

# 2

## NATIONAL OUTPUT AND EXPENDITURE

---

*The Sri Lankan economy grew by 5.6 per cent during the first half of 2015 compared to the growth of 1.3 per cent recorded during the corresponding period of 2014 as per the rebased estimates of the Department of Census and Statistics (DCS). The strong growth observed in Services related activities and the recovery in Agriculture and Industry activities contributed to this growth. Continuation of the conducive monetary policy stance in a low and stable inflationary environment and the favourable weather conditions that prevailed during this period supported the growth amidst the slowdown in net external demand and policy uncertainty that prevailed during the first half of 2015. It is expected that the economy will benefit from the stability in the policy making environment and improvements in domestic and external market conditions during the remaining period of the year. The economic growth is expected to be broad-based where Agriculture, Industry and Services activities will contribute positively towards the economic growth. Traditional as well as emerging services activities will support the economic growth during the remaining period of the year. Further, the recovery in Industry activities, especially those of manufacturing, is also expected to continue, while the construction activities are envisaged to rebound during the second half of the year.*

## Developments in 2015

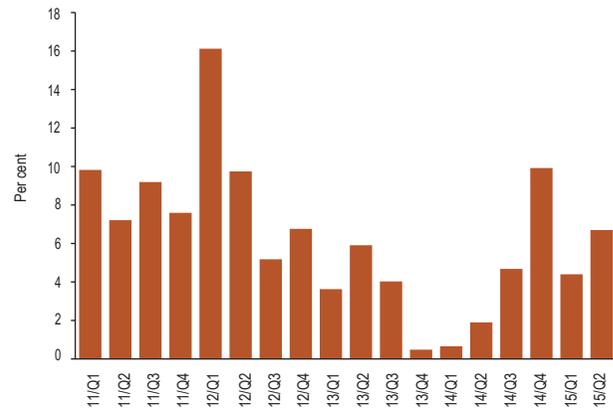
### Output

- The Gross Domestic Product (GDP) grew by 5.6 per cent (2010 constant prices) during the first half of 2015 compared to 1.3 per cent growth recorded during the corresponding period of 2014. The recorded growth was mainly buoyed by the expansion in Services, supported by the recovery in Agriculture and Industry related activities<sup>1</sup>. Accordingly, Services related economic activities grew by 7.1 per cent in value added terms during the first half of the year, which is mainly attributable to the higher contribution recorded in financial, insurance and real estate services, other personal services, public services related activities, and wholesale and retail trade services. The value added in Agriculture, forestry and fishing activities grew by 3.3 per cent during the first half of the year mainly due to the expansion observed in the growing of rice, and marine fishing and aquaculture activities, while Industry related economic activities grew by 1.3 per cent in value added terms mainly with the recovery of manufacturing activities.
- The economy is projected to grow by 5.7 per cent in 2015 compared to the growth of 4.5 per cent recorded in 2014. The overall growth is projected to be broad-based where Services, Industry and Agriculture are expected to contribute positively towards this growth. The growth momentum in the Services activities is expected to continue with significant contributions from financial, insurance and real estate, public services, and other personal

<sup>1</sup> Under the rebasing exercise, methodological changes have been introduced in relation to compilation of GDP. Accordingly, the gross value added of economic activities is compiled using the basic price. Thus, Taxes less Subsidies on Products is added to the gross value added in order to obtain the GDP at market price. During the corresponding period under concern, Taxes less Subsidies on Products grew by 13 per cent due to higher contribution from taxes on products compared to the subsidies granted.

Chart 2.1

Quarterly GDP Growth Rates (a)



(a) Based on the revised base year (2010) GDP estimates of the DCS

services. Meanwhile, construction activities are expected to recover gradually, contributing to the Industry related growth along with growth in manufacturing activities. Further, Agriculture, forestry and fishing related economic activities are expected to grow further with the higher contribution from the growing of rice, other cereals and oleaginous fruits.

## Growth in Economic Activities

### Agriculture, Forestry and Fishing

- The Agriculture, forestry and fishing activities grew by 3.3 per cent in value added terms during the first half of 2015, recovering from 0.7 per cent contraction posted in the corresponding period of 2014. The conducive weather conditions that prevailed during the period supported the revival of Agriculture activities. The growing of rice, and marine fishing and aquaculture activities mostly contributed to this recovery. Meanwhile, growing of other perennial crops, other cereals, oleaginous fruits, other beverage crops, and forestry and logging activities also contributed positively towards the growth in Agriculture activities. However, contraction recorded in the growing of tea, rubber, and spices, aromatic, drug and

pharmaceutical crops, and fresh water fishing dampened the overall growth in Agriculture related activities.

## Production Trends and Institutional Support: Agriculture

### Agriculture Production Index (API)

- The Agriculture Production Index (API), which measures the output of Agriculture and Fishing activities, recorded a growth of 6.6 per cent during the first half of 2015. The Paddy subsector recorded a growth of 28.7 per cent benefitting mainly from the favourable weather conditions. Livestock and other crops subsectors contributed positively to the overall agriculture output recording a growth of 8.9 per cent and 4.2 per cent, respectively. However, the rubber subsector witnessed a pronounced decline of 17.4 per cent particularly due to the reduction of tapping operations in response to low market prices prevailed during the period. The coconut subsector recorded a growth of 5.2 per cent while the tea subsector declined marginally by 0.6 per cent during the first half of 2015. Further, the fishing subsector also declined by 1.1 per cent in the first half of 2015 owing to a significant decline in inland fish production.

Table 2.1

Agriculture Production Indices Index Points (2007-2010=100)

Item	2014 First Half (a)	2015 First Half (b)	Rate of Change (%)
Agriculture and Fishing	130.6	139.2	6.6
1 Agriculture	125.5	136.2	8.6
Tea	111.4	110.8	-0.6
Rubber	90.9	75.1	-17.4
Coconut	100.7	105.9	5.2
Paddy	119.6	153.9	28.7
Other Crops	153.9	160.4	4.2
Livestock	145.6	158.5	8.9
2 Fishing	155.1	153.5	-1.1

(a) Revised  
(b) Provisional

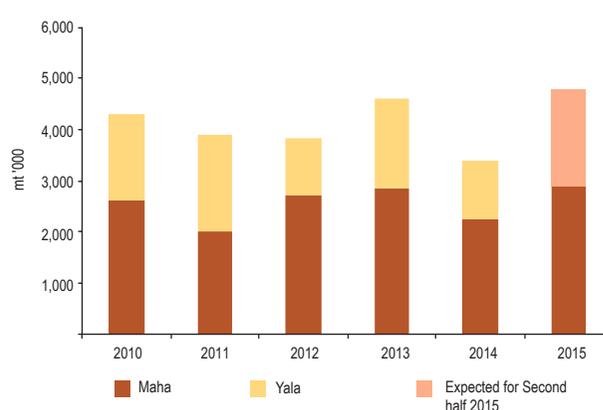
Source: Central Bank of Sri Lanka

### Paddy

- Paddy production in 2015 is expected to increase by 41 per cent to 4.8 million metric tons. The increase in paddy production in the year would be a combined outcome of an increase in production by 28.7 per cent to 2.9 million in the 2014/15 Maha season and the estimated increase of around 65 per cent (1.9 million metric tons) in 2015 Yala season. The bumper harvest recorded in the Maha season, which accounts for about 60 per cent of total annual production, can be attributed to improved paddy harvest resulting from favourable weather conditions and an increase in the extent cultivated. Meanwhile, increased guaranteed purchasing price of paddy also motivated farmers to convert marginal lands for paddy cultivation. The extent sown during the 2014/15 Maha season increased by 18.6 per cent while the extent harvested increased by 26.6 per cent over the corresponding season of the last year. Meanwhile, the Paddy Marketing Board (PMB) purchased 153,996 metric tons of paddy from the 2014/15 Maha harvest compared to 4,563 metric tons in 2013/14 Maha season in an effort to stabilise paddy prices. Further, the PMB is expected to procure around 180,000 metric tons of paddy from the 2015 Yala harvest. The estimated annual paddy production, equivalent

Chart 2.2

Paddy Production



to 2.9 million metric tons of rice, would be sufficient to meet the rice demand of the country for approximately 14 months.

- **The increased Maha paddy harvest resulted in lower paddy prices in the open market leading to a reduction in retail rice prices.** The average retail prices of Samba and Nadu decreased in the second quarter of 2015 by around 3 per cent and 9 per cent to Rs. 89.3 and Rs. 77.2 per kilogram, respectively compared to the first quarter of 2015. Consequently, the government increased tariffs on rice imports with the imposition of a customs duty of Rs. 35 per kilogram and other taxes in place of the Special Commodity Levy (SCL) with effect from May 2015 to stabilise rice prices and safeguard farmers' income. Subsequently, the quantum of rice imports, which recorded a significant growth since April 2014, decreased during the second quarter of 2015.

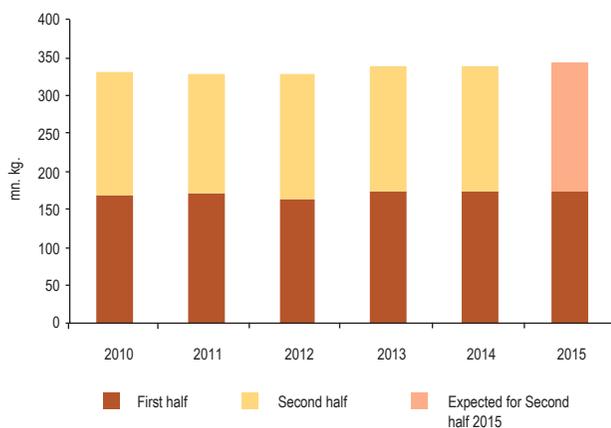
**Tea**

- **Tea production decreased marginally by 0.6 per cent (year-on-year) to 172.6 million kilograms during the first half of 2015.** This is a combined effect of 7.1 per cent growth in the first quarter owing to favourable weather conditions in all tea growing regions and 6.3 per cent decline during the second quarter of the

year. Both high grown and low grown tea, which collectively accounts for around 85 per cent of the total tea production, declined by 1.7 per cent and 1.4 per cent, respectively during the first half of 2015. However, the output of medium grown tea grew by 1.7 per cent supported by favourable weather conditions in major medium tea grown areas. Meanwhile, as most of the prime export destinations of Sri Lanka are currently experiencing economic setbacks mainly owing to declined oil prices, the demand for tea at the global market has not shown a significant growth thus far during the year.

- **Tea prices continued to decline at the Colombo Tea Auction (CTA) in response to declining tea prices in the global market.** The average tea prices during the first half of 2015 declined by 14.3 per cent to Rs. 409.6 per kilogram over the corresponding period of the last year. The highest decrease (year-on-year) in average tea prices at the CTA was recorded for low grown tea (16 per cent), followed by medium grown tea (12.5 per cent) and high grown tea (10 per cent). The drastic fall in domestic tea prices is part of a broader global trend of decline in tea prices as demand from Russia and the Middle East slowed down due to the significant decline in petroleum prices and the imposition of sanctions. In line with the continuous decline in tea prices, the average price received by smallholders for green leaves reduced to Rs. 60 per kilogram during the first half of 2015 from Rs. 70 per kilogram in the first half of 2014. The government implemented a green leaf subsidy scheme in order to maintain a guaranteed price for smallholders. Accordingly, arrangements were made to pay Rs. 80 per kilogram for green leaf supplied by smallholders since March 2015. Moreover, with a view to stabilising tea prices, the government also took measures to release funds up to Rs.1 billion to the Sri Lanka Tea Board (SLTB) to purchase tea at the Colombo tea auctions.

**Chart 2.3** Tea Production



## Rubber

- Rubber production declined by 17 per cent to 50,394 metric tons during the first half of 2015 largely due to the reduction of tapping days owing to a continuous decline in rubber prices at the international market.** Unfavourable weather conditions experienced during the second quarter of the year also affected the domestic rubber production where smallholders slowed down their tapping operations. During the first half of 2015, crepe rubber production declined by 36.6 per cent to 6,108 metric tons while sheet rubber production declined by 19.9 per cent to 25,305 metric tons. Meanwhile, the production of unspecified category, which accounts for 40 per cent of the total rubber production, declined by around 4 per cent to 18,981 metric tons during the first half of 2015 from 19,776 metric tons over the corresponding period of the last year. As per the World Rubber Industry Outlook, the total world rubber demand is expected to grow by 1.8 per cent in 2015 and 4.1 per cent in 2016.
- Natural rubber prices continued their downward trend during the first half of 2015 in both global and domestic markets.** The declining trend of natural rubber prices at the global market was largely due to the slowdown in global demand and the accumulation of large stockpiles in major rubber consuming countries. Meanwhile, the average price of Ribbed Smoked Sheet 1 (RSS1) at the Colombo Rubber Auction declined by 16.3 per cent to Rs. 252 per kilogram while latex crepe 1X declined by 12.9 per cent to Rs.277 per kilogram during the period under review. Further, measures to promote the rubber industry continued targeting a rubber production up to 200,000 metric tons by 2020. The government introduced a guaranteed purchase price

scheme for rubber smallholders through the interim Budget 2015 in order to encourage the production of rubber while helping small holders who were adversely affected due to low market prices. Accordingly, measures were undertaken to pay the difference between the monthly average price of RSS rubber in the Colombo Rubber Auction and the guaranteed purchase price (Rs. 350 per kilogram) to smallholders since March 2015.

## Coconut

- Coconut production increased by 5.2 per cent to around 1,500 million nuts during the first half of the 2015.** The lagged effect of drought conditions experienced in all major coconut growing areas during February to April 2014 adversely impacted the coconut production in the first quarter of 2015. However, production in the second quarter rebounded with a growth of 6.8 per cent in comparison to the corresponding quarter of the last year. Meanwhile, the production of Desiccated Coconut (DC) declined by 38.3 per cent to 16,108 metric tons. The decline was largely due to the usage of fresh nuts for the production of Virgin Coconut Oil (VCO) and coconut milk which had a higher demand in the international market. However, the VCO production, which increased significantly during the first quarter of the year, slowed during the second quarter largely due to the shutting down of mills to adopt ISO certification. In addition, reduced prices at the global market also contributed to the lower VCO production during the second quarter of the year. Coconut oil production increased by 16.7 per cent to around 27,167 metric tons during the first half of 2015. Further, coconut cream, milk powder and liquid coconut milk production also grew by 14 per cent to 14,010 metric tons during the period under review. It is also observed that there is a huge demand in the international

market for king coconut and coconut water, where king coconut exports during the first half of 2015 increased by 77 per cent to 1,820 metric tons from 1,027 metric tons in the corresponding period of the last year.

- **Prices of coconut and coconut based products remained high in comparison to the corresponding period of the last year, driven by the emerging industrial demand for raw coconut nuts.** The average retail price of fresh coconuts during the first half of 2015 remained at around Rs. 53 per nut compared to Rs. 46 recorded in the corresponding period of the last year. However, prices of fresh coconuts in June 2015 declined drastically to Rs 42 per nut due to low demand for DC and VCO production. Meanwhile, the average price of coconut oil during the first half of the year decreased to Rs. 281.7 per litre from Rs. 289.7 per litre recorded in the corresponding period of the last year, supported by increased domestic production of coconut oil and increased palm oil imports. Further, the average price of DC at the Colombo Coconut Auction increased by 11 per cent to Rs. 327.2 per kilogram from Rs. 294.8 per kilogram in the corresponding period of 2014. In the international market, the average export price of DC during the first half of 2015 increased to US dollars 2.8 per kilogram from US dollars 2.1 per kilogram in 2014. Meanwhile, restrictions on fresh coconut exports, which was introduced to increase the availability of fresh coconuts to local industries and curtail increasing local nut prices, have been removed with effect from 1 June 2015 considering the improvements in the domestic coconut supply during the year. Further, the SCL on palm oil imports was increased to Rs. 105 per kilogram from Rs. 90 per kilogram with effect from 18 June 2015 to bolster the domestic coconut oil industry. However, the SCL on palm oil imports was reduced subsequently to Rs. 90 per kilogram with effect from 21 July 2015.

### Other Field Crops

- **Production of Other Field Crops (OFCs) increased marginally by 1 per cent to 655,615 metric tons in the 2014/15 Maha season despite high crop damages recorded in the early part of 2015 caused by heavy rain and floods.** Production of crops such as big onion, chillies, cowpea, green gram, kurakkan and potatoes increased during the 2014/15 Maha season partly supported by remunerative prices fetched for selected commodities due to high levels of SCL on imports of such commodities. Meanwhile, maize production increased by around 15 per cent to 276,349 metric tons in 2015, which is an excess production compared to the estimated annual requirement of maize (181,872 metric tons). Further, the production of ground nuts and cowpea also exceeded the national demand in 2015. Meanwhile, it is expected that the production of black gram, red onion, and gingelly would meet around 80 per cent of the total domestic requirement for this year. However, the production of selected OFC items recorded a declining trend partly due to the lesser extent of land cultivated compared to the last year. In this regard, promoting off-seasonal production, expanding storage capacity and strengthening research and development activities on post harvest technology and seed production are important.

### Vegetables

- **Vegetable production increased by 2.3 per cent to 744,683 metric tons in the 2014/15 Maha season.** Weather related setbacks experienced during the latter part of the last year resulted in crop damages thereby reducing the market supply and escalating vegetable prices during the early part of this year. Further, Maha cultivation was also delayed due to

the reestablishment of crops in the weather affected areas. However, the increased supply of vegetables during the month of March helped curtail the pressure on vegetable prices. Meanwhile, the market supply of vegetables declined during May to mid-June resulting in an increase in vegetable prices. However, the Yala harvest, which reached the market mid-July, helped decelerate vegetable prices there after.

### Sugar

- **Sugar production declined by 8.2 per cent to 11,231 metric tons during the first half of 2015.** This is the combined outcome of a 16 per cent increase in production at the Pelwatta sugar factory and a decline in production at the Sevenagala and Gal Oya sugar factories by 0.1 per cent and 0.2 per cent, respectively due to severe drought conditions that affected the planting of sugar cane. However, with the view of enhancing sugarcane production, the government increased the purchasing price of sugarcane to Rs.4,500 per metric ton from Rs.4,100 per metric ton. Given the increased purchasing prices, it is expected that total sugar production would increase by 15 per cent to 60,000 metric tons in 2015, which would be equal to around 10 per cent of the total sugar requirement of the country.

### Fisheries

- **Fish production declined by 1.1 per cent to 256,000 metric tons during the first half of 2015 mainly due to the significant decline in inland fish production.** Inland capture and shrimp farm production declined by 25 per cent and 36 per cent, respectively while aquaculture increased by 44 per cent. The significant decline in inland fish production was mainly driven by adverse weather conditions experienced during the early part of 2015 where the high level

of water in major reservoirs reduced the fish netting areas which led to a less fish harvest. Further, the reduction of releasing fingerlings to the tanks in 2014 also contributed to the lower production. However, it is expected that inland fish production would increase with the seasonal tank harvesting in the second half of the year. Meanwhile, marine fish production increased marginally by 3 per cent during this period. The growth in marine fish production was largely driven by deep sea fish production which recorded a growth of 4.6 per cent during the first half of the year. In the meantime, the Government undertook several policy measures to establish a Vessel Monitoring System (VMS) with the view of lifting the ban imposed by the European Union (EU), the major market for Sri Lankan sea food exports, on Illegal, Unreported and Unregulated (IUU) fishing concerns. It is noted that around 570 multiday boats were equipped with transponders during the first half of 2015. The cost of the installation of necessary equipment, such as transponders in multiday boats, is provided to fisherman through a payment plan. The introduction of VMS would help to strengthen the international standards and compliance applicable for deep sea fishing while eliminating IUU fishing. Meanwhile, in order to strengthen the national fishing fleet, around 39 boats with outboard engines and 85 multiday boats were added during the first half of 2015. Furthermore, in order to increase the inland fish and aquaculture production, the Ministry of Fisheries in collaboration with the Food and Agriculture Organisation (FAO), undertook several measures, including increase of fish fingerling and fresh water prawn post larvae stocking, proper management of water bodies with community participation and the establishment of community based mini-hatcheries during the first half of the year.

## Livestock

- **Milk production increased by around 4 per cent to 213 million litres during the first half of 2015 over the corresponding period of the last year.** The slow growth was attributed to the long term effects of the Foot and Mouth Disease epidemic that prevailed the last year. Meanwhile, total milk collection of large scale milk product manufacturers increased significantly by 30 per cent to 128.9 million litres in the first half of 2015. This improvement was particularly pronounced due to the progress of the modernisation of Polonnaruwa, Digana and Ambewela milk factories of MILCO. Further, Ridiyagama farm of NLDB received the first consignment of pure and cross bred cattle from Australia during the month of July in the last year, and the farm was further developed to expand its capacities and converted to a modern dairy farm where European type cattle could be nurtured under an intensive management system. Given the current situation, it is expected that milk production would increase by 2 per cent to 426 million litres in 2015, which would be sufficient to meet around 56 per cent of the total domestic demand. Meanwhile, egg production increased by 11 per cent to 1,171 million, while poultry meat production increased by 13 per cent to 80,750 metric tons during the first half of 2015. Further, Broiler parent chick production recorded a growth of around 22 per cent during the first half of 2015 which largely contributed to the growth in the chicken production.

## Industries

- **The Industry related economic activities grew by 1.3 per cent in value added terms during the first half of 2015 recovering from the contraction of 4.5 per cent recorded in the first half of 2014.** The recovery in the

Industry related activities is broadly in line with the rebound in manufacturing activities. Further, construction activities witnessed a recovery during the second quarter thereby partially offsetting the negative growth in construction recorded during the first quarter of the year. Electricity supply related activities, and sewerage, waste treatment and disposal activities maintained a higher growth during this period compared to the corresponding period of 2014. Water collection, treatment and supply activities also contributed positively, yet at a slower pace compared to the first half of 2014. However, mining and quarrying activities continued to contract, affecting the Industry related growth.

- **The manufacturing activities picked up during the first half of the year contributing to the Industry related growth, while the setback in construction, and mining and quarrying activities continued.** Manufacturing activities, the largest segment of the Industry activities, grew by 4.5 per cent during this period recovering from the stagnant performance recorded in the corresponding period of 2014. This growth was mainly attributable to the manufacture of food, beverages and tobacco products, the major sub category of manufacturing activities, which grew by 6.5 per cent during the period under review, recovering from the 0.4 per cent contraction recorded during the first half of 2014. Meanwhile, sewerage, waste treatment and disposal activities continued to expand by 22.4 per cent during the period in comparison to 9.9 per cent growth observed during the corresponding period of 2014. Electricity supply related activities, and water collection, treatment and supply activities also grew by 4.1 per cent and 3.2 per cent, respectively, during the first half of 2015 compared to 0.3 per cent and 5.7 per cent growth recorded, respectively, during the same period of 2014.

However, construction activities, which is the second largest segment of the Industrial activities, contracted by 5.1 per cent during the period compared to 15.1 per cent contraction recorded in the corresponding period of 2014 with a positive growth during the second quarter of the year. Further, mining and quarrying activities contracted by 5.7 per cent during the period in comparison with 4.4 per cent contraction recorded in the first half of 2014, dampening the Industrial growth.

### Production Trends and Institutional Support: Industry

- The industrial activities comprises mining and quarrying, manufacturing, electricity, gas and water and construction sub categories. Among these, manufacturing activities provide the highest contribution to industry activities accounting for more than 54 per cent of total industry activities. The Factory Industry Production Index which is computed covering 17 major activities using the International Standard Industrial Classification (ISIC), Revision 4, measures the performance of manufacturing activities of the economy<sup>2</sup>.

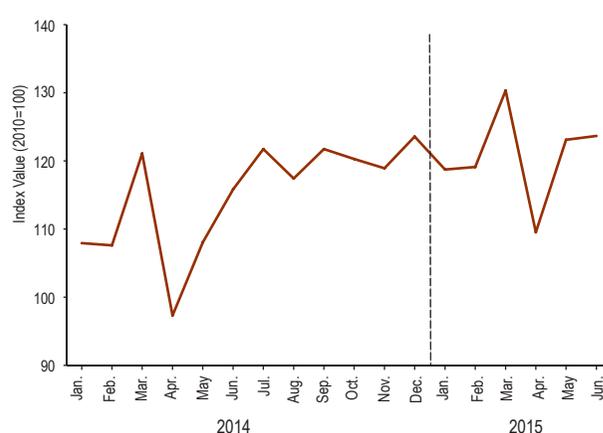
### Factory Industry Production Index

- Factory Industry Production Index (FIPI), a leading indicator of industrial output, showed a year-on-year growth of 10.1 per cent during the first half of 2015. Wearing apparel, beverages, tobacco products, chemicals and chemical products and other non-metallic mineral products are the major subsectors that contributed positively to factory industry output during the period. However, textiles, rubber and plastic products, refined petroleum products,

leather and related products, basic metals and fabricated metal products subsectors recorded a decline in the first half of 2015 against the corresponding period of 2014.

- Food products subsector, a major subsector in FIPI, which showed a positive performance since June 2014, continued its growth momentum during the first half of 2015 as well. Food products subsector showed a growth of 4.3 per cent during the first quarter of 2015, and a marginal growth of 0.4 per cent during the second quarter of 2015, hence recorded a year-on-year growth of 2.4 per cent during the first half of 2015. This was mainly supported by a considerable increase in production of bakery products, prepared meals and dishes, macaroni, noodles and similar products along with a notable increase in dairy products and prepared animal feed. However, the processing and preserving activities of fish showed a negative growth of 1.2 per cent which was mainly due to the decline in inland fish production due to adverse weather conditions. Also, the manufacture of sugar declined by 66.1 per cent mainly due to decline in production of the Sevenagala factory, which was affected by adverse weather conditions. Meanwhile, government took initial steps to introduce a 50 per cent tax reduction for the entrepreneurs

Chart 2.4 Factory Industry Production Index (FIPI)



<sup>2</sup> The weights in the FIPI are assigned for each industry using 2010 as the base year. Significant structural changes seen in the economy since then have resulted in emerging new industries with relatively higher weights, while the significance of some of the existing industries in the sample has declined. This will be taken into account in the next revision to the FIPI.

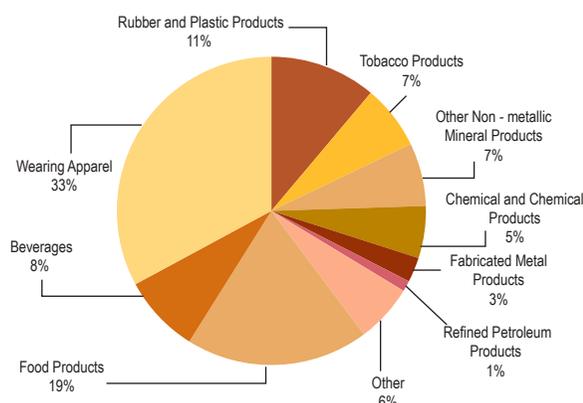
who commence businesses in vegetable and food processing industry, in line with its Budget for 2015, which will contribute further expansion of the food industry in the period ahead.

- **The beverages subsector showed a noteworthy growth of 13.7 per cent during the first half of 2015.** The considerable 12.9 per cent growth of production of liquor, the largest subsector in the beverages subsector was the main contributor towards this performance. Similarly, the manufacture of soft drinks, mineral water and bottled water also grew by 19.9 per cent supporting the expansion of beverages subsector further. However, the manufacture of malted beverages, including malted milk products showed a setback recording a negative growth of 0.4 per cent. Increased demand from the tourism sector has supported the expansion of food as well as beverages subsectors during the period.
- **Wearing apparel subsector which is a leading subsector in FIPI performed at a very healthy rate during first half of 2015.** The subsector recorded a significant year-on-year growth of 22.6 per cent for the first half of 2015. Sri Lanka's international reputation as

a reliable and a quality apparel manufacturer under the principles of ethical working conditions, environmental friendly green manufacturing and the availability of competent and literate workforce continued to support the industry to remain competitive in the international market.

- **The chemicals and chemical products subsector expanded by 5.3 per cent during the first half of 2015 benefiting from increased output in related industries such as fertilizer, paints and varnishes, soaps and detergents.** The production of fertilizer which is the leading output in the chemicals and chemical products subsector reported an overall growth of 0.9 per cent during first half of 2015. Further, production of paints and varnishes showed a significant growth rate of 27.3 per cent during the first half of 2015.
- **Non-metallic mineral products subsector performed well during the first half of 2015.** The output of non-metallic mineral products which reflected a slower year-on-year growth of 5.3 per cent during the first quarter of 2015 largely due to the lower level of construction activities, recorded an improved performance during the second quarter with a year-on-year growth of 22.8 per cent thereby achieving a year on year growth of 13.0 percent for the first half of this year. Increased production of cement, lime and plaster which accounts for nearly 50 per cent of output of this subsector recorded a year-on-year growth of 16.2 per cent along with an increase in the production of articles of concrete which grew by 29.8 per cent supported the favourable performance of this subsector. However, the manufacturing of clay building materials such as clay tiles, reflected a decline in performance reporting a negative growth of 12.4 per cent during the first half of 2015.

**Chart 2.5** Composition of Factory Industry Production Index (FIPI) - First Half 2015



- **Further, the output of tobacco products subsector also recorded a year-on-year growth of 15.3 per cent during the first half of 2015.** Increased demand due to higher disposable income resulting from salary increases during the reference period has supported the growth of this sector.
- **Rubber and plastic products subsector showed a mix performance during the first half of 2015.** Even though, this subsector contracted by 2.6 per cent during the first quarter of 2015, it reported a positive growth by 2.8 per cent during the second quarter of 2015. Overall, the subsector reflected a marginal contraction of 0.1 per cent during the first half of 2015 compared to the corresponding period of 2014. Lower manufacture of rubber tyres and tubes as well as other rubber products such as gloves, rubber compounds has caused this performance during this period. Continuously declining domestic raw rubber production was attributed to this performance. Further, lower rubber prices in the world market, which make imported rubber products much cheaper, have also affected the tyre manufacturing industry unfavourably. In addition, advanced economies like USA have imposed antidumping and countervailing duties on tyres manufactured in China that are imported to the USA and as a result, those production flows may divert to developing countries, including Sri Lanka, at a lower price than domestic market prices.
- **The textile subsector too showed a weak performance recording a contraction of around 4.6 per cent during the first half of 2015.** Severe competition from imports of textile and textile articles during the period at cheaper prices adversely affected the local textile manufacturing subsector. Given the stiff competition from low cost suppliers to traditional markets like USA and Europe, the industry should consider exploring new export markets.
- **Factory production of refined petroleum based products which entirely comprises the production in refinery of Ceylon Petroleum Corporation reported a negative performance during the period.** The subsector showed a negative growth of 39.2 per cent during first quarter and 5.2 per cent during second quarter of 2015. The overall reduction in the refined petroleum based products sector during the first half of 2015 was 23.7 per cent when compared with the corresponding period of 2014. Lower refinery process due to closure of the refinery for repairs and maintenance resulted in a contraction in refined petroleum products.
- **The output of basic metals which reflected a slight growth of 0.6 percent during the first quarter of 2015 declined by 5.5 per cent during the second quarter of 2015 leading to a decline of 2.4 per cent during the first half of 2015.** The contraction in manufacturing of basic iron and steel products was the main factor affecting this performance. Further, the decline in manufacturing of footwear related products resulted in a negative growth of 14.7 per cent in leather and related products subsector during first half of 2015 compared to the corresponding period of the previous year.
- **The government continued to facilitate industrial sector development through its Ministries and state institutions.** The Ministry of Industry and Commerce continued the regional industrial development programme to promote regional industrialisation. Currently, there are 27 industrial estates covering 17 districts and 8 provinces providing 17,347 employment opportunities. The work relating to Stage II of the Trincomalee Industrial Estate and Thiraimadu Industrial Estate continued during this year. Further, two more industrial estates are to be developed at Welioya in Mullaitivu district and Musali in Mannar district to promote the garment industry.

- Institutional support for the development of Small and Medium Enterprises (SMEs) sector of the country continued during first half of 2015. Ministry of Industry and Commerce developed the National Policy Framework for SME Development with the objective of strengthening the SMEs sector. The National Enterprise Development Authority (NEDA) continued to strengthen Regional Enterprise Forums at Divisional Secretariat level and currently, there are 34 Regional Enterprise Forums. In addition, a number of programmes such as Women Entrepreneurship Development Programme, “Upadidhari Vyavasayake Udanaya” Programme and Moratuwa Wood Furniture Entrepreneurs Development Programme continued to enhance entrepreneurship, marketing, technical and financial management skills of SMEs at regional level. Further, NEDA plans to hold Business Development Services (BDS) fairs in selected districts in order to create linkages/ interaction between SMEs and BDS providers at regional and national level.

### Services

- The Services related economic activities, the highest contributor to the first half 2015 growth, grew by 7.1 per cent in value added terms, compared to the growth of 4.2 per cent recorded in the corresponding period of 2014. This growth was largely attributable to the substantial expansion in financial, insurance and real estate activities including ownership of dwellings. Further, wholesale and retail trade, public administration services, and other personal service activities also recorded a noteworthy contribution to the Services growth. However, IT programming related activities, education and professional services contracted during this period while all the other services related activities witnessed a positive growth.

### Wholesale and retail trade, transportation and storage, and accommodation and food service activities

- Wholesale and retail trade, transportation and storage, and accommodation and food service activities, the largest segment of the Services activities, grew by 4.6 per cent during the first half of 2015 in value added terms in comparison with 1.8 per cent growth recorded in the corresponding period of 2014. Wholesale and retail trade activities, which grew by 5.8 per cent during the first half of 2015 compared to 12.8 per cent growth recorded during the corresponding period of 2014, mainly contributed to the overall growth in these activities. Meanwhile, transportation of goods and passengers including warehousing activities rebounded with a 2.2 per cent growth during the period, recovering from the 8.7 per cent contraction recorded in the first half of 2014. Moreover, accommodation, food and beverage service activities also recovered during the first half of 2015 recording an 8.6 per cent growth compared to 3.6 per cent contraction recorded in the same period of 2014. Further, postal and courier activities grew significantly by 20.1 per cent during the period under review against the 9.0 per cent contraction recorded during the first half of 2014.

### Information and communication

- Value added of the information and communication activities grew by 11.8 per cent during the first half of 2015 in comparison with 18.0 per cent growth recorded in the first half of 2014. This growth was mainly buoyed by the continuous expansion in telecommunication activities, which grew by 17.7 per cent during the first half of the year, compared to 22.2 per cent growth recorded in the corresponding period of 2014. Further, programming and broadcasting

activities and audio/video productions grew by 8.4 per cent within the period recovering from 0.6 per cent contraction recorded during the first half of 2014. However, IT programming consultancy and related activities contracted by 4.7 per cent during the first half of the year compared to 11.6 per cent growth in the first half of 2014.

### **Financial, insurance and real estate activities including ownership of dwellings**

- Financial, insurance and real estate activities including ownership of dwellings grew by 14.0 per cent during the first half of 2015 compared to 8.2 per cent growth recorded during the same period of 2014. This growth was mainly attributable to 16.2 per cent growth in real estate activities including ownership of dwellings compared to 1.9 per cent growth recorded in the corresponding period of 2014. Meanwhile, financial service activities and auxiliary financial services grew by 12.7 per cent during the first half of 2015 compared to 16.2 per cent growth recorded in the first half of 2014. Further, activities of insurance, reinsurance and pension funding also posted a growth of 7.5 per cent during this period in comparison with 2.2 per cent growth recorded in the first half of 2014.

### **Professional services and other personal service activities**

- Professional services and other personal service activities grew by 7.8 per cent during the first half of 2015 compared to 2.5 per cent growth recorded in the first half of 2014. This growth was mainly buoyed by the substantial growth in other personal service activities, the main contributor to the segment,

which grew significantly by 11.6 per cent during the period compared to 2.4 per cent growth observed in the first half of 2014. However, professional, scientific, technical, administration and supporting services activities recorded a contraction of 11.5 per cent during the period against the 2.9 per cent growth recorded in the corresponding period of 2014.

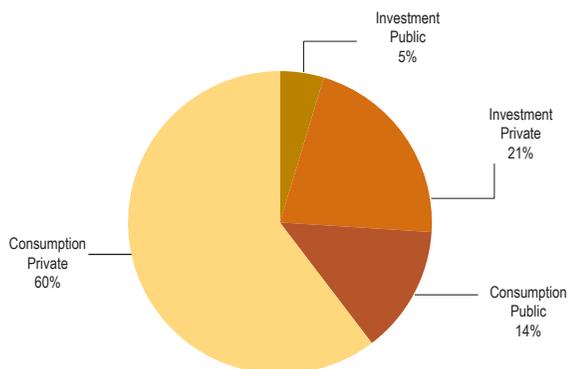
### **Public administration, defence, education, human health and social work activities**

- Public administration, defence, education, human health and social work activities grew at a slower pace of 3.3 per cent during the first half of 2015 in value added terms compared to 7.8 per cent growth recorded in the corresponding period of 2014. This growth was mainly attributable to public administration and defence, and compulsory social security activities, which grew by 7.5 per cent during the period in comparison with 4.9 per cent growth recorded in the same period of 2014. Meanwhile, human health activities, residential care and social work activities grew marginally by 0.9 per cent during this period in comparison with 7.4 per cent growth posted in the first half of 2014. However, education services contracted by 4.0 per cent against 14.7 per cent growth posted during the corresponding period of 2014.

### **Expenditure**

- Gross Domestic Expenditure (GDE), which includes the demand generated from domestic consumption and investment expenditure, is projected to grow by 8.7 per cent in nominal terms during 2015 compared to the estimated growth of 6.8 per cent in 2014. Accordingly, the value of the GDE is projected to be Rs. 12,091 billion in 2015 compared to Rs. 11,128 billion in 2014.

**Chart 2.6** Composition of Domestic Demand-2015 (a)



(a) CBSL projections based on the medium term macroeconomic framework

This growth is expected to be driven by the consumption expenditure amidst the slowdown in investment expenditure of the economy. Meanwhile, GDP at current market prices, which is the sum of GDE and the net external demand, is expected to increase by 9.9 per cent to Rs. 11,313 billion with a real growth of 5.7 per cent and an implicit GDP deflator of 4.0 per cent during 2015. Further, the growth in net external demand of the economy is expected to be favourable in nominal terms during the year compared to 2014. It is anticipated that prevailing low global commodity prices, especially that of oil, would reduce the import cost, while the depreciation of the rupee and some macro-prudential and fiscal measures introduced recently would discourage imports dampening the imports growth in nominal terms.

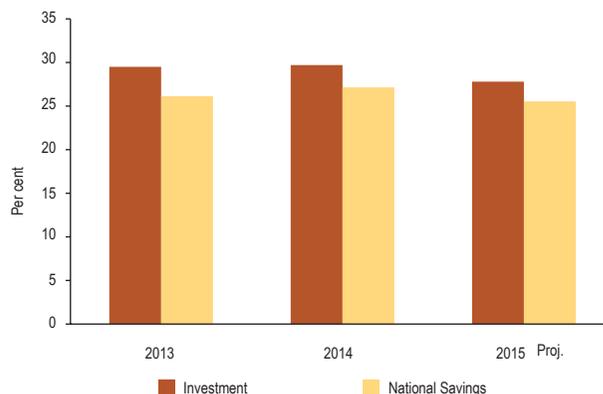
### Consumption

- Consumption expenditure, which comprises private and public sector consumption, is projected to grow by 10.8 per cent in 2015 compared to an estimated 6.4 per cent growth for 2014 in nominal terms. This growth is expected to be supported by significant

expansion in both private and public consumption expenditure.

- Private consumption, the main contributor to the consumption expenditure, is projected to grow by 8.0 per cent during the year, compared to estimated growth of 4.7 per cent in 2014. The growth in private consumption activities is expected to be driven by the increase in disposable income of the consumers benefiting from the low inflationary environment and the salary increases, especially in the public sector. Further, external trade statistics also reveal an increasing trend in expenditure on consumer goods as reflected by the significant growth in import trade indices, both in nominal and real terms, during the first eight months of the year.
- In line with the approved budget estimates for 2015, public consumption expenditure is projected to grow by 25.3 per cent compared to 15.9 per cent growth recorded in 2014. The major contributor to the public consumption is the expenditure on salaries and wages, which represents a greater portion of government recurrent expenditure. Accordingly, the increase in salaries of the public sector employees during the year is expected to contribute mostly on the projected increase in public consumption. As per the budgetary estimates, expenditure

**Chart 2.7** Investment and Savings as a Percentage of GDP (a)



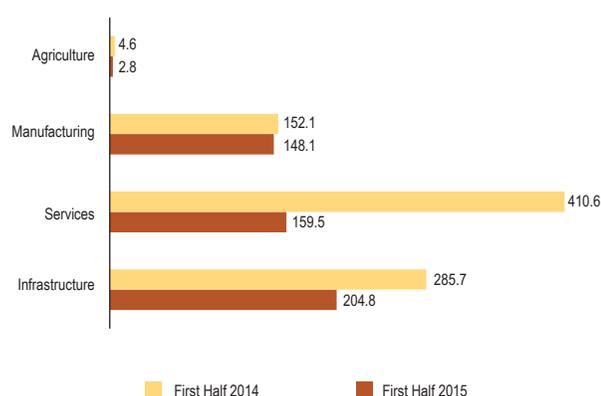
(a) CBSL estimates based on the medium term macroeconomic framework

on salaries and wages is expected to increase by 29.3 per cent, while the expenditure on other purchases of goods and services is expected to increase by 14.6 per cent during the year compared to the last year.

## Investment

- **Investment expenditure, which includes private and public investments, is projected to grow by 2.9 per cent during 2015 compared to the estimated growth of 8.0 per cent for 2014.** This projected slowdown in investment activities in the economy is broadly in line with the rationalization of public investment activities, while private investment is expected to improve with the relatively low interest rates and improving business environment. A slowdown is observed in construction activities, which represents a greater portion of investment expenditure, during the first half of the year. However, the gradual growth in construction activities recorded during the second quarter of the year is expected to continue during the remaining period of the year. As revealed by the trade indices, imports of investment goods witnessed a significant improvement during the first eight months of the year recovering from the contraction observed during the corresponding period of 2014.

**Chart 2.8** Foreign Direct Investment\* of BOI Enterprises (US\$ million)



\* Including loans

- **Private investments, which are estimated to account for around 80 per cent of the total investments, is projected to increase by 8 per cent in 2015.** Supporting the private sector investment activities, private sector credit for personal housing including purchasing/construction/repairs from commercial banks has increased by 32.5 per cent by end June 2015 compared to the corresponding period of the previous year. This development is expected to continue during the second half of the year as well, benefiting from the prevailing low interest rates and improving business environment.
- **Public sector investment expenditure is projected to contract by 15.4 per cent during 2015 compared to the estimated 12.3 per cent growth in 2014.** This decline is largely attributable to the comparative slowdown in large-scale infrastructure development projects pending financial and environment impact review during the first half of the year. Reflecting the setback in public investments, government capital expenditure and net lending witnessed a 20.9 per cent decline during the first seven months of the year. However, capital expenditure is expected to increase gradually during the remaining period of the year benefiting from the political stability and realisation of targeted disbursement cycle of external funded activities enabling public investments to be maintained around 5 per cent of GDP in 2015.

- **Inflows of Foreign Direct Investments (FDI), including loans to the Board of Investment (BOI) registered companies, in the first half of 2015 amounted to US dollars 515.1 million compared to US dollars 853.0 million in the first half of 2014, reflecting a year-on-year decline of 39.6 per cent.** The main reason for the contraction in FDI during the period was the decrease in FDI inflows relating to

infrastructure projects by 28.3 per cent and services by 61.2 per cent. Majority of FDI during the period was on account of infrastructure related projects representing around 39 per cent of total FDI (US dollars 204.8 million). FDI in the services sector amounted to around 31 per cent of total FDI inflows (US dollars 159.5 million) whereas FDI in the manufacturing sector amounted to US dollars 148.1 million representing about 29 per cent of total FDI during the first half of 2015.

### Savings

- **Both domestic and national savings are expected to slowdown during the year.** Increase in both public and private consumption expenditure is expected to dampen the domestic savings. Further, the public sector is expected to maintain a current account deficit albeit at a lower level than recorded in 2014. Dissavings of the public sector reflect the increase in public consumption expenditure amidst the effort to improve government revenue collection. Meanwhile, expected significant deterioration in net factor income from abroad and the slowdown in net current transfers would also dampen the national savings.

### Prospects for 2016

- **As projected under the medium term macroeconomic framework, the economy is expected to grow by around 6.5 per cent in 2016.** The major economic activities namely, Agriculture, Industry and Services are envisaged to contribute positively towards the economic growth. The growth is anticipated to be driven by conducive developments in the domestic front supported by the improvement in external demand. The persistent contribution from consumption expenditure, coupled with expected revival in investment expenditure would drive the domestic demand.

- **Agriculture activities are envisaged to rebound strongly in 2016.** Although the continuous decline in the tea prices and rubber prices at the global market in the recent period deteriorated the domestic production, it is expected that the external demand for these exports would be rebounded driven by the recovery in the world economy. Meanwhile, the strong growth in global demand for coconut based commodities is also expected to provide the impetus to the development of domestic production while helping to continue its growth momentum in 2016. Further, it is expected that the domestic production of many field crops such as maize, potato, red onion, black gram and big onion etc, would continue to grow triggered by favourable weather conditions. It is expected that the domestic dairy industry would meet up to around 55 per cent of the domestic milk requirement during 2016 given the modernisation of milk factories and imports of new cattle which would enhance the domestic production capacities. Further, domestic sugar production also expected to meet around 15 per cent of total domestic demand of sugar in 2016. Meanwhile, total fish production in the country is expected to show an improvement in 2016 with the expected expansion of deep sea fish production and inland fish catch. With these supply side developments in the domestic agriculture fronts, it is expected that the agriculture sector to contribute overall growth positively in 2016.
- **Manufacturing activities are expected to continue supporting the growth momentum in the remainder of the year 2015 and in 2016.** Improvements in both the domestic and external economic conditions and enhanced economic and political stability in the country are expected to affect favourably towards the achievement of this growth. Resumption of government infrastructure development projects as well as the enhancement of the

private sector construction activities are expected to boost manufacturing activities. Export oriented industries, such as textile and wearing apparel, rubber and leather based products are expected to perform favourably facilitated by the healthy external conditions and with increased opportunities in non-traditional markets. Lower inflation and interest rates, development of infrastructure, economic and political stability are expected to enhance investor confidence and stimulate investments both locally and internationally expanding manufacturing activities. However, lower commodity prices in the international market can have a mixed impact on the performance of manufacturing sector activities.

- **The drive in the Services related economic activities is expected to continue during 2016, boosting the overall economic growth.** This growth is projected to be broad-based with the contribution from traditional economic activities such as trade and transport related activities coupled with dynamic sectors including IT programming, telecommunication, financial services etc. The financial activities are expected to gain from the conducive monetary policy stance that prevailed during the recent years, providing a favourable financial market condition for the acceleration in other economic activities in the short and medium term. As global industries become more and more information-intensive, IT programming and consultancy activities are expected to boost the services exports of the

country. Further, services exports are expected to benefit from the expected recovery in the global economy, especially in advanced economies. Meanwhile, professional and other personal services, which have emerged as high value added services, are also expected to remain as prominent services contributing to the overall activities related to Services.

- **Both public and private investments are expected to improve in 2016.** With the gradual stability in the policy making environment, public expenditure on investment activities is expected to increase. Accordingly, infrastructure development activities, which slowed down during 2015, would regain its momentum during 2016. Meanwhile, the continued improvement in investor confidence would boost private investment activities further in 2016.
- **In maintaining the expected growth momentum in the economy during 2016, improvement in national savings is important.** The investment demand of the economy is projected to be around 29 per cent of GDP in 2016 contributing to a higher economic growth. In this regard, both private and public savings have to be encouraged to further facilitate reducing reliance on external financing to bridge the savings–investment gap of the country. From the fiscal front, improving the current account balance through fiscal consolidation efforts in order to achieve and sustain a positive level of public savings would contribute to improving domestic savings and investment climate.

