Credit Alert

Global Research
10 January 2023

Sri Lanka – Debt restructuring faces further delays

- **We think debt restructuring could be pushed back to end-2023 due to delays in the IMF programme**
- **Economy is likely to contract in 2023; external sector has improved due to import contraction**
- **Financial-sector liquidity and solvency risks are building with looming domestic debt restructuring**
- **We refresh our recovery model; we now see fair value between 22 and 33 at exit yields of 11-15%**

IMF approval likely to get pushed back to Q2-2023

IMF board approval for Sri Lanka's Extended Fund Facility (EFF) programme has been delayed as negotiations with bilateral lenders take longer than expected. We now expect board approval to happen in Q2-2023 (versus Q1 previously) given delays in securing financing assurances from bilateral creditors. This could further delay negotiations with commercial creditors, which we expect will be pushed back to H2. As a result, we expect a restructuring deal to be reached only by end-2023. Achieving the IMF's qualitative and quantitative targets, including the timely restructuring of commercial debt, could pose challenges, potentially disrupting the IMF programme.

Against this backdrop, we expect Sri Lanka's economy to contract a further 1.0% in 2023, following an estimated 7% contraction in 2022. This would make achieving a primary deficit target challenging. We now expect a primary deficit of 2.2% of GDP in 2023, versus the 0.7% target set by the IMF; this pushes our 2023 fiscal deficit forecast to 11.0% from 9.0% previously.

The suspension of external debt service and the suppression of imports have helped to balance the external accounts; a gradual recovery in remittances and tourism flows has also helped. However, we are concerned about the liquidity and solvency of the banking sector given its exposure to a weak economy and sovereign debt.

We refresh our debt restructuring model to reflect our latest views on the economy and the restructuring timeline. Based on an exit yield of 11-15%, we calculate a recovery value of 22-33 for the Eurobonds. Under our base-case assumption of a 13% exit yield, we estimate a recovery value of 28. Since our fair value estimates are similar to where the SRILAN curve is currently trading, we remain *Market weight*.

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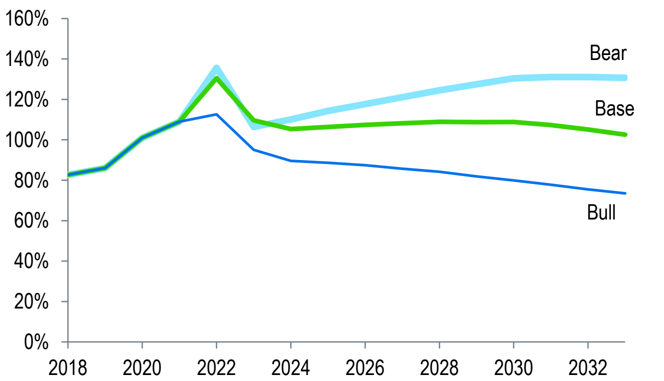
Issuer recommendation

Sri Lanka
Market weight

Figure 1: Base case – Gradual debt reduction

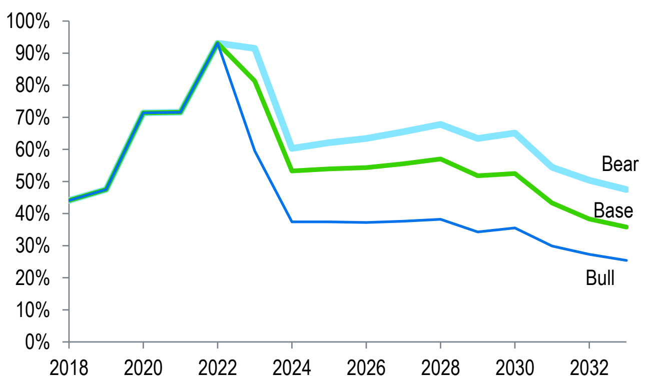
Projected debt-to-GDP ratio under different scenarios



Source: Standard Chartered Research

Figure 2: Interest costs set to stabilise after 2024

Projected interest-to-revenue ratio under different scenarios



Source: Standard Chartered Research

IMF Executive Board approval has been delayed

IMF board approval likely to be pushed back to Q2-2023

IMF board approval has already been delayed due to Sri Lanka's difficulties in meeting the conditions for approval. We now expect IMF board approval in Q2-2023, as we see a very low likelihood of the government obtaining the necessary financing assurances from bilateral creditors in Q1. Obtaining these assurances is proving challenging. Moreover, while Sri Lanka has announced ambitious fiscal consolidation plans for 2023, the feasibility of these plans is in doubt. We think Sri Lanka needs to make more progress on both fiscal and structural reforms, including passage of a new Central Bank Law to promote an independent central bank. The new law has received cabinet endorsement but is still awaiting presentation in parliament.

Slow progress on restructuring talks

Slow progress on talks with bilateral lenders is delaying the start of negotiations with commercial lenders

Since the Sri Lankan authorities announced a debt standstill in April 2022, progress on debt restructuring negotiations with bilateral creditors has been limited. While Paris Club lenders have affirmed their support for debt rescheduling, the proposal lacks details. Moreover, progress on negotiations with China – the biggest bilateral lender – has been limited. China's government appears to have designated China Exim Bank and China Development Bank as the lead negotiators on its behalf, but progress has been slow. Discussions with India are also still ongoing. These delays have prompted Sri Lanka's President to further extend the target for IMF board approval to Q2-2023 from January.

We expect the government to focus on commercial debt negotiations only after agreements on bilateral debt have been concluded. Slow progress on bilateral debt restructuring negotiations is likely to push commercial debt restructuring to H2-2023, in our view. As a result, we see Sri Lanka's Eurobond debt restructuring being finalised only by end-2023.

Risks remain in 2023, even after IMF board approval

IMF programme could continue to face disruptions even after the first disbursement

While IMF board approval may ease initial external financing concerns, Sri Lanka still has a long way to go before achieving economic stability, which is unlikely before 2024, in our view. We also see a risk of disruptions to the IMF programme even after the first approval (which will pave the way for the first disbursement). The IMF will continue to review the programme every three to six months, and subsequent board approvals will be contingent on meeting benchmarks for the disbursement of future tranches. These benchmarks include a comprehensive debt restructuring to achieve medium-term debt sustainability. The government will have to remain committed to urgently resolving the current crisis and staying on the track with the IMF programme.

Politics and policy execution delays are key risks

Risks of political upheaval remains high in 2023

Building political consensus on tough reform measures will be challenging as fiscal consolidation further weakens a faltering economy. A lack of strong support from parliament further complicates the president's task. The opposition has called for the dissolution of parliament (possibly after the current parliament's 2.5-year term ends in February 2023) and elections to generate fresh political momentum for the reform process. However, the president and the government have expressed their intention to focus on stabilising the economy first. Provincial elections are scheduled for March; while local media reports have suggested that they may be delayed further, the opposition has indicated that it might seek judicial advice and attempt to block any delays. The presidential office has said that the elections are on track to be held in March, but the risk of political unrest remains high in 2023.

While we do not expect a significant departure from current IMF policies, progress could be delayed if a new government tries to negotiate its own policy mechanisms to achieve the IMF debt sustainability goals. The current IMF programme will need strong legislative support, especially for the Central Bank Act.

Debt restructuring-related IMF benchmarks will be difficult to achieve

Holdout creditors could delay subsequent IMF reviews

Financing assurances from official creditors would be sufficient to secure the first IMF board approval and disbursement. However, subsequent IMF approvals will be contingent on Sri Lanka agreeing with official and private creditors on a comprehensive debt restructuring. With a large haircut likely for Eurobond holders, the probability of holdout creditors is high.

A similar delay in financing assurances has plagued Suriname since mid-2022. As a result, the country was unable to finalise its external debt restructuring by the end-2022 deadline the IMF had set when the programme was approved in December 2021.

Government privatisation plans could face significant delays

SOE restructuring is likely to focus on CEB and CPC

Government plans to restructure SOEs like Sri Lankan Airlines, Sri Lanka Telecom, Sri Lanka Insurance, Hilton Colombo and Water's Edge were not included in the 2023 budget. Restructuring and privatisation of these SOEs had been intended to raise foreign-currency reserves and cut government debt. Loans and guaranteed loans of several SOEs owed to China Exim Bank were transferred to the Treasury's balance sheet in a bid to improve SOE finances and make them more attractive investments. SOE restructuring is likely to focus initially on Ceylon Electricity Board (CEB) and Ceylon Petroleum Corporation (CPC), and to be extended to other SOEs later, as stated in the Fiscal Management Report.

2023 budget is optimistic and lack details on revenue generation

We expect the primary deficit to narrow to 2.2% of GDP in 2023 from an estimated 3.8% in 2022

The 2023 budget broadly adheres to the targets set under the IMF staff-level agreement (SLA), though achieving them will be challenging, in our view. We think the 3.3ppt reduction in the 2023 primary deficit to 0.7% is very ambitious. The budget forecasts a reduction of the 2023 fiscal deficit to 7.9% of GDP from a revised estimate of 9.8% for 2022. We revise our 2023 fiscal deficit forecast to 11% of GDP from 9%.

Figure 3: Fiscal targets are ambitious, execution is key

Fiscal accounts, LKR tn, % of GDP

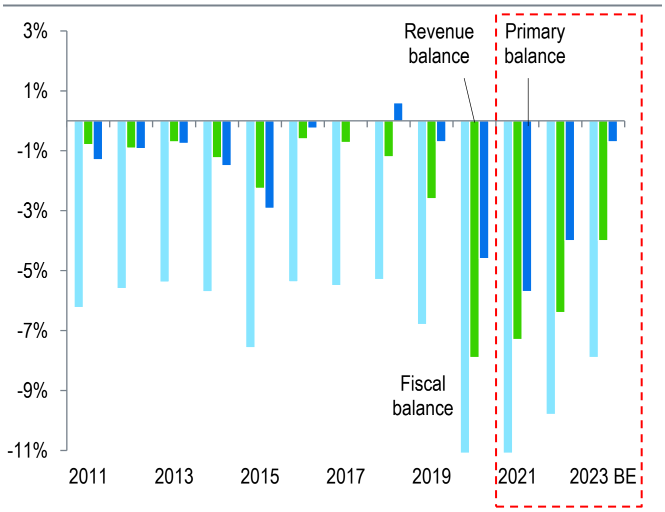
	2022RE	2023BE LKR tn	2023P	2022RE	2023BE % of GDP	2023P
Fiscal balance	**-2.3**	**-2.4**	**-3.2**	**-9.8**	**-7.9**	**-11.0**
Revenue balance	-1.5	-1.2	-2.0	-6.4	-4.0	-6.7
Primary balance	-1.0	-0.2	-0.6	-4.0	-0.7	-2.8
Total revenue	**2.1**	**3.4**	**3.2**	**8.7**	**11.3**	**10.1**
o/w tax revenue	1.9	3.1	2.9	7.8	10.3	9.1
Total expenditure	**4.4**	**5.8**	**6.6**	**18.6**	**19.2**	**21.1**
Revenue exp	3.6	4.6		15.1	15.2	17.6
Interest	1.4	2.2	2.6	5.8	7.2	8.8
Salaries and pensions	1.3	1.4	1.4	5.3	4.5	4.5
Public investment	1.1	1.2	1.0	4.5	4.0	3.5

BE= Budget estimates, RE= Revised estimates, P= Standard Chartered Research projection

Source: CEIC, Budget documents, Standard Chartered Research

Figure 4: Government expects deficits to narrow sharply

Government estimates of fiscal accounts, % of GDP



Source: CEIC, MoF, Standard Chartered Research

The key reasons why we expect a larger deficit than the government are that we factor in (1) a lower 50% y/y growth in tax revenues in 2023, versus the government budget forecast of c.70%; and (2) higher revenue expenditure due to increased interest expenses and subsidies. In the absence of domestic debt restructuring, we expect the government's interest-to-GDP ratio to be c.8.5% in 2023, exceeding the budgeted 7.2%.

We expect the primary deficit to narrow to 2.2% of GDP in 2023 from an estimated 3.8% in 2022. We acknowledge risks to our forecasts given uncertainty around the timing and nature of the debt restructuring. The actual fiscal deficit could also be smaller than expected in case of a build-up of overdue government payments due to lack of availability of funds, as was the case in 2022.

Sharp rise in revenue-to-GDP ratio will require focused measures

The government expects revenue to increase to 11.3% of GDP in 2023 (2022: 8.8%) on 70% growth in tax revenue, even as the economy is likely to remain in recession in 2023. We expect lower but still-robust revenue growth of 50%, supported by higher inflation (nominal GDP growth expected closer to 27%), new tax measures and an increase in tax rates. The government proposed several measures in the run-up to the budget, including raising VAT rates (along with lowering thresholds and rationalising exemptions) and raising direct taxes. However, weak industrial and services activity amid shortages of essential goods is likely to weigh on revenue growth.

Expenditure increase is mostly due to higher interest costs

Higher interest costs and subsidies to be balanced by lower investment spending

Increased interest expenses explain most of the projected increase in government spending in 2023. Interest expenses during the year will depend on progress on debt restructuring (both domestic and external). Restructuring delays are likely to lead to a further rise in interest costs in 2023. The expenditure plan lacks details on subsidy rationalisation measures. The proposed salary and hiring freeze for the government sector could also be difficult to implement amid still-high inflation. We estimate that public investment would have to decline to 3.5% of GDP this year (versus 4.0% estimated in the 2023 budget and 4.5% in 2022) in order to meet the government's fiscal deficit targets.

Medium-term fiscal projections stick to IMF targets

The government targets a 2025 primary surplus of above 2% of GDP, lowering the overall debt-to-GDP ratio to 100% in 2025 from 110% in 2021. The revenue-to-GDP ratio is projected to increase to 15% of GDP by 2025. The government has a medium-term GDP growth of 5%, and aims for long-term growth in the 7-8% range. Our revenue growth and fiscal consolidation assumptions are more conservative (Figure 9).

We expect the economy to contract further in 2023

We expect Sri Lanka's economy to contract by 1.0% in 2023, after a likely 7.0% contraction in 2022. Consumption is likely to slow further as inflation remains high; we project 2023 inflation at 28% (down from an extremely high 49% in 2022). Private investment is likely to decline given the still-uncertain domestic outlook and shortages of key input materials, including fuel and electricity. Public investment is likely to remain limited given extremely limited fiscal space. Fiscal space could be constrained further if revenue growth misses budget targets, or if additional budget support is needed for weaker sections of the economy severely impacted by higher inflation.

We expect Sri Lanka's economy to contract 1% in 2023, after a likely 7% contraction in 2022

Downside risks remain, especially in case of delays to our expected timeline for IMF board approval. The availability of essential commodities and key infrastructure may remain a constraint, even if the supply situation eases from here. Global energy prices will be a key factor. Sustained crude oil prices below USD 80/bbl would provide significant relief for the domestic economy. Further, sharp fiscal consolidation and tighter monetary policy are likely to weigh on growth. We expect the recovery to be only gradual in 2024; we forecast 2024 GDP growth at 3.0%, assuming that the debt restructuring process is completed by end-2023.

External account has remained balanced

External pressures have eased due to import suppression and the suspension of debt service

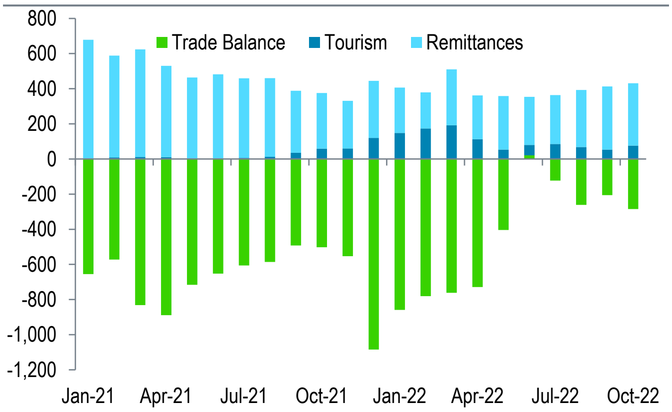
Sri Lanka's current account has remained balanced amid import bans on selected non-essential items and the non-repayment of a significant portion of its external liabilities since April 2022. All three key external-sector parameters – the trade balance, remittances and tourism – have improved.

- The trade deficit has narrowed sharply. It averaged USD 209mn in April-October 2022, compared to monthly averages of USD 782mn in January-March 2022 and USD 678mn in 2019.
- Remittances have also improved thanks to recent domestic political stability. Monthly remittances averaged USD 356mn during the August-November period, up from USD 270mn between January and July. We expect the improving trend to continue in 2023, with annual remittances at around USD 5bn (up from an estimated USD 3.5bn in 2022, but still well below USD 7.1bn in 2020).
- Tourism revenues averaged only USD 65mn between May and November 2022 due to the domestic political crisis and shortages of essential items. With the situation slowly improving, tourism revenues could rise to around USD 2.0-2.5bn in 2024 – nearly doubling from 2022 but still just half the 2018 level.

The gradual improvement in the C/A balance and lower capital account outflows (on the external debt servicing standstill) have helped the Central Bank of Sri Lanka (CBSL) to clear private-sector and other FX arrears. Consequently, FX reserves have gradually started to rebuild, though they remain precariously low. Gross FX reserves improved to USD 1.9bn at end-December from USD 1.7bn in August, with usable reserves now slightly above USD 400mn (excluding the USD 1.5bn PBoC swap line).

Figure 5: External sector is improving

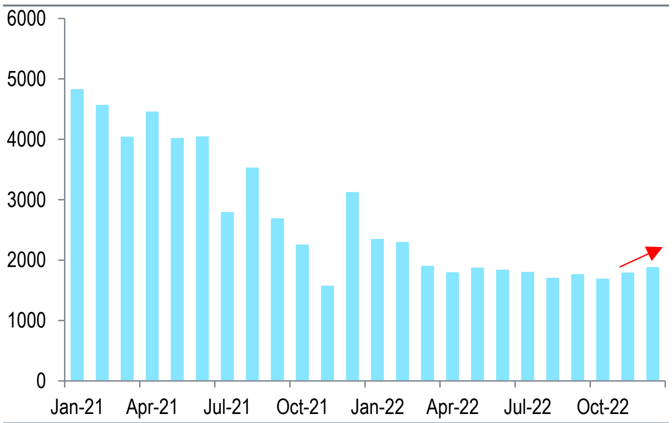
BoP components, USD mn



Source: CBSL Standard Chartered Research

Figure 6: FX reserves showing signs of stabilisation

USD mn



Source: CBSL, Standard Chartered Research

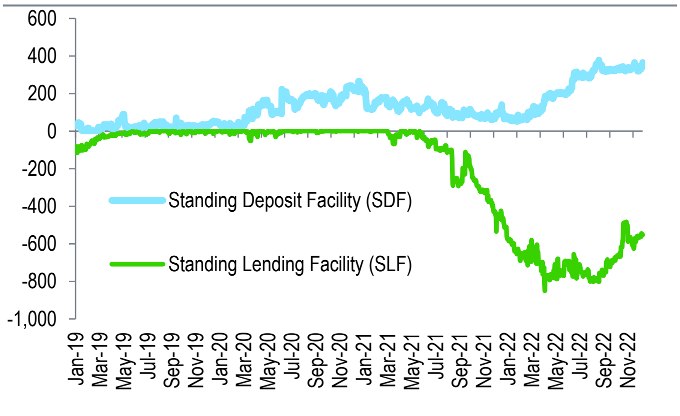
Financial-sector challenges grow

Sri Lanka's banking sector, already facing pandemic-related asset quality challenges, has been further hit by its increasing exposure to the sovereign. With no access to external funds since 2020, the government has had to depend solely on domestic markets and the central bank to finance the fiscal deficit. The increasing risk of domestic debt restructuring has reduced foreign investors' appetite for sovereign debt (T-bills and T-bonds). This has increased the burden on domestic banks – especially state-owned banks – to buy government paper, tightening their liquidity position. Meanwhile, foreign banks are parking their excess liquidity with the central bank, as stricter counterparty limits due to sovereign-related risks have made them reluctant to lend to liquidity-deficient domestic banks (Figures 7 and 8).

Banking-system profitability likely weakened in 2022 due to increases in provisioning, though slower credit growth likely kept banks' capitalisation stable. Given the banking system's large exposure to the sovereign (more than 40% of assets), a sovereign domestic debt restructuring would have to be accompanied by regulatory forbearance for domestic banks to mitigate capital erosion from NPV losses. However, even if such forbearance was provided, the loss of interest revenues due to coupon cuts would erode most of the sector's profitability, creating growth and lending challenges for banks. Maturity extension would also lead to a further liquidity squeeze in the sector, reducing banks' ability to support economic growth.

Figure 7: Domestic banks are borrowing, while foreign banks are lending to CBSL

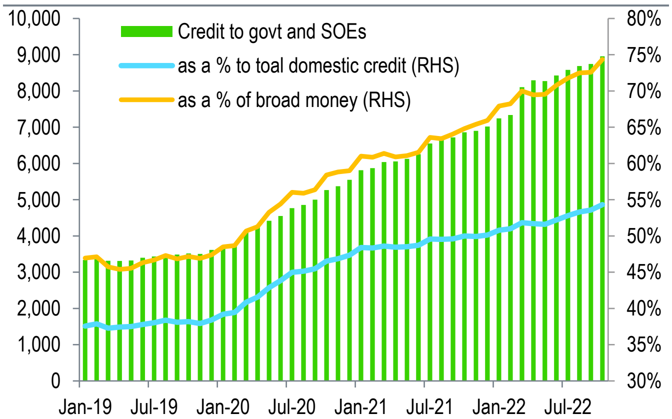
LKR bn



Source: CBSL, Standard Chartered Research

Figure 8: Banking sector's exposure to government continues to grow

LKR bn (LHS), % (RHS)



Source: CBSL, Standard Chartered Research

Debt restructuring – Macro assumptions

We think a 10-year timeframe will be required for the stabilisation of Sri Lanka's macroeconomic metrics. Macroeconomic developments will greatly impact the debt sustainability trajectory and will therefore be an important part of the debt restructuring negotiations. We summarise our macroeconomic assumptions for 2023-33 below under three different scenarios – base, bull and bear case. Our detailed macroeconomic assumptions are shown in Figure 15.

Figure 9: Summary of our assumptions under three scenarios

Real GDP growth (%); revenue (% of GDP); USD-LKR

	Base	Bull	Bear
Growth	-1% in 2023, 3% in 2024 4% thereafter until 2033	1% in 2023, 4% in 2024 5% thereafter until 2033	-3% in 2023, 2% in 2024 2.5% thereafter until 2033
Inflation	5.5% from 2025 onwards	5% from 2025 onwards	6% from 2025 onwards
Revenue	15.0% of GDP by 2033 Primary surplus in 2029	16.0% of GDP by 2033 Primary surplus in 2027	14.0% of GDP by 2033 Primary surplus not achieved before 2033
USD-LKR	350 in 2023, 325 in 2024 4.0% p.a. depreciation after 2024	350 in 2023, 325 in 2024 3.0% p.a. depreciation after 2024	350 in 2023 5.0% p.a. depreciation after 2023

Source: Standard Chartered Research

Other assumptions (all three scenarios)

- Inflation stabilises to 5-6% from 2025 onwards. Gradual spending rationalisation (including salaries and subsides) helps to achieve a primary surplus.
- Interest cost on existing debt stock declines in line with our restructuring assumptions; new funding is raised at 2ppt over inflation for T-bills and 3ppt over inflation for T-bonds after restructuring.

What will restructuring look like?

A comprehensive restructuring – including both domestic and external commercial debt – is needed, in our view. As we argued in *Sri Lanka – A long and arduous road ahead*, to achieve debt sustainability, debt restructuring will have to focus on reducing interest costs as well as stabilising debt. A comprehensive restructuring will likely involve:

- Coupon reduction and maturity extension for LCY T-bonds and T-bills
- Coupon reduction and maturity extension for Sri Lanka Development Bonds (SLDBs)
- Maturity extension of bilateral and multilateral debt, including central bank swaps
- Eurobond restructuring involving varying degrees of haircuts, coupon reduction and maturity extension

We assume coupon reduction and maturity extension for domestic debt

Debt under domestic law to be subject to coupon reduction and maturity extension

In our base-case scenario, we expect the interest cost-to-revenue ratio to remain high at c.72.6% in 2023, despite the external debt payment standstill, with domestic debt contributing c.96% of total interest payments (the remainder paid to multilateral lenders). Against this backdrop, we believe local debt restructuring will be needed to materially reduce interest costs. That said, with over 40% of local banks' asset base exposed to the public sector, a principal haircut on local debt would erode the banking sector's capital, with broader implications. Hence, we think local debt restructuring will entail converting the current stock of T-bills and T-bonds into longer-maturity T-bonds, and cutting the coupon on T-bonds by c.50% with no principal haircut. We expect similar treatment for SLDBs.

We assume bilateral and multilateral loans are rolled over

We assume that bilateral and multilateral loans will be rolled over, with no change in coupon rates

The Paris Club has taken a first step of proposing a 10-year debt moratorium, with principal to be repaid over the next 15 years. While China and India are not part of the Paris Club, Chinese Premier Li Keqiang said following a meeting with the IMF managing director that China is willing to work with other creditors “to formulate and participate in a fair and equitable debt restructuring plan”. Discussions are still at a preliminary stage and details are lacking. We assume in all three of our scenarios that bilateral and multilateral loans will receive a 10-year debt moratorium, as suggested in the Paris Club’s initial proposal, while multilateral debt will be rolled over during the period, with continuing payment of a 2% coupon. Given low interest costs on multilateral debt, a significant maturity extension would deliver substantial NPV gains for the government.

Eurobond restructuring: We see recovery value at 22-33

Eurobond restructuring will likely involve varying degrees of haircuts, coupon reduction and maturity extension

We continue to assume a comprehensive restructuring of USD bonds involving varying degrees of principal haircuts, coupon reduction and maturity extension. Details of our updated assumptions are shown in Figure 15.

Figure 10: Coupon cut, principal haircut and maturity extension for Eurobonds

Profile of restructured Eurobonds

	SRILAN 30N	SRILAN 33N	SRILAN 38N	SRILAN 43N	
Restructuring date	31-Dec-2023	31-Dec-2023	31-Dec-2023	31-Dec-2023	
Maturity date	31-Dec-2030	31-Dec-2033	31-Dec-2038	31-Dec-2043	
Original principal	3,000	3,500	3,500	3,697	13,697
Maturity	7	10	15	20	
Haircut	50.0	40.0	25.0	20.0	30.9
Reduced principal	1,500	2,100	2,625	2,957	9,182
Average coupon	3.00%	3.25%	3.50%	4.00%	3.50%
Coupon steps	1.5% for 2.5 years, 3.0% up to 4.5 years, 4.5% thereafter	1.625% for 3 years, 3.25% up to 7 years, 4.875% thereafter	1.75% for 5 years, 3.5% up to 10 years, 5.25% thereafter	2.0% for 6.5 years, 4.0% up to 13.5 years, 6.0% thereafter	

Source: Standard Chartered Research

Our base case assumes an exit yield of 13%

Sovereign credits’ yield-to-maturity (YTM) has increased across various rating buckets in an environment of rising interest rates. The weighted average YTM of B- sovereigns has decreased to 9.4% currently from 11.9% in June 2022, while the YTM of CCC+ sovereigns has increased to 26.5% from 18.4%. The divergent YTM moves of the two rating buckets are due to changes in the constituents of the buckets. Pakistan, which is trading at a high probability of default, was downgraded to CCC+ from B-. Meanwhile, Türkiye (trading at a relatively low YTM) was downgraded to B- from B. The 10Y bonds of comparable sovereigns – such as Nigeria, Angola, Egypt, Gabon and Mozambique – are trading at YTM of 10-13%. Given where these comparables are trading, we think a 13% exit yield for Sri Lanka is warranted under the Eurobond restructuring.

We see recovery value 22-33 for the Eurobonds

Based on an exit yield range of 11-15%, we calculate a recovery value of 22-33 for the Eurobonds. Under our base-case assumption of an 13% exit yield, we estimate a recovery value of 28. We continue to see bonds with single-series CAC clauses trading at a premium. The premium is justified, in our view, given the likelihood of more favourable treatment for these bonds in a debt restructuring scenario (as was seen in the case of Ecuador's Eurobond restructuring in 2020).

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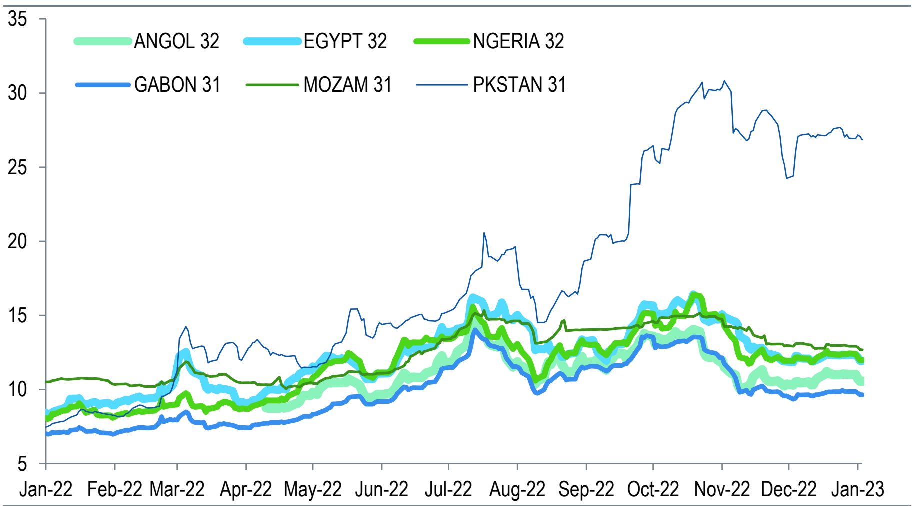
Figure 11: YTM of single-B and CCC rated comparables is between 10-13%

YTM (%)



Source: Bloomberg, Standard Chartered Research

Figure 12: We see a recovery value of 22-33, depending on exit yield used

Recovery values of restructured Eurobonds

Restructured bonds	Amount (USD mn)	Principal haircut (%)	Principal outstanding (USD mn)	Average coupon	Recovery value at various exit yields (cents)				
					11%	12%	13%	14%	15%
SRILAN 30 N	3,000	50	1,500	3.00%	32	31	29	28	26
SRILAN 33 N	3,500	40	2,100	3.25%	33	31	29	27	25
SRILAN 38 N	3,500	25	2,625	3.50%	34	30	28	25	21
SRILAN 43 N	3,697	20	2,957	4.00%	32	29	26	24	20
Weighted average		30.9	9,182	3.52%	33	30	28	26	22

Source: Standard Chartered Research

Debt stabilises at high levels; interest cuts provide relief

In our base case, government revenues increase gradually to 15% of GDP by 2033. Our expected restructuring plan under this scenario achieves only a modest decline in debt over the 10-year period, to 102.6% of GDP by 2033. However, interest rate reduction through local debt restructuring, and a gradual increase in revenues, materially improve interest affordability to below 36% of revenues by 2033.

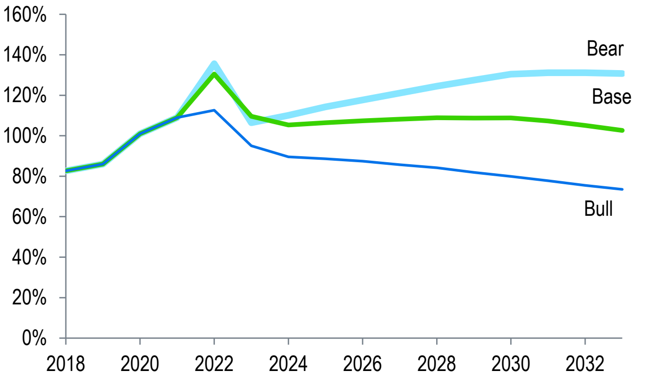
In our bull case, revenues rise to 16% of GDP. Our expected restructuring plan under this scenario achieves a sharp decline in debt to 73.5% of GDP by 2033. In addition, interest rate reduction and revenue increases improve interest affordability significantly to c.25% of revenues by 2033.

In our bear case, revenues increase gradually to just 14.0% of GDP by 2033. Our expected restructuring plan under this scenario would keep debt elevated at 130.7% of GDP by 2033. Interest affordability would remain poor, with the interest-to-revenue ratio at c.48% in 2033.

These scenarios highlight that while debt restructuring will play an important role in achieving debt sustainability, revenue reforms and a sustainable increase in revenue will be crucial to achieving long-term debt sustainability. Details of the debt and interest trajectory under our three scenarios are shown in Figure 16.

Figure 13: Debt stabilises at a high level in our base case…

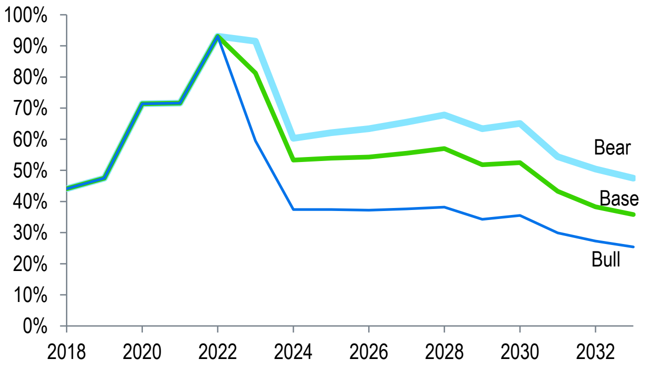
Projected debt-to-GDP ratio under different scenarios



Source: Standard Chartered Research

Figure 14: …while interest costs decline sharply

Projected interest-to-revenue ratio under different scenarios



Source: Standard Chartered Research

Figure 15: Detailed macroeconomic assumptions

Base case	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Real GDP	-1.0%	3.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Inflation	28%	8.0%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
USD-LKR	350	325	338	352	366	380	395	411	428	445	463
Fiscal balance (% of GDP)	-11.4%	-8.5%	-8.3%	-8.2%	-8.2%	-8.1%	-7.2%	-7.5%	-5.9%	-5.1%	-4.7%
Revenue (% of GDP)	*11.1%*	*11.2%*	*11.7%*	*12.2%*	*12.7%*	*13.2%*	*13.8%*	*14.3%*	*14.8%*	*15.3%*	*15.3%*
Primary balance (% of GDP)	-2.5%	-2.5%	-2.0%	-1.6%	-1.1%	-0.6%	0.0%	0.0%	0.5%	0.8%	0.8%
Bull case											
Real GDP	1.0%	4.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Inflation	20%	7%	5%	5%	5%	5%	5%	5%	5%	5%	5%
USD-LKR	350	325	335	345	355	366	377	388	400	412	424
Fiscal balance (% of GDP)	-8.3%	5.6%	-5.9%	-5.6%	-5.0%	-5.1%	-4.2%	-4.4%	-4.0%	-3.7%	-3.7%
Revenue (% of GDP)	*13.1%*	*13.5%*	*14.0%*	*14.5%*	*15.0%*	*15.5%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*
Primary balance (% of GDP)	-0.5%	-0.6%	-0.7%	-0.2%	0.6%	0.8%	1.3%	1.3%	0.8%	0.6%	0.3%
Bear case											
Real GDP	-3.0%	2.0%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Inflation	40%	9%	6%	6%	6%	6%	6%	6%	6%	6%	6%
USD-LKR	350	368	386	405	425	447	469	492	517	543	570
Fiscal balance (% of GDP)	-14.2%	-10.5%	-10.3%	-9.7%	-9.7%	-10.1%	-9.7%	-9.9%	-7.8%	-7.2%	-6.8%
Revenue (% of GDP)	*10.1%*	*10.5%*	*11.0%*	*11.5%*	*12.0%*	*12.5%*	*13.0%*	*13.5%*	*14.0%*	*14.0%*	*14.0%*
Primary balance (% of GDP)	-5.0%	-4.2%	-3.4%	-2.4%	-1.9%	-1.6%	-1.4%	-1.1%	-0.1%	-0.1%	-0.1%

Source: Standard Chartered Research

Figure 16: Debt stabilises at a high level in our base case, while interest costs decline sharply

Debt sustainability metrics under our scenarios and assumptions

Scenarios	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Base case												
Debt/GDP	130.5%	109.6%	105.3%	106.4%	107.4%	108.2%	108.9%	108.7%	108.8%	107.3%	105.1%	102.6%
Interest/revenue	93.1%	81.3%	53.3%	53.9%	54.3%	55.5%	57.0%	51.8%	52.5%	43.3%	38.3%	35.8%
Effective Interest rate	7.3%	8.4%	5.9%	6.2%	6.5%	6.9%	7.3%	6.9%	7.2%	6.2%	5.8%	5.5%
Bull case												
Debt/GDP	112.6%	95.0%	89.6%	88.6%	87.4%	85.7%	84.2%	81.9%	79.9%	77.8%	75.5%	73.5%
Interest/revenue	93.1%	59.5%	37.4%	37.4%	37.2%	37.6%	38.2%	34.3%	35.5%	29.9%	27.3%	25.4%
Effective Interest rate	7.4%	8.3%	5.8%	6.2%	6.4%	6.9%	7.3%	6.9%	7.4%	6.4%	6.0%	5.7%
Bear case												
Debt/GDP	135.6%	106.4%	110.1%	114.3%	117.7%	121.1%	124.5%	127.5%	130.4%	131.1%	131.1%	130.7%
Interest/revenue	93.1%	91.5%	60.3%	62.1%	63.4%	65.5%	67.8%	63.4%	65.1%	54.4%	50.4%	47.5%
Effective Interest rate	7.4%	9.0%	6.2%	6.4%	6.6%	6.9%	7.2%	6.8%	7.1%	6.1%	5.6%	5.3%

Source: Standard Chartered Research

Disclosures appendix

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Recommendation structure (effective 13 July 2020)

	Standard Chartered terminology	Impact	Definition
Issuer recommendation	Overweight	Outperform	We expect the credit spreads of the issuer's bond complex to <Impact> in comparison to other issuers in the relevant Bloomberg index over the next 6 months
	Market weight	Perform in line	
	Underweight	Underperform	

Relevant Bloomberg indices

EM sovereigns: Bloomberg Emerging Markets Sovereign Total Return Index

EMEA corporates: Bloomberg EM USD Corporate Quasi Sov EMEA Index

Asia IG corporates: Bloomberg Asia Ex-Japan USD Credit Corporate IG

Asia HY corporates: Bloomberg Asia Ex-Japan USD Credit Corporate HY

Previous recommendation structure (effective prior to 13 July 2020)

	Standard Chartered terminology	Impact	Definition
Issuer - Credit outlook	Positive	Improve	We expect the fundamental credit profile of the issuer to <Impact> over the next 12 months
	Stable	Remain stable	
	Negative	Deteriorate	

Standard Chartered Research offers trade ideas with outright Buy or Sell recommendations on bonds as well as pair trade recommendations among bonds and/or CDS. In Trading Recommendations/Ideas/Notes, the time horizon is dependent on prevailing market conditions and may or may not include price targets.

Recommendation distribution (as of 10 January 2023)	Coverage percentage	(IB%)
Overweight (Buy)	17%	(17.2%)
Market weight (Hold)	71%	(18.4%)
Underweight (Sell)	12%	(21.4%)
Total (IB%)	**100%**	**(18.6%)**

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Issuer recommendation history

Issuer	Date	Issuer recommendation
Democratic Socialist Republic of Sri Lanka	11-Aug-2022	MARKET WEIGHT
	9-Mar-2022	UNDERWEIGHT
	9-Feb-2022	MARKET WEIGHT

Regulatory Disclosure

Subject companies and/or issuers: Democratic Socialist Republic of Sri Lanka