Government Securities Secondary Market Development Issues - The Case of Sri Lanka

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Overview

• Development of Government Securities Market in Sri Lanka
• Current Status of Government Securities Market
• Issues and Challenges in Developing Secondary Market
Development of Government Securities Market in Sri Lanka

• Sri Lanka regained its independence in 1948 and the Central Bank was established in 1950. Since then, public debt management has been under the Central Bank as an agency function.

• In 1997, Sri Lanka government introduced Treasury bonds which is a tradable medium to long term debt instrument.

• In 2001, the first dollar denominated debt instrument, Sri Lankan Development Bonds (SLDBs) was introduced to tap excess forex resources in the local market.

• Currently, Treasury bond is the main instrument used for mobilization of funds for government budget. In addition, Treasury bills and SLDBs are also issued under the annual borrowing programme.
Development of Government Securities Market in Sri Lanka / Contd..

• Key policy measures introduced to develop the secondary market operations include followings;
  – In 1981, introduction of secondary market operation for Treasury bills
  – In 1986, the commencement of weekly issues of Treasury bills
  – Introduction of marketable debt instruments such as Treasury-bonds from 1997.
  – Dedicated primary dealer system from 2000.

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• Key policy measures introduced to develop the secondary market operations include followings;

  – Opening of Treasury Bills and Bond Markets for foreign investors was limited since 2006 (5% in 2006 and then 10% in 2007 and 12.5% in 2012 and reduced to 10% in 2015).

  – Extended PD system by allowing banks as PDs.

  – Introduction of Two-way quotes system for all PDs for all outstanding marketable instruments.

  – Development of market based yield curve.

  – Introduction of Bloomberg platform to record all trading above LKR 50 mn in order to improve transparency and price discovering in secondary transactions.

  – Secondary market operations are made free from taxes to encourage tradings in the secondary market.
Current Status of Government Securities Market in Sri Lanka

• As at end 2016, SL GDP: USD 82bn

• Total Government Debt: 80% of GDP
  – Domestic Debt: 45.1% of GDP
  – Foreign Debt: 34.2% of GDP
Current Status of Government Securities Market in Sri Lanka

Domestic Debt by Instruments

- High concentration towards market-based instruments.
- More rely on T Bond: Medium to Long-term instruments to lower the rollover risk.
Domestic Debt by Ownership

2010
- Provident and Pension Funds: 41%
- Commercial Banks: 24%
- Private Business and Individuals: 20%
- Insurance Funds: 1%
- Savings Institutions: 11%
- Central Bank: 3%
- Other: 0%

US$ 22.69Bn

2016
- Provident and Pension Funds: 39%
- Commercial Banks: 32%
- Private Business and Individuals: 12%
- Savings Institutions: 8%
- Central Bank: 8%
- Insurances Funds: 1%
- Other: 0%

US$ 36.69Bn

Provident funds, saving institutions, commercial banks, insurance companies and private corporates are major investors
Current Status of Government Securities Market in Sri Lanka

Marketable Debt Instruments by Ownership-2016

- Long-term funds such as super annuation funds, insurance companies, banks and saving institutions are key investors in Government Securities Market.

US$ 27.21Bn

**T-Bonds**
- Commercial Banks: 19%
- EPF and Other Provident Funds: 45%
- Savings Institutions: 10%
- Insurance and Finance Companies: 2%
- Foreign Investors: 6%
- Private and Other: 11%
- Departmental and other Official Funds: 7%
- Total: US$ 27.21Bn

US$ 5.44Bn

**T-Bills**
- Bank Sector: 73%
- Private and Other: 10%
- Foreign Investors: 2%
- Departmental and other Official Funds: 1%
- EPF and Other Provident Funds: 5%
- Savings Institutions: 2%
- Insurance and Finance Companies: 7%
- Total: US$ 5.44Bn
Issues and Challenges in Developing Secondary market...

– Supply related issues
– Demand related issues
– Infrastructure issues
– Other issues
Issues and Challenges in Developing Secondary market / Contd.

• Supply Related Issues
  – Lack of annual borrowing calendar.
  – Lack of regular issuance plan for Treasury Bonds.
  – Add-hoc changes in issuing plan and system of conducting primary auctions
  – High fragmentation of tradable instruments.
  – Bunching of maturities leading to high Refinancing Risk.
  – Lack of buy-back, switching and reverse auctions process in the secondary market to address bunching issues.

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Issues and Challenges in Developing Secondary market / Contd.

• Demand Related Issues
  – Limited investors in the longer end of the yield curve.
  – Lack of well liquid market due to limited trading.
  – More “buy and hold” type investors.

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Issues and Challenges in Developing Secondary market / Contd.

• Infrastructure Issues
  – Lack of mandatory requirement for Primary Dealers to be success in the primary action.
  – Non availability of Central Counter Party System.
  – Non availability of comprehensive low cost trading platform.
  – Non availability of developed derivatives market.
Other Issues

- Week monetary policy transmission to medium-long term yield curves.

- Since early 2015, policy rates were increased by 125 basis points whereas one-year T-Bill rates increased by 380 basis points.

- T-Bond yield curve also shifted upwards significantly due to 100% market based primary auction system compared to the previous hybrid system.