Uganda Economic Outlook 2017

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Uganda's economic outlook for the financial year 2017/18 is positive, with real GDP growth expected to reach 5%

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With the prevailing strong macroeconomic fundamentals in the country, we now have the right economic environment to drive growth in Uganda. Annual headline inflation is under control and within single digits despite the recent sharp increase in food prices. The Shilling has been very stable lately and as of August it had strengthened slightly against the US Dollar. The BOU Central Bank Rate (CBR) is also at its lowest ever at 10%. Following this reduction in CBR, most banks have followed suit by reducing their prime lending rates.

Currently, commercial bank lending rates are at the lowest they have been for a while, with the average lending rates across the industry down to 19%. This should result in a recovery of the private sector credit.

In addition to all the above good macroeconomic environment, the negative external shocks that have been affecting growth of the economy are expected to soften going forward. A combination of all these factors, together with the accelerated investments we are beginning to see in the oil and gas sector, should spur economic growth this financial year.

Investment in the large infrastructure projects should result in a boost in the manufacturing sector as well as the services sector, notably tourism.

During his budget speech, the Honorable Minister of Finance made it clear that the Government's macroeconomic goal for financial year 2017/18 will be to maintain macroeconomic stability and to support the rapid growth of the economy that is necessary to achieve economic transformation.

It is against this background that Government has committed to reduce issuance of Government securities for purposes of financing the budget deficit over the medium term. This has been a major problem in the past as high domestic borrowing by Government has been crowding out the private sector. Government has also committed to faster implementation of the planned infrastructure projects.

Government is projecting growth in the economy to pick up this financial year to about 5.0% and continue rising over the medium term to an average of 6.3%. This growth will be supported by both private and public sector investments especially in the oil and gas sector, improvements in agricultural production and growth in domestic consumption.

This assumes that government will maintain macroeconomic stability, improve its efficiency in implementing public infrastructure projects and tackle corruption.

In order to make this growth a reality, it is important that Government clears all the arrears it owes to domestic enterprises. As at the end of June 2016, government had accumulated domestic arrears that were equivalent to 3.2% of GDP. This is severely constraining businesses and denying the economy this badly needed liquidity and purchasing power.

After nearly a decade of robust economic growth up until 2010, growth in Uganda has been slowing down for a number of reasons

During the period 2000 to 2010, the economy was growing at an average annual rate of about 8%. Private investment and exports were the important drivers of growth during that period.

Since 2010, growth has been more erratic ranging from a high of 6.8% during the financial year 2010/11 to a low of 3.9% in the financial year 2016/17. This sluggish and uneven growth resulted in Government failing to meet its desired 7.2% annual growth rate which was the target for the National Development Plan I (NDP I) over the five year period 2010/11 to 2015/16.

This trend of slow growth has continued during the current five year period of NDP II. The current NDP II is the second in a series of five-year plans, which are designed to achieve Uganda's Vision 2040. The goal of Vision 2040 is to transform Uganda from a predominantly peasant and low-income country to a competitive upper middle income status over a 30-year period. NDPII prioritizes agriculture, tourism, infrastructure, mineral, oil and gas and human capital development.

The slowdown in growth is due to many factors. These include the after effects of the 2010 – 2012 global financial crisis which resulted in a stagnation in demand of goods in many of our export markets and a global decline in commodity prices. Further, the uncertainity and anxiety surrounding the 2011 presidential and parliamentary elections contributed to a reduction in economic activity and a decline in foreign direct investment (FDI).

Thereafter we saw the withdrawal of budget support by development partners in the year 2012 as a result of financial mismanagement and governance issues in a number of Government departments.

This withdrawal of financial support to the budget by development partners forced the government to start exploring nontraditional financing options such as non-concessional borrowing and using domestic debt to finance the budget. This marked the beginning of the rapid growth in public debt which has risen close to 40% of GDP.

The economic situation was made worse by the onset of the civil war in South Sudan in 2013. Before the war, South Sudan was Uganda's leading export destination with exports both formal and informal estimated to have exceeded $ 1 billion during the financial year 2008/09.

Since the civil war started in 2013, Uganda's exports to South Sudan have been declining every year from $414 million in 2013, to $385 million in 2014 then further down to $353 million in 2015.

Then came the 2016 elections that again resulted in a decline in economic activity for the rest of that year. In fact; the lag effect of this economic slowdown continued well into 2017. Subsequently, consumer spending was constrained as a result of the low purchasing power and weak demand in the economy.

Many local businesses were greatly affected by this slowdown and eventually sought Government's intervention in the infamous "bail outs" of 2016. The situation further worsened by the adverse weather related factors, mainly due to the very long drought of 2016.

A combination of all these factors plus the usual suspects namely corruption, poor management, planning and execution of public infrastructure projects, delays in implementation of Government programs and projects and low domestic revenue collections are all collectively responsible for the decline in growth of the economy that we are now experiencing.

Growth in FY 2016/17 was only 3.9%, which is lower than the 5% growth that was initially projected

Growth in all sectors of the economy slowed down during the financial year 2016/17.

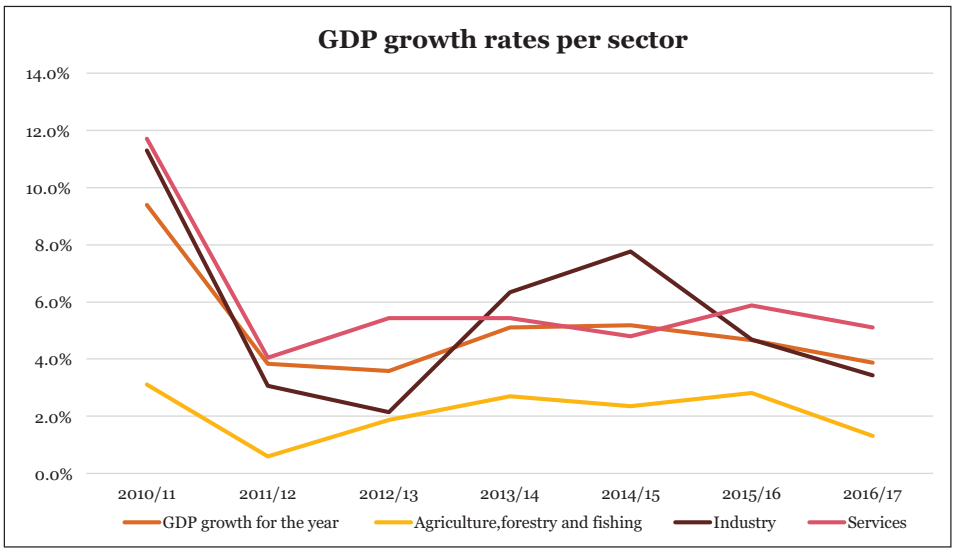
Agricultural output grew by only 1.3% compared to the growth of 2.8% in 2015/16; industrial sector growth slowed to 3.4% during 2016/17 which was below the 4.7% of the previous year, and growth in the services sector slowed to 5.1%, compared to the 5.9% growth in 2015/16[1]. Overall, the economy grew by 3.9% in financial year 2016/17 compared to growth of 4.7% in 2015/16.

With annual population growth of about 3% per annum, this means that the per capital growth in the economy was only 0.5%.

The slowdown in growth is mainly due to a combination of domestic factors. These include; the long drought of 2016 which affected agricultural output, tight financial conditions that culminated into low private sector credit growth and the slow implementation of government infrastructure projects which in return has delayed the realization of the economic benefits expected from these investments.

The Government is very optimistic that the slowdown in the growth of the economy is temporary, and expects the decline in growth to be reversed this financial year 2017/18.

It is on this basis that Government is projecting the economy to grow by 5% this financial year. The growth will be driven mainly by improved efficiency and effectiveness in implementation of public investments, higher FDI particularly in the oil and gas sector, a recovery in private sector credit growth as lending rates continue falling and growth in the agricultural sector as normal weather conditions return.



Source: UBOS

1.3%

Rate of growth of Agricultural output in 2016/17 compared to the growth of 2.8% in 2015/16.

[1]Bank of Uganda: State of the Economy Report (June 2017)

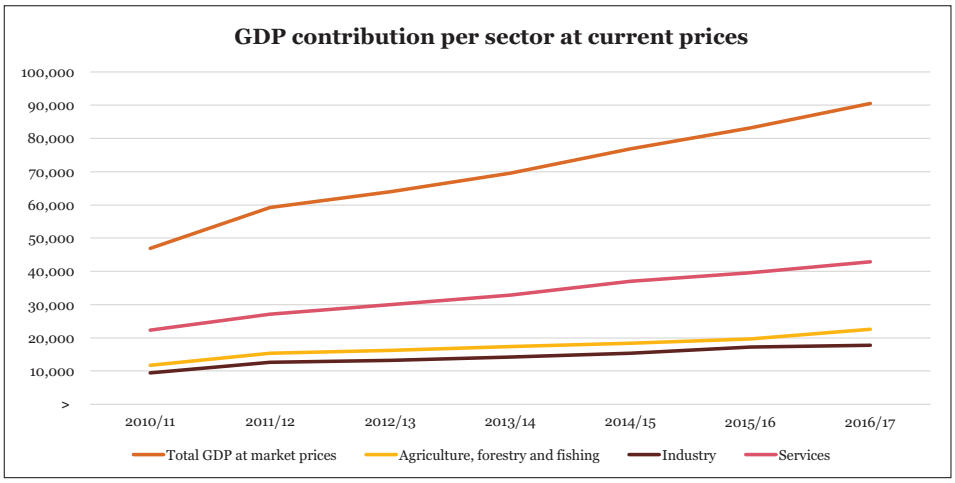
The economic outlook for FY 2017/18 is positive and very promising with real GDP growth expected to reach 5%

Government is optimistic that the economy will grow by at least 5% this financial year.

The growth will be driven mainly by strong performances in the industry and services sectors, and also by public infrastructure investment and other investments in priority sectors. Rising private consumption and a recovery in private sector credit growth should result in an increase in domestic consumption, which will spur growth of the economy.

This optimism is also shared by the IMF. According to their most recent report on the performance of the Uganda economy, the IMF says that the economic outlook is broadly favorable. With steadfast policy implementation and assuming improved weather conditions, the IMF is predicting the economy to grow by 5% this financial year. Over the medium term, the IMF expects the ongoing investments in public infrastructure and investments in the oil and gas sector to propel growth of the economy to rates of between 6.0% and 6.5%.

With the planned public infrastructure investments, public debt will increase. However the IMF is of the view that debt will remain manageable, as long as these public investments lead to higher growth and the government continues to increase its domestic revenue collections[2].



Source: UBOS

5.0%

With steadfast policy implementation and assuming improved weather conditions, the IMF is predicting the economy to grow by 5% this financial year.

[2]IMF Uganda Country Report 2017

Fiscal stimulus through public infrastructure investments expected to drive growth of the economy

The main risk to economic growth remains the current slow pace of implementation and execution of the budgeted public investments and infrastructure development projects.

If this slow pace continues, it will deter growth of the economy, as was the case last financial year. Therefore, in order to achieve the projected 5% economic growth there must be huge improvements in the efficiency and effectiveness in the way public infrastructure and investment projects are executed. The major infrastructure projects currently underway such as the power generating plants, roads, airports, the standard gauge rail system, water treatment and sanitation plants, the oil and gas infrastructure facilities, are supposed to create the foundations of Uganda's modern economy.

When done properly, all these projects should have a huge multiplier effect on the economy. This is because every dollar spent on infrastructure leads to an outcome of greater than two dollars[3]. With the right execution, all these public investment infrastructure projects can have a powerful effect on the economy. They have the potential to raise output in the short term by boosting demand, creating jobs, and increasing the economy's productive capacity in the long term.

In addition, the boost to GDP that the country will get from increasing public infrastructure investment will help to counter the rise in public debt as a percentage of GDP.

This will help to keep in check the public debt-to-GDP ratio, so as to ensure that the debt does not rise disproportionately compared to the size of the economy. In other words, all these planned public infrastructure investment projects should pay for themselves, if done correctly.

However, in order to reap these benefits, Government will have to invest well. That is, invest where there is a clear need for the investment, and invest efficiently.

If we achieve this, these public investment projects will provide a much needed boost to the economy, both today and in the future.

[3]Study by the World Economic Forum - 2014

BOU's reduction in the CBR rate is gradually feeding through to the economy in form of reduced commercial bank lending rates

The Bank of Uganda (BoU) has cautiously pursued an expansionary monetary policy throughout the financial year 2016/17 by continuously easing of monetary policy through reductions in the CBR rate.

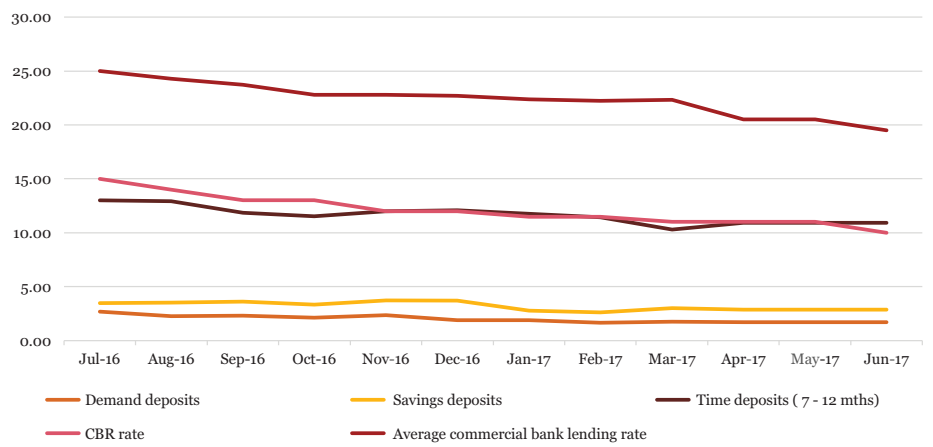
This reduction in the CBR rate has gradually fed through to commercial bank interest rates, although at a relatively slow pace. The weighted average lending rate on shilling denominated loans has fallen from the peak of 25% in February 2016 to an average of 20% as of today.

This is a decline of 5 percentage points. In the same time the CBR has fallen by 6 percentage points from 16% to 10%.

Although the fall in the lending rates by 5 percentage points is marginally lower than the 6 percentage points reduction in the CBR over the same period, the reduction in lending rates is a very welcome development and we hope it will result in the growth of private sector credit this financial year.

Despite the monetary policy easing, growth in private sector credit has remained subdued. For example, in the financial year 2015/16, private sector credit grew by 16.2%. However, in the first eleven months of FY 2016/17, private sector credit grew by only 4.2%. The slight decline in private sector growth in part highlights the supply-side constraints to credit growth.

The prime lending rates have been falling with the reductions in the CBR



Source: Bank of Uganda

According to BOU, demand for credit (on the basis of loan applications) remains robust while supply of credit (based on loan approvals) remains subdued. Since January 2017, value of loan applications has averaged about Shs. 1,677 billion, while value of approvals has averaged Shs. 810 billion per month.

That represents a loan approval rate of less than 50%. The sectors that have suffered most from lack of available credit facilities are manufacturing, building, construction and real estate sectors.

Loans to these sectors made up 27% of the total private sector credit, whereas loans to trade and retail, agriculture, household, personal and salary loans comprised of 47% of the total private sector credit during the financial year 2016/17.

The economy is heavily dependent on small retail businesses, and these businesses become very constrained when the lending rates are high, as this limits access to credit and thereby undermining their ability to expand.

We expect the improving economic activity and a reduction in lending rates to result in a recovery in private sector credit growth. The ratio of Non-Performing Loans (NPLs) to total loans, has also decreased from a high of 10.5% as of December 2016 to an industry wide average of 6.3% as of March 2017[4].

[4]Bank Of Uganda – State of the Economy Report (June 2017)

The economy has more than doubled in size over the last five years, but this has had limited impact on poverty reduction and creation of employment

While economic output as measured by GDP has doubled over the past five years, poverty incidence has only fallen slightly.

In addition to this, the number of poor people has risen in line with the population growth. High levels of income inequality are negatively affecting the conversion of growth in the economy into poverty reduction. These inequalities in the population are resulting in huge disparities in access to education, health and basic services.

All the barriers to more inclusive and dynamic economic growth in Uganda are known and very well-articulated in Vision 2040. The NDP II prioritized five sectors as: agriculture, tourism, infrastructure, mineral, oil and gas and human capital development[5].

There are key interventions that will be implemented in each of the five sectors in order to drive growth in the economy. In particular, NDPII assumed that during the five year period of 2016 to 2020, there will be increased productivity in all the five sectors, more value addition to our commodities especially agricultural and mineral products, we will have an environment where industrialization can flourish, and there will be major improvement in the delivery of public services.

The plan assumed that if we meet these objectives, the economy would grow by an average of 6.3% per annum during the five year NDP II period. Unfortunately our annual growth over the first two years of the current NDP II period have been disappointing. Growth in 2015/16 was 4.7% and in 2016/17 it was only 3.9%. This translates to an average annual growth of 4.3% for these first two years of NDP II, which is 2% below our target of 6.3%.

6.3%

Projected growth of the economy during the five year NDP II period.

[5]National Development Plan II

The current economic slowdown in growth of the economy may be the wake-up call we need to review our model of economic development

70%

Rate of the population in Uganda that depends on agriculture for their livelihood.

Why has the impressive economic growth record of the early 2000's which resulted in a quadrupling of the size of the economy, had very limited impact on poverty reduction, job creation and productivity?

Why has it so far failed to deliver the inclusive growth and meaningful economic development transformation which is key to our attainment of middle income status by 2020?

Is this a sign of an economic development model that is no longer working? As we mentioned in our *Economic Outlook* bulletin of last quarter, we know the priorities, and we have even put in place policies and designed programs aimed at addressing these national priorities. Our biggest problem is implementation and execution of these policies and programs in a manner that is efficient, effective and transformational.

For example, we already know that it is only through education and skills development that we will develop our human capital, and ensure Ugandans have a secure foundation for inclusive growth. But how many of our youngsters who enroll for primary education make it to upper secondary school, or tertiary institutions?

What impact is this having on our ability as a country to avail firms with skilled workers? If we could fix this problem, what impact would it have on providing the youth with an escape route from poverty?

When it comes to human capital development, the issue is not just access to education and skills development but also the quality of the education system. We must equip our young generation with skills as a catalyst for dynamic and inclusive economic growth.

With regards to manufacturing and industrialization, the objective must be to develop and implement national strategies aimed at fostering the entry of firms into higher value-added areas of labor-intensive production.

Agriculture is the sector with the greatest impact on the socioeconomic bottom line of Uganda, as most people depend on it for their livelihood.

With the ever increasing changes in weather conditions, what kind of interventions from both a policy and public investment perspective are planned to ensure an average year-on-year growth rate of at least 5% in the agriculture sector?

If we were to achieve this 5% annual year on year growth rate in the sector, we would not only be guaranteeing the food security for all Ugandans, but we would also be creating internal and external demand as well as multiple revenue streams from the sale of agricultural produce. This is because on one hand, agriculture can create jobs and feed the nation, but on the other, the price of food can be a key determinant of the inflation rates in the country.

In conclusion, we are cautiously optimistic that the economy will rebound from the slow growth of last financial year to grow by at least 5% this financial year as projected by the Government

However in order to achieve this growth, all the risks to the growth of the economy we have highlighted in this bulletin will have to be managed very well. In addition to managing these risks, implementation of Government's budget for FY 2017/18 will also be very important.

Government will have to increase its domestic revenue collection by at least 0.5% of GDP as was the case in FY 2016/17. This is very important as it will ensure debt sustainability while at the same time providing the funding necessary to finance the public investment projects.

With spending on social services having declined in real terms, Government needs to make great efficiency gains in order to protect the quality and level of social services delivery especially to the poor.

The tight current spending envelope will also require strong expenditure controls and efficiency gains to avoid the need for supplementary budgets or renewed domestic arrears.

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