Sri Lanka’s Central Bank demands commercial banks provide cheaper credit

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The Central Bank of Sri Lanka announced a half percent (50 basis points) rate cut on August 23 and demanded commercial banks provide lower cost loans to businesses or face the imposition of lending rate caps.

The Central Bank (CB) wants lending rates to businesses reduced to about 8 percent, a 2 percent reduction on current rates. To facilitate this, the CB has asked banks to cut the interest paid on deposits to 7 percent. The demands are a desperate attempt by the bank and the government to halt Sri Lanka’s falling economic growth rates. The cuts were needed, the CB said, to “boost credit flows to productive sectors and, in turn, help the revival of the economy.”

The CB slashed rates twice this year, calling on the commercial banks to follow suit. The commercial banks were reluctant to do so, however, because of uncertainties in Sri Lanka’s economic and political situation.

The Central Bank previously predicted that Sri Lanka’s gross domestic product (GDP) would grow by 3.1 percent in 2019. Moody’s, the international rating agency, however, is projecting just 2.6 percent.

The April 21 terrorist bomb attacks on Sri Lanka produced a sharp fall in tourist arrivals that has impacted on growth rates. The terrorist attacks were not the sole reason for the fall in economic activity, however. The country’s growth rate declined in 2017 and 2018 to 3.4 and 3.2 respectively, as a part of global economic downturn.

Sri Lanka’s battered economy also faces mounting debt repayments. Addressing an August 27 meeting, Megapolis and Western Development Minister Patali Champika Ranawaka said that the country would be declared bankrupt if the government was unable this month to service loans obtained from the international financial market. He referred to Argentina, which Standard & Poor’s said last month had defaulted, and to Greece and Ireland.

Ranawaka’s comments, which are aimed at justifying the imposition of further austerity measures on workers and poor, follow remarks by CB Governor Indrajit Coomaraswamy last month.

Coomaraswamy declared that “managing debt” was the economy’s biggest risk and pointed out that Sri Lanka has to pay almost $US6 billion this year, more than $5 billion next, and $4 billion in 2021 and beyond. The CB governor told a meeting of bankers last week that the cabinet had approved measures to raise $500 million through Samurai bonds.

An August 30 statement by Moody’s warned that the “credit profile of Sri Lanka reflects ongoing governmental liquidity and external vulnerability risks… Key credit challenges include large borrowing requirements, with a high reliance on external funding, and low foreign exchange reserves coverage of forthcoming economy-wide external debt maturities.”

The escalating financial crisis in Sri Lankan is a sharp expression of global economic developments. The US and other countries around the world have reduced interest rates to record lows amid declining global demands for goods and services under the conditions of escalating geopolitical tensions, especially the trade conflict between US and China.

India’s second quarter economic growth was down to a six-year low of 5 percent after 5.8 percent growth in the first quarter of 2019. Indian Finance Minister Nirmala Sitharaman announced measures on August 23 to boost big business, including lower taxes, the speed-up of goods and services tax (GST) refunds and increased spending on the auto industry.

The Sri Lankan government’s economic problems are being compounded by an accelerating foreign capital flight. Quoting market sources, Reuters recently reported that “foreign investors have been exiting Sri Lankan government securities, echoing the trend in other emerging markets.” Just over 53 billion rupees has been sold in Sri Lankan government securities up to September this year and there has been a fall of 2.5 percent in the Colombo stock market index.

In late August the International Institute of Finance revealed that investors have withdrawn $13.8 billion from so-called emerging markets that month. “The resurgence of the trade conflict, combined with increased fears of a global slowdown, have been catalysts for the ongoing EM [emerging markets] portfolio reversal,” it noted.

Sri Lankan’s monetary policy is under tight scrutiny from the International Monetary Fund (IMF) which approved a $1.5 billion loan facility in mid-2016 with disbursements spread up until next year.

One of the IMF’s main demands is that the budget deficit be reduced to 3.5 percent of GDP by next year. Under this directive, the government is imposing major social cuts, privatising and corporatising state-owned enterprises, widening its tax net, increasing the cost of utility services and imposing other austerity measures.

Colombo has already instituted a new regressive tax regime with increased direct and indirect taxes from all working people and small businesses including the self-employed. In July, the cash strapped state treasury directed all ministries to slash their spending by at least 15 percent.

While the IMF and the government claim these harsh attacks are a prescription for economic recovery, these measures have been a social catastrophe for working people, youth and the poor.