Ratings agency warns of Sri Lanka's exposure to European crisis

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18 June 2012

Sri Lanka and other Asian countries, such as India and Indonesia, are at risk of credit ratings downgrades because of the European sovereign debt crisis, Fitch Ratings warned last week. The European crisis was the "single biggest" external issue that may affect the ratings, Andrew Colquhoun, head of Asia-Pacific sovereign ratings at Fitch, told the media.

Of these countries, Sri Lanka was "most at risk" from any disruption to global funding markets because of its high external borrowing needs and weak balance sheet, he said. According to projections, Sri Lanka's gross external financing requirements this year equal 95 percent of the country's foreign reserves.

Sri Lanka's present Fitch rating is BB-, which is three levels lower than the company's lowest investment grade BBB-, its rating for India and Indonesia. "If the pressures coming from overseas or from other parts of the world were to intensify, the countries that could most quickly see negative pressure develop on sovereign credit profiles" included the three Asian states, Colquhoun told a conference in Hong Kong.

Sri Lanka faces a grave balance of payments situation mainly due to declining exports, triggered by the European economic crisis, and a continuous rise in imports.

Compared to last year, the value of Sri Lankan exports dropped in the first four months of this year by 3.1 percent to $US3.3 billion. The declines in March and April, compared to last year, were 10 and 9 percent respectively. These figures were the worst since the 13 percent annual decline recorded in 2009 due to the initial global financial breakdown.

Sri Lankan earnings from its main exports, apparel, tea, rubber and coconut, are falling because of declining prices for these products in the major markets of Europe and US due to the financial crisis and government austerity programs imposed on working people.

By contrast, Sri Lankan imports grew at around 12 percent in the first four months of this year, reaching $6.6 billion. The trade deficit expanded by 32 percent to $3.3 billion. Imports grew despite efforts by the government to curb them, including devaluation of the rupee, increased interest rates and higher import taxes.

The government depends increasingly on foreign loans to bridge the gap. The country's total debt increased by almost 12 percent over the past year, to 5,133 billion rupees ($38 billion). Debt servicing costs rose by more than 9 percent to 895 billion rupees. The Central Bank has called for offers from international banks to obtain up to $1 billion, in exchange for sovereign bonds, later this year.

An International Monetary Fund (IMF) team is currently in the island assessing the government's implementation of the IMF's conditions before releasing the final $400 million tranche of the $2.6 billion loan negotiated in 2009. According to some reports, the government is seeking an additional $500 million loan from the IMF.

In a June 13 statement, the Ceylon Chamber of Commerce indicated nervousness about the government's dependence on foreign borrowings, saying there was "a need to recognise that the balance of payments cannot be placed on a more sustainable footing merely through increased foreign borrowing. This only serves to raise the risks associated with the economy at a time of elevated global economic uncertainty."

The business organisation called for increased exports, more remittances from Sri Lankan workers overseas and "a higher level of non debt-creating capital inflows (FDIs and portfolio flows into the stock market).”

Sunday Times economist Nimal Sandaratne commented: “Expecting the large trade deficit to be offset by remittances, tourist earnings and capital inflows is rather optimistic. The only way that there could be an overall balance of payments surplus would be through the borrowing of banks, international aid flows, the remaining IMF loan instalment and a further line of credit from the IMF. However, these are contingent liabilities and result in a debt burden.”

Remittances during the first four months of 2012 from expatriate Sri Lankan workers, mostly female domestic workers toiling in the oil-rich Arabian Gulf, reached nearly $2 billion. Earnings from tourism amounted to $340 million, Foreign Direct Investments (FDI), including local loans, added $238 million and portfolio investments contributed $182 million, well short of bridging the $3.3 billion trade gap.

Workers’ remittances are vulnerable to escalating threats of war by the US and other imperialist powers in the Middle East, particularly against Syria and Iran. FDIs and portfolio investments are also exposed to the country’s economic and political instability, reflected in the already adverse Fitch rating. The Colombo Stock Market has become the worst performing stock exchange in South Asia. In May alone, it declined by 587 points or almost 11 percent.

Over the past year, the Central Bank slashed the country’s foreign currency reserves, which stood at $8.1 billion in June 2011, to $5.52 billion by February. This sell-off sought to keep the rupee arbitrarily strong amid the widening trade deficit. Since the Central Bank stopped selling reserves in February, heeding the dictates of the IMF, the rupee has fallen by more than 13 percent against the US dollar, another signal of financial fragility.

The rupee devaluation, along with drastic fuel price increases imposed by the government, also raised the official inflation rate to 7 percent in May, a nine-month high, causing further immense hardship to ordinary working people.