

NEWS

Sri Lanka misses deficit target, IMF withholds loan



The loss of GSP+ is affecting Sri Lankan exports, but India is attempting to step into the gap

Future looks gloomy for Sri Lankan exports

THE European Union's decision to suspend preferential trade benefits to Sri Lanka because of human rights "shortcomings" during the island's 26-year civil war is expected to have a significant impact on the latter's export sector.

Generalised System of Preferences Plus (GSP+) allowed the island to export some 7000 items to the EU on a duty free basis.

Chief among the beneficiaries of this facility was Sri Lanka's garment industry which is also its biggest foreign exchange earner, providing employment to 300,000.

Other beneficiaries includes the cable manufacturing sector, leatherwear, fisheries and ceramic exports.

Commenting on the decision made by the EU on February 15, A Sukumaran, a clothing exporter who is chairman of the Joint Apparel Association Forum, an industry body said: "It will have an impact on the industry".

"Over 50 percent of our apparel exports go to the EU. Whatever

apparel qualifies for GSP Plus, costs will go up by about 10 percent. Many of our buyers have told us we have to bear the extra cost." Sukumaran added.

Loss of the GSP+ benefits would mean Sri Lankan exporters would be charged an import duty of about 9.6 percent by EU member states.

"It will be extremely costly for exporters," said Sukumaran.

"I do not think many are working on 10-15 percent margins. Unless some of the buyers are ready to bear part of the burden it will be a problem."

However, some garment industry figures are optimistic. Kashyapa De Silva of Clariant, a Swiss based manufacturer of dyes and chemicals for the industry says that despite the "loss" of the E.U. market, there is enough scope for the garment industry to expand in the US market.

According to De Silva, the local industry's advantage is quality, which cheap, mass market producers of garments such as China and Bangladesh are unable to match.

However, many analysts have said they fear factories would be forced to close, resulting in large-scale lay-offs of workers.

There was more bad news for the Sri Lanka's exports industry with Kenya overtaking Sri Lanka as the top tea exporter in 2009.

According to Tea Board of Kenya, the country exported 342 million kilogrammes to 47 world markets, accounting for 22 per cent of the world tea exports last year.

In a statement, the Board said, "We did dislodge Sri Lanka as the leading tea exporter last year and hope we will continue maintaining the same position".

Out of the 40 per cent of all global tea bags used in making the popular beverage, at least 10 per cent of its content is Kenyan, it added.

It said, Sri Lanka, formerly number one tea exporter, sold 280 million kilogrammes, representing a shortfall of 29 million.

Analysts attributed the success to the efforts made in research and development efforts in the African nation.

SRI LANKA missed the budget deficit targets for 2009 set by the International Monetary Fund as a condition for a \$2.6 billion loan, according to data published by the finance ministry.

Meanwhile, following an assessment, the IMF announced it would delay a third tranche of the financing until it sees the budget after April 8 parliamentary elections.

The south Asian island failed to achieve the December quarter budget deficit target of reducing the end-2009 deficit to 7 percent of GDP set by the IMF. The deficit instead stood at 9.7 percent.

The IMF had approved the loan in a 20-month programme aiming for prudent fiscal management with certain quarterly targets after identifying Sri Lanka's high deficit as a major weakness. Achieving the targets was required to get the loan payments in a scheduled eight tranches.

"The budget deficit of 469,627 million rupees turned out to be 9.7 percent of the GDP," the Ministry of Finance said on its website www.treasury.gov.lk. This is the worst fiscal deficit since the country hit 10.8 percent in 2001.

According to the the ministry, it will again miss the target for this year as it expects the deficit will be around 7.5 percent of gross domestic product, versus a target of 6 percent.

"It is expected that the revenue deficit will decline to 1.5 percent of GDP and the budget deficit to around 7.5 pct of GDP in 2010," the ministry stated.

The report estimated 2010 budget revenue at 825 billion rupees and expenditure at 1,263 billion. It expects to finance the 2010 deficit through 102 billion

rupees of foreign borrowing and the rest via domestic borrowing.

Announcing the delaying of the third tranche of the loan, Koshy Mathai, Sri Lanka's resident IMF representative, told Reuters: "We just want to see their plans once they are ready for the budget. That's the stage when really they will be in a position to enunciate their overall comprehensive plan."

"For end-December, the government has met the targets agreed under the program for net international reserves and reserve money. Final data for the overall budget balance are not yet available, but the ceiling on domestic budget borrowing -- consistent with the government's overall deficit target of 7 percent of GDP -- was exceeded by a substantial amount," the IMF noted.

"This mainly reflects faster-than-expected infrastructure project implementation, higher interest payments, and sluggish fourth-quarter revenue growth."

Sirimal Abeyratne, a senior economics lecturer at the University of Colombo, said the government will have to take serious steps to continue the IMF loan, which boosted foreign investor confidence after the end of a 25-year war in May.

"I haven't seen any serious government efforts to reduce the deficit last year in line with IMF target. If it continues without reforms in expenditure and revenue sides, I don't think we could achieve 7.5 percent target this year."

Full suspension of the IMF loan could lead to rating downgrades, volatility in macroeconomic fundamentals, withdrawal of foreign funds from government securities, and increased borrowing, according to media reports.

Shares up but foreign investors continue to leave

THE Colombo stock exchange hit a new record high of 3843.67 points on Monday, March 1 but foreign investors continued selling their holdings amidst political and economic concerns. The All-Share Price Index .CSE of the Colombo Stock Exchange share price gains were led by retail buying. "It's retailer-driven and the market will further go up due to

retailers," said Jaliya Wijeratne, director of institutional sales at SMB Securities. "Foreigners have been leaving due to problems in their own countries." Wijeratne added. However most analysts said the exit of the foreigners was due to Sri Lanka's own political and economic concerns as other emerging markets are still seeing foreign investment inflows. A

recent decision by the International Monetary Fund to withhold the third tranche payment of a eight tranching loan, President Rajapakse's populist tax cuts and volatile political landscape has had an adverse impact on sentiment of foreign investors, closely monitoring Sri Lanka as a "frontier economy" since the end of the war. Analysts say many investors

will take a wait-and-see approach until they are sure about a degree of political and economic stability under relatively prudent fiscal management. Foreigners were net sellers for 15 million rupees worth of shares on Monday, March 1. They have been net sellers in 30 out of the 37 trading sessions so far this year. Foreigners, who had been net buyers since

2001, turned net sellers in 2009, selling 785.3 million rupees worth of shares. They have sold a net 5.1 billion worth shares so far this year and 2.54 billion rupees since the January 26 presidential election results were announced. The bourse is still up 13 percent so far this year, following a 125 percent rally in 2009, one of the best in Asia.