reached 447.6 while the MPI declined by 25.4 per cent and reached 698.5 at the end of 2000.

Market capitalisation of the Colombo Stock Exchange fluctuated over the year along with fluctuations in share prices. The highest level of market capitalisation during the year was Rs. 113.1 billion at the end of the first trading day of the year. The lowest level recorded was towards the beginning of May, at Rs. 84.9 billion. Although the market recovered thereafter, with market capitalisation increasing to Rs. 104 billion by October, the year as a whole saw a decrease of 21 per cent in market capitalisation. At end December 2000, market capitalisation stood at Rs. 88.8 billion. Some companies continued to dominate the market in terms of market capitalisation and the top ten companies in terms of market capitalisation contributed nearly 40 per cent of the total market capitalisation at end December 2000. These were John Keells Holdings, Ceylon Tobacco, Nestle Lanka, Commercial Bank, Hayleys, DFCC Bank, Hatton National Bank, National Development Bank, Aitken Spence and Sampath Bank.

Total annual turnover declined, from Rs. 14,293 million in 1999 to Rs. 10,624 million in 2000, while the average daily turnover decreased from Rs. 59 million in 1999 to Rs. 44 million in 2000. The highest monthly turnover of Rs. 1,836 million was recorded in June, while the lowest monthly turnover of Rs. 407 million was in September. Of the sixteen sectors, banking, finance and insurance accounted for the largest share of the total turnover (nearly 40 per cent). The market price earnings ratio declined further from 6.6 at the end of 1999 to 5.2 by the end of 2000.

As in 1999, the total value of sales by foreign investors exceeded their purchases in 2000. Total purchases by foreign investors during the year amounted to Rs. 1,445 million (US dollars 19 million), while total sales by foreign investors amounted to Rs. 4,810 million (US dollars 63 million). Accordingly, the net outflow during the year was Rs. 3,365 million (US dollars 44 million), compared to a net outflow of Rs. 902 million (US dollars 13 million), during 1999.

Chart 10.6
Share Market Indicators

Chart 10.6.1
Share Price Indices

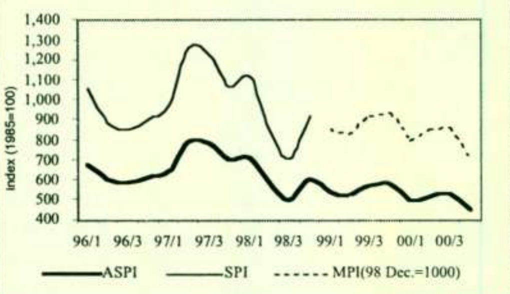


Chart 10.6.2
Stock Market Transactions

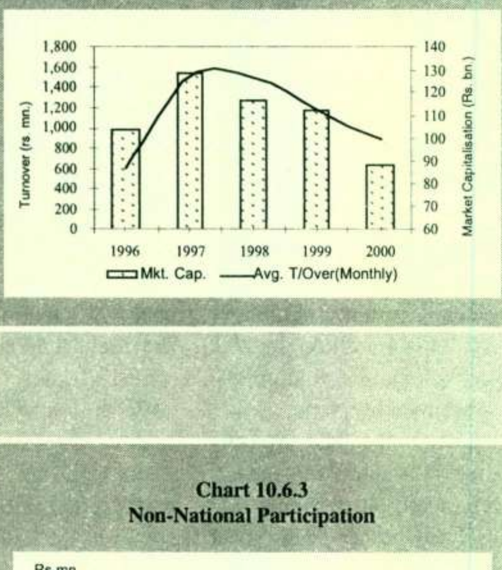


Chart 10.6.3
Non-National Participation

Sectoral Performance

Only two sectoral price indices improved over the year, namely, the chemicals and pharmaceuticals sector by 3.4 per cent and the stores and supplies sector by 6.5 per cent. Of the 14 sectoral price indices which recorded decreases, the construction and engineering sector index was the biggest loser, declining by 37.9 per cent. Other sectors which fell significantly were diversified holdings (29.8 per cent), hotels and travel (28.4 per cent), banks, finance and insurance (28.3 per cent), motors (27.3 per cent), manufacturing (22.4 per cent), plantations (21.5 per cent), investment trusts (19.8 per cent), trading (19.3 per cent) and footwear and textiles (17.8 per cent).

Although most of the sectoral indices declined during the year, of the top 10 companies in terms of market capitalisation, eight recorded improvements in profits for the first three quarters of 2000, compared to the same period in 1999. Plantations sector companies also recorded improvements in cumulative profits at the end of the third quarter 2000. In other sectors however, many companies recorded declines in cumulative profits at the end of the third quarter, particularly in the hotels and travels, land and property, manufacturing and banks, finance and insurance sectors.

Regional and Major International Stock Markets

Most international markets also saw a decline in share prices during the year. In the Asian region, Karachi (KSE 100) improved by 6 per cent, but the share price indices of most other markets declined. Bangkok (SET) declined by 40 per cent, Bombay (BSE Sensitive) declined by 18 per cent, Hong Kong (Hang Seng) declined by 7 per cent, Jakarta (Composite) declined by 37 per cent, Kuala Lumpur (Composite) declined by 14 per cent, Manila (Composite) declined by 27 per cent, Seoul (Composite) declined by 45 per cent, Taipei (Weighted Price) declined by 40 per cent and Singapore (Straits Times) declined by 18 per cent. Sydney (All Ordinaries) however, recorded a 2 per cent increase.

Major international markets also experienced an overall decline in prices. Tokyo (Nikkei) declined by 24 per cent, while New York (Dow Jones Industrial Average) and London (FT - SE 100) declined by 6 per cent and 7 per cent, respectively.

Developments in the Market

Some significant changes were made by the CSE during the year with regard to the listing rules and internal systems and procedures relating to listing. These came into effect in November 2000. Along with these changes, steps were also taken to reduce significantly the cost of listing. Accordingly, the CSE now has the authority to approve

TABLE 10.22

New Share Issues of Companies During 2000 (a)

Name of Company	Date of Opening List	No. of Shares ('000)	Par Value (Rs)	Premium (Rs)	Value of Shares on Offer (Rs.Mn)	No.of Shares Taken up by Underwriters ('000)	No. of Shares Subscribed for by Public ('000)
Malwatte Plantation Ltd.	04.05.2000	4,000	10	-	40	3,111	889
Asian Aliance Insurance Co. Ltd.	24.11.2000	2,000	10	-	20	1,192	808

(a) Based on the date of issue to the public.

Source : Colombo Stock Exchange

TABLE 10.23

Category-wise Distribution of Shares Traded in the Secondary Share Market in 2000

Category of Investment	No. of Transactions	No. of Shares ('000)	Value (Rs.mn.)
Banks, finance & insurance	44,307	125,467	4,401
Beverages, food & tobacco	9,382	35,963	371
Constructions & engineering	2,025	9,377	120
Chemicals & pharmaceuticals	2,202	2,724	73
Diversified	14,754	40,814	3,258
Footwear & textile	1,310	4,719	8
Hotels & travels	9,285	92,751	598
Investment trusts	378	270	6
Land & property	2,534	7,021	39
Manufacturing	24,078	85,363	1,036
Motors	1,195	1,168	32
Oil palms	7	1	0
Plantations	44,982	36,374	523
Services	994	950	32
Store & supplies	258	396	22
Trading	2,586	5,230	97

Source: Colombo Stock Exchange

listing applications, whereas earlier a dual evaluation process by both the Securities and Exchange Council and the CSE was adopted. This change is expected to expedite the listing process. Also, the merit-based listing rules have been replaced with a disclosure-based approach to evaluating listing applications. According to the new rules, a company may be granted a listing on the CSE by way of an introduction, for which the only requirement is that the company should have a minimum of 100 shareholders. Unlike in the case of an offer for subscription or an offer for sale of shares, there is no requirement of a public issue in the case of this new method of obtaining a listing, which is now available to companies along with the two previous methods of listing. Further, the public holding requirement of 25 per cent for main board companies and 10 per cent for second board companies, in order to qualify for a listing, has also been removed.

In the case of listing debt securities, the requirements of a specified ratio of debt to shareholder funds, and a

TABLE 10.24

Debenture Issues during 2000

Issuer	Date of Issue	Maturity Period	Type of Debenture	No. of Debentures	Price per Debenture	Amount (Rs.mn.)	Interest Rate %	Status of Subscription
1. Eagle Insurance Co. Ltd.	13.03.00	3 yrs	Guaranteed redeemable	3,000,000	10	30	14.5% payable bi-annually	
2. Sri Lanka Telecom	13.03.00	5 yrs	Unsecured redeemable debentures	1,500,000	1,000	1,500	14% p.a. payable quarterly 14.5% p.a. payable annually	Oversubscribed
3. Suntel Limited	30.11.00	5 yrs	Guaranteed redeemable	700,000	1,000	700	W.A. 3 Year T.bond rate+ premium of 80 basis points payable bi annually	Oversubscribed
		6 yrs	Guaranteed redeemable	150,000	1,000	150	W.A. 3 Year T.bond rate+ premium of 105 basis points payable bi annually	Oversubscribed
		7 yrs	Guranteed redeemable	150,000	1,000	150	W.A. 3 Year T.bond rate+ premium of 130 basis points payable bi annually	Oversubscribed
Total				**5,500,000**		**2,530**		

W.A.- Weighted Average.

Source : Colombo Stock Exchange

Chart 10.7
Stock Prices

Chart 10.7.1
Comparison with Major Internation Markets
(99 Dec. = 100)

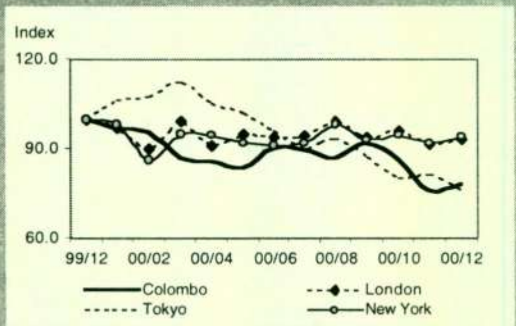
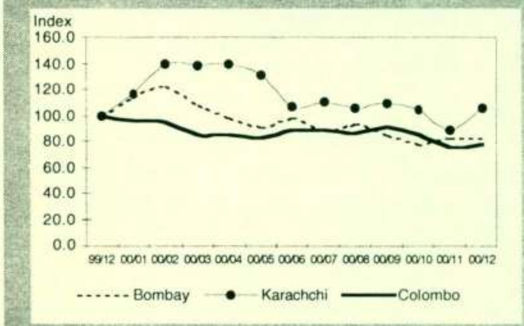


Chart 10.7.2
Comparison with South Asian Markets
(99 Dec. = 100)



specified return on investment of shareholder funds, as well as the requirement of a capital redemption fund, have been removed. Further, a second board has been introduced for listing of debt securities, where companies which have been in business for a minimum of 3 years may apply for a listing of debt. Also, when applying for a listing, companies now need to have their applications sponsored only by a sponsor registered with the CSE, whereas earlier a member firm of the CSE was required to sponsor any application for a listing.

Meanwhile, the government announced a series of fiscal incentives for the development of the capital market in the budget proposals for the year 2000. Among the incentives announced were the full liberalisation of foreign investment in the debt market, permitting up to 100 per cent foreign ownership of licensed stock broking firms, permitting foreign ownership of up to 60 per cent of the issued capital in the case of banks and 90 per cent in the case of insurance companies, and permitting foreign investment in units of equity/growth unit trusts where the relevant trust deeds do not permit more than 20 per cent of the total investment to be in government securities.

Another positive development in the domestic capital market during the year was the issue of ratings by Fitch Ratings Lanka Limited (formerly Duff & Phelps Credit Rating Lanka Ltd.), the first credit rating agency in Sri Lanka, which was established in 1999. Two ratings given during the year were made public; namely, the rating of SL AA+ given for the Rs. 1.5 billion debenture issue of Sri Lanka Telecom and the rating of SL AAA given to John Keells Holdings Ltd., which was a corporate rating. Up to now, only local ratings have been given by this agency.

Medium and Long-term Government Securities

Treasury Bonds

During 2000, Treasury bonds continued to be a major medium-term debt instrument used by the government. These bonds provide the private sector with medium-term bench mark interest rates and a risk free yield beyond one year. Treasury bonds were issued with a maturity period of 2-6 years, while the 2-year callable bonds were issued for the first time in November 2000. By introducing this new debt instrument, the government had the option to redeem them after the first year of issue, on a date prior to maturity. This provides the government an opportunity to benefit from future declines in interest rates.

The 'Jumbo' issues, which were introduced in 1998, continued in 2000. The purpose of these issues was a to build up a large securities reserve, create a highly liquid

TABLE 10.25
Treasury Bond Issues during 2000

Maturity Period	Coupon Rate (% per year)	Weighted Average Yield to Maturity	Outstanding Amount at end Year (Rs. Million)
2 Year (a)	10.75	12.00-22.19	69,421
3 Year	11.00	12.02-18.71	63,849
4 Year	11.25	12.17-13.05	34,804
5 Year	11.50	12.46-13.02	20,550
6 Year	11.75	12.53-13.21	15,500
Total			204,124

Source: Central Bank of Sri Lanka

(a) Includes three callable bond auctions held in November and December 2000.

secondary market and lower government borrowing cost. Under this system, there were 34 series of bonds with 14 series for 2-year bonds, 9 series for 3-year bonds, 3 series for 4-year bonds, and 4 series each for 5-year bonds and 6-year bonds. Despite the shortfall in liquidity during the year, all auctions except three, were over-subscribed, as investors were attracted by high interest rates. In spite of over-subscription, all bids were rejected at a callable auction held on 07 December 2000, owing to bid rates being unacceptably high. Consequent on the high liquidity in the market and the continuing decline in inflation, the Central Bank decided to lower the coupon rates for Treasury bonds by 25 basis points effective from 03 January 2000, with the coupon rates on all maturities being in the range of 10.75-11.75 per cent. Treasury bonds with maturities of 2-6 years were issued in the first half of 2000, only 2 and 3 year Treasury bonds were issued in second half of 2000. Mixed movements were seen in yields on Treasury bonds in the first half of 2000, but yields on bonds rose in the second half, in line with the short and long-term rates in the financial system. The weighted average yields for 2-year (including the call option of Treasury bonds), 3-year, 4-year, 5-year and 6-year Treasury bonds varied within a range of 12.00-22.19 per cent, 12.02-18.71 per cent, 12.17-13.05 per cent, 12.46-13.02 per cent and 12.53-13.21 per cent, respectively during the year.

The total gross value of Treasury bonds issued under different series stood at Rs.125,322 million in 2000, compared to Rs.63,452 million in 1999. Reflecting the popularity of Treasury bonds as a medium-term investment instrument, new Treasury bonds issued during 2000 amounted to Rs.99,257 million as against Rs.55,952 million in 1999. Accordingly, the total value of outstanding Treasury bonds stood at Rs.204,124 million at end 2000, compared to Rs.104,867 million as at end 1999.

Special issues amounting to Rs.35,500 million were made to the two state commercial banks and institutional investors during the year. This included the special issues of Treasury bonds amounting to Rs.24 billion in May and June 2000, to the two state banks by the Treasury in order to set off some of the liabilities of the government to those banks.

Rupee Loans

The Rupee Loan Programme (RLP) continued to be an important source for medium and long-term government borrowings. Under this scheme, there were 15 rupee securities floated during the year with the total subscriptions for these loans amounting to Rs.42,211 million in comparison to Rs.22,985 million in 1999. Rupee loans are sold at par and carry a fixed rate of interest. The rate is administratively determined, based on market trends in interest rates. These loans were floated with tenors of 1-year, 5-6 years and 8-10 years and carried interest rates of 11.90 per cent, 11.00 per cent and 12.00 per cent, respectively. In 2000, EPF and NSB continued to be the major subscribers to the RLP, accounting for 97.6 per cent of total subscriptions.

TABLE 10.26
Rupee Loans Floated during 2000

Maturities (Years)	Volume (Rs. Million)	Interest Rates (% p.a.)
1	8,000	11.90
5-6	11,000	11.00
8-10	23,211	12.00
Total	42,211	11.00-12.00

Source: Central Bank of Sri Lanka

During the year, total rupee loans amounting to Rs. 40,378 million were repaid at maturity, resulting in an increase in the outstanding rupee loan level from Rs. 262,056 million at end 1999 to Rs. 263,889 million at end 2000.

Unit Trusts

The total number of Unit Trusts (UTs) remained unchanged at 12 at end December 2000. These included three growth funds, four balance funds, four income funds and one index fund. A downturn was observed in the performance of the industry. For the industry as a whole, the combined Net Asset Value (NAV) dropped by 18 per cent in 2000, in comparison to a decline of 1 per cent recorded in 1999. A slight drop was recorded in the number of unit holders, as well as in the number of units in issue.

The downturn in Unit Trusts may be attributed particularly to the setback in the stock market, since a large portion of the investment portfolios of these funds are in equities. In terms of the performance of the different types of funds, the combined NAV of growth funds and balance funds dropped by around 20 per cent each in 2000, in comparison to a 4 per cent drop recorded in 1999. About 73 per cent and 61 per cent of the total investment

TABLE 10.27
Unit Trust (a)

	1996	1997	1998	1999	2000(b)
1.Total assets (Rs. mn.)	2,652	3,097	2,687	2,649	2,173
2.Net assets value (Rs. mn.)	2,637	3,072	2,675	2,639	2,162
3.Investments in equities (Rs. mn.)	1,599	2,244	1,773	1,680	1,109
4.(3) as a ratio of (2)	61	73	66	64	51
5.Total no of unit holders	25,240	26,441	27,709	27,536	26,863
6.No. of units in issue (mn.)	-	380	395	393	387
7.No. of unit trusts	5	10	10	12	12

Source: Unit Trusts

(a)At end December
(b)Provisional

portfolios in these funds, respectively, were in shares. The combined NAV of income funds also declined by 3 per cent at end December, 2000, in contrast to a 20 per cent increase in 1999. This may be attributed to the redemption of Treasury bills in some income funds during 2000. Out of the total investments of income funds, 47 per cent were invested in government paper while 53 per cent were invested in other income yielding instruments, such as repurchase agreements, debentures, commercial paper and asset backed notes, in 2000.

In response to volatility in the market, fund managers of growth funds as well as balance funds took steps to diversify their investment portfolios in order to improve the performances of these funds, minimising possible losses to unit holders. Accordingly, in growth funds, the equity exposure, which was around 83 per cent of total investments in 1999, was reduced to around 73 per cent at end December 2000. Similarly, in balance funds, the equity exposure, which was around 69 per cent of total investments in 1999, has been contained to around 61 per cent in 2000. Correspondingly, investment in instruments such as government paper and other market instruments, was raised by around 10 per cent during 2000.