Spotlight: Econ Op-eds in Summary

Week ended 07th October '20

In Summary

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

1. Moody's decision to downgrade Sri Lanka premature
By: Dinesh Weerakkody

- Moody's during this week decided to downgrade Sri Lanka's long-term foreign currency issuer and senior unsecured ratings to Caa1 from B2 and changed the outlook to stable, a move, analysts say is premature and unwarranted for, and could result in several investors suffering unnecessary losses and missing out on potential business opportunities.

- The Caa rating indicates that debt is judged to be speculative of poor standing and is subject to very high credit risk. While Sri Lanka's large financing needs over the near- to medium-term can put more pressure on the sovereign's external liquidity position, the latest rating does not reflect the potential for growth to recover in 2020-21. It had also failed to recognize that Institutional strength in many areas is high rated peers like Iraq.

- Going forward, the government is best advised to work on a medium-term financing strategy that can deliver a manageable cost of debt, and a faster and more sustained build-up in non-debt creating foreign exchange inflows. Furthermore, a progressive Budget and joint Government-private sector led initiatives to attract FDI and further strengthen Sri Lanka's exports must become a national priority.

Moody's this week downgraded the Government of Sri Lanka's long-term foreign currency issuer and senior unsecured ratings to Caa1 from B2 and changed the outlook to stable.

The decision to downgrade Sri Lanka's rating two notches from B2 to Caa1, citing wide budget deficits, slow reforms and weak institutions was according to analysts too harsh and unwarranted given that Sri Lanka has done extremely well in the containment as well as handling of COVID-19. Moreover, they note that several investors could suffer unnecessary losses and miss out on potential business opportunities.

A Moody's Caa rating indicates that debt is judged to be speculative of poor standing and is subject to very high credit risk. The Government on Tuesday severely criticized the sovereign rating downgrade done by international rating agency Moody's, and insisted that it was "premature" and "unfair".

Moody's assessment is that the coronavirus induced shock, which Moody's regards as a social risk, could significantly weaken Sri Lanka's already fragile funding and external positions. Moody's fear is that heightened liquidity and external risks stem from Sri Lanka's limited secured funding sources to meet its material external debt service payments over the coming years, during which period market refinancing will remain vulnerable to shifts in investor sentiment.

In addition, fiscal and external pressures will continue to limit the scope for reforms to address long-standing credit vulnerabilities, denoting weakening institutions and governance, an important driver of today's rating action. The stable outlook however denotes balanced credit risks at the Caa1 rating level.

Sri Lanka's large and recurring financing needs over the near- to medium-term risk can put more pressure on the sovereign's external liquidity position. Sri Lanka's latest rating does not however reflect the potential for growth to recover in 2020-21 and to escalate growth rates back to near normal.

Institutional strength in many areas also provides credible support for the Government's argument compared to similarly rated peers like Iraq. Moody's has also lowered Sri Lanka's local currency bond and bank deposit ceilings to B1 from Ba2, lowered its long-term foreign currency bond ceiling to B3 from Ba3 and lowered its foreign currency bank deposit ceiling to Caa1 from B3. These ceilings act as a cap on the ratings that can be assigned to the obligations of other entities domiciled in the country.

Debt repayments

Sri Lanka's debt repayments in 2021 is expected to be around $ 4.5 bn. State Minister of Money and Capital Market and State Enterprise Reforms Ajith Nivard Cabraal emphasised that the Government is ready and able to meet all debt repayments.

The Minister noted: "We have sufficient reserves to meet our debt obligations without default. There will be no interruptions whatsoever."

The Government is already exploring multiple options to boost foreign exchange reserves including a $ 1 bn SWAP agreement with India, attracting investment to the securities market and possible Panda and Samurai bonds.

Sri Lanka will also receive $ 700 mn as the second tranche of a $ 1.2 bn syndicated loan from the China Development Bank. The first $ 500 mn has already been transferred in March this year. Import restrictions and oil price reductions have also boosted the reserves significantly.

Way forward

An agreement with the International Monetary Fund (IMF) has also not been ruled out. However the State Minister noted that Sri Lanka was not keen to avail itself of the IMF's Rapid Credit Facility introduced earlier this year to help countries deal with the fallout from the COVID-19 pandemic as it did not provide significant funds.

The IMF's mainstream facilities to emerging markets would be more beneficial to Sri Lanka. Sri Lanka's rating could get reviewed if financing risks diminished materially and sustainably. Going forward the government is best advised to work on a medium-term financing strategy that can deliver a manageable cost of debt, and a faster and more sustained build-up in non-debt creating foreign exchange inflows.

A progressive Budget and joint Government-private sector led initiatives to attract FDI and further strengthen Sri Lanka's exports must become a national priority.

For the full article - Refer Daily FT

2. The debt challenge
Daily FT Editorial

- With an estimated USD 13 Bn. to be paid till 2023, Sri Lanka faces significant challenges with its debt servicing obligations over the next few years. Combined with the country's low growth figure's it will pose significant economic challenges for the better part of the decade. Additional loans may be required to this end.

- Sri Lanka will manage its debt commitment this year, but maintaining Rupee stability for the 2021 commitment will be difficult unless reforms are implemented and there is an improvement in the pandemic situation. The government's policy direction along with the budget will play a major role in this process.

- It is paramount that the government implements long term solutions including increasing public revenue via taxation, reform of State Owned Enterprises, expenditure rationalisation and improve the ease of doing business in order to boost investment and exports to build reserves and repay debt without relying on more borrowings.

The ratings downgrade by ratings agency Moody's this week has worried many who are concerned about the multiple challenges Sri Lanka faces to meet an estimated $ 4.5 billion in debt repayments next year. Even though multiple options including SWAP arrangements and a US Repo have been mooted, much will depend on Budget 2021 that the Government will present in November to set in place policy priorities.

Sri Lanka with its debt to GDP ratio estimated at about 86% faces having this increase to 100% next year. It is also hampered by a 9% Budget deficit this year, which will need to shrink substantially in the next two years to address investor concerns. These, along with significant tax and other reforms will have to be outlined in the Budget, irrespective of whether the Government will opt for an agreement with the International Monetary Fund (IMF).

Once the conflict was over, the Government borrowed extensively for infrastructure projects, but failed to jumpstart investment and broaden exports. Sri Lanka will meet its debt repayments this year, but unless reforms and an improvement in the COVID-19 situation changes next year, allowing the country to return to international financial markets, its ability to raise funds to repay debt due in 2021 while keeping the rupee at its current levels will be tough.

Until 2023, the Government has to repay an estimated $ 13 billion, which is mostly going to have to come through more debt. This, together with low growth, means Sri Lanka will remain on the knife edge economically for the better part of this decade. Sri Lanka can join international calls for assistance, but it will be just another short-term solution. If the Government is serious about turning around the economy, it will have to initiate difficult reforms that have been kicked down the road by successive governments.

Public revenue needs to grow to about 15% of GDP for Sri Lanka to sustainably fund education, healthcare, housing, and other welfare support needed for as much as 40% of the population. Without taxes, there is simply no other revenue source to achieve this.

Another tough but crucial step will be reforming State-owned enterprises (SOEs). The Government cannot keep funding its losses, but trimming the public sector will be deeply unpopular. Slashing defence allocations, which have remained the highest component of the budget despite the war ending over a decade ago, and rationalising other expenditure is also important. Strongly connected to this is effectively fighting corruption and proactively promoting transparency, which is the cause that has been ignored in the 20th Amendment.

Persistent issues, such as the relatively low ranking in the Doing Business Index, high utility costs compared to regional peers, high costs of land acquisition, and rigidity in labour laws and Government procedures remain the main impediments in terms of attracting FDIs to the country. Sri Lanka needs investment and exports to build reserves and repay debt without relying on more borrowings. So far the signs are that international assistance will be limited, making reforms the only realistic path for the Government, should it choose to take the responsible route.

Spurring domestic industries is a positive move, but it will need to be underpinned by a wider set of policies that will give confidence to international markets. Only then will the economy be on a truly sustainable path, and Sri Lanka's fiscal woes will be addressed.

For the full article – Refer the Daily FT