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NATIONAL OUTPUT AND EXPENDITURE

*S*ri Lanka's economy continued to experience strong economic growth of 7.2 per cent in the first half of 2012, indicating its resilience to face challenges arising from both domestic as well as external fronts. Although this GDP growth is lower than the growth of 8.1 per cent recorded in the first half of 2011, it is a creditable performance as it was achieved amidst the slowing down of the world economy and the repercussions of policy measures taken by the Government and the Central Bank to maintain the stability of the economy. The annual growth in 2012 is projected at 6.8 per cent. The prevailing conducive macroeconomic environment in the country with higher investor confidence and the continued public and private sector investment in infrastructure is expected to positively contribute to sustain growth prospects during the second half of the year. However, some downside risks remain, such as deviations from the expected level of hydropower generation and agriculture production, and further deceleration in factory industry output and external trade which could have a detrimental effect on growth prospects during the second half of the year.

Developments in 2012

Output

- During the first half of the year, the economy is estimated to have grown by 7.2 per cent. Economic growth in the first half of 2012 was broad based. All three sectors, viz., Agriculture, Industry, and Services, grew and contributed to overall economic growth. The Agriculture sector, which contracted by 1.4 per cent in the first half of 2011 due to adverse weather conditions, recorded a growth of 10.3 per cent in the first half of 2012. The significant growth in the Agriculture sector could be attributed mainly to the favourable performance in domestic agriculture with the bumper paddy harvest in the Maha season, increased output in vegetables and highland crops and a marked increase in fish production. Despite the relatively lower growth recorded in manufacturing and electricity generation activities, the Industry sector recorded a 10.2 per cent growth during the first half of 2012 as against the 10.3 per cent growth recorded in the corresponding period of 2011, due to the significant expansion in construction and mining and quarrying sub-sectors. The growth in the Services sector decelerated in the first half of 2012 to 5.1 per cent from 9.1 per cent achieved in first half of 2011. The slowing down of exports due to the sluggish recovery of the global economy and the deceleration in imports, consequent to the measures taken to rein in

the high growth of credit and expenditure on imports, constrained the growth of the Services sector during the first half of 2012.

- In 2012, the economy is projected to grow by 6.8 per cent from a growth of 8.3 per cent in 2011. Given the 7.2 per cent growth in the first half of 2012, the economy is projected to grow by 6.3 per cent in the second half of the year compared to the 8.4 per cent growth recorded during the same period in 2011. The deceleration in growth for 2012 could be attributed to the relatively lower growth in Agriculture and Services sectors during the year. Although the projected growth for Agriculture sector is 5.6 per cent which is higher than the previous year, the sector deviated from the envisaged high growth target due to the prolonged drought that has adversely affected the yala cultivation season. The Services sector is projected to grow by 5.4 per cent with the decline in external trade and transport while the Industry sector is forecasted to grow by 10 per cent with the continued high growth in construction activities.

Sectoral Performance

Agriculture

Export Agriculture

- Tea production in the first half of 2012 declined by 4.4 per cent to 163.2 million kg mainly due to the dry weather conditions in major tea growing areas. The decline of tea production during this period was evident in all three elevations of which higher declines were reported from up country and low country elevations mainly due to impact of the drought during the high yielding season. The average yield of tea per hectare during the first half of 2012 dropped by 4.3 per cent to 735.5 kg compared to 768.9 kg in the corresponding period of the previous year. In the first half of 2012, low grown tea consisted of 59 per cent of the total

Chart 2.1

Quarterly GDP Growth Rates

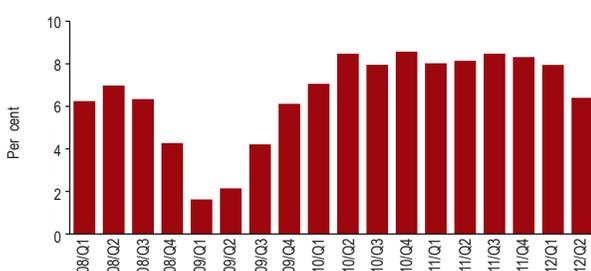


Table 2.1

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

Item	2011 First Half(b)	2012 First Half (c)	% Change
Agriculture and Fishing	110.9	123.1	11.0
1 Agriculture	108.3	120.5	11.2
Tea	109.5	104.7	-4.4
Rubber	120.2	120.4	0.2
Coconut	94.3	105.6	12.0
Paddy	106.8	145.6	36.4
Other Crops	114.8	121.9	6.2
Livestock	109.0	114.8	5.3
2 Fishing	123.1	135.3	10.0

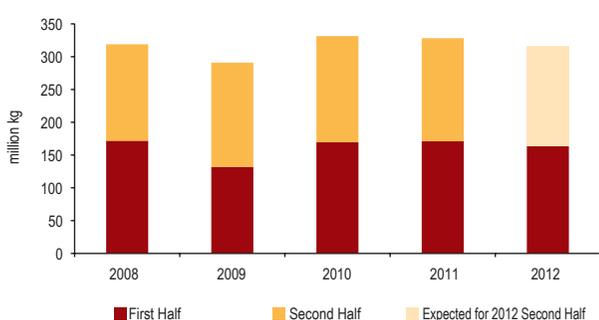
Source: Central Bank of Sri Lanka

(a) The average values used for the base value in the half year production index was changed from the period 1997-2000 to 2007-2010.
(b) Revised
(c) Provisional

production while medium and high grown tea accounted for 17 per cent and 24 per cent, respectively. Further, during the same period, the contribution of tea small holders in total tea production declined to 70 per cent (114.16 million kg) compared to 74.6 per cent (127.4 million kg) in the corresponding period in 2011. In terms of varieties of tea produced, orthodox black tea production declined by 3.8 per cent to 150.8 million kg while CTC (crush, tear, curl) tea production declined by 11.4 per cent to 10.9 million kg, year-on-year, during the first half of 2012. Total tea production in 2012 is expected to decline by 3.8 per cent to 315 million kg, over the last year, mainly due to the dry weather conditions which delayed the usage of fertilizer on high yielding vegetative propagated (VP) tea bushes.

Chart 2.2

Tea Production



- **Tea prices at the Colombo Tea Auction (CTA) on an increasing path since March 2012.** In the first quarter, high, medium and low grown tea prices declined by 12 per cent, 13 per cent and 9 per cent, year-on-year, to Rs. 335 per kg, Rs. 313 per kg and Rs. 371 per kg, respectively. However, the trend reversed with the beginning of the second quarter thereby increasing the average tea prices of high, medium and low grown tea by 9.6 per cent, 10.2 per cent and 14.4 per cent, year-on-year, to Rs. 355 per kg, Rs. 353 per kg and Rs. 424 per kg, respectively. The shortage of black tea supply amidst increased demand from Middle Eastern countries for the Ramazan festive season largely contributed to the high tea prices recorded during the second quarter of the year. The increase in the net sale average price of tea at the CTA helped increase producer margins which declined last year with the wage revisions.
- **Rubber production during the first half of 2012 increased marginally by 0.2 per cent, year-on-year, to 80,788 metric tons.** Of the total rubber production, sheet rubber production increased by 1.3 per cent to 31,008 metric tons while the production of crepe rubber declined by 10 per cent to 31,232 metric tons during this period. The price of Latex Crepe Rubber sharply declined during the first half of the year encouraging many producers to shift their production to Ribbed Smoked Rubber (RSS) which fetched relatively higher prices during this period. The exports of Latex Crepe Rubber during the first half of 2012 declined by 13 per cent to 10.9 million kg whilst the export of RSS increased by 5.5 per cent to 7.2 million kg. The gradual improvement of tapping extent of regional plantation companies with improved clones and adoption of better agriculture practices supported by the fertilizer support programme have improved the total rubber production of regional plantation companies, year-on-year, by 1.6 per cent to 12.27 million kg. Further, during this period, domestic usage

of natural rubber increased to 57,009 metric tons compared to 55,028 metric tons recorded during the corresponding period of 2011 as a result of expanding rubber based manufacturing products such as tyres and tubes. Rubber production in 2012 is expected to grow by 2.4 per cent to 162,000 metric tons supported by favourable weather patterns and remunerative prices, particularly in the fourth quarter, and expanding domestic rubber based industries.

- **The average price of all varieties at the Colombo Rubber Auction (CRA) declined in the first half of 2012 compared to the highest ever prices recorded during the first half of 2011.** The decline in the price of rubber which commenced in the fourth quarter of 2011 continued in 2012. A build up of stocks in global markets and supply improvements in major natural rubber producing countries alongside the slowdown in demand from major buyers like China contributed to the decline in rubber prices. The average price of both Ribbed Smoked Sheet 1 (RSS1) and Latex Crepe 1X declined at the CRA by 23 per cent and 32 per cent, year on year, to Rs. 435 per kg and Rs. 428 per kg, respectively, in the first half of 2012. Export prices of RSS1 and Latex Crepe 1X also declined during this period by 28 per cent and 22 per cent to Rs. 459 per kg and Rs. 426 per kg, respectively.
- **Coconut production increased significantly by about 12 per cent to 1,495 million nuts in the first half of 2012 from 1,336 million nuts in the corresponding period of 2011.** The increase in coconut production was mainly attributable to the lag effect of higher rainfall in major coconut growing areas during the last two years. Coconut oil production also increased by around 23 per cent to 38,498 metric tons (equivalent to 298 million nuts) in the first half of 2012 from 31,261 metric tons (equivalent to 230 million nuts) in the first half of 2011. The increase in coconut oil production was

partly due to increased coconut production and the imposition of higher import levies on edible oil by Rs. 20 per kg to Rs. 65 per kg effective from February 2012. Moreover, a Special Commodity Levy (SCL) was imposed on imported palm oil from May 2012 at a rate of Rs. 90 per kg. These measures resulted in a significant decline in palm oil imports during the first half of 2012. Lower import of palm oil is expected to stimulate the coconut oil industry. Further, Desiccated Coconut (DC) production increased by 49 per cent to 24,474 metric tons (equivalent to 190.8 million nuts) in the first half of 2012 largely due to healthy global demand. A decline in coconut prices helped reduce the cost of production of the DC industry thereby increasing export competitiveness.

- **The price of coconut, copra and coconut oil declined in the first half of 2012 mainly due to improved production during the period under review.** The average auction price of coconut at the Colombo Coconut Auction (CCA) declined to Rs. 25.20 per nut in the first half of 2012 from Rs. 37.60 per nut in the same period in 2011. The average price of coconut oil declined to Rs. 209.40 per kg in the first half of 2012 from Rs. 320.70 per kg in the corresponding period in 2011 supported by a significant decline in the average price of copra, year on year, by 34 per cent. The average DC price at the CCA also declined to Rs. 177 per kg in the first half of 2012 from Rs. 300.50 per kg in the corresponding period of 2011. The average export price of DC also declined during the first half of 2012 to US dollars 1.77 per kg from US dollars 2.87 per kg in the first half 2011.

Domestic Agriculture

- **Paddy production in the 2011/12 Maha season increased significantly by 36.4 per cent to 2.7 million metric tons, which was higher than the average production during the last three Maha seasons (2.3 million metric tons),**

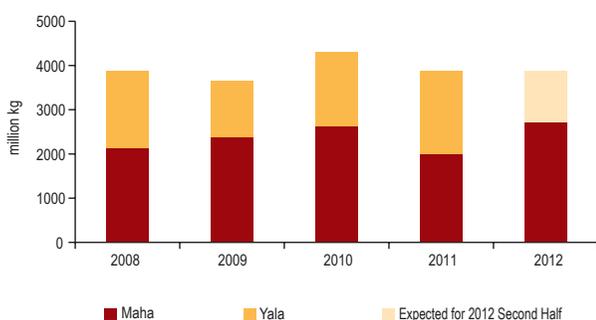
largely due to favourable weather conditions.

The gross extent harvested during the 2011/12 Maha season increased by 76,143 hectares while the average yield (4,417 kg per hectare) was the highest recorded for the last three years. In the Northern Province, 83,807 hectares of paddy lands which is an increase of 18,227 hectares were cultivated during the Maha season. Accordingly, in the 2011/12 Maha season, 10.8 per cent of the total paddy production in the country was harvested in the Northern Province. However, in the Kurunegala and Puttlam districts together gross extent sown declined by 22,732 hectares largely due to the decline in cultivation in rain fed and minor irrigation areas.

- **Paddy production in 2012 Yala season is estimated to have declined by about 38 per cent, year-on-year, to 1.16 million metric tons due to the persistent drought in major paddy growing areas.** Paddy production in the Yala season is estimated to be the lowest after the 2009 Yala season which was also affected by a similar drought. It is estimated that around 10 per cent of the total cultivated lands, have been affected due to the drought condition. The higher damages were reported from the areas where irrigated water is used for cultivation including Mahaweli areas. The improper cultivation practices and crop diversification of farmers largely resulted in excessive utilisation of water from reservoirs in the dry zone at the beginning of the Yala season. This caused increase in crop damages as

the season progressed since the expected rainfall from the South West monsoon in May and June delayed. Therefore, it is necessary to adopt proper agronomical and water management practices for cultivation of paddy and other field crops in view of changing climatic conditions in the country to ensure minimum crop damage and to increase resource efficiency.

- **Total paddy production in 2012 is estimated to have increased by 0.2 per cent to 3.88 million metric tons, compared to the previous year.** The rice equivalent of this production (after provisioning for seeds and post harvest losses) would be in excess of the country's annual estimated total rice consumption of 2.3 million metric tons. However, paddy prices showed an upward movement since July due to expectations of lower harvest in the 2012 Yala season.
- **Other Field Crops (OFC) recorded a considerable growth in 2011/12 Maha season largely due to the favourable weather conditions that prevailed and higher farm gate prices.** During the Maha season, the total area cultivated increased by 9.5 per cent to 119,002 hectares and the total production of OFCs increased by 6.3 per cent to 473,685 metric tons. Maize, black gram, cow pea, ground nuts and potatoes reported satisfactory progress in term of extents cultivated and production during the 2011/12 Maha season of the year. However, the production of OFCs such as red onion, ginger and manioc recorded a marginal decline during this season. It is necessary to introduce high yielding seeds and enhance the skills of farmers while encouraging the use of fertilizer to improve the yield of these crops.
- **During the 2011/12 Maha season vegetable production improved significantly due to favorable weather.** Daily vegetable supply through the Dambulla market improved significantly during the first quarter of 2012.

Chart 2.3**Paddy Production**

The increase in vegetable supply from the Northern Province, increased use of fertilizer and successful implementation of home gardening under the “Divi Naguma” programme largely contributed to the growth in vegetable production. As a result, prices of many vegetable varieties declined during the first quarter of 2012 compared to the corresponding period of the previous year. However, vegetable prices remained higher during the 2012 Yala harvesting period compared to the corresponding season of the previous year as a result of the shortfall in vegetable supply due to impact of the drought.

Fishing

- **Total national fish production in the first half of 2012 increased by 10 per cent to 225,790 metric tons compared to the corresponding period in 2011.** Of the total fish production, marine fish production grew by 8 per cent to 199,530 metric tons mainly due to favourable weather conditions during the period, relatively high prices and an increase in fishing fleet. Coastal and offshore fish production recorded a growth of 11 per cent and 3 per cent, respectively. During the first half of 2012, supply of marine fish recorded a growth of 43 per cent to 32,480 metric tons from the Northern Province compared to the corresponding period in 2011 contributing 16 per cent of the total fish supply. However, the growth of fish production in some provinces such as Western and Eastern provinces was lower than expected due to the impact of climatic changes. During this period, the inland fishing sector recorded a growth of 26 per cent mainly due to increased fish fingerlings stocking in the reservoirs. The lower water levels prevailed in inland waters due to dry weather condition also helped to increase the fish catch. Despite the increased supply of marine fish, the retail prices of many marine fish varieties remained higher during the first half of 2012 compared to the corresponding period of 2011. During the first half of 2012, the average price of large

marine fish varieties increased by 11 per cent to Rs. 620.70 per kg and the average price of small marine fish varieties increased by 10 per cent to Rs. 165.80 per kg.

Industry

- **Industry sector grew by 10.2 per cent in value added terms during the first half of 2012 compared to a growth of 10.3 per cent during the corresponding period of 2011.** All four major sub-sectors within Industry, namely, mining and quarrying, manufacturing, electricity, gas and water, and construction contributed positively to achieving this growth. The Industry sector is projected to grow by 10 per cent during the year.

Mining and Quarrying

- **The mining and quarrying sub sector recorded a growth rate of 20.6 per cent during the first half of 2012 compared to the growth of 17.5 per cent in the first half of 2011.** Gem and other mining activities grew by 9.8 per cent and 24.6 per cent, respectively. This sub sector largely benefitted from the growth in other mining activities including the mining of sand during the first half of the year, with the expansion in construction related activities.

Manufacturing

Processing

- **The processing sub sector which includes the processing of tea, rubber and coconut expanded by 6.5 per cent during the first half of 2012 compared to the growth of 2.7 per cent in the first half of 2011.** The growth in the processing sub sector was mainly due to the better performance in rubber and coconut production, as tea production declined during this period.

Cottage Industry

- The cottage industry sub sector continued to grow by 5.5 per cent during the first half of 2012 compared to the growth of 7.2 per cent in first half of 2011. Government efforts at increasing self employment; growth momentum in construction which stimulates small industries such as rock metal products, brick and cement blocks manufacturing; and further improvement in agricultural activities in the Northern Province of the country contributed towards the growth in this sub sector.

Factory Industry

- The robust performance of factory industry witnessed in 2011 continued into the first quarter of 2012. Thereafter however, performance of factory industry slowed down with both external as well as domestic economic developments weighing down on factory industry performance. Weaker global economic activity has dampened demand for Sri Lanka's exports. With respect to domestic economic developments, the upward adjustment of domestic energy prices, tightening of monetary policy, the upward adjustment of selected taxes as well as the depreciation of the rupee weighed down on domestic demand and therefore on production for the domestic market. The industrial production index (IPI), which recorded double-digit growth of more than 10 per cent, year-on-year, in January 2012, decelerated thereafter. Hence, for the six-month period ending June 2012, factory industry recorded a modest growth of 4.3 per cent, in comparison to the 11.8 per cent growth recorded for the first half of 2011.
- Performance of domestic market oriented industries however, was supported by the sound performance of the food, beverages, non-metallic mineral products, and chemical and chemical products. Food products, which

account for just under a quarter of factory industry, recorded a growth of 3.7 per cent for the first six months of 2012. Within food products, the dairy industry recorded a growth of 3.5 per cent, year-on-year, in the first half of 2012 while the growth of bakery products moderated to 4.8 per cent, year-on-year, amidst escalating input costs.

- Beverage products recorded a year-on-year growth of 6.1 per cent in the first six months of 2012, driven mainly by soft drinks, mineral water and bottled water product categories, on the back of continued strong demand from travel and tourism related activities. In the corresponding period in 2011, beverage products recorded a growth of 7.2 per cent. The manufacture of value added tea products meanwhile, maintained its growth momentum in the midst of sluggish demand from export markets.
- Growth of the non-metallic mineral products sector, which mainly comprises cement and building materials sub sectors, grew by 5.2 per cent during the first six months of 2012. Local cement production grew by 4.6 per cent in the first six months of 2012. Although there has been some slowdown in residential housing construction activity, demand arising from the government's infrastructure development

Table 2.2

Factory Industry Growth

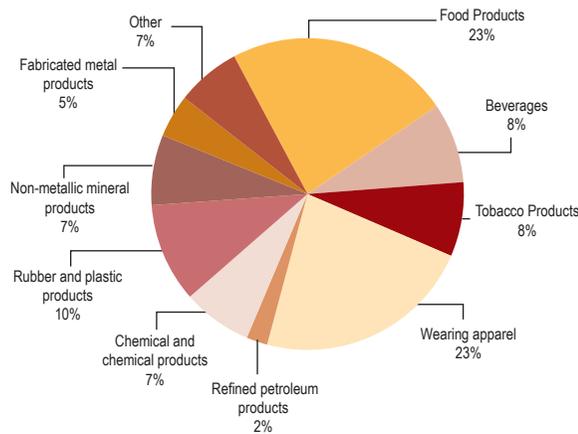
	per cent		
	2011		2012
	First Half (a)	Annual (a)	First Half (b)
Overall Growth of Factory Industry	11.8	9.1	4.3
of which,			
Food	10.7	8.7	3.7
Beverages	7.2	10.2	6.1
Tobacco	2.6	6.0	-4.8
Textiles	6.1	0.9	8.0
Wearing apparel	21.2	13.8	2.8
Chemicals & chemical products	-3.0	-4.3	19.3
Rubber and plastic products	27.1	16.5	2.4
Non-metallic mineral products (including cement)	15.9	16.7	5.2

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

Chart 2.4

Composition of Factory Industry Production - First Half 2012



projects and commercial construction activity supported the demand for cement during this period.

- Most export market oriented industries were adversely affected by faltering global economic activity.** Growth of the wearing apparel industry moderated to 2.8 per cent for the first half of 2012. Nevertheless, in the midst of weaker demand from most advanced countries and heightened competition, apparel manufacturers have taken steps to access new markets.
- Factory production of rubber based products including tyres and gloves moderated, with the industry recording a growth of 2.4 per cent for the first half of 2012.** The downturn in Europe and the resultant fall in import demand has adversely affected tyre exports. Industrial and medical glove exports were also affected by the muted demand from major export markets.
- In the non-metallic mineral products category, tableware manufacturers recorded a growth of 12.4 per cent, driven mainly by the US market.** This growth was recorded in the midst of heightened competition and higher input costs mainly as a result of higher energy prices. Tableware manufacturers also benefitted from greater access to new markets such as India.
- Ship building, which is categorised under the fabricated metal products sector, benefitted from orders mainly from regional ship owners in India and Singapore.** Ship repairing grew marginally during the first six months of 2012 on account of lower ship traffic resulting in fewer repairs. Boat builders were adversely affected by the persistent problems in the Euro area resulting in lower export orders for pleasure boats.
- With respect to policy relating to factory industry, the government continued its regional industrial development policy during the first half of 2012, through the Ministry of Industry and Commerce.** Development of infrastructure needed for promoting industry was continued by way of establishing industrial estates in different parts of the country, particularly in the Northern and Eastern provinces.
- The government also demonstrated its commitment towards productivity improvement through various energy efficiency improvements and waste management programmes conducted by the Ministry of Industry and Commerce.** The ‘Energy Efficiency Improvement’ and ‘Transfer to Appropriate Energy’ programmes have been launched, focusing on companies with large energy bills due to inefficiencies and wastage in energy consumption. Meanwhile, the industrial waste management programme and the improvement of by-products through waste exchange in the industry sector are currently taking place in parallel.
- Various state and private sector institutions meanwhile, have taken measures to develop industries in the regions affected by the conflict.** The Industrial Development Board took a policy decision to start district offices in Mannar, Mullattivu and Kilinochchi districts in order to enable potential industrialists in these regions to benefit from its services. Meanwhile,

the Achchuveli Industrial Estate is to function again, with support obtained in this regard from the Indian and Sri Lankan governments. In this regard, the two governments have entered into a Memorandum of Understanding (MOU) to developing infrastructure facilities such as telecommunication, electricity and internal roads.

- **With respect to the apparel sector, the Joint Apparel Association Forum (JAAF) has continued to take measures to develop the sector.** The JAAF continued its island-wide image building programme with the objective of retaining the current labour force in the apparel sector and recruiting new labour for future operations. International image building activities will be conducted by the JAAF during the second half of this year to boost the image of apparel manufactured in Sri Lanka in the global market. The JAAF is also focusing on reviving small and medium scale apparel industrialists in order to expand capacity in this sector.

Electricity, Gas and Water

- **The electricity, gas and water sub sector expanded by 5 per cent during the first half of 2012.** Value added in electricity generation grew by 4.6 per cent during this period compared with a 15 per cent growth during the same period of the previous year. This was mainly due to the unfavourable weather conditions that resulted in a decline in hydro power generation during the first half of 2012 and the high base of the previous year. The water sub sector which includes collection, purification and distribution of pipe borne water, recorded a growth of 8 per cent in the first half of the year with the expansion of new connections and the implementation of new water supply projects. The gas sub sector contributed to the overall growth with a 7.3 per cent growth over the corresponding period in the previous year.

Construction

- **During the first half of 2012, the construction sub sector recorded a growth of 17.9 per cent compared to a growth rate of 12.5 per cent in first half of 2011.** The expansion in the sector was reflected by the growth in construction material availability. For example, cement availability which is a key indicator of activity levels in the construction sector, grew considerably in the first half of 2012. Cement imports and local production increased by 86.8 per cent and 3.5 per cent, respectively. In line with these developments, the building material imports volume index also expanded by 26.7 per cent during the first half of 2012. Government's mega infrastructure projects in the areas of roads, ports, urban development, electricity and water sectors together with regional development projects implemented under the 'Gama Naguma', 'Maga Naguma' and 'Pura Naguma' programmes mainly contributed to the expansion of the construction sector.

Services

- **The Services sector grew by 5.1 per cent in the first half of 2012 compared to the 9.1 per cent growth during the corresponding period of 2011.** The growth of the Services sector decelerated due to a slowdown in some of the key sub sectors such as wholesale and retail trade, transport and communications. The impact of policy measures implemented in early 2012 for macroeconomic stabilisation and the dampening of certain economic activities due to the slowing down of the global economy contributed to the deceleration in the Services sector.

Wholesale and Retail Trade

- **The wholesale and retail trade sub sector recorded a growth of 5.3 per cent during the first half of 2012 as against an 11 per cent growth recorded in the first half of the previous year.** This was mainly due to the lower

growth in import and export trade. Value added of import trade activities increased by only 4.4 per cent during the first half of 2012 as a result of policies introduced to discourage the consumption of imported goods at the end of the first quarter of 2012. The decline in consumer goods imports was 5.1 per cent in volume terms, while intermediate goods recorded 1.5 per cent growth. However investment goods imports grew at a higher rate of 28.1 per cent. The growth rate of the export trade sub sector decelerated from 13.7 per cent in first half of 2011 to 2 per cent in the corresponding period of 2012 mainly due to adverse developments in international markets. The slowdown in industrial exports was dominated by textile and garments and food, beverages and tobacco. Industrial exports grew by 4.9 per cent while agricultural exports declined by 5.9 per cent. The domestic trade sub sector expanded by 7.1 per cent with satisfactory performance in both domestic agriculture and industry sub sectors.

Hotels and Restaurants

- The hotels and restaurants sub sector, which expanded significantly in 2011, further improved in the first half of 2012. Tourist arrivals increased by 18.7 per cent to record 452,867 during the first six months of the year. Despite the significant increase in tourist arrivals, foreign guest nights of all graded hotels declined by 2.2 per cent in the first half of the year reflecting the increased contribution of ungraded guest houses and unregistered businesses catering to foreign tourists. Local guest nights of all graded hotels also declined by 3.5 per cent. Therefore, the average hotel occupancy rate declined to 66.7 per cent in first half of the year from the 72.9 per cent in corresponding period of the previous year. As one of the fastest growing industries, the tourism sector recorded a revenue of US dollars 459.9 million in the first half of 2012, a 24.3 per cent increase over the first half of the previous year. The value addition

in the sector rose by 22.6 per cent during the first half the year following recent investment towards upgrading and capacity expansion of tourist hotels.

Transport and Communication

- Value added in the transport and communication sub-sector increased by 6.1 per cent in first half of 2012, largely due to the expansion in passenger transport activities and telecommunications. However this was a deceleration from the 12.2 per cent growth in the first half of 2011. The transport sub sector, which includes railway, passenger and goods transport, grew by 6 per cent in the first half of 2012 from 11.8 per cent growth in the first half of the previous year. Deceleration in transport activities was reflected in the moderate growth of passenger kilometres operated by the SLTB and private bus operators along with the decline in new vehicle registration by 5.7 per cent in first half of this year. However, in line with the boom in tourism, passenger kilometres operated by the two national airlines increased by over 20 per cent in the first half of 2012.
- Cargo handling, ports and aviation sub sector grew by 8.8 per cent in the first half of 2012 compared to a growth of 9.9 per cent recorded during the corresponding period of 2011. This deceleration in growth was the combined outcome of a decline in the volume of container handling in terms of twenty-foot equivalent units (TEUs) and the slowdown in cargo handling during the first half of 2012. The reduction in international trade volumes mainly contributed to the relatively lower growth in this sub sector.
- Post and telecommunication sub sector grew by 6 per cent during the first half of the 2012 compared to a growth of 15.6 per cent in the previous year. The total number of telephone subscribers, which includes both fixed and mobile subscribers, grew by 4.5 per cent

during the first half of 2012, while the fixed subscriber base declined by 3.5 per cent and the mobile subscriber base increased by 6 per cent. Telephone density (connections per 100 persons) increased to 112 during the first half of 2012 from 105 in the corresponding period of the previous year. Data transferring through Wireless and Wireline Broadband accelerated further during the first half of 2012, benefiting from the adoption of latest NGN (Next Generation Network) technology and improvement of mobile broadband coverage. IPTV (Internet protocol based pay TV service delivered over wire line) has also shown a strong growth momentum and the service has strong potential for future expansion, thus providing stimulus for the expansion of fixed broadband services during the second half of the year.

Banking, Insurance and Real Estate

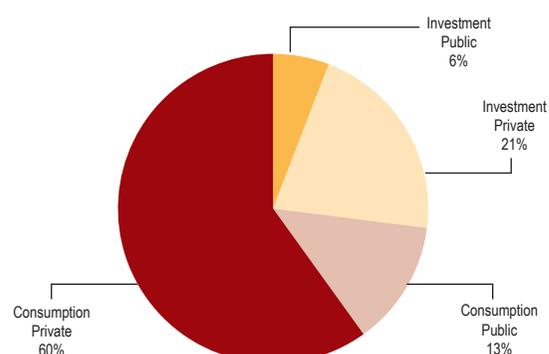
- **Banking, insurance and real estate sub sector grew by 6.8 per cent during the first half of 2012 from 7.6 per cent in the corresponding period in the last year.** Healthy performance in commercial banking activities during the first half of the year contributed to this growth. The profitability in the commercial banking sector increased considerably owing to an increase in net interest income and non interest income from foreign exchange related activities. Meanwhile other institutions in the sector such as non-bank financial institutions and insurance companies also performed well during the period under review with an improvement in interest income and premia.

Expenditure

- **Gross Domestic Expenditure (GDE), which includes aggregate demand generated from domestic consumption and investment activities, is projected to increase by 13.5 per cent in nominal terms during 2012, from 23.5 per cent in 2011.** Accordingly the value of the

Chart 2.5

Composition of Domestic Demand - 2012



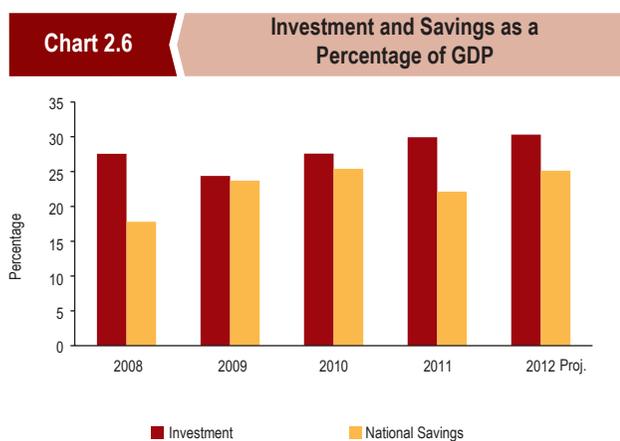
GDE is projected to be Rs. 8,504 billion in 2012 compared to Rs. 7,495 billion in 2011. This increase of GDE would be the combined outcome of the expected expansion in real domestic demand and the estimated upturn of the general price level during the year. Meanwhile, GDP at market prices which is the sum of GDE and net exports is expected to increase by 15.6 per cent to Rs. 7,561 billion with a real growth of 6.8 per cent and an implicit GDP deflator of 8.2 per cent during 2012.

- **Consumption expenditure which captures both private and government sector consumption is expected to grow by 12.2 per cent to Rs. 6,212 billion in 2012.** The corresponding increase in consumption expenditure for 2011 was 22.4 per cent. Deceleration in consumption is consistent with the projected slowdown in the economy, particularly the deceleration in the consumption of imported goods. Private Consumption Expenditure (PCE) which accounts for a share of around 82 per cent of total consumption is expected to decelerate, recording a growth of 11.7 per cent in 2012 compared to an expansion of 25.1 per cent in 2011.
- **According to budget estimates, government consumption expenditure is estimated to increase by 14.7 per cent during 2012 from 10.9 per cent in 2011.** The expected growth in the government wage bill which consists of

salaries for both civil administration and defence is 14.9 per cent in 2012 when compared to the 6.3 per cent growth in 2011. Moreover government expenditure on other purchases is projected to increase as well.

Investment

- During 2012 investment expenditure which includes private and government investments is projected to grow by 17 per cent, compared to a growth of 26.7 per cent in 2011. However, the investment to GDP ratio is projected to improve to 30.3 per cent in 2012 from 29.9 per cent in 2011.
- Public sector investment activities are projected to increase by 21.6 per cent during 2012 from 18.7 per cent in the previous year. The growth in public sector investment would be driven mainly by mega infrastructure development projects along with the medium and small scale construction activities focused on regional infrastructure development.
- Private sector expenditure on investment activities is also projected to grow further during 2012 reflecting improved investor confidence supported by the continuation of the peaceful environment in the country. Expected growth in private sector expenditure on investment in 2012 is 15.9 per cent compared to the 29 per cent growth recorded in 2011. Growth



of private investment activities is expected to decelerate with the decline in private sector credit growth consequent to the enforcement of a credit ceiling for the banking sector and prevailing higher interest rates.

Foreign Direct Investment

- Inflows of Foreign Direct Investment (FDI) in the first half of 2012 amounted to US dollars 423.2 million compared with US dollars 413.3 million in the first half of 2011. Infrastructure development related activity accounted for US dollars 194.9 million of the total FDI received during this period. Projects in relation to infrastructure development included those in housing and property development as well as construction of shop and office complexes; enhancing telephone and telecommunication networks; and power generation. FDI in the manufacturing sector accounted for US dollars

Table 2.3 Foreign Direct Investment of BOI Enterprises by Sector (a)

Sector	US \$ Mn.	
	January - June 2011	January - June 2012 (b)
Manufacturing		
Food, beverages and tobacco products	8.6	27.5
Textile, wearing apparel and leather products	18.7	31.6
Wood and wooden products	0.1	2.1
Paper, paper products, printing and publishing	0.3	3.3
Chemical, petroleum, coal, rubber and plastic products	12.6	5.2
Non-metallic mineral products	6.4	5.4
Fabricated metal products, machinery & transport equipment	29.0	12.1
Rubber products	n.a	16.9
Manufactured products (n.e.s)	7.2	6.7
Sub Total	83.0	110.9
Agriculture	0.9	4.5
Services		
Hotels & restaurants	189.1	85.9
IT & BPO (c)	5.6	14.8
Other Services	13.4	12.1
Sub Total	208.1	112.9
Infrastructure		
Housing, property development and shop office	18.0	7.5
Telephone and telecommunication network	98.0	38.0
Power generation	5.4	20.6
Fuel, gas, petroleum & others	n.a	42.6
Port container terminals	n.a	86.1
Sub Total	121.4	194.9
Grand Total	413.3	423.2

Source: Board of Investment of Sri Lanka

- (a) Includes loans
 (b) Provisional
 (c) Information technology and business process outsourcing
 n.a - not available
 n.e.s - not elsewhere specified

110.9 million, with textile, wearing apparel & leather products; food, beverages & tobacco; rubber products; and fabricated metal, machinery & transport equipment sub-sectors together accounting for more than 75 per cent of that amount. The services sector accounted for FDI amounting to US dollars 112.9 million, with the hotels and restaurants subsector accounting for US dollars 86.0 million of that amount. FDI in the agriculture sector amounted to US dollars 4.5 million. In terms of origin, Hong Kong (US dollars 110 million) and India (US dollars 101 million) accounted for the largest amounts of FDI inflows.

Savings

- **On the resource side, domestic savings, which include private savings and government savings are expected to recover in 2012 from the decline in the previous year.** Domestic savings as a percentage of GDP (domestic savings ratio) is projected to improve from 15.4 per cent in 2011 to 17.8 per cent in 2012. The recovery in domestic savings is particularly due to the improvement in the external trade balance. It is expected that government dis-savings which is measured by the current account deficit of the government budget would be lower in 2012. National savings which is the sum of domestic savings, net factor income from abroad (NFIA) and net foreign private transfers, are also projected to improve as a percentage of GDP to 25.1 per cent in 2012 from 22.1 per cent in 2011.

Prospects for 2013

- **It is expected that agricultural production will further improve due to expected favourable weather conditions, the continuation of remunerative prices and government commitment through policy consistency.** Any substantial improvement in tea production beyond the average tea production in the last

three years (330 million kilo grams) is unlikely due to the slow pace of improvement in tea yields due to structural hindrances in the sector. Rubber production in 2013 is expected to further improve with the expansion of rubber cultivation in nontraditional areas during the last several years. Coconut production in 2013 is likely to decline due to the lag effect of the drought this year. If weather conditions are favourable, fish production will continue to increase supported by favourable developments such as an improvement in fishery fleet, infrastructure development and attractive prices amidst the high cost of production. Moreover, milk production in the country will further grow in 2013 due to high producer prices, the expected expansion in production in Northern and Eastern provinces, and government commitment through subsidy programmes aimed at revitalising the rural dairy sector. The progress in paddy, other field crops, vegetables and sugar would continue in 2013 in line with government attempts to reduce the country's expenditure on food imports by attaining self sufficiency in domestic production.

- **Performance of factory industry is expected to gather momentum in 2013.** However, global market sentiment may weigh down on industrial production until well into the latter part of 2013, given the sluggish recovery of the global economy. Nevertheless, export demand for textiles and wearing apparel, rubber based products, ceramics including floor and wall tiles, ships and boats, is expected to pick up along with the easing of the European crisis situation. Tourism is expected to propel domestic demand in the food and beverages sectors. The continuation of state-driven infrastructure development projects, together with investment activity undertaken by the private sector, particularly in the hotels sector, are expected to increase demand for building materials including cement.

- The telecommunication sector would be one of the main facilitators for sustaining the Sri Lankan economy on a high growth path with new investments in upgrading telecommunication infrastructure resulting in increased speed and adaptation of the latest NGN (Next Generation Network) technology. In 2013, the telecommunication sector would be benefitted by the expected expansion of mobile broadband internet coverage and IPTV (Internet Protocol based Pay TV service delivered over wire-line) service which has also shown a strong growth potential in the recent past. IPTV would also provide stimulus to the expansion of fixed broadband services. Further there is a great potential to improve the money transferring services in Sri Lanka through the newly introduced mobile money transfer systems, which provide the rural community with the ability to exchange money at a relatively low cost. With all these developments in the telecommunication sector, provincial disparities in telecommunication penetration would be reduced further in 2013.
- Although the tourism sector would be benefitted by the large scale infrastructure development activities and investments focused on the hotel industry in 2013, the slowdown in the euro zone economic activities would somewhat constrain the growth potential of this sector. However an increase in the Asian tourist inflow could be expected with improvements in income levels consequent to the higher economic growth in most of the Asian countries including India and China. Further, Russia and some of the other Eastern European countries have also been identified as emerging markets for the tourism industry. Therefore plans relating to personnel development in the leisure industry should target the improvement of skills to cater to a diversified market.
- Investment activities are expected to expand further in 2013 with the high growth momentum in the construction sector due to the large scale infrastructure development activities undertaken by the public and private sectors, regional level public investment activities and private investment in selected sectors such as the hotels, manufacturing and telecommunication. Investment activities are expected to further improve with the flow of foreign investment to some sectors of the economy.
- Government sector investment activities would continue to expand in 2013. Public investment would focus on the continuation of infrastructure development and reconstruction activities in the Northern Province along with the mega construction projects such as road construction including highways, power generation and transmission, port developments and extension of railway lines. Moreover, the development of small and medium scale regional infrastructure facilities are also expected to continue in 2013.
- During 2013, domestic savings and national savings are projected to increase. Domestic savings, which include private savings and government savings, are expected to improve in 2013 with an increase in private savings resulting from the expected deceleration in private consumption and improvement in government dis-savings in 2013. National savings, the sum of domestic savings, net foreign private transfers and net factor income from abroad, would also expand in 2013 with the expected growth in domestic savings and private remittances.
- Realisation of growth targets for 2013 and beyond depends on sustained investment in all key sectors of the economy. In addition, the development of human capital particularly technical and entrepreneurial skills is vitally important. Furthermore, the private sector will also have to play a major role by investing in key sectors and increasing the output of the country by taking advantage of feasible and sustainable business opportunities.