Sri Lanka's Central Bank chief calls for more IMF aid

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Despite Sri Lankan government efforts to paint a rosy picture of the country's economy, Central Bank Governor Ajit Nivad Cabraal last week called for further International Monetary Fund (IMF) assistance this year. He did not elaborate on the purpose, but the move reflects deepening economic and balance-of-payments problems.

Cabraal made his announcement on January 3, while presenting "Road Map 2012 and Beyond," a propaganda piece praising President Mahinda Rajapakse's economic achievements. The central bank chief said Sri Lanka would seek a fresh "follow up or surveillance program" with the IMF as the $US2.6 billion loan obtained in 2009 is due to expire early this year.

That loan was granted to avert a balance-of-payments crisis produced by the 2008-09 global financial meltdown, compounded by the huge costs of the just-completed civil war against the Liberation Tigers of Tamil Eelam. The IMF required austerity measures to halve the budget deficit from 10 percent in 2009 to 5 percent in 2012. These measures cut the living conditions of workers and the rural poor, raising the prices of essential items, while slashing education, health and welfare programs.

Last September, the IMF withheld the final two instalments of this loan, amounting to $800 million, citing the government's failure to fully meet the budget deficit targets and its refusal to devalue the rupee. At that time, Cabraal claimed that the government did not need the IMF funds "as our reserves are strong."

Now, however, Cabraal and the government have reversed their position. An IMF team is scheduled to visit the country next week to lay down new terms.

Under the impact of worldwide recessionary tendencies, Sri Lanka's trade deficit for 2011 rose to $7.73 billion by last October and was expected to reach $9 billion by the end of the year. In October, the country's exports recorded a year-on-year decline of 4.9 percent.

The Central Bank had refused to devalue the rupee because it feared that international investors would withdraw funds invested in treasury securities, undermining financial market confidence in future efforts to raise foreign funds.

Initially, the finance ministry and the Central Bank, both supervised by President Mahinda Rajapakse as finance minister, were at odds over how to deal with the escalating trade deficit. The Central Bank sold dollars to defend the rupee, rapidly depleting its reserves, but last November, the government depreciated the rupee by 3 percent under IMF pressure.

Nevertheless, the Central Bank continued to defend the rupee, selling about $1.76 billion during first ten months of 2011. As a result, the country's foreign reserves quickly fell 25 percent, from a peak of $8 billion in August to $6 billion at the end of the year.

Cabraal has now shifted ground. Presenting the Road Map 2012, he said the rupee could be "flexible" in the future, given the pressure on Sri Lanka's balance of payments and declining reserves. This indicates the government's readiness to further devalue, triggering new price increases for essentials, again cutting the living conditions of the working class.

Rating agencies are pressing the government to fully adhere to the IMF program. On December 24, Fitch Ratings said Sri Lanka was among the “four highest-risk financial systems in Asia Pacific,” the others being China, Indonesia and Hong Kong.

Likewise, Moody’s issued a statement on January 4, saying that “Sri Lanka’s fiscal space and flexibility are constrained, in comparison to most other sovereigns, and could prove vulnerable to shocks.” It called for continued fiscal “reforms,” debt reduction and a strengthening of the balance of payments.

The “Road Map” said last year’s 8.3 percent gross domestic product (GDP) growth would fall to 8 percent this year but jump to 9 percent next year. It claimed that foreign direct investment would reach $2 billion this year, export income would rise to $12.5 billion, with tourism earning $1.2 billion. Cabraal said remittances from Sri Lankans working overseas would increase to $6.5 billion. Combined with foreign loans, this would mean the country would achieve a foreign exchange inflow of $25 billion, he asserted.

Cabraal contrasted this inflated forecast with that of the crisis-ridden European countries. But his estimates of growth and foreign exchange inflows all depend upon the state of the world economy, including Europe. Last year’s GDP growth was mainly centred not on the production sector but on the services sector—including tourism, financial services, telecommunications and trade services—which amounted to 58 percent of GDP.

In a research paper issued on Monday, Standard Charted Bank’s Sri Lankan economist Samantha Amarasinghe described the Central Bank’s estimates as “optimistic given the gloomy external environment in our view.” The paper noted that as Europe and US accounted for 56 percent of Sri Lankan exports, a further slump in demand was likely. It added: “Given the debt crisis in Europe, growth in tourist arrivals is likely to slow unless increased arrivals from Asia compensate. The ongoing political turmoil in the Middle East may have longer-term implications for remittance inflows.”

The paper also warned that the political upheaval in the Middle East and North Africa would affect tea sales. These countries account for 55 percent of Sri Lankan tea exports. Moreover, if the European Union proceeded to ban crude oil imports from Iran, oil prices would rise, drastically affecting Sri Lanka as well as other countries. For these reasons, the research paper downgraded the bank’s growth forecast for 2012 to 7.5 percent.

Clearly, the financial markets are unimpressed by the “optimism” of the government’s forecasts and are intensifying the pressure on Rajapakse. His regime will have no choice but to implement a new round of IMF austerity measures, setting the stage for social unrest and class struggles.