AMBEON SECURITIES

SRI LANKA LOCAL CURENCY RATING UPGRADED TO CCC+ BY S&P

What does this mean for Sri Lanka?

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S&P Global Ratings raised its long- and short-term local currency sovereign credit ratings on Sri Lanka to 'CCC+/C' from 'SD/SD' (selective default) with a stable outlook. Issue rating for locally currency bonds maturing 2023 was also raised to CCC+ from D.

Local currency rating assesses a country's ability to meet obligations in its own currency while foreign currency rating assesses the country's ability to meet its obligations in a foreign currency. This has several implications.

Improved Creditworthiness

The upgrade from "SD" (selective default) to "CCC+" indicates an improvement in Sri Lanka's creditworthiness in its local currency obligations. This change reflects a more positive outlook on the country's ability to meet its debt obligations in Sri Lankan rupees (LKR).

Stable Outlook

The stable outlook on the CCC+ rating suggests that S&P Global Ratings believes Sri Lanka's fiscal situation has improved to some extent through the debt restructuring exercises. However, it also acknowledges ongoing economic, external, and fiscal pressures that continue to pose risks to the country's fiscal sustainability.

Foreign Currency Rating

It's important to note that Sri Lanka's foreign currency rating remains at "Selective Default" (SD), indicating ongoing challenges in servicing foreign currency-denominated debt.

Risks and Future Scenarios

Downside Scenario: Further restructuring of obligations denominated in Sri Lankan rupees, rapid inflation, a rising interest burden, or worsening fiscal performance could lead to a downgrade in the local currency ratings.

Upside Scenario: If the government's local currency debt situation improves, fiscal metrics strengthen, and the economy performs better than expected, there could be room for further upgrades especially in the foreign currency rating to CCC or lower B category.

Debt Situation

Despite the restructuring efforts, Sri Lanka still faces significant challenges. The government's local currency debt remains high, and it has a substantial interest burden, which is a significant portion of its revenues. The government will need favorable economic conditions and continued fiscal consolidation to manage these challenges effectively.

Impact on Borrowing Costs

The upgrade could potentially lead to lower borrowing costs for the Sri Lankan government in the domestic market. A higher credit rating generally implies lower interest rates on newly issued bonds.

Debt Restructuring

The upgrade comes after the completion of a domestic debt restructuring program. This program involved renegotiating the terms of government bonds and other debt instruments held by superannuation funds. The restructuring was viewed as a distressed exchange, meaning that the government had to modify the terms of the debt due to its high interest burden and local currency debt levels.

As part of restructuring, outstanding provisional advances and Treasury bills held by the central bank were converted into Treasury bonds with maturities in 2029-2038, carrying fixed interest rates that will step down in 2025 and 2027. A much smaller portion of the outstanding credits have been converted to short-term Treasury bills. S&P Global Ratings' sovereign ratings do not reflect the government's capacity and willingness to service financial obligations to public sector enterprises or similar official creditors. As of May 2023, local currency-denominated Treasury bills and bonds outstanding were approximately LKR14.1 trillion, or about 60% of GDP. Banks, which were not included in the domestic debt exchange program on local currency bonds, are estimated to hold approximately 27% of Treasury bills and 43% of Treasury bonds. S&P estimate that the government's interest burden will be more than 70% of revenues for 2023, and will remain above 50% in 2026.

Source: S&P, Press Releases

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