Setting tomorrow's priorities

A look at Uganda's 2016/17 National Budget

June 2016

Welcome

Please find enclosed highlights and analysis based on the speech by the designated Minister of Finance and Economic Planning on 8th June 2016

We hope that you will find this publication helpful, and we look forward to your comments.

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The Economy

Global economic performance 2015

In 2015, global output contracted and this came against the heel of low commodity prices particularly for oil and sluggish demand for raw materials by China. As a result, global real Gross Domestic Product (GDP) declined from 3.4% in 2014 to 3.1% in 2015. Other factors that contributed to this decline included:

- weaker capital flows;
- subdued global trade; and
- increasing financial market volatility particularly in emerging markets and developing economies.

While advanced economies are on the path to recovery following the effects of the global financial crisis, this too has been subdued with GDP in the Euro area still below its pre-crisis high of 2008.

BRICS

India posted the largest contribution to global growth in 2015 with 7.3% . Russia's GDP shrunk on account of low oil prices and biting economic sanctions. Brazil's GDP yet again shrunk by 3.8% as debt payments eat up a large chunk of the country's output.

Sub Saharan Africa (SSA)

SSA's economic growth declined from 5.1% in 2014 to 3.4% in 2015. This was mainly attributed to the sharp decline in oil and other commodity prices as the region's leading oil exporters were hit hard. Despite the decline, SSA's economic growth beat global growth for the 15th year in a row. For example, the combined GDP of SSA's four largest economies (Nigeria, South Africa, Angola and Ethiopia) overtook the economic output of Italy in 2015. This reinforces SSA's resilience and potential as a region to invest in.

Economic growth in the East African Community (EAC) declined from 5.8% in 2014 to 3.4% in 2015 mainly as a result of the unstable political environment in Burundi and uncertainties associated with general elections in Tanzania and Uganda.

Global Economic Growth Projections (%)

	2014	2015	2016	2017
World	3.4	3.1	3.2	3.5
US	2.4	2.4	2.4	2.5
Euro Area	0.9	1.6	1.5	1.6
Japan	-0.1	0.5	0.5	-0.1
China	7.4	6.9	6.5	6.2
India	7.3	7.3	7.5	7.5
Brazil	0.1	-3.8	-3.8	0.0
Russia	0.6	-3.7	-1.8	0.8
SSA	5.0	3.4	3.0	4.0
S. Africa	1.5	1.3	0.6	1.2
Nigeria	6.3	2.7	2.3	3.5

Source: IMF, World Economic Outlook, April 2016

Uganda Economic Performance

In FY2015/16, Uganda's economy showed resilience and registered remarkable growth in spite of external shocks and election related uncertainty. GDP grew by 4.6% and while this was below the official government projection of 5%, it significantly outperformed the SSA region.

Accelerated growth was hampered by low commodity prices which affected export earnings and the slow recovery of major trading partners. Political instability in South Sudan, one of Uganda's major export destinations, continues to affect economic performance. High interest rates continued to be prevalent in FY 2015/16 largely brought about by a high level of government domestic borrowing to finance ambitious infrastructure projects. This weakened domestic demand as the private sector was starved of adequate credit.

The political climate in Uganda also affected the country's growth prospects as investors cautiously watched the outcome of the February 2016 elections. However, the re-election of NRM party is expected to restore long term confidence due to continuing of the investor-friendly policy.

The country's economic growth outlook is optimistic with real GDP growth expected to average at 6.3% over the medium term. The government's economic policies are expected to remain focused on keeping inflation low and boosting growth. Monetary policy easing is expected to come through in early 2017 which would relieve the tight credit conditions and boost private consumption.

High interest rates continued to be prevalent in FY 2015/16 largely brought about by a high level of government domestic borrowing to finance ambitious infrastructure projects

Macro economic indicators

Inflation

The economy experienced elevated inflationary pressures due to the impact of dry weather on food supply as well as that of the depreciation of the Uganda shilling on import prices.

At the end of 2015, inflation came in at 8.5% year-on-year well above BoU's 5.0% inflation target; however this subsided to 5.4% in May 2016. This was as a result of BoU's intervention in stabilising the exchange rate as well as the pass-through impact of declining fuel prices on consumer prices.

In the long term, the Consumer Price Index (CPI) inflation in Uganda is forecast to average around 5.5% annually. Food will continue to be a key driver of inflation over the coming years as weather patterns continue to become more unpredictable. Therefore, the government's plan to embark on the establishment of an Agriculture Insurance Scheme in 2016/2017 is a welcome measure

Interest rates

Commercial bank lending rates remained high in FY 16 due to high inflation and the limited availability of long term capital as the private sector was crowded out of the debt market due to high government borrowing.

As a result, credit growth to the private sector declined by about 8% in March 2016 compared to prior year. Access to credit by the private sector is expected to improve in FY 17 as inflation comes down and as a result of the government's gradual withdrawal from the domestic debt market.

Public Debt

As of 31st March 2016, Uganda's total public debt stock (domestic and external) was UGX 27.4 trillion (USD 8.1 billion) compared to UGX 21.5 trillion (USD 7.3 billion) by end of March 2015, indicating a 27 per cent increase over the past one year.

The increase was as a result of the huge depreciation that hit the Shilling over the past year as 38% of the debt was Shilling denominated. In addition, government's external borrowing for investment in infrastructure projects was also a major contributor. Nonetheless, the country's public debt remains sustainable at approximately 33% of GDP especially in comparison to other SSA countries such as Kenya which stood at 53% in 2014.

The IMF categorises Uganda as a low risk of debt distress.
The government has in recent years increasingly looked to the domestic bond market to finance its budget deficit. However, rising costs of domestic financing is forcing the government to cap domestic financing. As at March 2016, total domestic debt had increased by approximately 15% compared to the prior year.

Huge depreciation hit the shilling over the past year as 38% of the debt was Shilling denominated

External debt

Despite the increase in domestic financing external debt continues to make up the bulk of the total public debt accounting for 62%% as at March 2016. In FY 2015/2016, the Ministry of Finance postponed the planned denominated Eurobond issuance of USD 1 billion hence avoiding currency risk and high borrowing costs.

In the long term, borrowing costs are expected to come down as rates on Uganda's treasury bonds have been declining. For example the 2-year treasury bond yield declined from 23.6% in January 2016 to 16.2% in March 2016, which is below the yield of 16.7% at the end of the 2014/15 financial year.

Trade and investment

The country experienced a sharp widening of the trade deficit to USD 2,081 million in 2015 brought about by the narrow export base and heavy reliance on imports particularly capital goods that are needed for the completion of the NDP II infrastructure projects. The deficit is likely to widen further in FY 2016/2017 to USD 2,113 million equivalent to 9.3% of GDP.

In the long term, we expect the deficit to narrow upon the onset of oil production in 2021 as the country transitions into a net exporter of oil.

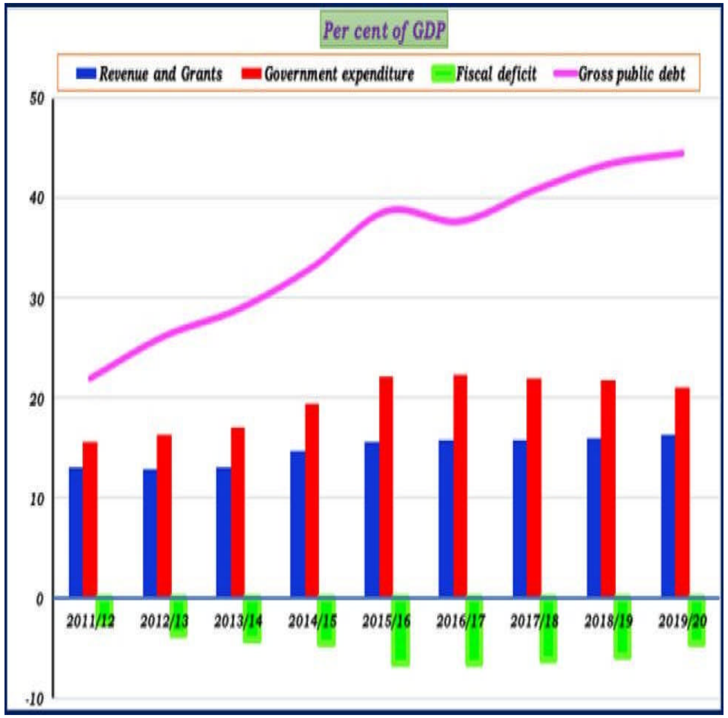
Macro economic indicator	FY 15 actual	FY 16 actual	FY 17 target
GDP Growth	5.0%	4.8%	5.5%
Headline inflation	5.8%	6.8%	6.9%
Fiscal deficit including grants and HIPC debt relief	-4.2%	-6.4%	-6.6%
Budget as a %age of GDP	18.2%	21.2%	22.4%
Domestic revenue as %age of GDP	12.8%	13.2%	13.9%

Macro economic indicators (continued)

The government's overall goal to transform Uganda into a lower middle income country with a per capita GDP of US$ 1,033 by 2020 requires the structural bottlenecks that have historically hindered growth be continuously addressed. While significant progress is being made in revamping infrastructure in strategic sectors of transport, energy and health, there is need for greater transparency, efficiency in service delivery and commitment to fiscal management particularly in relation to managing recurrent expenditure.

The country continues to rely significantly on agriculture, which makes up more than 60% of the export base. This exposes the country to price volatility in the international commodity markets and the changing weather patterns. Therefore, diversification of the export base should be an overriding consideration.

Nonetheless, the country's long term growth forecasts remain strong especially in view of future oil production and further discoveries in the oil and gas industry which are expected to boost the economy and the country's external account over the long term.



Source: BoU, Current State of the Economy, December 2015

Fiscal Performance

Projected outcome for FY15/16

Based on the projected outcome for FY15/16 performance for this year is tracking fairly close to the original budget, with domestic revenues slightly ahead and total expenditures only 0.1% over. Increased outgoings were attributed to higher domestic borrowing costs and the election, but with these largely being met by reallocations from other votes. The projected deficit is UGX 5,821 billion which is 6.6% of GDP (net of HIPC debt relief).

Budget for FY16/17

The total budget value is UGX 26.3 trillion which is 9.9% up on the FY15/16 figure of UGX 23.9 trillion The planned deficit is UGX 6,334 billion which is 6.8% of GDP (a 0.2% increase over the current year). The deficit is to be funded by a higher proportion of external borrowing as opposed to domestic lending (budgeted at UGX 597 billion net compared to UGX 1,616 billion for the current year), in an effort to relieve pressure on the domestic credit market. The increased public debt has a flow on impact on the budgeted interest costs, which are up by 21.9% to UGX 2,023 billion. A continuing trend is the decline in external budget support grants, which are expected to be UGX 55 billion in FY16/17 (compared to FY15/16 figures of UGX 253 billion budgeted and UGX 120 billion actual) with a drop to UGX 34 billion in the following year. This is offset by an increase in project support grants and concessional project lending. Of the budgeted UGX 5,737 external lending, UGX 2,521 billion comprises concessional project loans, related to infrastructure initiatives such as the Isimba and Karuma hydro dams, redevelopment of Entebbe Airport and Northern Corridor Integration.

Budget summary

	FY15/16 Budget UGX b	FY15/16 Projected UGX b	FY16/17 Budget UGX b
INCOMING			
Domestic revenue	**11,333**	**11,598**	**12,914**
Grants	**1,296**	**1,247**	**1,545**
Budget support	253	120	55
Project	1,043	1,127	1,490
Borrowing (fiscal deficit)	**5,881**	**5,821**	**6,334**
Domestic (net)	1,669	1,616	597
External (net)	4,212	4,205	5,737
Total Incoming	**18,510**	**18,666**	**20,793**
OUTGOING			
Government spend (excl interest)	**16,655**	**16,776**	**18,408**
Recurring	6,993	7,413	7,577
Development	7,183	7,061	9,226
Not specified	2,479	2,302	1,605
Debt servicing and repayments	**2,035**	**1,890**	**2,303**
Interest	1,688	1,659	2,023
External	172	151	169
Domestic arrears	175	80	111
Adjustment	-180		82
Total Outgoing	**18,510**	**18,666**	**20,793**
Domestic debt refinancing	4,787	4,787	4,978
Appropriation in aid (MDAs)	495	495	672
TOTAL BUDGET	**23,972**	**23,948**	**26,361**

Source: MOFPED Background to the Budget, Tables 7.3 and 21, Budget speech

Domestic revenues

Projected outcome for FY15/16

After being almost UGX 200 billion behind their collection target at the three quarter stage in March, the URA is now projected to exceed the annual target by UGX 121 billion, a 1.1% margin. The total tax revenue of UGX 11,192 billion represents a 14.5% increase over the prior year. The total domestic revenue has been aided by an unbudgeted sum of UGX 124 billion described as oil revenues which is understood to comprise the second instalment of the Tullow capital gains tax settlement.

Domestic revenues as a percentage of GDP are 13.2% for the year (FY14/15 12.8%) and this is projected to increase to 14.8% in FY16/17 and 14.9% in the following year. The Government has a target to increase this ratio by 0.5% per annum on average over the next five years. Comparative figures for our EAC neighbours (see table) show that Uganda is lagging in this area.

A breakdown of tax revenues by source is set out on the following page. Factors negatively affecting the current year revenues are lower import demand due to currency devaluation, a slow down in activity due to the election and tight credit conditions in the private sector. This is reflected in underperformance in domestic income and consumption taxes, while international trade taxes and reduced refunds made up the shortfall. It is stated that there was improved performance seen in respect of corporate income tax (CIT) due to URA audit and recovery activities.

Domestic revenues summary

	FY15/16 Budget UGX b	FY15/16 Projected UGX b	Outcome v. Budget %	FY16/17 Budget UGX b	Increase %
Tax revenue (URA)	11,071	11,192	101.1%	12,480	11.5%
Non tax revenue	262	282	107.6%	302	7.1%
Oil revenues	0	124		132	6.5%
Total Domestic Revenue	**11,333**	**11,598**	**102.3%**	**12,914**	**11.3%**
% of GDP	12.9%	13.2%		14.8%	

Source: MOFPED Background to the Budget, Tables 7.3 and 21

EAC: Domestic revenues as % of GDP

	FY15/16 Projected %
Kenya	16.8
Rwanda	21.9
Tanzania	14.8
Uganda	13.2

Domestic revenues

Forecast for FY16/17

The URA tax collection target for the coming year is UGX 12.5 trillion, representing a UGX 1.3 trillion or 11.5% increase over FY15/16. The increase in excise duty rates is expected to contribute around UGX 230 billion of this while the balance is expected to come from other tax measures, general economic upturn and improvements in tax administration efficiency. The latter comprises various measures including:

- Expanding the tax base to include the informal sector;
- Enhancement of compliance, through comprehensive audits, taxpayer education, promoting the issue of receipts and introduction of Electronic Fiscal Devices (EFDs) to track VAT invoicing;
- Elimination of tax avoidance and evasion; and
- Enforcement of collections, including investment in tax collection infrastructure.

Tapping into the informal sector is to be done in collaboration with other entities such as URSB, KCCA and other local governments, under expansion of the Taxpayer Expansion Registration Project. The URA will also use the national ID system to identify taxpayers.

Particular revenue sources that are expected to contribute proportionately more in the coming year are corporate income tax (CIT), domestic withholding tax, rental tax, domestic excise duty and international trade taxes. The last revenue source is driven by increased excise duty rates (especially on petroleum) and an expected upturn in import volumes (notwithstanding the call to Buy Ugandan).

Sources of tax revenue

	FY15/16 Budget UGX b	FY15/16 Projected UGX b	Outcome v. Budget %	FY16/17 Budget UGX b	Increase %
Direct domestic (income)	**3,684**	**3,655**	**99.2%**	**4,218**	**15.4%**
PAYE		1,745		1,891	8.4%
CIT		775		961	24.0%
WHT		673		798	18.6%
Rental tax		45		61	35.6%
Tax on bank interest		332		371	11.7%
Other		85		136	60.0%
Indirect domestic (cnsmptn)	**2,682**	**2,433**	**90.7%**	**2,652**	**9.0%**
VAT		1,717		1,790	4.3%
Excise		716		862	20.4%
International trade	**5,043**	**5,136**	**101.8%**	**5,591**	**8.9%**
Import duty		978		1,151	17.7%
VAT		2,003		2,088	4.2%
WHT		229		222	-3.1%
Excise		232		294	26.7%
Petroleum (excise duty)		1,381		1,474	6.7%
Infrastructure levy		67		76	13.4%
Other		246		286	
Balancing/Other	-103	150		*206*	
Refunds	-235	-182		*-187*	
Net tax revenue	**11,071**	**11,192**	**101.1%**	**12,480**	**11.5%**

Source: MOFPED Revenue Projections Annex 2

Government spending

Sector allocations for FY16/17

The planned government spending for the coming year, inclusive of external financing and statutory payments but excluding interest costs, totals UGX 18.4 trillion (19.8% of GDP). This is allocated to the specific sectors as set out in the table. Each sector comprising a number of separate votes.

Works and Transport continues to be the main recipient, which is not unexpected given the Government's continued focus on infrastructure development. The biggest vote by some margin within this sector in UNRA and they also account for a large part of the 14.9% increase.

Consistent with the Government's priorities and as outlined in the budget speech, significant increases are also reflected for Education, Health, Public Sector Management (a large part of which is directed to local government), Agriculture, Water & Environment and Tourism.

Sector allocations

	FY15/16 Budget UGX b	Share %	FY16/17 Budget UGX b	Share %	Increase %
Works and Transport	3,329	20.0%	3,824	20.8%	14.9%
Education	2,029	12.2%	2,447	13.3%	20.6%
Energy & Minerals	2,826	17.0%	2,377	12.9%	-15.9%
Health	1,271	7.6%	1,827	9.9%	43.7%
Security	1,636	9.8%	1,579	8.6%	-3.5%
Public Sector Mgmt.	948	5.7%	1,274	6.9%	34.4%
Justice/Law & Order	1,051	6.3%	1,104	6.0%	5.0%
Accountability	1,006	6.0%	962	5.2%	-4.4%
Agriculture	480	2.9%	823	4.5%	71.5%
Water & Environment	547	3.3%	690	3.7%	26.1%
Public Admin	758	4.6%	532	2.9%	-29.8%
Legislature	371	2.2%	470	2.6%	26.7%
Social Development	90	0.5%	193	1.0%	114.4%
Lands, Housing & Urban Dvpmt	165	1.0%	147	0.8%	-10.9%
Tourism, Trade & Industry	81	0.5%	104	0.6%	28.4%
ICT	67	0.4%	55	0.3%	-17.9%
Total (excluding Interest)	**16,655**	**100.0%**	**18,408**	**100.0%**	**10.5%**
Interest	**1,688**		**2,023**		**19.8%**
Total (including Interest)	**18,343**		**20,431**		**11.3%**

Source: MOFPED Background to the Budget, Table 7.4

Key Sectoral Reforms

Agricultural sector

Background

The agricultural sector remains the backbone of Uganda's economy. This categorization is corroborated by the recognition that 85% of Uganda's labour force is employed in agriculture and income from key agricultural exports represents 36% of Uganda's foreign exchange earnings. In FY 16/17, the sector contributed 26% to GDP and experienced a growth of 3.2% (FY 14/15: 2.3%). It is therefore no surprise that Uganda's inclusive economic growth strategy, designed to alleviate poverty and achieve middle income status, recognizes the need for significant investment in the agricultural sector.

The subtle contradiction between the categorization of the agricultural sector as a backbone of the economy and its contribution to GDP is a function of the challenges that have, for many years, blighted the sector. These challenges largely revolve around the recognition that a significant proportion of Uganda's agricultural output is produced by small holder farmers.

These small holder farmers, many of whom are trapped in poverty, apply inefficient and ineffective agricultural practices that contribute to low agricultural productivity and production. For example, individual farm sizes remain relatively small (on average not exceeding 2 hectares), farming technology is largely rudimentary whereas limited accessibility of rural areas hinders the small holder farmers access to valuable agricultural extension services and markets.

There are several other challenges that are not restricted to the small holder farmer and affect the agricultural sector in Uganda as whole. These, as also identified in the National Agricultural Policy, include a failure to maintain a consistent policy regime and functional institutions, low value addition to agricultural produce, limited access to markets, a lack of access to affordable finance and land fragmentation that constrains productivity.

The Continued Relevance of the Agricultural Sector

Addressing the agricultural sector's challenges is essential to realizing the Government's goal of developing an integrated private sector-led and market-oriented economy that will transform Uganda into a middle income economy. This assertion is supported by the recognition that, with a significant proportion of the population employed in agriculture (amongst other factors), it will be difficult to achieve structural transformation without modernizing the agricultural sector.

Transformation of low productivity agriculture into high productivity commercial agriculture, is in Uganda's case, an essential pre-condition for successful industrialization. And successful industrialization in Uganda hinges on development of industries in which Uganda has a comparative advantage. Uganda's conducive climatic conditions and abundance of arable land (amongst other factors) give it a clear agricultural comparative advantage making clear the case for development of agro-processing industries.

Agricultural sector (continued)

Development of agro-processing industries strengthens backward and forward linkages along the agricultural value chain directly contributing to the wealth creation agenda through creating employment and increasing the value of agricultural products to the end consumer.

These industries also strengthen production and consumption linkages which contribute to higher rural incomes, improved food and nutrition security, increased savings especially in rural areas allowing for mobilization of capital for domestic industry and the expansion of domestic markets for non-agricultural products.

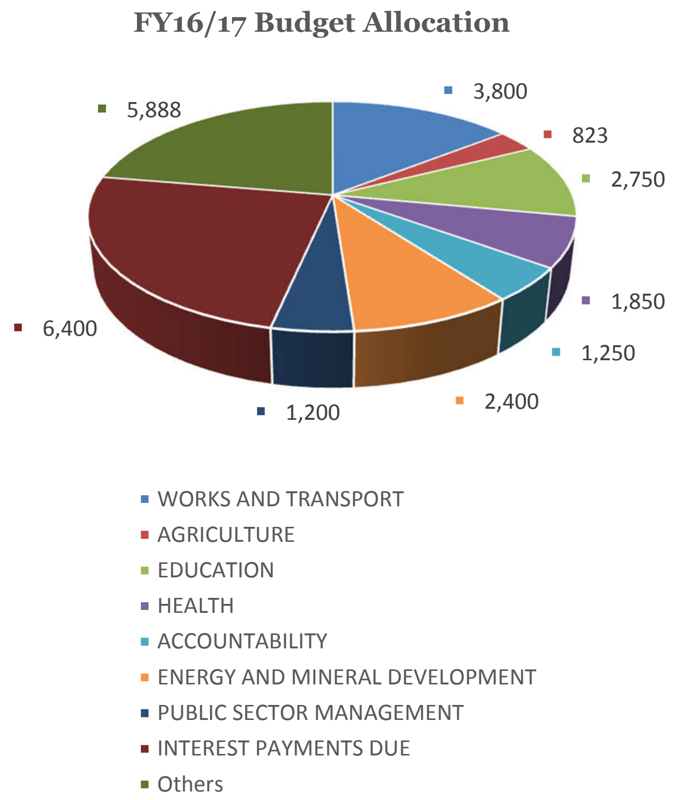
The FY16/17 budget and the agricultural sector transformation objective

It was therefore welcome that the Minister, in presenting the FY 16/17 budget, specifically recognized the need for the government to overhaul and reorganize the agricultural sector with key interventions that focus on reforming land ownership and use, increasing investment in farmer training, providing extension services to farmers, enabling irrigation finance and increasing access to markets.

This commitment was reflected in the allocation of UGX 823 billion to the Agricultural Sector representing an increase of 69% from the FY 15/16 budget allocation of UGX 480 billion.

It is expected that this resource allocation (together with funding to the agriculture sector in subsequent periods) will enable Uganda increase its agricultural production. For example, coffee production and export is projected to increase six fold from the current 3.6 million bags to 20 million bags (valued at US$ 2.4 billion) in the next four years. This focus is important considering that coffee exports currently represent 13.6% of Uganda's foreign exchange earnings.

What was not clear though from the presentation of the budget was what, as phrased by the Minister, "the total overhaul and reorganization of the agricultural sector" will entail. Clarity on the government's planned policy adjustments and the sectoral interventions is necessary to assess whether or not the increase in budget allocation to the agricultural sector will achieve the desired transformation of the sector.



Agricultural Sector (continued)

The Policy Environment

It is clearly recognized in the National Agricultural Policy that the lack of a consistent policy regime is one of the key challenges that has frustrated the transformation of the agricultural sector.

There is also, to some extent, a lack of coherence in policy implementation. Therefore clarity on the nature and extent of the planned overhaul and reorganization of the agricultural sector is required to reassure sector players that government interventions will indeed result in increased production and productivity in the sector.

Some of the key issues on which clarity has not been provided is the funding allocated to and the expected impact on productivity of key NDP II Core Projects namely (i) the Agricultural Development Cluster Project (ADCP) that aims to raise productivity, production, and commercialization of coffee, maize, rice, beans and cassava in specified clusters of districts across the country; and (ii) the Markets and Agriculture Improvement Project (MATIP II). The categorization of these as core projects implies that their implementation is intended to have a profound impact on agricultural productivity and access to markets

The current policy regime emphasizes the pursuit of a private sector-led and market-oriented economy primarily through the elimination of constraints that frustrate private sector investment in agriculture.

Whereas it may not represent a significant proportion of the budget allocation to the sector, funding to support policy coherence, implementation and enforcement efforts should be singled out because the success of all other sector initiatives depends on the sector's policy foundation.

This will be of even greater importance in FY 16/17 where, as indicated in the current budget, new policies and initiatives will be introduced and existing ones implemented. The policies and regulations that will receive focus include the Fertilizer Policy, the Seed Policy, the Irrigation Policy, the Mechanization Policy, the Plant Variety Protection Regulations and the requirements of the Plant Protection and Health Act. There will also be focus on the effective implementation of the refined Agriculture Single Spine Extension System and operationalization of the Agriculture Police Unit.

The developments in the policy environment clearly demonstrate that collaboration and coherence in policy implementation and enforcement, in an already crowded policy environment, is essential to the success of the sector.

Realizing the potential of agricultural production zones

Implementation of initiatives that support the commodity based approach in the development of Uganda's agricultural production zones is essential to the realization of Uganda's comparative advantage.

The budget was silent on incentives that would support effective operationalization of the already identified agricultural production zones.

Operationalization of the production zones would, amongst other initiatives require incentivisation of small holder farmer aggregation (for example through strengthening of cooperatives) and the establishment of agro-processing industries that create both backward and forward linkages.

The focus of the medium to long term is the development of key agricultural products namely Cotton, Coffee, Tea, Maize, Rice, Cassava, Beans, Fish, Beef, Milk, Citrus and Bananas. Effective incentives would, for example, be aligned to directly verifiable improvements such as the development of the agricultural supply chain from small holders. Incentives would also focus on the development of infrastructure that has a direct linkage to the development of an agricultural production zone.

Agricultural Sector (continued)

Whilst there is a recognition that a significant proportion of the budget is allocated to development of energy and transport infrastructure, a direct linkage between these infrastructure projects and the impact on identified agricultural production zones would have corroborated the plan to realize Uganda's agricultural comparative advantage.

Access to markets

Key FY16/17 interventions that are designed to address access to markets and improve on the competitiveness of Uganda's agricultural produce are the implementation of the Nairobi Package and the second phase of MATIP II.

Uganda expects to benefit from the implementation of the Nairobi Package under which all signatories (which include developed countries) are expected to abolish export subsidies for farm produce. Implementation of this agreement is expected to benefit local production by increasing competitiveness of local agricultural produce on both the domestic and international markets. There is also a specific recognition that there is need for focus on the development of cotton.

Under MATIP II, the Government plans to construct mini-storage facilities; provide five units of first level value addition equipment for cleaning, grading/sorting and de-stoning; establish quality control, management, grading and standardization systems; and undertake the construction of an additional 14 markets.

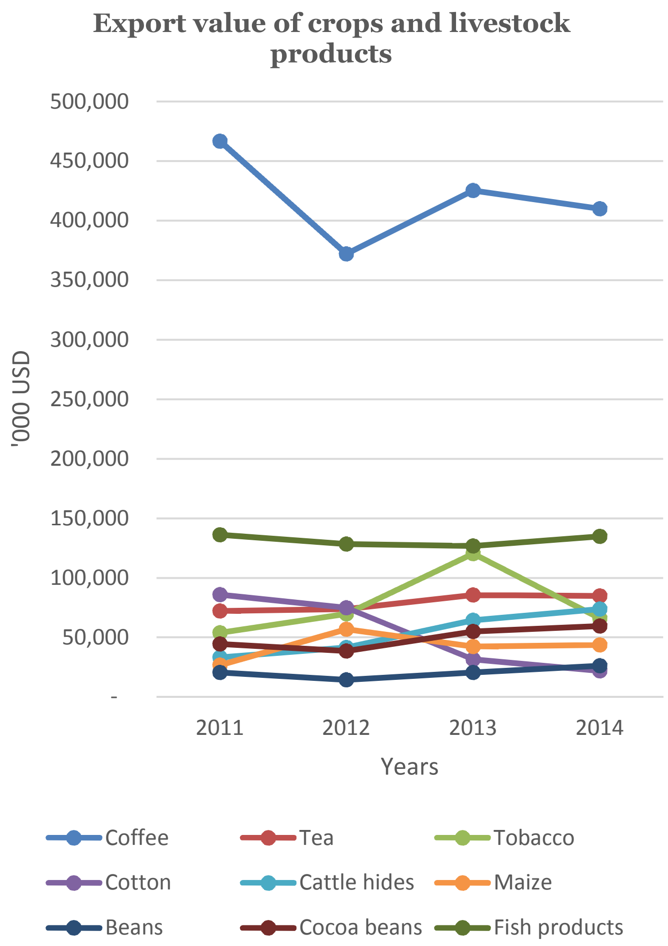
Whereas the Nairobi Package (if it is implemented and enforced) and MATIP II are good initiatives that will support the access to markets objective, it is not clear on how the budget allocation will support their implementation. Specifically though, it is unclear what impact the implementation of these initiatives will have on the production of and value addition to crops under the ADCP.

Agricultural Finance

Initiatives to address the availability and affordability of agricultural finance did not receive prominent mention in the budget.

The analysis of FY15/16 financial performance recognizes that growth in agricultural sector lending declined to 17.9% (FY 15/16: growth of 35.8%). This of course is a function of both affordability of finance, the rate of return on agricultural investments and growth of the agricultural sector.

The introduction of Agricultural Insurance Finance (AIF) support budgeted at UGX 5 billion will assist qualifying investments to manage the risk of investments in agriculture. The government has also committed to continue funding under the Agricultural Credit Facility (ACF) which in FY 14/15 disbursed UGX 179.02 billion.



Agricultural Sector (continued)

Intervention through the AIF and ACF, amongst other measures is welcome. However, it is also unclear what the impact of these interventions will be on improving agricultural production and productivity to achieve the desired agricultural targets particularly recognizing that AIF and ACF funding are equivalent to 0.025% and 0.9% of the agricultural sector's FY 15/16 GDP of UGX 19,880 billion.

Other considerations

Structural deficiencies

Eliminating structural deficiencies in the agricultural sector (many of which have been articulated above) will improve the rate of return on investment in agricultural enterprise and in a way act as a catalyst for increased uptake of affordable (or subsidized) agricultural finance such as that under ACF (to the extent that it does not contradict the Nairobi Package).

One such deficiency the elimination of which the FY 16/17 budget seeks to fund is the reliance on rain fed agriculture through for example the construction of valley tanks and community irrigation schemes.

Another budgetary intervention is the provision of extension services which the government will fund under the Single Spine Extension System with UGX 39 billion (FY 15/16: UGX 10 billion) directed at the wage budget for extension workers at the local government level.

Like other interventions mentioned above, the budget is light on the correlation between the efforts to eliminate structural deficiencies, the alignment of these interventions to the agricultural production zones and the expected impact, in FY16/17, of these measures on production and productivity for each of the key agricultural products.

Budget Sensitivity Analysis

One of the key factors to which the decline in GDP growth (FY15/16: Actual 4.6% vs Budget 5.0%) has been attributed is the significant decline in world commodity prices and exchange rate volatility. These are factors that remain largely outside the control of the government. It is therefore surprising that the budget is silent on what impact adverse variations in commodity prices and exchange rates will have on its ability to generate the revenue required to execute its budgeted expenditure plan.

This is an exposure that a budget sensitivity analysis would address and would include a project priority matrix that shows expenditure priorities and how these would be impacted. Such an analysis would for example also include an alignment of the economic contribution (GDP contribution, foreign exchange earnings and employment) of each of the key agricultural products supported under the budget.

Budgetary fiscal discipline

It was surprising that the agricultural sector, considered to be the backbone of Uganda's economy, had the lowest budget absorption (at a rate of 70% of funds allocated) at the FY 15/16 semi-annual budget performance review.

Whilst the increase in resource allocation is welcome, it is evident that the success of the budgetary interventions will not rest on remediating the structural deficiencies in the agricultural sector but will also hinge on addressing the key administrative bottlenecks that contribute to the low budget absorption. And the efficiency in budget absorption is more than a focus on resource utilization, it is also (and equally as important) a function of the timely utilization of allocated resources.

Therefore the articulation of remedial measures to address budget absorption shortcomings would inspire confidence in the realization of the projected agricultural outturn envisaged in the FY16/17 budget and beyond.

Agricultural Sector

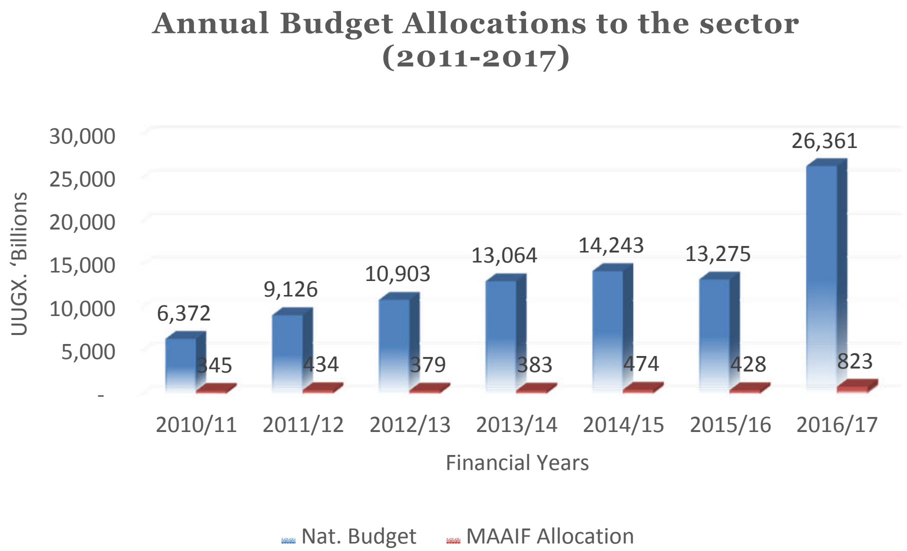
Conclusion

Whilst it is envisaged that significant investments in the agriculture sector will be private sector driven, as is the case in many countries with thriving agricultural sectors, the appropriateness, coherence and consistency in government policy will undoubtedly influence the nature, timing and extent of private sector investment.

In an environment such as this where the government continues to face resource scarcity challenges, the 69% increase in the budget allocation to the agricultural sector is a welcome and clear statement of intent showing the government's commitment towards transforming the agricultural sector.

Whereas the resource allocation to the agricultural sector represents 3% of the total FY16/17 budget (significantly less than the 10% prescribed by the Maputo Declaration), the key issue towards the refinement of the budget allocation remains two fold (i) improving the efficiency and effectiveness of the agricultural policy environment; and (ii) aligning budgetary interventions to agricultural policy priorities supported by measureable agricultural performance targets.

The absence of this alignment in the FY16/17 budget will most likely compound the ineffectiveness of otherwise well-intentioned agricultural intervention initiatives.



FY	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
National Budget	6,372	9,126	10,903	13,064	14,243	13,275	26,361
MAAIF Allocation	345	434	379	383	474	428	823
% of National Budget	5.4%	4.8%	3.5%	2.9%	3.3%	3.2%	3.2%

Energy and Transport

Introduction

Key among Government's priority areas in the short and medium term is the development of the energy and transport sectors on the basis that these areas form the backbone of Uganda's propulsion to becoming a middle income country by 2020 and attaining economic transformation by 2040.

These two sectors have consistently been allocated more than 30% of Uganda's total Government spend (excl debt repayments) with 34% being allocated in the FY17 budget (FY16 33%).

Government estimates that the stimulatory impact of the current development of these sectors will start to be felt in FY18 when acceleration of economic growth is expected to commence (FY17 growth is estimated to be 6.2%).

Energy and Transport have jointly taken the biggest share of Gov't spend excl debt repayment, 34% in FY17 and 33% in FY16

Is all the Government focus worth it?

Our view is that Government's approach and focus on the above infrastructure sectors is the correct route to take, on paper. However, Uganda's target of reaching middle income status by 2020 and achieving economic transformation by 2040 is an ambitious one.

For Government to have a chance of meeting its tight objectives through the investment and development of these two sectors, plenty of effort has to be put in throughout the implementation process.

Government has to ensure that these projects are efficiently implemented and managed, with minimal wastage and diversion of funds, and proper monitoring and evaluation of progress of the projects.

In addition, the projects have to be aimed at areas which have real potential to provide further value addition and to attract the private sector.

This will ensure that the economy derives a higher economic return and bigger multiplier effect from the huge investments.

Value addition around development projects is important in attracting the private sector as part of growth stimulation

Energy and Transport cont'd

What do we need to get there?

In a recently published World Bank report, Uganda Economic Update - April 2016, which focuses on public investment returns, it is stated that currently for every 1 USD spent by Government on the public investment, the Uganda economy only generates 70 US cents in additional economic activity.

This is quite a small multiplier effect which hardly spurs the required economic growth targets set for the medium term. Ideally, public investment should generate much more greater economic activity for any developing economy such as Uganda that has ambitious transformational targets.

By way of example, the same World Bank report refers to the US where between 1954 and 2001 during the development of the interstate highway network, 6 USD of additional economic activity was generated for every 1 USD invested.

Government therefore has to ensure that budget plans and allocations made for the different infrastructure sectors are well executed, from commencement of implementation through to completion, for each and every project and public investment in order to achieve the desired economic outcomes.

In his budget speech, the Minister specifically mentioned that as part of project selection appraisal of future roads, the Government shall first evaluate the potential of value addition in the area before committing any funding.

In addition to selecting projects around areas that will provide value addition, there are other key indicators of a potential efficient and effective budget. Some of the main indicators which we shall look at are as follows:

- the resource allocation split in Government spend between recurrent and development expenditure. The higher the proportion of development expenditure, the more efficient and effective the budget is likely to be.

- the nature and cost of funding to Government to be used for the different projects. Generally, the lower the cost of funding, the more efficient and effective the budget is likely to be.

- In addition one also has to monitor the ratio of actual spend in a year compared to the initial budgeted spend. A sign of inefficiency is if there is a huge variance between what was budgeted for and what was disbursed/spent, either a significant shortfall (underspending) or an excess (overspending).

In light of the above, we shall now look at the Government's planned budgetary expenditure and proposed policies directly relating to the energy and transport sectors within this context of efficiency and effectiveness.

For Government to have a chance of achieving its ambitious growth targets, implementation of energy and transport projects should be properly monitored

Energy and Transport (continued)

Energy - Summary of key planned FY17 projects and reforms

The main hydro power projects that Government will be focusing on in FY17 are the 600MW Karuma Hydro Power Plant (UGX 873 billion) and the 183MW Isimba Hydro Power Plant (UGX 502 billion).

Although the Background to the Budget FY17 document mentions that the construction of the 600MW Ayago hydro electric power project is planned to start in FY17, it was not mentioned in the Budget Speech, where only the Karuma and Isimba projects were mentioned for FY17. In addition, the Central Government detailed estimates breakdown specifically shows that no development expenditure is planned on Ayago in FY17.

This inconsistency and lack of clarity in the budget documentation on such a key project has to be explained by Government otherwise it may result in uncertainty and doubt in the planning process.

Government has proposed some tax exemptions on renewable generation projects to attract private investment

Government has also planned significant expenditure on a number of electricity transmission and interconnection projects throughout the country of approximately (UGX 300 billion) in FY17, which is close to double what was budgeted for in FY16.

Government is encouraging the private sector to invest in different sources of renewable energy as this shall be key in achieving the overall generation capacity of 2,500 MW by 2020 as per the NDP II.

For FY17, Government has proposed a VAT exemption on all renewable energy generation projects including solar generation, and an import duty exemption on imports of goods for use in solar and wind energy generation, both of which greatly reduce the investment cost (particularly of importation of goods and services).

These proposed tax reforms are aimed at attracting and promoting further investment by the private sector in renewable energy generation.

Summary of budgeted FY17 Energy expenditure split between recurrent and development expenditure

ENERGY FY17	Total Recurrent Exp (UGX billions)	Total Dev't Exp (UGX billions)	Total Budgeted Exp (UGX billions)
Energy Planning, Management & Infrastructure Dev't	1.10	492.33	**493.43**
Large Hydro power infrastructure	0.00	1,402.03	**1,402.03**
Policy, Planning and Support Services	3.61	17.38	**20.99**
Rural Electrification	0.00	269.16	**269.16**
Total	4.71	2,180.90	**2,185.61**

Energy and Transport (continued)

Transport – Roads - Key FY17 projects

According to the National Budget Framework Paper FY16/17, on average 60% of UNRA's development budget will be allocated to upgrading gravel roads to bitumen standard which is in line with the NDP II target of increasing the stock of paved roads by 400km annually. The other 30% of the development will be allocated to rehabilitation of the old paved roads aimed at reducing the road maintenance backlog.

The key road projects that are expected to be funded in FY17 are the Kampala Entebbe expressway (UGX 307 billion) and the Northern bypass phase II (UGX 89 billion).

Some of the other key projects budgeted for UNRA under the FY17 2.5billion development expenditure as listed in the detailed Central Government estimate but not mentioned in the Background to the Budget (BTTB) include

- Kampala Flyover project (UGX 229 billion)
- Transport Corridor project (UGX 260 billion)
- North Eastern Corridor (UGX 102 billion)
- Kibuye-Busega Mpigi (UGX 134 billion)
- Kampala-Jinja expressway (UGX 60 billion)

Transport – Railway

Under the railway subsector, some work on the eastern part of the Standard Gauge Railway will commence in FY17 with the acquisition of land between Malaba and Kampala (UGX 118billion) as stated in the budget speech.

However, although the BTTB states that construction will commence in FY17, only funds budgeted for acquisition of land are allocated for FY17 as per the detailed expenditure breakdown.

These inconsistencies on such key road and railway projects have to be clarified by Government to avoid planning uncertainties and creating doubt in the private sector.

Government should provide clarity on inconsistencies in budget documentation for key projects in both the energy and transport sectors

TRANSPORT FY17	Total Recurrent Exp (UGX billions)	Total Dev't Exp (UGX billions)	Total Budgeted Exp (UGX billions)
Ministry of Works and Transport	43.47	358.26	**401.73**
Uganda National Roads Authority	80.89	2,553.23	**2,634.12**
Road Fund	417.84	0.00	**417.84**
Kampala Capital City Authority	0.00	343.70	**343.70**
Local Governments	0.00	22.64	**22.64**
Total	542.20	3,277.83	**3,820.03**

Energy and Transport (continued)

Transport - Air

The rehabilitation of Entebbe International Airport (UGX 113 bn) is also a key project which started during the current financial year of which Phase 1 of construction (rehabilitation of runways, taxiways and aircraft parking aprons) is expected to end in 2018.

Transport –key tax reforms

The Government has set out to promote investment in the transportation industry by the private sector by reducing import duty taxes for one year on some heavy duty commercial vehicles in FY17 i.e. road semi-trailer tractor heads, goods carrying vehicles of different capacities and buses exceeding 25 persons.

Road semi-trailer tractor heads and goods vehicles of 20 tons are now subject to 0% import duty for a year (from 10 % and 25% respectively), while buses carrying at least 25 persons and goods vehicles of 5-20 tonnes are now subject to 10% import duty for a year (from 25%).

High level commentary on budget efficiency

a)Resource allocation – Development budget vs Recurrent budget

There is a clear aim at restricting recurrent expenditure to a minimum for both energy and transport sectors. Under the Energy sector, 0.22% has been allocated to recurrent expenditure with the balance of 99.67% allocated to development expenditure, for FY17.

For the transport sector, a portion of 14% has been allocated to recurrent expenditure with the balance of 86% allocated to development expenditure.

On average, these allocations are all within the same range as prior year (marginal improvement) which is consistent with Government's NDP II objective of minimising planned recurrent expenditure and maximising the development and capital expenditure.

In our view, the current planned allocation proportion between recurrent and capital expenditure is sufficient for an efficient budget although there is more room for improvement particularly in the transport sector.

b) Nature and source of Funding

The planned budgeted expenditure for the transport and energy sectors in the next financial year is going to be funded mostly by external financing.
Of the total UGX 2.2 trillion planned FY17 expenditure marked for the energy sector, 82% is going to be from external funding (FY16 - 87%).

For the transport sector, Government plans to borrow 43% externally of the total UGX 3.8 trillion planned budgetary expenditure in FY17 (FY16 38%).

The available budgetary documentation does not breakdown the detail of the different internal and external borrowing sources and specific budgeted interest rates/costs for each, to enable us to better analyse the implications of the proportions and allocations.

However, there are government reforms that can reduce the cost of funding (reduced market interest rates) to Government, such as transparent political reforms.

High level commentary on budget efficiency – continued

c) Budget Performance – Target expenditure vs Actual expenditure

This indicator can only be fully assessed at the end of the financial year when the actual expenditure for the respective year is confirmed, however we can highlight progress on what is currently taking place in the current year on different projects under the two sectors.

In the energy sector, some of the key investment projects were ahead of schedule by December 2015 e.g. Karuma project was above 50 percent of the target expenditure whereas the Isimba hydro power plant project was close to 90%.

However, further development work on the Karuma Hydropower project has recently been put on hold pending quality control queries, which will directly affect its progress by year end.

In the transport sector, specifically the road sector, execution has generally been behind schedule for the development/capital targets coupled with over spending under the recurrent budget targets (154% by the third quarter and is expected to reach 174% by end .June 2016). This has been caused mainly by poor management of contracts execution and the restructuring of UNRA, according to MOFPED and the World Bank report – Uganda Economic update April 2016.

The report further states that while there was a slow execution of the development projects in the transport sector which left space in the budget, it increases the risk of tilting the balance of expenditure towards recurrent expenditures, which as explained earlier, further decreases the effectiveness and efficiency of the budget.

The budget has potential to make the country meet its medium and long term objectives, but structural and political reforms are required to achieve effectiveness and efficiency.

Conclusion

In conclusion, this is a budget that correctly places energy and transport at the forefront and has the potential to be effective and efficient enough to drive the economy to meet its medium and long term targets.

With proper implementation policies and a strong monitoring and appraisal framework in place throughout the investment process, Uganda has a shot at achieving middle income status by 2020 and economic transformation by 2040,

However, there are some inconsistencies highlighted above for both sectors between what is budgeted for in some of the source policy documents and what has been planned and mentioned by the Minister, which have to be addressed going forward.

A Strong Banking Sector

Overview of performance during the 2015 calendar year

The Ugandan banking sector is in a sound financial state, reporting an 11.5% increase in annual after tax profits to UGX 541.2 billion, and an adequate total capital ratio of 21% to its risk weighted assets during the year ended 31 December 2015. The average return on equity for the industry also remains healthy at nearly 16%.

Industry performance was driven largely by the performance of the top players, i.e., Stanbic, Standard Chartered Bank, Centenary Bank and Crane Bank (who collectively control at least 47% of all banking assets, 46% of customer deposits and 49% of loans) .

Whereas Stanbic and Centenary Bank reported steady growth and profitability, Standard Chartered registered a sharp decline in net profits while Crane Bank suffered a UGX 3 billion loss even though underlying performance remained strong.

Overall, the industry showed resilience given turbulence in currency and interest rates in the year and the uncertainty arising from the 2016 general election.

Impact of the monetary policy on interest rates during the year

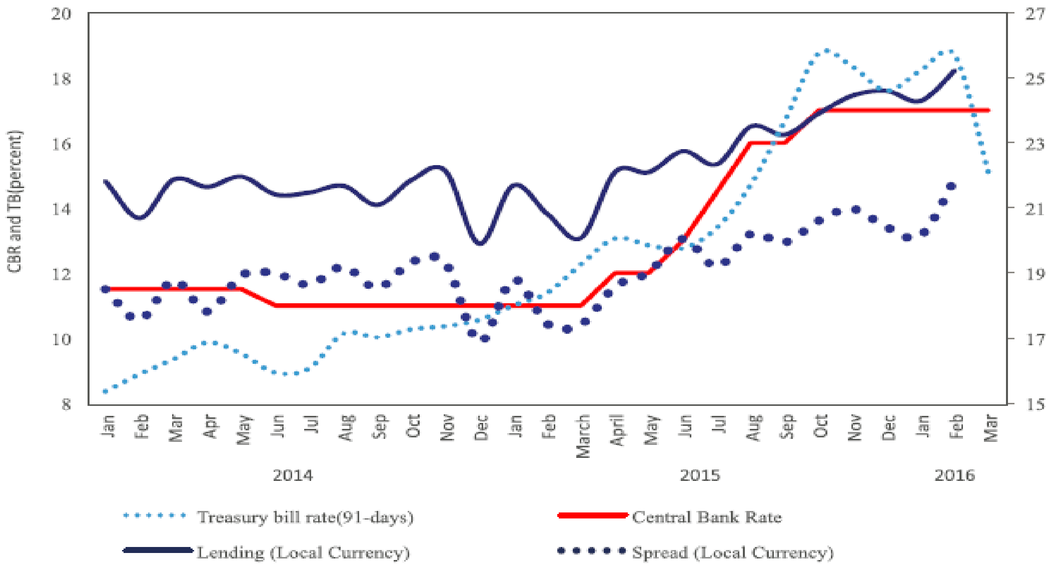
The Uganda Shilling fluctuated between 2,800 and 3,700 from January to September 2015, eventually settling at 3,360 in December 2015.

This has been attributed to a global strengthening of the US dollar as the US economy rebounded, a sharp decline in forex earnings from exports in light of a global decline in commodity prices whilst demand for dollars increased strongly from the corporate sector. Speculation in the market also exacerbated the situation before measures by BOU restored demand for the UGX.

Pressure on the UGX not only worsens the current account but also creates inflationary pressure, this being an import led economy.

Against this backdrop, Bank of Uganda (BOU) raised its key policy central bank rate (CBR) from 13% in June 2015 to 17% in October 2015. This was maintained until April 2016 and revised down to 16% thereafter.

The upward adjustments to BOU's CBR and an expansionary domestic borrowing program through issuance of Government paper strengthened the UGX and reduced inflation from 8.5% in December 2015 to 5.4% in May 2016. However, the actions put upward pressure on average bank lending interest rates from 21.6% during FY 2014/15 to 23.93% during FY 2015/16.



Source: Bank of Uganda

Impact of the monetary policy on interest rates (continued)

The vast majority of loans in Uganda attract variable interest rates. Following the rise in the interest rates during the year, some borrowers struggled to service debt, leading to higher performing loans (NPLs) and pressure on banks from Government to lower their costs of borrowing.

The industry registered an 116 basis points (bp) increase in the NPL to total gross loans ratio from 4.13% in 2014 to 5.29% in 2015. This followed a 184 bp reduction in this ratio between 2013 and 2014. It is a widely understood that an increase in interest rates is directly correlated to increase in NPLs.

The risk of higher interest rates has reduced as inflation is now around the policy target of 5%, permitting the recent reduction in the CBR. Current trends suggest that all things remaining equal, we can expect CBR and interest rates in general to reduce in the short-medium term.

Uganda's average commercial bank lending rate during the 2015 calendar year (22.60%) is much higher compared to economies enjoying rapid economic growth and transformation such as Nigeria (16%), Malaysia (4.6%), Turkey (9.5%), Indonesia (7.25%) and India (9.7%)- which witnessed similar rises and falls in their currencies and stocks during the year.

Considering that Uganda needs to invest in capital formation in order to achieve economic growth targets, access to affordable credit is a critical factor to our growth ambitions. Banks are also coming under increasing pressure from Government to lower interest rates to deal with default on a more transparent and fair basis.

If commercial banks are to lower their net interest margins without impacting profitability, deliberate action needs to be undertaken by all players in the market, that is, the commercial banks themselves, Government and borrowers.

A key driver of commercial bank lending interest rates is the CBR which is the benchmark for setting commercial bank interest rates. Another major driver is the yield on Government treasury bills and bonds. Therefore in order to promote lower commercial banking lending rates, it is necessary to take actions that lower both CBR and yields on Government paper. Whilst CBR is mainly a function of underlying economic fundamentals such as inflation and forex rates, and whilst treasury bills and bonds can and have been used as a monetary instrument, yields on Government paper are also driven by the extent of Government domestic borrowing. Moreover, high yields on Government paper discourage banks from lending to the private sector by offering attracting rates at no perceived risk and with minimal overheads.

Accordingly, optimising domestic borrowing and related yields is going to be important in order to create appropriate conditions for credit to the private sector to grow and thrive.

In this regard, the proposal to reduce the issuance of Government securities from UGX 1.384 trillion in 2015/16 to UGX 612 billion is highly welcome as it presents immense opportunities for the provision of affordable private credit. It is very important for the sector and the economy that Government sticks to this commitment and sustains it in the long-term. However, it is questionable whether it can be sustained in light of the ambitious public investment program in infrastructure and Uganda's reduced access to concessional borrowing.

Whilst reduced domestic borrowing is a necessary condition for the reduction in interest rates, it is by no means sufficient and there are additional areas to consider including:

- Actions that Government needs to take to reduce Uganda's overall country risk which is ultimately reflected in its credit rating, currently at B+. These include anti-corruption measures and improving our trade deficit. Reduced country risk means reduced cost of Government borrowing which consequently private sector costs of borrowing;
- Actions that commercial banks need to take to reduce operating costs such as optimizing their investments in technology; development of low-cost delivery channels and improving their management of credit; and
- Actions that the borrowing public should take to improve their credit and overall risk profile. These include correct and transparent financial reporting, effective enterprise risk management as well as financial prudence and discipline.

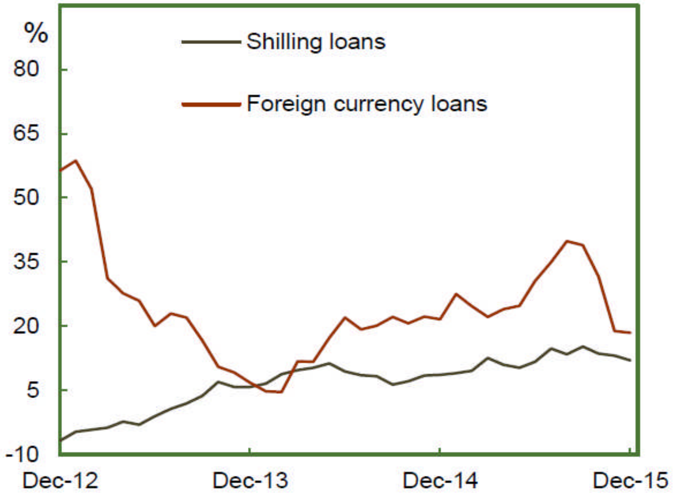
Commercial bank lending to the private sector

In 2015, the total loan book was valued at UGX 10.8 trillion and annual credit growth increased by 90bp.

Credit growth resulted from a 3.3% growth in shilling loans to UGX 5.9 trillion during the year.

However, growth in foreign denominated loans dropped by 3.1% to USh.4.9 trillion. This decline was attributed to high interest rates and postponement of investment decisions pending the 2016 general election.

Annual percentage growth of loans



Source: Bank of Uganda

Over the years, the building, construction, mortgage and real estate sectors have received the largest share of commercial bank lending. This is good news for the economy as, according to the World Bank Uganda Economic Update – April 2016, construction drove Uganda's GDP in FY16 and it is predicted to be the catalyst for economic growth in the medium term.

However, the share of agriculture and manufacturing needs to increase if Uganda is to achieve the rapid economic growth targets Government has set. This is because Uganda enjoys comparative advantages in agriculture, which is the largest employer and creates strong linkages for manufacturing growth..

On the other hand, manufacturing supports both import substitution and exports growth thereby enhancing Uganda's current account and boosting economic growth.

This is consistent with Government's National Development Plan and the President's State of the Nation address of 31 May 2016 which identifies commercial agriculture, manufacturing and tourism as areas of focus.

We expect the creation of a common market in the East African Community to expand market opportunities for Ugandan traded goods industries and should enhance incentives for private investment in these industries.

Annual credit growth by sector

Sector	FY13/14	FY14/15	FY15/16
Agriculture	7.96%	9.42%	9.43%
Mining and Quarrying	0.34%	0.40%	0.53%
Manufacturing	14.41%	14.36%	15.30%
Trade	19.26%	19.27%	18.89%
Transport and Communication	5.52%	5.18%	6.08%
Electricity and Water	1.27%	1.74%	1.72%
Building, Mortgage, Construction and Real Estate	22.67%	23.32%	23.80%
Business Services	4.64%	4.48%	4.35%
Community, Social & Other Services	3.20%	3.42%	3.27%
Personal Loans and Household Loans	16.77%	16.46%	15.21%
Other Services	3.95%	1.96%	1.44%

Source: Bank of Uganda lending indicators

Mobile money- an emerging cashless future

There were 21.2 million registered mobile money customers in Uganda by December 2015, more than half of the entire population.

In terms of monetary value, UGX 32.5 trillion was transacted through the mobile money system in calendar year 2015. This accounted for over 30% of GDP and represents growth of 35% in the value of transactions from 2014.

While the adoption of internet and online banking is still very low in Uganda, we have witnessed phenomenal growth of mobile money services in Uganda since inception in March 2009.

This platform has brought access to basic payment services within reach of millions of Ugandans who do not have ready access to bank branches or own a bank account.

The growth in mobile money is a combination of both technological innovation and an explosion in the number of access to mobile phones in Uganda.

Banks have recognised the need to embrace mobile money which has been able to reach 4 times the number of Ugandan's that banks have in over five years.

A number of commercial banks have devised ways of tapping into the mobile money market for bank products, enabling customers to deposit mobile money directly onto their bank accounts from their phones, or withdrawing money from their bank accounts onto their mobile money accounts.

Some products that are still in discussion with telecom companies include micro savings and loan products via mobile money.

The macro economic implications of this platform are great and provide enormous potential for e-commerce and consumer marketing, with consumer goods companies bypassing the need for extensive distribution infrastructure.

Given the exponential growth in mobile money services, BOU issued mobile money guidelines in 2013 to provide clarity on the roles and responsibilities of the various players, which include the service providers, customers and agents.

The guidelines also stipulate the approved procedures, foster consumer protection; enhance competition and promote financial inclusion. They spell out the role of BOU, Uganda Communications Commission and the rest of the stakeholders.

With the adoption of BOU's regulatory model, mobile money operators are required to collaborate with supervised financial institutions and maintain an escrow account with sufficient deposits to cover the mobile money that has been sold to their customers.

The Regulations are necessary given the growth of the mobile money services in the economy and the value of transactions.

In a wider sense, the success of mobile money brings to life a potential threat to banking as we know it. This threat is even more significant considering the growth of Financial Technology (FinTech) companies worldwide which are innovating products and services currently provided by traditional financial services players.

A recent PwC publication states that "*FinTech is gaining significant momentum and causing disruption to the traditional value chain. In fact, funding of FinTech start-ups more than doubled in 2015 reaching $12.2bn, up from $5.6bn in 2014 based on the companies included on our DeNovo platform. Cutting-edge FinTech companies and new market activities are redrawing the competitive landscape, blurring the lines that define players in the Financial Services sector*" .

As such, bank response to this emerging threat and opportunity is critical and must start now otherwise it will be too late to react.

Banking Sectoral Reforms

As mobile money and FinTech grow exponentially, traditional banking faces pressure to maintain customer value and protect profitability. Quickly adopting opportunities in the Financial Institutions (Amendment) Act is critical to the growth and sustainability journey.

The enactment of the FIA Act brought with it ground breaking innovations aimed at widening and deepening access to borrowing and financial services as follows:

Islamic banking
This is premised on the principle of risk sharing rather than risk transfer. It's a model that provides access to affordable credit and is bound to deepen financial inclusion as well as bring certainty in the market by stabilizing the cost of borrowing.

By conserving cashflows and spreading out the loan recovery period over potentially longer periods of time, Islamic banking has the potential to improve business cashflows and therefore success. This proof of concept was provided by the global financial crisis which left Islamic finance unscathed.

Agency banking
This enables commercial banks to use other typical businesses/ establishments, e.g., petrol stations, shops and supermarkets to extend simple services such as cash transactions and loan applications) on behalf of banks.

We therefore expect a drop in operating cost and access to banking by hitherto unserved communities.

(c) Banc assurance
This is a service that will allow commercial banks to operate as agents on behalf of insurance companies. This is bound to increase insurance sector penetration and reduce cost of service delivery by leveraging on existing bank delivery channels.

It is now vital that implementing regulations are put in place urgently to enable banks to roll out new services. BOU should also communicate its timelines for the release of the regulations to aid in proper planning.

Banks will also need to invest in supporting technologies to exploit the new services and delivery channels.

Other reforms include forthcoming changes to capital adequacy requirements for all banks in line with Basel III to establish capital conservation buffers of up-to 2.5%. Secondly, BOU has identified Domestic Systemically Important Banks (DSIBs), whose failure might trigger a domestic financial crisis. These banks are required to maintain an extra buffer above minimum requirements between 1 – 3.5%.

These changes mean that minimum core capital for DSIBs may go as high as 18% from the current 12%. Whilst higher capital ratios increase bank capacity for lending to single borrowers, they dilute returns on equity and capacity to pay dividends and internationally are already informing bank presence in certain jurisdictions.

Government plans to recapitalize UDBL as a vehicle for private sector growth.

In the State of the Nation address of 31 May 2016, the Ugandan President discussed transparency and fairness in banking with regard to bank resolution of NPLs as well as high costs of lending. He also referred to capitalization of Uganda Development Bank Limited with UGX 500 billion. These remarks were echoed in the Budget Speech and are a strong indication of Government's u-turn on its role in the private sector which has been a topic of discussion for sometime.

As Uganda pursues aggressive economic growth targets, it is perhaps inevitable that Government will play a more active role in catalyzing or supporting growth and stability. With rampant corruption and a blemished past of intervention with NPLs, it is vital that any interventions are informed by a clear policy that is in itself fair and transparent and follows market principles. The absence of measures of this kind may very well result in more harm than good from any intervention.

Furthermore, whilst banks should be encouraged to treat customers fairly at all times, Government must also bear in mind that recovery of NPLs is imperative in order to protect depositors whose money is at stake and for the stability and sustainability of the banking industry.

The Insurance Sector

Overview of performance during FY2015/16

Uganda's insurance market has shown positive growth trends over the past five years. During 2015, gross premiums underwritten by the industry grew by 21.58%. This growth was mainly attributed to premiums from infrastructure projects and medical insurance.

In terms of composition, non-life business continued to dominate the insurance industry in terms of premiums underwritten. It accounted for 76% of the total industry premiums while life and Health Membership Organizations (HMOs) contributed 16% and 8% respectively.

However, life insurance premiums grew much faster at 36% while non-life and HMOs grew by 21% and 0.3% respectively during the year.

The insurers' (including HMOs) Net Asset base rose by 18% to UGX 373bn in 2015- highlighting the growing strength of companies to handle insurable risks locally and provide adequate protection to the insuring public.

However, insurance total assets are still less than 1% of GDP compared to 3.2% in Kenya, 12% in South Africa and an average of 2.6% for emerging markets. This points to untapped potential in the industry. Although market penetration is still below 1%, the favorable investment climate has encouraged several foreign players to join the market over the years.

Several ongoing large infrastructure projects represent a significant growth opportunity for the industry.

However, the small size of Ugandan insurers' balance sheets means that local insurers retained only a small fraction of related premiums with the remainder reinsured overseas. This is the correct commercial approach but represents a cost to the economy that needs to be resolved in the long-term considering that these are long-term assets which will require life-time cover. This is an area that merits Government attention in the coming years but on which the Budget was silent.

The industry currently comprises eight licensed life insurance companies, twenty one non- life insurance companies and one national reinsurance company. There are also 12 licensed HMOs, one reinsurance broker, 27 insurance brokerage firms and 18 Loss assessors/Adjustors.

Unlocking this growth potential will require significant long term capital investment and capacity building in many other respects to provide the Ugandan insurance industry with the muscle to cope with high risk infrastructure assets.

The FinScope III Survey on financial inclusion by the Economic Policy and Research Center (EPRC) indicates that only 2% about 350,000 of the adult population has access to formal insurance. The survey also revealed that 55% of the adult population did not know how formal insurance works, whereas 50% revealed that it was too expensive to take on.

Further still, despite agriculture being the backbone of the economy, insurance products for agricultural risks are only being offered by 8 licensed insurers currently.

It is vital that the industry not only addresses the low level of awareness about insurance products but also develops insurance products to meet the needs of the majority of the population.

Drawing from other emerging economies, some of the strategies that can be adopted to broaden the insurance base include:

- Aggressive marketing of insurance products and services as well as segmenting audiences to ensure the messages match audience needs,
- Adoption of risk-based premium pricing as opposed to fixed premium pricing, and
- Innovations into development of new insurance products, including mobile phone enabled insurance solutions.

Insurance Sectoral Reforms

In line with the 2016/17 financial budget as well as enactment of the Financial Institutions (Amendment) Act, 2016, we can expect to see the following sectoral reforms during 2016/17:

Introduction of health insurance for the private sector. The National Health Insurance Bill 2016 has already been gazetted and once approved by Parliament will improve access to healthcare through mandatory contributions of 4% of monthly salary deductions each by both employers and employees.

Whilst a healthy workforce is an imperative to economic growth, the proposed reforms require more thinking if they are to gain acceptability and work for the good of all.

Given the existing income tax and social security contribution rates, Uganda ranks as one of the highest personal tax countries in the world, ahead of the USA, South Korea, Turkey, and the entire EAC. The proposal therefore risks eroding disposal income and as a result, consumer spending which is vital to economic growth.

The move also highly risks rendering Uganda's labour market even less competitive regionally, particularly in light of regional integration, by increasing the cost of employment.

This is especially so considering that it will take many years, if at all, for universal healthcare to reach the standards of private healthcare currently availed by many employers.

Other changes

- Introduction of agricultural insurance products in line with the allocation of UGX 5 billion in the FY16/17. This subsidy is aimed at boosting agricultural investment by mitigating risks and losses suffered from weather disasters. It is therefore vital that appropriate implementing mechanisms are put in place to ensure the success of the program and lay the foundation for further successful interventions.

- Issuance of banc assurance policies- a service that will mandate commercial banks to operate as agents on behalf of insurance companies. This is bound to increase the insurance sector penetration.

- The Co-Insurance Syndicate- the syndicate is restricted to oil and gas risks and is soon expected to be operationalized with Uganda Reinsurance Company providing managerial oversight. It is important to assess the portion of insurance risk the Ugandan market is able to cover locally considering the size of the Albertine Region oil project.

Further engagement of all stakeholders will be necessary to see through the successful implementation of these innovations which are positive for the Uganda insurance industry.

Capital Markets

Overview of performance during FY2015/16

The Uganda Securities Exchange (USE) currently has a total market capitalization of about UGX 70.3 trillion comprising 8 Ugandan companies with a market capitalization of UGX 4.3 trillion (about 6% of GDP) and 8 cross listed Kenyan companies with a market capitalization of UGX 66 trillion (over 70% of GDP).

During FY 15/16, the capital markets industry witnessed a decline in activity with no primary issues being recorded in the bond and equity markets and secondary trading at the USE declining. The decline resulted from a high interest rate environment that saw investors shift from equities to the government securities market.

However, progress was recorded on the legal-regulatory front as well as in public education initiatives.

The Capital Markets Authority Statute of 1996 and subsidiary regulations address the licensing of brokers/ dealers and of stock exchanges., and established the Capital Markets Authority (CMA) as the securities regulator in Uganda. The USE was inaugurated in June 1997 and is now trading the stock of 16 companies.

The relatively small size of Uganda's capital markets compared to Kenya that has over 60 listed companies presents a huge opportunity on the basis of Uganda's stock markets' capitalization as a proportion of GDP.

The capital markets in Uganda can be positioned as an alternative source of long term capital to achieve the annual projected growth of 7% in line with Government's objective of reaching middle income status by 2020.

Some large local businesses have been reluctant to turn to the capital markets, in part because of strict disclosure requirements that would force them to adhere to higher audit standards than most Ugandan businesses normally achieve.

Although Uganda's capital market is open to foreign investors subject to some share issuance requirements, a number of multinationals whose operations extend to Uganda are already listed on stock exchanges abroad. The listing standards, regulatory environment, valuation, quality of institutional investors, visibility to customers and suppliers in these stock markets make access to public capital easier.

During FY16/17, activity at the USE is expected to intensify as a result of projected off-shore investor activity, low interest rates and economic growth.

The capital markets industry can borrow strategies from other jurisdictions in order to boost growth in this sector. These include:

Issuance of Commercial Paper- these are unsecured, short-term promissory notes issued and sold to raise funds from time to time. They are an alternative to commercial bank financing and depending on the issuing company may or may not be listed.

Developing a vibrant private placement mechanism that would enable companies raise funds from institutional investors and other highly qualified investors before listing their shares. Although the average Ugandan's disposable income may not be sufficient to invest directly in capital markets, investment can be done through investment vehicles such as collective investment schemes, retirement benefit schemes and savings and credit cooperatives (SACCOs).

Listing by introduction- this removes the requirement to make an Initial Public Offering.

Taking advantage of the Alternative Investment Market Segment- this targets small and medium size high growth companies as well as institutional and high net worth individuals who do not meet the eligibility listing requirements of the main quotation market segment.

Capital Markets- Generating future wealth by saving

The total amount of institutional savings in Uganda (provident funds, retirement benefit funds and life insurance savings) is currently about USD 2bn (about 10% of GDP).

Savings play a very important role in economic growth as they are a critical source of funds for investment. Without adequate savings, a country has to borrow externally in order to achieve economic growth targets. Apart from the resulting debt burden, the country also becomes economically dependent and this is the case for Uganda which has borrowed tremendous amounts to finance large infrastructure projects especially in energy. Of equal, if not more significance is that the fact this borrowing is mainly from one country, China, whose changing economic structure has already negatively affected other African country economies like Liberia and Zambia.

Whilst Uganda's average gross savings rate defined as GDP less consumption plus net transfers, for 2011-2014, is 19% and compares well to regional peers, the net savings ratio which adjusts for resource depletion and environmental factors is at approximately 3%. In comparison, Tanzania stands at 15%, Rwanda – 7% and Kenya – 4%. On the other hand, China and India saved at 34% and 19% respectively over the same period.

Government has in the last few yeas implemented reforms to improve national savings, for instance through enactment of the Uganda Retirement Benefits Act and this has benefited private sector pensions and spurred growth of the fund management industry.

This is a strong indicator that those reforms were appropriate. However, there have been delays in other respects of pensions liberalization. Unfortunately the Budget Speech did not provide an update on the reform program and so this is an area that needs amplification by Government in the months ahead.

In addition, more needs to be done to encourage household savings, particularly where such savings are funneled into capital markets via collective investment schemes and the like. Areas to consider include allowing additional deductions from earnings on individual savings and relief from withholding tax and other taxes on interest on individual savings, etc.

Oil and Gas Sector

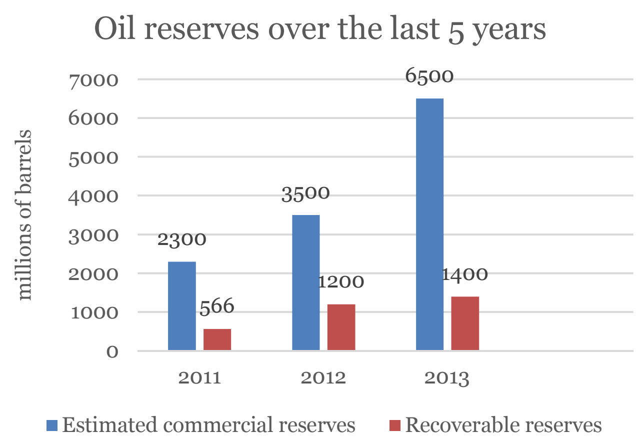
Revenue forecast

Uganda's first oil is now expected to flow by 2020. The oil and gas discoveries in Uganda have been described as Africa's biggest onshore finds in 20 years. With one of the highest success rates of more than 85 per cent of drilled wells finding oil and very low finding costs of less than US$1 per barrel (compared with a world average cost of between US$5-25), Uganda's oil revenues are expected to significantly contribute in transforming the country from a low-income to an upper middle-income country by 2040 and from a net importer to a net exporter of oil and its products. The graph shows the progress of oil discovery since 2011 with current reserves standing at 6.5 billion barrels out of which 1.4 billion is estimated to be recoverable.

Uganda's oil reserves are expected to significantly contribute in transforming the economy from a low income to an upper middle-income country by 2040

The Government anticipates that oil production will go a long way in funding other sectors of the economy. The statistics support the supposition that oil will indeed be a great contributor to economic growth. Oil production is expected to begin at a projected daily rate of 125,000 barrels per day (bls/d), although this could be as high as 200,000 bls/d, placing Uganda in the ranks of mid-sized oil producers. Assuming Government's aggregate share of gross daily production of 40% , Uganda would be entitled to 50,000 bls/d of crude oil produced. With an estimated crude oil price of $60 in 2020, this translates into $3 million of income per day and approximately $1 billion annually. This estimate does not include revenues from refined products and other revenues likely to arise from secondary and tertiary activities associated with the industry. Based on the FY16/17 budget, such income would equate to 26% of domestic revenues.

Oil production is expected to begin at a projected daily rate of 125,000 bls/d which translates into a government share of approximately $1 billion annually



Sector Outlook

The need for economic diversification

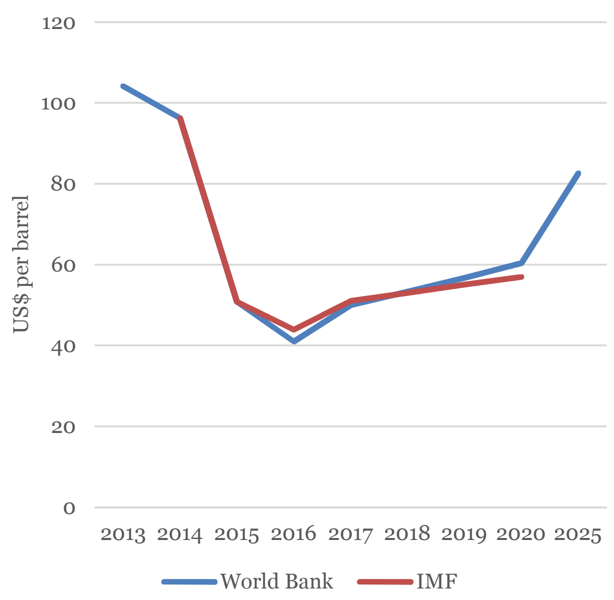
It is no doubt that with appropriate planning and a clearly thought out strategy, the oil discoveries in Uganda will achieve the desired growth and transformation. Whereas the Government has attained major achievements over recent years, (e.g. putting in place the base legal and regulatory framework, setting up the necessary institutions, sponsoring Government employees to various education programmes, steps towards the crude oil export pipeline and refinery), the journey has just begun.

The challenges for resource rich countries are real and without appropriate planning, there is a risk that Uganda's oil blessing may turn into a curse. Economic diversification and commitment to transparency are powerful tools to overcome this risk.

Economic diversification and transparency are powerful tools to overcome the oil curse risk

Impact of oil price movements

Crude oil prices forecast



Source: IMF Commodity Price Forecasts till January 2021, World Bank Commodity Forecast Price Data April 2016

The development of the oil and gas sector, if managed in a transparent and efficient way, will help the Government to achieve its target of becoming a middle income country. However, the country will also need to continue investing in other sectors such as agriculture, tourism and manufacturing in order to have a well-balanced economy. This is especially important considering the volatility of oil prices. Countries that are heavily reliant on oil suffer major economic challenges when the prices drop significantly, as has been the case recently with Nigeria and Angola.

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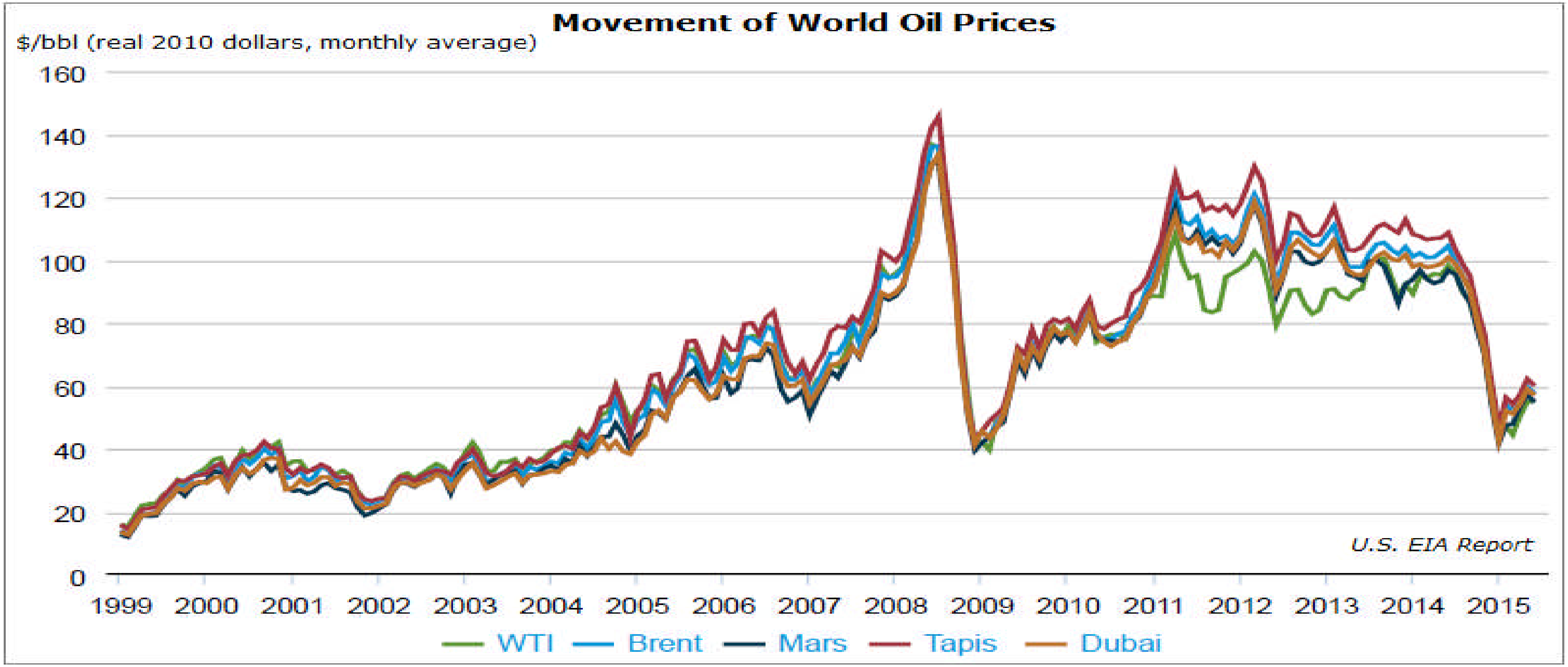
Impact of oil price movements

Historic trends of oil prices



The need for a tight resource management and regulatory framework

Resource management

The Public Finance and Management Act 2015 details how oil revenue is to be used, with the main focus on financing infrastructure and development projects rather than the recurrent expenditure. The Act creates the Petroleum Fund and the Petroleum Revenue Investment Reserve, the latter managed by the Bank of Uganda. Whereas this is a positive step, the Act must be supported by increased transparency and budget discipline in order to avoid the temptation of using petroleum revenues to fund unplanned short-term activities. It will be important to have effective policies in place for managing and monitoring oil revenues in advance of receipt, for example through capping spending from oil revenues, and having in place an informed investment advisory committee that plans for and manages the resultant investments. A report by the Center for Global Development indicates that 'resource-rich African countries' can benefit by setting up three separate sovereign wealth funds, namely a stabilization fund, a development fund and a saving fund. This approach of maintaining strict boundaries will go a long way in creating solutions for development and ability to support economic diversification.

Regulatory framework

Putting in place policies for revenue management should go hand in hand with tightening the regulatory and fiscal framework. A lot of progress has been made in this area already, including the introduction of taxing provisions in 2008 (with subsequent amendments to support sector developments), the upstream and midstream Acts enacted in 2013, the Public Finance Management Act of 2015, constitution of the Petroleum Authority of Uganda, incorporation of the National Oil Company and finalisation of the regulations for upstream and midstream operations. However, there is need to urgently finalise the remaining aspects of the regulatory framework, such as the National Content Regulations, which are currently under formulation as well as standards and codes which are currently being developed by UNBS. The Government should also continue to refine the taxation provisions to ensure a balance between maximising Government revenues and attracting new investment.

It will be important to have effective policies for managing and monitoring oil revenues, such as capping spending from oil revenues and having an informed investment advisory committee

The model Production Sharing Agreement was revised in preparation for the first licensing round which commenced in 2015. Seven firms submitted bids for exploration and are awaiting feedback from the Government. These are Armour Energy and Swala Energy (Australia), Rift Energy (Canada), Niger Delta Petroleum Resources, Oranto Petroleum and Waltersmith Petroman (Nigeria) and Glint Energy (USA). Production licences for the existing players in the sector are expected to be issued by the third quarter of 2016. It is therefore important that by the time the next round of exploration starts, as well as production, the key aspects of the fiscal and regulatory regime have been finalised.

Significant progress has already been made towards infrastructure development….

The other immediate challenge for the country is putting in place the appropriate infrastructure to support the 2020 first oil projection. The government has made some good progress on planning for the infrastructure that the country will require, including the following:

- Negotiations of the project agreements for the Oil Refinery between GOU and the RT Global Resources led consortium are in the final stages and are expected to be concluded by the end of September 2016. The private developer will acquire 60 percent, with 40 percent shared between the regional states. So far Kenya has confirmed its shareholding of 2.5% in the project and Tanzania 8%. Documentation for the lead investor consortium and GOU to constitute a Special Purpose Vehicle (the Refinery Company) to take forward engineering and financing aspects of the project has been finalised. Acquisition of land for the refinery development is in progress. So far 97% of the affected persons who opted for cash compensation have been fully paid and 533 acres of land purchased for construction of resettlement houses and other social infrastructure. The first phase of the refinery is expected to be in place by 2018.
- A detailed routing study, baseline environmental survey and the resettlement action plan study for Hoima-Buloba multi-product pipeline are on-going.
- The pipeline route to the Tanzanian port of Tanga was agreed in April this year. The two Governments are now in talks to progress to the next steps.
- The master plan and the detailed designs for the airport, at Kabaale in Hoima District were completed. The airport will facilitate transportation of equipment and personnel during the development of the oil fields and the Refinery.

The Government has set aside UGX 188.2 billion this coming year to implement programmes for oil and gas development as per the 2016/17 budget. With the estimated investment in the refinery of $4 billion and $4 billion for the pipeline, the task for the Government is to critically consider access to additional funding at an affordable cost. Other important factors to consider will be to include the technical capabilities of contractors that will be engaged to construct the infrastructure, quality of materials that will be used, the level of technical expertise on the Government's side to monitor quality and putting in place the support systems which include transport and utilities. The country should also be looking at achieving lower construction, operating and maintenance costs for this infrastructure, particularly the refinery and the pipeline in order to achieve acceptable prices and lower the tariff for transporters.

Key task for Government is accessing funding at an affordable cost. It should also be looking to achieve lower construction, operating and maintenance costs

The government must plan for national content maximisation

Another critical issue concerns national content. The National Content Policy and Strategy for the oil and gas sector is in the final stage of formulation and the National Content Regulations for the Midstream activities have been published and are operational.

The government is now working on finalising the National Content Regulations for the upstream activities. It is important for the Government to clearly define national content in a manner that will make it achievable and ensure inclusiveness.

The objective should be to support Ugandans to take up the opportunities through enterprise development, strengthening the private sector associated with the oil and gas industry, capacity building and possibly establishment of a local area development fund.

These should cover the entire value chain including the secondary and tertiary industries. The secondary industries include plastics, agro-chemicals, fertiliser, lubricants, paint, bitumen and thermal power generation, among others.

- Key tertiary industries that are likely to benefit include manufacturing (e.g. steel, cement), transport, hotels, construction, real estate, insurance, banking and environmental health and safety.

Ugandans should be sensitised through training and supported to be able to participate in the sector. Ability to build robust local economic activities will be a major contributor to economic diversification.

The objective should be to support Ugandans to take up the opportunities through enterprise development, strengthening the private sector and capacity building

Telecommunications sector

Overview

Being a landlocked country, Uganda depended entirely on satellites for its international connectivity until 2009 when several international submarine fibre optic cables landed on the East Africa's coast. Since the initial connections to fibre cables in 2009, prices for international bandwidth have significantly reduced, but retail pricing of broadband services is still relatively expensive

The Government registered a number of achievements in FY 16. The second phase of the National Backbone Infrastructure has been completed and the Government has connected 72 of its agencies to e-government with a view of improving efficiency in delivery of work. The National Information Technology Authority Uganda (NITA-U) is implementing the National Data Transmission Backbone Infrastructure and e-Government Infrastructure Project (NBI/EGI). The major aims are to connect all major towns within the country onto an Optical Fibre Cable based Network and to connect Ministries and Government Departments onto the e-Government Network. NITA-U's work is aimed at making access to the internet cheaper. NITA –U should engage stakeholders to develop the strategy which is planned for Uganda to benefit from the proposed ICT parks in Namanve and Entebbe. The strategies should be in line with vision 2040 for the country and aim at improving GDP.

Internet Usage

During the financial year 2015/2016, the services sector comprising of Telecoms and other services grew by 6.6% compared to 4.5% in FY14/15.

According to the FY16 Budget Speech, ICT sector contributed 2.5% of GDP in 2015. On average, the sector employed 1.3 million Ugandans through its value chain and is projected to raise UGX 84.4 billion in tax revenue in 2015 (4.4% of the total expected tax revenue of UGX 11,192 billion).

In 2015, internet users increased by 53% from 8.5 million in 2013 to 13 million in 2015. However, macroeconomic trends including low urbanisation, high capital investment costs to increase coverage in rural areas, a high dependency ratio and limited disposable income among others continue to hamper growth in the industry.

These trends together with competition in the market, have led to low average revenue per user ("ARPU") of USD 3 in 2015 compared to the global average. This limits return on investment by the telecommunications companies.

In 2015, internet users increased by 53% from 8.5 million in 2013 to 13 million in 2015

Revenue per user fell to less than USD 3 in 2015.

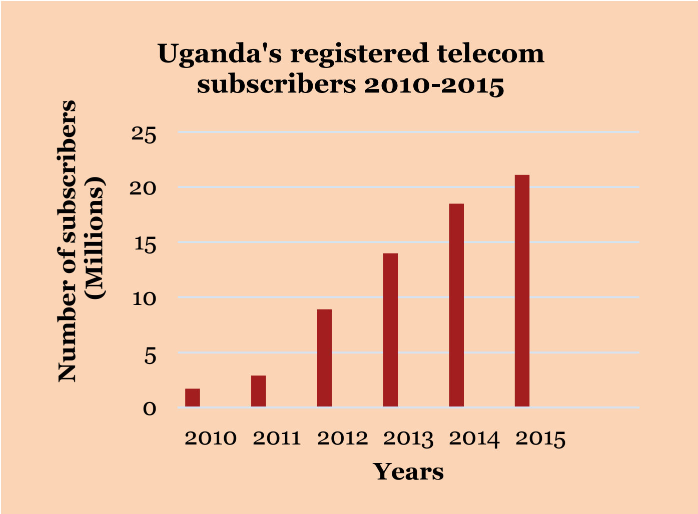
The rise of mobile money transactions

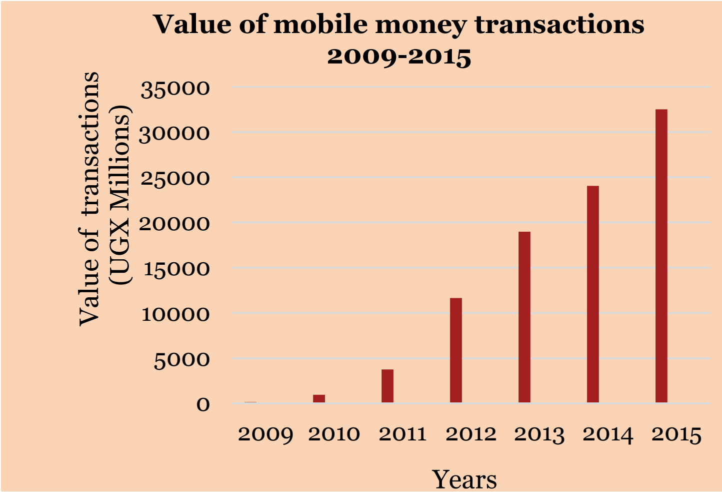
The number of mobile money users has continued to grow while the number of bank accounts have remained at about 5 million people. The mobile money market grew to 21.457 million people in 2015 with a penetration rate of 54.9%. There is still plenty of room for growth in mobile money subscriptions. Mobile money services have grown with the value of transactions rising to over UGX 30 trillion at the end of 2015.

Banks have recognised the need to embrace mobile money which has been able to reach 4 times the number of Ugandans that banks have in over five years. Banks are now devising ways of tapping into the mobile money market for bank products. Some of the products which banks are discussing with telecom companies include, micro savings and loan products via mobile money.

Stanbic Bank's Managing Director observed in PwC's publication 'The Africa Business Agenda, May 2016', that the potential for collaboration between the Banks and the telecoms for increased market share is huge. Stanbic Bank is reviewing international remittances, insurance products and services that fit into a win-win category to identify ways of working with telecom companies.

mobile money has been able to reach 4 times the number of Ugandans that banks have in over five years





Source: Bank of Uganda

Regulatory environment and government policy for the sector

In line with Government's policy of achieving middle income status by 2020, structures to support the ICT development have been put in place. Two ICT parks are to be set up, one at Namanve and another one in Entebbe. Work on the Entebbe park is to commence in FY17.

The Uganda Communications Commission (UCC) has reported that it is in the process of drafting infrastructure sharing regulations, in order to reduce the cost of network deployment and ensure efficient use of existing resources.

According to the World Bank report on Uganda's economic update issued in April 2016, the Government of Uganda has good policies but the policies are not effectively managed and strengthened in order to achieve the desired value for money yield.

The World Bank recommends that Uganda's policies should be improved through the use of enhanced monitoring and evaluation. The Government of Uganda should address the feedback from the World Bank to ensure that the country maximises value out of the two planned ICT projects.

The parks will need to keep pace with the speed of technological change. For instance, the mobile network keeps evolving and therefore Government has to have a national plan on mobile telephony which has to be monitored and updated on a regular basis. The plan should be discussed and debated with the relevant stakeholders.

BOU's regulatory concerns for mobile money include: Protection of customers' funds in the mobile money platform, addressing Anti Money Laundering concerns and Countering of Financing of Terrorism, ensuring that all transactions carried out on the mobile money platforms are traceable and accounts held at the banks are fully auditable – Breaking down the Escrow account balances, replication of Data held by the Mobile Money service providers at the Licensed Financial Institution, Data Back-up Arrangements and Business Continuity Liquidity Concerns, Service Interruptions, Complaints Handling, Non-Exclusivity and Interoperability.

The World Bank recommends that Uganda's policies should be improved through the use of enhanced monitoring and evaluation

The Mobile Money Regulations which were issued in 2013 addressed some of the highlighted challenges but the need to protect customer balances remains.

Some Telecom companies plan to make investments aimed at improving the network. For example, MTN Uganda announced that it has obtained a syndicated loan from Stanbic Bank which loan is targeted at improving their telecoms infrastructure in 2016 and 2017.

Further, the President of Uganda, in his communication during the Budget Speech, announced that the Government is planning to enter into a Public Private Partnership with an investor to track the international incoming calls as the Government is of the view that there is tax which is not collected.

The FY16 budget has neither introduced nor repealed any tax provisions which are specific to the mobile telephony industry. The growth of the products of mobile telephony in Uganda and Africa at large are setting tomorrow's priorities.

Manufacturing sector

Introduction and background

During the FY 2015/16, the manufacturing sector continued to be one of the drivers of the economy contributing 8.4% of GDP. This was less than the projected contribution of 8.6% and represented a modest increase of 0.4% when compared to the 8.0% achieved in FY 14/15.

As part of the Tourism, Trade and Industry Sector, Government's outlook for the manufacturing sector in the medium term is based on the Sector's vision to

"create world class Industrial Products"* and its mission *"to develop and promote private sector competitiveness and export led wealth creation".

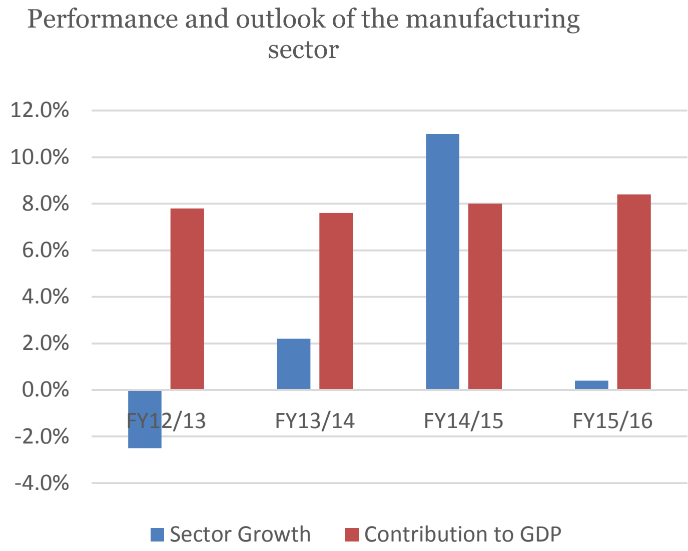
Furthermore, the medium term objectives of the sector *"to deliver tradable quality and sustainable products and services resulting from the continued development of a competitive export oriented industrial sector and to improve competitiveness and market access of Uganda's goods and services"* are consistent with the second National Development Plan (NDP2).

Government sets out its objectives and outlook in Budget Speech FY 2016/17 and how the manufacturing subsector will be developed to achieve Vision 2040 which aims at socio-economic transformation and propelling Uganda into middle income status by 2020.

Performance

Over the past five years, the growth of the manufacturing sector has continued to fluctuate, registering a marginal growth rate of 0.4% in FY 2015/16 when compared to the 11% and 2.2% growth in FY 2014/15 and 2013/14 respectively.

The reduction in growth in FY 15/16 is attributed to the uncertainties related to an election year, and the general slow down of the global economy.

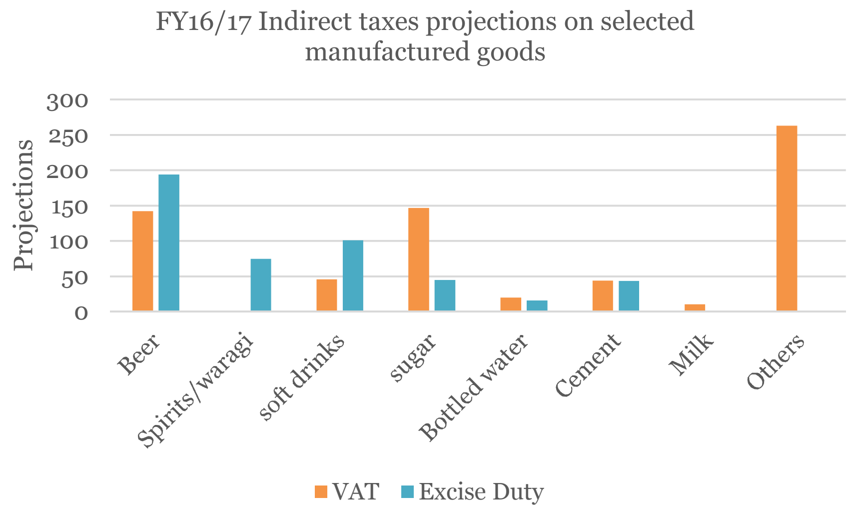


Source: MOFPED Background to the Budget, Appendix Table 9A

Notwithstanding the deceleration in the rate of growth, the manufacturing sector experienced enhanced performance and new entrants in the production of beverages and chemicals, as well as other manufacturing subsectors like metal fabrication, pharmaceuticals and other chemicals, paper, plastics, electronics, cosmetics etc.

Forecast

Government expects an increase in the revenue contributed by the sector in the form of consumption taxes estimated at UGX 1,149 billion (VAT UGX 674 billion, Excise duty UGX 475 billion , FY 15/16 1,025 billion). Below is a graph showing the projected revenue in form of indirect taxes from a selection of manufactured goods.



Source: MOFPED Revenue Projections FY 2016-17 Annex 2

Government further projects an increase in the contribution of manufactured goods to comprise 13% of total exports in FY 2016/17 and further increase to 15% by FY2017/18 as part of the planned medium sector outcomes of the competitive export oriented industrial sector.

Transforming the manufacturing sector

The selected key focus areas for the manufacturing sector in FY16/17 include:

- *Promotion of production, productivity, investment and export of goods and services through value addition to strategic commodities; and*
- *Sustaining the development and maintenance of strategic infrastructure with emphasis on energy and transport to accelerate the country's competitiveness.*

The selected areas aim at:

- Increasing the share of manufactured goods in total exports which is demonstrated by the projected growth in the share of manufactured goods to 13% of total exports. The increase in exports will in turn improve the balance of payments and reduce further depreciation of the Uganda Shilling.
- Improving private sector competitiveness. This is partly supported by the amendment to the Finance Act 2016 imposing import duty on certain imports like steel products and electronics from the COMESA region which were competing directly with similar products that are manufactured in Uganda.

- Increasing market access for Uganda's products and services in the regional and international markets. For example the Buy Uganda Build Uganda (BUBU) policy which is premised on supporting and encouraging the consumption of locally produced goods and services. Furthermore, Government is committed to the common market areas in the EAC and COMESA (and the proposed tripartite merger with SADC) which guarantee our exports duty and quota free access thus providing available export destinations for Uganda's products and to re energise participation in trade arrangements like AGOA.

- Promoting the development of value added industries in agriculture and minerals. For example the available tax exemptions on business profits derived from new investments in agro-processing have proved to be quite attractive.

Government strategy to achieve the desired growth

In a bid to create a competitive and export oriented industrial sector.

Manufacturing has been selected as one of the primary growth sectors for the "Productivity Enhancement Programme".

Government plans to achieve productivity enhancement in manufacturing through:

- Increased commercialisation by addressing constraints in the entire value chain by conducting research and development, providing business advice and enforcing standards to improve product quality.

- Enhancing private sector capacity by increasing access to affordable long term capital financing, providing work space and building industrial parks and operationalising Free Trade Zones.

- Improving public institutional response to private sector entrepreneurs by reorienting public sector agencies like the Uganda Investment Authority, the Investment Export Promotion Board, Uganda Registration Services Bureau, Missions Abroad among others.

Furthermore, Government is committed to increase market access for Uganda's products within the EA region and other international markets through improved infrastructure projects. Such initiatives include the Standard Gauge Railway, expansion of Entebbe Airport and investment in energy infrastructure to exploit the available renewable energy sources like hydro and geothermal power (planned to increase the country's power generation capacity from 850 MW generated in 2015/16 to 2,500 MW in 2020).

The focus on strategic infrastructure that will directly benefit the urgent need for value creation and export will help overcome the long term challenge of limited infrastructure that has been facing the manufacturing sector.

Challenges

The manufacturing sector continues to face challenges which hamper its growth and the creation of new investments. Some of these bottlenecks include:

- Weak institutional support whereby there is little or no response to private sector needs. Government's plan to create a centralised registration bureau is yet to be implemented;
- Limited access to affordable credit and financial infrastructure to support Small and Medium Enterprises (SME's);
- Unreliable, and inadequate physical infrastructure, particularly quality transport, energy, and communication infrastructure;
- Lack of serviced industrial parks across the country;
- Unreliable local supply of inputs, leading to import of substitutes;
- Low level of technology and a lack of local capability for technological innovation, which adversely impacts on productivity;
- Inadequate entrepreneurship and managerial skills; and
- High tariffs and unreliability of power.

Whereas Government intends to create a competitive and export oriented industrial sector, the budget did not fully address the practical measures required to deal with the challenges in the manufacturing sector.

The potential growth in the manufacturing sector will not be optimally attained without enhancing the environment that favours growth.

Government should consider the use of fiscal policy to continue attracting investments by say, reinstating the investment deductions for new plant and machinery which is invested to enhance productivity.

As discussed in the growth strategy, Government commits to enhance productivity in the manufacturing sector through increased commercialisation, enhancing private sector capacity and improving public institutional response to private sector needs. These measures are welcome but the challenge remains in getting them implemented in practice.

Social Services

Introduction

The budget strategy for the FY 2016/17 aims to facilitate Government's long- term socio-economic transformation agenda of propelling Uganda into a middle income country by the year 2020 as enshrined in the Second National Development Plan (NDP2) and later into a first world economy as envisioned in the Vision 2040.

Social service delivery is a critical aspect in facilitating Government's long- term socio-economic transformation agenda of propelling Uganda into a lower middle income country status by the year 2020. The 2014 National Population and Housing Census (Census) provided evidence that has formed the basis for the strategic priorities for the next financial year. According to the Census Report, Uganda's population is growing steadily at the rate of 3% per annum.

The budget strategy for the FY 2016/17 under the theme, "**Enhanced productivity and job creation**" has therefore been formulated to respond to this call to achieve the desired socio-economic transformation as enshrined in Vision 2040 and National Development Plan II.

Budget theme has been formulated to respond to the call to achieve the desired socio-economic transformation

The provision of Social services is very challenging, as Uganda's high population growth puts pressure on the resources, state of infrastructure development and maintenance.

In the last year, Government's focus was mainly on ensuring access to quality social services that improve the well-being, knowledge and skills of the population. Improving access to quality education and skills development, health, water and sanitation is central to this objective. 26% of the approved budget is being allocated towards social service delivery.

Priorities for 2016/17

The resource envelope for FY 2016/17 compared to FY 2015/16 has not changed. There are many competing priorities, including infrastructure development and energy projects. The Government however, recognises the importance of social service delivery in achieving the agenda of socio-economic transformation.

The policy direction for this year's budget priorities and programmes as well as resource allocations has therefore been aligned towards achieving the commitments in the NRM Manifesto 2016, NDP2 and the Sustainable Development Goals (SDGs) with 26% of the approved budget resources being allocated towards social services.

Approved Government spend

The table below shows the approved sector allocations for FY 2016/17 towards social services, out of the approved total budget of the 26 trillion.

Sector	Budget allocation (Billions)	% of total budget
Education	2,745	13.3
Health	1,853	11
Water and Environment	656	3

Education

Prior year Performance

In FY 16, Government allocated just over UGX 2 trillion to the education sector. A number of achievements were registered. For example:

- Access to basic and secondary education increased with enrolment rising from 8.5 million to 8.8 million pupils at primary school level; and from 1.36 million to 1.39 million students at secondary school level.
- Primary school level pass rates were recorded at 88.3%, and pass rates at secondary at 91% in 2015.
- In order to enhance tertiary education, salaries of teaching staff in Public Universities were also increased.

Challenges in delivering quality education in an efficient manner still remain.

- The 2014 Census revealed that 72% of the population were reported to be literate and proficiency in literacy has also declined;

Quality education is required to accelerate the country's socio-economic development through making the population functionally literate and productive

- For example, according to the Twaweza Report for June 2016, policy and resource allocation into primary education has not translated into learning outcomes, as too many children in Primary 3 to 7 are unable to complete primary 2 level work;
- There is lack of adequate teaching and learning materials and infrastructure;
- Teaching staff morale remains low characterised by absenteeism due low remuneration in comparison to their counterparts in the East African region;
- Low remuneration is a general public service issue. As a result, key talented personnel continue to migrate from Uganda in search for greener pastures.

Priorities for 2016/17

The NDP2 emphasises equity and holistic education. In order to achieve this goal, Government has allocated UGX 2.7 trillion to the education sector, representing the third largest allocation for the approved budget for FY 16/17. This marks an increase of 5.3% up from 8%, compared to UGX 2.1 trillion in FY 2015/16.

Government recognises that quality education is required to accelerate the country's socio-economic development through making the population functionally literate and productive.

Proposed expenditure will be on the following:

- Operationalising 2 public universities of Soroti, Kabale and Lira to offer science related programmes;
- Expanding the student loan scheme to cater for university students and diploma holders to access higher education;
- Recruitment of tutors for the 20 technical institutes;
- Increasing salaries of teaching and non-teaching staff in public universities; and

Budget allocation of 13.3% of the national budget towards education marks an increase of 5.3% up from last year's budget

- Increasing salaries of primary school teachers by 15% which is the last instalment of government's commitment to increase teacher's salaries in a phased manner. This comprises UGX 122 billion of the total allocation.

Education (continued)

Human Capital Development

Skills development and strategies to stimulate employment are linked to improved agricultural productivity and value addition. This is closely linked to this year's theme "Enhanced productivity and job creation".

Uganda's high population growth rate has continued to generate increased demand for jobs and necessitates increasing the access to, and quality of, education at all levels and putting more focus on vocational training to equip the labour force with the skills required to compete in the job market.

This year's theme, "**Enhanced productivity and job creation**" aims to create jobs for the growing population.

Government is not able to provide jobs for all and therefore funding of education is going to be focused on achieving a skilled labor force that can be employed by the private sector.

66% of the allocation for education will be spent on teacher salaries and increments

Key education services being targeted include school teaching, vocational training, teacher training and development and research.

Whether this will achieve the desired objectives

66% of the allocation for education will be spent on teachers' salaries and increments. This means that significant amount of resources will have to be sought from external sources for other non-salary requirements that can support growth in the sector.

An increment in the teachers' salaries with no corresponding investment in accompanying infrastructure may not achieve the desired results of transforming the sector. Expenditure for this year's budget prioritises infrastructure development in vocational training centres while early childhood education continues to be a challenge.

In some instances, pupils in rural areas continue to learn under trees without the required learning materials or infrastructure.
Government's plans do not seem to address these key challenges.

Investments in key priorities such as infrastructure and teaching resources and materials is crucial if the goal of improving the quality of our education system is to be achieved. Without a good education, pupils will be less likely to get jobs and be able to look after their families in the future.

In FY 2015/16, learning and skills outcomes of the education system were identified as key challenges to development of the education sector, with students and pupils completing levels of education without achieving the desired learning objectives.

Government has promised to take "tough" measures on teachers who are absent from schools, but has not addressed the provision of facilities to ensure pupils access quality education. Without the requisite study materials and infrastructure at lower levels, Government may not achieve the desired objective of enhanced productivity and job creation.

The Private sector has available resources to transform the education sector as a key partner in growth and development and has already made significant strides in the right direction. Investment in quality infrastructure to support delivery of social services will be key to achieving the goal of socio-economic transformation.

Health

Prior year performance

The health sector received an allocation of 1.270 trillion in 2015/16, comprising 7% of the total national budget, which was below the recommended 10% as per the Abuja declaration.

A number of achievements were however registered with the limited resources, for example:

- There's been a general decline in the risk of mothers dying in health facilities while giving birth. Facility based maternal mortality has reduced from 168 deaths per 100,000 deliveries in FY 2012/13 to 146 deaths per 100,000 in FY 2014/15.
- Infant mortality rates have also reduced to 53 deaths per 1000 live births from 77 deaths per 1,000 live births in 2002.
- The proportion of deliveries in health facilities stood at 44.4 per cent in FY 2013/14 and is expected to reach 56 per cent in FY 2016/17.
- Reported Malaria cases have reduced from 460 per 1,000 persons in FY 2013/14 to 367 in FY 2015/16.

Government reduced spending on health from 8.7% in 2013/14 to 8.5% in 2014/15, and 7% in 2015/16

According to the Annual Health Sector Performance Review Report for 2014/15, the positive performance (fewer maternal deaths than anticipated) is attributed to efforts to strengthen health service delivery such as improved capacities to monitor women in maternity, and availability of ambulances to 19 Districts that support transportation of patients to facilities.

It is evident that greater interventions and financial investments with regard to improving women's health, and strengthening capacities of facilities to handle the more common causes of maternal death mentioned above, are critical.

Government expenditure on health has reduced from 8.7% in 2013/14 to 8.5% in 2014/15, and 7% in 2015/16. This is well below the recommended percentage as per the Abuja Declaration. Greater allocations and investments in health services and infrastructure are important in order to make improvements in key areas such as child and maternal mortality and morbidity.

Government also constructed and equipped a number of hospitals and health centres, aimed at developing centres of excellence in order to increase access to quality medical services and reduce the cost of travel abroad for healthcare.

Some partnerships with the private sector aimed at developing key health infrastructure were concluded. For example The Aga Khan Development Network will complete establishment of a teaching hospital by 2020 at Nakawa, and Italian developers are constructing an International Specialised Hospital at Lubowa with the plan to make it operational by 2018.

A number of challenges need to be addressed. There is need to establish interventions to evaluate performance and monitor efficiency of health services, ensuring availability of the healthcare workers at the health facilities and making sure that there is adequate financing to guarantee access to health care for all.

Health (continued)

Budget allocation for FY16/17

The Government of Uganda has steadily increased its budget allocation to the health sector. The health sector is expected to receive 1.853 trillion in FY 2016/17(11 % of the FY budget) from UGX 1.270 trillion in FY 2015/16 (7% of the FY budget) reflecting an increase in budget allocation.

The main focus of the budget expenditure will be aimed at the following key areas:

- Accelerating interventions to improve availability of healthcare workers at health centres;
- Improving maternal, new born and child health to reduce deaths;
- implementation of National Prevention Strategy for HIV AIDS and expansion of Anti-Retroviral treatment coverage to 80%, with emphasis on most at risk population and elimination of Mother to Child Transmission;
- Interventions for adequate health financing by formulation of the National Health Insurance Bill 2016 aimed at mandatory monthly contributions from salary deductions by both employers and employees; and
- Government hopes to use external funding received from Global Fund for AIDS, TB and Malaria to construct a State of the Art Warehouse at Kajansi.
- A new management information system (MIS) and additional trucks procured to further strengthen the NMS distribution fleet in distribution of drugs to health centres and facilities.

Whether the budget will achieve the desired objectives

The biggest challenge at the moment is developing the required infrastructure (technology, tools and staff) to attend to Uganda's growing population. Uganda's population growth rate, driven by high fertility rate, poses challenges to health care delivery. The country needs to address this challenge.

Accessibility to health facilities, medications and qualified staff are all important in transforming the healthcare system. Providing targeted education and professional training to healthcare givers is key. Government is taking a steps in the right direction to address these challenges.

However, qualified healthcare givers should be complemented with properly facilitated /stocked centres to achieve the desired results. Government has not adequately addressed this, but is relying on donor aid to manage stock levels and ensure available drugs and medicine reaches the desired recipients.

Donor financing to the sector constitutes 72% of the sector's development budget and thus places Government at the hands of donor terms and conditions as well as availability of funds to execute this FY's budget. Unfortunately in FY2016/17, health sector was not able to absorb 86% of donor aid provided towards government programs. Measures need to be put in place to address the monitoring and evaluation of such programs to ensure outputs achieve intended results.

Private Sector is increasingly playing a key role in provision of health facilities and Government should commit to establishing a favorable environment to attract private investors in this sector.

It also remains to see how the National Health Insurance scheme which Government hopes to introduce will be utilized to provide affordable health care to all. Tasking only employers and employees to carry the burden of financing healthcare may not be sufficient to achieve the desired objective of providing healthcare for all in light of the high unemployment rates in the country.

In FY2016/17, the health sector was not able to absorb 86% of donor aid provided towards government programs

Water and Sanitation

The Government recognises that access to safe water and sanitation is critical for maintaining hygiene at household level and impact on health and ultimately labour productivity.

The budget allocation for water and sanitation in FY 15/16 was less than 1%. Government's primary focus has been on improving key water and sanitation infrastructure by expanding piped water schemes, urban sanitation facilities and facilities to improve rural water access facilities including boreholes, protected wells and gravity flow.

Priorities for 2016/17

To this end, the Government has allocated UGX 689 billion towards water and environment, representing 2.9% of the approved budget. This budget is being spent on water and sanitation initiatives along with environmental sector.

The Government recognises that a healthy population is key to achieving productivity, and a number of achievements have already been registered in this regard. Priorities in 2016/17 will be made towards:

- Increasing access to safe water to 79% in rural areas and reach 100% coverage in urban areas.
- Construction of 33 water supply schemes and 147 sewerage and sanitation facilities for both public and households in various towns.

Whether the budget will achieve the desired objectives

According to World Bank reports, nearly 65% of the Ugandan population has access to safe water. However, this means 35% of the Ugandan population does not have access to safe water, with the majority being in rural areas.

The costs of developing infrastructure related to providing water in remote areas is more than delivering similar services to urban areas, and therein lies the challenge. Donor aid has supported government initiatives on this, but the Government needs to do more.

According to World Bank reports, nearly 65 percent of the Ugandan population has access to safe water. However, this means 35 percent of the Ugandan population does not have access to safe water, with the majority being in rural areas

This can be done through involving the private sector players in water infrastructure development and provision of water services, construction of valley dams and valley tanks and other water structures.

The budget does not however address interventions in improving sanitation such as rehabilitation of critical sewer networks in selected areas around urban centres and the city. The demand for utilities such as water and sewerage services is likely to increase as commercial housing continues to be a lucrative segment of the construction industry. Resources need to be availed to transition from site-based septic tanks to sewerage network connections as population grows due to the increasing urbanization pressures.

A number of interventions to ensure that there is sustainable access to safe water and sanitation would need to include developing water source protection measures and working with private sector to develop and promote water safety plans in all piped water supplies.

Moving forward

Achieving the status of a middle income country by 2020 is a big step. The expectations from the general public will always be high and this means that the Government together with the local authorities have to find strategies that will improve service delivery and further create an enabling environment for the development of all these programs.

One strategy involves the empowerment of the citizens both in decision-making and actual implementation. Where the local Governments do not have the capacity to monitor and evaluate effectiveness of these programs, Government should partner with private sector to provide support, implementing measures such as output based performance measures to ensure that funds are being utilized for the purpose that they have been disbursed for and they have achieved the desired results.

There is a further need to encourage private sector involvement in social service delivery. Part of this can be in the form of partnerships to deliver key services such as the ones that are happening in the health sector.

Private sector can provides quality social services and they have the financial capability to do so. They have greatly supplemented Government efforts in education and health sectors. Government can no longer ignore this fact and needs to pursue partnerships with the private sector in order to achieve the objective of delivering social transformation to the people of Uganda and making the dream to become a middle income country a reality.

Government also needs to create an enabling environment to attract private investors to invest in social services. The private sector remains the major revenue base contributing up to 75% of GDP and is also increasingly playing a key role in the provision of social services, particularly in the health and education sectors. With Uganda's growing population rate, currently at about 3% per year, attracting private sector investments will also achieve the result of creating more jobs for the increasing young population.

Taking measures such as penalising Accounting officers for unsatisfactory performance of externally funded projects which results in poor absorption of funds does not necessarily address the issue of service delivery. Government will need to invest in measures aimed at monitoring and evaluation of Government programs to ensure that they are being effectively implemented.

Better service delivery may be achieved through empowering local Governments to be able to bring services closer to the people. Personnel at local Government need skills and capacity to monitor Government programs so that the intended beneficiaries receive the services.

Government should continue to work with donors to implement alternative approaches to current problems. For example, the Uganda Teacher and School Improvement Project (UTSEP) and the Girls Education Challenge (GEC) programs are all supported by donors and are aimed at ensuring that education is more efficient and effective . This should also be facilitated by monitoring and evaluation of such programs. Ensuring that donor aid is used for the purpose that it is provided will greatly supplement Government efforts of realizing some of the objectives of transforming our socio-economic status.

Government together with the local authorities have to find strategies that will improve service delivery and further create an enabling environment for the development of all these programs

East African Highlights

East Africa at a Glance

THE ECONOMY

Kenyan economy

Steady growth

Kenya's GDP grew by 5.6% in the 2015/2016 financial year as compared to 5.3% in 2014/2015 financial year. This was lower as compared to GDP growth in neighbouring countries such as Tanzania (6.9%), Rwanda (6.5%) and Ethiopia (10.2%) during the same period. However, growth in mining and quarrying; information and communication; and wholesale and retail trade decelerated during the same period.

Growth in the economy was mainly driven by ongoing infrastructural investment, increased investor and consumer confidence and improved agricultural production. Kenya is ranked amongst the 7 best countries for investments and the 2nd biggest market for retail investors in Africa.

Increased investor confidence in the economy.

Performance per sector

Highlights

Highlight by sector is as follows;

- The agricultural sector grew from 3.5% in 2014/15 financial year to 6.2% in 2015/16. This was largely achieved through improved crop and livestock production over the review period.
- Manufacturing sector grew by 3.5% in 2015 /16 as compared to a slower growth of 3.2% in 2014/15. This was attributed to reduced production costs arising from lower cots of petroleum and electricity inputs.
- Building and construction sector registered growth of 13.6% in 2015/16.
- Tourism went down to Kshs 84.6b in 2015 /16 as compared to Kshs 87.1b in 2014/15 financial year. The suppressed performance was on account of security concerns, particularly in the coastal region and restrictive travel advisories from some European source markets.
- The energy sector witnessed a steady rise in global crude oil and other liquid inventories.
- The Capital market performance was depressed in 2015. The Nairobi Stock Exchange (NSE) 20-share index recorded a high of 5,346 points during first quarter of the year but dropped by 24% at the end of the year. The total number of shares traded also reduced by 16%

GDP growth of 5.6% in the financial year compared to 3.8 % growth in Sub-Saharan Africa.

Uganda economy

Summary

The economy is estimated to have grown at a rate of 4.6% during the financial year 2015/16 in comparison to a projected growth of 5.8%.

The decline in the growth rate was due to a sharp fall in international commodity prices such as coffee, tea and minerals; a decline in private sector credit growth as a result of high interest rates and strengthening of the US dollar which made imports more expensive and caused domestic inflation.

The real GDP is projected to continue to grow to an average of 6.3% per annum over the medium term.

Uganda's headline inflation has increased to 5.4% as of May 2016 in comparison to 3.1% in the financial year 2014/15

The budget deficit for the financial year 2015/16 is estimated at 6.4% of GDP largely financed by external borrowing through concessional, non-concessional loans and to a less degree by domestic borrowing equivalent to 1.6% of GDP.

Budget Theme FY 16/17:
Enhanced productivity for job creation

In terms of revenue performance, total tax collections in the financial year 2016/17 are projected at UGX 12,914.3 billion up from financial year 2015/16 financial year projected outturn of UGX 11,598 billion.

The projected increase is to be achieved by gradually formalizing the large informal sector, improving efficiency in tax collection and compliance.

The priority areas highlighted in the 2016/17 financial year budget are:

- Agriculture production and productivity;
- Unlocking Uganda's tourism potential;
- Effective development and maintenance of infrastructure;
- Human capital and skills development;
- Improving good governance.

Tanzanian economy

Past performance 2015/16 financial year

The economy of Tanzania is estimated to have attained real GDP growth of 7.0% in the 2015/16 financial year. GDP is expected to grow by 7.2% in the 2016/17 financial year.

Performance in key sectors of the economy was as follows:

- The construction industry grew by 16.8% in the 2015/16 financial year (2014/15 : 14.1%) due to increased government spending on infrastructure projects.
- Information, communication and technology grew by 12.1% in the 2015/16 financial year due to increased mobile penetration.
- The financial services sector grew by 11.8% in 2015/16 financial year (2014/15: 10.8%) due to higher lending to the private sector.
- Mining and quarrying grew by 9.1% in the 2015/16 financial year and the agricultural sector recorded a reduced growth of 2.3% in the 2015/16 financial year (2014/15 : 3.4%)

• The average inflation rate in the 2015/16 financial year was 5.6% compared to 6.1% in the 2014/15 financial year. The reduction in inflation is due to a large extent to the fall in global petroleum prices.

The priority areas mentioned in the budget speech for 2016/17 financial year include the following:

- Focus on industrial growth and construction of basic industry through the implementation of specifically identified projects and creating industrial clusters;
- Integration of economic development and human resources by improving school environment, vocational training and health initiatives;
- Improving business environment through improvement of infrastructure relating to power, water, roads, ports and railway and reducing bureaucracy; and
- Focus on effective implementation.

Macro-economic objectives for 2016/17 include:

  - Real GDP growth: 7.2%
  - Tax revenue to GDP ratio: 13.8%
  - Contain inflation to single digits: range of 5% to 8%.

Rwandan economy

Rwanda's economy is projected to grow 6% in the 2016/17 financial year from 7% in 2015/16. The agriculture sector is expected to grow 4.3% from 5%, industry 5.6% from 7% and services 7.1% from 7%.

Rwanda's real GDP growth rate decreased to 6.9% in 2015/16 as compared to 7.0% achieved in 2014/15. Performance highlights include 5% agricultural sector growth; 7% industry sector growth; and 7% services sector growth. The strongest growing sub sectors were information and communication, financial and cultural, domestic and other services growing at 15.9%, 10.1% and 10.8% respectively.

Inflation continues to be well contained with an average of 2.5% in 2015 and it is projected at 4.7% in 2016 and at or below 5% for the next three years. This is attributed to the projected drop in import prices in foreign currency.

Both exports and imports declined in the 2015 /16 financial year as compared to the 2014/15 financial year. The decline in exports was mainly attributed to minerals impacted by the fall in international commodity prices. The decline in imports is attributed to a fall in the value of energy and lubricants as a result of a fall in prices.

The forex market has been under pressure mostly resulting from increased imports to support high economic growth. The strengthening of the US Dollar, the effect from high depreciation of regional currencies and associated speculative behaviour resulted in annual depreciation of 7.6%.

Rwanda's financial sector remains solvent and with sufficient capital buffers. The capital adequacy ratio for banks was 22.5% in December 2015 while for MFIs was 31.1%. The liquidity ratio for banks stood at 45.9% in December 2015 while for MFIs was 89.6%.

The allocation of resources in the 2016/17 financial year has been made taking into account the Economic Development and Poverty Reduction Strategy (EDPRS2) priorities. The main areas of focus under EDPRS 2 are :-

- Economic transformation – 27%
- Rural development – 13%
- Productivity and youth employment – 6%
- Accountable governance – 10%
- Foundational issues – 45%

Common themes across the region

Transport Infrastructure

Transport Infrastructure development continues to be a key growth factor anticipated to spur economic development in the region. Kenya is on track to deliver the first phase of the SGR from Mombasa to Nairobi by June 2017 while plans are underway for the second phase.

On the other hand, Uganda is expected to commence construction of their Eastern Standard Gauge Railway from Kampala – Malaba. This is expected to be synchronized with the construction by Kenya of the Nairobi – Kisumu – Malaba railway.

Governments across the region are prioritizing improvements of roads especially in cities and urban areas. Kenya's government has highlighted highways expected to be completed in the current year including Outer Ring Road while Uganda's government has highlighted roads such as the Kampala- Entebbe express way.

Cross border trade

Kenya's government has proposed streamlining the training, licencing and regulation of clearing agents to help address increasing threats from terrorism, drug trafficking and related cross border criminal activities.

Kenya plans to seek input from the EAC countries to achieve a harmonised approach.

Key highlights- EAC

	Kenya	Tanzania	Uganda	Rwanda
Real GDP growth	5.6% (5.3%)	7.0% (7.2%)	4.6% (5.3%)	6.0% (7.0%)
Overall inflation	6.6% (6.9%)	5.6%(6.1%)	5.4% (3.1%)	4.4% (2.1%)
91 day TB rates	10.8% (8.9%)	18.25 (15.73)	14.76 (14.13)	6.0 (4.1%)
	KSHS	**TSHS**	**UGX**	**RWF**
Exchange rate to the dollar (Local currency = US$1)	98.2 (87.9)	1,985(1,653)	3,352 (3,115)	747 (716)
Total budgeted spend (billions)	2,265 (2,002)	29,450 (22,495)	18,666 (18,133)	1,949 (1,848)
Budgeted recurrent (billions)	1,456 (1,280	17,719 (16.576)	8,773.02 (8,716)	973 (893)
Budgeted development (billions)	809 (721)	11,821 (15,919)	9,892.98 (6,802)	770 (776)

•*Note – Prior year comparatives in brackets

Customs and Excise Duty

Kenya

Customs

Proposed amendments include:

- Introduction of specific duty rate of USD 200 per Metric Ton on a range of iron and steel,
- Increase of import duty from 10% to 25% on Aluminium Cans,
- Remission of the import duty on aluminium plates and sheets,
- Increase of import duty from 10% to 25% on aluminium cans,
- Duty exemption on Heating, Ventilation and Air Condition (HVAC),
- Proposed legislation to the streamline, training, licensing and regulation of Kenya clearing agents and
- Reduction of import duty from 25% to 10% on energy efficient stoves.

Promoting growth of industries and employment creation.

Excise duty

- Introduction of excise duty on kerosene at KES 7,205 per 1000 liters.
- Introduction of ad valorem rate of 20% on the value of the vehicle.
- Introduction of excise duty at the rate of 10% on cosmetics and beauty products.

Enhancing Equity and Fairness.

Uganda

Excise duty

Proposed amendments include the increase in excise duties on:

– *Diesel and petrol by UGX 100;*

– *Soft cup cigarettes to UGX 50,000 per 1000 sticks and Hinge Lid cigarettes to UGX 80,000 per 1000 sticks*

– *Sweet and confectionaries to 20%*

- Introduction of excise duty at the rate of 80% on ready to drink spirits.
- Exemption of specialised hospital furniture from the 10% excise duty.

Tanzania

Customs

Proposed increase of import duty rate on:

- Cement (from 25% to 35% for one year)
- Certain iron or non-alloy steel products (from 0% to 10%)
- Made up fishing nets (from 10% to 25%)
- Oil and petrol filters and intake air filters (from 10% to 25%)
- Aluminium milk cans (from 10% to 25%)

Excise duty

Proposed amendments include:

- 5% increase on fixed tariffs on non-petroleum excisable products
- Increase in ad valorem rate for imported furniture (on specific HS codes) from 15% to 20%
- Extending the application of 10% excise duty on mobile money charges
- Abolition of the use of plastic bags of less than 50 microns to protect environment

Direct and Indirect taxes

Kenya

Income tax

- Proposed regulations to facilitate implementation of the apprenticeship tax incentive for employers;
- Reduction of corporate tax rate from 30% to 20% for developers who construct at least 1,000 units per year;
- Proposed rules to facilitate implementation of simplified residential rental income less than ten million shillings per year;
- Introduction of a minimum taxable residential rent income threshold of KES 12,000 per month;
- Proposal to empower the Commissioner to appoint withholding tax agents for rental income;
- Tax amnesty for tax payers who own assets and businesses outside the country provided they submit their return for the year 2017;
- Proposal to expand tax bands and increase personal relief by 10% and
- Proposal to exempt bonuses, overtime and retirement benefits for low income employees from tax.

Expecting more amendments in the income tax bill.

Uganda

Income tax

- Tax relief awarded to taxpayers who merge or acquire loss-making businesses and continue to operating the business after merger transaction;
- Clarity has been provided as to when a non-resident person is entitled to benefit from a tax exemption or reduced tax rate under a Double Taxation Agreement (DTA) and
- Government has developed a new policy to guide negotiation of DTAs and will be commencing on renegotiating DTAs that do not comply with this policy.

Tanzania

Income tax

- Reduction in the marginal tax rate by 2% (from 11% to 9%) for individuals on the lowest tax band;
- Removal of tax exemption on disposal of DSE listed shares and
- Powers to Commissioner to determine rental income for purpose of withholding tax.

Kenya

Value Added Tax

Proposal to exempt the following from VAT:

- Made up garments and leather footwear procured from the Export Processing Zones,
- Raw materials for manufacture of animal feeds,
- Parks entry fees charged,
- Commissions earned by tour operators and
- Liquefied petroleum gas.

- Proposed extension of the transitional period of VAT exempt status on petroleum products by one year.

Uganda

Value Added Tax

- VAT relief to solar, wind and geothermal energy producers;
- VAT imposed on imported services used by Business Process Outsourcing (BPO) companies to be refunded at the time of export or offset if the services are consumed in Uganda and
- VAT relief on supplies procured from domestic market for aid funded projects.

Tanzania

Value Added Tax

Proposed introduction of VAT on:

- Tourism services (including supplies of tourist guiding, game driving, water safaris, animal or bird watching, park fees and ground transport services) and
- Bank charges in the form of fees charged by banks.

Introduction of VAT at 0% on the cross-union supplies of goods (i.e. between Zanzibar and Tanzania mainland)

Proposed VAT exemptions include:

- Aviation insurance,
- Bitumen products and
- Certain agricultural products.

Tax - Rwanda

The Minister did not make any pronouncements on tax measures. The Income Tax legislation is under review and currently before the parliament for deliberation.

Some of the proposed changes under the draft law cover the following:

- A new provision on capital gains tax to address the sale or disposal of shares;
- Introduction of 5% tax on the disposal or transfer value of immovable property;
- Restriction of management fees to be paid to non-resident persons;
- Introduction of transfer pricing guidelines and
- Clarification on basis for taxation of housing and motor car benefit provided to employees by employer.

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