



# Gradient Alliance

Monthly Bulletin: February 2016

## In Economic news:



- World Bank highlights SL's progress and key challenges that need to be addressed."
- ADB "reorients", with SL to receive USD 2bn in new funds.
- French oil giant Total to explore oil in the East.
- Sampur coal power plant receives environmental approval.
- ETCA under pressure due to it's lack of transparency.
- Private sector credit in record growth in 2015.
- Deflation returns in January 2016.
- Rupee in February at 142.56/146.58 vs. USD (-0.35% MoM).
- Stock market closes at 6,191.81 in February (-2.3% MoM).

## In Business news:

- Tourist arrivals reach 194,280, +24.4% YoY; CAL says unregulated abodes and luxury apartments impact star class accommodation.
- Vehicle regs. falls 34.5% YoY in January 2016 as 70% LTV and high taxes kick in.
- Dialog and Airtel to merge?.
- LMD-Nielsen business sentiment index falls to 151 (-6 pts MoM).

## In Consumer news:

- Nielsen consumer confidence index falls further to 70 (-5 pts MoM).
- Imported rice prices up.
- MA'S Curry Paste and Seasoning range in new packaging.



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## In Economic news:

**World Bank highlights SL's progress and key challenges that need to be addressed.** The World Bank identified several country positives but also noted a series of issues. It notes;

- Annual growth has averaged over 6% in the past decade and poverty declined from 22.7% in 2002 to 6.1% in 2012/13.
- SL performed very well on the Millennium Development Goals and has ended its internal armed conflict.
- Ample opportunities to build on its success due to its enviable location for trade, relatively educated work force and remarkable natural assets. Challenges to be addressed;
- Has one of the lowest tax-to-GDP ratios in the world, with a tax and customs systems characterised by a large number of exemptions and weak administration.
- Para-tariffs has made the present import regime one of the most complex and protectionist in the world.
- FDIs (remains below 2% of GDP), far lower than the levels of FDI in other middle-income countries, particularly in Southeast Asia.

**French oil giant Total to explore oil in the East.** SL signed a Joint Study Agreement (JSA) with Total, a French Petroleum company, to study oil prospects in the East coast of the country.

Dailyft.lk summarised the key benefits from JSA:

- "Acquisition of several million dollars' worth of seismic and other data in areas that currently have none, allowing Government to assess future production potential at no cost.
- Exposure of Sri Lankan technical and academic staff to modern data



- Suffers from a skills mismatch, a result of the education system not equipping people with the abilities that businesses want.
- Despite significant economic gains over the past few years, 40%



of the population lives on less than Rs. 225 a day with growing inequality and higher numbers of poor living in urban areas.

- Ineffective governance critically impedes the SL's ability to mobilise revenues and spend effectively. Additional issue is the 50% increase in the size of the public sector in the last decade and large state presence in key economic sectors, including banking.
- Needs a framework for reconciliation to address grievances which fueled past conflict, for institutional reforms, and manage issues of an aging popn. as it moves past its demographic peak.

acquisition and interpretation methods.

- Receiving a ground rental of USD 1 per Sqkm for the entire acreage of the JSA valued at approximately Rs. 7m per annum.
- Procuring of goods and services for associated activities locally, where available and when reasonable so to do."

The government is also to call for tenders to carry out further development of gas deposits identified in the Mannar basin (Northwest of the country).

According to Dr. B.M.S Batagoda, Secretary, Power and Energy Ministry "There is some gas discovered by Cairn. They discontinued the exploration, but that asset belongs to us now.

We are looking for potential investor to develop that now. This is not for exploration, but to develop whatever discovered".



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## In Economic news:



**ADB “reorients” with Sri Lanka to receive about USD 2bn in new funds.** The Asian Development Bank (ADB) is to significantly increase its lending to Sri Lanka to the tune of USD 2bn over 2016-18 (vs. USD 1.5bn in 2012-15).

Perhaps an indication of the need to be more engaged given the anticipated entry of the newly incorporated China led Asia Infrastructure Investment Bank (AIIB) in which Sri Lanka is a member, ADB decidedly expanded its SL portfolio.

According to Mr. Takehiko Nakao, President, ADB;

- “ADB is re-orienting its operations to meet the evolving needs of Sri Lanka as it moves to become an upper middle income country in the next few years. We have decided to increase annual lending in 2016 to USD 700m.
- In addition to infrastructure, human resource development would remain a key focus for the bank.

According to Tadateru Hayashi, Senior Country Economist, ADB,

- “As Sri Lanka continues its economic growth ADB will look to introduce new products and services.
- Tourism, logistics, renewable energy and human capital development are some of the areas that we are looking at. Since

the internal road network is almost completed, the ADB will look into partnership opportunities in expressways and railway under the new Country Partnership Strategy;”

As of July 2015, ADB approved a total of 194 loans, both sovereign and non sovereign, to Sri Lanka with cumulative lending of USD 7bn.

ADB further notes • “If Sri Lanka is not able to adequately develop the expertise and innovation of its people and industries it could be stuck in what economists call the “middle income trap” where the country breaks out of poverty but cannot move to the next level of prosperity.

- For Sri Lanka to achieve a higher- income status the country needs to invest heavily in physical and financial infrastructure as well as in skills and education.
- An additional challenge is that Sri Lanka is vulnerable to extreme weather events such as floods and droughts. Climate change worsens the impact of these events. To address these challenges the government pursuing policies that support disaster risk management, climate change and adaptation.”



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## In Economic news:

**Sampur coal power plant finally receives environmental approval.** According to Mr. Ranjith Siyambalapitiya, Minister of Power and Energy, the Sampur coal power plant has received environmental approval enabling its construction to start soon.

The first and second phases are to commence in the next few months. The project will be built on 500 acres of land in the Sampur area at an estimated cost of USD 600m.

The much delayed plant is funded by the Indian government, with the MoU for the first 500 MW phase signed as back as December 2006, between the Ceylon Electricity Board and India's National Thermal Power Corporation.

The power station is expected to come online in late 2017.

**ETCA under pressure due to its' lack of transparency.** The much in the news Indo-Lanka Economic and Technology Cooperation Agreement (ETCA) continued to raise eyebrows with several professionals concerned over its' lack of transparency and the non involvement of those in the industry in its formulation.

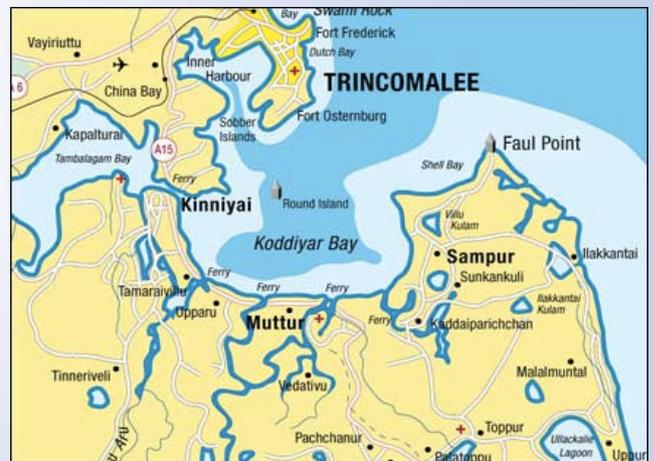
It was reported that the government met with major IT sector players including SLASSCOM and Sri Lanka Computer Society to identify issues, however its' outcome were not revealed.

According to Mr. Indika Gamage, President of Sri Lanka Information Technology Professionals Association "Sri Lanka should have a national policy when dealing with such important agreements. No official draft has been released so far. Though this is a blind act, major IT firms are still silent on this issue."

However according to the government, there is no threat to IT professionals in ETCA as the mode 4 services of the GAAT convention has not being included in the proposed agreement.

Mode 4 services relates to movement of natural persons where a professional in one country can render his services by physically moving into another country without facing barriers.

The govt. says ETCA will help regularise the sector especially Business Processing Management (BPM) sub sector.



The Information Technology Professional's Association notes there are over 80,000 IT professionals, the largest profession in the services sector contributing over 30% of services GDP.

However according to 2013 National ICT Workforce Survey SL has an over supply of ICT graduates. Mr Gamage further notes "Sri Lankan IT professionals have a good international reputation and we are competing at the top level with other developed countries in this sector. But this [ETCA] may be the end of it,"

Mr. Ranil Wickramasinghe, Prime Minister assured that the ETCA will not lead to Sri Lankans losing jobs. He noted

"We still haven't seen India's version. We have to put the 2 proposals together before we can come to an agreement. We will not allow foreigners to be given jobs at the expense of SL nationals."

ETCA will seek to boost cooperation in technical areas, scientific expertise and research amongst institutions, boost standards of goods and services able to compete on the global market and improve opportunities for manpower training and human resource development. Without an improvement in training we may experience shortages in the future."



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## In Economic news:

**Sri Lanka hikes interest rates.** The Central Bank of Sri Lanka (CBSL) increased interest rates by 50 basis points surprising many in the market. CBSL cited risks to the macroeconomy from excessive money supply growth and a continued trend in inflation as reasons for the sudden hike. According to CBSL

- “In spite of the recent policy measures taken by the Central Bank and some upward adjustments observed in market interest rates, certain risks to macroeconomic stability continue.
- “In particular, the Monetary Board was of the view that the excessive growth of broad money fuelled by domestic credit expansion in the midst of continued upward trend in underlying inflation requires pre-emptive policy measures in order to contain further build-up of demand driven inflationary pressures.”

The Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) now stands at 6.50% and 8.00%. Credit to the private in 2015 grew 25.1% YoY reaching a record Rs.3.5 trillion.



**CSE calls for CCP partners.** The Colombo Stock Exchange (CSE) called for Request for Information (RFIs) inviting potential suppliers for the Central Counter Party (CCP) system.

The system is likely to implemented in 2017. The CSE said establishing a CCP is a key development in the SL capital market, and is focused on improving market integration and addressing key risk elements.

Central counterparties are the globally accepted mechanism for minimizing settlement risk and utilize a Delivery Vs Payment settlement environment where securities and funds are exchanged simultaneously.

CSE is also in the process of implementing a Risk-based Capital Adequacy Requirement to all stockbroker Firms who are Members/ Trading Members of the CSE and licensed by the Securities and Exchange Commission of Sri Lanka (SEC).

The Risk-based Capital Adequacy Requirement would replace the minimum Net Capital requirement of Rs. 35 million, which is currently applicable to Stockbroker Firms.





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## In Economic news:

**Colombo best place to live in South Asia.** Colombo was ranked 132nd out of 230 cities in Mercer's Quality of Living Index, the best in South Asia, improving two places from 2015.

Colombo ranks higher than other South Asian cities, including Hyderabad (ranking at 139; the best performing Indian city), Bangalore (145), Chennai (150), Mumbai (152), New Delhi (161), Islamabad (193), Lahore (199), Karachi (202) and Dhaka (214).

The Quality of Living Index is based on 39 factors, grouped into 10 categories, that help assess living conditions. This includes the political and social environment, economic environment, socio-cultural environment, medical and health considerations, schools and education, public services and transportation, recreation, consumer goods, housing and natural environment.

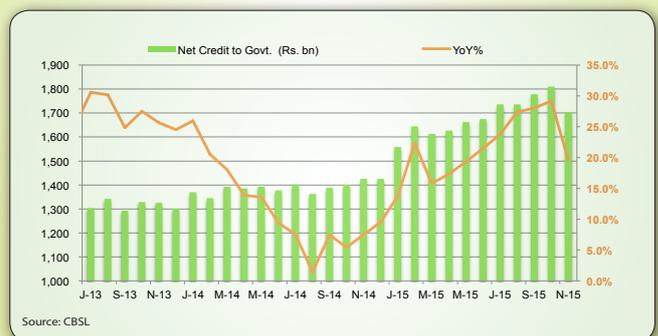
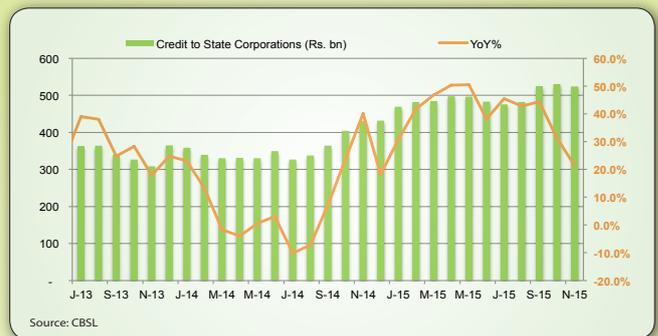
Vienna retained the top spot followed by Zurich (2), Auckland (3), Munich (4) and Vancouver (5).



## Private sector credit in record growth in 2015.

Credit to private businesses and personal customers grew 25.1% YoY to Rs.3,449.4bn in 2015.

As at November 2015 (latest information), credit to state corporations increased 21.4% YoY to Rs.524.0bn and net credit to the government rose 19.6% YoY to Rs.1,704.8bn.



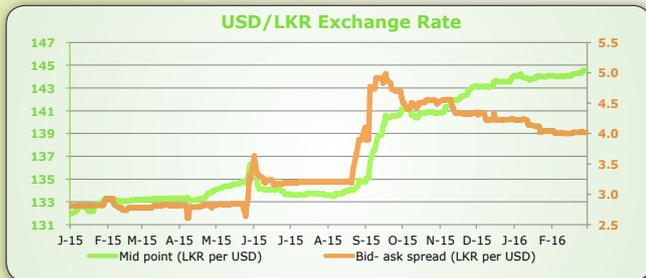


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## In Economic news:

Rupee in February 2016 at 142.56/146.58 vs. USD (Rupee weaker 0.35% MoM).

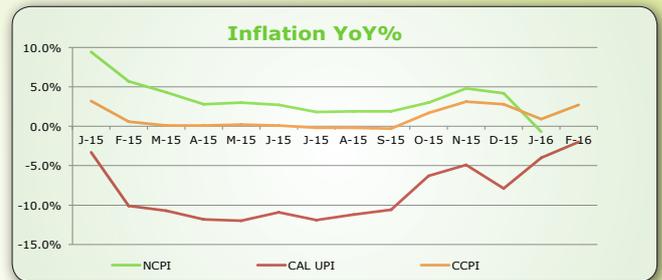


Source: CBSL

**Deflation returns in January 2016.** Segments of the National Consumer Price Index (NCPI) decreased to negative 0.7% in January 2016. Annual average NCPI inflation decreased to 2.9% in January 2016 from 3.8% in December 2015.

Prices of vegetables, green chilies, limes, big onions, potatoes and coconuts decreased. Meanwhile, prices of fresh fish, dried fish, some varieties of fruits and eggs increased.

Prices in Alcoholic Beverages, Tobacco and Narcotics; and Clothing and Footwear sub-categories also increased. Prices in Transport sub-category decreased.



Source: CBSL



Source: CSE

**Stock market closes at 6,191.81, down 2.3% MoM.** Baring (-0.7% MoM) all other sectors recorded negative growth during the month. Worst performing sectors in the month were investment trusts (-13.5% MoM), construction & engineering (-8.8% MoM) and telecommunications (-6.7% MoM).

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## In Business news:



- Middle East arrivals increased 14.7% YoY to 10,109.

## In tourism news:

- Capital Alliance Partners says the glut in luxury apartments and the unregulated hospitality sector could cost the regulated hotels by as much as USD 480m, as the apartment units could be rented out at a fraction of the cost charged by the graded hotels.

It observes Sri Lanka's star -graded city hotels fetch rates 15% higher than the regional peers which

**Tourist arrivals up 24.4% YoY in Jan 2016.** Tourist arrivals in Jan 2016 was 194,280 up 24.4% YoY. According to Sri Lanka Tourism Development Authority,

- Indian arrivals were 28,895 (+25.9% YoY)..
- Western Europe: U.K: 16,253 (+21.2% YoY), Germany: 12,760 (+23.0% YoY) and France: 9,878 (+8.6% YoY).
- China and Hong Kong 26,083 (+122.3% YoY).
- Russian arrivals decreased 9.5% YoY to 8,358 while North America traffic was 9,160 (+17.3% YoY).

have caused a shift towards unregulated segments.

In 2014 the unregulated market has accounted for 36% of room nights which has cost the regulated sector by as much as USD 97m. CAL Research expects 3,000 new luxury units to hit the Colombo city market by 2018."

- Nepalese billionaire Binod Chaudhary is expanding his hotels and resorts footprint in Sri Lanka in partnership with Galle Face Hotels Group, Jetwing and Watawala Plantations. In the first two years about 127 rooms will be revamped and branded under Zinc.

- The Sri Lanka Tourism Development Authority endorsed the minimum room rate. According to General Malraj B. Kiriella, Director General SLTDA

"There are 2 thoughts in the system of minimum rates. Minimum rates benefit the whole hotel industry. Especially in the scenario of protecting lower category star hotels to get a better rate.

In contrast, minimum rates are not a key factor to reduce the occupancy rate in Colombo hotels and it adds value to the yield in order to assure the benefits of hotel industry employees.

The potential investor assures the sustainability of the return due to the minimum rate."





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## In Business news:

**Vehicle registrations falls 34.5% YoY in Jan 2016.** According to JB Securities total vehicle registrations fell 31,854, -34.5% YoY, impacted by the full effects of the 70% LTV



rule and significant increases in tariffs. In January

- Motorcar registrations were 2,888 (-41.5% YoY). SUV and vans also to 559 (-64.9% YoY) and 359 (-54.0% YoY)

“Brand new car regs. were 1,023 units (1,939 units in Jan 2015) with 253 Maruti units. Pre-owned car regs. were 1,865 units (3,072 in Jan 2015) while 52 premium cars were registered (102 in Jan 2015).

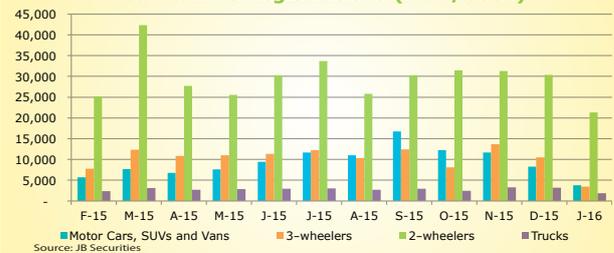
Electric cars regs. were 173 units (15 units in Jan 2015), with 470 Nissan Leafs units..

- 3 wheeler registrations were down to almost a four year low of 3,440 (-58.3% YoY). Three wheeler on road price has increased to LKR 600,000 due to tariffs increasing by LKR 100,000 – this along with the 70% LTV rule has increased the down payment to LKR 180,000 a sum too large for the marginal buyer. Financing share was 86%.

- Motorcycle registrations were 21,287 (-27.0% YoY). All brands suffered from contraction in volumes in comparison to the previous month but Hero volumes halved falling from 7,779 units in Dec 14 to 3,858 units in Jan 2015. Financing share was 57.6% consistent with the previous months.

- Total truck registrations were 1,851 (-21.4% YoY) with mini trucks accounting for 801 and lite trucks recorded at 503.”

Motor Vehicle Registrations (New/Used)



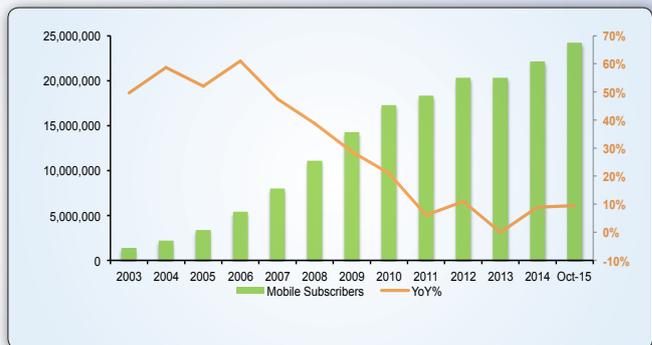
Source: JB Securities

**Dialog and Airtel to merge?.** It was reported that a merger between Dialog and Airtel operations in Sri Lanka is being discussed. Dialog has 10.5m connections (41% share) and Airtel has about 2.3m connections (9% share).

As the merger will give Dialog 50% of the market Competition Commission is likely to scrutinise the deal.

According The Economic Times the recently enacted floor price for mobile tariffs has made Airtel uncompetitive in the local market.

On a separate note, Bharti Airtel and Axiata’s telecom units in Bangladesh merged.



Source: Central Bank of Sri Lanka



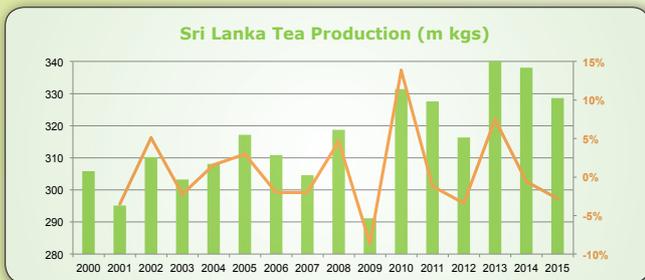
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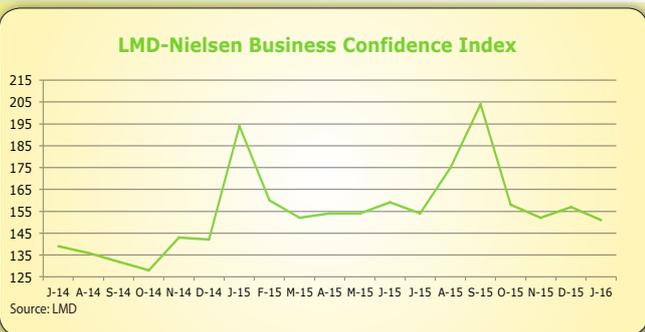
### Tea production in 2015 at a three-year low.

Tea production in 2015 declined to 328.9m kgs, down 2.8% YoY affected by adverse weather conditions and trade union action curtailing smooth production.



Source: Sri Lanka Tea Board

According to Asia Siyaka Commodities, Sri Lanka would need exceptional growing conditions and a revival in the market at least through a depreciation of the rupee, if the 2016 annual production figure of over 330m kgs is to be met. It noted



### LMD-Nielsen business confidence index falls to 151 in January 2016 (-6 bps MoM).

As per Mr. Shaheen Cader, Managing Director, Nielsen, "the decline is despite past revenue being good. Businesses are concerned mainly about an economic slowdown, the depreciation of the rupee (pushing up prices) as well as an increase in negative sentiment about business performance in the next few months."

**THE ECONOMY** - Less than half (versus 51%, in December) are confident that the economy will pick up in the coming 12 months, whilst 36% expect conditions to remain as is and 20%



• A key factor would be the dry conditions projected for 1Q 2016 and this could play a significant part in 2Q as well.

• Reduced fertiliser subsidy and banning of cost-effective weedicide would place both estate and smallholders under pressure, considering the added restriction of lower prices.

• Continuing uncertainty over wage negotiations could also trigger disruption of work in estates, any negotiated wage increase would further pressurize the plantation companies.

anticipate a worsening economic climate. Respondent comment: "the Govt's economic policies are likely to take effect gradually, and it is likely to be favourable to business."

Respondent comment: "There is a lack of stability in the economy, at the moment. Because the tax structure has changed, some industries have thrived while others have been badly affected."

**BIZ PROSPECTS** - 52% point to improved business in the next 12 months, although the level of optimism has diminished compared to the prior month's responses. Almost 33% say the status quo is likely to be maintained.

**INVESTMENT** - Over 25% views the current investment climate in a positive light, whilst an almost equal number hold a negative view and the majority (49%) can't quite make up their minds.

Respondent comment: "the investment climate in the country looks positive, because of budget plans and proceedings with regard to investment.. "We've got many opportunities to expand in investments. However, at the moment, there is no push from the govt. to improve the investment climate in the country," says a corporate executive.



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## In Consumer news:

**Imported rice prices up.** The government decided to increase the import duty on rice from Rs. 35 to Rs. 50 per kg effective from February 01, 2016.

Finance Minister Mr. Ravi Karunanayake's proposal to submit the relevant Gazette Notification under the "Revenue Protection Act" to the parliament for approval, was approved by the cabinet.

It noted that this decision has been taken with the view of protecting local farmers, who cultivate paddy and are assured a reasonable market price for paddy harvested in the coming Maha season 2015/2016.



**MA'S Curry Paste and Seasoning range in new packaging.** MA's Tropical Food Processing relaunched its MA's Kitchen signature Curry Paste range in a new pack and fresh logo. MA'S also revised some of its recipes to reduce kitchen time providing families a convenient way to prepare their meals safely and without compromising on taste.

According to Mr. Mario De Alwis, Managing Director, Ma's Food Processing "We have worked to produce the perfect taste and convenience combinations which are the ideal solution to the busy people who want to prepare quick but wholesome meals".

## Nielsen consumer confidence declines to 70 in January 2016 (-5 bps).

Consumer confidence continues to decline sharply – for the third month in a row, in fact – as consumers seemingly become increasingly concerned about job prospects. That said, consumer sentiment on purchasing power has largely remained unchanged.

Accordingly, the Nielsen Consumer Confidence Index (CCI) dropped by five basis points, to 70, in January. Less than a quarter of CCI respondents state that job prospects for Sri Lankans will be positive in the next 12 months. In terms of their personal finances as well, the majority (78%) of those surveyed are of the view that conditions are likely to deteriorate in the 12 months ahead.

Meanwhile, at least one-in-five poll participants feel that the next 12 months will be 'good' for people to purchase essential items – this marks a slight improvement from 16 percent of consumers saying the same in the previous month.

**Q: What do you think the job prospects for Sri Lankans will be in the next 12 months?**

	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN
Excellent	2	3	2	5	8	3	6	3	4	4	1	2
Good	42	27	33	22	19	21	54	51	33	31	33	22
Not so good	47	52	53	52	49	60	31	41	46	49	48	57
Bad	9	18	12	21	24	16	9	5	17	16	18	19
Base	100	100	100	100	100	100	100	100	100	100	100	100

**Q: What do you think your state of personal finances will be in the next 12 months?**

	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN
Excellent	2	1	3	5	3	1	2	0	2	3	0	0
Good	41	23	31	25	18	28	38	29	27	20	24	22
Not so good	43	58	50	58	66	53	44	62	50	59	47	57
Bad	14	18	16	12	13	18	16	9	21	18	29	21
Base	100	100	100	100	100	100	100	100	100	100	100	100

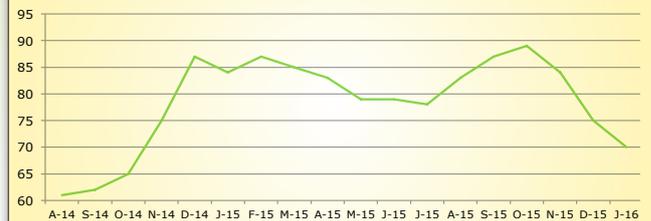
**Q: How do you think the next 12 months will be for people to buy the things they need?**

	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN
Excellent	4	1	3	4	5	3	4	3	5	4	1	0
Good	45	25	30	30	29	35	41	42	41	19	15	20
Not so good	43	61	56	49	52	43	46	46	44	64	50	52
Bad	8	13	11	17	14	19	9	9	10	13	34	28
Base	100	100	100	100	100	100	100	100	100	100	100	100



Less than a quarter of respondents state that job prospects for Sri Lankans will be positive in the next 12 months...

Nielsen Consumer Confidence Index



Source: LMD

# Gradient Alliance

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