Sri Lankan currency falls sharply

Saman Gunadasa
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The Sri Lankan rupee has fallen sharply in value by more than 4 percent against the US dollar since the Central Bank, in line with government policy, floated the currency on September 4. By Friday it reached 143 rupees to the dollar as compared to 137 two weeks ago.

The floating of the currency to depreciate its value is the first major austerity move taken by the "national unity government" of President Maithripala Sirisena and Prime Minister Ranil Wickremesinghe.

Finance Minister Ravi Karunanayake told the Reuters news agency last week that the government "will ensure that before too long it [the rupee] will be brought back to an acceptable level." He did not say what he regards as an acceptable level.

However, Reuters commented: "The market expects the currency to fall further in the short term if the Central Bank fails to tighten interest rates or the country does not see strong inflows soon." Since January, the Sri Lankan rupee has depreciated by about 7.5 percent.

Foreign investors are already leaving to seek higher profits elsewhere. The Colombo Stock Market has hit a seven-week low. "Most global investors led by the USA will signal investors to exit from such fragile markets and re-invest their assets in their home country, such as the USA, to the detriment of markets, including the markets in countries like Sri Lanka," First Capital Equity analyst Reshan Wediwardena told the media.

An International Monetary Fund (IMF) team visiting Sri Lanka to discuss the country's budget praised the floating of the rupee, which is a longstanding IMF demand. A statement last Friday declared: "The mission welcomes the CBSL's (Central Bank) recent decision to cease setting daily spot prices for the rupee and let market forces play a greater role in determining the exchange rate."

During first half of 2015, the government spent $US1.4 billion from its reserves to defend the rupee fearing its depreciation would push up prices and fuel discontent among workers and poor against the government. The country's reserves have fallen to $7.5 billion, which includes an Indian loan of $1.5 billion as part of a currency swap agreement.

Like other emerging economies, Sri Lanka has been hit hard by international currency turmoil, provoked most recently by China's sharp devaluation of the yuan in August and concerns internationally about the impact of a rise in US interest rates. While the US Federal Reserve last week postponed an interest rate hike, the Sri Lankan currency remains under pressure.

The IMF team pointed to a worsening economic situation in Sri Lanka, predicting growth for 2015 of 5 to 5.5 percent, significantly below the government estimate of 7 percent.

The country's total debt has ballooned to 8.2 trillion rupees ($58.7 billion), almost half of which is foreign debt. The government's annual debt servicing costs have now surpassed total government revenue, aggravating the country's balance of payments problems.

The trade deficit has increased to $4 billion during first six months of the year, a 15.6 percent increase compared to last year. Tea exports are continuing to decline in line with falling commodity prices internationally.

The falling value of the rupee will hit the working class and poor the hardest as it will drive up prices. According to the Sri Lankan-based *Sunday Times*, the wholesale traders association complained to Finance Minister Karunanayake that they were unable to maintain stable prices.

The cash-strapped government announced an increase in commodity taxes on potatoes and sugar of 10 rupees and 12 rupees per kilogram respectively on September 9. Potato prices instantly rose by 10 rupees but the government forced sugar merchants not to increase prices. Importers, however, are insisting that domestic sugar prices cannot be maintained amid fluctuating international prices and a falling rupee.

On September 12, in another bid to shore up foreign reserves, the Central Bank restricted a leasing arrangement on vehicles to 70 percent of their value, down from 100 percent, in an effort to slow imports.

To avert a balance of payments crisis, the government is still seeking a $4 billion loan from the IMF, which flatly rejected a similar request in March citing its failure to cut the 2014 budget deficit to 5.2 percent of GDP. The government has promised to contain this year's deficit to 4.4 percent.

The IMF mission is calling for sweeping pro-market reforms, including in "fuel and electricity pricing, subsidies, trade policy, liberalisation of factor markets (particularly land), and the investment environment." It also advocated "putting state firms on a commercial footing, allowing them to make market-based financial decisions (including pricing) and subjecting them to the greater financial discipline."

Such "reforms" will impact heavily on the working class. Fuel and electricity prices have already risen sharply. The privatisation or corporatisation of key state enterprises such as the Electricity Board, Petroleum Corporation, Water Board and Ports will only lead to further price hikes and job losses.

Underscoring the IMF's demands, a column in the *Wall Street Journal* on September 15 advised: "Most urgent is macroeconomic stability. Sri Lanka's rising debt is unsustainable and the country is heading for another balance-of-payments crisis. It is dangerously reliant on foreign commercial borrowings at a time of increasingly volatile capital flows to emerging markets. Taxation and expenditure need radical surgery to prevent further public debt accumulation and make debt financing more sustainable. The printing press must be stopped."

The columnist called for a "bonfire of domestic red tape to free up the private sector," education reform so as to compete with other cheap labour countries and the restructuring and downsizing of what it branded as "bloated, loss-making public sector."

The new "national unity" government in Colombo has been formed to ruthlessly implement this austerity agenda and to suppress any working class resistance.