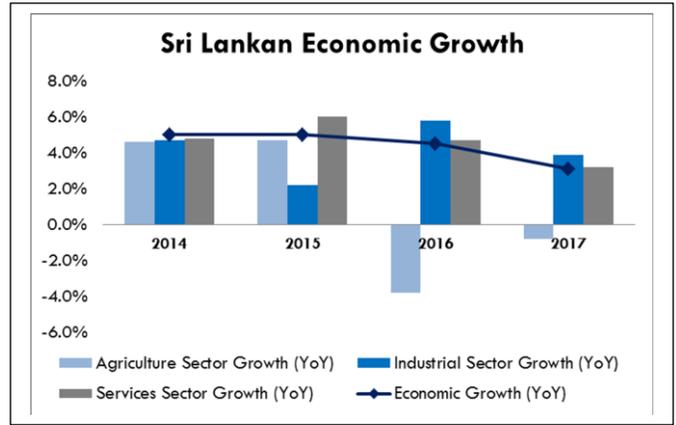


Country Report

Sri Lankan Economy during 2017

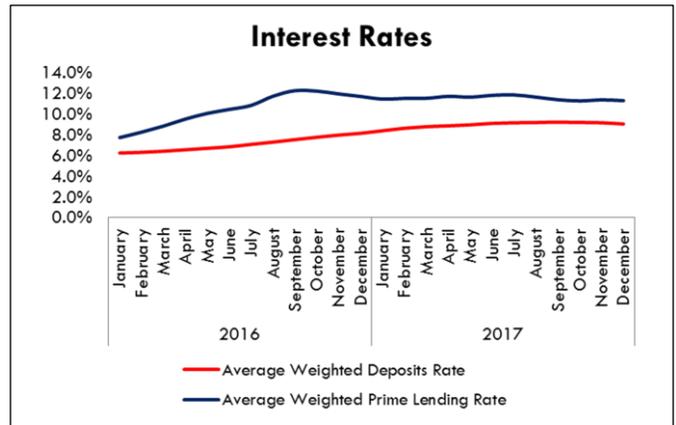
Economic growth has moderated to 3.1% during 2017 amidst contraction in agriculture sector for the second consecutive year. Country's agriculture sector was impacted badly over last two year period due to unfavorable weather conditions (severe droughts as well as heavy rainfalls). Industrial and services sectors too recorded a relatively moderate growth due to the slowdown in construction, Real estate and transportation sectors. Further, tight monetary policy and fiscal policy stance prevailed during the year also resulted in a slowdown of economic activities due to contraction in public and private investment spending.



Source: Department of Census & Statistics

Following numerous tightening monetary policy measures during 2016 amidst higher private sector credit growth, the country's interest rate regime was fairly stable during 2017. External position was also strengthened during the year with a foreign reserve buffer of USD 8Bn compared to USD 6Bn levels during 2016. Inflation too demonstrated a downward trend during the latter part of 2017 amidst moderate food inflation.

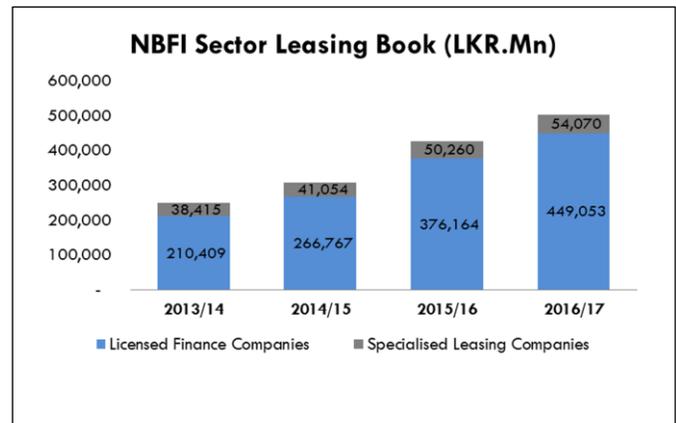
However, financial institutions experienced a margin pressure during the year due to the increase of deposit rates at a faster pace than lending rates. Further, asset quality was also under pressure due to the increased agricultural based non-performing loans.



Source: CBSL

Market Structure

The leasing industry, which commenced in 1984 with only three companies, has grown significantly over the years to have about 67 financial institutions actively involved in leasing. Among them are 44 Licensed Finance companies (LFCs), 12 Licensed Commercial Banks (LCBs), 6 Specialised Leasing Companies (SLCs) and 5 Licensed Specialised Banks (LSBs). The significant number of new entrants has created intense price competition in the industry. This has resulted in a drastic reduction in margins and also market shares. Top 3 leasing establishments who accounted for nearly 41% of the Non- Bank Financial Institutions (NBFI) sector leases a 3 year ago now account for around 37% of the sector leases. Commercial banks and specialized banks have been able to increase their market shares at the expense of leasing companies and finance houses.



Source: CBSL

Performance

Country's leasing industry is mainly centered on vehicle leasing over equipment leasing due to the absence of established second hand market and difficulties in recovery of leased assets in the event of default.

NBFI sector leasing book valued LKR 503.1Bn (USD 3.3Bn) as at 31st March 2017. Sector leasing book growth was moderated to 18% during 2016/17 compared to 39% growth during previous year. This was mainly due to the introduction of LTV (Loan to Value) ratio for vehicle leasing by Central Bank of Sri Lanka (CBSL) coupled with the tight monetary policy stance prevailed during the year. Furthermore, currently the industry participants have been taking proactive measures on asset quality management due to increased cases on non performing leases.

Regulatory Requirement

Leasing in Sri Lanka is governed by the Finance Leasing Act No 56 of 2000. Under this Act, all companies, which wish to engage in leasing, should be registered with the CBSL. Presently, there are 67 institutions registered and licensed to conduct leasing business in the country.

In order to strengthen the sector stability, during the period under review the CBSL has issued directives on minimum core capital requirement for LFCs. Accordingly LFCs has to maintain minimum unimpaired capital of LKR 400Mn until 31st December 2017 and LKR 1Bn as at 1st January 2018. There after the capital requirement will be increased by LKR 0.5Mn annually to reach LKR 2.5Bn by 1st January 2021. Furthermore, the regulator has the intention to introduce the Basel 3 based capital management framework for the NBFI sector; this will include the maintaining of capital requirements for operational risks as well.

A notable development within the sector was the introduction of LTV ratio of 70% for vehicle leasing during latter part of 2015 due to the Country's BOP crisis prevailed during that period. This was further tightened during 2017 with the implementation of multiple LTV limits based on Vehicle Category. As a result there has been a considerable shift in demand for registered vehicles over unregistered vehicles.

Future prospect

Country's leasing industry has been remained under pressure during recent past largely owing to macro prudential initiatives to restore the country's stability. Moreover, factors such as volatile interest rate and exchange rate regimes coupled with higher vehicle import taxes also adversely impacted for sector growth.

Further, the financial services sector is burdened with higher taxes and levies imposed on them and with the increase of VAT (Value Added Tax) and NBT (Nation Building Tax) on the financial services sector it is likely to reduce the internal capital formulation of these companies.

However, the country's economic growth is projected to rise to 4.4% in 2018 and reach 5% over medium term horizon. Inflation too is projected to revert to around 5% by end-2018, as food prices stabilize. These developments will provide some positive impetus for country's business sentiment and overall sector growth.