Spotlight: Econ Op-eds in Summary

Week ended 05th January '22

In Summary

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

Forget Fitch, the reality is resolving the forex crisis
By Dinesh Weerakkody

- Sri Lanka's credit ratings were reduced to 'CC' by Fitch, in December due to worsening external liquidity position, drop in foreign exchange reserves and high debt payments. While this was challenged by CBSL, credit ratings go by global standards and many institutional investors become unable to invest in countries below a certain credit rating (below CCC-).

- Sri Lanka's ability to meet its debt obligations had been questioned in the absence of external financing sources. However Finance Minister Basil Rajapaksa has told Parliament that the country will not default on its debt repayments in 2022 despite being faced with a severe foreign reserves crisis.

- Amidst these conditions, the Cabinet is seriously contemplating IMF support. An IMF program would certainly help to unlock concessionary multilateral and bilateral financing, but the IMF would want serious restructuring to bring about future debt sustainability.

Fitch downgraded forex-strapped Sri Lanka by one notch to 'CC,' citing mounting fears of a sovereign default. Sri Lanka is due to repay close to US$ 1bn worth of (total) debt in January and a total of over US$ 7.3bn for 2022.

Fitch would made this decision preemptively according to analysts given that Sri Lanka's economy has contracted by 1.5% YoY in the third quarter of 2021, following a 12.3% expansion in the previous period, according to the data of the Census and Statistics Department. The foreign exchange crisis has so far wrecked Lanka's recovery from the coronavirus pandemic.

Fitch justified its view saying: "The downgrade reflected its view of an increased probability of a default event in the coming months as Sri Lanka's foreign reserves slumped to US$ 1.58bn at the end of November."

The CBSL was quick to respond by saying it was a reckless action by the rating agency despite being informed of the imminent inflows as outlined in the Six-Month Road Map and the progress of inflows announced during the week.

All this is well and good. But we have a serious forex crisis that needs resolving. Unfortunately for Sri Lanka, credit rating institution go by global standards and their conclusions are based on hard research and data published in various public domains. And they also do several tests on the capacity of the borrower to honour borrowings and obligations and also the probability of realising projected incomes.

Unlike Argentina, Ecuador or Lebanon, that have defaulted, Sri Lanka has so far never defaulted. So we still have some bargaining power left with the IMF. Why we did not go to the IMF with our heads held high at the onset of the pandemic, like many others did, remains a mystery to many people. The country belongs to the 22 mn people who inhabit this country. Not only to the set of bureaucrats or politicians who hold executive authority in trust for a term to take decisions on behalf of the 22 mn.

A CEO of a fund that invests in Sri Lankan bonds noted that their HQ internal rating guidelines do not allow them to hold investments in CCC-rated debt and now even worse CC-rated debt. So was the pandemic the 'only' cause of this forex crisis? According to several economists, it is certainly not the case.

Default concerns

Fitch in a statement said: "The downgrade reflects our view of an increased probability of a default event in the coming months in light of Sri Lanka's worsening external liquidity position, underscored by a drop in foreign-exchange reserves set against high external debt payments and limited forex inflows. The severity of financial stress is illustrated by elevated Government bond yields and downward pressure on the currency."

Further the statement said: "We believe it will be difficult for the Government to meet its external debt obligations in 2022 and 2023 in the absence of new external financing sources. Obligations include two international sovereign bonds of US$ 500mn due in January 2022 and US$ 1bn due in July 2022. The Government also faces foreign-currency debt service payments, including principal and interest, of US$ 6.9bn in 2022, equivalent to nearly 430% of official gross international reserves as of November 2021."

However Finance Minister Basil Rajapaksa has told Parliament that the country will not default on its debt repayments in 2022 despite being faced with a severe foreign reserves crisis.

Way forward

Last week the newspapers reported the Cabinet is seriously contemplating IMF support. An IMF program would certainly help to unlock concessionary multilateral and bilateral financing, but the IMF would want serious restructuring to bring about future debt sustainability.

On the other hand, if the Government is confident of the forex flows it would not need to engage in any formal debt renegotiation process which technically constitutes a default.

Given the challenges ahead for Sri Lanka, whoever advised the Government to refrain from seeking IMF support in early 2020 must be held accountable by Parliament. Anyone who can understand basic math would have known when Sri Lanka lost its tourism-related income in 2020 what it would then do to the forex reserves of the country.

In fact, CBSL had anticipated in September US$ 3.5bn reserves by the year end, However, Sri Lanka's gross official reserves fell to US$ 1,587mn in November, about one month of imports.

The Government should also look to expedite the paperwork relating to all grants and concessionary funds that are stuck due to bureaucratic delays and fast-track those potential Indian credit lines in the pipeline.

Ironically, some Ministers and many MPs does not still comprehend the serious economic situation and the severity of the challenges faced by the daily wage earners in the country and they continue business as usual, regardless.

For full article – Refer Daily FT

2. Tangled diplomacy of Sri Lanka's currency crisis
By Dushni Weerakoon

- Sri Lanka ended 2021 with foreign currency reserves to support a month of imports. The luring foreign reserve crisis is like that of 2009. The state has avoided approaching the IMF on both occasions. Unlike 2009, this time, Sri Lanka has considerably high foreign debts to be settled in the foreseeable future.

- Government's reluctance to approach IMF lures mainly around the statutes. Yet, they have failed to put forward a credible policy which addresses the solvency weakness. However, the state is still hedging government to government deals with various countries.

- These alternative arrangements have been diplomatic headaches in terms of China and India. The weaker position of Sri Lanka in negotiations is affecting the government's credibility on various levels. A quicker inflow of FDIs and effective policy strategies will not save the universal sacrifice Sri Lankans are to do in the year to come.

Sri Lanka ends 2021 with foreign currency reserves in hand (US$ 1.6 Bn) to support a month of imports. For much of the year, a shortage of dollars saw uncleared essential imports piling up at the Colombo port as domestic prices soared. Directions from the country's central bank to maintain an artificially fixed rate have seen a parallel black market emerge, as businesses have struggled to find hard currency.

Added to this, mandated conversion of foreign currency earnings into Sri Lankan rupees is instilling fear that the country is heading swiftly towards both a currency and economic crisis.

The last time that reserves fell to such a perilous state was in February 2009 amid the global financial crisis, as Sri Lanka battled the final stages of a separatist war. Then too, there was a stubborn disinclination to approach the International Monetary Fund (IMF) and instead lobby friendly governments for help.

With the very same political leaders and policy advisors at the helm, Sri Lanka has spent much of this year in government-to-government negotiations. The similarities end there. Unlike in 2009, the country is staring down the barrel of foreign debt settlements to the tune of US$ 4.5 Bn on average per annum in the foreseeable future. That harsh reality surely calls for a rethink and reset of economic strategising this time around.

The reluctance to sign on to an IMF agreement is perhaps understandable. The 'conditions' tied to a rescue package typically call for austerity that can have destabilising socio-political effects. While there might be a softening of conditions in a COVID-19 ravaged global economy, helping Sri Lanka to regain its creditworthiness — from its current non-investment grade — will involve some bitter medicine. For governments opposed to making themselves accountable to the IMF and surrendering policy autonomy, the alternative is to put forward credible policy measures to achieve similar end goals.

Sri Lanka has failed to do this so far. In setting the 2022 Budget, the Treasury missed an opportunity to look beyond one-off tax measures to finance fiscal gaps. Similarly, a central bank road map spelt out intended actions to bridge the immediate foreign currency gaps. Both policy documents lacked the necessary details to allay concerns about Sri Lanka's solvency weaknesses. The Government is still hedging its bets that government-to-government deals — involving swaps, credit lines, equity sales and foreign direct investment (FDI) — will come in time to avert a major crisis.

Sri Lanka approached its regional powerhouses — China and India — for swaps and other credit lines early on. In what appears to be a reciprocal gesture, laws to ease rules and regulations governing FDI for the China-backed Colombo Port City were fast-tracked. India's Adani Group was given a 51% stake to develop Colombo port's west container terminal. Several overtures were made to Middle Eastern countries, especially for oil import credit lines. A US$ 3.6 Bn deal with Oman is on hold though, following a request for an offshore block in the Mannar Basin for oil exploration in lieu of interest payments. In this mixed bag is yet another controversial agreement to transfer a 40% government equity stake in a natural gas power plant to a US-backed firm. The latter deal has even pitted the ruling coalition partners against each other.

All told, drumming up alternative financing arrangements has not been without diplomatic headaches for the Government. A consignment of Chinese fertiliser imports that were deemed to have not met acceptable standards provoked a sharp rebuke from its embassy in Colombo.

In the meantime, India has expressed concerns over what it sees as China's growing footprint in northern Sri Lanka power projects, a region that has traditionally been a beneficiary of Indian assistance. Still, following a visit by Sri Lanka's Finance Minister in December, India agreed to work out an economic relief package to be announced in January 2022. There too though, protracted negotiations on yet another controversial Indian investment developing oil tanks in eastern Sri Lanka are high on the agenda.

The upshot is that Sri Lanka is negotiating for economic assistance from a weak position. Until the parties are satisfied, delays to announced credit pipelines have become routine. This uncertainty is taking a heavy toll on business confidence and the economy in general, and by association, on the Government's credibility. Whatever scope was available at the beginning of the year to spell out and implement a convincing policy path has all but dissipated. The result is that Sri Lanka enters a new year with a black cloud of uncertainty hanging over its economy.

The longer the delay on decisive policy action to restore Sri Lanka's sovereign creditworthiness and debt serviceability, the more painful the adjustment path will be. Even if the Government is successful in securing some short-term funds to meet its immediate foreign debt settlements, alongside a quickened pace of FDI inflows, the scale of imbalances suggests that building more effective policy strategies will require near-universal sacrifice from Sri Lankans in the year to come.

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