Spotlight: Econ Op-eds in Summary

Week ended 23rd September '20

In Summary

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

1. Debt servicing challenges for LDCs and the way forward
By: Dinesh Weerakkody

- As at August 2020, emerging markets and developing countries are burdened with a significant amount of external debt and debt servicing obligations due in 2020. A failure to address the debt and financing needs of developing countries could result in a fundamental collapse of social and economic systems, in addition to large scale loss of livelihoods, which increases the risk of major setbacks in the country's development.

- In the wake of the pandemic, developing countries with high debt burdens would require fresh credit to finance emergency measures. With such further rises in debt, these countries are experiencing large capital outflows due to a fall in market sentiment with investors fearing defaults. Such a situation could lead to a significant economic crisis in those countries.

- Multilateral institutions therefore need to rise up to this challenge to give life support to those countries which are already suffering from a high debt burden. While institutions such as the IMF and the G20 countries have already provided relief to a number of LDCs, the institutions are encouraged to do more.

Today the developing and poorest countries of the world host 71% of the global population and account for 33% of the global GDP. As at August 2020, emerging markets and developing countries have about $ 11 tn in external debt and about $ 3.9 tn in debt service due in 2020. Of this, about $ 3.5 tn is for principal repayments. Around $ 1 tn is debt service due on medium- and long-term debt, while the remainder is short-term debt, much of which is trade finance.

Given this backdrop, many organizations have called the IMF to provide systematic and comprehensive debt relief to Less Developed Countries (LDCs). Also organizations like the International Chamber of Commerce (ICC), the largest and the most representative business chamber, has continued its advocacy in cooperation with partners from the trade union movement and civil society to ensure all developing economies in need receive appropriate forbearance from debt payments – from both sovereign and private creditors and for the fiscal space needed to support their domestic economies and citizens through the crisis.

ICC has also recognized the need for a global roadmap in the wake of COVID-19 to provide systematic and comprehensive debt relief – and, in appropriate circumstances, debt cancellation – to allow developing economies to build back from the crisis.

Debt financing

According to experts, LDCs run the fundamental risk of a series of debt defaults, which will further amplify the unprecedented economic downturn. Therefore, a failure to address

the debt and financing needs of developing countries could result in a fundamental collapse of social and economic systems, in addition to large scale loss of livelihoods.

Due to the pandemic, global poverty is today rising for the first time after many years. The World Food Program has said the pandemic would likely double the number of people suffering from acute hunger to around 270 mn globally.

The Organization for Economic Co-operation and Development (OECD) said the availability of external private finance to developing economies will shrink by $ 700 bn in 2020 compared to 2019 levels. This is 60% more than what was recorded in the immediate aftermath of the 2008 global financial crisis. According to the OECD, this increases the risk of major setbacks in development that will, in turn, increase our vulnerability to future pandemics, climate change and poverty.

Financing requirements

UNCTAD and IMF have estimated that developing countries need $ 2.5 tn immediately to deal with the pandemic and its ripple effects in terms of economic support and facilitation to their population. IMF has already suspended debt repayments for the 25 poorest developing countries till October 2020. The G20 countries declared a similar suspension for 73 of the poorest countries from May till the end of this year.

The UN has suggested there must be a "full standstill on all debt service (bilateral, multilateral and commercial) for all developing countries". For highly indebted developing countries, the UN has suggested additional debt relief so that they don't default on repayment and also have the resources to fund other development needs covered under the UN sustainable development goals.

For developing countries with high debt burden, they certainly require fresh credit to finance emergency measures to fight the pandemic given the ongoing health crisis.

Foreign exchange

Debt service is not the only source of pressure on foreign exchange for LDCs. The East Asian debt crisis was triggered by a large capital flight creating a shortage of foreign exchange in the context of economies with a long history of managed fixed exchange rates.

According to estimates there has been a capital outflow of around $ 100 b in May and June from emerging and developing countries. The most vulnerable countries like Argentina, Venezuela and Lebanon where there are high debt levels and large devaluations would certainly face a huge economic crisis. Multilateral institutions therefore need to rise up to this challenge to give them life support.

For the full article - Refer Daily FT

2. Balance of payments deficit increases despite lower trade deficit
By: Nimal Sanderatne

- Both Sri Lanka's exports and imports fell in the first seven months of 2020, compared to a similar period in 2019. While the net effect was a reduction in the trade deficit, the decline in worker remittances and tourism earnings had a far greater impact on the BOP.
- The BOP deficit for the first 7 months of 2020 stands at USD 939 Mn. compared to a BOP surplus of USD 1.4 Bn for the same period of 2019. Additionally, this has led to an erosion of foreign currency reserves, increasing the nation's external financing vulnerability given large debt service obligations.
- While the trade deficit may be contained to around USD 6 Bn, provided there is continued trade performance and foreign inflows, it is imperative to obtain international assistance for debt relief in the near term to cushion the impact. However, the longer-term solution to Sri Lanka's BOP issues lies in increasing exports.

Trade performance

While exports fell by 20.7% from US$ 6.99 billion in the first seven months of last year to US$ 5.5 billion in the same period this year, imports fell by 21.4% - from US$ 11.3 billion to nearly US$ 9.0 billion (US$ 8.97 billion) over the same period and compensated for reduced exports.

The significant decrease in imports was due to the restriction of imports of motor vehicles, gold and a whole range of non-essential imports. There was a significant decrease in oil imports too owing to a 39% decrease in international oil prices.

Consequently, the trade deficit was contained at US$ 3.47 billion in the first seven months of this year compared to US$ 4.3 billion for the same period last year.

The average monthly exports were US$ 960 million in the three months of June, July and August this year. Merchandise exports were US$ 969 million in August compared to US$ 1.06 billion in July and US$ 906 million in June this year.

BOP 2020

Although this year's trade deficit is likely to be contained to a modest amount mainly due to decreased imports, the balance of payments deficit is likely to be high due to the two recent strengths of the BOP, workers' remittances and tourist earnings, weakening. Earnings from tourism have fallen sharply and workers' remittances have dipped significantly. Other inflows of capital too are small.

Surplus to deficit

Consequently, the trade deficit will not be offset by much and the BOP deficit will be large. In the first seven months of this year the BOP deficit reached US$ 939 million, compared to a BOP surplus of US$ 1490 million for the same period last year. The BOP deficit would lead to an erosion of the country's foreign reserves.

Prospect

If the trade performance continues as in the first seven months, the trade deficit could be reined in to about US $ 6 billion this year. If exports have averaged about US$ 900 million

a month in June – August accelerate, they could make a useful contribution to narrow this year's trade deficit further.

On the other hand, the relaxation of controls on non-essential imports like gold could widen the trade and balance of payments deficits. Furthermore, the restriction of imports should not hamper exports that are dependent on imports of raw material.

Foreign reserves

The country's external reserves declined from US$ 7.6 billion at the end of 2019 to only US$ 6.5 billion by the end of June this year. This erosion of foreign reserves in a context of large debt servicing obligations has increased the country's external financial vulnerability to a critical level.

As suggested in this column earlier, it is imperative to obtain international assistance in the form of debt relief from multilateral international organisations, and creditor nations and concessionary loans from friendly countries. Meanwhile the interim measure to strengthen reserves by obtaining a financial swap of US$ 400 million from the RBI has increased foreign reserves to US$ 7.1 billion.

In conclusion

Hopefully the trade deficit will be contained to around US$ 6 billion this year owing to reduced imports, growth in merchandise exports and financial inflows, including remittances and earnings from ICT services. The longer-term solution to the country's balance of payments problem lies in increasing exports.

For the full article – Refer the Sunday Times

Disclaimer: Information collected/analysed is from sources believed to be reliable or from the Central Bank/Government. Frontier Research Private Limited however does not warrant its completeness or accuracy. The bullet points provided for each summarised opinion article is written by Frontier Research and has no connection to the respective author.

Furthermore, the information contained in these reports/emails are confidential and should not be shared publicly. Disclosure, copying and distribution is strictly prohibited. Frontier Research has taken every reasonable precaution to minimize the risk of viruses, but is not liable for any damage you may sustain as a result of any virus or other malware in this email. Frontier Research reserves the right to monitor and review the content of all messages sent to or from this email address for operational, business and security reasons.

This communication including any attachments contained herein is governed and bound by the "Confidentiality and Disclaimer" detailed and available for your specific reference at our corporate website..