Economics

Uganda: Annual economic outlook

The Winner of the Great Lakes

19 February 2010

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Projections for 2010

- Real GDP growth is pick up to 7.3%, after exceeding expectations with growth of 7.1% in 2009
- Average annual inflation to fall to 8.9%
- Shilling to appreciate slightly to an annual average exchange rate of 1 934UGX/USD
- Trade deficit is projected to widen to 4.9% of GDP
- Fiscal deficit is expected to increase to 3.8% of GDP

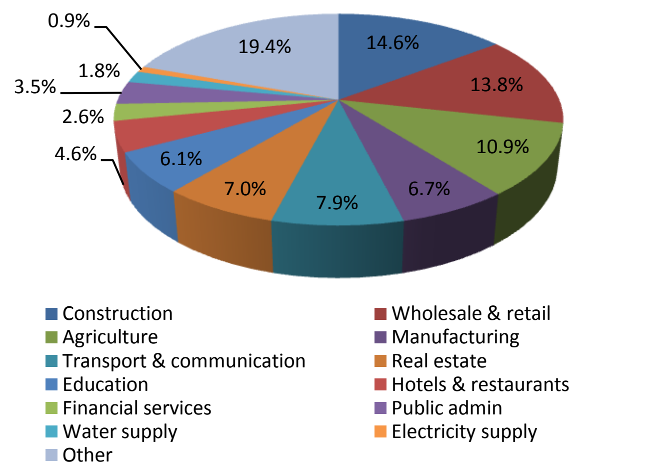
Recent trends

Production

Uganda continued to show remarkable spirit as it defied regional and international patterns by growing at 7% in FY2008/09, from 9% the previous year. This as private and public investment continued to show strength providing impetus to the construction sector. Trade was affected by the slump in global demand; however, it managed to continue to grow above 5%, thanks to demand from neighbouring countries. Transport also benefited from the regional dynamics of increasing cross border trade. Telecommunications remains the fastest-growing sector in the economy, although its contribution to GDP remains small.

Construction surpassed agriculture as the largest sub-sector in the economy in fiscal year 2005/06, as its contribution to real GDP increased from 9.3% in FY 2004/05 to 11.4% while agriculture's share decreased slightly from 10.4% to 10.3%. The industry sub-sector contributed 14.6% to real gross domestic product (GDP) in the most recent fiscal year (2008/09), see Figure 1. The growth of this sector was hardest hit by the decline in economic activity associated with the global financial crisis. Its growth was a mere 2.2% in FY2008/09 compared to as much as 23.2% in FY2005/06. Wholesale and retail trade, and repairs' contribution to GDP increased to more than that of agriculture, reaching 13.8% in the most recent fiscal year.

Figure 1: Real gross domestic product by activity (FY2008/09)



Source: Bank of Uganda

The agricultural sector contributed 10.9% to real GDP in FY2008/09, of which three quarters was in the form of food crops. Agricultural production also consists of cash crops and livestock. The performance of this sector is highly volatile: the average growth in production of cash crops was 2.6% in the past nine years; however, annual performance was within a range of a decline of 10.6% and growth of 12.5%. This reflects the agricultural sector's vulnerability to weather conditions and the availability of seeds and fertiliser. The production of food crops was less volatile; annual year-on-year growth was between -1.5% and 5.7% in the same period. Agricultural production in Uganda is mainly by small-scale subsistence farmers, whose participation in the production of cash crops is highly sensitive to food security considerations and budget constraints. Overall growth in the agriculture sector has been positive in the past two fiscal years (FY2008/09 and FY2008/07), reaching on average 3% compared to a marginal decline of 0.3% in the preceding five years.

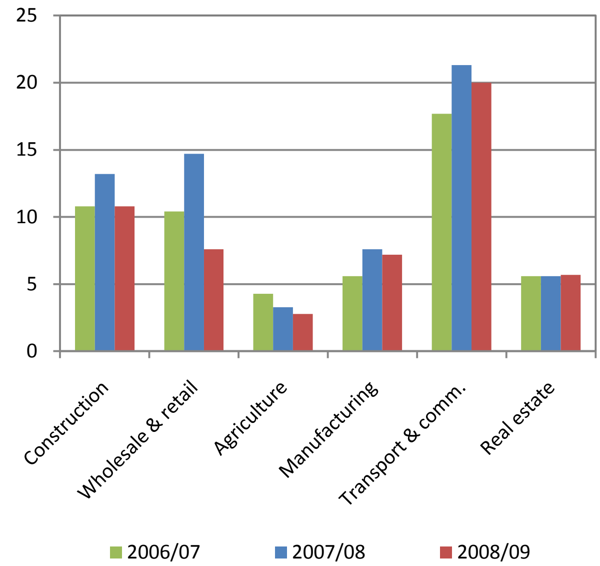
As stated above, construction is the largest industrial sub-sector in the Ugandan economy. This sector has known double-digit growth for most of the latter part of the decade; however, growth was severely impaired in FY2008/09 as capital expenditure programmes (largely of foreign investors) were postponed or even cancelled. The second largest industrial sub-sector is manufacturing, which contributes 6.7% to real GDP. Growth in this sector was on average 6.5% in the past decade, continuing to strong growth performance in FY 2008/09 at 7.2% year on year. Continued constraints in the provision of electricity as well as tight credit supply are limitations to the performance of this sector, believed to be producing far below its potential. Electricity production capacity is estimated at 355 megawatts (MW), which is substantially lower than that of Tanzania (1 310 MW) and Kenya (940 MW). Its contribution to GDP is tiny: 0.9%. The generation of hydropower continued to be supplemented with thermal power in 2009. The prospect of thermal power generation using locally produced (heavy fuel) oil and diesel bodes well for this sector in 2010, while the completion of the Bujagali hydropower project (250 MW) in 2011 and inception of the Karuma hydropower project (700 MW) further support performance in the medium term. Mini-hydropower stations are to add 40MW to power-generation capacity in the short term.

Mining and quarrying is currently a small sector forming only 0.3% of GDP; growth was strong in FY2008/09; 9.2%. New geophysical data on minerals prevalent in Uganda obtained through airborne surveys that started at the end of 2006 was released in 2009. These surveys identified the occurrence of various metallic and industrial minerals. Identified metals include gold, copper, columbite tantalite and tin (cassiterite). The occurrence of the following industrial minerals was confirmed; clay, limestone, mica, talc, vermiculite and granite gneiss. Increased activity in mining exploration is visible in the number of licences issued; this number increased from 220 in 2004 to 498 as of 30 June 2009. Production of, for example, vermiculite (used in the production of heat-resistant piping or insulation material) will start in 2010. Exploration in the Lake Albert Rift Basin also contributed to the improved performance in this sector.

The aggregate of the services sector constitutes over half of the economy, of which wholesale and retail trade, and repairs form the largest share; 13.8% of real GDP. The services industry grew by 9.4% in FY2008/09, following growth of 10.2% in the preceding fiscal year. Telecommunications is the strongest growing sub-sector and has been for most of the past decade; its contribution to GDP has grown from 0.7% in 2001 to approximately 4% in 2009. The challenge for operators in this space will be to increase or at least maintain the average revenue per user while continuing to expand their customer base. The mobile subscriber base has shown exceptional expansion in the past year. It is believed to have almost doubled between March 2008 and March 2009 reaching over 11 million (or 30% of the population).

Financial services was the second-best performing sector in the previous fiscal year, growing at 21.1%. Its contribution to GDP remains small: 2.6% of real GDP in FY2008/09. High levels of growth in the services industry are further supported by road, rail, and water transport, which grew at 12.4%. The state of infrastructure continues to be of concern; however, increased investment in improving the road network is beginning to bear fruit. The transport sector remains relatively small, contributing 3.4% to real GDP. Real estate activities contribute a significant share to GDP, namely 7% in FY2008/09. This sector has shown consistent growth of 5.5% over the past decade.

Figure 2: Real growth of largest sectors



Sources: Bank of Uganda, Standard Bank

Domestic expenditure

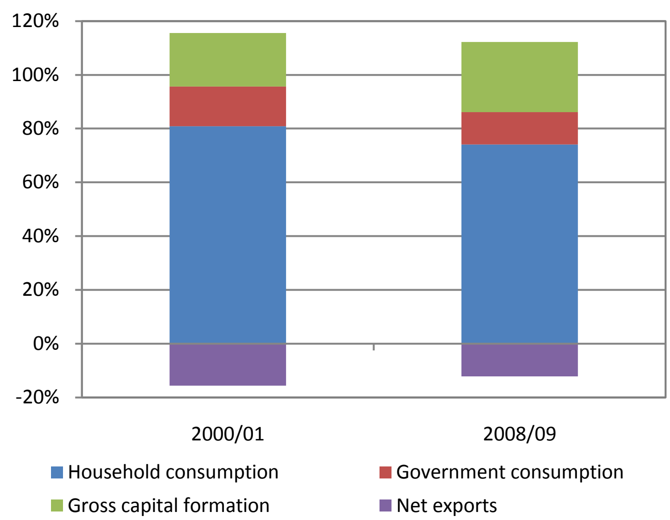
Gross domestic expenditure (GDE) continues to be larger that GDP, with the difference between the two widening in FY2008/09 as growth in imports outpaced that of exports. This development is mainly on the back of growing fixed capital formation. Its contribution to GDP was 11% in FY2000/01 compared to 26% in the fiscal year that ended in June 2009. Government increased its contribution to fixed investment as it almost doubled its development expenditure, encompassing large-scale investment in energy and transport infrastructure in the past fiscal year. Government development expenditure increased from UShs1 333 billion in FY2007/08 to an estimated UShs2 613 billion in FY2008/09. Expenditure is set to rise by another third in the current fiscal year. The government has in past fiscal years been unable to fully deliver on its expenditure commitments due to capacity constraints.

In December 2009, the IMF estimated that in FY2008/09 development expenditure fell UShs700 billion short of its target, more recent government estimates indicate that development expenditure was UShs100 billion below the approved amount. Government consumption expenditure has stabilised at slightly above 10% of GDP, as government aims to use increased revenue collection and debt financing for capital expenditure.

Private investment was bolstered by positive results in oil exploration activities by foreign companies, as well as improved availability of geological information regarding mineral deposits. Foreign direct investment (FDI) was equal to one fifth of gross fixed capital formation in 2008, totalling US$787 million. Direct investment from abroad in the first three quarters of 2009 was equal to US$390 million; the annual figure for 2009 is expected to remain below US$700 million despite inflows increasing towards the end of the year.

Capital expenditure on exploration activities in Lake Albert is believed to have contributed a large share of these FDI flows in 2009. Investment in exploration and appraisal in the Ghanaian and Ugandan oil sector by Tullow alone was to equal £500 million (approximately US$785 million) in 2009. Tullow Oil has found hydrocarbons in 26 out of 27 wells drilled so far (of nine in 2009) in the Lake Albert Rift Basin. Commercial development of oil reserves in the short to medium term, as well as the return of foreign investors to other sectors of the economy in 2010 will induce increased inflows of FDI.

Figure 3: Structure of GDP by expenditure (% of GDP at constant prices)



Sources: IMF, Standard Bank

Private investment has, in addition to mining, benefited the transport; information communication and technology; manufacturing and financial intermediation sectors. The Uganda Investment Authority (UIA) reportedly licensed 334 projects in the financial year ending in June 2009, with an estimated value of US$2.6 billion. The last quarter of that fiscal year saw 65 projects valued at US$415 million being licensed, compared to 83 projects in the preceding quarter worth an estimated US$223.4 million. While a large portion of these investments are made by locals, the United Kingdom, China, India, Nigeria and Kenya are reported to be Uganda's main sources of FDI. The UIA hopes to attract $3 billion in foreign and domestic investment in 2010 following growth in the construction, food processing and ICT industries. Its strategy includes the creation of industrial parks such as the recently opened Kampala Industrial and Business Park (KIBP) at Namanve. The park aims to attract 230 investors in agro-processing, ICT (including business process outsourcing), mineral beneficiation and the hotel industry: a total investment of US$2.7 billion. The UIA has been mandated to set up 22 industrial parks with a minimum of four new parks every financial year. Kasese, Kabale and Masaka in the west and Arua in the north have been identified as destinations for industrial parks to be created in FY2009/10. The success of this strategy hinges on linking these locations to the necessary (soft and hard) infrastructure.

Household consumption expenditure continues to constitute the largest share of GDP: 74% in FY 2008/09. Growth of household consumption rebounded after it declined to 5.2% in FY2007/08 from 9.4% a year earlier, reaching 10.5%; despite relatively poor performance in the agricultural sector (which provides an income to over half of the households in Uganda) in FY2008/09 and increasing consumer inflation in the middle of this fiscal year. While the agricultural sector did not do well, the production of food crops improved compared to the previous year (with the performance in cash crops declining sharply). This allows households to increase spending on consumption goods. Household consumption is likely to have been further supported by the increased development expenditure by the government, as well as the delayed proceeds from exceptional performance in the production of cash crops in the previous year.

The negative contribution net exports (exports minus imports) to GDE widened in FY2008/09 to -12.4%, from -10.1% FY 2007/08, as the growth in imports outpaced growth in exports over this period. This mainly reflects continued growth in private fixed investment necessitating the importation of machinery equipment, vehicles, mineral products and chemical (and related) products, which swelled the import bill. Oil constitutes approximately 10% of total imports.

Monetary policy

The previous year presented substantial challenges to the implementation of monetary policy as Uganda faced internal and external shocks affecting the aim of achieving low and stable inflation. The central bank of Uganda uses Net Domestic Assets (NDA) as an interim operating target with base money forming the indicative target for the purpose of controlling inflation.

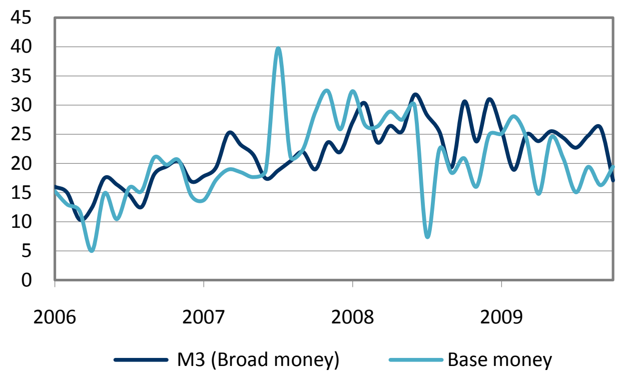
The formal targets for monetary policy in FY2008/09 were initially aimed at curbing the second-round effects of exogenous shocks to food prices, as well as transport costs, broad money (M2), which comprises the amount of currency in circulation, private sector demand, and time and savings deposits, was set to expand by 18% supported by private sector credit extension growth of 26.4%. Broad money, however, increased by 25.7%, while credit to the private sector increased by 29.8% in the 12 months to June 2009. The strong growth of this monetary aggregate was mainly on the back of increased time and savings deposits, which grew by 38.7% in FY2008/09. This increase in deposits is associated with increased mobilisation efforts by the banking sector and an increase in the number of operational banks in this period (from 16 in June 2008 to 21 in June 2009).

Monetary aggregate growth slowed in the third quarter of 2009, reaching 24.3% y/y (M2). This decline in growth was mainly due to the decline in base money related to fiscal consolidation. Private sector credit growth slowed substantially to 18% y/y at the end of the third quarter of 2009 compared to 52.8% a year earlier. This decline in the extension of credit to the private sector is not only a reflection of tight credit conditions, but also of subdued aggregate demand at the end of 2009.

Money supply (M3), the sum of net domestic and foreign assets, grew at a similar pace reaching 24.1% in FY2008/09. Growth in net foreign assets constituted over 50.7% of growth in M3. Growth in M3 has accelerated recently reaching 26.1% on an annual basis in the quarter ended in September 2009. This was mainly attributed to an increase in net foreign assets (NFA) held by the Bank of Uganda in the form of reserves. Uganda was allocated a total of SDR1 43.7 million (approximately US$225 million) by the IMF in the form of Special Drawing Rights (SDR) in August and September 2009.

The Bank of Uganda aims to reduce inflation to 7.5% by June 2010, and has set the following targets for monetary aggregates to achieve this: broad money growth of 21.2% and reserve money growth of 21%. In doing so, the Bank aims to accumulate an additional US$288 million in net international reserves and a cumulative change in net domestic assets (NDA) of USh288 billion.

Figure 4: Money supply growth (% y/y)



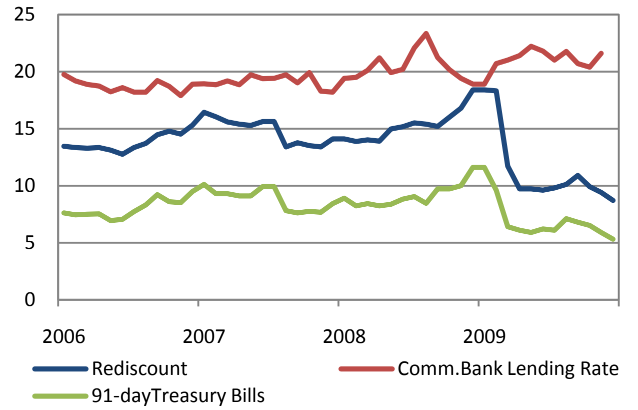
Source: Bank of Uganda

In the third quarter of 2009, the BoU adopted a “flexible implementation of the reserve money program”, which entails the use of (reverse) repurchase agreements (repos) to manage short-term liquidity variations, while allowing the use of auctions of Treasury bills and bonds to accommodate more structural liquidity requirements. This has been found to reduce the volatility of interest rates.

Interest rates increased in FY2008/09 as monetary policy tightened, peaking at the beginning of 2009, with the rediscount rate reaching 18.4% and the 91-day T-bill yield 11.6% in January 2009. Both rates generally followed a declining trend since the end of the first quarter of 2009 (rising slightly in August/September), as the decline in inflation allowed for a more expansive monetary policy stance. The rediscount rate stood at 8.11% in early February 2010; the yield on 91-day T-bills was as low as 4.5% in the same month.

The newly appointed deputy governor, Dr. Louis Kasekende, recently revealed in an interview that the BoU will continue using its instruments to keep interest rates low to induce banks to increase lending to the private sector. In the same interview, the deputy governor referred to the Bank’s preference for a weaker shilling, which is supportive of exports.

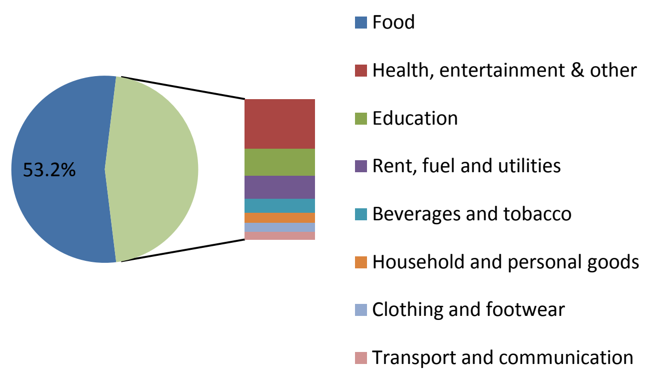
Figure 5: Interest rates (% per annum)



Source: Bank of Uganda

The BoU increased its interventions in this market to maintain stability in the foreign exchange market as offshore investors reversed their positions on the Ugandan Stock Exchange (USE) and retreated from investing in government securities at the end of 2008 and the beginning of 2009 causing the currency to depreciate sharply. The BoU interventions amounted to net sales of US$235.2 million in FY2008/09 compared to a net purchase of US$74.9 million in the previous year. The currency, however, showed increasing strength in the past year as the global search for yield recommenced and risk aversion declined.

Figure 6: Food’s contribution to consumer price inflation in 2009



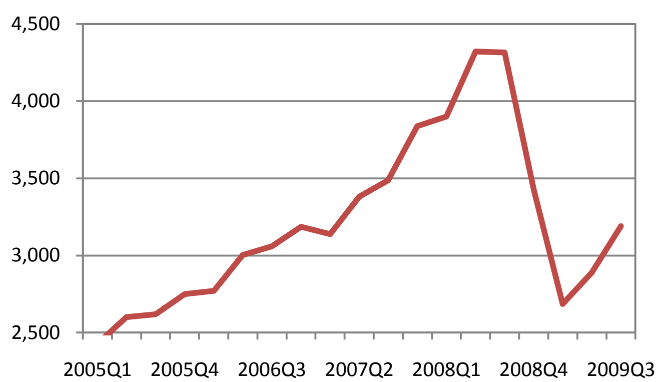
Sources: Uganda Bureau of Statistics, Standard Bank

Monetary targets for FY2009/10 are aimed at facilitating the gradual reduction of core inflation (which excludes food, rent, fuel and utilities) to the target level of 8%, allowing for a further decline to 5% in the next fiscal year. Core inflation declined to on average 8.3% in 2009 from 8.8% in 2008. Overall consumer inflation increased from on average 12% in 2008 to 12.9% in 2009, mainly on the back of high food inflation, which was equal to 25.3% in 2009 compared to 19.8% in the previous year. Food inflation contributed 53% to inflation in the past year compared to 45% in the previous year. The second-largest contributor to inflation was the health and entertainment sector: 16% of inflation in 2009 was due to increasing prices in this sector. Year-on-year inflation in the category was on average equal to 11% in 2009, while in 2008 inflation in this sector was substantially lower at 6.8%.

International trade

As the crisis unfolded in the fourth quarter of 2008, global trade reversed its upward trend in dramatic fashion. Global exports decreased by 21% in the last quarter of 2008 after stagnating in the previous quarter. Global trade fell further at the beginning of 2009 to levels previously known at the beginning of 2006. Recent trade figures coming out of China show that it surpassed Germany in January to October 2009 to become the world's biggest exporter. Similarly, import growth showed significant improvement when it surged to 55.9% y/y in December, from 26.7% y/y in November. Chinese import growth holds greater significance for exporters around the world as it implies that China's appetite for the rest of the world's goods and services has made a strong return.

Figure 7: World merchandise imports (US$ billions)



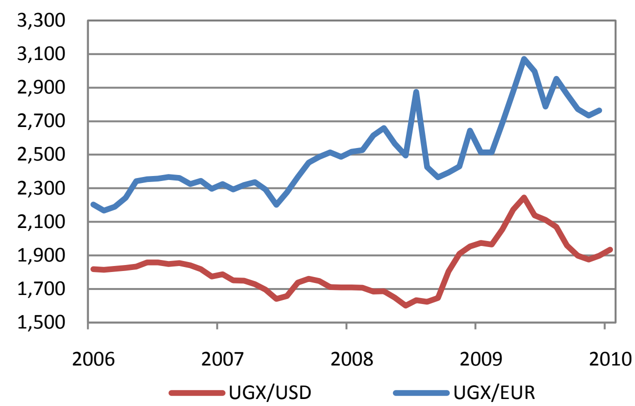
Source: World Trade Organisation

As global demand plummeted, so did prices of various industrial metals and minerals. These recovered to some extent on the eve of the return to growth (albeit subdued in most advanced economies) in the second half of 2009. Breakfast commodities, such as tea and Arabica coffee prices made a strong comeback in 2009 reaching new highs towards the end of the year. Prices of Arabica and tea are, however, expected to decline gradually in 2010 and 2011. According to the World Bank, tea prices in 2010 are expected to average 230 dollar cents/kg from US$272 dollar cents/kg during 2009 (average of Colombo, Kolkata and Mombasa auctions). Global Arabica and Robusta coffee prices during 2009 were 30% higher and 12% lower than their respective 2008 averages of $3.17/kg and $1.64/kg. Arabica prices are expected to drop to US$2.7/kg in 2010, while the average price of Robusta coffee is expected to reach US$1.78/kg. Uganda's exports are predominantly of Robusta coffee; however, estimations by the Ugandan Coffee Development Authority (UCDA) are that the relative share of Arabica coffee is increasing thus allowing producers to take advantage of the higher prices.

External sector

The Ugandan shilling continued to show strong depreciation in the first half of 2009, following the onset of the global financial crisis in the third quarter of 2008. After depreciating by 18.7% against the US dollar in the last quarter of 2008, to UGX1 954.31/USD, the currency declined another 14.9% in value against the dollar in the first five months of 2009, to an average of UGX2 245.6/USD in May. As the global financial system regained stability in the second half of 2009, risk aversion declined allowing portfolio inflows to resume. The currency regained some of its value in this period, appreciating to on average UGX1 875/USD in November 2009, before resuming a depreciating trend at the end of last year into the beginning of this year. This aligns with the statements made by the deputy governor, in which he said the BoU has a preference for a competitive exchange rate.

Figure 8: Ugandan shilling exchange rate

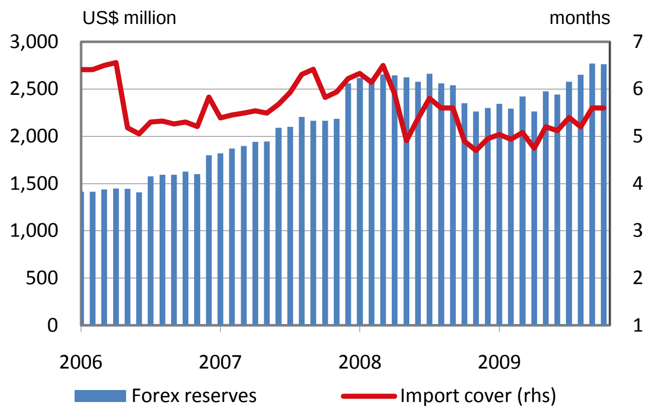


Source: Bloomberg, Standard Bank

The net outflow of portfolio liabilities on the balance of payment (BoP) led to a decline of the surplus on the capital and financial account in FY2008/09 from US$1 203 million in the previous year to US$1 045 million. This as offshore investors retreated from the Ugandan securities market. The decline in the surplus on the capital and financial account together with widening deficits in the current account led to an overall deficit on the BoP amounting to an estimated US$179.5 million in the previous fiscal year (1.5% of GDP). This is the first time Uganda has had a negative balance since FY2000/01. As a result, gross reserves decreased by approximately US$63.9 million (excluding revaluation) compared to an increase in reserves in the previous fiscal year of US$538.9 million. Reserves reached their lowest point of the year in April 2009, amounting to US$2 261.8 million or 4.75 months of imports of goods and services. Since then reserves have recovered to over 5.5 months of imports, supported by the allocation of Special Drawing Rights (SDRs) of approximately US$225 million by the IMF in the third quarter of 2009. The most recent report shows that total external reserves stood at US$2 761.7 million in October 2009.

The deficit on the trade balance widened to US$936 million at the end of FY2008/09, from US$913.5 million in the previous year, as growth in exports was insufficient to close the gap. Exports performed well despite the global financial crisis increasing by 18.9% over the past fiscal year. The increase in exports was largely attributable to increased Informal Cross Border Trade (ICBT). It must be noted that the rise in ICBT shown in numbers published by the Ugandan Revenue Authority (URA) reflect potential improvements in the *measurement* of informal trade rather than actual increased trade to some extent. Considering developments in the region it is safe to say that conditions in the west of DRC and south Sudan have become more conducive to trade. This, as well as the regional shortage of food, supports the notion that regional (informal) trade did indeed increase in 2009.

Figure 9: Gross foreign exchange reserves



Source: Bank of Uganda

ICBT constituted 56% of total exports of goods in the year ended September 2009. The share of informal trade increased markedly since September 2008 when it stood at less than a third of total exports in the preceding quarter compared to close to 60% in the third quarter of 2009 (the most recent quarter for which data is available). The value of informal trade peaked in May 2009, reaching approximately US$234 million in a single month. Competition from other African countries, such as Kenya, that are keen to serve the southern Sudan market could potentially limit further exports from Uganda to the region. Domestic production capacity is also increasing in southern Sudan; this together with an increased retail presence is also likely to reduce demand from Uganda.

The Minister of Finance stated in his budget speech for FY2009/10 that 70% of exports to the region are manufactured goods. This is a notable development in light of an export-driven strategy that could drive Uganda's economic performance. Countries of the Common Market for Eastern and Southern Africa (COMESA) overtook the European Union (EU) as the most important destination for formal exports from Uganda in 2007. The share of formal exports to COMESA increased from 28% in 2006 to 47% in 2008, reducing its dependence on traditional partners and traditional products. Coffee formed approximately 10% of exports in FY2008/09 compared to over 50% 10 years ago.

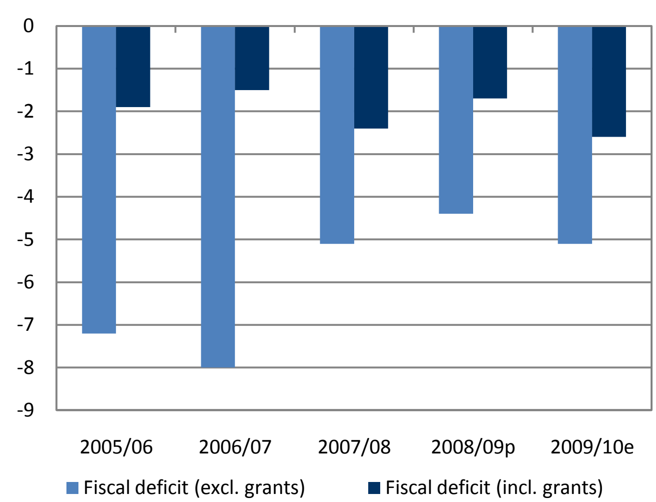
Imports continued to grow in 2009 on the back of private investment requiring machinery equipment and industrial materials from foreign markets. Growth in imports was equal to 14.6% in the year ended June 2009, with the total import bill amounting to US$4 021.6 million (freight on board). Government imports are less than 5% of the total import bill, increasing from US$176 million in FY2007/08 to US$199 million in FY2008/09. The value of oil imports, which constitute 13% of total imports, declined to US$537 million as the international price of oil subsided.

As mentioned earlier, the services and income account balance deteriorated further, mainly as a result of increased outflows of services, with the deficit reaching US$1 553 million in FY2008/09. Net current transfers remained at levels similar to those of the previous year; however, the composition changed as transfers to the government decreased by 5.8% while private transfers increased by 9.6%. Contrary to popular belief, remittances by private workers to Uganda seem to have continued to increase despite the global turndown, reaching US$745 million in FY2008/09 compared to US$546 million and US$460.05 million in FY2007/08 and FY2006/07 respectively. This could be related to the manner in which transfers are captured on the balance of payments. The transfers could include net premiums and claims on non-life insurance, pensions receivable from foreign governments or scholarships for education.

Public and external solvency indicators

In line with the developmental trend set in the 2008/09 budget, the current budget continues to direct resources towards transport and communication infrastructure as encompassed in the theme 'Enhancing Strategic Interventions to Improve Business Climate and Revitalize Production to Achieve Prosperity for All'. Development expenditure was set to rise from 7.7% of GDP in the previous fiscal year to 8.6% of GDP in FY2009/10.

Figure 9: Budget balance (% of GDP)



Sources: IMF, Standard Bank

Preliminary results for FY2008/09 show that expenditure fell short of the target, reaching an estimated 16.9% of GDP. Tax revenue, on the other hand, was on target at 11.9% of GDP, grants are, however, expected to fall slightly short of the target, reaching 2.6% of GDP rather than the budgeted 3.2%. The overall balance for FY2008/09 is therefore expected to be lower than anticipated in the budgeting process, reaching -1.7% (including grants) and -4.4% (excluding grants), according to estimates produced in conjunction with the IMF under the Policy Support Instrument (PSI) review in October 2009.

Donor partners and development finance institutions continued to provide much-needed budget support in the past fiscal year as the scope for domestic financing was constrained by lack of liquidity in markets. Donor disbursements of project grants were below target thus limiting the execution of externally financed projects. Only Ush257 million of the budgeted Ush738.3 million for project grants is estimated to have been received. Budget support exceeded the budgeted amount of Ush494.9 million by Ush30 million, helping to support government spending. The overall budget deficit was financed by additional credit from external sources, mainly in the form of project loans on concessional terms. The planned domestic financing of Ush295.8 million did not materialise.

Uganda has a modest level of external debt following debt relief received under the Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) programmes earlier this decade. Uganda's domestic and external debts were estimated to be 8.4% and 15.9% of GDP respectively at the end of FY2008/09 from 10.7% and 12.3% in FY2007/08. It is estimated that domestic debt will decline further to 6.7% of GDP in FY2009/10. External debt is also set to be reduced temporarily in this fiscal year; however, financing needs brought about by the infrastructural development plan are set to put pressure on external financing. Debt levels risk becoming unsustainable if the government is not able to access (semi) concessional resources to finance its developmental expenditure. The government recently announced it will finance the Karuma hydropower project itself as it was unable to find private investors to invest US$1.3 billion in the project, which is set to be completed in 2014. This commitment adds to the burden of an already ambitious energy, communication and transport investment plan.

The ambitious road development and maintenance development plan requires on average over US$560 million per annum for the periods FY2010/11 and FY2014/15. The World Bank approved a US$190 million loan on concessional terms in support of the Road Development and Maintenance Plan in the period FY2010/11 – FY2013/14. The United Kingdom's Department for International Development (DFID) will provide an additional US$8 million grant in support of the overall Transport Sector Master Plan over a four-year period. Additional support is expected from the European Union through the European Development Fund (EDF) and the African Development Bank, as well as various other bilateral development partners. The government will, however, need to finance about two thirds of expenditure on road development and maintenance in the current fiscal year.

National policy assumptions and the international environment

The government's medium-term macroeconomic policies and expenditure programmes are informed by the 2004 Poverty Eradication Action Plan (PEAP), the National Resistance Movement (NRM) 2006 Election Manifesto, and various policies and strategies at sector level. Uganda's long-term national vision is described in the Vision 2025 document that encompasses the central theme of a 'Prosperous people, harmonious nation and beautiful country'. A National Development Plan is expected to be released in 2010; this will accommodate the absence of an updated PEAP as its second revision expired at the end of FY2007/08. The 2004/05-2007/08 PEAP addressed the following challenges: (i) consolidating national security, reducing regional inequity and addressing the consequences of conflict; (ii) restoring sustainable income growth for the poor; (iii) building strong social and economic infrastructure; (iv) enhancing human development; and (v) using public resources efficiently.

The National Development Plan (NDP) will set national development goals of growth, employment and prosperity for FY2010/11-2014/15. In this, Uganda is moving past an attempt to reduce poverty to that of the generation of wealth. The plan prioritises the following (i) restoration of agricultural growth; (ii) infrastructural development; (iii) increasing efficiency and effectiveness of government expenditure; (iv) rebalancing of public expenditure between social and productive sectors; (v) employment creation; (vi) strategic government intervention in the private sector through sectoral incentives; and, last but certainly not least (vii) the adoption and implementation of a policy framework for the exploitation and use of oil revenues. The latter is important if Uganda is to avoid the symptoms of "Dutch disease" that could follow from exports of oil in the future, while ensuring transparency and accountability in revenue receipts from oil as well as their expenditure.

The second goal of the NDP is to be elaborated on in the National Transport Master Plan (NTMP), which covers the 15-year period between 2008 and 2023. This plan outlines ambitious plans to improve and expand the road, rail and waterway transport network, as well as establish an advanced information, communication and technology (ICT) infrastructure. The transport network is aimed at improving the link to the east of the Democratic Republic of Congo, south Sudan and the ports of Dar-es-Salaam and Mombasa. The ICT network includes the completion of phase 2 of the National Data Transmission Backbone that will extend the reach of the undersea fibre optic data cable, which shored in Kenya and Tanzania in 2009, to the private and public sectors beyond Kampala, Entebbe, Bombo and Jinja. This project was the centre of corruption allegations in 2009 with regard to the US$106 million contract that was allocated to China's Huawei Technologies, using a loan from China's Exim Bank.

Other sector policies include the National Industrial Policy, approved in January 2008. Uganda aims to (i) increase the share of value added by this industry to GDP from its current level of 24% to 30%; (ii) increase the share of manufactured exports to total exports to 30%; and (iii) increase its global competitiveness score as produced by the World Economic Forum to 4.2 within 10 years of implementation of the industrial policy. Uganda reached position 108 out of the 133 countries ranked in the 2009/10 report, an improvement from 128 in

Figure 10: Road infrastructure development programme

Sources: Uganda National Roads Authority

2008/09. A score of 4.2 would put Uganda on par with Panama and Mexico, which had scores of 4.21 and 4.19 respectively in 2009/10. While an absolute improvement in Uganda's score would be commendable, it is its position to countries such as Panama and Mexico in the next 10 years that is relevant. The industrial policy broadly identifies resource based, agro-processing, knowledge based word/s missing and engineering for capital goods as industries as the principal focus.

Presidential and parliamentary elections are scheduled to take place in the first quarter of 2011, for which the NRM will prepare its revised manifesto. The NRM is expected to dominate these elections as it did those held in 2006 in which it won 191 out of 284 seats in parliament (67%). The NRM's presidential candidate, Yoweri Museveni, won 59% of votes in those elections extending the duration of his rule to 20 years. The NRM is not likely to deviate far from the central theme it used for the 2006 elections of "Prosperity for All", thus continuing to emphasise the need to translate growth that has in the past helped to reduce poverty into increased employment and access to services for Ugandans.

On the monetary policy front, the central bank aims to move to an inflation-targeting policy in the medium to long term. The current framework, in which broad money acts as an intermediate target for monetary policy, causes interest rates to be more volatile resulting from the fact that money demand is not stable. The monetary authority has therefore revised its monetary policy operating procedures to allow for more frequent evaluation of broad money targets and more active intervention in the money market using (reverse) repurchase agreements.

International environment

The close of 2009 signalled the end of the global economic recession. The global economy shrank by 0.8% in 2009, following growth of 3% in 2008. The advanced economies were by far the worst affected by the recession; the collective of economies contracted by 3.2% in 2009. Of these economies, Japan, the Euro area and the United Kingdom were the hardest hit by the global financial and economic crisis. Conversely, emerging and developing economies showed positive growth of 2.1% in 2009, albeit significantly slower than the buoyant 6.1% in 2008.

Table 1: Global economic outlook

Real GDP growth (year-on-year)				
	2008	2009	2010f	2011f
World	3.0			
Advanced economies	0.5	-3.2	2.1	2.4
United States	0.4	-2.5	2.7	2.4
Euro-zone	-0..6	-3.9	1.0	1.6
United Kingdom	0.5	-4.8	1.3	2.7
Japan	-1.2	-5.3	1.7	2.2
Emerging and developing economies	6.1	2.1	6.0	6.3
China	9.6	8.7	10.0	9.7
India	7.3	5.6	7.7	7.8
Brazil	5.1	-0.4	4.7	3.7
Russia	5.6	-9.0	3.6	3.4
Africa	5.2	1.9	4.3	5.3
Sub-Sahara	5.6	1.6	4.3	5.5
Developing Asia	7.9	6.5	8.4	8.4

f = forecast. Source: IMF

Of the BRIC economies, Russia and Brazil were the laggard performers, with negative growth rates of 9% and 0.4% respectively in 2009. China and India's economies were a lot more resilient to the recession than expected. China's economy exhibited growth of 8.7% in 2009, which is less than a percentage point lower than its growth rate for 2008. On the contrary, Africa's real economy was pummelled by the global economic slump and, in particular, the collapse in global trade. As a result, economic growth slowed to 1.9% in 2009, from 5.2% in 2008.

The resilience of emerging and developing economies partly explains the bounce back in economic performance projected for 2010. The world economy is expected to grow at 3.9% in 2010, which is even stronger than its 2008 growth performance. This strong projection is largely based on an expectation that the advanced economies will exhibit a strong recovery in 2010, with a growth rate of 2.1%. However, increasing concerns about a double-dip recovery, party due to the rising risk of sovereign debt defaults, could mute the strength of the recovery. Stronger advanced economies are positive for providing a lift to consumer spending, which is supportive of a recovery in export-led emerging economies that will, in turn, support a recovery in demand for Africa's commodities.

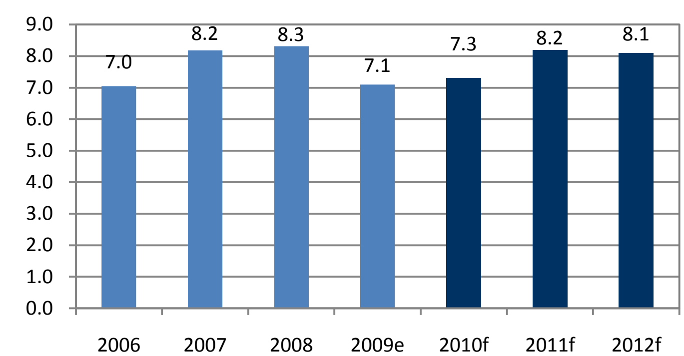
Higher commodity prices and an increase in economic activity are expected to spur an increase in inflation in 2010. Average inflation in the advanced economies is thus projected to increase to 1.3% in 2010, from 0.1% in 2009, while that of emerging and developing world is expected to increase from 5.2% to 6.2%.

Forecast summary

Domestic expenditure

Economic growth in Uganda is projected to increase to 7.3% in 2010. GDP growth is believed to have slowed to 7.1% in 2009 on the back of slowing domestic investment slowed in the midst of uncertainty about the effect of the global economic crisis. Uganda's growth is expected to increase over the medium term as the resource sector attracts investment (mainly oil), while improvements to transport and the electricity generation infrastructure begin to show positive results for agriculture and industry. The oil industry is expected to attract substantial fixed capital expenditure following the prospects of further discoveries as well as the commercial production of proven reserves in the hands of Tullow Oil. Private investment in construction, and to a lesser extent machinery and equipment, is expected to continue although at a slower pace, providing further impetus to growth. Strong demand from the region for Ugandan goods will continue to support growth of the external sector with demand from advanced economies providing further support.

Figure 8: Real GDP growth (%)



Sources: IMF, Standard Bank

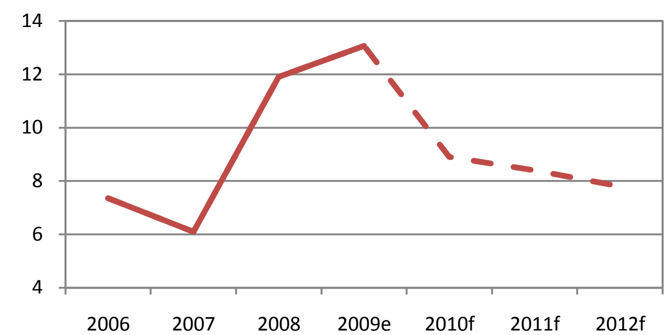
Household consumption expenditure is heavily dependent on the performance of the agricultural sector, which provides a livelihood to close to two thirds of households. Weather conditions continue to cause volatility in this sector in the region. It is welcome that the government has moved to decrease the dependency of this sector on manual labour and the vulnerability of production to disease while improving water management in rural areas. Higher international prices for tea and coffee are likely to incentivise increased production in the coming season. While an inflationary environment negatively affected household consumption in 2009, generally lower prices in 2010 are likely to support consumption.

On the public investment front, the government's expenditure on energy and transport infrastructure will peak in the medium term as the growth plans for public investment in hydropower and the expansion and improvement of the road network take effect. Absorptive capacity of the public sector in executing its development plans continues to present a risk to the contribution of public fixed investment. Growth in government consumption expenditure is likely to continue to be moderate. The elections in March 2011 could provide impetus to higher consumption expenditure towards the end of this year as the electoral process unfolds.

Monetary policy

Inflation continues to be sensitive to weather conditions and the supply of food in the region. Regional demand for Uganda's agricultural products will continue to pose a risk to the price of food in Uganda. Improved rains in the beginning of 2010 bode well for an increase in food supply in neighbouring Tanzania and Kenya. While food inflation has declined over the past year it is expected to remain in the double digits this year, keeping the inflation rate above the central bank's target of 7.5% for June 2010. Non-food inflation is also set to face continued pressure from expenditure related to private and public investment. On the other hand, the prospect of oil prices remaining far below the peak experienced in the recent past bodes well for low inflation in the fuel and transport categories. Annual inflation is expected to average 8.9% in 2010 declining over the medium term, assuming the absence of exogenous shocks in the form of drought.

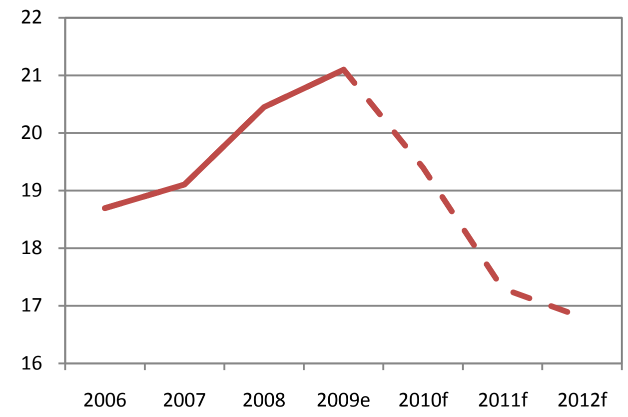
Figure 9: Consumer price inflation (%, annual average)



Sources: Uganda Bureau of Statistics, Standard Bank

As foreign exchange inflows are expected to rise in 2010 on the back of private investment, as well as increased government investment (particularly in the next fiscal year), net foreign assets are expected to increase and thus monetary growth is projected to increase. Under the central bank's new operating procedures it is likely to use repos and foreign exchange sales to control short-term increases in liquidity that are deemed undesirable. Following the expectation of a lower inflationary environment in 2010, the central bank is likely to lean towards a more accommodative monetary policy stance as a means of stimulating private sector credit extension. The weighted average lending rate is therefore expected to moderate to an annual average of 19.4% in 2010, from 21.1% in 2009, supported by central bank initiatives to lower yields on government securities and improve legislation in the areas of property rights, collateral registries and contract enforcement.

Figure 10: Interest rates (%, annual average)

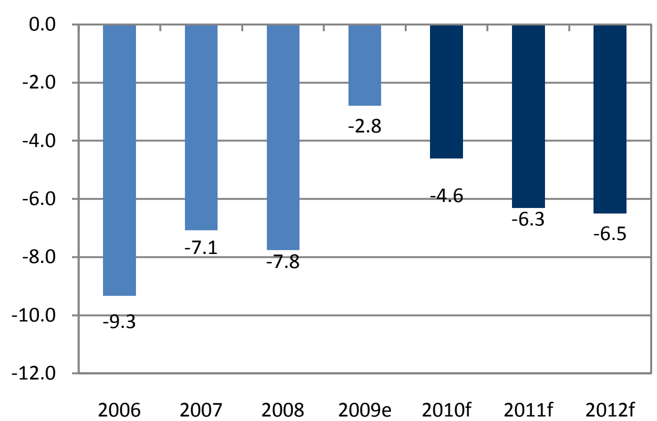


Sources: Bank of Uganda, Standard Bank

External sector

Uganda's terms of trade are expected to deteriorate in 2010, largely on account of higher oil prices, as well as high input prices for construction and capital expenditure against lower prices for traditional exports (coffee). Strong regional demand for Uganda's manufacturing and agricultural products will, however, provide support to the price of exports. Nominal export earnings are projected to grow by more than 10% in 2010, on account of improved global demand as well as demand from the region. The growth in the nominal import bill is expected to accelerate to close to 25% in 2010, from a relatively flat 2009 in dollar terms. This increase in imports related to projects like the construction of roads and hydroelectric power stations, oil exploration and exploitation. and continued investment of the services sector in the private sector. The growth in imports is projected to contribute to a wider trade deficit of 4.6% of GDP in 2010, compared to 2.8% in 2009.

Figure 11: Trade balance (% of GDP)

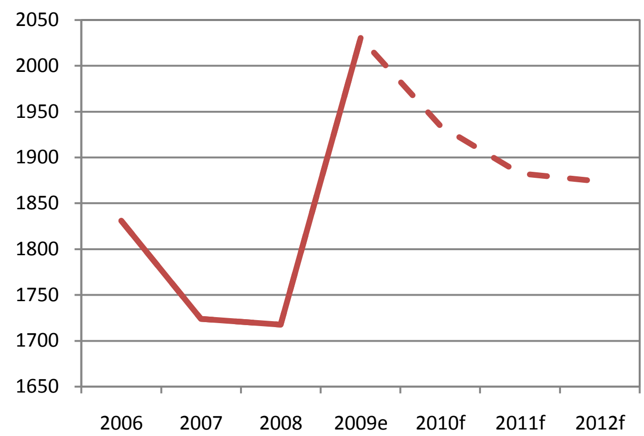


Sources: IMF, Standard Bank

With the deficit on the services and income accounts remaining relatively unchanged in 2009, and current transfers seeming to have surprisingly remained relatively unscathed in 2009, the slowdown of imports in conjunction with strong export performance has led to a decline in the current account deficit in 2009. As imports gather momentum in 2010, the current account deficit is expected to expand.

While the capital and financial account typically finances the current account deficit, the reversal of capital flows, tighter credit conditions and the flight to safety led to a deficit on the balance of payments for the first time in a decade in the second quarter of FY2008/09. Amid continued constrained circumstances, Uganda warmly welcomed support in the form of SDR allocations by the IMF, which helped to support the BoP in the third quarter of 2009. However, the return of portfolio flows to Uganda in light of decreased risk aversion in global financial markets, continued buoyant FDI and improved availability of other forms of international finance will ensure that the current account deficit receives sufficient cover in 2010. These stronger fundamentals are positive for the Ugandan shilling, which is projected to appreciate slightly to an annual average exchange rate of UGX1 934/USD in 2010, from UGX2 030/USD in 2009. The appreciation pressure that would emerge from increased inflows of capital to Uganda in 2010 is expected to be managed by the central bank, following its expressed preference for a weaker currency.

Figure 12: Exchange rate, UGX/USD (annual average)



Sources: Bloomberg, Standard Bank

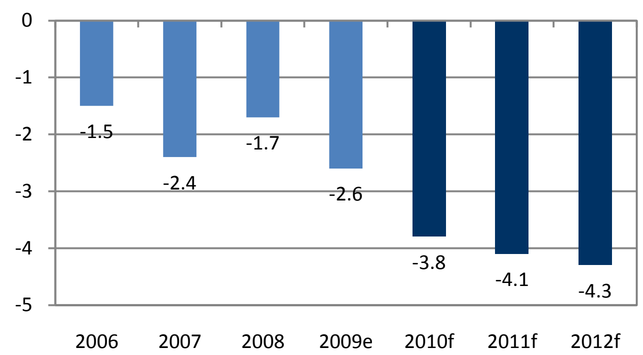
As the foreign exchange inflows improved in 2009, international reserves resumed their upward trend, returning to the regionally high import cover of 5.6 months, from the lows of 4.7 months in November 2008. Given the improved fundamentals in the external sector, the central bank is likely to continue to hold a strong reserves position that will allow it to counter appreciation pressures. The reserve position is expected to at least maintain a level of five months of import cover.

Public and external solvency

While the Ugandan Revenue Authority continues its efforts to increase domestic revenue; the scale of budget support and project grants provided by development partners is expected to diminish over the medium term. Grants have in the past formed an important source of income for the government and keeping the budget deficit below 3%. As this form of income decreases, the government o is expected to increasingly rely on external lending to finance its development expenditure. Uncertainty around the availability of foreign concessional financing has therefore limited the scope of fiscal expenditure plans. Mobilisation of domestic revenue has been constrained further by the implementation of the East African Community (EAC) Customs Union, which requires Uganda to align its tariffs on imported goods to the Common External Tariff (CET) structure of the EAC while eliminating tariffs on goods from other member states.

International trade taxes are a very important source of revenue for Uganda, forming close to 50% of domestic revenues. With these limitations on the revenue and financing side, the government aims to create fiscal space through increasing the efficiency of expenditure. Concerns around the absorptive capacity of government to execute development projects have again been raised by the IMF and development partners following underspending in the FY2008/09 budget, and are likely to persist in the medium term in the absence of bold measures to reduce constraints to technical and administrative capacity.

Figure 13: Fiscal balance (% of GDP)



Sources: IMF, Standard Bank

The 2009/10 budget aims to provide fiscal stimulus of 1.4% of GDP; however, this is not likely to be fully realised as underspending of the budget continues. The official estimate of the budget deficit (including grants) for FY2009/10 was -3.9%. The deficit is expected to be just over 3%. The coming fiscal year is set to face a larger deficit on the back of lower levels of support from development partners and increased planned spending, bringing the average deficit for 2010 to 3.8%. The medium-term outlook provides for a gradual increase in the deficit in relation to GDP. Public debt will edge up in conjunction with these increasing deficits, while remaining sustainable under the assumption that Uganda will finance its deficits with semi-concessional loans.

Outlook

Growth is expected to increase to 7.3% in 2010. Regional demand for products and services provided support for aggregate demand last year as global demand faltered. This demand is expected to remain strong; however, competition to serve this demand will increase. Uganda is well placed to continue serving these markets, the completion of transport and energy infrastructure projects are now more pivotal than ever to ensure that Uganda succeeds in taking advantage of this opportunity. The private and public investment drive ensured strong performance in the construction industry in the past year and will remain a driver of growth in the coming years. Growth in financial services and the telecommunications sectors are also major drivers of growth. Continued spending by the government on education and public administration will ensure their continued contribution to growth.

Government spending will, however, need to become more efficient as the sizeable support from development partners in the form of project financing and grants is not expected to continue. The fiscal deficit in 2010 is expected to expand to 3.3% of GDP; continued underspending on development projects is expected to reduce financing needs. The scope to increase revenue collections is limited, considering the small tax base and the heavy reliance on international trade taxes. This will further increase the financing needs in the medium term in light of the ambitious expenditure targets.

Inflation remains highly sensitive to developments in agricultural production and demand from the region. Weather conditions in the region in the beginning of 2010 were favourable, which is likely to relieve pressure on regional demand for food from Uganda. This implies lower food inflation in Uganda in 2010. The decrease in oil prices last year helped bring down the prices of fuel and transport. The prospect of a relatively stagnant oil price in 2010 is likely to be conducive to continued low inflation in these categories. Average annual inflation is expected to equal 8.9% in 2010.

The trade balance is expected to deteriorate in 2010 as growth in imports resumes, outpacing that of exports. Overall, the balance of payments will continue receiving support from portfolio flows and increased levels of foreign direct investment associated with decreased risk aversion in global markets, as well as large-scale capital expenditure in the oil industry, which is keen to add to the two million barrels of proved reserves in Uganda as well as begin to exploit these reserves commercially.

The economy of Uganda continues to benefit from prudent macroeconomic policies, making it fairly resilient to exogenous shocks such as those presented by the global financial crisis that led to the reversal of capital flows. Uganda grew by a remarkable 7.1% in 2009, following growth of on average 8% in the past five years. This makes Uganda the fastest-growing economy in the region. Uganda has succeeded in reducing poverty on a scale unprecedented in neighbouring Burundi, Rwanda, Tanzania, DRC and Kenya. In addition, it has achieved a diversified economy with a thriving services sector.

Uganda is now challenged to remain ahead of the pack by realising its ambitious infrastructure plans that will, in turn, assist in improving the performance of the manufacturing and agricultural sectors. While the prospect of oil revenues is enthralling, the exploitation of this resource will not in itself be the source of sustainable growth. It is important to seek the development of industries that will provide employment and income to the vast population that now survives on small-scale agriculture.

Uganda

Standard Bank forecasts of selected indicators

	2006	2007	2008	2009e	2010f	2011f	2012f
National Accounts							
Gross Domestic Product (billions of constant LCU)	14192.2	15353.5	16629.3	17810.0	19110.2	20677.2	22353.1
% change	7.0	8.2	8.3	7.1	7.3	8.2	8.1
Final Consumption Expenditure of							
Households (billions of constant LCU)	11360.2	11815.6	13533.3	14616.0	16165.2	18331.4	21154.4
% change	14.4	4.0	14.5	8.0	10.6	13.4	15.4
Gross Fixed Capital Formation (billions of constant LCU)	2904.0	3487.5	3328.2	3394.8	4022.8	4497.5	5343.0
% change	2.7	20.1	-4.6	2.0	18.5	11.8	18.8
Agricultural production (billions of constant LCU)	3073.9	3097.2	3010.4	2735.1	2891.2	3046.0	3248.2
% of GDP	21.7	20.2	18.1	15.4	15.2	14.8	14.6
Prices							
Inflation (annual average, %)	7.4	6.1	11.9	13.1	8.9	8.4	7.8
Monetary sector							
Interest rate, Lending rate (annual average, %)	18.7	19.1	20.5	21.1	19.4	17.3	16.8
Exchange rate, annual average (LCU/USD)	1830.9	1724.0	1717.7	2030.4	1934.6	1882.7	1874
External sector							
Trade balance (% of GDP)	-9.3	-7.1	-7.8	-2.8	-4.9	-6.3	-6.5
Public and external solvency indicators							
Public debt (% of GDP)	25.4	24.9	24.3	22.3	21.0	22.3	24.4
Fiscal deficit (incl. grants), % of GDP	-1.5	-2.4	-1.7	-2.6	-3.8	-4.1	-4.3

Sources: Bank of Uganda, Bloomberg, IMF, Uganda Bureau of Statistics, Standard Bank

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