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NATIONAL OUTPUT AND EXPENDITURE

The Sri Lankan economy is projected to grow by around 3.0 per cent in 2019 compared to the growth of 3.2 per cent recorded in 2018 amidst a subdued performance recorded in the second quarter which was adversely affected by the Easter Sunday attacks. According to official statistics, the economy grew at a slower rate of 2.6 per cent during the first half of 2019, compared to the 3.9 per cent growth recorded in the corresponding period of 2018. In particular, tourism and related services activities, such as transportation, were severely affected by the Easter Sunday attacks. During the first half of the year, activities such as financial services, wholesale and retail trade, and other personal services were among the major contributors to growth in Services activities. In the meantime, the recovery in construction, and mining and quarrying activities spurred the expansion in Industry activities during the first half of the year. Moreover, there was a substantial recovery in growing of oleaginous fruits and an expansion in growing of rice, which largely supported the growth in Agriculture activities. Going forward, most of the activities which were affected by the Easter Sunday attacks are recovering faster than initially expected which would help accelerate growth during the second half of the year. Further, the accommodative monetary policy stance as well as possible fiscal slippages particularly ahead of upcoming elections could stimulate the aggregate demand in the economy. However, the near term growth outlook might be affected by some downside risks as well, due to uncertainties arising from the upcoming elections during the latter part of the year and in 2020. Further, synchronised global economic slowdown could dampen external demand, while any unfavourable weather conditions could hamper Agriculture and related economic activities.

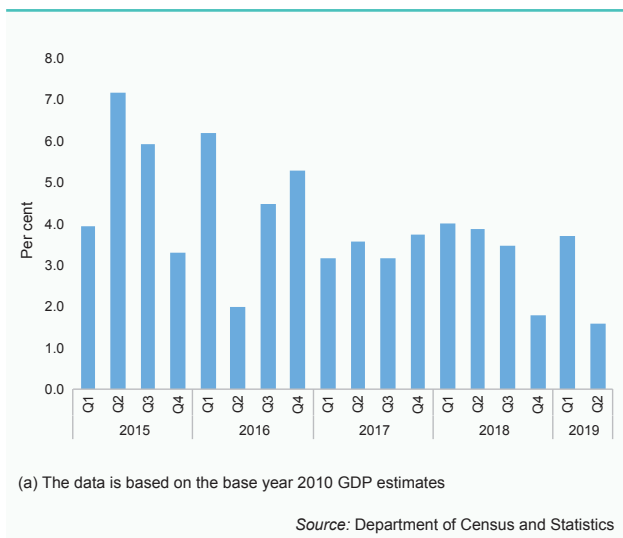


Developments in 2019

Output

- The economy grew by 2.6 per cent during the first half of 2019 compared to the growth of 3.9 per cent recorded in the corresponding period of 2018. The three major economic activities, namely Services, Industry and Agriculture activities grew by 2.8 per cent, 2.3 per cent and 3.2 per cent, respectively, during the first half of 2019. The growth in Services activities was mainly driven by the expansion in financial services, wholesale and retail trade activities and other personal services activities in spite of the slowdown recorded during the second quarter due to the Easter Sunday attacks, while accommodation, food and beverage service activities contracted and transportation services was subdued as these activities were adversely affected by the Easter Sunday attacks. Meanwhile, the growth in Industry activities was largely supported by the recovery in construction and mining and quarrying activities during the period. The growth in Agriculture activities was mainly driven by the substantial recovery in growing of oleaginous fruits (coconut, king coconut and oil palm) together with the expansion in growing of rice.

Figure 2.1
Quarterly GDP Growth Rates (a)



- As per the medium term macroeconomic framework of the Central Bank, the economy is projected to grow by around 3.0 per cent in 2019 compared to 3.2 per cent growth recorded in 2018. It is envisaged that the economy would gradually recover during the second half of the year from the adverse impact caused by the Easter Sunday attacks. Further, according to the Business Outlook Survey, the demand prospects indicate an improvement at the beginning of the second half. Considering the Services activities, the setback in the tourism industry caused by the Easter Sunday attacks would negatively affect the growth in accommodation, food and beverage service activities during the second half of the year as well. However, it is anticipated that the impact to other Services activities might ease off during the second half of the year with the normalization of domestic economic activities. Accordingly, the growth in Services activities would mainly be driven by the expansion in financial services and wholesale and retail trade activities. In the meantime, the expected growth in Industry activities would largely be supported by the expansion in manufacturing and construction activities with the normalisation of the domestic economy and the picking up of government construction activities. Meanwhile, Agriculture activities are expected to continue its growth momentum during the rest of the year provided that favourable weather conditions prevail throughout the year.

- There are some upside and downside risks that might affect growth projections particularly in the second half of 2019. The anticipated fiscal slippages arising from the upcoming elections could stimulate both private and government expenditure of the economy in the short run. However, the uncertainty arising from the election cycle could have an adverse impact on economic activities, delaying investment decisions of the private sector as revealed by business surveys as well.

Weaker than expected global growth would pose a downside risk to external demand. Meanwhile, any adverse disturbances to the prevailing weather conditions would have detrimental effects on the growth of major agricultural crops, which would also have spill over effects on manufacturing activities such as food processing and Services activities such as trade and transportation.

Growth in Economic Activities

Agriculture, Forestry and Fishing

- **Agriculture, Forestry and Fishing activities recorded a growth of 3.2 per cent during the first half of 2019 compared to the growth of 5.3 per cent recorded in the corresponding period of 2018.** This growth was largely buoyed by the substantial recovery in growing of oleaginous fruits (coconut, king coconut and oil palm) during the first half of the year. Further, growing of rice, animal production, growing of fruits, growing of rubber, growing of other perennial crops, plant propagation and support activities to agriculture and growing of sugar cane contributed positively towards the overall growth in Agriculture activities. However, growing of vegetables, forestry and logging, growing of cereals, growing of spices, fishing activities and growing of tea contracted during the period.

Production Trends and Institutional Support: Agriculture

Agriculture Production Index

- **The Agriculture Production Index (API), which measures the output of Agriculture and Fishing activities, recorded a growth of 1.6 per cent during the first half of 2019.** The Paddy subsector recorded a growth of 28.2 per cent, benefitting mainly from favourable weather conditions that prevailed during the 2018/19 Maha season. Coconut and rubber

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

Item	2018	2019	Growth Rate (%)	
	First Half (a)	First Half (b)	2017/18 (a)	2018/19 (b)
Agriculture and Fishing	135.5	137.7	14.8	1.6
1 Agriculture	132.1	134.7	18.8	2.0
1.1 Agriculture Crops	124.4	127.1	19.9	2.2
Paddy	128.2	164.3	62.6	28.2
Tea	101.1	101.3	1.3	0.2
Rubber	59.9	62.2	-10.9	4.0
Coconut	86.0	111.2	-5.5	29.3
Other Crops	168.6	135.4	22.4	-19.7
o/w Vegetables	170.4	139.5	30.5	-18.1
Fruits	183.9	133.1	12.1	-27.6
Other Field Crops	176.2	151.3	29.1	-14.2
1.2 Livestock	192.6	195.0	13.0	1.2
2 Fisheries	152.5	152.5	0.6	0.0

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

subsectors contributed positively to the overall agriculture output, recording a growth of 29.3 per cent and 4.0 per cent, respectively. Meanwhile, the tea subsector witnessed a marginal growth of 0.2 per cent. Growth in the tea subsector was subdued due to dry weather that prevailed in the first quarter of the year and labour issues that emerged during wage negotiations in the plantation sector. Further, the fishing subsector broadly remained unchanged during the period under review, compared to the first half of 2018.

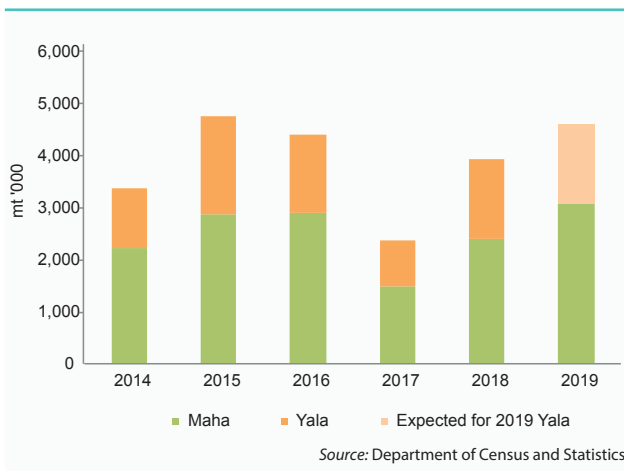
Paddy

- **According to available information, paddy production in 2019 is expected to increase by 17.4 per cent to 4.6 million metric tons compared to the production of 3.9 million metric tons in 2018.** The increase in paddy production in the year would be a combined outcome of an increase in production by 28.2 per cent in the 2018/19 Maha season and the estimated growth of 0.5 per cent in the 2019 Yala season. Accordingly, estimated production of 2018/19 Maha and 2019 Yala seasons is 3.1 million metric tons and 1.5 million metric tons, respectively. The bumper harvest recorded in the 2018/19 Maha season, which accounts for about 67 per cent of estimated total annual production, can be attributed to the improved paddy yields

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resulting from the favourable weather conditions and an increase in the extent cultivated and harvested. Meanwhile, the guaranteed paddy purchasing scheme also motivated farmers to convert marginal lands for paddy cultivation. The extent sown during the 2018/19 Maha season increased by 12.1 per cent while the extent harvested increased by 16.2 per cent over the corresponding season of the last year. Meanwhile, the Paddy Marketing Board (PMB) purchased a stock of around 50,000 metric tons of paddy from the 2018/19 Maha harvest, compared to 4,605 metric tons in the 2017/18 Maha season. The estimated annual paddy production, which is equivalent to 2.9 million metric tons of rice, would be sufficient to meet the country's household demand for rice for approximately 15 months. Meanwhile, the quantity of rice imported during the first half of 2019 was only 11,066 metric tons in comparison to the 239,519 metric tons of rice imports in the corresponding period of the last year. The fertiliser in-kind subsidy programme continued during the period, and around 197,000 metric tons of fertiliser were issued under the subsidy programme to 930,481 paddy farmers. Further, in addition to paddy seeds, parachute pallets were distributed among farmers at a subsidised rate with a view to encouraging farmers to produce required paddy seeds while minimising losses incurred during paddy cultivation, and thereby enhancing productivity.

Figure 2.2
Paddy Production

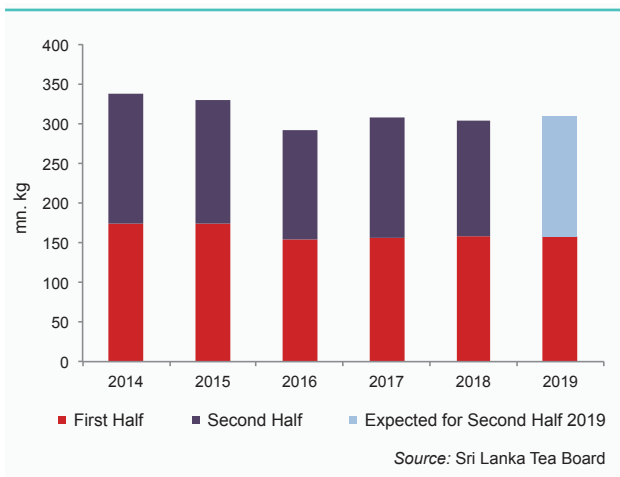


- The increased paddy harvest from 2018/19 Maha season resulted in lower paddy prices in the open market, leading to a reduction in retail rice prices.** The average open market paddy price of Samba decreased by 23.7 per cent to Rs. 39.20 per kilogramme during the first half of the year, compared to the corresponding period in the previous year, while the average paddy price of Nadu was Rs. 38.21 per kilogramme recording a price decline of 4.6 per cent, compared to the first half of 2018. Meanwhile, the average retail price of Samba rice was recorded at Rs. 106.25 per kilogramme during the first half of the year, which was a decrease of 1.0 per cent compared to the previous year. The average retail price of Nadu rice was Rs. 90.90 per kilogramme, which was a decrease of 2.5 per cent compared to the same period of the preceding year.

Tea

- Tea production increased marginally by 0.2 per cent to 158.5 million kilogrammes during the first half of 2019, in comparison to 158.2 million kilogrammes in the corresponding period in 2018.** This is a combined effect of a 1.2 per cent decline in the first quarter of 2019 owing to trade union action in major tea growing regions, and a 1.4 per cent growth during the second quarter of the year, supported by favourable weather conditions. High grown tea production, which accounts for around 22 per cent of the total tea production, declined by 4.4 per cent during the first half of 2019. However, the output of both medium grown tea and low grown tea, which collectively contribute to 78.2 per cent of the total production, grew by 4.3 per cent and 0.9 per cent, respectively, supported by favourable weather conditions in major low and medium grown areas. Meanwhile, tea production has increased to 209.2 million kilogrammes during the first eight months of 2019 registering a growth of 3.2 per cent in comparison to the same period in the preceding year. The Sri Lanka Tea Board (SLTB) continued its Factory Modernisation Subsidy

Figure 2.3
Tea Production



Scheme and Tea Replanting Subsidy Scheme for tea estates that are above 10 acres in extent. The "Best Leaf 60" programme, which is aimed at minimising post-harvest losses and upgrading the average best leaf standards, continued during the first half of 2019. In addition, SLTB continued making necessary arrangements to minimise malpractices at field level such as refuse tea dealing and sugar contaminated tea production.

- **Tea prices continued to decline at the Colombo Tea Auction (CTA) during the first half of 2019.** Average tea prices during the first half of 2019 decreased by 7.3 per cent to Rs. 560.73 per kilogramme in comparison to the corresponding period of 2018. The highest year-on-year decline in average tea prices at the CTA was recorded for medium grown tea (10.4 per cent), followed by high grown tea (8.1 per cent) and low grown tea (6.3 per cent). The significant decline in domestic tea prices was mainly due to the increased volumes received by CTA together with relatively less demand from large scale buyers who are shifting towards alternatives such as CTC teas, whereas the sellers specialise in orthodox tea. In line with the continuous decline in tea prices, the average price received by smallholders for green leaves reduced to Rs. 81.92 per kilogramme during the first half of 2019 from Rs. 88.63 per kilogramme that was recorded in the first half of 2018. Meanwhile,

the Cabinet of Ministers approved a proposal submitted by the Ministry of Plantation Industries to reduce the levy imposed on tea exports to Rs. 3.00 per kilogramme from Rs. 3.50 per kilogramme.

Rubber

- **Rubber production increased by 4.0 per cent to 41.8 million kilogrammes during the first half of 2019, compared to the same period in the preceding year, largely due to favourable weather conditions.** During the first half of 2019, crepe rubber production increased significantly by 32.9 per cent to 9,128.3 metric tons, while sheet rubber production increased by 4.0 per cent to 20,878.6 metric tons. Meanwhile, production of unspecified category, which accounts for 28.1 per cent of the total rubber production, declined by 11.1 per cent to 11,750.3 metric tons during the first half of 2019. Further, total rubber production during the first eight months of 2019 witnessed a marginal decrease of 0.3 per cent to 53.3 million kilogrammes. Rubber Development Department (RDD) carried out its action plan prepared for increasing rubber production from 82,560 metric tons in 2018 to 200,000 metric tons by 2040. In view of a Cabinet decision and a Budget proposal in 2019, it was decided to double the payments given for rubber replanting. Accordingly, replanting subsidy payment and new planting subsidy payment were increased to Rs. 350,000 per hectare and Rs. 300,000 per hectare, respectively, with effect from 01 January 2019.
- **Average natural rubber prices in both global and domestic markets were low during the first half of 2019 in comparison to the same period in the previous year.** The decline in natural rubber prices in the global market was largely due to the slowdown in global demand owing to US-China trade tensions. Meanwhile, the average price of Ribbed Smoked Sheet No. 1 (RSS1) at the Colombo Rubber Auction declined by 6.5 per cent to Rs. 270.80

per kilogramme, while Latex Crepe 1X declined by 18.3 per cent to Rs. 266.13 per kilogramme during the period under review.

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Coconut

- Coconut production increased by 29.3 per cent to 1,575 million nuts during the first half of 2019, in comparison to the same period in 2018.** The lagged effect of favourable rain experienced in all major coconut growing areas during the last quarter of 2018 largely contributed to the increase in coconut production. Accordingly, desiccated coconut production increased by 160.3 per cent to 22,023 metric tons. Meanwhile, coconut oil production increased by 806.8 per cent to 25,852 metric tons during the first half of 2019. Similarly, the virgin coconut oil production, which operated below capacity during 2018 primarily due to the temporary shutdown of mills, grew by 16.2 per cent to 6,725 metric tons during the first half of 2019. Further, coconut cream, milk powder and liquid coconut milk production declined by 3.0 per cent to 31,930 metric tons during the period under review. Meanwhile, coconut production is estimated to have increased by 25.4 per cent during the first eight months of 2019 to 2,105.8 million nuts, in comparison to 1,679.3 million nuts recorded in the corresponding period of 2018. During the first half of 2019, the Coconut Development Authority (CDA) continued to support the small scale and informal coconut sector by providing accessories, machines and tools, awareness on business and financial management, and conducting technology transfer programmes.
- Prices of coconut and coconut based products remained low during the first half of 2019, compared to the corresponding period of the previous year, amidst rising industrial demand for raw coconuts.** The average retail price of fresh coconuts remained at Rs. 51.60 per nut during the first half of 2019 compared

to Rs. 77.61 per nut that was recorded in the corresponding period of the last year. Meanwhile, average price of a bottle of 750 millilitre coconut oil decreased to Rs. 262.58 during the first half of the year from the average price of Rs. 288.56 recorded in the same period of the previous year, supported by increased domestic production of coconut oil and increased palm oil imports. Further, the average price of desiccated coconut at the Colombo Coconut Auction decreased by 47.5 per cent to Rs. 250.08 per kilogramme from the average price of Rs. 476.30 per kilogramme recorded during the corresponding period of 2018. In the international market, average export price of desiccated coconut decreased to Rs. 275.24 per kilogramme during the first half of 2019 from the average price of Rs. 534.45 per kilogramme recorded in the same period of the preceding year.

Other Field Crops

- Production of Other Field Crops (OFCs) decreased by 13.9 per cent to 369,488 metric tons in the 2018/19 Maha season due to heavy crop damages recorded in the early part of 2019 caused by adverse weather and the "Sena" caterpillar (Fall Armyworm) infestation.** Production of crops such as big onion, chillies, cowpea, green gram, kurakkan and potatoes decreased during the 2018/19 Maha season mainly due to crop damages. Maize production also decreased by 9.3 per cent to 220,425 metric tons in the 2018/19 Maha season mainly due to heavy crop damages, estimated at around 75,000 metric tons, caused by the Fall Armyworm outbreak. Further, production losses of ground nuts, cowpea and green gram were also reported. However, it is expected that the production of OFCs would rebound during the 2019 Yala season. Meanwhile, the Department of Agriculture (DOA) implemented several measures to mitigate the Fall Armyworm infestation while improving awareness among farmers on controlling Fall Armyworm attacks.

Vegetables

- **Vegetable production decreased by 15.2 per cent to 835,741 metric tons in the 2018/19 Maha season.** However, the supply of vegetables to the market remained at satisfactory level, enabling the maintenance of relatively low vegetable prices during the early part of the year despite dry weather conditions experienced in most districts throughout the first half of 2019 and the Fall Armyworm infestation resulting in crop damages. Nevertheless, the decreased supply of vegetables from the 2018/19 Maha harvesting, which continued during the months of March and April, escalated the pressure on vegetable prices in the New Year season. The decreasing trend in prices of both low-country and up-country vegetables, which was observed in the latter part of the second quarter of 2019, reversed at the beginning of the third quarter of 2019, mainly due to the limited supply resulting from rainy weather conditions.
- **In line with the national agricultural policy, the Ministry of Agriculture and its agencies took several measures to increase agricultural productivity and popularise improved technologies for agriculture.** Accordingly, programmes were conducted to create awareness among farmers and Extension Officers on early detection of pests and control measures. Further, to improve OFC production such as maize, big onion, green gram and cowpea, certified seeds and drip irrigation were popularised among farmers while promoting good agriculture practices among stakeholders.

Sugar

- **Sugar production increased by 95.8 per cent to 24,233 metric tons during the first half of 2019.** All three factories, namely, the Sevanagala and Pelwatte Units of the Lanka Sugar Company (Pvt.) Ltd. and Gal Oya (Hingurana) Sugar Industries Ltd., recorded considerable increase in production mainly due to favourable weather

conditions, increased sugar cane supply owing to the proper implementation of sugar cane cultivation plans, and increased cultivation extent. Accordingly, production of the Sevanagala and Pelwatte sugar factories increased by 60.4 per cent and 70.8 per cent, respectively, while sugar production in the Gal Oya factory increased by 293.9 per cent. It is expected that total sugar production would increase by 28.5 per cent to 65,690 metric tons in 2019, which is equivalent to around 11 per cent of the total domestic sugar requirement of the country. Meanwhile, the Ministry of Plantation Industries (MPI) took actions for the development of the sugar industry while the Sugarcane Research Institute (SRI) continued their services in providing necessary technical knowledge on crop management including fertiliser application, pest and disease management and improvement of degraded soil, etc.

Livestock

- **Milk production grew by 6.0 per cent to 253.9 million litres during the first half of 2019, in comparison to the corresponding period of last year.** The growth can be attributed to cattle rearing best practices, which were popularised under the Livestock Sector Master Plan. Meanwhile, the average cost of production of a litre of milk increased due to higher prices of concentrated cattle feed, resulting in a higher average farmgate price of milk. It is expected that milk production would increase by around 10 per cent to 517 million litres in 2019, which would be sufficient to meet around 43 per cent of the total domestic demand. Poultry meat production increased by 9.8 per cent to 111,480 metric tons during the first half of 2019. Further, broiler parent chick production recorded a growth of around 24 per cent during the first half of 2019, which largely contributed to the growth in the chicken production. Meanwhile, egg production decreased by 14.1 per cent to 1,324 million as a result of lower demand from the hotel sector due to the Easter Sunday attacks.

Fisheries

- Fish production increased only marginally by 0.03 per cent to 254.5 million kilogrammes during the first half of 2019, compared to the corresponding period in 2018.** Coastal fish production declined marginally by 0.1 per cent to 119,250 metric tons during the period under review, particularly due to weather related disturbances. Meanwhile, marine fish production also decreased by 3.5 per cent. The decline in marine fish production was largely driven by deep sea fish production, that declined by 7.4 per cent to 93,690 metric tons during the first half of the year. However, inland capture and aquaculture production increased by 28.5 per cent and 18.1 per cent, respectively, although production of shrimp farms decreased by 11.5 per cent. The considerable increase in inland fish production was mainly driven by dry weather conditions experienced in early 2019 during which low levels of water in major reservoirs increased the fish netting areas. Further, the increase of releasing of fingerlings to tanks in 2018 also contributed to the increased production. Further, the total fish production declined marginally by 0.6 per cent to 336,420 metric tons during the first eight months of 2019. In view of increasing inland fish and aquaculture production, the Ministry of Fisheries and Aquatic Resources, in collaboration with the National Aquaculture Development Authority (NAQDA), took several steps, including the enhancement of the stocks of fish fingerlings and fresh water prawn post larvae, proper management of water bodies with community participation, and the establishment of community based mini-hatcheries. NAQDA rehabilitated 20 reservoirs and stocked 220,750 fingerlings and 118,000 freshwater prawn post larvae under a special project during the period under review to develop culture based fisheries in wet zone reservoirs.

Industries

- Industry activities grew by 2.3 per cent during the first half of 2019 compared to the growth of 2.2 per cent recorded in the corresponding period of 2018.** Recovery in

construction, and mining and quarrying activities primarily supported the expansion in Industry activities. However, manufacturing activities recorded a moderate growth during the first half of the year. Considering the other Industry activities, electricity, gas, steam and air conditioning supply activities, sewerage, waste treatment and disposal activities and water collection, treatment and supply activities also contributed positively towards the overall growth in Industry activities during the period.

- The rebound in construction and mining and quarrying activities mainly contributed to the expansion in Industry activities during the first half of 2019.** Accordingly, construction and mining and quarrying activities grew by 4.7 per cent and 2.8 per cent, respectively, during the first half of 2019 compared to contractions of 0.8 per cent and 1.2 per cent, respectively, recorded in the corresponding period of 2018. This recovery in construction activities was reflected by the 3.9 per cent increase in cement availability during the first half of 2019 against 0.7 per cent contraction recorded in the corresponding period of 2018. Meanwhile, manufacturing activities grew at a moderate pace of 0.9 per cent during the first half of 2019 in comparison to the growth of 3.7 per cent recorded in the corresponding period of 2018. This moderation was largely attributable to the decline observed in manufacture of wood and of products of wood and cork (except furniture) and manufacture of basic metals and fabricated metal products together with the moderate growth in manufacture of food, beverages and tobacco products during the first half of 2019 compared to the corresponding period of 2018. In the meantime, manufacture of coke and refined petroleum products, manufacture of textiles, wearing apparel and leather related products, manufacture of furniture and manufacture of other non-metallic mineral products contributed positively towards the growth in overall manufacturing activities. In relation to other Industry activities, the electricity, gas, steam and air conditioning supply activities recorded a growth of 3.8 per cent during the first half of 2019 compared to 5.8 per cent growth

recorded in the corresponding period of 2018. Further, water collection, treatment and supply activities and, sewerage, waste treatment and disposal activities grew by 6.9 per cent and 8.7 per cent, respectively, during the first half of 2019 compared to respective growth rates of 2.5 per cent and 6.3 per cent recorded in the corresponding period of 2018.

Production Trends and Institutional Support: Manufacturing Activities

Index of Industrial Production

- The manufacturing sector registered a marginal growth during the first half of 2019 with increased production in major subsectors.** As per the Index of Industrial Production (IIP), the manufacturing sector witnessed an overall expansion of 1.4 per cent during the first half of 2019, compared to the growth of 1.0 per cent recorded in the corresponding period in the previous year. Several subsectors of the IIP, including the manufacturing of textiles, wearing apparel, beverages, coke and refined petroleum products, chemical and chemical products, rubber and plastic products, and other non-metallic mineral products expanded while other sectors, including the manufacturing of food products, tobacco products, wood products except furniture, basic metals, and fabricated metal products witnessed a contraction in production during the reference period.
- Partly affected by the Easter Sunday attacks, the food products subsector, the largest subsector in the IIP, slowed down during the first half of 2019 compared to an expansion witnessed in the similar period of the previous year.** During the period under review, the food products subsector recorded a slowdown in all months except for the months of March and May. Overall, this subsector registered a contraction of 2.8 per cent during the first half of 2019, compared to a growth of 2.8 per cent recorded in the corresponding period in 2018. Lower production of canned fish, chicken products, milk powder, wheat flour and ice cream items triggered by lower demand contributed to the slowdown in food production.
- The apparel and textiles export industries remained resilient, despite the slower growth in major traditional export markets.** The manufacture of wearing apparel subsector, which accounts for around one fifth of the IIP, registered a growth of 2.8 per cent during the first half of 2019 in comparison to the growth of 3.9 per cent recorded in the corresponding period of the previous year. Meanwhile, the manufacture of textile products that showed a slowdown in the first half of 2018, noted an expansion in 2019 underpinned by strong external demand, as reflected by increased export revenues. The increased production of printing of fabric mainly contributed to the positive developments in the textile industry.
- The manufacture of coke and refined petroleum products, which entirely consists of refined petroleum products of the Ceylon Petroleum Corporation (CPC), reverted to an expansion during the first half of 2019.** The CPC has improved its capacity utilisation with the refinery renovation project that took place during the first quarter of 2018 in three main sections of the plant, namely the process plant, utilities and the tank farm, with the aim of boosting efficiency,

Figure 2.4
Index of Industrial Production (IIP)



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reliability and productivity of the Sapugaskanda oil refinery. Accordingly, with the increased production of petrol, auto diesel, furnace oil and bitumen, the coke and refined petroleum products subsector witnessed a significant growth of 23.0 per cent during the first half of 2019 compared to a contraction of 3.9 per cent recorded in the same period in the preceding year. Depending on global price movements, refining of petroleum products domestically can be cheaper than importing refined petroleum products at times. Since only around 30 per cent of the domestic oil requirement can be refined in the country with existing capacity, it is vital to modernise the Sapugaskanda oil refinery by upgrading machinery and expanding its capacity, enabling the CPC to increase its production capacity. It is expected that the new refinery projects proposed to be established in the Hambantota industrial zone by Singapore and Oman investors would support increasing the petroleum refining capacity of the country in the medium term.

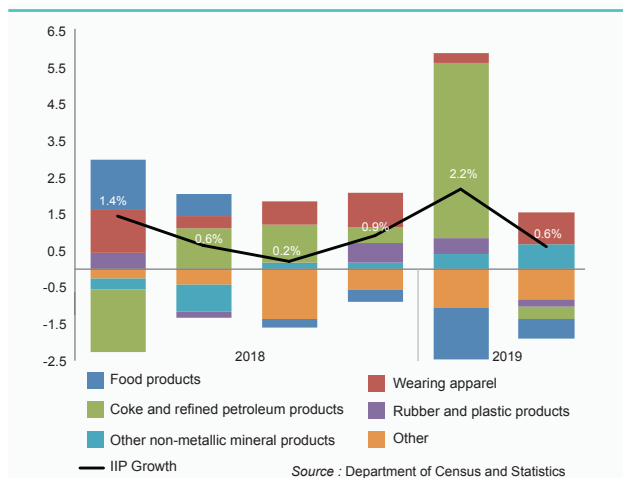
- **The manufacture of other non-metallic mineral products subsector showed signs of recovery during the first half of 2019.** This subsector registered a growth of 7.0 per cent during the first half of 2019 compared to a contraction of 6.6 per cent in the corresponding period of 2018. The increased production of

cement, glass bottles and porcelain tableware contributed to the favourable developments in this subsector. Domestic cement production, which plays a major role in this subsector, witnessed an increase of 23.2 per cent while the imports of cement recorded a contraction of 5.9 per cent during the first half of 2019. The growth in the production of cement was mainly supported by capacity enhancements by cement manufacturers.

- **The manufacture of rubber and plastic products, leather and related products, and chemicals and chemical products which account for around 10 per cent of the overall IIP, recorded an expansion during the first half of 2019.** Increased production of rubber sheets, plates, strips and elastic contributed to the growth in rubber and plastic products, while the leather and related products expanded due to a growth in the production of school bags, school shoes and shoes for men. Meanwhile, the manufacture of chemicals and chemical products subsector recorded an increase of 3.3 per cent in the first half of 2019 as against a decline of 6.8 per cent witnessed in the similar period in 2018. The growth in chemical products was largely due to the increased production of fertiliser, paints and sanitary napkins.
- **The manufacture of beverages subsector showed an expansion during the first half of 2019 supported by increased production of beer and non-alcoholic beverage products such as soft drinks.** Accordingly, the beverages subsector recorded a growth of 5.4 per cent during the first half of 2019, in comparison to 6.1 per cent recorded in the corresponding period in 2018. Drought and warm weather conditions that prevailed in a large part of the country during the period under review resulted in a higher demand for soft drinks. Meanwhile, the excise tax applicable to liquor production was raised during the first quarter of 2019, which resulted in a decline in distilling, rectifying and blending of spirits and thereby leading to a decline in overall liquor production.

Figure 2.5

Contribution to Year-on-year Change by Major Divisions of IIP



- Subsectors such as the manufacture of wood products except furniture, the manufacture of fabricated metal products, and the manufacture of electrical equipment and machinery witnessed a contraction while the manufacture of furniture recorded an expansion during the first half of 2019.** Lower production of steel and aluminium bar caused the slowdown in the manufacture of fabricated metal products subsector (-7.7 per cent), while decreased production of electric panelboards, optical isolators and freezers resulted in a slowdown in the manufacture of electrical equipment subsector (-2.1 per cent). The manufacture of wood products except furniture registered a contraction of 9.8 per cent during the first half of 2019 compared to an expansion of 13.5 per cent recorded in the corresponding period in 2018 largely due to a reduction in the production of Medium Density Fibreboards (MDF) and plywood. However, the manufacture of furniture subsector recorded a growth of 4.2 per cent compared to a contraction of 13.6 per cent recorded in the corresponding period of the previous year supported by increased production of plastic chairs, rubber mattresses and office chairs.
- Other subsectors in the IIP, including the manufacture of tobacco products, reproduction of recorded media and the basic metals witnessed a decline during the first half of 2019.** The manufacture of tobacco products further contracted by 11.1 per cent, while printing and reproduction of recorded media subsector, and the production of basic metals registered a contraction of 3.7 per cent and 5.6 per cent, respectively, during the period under review. Increased taxes on tobacco products adversely affected the tobacco manufacturing industries and thereby the tobacco production. Meanwhile, the slowdown in the printing and reproduction of recorded media was largely due to the reduced production of cartons and currency notes. In the meantime, supported by the increased production of corrugated paper, cardboard boxes and paper bags, the manufacture of paper and paper products recorded a growth of 5.9 per cent during the period under review compared to a contraction of 17.2 per cent recorded in the same period in the previous year.
- The Ministry of Science, Technology and Research (MSTR) and the Ministry of Industry and Commerce, Resettlement of Protracted Displaced Persons, Co-operative Development and Vocational Training and Skills Development (MIC) took several policy measures to promote the industrial sector in the country.** The MSTR successfully concluded its first 'Shilpasena Exposition' with the participation of all line ministries, state organisations, universities, tri-forces, police, private sector and other relevant stakeholders in July 2019. Moreover, the MSTR continued to provide inputs to formulate a national mineral policy to create a positive environment for mineral-based industries. Meanwhile, a technology transfer programme, which has been conducted through countrywide Vidatha Resource Centres, to accomplish the technology requirements of entrepreneurs and potential entrepreneurs, continued during the first half of 2019 as well. During 2019, the MSTR allocated around Rs. 12.2 million for 33 science and technology special projects under different fields covering rural communities in 15 districts to expand the applications of technology while providing solutions to issues encountered by the public. In the meantime, the National Institute of Fundamental Studies (NIFS) continued to develop microbial biofertiliser to reduce the use of imported chemical fertiliser. The NIFS is expected to apply biofertiliser to around 15,000 acres of rice cultivation during 2019 and 50,000 acres in 2020. Meanwhile, the Cabinet of Ministers approved the provision of long term loan facilities for companies that will start Sri Lankan mechatronic based product development and design and certify mechatronics products under the 'Enterprise Sri Lanka' loan scheme. Under the 'Enterprise Village Development' programme

of the MIC, which focuses on promoting high value-added market based products for the export market, around 444 new entrepreneurs are expected to benefit during 2019 while around 48 entrepreneurs are expected to benefit under the 'Shilpa Saviya' programme. In both programmes, more than 80 per cent of the beneficiaries are women.

- The Board of Investment (BOI), various relevant ministries, public institutions and industry chambers continued to promote the domestic industrial sector.** Since 2017, two companies have signed agreements with the BOI to invest in the Hambantota industrial zone. Agreements related to the Silver Park Petroleum Refinery project, with US dollars 3,850 million worth of investment, was signed in 2019 while the Lanwa Sanstha Cement Corporation (Private) Limited signed an agreement for an estimated investment of US dollars 100 million in 2018. In addition, the Cabinet gave its approval to establish another refinery at the Hambantota industrial zone by Sugih Energy International (SEI), Singapore. However, the final approvals for this refinery project is subject to Environmental Impact Assessment (EIA). Meanwhile, the BOI signed several agreements with a number of private companies to set up factories in Sri Lanka to manufacture several industrial products including tyres and aluminium food containers while providing a range of services to meet increasing demand emerging from international markets. The National Chamber of Commerce (NCC) continued its endeavours to educate and uplift the Small and Medium Enterprise (SMEs) sector by conducting training programmes in various parts of the country during the first half of 2019. Further, the NCC, together with the Ministry of Health, Nutrition and Indigenous Medicine, conducted an 'International Healthcare Exhibition' in July 2019 with the aim of providing opportunities to promote indigenous and western medicinal products and services. Meanwhile, the Industrial Technology Institute (ITI) offered services in food technology areas to upgrade

selected Micro, Small and Medium Enterprises (MSMEs), particularly in Jaffna, Killinochchi and Vavuniya districts during 2019. In the meantime, the Industrial Development Board (IDB) continued its activities to modernise and upgrade infrastructure facilities in industrial estates during the first half of 2019.

Services

- Services activities, which represent the largest share of the economy, grew by 2.8 per cent during the first half of 2019 compared to the growth of 5.1 per cent recorded in the corresponding period of 2018.** Financial services and wholesale and retail trade activities mainly supported this growth during the period. Further, other Services activities including other personal services, real estate activities, public administration services, insurance, telecommunication, professional services, IT programming consultancy and related activities, education and human health activities contributed positively to Services growth during the first half of the year. However, accommodation, food and beverage services contracted while transportation activities recorded a marginal growth during the period mainly on account of the adverse impact of Easter Sunday attacks.

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

- Wholesale and retail trade, transportation and storage, accommodation and food service activities grew by a moderate rate of 1.3 per cent during the first half of 2019 compared to 4.7 per cent growth recorded in the corresponding period of 2018.** This moderation was mainly attributable to the slowdown in wholesale and retail trade activities, which grew by 2.8 per cent during the first half of 2019 compared to 5.5 per cent growth in the corresponding period of 2018, though it

remained as a major contributor to the growth recorded. Meanwhile, accommodation, food and beverage services activities contracted by 2.6 per cent while transportation activities recorded a marginal growth of 0.2 per cent during the first half of 2019, compared to 7.1 per cent and 3.4 per cent growth rates, respectively, recorded in the corresponding period of 2018, mainly due to the adverse impact of the Easter Sunday attacks on tourism related activities. Meanwhile, postal and courier activities recorded a growth of 2.9 per cent during this period compared to 2.4 per cent growth recorded in the corresponding period of 2018.

Information and Communication Activities

- **Information and communication activities grew by 10.9 per cent during the first half of 2019 compared to 10.0 per cent growth recorded in the corresponding period of 2018.** This higher growth was mainly attributable to the growth of 10.9 per cent in telecommunication services during the first half of 2019 compared to 10.4 per cent growth recorded in the corresponding period of 2018. Further, IT programming consultancy and related activities also grew by 11.9 per cent during the first half of 2019, compared to 11.3 per cent growth recorded in the corresponding period of 2018 reflecting the continuous developments in the IT industry of the country. Meanwhile, programming and broadcasting activities and audio video productions recovered, recording a growth of 4.6 per cent during the first half of 2019 against the 2.0 per cent contraction recorded in the first half of 2018.

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

- **Financial, Insurance and Real Estate Activities, including Ownership of Dwellings grew by 5.5 per cent during the first half of 2019 compared to 8.5 per cent growth in the corresponding period of 2018.** Financial service activities

and auxiliary financial services, which grew by 8.8 per cent during the first half of 2019 compared to 11.5 per cent growth in the corresponding period of 2018, mostly contributed to this growth recorded. Further, real estate activities, including ownership of dwellings grew by 1.6 per cent during the first half of 2019, compared to 5.3 per cent growth recorded in the corresponding period of 2018, contributing positively to the overall growth within the segment. Moreover, insurance, reinsurance and pension funding activities also grew at a higher rate of 7.3 per cent during this period compared to 7.0 per cent growth recorded in the corresponding period of 2018.

Professional Services and Other Personal Service Activities

- **Professional services and other personal service activities expanded by 2.9 per cent during the first half of 2019 compared to 5.4 per cent growth recorded in the corresponding period of the previous year.** Expansion in other personal service activities, though at a slower rate of 3.0 per cent during the first half of 2019 compared to 5.4 per cent growth recorded in the corresponding period of 2018, mainly contributed to the growth recorded. Moreover, professional services expanded by 2.0 per cent during the period, compared to 5.8 per cent growth recorded in the first half of 2018.

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

- **Public administration, defence, education, human health and social work activities grew by 1.3 per cent during the first half of 2019 compared to the stagnant performance recorded in the corresponding period of 2018.** The upturn in the growth of this segment was primarily driven by the recovery in public administration and defence related services, which grew by 1.7 per cent during the first half of

2019 against 0.8 per cent contraction recorded in the corresponding period of 2018. Meanwhile, education services grew marginally by 0.9 per cent during this period compared to 3.4 per cent growth recorded in the first half of 2018. In the meantime, human health activities, residential care and social work activities recovered by 0.8 per cent during the first half of 2019 against 1.6 per cent contraction recorded in the corresponding period of 2018.

Expenditure

- Gross Domestic Expenditure (GDE) at current prices, which consists of the consumption and investment expenditure of the economy, recorded a marginal growth of 0.2 per cent during the first half of 2019 compared to 10.2 per cent growth in the corresponding period of 2018.** This slowdown was mainly attributable to the substantial decline in investment expenditure during the first half of the year which contracted by 13.3 per cent against 9.9 per cent growth recorded in the corresponding period of 2018. Considering the components of investment expenditure, even though the gross domestic fixed capital formation recorded a positive growth, the significant decline in changes in inventories and acquisition less disposals of valuables during the first half of the year caused the contraction in total investment expenditure. The consumption expenditure at current prices grew by 5.4 per cent during the first half of 2019 compared to 10.4 per cent growth recorded in the corresponding period of 2018 contributing positively to the growth in GDE. In the meantime, net external demand at current prices recorded a considerable improvement of 41.9 per cent during the first half of 2019 supported by the higher growth in exports and the decline in imports, against 21.6 per cent contraction recorded in the corresponding period of 2018. In this regard, export of goods and services at current prices grew by 13.9 per cent during the first half of 2019 compared to 12.3 per cent growth recorded in the corresponding period of 2018. Meanwhile, imports of goods and services contracted by 1.5 per cent during this period against 14.8

per cent growth recorded in the first half of 2018. As a result, GDP, which consists of GDE and the net external demand, grew by 3.8 per cent at current market prices during the first half of 2019 compared to 9.4 per cent growth recorded in the corresponding period of 2018.

- GDE, at current market prices, is projected to grow by 6.0 per cent in 2019 amounting to Rs. 16,436.4 billion compared to 7.9 per cent growth recorded in 2018.** This projected growth in GDE is expected to be supported by the expansion in both consumption and investment expenditure. Meanwhile, net external demand is projected to improve by 10.6 per cent in 2019 against 10.3 per cent contraction recorded in 2018, with a slowdown in imports and an increase in exports, though it would be suppressed by slowing global economic growth. Accordingly, GDP at current market prices is projected to grow by 7.2 per cent in 2019 compared to 7.7 per cent growth recorded in 2018.

Consumption

- Consumption expenditure, the major expenditure component of the economy, is projected to grow by 4.8 per cent in 2019 at current market prices amounting to Rs. 11,929.6 billion compared to 8.3 per cent growth recorded in 2018.** As a percentage of GDP, consumption expenditure would be 77.0 per cent in 2019 compared to 78.8 per cent of GDP in 2018. Both private and government consumption expenditure are anticipated to contribute to the expansion in total consumption expenditure even though some slowdown is expected in both categories. Accordingly, private consumption expenditure at current market prices, is projected to grow by 5.1 per cent in 2019 compared to 7.4 per cent growth recorded in 2018. Considering the government expenditure data during the first half of 2019 and the projections of the Central Bank of Sri Lanka, the public consumption expenditure is expected to expand further in 2019 compared to 2018.

Investment

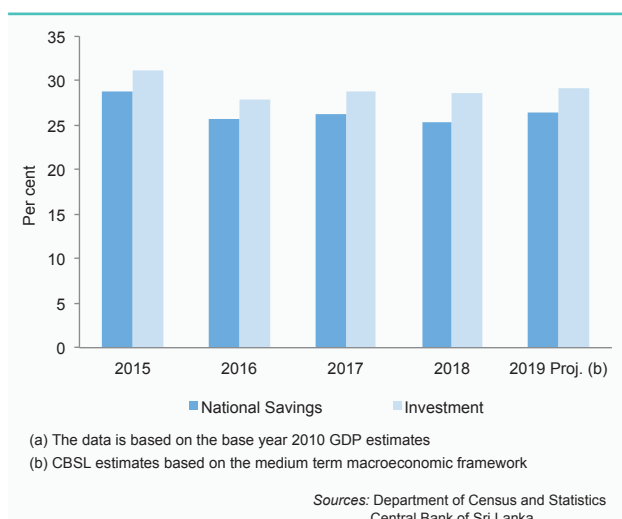
- **Investment expenditure, at current market prices, is projected to grow by 9.1 per cent in 2019 compared to 6.8 per cent growth recorded in 2018.** As a percentage of GDP, it is expected to increase to 29.1 per cent in 2019 compared to 28.6 per cent in 2018. Based on the projections of the Central Bank of Sri Lanka, the government investment expenditure is expected to decline in 2019 compared to 2018 though there would be some pickup in constructions related investment due to the election cycle. Accordingly, private investment expenditure is expected to contribute mostly for growth in investment in 2019. The credit granted by commercial banks to the private sector for the purposes of personal housing including purchasing/ construction/ repairs activities recorded a growth of 7.6 per cent as at end of June 2019 compared to 14.6 per cent growth recorded as at end June 2018. The cement availability recorded a recovery during the first half of the year indicating an expansion in construction activities, which represent a major share of overall investments. However, as per the trade indices for the first half of the year, the importation of machinery and equipment and the importation of other investment goods contracted during the first half of the year.

- **Foreign Direct Investment (FDI)¹, including loans to projects approved by the Board of Investment (BOI), decreased by 61.3 per cent to US dollars 553.2 million during the first half of 2019 compared to US dollars 1,427.9 million recorded in the corresponding period in 2018.** The contraction in FDI inflows during the reference period was mainly caused by a reduction in FDI inflows to infrastructure projects and services sectors, which recorded a drop of 75.8 per cent and 11.1 per cent, respectively. However, FDI inflows pertaining to the manufacturing sector, which accounted for around one fourth of total FDI inflows during the period under review, registered a growth of 10.7 per cent to US dollars 138.6 million. In the meantime, FDI inflows to the agriculture sector continued to be at marginal levels during the first half of 2019 as well.

Savings

- **Both domestic and national savings are expected to increase as a percentage of GDP in 2019 compared to the previous year.** Accordingly, domestic savings are projected to increase to 23.0 per cent of GDP in 2019 compared to 21.2 per cent of GDP in 2018. This increase in domestic savings could be a combined outcome of the expansion in private savings and the slowdown in government dis-savings. Meanwhile, in rupee terms, net primary income from the rest of the world is expected to contract at a higher rate in 2019, while net current transfers from the rest of the world is projected to grow at a moderate pace compared to 2018. Consequently, national savings are projected to be 26.5 per cent of GDP in 2019 compared to 25.4 per cent of GDP in 2018. Further, the savings - investment gap would be narrowed down to 2.6 per cent of GDP in 2019 compared to 3.1 per cent of GDP in 2018.

Figure 2.6
Investment and Savings as a Percentage of GDP (a)



1 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.

Expected Developments

- **The Sri Lankan economy is projected to grow by around 3.5 per cent in real terms in 2020.**

The growth is expected to be broad based and positively contributed by all major economic activities. Further, investor confidence, which was adversely affected by domestic uncertainties, is expected to improve, boosting private investments. The expected surge in government spending ahead of national elections together with the pick up of private spending in line with the normalisation of consumer behaviour would strengthen the domestic demand during the year. The economy would also continuously benefit from the preferential trade agreements with major trading partner economies and the easing of global oil prices. Further diversification of the export portfolio and improvement of the tradable sector would help sustain improvement in the external sector of the economy.

- **The agriculture sector is envisaged to rebound in 2020.** Surplus production of the 2018/19 Maha and 2019 Yala season resulted in the availability of sufficient rice to meet household demand until January 2020 according to the Department of Agriculture. Although the Department of Meteorology forecasts heavy rains during the months of October and November 2019, the rainfall thus far received might not be sufficient to fill the already low water levels of major water reservoirs, posing a threat to water availability to meet the requirements for the 2019/20 Maha season. Hence, an increased focus is required on climate risk reduction, adaptation measures and preparedness for drought response interventions. Although the continued decline in tea and rubber prices in the local market during the first half of 2019 weakened domestic production, global demand for these exports could rebound with a possible recovery in economies that import these commodities. Meanwhile, the expected growth in coconut production will compensate for the increasing demand from coconut based industries and incentives coconut based product exports.

Further, it is expected that domestic production of many field crops such as maize, potato, red onion, black gram and big onion would continue to grow, supported by favourable weather conditions. It is also expected that the domestic dairy industry would meet up to around 45 per cent of the domestic milk requirement during 2020, given the improvement in the production capacities of milk factories and the proper implementation of veterinary services, which would also enhance the domestic production capacity. Further, local sugar production is also expected to meet around 12 per cent of the total domestic demand of sugar in 2020. Meanwhile, the total fish production in the country is expected to show an improvement in 2020 with the expansion of deep sea fish production and inland fish catch. With these supply side developments in the domestic agriculture sector, it is expected that the agriculture sector will contribute to the overall growth positively in 2020.

- **Industry related economic activities are expected to continue the positive momentum in 2020, assuming that investor confidence improves.** Growth in manufacturing and construction activities are expected to drive the industry growth benefitting from GSP+ concessions as well as the realisation of government construction projects as planned, providing an impetus for private construction activities. Construction activities are expected to grow at a higher rate with the acceleration of government-initiated development projects such as the continuation of the Central Expressway and the first phase of the Light Rail Transit System. In addition to the buildings to be constructed in the Colombo Port City, infrastructure developments within and outside the city of Colombo, including an elevated road from the New Kelani Bridge and an underground road connecting the Port City to the rest of the Colombo commercial district, are to be implemented. Development of a second terminal at BIA and upgrading of three airports, namely Jaffna

(Palaly), Ratmalana and Batticaloa airports, as international airports are also among the aviation related construction projects expected to contribute to growth. A large number of urban housing projects, being constructed under the urban regeneration project, is expected to fill the demand for affordable urban housing to some extent, in addition to the various condominium development projects undertaken by the private sector. Meanwhile, manufacturing activities, particularly manufacturing firms involved in textile and apparel and food and beverage sectors, are expected to provide a significant contribution to industrial activities. The growth in apparel manufacturing would be supported by improved demand from main export destinations as Sri Lanka is primarily focusing on niche markets, while the growth in manufacturing of food and beverages would be primarily driven by domestic market amidst a gradual pick up of demand from the tourism sector. Preferential trade arrangements would contribute to sustainable growth in textile and apparel manufacturing activities. In addition, industry related activities would benefit from the diversification of the export portfolio, which will enable the country to become more integrated with global value chains, while promoting other value-added products such as mineral products. As the manufacturing sector is becoming highly exposed to mounting trade tensions between the United States and China, the future progress of the domestic manufacturing sector could be sustained through maximising capacity utilisation, increasing labour productivity, improving product and service quality, enhancing supply chain collaborations and improving international trade linkages. However, consistent policies, investor-friendly government mechanism as well as anti-dumping laws are among the prerequisites for sustainable industrial development. Structural bottlenecks such as skill mismatch, low labour productivity, rigid labour laws have also been identified as issues that need to be addressed in order to unleash the full potential of industry activities. Going forward, favourable policies are

required, specifically in the areas of technology transfer, science and innovation to encourage manufacturers to increasingly use advanced technologies while continuously investing in research and development activities.

- **Services related activities are expected to drive the growth during 2020, supported by all major economic activities within this segment.** This growth is expected to be broad-based and widely supported by economic activities such as wholesale and retail trade, financial services, insurance, telecommunication, transportation and professional services as well as government sector driven services such as public administration and defence, education and health related service activities. Some of the services activities such as accommodation, food and beverage service activities including hotels and restaurants which were adversely affected by the Easter Sunday Attacks, are expected to rebound during the year. The tourism industry needs to have short term as well as long term strategies for optimising its capacity. Many of the Services activities are complimentary to each other which would support broad-based growth. For example, transportation activities would be a direct beneficiary of the extension of road/expressways and rail networks as well as expansion and upgrading of the airports. Enhanced connectivity makes Sri Lanka attractive to foreign investors as well as tourists. Further, better public transportation modes would be needed to replace personal modes of transport adding more value to the economy. Similarly, Sri Lanka needs to be elevated as an exporter of high value services such as research and development services, healthcare and wellness, higher education, IT development and consultancy services. Since Artificial Intelligence (AI) enabled solutions are expected to lead the next revolution by replacing traditional IT platforms, upgrading the potentials of the IT industry is important to cater the possible demand

emanating from the global arena. Meanwhile, proper strategies to attract investment and adopt new technology, together with an enabling environment are essential in promoting such services exports. Implementation of educational reforms and strengthening R & D in the areas of science, technology and innovation must be among key government priorities in relation to the sustainable positioning of Sri Lanka as a high value services exporter.

- **Investment activities are expected to continue its growth momentum in 2020, driven by higher contribution from private investment activities.** The private investment expenditure on large scale infrastructure projects, together with the FDIs, would provide an impetus for growth in total investment activities. Further, the substantial number of residential and mixed condominium projects and the investments in the Colombo Port City development project would contribute to the growth in private investment. Moreover, public

investments are also expected to contribute positively for the growth in investment with the continuation of prioritised infrastructure development projects. It is essential to strengthen the investor confidence that has deteriorated due to policy inconsistency to achieve the desired level of private investment.

- **Maintaining savings at a desirable level is vital to sustain economic growth.** In this regard, achieving and sustaining a positive level of government savings is important. Continuous effort for fiscal consolidation by developing prudent measures to improve the government revenue would contribute to improve domestic savings and space for investment. Further, maintaining inflation at a low and stable level and promoting long term private savings are material in bridging the savings - investment gap, thereby reducing reliance on external funding sources, despite the demand for higher investment expenditure.