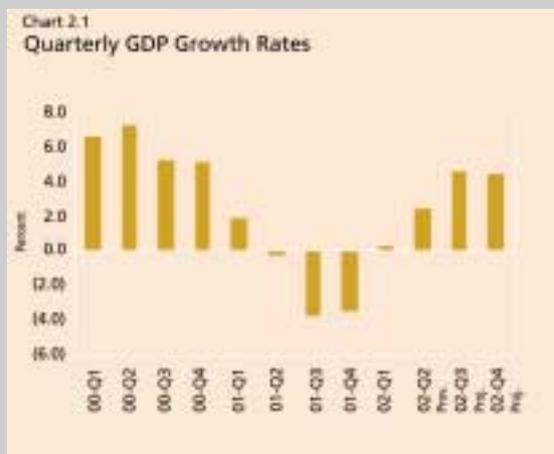


2. OUTPUT AND ECONOMIC GROWTH

In 2002, the economy is on a path of recovery from the depressed performance and negative growth during 2001. Recovery will be gradual, from virtually no growth in the first quarter to around 5 per cent growth in the last two quarters. Economic prospects are expected to improve further in the medium-term with policy adjustments and the implementation of structural reforms. The success of the ongoing peace process is critical for these projections.



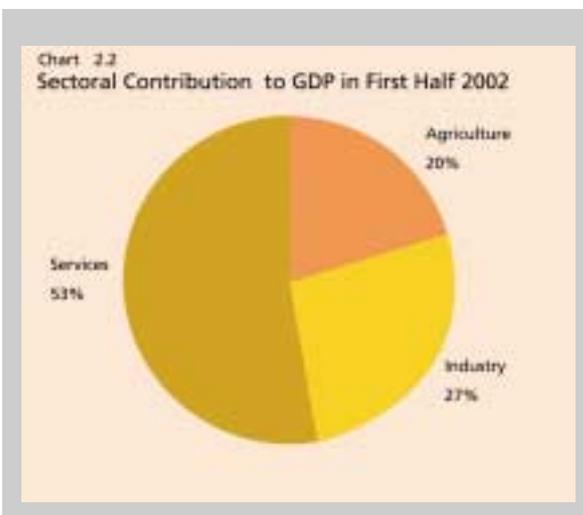
Outlook for 2002

- ◆ The Gross Domestic Product (GDP) grew by 1.4 per cent during the first half of 2002 over the corresponding period of the previous year. Though the growth was low, in absolute terms, it indicates that the economy has bottomed out from the negative growth of 3.5 per cent, during the latter half of 2001. Growth during the first half was also an improvement over the performance in the first half of 2001, when the economy grew by 0.9 per cent.
- ◆ In Agriculture, the recovery was mostly due to the favourable performance in domestic agriculture. The Services sector also improved, with contributions from transport, import trade, domestic trade and communication activities. However, the Export and Industry sectors continued to suffer due to slow recovery in the global economy, continued interruptions in power supply until May and stagnation in the construction industry.
- ◆ In Agriculture, paddy production increased by nearly 10 per cent. The increase in the output of most varieties of vegetables and subsidiary food crops, particularly potatoes, and minor export crops, also contributed to better performance in domestic agriculture. In plantation agriculture, production of tea recovered strongly during the second quarter. However, coconut production continued to drop due to the lagged effect of the drought in 2001.

- ◆ The Services sector recorded a moderate growth during the first half of 2002. Of the services activities, Transport, storage and communications recorded the highest growth. The telecommunications sub-sector provided the impetus for this growth, expanding further by 19 per cent. Increased goods and passenger transport activities to the Northern and Eastern provinces helped increase output. The ongoing peace process also boosted domestic trading activities, while import trade, which deteriorated in 2001, showed signs of recovery. The entire decline in expenditure on imports in US dollar terms was due to a decline in prices, while import volumes, in fact, grew by 5.5 per cent.
- ◆ In the Industry sector, all sub sectors, namely, Manufacturing, Construction, Electricity, gas and water, and Mining and quarrying, reported contractions, delaying a full recovery from the economic downturn during the previous year. The contraction in Manufacturing was due to the depressed performance of manufactured exports,

which reflected the continued low global demand. The downturn in the construction industry was the result of low investment by both private and public sectors in major infrastructure projects. Some activity was reported in the housing sector.

- ◆ The economy is expected to recover more strongly during the second half of the year. Normal weather conditions, uninterrupted power supplies, declining interest rates, increasing capital inflows, recovery in manufactured exports as the world economy recovers, improved external trade, tourism and port activities, more trade and transport activities as the country becomes peaceful and restored investor confidence will be the major sources of this revival. Accordingly, a moderate growth rate of about 3 per cent is projected for the year 2002, as a whole.
- ◆ Obviously, these projections are subject to changes in the underlying assumptions. The most recent projections on the US economy, the largest market for Sri Lankan manufactured exports, indicate that the situation there is gloomier than earlier expected. This, in turn, could jeopardize the expected recovery in the Industry sector during the second half of the year. Political uncertainty has also created some concerns and, if continued, will impact negatively on the economic front. On the positive side, if the ongoing cease-fire remains and the peace process progresses strongly, business confidence will be enhanced, increasing investment activity and total output in the economy.



Outlook for 2003

- ◆ In 2003, the economy is expected to grow by about 5.5 per cent. This exceeds the long-term average growth rate of 5 per cent. The world economic outlook is expected to be better in 2003, especially during the second half and this, in turn, will reflect positively on the domestic economy. The expected donor assistance for reconstruction and rehabilitation activities in the Northern and Eastern provinces will also generate economic activities that would boost overall growth.
- ◆ The major growth areas in 2003 will be industry and services. Export oriented industries will move in parallel with the recovery in global demand.

Rehabilitation in the war torn North will provide impetus to activity in the construction industry. In addition, investment activities in required infrastructure that had remained low, are expected to pick up in 2003. The growth in the primary and secondary sectors of the economy would create demand for services in sectors such as transport, communications, trade, financial and leisure activities.

- ◆ The achievement of the expected growth in 2003 depends heavily on the world economic outlook and the success of the ongoing peace process. Further, political stability in the country will also be needed to achieve this target.