Sri Lanka
CRT-4
August 22, 2019
Region: Asia

Country Risk Criteria Procedures
Guide to Best’s Country Risk Tiers

• The Country Risk Tier (CRT) reflects AM Best’s assessment of three categories of risk: Economic, Political, and Financial System Risk.

• Sri Lanka, a CRT-4 country, has high levels of economic, political, and financial system risk. In 2018, its economy grew 3% as reforms implemented as part of the country’s IMF program bolstered investor confidence. Following a terrorist attack in 2019, growth is expected at 3.3%, below potential due to lost tourism revenue.

• Inflation is expected to be around 4%. The inflationary outlook faces headwinds from possible currency depreciation and increased fuel and electricity costs.

• The map depicts the countries in the region AM Best evaluates for country risk. Countries in South Central Asia are all categorized as CRT-3, CRT-4, or CRT-5.

Regional Summary: South Central Asia

• Led by India, the region has been the world’s fastest growing in recent years. Imports have risen on rising domestic demand; exports remain below potential, with the region still only weakly integrated into global value chains.

• Private investment remains low; significant increases in investment and credit are needed for the region to meet its full growth potential and extend poverty-reduction gains.

• Risks to growth include heightened geopolitical tensions and security concerns, delays in reform implementation, insufficient job creation for a growing population, infrastructure deficiencies, climate change-related challenges, widening fiscal and current account deficits, and inadequate international reserves to manage shocks.

• Inflation throughout most of the region has been relatively stable, although some countries have experienced inflationary pressure owing to domestic currency depreciation (Pakistan) and volatility in energy pricing. Global financial conditions have led to the adoption of more accommodative monetary policy stances.
Economic Risk: High

- Political infighting in Sri Lanka has dampened the country’s growth prospects and led to heightened security concerns. These in turn have negatively affected the country’s tourism sector, which is approximately 5% of GDP.

- The government faces rising debt repayment costs and has limited external buffers. Debt repayments as a percentage of GDP have outpaced spending on both health and education; however, the country is still considered to be within the World Bank’s high human development category ranking 76 out of 189 in the latest Human Development Index.

- Sri Lanka’s Inland Revenue Act, which went into effect in 2018, raised the corporate tax rate and simplified the tax system, and is expected to increase government revenue.

Political Risk: High

- The government is led by President Maithripala Sirisena whose five year term expires at the end of 2019. In late 2018, Sri Lanka experienced a constitutional crisis and political deadlock following President Sirisena’s dismissal of Prime Minister Ranil Wickremesinghe. Following extensive political machinations (including the attempted dissolution of parliament by Sirisena, which was declared unconstitutional by Sri Lanka’s supreme court), Wickremesinghe was reinstated as Prime Minister.

- The reformed government is led by Wickremesinghe’s United National Party (UNP), which has a slight parliamentary majority. However, it no longer has the two thirds majority coalition it had prior to the upheaval.

- Sri Lanka has only one commercial court, meaning the resolution of commercial disputes is a lengthy process—the court currently has a backlog of over half a million cases. Sri Lanka did improve in the latest Doing Business ranking and now ranks 100 out of 190 countries, up from 111.

- In 2019, coordinated IED attacks on Easter at churches and hotels killed over 200 people and injured several hundred more. The attacks were carried out by members of a local militant Islamic group that was subsequently largely dismantled though Sri Lankan police efforts.

Financial System Risk: High

- The insurance industry is regulated by the Insurance Regulatory Commission of Sri Lanka. The banking industry is regulated by the Central Bank of Sri Lanka.

- As a result of the 2018 political crisis and the 2019 terror attacks, Sri Lanka was delayed in meeting its reform agenda with the IMF under its 2016 USD1.5 billion Extended Fund Facility agreement. The IMF has agreed to a one-year extension until 2020.

- The IMF has highlighted Sri Lanka’s high public debt, large refinancing needs, and low reserves as key risks. Reforms to Sri Lanka’s Central Bank law are expected to help rebuild reserves.