Spotlight: Econ Op-eds in Summary

Week ended 14th October '20

In Summary

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

1. Sri Lanka's economic dependency deepens after Moody's rate cut
By: Shihar Aneez

- Sri Lanka's high levels of debt have combined with the expectation of a recession this year to result in large financing requirements. Along with a high fiscal deficit, this has led rating agencies to downgrade Sri Lanka's credit rating this year. This makes it extremely difficult to finance our payments without bilateral funding.

- There are only a few countries that can provide any support. Japan and the EU are unlikely to be able to help, given diplomatic tussles with Japan and the EU already suffering on its own. The MCC grant might be up for discussion with the US, but even this is unlikely to be a large amount.

- That leaves China as one of the country's only ways to get financial support. The visit to Sri Lanka of a high-powered delegation is a positive step towards this, as is the US$ 500 mn budgetary assistance that followed. China has also pledged further investment as well. If all goes well, this might even prompt geopolitical support, which can continue to support Sri Lanka's financial situation.

Moody's Investors Service last week downgraded the island nation's sovereign rating to Caa1, which is "poor quality and very high credit risk," equal to the rating of Iraq, Mali, Angola, and Congo, from B2 or "speculative and a high credit risk," the ratings enjoyed by countries like Turkey, Kenya, Nigeria, and Jamaica.

The rating agency has said the coronavirus-induced shock will significantly weaken Sri Lanka's already fragile funding and external positions. It also said the 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.

Moody's rating downgrade follows the rating cut by both Fitch Ratings and Standard and Poors' early this year. With all three downgrading, the Government's borrowing cost from international capital market is likely to be expensive than earlier. The government is unlikely to tap the global capital markets for ISBs this year given the COVID-19 pandemic and possible higher risk premium it will have to pay.

No default at any cost

State Finance Minister Ajith Nivard Cabraal last week assured that Sri Lanka would never default any sovereign debts and said that the decision to ban all the import was due to preserve dollars to repay the foreign loans. As the Minister said, the $ 1 billion international sovereign bond borrowing was repaid last week.

The Government will have to pay nearly $4.5 billion per annum for the next three years and this means it needs a lot of foreign borrowing in the face of possible slowdown in the exports due to lingering COVID-19 pandemic.

Cabraal separately in the Parliament this week said the Government would not either sell any assets or cut down any government expenditure to manage the ballooning fiscal deficit, adding that the authorities are looking at all the options including panda bonds, samurai bonds, treasury bond swaps, and syndicated loans to boost the reserves.

Sri Lanka has also planned to insulate some investors from exchange rate fluctuations to attract more foreign inflows into local-currency bonds and other sectors. The risk cover is subject to inflows being in a range of $25 million to $1 billion. Foreign Direct Investments (FDIs) could slow down in the next few months if not for years as global corporates are looking for cost cutting to survive in the business.

Sri Lanka's key foreign exchange earner foreign remittances could slow down as most of the countries which provide jobs to locals are still struggling to recover from the COVID-19 pandemic. Tourism earnings will have to wait until the authorities open the main international airport, which has been postponed indefinitely due to the latest situation on COVID-19.

Export earnings from garments also could slow down unless the world increasingly demand more personal protection equipment (PPE), which have been helping Sri Lanka's exports up at the moment. With the latest cluster found in one of the top garment exporters, export revenue from the textile could have a hit.

As a result, Sri Lanka's economic dependency on large economies for bilateral loans and grants to cushion its reserves will deepen and the island nation hardly has many options in this.

Debt, economic crisis

Sri Lanka is likely to see a contraction in her economic growth this year, if the fear of COVID-19 spreading continues and the policy makers do not massage the economic numbers. It will be the first negative economic growth since 2001 following the terrorist attack on the main Colombo airport.

Sri Lanka's debt to Gross Domestic Product (GDP) has risen to 86.8% at end 2019 from 83.7% in the previous year. The rupee was under depreciation pressure until the Government imposed the import ban to preserve US dollars. Foreign inflows are expected to slow with the tourism taking a bow after the pandemic. The fiscal deficit is expected to hit 11-year high of 9% this year due to lack of revenue and unavoidable high expenditure in the face of long lockdown.

Japan's LRT woes

With this new development, the Japanese Government is highly unlikely to come forward for any soft loan or grants for Sri Lanka. The Central Bank has been in discussion with its Japanese counterpart for a $500 million borrowing through Samurai bonds. However, this deal has yet to reach final stages, Government officials say.

EU, US struggles

The European Union (EU), except for the current GSP plus trade concessions, is unlikely help Sri Lanka in its looming economic crisis. With the pandemic, the EU has its own woes to overcome.

Major EU countries have expressed interest in pumping their money in the private sector. However, bureaucratic measures that had ranked Sri Lanka behind many of its peers in dong business and perception of alleged malpractices involved with approvals in

Government offices have discouraged EU investors. So Sri Lanka is not going to get the money to face the impending economic crisis from EU countries either as grants or investments.

The United States, on the other hand, has been ready to help Sri Lanka through its $480 million grant of Millennium Challenge Corporation after the Sri Lankan Government sought assistance since 2002. The MCC deal is not completely off the table yet. The Government has yet to officially approach the US authorities while the MCC also has not completely terminated the deal.

It is evident that given the upcoming Presidential Election and the worst impact of the pandemic in the world, the US may not be able to help Sri Lanka to come out of its economic crisis. The world's largest economy will undergo some policy shift if the Democrat Joe Biden wins in the next month presidential poll.

The US Federal Reserve and the Central Bank of Sri Lanka have recently entered into an agreement to use US dollar liquidity as a temporary source when required. The facility is available for 'Foreign and International Monetary Authorities' (FIMA).

The Central Bank has pledged $1 billion worth of US Treasury Bonds to be held in its reserve and enter into a repo facility with the FED. This will help the country to settle some short term debts, but still they are not investments.

India's approach

India has already signed for a $ 400 million three-month currency swap to boost Sri Lanka's foreign reserves while both countries are in discussion for debt moratorium. Both are also in discussion for a $1.1 billion currency swap. India is Sri Lanka's top trading partner and Indian private sector has expressed to invest in Sri Lanka in many ways.

However, India has its own limitations given it is the second worst COVID-19-hit country in the world.

More than everything in the current geopolitical context, India is worried about increasing China's influence in Sri Lanka.

There has been controversy surrounding the 13th Amendment which is about power devolution as some Sri Lankan legislators see it as an Indian interference in policies. India has been of the view that it could curb any future ethnic conflicts.

India also prefers more private sector investments that government-to-government financial assistance.

China, China, China

When it comes to Sri Lanka's bilateral borrowings in the current context, the only country it could rely on with very little or no conditions is China. Though there are many concerns raised by India and the West led by the United States on possibility of China using the South Asian island for its military purposes, the Colombo Government had been increasingly compelled to depend on China for infrastructure financing and investments.

It is unlikely that any other countries will lend Sri Lanka at this difficult time given COVID-19 pandemic in the US, India, and many Europe nations. Those countries are still struggling to recover from the worst ever deadly disease since 1918.

In this background, the visit of a 'high-powered Chinese delegation' this week, led by senior Chinese leader and top foreign policy official Yang Jiechi, who is a member of the Communist Party of China's Politburo is crucial.

The first-ever Chinese visit to a South Asian nation since the global coronavirus epidemic and the Sri Lankan Government's 'travel bubble' plan to allow the Chinese delegation without quarantine into the country explains the influence China has in this island nation. The visit took place amid worsening India-China relations and rising US-China tension. The Chinese delegation met Sri Lanka's President and the Prime Minister and the meeting came two weeks after the virtual meeting between the prime ministers of Sri Lanka and India.

It also comes days after the 'Quad' meeting in Tokyo, where US Secretary of State Mike Pompeo urged to collaborate the regional allies in Indo-Pacific against what he called Chinese Communist Party's "exploitation, coercion and corruption". China has already lent $ 500 million "facility agreement" in March to fight against COVID-19 on Colombo's request. The meeting also is seen as crucial for China to move ahead with its key investment launched by Xi-Jinping in 2014 after the project company was included in a blacklist by the United States.

China has been flexible on lending for Sri Lanka, mostly with no strong conditions like other countries though there will not be any soft loans, say a Government official. "As far as Sri Lanka can ensure the repayment on time and the deals are only on commercial basis, there should not be any concerns both locally and internationally."

For the full article - Refer Daily FT