Spotlight: Econ Op-eds in Summary

Week ended 11th March '20

In Summary

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

1. Countering coronavirus
By: DailyFT

- The fallout of the coronavirus could be serious for Sri Lanka given the slow growth, high debt and other structural challenges. Export sector is particular will suffer loss of revenues. Recover of the tourism industry after Easter Sunday is also threatened. While the government stepped in, the fiscal support may not be viable in long run.

- The apparel industry faces a dual shock due to supply chain disruptions and slowdown of the export markets. If such disruptions are prolonged, layoffs in the industry maybe inevitable. Construction industry also saw some delays. While been a major growth contributor, it is also highly dependant on imports. So, this slowdown can impact positively on the trade deficit.

- Sri Lanka also has significant debt repayments due this year. Slashing of rates by the US Federal Reserve due to the virus, could help Sri Lanka in raising cheaper debt repayment funds. While Sri Lanka's economy is positioned to combat the virus better, the virus has managed to take the lustre off the expected growth turnaround.

Sri Lanka, along with the rest of the world is bracing for the impact of coronavirus, with economists concerned the fallout could be serious for an economy already battered by slow growth, high debt and suffering from consistent structural challenges. Exporters in particular are worried that the loss in revenue could be as high as $750 mn with sectors that are already suffering continuing to be hit once again by the outbreak.

Perhaps top of the list is tourism. Having been severely hit by the Easter Sunday attacks last year the industry was making a faster than expected recovery and was set to do well in 2020 before the coronavirus took down such hopes. While it is difficult to predict exactly how much in earnings could be lost, it is nonetheless concerning when considering the fiscal challenges faced by the country and the estimated 7% or higher Budget deficit that is expected this year.

The Government has already stepped in by extending the moratorium that was put in place after the Easter Sunday attacks by one year, under a larger moratorium covering all Small and Medium Enterprises (SMEs). Sweeping tax cuts that were introduced by the Government shortly after the presidential elections is also expected to boost growth and counter some of the impact of coronavirus but given the challenging macroeconomic fundamentals faced by Sri Lanka, it may not necessarily be able to maintain this fiscal support in the long term.

In addition to tourism, the sectors of apparel and construction could be the next worst hit. Apparel of course is facing a double whammy due to both supply chain disruptions and possible slowdown of growth in key export markets. The International Monetary Fund (IMF) has warned that the world could be facing its first recession since the global financial

crisis more than a decade ago, which could hit developed countries such as the US, UK and Europe harder.

In response the US Federal Reserve this week announced plans to slash rates that could help developing economies such as Sri Lanka raise cheaper debt repayment funds from international financial markets but still does little to offset other challenges such as industries finding new source markets. Top industry officials have already predicted that factories may need to close earlier and stay closed past the Sinhala and Tamil New Year in April due to lack of supplies and orders. At the moment companies have mostly decided to keep people on pay roll but if the disruptions are prolonged then layoffs may become inevitable.

Construction has already seen some of its projects delayed as Chinese workers remain in their homes country after returning to celebrate the Chinese New Year. Traditionally construction has been a major growth contributor but it is also highly dependent on imports so a slowdown could have mixed results. The silver lining in this instance is that a construction industry slowdown could reduce the trade deficit and reduce impact on reserves. The same could happen if vehicle imports are also curbed.

Maintaining strong macroeconomic fundamentals in such an environment could be challenging and it is crucial to consider this as Sri Lanka also has to repay $4.8 bn in debt repayments this year. Fortunately for Sri Lanka the next large repayment of $1 bn is only due in September giving the Government some breathing room to get elections behind them before tackling the debt situation. The relative smallness and the insular nature of Sri Lanka's economy could assist it to weather this storm better but coronavirus has nonetheless managed to take the lustre off the growth turnaround that was expected in 2020.

For the full article – Refer Daily FT

2. Only small balance of payments surplus despite significant decrease in trade deficit
By Nimal Sanderatne

- While the trade deficit in 2019 improved by USD 2.3 bn due to a contraction in import expenditure, the Balance of Payments (BOP) surplus was only USD 337 mn due to the effects of lower earnings from tourism, a dip in workers' remittances and large capital outflows.

- Exports grew slowly in 2019 as well, rising only 0.4% for the year. Therefore, it was clearly seen that the trade deficit only contracted due to a slowdown of imports, which would be unsustainable in the long run. Weak economic conditions globally in 2020 could mean that exports remain weak as well.

- However, an export-growth driven BOP improvement is vital to reduce the country's external vulnerability. This is especially important in the wake of the coronavirus, which could have damaging impacts on our tourist sector, further reducing the support on the BOP. Hence, targeting action to improve our trade deficit will be vital.

Despite a significant decrease in the trade deficit by USD 2.3 bn last year, the balance of payments (BOP) surplus was only USD 377 mn. The reduced trade deficit last year did not improve the balance of payments by much owing to lower earnings from tourism, a dip in workers' remittances and large capital outflows.

A much higher BOP surplus of USD 2 bn or more is needed to strengthen the country's foreign reserves and reduce the nation's foreign debt and external financial vulnerability. An improvement in the trade balance, as well as the capital account, is needed to achieve this.

Expectation

The large trade deficit of USD 10.3 bn in 2018 resulted in a BOP deficit of USD 1.67 bn. With the reduced trade deficit of USD 8 bn in 2019, the expectation was a balance of payments surplus of about USD 2 bn. However, the balance of payments surplus was a mere USD 377 mn.

Reasons

The expected increase in the balance of payments surplus did not materialise owing to lesser earnings from tourism, decreased workers' remittances and net capital outflows. The decline in the trade deficit failed to strengthen the country's external finances and financial vulnerability.

Trade Balance

The significant contraction in the trade deficit in 2019 was mainly due to a sharp decrease in import expenditure of about USD 3 bn or 10.3% from 2018. Significant export growth in the early part of the year tapered off to increase by only 0.4% in 2019. Industrial exports increased by 1.8%, agricultural exports declined by 4.6%. Tea exports decreased by 5.7%.

Despite the decreased trade deficit, the balance of payments surplus was only USD 377 mn due to a decline in tourist earnings, workers' remittances and a net outflow of foreign investment from the government securities market, especially during December 2019, and net outflows from the Colombo Stock Exchange.

Workers' remittances were 4.3% lower in 2019 compared to 2018. Earnings from tourism decreased by 18 percent from USD 4.4 bn to USD 3.6 bn. Foreign direct investments too decreased from USD 1,662 mn in 2018 to USD 772 mn.

Weaknesses

The analysis of the 2019 balance of payments once again discloses the weaknesses of the country's external finances. Despite the decrease in the trade deficit, it is too high to achieve a balance of payments surplus of significance. The decrease in the trade deficit of 2019 was brought about almost entirely by shrinkage in imports rather than increased exports. Such a lowering of the trade deficit is unsustainable.

Only a significant export growth would improve the country's balance of payments and enable the Island's import-export economy to achieve higher and more inclusive growth.

Exports

Export growth continues to be insignificant. An analysis of exports discloses that export growth is confined to a few exports, most notably garments that are facing severe competition. The recessionary conditions in the world in 2020 and trade limitations could hurt manufactured exports.

Agricultural exports

Agricultural exports have fared dismally once again with a decrease of 4.6%, Earnings from tea, the country's main export, decreased by as much as 5.7% last year. Other agricultural exports too have fared inadequately. The resuscitation of agricultural exports is vital to enhance total export earnings.

Concluding reflection

The performance of the country's external finances does not augur well for the economy. The balance of payments continues to be weak and the country's external financial vulnerability is increasing. A much-improved balance of trade is vital to enable a significant balance of payments surplus that could reduce the nation's external vulnerability.

This could be achieved only with a reduced trade deficit driven by export growth. Revival of tourism, net inflow of capital and increased foreign direct investment that are vital for an improvement in the balance of payments and long-term economic growth and economic development.

The current global economic conditions and the impact of the Coronavirus on tourism does not augur well for the improvement of the trade balance and balance of payments. The continuing outflow of capital in 2020 is a severe threat to the external finances of the country.

For the full article – Refer The Sunday Times

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