Economic Effect of Lockdowns

Unlike previous episodes of epidemics, such as SARS, H1N1 or Ebola, the rapid evolution of the COVID-19 outbreak into a pandemic within a short period required countries across the globe to introduce lockdowns and other types of mobility restrictions in an unprecedented manner. The effect of such restrictions is reflected in the global economic contraction of 3.1% in 2020 as per the estimates of the IMF.

In Sri Lanka also, the socio-economic effects of the pandemic and the associated lockdowns and mobility restrictions have been substantial. The first wave of the pandemic during March-May 2020 was addressed by a strict nationwide lockdown, which was relaxed in a phased manner thereafter. The nationwide lockdown resulted in the Sri Lankan economy contracting by 16.4%, y-o-y, during the second quarter of 2020. The second wave during October-November 2020 was addressed by selective lockdowns and mobility restrictions, which reduced the economic fallout to some extent. Yet, the recovery process was disrupted, and the economy recorded a growth of only 1.3%, y-o-y, in the fourth quarter. Accordingly, these resulted in Sri Lanka recording its highest economic contraction of 3.6% in 2020, in contrast to the initial expectation of a real GDP growth rate of around 5%. The third wave of the pandemic since April 2021 has been, by far, its largest wave. Mobility restrictions during the third wave were also selective.

While lockdowns and mobility restrictions were necessary to prevent the spread of the pandemic, their impact in terms of macroeconomic performance was severe. According to projections made by the Central Bank in April 2019, Sri Lanka's nominal GDP was expected at Rs. 17.39 tn in 2020 and Rs. 19.17 tn in 2021. However, with the pandemic, the economy recorded a nominal GDP of only Rs. 14.97 tn in 2020 and is likely to record a nominal GDP of about Rs. 16.5 tn in 2021. This indicates a staggering annual loss of GDP in nominal terms of about Rs. 2.5 tn.

While the COVID-19 pandemic has not spared any key economic sector, it must be mentioned that key foreign exchange earning sectors pertaining to trade and tourism related activities have been hard-hit by the pandemic. In turn, this has been reflected in the decline in the foreign exchange flows to the country, thereby negatively weighing on the stability of the exchange rate and having negative spillover effects on investor confidence. On the fiscal front, the slowdown in economic activity contributed to the reduction in government revenue amidst rising expenditure, thereby exerting significant pressures on the fiscal sector and warranting additional borrowing.

The impact of the lockdowns and mobility restrictions may also be assessed from a labour market perspective. According to the Labour Force Survey Quarterly report for the fourth quarter of 2020 published by the DCS, out of the 8.03 mn of the employed population, own account workers and contributing family workers and those employed in the private sector accounted for 82% of total employment. Further, according to the Labour Force Survey Annual Report for 2019, informal sector employment accounted for 57.4% of total employed. This highlights that even among those engaged in employment, the majority are vulnerable in the wake of such disruptions. Furthermore, Sri Lanka has recorded unemployment rates above 5% since the onset of the pandemic, compared to the average unemployment rate of 4.4% since the end of the conflict. In this regard, such loss of livelihoods results in increased vulnerability and increased poverty, especially in relation to those who are just above the poverty line and those who are outside the ambit of social safety nets.

The recovery observed during the first half of 2021 has been on the back of the extraordinary support provided by the Central Bank to all stakeholders of the economy, via various channels since the onset of the pandemic in March 2020. This includes support to the private sector, the banking sector and the Government. The financial sector has also extended broadbased support to borrowers, including businesses and individuals, to smoothen the negative effects of COVID-19 related disruptions. The Central Bank also took steps to protect affected businesses and individuals from undue penalties and forced acquisitions. However, such stimulus cannot be continued indefinitely without adverse macroeconomic repercussions and financial system stability concerns. At the same time, going forward, it is necessary in future credit evaluation to recognise the pandemic effects on relationships between financial institutions and their clientele.

The above highlights that the COVID-19 pandemic and the lockdowns that it entail create a vicious cycle that can have a scarring impact on businesses and households in the near term and thereby the overall growth trajectory and potential of the Sri Lankan economy in the medium term. Going forward, it is imperative that the Government continues to proactively and holistically strike a balance between minimising the human toll of the pandemic while also minimising the economic toll of these circumstances on the Sri Lankan economy which had already been struggling to recover from a long period of sub-par growth. The cornerstone of maintaining this balance is the ongoing COVID-19 vaccination drive spearheaded by the Government. The much-acclaimed progress that has been observed especially since July 2021 is expected to minimise any disruptions stemming from COVID-19 in the period ahead. However, the public's close adherence to prescribed health guidelines will also be vital to the recovery of the economy. Only then can a virtuous cycle of macroeconomic stability, improved economic growth and enhanced resilience be established to pave way for the creation of an inclusive and sustainable growth trajectory for the Sri Lankan economy.