

NEWS

Sri Lanka's credit rating may be downgraded

Bloomberg

SRI LANKA'S credit rating may be lowered by Fitch Ratings if the island nation fails to narrow its budget deficit, derailing a \$2.6 billion loan from the International Monetary Fund.

Sri Lanka's 2009 budget shortfall, which exceeded target and widened to 9.7 percent of gross domestic product, "indicates significant fiscal slippage attributable to the post-war reconstruction phase," Ngiam Ai Ling, a Singapore-based director of Asian sovereigns at Fitch, said in response to e-mailed questions.

Central bank Governor Nivard Cabraal said that Sri Lanka is likely to find it "challenging" to meet the 2010 budget deficit target and may seek some "leeway" from the IMF as the island emerges from a civil war that ended last year. The Washington-based lender said Feb. 25 that it may consider changing the loan package to Sri Lanka because of a deterioration in public finances.

"Sri Lanka's ratings or outlook could face downward pressure if there is a lack of commitment to a sustainable medium-term fiscal program and public debt consolidation, or if difficulties in meeting fiscal objectives cause the authorities to abandon the IMF program," Ngiam said.

Sri Lanka, which plans to sell \$500 million of dollar-denominated sovereign bonds this year, had its outlook revised to stable from negative on Oct. 9 by Fitch. The credit assessor affirmed the country's rating at B+, its fourth-highest non-investment grade.

Under the IMF loan approved

in July, Sri Lanka was expected to cut its deficit to 6 percent of GDP in 2010, from 7 percent last year, and to further reduce it to 5 percent by 2011. The IMF said Feb. 25 it will decide whether to grant Sri Lanka a third loan tranche of about \$330 million after completing a review of the \$41 billion economy once the government presents its 2010 budget.

President Mahinda Rajapaksa has pledged to spend \$1 billion a year to build new roads and power plants in the island's war-torn north.

Sri Lanka's finance ministry said March 2 that the pressure on the budget deficit will "ease" in 2010, assuming the economy grows by 6 percent to 7 percent.

The Central Bank of Sri Lanka on March 18 maintained benchmark interest rates at a five-year low to boost consumer demand and drive growth. Still, the central bank won't rule out raising the amount of deposits that lenders need to set aside as reserves from the current level of 7 percent, Cabraal said. Inflation may accelerate until April and then moderate, he said, targeting an average inflation rate of between 5 and 6 percent by end-2010. Consumer prices in Colombo, rose 6.9 percent in February from a year earlier, the most in 12 months, after gaining 6.5 percent in January.

"With inflationary pressures clearly building within the system, the monetary policy stance on quantitative targets and policy interest rates may need to be more tightly administered," Fitch's Ngiam said.



An increasing number of Chinese nationals are now in Sri Lanka, like these workers at Hambantota

China provides more money to Sri Lanka

CHINA has loaned US\$290 million (\$405 million) to the Sri Lankan government to build an airport and expand the island's railway network, according to Sri Lanka's foreign ministry.

The Export-Import Bank of China loaned \$190 million to construct a second international airport in Sri Lanka's south and \$100 million to develop the island's railways.

The loan agreement was signed in Beijing last week and the two countries also discussed more funding for highways in the island's war-ravaged Jaffna peninsula, the foreign ministry said in a statement.

Officials in India, Sri Lanka's neighbour and China's rival, fear Beijing is trying to undermine Delhi's influence in the region through its economic assistance.

India, for its part, has just announced a credit of \$70m to help upgrade Sri Lanka's southern railway line. The two countries

are vying for contracts in Sri Lanka following the end of more than 20 years of civil war.

However, analysts say India is playing a losing game.

Sri Lanka successfully played off its larger neighbours against each other during the war to obtain military and monetary assistance needed to sustain the war.

However since the end of the war, although Sri Lanka praises India as its closest ally, China has won all the key development projects in the island clearly indicating Sri Lanka has strategically aligned itself with China for political and economic support in the post war period.

The new airport will be near a vast sea port at Hambantota, which is largely being funded by the Chinese government's lending arm, the Export-Import Bank. Both projects have the same Chinese state-owned company as contractor, says the BBC's

Charles Haviland in Colombo.

Meanwhile, Sri Lanka received further funding assistance from China to build a flood protection system for parts of the capital Colombo, a government minister said.

Colombo suburbs of Kotte, Dehiwela-Mount Lavinia, Maharagama, Kesbewa and Moratuwa will be protected from storm water flooding by the project, minister Gamini Lakshman Peiris said.

The 6,800 million rupees (59 million US dollar) project will be financed with a loan from China Construction Bank.

China, which is a key military and political ally of Sri Lanka, loaned the island \$1.2 billion in 2009.

The projects Beijing is financing in Sri Lanka include a host of road improvements in the formerly war-torn north, a huge theatre in the capital and coal power plants.

Sri Lanka seeks to reverse EU withdrawal of GSP+

SRI LANKAN officials have been in talks with EU officials in Brussels, in an attempt to reverse the decision to withdraw GSP+.

The EU decision, announced last month, followed a report by the European Commission highlighting serious short-comings on Sri Lanka's commitment to implement international conventions on human rights - the basis on which GSP+ was granted.

The high level, four member delegation, led by the Treasury

Secretary, P.B. Jayasundara, arrived in Brussels early last week. The group included Attorney General Mohan Peiris, Foreign Affairs Secretary Romesh Jayasinghe and Justice Ministry Secretary Suhada Gamlath.

It is believed they focused on the detrimental impact of the removal of GSP+ on the Sri Lankan economy and levels of unemployment. John Clancy, EU Commission's trade spokesman,

reiterated the importance of addressing the identified concerns so that "significant improvements on the effective implementation of the human rights conventions" occurred.

The head of the EU delegation, Bernard Savage, added "One must not hasten to think there will be an immediate change in the EU stance following this week's talks. The talks will lay the ground work for a positive development on the extension of the GSP+ and

other issues. The two sides will discuss the Commission report issued on Sri Lanka in December last year and see what needs to be done"

Sri Lanka's foreign ministry has previously described the necessary goals as 'unattainable targets'. Officials rebuked the announcement of the withdrawal, warning that any discussions should be "sensitive" to Sri Lanka's sovereignty. This round of talks was described as a 'preliminary exch-

ange of views' and the two sides are believed to meet again shortly.

GSP+ (Generalised System of Preferences) is a trade concession that was awarded to Sri Lanka by the European Union (EU) following the tsunami. The basis for granting such a concession is recipient country's commitment to implementing 27 conventions on human and labour rights. In 2008, a reported total of EUR 1.24 billion was imported by EU from Sri Lanka.