

## Investor Response to Sovereign Debt Restructuring: Evidence from Sri Lanka

Wijesooriya R.P.M.R.<sup>1</sup>, Kongahawatte S.D.L.<sup>2\*</sup>, Peiris T.M.S.<sup>3</sup>, Chaturanga B.T.K.<sup>4</sup>

University of Sri Jayewardenepura, Sri Lanka, <sup>1,2,3,4</sup>

*ruwangawijesooriya@sjp.ac.lk, kongahawatte@sjp.ac.lk, miyuki@sjp.ac.lk, btk@sjp.ac.lk*

### ABSTRACT

The existing body of literature presents mixed views on the impact of sovereign debt restructuring announcements on corporate performance and capital market investments, highlighting the divergence of capital market investors' responses to such announcements in different financial markets. Given the absence of solid literature on investor reactions to sovereign debt restructuring announcements in Sri Lanka, we examine the response of investors in the Colombo Stock Exchange (CSE) to the official announcement of the 2023 sovereign debt restructuring. We employ the standard event study methodology to examine investor responses to the debt restructuring announcement in Sri Lanka. Our estimation window spans 240 days, while the test window covers 21 days (from day t-10 to day t+10). The market model is utilized to estimate expected returns, enabling the calculation of abnormal returns. The final sample consists of 265 stocks with return data available for the period from January 2022 to August 2023. Share prices, risk-free rates, and market index values are obtained from TR EIKON. We find significant positive average abnormal returns on the sovereign debt restructuring announcement date. Any abnormal positive return preceding the announcement is absent indicating no information leakage. Further, we find that the investors in the financial sector and the investors of large firms respond positively to the sovereign debt-restructuring announcement. This finding supports the notion that the large-scale private investors of sovereign bonds benefitted from the government's decision to restructure the domestic sovereign bonds owned by the Employee Provident Fund (EPF). This study provides new evidence on how investors respond to sovereign debt restructuring announcements in a frontier market using the event study methodology.

**Keywords:** Colombo Stock Exchange, Event study methodology, Investor response, Sovereign debt restructuring