

## Spotlight: Econ Op-eds in Summary

Week ended 28<sup>th</sup> October '20

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### In Summary

*The underneath contains summaries of the articles given above, including key extracts from these articles.*

#### **1. Moody's concerns: Do politicians and advisors realise the critical situation? Part 1**

**By: Tudor Wijenayake**

- The recent sovereign downgrade by Moody's underscores many debt related struggles in Sri Lanka's economy. The country has quite a lot of debt that is outstanding over the next few years, and the recent downgrade actually makes it more expensive to rollover this debt, and interest rates on Sri Lankan borrowings will increase.
- The government's main response to this has been to depend on borrowing from allies such as India and China. However, response from India has been relatively muted, with an extended US\$ 1 bn SWAP facility not seeing too much positive response. China has been more receptive, providing budgetary finance, but even this hasn't been too large.
- Given the lack of success in such measures, as well as the geopolitics surrounding this, Sri Lanka would probably need to work with the IMF and address the country's own budgetary troubles as well. While funding from the IMF has been delayed, working to shore up government finances could help. By addressing underlying issues, Sri Lanka might be able to successfully meet the challenging years ahead.

Moody's, the world's economic watch-dog, in late September downgraded Sri Lanka's long-term foreign currency ratings from B2 to Caa1, , raising concerns on the country's debt payment affordability, high budget deficits and limited room for reforms.

Within two weeks of Moody rating, a high level seven-member Chinese delegation led by Yang Jiechi, arrived in Sri Lanka for discussions and promised a \$500 Mn concessionary loan.

The United States Secretary of State Mike Pompeo is expected to visit Sri Lanka during the latter part of October.

#### **Moody's concerns**

The rating agency Moody highlights persistent debt repayment challenges:

1. Budget deficits estimated to be 8%-9% for 2020
2. Debt as a percentage of GDP would reach 100%
3. Warns of shrinking reserves, slow growth and high debt repayments with little space for genuine reforms.
4. Increased Government borrowings could crowd out private sector
5. Central Bank to be challenged by currency depreciation and high inflation

## 6. Slow reforms of weak Government institutions

Despite efforts by the Government to secure bilateral relief, **Moody's warns of market instability and absence of IMF help.**

### **Sri Lanka's debt situation**

On 2 October, the Government settled \$1 Bn maturing International Sovereign Bond from existing reserves which stood at \$7 Bn at August end.

**The country's foreign debt stands at \$ 56Bn or about 86% of GDP, with further payments of \$4.5 billion due each year until 2023.** Until these debts are settled, the country would be in a crucial period.

With foreign exchange earnings less than expenses, repayment of loans would require further foreign borrowing, an unending increasing situation. **With Moody's new rankings, interest rates for future loans would be higher.**

### **Response**

The downgrading of the economy by Moody's was challenged by the Treasury and the Central Bank. Ajith Nivard Cabral argued that the country's downgrading is "unwarranted" as the economy is on a path of recovery.

**They overlooked the fact that the trade deficit narrowed due to reduction of imports. Current foreign reserves of \$6.4 Bn are mostly borrowed rather than earned.** Although exports have recovered to some extent since May-June, revival of tourism would be far away. Also, workers remittances have reduced and, this year's deficit would be around \$ 2 Bn. Thus, foreign reserves could only be supported by foreign borrowings, leading to further downgrades.

### **Additional borrowings**

The Government is hopeful of borrowing from friendly countries. **We received a \$1.2 Bn syndicated loan from China Development Bank, of which \$500 Mn which was received in March 2020.** The Government expects a SWAP agreement of \$1 Bn with India as well. But when PM Mahinda Rajapaksa visited India in February, his request received poor response.

The recent telephone conversation between MR and Indian PM Modi too failed to bring positive results. The Government also expects funds from Japanese Samurai bonds, but relations between the countries have reached a low-level.

### **Loans from the IMF**

**The country's request for \$700 Bn from the International Monetary Fund (IMF) received a poor response** probably due to the noncompliance of IMF conditions. IMF assistance given at low interest with long repayment would boost international confidence in Sri Lanka.

With additional loans at higher interest to settle current loans, how far can the country continue? Thus, it is extremely important our foreign exchange earnings should exceed expenditure, only possible with improving exports, tourist earnings and remittances from abroad. **The Budget for 2021 must reduce the fiscal deficit and prioritise expenditure targeting enhancing exports and reduce imports.**

### **Chinese visit**

In the middle of corona epidemic, seven member Chinese delegation led by Yang Jiechi, former Foreign Minister of China and a member of the Chinese Communist Party Politburo, made a sudden visit and held discussions with President Gotabaya Rajapaksa and the Prime Minister. Among the discussed items are Port City law expected to be passed before November end and implementation of Hambantota Industrial Scheme. Also President Gotabaya is expected to visit China later this year.

The President wished China to purchase more Sri Lankan goods to reduce trade deficit with China. In addition more Chinese investments, Chinese participation in domestic tea auctions, also Chinese tourists to Sri Lanka. Chinese promised a \$ 500 concessionary loan, the agreement to be signed when President visits China.

Yang Jiechi had separate talks with PM Mahinda Rajapaksa. An official statement informed that, in addition to completing current large-scale projects, future areas of bilateral cooperation was discussed. Early commencing of Hambantota Industrial Scheme and the China-Sri Lanka Free Trade Agreement was discussed.

On the sidelines of Yang's visit an agreement was signed to provide Yuan 600 million (Rs. 16.5 billion) as a grant, between the Chairman of China International Development Cooperation Agency and the Treasury Secretary.

Yang's visit to Sri Lanka came days after the top diplomats of four Indo-Pacific nations US, Japan, India and Australia, met in Tokyo to increase their involvement in a regional initiative called 'Free and Open Indo-Pacific' aimed at countering China's growing influence in the region.

### **Tax changes implemented**

At the first Cabinet meeting in November 2019, new President Gotabaya Rajapaksa announced the removal of PAYE tax and the reduction of VAT, NBT was completely removed. The tax threshold for VAT was raised from existing Rs. 1 Mn to Rs.25 Mn, effective from the first of December.

According to the IRD, revenue collected in 2018 amounted to Rs. 650 Bn and in 2019, Rs. 785 Bn. IRD estimated the tax loss to be around Rs.143 Bn or around 20%.

The tax reduction was aimed at the next General Election expected early 2020, but companies who benefited from tax reduction failed to pass over the benefits to customers. The deficit was filled with loans from local banks and Central Bank bonds. In addition, coronavirus containment measures messed up revenue but expenses mounted, all leading to severe financial problems.

[For the full article - Refer The Daily FT](#)

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