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Press Release

Issued By	Economic Research Department
Date	02.07.2013

Moody's change of Sri Lanka's Sovereign Rating Outlook from 'Positive' to 'Stable' is a contradiction of its own Assessment

Central Bank of Sri Lanka (CBSL) is of the view that the latest move by Moody's of changing the outlook on Sri Lanka's B1 foreign currency sovereign rating from '*Positive*' to '*Stable*', is ill-advised and backward looking, and is not a proper reflection of the external position and the recent improvements in the Sri Lanka economy.

The underlying rationale for the latest rating stance is described by Moody's as (a) inadequate improvement in the external payment position in the past two years, and (b) slowdown in the pace of fiscal consolidation process.

In terms of the external payment position, Moody's asserts that the official international reserves remain 'below the peak' level achieved when the outlook was changed to '*Positive*' in July 2011; while also claiming that the net liability position of commercial banks doubled during July 2011 and February 2013. However, this assertion disregards several obvious factors that an impartial analysis would have clearly revealed:

(a) A strong consolidation of international reserves in terms of standard reserve adequacy measures has taken place since June 2012, when Moody's reaffirmed Sri Lanka's Outlook as '*Positive*'. The import cover of official reserves and total reserves (including commercial bank assets) in July 2012 stood at 4.2 months and 5.2 months respectively; while in May 2013, these figures have risen to 4.3 months and 5.4 months, respectively. Further, the reserve cover for short-term liabilities has improved steadily during the last year.

(b) In the recent past, several commercial banks have raised funds via foreign capital markets, and such funds have been broadly medium to long-term. Hence, there would not be any new additional pressure on Sri Lanka's external payment position. Accordingly, the claim that a substantial increase in net foreign liabilities of commercial banks has occurred does not recognize the maturity profile of such liabilities.

(c) Sri Lanka's external sector has performed satisfactorily in the first four months of 2013, with earnings from tourism continuing to grow with increasing recognition of Sri Lanka as an attractive tourist destination; Workers' remittances continuing to rise, supported by the diversification of migrant destinations and further expansion of formal channels for remitting money; Foreign investment at the Colombo Stock Exchange (CSE) continuing to grow, with increased activity at the CSE, indicating a gradual build-up of investor confidence. At the same time, inflows in terms of foreign direct investments are poised to record a historically high level of US dollars 1.8 billion, in 2013, with major projects that are already in the pipeline. Substantial inflows have also been recorded in the government securities market on a cumulative basis. In addition, there has also been a marked contraction in the trade deficit during the first four months of the year.

With regard to Moody's assertion that there is a slower pace of fiscal consolidation, it needs to be highlighted that the Government has given a strong commitment to continue the fiscal consolidation process, by reducing the budget deficit each year since 2009. The budget deficit declined from 9.9 per cent in 2009 to 6.4 per cent in

2012 and is expected to decline further to 5.8 per cent of GDP in 2013. The Debt to GDP ratio has also gradually declined, even though it marginally increased to 79.1 per cent of GDP in 2012 from 78.5 per cent in 2011 owing to currency depreciation. Further, the financial conditions of major State Owned Enterprises have improved, mainly due to market based price adjustments being made to consolidate the fiscal position further. These developments show that Sri Lanka is on a clear path of fiscal consolidation, and hence, the Moody's statement that there is a "slowdown in the pace of fiscal consolidation", is not justifiable.

Overall, it must be noted that the CBSL and the Government have acted constructively to address the concerns that Moody's have raised during the course of pre-announcement discussions, which are summarized below:

Concerns Raised	**Current Status**
Possible Re-emergence of inflationary pressures	Current status indicate that concerns related to inflation have been substantially addressed since Sri Lanka has enjoyed single digit inflation over the past 53 months
Poor performance of State Owned Enterprises	Current indications are that these vulnerabilities have now eased considerably
Low Revenue to GDP ratio	Notwithstanding low revenue in the short term, the government has given a strong commitment by reducing budget deficit each year
Persistent risks in debt dynamics	Current developments show that Sri Lanka is now on a clear path of fiscal consolidation
BOP pressure could re-emerge with the deterioration in the current account deficit	The current account deficit has reduced, and further improvements are expected
Reserves are lower than expected	Foreign reserves have strengthened to a comfortable level
External vulnerability risks have not significantly reduced	External vulnerability indicators have improved considerably

In June 2012, Moody's indicated that the conditions that could change the Rating upwards would be an improvement in the government's fiscal management and debt position, lower and less volatile inflation, and, sustainable improvements in foreign currency reserve adequacy, supported by a flexible exchange rate policy and foreign direct investment inflow. Moody's also indicated that the conditions that could change the Rating downward would be a failure to progress on fiscal consolidation, loss of inflation control, a substantial worsening of the country's external balance and foreign currency liquidity position, or a reversal of recently achieved political stability which could adversely impact resident and foreign investor confidence.

Accordingly, it would be seen that the Sri Lankan authorities have taken constructive policy measures that would warrant an upward revision of the rating as indicated by the Moody's in June 2012 instead of a lowering of the outlook. Therefore, Moody's change of Sri Lanka's Rating outlook from "Positive" to "Stable" is a contradiction of its own assessment in June 2012.