KPMG

Economic Snapshot H2, 2016

Uganda

Inflation – Consumer price inflation eased slightly in July, with marked disinflation in the energy sub-index partly offset by inflationary pressure in food prices. Figures from the Uganda Bureau of Statistics (UBOS) show that the consumer price index (CPI) rose by 5.1% y-o-y in July following a 5.9% y-o-y increase in June. The sub-index for energy recorded a marginal 2.1% y-o-y increase during July following a 6.6% y-o-y rise in June. In turn, after recording three consecutive months of deflation (most recently -1.3% y-o-y in June), the food crops sub-index rose by 3.5% y-o-y in July. Uganda has enjoyed a disinflationary trend in 2016 due to the stability of the exchange rate, subdued food and fuel prices, and lacklustre domestic demand.

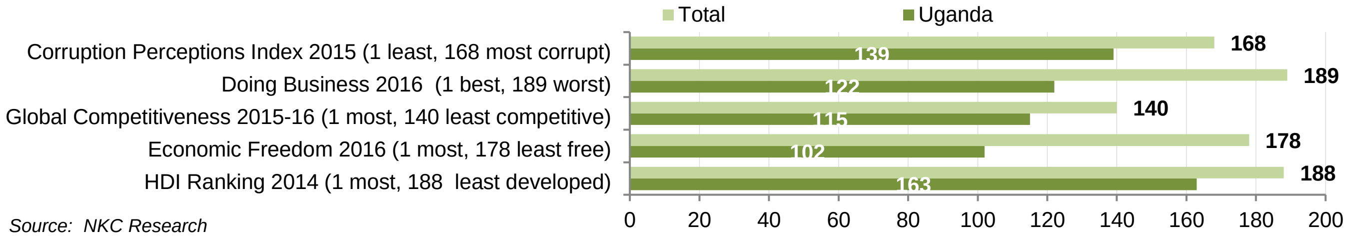
Growth – After recording a 5.6% real GDP growth rate in 2015, the Ugandan economy lost some momentum during the first quarter of this year. Economic growth dropped to 3.4% y-o-y during Q1 2016, which is notably lower than the growth rate recorded the previous quarter (+5.4% y-o-y) as well as growth recorded in Q1 2015 (+5.5% y-o-y). This was largely due to disappointing performances in the agricultural and industrial sectors.

National development plan – Uganda's overall economic policy continues to be guided by the new National Development Plan (NDP II) which came into force in June 2015. The recently approved fiscal budget for the 2016/17 fiscal year (FY, July - June) is broadly in line with the NDP II with a distinct focus on the agricultural, energy and tourism sectors, as well as the development of strategic infrastructure.

OPPORTUNITIES	STRENGTHS
While the development of the oil sector has been delayed due to numerous economic and political considerations, the country is still expected to become an oil exporter over the medium term.	The commencement of oil production will have a positive effect on external balances and improve energy security.
Ongoing integration within the East African Community (EAC) presents significant business opportunities.	Kampala continues to demonstrate a steady commitment to macroeconomic reforms, supported by the International Monetary Fund (IMF).
Substantial renewable energy potential.	Extensive infrastructure projects underway to increase power capacity.
Large-scale infrastructure development opportunities to address a severe infrastructure deficit.	Fast-rising foreign direct investment (FDI) inflows; set to continue with increasing interest in the oil sector and downstream related activities.

VULNERABILITIES	WHAT IS BEING DONE?
Significant infrastructure shortfalls (transport, water, power).	Progress in addressing infrastructure shortfalls is ongoing, but has been slow.
Dependence on agriculture and hydropower for electricity renders the economy vulnerable to adverse weather patterns.	Development of the nascent oil sector should reduce the economy's dependence on agriculture going forward.
Although improving, bureaucracy and corruption remain problems.	President Yoweri Museveni has consolidated power over the past year, and this will continue to create scope for graft and rent-seeking going forward.
Wide current account and fiscal account deficits are concerning.	Both the current account and fiscal deficits are driven by public investment, which emphasises the importance of prudent financial management.

MEGA TRENDS	
Population	37,101,745 (July 2015 est.); Age 15 - 64: 49.5%
Population growth rate (%)	3.24% (2015 est.)
Life expectancy at birth	Total population: 54.9 years; male: 53.5 years; female: 56.4 years (2015 est.)
HIV/AIDS	Adult prevalence rate: 7.1%; People living with HIV/AIDS: 1.5 million (2015 est.)
Adult literacy rate (age 15 and over, can read and write)	Total population: 73.9%; male: 80.9%; female: 66.9% (2015 est.)
Urbanisation	Urban population: 16.1% of total population (2015); Urban population growth: 5.4% (2015)
Population below national poverty line	19.7% (2013 est.)
Unemployment rate	3.8% (2014)
Employment (% of total)	Agriculture: 40%; Industry: 10%; Services: 50% (2015 est.)
Labour participation rate (% of total population ages 15+)	77.4% (2014)
Business language	English
Telephone & Internet users	Main lines in use: 328,811; Mobile cellular: 20.22 million; Internet users: 7.13 million (2015)
Sources: CIA World Factbook, World Bank, UNESCO, ITU, UNAIDS & NKC Research	



Source: NKC Research

Risk environment / Risk outlook

Sovereign Risk Ratings		
S&P Global Ratings	**Fitch**	**Moody's**
B/Stable	B+/Stable	B1/Negative

S&P Global Ratings affirmed Uganda's sovereign credit rating at "B" on July 8, while also maintaining the rating's outlook at stable – a level at which it has been since a one-notch downgrade in January 2014. The agency noted that Uganda's economic growth remains strong, inflationary pressures are easing, the shilling has found some stability, while the government's domestic financing costs have declined. However, these positive factors are counterweighed by low GDP per capita figures and wide current and fiscal account deficits. With regard to the latter, the agency stated that Uganda's fiscal position is temporarily under pressure due to the implementation of large infrastructure projects, and that this pressure is expected to persist until 2018. While acknowledging that the management of public finances has been supported by the checks and balances included in the Public Finance Management Act, the agency still expects public debt to remain on an upward trajectory. **Moody's Investors Service**, in turn, affirmed Uganda's sovereign credit rating at "B1" in November last year, but the ratings agency decided to adjust the country's rating outlook from stable to negative. The agency noted that the country's credit profile is under pressure due to deteriorating fiscal and debt metrics; a continued weakening in Uganda's external payments position; and rising inflationary pressures in the context of deteriorating economic growth prospects. However, Moody's also acknowledged that Uganda's key credit metrics will remain in line with those of its "B1" peers if these credit-negative trends dissipate or reverse in the next 12 - 18 months, which warrants an affirmation of the country's current credit rating. Moreover, Uganda's credit-positive characteristics include a track record of economic growth above the peer median, lower GDP growth volatility, continued bilateral and multilateral support, and a largely favourable debt structure. Furthermore, **Fitch Ratings** affirmed Uganda's long-term foreign and local currency Issuer Default Rating (IDR) "B+" in August last year, maintaining the outlook at stable. This follows a one-notch rating upgrade in February 2015. According to Fitch, Uganda's economy has regained its momentum and the agency expects growth to pick up steadily going forward. The agency commended the BoU for its swift policy response in 2015 (600 bps increase in the policy rate between April and October last year) to contain the expected inflationary impact of a sharply weaker exchange rate. The agency noted that external imbalances and adverse sentiment towards emerging markets are expected to exert continued pressure on the shilling, but acknowledged that the freely floating exchange rate regime, together with the central bank's willingness to increase interest rates, underpin policy credibility.

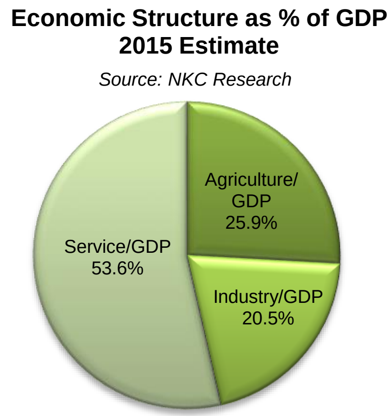
Infrastruc-ture	Diversity of the Economy	Banking Sector	Continuity of Economic Policy	GDP Growth	Key Balances	Foreign Investment	Socio-economic Develop-ment	Forex Reserves
Improving; but severe deficit	Limited, but improving	Fair, and improving	Generally stable	Strong	Twin deficits	Strong and rising	Low	Modest

Stock Market	Listed Companies	Liquidity	Market Cap	Dominant Sector	Daily Trading Volume
Uganda Securities Exchange	16 (including cross-listed companies)	Limited	$6.6bn (USE, late August, 2016)	Banks	Varies between one million and 40 million shares weekly
Capital Market	**Development**	**Liquidity**	**Maturity Range**	**Municipal Bonds**	**Corporate Bonds**
Yes	Underdeveloped	Fairly low	91-days to 364-days (T-bills) 1-Yr to 10-Yr (Govt. Bonds)	No	Yes

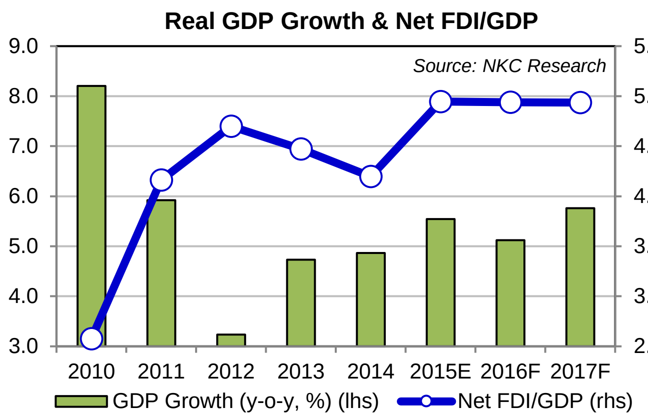
Macro-economic overview

Uganda endured significant external headwinds in 2015, with the shilling exchange rate losing nearly a quarter of its value during the year, which necessitated aggressive monetary tightening and in turn resulted in a marked increase in public borrowing costs which exacerbated an already-stretched fiscal position. External headwinds have abated more recently, with the shilling recovering somewhat and finding some stability, while the Bank of Uganda (BoU) has been able to ease domestic monetary policy in support of economic activity. However, there is a real risk that the central bank has eased monetary conditions prematurely given the nature of disinflation in recent months, and considering the persisting risk of a resurgence in external pressure on the domestic currency. The latter relates to expectations of tightening monetary conditions in the US later this year while weather developments could also have a notable impact on the country's merchandise trade balance.

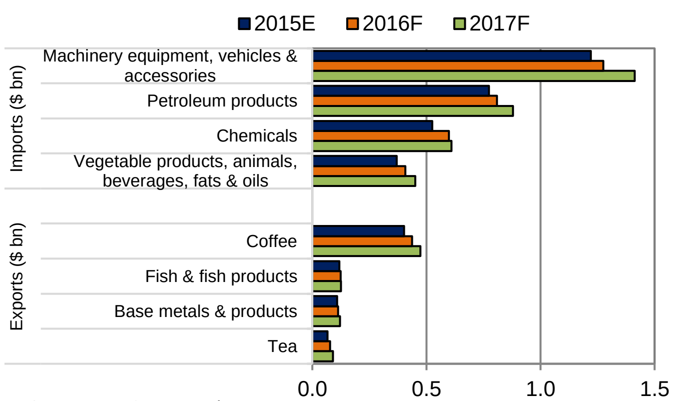
Uganda's fiscal situation remains a salient source of downside risk as the government reconciles an ambitious infrastructure investment programme with fiscal consolidation efforts. Some progress has been made with regard to the country's fiscal framework, but increasing use of external financing to fund infrastructure projects will require prudent and effective financial management going forward. Furthermore, the country's current account deficit, while largely investment-driven, remains uncomfortably wide, and increases Uganda's dependence on external financial inflows.



Formal economic activity in Uganda is dominated by the services sector, which accounts for over 50% of GDP. The services sector is dominated by sub-sectors related to wholesale & retail trade, information & communication technology (ICT), real estate activities and education. While formal economic production is dominated by the services sector, the majority of the population is engaged in some form of agricultural activity, but the sector only accounts for around a quarter of formal economic output. In addition, the country's most salient export products are also agricultural in nature, and dominated by coffee, tea, tobacco, sesame and fish products. The country remains a net food importer, and the lack of agricultural infrastructure renders agricultural output highly vulnerable to adverse weather conditions. The Ugandan industrial sector is dominated by manufacturing and construction, with the former receiving government support through various incentive schemes, while the latter is directly stimulated by public investment in infrastructure. The industrial sector will become an increasingly important contributor to future economic growth due to the development of the country's fledgling hydrocarbons sector.



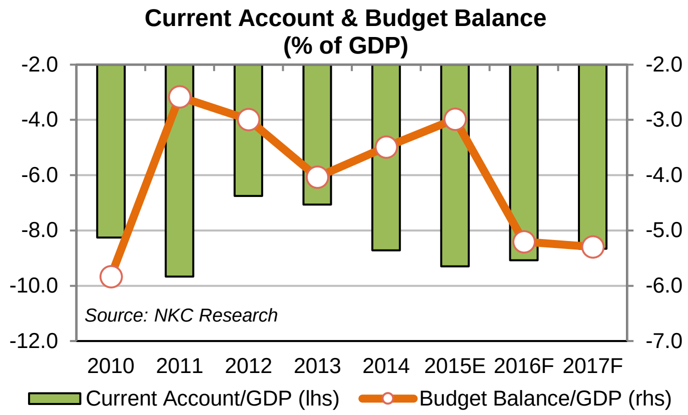
Uganda's real GDP growth performance has been very volatile in recent quarters. Real GDP growth dropped from a recent peak of 7.1% y-o-y in 2015 Q3 to a disappointing 3.4% y-o-y in Q1 this year. This was largely due to weak growth in the agricultural sector, with the latter expanding by 0.5% y-o-y (at factor costs) during Q1. The industrial sector also disappointed, growing by 2.6% y-o-y during the quarter. Consequently, economic growth during the first quarter of the year was primarily driven by the services sector, with the latter growing by 6.4% y-o-y. Economic growth is expected to improve during the remainder of the year, with services sub-sectors such as telecommunications and transport showing strong growth, accompanied by industrial sub-sectors such as mining, manufacturing and construction. In addition, the agricultural sector is projected to recover from the slump in Q1, but agricultural growth is expected to remain subdued due to the sector's vulnerability to adverse weather conditions and the lack of agricultural infrastructure. Turning to FDI, Uganda's ability to attract foreign interest received a considerable boost in June when the government licenced Turkey's ASB Group to establish a special economic zone (SEZ) in Nakeseke, central Uganda. This is the first SEZ to be licenced under the Free Zone Act of 2014, which intends to reduce policy uncertainty and provide a legislative framework in which SEZs can develop.



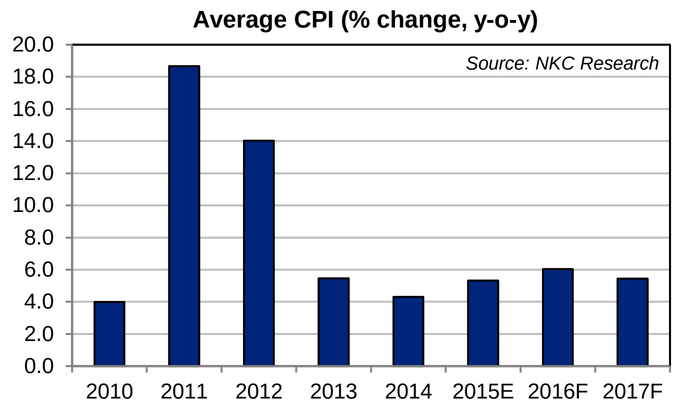
Source: NKC Research

Main Imports: % share of total	2015E	2016F	2017F
Machinery equipment, vehicles & accessories	25.03	25.27	25.72
Petroleum products	15.90	16.02	16.01
Chemicals	10.78	11.87	11.09
Vegetable products, animals, beverages, fats & oils	7.59	8.07	8.20
Main Exports: % share of total	**2015E**	**2016F**	**2017F**
Coffee	15.32	14.56	14.05
Fish & fish products	4.48	4.15	3.74
Base metals & products	4.13	3.74	3.59
Tea	2.54	2.57	2.69

Total exports during the first half of 2016 amounted to just over $1.4bn, reflecting a 4.1% y-o-y increase. This performance was largely due to a resurgence in gold exports. Receipts from the yellow metal reached $169m during H1 2016 compared with less than $1m during the same period a year earlier. This strong performance was counterweighed by a disappointing performance in coffee exports, with the latter dropping 23.5% y-o-y to reach $165m during the first semester. Other notable exports during the quarter include fish products (-4.6% y-o-y to reach $60m) and tea (+15.3% y-o-y to reach $37m). In turn, total imports amounted to $2.4bn during the first half of the year, reflecting a significant 20.9% y-o-y decrease. The largest import categories during the semester were machinery & equipment (-26% y-o-y to reach $472m) and petroleum products (-30.3% y-o-y to reach $294m). Overall, this resulted in a merchandise trade deficit of $934m in H1 2016, which is a remarkable 42.2% y-o-y narrower than the previous year's deficit.



The Ugandan Parliament approved the fiscal budget for the 2016/17 fiscal year in late-May. Total government expenditure is expected to amount to just under USh26.4trn ($7.9bn) in FY 2016/17, with nearly 19% of the budget directed towards domestic debt refinancing for maturing domestic debt. Consequently, expenditure excluding debt refinancing is expected to reach around USh20.8trn ($6.2bn), reflecting an increase of 11.4% compared with the previous fiscal year. Overall, this is expected to result in a fiscal deficit of 6.6% of GDP, which is slightly wider than the 6.4% of GDP deficit expected in the 2015/16 fiscal year. Our projected fiscal deficit of 5.2% of GDP is much narrower than official forecasts. This is due to our expectation that project execution delays and financing shortfalls are likely to curtail public investment, which will in turn limit the extent to which government spending exceeds revenue. That being said, the country's fiscal deficit is expected to remain wide over the medium term. Turning to external balances, Uganda recorded a $381m current account deficit during the first quarter of this year, which is a notable 24.4% y-o-y narrower than the previous year's deficit. This was largely due to a 56.5% y-o-y narrowing of the merchandise trade deficit, reaching $239m during the quarter. This was partly offset by a near tripling of the services deficit (reaching $207m) and a 29.4% y-o-y widening of the income account deficit (reaching $252m). In turn, the transfers surplus remained largely stable on a y-o-y basis, reaching $317m during the quarter.



The Monetary Policy Committee (MPC) of the Bank of Uganda (BoU) has adopted an expansionary policy stance, with August marking the third cut in the country's benchmark interest rate since the beginning of 2016. The MPC lowered the country's central bank rate by 100 bps to 14% in August following similar reductions in March and June this year. The BoU has thus reduced the country's benchmark interest rate by 300 bps this year. This follows an aggressive contractionary policy stance in 2015, with the central bank increasing the country's policy rate by 600 bps between April and October. In the August MPC statement, the BoU noted that the near-term outlook for inflation has improved as a result of the recent stability of the shilling exchange rate, with both annual headline and core inflation now expected to decline to around 5% y-o-y by the end of 2016. While conceding that the outlook for inflation is subject to several risks, primarily emanating from increasing uncertainty over international developments potentially affecting the domestic currency, and weather related risks putting upward pressure on food prices, the BoU stated that a continued easing of monetary policy is warranted to support the recovery in private sector credit and hence support real economic growth.

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