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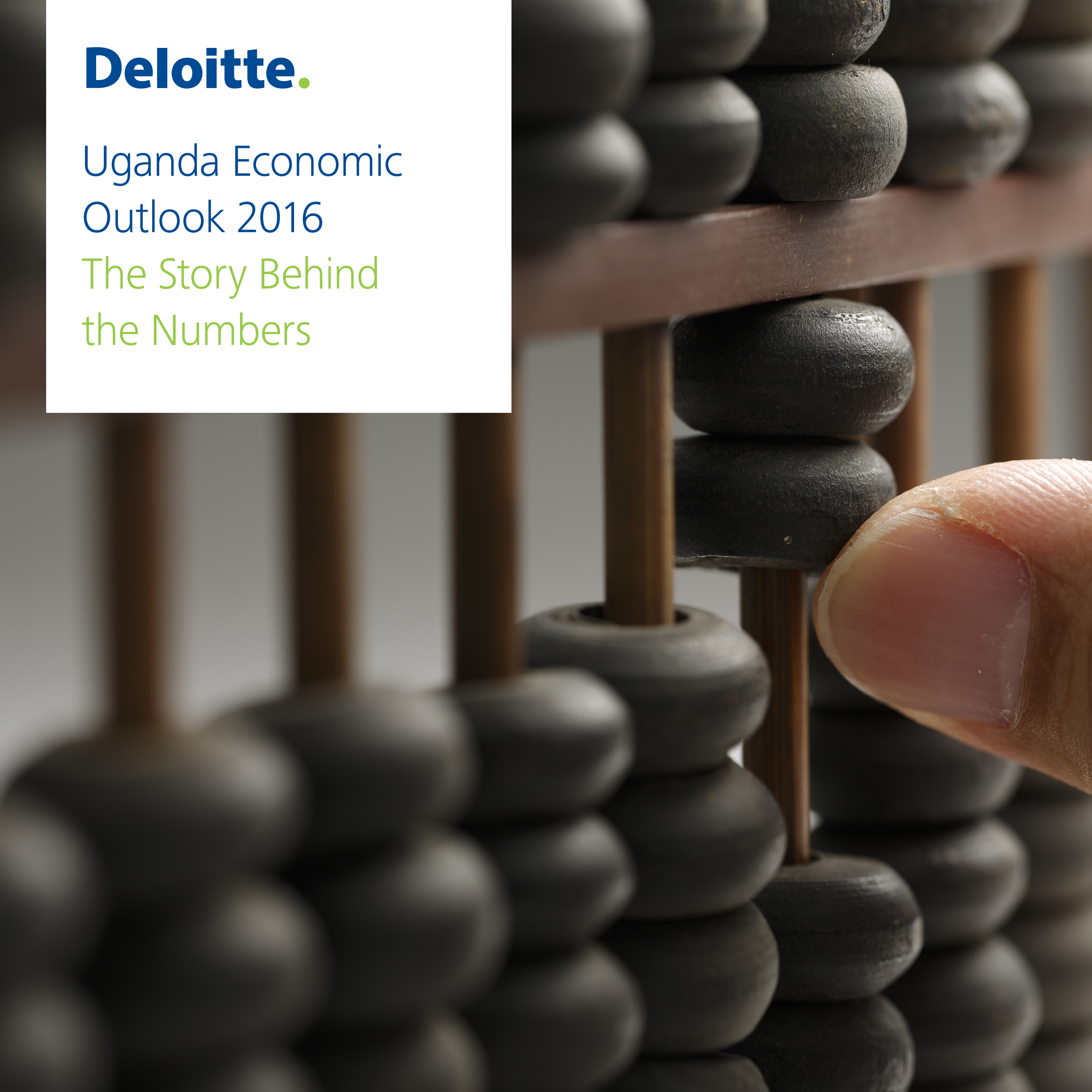
# Uganda Economic Outlook 2016

## The Story Behind the Numbers



# Preamble

The Uganda Economic Outlook 2016 report provides an overview of Uganda's economic environment and key sectors. The report also highlights significant allocations from the 2016/17 budget to various sectors in the country.

June 2016

# Uganda Economic Review

## Political overview

Uganda held both its presidential and parliamentary elections in February 2016 with the incumbent Yoweri Museveni winning his fifth elected term in office. Museveni's National Resistance Movement (NRM) party also retained its majority in the Parliament. This is likely to ensure policy continuity and support the passage of investor-friendly regulations in the short term.

Uganda's political and security environment is relatively stable, however, clashes between ethnic groups persist especially in western Uganda, where the country's oil reserves are located. The country remains at risk of terrorist attacks by al-Shabab given Uganda's ongoing military intervention in Somalia.

Corruption remains pervasive, driving up costs for businesses and complicating business operations in Uganda. Amnesty International issued a report in December 2015 accusing the Ugandan police force (UPF) of making arbitrary arrests and engaging in intimidation of opposition activists in the run up to the election.

According to the Economist Intelligence Unit (EIU), relations with fellow member states of the East Africa Community (EAC) — Kenya, Tanzania, Rwanda and Burundi — will remain positive; Uganda's government is a strong advocate of further integration of the EAC and relations with member states remain positive. The President remains the African Union (AU)-appointed mediator in Burundi's political crisis, and plays an active role in South Sudan's peace process, as well as in Somalia, where Ugandan troops are the largest contingent of the AU-sponsored peacekeeping mission.

## Economic overview

Uganda's GDP increased from about 5% in 2014 to an estimated 5.6% in 2015 driven by infrastructural development primarily being funded by the Chinese, according to data released by the Uganda National Bureau of Statistics (UNBS).

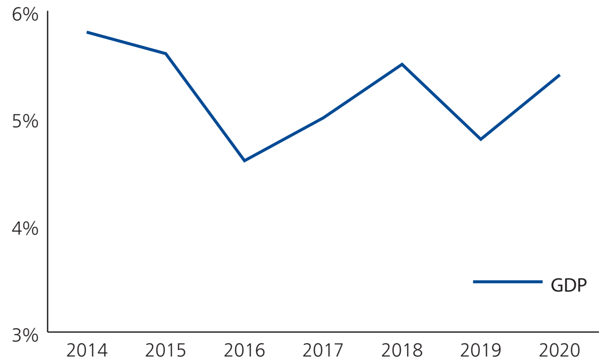
Government debt in the financial year 2014/15 stood at 34.7% of GDP and according to EIU, this is expected to increase significantly in 2015/16 due to heavy depreciation of the shilling in the middle months of 2015 thus increasing the cost of borrowing.
Tight monetary conditions were imposed throughout most of 2015/16 by the central bank to counter the depreciation of the shilling. This increased lending rates to an average of 25% on loans issued by commercial banks, thus increasing the cost of capital and slowing down investment in the period. Inflation rose throughout 2015 and peaked at 8.5% but was eventually brought down to 5.1% by end of the first quarter in 2016.

Uganda's current account deficit stood at 5.2% of GDP in 2015. According to EIU, this is expected to contract further due to high imports of high value inputs for infrastructural development. Coffee accounts for 20% of total export earnings and a third of foreign exchange earnings. The Uganda Coffee Development Authority (UCDA), the industry regulator launched a National Coffee Strategy meant to increase export revenue from USD 0.5 billion in 2014/15 to USD 2.5 billion by 2040. Future oil production is expected to turn the country's deficit account into surplus, following the announcement that the proposed USD 4 billion oil export pipeline from Western Uganda would be constructed to pass through the Tanzanian port of Tanga.

The economy continues to manifest an overall satisfactory performance with regard to maintenance of macroeconomic stability. Assuming that the country does not suffer a bout of drought that will affect food crop and cash crop production, the agricultural sector is expected to register improved performance. Similarly, the performance of the industrial sector is expected to improve as additional power generation capacity comes on board.

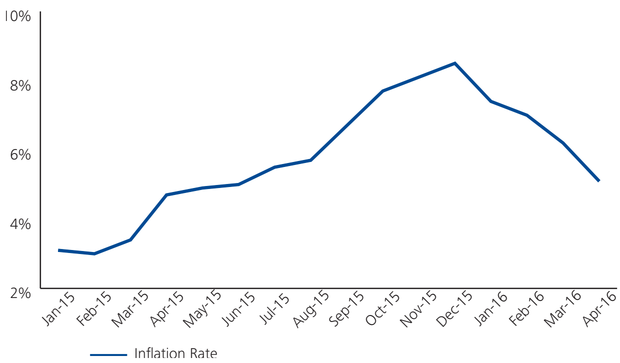
The official outlook is that the Uganda's economy is projected to grow by 5.5% next financial year. Over the medium term, GDP growth is projected to average 6.3% per annum.

**Chart 1: GDP annual growth estimates (%)**




*Source: Economist Intelligence Unit (EIU)*

**Chart 2: Monthly trend inflation 2015-2016**




*Source: Bank of Uganda*

## GDP

EIU forecasts lower growth for 2016 due to significantly lower economic activity arising from tight lending conditions and lower investment flows. This is following the uncertainty surrounding the presidential elections.

Investment in infrastructure will have a strong bearing on economic growth, with the construction industry expected to expand rapidly. The power sector is poised for growth, with a total of eight generation projects including two large Chinese-funded hydropower projects, scheduled to be commissioned in 2017-18.

There is also intense development around the Lake Albert region where the oil reserves are located. This will support the burgeoning manufacturing industry, although limited access to markets and labour market rigidities will continue to hold back progress.

Thereafter, growth is expected to increase but at a slow pace due to rural infrastructural constraints and slow growth in the agricultural sectors which contribute about 25% of the GDP.

## Inflation

Bank of Uganda had its job cut out with both headline and core inflation being on the upward trend during the early part of the 2015/16 fiscal year. The BOU’s monetary policy stance was supported by the sustained abating of food and energy prices in 2016. This led to the easing of the overall and core inflationary pressure.

The reduction in inflationary pressures is attributed to stringent monetary policies that were enforced in order to curb inflation that was being caused by the depreciation of the shilling.

The EIU expects the central bank to maintain a cautious tight monetary policy in near future despite relative stability of the shilling and conclusion of the presidential elections which caused double digit inflation in 2011 due to excessive government spending.

The EIU forecasts inflation to average 7.1% between 2017 and 2020.

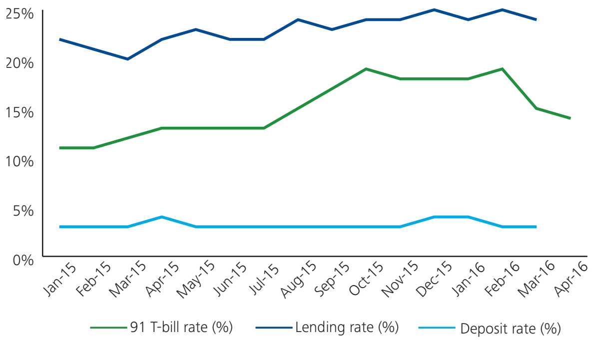
## Interest rates

The outlined monetary and fiscal policies' stance as well as the imperfectly competitive structure of the financial system continues to influence pricing in the money market. Whereas commercial banks lending rates were fairly stable, they remained high due to: the large fiscal deficit that gives the banks the option of investing in risk-free government securities; perception of high risks in lending to the private sector in view of the depressed state of the economy, the generally uncompetitive banking system where banks are content to serve "niche" market segments; and high operating costs from modernisation, outreach expansion and low income base of customers.

According to the Central Bank, lending rates in commercial banks have increased from about 21% in January 2015 to 25% in February 2016. This is due to contractionary monetary policies that were implemented by the Central Bank to control inflation. Treasury bill rate increased from 11% to 19% in the same period.

With inflationary pressures currently falling, the BoU's relaxation of monetary policy is required amid concerns over weak economic activity. By lowering its policy rate, the BoU may reverse these trends.

**Chart 3: Interest rates 2015-2016**




*Source: Bank of Uganda*

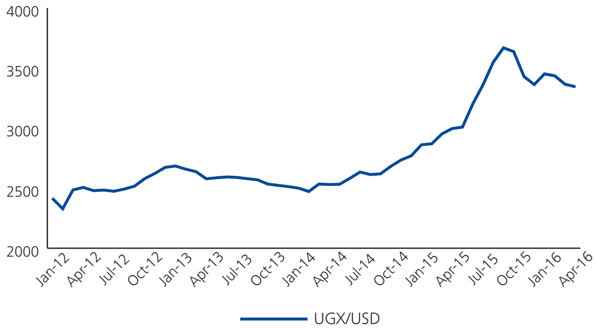
### Exchange rates

Developments in the external sector, coupled with market sentiments and expectations influenced the foreign exchange market.  During the year 2015/16, the foreign exchange market was characterised by a substantial depreciation.  Whereas a general depreciation trend was observed, it was characterized by limited volatility as the BOU able to appropriately intervene to obviate such volatility.

The shilling has continued to depreciate against the USD; although at a much slower pace aided by seasonally high agricultural export earnings as well as the BoU’s aggressive monetary tightening stance.

The shilling is forecast to average UGX 3,459:USD1 in 2016, down from UGX 3,241:USD1 in 2015, with downward pressure fueled by the sizeable fiscal and current-account deficits. Thereafter, tighter fiscal policy and steady foreign investment inflows, following stable political climate and anticipated oil production  will result in a progressively slower rate of depreciation, with the shilling forecast to slide to UGX 4,007:USD1 in 2020.

**Chart 4: UGX/USD 2012-2016**




*Source: Bank of Uganda*

# Sectoral perspectives

## Financial services

### Banking

The effects of an aggressive monetary policy adopted in 2015 by the Government of Uganda (GoU) have been felt within the commercial banking sector. After maintaining the Central Bank Rate (CBR) at 11 percent from June 2014, the Bank of Uganda (BoU) increased the CBR to 17% in October 2015. Interest rates increased in line with this and this is expected to have a negative impact on asset quality and uptake of private sector credit.

According to Business Monitor International (BMI) the sector is adequately capitalised and much better able to withstand credit shocks thanks to regulatory measures taken in recent years by BoU. There is a risk of crowding out of the private sector as commercial banks are more likely to lend to the government during periods of high interest rates.

### Insurance

The insurance industry has contributed to and benefited from economic development in Uganda. Gross Written Premiums (GWP) increased from UGX 502 billion in 2014 to UGX 611 billion in 2015 representing a 28% growth. The sector which is 76% dominated by non-life business benefited from the increase in insurable assets leading to the uptake of of local insurance by large infrastructural projects, increase in uptake of loans leading to increased demand for Loan Protection Insurance. The Insurance Regulatory Authority (IRA) forecasts that further progress in the insurance industry will be driven by developments of mobile technology, diversification of target markets to increase penetration and innovation of insurance products such as bancassurance, agricultural insurance and oil and gas insurance.

### Retirement benefits

In 2010, the GoU set out a framework for changes to be implemented in the regulation of the pension sector. The aim was to allow workers to have a choice in the pension schemes they contribute to and the way they receive their benefit payments i.e. annuity or lump sum, while ensuring maximum safety for their savings. These reforms also target to widen the scope of the pensions sector, to cover the formal and informal sectors.

These changes were to be regulated by two pieces of legislation, the Uganda Retirement Benefits Regulatory Authority Act 2011 (URBRAA) and Liberalization of Pension of Pension Sector Bill (the Bill). The bill will avail more products in the market, which will attract more players and increase public awareness on retirement savings.

With NSSF as the only pension fund available to workers, the Bill will also reduce the taxpayers' money used to fund pensions because it proposes a more sustainable model in which the civil servants would contribute to their own retirement benefits.

### Capital markets

The Uganda Securities Exchange (USE) has a total of 16 companies trading on the bourse with 4 companies cross listed from neighbouring Kenya. The capital market in Uganda still lags behind in the region with market capitalisation as a percentage of GDP stood at 5.5% of equity and 0.27% for debt as at October 2015. In Kenya, stock exchange market capitalisation to GDP was at 41% during the same period.

The Capital Markets Authority (CMA) of Uganda prepared a 10 year Capital Markets Development Masterplan in December 2015 that among others aims to increase supply of securities, widen demand for securities by broadening investor base and simplify legal, fiscal, regulatory and institutional frameworks.

## Agriculture and Industrialisation

### Agriculture

The agricultural sector is important to the Ugandan economy in that it employs approximately 69% of the population and contributes about 26% to the GDP in 2015.

The sector has the potential to transform the economy of Uganda in general and that of specific sectors such as manufacturing and services. The government has increased allocations to the agricultural sector in the 2016/17 budget to UGX 832.42 billion representing a 65% increase. The main agricultural crops include coffee, grains, sugarcane, cotton and tea. The government identifies agriculture as a vital contributory growth sector capable of reducing poverty and stimulating economic growth.

Developments going forward will focus on increasing production and productivity, improving household food security, increasing farmers' income and increasing the value of exports.

### Industrialisation / manufacturing

In Uganda, manufacturing is dominated by Micro, Small and Medium Enterprises (MSME) contributing approximately 20% of GDP, generating over 80% of manufactured output and accounts for approximately 90% of the entire Private Sector.

The government through the National Development Plan has come up with a MSME policy that aims to tackle challenges facing the sector such as lack of information, standardization and product certification, legal and institutional challenges.

Priority actions that will create a competitive export oriented industrial sector, improve competitiveness and market access for Uganda's goods and services include the establishment of industrial and business parks. This will create jobs and add value to locally available raw materials. Infrastructure and utilities have also benefited from the setting up of industrial parks  roads, waterways and power lines being built to investors requirements.

## Extractive Industry

The first major discoveries of oil reserves were made in the Lake Albert area of Uganda by Tullow Oil in 2006. Since then, recoverable reserve estimates have risen to approximately 750 million barrels.

Following negotiations between International Oil Companies (IOC) and the Ugandan Government an agreement was reached on the construction of a 60,000b/d refinery in the Hoima district, Western Uganda to refine domestically produced crude, when production begins from the Albertine discoveries in 2020.

The next step in commercialization of these discoveries is new infrastructure, including an export pipeline. A range of possible pipeline routes to ports, initially to Lamu or Mombasa in Kenya and later to Tanga in Tanzania, have been signed. Delayed progress in developing an export route for these inland discoveries is stalling upstream development.

UGX 188.2 billion has been allocated to implement programmes for oil and gas development, institutional and skills development including operationalizing the National Petroleum Authority and establishment of the National Oil Company.

According to BMI Uganda's power sector remains focused on hydropower capacity, which will leave the country vulnerable to potential intermittent electricity generation during periods of decreased rainfall or drought. Approximately 90% of the country's electricity is generated from hydropower.

Uganda is currently exploring the potential for geothermal energy, and will drill three exploration wells. It is estimated that up to 30MW can be generated from each successful well. The government is also exploring possibilities of developing nuclear power capacity and solar power production.

BMI forecasts power production to increase in the medium term with the biggest increase coming in 2018, when three hydropower plants are expected to come online. Total generating capacity will be 827MW. The power plants are the (183MW) Isimba, (44.7MW) Muzizi and (600MW) Ayago hydropower plants.

## Public sector

The GoU intends to refocus public service efforts to improve delivery of quality outputs. This is expected to reduce wastage, laxity and limited responsiveness. Actions such as 50% cut in advertising budget for ministries and a forensic audit of government salaries, wages and pensions have been proposed.

### Security

The defence budget in Uganda has been on the rise, owing largely to the deteriorating security situation in the region, and with Ugandan troops deployed in many of the neighbouring conflict areas. A record breaking budgetary allocation of UGX 1,633 billion was made in the 2015/16 budget to be used mainly for acquisition of modern weaponry, strengthening intelligence capability, training and welfare.

Allocations in 2016/17 reduced to UGX 1588.03 billion to build capacity of the security forces to maintain security for both national and across the region purposes. Security and defense spending is forecast to increase due to instability in the region as Uganda seeks to maintain its dominant combat and peace keeping missions in the region.

### Environment and natural resources

Access to safe water is a requirement in the growth of urban centers and for use in agriculture. Expansion efforts by the government have resulted in increase in the number of new water connections (by new users) according the Ministry of Water and Environment. In June 2015, the population with access to safe water in the urban areas was 73% with that in the rural areas at 65%.

The government is also encouraging use of PPP’s for construction of water production facilities whose costs are shared with private farmers and developers.

The government also banned use of plastic/polythene bags early in 2015 to prevent environmental degradation. Also, all land title issued in wetlands were cancelled to assist in conservation efforts.

## Infrastructure and construction

Infrastructural development continues to be a national developmental priority as indicated by the GoU. The sector continues to be accorded priority due to the multiplier effect it has in stimulating growth and development in Uganda.

### Road

Developments to the road network in Uganda have the capability to support overall economic growth and reduce the cost of doing business in the country. According to BMI, the landlocked nation is currently reliant on a poor quality road network for 97% transporting heavy cargo.

Government has embarked on a drive to upgrade major roads to bitumen standard, development of the road network and construction of key bridges, such as the Nile bridge in Jinja. In the 2015/16 budget, the sector was allocated UGX 3,328 billion, an increase of UGX 753 billion from the previous year. The trend has continued with allocations in the 2016/17 budget increasing to UGX 3,827.54 billion.

### Rail

Under the railway sector, the Ugandan Government in collaboration with other Partner states within the East African region is undertaking efforts to revitalize the railway transport system. Government will fast track the construction of the Standard Gauge Railway (SGR) throughout Uganda.

In 2016, construction is scheduled to start on the 1,614km standard gauge railway (SGR) line in Uganda, which aims to connect the country with its East African neighbours Rwanda, Kenya, the Democratic Republic of Congo and South Sudan. Also known as the Southern Corridor Railway, 90% of the project will be funded by the Export-Import Bank of China, with the USD3.2 billion construction to be undertaken by China Harbour Engineering Company. It will stretch from western Uganda's Kasese district via Kampala, to the border town of Malaba, to meet Kenya's own SGR (under construction and due for completion in 2017). It is due for completion in 2018.

### Airport

In August 2015, the Ugandan parliament approved a loan of nearly USD 325 million from the China Exim Bank to upgrade Entebbe International Airport. Parliament approved the loan's initial tranche of USD 200 million to cover first phase of the project, on condition the remaining loan amount of USD125 million will come in FY2018/19 for the second phase of the project. Work is expected to start in June 2016.

## Healthcare and Pharmaceuticals

In the 2015/16 fiscal year, priority was on the reduction in morbidity and mortality rates from causes of ill health and premature death, and narrowing disparities in access to health services. This was via improving quality access to health by constructing and equipping hospitals and health centers.

The health sector received UGX 1,270.8 billion during this fiscal year a reduction of UGX 6 billion from the previous year. According to BMI, this still remains below the Abuja Declaration target of 15% of total government expenditure.

The government relies on aid from donors to fund the healthcare sector with 40% of healthcare spending funded from external sources.

In 2014, local pharmaceutical manufacturers received government approval to be protected from foreign competition in order to expand the population's access to medicines. This will lead to a reduction in Uganda's extreme import reliance and has the potential to expand the population's access to lower-value medicines.

Opportunities exist in dissemination of drugs to the population. According to the Ministry of Health, in November 2015, over 750,000 people were affected by a drug shortage in government facilities due to challenges from distribution by the National Medical Stores.

## Tourism

Tourism has been highlighted by the government as one of the fastest growing service sectors in the Ugandan economy, and the single largest export earner.

About 26.4% of the country's total area is under protected areas such as national parks, species management areas, game reserves, wilderness areas, marine reserves and Ramsar sites. Total industry contribution to GDP is approximately 9% employing approximately 8% of total workforce in Uganda.

Although the direct allocation to this sector has been low, one can argue that the linkages with other sectors like infrastructure, education, security, agriculture or energy will indirectly boost the sector. UGX 158.5 billion was allocated to the tourism sector in the FY 2015/16 budget. In this years budget, allocations have increased to UGX 158.5 billion.

The Government has developed a 10-year tourism master plan and a five-year sector Development Plan to guide the implementation of critical activities to drive tourism growth in the country. Actions to revitalize the Tourism and Hospitality Industry in the medium term include:

- Undertake human capital development in the hospitality sector to fulfil the requirements for high standard of performance in the hospitality industry;
- Complete the rating and ranking of hotels and restaurants;
- Develop strategic tourism infrastructure in partnership with the private sector; and
- Enact and enforce sector regulation to ensure the maintenance of sector standards at internationally acceptable levels.

## Information, Communication and Technology (ICT)

The ICT sector in Uganda has steadily been growing with the Ministry of Information and Communications Technology quoting an average 19.7% annual growth. This resulted in an average contribution to GDP of around 2.5% in 2015, employment of approximately 1.3 million Ugandans and UGX 484.4 billion in tax revenue collection in 2015.

The mobile market grew to approximately 23 million people in 2015 representing a penetration rate of 54.9%. According to BMI mobile internet users represented 98% of all internet subscribers in 2015. The sector is expected to improve access to high speed broadband services from 512 Kilobytes per second to 4 Mbps and 30Mbps for rural and urban households respectively. This will support business productivity and facilitate communication. The National Backbone Infrastructure (NBI) will also be extended to cover more areas in the country.

The government has prioritised investing in the national ICT infrastructure in order to enable a conducive business environment. Following the directive by Head of States to implement the One-Network-Area (ONA), all countries implemented the ONA by January 2015. This enables calls between to be charged at the local call rates aimed at reducing the cost of cross border transaction costs.

Other areas where the government intends to focus on to further boost the sector include; a favourable legal and regulatory environment, development of a quality stock of ICT Human Capital, development and use of innovative ICT solutions, promoting ICT research and development and adoption of ICT in public service delivery.

## Education

Government continues to support the education sector with free universal education to A-Level's, secondary schools and primary schools, provision of funds for the necessary physical infrastructure, support private sector vocational institutions with resources and development and retention of a pool of national expertise in certain sectors. As a result of the 2014 census, the GoU reported 72% of the population to be literate.

In last year's budget, the sector was allocated UGX 2,029 billion (8% of the total budget amount) for human capital improvements.
A teachers strike in 2015 prompted allocations to the sector go up to cater for increase in salaries. In May 2015, teachers called off the strike after government agreed to give them 15 % increment in the 2016/17 financial year.

In order to enhance tertiary level education, salaries of teaching staff in Public Universities have been increased with a UGX 50 billion allocation in the 2016/17 budget. A further UGX 78 billion has been provided for in next year's budget.

According to the budget speech 2016/17 priorities for implementation in the formal education sector will include the following:

- Recruitment of tutors for the 20 Technical Institutes started this financial year. UGX 6.672 billion has been provided for this purpose;
- Operationalizing three Public Universities in Soroti, Kabale and Lira which are to offer Science related programmes which are critical to the Economic Development of the Country. For this, a total of UGX14.09 billion has been allocated;
- Expand the Student Loan Scheme to cater for the Second Cohort of 1,000 University students and 200 students of Diploma courses to improve access to higher education. An additional UGX 6 billion has been provided for this purpose;
- Increase of salaries of Primary teachers by 15% which will be the last instalment in Government's commitment to increase teachers' salaries by 50% in a phased manner. For this, an additional UGX 122 billion has been provided.

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