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NATIONAL OUTPUT AND EXPENDITURE

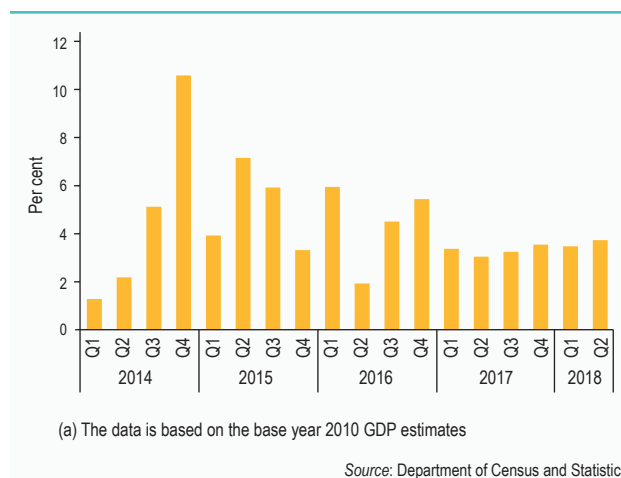
The Sri Lankan economy is expected to grow by 4.0 per cent in 2018 compared to 3.3 per cent growth recorded in 2017 in the midst of the challenges that emanated from both domestic and external fronts. According to official statistics, the economy grew by 3.6 per cent during the first half of 2018 compared to the growth of 3.2 per cent recorded in the corresponding period of 2017. Continuous expansion in Services activities buttressed by the recovery in Agriculture activities supported economic growth, while Industry activities slowed down hindering the overall growth of the economy. The expansion in financial services and trade activities mainly supported the growth in Services activities, while the recovery in paddy, vegetables, cereals and fruits mainly contributed to the upturn in Agriculture activities. However, the setback observed in construction activities primarily dragged down growth in Industry activities. The continuation of the government's fiscal consolidation process and policy uncertainty that impacted investor sentiments, together with the lagged effect of the tight monetary policy stance that prevailed during the previous year dampened economic growth during the period. Going forward, the economy would benefit from the bilateral and multilateral trade arrangements with leading economies as well as efforts to improve ease of doing business, develop more focused investment promotions, trade facilitation, factor market reforms and other favourable developments on the policy front. However, there are downside risks for the projected growth outlook emanating from hikes in global commodity prices, particularly crude oil, geopolitical tensions in major trading partner economies and other external shocks, contractionary fiscal measures, and unanticipated adverse weather conditions.

Developments in 2018

Output

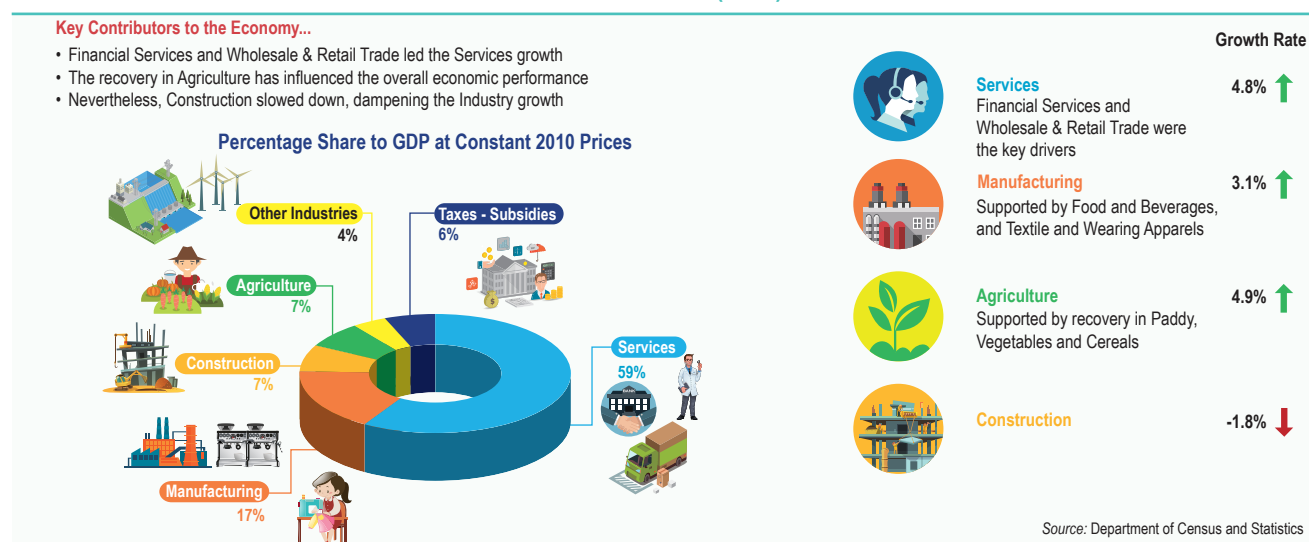
- The economy grew by 3.6 per cent during the first half of 2018 compared to 3.2 per cent growth in the corresponding period of 2017.** Services and Agriculture activities grew by 4.8 per cent and 4.9 per cent, respectively, while a moderate growth of 1.6 per cent was recorded in Industry activities. The expansion in Services activities was mainly driven by the growth in financial services, trade, other personal services and real estate activities. In the meantime, the recovery in paddy, vegetables and cereals together with the positive contributions from fruits, animal production, fishing, spices, and forestry and logging stimulated the growth in Agriculture activities. However, the setback in construction, and mining and quarrying activities dragged down the Industry growth despite the expansion in manufacturing activities.
- As per the medium term macroeconomic framework of the Central Bank, the economy is projected to grow by 4.0 per cent in 2018 compared to 3.3 per cent growth recorded in 2017.** This projected annual growth is expected to be mainly supported by Services and Agriculture activities, while some moderation is anticipated in Industry activities. The continuous expansion

Figure 2.2
Quarterly GDP Growth Rates (a)



of financial services, wholesale and retail trade activities, together with the development in accommodation services supported by the upsurge in tourist activities, are expected to drive the growth in Services activities. In the meantime, the recovery in Agriculture activities is expected to continue for the rest of the year, contributing positively to the overall economic growth. Meanwhile, the projected moderation in Industry activities is largely due to the recently observed slowdown in construction activities which is reflected by indicators such as cement availability and building material imports. However, manufacturing activities would positively contribute to the performance in Industry activities with the expansion in manufacture of

Figure 2.1
Gross Domestic Product (GDP) - 2018 H1



textiles and wearing apparel and the positive spillovers from agriculture recovery. As per the prospects revealed by the Business Outlook Survey, the overall demand and production of the economy are anticipated to improve from the beginning of the second half of the year. At the same time, the expectation for activities in the Purchasing Managers' Index (PMI) for Services activities for the month of September indicates an improvement in the next three months. Further, PMI for Manufacturing activities for the month of September also anticipates an improvement in overall manufacturing activities in the near future. However, the survey participants highlighted that the policy uncertainties and prevailing economic conditions adversely impact their business decision making.

- **There are some downside risks for the growth projections for 2018, arising from both domestic and external fronts.** The rising trend in global crude oil prices could increase domestic energy cost, thereby increasing the input cost of local industries such as manufacturing, construction and transportation. Further, the geopolitical tensions in the middle eastern countries, particularly in Iran, and other major trading partner economies, would impact the country's exports. Further, the tight monetary policy stances in the US, UK and euro area can impact the external demand. Meanwhile, any unanticipated adverse weather conditions would adversely impact the recovery in major agriculture crops, thereby hindering the growth in Agriculture activities which would spillover to other industry activities, such as food processing related manufacturing activities and Services activities such as trade and transport.

Growth in Economic Activities

Agriculture, Forestry and Fishing

- **Agriculture, Forestry and Fishing activities recovered significantly during the first half of 2018 by recording a growth of 4.9 per cent in value added terms against 3.8 per cent contraction in the same period of 2017.**

This upturn was largely supported by the substantial recovery in growing of rice, vegetables and cereals, which grew by 58.2 per cent, 14.8 per cent and 38.1 per cent, respectively, in value added terms, together with the positive contributions from growing of fruits, animal production, fishing, growing of spices, and forestry and logging. However, growing of oleaginous fruits (coconut, king coconut, oil palm) contracted by 4.6 per cent in value added terms during this period, due to the lingering effect of drought conditions that prevailed during the previous year. Further, value added of growing of rubber, other perennial crops and growing of sugarcane, tobacco and other non-perennial crops also contracted during the first half of the year, hindering the recovery in Agriculture activities to a certain extent.

Production Trends and Institutional Support: Agriculture

Agriculture Production Index

- **The Agriculture Production Index (API), which measures the output of Agriculture and Fisheries sectors, recorded a growth of 13.3 per cent during the first half of 2018.** The paddy sub-index recorded a significant growth of 62.6 per cent, benefitting mainly from the

Table 2.1
Agriculture Production Index (2007-2010=100)

Item	2017 First Half (a)	2018 First Half (b)	Growth Rate (%)	
			2016/17 (a)	2017/18 (b)
Agriculture and Fishing	118.1	133.8	-11.7	13.3
1 Agriculture	111.2	130.0	-15.6	16.9
1.1 Agriculture Crops	103.7	122.9	-19.6	18.5
Paddy	78.8	128.2	-49.2	62.6
Tea	99.8	101.1	0.8	1.3
Rubber	67.2	58.6	-5.9	-12.8
Coconut	91.0	86.2	-13.2	-5.3
Other Crops	137.8	163.8	-9.6	18.9
o/w Vegetables	130.6	170.4	-17.3	30.5
Fruits	164.0	176.3	12.5	7.5
Other Field Crops	136.5	176.2	-18.6	29.1
1.2 Livestock	170.5	186.5	11.3	9.4
2 Fisheries	151.6	152.5	5.7	0.6

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

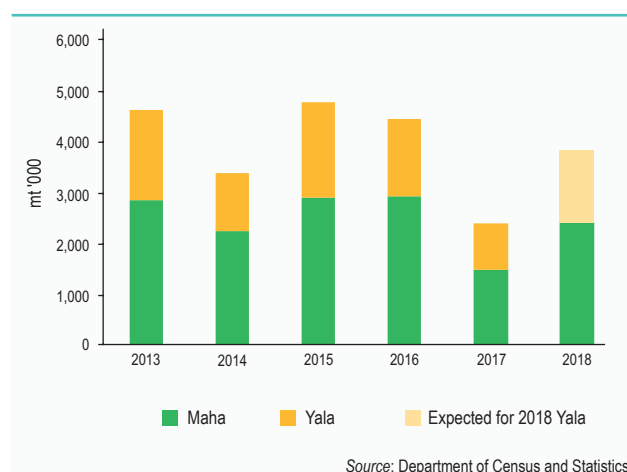
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favourable weather conditions and increased cultivated extent. Livestock and other crops (fruits, vegetables and other field crops) sub-indices also contributed positively to the overall index, recording a growth of 9.4 per cent and 18.9 per cent, respectively. However, the rubber sub-index witnessed a pronounced decline of 12.8 per cent, particularly due to the reduction of tapping operations in response to low market prices that prevailed during this period and adverse weather conditions experienced during the latter part of the first half. The coconut sub-index also recorded a decline of 5.3 per cent, while the tea sub-index increased marginally by 1.3 per cent during the first half of 2018. Further, the fisheries sub-index also increased by 0.6 per cent during the first half of 2018, amidst weather related disturbances that disrupted fishing activities.

Paddy

- Paddy production is estimated to recover from adverse weather conditions experienced in 2017, with an increase of around 60 per cent in 2018 which is expected to be sufficient to meet the entire domestic household demand for rice.** Conducive weather conditions that prevailed during the 2017/18 Maha season and the 2018 Yala season are expected to support a production of 3.8 million metric tons during the year. According to the Department of Census and Statistics (DCS), the 2017/18 Maha

Figure 2.3
Paddy Production



paddy production increased by around 62.6 per cent to 2.4 million metric tons over the previous Maha season, which was affected by drought conditions. Meanwhile, 1.4 million metric tons of paddy production is forecasted for the 2018 Yala season, which is irrigated mainly by stored water, resulting in a 56.8 per cent increase compared to the previous Yala season. Out of the stock of available paddy, about 2.4 million tons of rice are projected to be milled, which will be sufficient to meet approximately 12 months of local household demand. At the beginning of the year, low harvests in 2017 and diminishing stocks also drove up local prices, prompting the government to take a proactive stance to encourage rice imports. During the first six months of 2018, around 239,519 metric tons of rice have been imported into Sri Lanka at a total cost of US dollars 100.1 million. In spite of the increased production, paddy and rice prices of selected varieties remained elevated during the first half of 2018, compared to the corresponding period of 2017. The average open market paddy price of Samba increased by 6.8 per cent to Rs. 51.35 during the first half of 2018, compared to the corresponding period of 2017. However, the average paddy price of Nadu was Rs. 40.05 per kilogramme, which was a drop of 17.1 per cent, compared to the same period of the previous year. Meanwhile, the average retail price of Samba rice was Rs. 107.36 per kilogramme during the first half of 2018, which was an increase of 12.8 per cent from the same period of 2017. The average retail price of Nadu rice was Rs. 93.26 per kilogramme, which was an increase of 7.2 per cent, compared to the corresponding period of the previous year.

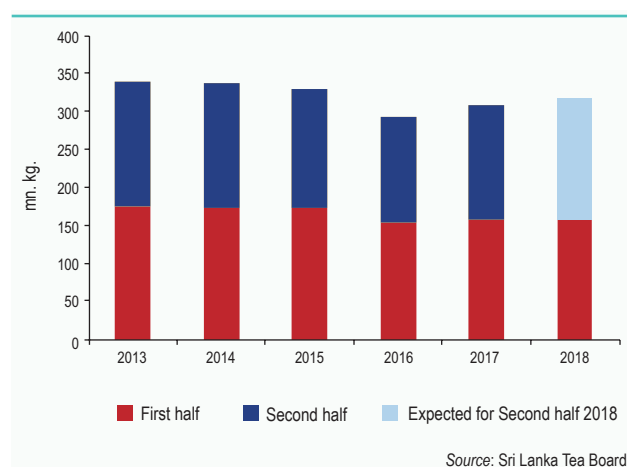
- The government took measures to reintroduce the fertiliser subsidy programme from the 2018 Yala season onwards, replacing the fertiliser cash grant programme, which was in place from the 2016 Yala season.** The approval of the Cabinet of Ministers was granted to provide 50 kilogrammes of fertiliser in bulk for paddy cultivation at a price of Rs.500 and 50 kilogrammes of fertiliser in bulk for several selected other crops at a price of Rs 1,500.

Fertiliser subsidies are issued on the basis of recommendations given by the Department of Agriculture, which are based on agro climatic zones and irrigation schemes. The government took steps to continue the importation of rice as a measure to avoid shortages in the market during the festive season in April 2018. However, the importation of rice during the first half of 2018 was 29.1 per cent lower than the imports witnessed during the corresponding period of 2017, due to adequate stocks of paddy being available in the market for milling.

Tea

- **Total tea production at 158.2 million kilogrammes during the first half of 2018, recorded a marginal increase of 0.9 per cent over the production during the same period of 2017.** Rainy weather conditions that prevailed in tea plantation districts during the months of May and June had a negative impact on the production of tea leaves, which hampered the growth momentum during the period under review. Accordingly, all elevations witnessed only a modest expansion in output with low grown tea production being the main contributor, increasing by 1.0 per cent to 97.7 million kilogrammes during the first half of 2018. Meanwhile, both high and medium grown tea production increased by 0.7 per cent each to 36.1 million kilogrammes

Figure 2.4
Tea Production



and 24.4 million kilogrammes, respectively, during the period. The contribution made by the tea smallholder sector to total tea production increased slightly to 73.9 per cent during the first half of 2018, from 73.8 per cent during the first half of 2017.

- **During the first half of 2018, prices at the Colombo Tea Auction (CTA) fell marginally by 2.2 per cent to Rs. 605.17 per kilogramme compared to the corresponding period of the previous year.** The highest decline was recorded for medium grown tea (5.5 per cent), followed by high grown tea (2.9 per cent) and low grown tea (1.7 per cent), during this period. Moreover, the average price at the CTA for the month of July 2018 also declined by 9.6 per cent, year-on-year, to Rs. 535.80 per kilogramme. However, the average export price (FOB) of tea increased by 4.0 per cent to Rs. 828.13 per kilogramme during the first six months of 2018 from Rs. 796.34 per kilogramme in the corresponding period of 2017. The quantity of tea offered at the CTA during the first half of 2018 also recorded an increase of 3.4 per cent. Meanwhile, export earnings marginally increased by 0.1 per cent compared to the earnings in first half of 2017.

Rubber

- **Continuous rain in rubber growing areas in the wet zone caused a loss of tapping days in rubber plantations, resulting in a significant decline in the rubber yield.** Rubber production during the first half of 2018 witnessed a considerable decline of 12.8 per cent to 39.3 million kilogrammes, in comparison to the same period of 2017. Sheet rubber production, the largest component of total rubber production, decreased by 12.8 per cent to 19.6 million kilogrammes, while crepe rubber production marginally increased by 0.5 per cent to 6.9 million kilogrammes. Meanwhile, production of centrifuged latex and other category of rubber recorded a decline of 18.7 per cent to 12.8 million kilogrammes during the first half of 2018. Rubber prices, on average, remained at lower levels

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during the first half of 2018, in comparison to the corresponding period of 2017. The average price of Ribbed Smoked Sheet Number 1 (RSS1) registered a significant decrease of 12.6 per cent to Rs. 289.78 per kilogramme during the first half of 2018, whilst the average price of latex crepe witnessed an increase of 4.4 per cent to Rs. 325.93 per kilogramme at the Colombo Rubber Auction.

Coconut

- Coconut production is estimated to have declined by 5.3 per cent during the first half of 2018 to 1,220.2 million nuts, in comparison to the production in the first half of 2017.** The decline can be attributed to the lagged effect of drought conditions that prevailed in the latter part of 2016 and early 2017. Hence, production volumes of many coconut based products decreased during the period under review. Coconut oil production decreased by 70.6 per cent to 2,851 metric tons, while desiccated coconut (DC) production declined by 48.5 per cent to 8,461 metric tons. Virgin coconut oil production at 5,785 metric tons was also lower by 16.7 per cent. Despite the reduction in nut production, coconut cream, coconut milk powder and coconut milk production increased by 51.4 per cent to 32,909 metric tons during the first half of 2018. Supply shortfalls resulted in a sharp increase in market prices of coconut in 2018. The average wholesale price increased by 28.3 per cent from Rs. 55.80 per nut during the first half of 2017 to Rs. 71.58 per nut during the same period of 2018. Similarly, the average retail price increased by 25.8 per cent, from Rs. 61.71 per nut in the first half of 2017 to Rs. 77.61 per nut in the first half of 2018. However, compared to prices in December 2017, the average retail price of coconut decreased by 7.9 per cent from Rs. 83.42 per nut to Rs. 76.83 per nut in June 2018. The average export price (FOB) of the three major kernel products increased significantly by 49.5 per cent to Rs. 79.47 per nut, in the first half of 2018 from Rs. 53.15 per nut in the first half of 2017.

Other Field Crops

- Production of other field crops (OFCs) recovered, increasing by 42.3 per cent to 429,289 metric tons in the 2017/18 Maha season, mainly supported by favourable weather conditions.** Production of crops such as cowpea, green gram, finger millet ('kurakkan') and potatoes increased during the season. This was partly supported by remunerative prices fetched for selected commodities such as potatoes due to high levels of Special Commodity Levy (SCL) on imports of such commodities. Meanwhile, maize production increased by 48.4 per cent to 242,935 metric tons in the first half of the 2018, which was over 50 per cent of the country's estimated annual requirement of maize. Further, it is expected that the production of black gram and cowpea would meet around 80 per cent of the total domestic requirement for this year. However, production of selected OFCs such as soya beans and sorghum, observed a declining trend, partly due to the lower extent of land cultivated compared to last year.

Vegetables

- According to provisional estimates of the DCS, overall vegetable production increased by 20.6 per cent to 985,982 metric tons during the 2017/18 Maha season.** The production of low-country vegetables increased by 31.1 per cent, while up-country vegetables increased by 20.8 per cent, mainly due to an increase of the area under cultivation, on account of favourable weather conditions that prevailed in major cultivation areas during the beginning of the year. However, heavy pre-monsoon rains during mid-May caused floods in Puttalam and Ratnapura districts, which in turn, brought heavy damages to nursery stage vegetables cultivated for the 2018 Yala season. Further, torrential rains across the island throughout May 2018 considerably increased the loss to vegetables in early stages of cultivation in both up-country and low-country areas, resulting in low supply conditions, escalating vegetable prices from end May 2018 onwards. However, the harvest of the 2018 Yala season, which reached the market in mid-July, helped to ease vegetable prices thereafter.

Sugar

- **During the first half of 2018, sugar production increased by 56.0 per cent to 22,858.8 metric tons.** This is the combined outcome of a 299.2 per cent increase in production at the Sevanagala factory, due to conducive weather conditions that prevailed in those areas and a decline in production at the Gal Oya and Pelwatte factories by 59.8 per cent and 11.6 per cent, respectively, due to a delayed crushing season. However, with a view to enhancing sugarcane production, the government implemented several programmes with the Sugarcane Research Institute to increase the sugarcane cultivation. With the support of various efforts by the government, it is expected that total sugar production would increase marginally by around 1 per cent to 50,802 metric tons in 2018, which would be equal to around 9 per cent of the total sugar requirement of the country.

Fisheries

- **According to estimates of the Ministry of Fisheries and Aquatic Resources Development, total fish production, which includes marine and inland sectors, improved marginally by 0.6 per cent to 254,395 metric tons during the first half of 2018.** The off-shore and deep-sea subsectors, which account for around 46 per cent of the total marine fish production, showed an improvement of 1.8 per cent to 101,180 metric tons, compared to the corresponding period in the previous year. Meanwhile, the coastal subsector declined considerably by 7.1 per cent to 119,360 metric tons, mainly due to rainy weather that prevailed in coastal areas during May 2018. Output of inland fishery and aquaculture subsectors, which accounted for around 13 per cent of the total production, increased significantly by 35.2 per cent in the first half of 2018, compared to the first half of 2017. Growth in this subsector can be attributed to the increase in the release of fingerlings to inland reservoirs as well as improvements in the aquaculture sector. However, retail prices of fish remained elevated during the first half of 2018, compared to the corresponding period of 2017.

Livestock

- **The livestock sector witnessed a growth during the first half of 2018 compared to the first half of 2017.** According to estimates and projections of the Department of Animal Production and Health (DAPH), total national milk production increased by 8.5 per cent to 241.2 million litres during the first half of 2018, which was sufficient to meet around 40 per cent of the total domestic demand. Of the total milk production recorded during the first half of 2018, cattle milk production accounted for 84.4 per cent, while the remainder was buffalo milk production. Meanwhile, egg production registered an increase of 25.2 per cent to 1,538 million during the first half of 2018, due to the increased importation of layer parents that took place in 2017. Poultry meat production recorded an increase of 7.7 per cent to 100,040 metric tons during the first half of 2018. The average cost of poultry meat production increased during the first half of 2018, mainly due to the increase in prices of day-old chicks. Production of pork and beef also increased by 32.9 per cent and 2.4 per cent, respectively, during the first half of 2018. DAPH implemented several programmes to develop the dairy sector based on the Livestock Sector Master Plan. A livestock breeding project was implemented to upgrade the cattle population in Sri Lanka in order to improve genetic potential aimed at increasing milk production. Vaccination of animals throughout the country against diseases was carried out together with disease investigation and diagnosis, under the control of contagious and infectious diseases. Institutional support for livestock development was strengthened with the improvement of institutions catering to livestock farmers through the Field Veterinary Service Improvement Programme of DAPH.

Industries

- **The value added of Industry activities grew at a moderate pace of 1.6 per cent during the first half of 2018 compared to 4.5 per cent growth recorded in the corresponding period of 2017.** The contraction observed in construction and, mining and quarrying activities

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hindered the growth in industry activities. Meanwhile, manufacturing activities recorded a positive growth during the first half of the year, yet at a slower pace, compared to the growth recorded in the corresponding period of 2017. In the meantime, electricity, gas, steam and air conditioning supply activities grew substantially during first half of the year, while sewerage, waste treatment and disposal activities, and water collection, treatment and supply activities witnessed some slowdown.

- The moderate growth in Industry activities was largely attributable to the setback in construction activities, which contracted by 1.8 per cent during the first half of 2018 against the 3.6 per cent growth recorded in the corresponding period of 2017.** Reflecting the contraction in construction activities, the total cement availability of the country recorded a 0.7 per cent contraction, while the building material imports volume index decreased by 3.6 per cent during the first half of the year. Mining and quarrying activities, which are highly correlated with construction activities, also recorded a contraction of 0.4 per cent during the first half of 2018 compared to the 16.7 per cent growth recorded in the corresponding period of 2017. Meanwhile, the value added of manufacturing activities grew by a slower pace of 3.1 per cent during the first half of 2018 compared to the 3.3 per cent growth recorded in the corresponding period of 2017. The Index of Industrial Production (IIP) compiled by the DCS recorded a marginal increase of 1.1 per cent during the first half of 2018, reflecting the slower growth in manufacturing activities. Further, the PMI for manufacturing activities compiled by the Central Bank on a monthly basis also indicated a moderate pace of growth in manufacturing activities, on average, during the first half of the year. The recorded growth in total manufacturing activities was mainly driven by the recovery in the manufacture of food, beverages and tobacco products, which grew by 5.3 per cent in value added terms during the first half of the year benefitting from the recovery of agriculture activities, compared to the stagnant performance recorded in the corresponding period of 2017.

Further, value added of manufacture of textiles, wearing apparel and leather related products grew by 4.1 per cent in the first half of 2018 compared to the 3.8 per cent growth recorded in the corresponding period of 2017. However, the value added of manufacture of coke and refined petroleum products recorded a notable decline of 22.0 per cent during the first half of 2018 compared to the 13.7 per cent contraction in the corresponding period of 2017. Considering the value added growth of other industry related activities, electricity, gas, steam and air conditioning supply activities grew substantially by 6.9 per cent during the first half of 2018 compared to the 2.4 per cent growth in the corresponding period of 2017. Meanwhile, sewerage, waste treatment and disposal activities, and water collection, treatment and supply activities grew at a slow pace of 6.4 per cent and 1.9 per cent, respectively, in value added terms during the first half of 2018 compared to 8.7 per cent and 10.8 per cent growth, respectively, recorded in the corresponding period of 2017.

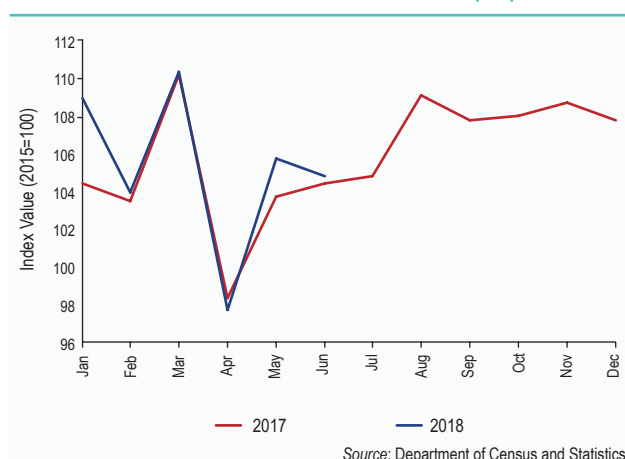
Production Trends and Institutional Support: Manufacturing Activities

Index of Industrial Production¹

- The Index of Industrial Production (IIP) registered a marginal increase of 1.1 per cent during the first half of 2018, as in the first half of 2017.** Most of the large subsectors of the IIP, including the manufacture of food products, wearing apparel, chemicals and chemical products, and rubber and plastic products registered marginal increases, while some smaller subsectors of the IIP recorded substantial reductions in production, limiting the overall growth to 1.1 per cent. Stagnant domestic demand restrained growth in the subcategories that mostly cater to the local market, such as manufacture of food products, beverages and non-metallic mineral products.

¹ The Index of Industrial Production (IIP) is compiled by the Department of Census and Statistics. The base year of the IIP is 2015 and the industries are categorised according to the International Standard Industrial Classification (ISIC) Revision 4. The IIP is to be used as the basis for the analysis of production trends instead of the Factory Industry Production Index (FIPI) used thus far.

Figure 2.5
Index of Industrial Production (IIP)



- The manufacture of food products, which accounts for over one third of the IIP, recorded a modest increase of 2.4 per cent in the first half of 2018 compared to the growth of 1.4 per cent in the corresponding period of the previous year.** The sector is driven mainly by domestic consumption demand, except for processing of tea. Hence, subdued consumer demand may have contributed to this modest increase in manufacturing activities. The categories of food manufacturing that showed a notable increase during the first six months are poultry-based products, canned fish, milk powder, jams and sauces, ice cream and iodized salt. The manufacture of wheat flour and rice milling products recorded an increase during the first half of 2018 compared to the corresponding period in the previous year.
- The manufacture of wearing apparel, which is the second largest subsector in the IIP, recorded an increase of 3.9 per cent in the first half of 2018, compared to a 3.3 per cent increase in the first half of 2017.** Although the Generalised System of Preferences plus (GSP+) scheme has been reinstated, a phenomenal increase in apparel has not been recorded. This indicates that the period in which GSP+ will be operative should be used by Sri Lanka to build capabilities in other value added industries as well. The manufacture of textiles registered a decline of 1.7 per cent during the first half of 2018, having grown by 1.5 per cent during the corresponding period of 2017.
- The manufacture of other non-metallic products registered a decline of 5.3 per cent during the first half of 2018, compared with high production level witnessed in 2017.** This subsector comprises the manufacture of cement, porcelain and ceramic products, glass products, clay building material and articles of concrete and plaster among others. During the first half of 2018, the manufacture of porcelain table-wear, glass bottles, roofing tiles and corrugated sheets declined notably, in comparison to the first half of 2017. Cement production also declined slightly during the first half of 2018 compared to the corresponding period of 2017. The decline in construction related raw-material could be attributed to the moderation in construction activities during the first quarter of 2018.
- The manufacture of coke and refined petroleum products declined moderately by 3.9 per cent in the first half of 2018, in comparison to the 14.5 per cent decline witnessed in the corresponding period of 2017.** Activities of the Sapugaskanda Oil Refinery, which declined considerably in 2017 due to several operational constraints that led to the temporary shutdown of the refinery, continued in the first half of 2018, with the scheduled renovation aimed at boosting efficiency.
- The manufacture of rubber and plastic products recorded an increase of 1.9 per cent, compared to a 2.4 per cent increase in the corresponding period of the previous year.** This outcome indicates that this export oriented industry is also stagnating in the face of low rubber prices in the international market and low production of rubber in Sri Lanka. The production of rubber tyres, gloves, sheet rubber types and crepe rubber recorded a mixed performance during the first half of 2018.
- The manufacture of chemicals and chemical products recorded an increase of 7.1 per cent during the first half of 2018, as against a decline of 15.3 per cent recorded during the first half of 2017.** This subsector comprises

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manufacture of fertiliser, pesticide, paints, varnishes, printing ink, soap, detergents, sanitary napkins, matches, perfume, plastics in primary form, etc. generally records high fluctuations, owing to the heterogeneous nature of industries included in this subsector and the differences in the determinants of their demand. The manufacture of fertiliser recorded a decline during the period. Meanwhile, production of paints, sanitary napkins, detergent, polybags and polythene rolls increased. The increase in the latter two products indicates that the initiatives undertaken to limit the usage of polythene in the country do not appear to have had a significant effect.

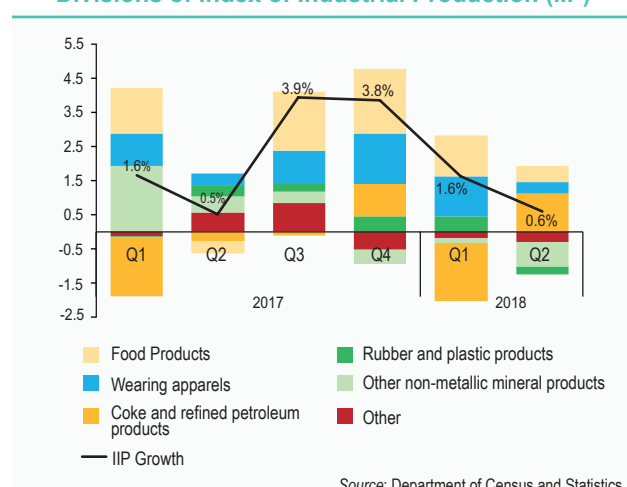
- **In comparison to the reduction of 5.1 per cent during the first half of 2017, the manufacture of beverages increased by 6.1 per cent during the same period in 2018, due to the increase in beer and arrack production.** In contrast, the manufacture of tobacco products continued to weaken, registering a decline of 7.4 per cent compared to the 3.9 per cent contraction in the first half of 2017 with a decrease in cigarette production.
- **The manufacture of basic metals and the manufacture of fabricated metal products increased by 11.4 per cent and 14.6 per cent, respectively, in the first half of 2018, compared**

to the increase of 9.5 per cent and 7.2 per cent, respectively, in the first half of 2017. While the increase in the production of lead and aluminium bars contributed to the higher produce of basic metals, the increase in the output of aluminium and steel products contributed to the rise in the manufacture of fabricated metal products.

- **Two small subsectors that recorded an increase in production in the first half of 2018 are the manufacture of leather and related products, which grew by 3.4 per cent, and the manufacture of wood products except furniture, which grew by 13.5 per cent.** While leather goods such as bags and jackets caused the growth in production numbers in the former category, the latter category grew because of the increase in saw milling and planing of wood and the increase in the production of railway sleepers and plywood.
- **Six further subsectors of the IIP, each of which account for less than 2 per cent of the IIP, recorded a decline in production.** Decline in the production volumes of almost all these categories, which include the manufacture of paper and paper products (-17.2 per cent), the manufacture of basic pharmaceuticals products and pharmaceutical preparations (-13.0 per cent), the manufacture of electrical equipment (-13.2 per cent) and the manufacture of furniture (-10.2 per cent) were substantial. Lower production of exercise books, newspapers, currency notes, certain types of medicinal capsules and Ayurvedic syrup, household electrical appliances, wires, mattresses, wooden furniture and water pumps contributed to this unfavourable outcome.
- **The Ministry of Industry and Commerce (MIC) and the Ministry of Development Strategies and International Trade (MODSIT) provided support for the industry sector by developing industrial zones, formulating regulations and providing investment approvals.** With recommendations from the MIC, the government decided to grant a 75 per cent waiver of the Port and Airport Development Levy (PAL) for the import

Figure 2.6

Contribution to Year-on-year Change by Major Divisions of Index of Industrial Production (IIP)



of high-tech machinery to use in manufacturing industries. In order to support automobile manufacturing, assembly and component manufacturing industries and to attract foreign direct investment (FDI) into the sector, the MIC embarked on preparing standard operating procedures. Further, the MIC plans to expand the Achchuveli industrial zone in the Northern province, expecting Indian investment in the area. Meanwhile, the Board of Investment of Sri Lanka (BOI) launched the web-portal of the Single Window Investment Facilitation Taskforce in May 2018 that would be used to provide investment approvals. The BOI started the development work relating to four new Export Processing Zones (EPZs) in Bingiriya, Mawathagama, Milleneniya and Charlie Mount Estate during the first half of 2018. Having identified that there are about 6,500 vacancies existing within the EPZs by mid-2018, half of which are for machine operators, the BOI set up a “Skill Development Task Force” with industry stakeholders and plans to carry out measures to improve the social acceptance of factory workers and to conduct islandwide job fairs with the Ministry of Labour and Trade Union Relations.

- **Several other ministries, public institutions and industry chambers continued their strategies to support the manufacturing sector.** The Ministry of Science, Technology, Research, Skills Development, Vocational Training and Kandyan Heritage (MSTRSVK), formulated the Basic Science Research Policy, the National Policy on Genome Centres, and an action plan for the National Genome Data Repository to support the implementation of the National Research and Development Framework. Further, the Ministry acquired land to establish a University College in Kinniya in the Trincomalee District to improve vocational training in the country. The Industrial Technology Institute (ITI) carried out technology transfer programmes to develop products that can be manufactured and marketed by Sri Lankan entrepreneurs. Meanwhile, the National Science Foundation (NSF) granted several scholarships and research grants to scientists engaged in

new product development initiatives. Meanwhile, the Ministry of Women and Child Affairs (MWC) expanded efforts aimed at increasing female entrepreneurship in the country. With the objective of increasing female labour force participation, the MWC expects to setup 2,000 daycare centres islandwide. Industry chambers and associations established in Sri Lanka also implemented numerous initiatives to support the manufacturing sector and assist the public sector in policy formulation. A Special Purpose Vehicle named “Lanka Rubber Global Consortium” was launched in January 2018 bringing together rubber products manufacturing companies, the Export Development Board (EDB), the Asian Development Bank (ADB) and local and foreign consultants to collaboratively undertake value chain development and improve export potential. The Ceylon Chamber of Commerce (CCC), in partnership with the Institute for the Development of Commercial Law and Practice (ICLP) launched the “CCC-ICLP Alternative Dispute Resolution Centre” to facilitate resolution of commercial disputes outside Courts of Law.

Services

- **Services activities, which represent the largest share of the economy, grew by 4.8 per cent during the first half of 2018 compared to 3.5 per cent growth recorded in the corresponding period of 2017, in value added terms.** This growth was primarily supported by the continuous expansion in financial services, wholesale and retail trade activities and other personal services activities. Further, real estate, transportation, accommodation, insurance, telecommunication, professional services, human health activities, and education services also contributed positively to the expansion in Services activities. However, public administration, and programming and broadcasting activities contracted during the first half of the year. The expansion in Services activities was also reflected in the PMI for Services activities compiled by the Central Bank, which on average, indicated an improvement during the first half of 2018.

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Wholesale and Retail Trade, Transportation and Storage, Accommodation and Food Service Activities

- The value added of wholesale and retail trade, transportation and storage, and accommodation and food service activities grew by 4.0 per cent during the first half of 2018 compared to 2.0 per cent growth recorded in the corresponding period of 2017. The expansion in wholesale and retail trade activities, which grew by 5.3 per cent during the first half of 2018 compared to 3.3 per cent growth recorded in the corresponding period of 2017, largely supported the growth in this segment. In the meantime, transportation of goods and passengers including warehousing activities grew by 1.8 per cent during the first half of 2018 compared to 0.1 per cent marginal growth recorded in the corresponding period of 2017. The positive spillovers from the recovery in the agriculture production might have favourably affected the expansion in wholesale and retail trade, and transportation services. Further, accommodation, food and beverage services activities recorded a favourable growth of 7.0 per cent during the first half of 2018 compared to 4.9 per cent growth recorded in the same period of 2017, while postal and courier activities grew by 5.7 per cent during the period compared to 6.0 per cent growth recorded during the corresponding period of 2017.

Information and Communication Activities

- The value added of information and communication activities expanded by 9.8 per cent during the first half of 2018 compared to 9.5 per cent growth recorded in the corresponding period of 2017. This growth was largely supported by the substantial growth in telecommunication activities, which grew by 12.9 per cent during the first half of 2018 compared to 10.5 per cent growth recorded in the corresponding period of 2017. Further, IT programming, consultancy and related activities expanded by 6.7 per cent during the first half of 2018 compared to 3.9 per cent growth recorded in

the same period of 2017. However, programming and broadcasting, and audio video production activities contracted by 16.8 per cent during this period against 22.1 per cent growth recorded in the first half of 2017.

Financial, Insurance and Real Estate Activities, including Ownership of Dwellings

- The financial, insurance and real estate activities, including ownership of dwellings expanded by 8.5 per cent in value added terms during the first half of 2018 compared to 7.7 per cent growth in the corresponding period of 2017. The growth momentum in financial service activities and auxiliary financial services provided impetus for the expansion in this segment. Accordingly, financial service activities and auxiliary financial services grew by 12.2 per cent during the first half of 2018 compared to 10.0 per cent growth in the corresponding period of 2017. In the meantime, real estate activities, including ownership of dwellings grew by 4.3 per cent during this period compared to 5.5 per cent growth recorded in the first half of 2017. Further, insurance, reinsurance and pension funding activities grew by 10.2 per cent during the first half of 2018 compared to 6.3 per cent growth recorded in the same period of previous year, contributing to the development of this segment.

Professional Services and Other Personal Service Activities

- The value added in professional services and other personal service activities expanded by 4.7 per cent during the first half of 2018 compared to 3.4 per cent growth recorded in the corresponding period of the previous year. This growth was primarily driven by the upturn in other personal service activities, which recorded a growth of 5.0 per cent during the first half of 2018 compared to 3.7 per cent growth recorded in the same period of 2017. Further, professional services expanded by 3.0 per cent during this period providing a positive contribution to this segment, compared to 2.0 per cent growth recorded in the first half of 2017.

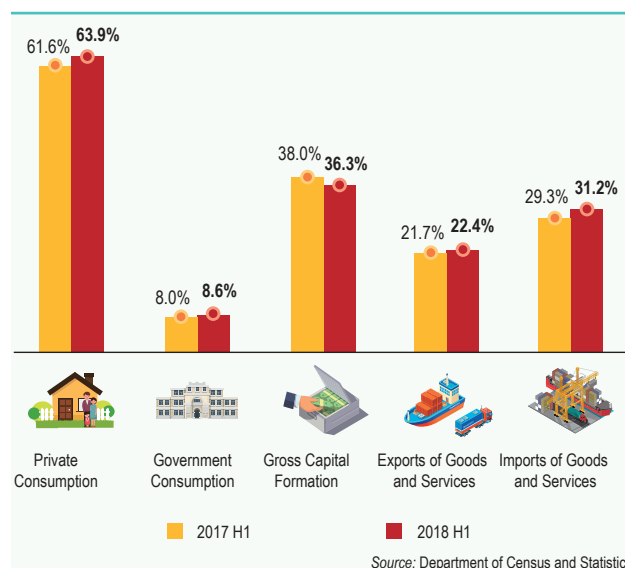
Public Administration, Defence, Education, Human Health and Social Work Activities

- Public administration, defence, education, human health and social work activities grew marginally by 0.5 per cent in value added terms during the first half of 2018 compared to the same growth rate recorded in the corresponding period of 2017. This moderation was largely due to the further contraction observed in public administration and defence related services which declined by 0.7 per cent during the first half of 2018 over the 4.7 per cent contraction recorded in the same period of 2017. Meanwhile, human health activities and education services grew by 2.2 per cent and 1.7 per cent, respectively, yet at a slower rate, compared to 11.9 per cent and 3.6 per cent growth, respectively, recorded during the corresponding period of 2017.

Expenditure

- Gross Domestic Expenditure (GDE), which is the aggregate of consumption and investment expenditure of the economy, grew by 9.2 per cent at current market prices during the first half of 2018 compared to 11.4 per cent growth recorded in the corresponding period of 2017.** This growth was largely buoyed by the expansion observed in the consumption expenditure amidst the slowdown in investment expenditure. Accordingly, consumption expenditure grew by 12.4 per cent at current market prices during the first half of 2018 compared to 6.0 per cent growth recorded in the corresponding period of 2017. Meanwhile, the growth in investment expenditure moderated to 3.2 per cent at current market prices during this period compared to 23.1 per cent growth recorded in the same period of 2017. This slowdown in investment activities was also reflected in the setback in the value added of construction activities during the first half of this year. In the meantime, net external demand further contracted by 24.1 per cent at current market prices during the first half of 2018 compared to

Figure 2.7
Total Expenditure of the Economy
(As a percentage of GDP)



17.1 per cent contraction recorded in the same period of the previous year. Even though exports of goods and services grew at a higher rate of 11.8 per cent during this period compared to 11.6 per cent growth recorded in the corresponding period of 2017, the upsurge in imports by 15.0 per cent compared to 13.0 per cent growth in the same period of 2017 dampened the net external demand. Subsequently, GDP, which is the aggregate of GDE and the net external demand grew by 8.0 per cent at current market prices during the first half of 2018 compared to 11.0 per cent growth recorded in the corresponding period of 2017.

- GDE is projected to grow by 9.3 per cent in 2018 amounting to Rs. 15,602.3 billion at current market prices compared to 11.7 per cent growth recorded in 2017.** This anticipated expansion in GDE is expected to be largely supported by the growth in consumption expenditure in the midst of the setback expected in the investment expenditure. Meanwhile, net external demand is projected to contract by 17.9 per cent in 2018 compared to 9.5 per cent contraction recorded in 2017. Accordingly, GDP at current market prices is projected to grow by 8.7 per cent in 2018 compared to 11.8 per cent growth recorded in 2017.

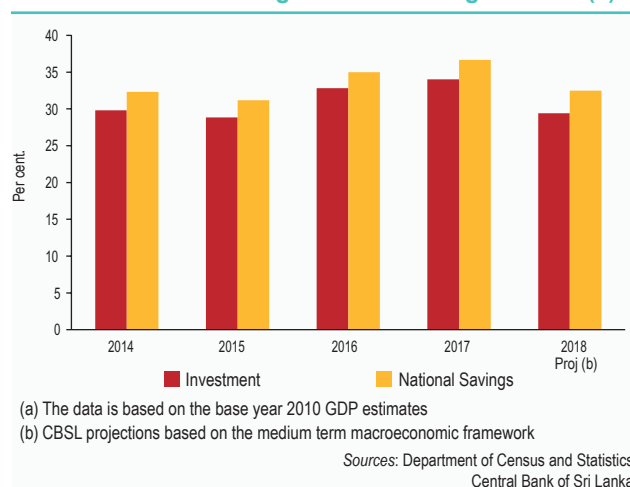
Consumption

- **Consumption expenditure, which is the largest expenditure category of the economy is projected to grow by 16.0 per cent in 2018 amounting to Rs. 10,898.4 billion at current market prices compared to 9.0 per cent growth recorded in 2017.** Both private and government consumption expenditure are anticipated to contribute to the expansion in total consumption expenditure. Accordingly, private consumption expenditure is projected to grow by 16.3 per cent in 2018 at current market prices compared to 8.7 per cent growth in 2017. When considering the behaviour of government consumption expenditure during the first half of 2018 and the projections for the rest of the year, public consumption expenditure is also expected to further expand in 2018 compared to 2017.

Investment

- **Investment expenditure is projected to contract by 3.6 per cent at current market prices in 2018 compared to 17.2 per cent growth recorded in 2017.** A moderation in public investment expenditure is expected when considering the government expenditure performance during the first half of the year and future projections. Further, credit granted by the commercial banks to the private sector for the purpose of personal housing, including purchasing/construction/repairs activities, grew at a slower pace of 14.6 per cent as at end June 2018, compared to 22.9 per cent growth recorded as at end June 2017, indicating a moderation in private investments related to construction, which is a major component in overall investments. With respect to investment goods imports, as indicated by volume indices, the building material imports during the first eight months of the year contracted by 3.0 per cent against 8.3 per cent growth recorded in the corresponding period of 2017. Meanwhile, the importation of machinery and equipment recorded a moderate growth, while importation of other investment

Figure 2.8
Investment and Savings as a Percentage of GDP (a)



goods recorded a substantial contraction during the first eight months of the year. Considering these developments and the business sentiment revealed by the business surveys, investment expenditure as a percentage of GDP is expected to decrease to 32.5 per cent in 2018 compared to 36.7 per cent in 2017.

- **FDI, including loans to projects approved by the BOI, increased substantially by 169.9 per cent to US dollars 1,622.9 million² during the first half of 2018, compared to US dollars 601.3 million during the corresponding period of 2017.** FDI inflows to infrastructure projects grew by 386.2 per cent to US dollars 1,344.8 million during the period under review. Moreover, FDI inflows to infrastructure, manufacturing and services sectors accounted for 82.9 per cent, 7.7 per cent and 9.4 per cent, respectively, of total FDI receipts during the first half of 2018.

Savings

- **Considering the savings of the economy, both domestic and national savings are expected to decline as a percentage of GDP in 2018 compared to the previous year.** Accordingly, domestic savings are projected to decrease to 24.7 per cent of GDP in 2018 compared to 29.5 per cent of GDP in 2017. Meanwhile, in rupee terms,

² The FDI figure corresponds to receipts, including loans, related to companies registered with the BOI and may differ from the estimates presented in Chapter 5, mainly due to the inclusion of FDI inflows to non-BOI companies in the latter.

net primary income from the rest of the world is expected to contract at a slower pace while net current transfers from the rest of the world is projected to grow at a higher pace compared to 2017. Consequently, national savings are projected to decrease to 29.4 per cent of GDP in 2018 compared to 34.0 per cent of GDP in 2017.

Expected Developments

- **As projected under the medium term macroeconomic framework of the Central Bank, the economy is expected to grow by 4.5 per cent in 2019.** All major economic activities, namely, agriculture, industry and services are expected to contribute positively towards overall economic growth. From the external front, the economy would benefit from preferential trade arrangements, while expected favourable developments from the policy front to improve the business climate would encourage domestic investments and FDIs. Further, in order to unleash the potential benefits from the developments in the external front, export portfolio needs to be diversified by improving the tradable sector of the economy to cater to the expected growth in external demand.
- **Most agricultural crops are expected to record a growth in 2019.** A reasonable paddy harvest is expected in 2019, unless disrupted by severe weather conditions. The tea industry is expected to record a modest growth in 2019 amidst challenges such as unpredictable weather conditions in major tea growing areas, rising cost of production, possible sanctions on major export destinations together with possible salary negotiations in the domestic plantation sector. Meanwhile, subdued price levels in the rubber industry are expected to adversely impact local rubber production. However, incentives to increase local rubber production by way of increasing subsidies given for replanting and new planting and expanding rubber cultivation to non-traditional areas could support higher production, along with elevated international oil prices. Coconut production is expected to record a growth in 2019, continuing the trend observed

from mid-2018. Moreover, external demand for coconut based products are also expected to help the growth in coconut production. Meanwhile, prudent management of fisheries resources, such as addressing issues relating to illegal fishing activities and the adaptation of modern technology, are expected to support the fishing industry to register an expansion in production during 2019. Numerous measures taken by the government to develop the livestock sector would enable the dairy and poultry industries to yield higher production levels in 2019. It is expected that the domestic dairy production would be sufficient to meet around 40 per cent of the local requirement in 2019, and egg and poultry meat production would record a high growth owing to the increased imports of layer parents and broiler parents during 2017 and 2018. Going forward, the development of the sector would depend on the adoption of commercially viable agriculture activities that include better management of agriculture resources, increasing mechanisation, improving quality of produce and global market access as well as emphasis on sustainable agriculture practices that are resilient to climate change.

- **Industry activities are expected to grow at a healthy pace in 2019.** The growth in the manufacturing sector, which remained tepid during recent years, is expected to improve gradually in 2019, with increased external demand along with greater access to markets, and the recovery in domestic demand. It is expected that the apparel sector would benefit more from GSP+ concessions during 2019, with improved capacity to meet the demand together with the expansion in food, petroleum and rubber products. However, attaining a higher growth momentum compared to the current low levels would require the realisation of initiatives aimed at promoting higher investments that would enhance the production capacity for high value added products. Moreover, expanded production should be targeting external markets through improved international trade linkages, in order to sustain the growth in the sector. In addition, the future progress of the manufacturing sector would

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also depend on successfully addressing issues, such as lack of skilled labour, quality of raw material as well as high cost of energy. Hence, promoting backward linkages particularly with micro, small and medium enterprises (MSMEs) through access to finance, carrying out initiatives to attract skilled workers through campaigns aimed at school leavers and retraining of existing workers, which would include vocational training for prospective employees, are aspects that could support growth in the manufacturing sector. Meanwhile, construction activities are expected to increase its contribution to the economic growth, provided that government initiated construction projects such as Colombo Port City Development Project, Hambantota industrial zone, new terminal of Bandaranaike International Airport, various projects proposed under the Western Region Megapolis Master Plan, extensions of Southern Expressway and Outer Circular highway would materialise as envisaged. Further, private constructions such as residential and commercial building projects would also contribute to achieve the expected growth of construction activities. Moreover, mining and quarrying activities would also benefit from the growth of construction activities.

- **Services related economic activities are expected to drive the growth during 2019.**

The growth in services activities is projected to be broad-based, supported by all major services categories, such as wholesale and retail trade, transportation, financial services, other personal services, accommodation, education and information technology related services. Conducive relationships that Sri Lanka maintains with leading and emerging economies, and enhanced trade relationships through preferential trade agreements are expected to support external trade, which will eventually boost wholesale and retail trade activities. Meanwhile, gradual implementation of current proposals to expand the public transport system by introducing electric and hybrid buses would deliver high quality transport services, thereby encouraging more passengers to use public transport services adding value to the economy. Further, if the

expansion of the passenger handling capacity of the Bandaranaike International Airport and rehabilitation of domestic airport network are materialized as planned, it would further support the growth in transportation activities as well as tourism related activities. In addition, launching of the worldwide tourism promotion campaign targeting major markets would attract high spending tourists to Sri Lanka in the future, thereby supporting the growth of tourism related services. Meanwhile, improved economic activities would maintain growth momentum of the financial services. Further, the sophisticated lifestyles of the growing middle income segment of the economy would boost the demand for high quality personal services, thereby contributing to the expansion of other personal services. However, in order to achieve desired benefits from these developments, increased attention should be given to the timely implementation of these development programmes, with an efficient mechanism to monitor the progress of the government projects.

- **Investment activities are expected to grow positively in 2019, supported by higher private investment.** Private investment activities along with FDIs are expected to grow significantly with the implementation of the government initiated new infrastructure projects, and with the support of consistent policy measures to improve investor confidence. In addition, the significant number of condominium and commercial building projects, which have already been initiated would also contribute to the growth in private investment.
- **Improving national savings and maintaining it at a sustainable level is vital to position Sri Lanka on a higher growth path.** In this regard, achieving and maintaining a sustainable level of government savings, as stipulated in the medium term fiscal targets through prudent expenditure rationalization and revenue enhancing measures, while encouraging remittances, is important. This, in turn, would support managing the savings - investment gap despite the demand for higher investment expenditure.