

# BANKING & FINANCE

## NEWS

# Commercial banks' profits slump

by Devika Karunaratne

**"It is damaging the profits of commercial banks and signalling the business community that the government is changing its development strategy"**



THE commercial banking sector recorded profits for the first half of this year. The half-yearly growth in earnings for commercial banks listed in the Colombo Stock Exchange indicates a slump except for Hutton National Bank. The half-yearly growth in earnings are: 6% for Commercial Bank, 20% for Sampath Bank, 43% for Seylan and 9% for Hutton National Bank. This is against a growth in earnings of 16.7% for Commercial Bank, 5.8% for Hutton National Bank, Sampath Bank 25.4% and -23.4% for Seylan Bank for the first quarter.

The reason given by the banking community for the drop in profits of commercial banks is the low interest rates. With the easing of the monetary policy by reducing the statutory reserve ratio in January and subsequently in March, the government committed itself to reducing interest rates.

This led the banks to lower both the lending rates and the deposit rates. However, before the reduction in rates most local

banks had mobilised high cost deposits which they will have to service till maturity. The prime lending rate (the rate that banks offer their prime customers) has dropped from about 18% to about 12%.

As a result the interest margin kept by the commercial banks thinned, which adversely affected the profits of the banks.

In this scenario, *The Sunday Leader* spoke to the chairman, Consult (Pvt) Ltd, Howard Nicholas, who said, "At the moment it appears the government has committed itself to low interest rates for long term development. The government has realised high interest rates retard economic growth, therefore has brought the interest rates down. The problem with this change is that it has far-reach-

ing implications. It is not only damaging the profits of commercial banks this year but signalling the business community and everybody else that the government is changing the development strategy. This means they are moving their concentration from the financial services sector to manufacturing and other sectors."

He said, "Upto now, over the last 10 to 12 years, subsequent governments have kept the high interest rates going. For that reason, a profitable business would be in the financial services sector. Also, any remunerative employment would be in the financial services sector. Now, the government has changed all that. It is a kind of a restructuring of the

entire economy. Banks will go bankrupt as there is no business for all of them to survive and the profit margins are also low.

"At Sri Lanka's level of development, it is essential manufacturing be the base to develop on. That is what the government is trying to do by bringing down interest rates.

Initially, what worried the authorities is the slump in credit growth. The downward trend in credit expansion implies that economic activities are going down. In fact, it is not necessarily the case. At the moment not only is credit growth falling but interest rates are, too. The reason is that companies tend to invest out of their retained profits.

"This happens all over the world. Profits move in the opposite direction to interest rates. The reason is that when interest rates are low, the companies keep more of their profits as they do not have to pay banks high interest. When profits increase, they do not have to borrow from banks as they have their own funds to invest in expansion projects or whatever

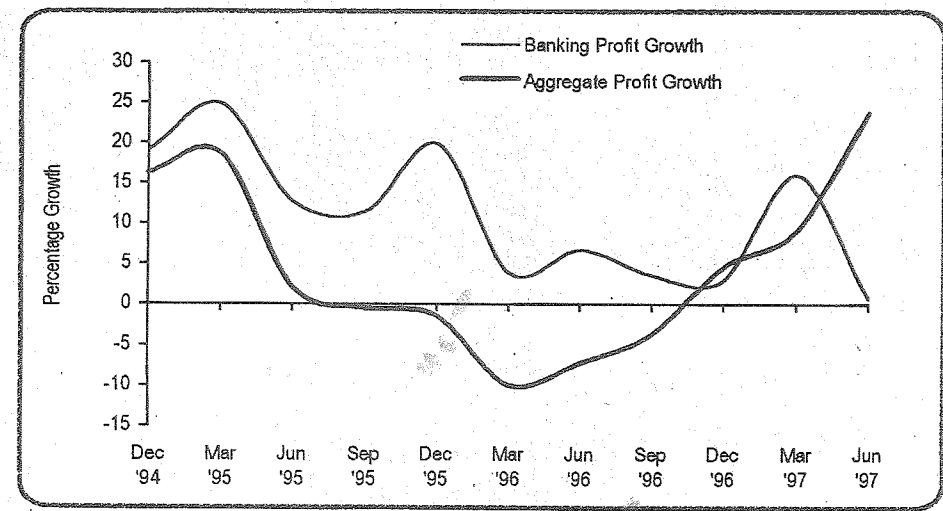
they wish to do. So there is actually no need for worry.

"To a certain extent, the authorities have been positive by reducing the interest rates as it has boosted profits in the companies (not financial service companies). But this positive situation is temporary and does not hold scope for economic growth. Since the economic atmosphere lacks dynamism there is no diversifying of business and expansion programmes.

"Overall development problems appear because they still have the problem of the exchange rate. There are cheaper goods available in the world market. Therefore it becomes hard for Sri Lanka to compete in the world emporium.

The reason for this year's economic growth is that the agriculture sector has fared well. Another area that has picked up is the garment sector but not industry as a whole. Textile and garments after nearly hitting rock bottom rebounded but in other exports, growth is stagnant.

Banking Sector & Aggregate Profit Growth of Top 50 Companies



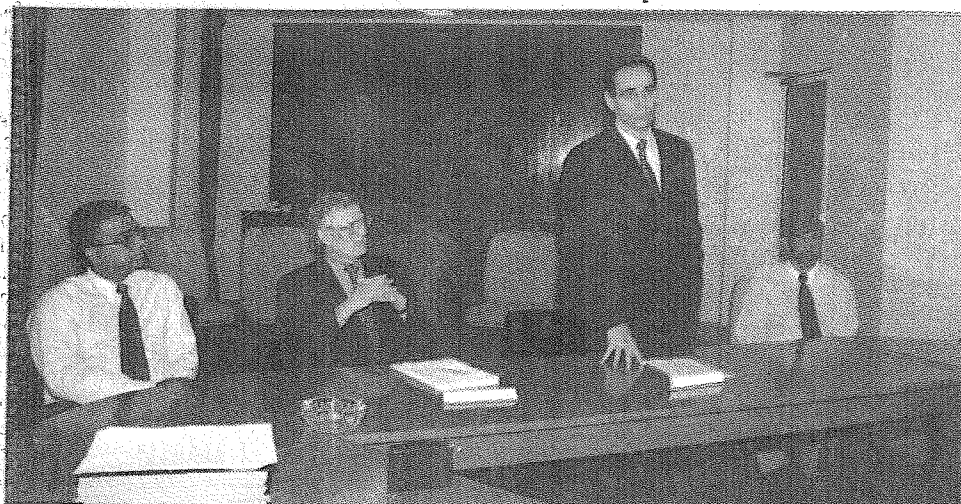
"Even in the textile and garments export sector was over 30% in 1993, fell and struggled back and seemed to rebound but the trend is downwards. There is actually nothing much of activity in the economy, so with such an unhealthy economy there is not much hope for economic recovery. The key

lies in the exchange rate."

Dr. Nicholas added, "An area of concern with most governments is the amount of money in the system. A high amount of money indicates there will be more spending and hence, inflation. The measurement of money in the system is by tracking fixed deposits and

savings, known to economists as M2. So most often governments tend to increase the interest rates to avoid the growth of money. But what they are actually doing is making savings and deposit rates more lucrative, thereby encouraging people to save more and this gives rise to M2."

## ANZ streamlines operations



## Refinery fire raises oil prices

LAST Sunday a fire at the Vizag oil refinery of Hindustan Petroleum Corporation Ltd (HPCL) destroyed storage tanks and the adjacent administrative buildings, making the company decide to stop production as a safety measure. The oil refinery produced 90,000 barrels per day.

The fire and subsequent shutdown of the refinery sent Asian oil product prices jumping, said oil

standards, the impact on Asia's demand and supply of oil products would be limited.

However, a loss of production may be significant to India over the long term as its demand in 2001/2002 is expected to be 115 million tonnes compared to 74 million in 1995/96.

However, Indian Union Minister of State for Petroleum, T.R. Baalu said the refinery would resume

## HNB students' scheme



HNB recently opened a student savings unit at St Thomas College, Mount Lavinia. This is the 24th in a series of such units opened throughout the island. This is a pioneering activity launched by HNB with the primary objective of inculcating the savings habit among children. The bank also plans to establish a long-term relationship with students and to popularise the Singithi Pathum scheme.

The Singithi Pathum scheme has been designed to encourage children to save. A minimum balance of Rs 2,000 in a minor savings account by December 1, would entitle the