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நிதி அமைச்சு
MINISTRY OF FINANCE

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PRESS RELEASE

Rating Action by S&P Global Ratings sans due consideration given to the strong macroeconomic policy framework of the New Government of Sri Lanka

The Government of Sri Lanka (GOSL) is disappointed with today's rating action by S & P Global Ratings (S&P) at a time when the Parliament of Sri Lanka has just passed, with an overwhelming majority, the new Government's first full-year Budget for 2021, which laid out a carefully crafted medium term policy framework, alongside a novel orientation for a solid recovery of the economy in the period ahead.

It is surprising to note that S&P, in its assessment has ignored the envisaged medium –term positive developments as a result of several key proposals presented in the Government Budget 2021 with regard to fiscal consolidation and deficit financing in the period ahead. As indicated in the Budget 2021, the Government has adopted a novel approach in relation to foreign financing, while enhancing the effectiveness of already secured financing channels, aimed at reducing the share of foreign financing of the budget deficit over the medium term. Yet, S&P, in its medium term projections, grossly overstates the level of fiscal deficit and the external deficit of the country. In contrast, the forward looking financing model of the Government, which is skewed heavily towards domestic financing, will capitalize on the benefits of increased domestic savings and the low interest rate regime already in place given the subdued levels of inflation and well anchored inflation expectations at present. In the immediate future, the ongoing economic recovery is expected to contribute to boost revenue for the Government. The envisaged improvements in economic growth, supported by low interest rate regime and incentives being offered for investment, would help consolidate government debt in the period ahead. Reflecting the impact of measures already put in place by the Government, the relative share of outstanding foreign debt has declined notably at present.

Based on such highly pessimistic assumptions, S&P projects a path of government debt to GDP ratio over 100 per cent from 2021. This is mainly due to the unrealistic estimate of the budget deficits from 2021, without considering the spillovers from the economic recovery facilitated by significant policy stimulus already in place. Further, any increase in the share of domestic government debt in a low interest rate regime and when the economic growth rate is expected to be above the real rate of interest, the government debt management would not be a major source of concern in the period ahead. Furthermore, with the strong pro-growth policy orientation of the Government as clearly articulated in the Budget 2021, a possible rise in local currency denominated government debt in the near term can be effectively managed within the envisaged fiscal consolidation path in the medium term, supported also by the expected normalization of government revenue. It is also unrealistic to assume that the Government will follow a rigid expenditure path, as the incentives offered to the private sector would provide much needed capital formation in the economy, including foreign direct investment to major infrastructure development projects in the country.

The recently introduced measures to entice foreign investors to the government securities market and the real economy through an attractive foreign exchange swap arrangement are likely to help enhance foreign currency inflows in the near term. The Government is expecting the disbursement of the 2nd tranche of the Foreign Currency Term Financing Facility proceeds from the China Development Bank in early 2021. Liquidity facilitation measures in the form of swap arrangements from abroad are explored by the Central Bank and a significant foreign exchange volume based facility from a major Central Bank is now at an advance stage of completion.

Sri Lanka's policy environment remains facilitative of enabling high economic growth beyond the recovery phase while preserving macroeconomic stability. On the back of over 11 years of well anchored mid-single digit levels of inflation, the Central Bank has pursued an increasingly accommodative monetary policy stance. Fiscal policy, as re-emphasised in the Budget 2021, remains focused on supporting the economy, while expecting to return to the envisaged path of consolidation in the period ahead. Further, both fiscal and monetary policies have placed an overly emphasis in supporting people and businesses amidst the COVID-19 pandemic, thereby ensuring a sustainable and equitable economic recovery, without jeopardizing the macroeconomic balance of the country.

In the above context, it is premature for S&P to announce a rating downgrade when the well-articulated policy framework presented in the Budget 2021 is receiving wider commendation for consistency and continuity, with a clear medium term view of fiscal consolidation on a realistic economic footing. Such action simply demonstrates the prejudicial approach, as in the case of recent rating actions by other international rating agencies without weighing the impact of alternative strategies of the Government.

Given these circumstances, the Government of Sri Lanka wishes to reaffirm to foreign investors that have put faith in Sri Lanka continuously over the past several years that Sri Lanka remains willing and able to meet its debt obligations, as it has done impeccably in the past. It is notable that the

Government has honoured all its liabilities so far during the year, in spite of the adverse speculation by some stakeholders. The Government wishes to reiterate that Sri Lanka will engage with all investment and development partners and implement the envisaged measures to build up reserves through non-debt creating inflows.

Investors are invited to approach the Sri Lankan policy authorities at the highest levels who always remain open for constructive dialogue and will welcome any one-on-one engagement or roadshow discussions, without being dissuaded by premature rating actions.