2

NATIONAL OUTPUT AND EXPENDITURE

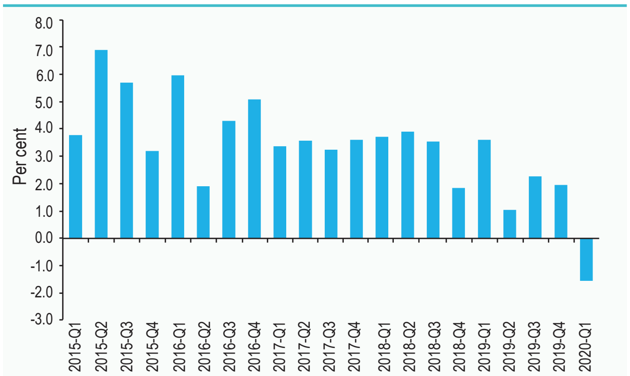
In the midst of the unprecedented challenges emanating from the COVID-19 pandemic domestically and globally, the Sri Lankan economy is projected to record a negative growth of around 1.7 per cent in 2020 compared to 2.3 per cent growth recorded in 2019. Consistent with the recent developments of the high-frequency economic indicators, it is expected that the economy would return to the growth path in the second half of the year following a substantial contraction in the first half. As per the available official statistics, the economy contracted in the first quarter of 2020 by 1.6 per cent compared to a growth of 3.7 per cent recorded in the corresponding period of 2019. This contraction in the overall economy was largely driven by the setbacks in industrial activities. Agriculture activities also recorded a contraction, mainly due to the subdued performance of growing of tea and coconut, and fishing, negating positive contributions of growing of rice, cereals, vegetables and fruits. However, Services activities contributed positively to soften the overall negativity, mainly due to the considerable growth recorded in financial services, wholesale and retail trade, and other personal services. All three major economic activities are expected to contract during the second quarter of the year mainly on account of the adverse effects of the COVID-19 pandemic. However, with the containment of the COVID-19 pandemic alongside the growth conducive fiscal and monetary policy stance and improved policy certainty following the general election, a recovery in the economy is expected during the second half of the year. It is also expected that the low interest environment and improved business confidence in a stable political environment would stimulate consumption and investment demand in the economy. Nevertheless, there are considerable downside risks to growth arising from both external and domestic fronts with the uncertainty of the recovery timeline of major trading partner economies as well as the possible impact from further waves of the COVID-19 outbreaks in the country, as observed in October 2020.

Developments in 2020

Output

- **The economy contracted by 1.6 per cent during the first quarter of 2020 compared to the growth of 3.7 per cent recorded in the corresponding quarter of 2019**. Even though Services activities recorded a growth, declines recorded in Industry and Agriculture activities resulted in a negative growth in the overall economy. Industry activities recorded a decline of 7.8 per cent during the first quarter of 2020 compared to the growth of 3.9 per cent recorded during the first quarter of 2019. The decline in construction activities was the largest contributor to the downturn in Industry activities during the first quarter of 2020, followed by manufacturing activities which also contracted mainly due to setback in the manufacture of textile and wearing apparels. Further, contraction in mining and quarrying activities also contributed to the decrease in Industry activities. In the meantime, Agriculture activities recorded a decline of 5.6 per cent during the first quarter of 2020 compared to the growth of 5.0 per cent in the corresponding period of 2019. This decline was largely driven by the subdued performance recorded in growing of tea and oleaginous fruits (coconut, king coconut and oil palm), and fishing activities during the quarter. However, Services activities maintained a growth of 3.1 per cent during the first quarter of 2020 compared to the growth of 3.7 per cent recorded during the first quarter of 2019. This growth was mainly supported by the expansion in financial services, wholesale and retail trade, other personal services and real estate activities (including ownership of dwelling). Meanwhile, taxes less subsidies on products declined by 10.8 per cent during the first quarter of 2020 compared to 1.3 per cent growth recorded in the corresponding period of 2019.

Figure 2.1
Quarterly GDP Growth Rates (a)



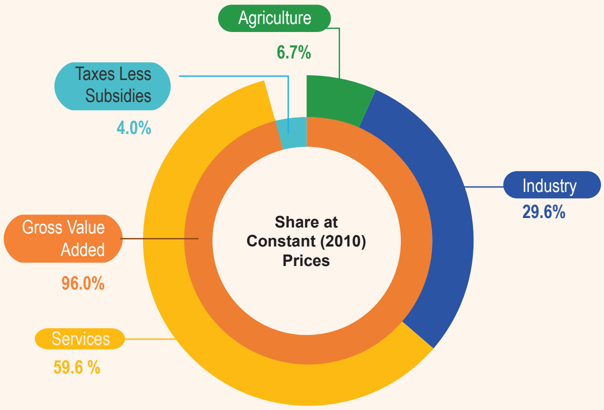
(a) The data are based on the base year 2010 GDP estimates

Source: Department of Census and Statistics

- **As per the medium term macroeconomic framework of the Central Bank, the economic growth is projected to contract by around 1.7 per cent in 2020 compared to 2.3 per cent growth recorded in 2019**. It is predicted that the economy would recover during the second half of 2020 amidst the setback caused by the COVID-19 pandemic related disturbances. Based on the information collected from various sources such as Business Outlook Survey and Purchasing Managers Index surveys, a recovery in economic activities from the third quarter onwards is anticipated, although adverse impacts from further waves of the COVID-19 outbreaks cannot be ruled out at this moment. With the gradual normalisation in economic activities, a substantial recovery is expected in manufacturing activities while political stability following the general election and concessionary measures introduced by the government to address long lasting cash flow issues would stimulate construction activities during the second half of the year. Considering the Services activities, the cross-border travel restrictions related to the COVID-19 pandemic act as an obstacle for the growth of tourism related economic activities such as accommodation, food and beverage service activities and transportation. However, pick-up in domestic tourism encouraged by attractive holiday packages offered by hotels and the expansion expected mainly in financial services, wholesale and retail trade, and public administration and defence activities would contribute positively for the growth in overall

Figure 2.2

National Output and Expenditure - First Quarter 2020



GDP	-1.6% ↓
Services	3.1% ↑
Industry	-7.8% ↓
Agriculture	-5.6% ↓
Taxes less Subsidies	-10.8% ↓

Performace of the Key Economic Activities during First Quarter 2020

Services Activities

Growth at Constant Prices (Year-on-Year)

Wholesale & Retail Trade	4.1%
Personal Services	3.4%
Transportation	-0.1%
Financial Services	9.0%

Industry Activities

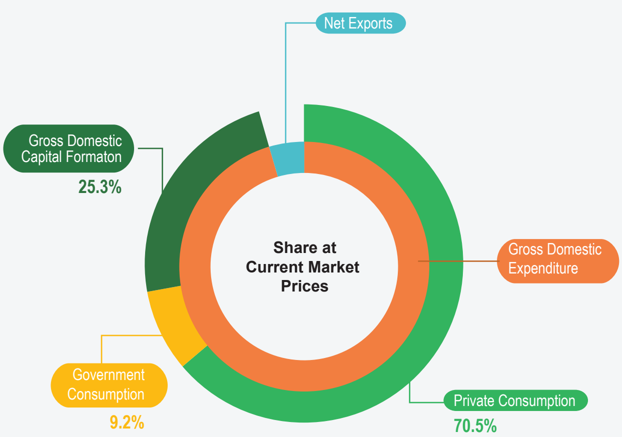
Growth at Constant Prices (Year-on-Year)

Manufacturing	-4.1%
Construction	-16.0%
Mining & Quarrying	-18.3%
Electricity	2.3%

Agriculture Activities

Growth at Constant Prices (Year-on-Year)

Total Fishing	-8.9%
Growing of Spices	1.5%
Growing of Fruits	7.4%
Growing of Oleaginous Fruits	-12.8%



Private Consumption	7.7% ↑
Government Consumption	11.4% ↑
Gross Domestic Capital Formation	-4.1% ↓
Net Exports	-151.0% ↓
Export of Goods and Services	-16.1% ↓
Import of Goods and Services	-4.2% ↓

Source: *Department of Census and Statistics*

Services activities during the second half of the year 2020. With regard to Agriculture activities, a considerable growth is expected in growing of rice, cereals, fruits and vegetables driving overall Agriculture activities to the positive territory negating the subdued performance in growing of tea, rubber and oleaginous fruits, and fishing activities. However, the contraction in the Taxes less Subsidies component would continue, especially, with the maintenance of low Value Added Tax (VAT) rates.

- **There are considerable downside risks to the expected growth projections for 2020 arising from both external and domestic fronts and the degree of the contraction in the second quarter of 2020.** A higher than expected contraction in the economy during the second quarter would move the economy deeper into the negative territory. From the external front, a slower than expected recovery in key trading partner economies which were severely hit by the COVID-19 pandemic might delay the rebound of some of the key export oriented industrial activities such as manufacture of textiles and wearing apparels, and rubber and plastic products. In particular, tourism activities which rely on global developments would continue to be disturbed by the pandemic related travel restrictions as some key economies such as India and Europe are still struggling to control infection rates. Accordingly, entire ecosystem built around tourism would continue to get affected during the second half of the year as well. Further, adverse implications arising from further waves of the COVID-19 outbreaks in the country particularly affecting export oriented manufacturing activities and domestic tourism related activities would have a detrimental effect on growth outlook during the second half of the year. In order to fully recover from the setback experienced in the first half of 2020, supporting the economic growth in the medium term, it is important to maintain a favourable growth in export volumes during the second half of 2020 and beyond. Less diversified export portfolio and concentration to a few markets also pose risks in external front. At the same time, although import restrictions help to reduce outflows and promote import substitutions, restrictions on raw material imports should be scrutinised immediately and effectively to minimise disturbances to the production process as highlighted by the business survey participants as well. Further, weather related disturbances might dilute positive developments of Agriculture activities. Any adverse impact on Agriculture activities would have spill over effects on other economic activities such as food and beverages related manufacturing activities and Services activities such as trade, transportation and personal services. Government revenue side issues arising from the significant tax reductions and lower economic activity levels due to the COVID-19 pandemic during the first half of the year, provide only a limited space for fiscal stimulus and public investment activities which play a critical role in boosting aggregate demand. However, improved political stability following the general election could eliminate uncertainty, which prevailed in the past several years delaying investment decisions of the private sector, resulting in a faster than expected recovery.

Growth in Economic Activities

Agriculture, Forestry and Fishing

- **Agriculture, Forestry and Fishing activities recorded a considerable contraction of 5.6 per cent during the first quarter of 2020 compared to the growth of 5.0 per cent recorded in the corresponding period of 2019.** This contraction was largely driven by the significant decline in growing of tea and oleaginous fruits (coconut, king coconut and oil palm), fresh water fishing, and forestry and logging during the first quarter of the year. However, growing of cereal (except rice), sugar cane, fruits, vegetables, rice and spices, and animal production contributed positively to slow down the contraction in Agriculture activities.

2

Production Trends and Institutional Support: Agriculture

Agriculture Production

- **The Agriculture Production Index (API),[1] which measures the output of agriculture and fishing activities, recorded a decline of 7.5 per cent during the first half of 2020 (provisional).** Within the index, the agricultural crops sub index declined due to notable declines in tea, rubber and coconut subsectors. However, the decline in API was limited to some extent supported by paddy and other crops subsectors, which include vegetables and other field crops. Further, the livestock subsector contributed negatively to the overall agriculture output, recording a marginal decline of 3.3 per cent. The fisheries subsector also declined significantly in the first half of 2020.

Paddy

- **According to the Department of Census and Statistics (DCS) and the Department of Agriculture (DOA), the production of paddy is expected to increase further in 2020 in comparison to the bumper harvest observed in 2019**. During this year, the production of paddy is expected to increase by 9.7 per cent to 5.0 million metric tons from 4.6 million metric tons recorded in 2019. Conducive weather conditions that prevailed during the 2019/20 Maha season and the 2020 Yala season are expected to increase this year's production to the highest level recorded in the last six decades. The production of paddy during the 2019/20 Maha season, which accounts for about 63 per cent of the 2020 annual paddy production, recorded an increase of 4.0 per cent to 3.2 million metric tons in comparison to the previous Maha season. The extent sown during the 2019/20 Maha season registered a marginal increase of 0.6 per cent while the net extent harvested increased by 2.4 per cent over the previous Maha season. Meanwhile, it is forecast that 1.8 million metric tons of paddy will be produced in the 2020 Yala season, reflecting a 21.3 per cent increase compared to the previous Yala season. The increase in paddy production in the 2020 Yala season can be partly attributed to the supply of fertiliser to paddy farmers free of charge during the season. The annual production of paddy in both Maha and Yala seasons is estimated approximately to be the equivalent of 3.2 million metric tons of rice, which is adequate to meet the domestic demand for rice for around 16 months. With the substantially high domestic paddy production as well as restrictions imposed on selected imports to ease the pressure on the exchange rate, rice imports declined to 10,726 metric tons during the period from January to August 2020 in comparison to the 14,518 metric tons of rice imports in the corresponding period of last year.

1 Since production data related to the fruits category was not available, the API has been calculated excluding fruits sector.

Table 2.1

Agriculture Production Index (2007-2010=100) (a)

Item	2019 First Half (b)	2020 First Half (c)	Growth Rate (%) 2018/19 (b)	Growth Rate (%) 2019/20 (c)
Agriculture and Fishing	**131.6**	**121.7**	**3.6**	**-7.5**
1 Agriculture	**127.3**	**122.7**	**4.5**	**-3.6**
1.1 Agriculture Crops	118.8	114.4	5.2	-3.7
Paddy	164.3	171.0	28.2	4.0
Tea	101.3	82.6	0.2	-18.5
Rubber	62.2	56.0	4.0	-10.1
Coconut	111.2	96.6	29.3	-13.1
Other Crops	109.0	112.4	-17.6	3.1
o/w Vegetables	139.5	150.1	-18.1	7.6
Other Field Crops	151.3	168.6	-14.2	11.4
1.2 Livestock	195.0	188.7	1.2	-3.3
2 Fisheries	**152.5**	**116.7**	**0.0**	**-23.5**

(a) Excluding fruits subsector
(b) Revised
(c) Provisional

Source: Central Bank of Sri Lanka

- **Paddy prices in the open market remained elevated during the period from January to August 2020 compared to the corresponding period of 2019, despite sufficient production in 2019 as well as in 2020.** The average open market paddy price of Nadu increased by 19.1 per cent to Rs. 46.84 in the period from January to August compared to the previous year, while the average open market paddy price of Samba also increased by 24.4 per cent to Rs. 49.07 during the same period in comparison to the previous year. Prices were driven upwards due

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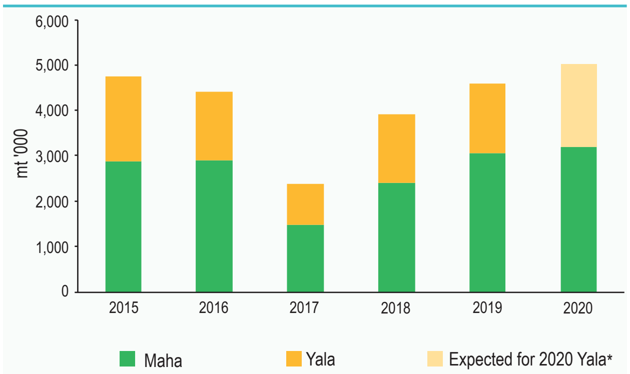
Figure 2.3
Paddy Production



* Department of Agriculture forecast

Sources: Department of Census and Statistics
Department of Agriculture

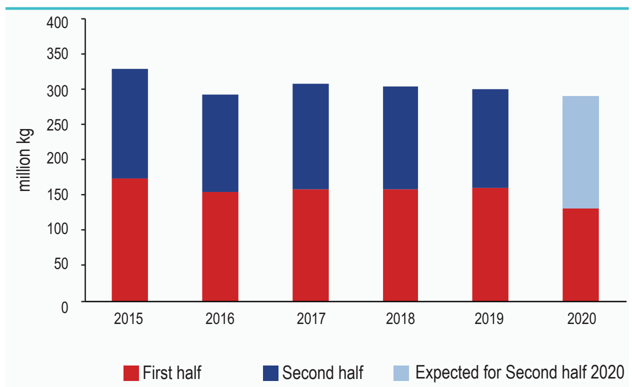
to the competition among private mill owners to purchase paddy stocks above the certified paddy purchasing price of Rs.50.00 per kilogramme of Nadu, Samba and Keeri Samba (dry) paddy varieties (and Rs.44.00 per kilogramme for paddy with high moisture content) imposed by the Government. Consequently, during the period from January to August 2020, the average retail price of Nadu rice recorded an increase of 9.4 per cent while the average retail price of Samba rice declined by 1.2 per cent compared to the corresponding period in the previous year. Accordingly, the average retail prices across different varieties of Nadu and Samba rice were Rs. 99.20 per kilogramme and Rs.101.97 per kilogramme, respectively. Meanwhile, the Government imposed a maximum retail price (MRP) of Rs. 90.00 per kilogramme for both Samba and Nadu rice on 10 April 2020. However, millers, wholesalers, and retailers were reluctant to sell their stocks at this administered price citing that the MRP was less than their cost of production. This resulted in a shortage of rice in the market and the Government revised the MRP on 28 May 2020 for Nadu and Samba rice to Rs. 96.00 per kilogramme and Rs. 98.00 per kilogramme, respectively.

Tea

- **The production of tea registered a notable decline of 16.0 per cent to 177.3 million kilogrammes during the period from January to August 2020**. The dry weather conditions prevailed in the first quarter of the year, disruptions to tea plucking and factory activities due to the COVID-19 lockdown and rainy weather conditions in the third quarter were the main causes for the decline in tea production during this period. High grown and low grown tea varieties, which collectively account for approximately 83 per cent of the total tea production, declined by 8.7 per cent and 20.0 per cent, respectively, during the period from January to August 2020. Further, the output of medium grown tea also declined by 9.5 per cent to 30.4 million kilogrammes.

- **Tea prices continued to increase at the Colombo Tea Auction (CTA) largely in response to the declining tea supply in the local market as well as in several major tea producing countries**. Average tea prices during the period from January to August 2020 increased by 15.5 per cent compared to the corresponding period of 2019. Accordingly, average tea prices during the period under review stood at Rs.630.80 per kilogramme. During the period from January to August 2020, the highest year-on-year increase in average tea prices at the CTA was recorded for low grown tea (16.7 per cent), followed by the prices of medium grown tea (16.6 per cent) and prices of high grown tea (12.8 per cent). The considerable growth in tea prices is partly due to the decline in quantity supplied to the CTA, stemming from the reduced production levels. The decline in tea production in few major tea producing countries such as India and Bangladesh and growing demand for Sri Lankan tea in China also contributed to the increase in

Figure 2.4
Tea Production



Source: Sri Lanka Tea Board

prices. Meanwhile, the average export price (FOB) of tea decreased by 0.8 per cent to US dollars 4.60 per kilogramme during the period from January to August 2020, compared to US dollars 4.70 per kilogramme recorded in the same period of 2019.

Rubber

- **Rubber production declined by 5.9 per cent to 50.2 million kilogrammes during the period from January to August 2020 compared to the same period last year, largely due to the reduction in tapping days due to the imposition of mobility restrictions during the COVID-19 outbreak alongside the decline in demand, particularly in global markets.** Dry weather conditions experienced during the first quarter of the year and rainy conditions thereafter also affected domestic rubber production. During this period, crepe rubber production declined by 22.0 per cent to 8.7 million kilogrammes while sheet rubber production declined by 5.9 per cent to 25.1 million kilogrammes compared to the corresponding period in 2019. Meanwhile, the production of unspecified categories of rubber, which account for around 33 per cent of the total rubber production, increased by 5.6 per cent to 16.4 million kilogrammes during the period from January to August 2020.

- **While prices of natural rubber demonstrated a declining trend in recent months in the wake of the COVID-19 pandemic, the rubber prices observed during January to August 2020 were generally higher than those observed in the corresponding period of 2019**. The price of Ribbed Smoked Sheet 1 (RSS1) at the Colombo Rubber Auction increased by 20.8 per cent, on average, to Rs. 309.24 per kilogramme in the first quarter of the year, but RSS1 was not traded in the auction from April to August 2020. Meanwhile, the average latex crepe 1X price increased by 20.6 per cent to Rs. 330.61 per kilogramme during the period from January to August 2020. In April, the average export price (FOB) sharply increased due to limited supply in the market at the height of COVID-19 related lockdowns worldwide, though this increase was temporary. On average, the export price (FOB) of rubber increased by 3.0 per cent to US dollars 1.9 per kilogramme during the period from January to August 2020, compared to US dollars 1.8 per kilogramme recorded in the corresponding period of 2019.

2

Coconut

- **The total coconut production declined by 11.3 per cent during the period from January to August 2020 compared to the 25.3 per cent growth recorded during the same period in 2019**. During the period under review, output fell to 1,867 million nuts from 2,104 million nuts recorded in the corresponding period of 2019. This decline in production can be attributed to the lagged effect of dry weather conditions that prevailed during mid 2019 in the coconut triangle and other coconut growing areas. Owing to the combined effect of decreased nut production and supply side disturbances related to the COVID-19 pandemic, the production and export of coconut-based products declined considerably during this period. Accordingly, desiccated coconut (DC) production declined by 43.1 per cent to 17,558 metric tons during the period from January to August 2020 from 30,868 metric tons recorded during the same period in 2019. Coconut oil output recorded a considerable decline by 60.4 per cent to 13,504 metric tons, mainly due to factory closures and mobility restrictions imposed to curb the COVID-19 outbreak. Virgin coconut oil production increased by 2.6 per cent to 9,062 metric tons. Meanwhile, the importation of coconut oil increased significantly to 30,575 metric tons during the period from January to August 2020 from 2,148 metric tons during the same period in 2019. In the wake of the coconut oil shortage in the domestic market, the Government revised the Special Commodity Levy (SCL) on coconut oil, virgin coconut oil and palm oil imports several times during the second quarter of the year. On each occasion, the SCL on coconut oil and virgin coconut oil imports was maintained at a lower level than the SCL imposed on palm oil, encouraging coconut oil and virgin coconut oil imports to the country. Moreover, copra exports and fresh nut exports also declined by 54.0 per cent and 7.1 per cent, respectively, during the period under review. In contrast, coconut cream and coconut milk production, which utilises around 12.2 per cent of the total nut production, recorded a 26.2 per cent increase in the period from January to August 2020 compared to the corresponding period in the previous year.

- **During the period from January to August 2020, the supply shortfall in coconut production resulted in a sharp increase in prices of coconut and coconut-based products**. Accordingly, the average auction price of coconut at the Colombo Coconut Auction increased to Rs. 48.18 per nut during the period from January to August 2020 from Rs. 25.86 per nut that was reported in the same period in 2019. The average retail price of a coconut increased by 39.4 per cent to Rs. 70.20 per nut compared to the corresponding period of 2019. Meanwhile, the average price increased significantly to Rs. 83.87 per nut during April 2020 as a result of disruptions to the coconut supply chain. However, by the end of August 2020, the price declined to around Rs. 72.28 per nut. Considering the high retail prices of coconuts, the Government imposed maximum retail prices for coconuts in September 2020, based on the size of the nut measured in terms of its circumference. Meanwhile, the average coconut oil price also increased significantly by 32.3 per cent, from Rs. 260.42 per 750 ml bottle during the period from January to August 2019 to Rs. 344.61 per 750 ml bottle during the corresponding period in 2020. The average local market price of desiccated coconut increased to Rs. 407.17 per kilogramme in the period from January to August 2020 from Rs. 241.52 per kilogramme during the same period in 2019.

Other Field Crops

- **Production of Other Field Crops (OFCs) increased with the support of favourable weather conditions during the 2019/20 Maha season**. Accordingly, production of Other Field Crops (OFCs) at 420,570 metric tons, registered an increase of 13.8 per cent during the 2019/20 Maha season while the extent cultivated also increased by 11.6 per cent to 110,435 hectares. Meanwhile, remunerative prices resulting from the imposition of high SCL on OFCs imports encouraged domestic farmers to increase production. Domestic production of OFCs such as cowpea, maize, green gram, gingerly, ground nuts, red onion, big onion and green chillies recorded an increase, while the production of finger millet, millet, soya bean and potato declined in the 2019/2020 Maha season compared to the previous Maha season. The decline in potato production was reflected in the significant reduction in the extent cultivated by 21.7 per cent to 2,069 hectares. Favourable weather conditions and import substitution policies are expected to have a positive impact on the overall production OFCs in 2020. Although the current import restrictions imposed on OFCs and spices could create market shortages of such products in the short term, such policies, combined with crop-specific interventions, could create positive effects on local production in the medium to long run.

Vegetables

- **The combined outcome of favourable prices and weather conditions has encouraged the performance of the vegetable sector during the 2019/20 Maha season**. Vegetable production during the 2019/20 Maha season registered an increase of 7.0 per cent, year-on-year, to 893,930 metric tons while the extent cultivated in major vegetable producing areas increased by 5.7 per cent to 67,605 hectares. Weather related disturbances during the early part of the 2019/20 Maha season resulted in a delay in vegetable cultivation thereby reducing the market supply and escalating vegetable prices. However, with the commencement of the harvesting period, vegetable prices remained subdued throughout February and March 2020. Meanwhile, inter-seasonal cultivation of vegetables, which is practiced during the months of March and April, was sluggish as a result of COVID-19 related lockdowns. However, vegetable supply received from the areas like Puttalam, Welimada and Embilipitiya helped curtail price pressure of both upcountry and low country vegetable varieties. Meanwhile, the market supply of vegetables declined during August 2020 due to the off-season, leading to increased vegetable prices.

Sugar

- **The production of sugar increased by 31.0 per cent to 31,757 metric tons during the first half of 2020 compared to the first half of 2019.** This is the combined outcome of the increase in production at the Sevenagala and Gal Oya factories by 17.2 per cent and 101.8 per cent, respectively, due to increased sugarcane cultivation amid attractive sugarcane prices. Meanwhile, sugar production at the Pelwatta factory reported a contraction of 2.2 per cent, due to low sugar cane yield that resulted from the drought conditions which prevailed in the area and inadequate application of fertiliser. It is projected that total sugar production would increase to around 73,000 metric tons in 2020, which would be sufficient to meet around 12 per cent of the total domestic sugar requirement of the country.

Livestock

- **According to the estimates of the Department of Animal Production and Health, the livestock sector showed a mixed performance during the first half of 2020.** Milk production grew by 8.2 per cent, year-on-year, to 240.7 million litres during the first half of 2020 largely due to part time farmers having extra time for the care and maintenance of their animals during the COVID-19 lockdown period and the high remunerative prices paid by milk collecting companies. Cattle milk production, which accounted for around 88 per cent of total milk production, increased by 12.5 per cent, year-on-year, to 211.8 million litres. However, buffalo milk production declined by 15.3 per cent to 28.9 million litres due to lower demand for buffalo milk products during the lockdown period and difficulties in feeding animals amidst mobility restrictions as buffaloes are typically reared with free-range grazing. It is expected that milk production would increase by around 20 per cent to 509 million litres in 2020, which however, would be sufficient to meet only around 42 per cent of total domestic demand. Meanwhile, egg production registered an increase of 2.5 per cent to 1,292 million, while poultry meat production recorded an increase of 4.9 per cent to 113,820 metric tons during the first half of 2020. The importation of broiler parents declined during the first half of 2020 due to restrictions imposed on live animal importation in response to the COVID-19 pandemic, resulting in lower availability of broiler day-old chicks in 2020. However, imports of layer parents increased significantly by 15.6 per cent during the period. Production of beef and mutton also declined by 34.2 per cent and 13.3 per cent, respectively, while pork production increased by 6.6 per cent, during the first half of 2020. Meanwhile, the Consumer Affairs Authority issued an Extraordinary Gazette dated 23/8/2020 prohibiting the use of rice or paddy for animal feed production while the importation of maize was also banned since January 2020. The limited availability of raw material for concentrate feed has led to an increased cost of production of eggs and poultry meat and higher retail prices in local markets, but this is expected to be short lived due to increased domestic production of raw material which would reach the market in the period ahead.

Fisheries

- **The production of fish declined by 15.7 per cent to 283,485 metric tons during the period from January to August 2020 with a significant decline in marine fish production**. The decline in production can be attributed to mobility restrictions and adverse weather conditions that caused disruptions to marine fishing activities. Accordingly, marine fish production decreased significantly by 20.2 per cent to 222,270 metric tons. The decline in marine fish production was driven by both the deep sea subsector and coastal and lagoon subsectors, which recorded declines of 19.4 per cent and 20.8 per cent, respectively. Inland capture and inland culture production increased by 7.5 per cent and 5.7 per cent, respectively, while shrimp farm production declined by 12.4 per cent, during the period from January to August 2020. Accordingly, inland fish production recorded a 5.6 per cent growth during the period from January to August 2020. The high levels of water in major reservoirs during the first quarter of 2020 reduced fish netting areas in inland water bodies while reduced movement of fishermen due to the COVID-19 lockdown led to less fish harvest. Further, disruptions to the fish supply chain and a considerable amount of fish wastage were observed due to fish market closures during the lockdown period. Therefore, the Government granted permission to continue fish supply activities while the Ceylon Fisheries Corporation accelerated fish purchases from fishing vessels. However, lower demand from the household sector during the lockdown period discouraged fish production, resulting in a substantial decline in fish prices during the curfew period. The temporary closure of hotels and restaurants and the slowdown in tourism activities also adversely affected the fisheries sector. Meanwhile, fish exports were also hampered due to global logistical issues and lower demand from export destinations. Nevertheless, a recovery in domestic prices was observed from the end of the second quarter with the easing of domestic lockdown measures.

Industry

- **Industry activities contracted by 7.8 per cent during the first quarter of 2020 compared to the growth of 3.9 per cent recorded in the corresponding period of 2019.** The setback was largely attributed to the significant contraction reported in construction, mining and quarrying, and overall manufacturing activities especially related to manufacture of textile and wearing apparels. However, electricity, gas, steam and air conditioning, water collection, treatment and supply activities, and sewerage, waste treatment and disposal activities contributed positively towards the overall expansion in Industry activities during the period.

- **Construction, and mining and quarrying activities contracted at a higher pace due to lack of mega projects, cash flow issues in the sector and lockdown related disturbances to contain the spread of the pandemic during the first quarter of 2020**. Accordingly, construction, and mining and quarrying activities contracted by 16.0 per cent and 18.3 per cent, respectively, during the first quarter of 2020 compared to growth of 6.9 per cent and 6.2 per cent recorded, respectively, in the corresponding period of 2019. This contraction in construction activities was partly reflected by 16.4 per cent contraction in cement availability during the first quarter of 2020 against 11.9 per cent increase recorded in the corresponding period of the previous year. Further, building material imports volume index recorded a decline of 29.0 per cent during the first quarter of 2020 against an increase of 3.3 per cent recorded in the same period of 2019.

- **Overall manufacturing activities contracted significantly by 4.1 per cent during the first quarter of 2020 in comparison to the growth of 2.5 per cent recorded in the corresponding period of 2019.** The contraction observed in total manufacturing activities was largely attributable to the notable decline in manufacture of textiles, wearing apparel and leather related products, manufacture of coke and refined petroleum products, manufacture of chemical products and basic pharmaceutical products, manufacture of furniture, and manufacture of rubber and plastic products during the first quarter of 2020 compared to the corresponding quarter of the previous year. However, manufacture of food, beverages & tobacco products, and manufacture of basic metals and fabricated metal products recorded a positive growth. With regard to other industry activities, electricity, gas, steam and air conditioning supply activities, water collection, treatment and supply activities, and sewerage, waste treatment and disposal activities grew by 2.3 per cent, 5.0 per cent and 1.8 per cent, respectively, during the first quarter of 2020 in comparison to 1.9 per cent, 6.3 per cent and 7.0 per cent, respective growth rates recorded in the corresponding period of 2019.

Production Trends and Institutional Support: Manufacturing Activities

Industrial Production

- **Except in the month of July, the manufacturing sector witnessed a year-on-year contraction every month up to August in the year 2020, due to the disruptions caused by the COVID-19 outbreak.** The manufacturing sector growth, as depicted by the Index of Industrial Production (IIP) compiled by the DCS, registered a decline of 10.2 per cent and 28.6 per cent in the first and second quarters of 2020, respectively, while recording an overall contraction of 19.2 per cent during the first half of 2020. The manufacturing sector growth declined substantially in the months from March to June 2020, recording index values below 100 points. Notably, the IIP registered a value of 49.7 index points in April 2020, the lowest performance since the inception of the index in 2015. While manufacturing activities across most subsectors deteriorated during the second quarter of 2020, the manufacture of food products, and basic pharmaceutical products and pharmaceutical preparations subsectors recorded a minor expansion in activity. This may be attributed to the essential nature of such segments. With the easing of mobility restrictions, reopening of workplaces, and the gradual restoration of normalcy to the economy, the overall IIP showed signs of improvement and recorded a positive growth, on a year-on-year basis, in the month of July 2020, followed by a year-on-year contraction in the IIP in August 2020. With the resurgence of the COVID-19 outbreak locally in October 2020, the manufacturing sector could experience a further setback stemming from the inability to continue with factory operations, the slowdown in local demand and fragile external demand that may have a dampening effect on obtaining new orders. However, the Government's recent initiatives to promote agro and natural resource based industries and traditional industries are expected to strengthen the domestic industry sector in the medium term by promoting import substitution and an eventual increase in industrial exports.

Figure 2.5
Index of Industrial Production (IIP)

Source: Department of Census and Statistics

- **Although the food manufacturing sector was affected by lockdown measures to a lesser extent, beverage manufacturing activities recorded notable contractions in the months of March, April and May 2020.** During the period under consideration, the manufacture of food products subsector, the largest subsector in the IIP, grew in all months except for marginal declines recorded in March and August 2020. Increased production of milk powder, wheat flour, rice based products and biscuits contributed to the surge in food production. In contrast, the manufacture of beverages subsector recorded a year-on-year contraction during March to May 2020 period due to reduced production of beer, arrack, and non alcoholic beverage products such as soft drinks. The closure of restaurants and liquor shops and subdued leisure activities adversely affected the beverage industry. However, beverage manufacturing activities have registered a positive growth since June 2020.

- **The apparel and textiles export industries were substantially affected by the COVID-19 pandemic, not only due to the decline in export orders from traditional export markets, but also due to limited labour availability as a result of mobility restrictions.** The manufacture of wearing apparel subsector, which accounts for approximately 20 per cent of the IIP, has registered year-on-year negative growth rates every month thus far during the year due to lower demand in export destinations, global supply chain disruptions, domestic mobility restrictions and

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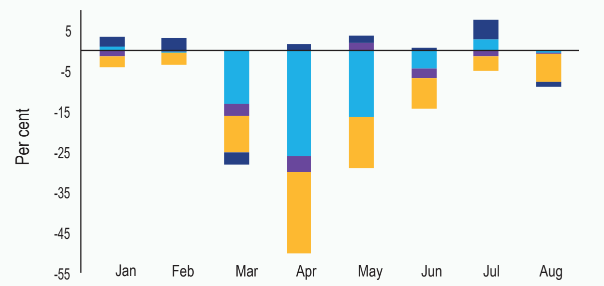
temporary closure of factories from mid March to end April. Accordingly, the contraction in wearing apparel subsector reached the maximum level in April 2020. Most factories gradually returned to normal operations from early May onwards with the gradual easing of mobility restrictions, but the subsector continued to record a year-on-year contraction in the subsequent months reflecting the subdued global demand. The manufacture of textiles industry, which primarily comprises weaving and finishing of textiles, also recorded a significant contraction during the period from February to May, but the sector has recorded positive year-on-year growth rates since June 2020. The production of coir fibre and finished fabrics regained its growth momentum in the post lockdown period. Given the COVID-19 pandemic, certain key apparel producers shifted to the production of personal protective equipment (PPE) with Sri Lanka exporting these products to the United States and Europe. In addition to PPE, which is a rapidly growing niche segment, the exploration and entry into other customer niches, such as luxury and high-end apparel, which possess relatively inelastic demand, may be essential to build the resilience of this key industry.

- **Except in the month of July, the manufacture of other non-metallic mineral products and the manufacture of fabricated metals subsectors also registered notable contractions during the eight months ending August 2020**. The reduced production of floor tiles, cement, glass bottles, and ceramic based glazed wall tiles largely contributed to the slowdown in this subsector. Subdued demand from the local construction sector and global markets also contributed to the lower production in the other non metallic mineral products subsector. Other non metallic mineral products subsector recorded a marginal growth in July 2020, but this recovery was short lived due to the lower domestic demand. Meanwhile, the fabricated metal products subsector, which primarily comprises ship building and repair activities, also followed a similar trend. The reduced production of aluminium products, lead oxide and storage tanks resulted in a contraction in this subsector index.

Figure 2.6
Contribution to Year-on-Year Change in IIP



Note : Figures in parenthesis are the weights of subsectors in IIP

Source: Department of Census and Statistics

- **The manufacture of coke and refined petroleum products subsector witnessed significant negative growth rates during most months up to August this year**. This decline was mainly driven by the lower demand for refined petroleum products in the domestic market and the partial closure of the Ceylon Petroleum Corporation (CPC) refinery for 45 days since 15 February 2020. However, in May 2020, a notable growth of 41.4 per cent was registered by this subsector compared to the same month in 2019 due to the shutdown of the CPC refinery for renovations in the same month in the previous year.

- **Although the COVID-19 related lockdown affected the manufacture of chemicals and chemical products, manufacture of tobacco products, and printing and reproduction of recorded media, a recovery was observed in these subsectors since June 2020 with the easing of lockdown measures**. The manufacture of chemicals and chemical products subsector significantly contracted during the nationwide curfew period, largely due to the reduced production of paints, fertiliser, and poly bags. In addition to the high level of taxes on tobacco products, the dampened consumer demand stemming from the COVID-19 outbreak led to reduced production of tobacco, die cuts, and cigarettes, causing a reduction in manufacturing of tobacco products during the lockdown period.

However, demand and production have picked up since June 2020. Meanwhile, reproduction of recorded media also witnessed a contraction since the beginning of the year, but the subsector has regained its growth momentum since June 2020.

- **Subsectors relating to the manufacture of rubber and plastic products, leather and related products, electrical equipment, paper and paper products, and wood products except furniture, declined with the imposition of the nationwide lockdown and continued to record a subdued performance till August 2020**. Decreased production of rubber sheets, plastic bottles, and tyres that cater to international markets, such as the United States, Germany, and Brazil along with subdued demand from the global manufacturing industry underpinned the slowdown experienced in the rubber and plastic products subsector. However, with the COVID-19 pandemic, export demand for industrial and surgical gloves expanded considerably with higher exports to the United States and Europe. The continued emphasis on health and safety precautions pertaining to COVID-19 is likely to ensure that such industries will receive a steady flow of orders. Meanwhile, the subdued demand in both local and foreign markets led to a reduction in the production of finished leather, leather bags, shoes and jackets, which contributed to the poor performance of the subsector. Reduced domestic demand for consumer durables during the lockdown period resulted in lower production, thereby causing a contraction in subsectors pertaining to the manufacture of electrical equipment. In the meantime, owing to the decreased production of corrugated paper, cardboard boxes, paper bags, and exercise books, the manufacture of paper and paper products subsector deteriorated since February 2020. Meanwhile, the manufacture of basic metals and furniture also recorded a subdued growth particularly with the imposition of mobility restrictions, but showed a recovery in the month of August.

- **The manufacture of basic pharmaceutical products and pharmaceutical preparations witnessed an expansion since April 2020**. Increased production of capsules and Ayurvedic balms, along with higher demand for health related products in the wake of the COVID-19 outbreak, supported the growth in this subsector.

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- **The Government has identified the importance of diversifying the industry sector, especially with the aim of promoting industrial exports**. With the 'production economy' approach of the Government, several State Ministries have been established to oversee specific aspects and subsectors of industrial activities, in view of creating a conducive environment to boost the industry sector. The current policy stance of the Government is envisaged to support not only the industry sector, but also to drive demand for the agriculture and services sectors through backward and forward linkages of the value chains.

- **Despite experiencing some setbacks due to the COVID-19 outbreak, activities of Government agencies overseeing industrial activity continued**. A National Policy on Mineral Resources is being finalised. This national initiative is expected to provide an enabling environment for mineral based industries to expand their scope for value addition, thereby enabling them to improve their potential to earn foreign exchange. To minimise disruptions in coconut based industries stemming from shortages of raw materials, a joint venture partnership has been proposed with several state owned organisations, including the Chilaw plantations, Kurunegala plantations, and the National Livestock Development Board (NLDB). Moreover, the National Science and Technology Commission (NASTEC) reviewed the Seed Certification Services Centre during the first half of the year and recommended developing grassroots level seed enterprises in the country. Meanwhile, the technology transfer and business development units at the Sri Lanka Institute of Nanotechnology (SLINTEC) evaluated the potential of upgrading laboratory level projects to the development and commercialisation stages while continuing to work with relevant Ministries in offering support to Small and Medium Enterprises (SMEs). The SLINTEC facilitated the work of science and technology entrepreneurs working with the Sri Lanka Inventors Commission (SLIC), to support COVID-19 related inventions. Although technology transfer programmes conducted through *Vidatha* Resource Centres were disrupted due to the COVID-19 outbreak, these programmes were conducted online. Accordingly, 202 programmes were completed during the first half of 2020. In the meantime, by end March 2020, the SLIC commenced a new project to identify innovative measures of addressing the COVID-19 outbreak. By end June 2020, several low cost alternatives to imported medical equipment were invented. An expert panel selected 46 of these inventions with high potential for commercial manufacturing with the aim to provide financial assistance through the SLIC. Meanwhile, the Industrial Technology Institute (ITI) undertook COVID-19 related product testing, including the testing of mask materials and hand sanitisers, and established new testing methods on the request of clients and the SLIC. Further, the ITI took steps to manufacture hand sanitisers in collaboration with the Sri Lanka Ayurvedic Drugs Corporation while also engaging with them on technology transfer and technology training activities pertaining to new product development, especially in the food and herbal sectors to cater to the evolving demand.

- **Industry Chambers and other relevant institutions continued to implement numerous initiatives to promote the domestic industrial sector**. The National Chamber of Commerce (NCC) continued its endeavours to educate and uplift SMEs by conducting training programmes during the first half of 2020. The NCC conducted bilateral discussions with foreign embassies on trade facilitation. The NCC also launched an online portal in January 2020 aimed at supporting Sri Lankan companies to promote their products and services to the global market. Meanwhile, the Ceylon Chamber of Commerce (CCC) continued to facilitate numerous trade delegations, training programmes, webinar series, and trade forums to promote trade and investment while initiating several activities focused on the business recovery of SMEs affected by the COVID-19 outbreak. The CCC also conducted surveys to analyse the impact of COVID-19 on businesses, trade, and labour markets. Activities of the Industrial Development Board (IDB) relating to the development of enterprise villages, which focused on the strengthening and supporting of women entrepreneurs at the village level, were continued during the reference period. The IDB also engaged in the modernisation and upgrading of infrastructure facilities in industrial estates, albeit at a slow pace due to disruptions stemming from the COVID-19 outbreak.

- **As key facilitators of foreign direct investment (FDI) and export industries, the Board of Investment (BOI) and Export Development Board (EDB) undertook various measures to ensure continuity and resilience of industrial enterprises in the wake of the COVID-19 outbreak**. To address the issue pertaining to the inability to physically submit import and export documentation due to travel restrictions, the BOI implemented a paperless import and export documentation process for BOI exporters, in collaboration with the Sri Lanka Customs. The BOI also introduced an online approval facility for the importation of selected raw material that are not liable for Customs duty. The BOI is expected to implement the paperless solution in line with the single window facility of the Sri Lanka Customs. During the first half of 2020, the BOI granted approval for around fifty companies to engage in the production of PPE as an additional activity, considering the growing demand for PPEs. Also, the BOI conducted initial discussions on the establishment of a rubber zone, agri park, and aquaculture parks. The BOI developed and began to implement a new comprehensive strategy ‘Reimagining FDI in Sri Lanka’ focusing on priority sectors. Accordingly, a structured approach is to be adopted to attract FDI to spur growth. The BOI is also in the process of developing special economic zones to attract both foreign and local investment. In this regard, steps have been taken to establish a pharmaceutical zone in the Arabokka BOI zone within the Hambantota district. Further, the BOI is in the process of establishing a textile zone in Eravur across a land extent of 300 acres. The proposed zone will also serve as a fabric manufacturing centre catering to both local and international markets. Meanwhile, the EDB conducted several trade fairs, market exposure, market development, product development, capacity development, and awareness programmes before the imposition of mobility restrictions in mid-March 2020. Accordingly, the EDB conducted several Buyer-Seller meetings and physical and virtual Business-to-Business meetings with representatives of Middle Eastern markets, the USA, Brazil and Japan to support Sri Lankan exporters. In addition, EDB and the Wellness Tourism Association conducted a Webinar series targeting local and international audiences to create awareness and interest in the Sri Lankan wellness tourism sector. The EDB also established a 'Help Desk' for exporters, entrepreneurs, and the public to assist them and to provide necessary guidance regarding procedures associated with other relevant institutions. This Help Desk is also expected to facilitate processes with Sri Lankan missions abroad, concerning the establishment of linkages between Sri Lankan exporting companies and global markets, especially in the context of the urgent need to explore unconventional export destinations in the wake of the COVID-19 pandemic. Further, the EDB has proposed an Export Stimulus Reward Scheme to encourage exporters to increase their volume of exports in the future.

- **The Government in collaboration with the Central Bank of Sri Lanka (CBSL) introduced an expansive package including debt relief, debt moratorium and working capital loan facilities to SMEs, self employed persons and individuals severely affected by the COVID-19 pandemic**. The Central Bank, in consultation with the Government, introduced the 'Saubagya COVID-19 Renaissance Loan Scheme Facility' in three phases to provide working capital loans to businesses adversely affected by the COVID-19 outbreak. Such loans are provided at the interest rate of 4 per cent per annum, with a repayment period of 24 months, including a grace period of 6 months. This scheme was expected to cumulatively disburse Rs. 150 billion to businesses affected by the COVID-19 pandemic. As of 15 October 2020, the Central Bank has approved 61,907 loan applications worth Rs. 178 billion received from COVID-19 affected businesses. Further, the Small and Medium Enterprise Line of Credit Scheme and the Rooftop Solar Power Generation Line of Credit Scheme funded by the Asian Development Bank (ADB) continued during the first half of 2020. By end June, around Rs. 30.8 billion was granted under these two credit schemes.

Services

- **Services activities, which represent the largest share of the economy, grew by 3.1 per cent during the first quarter of 2020 compared to the growth of 3.7 per cent recorded in the corresponding period of 2019.** This growth is largely supported by the expansion in financial services, wholesale and retail trade, other personal services, and real estate activities. Further, telecommunication, education, public administration and defence, professional services, IT programming and consultancy, human health, postal and courier services, programming and broadcasting services, and insurance activities also recorded a favourable growth. However, accommodation, food and beverage services, and transportation activities contracted during the quarter.

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 1.5 per cent during the first quarter of 2020 compared to 3.8 per cent growth recorded in the corresponding period of 2019.** This growth was mainly attributable to the expansion in wholesale and retail trade activities,

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which grew by 4.1 per cent during the first quarter of 2020 compared to 4.6 per cent growth in the corresponding period of the previous year. Moreover, postal and courier activities recorded a growth of 7.7 per cent during the first quarter of 2020 compared to the growth of 5.7 per cent recorded in the corresponding period of 2019. However, accommodation, food and beverage services, and transportation activities declined by 6.2 per cent and 0.1 per cent, respectively, during the first quarter of 2020 owing to restrictions on tourist arrivals and lockdown of the country since mid-March, compared to growth rates of 4.6 per cent and 2.7 per cent recorded, respectively, in the first quarter of 2019. Reflecting the subdued performance in tourism related economic activities and transportation, both tourist arrivals and earnings from tourism declined by 31.5 per cent during the first quarter of 2020 compared to the 4.6 per cent increase recorded in the same quarter 2020 while passenger kilometres served by the Sri Lanka Transport Board recorded a year-on-year decrease of 15 per cent during the first quarter of 2020.

Information and Communication

- **Information and communication activities grew by 13.5 per cent during the first quarter of 2020 compared to 15.8 per cent growth recorded in the corresponding period of 2019**. This was mainly driven by the 15.2 per cent growth in telecommunication services during the first quarter of 2020, compared to 17.5 per cent growth recorded in the corresponding period of the previous year, supported by greater demand for telecommunication services from the individual/residential sector during the lockdown amidst strict restrictions on mobility and initiatives for working from home. Further, reflecting the resilience of the information technology and business process management (IT/BPM) industry of the country, IT programming consultancy and related activities also grew by 9.6 per cent during the first quarter of 2020, on top of 11.7 per cent growth recorded in the corresponding period of 2019. Meanwhile, programming and broadcasting activities and audio video productions grew at a slower rate of 4.5 per cent during the first quarter of 2020 compared to 8.8 per cent growth recorded in the corresponding period of the previous year.

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

- **Financial, insurance and real estate activities, including ownership of dwellings grew at a higher rate of 6.1 per cent during the first quarter of 2020 compared to 3.6 per cent growth in the corresponding period of 2019.** This was mainly attributable to the higher growth of 9.0 per cent recorded in financial service activities and auxiliary financial services during the first quarter of 2020 compared to 4.4 per cent growth recorded in the corresponding period of the previous year. Further, real estate activities, including ownership of dwellings activities also grew at a higher rate of 4.2 per cent during the first quarter of 2020, contributing positively to the overall growth of the segment, compared to 2.2 per cent growth recorded in the first quarter of 2019. Moreover, insurance, reinsurance and pension funding activities grew marginally by 0.2 per cent during this quarter compared to 7.4 per cent higher growth recorded in the corresponding period of 2019.

Professional Services and Other Personal Service Activities

- **Professional services and other personal service activities expanded by 3.1 per cent during the first quarter of 2020 compared to 4.0 per cent growth recorded in the corresponding period of the previous year**. Expansion in other personal service activities, which recorded a growth of 3.4 per cent during the first quarter of 2020 compared to 3.8 per cent growth recorded in the corresponding period of 2019, mainly supported the growth in this segment. Further, professional services expanded at a slower rate of 1.6 per cent during the quarter, compared to 4.9 per cent growth recorded in the first quarter of 2019.

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

- **The public administration, defence, education, human health and social work activities grew by 1.3 per cent during the first quarter of 2020 compared to 1.9 per cent growth recorded in the corresponding period of 2019.** This growth is mainly attributable to the expansion in education activities, which grew by 2.4 per cent during the first quarter of 2020 compared to 4.3 per cent growth recorded in the first quarter of the previous year. Further, public administration and defence related services grew marginally by 0.9 per cent during the first quarter compared to the 2.0 per cent growth recorded in the first quarter of 2019. In the meantime, human health activities, residential care and social work activities recovered and grew by 1.2 per cent during the first quarter of 2020 against 1.6 per cent contraction recorded in the corresponding quarter of the previous year.

Expenditure

- **Gross Domestic Expenditure (GDE) which is the aggregate of consumption and investment expenditure of the economy at current market prices grew by 4.9 per cent during the first quarter of 2020 against 0.8 per cent contraction recorded in the corresponding period of 2019.** This growth was largely buoyed by the expansion observed in the consumption expenditure mainly driven by higher prices prevailed in the domestic market while investment expenditure contracted. Accordingly, consumption expenditure grew by 8.1 per cent during the first quarter of 2020 compared to 3.9 per cent growth recorded in the corresponding quarter of 2019. Meanwhile, the investment expenditure contracted by 4.1 per cent during first quarter of 2020 on top of the 11.9 per cent contraction recorded in the same quarter of 2019. This contraction in investment activities was also reflected by the setback in the value added of construction activities during the first quarter of this year. In the meantime, net external demand contracted significantly during the first quarter of 2020 compared to 72.5 per cent growth recorded in the same quarter of the previous year. Even though imports of goods and services contracted by 4.2 per cent during the first quarter of 2020 compared to 2.1 per cent contraction recorded in the corresponding quarter of 2019, the larger contraction of 16.1 per cent in exports compared to 21.7 per cent growth reported in the same quarter of the previous year due to lower demand from trading partner economies which were seriously hit by the COVID-19 pandemic, dampened the net external demand. Subsequently, GDP, which is the aggregate of GDE and the net external demand, grew at a slower pace of 1.9 per cent during the first quarter of 2020 compared to 4.8 per cent growth recorded in the corresponding period of 2019.

- **GDE, at current market prices, is projected to grow moderately by 2.4 per cent in 2020 amounting to Rs. 16,315.1 billion compared to 3.3 per cent growth recorded in 2019.** This anticipated growth in GDE would be resulted from the moderated growth in consumption expenditure with a marginal growth in the investment expenditure in nominal terms. Considering the external demand, the continuation of import restrictions would help curtail imports which would have a positive impact on the net external demand position. However, weaker external demand owing mainly to the COVID-19 outbreak would curtail the exports as well. Further, consumer prices in the domestic market are expected to remain elevated during the year compared to 2019. With these expected developments in the domestic and external fronts, GDP at current market prices is projected to grow by 3.0 per cent in 2020 compared to 4.5 per cent growth recorded in 2019.

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Consumption

- **Consumption expenditure, which is the largest expenditure category of the economy is projected to grow by 2.8 per cent in 2020 amounting to Rs. 12,155.8 billion at current market prices compared to 6.9 per cent growth recorded in 2019.** Owing to the expansionary measures taken from the fiscal and monetary fronts such as the reduction of taxes and significant reduction of interest rates, private consumption expenditure is expected to grow at a slower pace amidst the uncertainty in the economy due to the COVID-19 pandemic. Accordingly, private consumption expenditure is projected to grow by 2.7 per cent in 2020 compared to 6.8 per cent growth in 2019. Further, considering the government expenditure pattern during the first half of 2020 and based on the projections of the CBSL, consumption expenditure of the government is expected to increase at a moderate pace in 2020 compared to 2019 mainly due to the increase in salaries and wages with new recruitments to the public service.

Investment

- **Investment expenditure is projected to have a marginal growth of 1.1 per cent at current market prices in 2020 compared to 5.9 per cent contraction recorded in 2019**. Private investment is expected to pick-up during the second half, recovering from the setback experienced in the first half, supported by expansion in residential construction activities given the low interest rate environment, and benefiting from the introduction of new credit schemes and moratorium facilities. However, the contraction expected in private investments during the first half due to pandemic related developments as reflected by available indicators, would weigh on overall investment growth of the year. Credit granted by the commercial banks to the private sector for the purposes of personal housing recorded a growth of 6.3 per cent as at end June 2020 compared to 7.6 per cent growth recorded as at end June 2019. However, cement availability and building material imports recorded contractions during the first half of the year indicating a setback in construction activities, which represent a major share of overall investments. Further, the importation of machinery and equipment, and investment goods also recorded contractions in volume terms. On the other hand, the less flexible nature of the government's recurrent expenditure would limit the space for investments, amidst the considerable decline in government revenue during the first half of the year. Consequently, overall investment expenditure as a percentage of GDP is expected to decrease to 26.9 per cent in 2020 compared to 27.4 per cent in 2019.

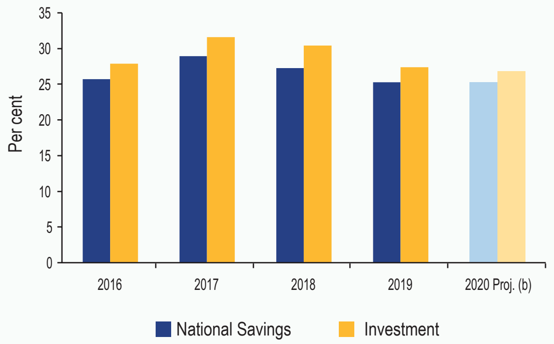
- **FDI, including loans to projects approved by the BOI witnessed a notable contraction of 36.5 per cent to US dollars 351.2 million[2] during the first half of 2020 compared to US dollars 553.2 million recorded in the corresponding period in 2019.** FDI inflows to infrastructure projects and services sectors recorded declines of 33.1 per cent and 58.3 per cent, respectively. FDI inflows to the manufacturing sector registered a contraction of 22 per cent to US dollars 108.1 million. In the meantime, FDI inflows to the agriculture sector continued to be at marginal levels during the first half of 2020.

Savings

- **Both domestic and national savings, measure as a percentage of GDP, are expected to improve marginally during the year compared to the previous year**. Accordingly, domestic and national savings would improve to 21.4 per cent and 25.4 per cent of GDP in 2020, respectively, from 21.3 per cent and 25.3 per cent of GDP recorded in the previous year, respectively. Meanwhile, in rupee terms, net primary income from the rest of the world and net current

2 The FDI figure corresponds to receipts, including loans, 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.

Figure 2.7
Investment and Savings as a Percentage of GDP (a)



(a) The data are based on the base year 2010 GDP estimates
(b) CBSL estimates based on the medium tern macroeconomic framework

Sources: Department of Census and Statistics
Central Bank of Sri Lanka

transfers from the rest of the world are projected to grow marginally. On the other hand, the savings - investment gap would be narrowed to 1.5 per cent of GDP in 2020 compared to 2.1 per cent of GDP in 2019 on par with the slowdown in investments.

Expected Developments

- **As projected under the medium-term macroeconomic framework of the CBSL, the economy is expected to grow by around 5.0 per cent in 2021**. A significantly high growth is to be recorded in the first half of 2021 supported by the base effect arising from expected contraction in the first half of 2020 due to disturbances related to the COVID-19 pandemic. At the same time, improved business confidence in a stable political environment and growth supportive policies, together with renewed external demand with the containment of the COVID-19 in major markets would reinforce the growth momentum related to Industry and Services activities while this supportive policy environment together with favourable weather conditions would boost Agriculture growth during the year 2021. The growth momentum could even be faster than expected if an effective vaccination for COVID-19 becomes publicly available by early 2021. Further, it is reiterated that in order to unleash the full potential of the recovery in the external front, the export portfolio needs to be diversified, exploring new markets. Meanwhile, continuation of the relaxed monetary policy stance to maintain a low interest regime would stimulate investments as well as consumption demand. Boost in investor confidence with current political stability would also attract much needed FDIs to the country expanding investment activities further.

- **The Industry related economic activities which were severely affected by the pandemic are expected to record a significantly high growth rate in 2021. Major markets for Sri Lanka's industrial exports are expected to normalise by early 2021 and contribute positively to the external demand for industrial exports thereby supporting the growth in manufacturing activities.** Moreover, strategically located Hambantota Industrial Park Project and the proposed dedicated textile/ garment manufacturing zone in Eravur are expected to attract large scale industries to the country upon the completion. The recent trend of relocating manufacturing bases away from China amidst the US-China trade war and efforts to diversify supplier bases which are currently centred to China following the supply chain disruptions experienced with the COVID-19 outbreak would also open up new avenues for the manufacturing sector of the county to expand. Further, the government policy of encouraging manufacturing of major pharmaceutical products as well as building materials locally would boost manufacturing capacity. Meanwhile, construction activities are expected to bounce back in 2021 with expediting the government-initiated construction projects such as Central Expressway and New Kelani Bridge and development of elevated roads from Colombo to Athurugiriya and the elevated highway project for the Port city. It is expected that construction of the Ruwanpura Expressway and building construction works of the Financial City would also commence during 2021 accelerating construction activities in the economy. However, in order to perform construction activities at full potential level, building approval processes need to be streamlined while vocational training needs to be more focused to provide required technical skills to the construction sector workers. Structural bottlenecks such as skill mismatch and low labour productivity have been identified as the key challenges that need to be overcome to ensure sustainable growth of the Industry activities. Therefore, maintaining a conducive policy environment that encourages continuous upgrades of skills, technology adoption and investment in research and development aiming to productivity enhancement are utmost important.

- **Services related economic activities are expected to continue its momentum during 2021**. The growth in Services activities is projected to be broad-based and supported by all major services categories such as transportation, wholesale and retail trade, accommodation, financial services, real estate, and other personal services. Even in the presence of certain import restrictions, domestic trading activities would grow at a higher rate particularly with the conducive policy of the government on agriculture and domestic industries. With the COVID-19 pandemic fears fading away, travel and tourism around the world would expand, restoring Sri Lanka's tourism related service activities. Meanwhile, destination promotion programs would also help attract high spending tourists to Sri Lanka. These economic activities would stimulate transportation and other personal services activities too. With the improvement of the passenger handling capacity of Bandaranaike International Airport and resuming regular operations at Mattala International Airport together with rehabilitation of the domestic airport network would further support transportation activities as well as tourism related activities. In order to unleash the full potential of the tourism activities and related services activities such as transportation and personal services, implementing a strategy to promote less popular airports/destinations for travel and tourism activities is important. For this purpose, partnering with low-cost airlines is an option to be considered.

- **Investment activities are expected to grow significantly in 2021, supported by higher growth in private investments**. Political stability established following the general election held in August 2020 and subsequent presentation of the new government's budget for the year 2021, are expected to increase private investments, as well as FDIs contributing higher growth in investment activities in 2021. The Port City, together with the Hambantota and Eravur Industrial Zones would provide ample opportunities for promoting Sri Lanka as a preferred destination for investors. Particularly, these would attract investments from firms intended to relocate their manufacturing bases away from China. Further, investments would be continuously attracted into import substitution industries such as manufacturing of pharmaceuticals products, automobile tyres and spare parts, building materials including tiles and bath wear, and commercial agriculture, supported by strong government encouragements. Apart from this, a significant number of condominium and commercial building projects which are in the pipeline would also contribute to the growth in private investment. Meanwhile, public investments would focus on prioritised infrastructure projects.

- **Achieving and maintaining national savings at a desirable level is important to position the Sri Lankan economy in a higher growth path**. However, domestic savings would remain below the desired level in 2021 with continued government dis-savings, although some increase could be seen in private savings. Following the challenging year of 2020, the net transfers from the rest of the world would improve in 2021, while net primary income would deteriorate. The decline in net primary income would weigh on the growth of national savings as a percentage of GDP widening the savings-investment gap, amidst the higher demand for investment expenditure, over the previous year.