AMBEON SECURITIES

SRI LANKA REACHED DEBT RESTRUCTURING AGREEMENT WITH OCC

Key highlights

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Sri Lanka has moved closer to finalizing the first review of its International Monetary Fund (IMF) program, as the Official Creditor committee (OCC) has agreed on a preliminary debt restructuring proposal. The country owes USD 4.36 Bn to Paris Club creditors and USD 1.68 Bn to India, which is also in the Official Creditor Committee. The deal is said to cover debt worth USD 5.9 Bn. Additionally, Sri Lanka has an agreement with China, operating independently from the Paris Club, with restructuring terms reportedly resembling those negotiated with the OCC.

The latest development

Sri Lanka has taken a significant stride in its economic recovery by reaching an initial agreement to restructure its debt with Official Creditor Committee (OCC), including India and the Paris Club.

Masato Kanda, the vice minister for International Affairs at Japan's Ministry of Finance, confirmed that the deal, though without specifics disclosed, doesn't involve a debt haircut. The deal is said to include rate cuts and tenure extensions.

The agreement revolves around defining key parameters for debt restructuring, mirroring an earlier agreement between Sri Lanka and China and aligning with the conditions outlined in the International Monetary Fund's $3 billion bailout package.

Significance to the IMF program

Despite initial doubts, Sri Lanka has navigated this process successfully, raising expectations for the IMF board to conclude the first review of Sri Lanka's EFF program by December and proceed to release the USD 333 Mn second tranche. The restructuring agreement is reportedly consistent with parameters laid out in the International Monetary Fund's $3 billion bailout.

Implementing a viable restructuring plan can enhance Sri Lanka's credibility with the IMF and other international lenders, potentially solidifying support for the ongoing IMF program.

Impact on Interest rates

Initially, an agreement for debt restructuring might alleviate immediate financial pressures, potentially leading to short-term stabilization in interest rates. Creditors may offer more favorable terms or defer payments, providing temporary relief.

Depending on the nature of the restructuring, if it leads to a more manageable debt burden and increases confidence in Sri Lanka's ability to repay, it could positively influence long-term interest rates, causing the rates to decline.

Impact on sovereign credit rating

The debt restructuring agreement have a positive impact on Sri Lanka's sovereign credit rating in the short term. Rating agencies would view it as a proactive step to address fiscal challenges. Sustainable implementation of the restructuring terms, improved fiscal discipline, and economic stability are crucial for maintaining or improving the sovereign credit rating in the long run.

Debt sustainability

A well-structured debt restructuring plan that reduces the overall debt burden, extends repayment schedules, or secures more favorable interest rates could enhance Sri Lanka's debt sustainability. This could create space for investment in development initiatives and economic growth.

Challenges remain

The restructuring plan is likely linked to broader economic reforms that Sri Lanka needs to undertake. The sustainability of these reforms and their effectiveness in addressing underlying economic issues, such as fiscal discipline and revenue generation, remain crucial challenges.

If the restructuring plan doesn't effectively address the root causes of Sri Lanka's debt issues or if the country's economic performance doesn't improve, debt sustainability could remain a concern. Overreliance on further borrowing or inability to meet repayment obligations could exacerbate the situation.

Source: Bloomberg, Economynext, Press releases

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