EMERGING ASIA ECONOMICS UPDATE

Sri Lanka: what does election mean for the economy?

- The landslide victory by Sri Lanka People’s Party (SLPP) will allow incumbent President Rajapaksa to consolidate power. This is likely to lead to an increase in corruption and nepotism and will also add impetus to Mr Rajapaksa’s plans to “restore relations” with China.

- Sri Lanka’s delayed parliamentary election (originally scheduled for 25th April) took place on Wednesday. The results show that the SLPP won 145 of the 225 seats in Parliament, with a further five seats won by close allies. This gives President Gotabaya Rajapaksa exactly the two-thirds majority needed to change the Constitution. The election completes a remarkable comeback for the Rajapaksa family, which lost power in the country following the 2015 election. Although Mr. Rajapaksa was elected last November, until now he had had to govern with a minority in parliament.

- The president is likely to use his large majority to make constitutional changes. The most likely is the removal of presidential term limits. This would reverse changes that were made in 2015 which reduced the powers of the president and spread them more evenly with the prime minister and parliament. Other changes to undermine the influence and oversight of independent bodies such as the national election commission and the judiciary are also likely.

- The changes are likely to give President Rajapaksa and Prime Minister Mahinda Rajapaksa (Gotabaya’s older brother, who was himself president from 2005-15) unchecked power. This should at least lead to a period of relative political calm. During 2015-19 the government was bedevilled by divisions between Prime Minister Ranil Wickremesinghe and President Maithripala Sirisena.

- However, we are concerned that increasing the power of the president will lead to a rise in corruption and nepotism and a shift towards more authoritarian government. Among other ills, this could damage Sri Lanka’s reputation with international investors.

- The government’s immediate priority will be supporting the economy through the downturn. Sri Lanka has done a good job of controlling the virus – the country has reported an average of just four new cases a day over the past week. The high-frequency mobility data that we track from Google suggest that daily life has returned broadly to normal.

- But a collapse in tourism, which before the crisis generated around 5% of GDP, means the economy is set to shrink this year. We have pencilled in a contraction of 4%, which would be the worst performance since at least 1962 (the earliest our records date back to).

- Against this backdrop, the government may push for a further loosening of fiscal policy. However, Sri Lanka’s weak fiscal position – the budget deficit is likely to exceed 10% of GDP this year, while government debt is set to reach 90% of GDP – leaves it with little room for manoeuvre. A big stimulus could set the country up for a conflict with the IMF. (Sri Lanka has been in an IMF deal since June 2016.)

- The election victory will also add impetus to Mr Rajapaksa’s plans to “restore relations” with China. During his brother’s presidency, booming Chinese investment provided an important support to demand, but left Sri Lanka saddled with debt that it was unable to pay off.

- The Hambantota port in the south of the country, which was constructed using Chinese money, provides a cautionary tale of how things can go wrong. A lack of traffic meant that Sri Lanka incurred heavy losses and was unable to repay the debts owed to the Chinese state-backed companies which helped to finance the project. In 2017, Sri Lanka was forced to hand over control of the port to China on a 99-year lease.

- The election result is also likely to lead to further question marks about the independence of the central bank, which has been in doubt since last November’s presidential election. Following the election, the long-serving governor of the CBSL, Indrajit Coomaraswamy, resigned and was replaced by a long-time ally of the Rajapakses, WD Lakshman. In June, two further members of the central bank’s board quit. The key threat is that the central bank loosens policy too aggressively, putting downward pressure on the currency.

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