2. OUTPUT AND ECONOMIC GROWTH

The growth in output evident from the first half of 2002 is expected to continue through 2003 in an improved macro-economic environment with stronger fiscal discipline, greater stability in prices and exchange rates, lower interest rates and the implementation of economic reforms. In 2004, growth is expected to be faster and more broad based, provided that the cease-fire and the peace process continue, and appropriate economic policies and reforms will be pursued.

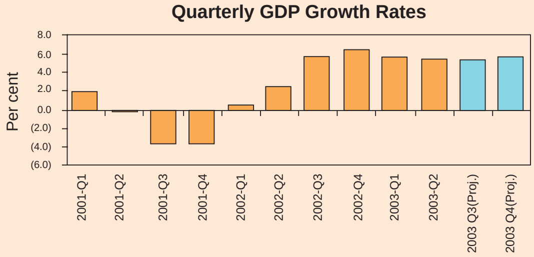
Developments in 2003

- The economy is projected to grow by 5.5 per cent in 2003 compared with 4.0 per cent in 2002. During the first half of 2003, the economy grew by 5.6 per cent and the annual growth projection is well on target.

- The cease-fire between the government and the LTTE since February 2002 and sound economic management, contributed to this comparatively high economic growth. Greater fiscal discipline, declining interest rates, a stable foreign exchange market and falling inflation were the constituents of that sound economic management.

- Growth is projected to be broad-based. All three major sectors are expected to contribute to overall economic growth. Industry and Services sectors are anticipated to grow by 5.8 per cent and 6.8 per cent, respectively. The Agriculture sector is projected to grow by 1.7 per cent. The Services sector will contribute two thirds of the overall growth (66 per cent). The contributions of the Industry and Agriculture sectors will be 28 per cent and 6 per cent, respectively.

Chart 2.1
Quarterly GDP Growth Rates



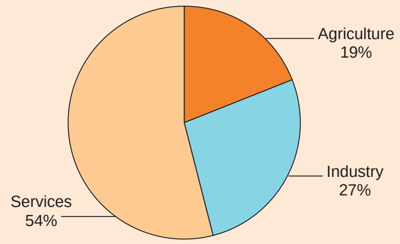
- In agriculture, the domestic agriculture sub-sector performed well, but the plantation agriculture sub-sector faced difficulties during the first half of the year. Paddy production in the Maha season was 1.91 million metric tons, the highest ever production for a Maha season. Total cultivated area under paddy increased by 18 per cent during the season benefiting from the cessation of conflict in the North and the East, and increased availability of water resources. The increase in acreage was 25 per cent in the North and East. However, the average yield per hectare declined as marginal lands were cultivated. According to provisional estimates, paddy production in Yala also reached a new high level. In addition, the production of vegetables, subsidiary food crops and minor export crops increased during the first half and this trend is expected to continue in the second half. The increase in domestic agricultural production contributed to dampen inflationary pressure during the year.

- Plantation agriculture however, faced problems during the first half. Tea production dropped by 4 per cent mainly on account of floods affecting low grown tea areas during the second quarter. Tea production is projected to perform better in the second half, containing the drop in annual production to about 3 per cent. The decline in coconut production by 7 per cent during the first half of 2003, was due to the lagged effect of the drought. However, the declining trend in coconut production during the past three years is expected to turn around from the second half of 2003.

Annual production in 2003 is projected to increase by 4.5 per cent. Rubber production, which increased by 5 per cent during the first half, is projected to grow at the same rate during the second half. The increase in production was a response to the increase in prices, by around 70 per cent, caused by the prevailing global supply shortage. Overall, the agriculture sector is projected to grow by 1.7 per cent during 2003.

- Recovery in the Industry sector was a significant feature during the first half of 2003. Although the Agriculture and Services sectors had recovered during the first half of the previous year, the Industry sector had lagged behind. All sub-sectors of the Industry sector, which had contracted during the first half of the previous year, regained their growth momentum during the first half of 2003. Recovery in this sector impacted positively on the Services sector as the demand for related services increased.

Chart 2.2
Sectoral Contribution to GDP in First Half, 2003



- During the first half of 2003, the Industry sector is estimated to have grown by 6.9 per cent and all sub-sectors of Industry contributed to this growth. Growth in the Electricity, gas and water sectors was notable. The recovery in electricity generation in contrast to the power cuts in the previous year and increased generation of low-cost hydro power enhanced value addition in the overall sector. The annual growth of the sub-sector is projected to be 23per cent. Manufacturing for export, which had suffered a severe setback since the second half of 2001, recaptured its growth momentum as evident from growth in industrial exports. Despite the slow recovery in world trade, the textiles and garment sector grew by over 15.3 per cent during the second quarter of 2003. The export manufacturing sub-sector is projected to grow during the second half too, though at a slower pace due to the base effect, compared with the first half. The construction sub-sector, which had experienced a setback during the past two years, showed signs of recovery during the first half of 2003. For the year as a whole, this sector is projected to grow by 4.5 per cent. Construction activity was mainly concentrated in housing construction. The industry sector, as a whole, is projected to grow by 5.8 per cent during 2003.

- The Services sector remained buoyant during the first half of the year and grew at 7.2 per cent. Of service activities, the banking, insurance and real estate sector is estimated to have grown by 12.8 per cent. Growth in the commercial banking sub-sector benefiting from the continuing sharper decline in deposit rates than in lending rates was partly responsible for this high growth. This high growth is expected to continue during the second half. The Transport, storage and communications sector, which grew by 5.6 per cent during the first half of 2002, is estimated to have grown by 9.9 per cent in the first half of 2003. The telecommunications sub-sector accounted mostly for this growth, its final output expanding by 23.7 per cent. Value added in port service rose by 12.1 per cent during the first half of the year. This high growth reflects enhanced productivity at the Sri Lanka Ports Authority (SLPA) and aggressive marketing by the Jaya Container Terminal (JCT) and the South Asia Gateway Terminal (SAGT), both providing world class container terminal facilities. As this fast growth was achieved on a low base in the previous year, growth in the port services sector is projected to decelerate during the second half of the year.

- In 2003, a further recovery is expected in the Wholesale and retail trade sector. During the first half of the year, this sector grew by 5.6 per cent, against 2.1 per cent during the first half of 2002. The recovery in exports trade was noticeable in this sector. In 2002, although imports had recovered from the contraction in 2001, the export trade sub-sector had lagged behind owing to slower recovery in world trade. In 2003, the export sector is projected to grow by 8.6 per cent. Reflecting the increase in production and improved consumer confidence, the domestic trade sector is projected to grow by 4.4 per cent in 2003.

- The residual services category which is not classified under a main heading is projected to grow by 4.5 per cent in 2003. This growth will come mainly from the hotel services sub-sector reflecting the upsurge in tourist arrivals. Hotel and related services, which had suffered a setback in the first half of 2002, recovered strongly in 2003 with the increase in tourist arrivals, mainly from India, UK, Germany, France and Japan. This trend in tourist arrivals are expected to continue during the second half of the year as well. Further, value added in private educational services, private health services and lotteries is also projected to grow during the year.

- GDP at current market prices is projected to be approximately Rs.1,788 billion, an increase of 12.8 per cent over the previous year. This increase combines a 5.5 per cent production growth and a 7.1 per cent increase in the price level. Accordingly, GDP per capita for 2003 is estimated at Rs.91,762, an increase of 10.1 per cent over the previous year's Rs.83,382, which surpasses the combined increase in inflation and population growth, indicating an overall improvement in living standards, on average. In US dollar terms, per capita GDP is estimated to increase by 9.3 per cent, from US dollars 872 to 953.

Outlook for 2004

- The economy is projected to grow by at least 6.0 per cent in 2004. This growth is projected to be broadbased, deriving from further growth in all three sectors; agriculture (2.9 per cent), industry (6.1 per cent) and services (7.0 per cent).

- In the plantation sector, growth will come from a recovery in tea and coconut production. Tea production, which suffered a temporary setback in 2003, is projected to increase by about 3 per cent and reach 310 million kg in 2004. Assuming that favourable prices will prevail, rubber production is projected to improve further, while coconut output is expected to grow by 6 per cent, reflecting the lagged effect of favourable weather conditions in 2003. The output of paddy and other crops is expected to perform well in 2004.

- All the sub-sectors in the Industry sector are projected to grow in 2004. Export manufacturing, electricity generation, construction and mining activities will contribute to this projected growth. In export manufacturing, output in the textiles and apparel product category is expected to grow with a recovery in international markets, continuous improvements in product quality, and closer relations with buyers in international markets. The output of the domestic market oriented industries is expected to grow in response to increased consumer demand arising from lower interest rates and higher per capita income.

- The Services sector is projected to grow by 7 per cent in 2004, contributing almost two thirds of the overall growth. This sector will benefit from the continued growth momentum in telecommunications, tourism and trade.

- The per capita income is projected to surpass US dollars 1,000 for the first time.

- However, the realisation of these results will depend on several major factors: that the peace process will continue, that macroeconomic management will improve further, that economic reforms will gather pace, that economic policy uncertainties will be reduced and that external assistance will be utilised efficiently. As mentioned ealier, improvements in the power supplies and basic infrastructure facilities and reforms of the labour market are critical to the continuation of the growth momentum observed in 2003.