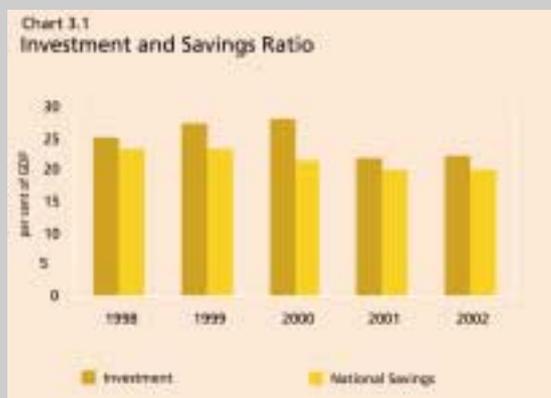


### 3. AGGREGATE DEMAND AND SAVINGS

In 2002, overall investment is expected to turn around after the return of investor confidence and economic growth. Domestic savings, however, are expected to rise at a slower pace. In the medium term, economic growth is expected to improve the level of real consumption and enhance potential savings. The government will be compelled to streamline its current expenditure to maintain the budget deficit at manageable levels.



#### Outlook for 2002

- ◆ Higher investment consequent upon rising investor confidence, falling interest rates and increasing consumer expenditure, would stimulate aggregate demand in 2002. However, the contraction in export demand and stagnant government investment expenditure would hold back the economy from attaining the originally expected growth rate in 2002.
- ◆ In 2002, consumption expenditure is projected to grow by 12.1 per cent in current terms. Private consumption expenditure is anticipated to grow at a higher pace and government consumption expenditure is expected to grow marginally due to fiscal consolidation. In real terms, private consumption expenditure will grow in line with the expected real economic growth.
- ◆ On the basis of the first half performance, the demand for imported goods, which declined during the previous year when the economy contracted by 1.4 per cent, is projected to increase in 2002. The increase in demand for intermediate goods and capital goods is expected to be noteworthy in the light of the growth seen towards the end of the first half. Although the demand for exports declined during the first half, mainly due to the continuation of weak global demand, it is expected to recover partly in the second half.
- ◆ Private sector investment, which contracted during the previous year, is expected to grow in 2002, by 23 per cent in current terms. However, a

contraction in government investment (including both central government and public corporations) by 12.2 per cent will partly offset this favourable impact. Total investment as a percentage of GDP, which bottomed out at 22.1 in 2001, is projected to be 22.5 per cent in 2002. This is still much lower than the ratio of 28 per cent in 2000. However, when adjusted for the purchase of three aircraft by the national carrier, a one-time occurrence, the comparable investment ratio in 2000 was 26.2 per cent.

- ◆ In 2002, domestic savings as a ratio of GDP are projected to decline marginally, from 16 per cent to 15.8 per cent, solely owing to the projected deterioration in the private savings ratio. Government dissavings, which were 4.9 per cent of the GDP in 2001, are expected to improve to 4.6 per cent, due to disciplined budgetary performance. Continuation of weak export demand, reduced profit margins and the contraction in overall economic growth in the previous year are the factors that are expected to affect private sector savings in 2002. The savings-investment gap as a ratio of GDP, which narrowed to 2.5 per cent in 2001, is expected to increase, as the investment ratio is expected to improve during the year.

### Outlook for 2003

- ◆ In 2003, consumption expenditure is predicted to rise with the expected economic growth. The improvement will solely depend on increased demand by households and the organised private sector, as the continued streamlining of public

expenditure will contain expansion in public consumption expenditure.

- ◆ The continued upturn in global economic activities will create a higher demand for exports in 2003 than in 2002. Consequently, increasing demand for intermediate goods for the export sector and the expected growth in the domestic economy in 2003, will increase the demand for imports.
- ◆ Real growth in overall economic activity, improved business confidence, better performance in the equity market, lower interest rates, and a high level of foreign investment are expected to promote investment in 2003, to around the level of 28 per cent of GDP achieved in 2000. It is expected that the private sector will be largely responsible for this improvement in investment expenditure.
- ◆ Domestic savings are expected to rise in 2003 mainly for two reasons; an increase in per capita income coupled with the anticipated impact of the tax reduction on interest income to 10 per cent and the decline in government dis-savings. However, it is expected that the resource gap, i.e., the savings-investment gap as a ratio of GDP, will widen, as the escalation in investment expenditure is projected to be higher than that in savings.
- ◆ These projections contain downward risks. Unexpected adverse developments in the ongoing peace process and political instability will be the potential threats to achieving the projected targets, together with lower than anticipated growth in the rest of the world.