

Seminar on “Measures to Revive Domestic
Construction Industry”

Economic Outlook of Sri Lanka and Prospects for the Construction Sector

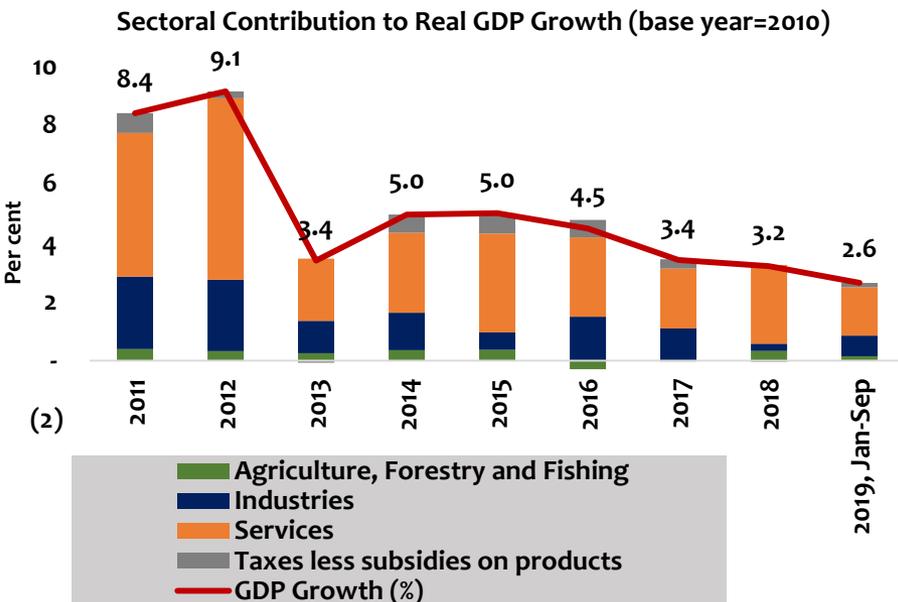
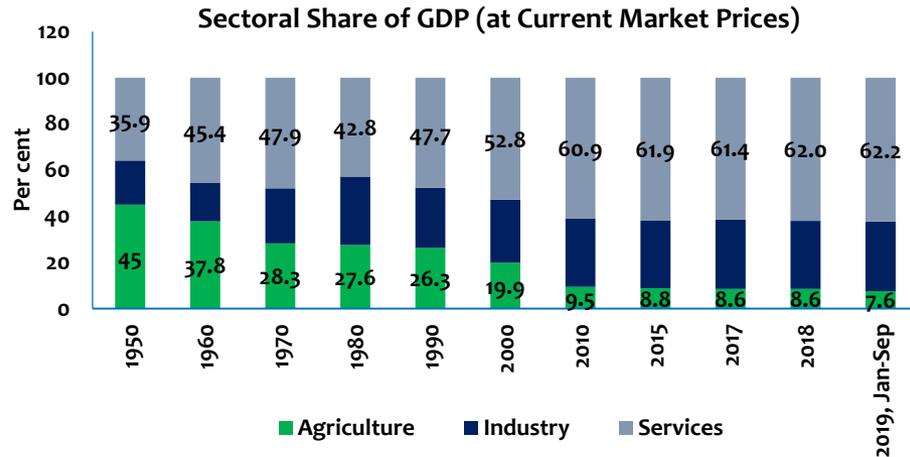
K M Mahinda Siriwardana
Deputy Governor
Central Bank of Sri Lanka

27 February 2020



Economic Outlook of Sri Lanka

Sri Lanka advanced to a service oriented economy from an agricultural economy, while the evolution of the industry sector has been gradual...



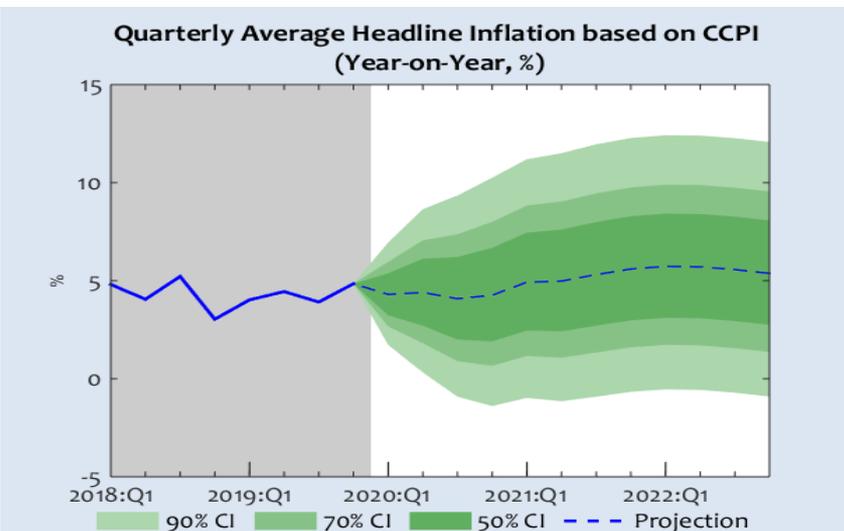
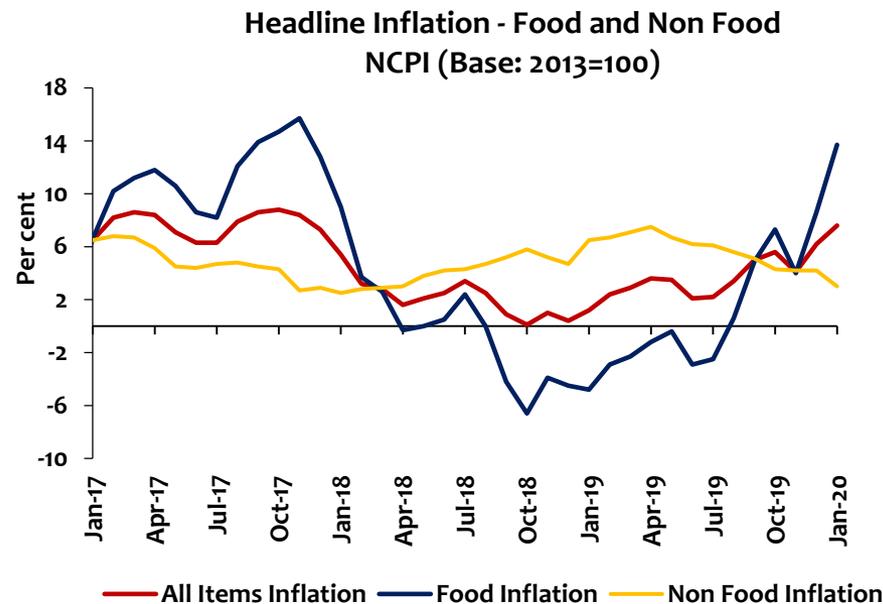
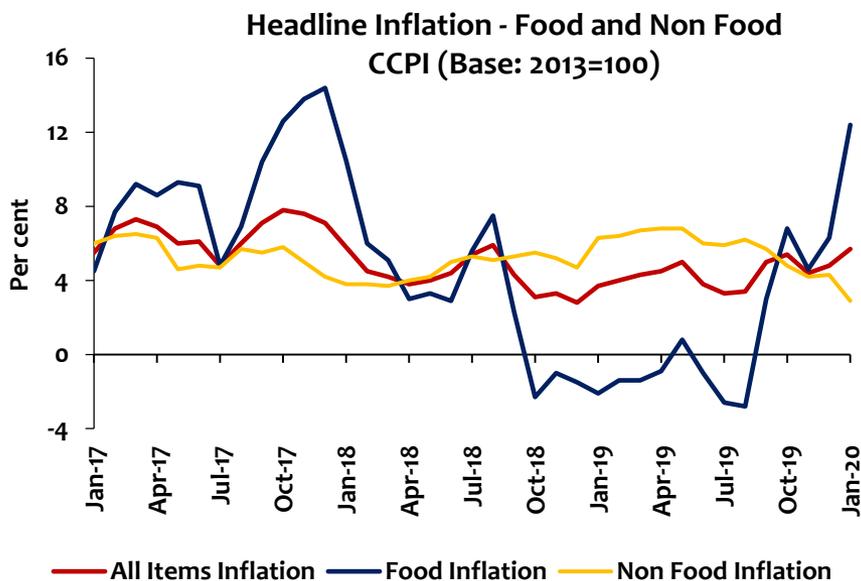
- Economic growth has been at or below 5% since 2013
- The low growth was mainly due to;
 - Unstable political situation
 - Inconsistent and unpredictable economic policies pursued by consecutive governments
 - Unfavourable weather conditions
 - Stagnant productivity
 - Global downturn
 - Cuts in government expenditure
 - Spillover effects of Easter Sunday attacks

The economy is recovering from the Easter Sunday attacks, supported by...

- Low and stable inflation environment
- Competitive exchange rate
- Low lending rates
- Improved consumer and investor sentiment
- Political stability
- Relaxed fiscal and monetary policy measures

Although it is too early to assess the possible impact of the spread of the corona virus, economic growth is likely to be somewhat affected at least in the short run.

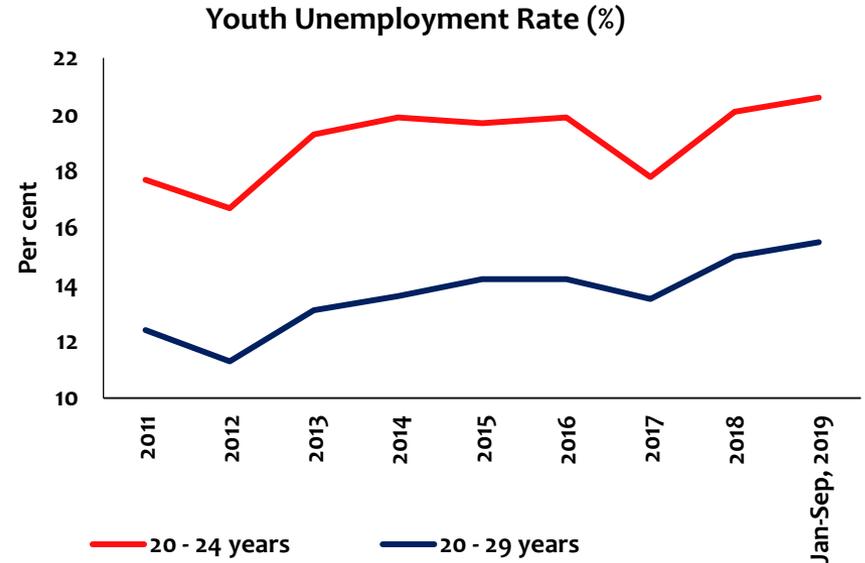
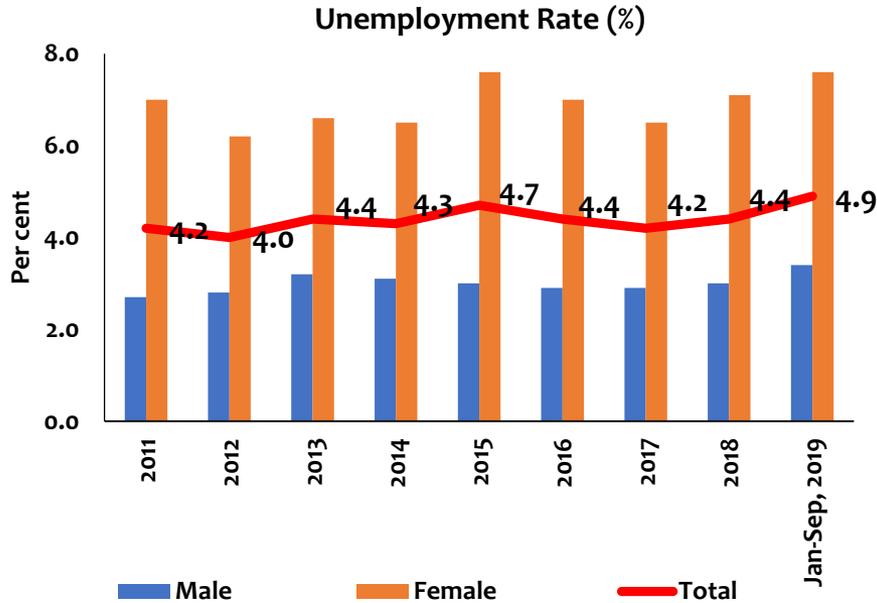
In spite of short term fluctuations, inflation remained in mid single digits...



Source : CBSL Staff Projections

- Reflecting subdued aggregate demand conditions, inflation, as measured using both CCPI and NCPI, has remained relatively low
- In spite of short term fluctuations, the near term forecast suggests that inflation will hover around 5 per cent in 2020, and stabilise between 4-6 per cent thereafter, assisted by appropriate policy measures and underpinned by well anchored inflation expectations

Unemployment rates among youth and females are high and persistent...

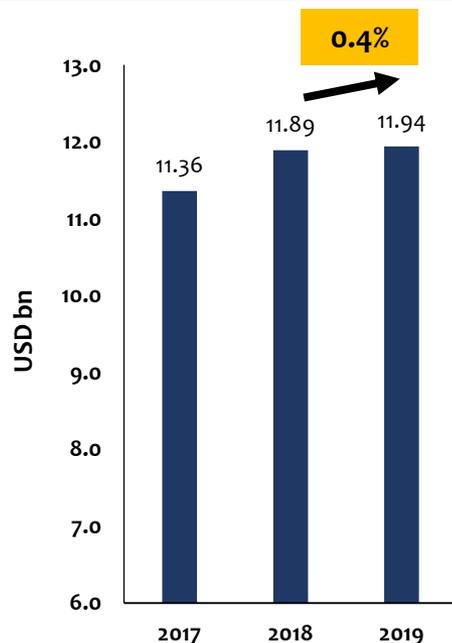


Source : Department of Census and Statistics

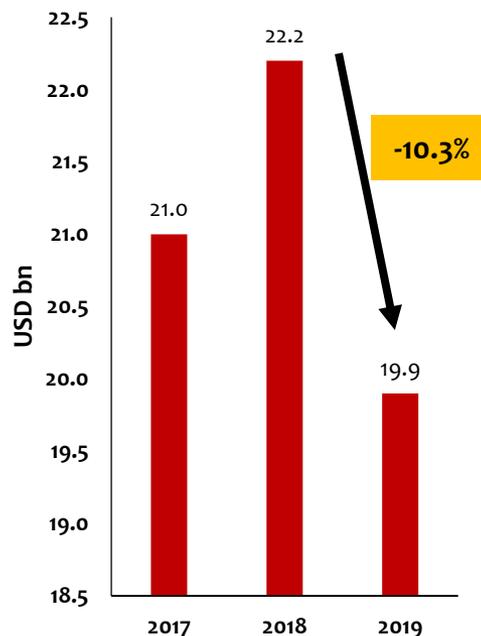
- In spite of extremely low female labour force participation, the unemployment rate among females who have an education attainment of GCE A/L and above is also high - 12.5 per cent during first 9 months of 2019
- Under-employment and low labour productivity are visible, particularly in the agriculture sector

During the year 2019, the merchandise trade deficit contracted significantly, driven by a sharp contraction in import expenditure

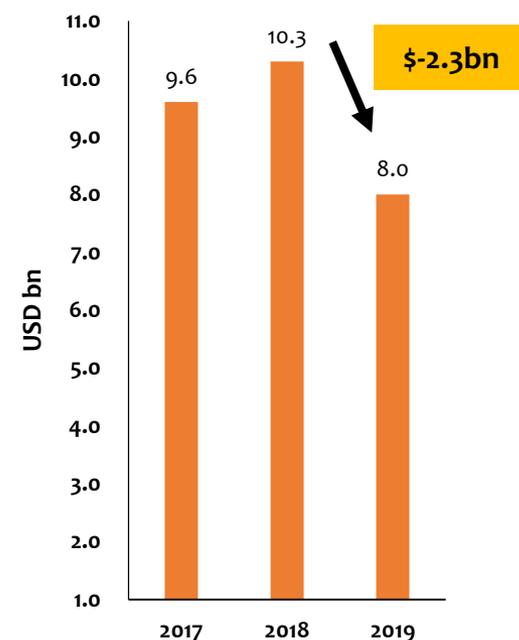
Exports (Jan-Dec)



Imports (Jan-Dec)



Trade Deficit (Jan-Dec)



Reduction in the Trade Deficit during 2019 was mainly supported by

A significant **decline in imports** driven by:

- Personal vehicles **USD 758 mn (-48.2%)**
- Gold **USD 436 mn (-99.4%)**
- Rice **USD 94 mn (-88.0%)**
- Refined petroleum **USD 231 mn (-7.9%)**
- Base metals **USD 120 mn (-17.6%)**

A marginal **increase in exports** driven by:

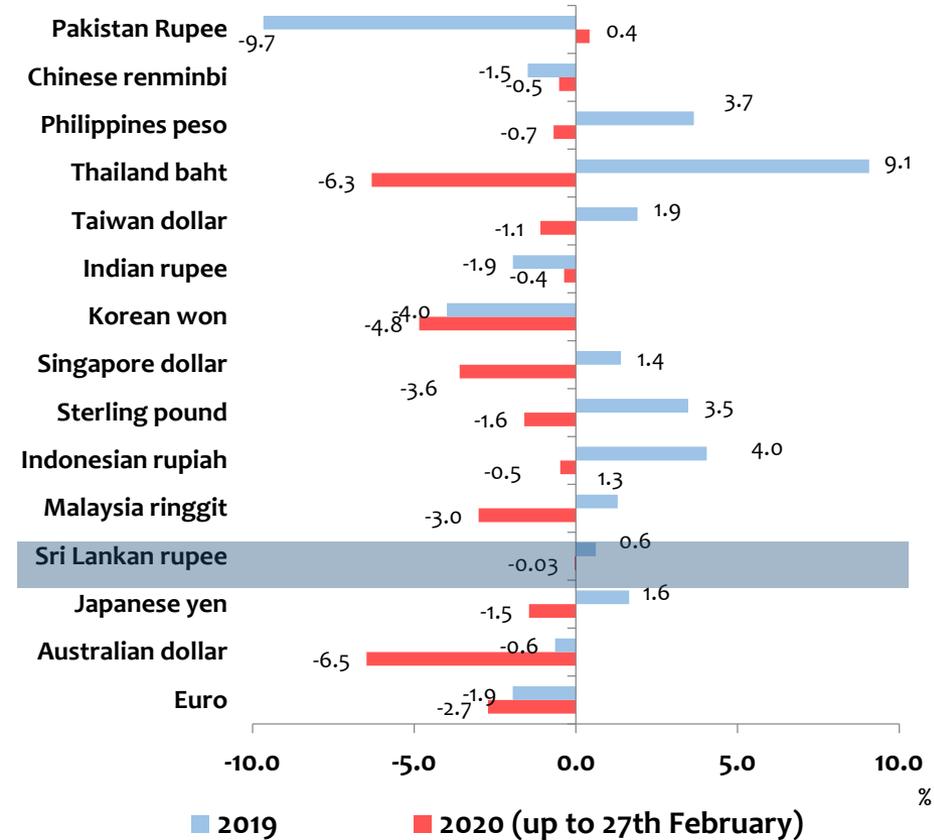
- Textiles and Garments **USD 279 mn (+5.2%)**
- Gems, Diamonds & Jewellery **USD 28 mn (+10.0%)**
- Transport Equipment **USD 26 mn (+21.3%)**
- Coconut **USD 19 mn (+6.0%)**

The Sri Lankan rupee, which appreciated by 0.6% against the US dollar in 2019, remained broadly unchanged so far during 2020...

Movement of Sri Lankan Rupee against USD



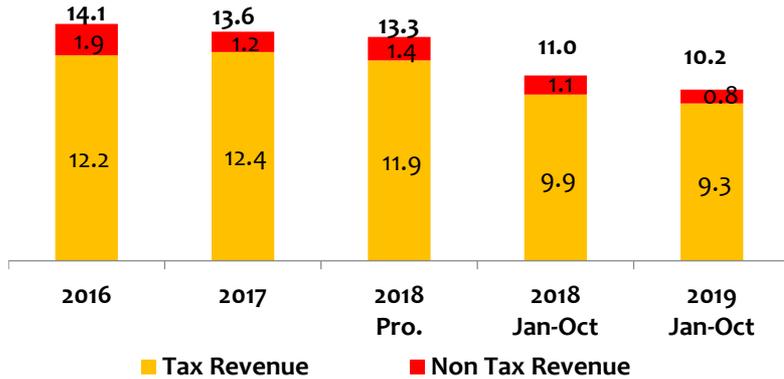
Movements in selected International Currencies against the USD



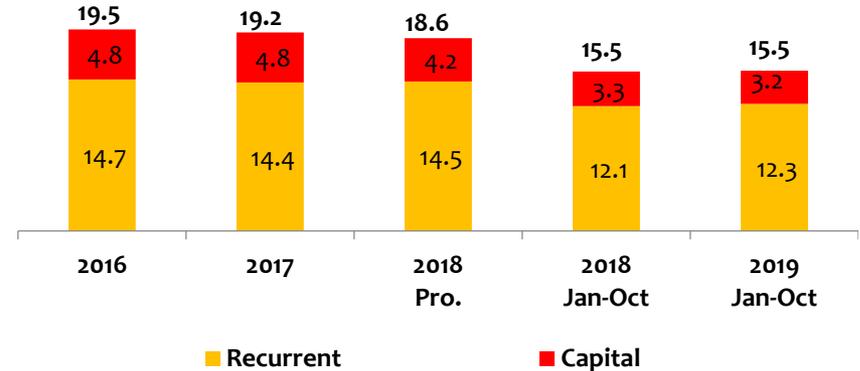
Gross official reserves increased to USD 7.6 bn by end December 2019, providing an import cover of 4.6 months

During the first ten months of 2019, the budget deficit increased to 5.3% of GDP

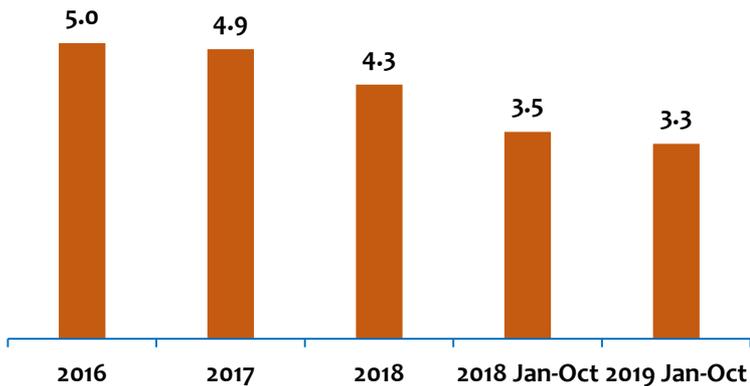
Government Revenue (as a % of GDP)



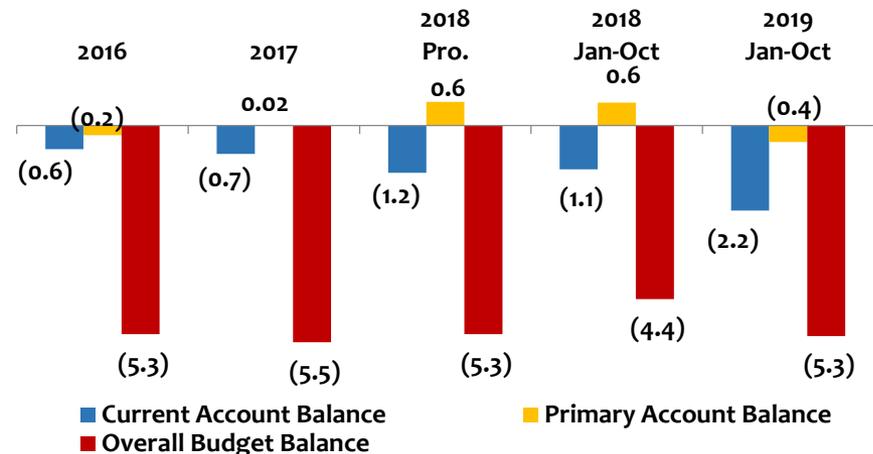
Government Expenditure (as a % of GDP)



Public Investment (as a % of GDP)

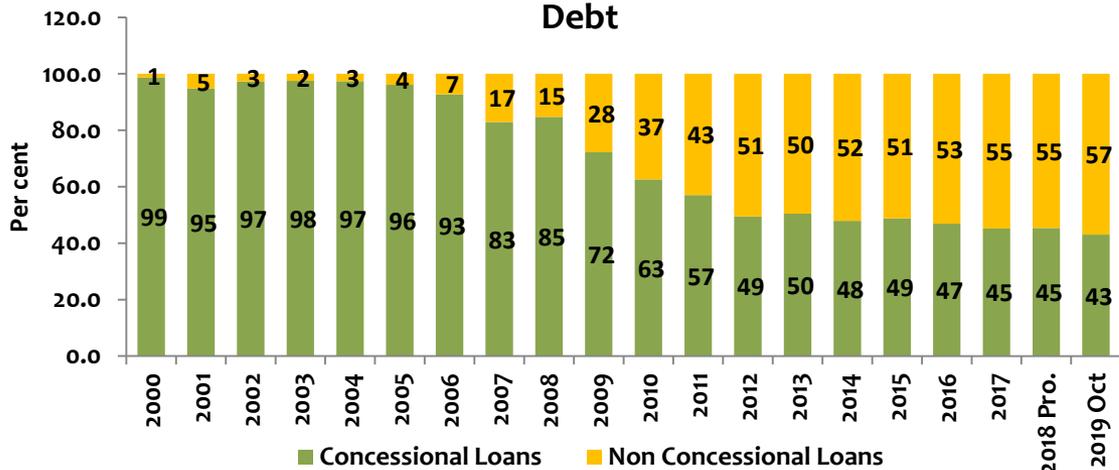


Key Fiscal Balances (as a % of GDP)

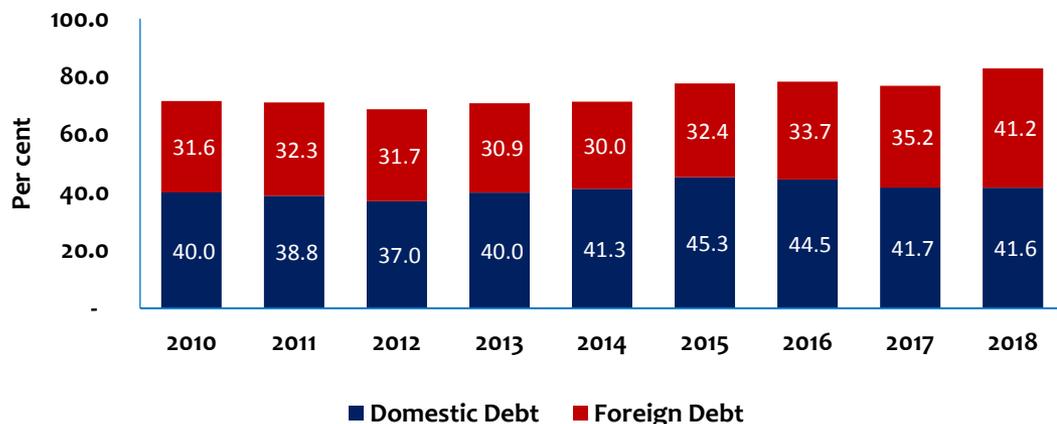


With Sri Lanka becoming a middle income economy, the share of concessional loans has declined gradually

Concessional & Non Concessional as a % of Foreign Debt



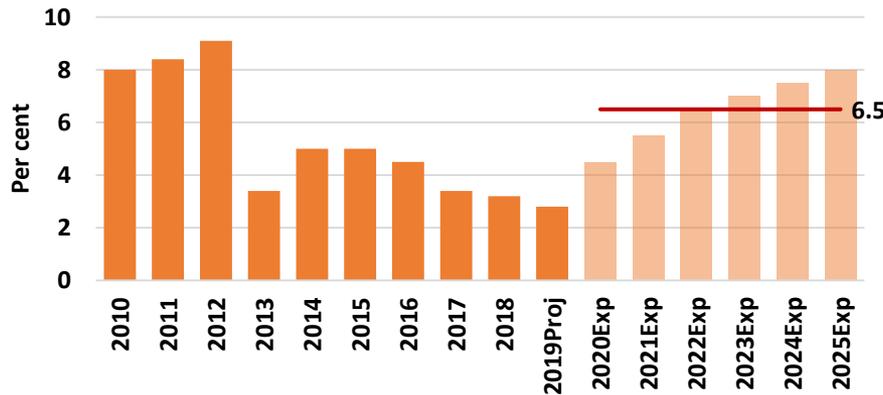
Outstanding Central Government Debt (% of GDP)



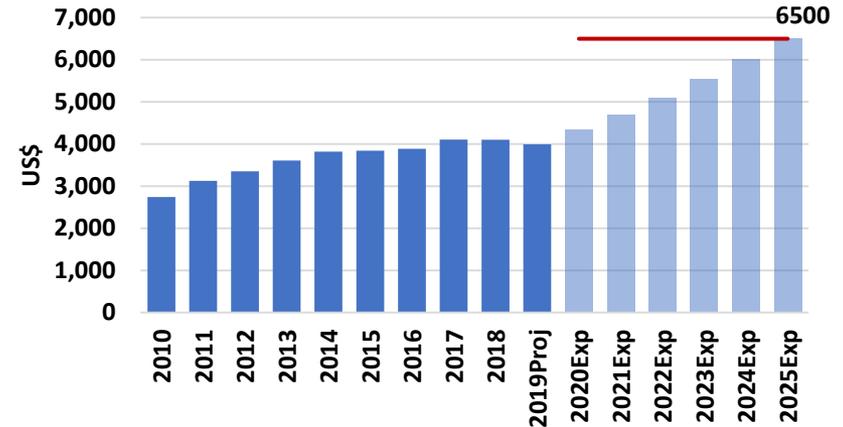
- With increased foreign debt, the country's vulnerability to external shocks has also increased, requiring policy makers to remain more vigilant.

Government's Medium Term Targets for key Macroeconomic Variables... (1)

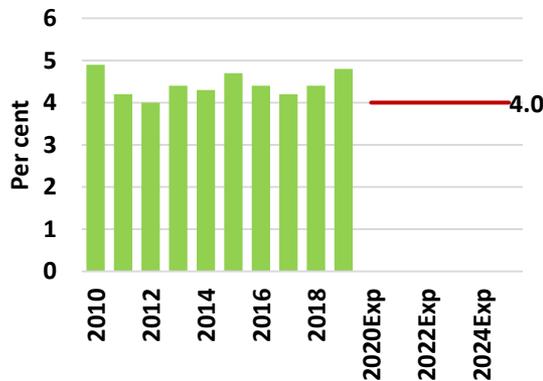
Real GDP Growth



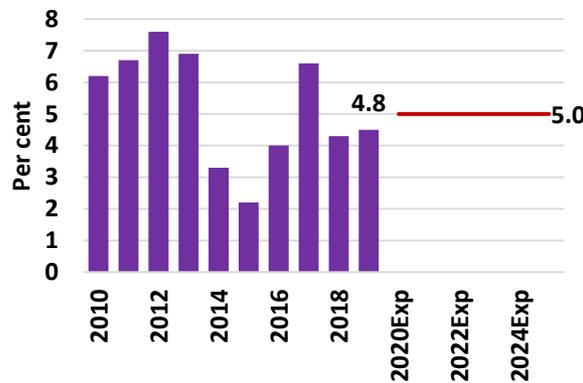
Per Capita GDP



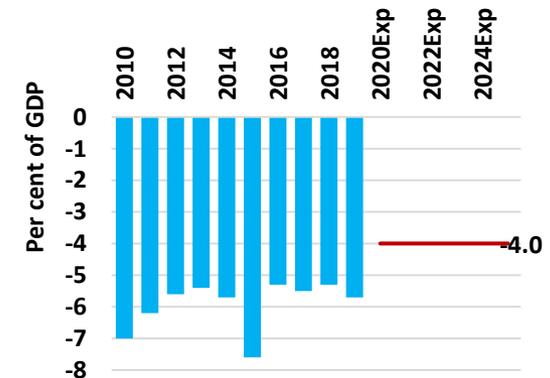
Unemployment Rate



Annual Average Inflation



Budget Deficit



In the medium-term, the economy is expected to reach its full capacity while accelerating growth towards 6.5%, gradually closing the output gap

Government's Medium Term Targets for key Macroeconomic Variables... (2)

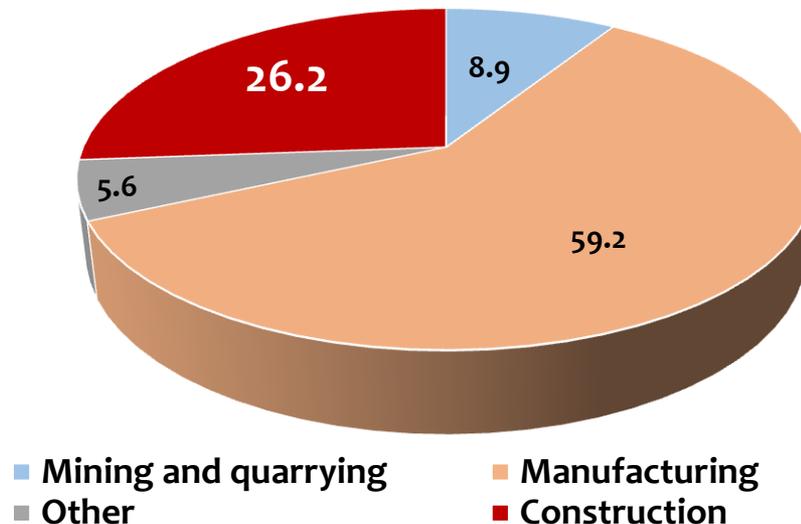
- **Appropriate structural reforms designed in line with the policy priorities of the government are key to sustain the medium term growth momentum of the economy**
- **Determined efforts to effectively implement the outlined policies are also important for the success**

Prospects for the Construction Sector

“Construction” in the Industry Sector in Sri Lanka...

- Sri Lanka’s industry sector activities are dominated by construction; mining & quarrying; manufacture of food beverages & tobacco, and manufacture of textiles, wearing apparel & leather related products

Composition of Industrial Activities in 2018



Sources: Department of Census and Statistics, Central Bank of Sri Lanka

In 2018, the construction sector accounted for 26.2% of the industry sector, which was about 6.8% of GDP

According to the Survey of Construction Industry 2016/17, three areas dominate the construction sector...

Distribution of Value of Contracts done by Types of Construction Activity - 2016

Type of construction activity	Value of Contract (Rs. Mn)	Percentage Share
Construction of buildings	281,205	39.4
Construction of roads and railways	309,539	43.3
Construction of utility projects	97,554	13.7
Construction of other civil engineering projects	11,266	1.6
Demolition and site preparation	83	0.0
Electrical, plumbing and other construction installation activities	9,935	1.4
Building completion and finishing	4,299	0.6
Other specialized construction activities	314	0.0
Total	714,195	100.0

Distribution of Value of Work done by Types of Construction Activity - 2016

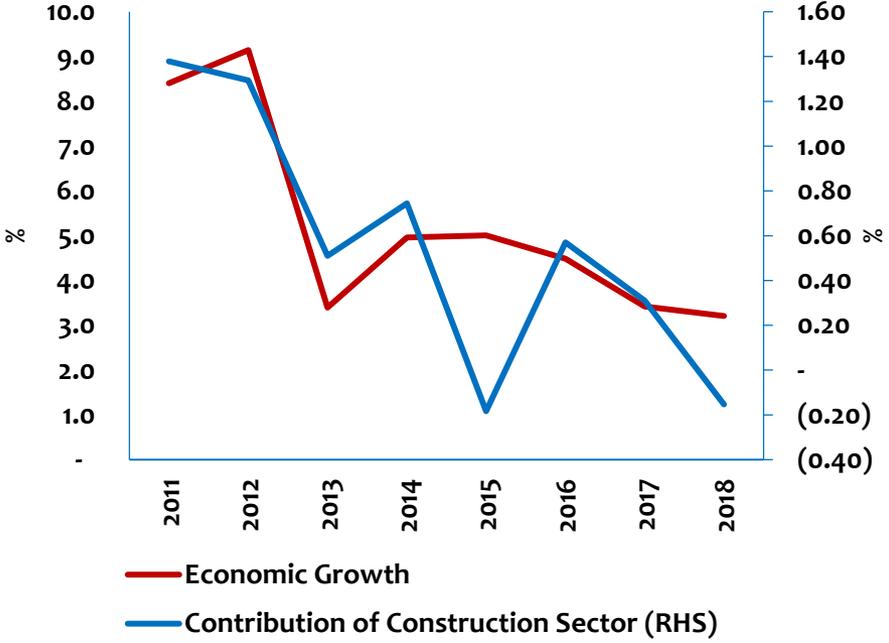
Type of construction activity	Value of work done (Rs. Mn)	Percentage Share
Construction of buildings	140,900	44.1
Construction of roads and railways	106,030	33.2
Construction of utility projects	52,642	16.5
Construction of other civil engineering projects	7,520	2.4
Demolition and site preparation	73	0.0
Electrical, plumbing and other construction installation activities	9,064	2.8
Building completion and finishing	3,089	1.0
Other specialized construction activities	314	0.1
Total	319,632	100.0

Sources: Department of Census and Statistics, Central Bank of Sri Lanka

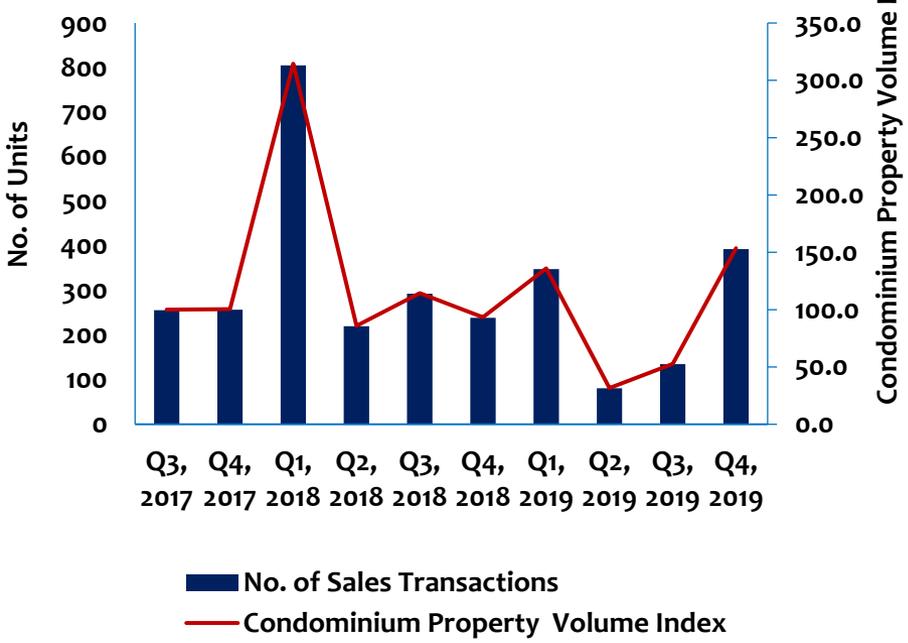
Construction of buildings, roads and railways, and utility projects are the key areas.

With subdued construction activities, the contribution of construction sector to the overall GDP growth has declined in the recent period...

Contribution of Construction Sector to Economic Growth



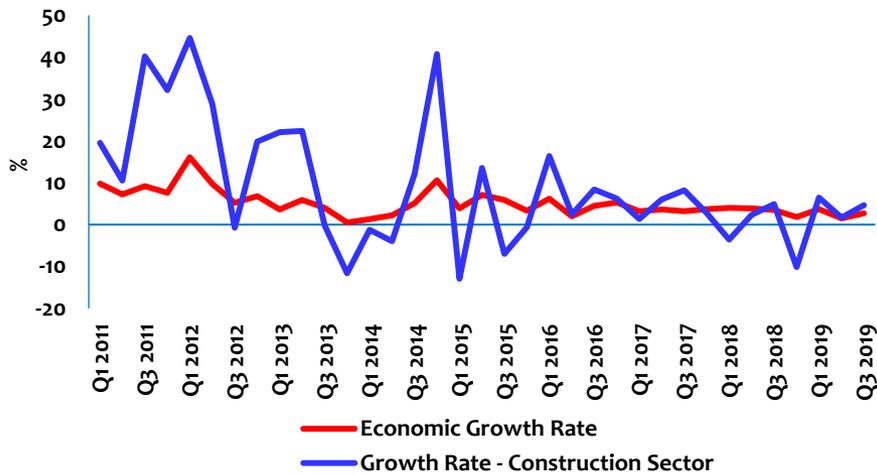
Sales Transactions and Condominium Property Volume Index



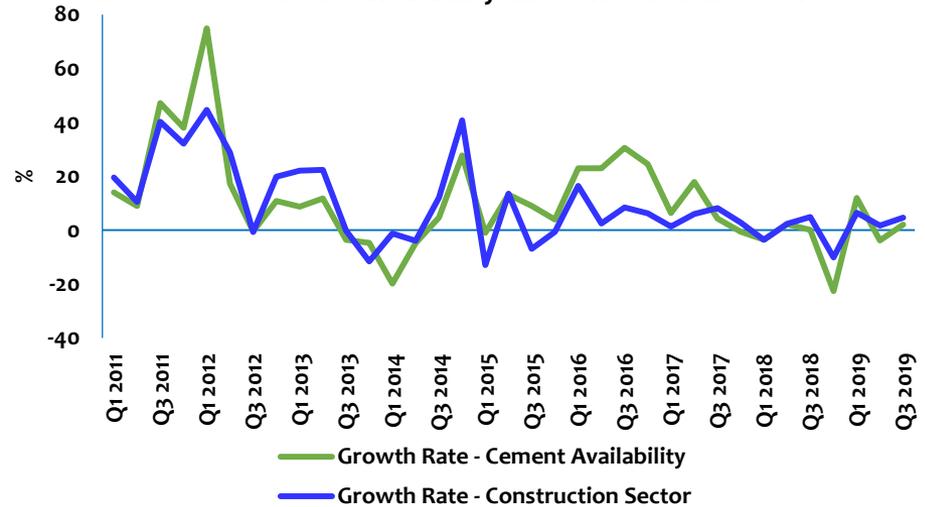
- In 2018, the construction sector accounted for 26.2% of the industry sector, which was about 6.8% of GDP
- The number of sales transactions related to the condominium property has declined in the recent period

Construction Sector Economic Indicators...

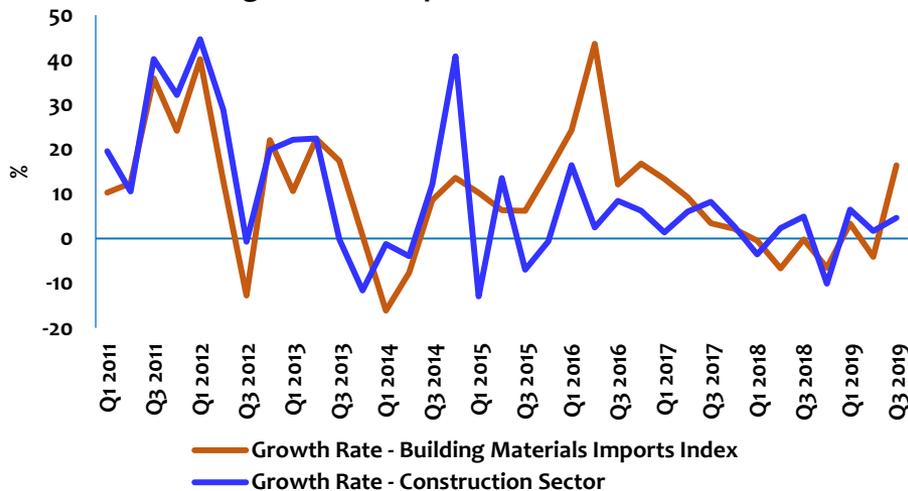
Real GDP and Construction Sector



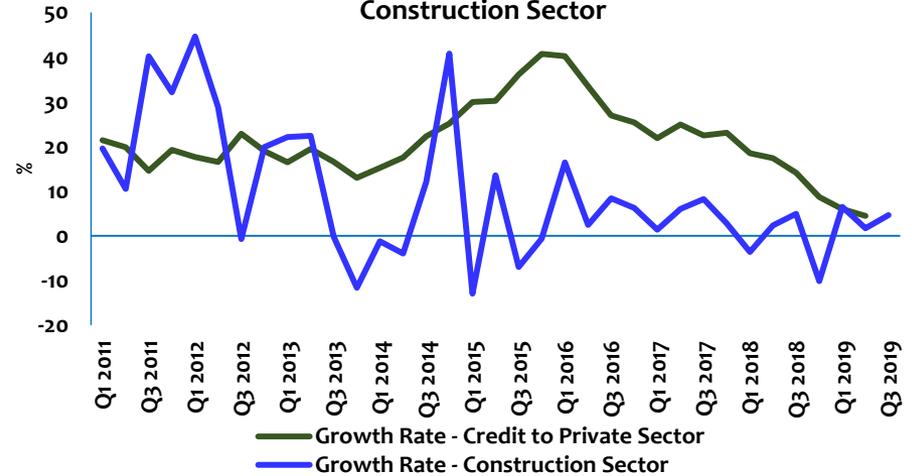
Cement Availability and Construction Sector



Building Materials Imports and Construction Sector



Private Sector Credit to Construction Sector and Construction Sector



The construction industry in Sri Lanka faces many issues... (1)

1. ***Cashflow problems due to delayed payments by the government for completed work***
 - Small and Medium Enterprise (SME) contractors in particular suffer due to delayed payments. The Ministry of Finance is making efforts to resolve this issue.
 - Following tax adjustments introduced will also help ease cash flow problems to a certain extent.
 - Reduction of Value Added Tax (VAT) from 15% to 8%
 - Removal of Nation Building Tax (NBT), with effect from 1 December 2019
 - Reduction of Income Tax rate applicable on construction industry to 14% from 28%, with effect from year of assessment 2019/20

The construction industry in Sri Lanka faces many issues... (2)

2. *High interest rates and issues with access to credit*

- Market lending rates adjusted downwards in response to monetary and regulatory measures taken by the CBSL
- Growth of private sector credit is expected to accelerate gradually in 2020 with ongoing reduction in market lending rates, fiscal stimulus and improved market sentiment
- SME credit support program is expected to provide a special credit support scheme to eligible SME borrowers, including those in the construction sector, helping for a recovery in construction activity

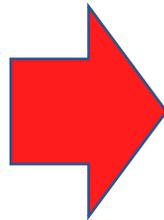
The construction industry in Sri Lanka faces many issues... (3)

- **Other Key issues**
 - *High cost of construction materials*
 - *Shortage of skilled workers*
 - *Delays in planning approvals*
 - *Low construction volumes*
 - *Competition from foreign contractors*

Government has identified the construction sector as an important subsector in the “National Policy Framework: Vistas of Prosperity and Splendour”

Strategies

- Facilitate a speedy approval process
- Ensure the security of domestic small and medium subcontracting firms
- Investment assistance to move to technical solutions to address labour shortage



Key Activities

- *Establish a system in which all required approvals can be obtained in one place or through the Internet*
- *Reduce time taken for approval of any building to be constructed to a total of 3 weeks*
- *Provide opportunity to pay past loans subject to grace periods that could be negotiated*
- *Replace the present system with the 2014 tax system and scrap the 15% VAT on apartments*
- *Reserve all state construction work for the domestic construction firms*
- *Revise the licensing system to regulate construction firms in their procurement of raw material*
- *Create facilities to train workers for the machinery to be increasingly used in the industry to overcome the issue of labour shortage*
- *Introduce new loan scheme for construction sector*

These policy measures are expected to generate a number of opportunities for the domestic small and medium sub-contracting firms

Government's projects pipeline will generate opportunities for the local construction industry ...

City Development Projects

- Lotus Tower project
- Strategic Cities Development Project (Kandy, Galle, Jaffna, Kurunegala)
- Township Development Projects
- Western Region Aero City Development Project
- Western Region Tech City Development Project
- Maritime City development project
- Western Region Administrative Cities Development Project
- Small Township Development Projects
- Greater Polonnaruwa Town Development Programme
- Urban Regeneration Project

Water Supply

- Water Supply and Drainage Projects
- Waste Water/ Sewage Treatment Plant Projects

Transport

- Light Rail Transits System
- Western Region Transport Development Project

Expressways

- Central Expressway Project
- Southern Expressway Extension Project (Matara – Hambantota)

Roads and Highways

- Outer Circular Highway Phase III (9.6km)
- Elevated Port Access road Project
- Northern Road Connectivity Project
- Southern Road Connectivity Project
- Integrated Road Investment I,II Program
- Priority Roads Project (PRP – Phase I & II)
- Major Bridges Construction Project of the National Road Network under JICA STEP Loan
- 100,000 KM Rural Road Development Project

Other

- Energy Sector Projects
- World Bank funded Climate Resilience Improvement Project
- Exim Bank (Hunan Branch) funded project
- New Bridge Construction project over Kelani River at Peliyagoda

Private sector construction work will also increase...

- The Colombo Port City is expected to provide higher value addition while creating immense potential within the development initiative...
 - The global launch of the CPC will kick off at the World Cities Summit 2020 in Singapore in July
 - A construction boom in relation to the CPC development is expected to take off in 2020/21
- Construction of apartments, hotels and shopping centers will continue, particularly in Colombo and suburbs.
- Housing sector, which still has an unmet demand, particularly from the middle income segments, is also an area with high potential
- Promotion of construction services could help increase foreign exchange earnings.

Construction sector participants will have to be ready for the emerging opportunities with new technologies while positioning themselves to benefit from these opportunities.

Summary...

- **Economic growth has been subdued in recent years, but a recovery is expected, supported by fiscal and monetary stimulus.**
- **Construction sector's growth has slowed down but a commensurate recovery is expected, supported by;**
 - **Government's targeted efforts to revive the sector**
 - **Expected pick up in economic activities**
- **Construction sector will have improved prospects**
 - **Public infrastructure investment projects will be continued on priority basis, amidst tight fiscal constraints.**
 - **Encouraging private sector participation in providing infrastructure facilities is important (eg. PPP) to complement government efforts**
 - **There is a need to fulfil unmet demand from sector such as middle income housing**
 - **The takeoff of Colombo Port City will provide further opportunities**

The construction sector in the past has contributed immensely to economic growth and development of the country and supported livelihoods of the public through generating productive employment opportunities while also creating an enabling environment for the economic activities to pick up...

It is our view that, in spite of challenges faced by the sector from time to time, the construction sector will prove its resilience and expand further in the future, utilizing the opportunities and prospects ahead of the country.

Thank You